

**Exhibit No.:**

**Issue(s):**

**Witness/Type of Exhibit:**

**Sponsoring Party:**

**Case No.:**

Rate of Return (ROR)/  
Capital Structure

Murray/Surrebuttal

Public Counsel

WR-2022-0303

**SURREBUTTAL TESTIMONY**

**OF**

**DAVID MURRAY**

Submitted on Behalf of the Office of the Public Counsel

**MISSOURI-AMERICAN WATER COMPANY**

CASE NO. WR-2022-0303

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Denotes Confidential and Highly Confidential Information that has been redacted

February 8, 2023

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**SURREBUTTAL TESTIMONY**

**OF**

**DAVID MURRAY**

**MISSOURI AMERICAN WATER COMPANY**

**FILE NO. WR-2022-0303**

1 **Q. What is your name and business address?**

2 A. My name is David Murray and my business address is P.O. Box 2230, Jefferson City,  
3 Missouri 65102.

4 **Q. Are you the same David Murray who filed direct and rebuttal testimony in this case?**

5 A. Yes.

6 **Q. What is the purpose of your testimony?**

7 A. I will respond to the rebuttal testimonies of the following Missouri American Water  
8 Company (“MAWC” or the “Company”) witnesses: Anne L. Bulkley and J. Cas Swiz. I  
9 will also respond to the rebuttal testimony of Staff witness Randall T. Jennings.

10 **Q. Has your review of any of the witnesses’ rebuttal testimonies caused you to change**  
11 **any of your positions?**

12 A. No.

13 **Q. What are your main conclusions after reviewing the various parties’ rebuttal**  
14 **testimonies as it relates to rate of return (“ROR”)?**

15 A. MAWC’s views on maintaining a conservative capital structure for ratemaking are at odds  
16 with its parent company’s, American Water Works Company’s (“American Water”),  
17 financial strategies. American Water has become more aggressive in its use of leverage  
18 (i.e. debt) in its capital structure over the last several years, but MAWC’s internally  
19 managed capital structure has maintained a common equity ratio above 50%. The  
20 discrepancy between American Water’s and MAWC’s common equity ratios allows

1 American Water to earn a significant margin over the cost of capital by inflating MAWC's  
2 per books common equity ratio. MAWC's witnesses indicate that if the Commission  
3 authorizes a capital structure consistent with American Water's on a consolidated basis,  
4 then American Water would make less investment in MAWC because it competes against  
5 sister subsidiaries for capital. I requested that MAWC provide specific information as to  
6 the specific process/analysis American Water performs to determine whether to provide  
7 capital to MAWC as compared to MAWC's sister subsidiaries. Based on the responses I  
8 received, it does not appear that American Water has a specific analytical process for  
9 making such decisions.<sup>1</sup>

10 The Company's and Staff's recommended returns on common equity ("ROE") are too high  
11 due to their conclusion that recent, and in Ms. Bulkley's case, projected, long-term interest  
12 rates are causing higher costs of equity. My analysis of utility stock valuations as compared  
13 to changes in long-term interest rates indicate that factors, other than interest rates, continue  
14 to support higher utility stock valuation levels. In fact, Ms. Bulkley suggests that the water  
15 utility stock valuation levels are currently too high and will decline. Therefore, Ms.  
16 Bulkley acknowledges that current water utility stock valuation levels have not declined  
17 along with interest rates. Because water utility valuation levels are much higher than those  
18 of electric and gas utilities, the Commission should authorize MAWC a lower ROE than  
19 the 9.25% the Commission authorized for The Empire District Electric Company  
20 ("Empire") in its 2019 rate case, Case No. ER-2019-0374, and the 9.37% the Commission  
21 authorized for Spire Missouri Company ("Spire Missouri") in its 2021 rate case, Case No.  
22 GR-2021-0108.

23 Ms. Bulkley's argument about predicted changes to water utility valuation levels is a  
24 distraction from what the Commission's key focus should be in this case: setting MAWC's  
25 rate of return ("ROR") consistent with current known and measurable capital market  
26 conditions. The Commission should recognize the reality of current high water utility stock

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<sup>1</sup> MAWC Responses to OPC Data Request Nos. 3058 (Schedule DM-S-1) and 3059 (Schedule DM-S-2).

1 valuation levels, and appropriately reflect MAWC’s lower cost of common equity through  
2 a lower authorized ROE consistent with my 9% recommendation.

3 **Q. Do you have any corrections you need to make to your testimony in this case?**

4 A. Yes. In responding to a data request I received from MAWC, I realized my rebuttal  
5 testimony at page 24, lines 18 to 20, was not accurate as stated. I had testified that the  
6 stock prices of Ms. Bulkley’s proxy group “generally had a positive correlation with  
7 increases in long-term bond yields.” This language should be deleted and replaced with  
8 “only declined slightly.”

9 **MAWC’S POSITION: ANNE BULKLEY AND J. CAS SWIZ**

10 **Q. Can you summarize Ms. Bulkley’s and Mr. Swiz’s criticisms of your capital structure**  
11 **recommendation?**

12 A. Yes. Ms. Bulkley and Mr. Swiz claim my recommendation to set MAWC’s allowed ROR  
13 based on capital structure ratios similar to American Water’s capital structure ratios will  
14 impair MAWC’s credit profile and its ability to attract capital from its parent company,  
15 American Water.<sup>2</sup> Ms. Bulkley and Mr. Swiz maintain that MAWC is a stand-alone  
16 company with its own financial and operational management. Therefore, they believe  
17 MAWC’s ratemaking capital structure should be set based on the capital balances shown  
18 on MAWC’s balance sheet, as well as the cost of the affiliate loans assigned to MAWC.  
19 Ms. Bulkley and Mr. Swiz claim that my capital structure position violates the “stand-  
20 alone” principle of ratemaking.

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<sup>2</sup> Swiz Rebuttal, p. 16, ln. 2 – p. 17, ln. 15 and Bulkley Rebuttal, p. 28, ln. 6 – 31, ln. 5.

1 **Q. Mr. Swiz compares MAWC’s situation to that of Spire Missouri when arguing that**  
2 **MAWC’s capital structure is appropriate for setting MAWC’s ROR.<sup>3</sup> Is Spire**  
3 **Missouri’s situation an appropriate comparison for guidance on MAWC’s capital**  
4 **structure?**

5 A. No. There are many significant differences between Spire Missouri’s circumstances and  
6 MAWC’s circumstances. As I will explain, MAWC’s circumstances are more similar to  
7 that of Liberty Utility Company’s (“LUCo”) Missouri subsidiaries, which I compared and  
8 contrasted in Empire’s 2019 rate case, Case No. ER-2019-0374, Liberty Utilities  
9 (Midstates Natural Gas) Corp. (“Liberty Midstates”) case, Case No. GR-2018-0013 and  
10 Liberty Utilities (Missouri Water), LLC (“Liberty Water”) case, Case No. WR-2018-0170.

11 **Q. What reason did the Commission cite for adopting Spire Missouri’s capital structure**  
12 **rather than Spire’s consolidated capital structure in Case No. GR-2021-0108?**

13 A. The Commission, in supporting its decision not to adopt the use of Spire Inc.’s consolidated  
14 capital structure, stated the following in its Report and Order:

15 275. Spire Missouri issues its own long-term debt secured by its own assets.<sup>4</sup>  
16  
17

18 It is important to emphasize that Spire Missouri issues long-term debt directly to third-  
19 party investors on a consistent and continuous basis, with third-party debt investors trading  
20 some of this debt in over-the-counter dealer markets. All of Spire Missouri’s long-term  
21 debt is sold to third-party investors. Unlike MAWC, Spire Missouri does not have affiliate  
22 long-term debt financing transactions with its parent company, or a financing subsidiary  
23 created for purposes of issuing debt on behalf of the parent and its subsidiaries. Because  
24 Spire Missouri continues to sell long-term debt directly to third-party debt investors, it  
25 maintains its own public credit rating.  
26

27 None of the above circumstances apply to MAWC. MAWC has not issued traditional  
28 corporate debt to third-party debt investors since the 1990s. Approximately 97% of the

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<sup>3</sup> Swiz Rebuttal, p. 9, lines 10-15.

<sup>4</sup> Case No. GR-2021-0108, Amended Report and Order, November 12, 2021, p. 85.

1 debt shown on MAWC’s balance sheet are affiliate notes between MAWC and American  
2 Water Capital Corporation (“AWCC”). AWCC is the entity that issues bonds directly to  
3 third-party debt investors and then lends these proceeds to American Water and its  
4 subsidiaries. Because American Water guarantees these bonds,<sup>5</sup> the terms of the AWCC  
5 bonds are based on debt investors’ evaluation of American Water’s business risk and  
6 financial risk (*i.e.* its overall credit quality). Consequently, only American Water needs a  
7 credit rating in order to market these third-party bonds. The AWCC bonds are not secured  
8 by a lien on MAWC’s assets or American Water’s equity ownership in MAWC.

9 **Q. What Missouri utility companies have a financing model similar to that of MAWC?**

10 A. Empire, Liberty Midstates, and Liberty Water. LUCo (a holding company for Algonquin  
11 Power & Utilities Corp’s ownership of its United States’ regulated utilities) has  
12 consolidated all of the debt financing needs of its regulated utility subsidiaries at the LUCo  
13 level, which also uses a financing subsidiary—Liberty Utilities Finance GP1 (“LUF”)—to  
14 issue bonds directly to third-party debt investors. LUF’s credit quality is based on LUCo’s  
15 credit quality because LUCo guarantees the bonds issued by LUF. Of LUCo’s three  
16 Missouri utility subsidiaries, only Empire still has legacy third-party debt it had issued  
17 prior to LUCo acquiring it. The Commission has determined that LUCo’s capital structure  
18 is appropriate to set the allowed ROR for all three of its Missouri subsidiaries.<sup>6</sup> To the  
19 extent the Commission desires guidance for purposes of setting MAWC’s allowed ROR  
20 from its own recent decisions on the most appropriate capital structure, its decisions for  
21 LUCo’s regulated utilities in Missouri are more comparable than its decision in the Spire  
22 Missouri case.

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<sup>5</sup> American Water Works Company’s December 31, 2019, SEC 10-K Filing, p. 63.

<sup>6</sup> Case Nos. ER-2019-0374, GR-2018-0013 and WR-2018-0170.

1 **Q. Are there other issues that illustrate MAWC’s circumstance is more similar to the**  
2 **circumstances of Empire, Liberty Water and Liberty Midstates (collectively,**  
3 **“Liberty Missouri Cos.”) as compared to Spire Missouri?**

4 A. Yes. MAWC and the Liberty Missouri Cos. are managed by service company employees.  
5 American Water Services Company (“AWSC”) employees manage all of the affiliate  
6 financing transactions completed to achieve certain targeted internal capital structures for  
7 MAWC and its sister subsidiaries. The same is true for the Liberty Missouri Cos., which  
8 are managed by the Liberty Utility Services Company (“LUSC”) employees. These  
9 internal capital structures are targeted for ratemaking, not for raising third-party debt  
10 capital and/or targeting a cost-efficient capital structure. The only entity that maintains a  
11 market-tested, objective capital structure, which appropriately and fairly captures the  
12 amount of debt capacity afforded by Missouri’s low-risk regulated utility operations, is that  
13 of the entity issuing debt directly to third-party debt investors. As I testified in the Liberty  
14 Missouri Cos. rate cases, LUSC’s and AWSC’s objective when setting their internal capital  
15 structures is to maintain equity ratio ratios it believes the Commission will allow. Based  
16 on my experience in this and other rate cases, this appears to be in the low 50% range.

17 **Q. Ms. Bulkley asserts that if the Commission adopts your recommended more leveraged**  
18 **capital structure, it needs to authorize a much higher ROE, do you agree?**

19 A. No. Ms. Bulkley claims that if MAWC were to target a similar capital structure to  
20 American Water’s, equity investors would require a higher equity risk premium to be  
21 compensated for the financial risk (*i.e.* additional debt in the capital structure) associated  
22 with it.<sup>7</sup> If this were true, then American Water’s stock would not be trading at the highest  
23 P/E ratio among its peers in the water utility industry (approximately 40x versus 30x to  
24 31x). If American Water’s investors viewed its more leveraged capital structure as a  
25 significant risk factor, then this would cause them to discount American Water’s stock to  
26 recognize this risk.

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<sup>7</sup> Bulkley Rebuttal, p. 37, line 15 – p. 38, line 9.



1 **Q. Ms. Bulkley suggests that if MAWC’s capital structure were managed to a level**  
2 **consistent with American Water’s on a consolidated basis, this would “make it**  
3 **difficult to access capital on reasonable terms.”<sup>8</sup> What does her position presume?**

4 A. Ms. Bulkley’s position presumes that MAWC’s business risk is significantly higher than  
5 American Water’s consolidated business risk.

6 **Q. What information does Ms. Bulkley rely on for purposes of her opinion that MAWC**  
7 **has more business risk than American Water?**

8 A. Ms. Bulkley claims American Water’s business is that of being a financing company. She  
9 states that American Water is “in the business of providing liquidity and credit management  
10 to many water utility operating companies.”<sup>9</sup> This is not consistent with investors’  
11 perception of the business risk profile associated with purchasing equity in American  
12 Water. However, Ms. Bulkley does acknowledge that American Water’s business risk is  
13 consistent with its ownership of subsidiaries with water utility investments across “more  
14 than a dozen regulatory jurisdictions across the U.S.”<sup>10</sup> Ms. Bulkley also notes Moody’s  
15 cited factors regarding American Water’s large size and diversity as support for American  
16 Water’s ability to have a strong investment grade credit rating despite the significant  
17 proportion of debt in its capital structure.<sup>11</sup>

18 **Q. Does Ms. Bulkley claim that you agree that MAWC cannot carry the same amount of**  
19 **leverage as American Water and maintain an investment grade credit rating?**

20 A. Yes. Ms. Bulkley testifies as follows:

21 Mr. Murray recognizes that American Water benefits from the  
22 diversification of utility operations across many jurisdictions, and  
23 that the benefits of this lower risk profile are transferred to MAWC  
24 customers through the relatively lower financing costs achieved by

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<sup>8</sup> *Id.*, p. 29, lines 4-5.

<sup>9</sup> Bulkley Rebuttal, p. 21, lines 1-2.

<sup>10</sup> *Id.*, p. 21, lines 3-7.

<sup>11</sup> *Id.* p. 31, line 19 – p. 32, line 4.

1 AWCC than could otherwise be obtained if MAWC were to seek  
2 financing on a stand-alone basis.<sup>12</sup>

3 **Q. Is Ms. Bulkley’s summary of your testimony accurate?**

4 A. No. Ms. Bulkley cites page 45 of my direct testimony. I discuss American Water’s  
5 business risk profile on page 45, lines 17-25, of my direct testimony. My testimony  
6 emphasizes that American Water’s high debt capacity is enabled by its low-risk regulated  
7 water utility subsidiaries, which include MAWC. I *did not* testify that the benefits of  
8 American Water’s lower risk profile are transferred to MAWC through lower financing  
9 costs than MAWC could otherwise obtain on its own. On the contrary, I testify that  
10 American Water is attempting to charge MAWC a higher ROR than is justified by its low-  
11 risk regulated water utility assets.

12 **Q. How?**

13 A. Through the request for a higher than necessary common equity ratio. Additionally, I  
14 found that the weighted cost of the debt (3.78%) AWCC charges American Water is  
15 cheaper than the weighted cost of the debt (4.47%) AWCC charges MAWC.<sup>13</sup>

16 **Q. Mr. Swiz claims that the Commission should adopt MAWC’s per books capital**  
17 **structure because the relevant consideration is not the source of the funds, but the**  
18 **risk associated with the use of funds.<sup>14</sup> Do you agree with Mr. Swiz that the risk**  
19 **associated with the use of funds should drive the determination of a fair rate of return**  
20 **for MAWC?**

21 A. Yes.

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<sup>12</sup> *Id.*, p. 32, lines 8-12.

<sup>13</sup> Murray Rebuttal, p. 14, lines 13-27.

<sup>14</sup> Swiz Rebuttal, p. 5, lines 8 – 10.

1 **Q. Do you agree that this principle supports the use of MAWC's per books capital**  
2 **structure?**

3 A. No. MAWC's capital structure is managed based on an internal policy to target a capital  
4 structure for ratemaking, not the risk of the use of the funds. In fact, Mr. Swiz confirmed  
5 that American Water does not analyze the business risk of its subsidiaries or analyze their  
6 credit metrics for purposes of determining the type or terms of capital it invests in them.<sup>15</sup>  
7 This type of analysis is fundamental to determining an optimal targeted capital structure,  
8 which balances the cost of capital against financial stability.

9 **Q. How do debt investors in AWCC determine their required returns on the AWCC debt**  
10 **they purchase?**

11 A. The cost of this debt is based on the business risk inherent in American Water's regulated  
12 water utility operations and the financial risk (*i.e.* use of debt) underlying American  
13 Water's capital structure. Consequently, a true match of the costs charged to MAWC  
14 captures the risk of the actual capital structure, which is American Water's consolidated  
15 capital structure, to which the third-party debt investors are exposed.

16 **Q. Mr. Swiz also seems to attempt to legitimize MAWCs capital structure by noting that**  
17 **MAWC's debt is not guaranteed by American Water.<sup>16</sup> Would American Water**  
18 **guaranteeing MAWC's debt have a legitimate purpose for MAWC's debt investor?**

19 A. No. MAWC borrows from AWCC, which is wholly-owned by American Water. These  
20 are affiliate loans. Being that American Water wholly-owns MAWC and AWCC, an  
21 American Water guarantee has no economic consequence because no third-party has an  
22 investment interest in the equity or debt.

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<sup>15</sup> MAWC response to OPC Data Request Nos. 3058 and 3059.

<sup>16</sup> Swiz Rebuttal, p. 10, lines 18-22.

1 **Q. Is it clear that MAWC would have a much lower credit rating if it had a capital**  
2 **structure consistent with that of American Water?**

3 A. No. First, although MAWC has obtained \*\*\* \_\_\_\_\_  
4 \_\_\_\_\_  
5 \_\_\_\_\_  
6 \_\_\_\_\_  
7 \_\_\_\_\_  
8 \_\_\_\_\_  
9 \_\_\_\_\_ \*\*\*

10 **Q. \*\* \_\_\_\_\_**  
11 \_\_\_\_\_

12 A. \_\_\_\_\_  
13 \_\_\_\_\_

14 **Q. \_\_\_\_\_**  
15 \_\_\_\_\_

16 A. \_\_\_\_\_

17 **Q. \_\_\_\_\_**

18 A. \_\_\_\_\_  
19 \_\_\_\_\_  
20 \_\_\_\_\_

21 **Q. \_\_\_\_\_**  
22 \_\_\_\_\_

23 A. \_\_\_\_\_

1 Q. \_\_\_\_\_  
2 \_\_\_\_\_

3 A. \_\_\_\_\_ \*\*

4 Q. **In which jurisdictions do these other water utility companies operate?**

5 A. A majority of their operations are in California, New Jersey, Pennsylvania and Connecticut.

6 Q. **Does S&P assign a stronger (i.e. better) regulatory advantage category to these other**  
7 **jurisdictions?**

8 A. Only Pennsylvania. Otherwise the other jurisdictions are assigned a weaker (i.e. worse)  
9 regulatory advantage categories than Missouri.

10 Q. **Are any of these companies similar in size to MAWC on a stand-alone basis?**

11 A. Yes. In fact, many are smaller.

12 Q. **How did you measure the size of MAWC compared to the comparable companies?**

13 A. Based on the book value of assets as of June 30, 2022.

14 Q. **What was the book value of MAWC's assets as of June 30, 2022?**

15 A. \$3.197 billion.<sup>17</sup>

16 Q. **What is the book value of the assets at June 30, 2022, for the comparable water utility**  
17 **companies used by each ROR witness in this case?**

18 A. The book values of the assets are as follows:

- 19           • American States Water Company: \$1.950 billion;  
20           • California Water Services Group: \$3.683 billion;  
21           • Essential Utilities: \$15.046 billion;

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<sup>17</sup> MAWC Balance Sheet at June 30, 2022.

- 1 • Middlesex Water Company: \$1.038 billion;
- 2 • SJW Group: \$3.541 billion; and
- 3 • The York Water Company: \$0.487 billion.

4 **Q. Do any of these companies have limited jurisdictional diversity?**

5 A. Yes. American States Water Company, California Water Services Group and SJW Group  
6 are all concentrated in the western part of the United States, with a majority of their  
7 operations in California. Middlesex's water utility operations are predominately in New  
8 Jersey and Delaware. York Water Company's water utility operations are solely in  
9 Pennsylvania.

10 **Q. Are any of these smaller and less geographically diverse companies as aggressive as**  
11 **American Water in their use of financial leverage (i.e. debt) in their capital**  
12 **structures?**

13 A. Yes. SJW Group's capital structure has similar leverage to that of American Water. SJW  
14 Group has a similar common equity ratio at approximately 40% (see Schedule DM-R-3  
15 attached to my rebuttal testimony).

16 **Q. How do SJW Group's funds for operations ("FFO")/debt ratios compare to American**  
17 **Water's FFO/debt ratios?**

18 A. SJW Group's FFO/debt ratios have been below 10% the last couple of years and are only  
19 expected to be in the 10-11% range over the next couple of years. This compares to  
20 American Water's FFO/debt ratios of around 13% the last couple of years and expectations  
21 of 12-13% over the next couple of years.

22 **Q. Does SJW Group have lower and more volatile earned ROEs than MAWC?**

23 A. Yes.

24 **Q. What is SJW Group's S&P issuer credit rating?**

25 A. 'A-'.

1 **Q. How does this compare to American Water’s S&P issuer credit rating?**

2 A. American Water’s S&P issuer credit rating is one-notch higher at ‘A’.

3 **Q. Did you estimate MAWC’s FFO/debt ratios in your direct testimony?**

4 A. Yes. I indicated that MAWC’s FFO/debt ratios have been in the range of 19.1% to 20.3%  
5 since 2019.

6 **Q. How did your calculations of MAWC’s FFO/debt ratios compare to those determined  
7 by S&P for purposes of determining the \*\*\* \_\_\_\_\_**

8 A. \_\_\_\_\_  
9 \_\_\_\_\_  
10 \_\_\_\_\_

11 **Q.** \_\_\_\_\_  
12 \_\_\_\_\_

13 A. \_\_\_\_\_  
14 \_\_\_\_\_  
15 \_\_\_\_\_  
16 \_\_\_\_\_ \*\*\*

17 **Q. How do MAWC’s assets as of June 30, 2022 compare to Missouri’s other large  
18 utilities?**

19 A. The book values of assets were as follows:

- 20 • Ameren Missouri: \$19.401 billion;
- 21 • Evergy Metro: \$9.184 billion;
- 22 • Evergy Missouri West: \$4.520 billion; and
- 23 • Spire Missouri: \$5.034 billion.

1 **Q. What S&P ratings are assigned to the debt of each of Missouri’s large regulated**  
2 **utilities?**

3 A. Ameren Missouri’s first mortgage bonds are rated ‘A’; Evergy Missouri West’s unsecured  
4 debt is rated ‘A-’; Evergy Metro’s first mortgage bonds are rated ‘A+’; and Spire  
5 Missouri’s first mortgage bonds are rated ‘A’.

6 **Q. Why are you providing information on the amount of assets and credit ratings for**  
7 **Missouri’s other utilities?**

8 A. Because Ms. Bulkley and Mr. Swiz claim that MAWC is charged a lower cost of debt  
9 because of its ability to access financing through AWCC. As demonstrated, Spire  
10 Missouri’s and Evergy Missouri West’s assets are not that much larger than MAWC’s  
11 assets. \*\* \_\_\_\_\_  
12 \_\_\_\_\_

13 \_\_\_\_\_ \*\* All of Missouri’s other large  
14 regulated utilities have an embedded cost of long-term debt of 4% or less as compared to  
15 MAWC’s 4.5% cost of debt.

16 **Q. Ms. Bulkley indicates that American Water can carry more leverage than its**  
17 **subsidiaries due to the fact that it is the largest water utility holding company**  
18 **diversified across many different regulatory jurisdictions.<sup>19</sup> Do you agree with her**  
19 **assertions?**

20 A. I agree that having operations in several jurisdictions diversifies risks, but it certainly does  
21 not justify an approximate 10% difference in American Water’s common equity ratio  
22 compared to that which it requests be used to determine MAWC’s ROR. As I have  
23 explained, rating agencies typically have less stringent financial ratio benchmarks for  
24 regulated water utilities, whether stand-alone or part of a holding company, as compared  
25 to most regulated electric and some gas utilities, such as Spire Missouri. This explains why

<sup>18</sup> Murray Rebuttal, p. 10, lines 1-10.

<sup>19</sup> Bulkley Rebuttal, p. 31, line 15 – p. 32, l. 4.



1 even water utility companies that have FFO/debt ratios in the 10% to 12% range still have  
2 at least an ‘A-’ credit rating.

3 **Q. Ms. Bulkley expresses concern that if the Commission were to adopt a more leveraged**  
4 **capital structure to set the ROR for MAWC, this would weaken MAWC’s credit**  
5 **metrics and “could limit MAWC’s options for access to capital from sources other**  
6 **than AWCC.”<sup>20</sup> What information does she rely on to support her position?**

7 A. Ms. Bulkley identifies Moody’s 2019 downgrade of American Water’s credit rating from  
8 ‘A3’ to ‘Baa1’ due to its steadily declining financial risk profile. As Ms. Bulkley identifies,  
9 at the time Moody’s downgraded American Water’s credit rating, its FFO/debt ratio had  
10 declined to 16% in 2016 from around 18% in 2014. Although American Water’s FFO/debt  
11 ratios have declined to around 13% in recent years, Moody’s has not downgraded  
12 American Water’s credit rating further. However, Moody’s cited the following “credit  
13 challenges” in its 2019 report as it relates to American Water’s creditworthiness:

- 14 • Primarily debt-funded free cash flow deficits increasing leverage
- 15 • Declining financial metrics
- 16 • Over \$2.0 billion of annual capex and up to 10% dividend growth  
17 assumed through 2026
- 18 • \$1.5 billion of asset sales proceeds used to offset future equity  
19 issuance, but not repay debt<sup>21</sup>

20 Moody’s further indicated the following about American Water’s ratings outlook:

21 American Water’s stable outlook incorporates our view that financial  
22 metrics will decline over the next few years (e.g., FFO to net debt and  
23 retained cash flow (RCF) to debt between 12-13% and 8-9%, respectively),  
24 but remain above our downgrade thresholds.

25 Consequently, I agree with Ms. Bulkley that Moody’s continues to express concern about  
26 American Water’s more aggressive use of debt.

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<sup>20</sup> Bulkley Rebuttal, p. 29, lines 7-10.

<sup>21</sup> Ryan Wobbrock, et. al, “American Water Works Company, Inc.: Update to credit analysis,” November 4, 2021.

1 **Q. If the Commission adopted your recommended ratemaking capital structure and**  
2 **ROE, what is your estimate of the impact on MAWC’s FFO/debt ratio?**

3 A. The revenue requirement difference attributed to my recommended capital structure and  
4 ROE compared to MAWC’s view of its implied ROE and capital structure from the 2020  
5 rate case is approximately \$23 million/year. The pro forma impact of the reduction to FFO  
6 and increase to MAWC’s debt ratio would reduce its FFO/debt ratio by approximately 4%  
7 to 4.5%. Applying this reduction to \*\*\* \_\_\_\_\_  
8 \_\_\_\_\_  
9 \_\_\_\_\_

10 **Q.** \_\_\_\_\_  
11 \_\_\_\_\_

12 A. \_\_\_\_\_  
13 \_\_\_\_\_  
14 \_\_\_\_\_  
15 \_\_\_\_\_ \*\*\*

16 **Q. Is it MAWC’s position that it is an independent company that should be viewed on a**  
17 **stand-alone basis without consideration for American Water’s financial policies?**

18 A. Yes. This is MAWC’s position, but the facts and circumstances prove that MAWC’s  
19 position is wrong. The cost of debt assigned to MAWC is based on American Water’s risk  
20 profile, which includes its use of leverage. Ms. Bulkley uses American Water’s declining  
21 FFO/debt ratios to bolster her position that if the Commission should adopt a capital  
22 structure consistent with American Water’s, this will constrain MAWC’s ability to access  
23 financing outside of American Water. However, if this is a concern for MAWC (a  
24 company that does not currently directly procure capital through the corporate debt  
25 markets), then it should be American Water’s concern (the company that directly procures  
26 capital through corporate debt markets for its subsidiaries).

1 If a more conservatively managed capital structure is important for capital attraction, then  
2 this needs to occur at American Water. However, anytime OPC has requested American  
3 Water-level financial information from MAWC, such as information related to American  
4 Water's anticipated common equity issuances of up to \$2 billion through 2026, MAWC  
5 has objected and refused to provide such information. While refusing to provide American  
6 Water information may be consistent with MAWC's stated position of independence,  
7 MAWC's stated position is at issue in this case. In fact, as compared to Ameren Missouri,  
8 Spire Missouri, Evergy Metro and Evergy Missouri West, MAWC's financing is even less  
9 independent from the parent company, yet each of these other Missouri utility companies  
10 provided OPC access to parent company information and documents. This allowed OPC  
11 to investigate the operating utility company's claims of being independent by comparing  
12 the substance of the operating company's Board of Director ("BOD") meetings to that of  
13 the parent company's BOD meetings. Even with the Missouri utility subsidiaries that issue  
14 their own debt to third-parties, OPC discovered that the subsidiary BOD minutes and  
15 materials lacked much substance.

16 **Q. What is MAWC's support for its position that it is a financially and operationally**  
17 **independent entity?**

18 A. Mr. Swiz continues to emphasize that MAWC is a stand-alone business because it has  
19 independent state operations, capital investments, and corporate governance.<sup>23</sup> He also  
20 testifies that MAWC's management team is responsible for development of independent  
21 operating capital and financing plans.<sup>24</sup>

22 **Q. Does Mr. Swiz testify about the analysis MAWC performs for purposes of**  
23 **establishing a targeted capital structure for MAWC?**

24 A. Yes. On page 15, line 12 through page 16, line 1 of Mr. Swiz's rebuttal testimony he  
25 describes what seems to be a fairly detailed analyses and planning process for purposes of

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<sup>23</sup> Swiz Rebuttal, p. 4, lines 19-21.

<sup>24</sup> Merante Direct, p. 7, lines 21-22.

1 determining a fair and reasonable balance of common equity and debt in its capital  
2 structure.

3 **Q. Have you reviewed the 2022 budget MAWC management provided to MAWC's BOD**  
4 **for approval?**

5 A. Yes. Please see the attached Schedule DM-S-4 for MAWC's 2022 budget.

6 **Q. Did MAWC hold a BOD meeting to discuss the 2022 Budget before it was approved?**

7 A. No.

8 **Q. Did MAWC's management provide presentations to the MAWC BOD to prove that**  
9 **procuring debt financing from AWCC was the most economical and prudent option?**

10 A. No.

11 **Q. Did MAWC's management provide a capital structure analysis to the MAWC BOD**  
12 **to illustrate that MAWC's budgeted capital structure would achieve certain credit**  
13 **metrics to allow for a lower cost of capital while maintaining a stable credit rating?**

14 A. No.

15 **Q. Is this the type of substance you would expect for an "independent" company?**

16 A. Yes.

17 **Q. Is it likely that presentations to American Water's BOD contain this type of**  
18 **substance?**

19 A. Yes.

20 **Q. Whose interests do MAWC's BODs represent?**

21 A. American Water's shareholder's interests as it wholly-owns MAWC.

1 **Q. Have any of the members of MAWC’s BOD also held other positions with the**  
2 **American Water family of companies?**

3 A. Yes. Three of the five members of MAWC’s BODs have held positions with other  
4 companies within the American Water family of companies.

5 **Q. Have you discovered anything in the MAWC BOD materials and meeting minutes**  
6 **which would lead you to believe that MAWC’s BODs is acting solely in the best**  
7 **interests of MAWC and its ratepayers?**

8 A. No.

9 **RESPONSE TO BULKLEY REBUTTAL TESTIMONY ON ROE**

10 **Q. Can you summarize Ms. Bulkley’s criticisms of your recommended ROE?**

11 A. Yes. Ms. Bulkley claims that my interpretation of the impact of market conditions on  
12 MAWC’s cost of equity (“COE”) in this case are inconsistent with my interpretation in  
13 MAWC’s 2020 rate case, Case Number WR-2020-0344. She indicates that I have changed  
14 my explanation for American Water’s high P/E ratios from low long-term interest rates in  
15 the 2020 rate case to high demand for its stock in the current market environment because  
16 of American Water’s favorable environment, social and governance (“ESG”) ratings rather  
17 than interest rates. Ms. Bulkley claims that my inconsistency in interpreting market  
18 conditions is due to personal bias for a desired outcome.<sup>25</sup> Although I will address her  
19 criticisms in more detail later in my testimony, I am simply reporting the market’s valuation  
20 of American Water’s stock. I am not manipulating American Water’s stock price, or  
21 predicting what it might be in the future as Ms. Bulkley suggests is appropriate in setting  
22 a fair and reasonable ROE in this case. I am simply comparing American Water’s stock  
23 price to its projected earnings. American Water’s P/E ratios continue to be extremely high.  
24 Because long-term interest rates increased significantly in 2022, then obviously long-term  
25 rates are not the explanatory variable they had been in the past for utility stocks.  
26 Consequently, my analysis and research is an attempt to understand and explain the factors

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<sup>25</sup> Bulkley Rebuttal, p. 18, line 12 – p. 19, line 2.

1 causing American Water's stock price to continue to be highly valued. This pure market  
2 data supports, at least on a conceptual basis, that MAWC's cost of equity is lower, whether  
3 it is due to macro factors, stock demand and/or lower business risks.

4 **Q. Ms. Bulkley claims that you placed no weight on your COE analysis for purposes of**  
5 **your recommended allowed ROE.<sup>26</sup> Is she correct?**

6 A. No. I recognize that my allowed ROE recommendation is not at parity with my COE  
7 estimate, but this does not mean I did not rely on my COE estimates in determining a  
8 reasonable recommended allowed ROE. COE analysis using complex methods, such as  
9 discounted cash flows ("DCF"), Capital Asset Pricing Models ("CAPM") and risk  
10 premium methods, can result in a wide range of COE estimates due to various assumptions  
11 (industry growth rates and equity risk premiums). However, there are simple,  
12 straightforward reasonableness tests (standard risk premium added to a company's own  
13 bond yield) and corroborating practical information (stock analysts' utility cost of equity  
14 assumptions) that can assist in determining the reasonableness of COE estimates. Ms.  
15 Bulkley believes allowed ROEs are the proper barometer to test the reasonableness of COE  
16 estimates. If utility investors followed Ms. Bulkley's advice, utility stocks would be wildly  
17 overpriced. They are not. I am not attempting to use methods and assumptions to target a  
18 desired allowed ROE. I am providing a reasonable, objective and logical analysis to  
19 provide the Commission information on utility companies' current cost of capital. I have  
20 observed and recognized that investors expect allowed ROEs to be higher than the COE.  
21 In fact, as I will discuss later, Ms. Bulkley actually cites to investor communications that  
22 confirm such views.

23 Consequently, my COE estimate of around 6% to 6.5% supports MAWC being authorized  
24 a lower ROE than the 9.25% ROE the Commission authorized Empire in Case No. ER-  
25 2019-0374 and the 9.37% the Commission authorized Spire Missouri in Case No. GR-  
26 2021-0108.

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<sup>26</sup> *Id.*, p. 5, lines 9-16.

1 **Q. Ms. Bulkley claims your authorized ROE recommendation is “mismatched” because**  
2 **it is applied to a more leveraged capital structure than that which is consistent with**  
3 **the proxy companies’ capital structures.<sup>27</sup> Does she accurately represent your**  
4 **approach?**

5 A. No. I included American Water in my proxy group COE analysis. My COE estimate for  
6 American Water is consistent with the COE estimates for the other water utility companies  
7 in my proxy group. Therefore, if anything, my approach of analyzing American Water’s  
8 specific financial fundamentals as compared to its stock price, is superior to Ms. Bulkley’s  
9 approach of applying an ROE she derived from not only other water utility companies with  
10 different capital structures, but also other gas and electric companies with different  
11 operating risks.

12 **Q. What other mismatch is inherent in Ms. Bulkley’s assessment of the cost of common**  
13 **equity as it relates to capital structure?**

14 A. Ms. Bulkley analyzed capital market data of publicly-traded holding companies that own  
15 regulated operating utilities. Therefore, her cost of equity estimates are based on the  
16 business and financial risk of the holding companies, not the individual operating utilities.  
17 As I show on Schedule DM-S-5, seven of Ms. Bulkley’s thirteen proxy companies have  
18 equity ratios generally below 45% with three of these companies having equity ratios below  
19 40%, which is even more leveraged than American Water’s capital structure.

20 I note that these common equity ratios include each company’s use of short-term debt,  
21 which is a financial risk factor utility equity investors consider when determining their  
22 required return on equity for investment in the holding company’s equity. Short-term debt  
23 not only adds leverage to the balance sheet, but it subjects the company to refinancing risk,  
24 which causes greater uncertainty in the equity investors’ expected return. I note these  
25 issues because Ms. Bulkley derived her ROE estimates by analyzing the cost of equity of  
26 the holding companies and then applied her ROE estimates to her derivation of less  
27 leveraged operating subsidiary capital structures. Therefore, she is guilty of her own

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<sup>27</sup> *Id.*, p. 34, line 1 through page 35, line 22.

1 accusation of mismatching, while I apply my ROE estimates to a capital structure similar  
2 to that which investors actually consider in determining their required market return on  
3 equity.

4 **Q. Does Ms. Bulkley appear to accept that water utility companies currently have a**  
5 **lower COE due to high valuation levels?**

6 A. Yes. Ms. Bulkley acknowledges that water utility stocks are currently trading at valuation  
7 levels that are well above historical averages.<sup>28</sup> However, as I discussed in my rebuttal  
8 testimony, instead of providing her estimate of the water utility industry's current COE,  
9 Ms. Bulkley apparently believes she has the ability to predict the water utility industry's  
10 future COE. For example, she states the following:

11 ...he [Mr. Murray] has failed to account for the fact that equity analysts  
12 view water utility stock prices as overvalued and are expecting their stock  
13 prices to decline. As water utility stock prices decline going forward, in the  
14 case of Mr. Murray's multi-stage DCF, the amount needed to be paid by an  
15 investor to capture the benefit of future dividends declines, thereby  
16 increasing the cost of equity.<sup>29</sup>

17 Ms. Bulkley supports her predictions by citing to various equity analysts'  
18 recommendations to either hold or even sell water utility stocks due to current high  
19 valuations. She even cites that water utility stocks are currently *expensively* priced.<sup>30</sup>

20 **Q. If a security is *expensive* to an investor, what does this mean for the issuer of the**  
21 **security?**

22 A. It is cheap to procure capital, which is synonymous with a low cost of capital. In fact, as I  
23 illustrated in various charts in my direct testimony, American Water likely has the lowest  
24 cost of equity of any company in the entire utility industry. American Water's low cost of  
25 equity is a function of its ownership of low-risk regulated water utility subsidiaries, which  
26 includes MAWC.

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<sup>28</sup> *Id.*, p. 17, lines 6-7.

<sup>29</sup> Bulkley Rebuttal, p. 55, lines 11-15.

<sup>30</sup> *Id.*, p. 57, lines 5-8.



1 **Q. Ms. Bulkley claims that the mere fact that your cost of equity estimates are below**  
2 **typical authorized ROEs proves that your cost of equity estimates are not reliable.<sup>31</sup>**  
3 **Does Ms. Bulkley quote investor information that corroborates your position that**  
4 **authorized ROEs are higher than utility companies' cost of equity?**

5 A. Yes. On page 56, lines 14-17 of her rebuttal testimony, Ms. Bulkley provides the following  
6 Morningstar information regarding its outlook for American Water's stock:

7 Morningstar currently rates American Water as 2 out of 5 stars and  
8 that its stock price is overvalued, but Morningstar states it is  
9 confident that American Water's **"returns on invested capital will**  
10 **remain at a healthy spread over its cost of capital for the**  
11 **foreseeable future"** (emphasis added)<sup>32</sup>

12 Because Morningstar's audience are investors, they are forthright about the widely  
13 accepted view in the investment community—utilities earn more than their cost of capital,  
14 which is due to the fact that they are typically authorized returns at a significant spread  
15 over their cost of capital. In my experience, the only time in which investors thought  
16 allowed returns were not at a "healthy spread" over the cost of capital was at the height of  
17 the financial crisis in early 2009.

18 **Q. Despite Ms. Bulkley's view that water utility stock prices will decline in the future,**  
19 **does she maintain that investors expect water utilities to grow faster now compared**  
20 **to their expected growth in early 2021?**

21 A. Yes. In rebutting Mr. Jennings's testimony, Ms. Bulkley indicates that the average  
22 projected growth rates for water utilities have increased compared to 2021.<sup>33</sup>

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<sup>31</sup> *Id.* p. 4, lines 20-23.

<sup>32</sup> Andrew Bischof, "American Water's Regulated Water Growth Should Top Most Electric Utilities," Morningstar Investor, November 8, 2022.

<sup>33</sup> *Id.*, p. 16, lines 5-8.

1 **Q. Does this demonstrate the fact that the utility business model is almost recession**  
2 **proof?**

3 A. Yes. Despite general concerns about a potential recession due to the Fed's aggressive  
4 monetary policy tightening, apparently utility companies are confident in continuing their  
5 growth in investment because otherwise their expected earnings growth rates would  
6 decline. Again, these types of factors explain why utility stock valuation levels have not  
7 declined much along with the increases in long-term bond yields. Under normal  
8 competitive conditions, companies expect their profitability and growth to decrease, but  
9 not so for utility companies. In fact, they use current market conditions as support to  
10 request a higher ROE.

11 **Q. Does your recommended allowed ROE allow for a significant spread over the COE?**

12 A. Yes. My allowed ROE recommendation allows for a 275 basis point margin over my COE  
13 estimate. As I explained in my direct testimony, some utility investors have indicated that  
14 they expect the allowed ROE-to-COE spread to average approximately 225 basis points  
15 over the long-term.<sup>34</sup>

16 **Q. Ms. Bulkley claims that your fairly stable ROE recommendations of 9% to 9.25% in**  
17 **cases since December 1, 2019, disregards changing capital market conditions over the**  
18 **same period.<sup>35</sup> Do you agree?**

19 A. No. I consider my recommended authorized ROEs as quite reasonable and measured. Ms.  
20 Bulkley is correct that this period included significant capital market changes, such as a  
21 decade-long secular decline in long-term bond yields, which caused utility P/E ratios to hit  
22 all-time highs in February 2020. While utility stock valuation levels in February 2020  
23 implied that the utility industry's COE was as low as in the 5% range, I recommended the  
24 Commission reduce its previous authorized ROEs of around 9.5% to 9.25%. While a 9%  
25 ROE at that time would certainly have been justified, a 9.25% ROE was more incremental  
26 and measured. Fortunately, the Commission did reduce both Empire's and Spire

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<sup>34</sup> Murray Direct, p. 19, line 26 – p. 20, l. 2.

<sup>35</sup> Bulkley Rebuttal, p. 48, l. 4 – 49, l. 7.

1 Missouri's authorized ROEs. Because equity capital market conditions tightened slightly  
2 for the electric and gas utility subsectors (I estimate their cost of equity is about 100 basis  
3 points higher than for water utilities), I have recently recommended Spire Missouri's and  
4 Ameren Missouri's authorized ROEs be set at 9.25% in Case Nos. GR-2022-0179 and ER-  
5 2022-0337, respectively, but as recognized by Ms. Bulkley herself, water utility stock  
6 valuation levels, especially for American Water, are at incredibly high levels. This justifies  
7 setting MAWC's ROE lower and also applying the ROE to a more leveraged capital  
8 structure.

9 **Q. Ms. Bulkley testifies that it is unnecessary to apply a multi-stage DCF method to the**  
10 **utility industry because it is a mature industry with relatively stable growth over time.**  
11 **She indicates that use of a constant-growth DCF is consistent with the views of equity**  
12 **analysts.<sup>36</sup> Did Ms. Bulkley provide any practical examples to support her testimony?**

13 A. No. Consequently, I requested Ms. Bulkley provide practical examples of equity analysts  
14 that actually determine a fair price to pay for a utility stock by using the constant-growth  
15 DCF using the assumptions she suggests. She could not provide an example. She indicated  
16 her testimony is based on her twenty years of experience reviewing equity analyst earnings  
17 per share ("EPS") growth rate forecasts (see Schedule DM-S-6). She apparently believes  
18 reviewing EPS forecasts, and not the equity analysts' more detailed analysis provided in  
19 their reports, as sufficient to support her testimony.

20 **Q. What have you observed in your experience of reviewing the analysis performed by**  
21 **the equity analysts that provide EPS growth forecasts?**

22 A. They typically value utility stocks using two primary methods: a projected P/E multiple  
23 based on estimated earnings two-to-three years from the current year and a multi-stage  
24 dividend discount model ("DDM") analysis (synonymous with DCF in the utility  
25 ratemaking setting). I have specifically reviewed multi-stage DDM analyses performed by  
26 Wells Fargo, Evercore ISI and U.S. Capital Advisors. In fact, I attached an example of  
27 U.S. Capital Advisors multi-stage DCF in my Direct Testimony (*see* Schedule DM-D-5).

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<sup>36</sup> *Id.*, p. 60, lines 1-8.

1 Contrary to Ms. Bulkley's assumption, in my twenty years of experience I have *never* seen  
2 an equity analyst determine the value of a utility stock consistent with Ms. Bulkley's  
3 assumptions. Investors do not naively assume a utility's dividend will grow at a constant  
4 rate in perpetuity at the same rate as analysts' projected 5-year compound annual growth  
5 rate ("CAGR") in EPS. My experience in reviewing such reports indicates that equity  
6 analysts use the projected EPS growth rate to assess if a particular company's P/E ratio  
7 should trade at a premium or discount to its peers (e.g. top quartile growth deserves a higher  
8 P/E ratio).

9 **Q. Did you review all of the recent equity research reports recently published on**  
10 **American Water?**

11 A. No. Despite MAWC providing this equity research in the 2020 rate case, in this case  
12 MAWC has not provided OPC access to this research.<sup>37</sup>

13 **Q. Could these reports contradict theories proffered by cost of capital witnesses such as**  
14 **Ms. Bulkley and contribute to MAWC's lack of cooperation in providing these**  
15 **reports?**

16 A. Certainly.

17 **Q. Ms. Bulkley also claims that the 6% market risk premium American Water used for**  
18 **its goodwill impairment analysis in November 2019 should not be used to assess the**  
19 **reasonableness of the various CAPM analyses in this case.<sup>38</sup> Why?**

20 A. She indicates that these assumptions, which are used to certify to investors that the fair  
21 value of its assets are no less than that reported on its balance sheet, are not meaningful  
22 because they are not forward-looking. She also states that because this information is from  
23 2019, it is outdated and no longer relevant.

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<sup>37</sup> OPC Data Request No. 3001.

<sup>38</sup> *Id.*, p. 71, line 3 through p. 73, line 8.

1 **Q. Did you request American Water’s more recent goodwill impairment assessments,**  
2 **which are completed annually in November?**

3 A. Yes, but MAWC has refused to provide this information.

4 **Q. If American Water had estimated that its cost of capital had increased significantly**  
5 **due to significant changes in capital market conditions, would this be a material factor**  
6 **that should be addressed in subsequent goodwill impairment reports?**

7 A. Yes.

8 **Q. Are you concerned about American Water’s resistance to provide these documents**  
9 **as well?**

10 A. Yes. Again, this type of information is used to attest to the accuracy and reliability of the  
11 value assigned to American Water’s regulated water utility assets. If the cost of capital has  
12 increased as much as Ms. Bulkley suggests, this should be of concern to American Water  
13 because it may impact the estimated fair value of its regulated water utility assets.

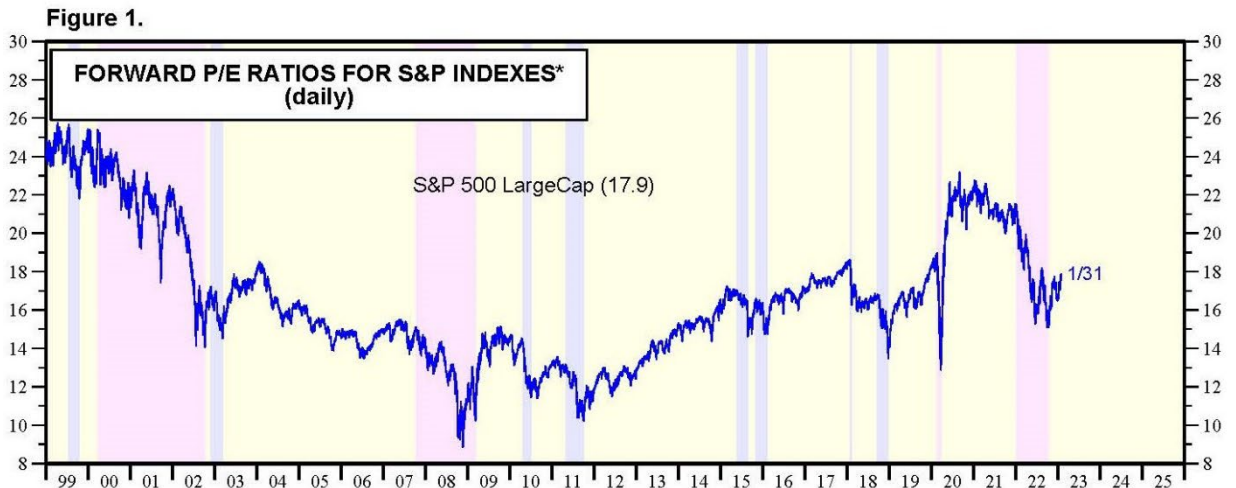
14 **Q. Ms. Bulkley shows annual stock market returns for the 13-year period 2009 to 2021**  
15 **to support her high market risk premium estimates.<sup>39</sup> If you used the 13-year period**  
16 **ending in 2008, what would this information imply about market risk premium**  
17 **estimates starting in 2009 when the S&P 500 had just declined by 37% in 2008?**

18 A. The arithmetic average annual S&P 500 market returns for the period 1996 to 2008 was  
19 7.05%. The arithmetic average annual long-term United States Treasury (“UST”) bond  
20 returns over this same period was 8.98%. Based on Ms. Bulkley’s logic of using a recent  
21 13-year total return to estimate a market risk premium, this would imply that investors’  
22 market risk premium was a negative 1.93% over UST bonds at the beginning of 2009.  
23 These arbitrary periods should not be used to justify an implied market risk premium. It is  
24 widely understood that during periods when the S&P 500 is trading at high valuation levels,  
25 the required returns going forward are lower, and when the S&P 500 is trading at lower

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<sup>39</sup> *Id.*, p. 71, lines 1-2.

1 levels, the required returns going forward are higher. See the following chart which shows  
2 the valuation levels of the S&P 500 over the last couple of decades:



5 **Q. Does Ms. Bulkley recognize that using select historical periods may cause counter-**  
6 **intuitive indications of investors' implied market risk premiums?**

7 **A.** Yes. Just a few pages earlier in in her rebuttal testimony, Ms. Bulkley explains the counter-  
8 intuitive conclusions one could make using historical earned market returns to estimate  
9 implied required market returns.<sup>40</sup> This logic is equally applicable when market returns  
10 have been unexpectedly higher or lower than investors expect over the long-term.

11 **Q. Ms. Bulkley testifies that the Commission authorized Spire Missouri a 54.25%**  
12 **common equity ratio in Case No. GR-2021-0108.<sup>41</sup> Is she correct?**

13 **A.** No. The Commission's authorized common equity ratio in Case No. GR-2021-0108 was  
14 49.86%.<sup>42</sup>

<sup>40</sup> *Id.*, p. 66, line 5 – p. 67, line 10.

<sup>41</sup> *Id.*, p. 42, lines 18-20.

<sup>42</sup> Case No. GR-2021-0108, Staff Accounting Schedules, Commission Amended Report & Order, December 13, 2021 (EFIS Item No. 456).

1 **Q. What do you conclude after considering Ms. Bulkley’s criticisms of your testimony?**

2 A. Ms. Bulkley freely admits that water utility stocks are trading at high valuation levels. She  
3 also acknowledges that expected growth for the utility industry is relatively stable over  
4 long periods. If expected growth rates for utilities are fairly stable, then the primary factor  
5 impacting investors’ assessment of a fair price to pay for utility stocks is their required  
6 return on equity (i.e. the cost of equity). The primary consideration should not be whether  
7 water utilities current higher valuation levels are due to the level of long-term interest rates,  
8 higher demand due to ESG considerations, lower business risk, defensive characteristics in  
9 light of recessionary fears, the ability to pass higher inflationary costs through to ratepayers  
10 and/or any other investor considerations. Rather, the primary consideration in setting a fair  
11 and reasonable ROE based on consideration of the COE is whether utility stock prices are  
12 higher because investors are willing to accept a lower return based on current business,  
13 interest rate, and/or economic conditions. The answer to this consideration is yes. This  
14 should be reflected in a lower authorized ROE for MAWC.

15 **RANDALL T. JENNINGS**

16 **Q. What are Mr. Jennings’ criticisms of your direct testimony and what is your**  
17 **response?**

18 A. Mr. Jennings testifies that my recommended ROE of 9% is inconsistent with my findings  
19 that MAWC’s COE has increased slightly since the 2020 rate case. As Mr. Jennings  
20 correctly notes, I recommended a 9.25% ROE in the 2020 rate case. However, the mid-  
21 point of my estimated COE range of 6% to 6.5% in this case is 25 basis points higher than  
22 the mid-point of my COE range of 5.5% to 6.5% in the 2020 rate case. My narrower range  
23 in this case is due to my concern that methodologies that rely more heavily on long-term  
24 bond yields are not as reliable in the current capital market environment. As I showed in  
25 several charts in my Direct Testimony, for the period since the onset of Covid-19, utility  
26 stocks’ P/E ratios have not exhibited their typical strong negative correlation to changes in  
27 long-term bond yields. Additionally, my comparison of the valuation levels of water utility  
28 stocks to the valuation levels of regulated electric and natural gas utility companies’ stocks

1 supports my position that water utility companies' costs of capital are lower than that of  
2 electric and gas utility companies. The resiliency of the water utility industry's P/E ratios  
3 in light of increasing long-term bond yields should be considered in determining whether  
4 Missouri's water utility companies should be awarded an ROE different from that of  
5 Missouri's gas and electric utility companies. Consequently, I decided a 9% ROE is  
6 reasonable, which is below the ROEs the Commission authorized Empire and Spire  
7 Missouri.

8 **Q. Mr. Jennings cites to your response to Staff Data Request No. 0279. Did you make a**  
9 **mistake in your response to this data request?**

10 A. Yes. In my response, I indicated that my American Water-specific multi-stage DCF cost  
11 of equity estimate in this case is 20 basis points higher than my estimate in the 2020 rate  
12 case. I incorrectly compared my 6.04% estimate using a 3.5% perpetual growth rate in the  
13 2020 rate case to my 6.24% COE estimate using a 4% perpetual growth rate in this rate  
14 case. If I had properly compared my company-specific multi-stage DCF COE estimates  
15 using a 4% perpetual growth rate in both cases, my COE estimate for American Water is  
16 essentially the same in both cases (approximately 6.25%).<sup>43</sup>

## 17 **SUMMARY AND CONCLUSIONS**

18 **Q. Can you summarize the main points of your surrebuttal testimony?**

19 A. Yes. MAWC witnesses claim that American Water is able to carry more leverage than  
20 MAWC because of its diversified holdings of several low-risk regulated water and sewer  
21 companies. I claim that American Water can carry more leverage because of its high  
22 quality, low-risk regulated water and sewer utility subsidiaries, which include MAWC.  
23 MAWC's witnesses' arguments are based on hypothetical scenarios of MAWC being a  
24 stand-alone company. My recommendation is based on the reality that MAWC is not a  
25 stand-alone company, but rather a company being charged debt costs based on the risk  
26 profile of its pure-play water and sewer parent company, American Water. The more

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<sup>43</sup> Murray Direct, Schedule DM-D-2 and Case No. WR-2020-0344, Murray Direct, Schedule DM-D-2



1 leveraged capital structure supporting MAWC's low-risk assets is that of American  
2 Water's consolidated capital structure. My recommendation matches the debt costs  
3 charged to MAWC with the capital structure in which American Water's debt investors  
4 invest.

5 Utility commissions in other states have not resisted American Water's financial strategy  
6 of targeting equity-rich capital structures at its subsidiaries to allow for higher cash flows  
7 to support even more debt at the holding company. Therefore, American Water has been  
8 increasing the delta between its actual consolidated common equity ratio and those it  
9 requests regulators approve for ratemaking. There is no objective evidence that  
10 demonstrates American Water's business risk has declined for any reason other than it  
11 owns high-quality, low-risk regulated water and sewer utility assets, which includes  
12 MAWC.

13 Water utility stock valuation levels support a lower cost of capital environment. American  
14 Water trades at the highest P/E ratio of all of its peers. Ms. Bulkley's attempt to speculate  
15 as to the direction of utility capital markets should be dismissed. MAWC's authorized  
16 ROE should be set below that which the Commission authorized Missouri's gas and  
17 electric utility companies.

18 **Q. Does this conclude your testimony?**

19 **A.** Yes.

**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI**

In the Matter of the Application of )  
Missouri-American Water Company’s )  
Request for Authority to Implement ) Case No. WR-2022-0303  
General Rate Increase for Water and Sewer )  
Service Provided in Missouri Service Areas )

**AFFIDAVIT OF DAVID MURRAY**

**STATE OF MISSOURI** )  
  ) **ss**  
**COUNTY OF COLE**         )

David Murray, of lawful age and being first duly sworn, deposes and states:

1. My name is David Murray. I am a Utility Regulatory Manager for the Office of the Public Counsel.
2. Attached hereto and made a part hereof for all purposes is my surrebuttal testimony.
3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.

  
\_\_\_\_\_  
David Murray  
Utility Regulatory Manager

Subscribed and sworn to me this 8<sup>th</sup> day of February 2023.



TIFFANY HILDEBRAND  
My Commission Expires  
August 8, 2023  
Cole County  
Commission #15637121

  
\_\_\_\_\_  
Tiffany Hildebrand  
Notary Public

My Commission expires August 8, 2023.