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Surrebuttal
File No. WR-2023-0344

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Case No.: *WR-2023-0344*
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MISSOURI PUBLIC SERVICE COMMISSION
FINANCIAL AND BUSINESS ANALYSIS DIVISION
FINANCIAL ANALYSIS DEPARTMENT

SURREBUTTAL TESTIMONY

OF

RANDALL T. JENNINGS

THE RAYTOWN WATER COMPANY

CASE NO. WR-2023-0344

Jefferson City, Missouri
November 2023

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RANDALL T. JENNINGS
THE RAYTOWN WATER COMPANY
CASE NO. WR-2023-0344**

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1 A. In direct testimony, Staff found an authorized ROE of 10.37% to be reasonable.¹
2 Staff finds Mr. Murray’s recommended ROE range flawed because Mr. Murray’s rebuttal
3 testimony is based on unreasonable circular logic. In his rebuttal testimony, Mr. Murray
4 assumed a projected Financial Risk Profile (“FRP”) for The Raytown Water Company
5 (“RWC”) to support his recommended ROE in the range of 9.12% to 9.90%.² In this surrebuttal
6 testimony, Staff will explain how the arguments raised by Mr. Murray are based upon projected
7 revenues and credit metrics RWC could obtain if RWC was granted the Non-unanimous
8 Agreement Regarding Disposition of Small Utility Company Increase Request filed on
9 September 13, 2023 (“Non-unanimous Agreement”).³

10 **RESPONSE TO OPC WITNESS MR. DAVID MURRAY**

11 A. **Implied Credit Rating**

12 Q. Please explain Mr. Murray’s disagreement with Staff’s implied credit rating
13 for RWC.

14 A. Mr. Murray agrees with Staff’s assignment of a “Strong” Business Risk Profile
15 (“BRP”) for RWC but disagrees with Staff’s analysis of RWC’s actual credit metrics for the
16 2022 calendar year and Staff’s conclusion that RWC has an FRP of “Aggressive,” causing its
17 credit risk profile to equate to an implied credit rating of ‘BB.’⁴

18 Instead, Mr. Murray calculates projected revenues and projected credit metrics using
19 the Non-unanimous Agreement to conclude RWC has an FRP of “Significant.” When paired

¹ Page 2, Lines 19-20, Randall T. Jennings Direct Testimony, Case No. WR-2023-0344.

² Page 6, Lines 12-13, David Murray Rebuttal Testimony, Case No. WR-2023-0344.

³ Page 5, Lines 3-8, David Murray Rebuttal Testimony, Case No. WR-2023-0344.

⁴ 2009 Standard & Poor’s ‘Criteria Methodology: Business Risk/Financial Risk Matrix Expanded.’

1 with the BRP of “Strong,” Mr. Murray concludes RWC has a projected implied credit rating
2 of ‘BBB.’

3 Q. Based on Mr. Murray’s projected implied credit rating of ‘BBB,’ what
4 is Mr. Murray’s recommended ROE in this proceeding?

5 A. 9.12%.⁵

6 Q. Do you agree with Mr. Murray’s recommended ROE of 9.12%?

7 A. No, I do not. As Staff will explain in additional detail, Mr. Murray bases his
8 analysis on circular logic regarding stipulations contained within the Non-unanimous
9 Agreement, not yet in effect, in order to calculate pro forma credit metrics to predict their effects
10 on RWC’s implied credit rating. He then uses this predicted future credit rating to establish
11 today’s RWC implied credit rating.

12 Q. How did Mr. Murray calculate his recommended ROE of 9.12%?

13 A. Mr. Murray stated “Staff’s recommended 3.5% equity risk premium should be
14 added to the average ‘BBB’ bond yield of 5.62% to set a fair and reasonable ROE of 9.12%.”⁶

15 Q. Do you agree with Mr. Murray’s answer of 9.12% when asked “If the generic
16 3.5% equity risk premium is added to a ‘BBB’ bond yield, what is the implied COE?”⁷

17 A. No, I do not. The average return on ‘BBB’ rated bonds have been rising the last
18 three months (July through September) from 5.81% to 6.15%, with the average for that time
19 frame being 5.98%.⁸ Adding 3.50% to this average would equal 9.48%.

⁵ Page 6, Line 15, David Murray Rebuttal Testimony, Case No. WR-2023-0344.

⁶ Page 7, Lines 20-22, David Murray Rebuttal Testimony, Case No. WR-2023-0344.

⁷ Page 5, Lines 19-21, David Murray Rebuttal Testimony, Case No. WR-2023-0344.

⁸ ICE BofA BBB US Corporate Index Effective Yield (BAMLC0A4CBBBEY) | FRED | St. Louis Fed (stlouisfed.org); <https://fred.stlouisfed.org/series/BAMLC0A4CBBBEY#0>

1 **B. Circular Logic**

2 Q. Do you agree with Mr. Murray’s use of projected financials and credit metrics,
3 based on Staff and Raytown’s Non-unanimous Agreement, resulting in a projected FRP of
4 “Significant” paired with a BRP of “Strong” resulting in an implied credit rating of ‘BBB’?⁹

5 A. No, I do not. Staff believes this to be circular logic. Mr. Murray uses the
6 stipulated revenue requirement increase of \$1,174,782 and Staff’s rate making income
7 statement, attached to the Non-unanimous Agreement. Using this information, which includes
8 the use of Staff’s recommended ROE of 10.37%, Mr. Murray calculates that RWC’s funds from
9 operations (“FFO”)/debt is expected to be 21.67%.¹⁰ This expected credit metric, based upon
10 an income calculated using Staff’s recommended ROE of 10.37%, leads Mr. Murray to
11 conclude that RWC will obtain an FRP rating of “Significant.” This expected improvement in
12 FRP, combined with his previous BRP rating of “Strong”, leads Mr. Murray to the conclusion
13 that RWC will obtain an implied credit rating of ‘BBB’¹¹ and because RWC will obtain an
14 implied credit rating of ‘BBB’ in the future, the ROE in the current rate case should be
15 established upon that future credit rating.

16 Q. What makes Mr. Murray’s conclusion a circular argument?

17 A. Mr. Murray bases his calculations and conclusions upon the Non-unanimous
18 Agreement. The terms and stipulations of the Non-unanimous Agreement can only be ordered
19 by the Commission and therefore cannot be counted upon to be in effect at the end of this rate
20 case. The reliance upon these terms and stipulations, not yet in effect, causes Mr. Murray’s
21 conclusions to be flawed.

⁹ Page 5, Lines 5-12, David Murray Rebuttal Testimony, Case No. WR-2023-0344.

¹⁰ Page 5, Lines 8-9, David Murray Rebuttal Testimony, Case No. WR-2023-0344.

¹¹ Page 5, Lines 9-12, David Murray Rebuttal Testimony, Case No. WR-2023-0344.

1 Q. Did Mr. Murray calculate the revenue requirement based upon his
2 recommended ROE of 9.12% compared to Staff's 10.37%?

3 A. Yes. Mr. Murray again enters into the same circular logic using Staff's rate
4 making income statement, the Non-unanimous Agreement and simply substitutes his
5 recommended ROE of 9.12% for Staff's recommended ROE of 10.37%. Using this
6 information, Mr. Murray calculates that RWC's annual revenue requirement will be reduced
7 by \$70,413.80,¹² adding that RWC's pro forma FFO/debt ratio would be approximately 20.19%
8 and still consistent with a 'BBB' rating.¹³ Unfortunately, these calculations are based upon the
9 remaining stipulations contained within the Non-unanimous Agreement. Again, the terms and
10 stipulations of the Non-unanimous Agreement can only be ordered by the Commission and
11 therefore cannot be counted upon to be in effect at the end of this rate case. The reliance upon
12 these terms and stipulations, not yet in effect, causes Mr. Murray's conclusions to be flawed.

13 Q. Do you agree with Mr. Murray's conclusions regarding the impact on RWC's
14 revenue requirement and resulting pro forma credit metrics if a lower ROE is substituted for
15 Staff's recommended ROE of 10.37%?

16 A. No, I do not. As discussed multiple times above, Mr. Murray uses circular logic
17 by basing his calculations on the remaining stipulations contained within the Non-unanimous
18 Agreement. The reliance upon these terms and stipulations, not yet in effect, causes Mr.
19 Murray's conclusions to be flawed and possible future credit ratings should not be used in a
20 current rate case.

21 Q. How does Mr. Murray conclude RWC should have an FRP of 'Significant'?

¹² Page 6, Lines 1-3, David Murray Rebuttal Testimony, Case No. WR-2023-0344.

¹³ Page 6, Lines 4-7, David Murray Rebuttal Testimony, Case No. WR-2023-0344.

1 A. Mr. Murray calculates “projected” credit metrics, again using the
2 Non-unanimous Agreement, resulting in an FRP of “Significant” and an implied credit rating
3 of ‘BBB.’¹⁴ Mr. Murray reasons that since RWC might obtain a projected implied credit rating
4 of ‘BBB’ in the future, the ROE in the current rate case should be established upon that possible
5 future credit rating.

6 Unfortunately, Mr. Murray again uses circular logic by basing his calculations on the
7 remaining stipulations contained within the Non-unanimous Agreement. As Staff stated earlier,
8 the terms and stipulations of the Non-unanimous Agreement can only be ordered by the
9 Commission and therefore cannot be counted upon to be in effect at the end of this rate case.
10 The reliance upon these terms and stipulations, not yet in effect, causes Mr. Murray’s
11 conclusions to be flawed. Possible future credit ratings should not be used to establish a return
12 on equity in a current rate case.

13 **C. Preferred Stock**

14 Q. Should Mr. Murray consider RWC’s Preferred Stock and RWC’s management
15 decisions regarding its Preferred Stock when considering its FRP and implied credit rating?

16 A. Yes. First, RWC’s application did not match the Corporate Resolution which
17 resulted in required interest payments that could have been deferred. Second, there are now
18 portions of the outstanding Preferred Stock that could now be viewed as debt. Both of these
19 can negatively impact RWC’s finances and credit metrics which would further support Staff’s
20 FRP of “Aggressive” and Staff’s implied credit rating of ‘BB.’

21 Q. When did RWC apply to issue Preferred Stock and what were the terms
22 requested in the application?

¹⁴ Page 5, Lines 9-12, David Murray Rebuttal Testimony, Case No. WR-2023-0344.

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1 A. On November 20, 2020, RWC filed an application to issue up to \$5,000,000 in
2 Preferred Stock bearing an interest rate not to exceed the prime rate per annum as reported
3 each January 1 in the Wall Street Journal and all dividends will be paid quarterly.¹⁵

4 Q. Does the Application differ from the Corporate Resolution attached thereto?

5 A. Yes. The Corporate Resolution stated that “the dividends due on such stock
6 shall accumulate if not paid.”¹⁶ The Commission Order approving the application was silent
7 regarding this difference. The result of RWC’s management incorrectly drafting its application
8 for financing is that RWC has a recurring short-term liability for the dividend payments that
9 could have been deferred and accumulated until redemption.

10 Q. What effect does the variable interest rate and required dividend payments on
11 the stock have on RWC’s finances?

12 A. For the first two years, 2021 & 2022, the required interest rate was 3.25%.
13 Beginning in 2023 the required interest rate has risen to 7.50%.¹⁷ As of July 27, 2023, the
14 prime rate is 8.50%.¹⁸ With the prime rate at its highest in over 20 years,¹⁹ RWC is forced to
15 continue paying the required dividend payments, further reducing its net income.

16 Q. Is there another effect RWC’s preferred stock has on its credit metrics and
17 implied credit rating?

18 A. Yes. RWC issued preferred stock in 2021 (\$1,070,000), 2022 (\$790,000) and
19 2023 (\$713,495 as of April 17, 2023) totaling \$2,573,495.²⁰ While preferred stock is an equity

¹⁵ Paragraph 7, Application, Case No. WF-2021-0131.

¹⁶ Corporate Resolution, Application Exhibit B, Case No. WF-2021-0131.

¹⁷ Data Request Number 0086.

¹⁸ Money Rates (wsj.com); <https://www.wsj.com/market-data/bonds/moneyrates>.

¹⁹ Bank Prime Loan Rate Changes: Historical Dates of Changes and Rates (PRIME);
<https://fred.stlouisfed.org/series/PRIME>

²⁰ Data Request Number 0086.

1 instrument, Mr. Clevenger was asked “Do the holders of the Preferred Stock have a right of
2 redemption?”²¹ He responded:

3 “Yes. After they [the Preferred Stock holders] have held their stock for
4 two years, they may redeem it with the Company.”²²

5 Due to this “redemption” option, the preferred stock could also be interpreted as debt. By the
6 end of 2023, any shares of Preferred Stock issued in 2021 will be eligible for the stock owner
7 to “redeem it with the company.” This minimum increase in debt (\$1,070,000 issued in 2021)
8 could in turn negatively affect the credit metrics Mr. Murray relies upon for his implied
9 ‘BBB’ credit rating.

10 **D. Additional Credit Rating Factors**

11 Q. Are there factors other than credit metrics leading Staff to believe RWC has an
12 FRP of ‘Aggressive’ and supporting an implied credit rating of ‘BB’?

13 A. Yes. First, RWC does not have a fully “exclusive” service territory and actually
14 overlaps in places with the Jackson County Water District No. 2 and the City of Independence.²³
15 This lack of exclusive area and room to expand potentially inhibits RWC from growing its
16 customer base.

17 Second, OPC has alleged that RWC’s management decisions appear to be questionable.
18 OPC witness Geoff Marke referenced the absence of a competitive request for proposal or any
19 independent cost benefit analysis as underscoring “the managerial imprudence that is obvious
20 upon review.”²⁴ OPC witness Angela Schaben stated “RWC recently spent millions of dollars
21 on AMI software for which it did not initiate formal competitive bidding through a request for

²¹ Page 14, Lines 21-22, Neal S. Clevenger Rebuttal Testimony, Case No. WR-2023-0344.

²² Page 15, Lines 1-2, Neal S. Clevenger Rebuttal Testimony, Case No. WR-2023-0344.

²³ Page 2, Lines 8-11, Chiki Thompson, Rebuttal Testimony, Case No. WR-2023-0344.

²⁴ Page 6, Lines 17-18, Geoff Marke, Rebuttal Testimony, Case No. WR-2023-0344.

1 proposal (“RFP”) process” and “as a result, little evidence exists to ensure ratepayers are
2 receiving a cost-effective result.”²⁵ If OPC’s allegations are to be believed and taken into
3 account, they would further support Staff’s FRP of “Aggressive” and Staff’s implied credit
4 rating of ‘BB’.

5 Third, Mr. Murray states that RWC will receive rate relief in this case associated with
6 the investments it made in its system resulting in increases in revenues. However, OPC witness
7 Geoff Marke is recommending, regarding its AMI investment, that RWC “retain the costs for
8 its investment but that any profit margin be eliminated for this needless spend.”²⁶ While
9 revenues may rise due to the increase in RWC’s rate base, these additional revenues will be
10 offset by payments due toward the Environmental Improvement and Energy Resource
11 Authority (“EIERA”) Bonds issued for the AMI investment.

12 The combination of the lack of opportunities for growth, management decisions
13 described by OPC witnesses as being imprudent with little evidence existing to ensure cost-
14 effective results, and any rate relief from the AMI investment being used to repay its financing,
15 support Staff’s assignment of an FRP of ‘Aggressive’.

16 Q. Do you agree with Mr. Murray that RWC’s retirement of EIERA loan principal
17 supports his position that RWC’s credit risk profile is consistent with an investment grade
18 credit rating?

19 A. No, I do not. The timeliness of loan payments alone does not warrant an
20 investment grade credit rating.

²⁵ Page 6, Lines 8-11, Angela Schaben Rebuttal Testimony, Case No. WR-2023-0344.

²⁶ Page 6, Lines 20-21, Geoff Marke Rebuttal Testimony, Case No. WR-2023-0344.

1 Q. Do you agree with Mr. Murray that RWC’s prefunding of interest payments
2 supports his position that RWC’s credit risk profile is consistent with an investment grade
3 credit rating?

4 A. No, I do not. When RWC submitted its application in WF-2021-0427 to
5 issue \$5 Million in EIERA bonds through the State of Missouri, \$356,000.00 was requested for
6 the construction of a new parking garage. Ms. Schaben discussed in her Rebuttal Testimony²⁷
7 that RWC should have been aware that the bond proceeds could not be used for that purpose
8 and instead, the bond language was changed to let part of the proceeds pay interest through
9 March 2024, totaling \$297,958.00.²⁸ This repurposing of the bond funds caused the loan
10 principal to remain at its original amount. This use of loan principal to prefund interest
11 payments caused additional interest to accumulate which could have been prevented had the
12 principal been simply returned. OPC witness Ms. Schaben even goes as far to state “[c]aptive
13 ratepayers should not be penalized with unreasonable rates based on poor Company
14 management decisions.”²⁹ If OPC’s assertion is to be believed and taken into account, it would
15 further support Staff’s FRP of “Aggressive” and Staff’s implied credit rating of ‘BB’.

16 **SUMMARY AND CONCLUSION**

17 Q. Please summarize the conclusions of your surrebuttal testimony.

18 A. I disagree with Mr. Murray’s use of circular logic regarding stipulations
19 contained within the Non-unanimous Agreement not yet in effect in order to calculate pro forma
20 credit metrics to predict their effects on RWC’s implied credit rating and then using that

²⁷ Page 7, Lines 1-23, Angela Schaben Rebuttal Testimony, Case No. WR-2023-0344.

²⁸ Page 7, Lines 17-20, Angela Schaben Rebuttal Testimony, Case No. WR-2023-0344.

²⁹ Page 8, Lines 12-14, Angela Schaben Rebuttal Testimony, Case No. WR-2023-0344.

Surrebuttal Testimony of
Randall T. Jennings

1 possible predicted future credit rating to establish today's RWC implied credit rating. Staff
2 used actual test year data and annual reports filed with the Commission from previous years to
3 establish its evaluation of RWC's BRP and FRP to help determine its current implied
4 credit rating.

5 Mr. Murray goes on to list reasons why RWC should be evaluated as having a
6 "Significant" FRP, one category higher than Staff's assessment of "Aggressive." In addition
7 to Staff's analysis of the actual 2022 financial statements, if OPC's assertions are to be believed
8 and taken into account, they would further support Staff's FRP of "Aggressive" and Staff's
9 implied credit rating of 'BB.'

10 As Mr. Murray's rebuttal testimony fails to provide sufficient reason to change my
11 original authorized ROE recommendation, I continue to recommend an authorized
12 ROE of 10.37%.

13 Q. Does this conclude your surrebuttal testimony?

14 A. Yes it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the Application of a Rate)
Increase of Raytown Water Company) File No. WR-2023-0344

AFFIDAVIT OF RANDALL T. JENNINGS

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

COMES NOW RANDALL T. JENNINGS and on his oath declares that he is of sound mind and lawful age; that he contributed to the foregoing *Surrebuttal Testimony of Randall T. Jennings*; and that the same is true and correct according to his best knowledge and belief.

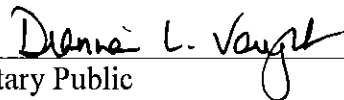
Further the Affiant sayeth not.



RANDALL T. JENNINGS

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 7th day of November 2023.



Notary Public

DIANNA L. VAUGHT
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: July 18, 2027
Commission Number: 15207377