Exhibit No. 204

OPC – Exhibit 204
Murray
Rebuttal
File No. WR-2023-0344

Exhibit No.:	______________
Issue(s):	Return on Equity (ROE)
Witness/Type of Exhibit:	Murray/Rebuttal
Sponsoring Party:	Public Counsel
Case No.:	WR-2023-0344

REBUTTAL TESTIMONY

OF

DAVID MURRAY

Submitted on Behalf of the Office of the Public Counsel

RAYTOWN WATER COMPANY

CASE NO. WR-2023-0344

October 24, 2023

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REBUTTAL TESTIMONY

OF

DAVID MURRAY

THE RAYTOWN WATER COMPANY

CASE NO. WR-2023-0344

I. INTRODUCTION

Q. Please state your name and business address.

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

Q. By whom are you employed and in what capacity?

A. I am employed by the Missouri Office of the Public Counsel ("OPC") as a Utility Regulatory Manager.

Q. On whose behalf are you testifying?

A. I am testifying on behalf of the OPC.

Q. Did you file direct testimony in this case?

A. No.

Q. What issue are you addressing in rebuttal testimony?

A. Staff's recommended return on common equity ("ROE") for purposes of setting The Raytown Water Company's ("Raytown") authorized rate of return ("ROR") in this case.

Q. What experience, knowledge and education qualify you to address this issue?

A. Please see Schedule DM-R-1 for my qualifications as well as a summary of the cases in which I have sponsored testimony on ROR and other financial issues.

Q. Why are you testifying in rebuttal?

A. I disagree with Staff witness' Randall Jennings' estimate of Raytown's credit risk profile, which forms the basis for his recommended authorized ROE of 10.37%. Mr. Jennings' estimates that Raytown's credit risk is consistent with a below investment-grade credit rating (*i.e.* junk bond rating). I estimate Raytown's credit risk profile is consistent with an investment-grade credit rating. Therefore, I believe Raytown's investment-grade credit risk profile supports a lower authorized ROE than Mr. Jennings' recommends in his direct testimony.

II. REBUTTAL OF STAFF WITNESS JENNINGS' RECOMMENDED ROE

Q. Can you summarize the basis for Mr. Jennings' recommended ROE of 10.37%?

A. Yes. Mr. Jennings estimated Raytown's ROR by applying Staff's Financial Analysis Department's "Small Utility ROR Methodology."[1] I am familiar with this methodology because I co-authored the whitepaper outlining this methodology with two other previous Financial Analysis Department employees, Shana Griffin and Zephania Marevangepo. The underlying principles of this methodology are guided by Standard & Poor's Global Ratings ("S&P") credit ratings methodology. Based on Mr. Jennings' application of this methodology, he estimated Raytown's credit risk to be consistent with S&P's 'BB' rating, which is below an investment-grade credit rating of 'BBB-' or higher. Mr. Jennings then added a generic equity risk premium of 3.5% to a recent implied 'BB' bond yield of 6.87% to determine his recommended ROE of 10.37%.

Q. How did Mr. Jennings estimate a 'BB' credit rating for Raytown?

A. S&P publishes a table (Schedule DM-R-2) which provides implied credit ratings for a company based on an estimate of a company's business risk profile ("BRP") and financial risk profile ("FRP"). Based on Mr. Jennings' assignment of a BRP of "Strong" and a FRP of "Aggressive," the S&P table indicates a guideline rating of 'BB+'. Apparently, Mr. Jennings rounded the rating to 'BB'.

[1] Jennings Direct Testimony, p. 5, lns. 5 – 6.

Q. What was Mr. Jennings' basis for assigning Raytown's water utility operations a BRP of "Strong"?

A. Mr. Jennings discussed the fact that S&P assigns "Excellent" BRPs for purposes of assigning ratings to larger water utility companies. Mr. Jennings testifies that Raytown's smaller size justifies the assignment of a riskier BRP of "Strong."

Q. Do you dispute Mr. Jennings assignment of a "Strong" BRP to Raytown's water utility operations?

A. No. However, instead of focusing purely on size, I recognized that unlike the water utility companies rated by S&P, Raytown does not issue debt directly to investors. While size may be a factor in the inability to issue debt directly to investors, it can also be due to other reasons, such as a less creditworthy company. However, Raytown has access to commercial banking facilities so it can procure debt capital through loans, which, in my opinion, supports assigning a "Strong" BRP to Raytown. My assignment of a "Strong" BRP to Raytown is consistent with my assignment of a "Strong" BRP to Confluence Rivers Utility Operating Company in Case No. WR-2023-0006.

Q. What FRP did Mr. Jennings assign to Raytown's water utility operations?

A. He assigned an "Aggressive" FRP to Raytown. Mr. Jennings' "Aggressive" FRP classification was based on his calculation and analysis of Raytown's actual credit metrics for the 2022 calendar year.

Q. Does the intersection of Mr. Jennings' assigned BRP of "Strong" and FRP of "Aggressive" imply a 'BB' credit rating based on S&P's benchmark tables?

A. No. As shown in Schedule DM-R-2, the intersection of these classifications indicates a 'BB+' credit rating.

Q. Does this one notch rating differential cause a significantly different estimate in the cost of capital?

A. Yes. This is primarily a function of Mr. Jennings' opinion that Raytown's credit risk profile is consistent with a non-investment grade credit rating. A difference of one notch in a credit rating is more significant between an investment grade rating category and a non-investment grade rating category. For example, for the nine months ending on September 30, 2023, the average monthly spread between 'A' and 'BBB'-rated bonds was 46 basis points where the average monthly spread between 'BBB' and 'BB'-rated bonds was 115 basis points. Because there are 3 notches between each rating category (*e.g.* 'BBB', 'BBB-', 'BB+' and 'BB'), a one notch rating differential between 'A' and 'BBB' is approximately 15 basis points (46 divided by 3), whereas a one notching rating differential between 'BBB' and 'BB' is approximately 38 basis points (115 divided by 3).

Q. How much of an adjustment to the ROE would be warranted based on the one-notch higher rating ('BB+') indicated in S&P's tables?

A. A downward adjustment of 42 basis points, which would lower the indicated ROE to 9.95% from 10.37%. I determined this adjustment by subtracting 1/3 of the 125 basis point spread Mr. Jennings calculated for the difference in 'BBB' and 'BB' utility bond yields for the three months ending on May 31, 2023.

Q. Do you agree with Mr. Jennings' assignment of an "Aggressive" FRP to Raytown?

A. No. Mr. Jennings assigned a FRP to Raytown based only on its 2022 credit metrics. Raytown will receive rate relief in this case. Debt investors understand that Raytown's past cash flow profile does not represent the expected cash flow profile subsequent to rate adjustments from this case. Raytown will receive rate relief in this case associated with the investments it made in its system, which are the primary cause of Raytown's increased use of debt in its capital structure. Debt investors anticipate Raytown receiving rate relief, which is one of the primary reasons investors view regulated utility investments as low-risk.

Therefore, it is important to consider such anticipated increases in revenues from rate increases in assessing Raytown's risk profile.

Q. What are Raytown's projected credit metrics based on Staff and Raytown's non-unanimous stipulation and agreement?

A. Using Staff and Raytown's stipulated revenue requirement increase of $1,174,782 and Staff's rate making income statement, attached to the Non-unanimous Agreement Regarding Disposition of Small Utility Company Revenue Increase Request filed on September 13, 2023,[2] Raytown's funds from operations ("FFO")/debt is expected to be 21.67% (*see* Schedule DM-R-3). This FFO/debt ratio is at the high end (*i.e.* less financial risk) of the FFO/debt ratio benchmark for a "Significant" FRP, which is one category higher than the FRP Mr. Jennings assigned to Raytown. Combining a FRP of "Significant" with a "Strong" BRP results in an implied credit rating of 'BBB'.

Although S&P assigns the most weight to the FFO/debt ratio, I also determined Raytown's pro forma Debt/EBITDA (earnings before interest, taxes, depreciation and amortization) and FFO/interest coverage ratios. Raytown's pro forma Debt/EBITDA ratio of 3.63x is also consistent with the benchmarks for a 'BBB' credit rating. Raytown's pro forma FFO/interest coverage ratio of 6.78x is consistent with a credit rating in the range of 'BBB+' to 'A-'.

Q. If the generic 3.5% equity risk premium is added to a 'BBB' bond yield, what is the implied COE?

A. 9.12%.

[2] Docket Sheet - WR-2023-0344 - Item 10 - EFIS (mo.gov)

Q. What is the revenue requirement impact of a 9.12% ROE compared to Staff's recommended 10.37% ROE?

A. It reduces Raytown's annual revenue requirement by $70,413.80.

Q. How would this lower revenue requirement impact Raytown's pro forma FFO/debt ratio?

A. It would lower Raytown's FFO/debt ratio to 20.19%, which is still consistent with a FRP of "Significant" and a 'BBB' rating.

Q. What if the Commission authorized a 9.9% ROE, which is the same as it intends to authorize Confluence?

A. Raytown's pro forma FFO/debt ratio would be approximately 21.11%, which is still consistent with a 'BBB' rating.

Q. What do you conclude from your analysis?

A. Raytown should be authorized an ROE in the range of 9.12% to 9.9%.

Q. What is your point recommended ROE?

A. I recommend Raytown be authorized a 9.12% ROE because this is consistent with Raytown's investment grade credit risk profile of at least a 'BBB' credit rating.

Q. What other information supports your position that Raytown's credit risk profile is consistent with an investment grade credit rating?

A. Raytown's loan from the State of Missouri's Environmental Improvement and Energy Resource Authority ("EIERA") is an amortizing loan. Consequently, the principal balance of this loan will decline over time. At December 31, 2022, the outstanding balance on Raytown's EIERA loan was $5 million. However, Raytown retired $235,000 of principal on March 1, 2023, leaving a balance of $4,765,000 at that date. As shown in Schedule DM-R-4, Raytown's loan balance will decline by another $175,000 on March 1, 2024 with an increasingly declining balance through the next twenty years. Unless Raytown issues more debt in subsequent periods, its credit metrics will continue to improve over time. This further supports Raytown being viewed as having a credit profile consistent with a solid investment grade credit rating.

Q. Has Raytown already pre-funded anticipated near-term debt service obligations?

A. Yes. According to the minutes of Raytown's August 10, 2022 Board of Directors meeting, because the proceeds from the EIERA bond issuance cannot be used to directly fund the construction of a new garage for Raytown's vehicles, it decided to use $291,145.67 of the bond proceeds to pre-fund interest payments on the debt through March 2024. This cash available to service the debt should also be deducted from the loan balance for purposes of assessing Raytown's credit quality.

Q. What impact would these considerations have on Raytown's FFO/debt ratios?

A. They would improve because these amounts would be deducted from debt, causing higher FFO/debt ratios.

III. SUMMARY AND CONCLUSIONS

Q. Can you summarize your rebuttal testimony?

A. Yes. I disagree with Mr. Jennings' opinion that Raytown's credit risk profile is consistent with a junk bond rating. His credit metric assessment does not consider the fact that Raytown's rates will be increased to reflect its investment in its system. Reflecting an expectation of a reasonable increase in rates from this rate case will cause Raytown's cash flows as compared to its debt to be consistent with an investment grade credit rating. Therefore, Staff's recommended 3.5% equity risk premium should be added to the average 'BBB' bond yield of 5.62% to set a fair and reasonable ROE of 9.12% to set Raytown's revenue requirement in this case.

Q. Does this conclude your testimony?

A. Yes.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

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 rebuttal 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 24th day of October 2023.

TIFFANY HILDEBRAND
NOTARY PUBLIC - NOTARY SEAL
STATE OF MISSOURI
MY COMMISSION EXPIRES AUGUST 8, 2027
COLE COUNTY
COMMISSION #15637121

My Commission expires August 8, 2027.

Tiffany Hildebrand
Notary Public

DAVID MURRAY, CFA

Educational and Employment Background and Credentials

I have been employed as a Utility Regulatory Manager at the Office of the Public Counsel (OPC) since July 1, 2019. Prior to accepting employment with the OPC, I was the Utility Regulatory Manager of the Financial Analysis Department for the Missouri Public Service Commission (Commission) from 2009 through June 30, 2019. I accepted the position of a Public Utility Financial Analyst in June 2000 and my position was reclassified in August 2003 to an Auditor III. I was promoted to the position of Auditor IV, effective July 1, 2006. I was employed by the Missouri Department of Insurance in a regulatory position before I began my employment at the Missouri Public Service Commission.

I was authorized in October 2010 to use the Chartered Financial Analyst (CFA) designation. The use of the CFA designation requires the passage of three rigorous examinations addressing many investment related areas such as valuation analysis, portfolio management, statistical analysis, economic analysis, financial statement analysis and ethical standards. In addition to the passage of the examinations a CFA charterholder must have four years of relevant professional work experience.

In May 1995, I earned a Bachelor of Science degree in Business Administration with an emphasis in Finance and Banking, and Real Estate from the University of Missouri-Columbia. I earned a Masters in Business Administration from Lincoln University in December 2003.

In April 2007 I passed the test required to be awarded the professional designation Certified Rate of Return Analyst (CRRA) by the Society of Utility and Regulatory Financial Analysts (SURFA). I served as a board member on the SURFA Board of Directors from 2008 through 2016. I am currently an active member of SURFA and am authorized to use the CRRA designation.

Case Participation

Case Participation While Employed with the Missouri Office of the Public Counsel (July 2019 through Current):

I sponsored testimony (mainly as it relates to rate of return issues, but also recent cases involving appropriate carrying costs related to extraordinary costs related to Storm Uri) in the following cases:

Confluence Rivers Utility Operating Company	WR-2023-0006
Elm Hills Utility Operating Company	WR-2020-0275
Empire District Electric Company	ER-2019-0374, ER-2021-0312, GR-2021-0320 and EO-2022-0040
Evergy Metro Company	ER-2022-0129
Evergy Missouri West Company	ER-2022-0130 and EF-2022-0155
Missouri-American Water Company	WR-2020-0344 and WR-2022-0303
Spire Missouri	GR-2021-0108 and GR-2022-0179
Summit Natural Gas of Missouri	GR-2022-0122
Union Electric	ER-2019-0335, ER-2021-0240, GR-2021-0241 and ER-2022-0337

Case Participation While Employed with the Staff of the Missouri Public Service Commission (July 2000 through June 2019):

In addition to supervising employees who sponsored rate of return (ROR) testimony as Manager of the Financial Analysis Department of the Missouri Public Service Commission, I directly sponsored ROR testimony in the following electric, gas and water case proceedings (I also filed ROR testimony in several other smaller proceedings that are not listed):

Union Electric	ER-2010-0036, ER-2011-0028, ER-2012-0166, ER-2014-0258, and ER-2016-0179
Empire District Electric Company	ER-2002-424, ER-2004-0570, ER-2006-0315, ER-2019-0374 and ER-2021-0312

Kansas City Power & Light Company	ER-2009-0089, ER-2010-0355, ER-2012-0174, and ER-2016-0285
KCP&L Greater Missouri Operations and Former Aquila Inc. dba Aquila Networks MPS and L&P	ER-2001-672, EC-2002-265, ER-2004-0034, ER-2005-0436, ER-2009-0090, ER-2012-0175, and ER-2016-0156
Spire Missouri West and former Missouri Gas Energy	GR-2001-292, GR-2004-0209, GR-2006-0422, GR-2009-0355, GR-2017-0216, and GR-2021-0109
Spire Missouri East (Laclede Gas)	GR-2017-0215
Missouri American Water Company	WR-2003-0500, WR-2007-0216, WR-2010-0131, and WR-2015-0301
Missouri Gas Utility	GR-2008-0060
Summit Natural Gas of Missouri	GR-2014-0086
Liberty Midstates Gas Company	GR-2018-0013

In addition to the above, I have sponsored testimony in other proceedings, such as merger applications, which involve various general financial matters.

Table 3

Combining The Business And Financial Risk Profiles To Determine The Anchor

	--Financial risk profile--					
Business risk profile	1 (minimal)	2 (modest)	3 (intermediate)	4 (significant)	5 (aggressive)	6 (highly leveraged)
1 (excellent)	aaa/aa+	aa	a+/a	a-	bbb	bbb-/bb+
2 (strong)	aa/aa-	a+/a	a-/bbb+	bbb	bb+	bb
3 (satisfactory)	a/a-	bbb+	bbb/bbb-	bbb-/bb+	bb	b+
4 (fair)	bbb/bbb-	bbb-	bb+	bb	bb-	b
5 (weak)	bb+	bb+	bb	bb-	b+	b/b-
6 (vulnerable)	bb-	bb-	bb-/b+	b+	b	b-

The Raytown Water Company Pro Forma Credit Metrics

	Pro Forma	S&P Benchmarks for Rating Assignment (Medial Volatility) Intermediate	Significant	Aggressive	Indicated Rating based on Strong Business Risk Profile
EBITDA	$1,311,882				
EBIDA	$1,211,072				
Debt	$4,765,000				
Debt/EBITDA	**3.63 x**	**2.5 - 3.5x**	**3.5 - 4.5x**	**4.5 - 5.5x**	**BBB**
Interest	$178,688				
Depreciation/Amort/CIAC	$589,144				
Implied FFO	$1,032,385				
Implied FFO/Debt	**21.67%**	**23% - 35%**	**13% - 23%**	**9% - 13%**	**BBB**
(FFO+Interest)/Interest	**6.78 x**	**5 - 7.5x**	**3 - 5x**	**1.75 - 3x**	**A-/BBB+**
Annual Debt Service	$358,000				
Debt Service Coverage	3.66 x				
EIERA Loan Debt Service Covenant	1.25 x				

Sources: Nonunanimous Stipulation and Agreement, September 13, 2023
and May 1, 2022 Loan Agreement Between Raytown Water Company &
Missouri State Environmental Improvement and Energy Resources Authority

BOND DEBT SERVICE

State Environmental Improvement and Energy Resources Authority
Water Facilities Improvement Revenue Bonds (Raytown Water Company Project), Series 2022

Period Ending	Principal	Coupon	Interest	Debt Service	Annual Debt Service	Bond Balance	Total Bond Value
07/12/2022						5,000,000	5,000,000
09/01/2022			25,520.83	25,520.83		5,000,000	5,000,000
03/01/2023	235,000	3.750%	93,750.00	328,750.00	354,270.83	4,765,000	4,765,000
09/01/2023			89,343.75	89,343.75		4,765,000	4,765,000
03/01/2024	175,000	3.750%	89,343.75	264,343.75	353,687.50	4,590,000	4,590,000
09/01/2024			86,062.50	86,062.50		4,590,000	4,590,000
03/01/2025	185,000	3.750%	86,062.50	271,062.50	357,125.00	4,405,000	4,405,000
09/01/2025			82,593.75	82,593.75		4,405,000	4,405,000
03/01/2026	190,000	3.750%	82,593.75	272,593.75	355,187.50	4,215,000	4,215,000
09/01/2026			79,031.25	79,031.25		4,215,000	4,215,000
03/01/2027	195,000	3.750%	79,031.25	274,031.25	353,062.50	4,020,000	4,020,000
09/01/2027			75,375.00	75,375.00		4,020,000	4,020,000
03/01/2028	205,000	3.750%	75,375.00	280,375.00	355,750.00	3,815,000	3,815,000
09/01/2028			71,531.25	71,531.25		3,815,000	3,815,000
03/01/2029	210,000	3.750%	71,531.25	281,531.25	353,062.50	3,605,000	3,605,000
09/01/2029			67,593.75	67,593.75		3,605,000	3,605,000
03/01/2030	220,000	3.750%	67,593.75	287,593.75	355,187.50	3,385,000	3,385,000
09/01/2030			63,468.75	63,468.75		3,385,000	3,385,000
03/01/2031	230,000	3.750%	63,468.75	293,468.75	356,937.50	3,155,000	3,155,000
09/01/2031			59,156.25	59,156.25		3,155,000	3,155,000
03/01/2032	235,000	3.750%	59,156.25	294,156.25	353,312.50	2,920,000	2,920,000
09/01/2032			54,750.00	54,750.00		2,920,000	2,920,000
03/01/2033	245,000	3.750%	54,750.00	299,750.00	354,500.00	2,675,000	2,675,000
09/01/2033			50,156.25	50,156.25		2,675,000	2,675,000
03/01/2034	255,000	3.750%	50,156.25	305,156.25	355,312.50	2,420,000	2,420,000
09/01/2034			45,375.00	45,375.00		2,420,000	2,420,000
03/01/2035	265,000	3.750%	45,375.00	310,375.00	355,750.00	2,155,000	2,155,000
09/01/2035			40,406.25	40,406.25		2,155,000	2,155,000
03/01/2036	275,000	3.750%	40,406.25	315,406.25	355,812.50	1,880,000	1,880,000
09/01/2036			35,250.00	35,250.00		1,880,000	1,880,000
03/01/2037	285,000	3.750%	35,250.00	320,250.00	355,500.00	1,595,000	1,595,000
09/01/2037			29,906.25	29,906.25		1,595,000	1,595,000
03/01/2038	295,000	3.750%	29,906.25	324,906.25	354,812.50	1,300,000	1,300,000
09/01/2038			24,375.00	24,375.00		1,300,000	1,300,000
03/01/2039	305,000	3.750%	24,375.00	329,375.00	353,750.00	995,000	995,000
09/01/2039			18,656.25	18,656.25		995,000	995,000
03/01/2040	320,000	3.750%	18,656.25	338,656.25	357,312.50	675,000	675,000
09/01/2040			12,656.25	12,656.25		675,000	675,000
03/01/2041	330,000	3.750%	12,656.25	342,656.25	355,312.50	345,000	345,000
09/01/2041			6,468.75	6,468.75		345,000	345,000
03/01/2042	345,000	3.750%	6,468.75	351,468.75	357,937.50		
	5,000,000		2,103,583.33	7,103,583.33	7,103,583.33		