Exhibit No.: _____
Issues: Return on Equity, Cost of Debt, Capital Structure
Witness: John Cochrane
Type of Exhibit: Surrebuttal Testimony
Sponsoring Party: Liberty Utilities (Missouri Water) LLC d/b/a Liberty
Case No.: WR-2024-0104
Date Testimony Prepared: October 2024

Before the Public Service Commission
of the State of Missouri

Surrebuttal Testimony

of

John Cochrane

on behalf of

Liberty Utilities (Missouri Water) LLC d/b/a Liberty

October 24, 2024

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LIBERTY UTILITIES (MISSOURI WATER) LLC D/B/A LIBERTY
BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION
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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is John Cochrane. My business address is 200 State St, 9th Floor, Boston, Massachusetts. I am a Senior Managing Director in the Power, Renewables & Utilities practice at FTI Consulting, Inc. ("FTI").

Q. Are you the same John Cochrane who provided direct and rebuttal testimony in this matter on behalf of Liberty Utilities (Missouri Water) LLC d/b/a Liberty ("Missouri Water", "Liberty" or the "Company")?

A. Yes.

II. PURPOSE

Q. What is the purpose of your surrebuttal testimony in this proceeding before the Missouri Public Service Commission ("Commission")?

A. I will respond to the rebuttal testimony of Commission Staff (Staff) witness Christopher Walters on capital structure and return on common equity. I will also respond to the rebuttal testimony of Office of the Public Counsel (OPC) witness David Murray of the OPC, on capital structure, cost of debt, and return on common equity.

Q. Staff witness Walters' rebuttal testimony (page 2 in Table CCW 1-R) shows a long-term debt cost rate of 5.04%. Given that this differs from your recommendation, why are you not responding to Mr. Walters' cost of debt?

A. Mr. Walters' recommended cost of debt in his direct testimony was 4.97%, which represents my updated cost of debt for Missouri Water as of April 30, 2024, and reflects

Commission-authorized long-term debt financings (see Case No. WF-2024-0135). A $12 million issuance was completed on April 1, 2024, at 5.875% and an additional $3 million is planned in 2024. Mr. Walters' rebuttal testimony on page 2 in Table CCW 1-R shows a long-term debt cost rate of 5.04%, which was my initial filed recommendation. I am assuming that was an oversight and Mr. Walters is still at 4.97%. The Company agrees with Mr. Walters' recommendation of 4.97% from his direct testimony.

III. CAPITAL STRUCTURE AND COST OF DEBT

A. Response to Staff Rebuttal Testimony on my Recommended Capital Structure

Q. Has Staff witness Walters updated his common equity ratio recommendation in his rebuttal testimony?

A. No, he is still recommending a 50.0% common equity ratio.

Q. What are his concerns with your 52.61% common equity ratio recommendation as of December 31, 2023 (which was updated to 52.99% as of April 30, 2024)?

A. Mr. Walters states that I acknowledge the mean and median for my proxy group over the period 2018-2022 were both 50.53%-50.45% common equity and 49.47%-49.55% long-term debt, with a range from 41.72% to 57.52% for the common equity ratios. He further states my 52.6% (updated to 52.99%) exceeds the mean (50.53%) and median (50.45%) of my proxy group.

Q. Is that his only rebuttal testimony comment concerning your common equity recommendation?

A. No. He also repeats the same selective quote from an October 25, 2023 Commission Order in Case No. WR-2023-0006 (Confluence Rivers Utility Operating Company, Inc.) that he used in his direct testimony. That quote simply states that "the Commission finds that staff's proposed hypothetical capital structure of 50% common equity and 50% debt is appropriate in this case…." Mr. Walters seems to suggest that this single Commission decision in a 2023 Confluence Rivers rate case sets a precedent for all utility common equity ratios, and more specifically Missouri Water. He also states that I overlooked the difference in financial risk between Missouri Water and the Proxy Group I used to estimate my cost of equity.

Q. What is Mr. Walters' position as to your common equity ratio?

A. He believes my initial recommendation of 52.6%, as well as Missouri Water's common equity ratio update of 52.99% as of April 30, 2024, should be rejected. This is in spite of his direct testimony, which shows that state authorized common equity ratios for water utilities exceed his recommended 50% common equity ratio (See Walters Direct, Table CCW-2).

Q. What did Table CCW-2 show?

A. The table showed that the average state utility commission authorized ROE for water utilities over an eleven year and three-month period ending March 31, 2024, was 50.68% and a max of 52.53%. The more recent results for 2021 through 2024 ranged from 50.56% and 52.53%. All these results exceed his recommended 50% common equity ratio and further support my updated recommendation of 52.61%, updated to 52.99%.

Q. Do you have any other response to Mr. Walters' rebuttal testimony on capital structure?

A. Yes. In my direct testimony, I demonstrated that the average and median common equity ratios for my proxy group over the 2018-2022 period were 50.45%-50.53% with a range of 57.52% to 41.72% for the group during that time. I also looked at the forecasted common equity ratios from Value Line for the 2023 and 2024 and the 2026-2028 period. The mean and medians were shown in Table 11 of my direct testimony and ranged from 51.43% to 52.50% and 50.50% to 53.50%, respectively, with a range for the proxy group of 42.50% to 62.00%. I then stated that my 52.61% "recommended common equity ratio is within the range for the proxy group for the historical 2018-2022 period, as well as the forecasted periods of 2023, 2024 and 2026-2028." My 52.61%/52.99% common equity recommendations were based on Missouri Water's capital structures on December 31, 2023, and April 30, 2024, but are supported by the range of my proxy group.

Q. Did you show any additional analysis supporting your common equity recommendation?

A. Yes, I showed that the common equity ratios for Liberty Utilities Co._(LUCo), Missouri Water's parent company, and Algonquin Power & Utilities Corp. (APUC) on December 31, 2022 (Direct Schedules JC-16 and JC-17) were 68.8% and 68.9%, respectively. Both of these ratios are higher than my recommendation for Missouri Water. These ratios show that LUCo and APUC are financed more conservatively than Missouri Water.

Q. What are your final comments on Mr. Walters' common equity recommendation?

A. Mr. Walters presents no new support for his 50% recommended common equity ratio in his rebuttal testimony. He ignores the common equity ratios of Missouri Water at year-end 2023 and April 30, 2024, the actual equity ratios of Missouri Water's direct and ultimate parents, which are higher, and finally the results from his own water utility industry authorized common equity ratios in Table CCW-2. Therefore, the Commission should reject his 50% recommendation.

B. <u>Response to OPC Rebuttal Testimony on my Recommended Cost of Debt and Capital Structure</u>

Q. Has OPC witness Murray updated his common equity capital structure recommendation of 47.5% or his 4.29% cost of debt recommendation?

A. No, he has not. In his Summary and Conclusion, on page 20, lines 1-4, of his rebuttal testimony, Mr. Murray states "Liberty Water's capital structure is not market-based. Therefore, the appropriate ratemaking capital structure and cost of debt for purposes of setting Liberty Water's authorized ROR is that which is consistent with LUCo's typical targeted capital structure and embedded cost of debt as of March 31, 2024." He further states on page 19, lines 14-19, that the Commission should reject my cost of debt and capital structure recommendations as it did in its prior decisions in Liberty Midstates' 2014 rate case, Case No. GR-2014-0152, in Liberty Water's 2018 rate case, Case No. WR-2018-0170, and The Empire District Electric Company's 2019 rate case, Case No. ER-2019-0374.

Q. Do you have further comments on Mr. Murray's statements above?

A. Yes, I will discuss later in my testimony his first statement that "Liberty Water's capital structure is not market-based". As for his other statements, his cost of debt recommendation is still based on his calculation of LUCo's embedded cost of debt of 4.29% on March 31, 2024, which is shown in my Rebuttal Schedule JC-15. His initial calculation was 4.48%, but he adjusted that down due to his opinion that LUCo's credit spreads on new notes issued in January 2024 were too high. The only support for his capital structure recommendation is LUCo's "typical targeted capital structure", which I presume is the 47.5% he recommended in his direct testimony.

Q. Did you address his 47.5% "typical targeted capital structure" in your rebuttal testimony?

A. Yes. As I discussed, Mr. Murray's 47.5% recommendation is based on his interpretation of a September 2017 Liberty Utilities Fixed Income Presentation (page 12 footnote 6 of his direct testimony), which is seven years old and clearly out of date. It is of no relevance for a 2024 rate case for Missouri Water. Mr. Murray has cited this 2017 presentation in past Liberty Missouri utility company cases to support his 47.5% common equity recommendation for Liberty utilities in Missouri. He doesn't point to or provide any analytical support for his recommendation in this case. The only common equity ratio calculations he performed were for LUCo for 2020-2023, using three different methods. His ratio results were 55.45%/46.86%/49.57% for 2020 based on Per Books, Adjusted and Adjusted and Excluding Short-Term Debt, 57.63%/50.14%/54.29% for 2021, 61.11%/57.29%/59.55% for 2022, and 60.38%/56.54%/61.39% for 2023. I also included recalculated ratios in Rebuttal Schedule JC-13 to adjust for some inconsistencies I found in Mr. Murray's calculations for 2022 and 2023, which were discussed in my rebuttal testimony. The recalculated results for the Adjusted and Excluding Short-Term Debt ratios were 63.98% instead of 59.55% in 2022 and 66.90% instead of 61.39% in 2023. These results are significantly higher than Mr. Murray's 47.5% common equity ratio recommendation and more in line with my 52.61% (52.99% updated) recommendation.

Q. Did Mr. Murray provide calculations for Missouri Water or APUC capital structure ratios as he has in the past?

A. No, he did not provide these in his direct testimony despite providing and using these calculations in past cases to support his recommendations (see <u>**Surrebuttal Schedule**</u>

JC-1 showing Murray Schedules DM-D-4 and DM-D-3-4 from the 2019 and 2021 Empire Electric rate cases, respectively). It should be noted that his calculations utilizing similar methodologies have been used by the Commission to support their determinations regarding capital structure ratios for Missouri Water and other Liberty utility companies in Missouri. Furthermore, it should be added that Mr. Murray has not performed these calculations for this case even though he references a number of those prior cases to support his recommendation within this case. The only exception is that in his rebuttal testimony he provided quarterly results for Missouri Water for December 31, 2021, through March 31, 2024, in his Schedule DM-R-3.

Q. What does Schedule DM-R-3 show for Missouri Water's capital structure ratios?

A. The schedule shows that Missouri Water had approximately $30 million of short-term debt outstanding, funded through Commission approved money pool advances from LUCo, from 1Q 2022 until 4Q of 2023. The increase from the 4Q of 2021 to the 1Q of 2022 ($14 million to $30 million) was related to the acquisition of the Bolivar water system in February 2022 for over $20 million (Murray Rebuttal, page 8, lines 2-4). In December of 2023, LUCo made a $17 million capital contribution to pay down this short-term debt to $15 million to begin the process of refinancing Missouri Water's short-term floating rate debt, as described in its financing application to the Commission in File No. WF-2024-0135 (see **Surrebuttal Schedule JC-2**). The refinancing process described in the application is intended to convert the short-term debt to more fixed rate long-term debt and common equity, which is a more appropriate capital structure given the long life and recovery period for Missouri Water's assets in rates.

Q. What other steps did Missouri Water take to refinance its capital structure to reduce floating rate risk and reduce short-term debt?

A. As mentioned above, on October 13, 2023, Missouri Water submitted an application to the Commission requesting authorization to issue long-term debt in the amount up to $30 million (Case No. WF-2024-0135). The Commission approved the application in an Order issued February 29, 2024, with an effective date of March 30, 2024, **Surrebuttal Schedule JC-3.** On April 1, 2024, Missouri Water issued $12 million of market-priced debt based on LUCo's new issuance rates (5.875% for 10-year term) provided by an external third-party investment bank's quoted pricing (see Murray Schedule DM-R-5 Confidential). Subsequently, in July 2024, LUCo made an additional $13 million capital contribution and planned to issue $3.5 million of additional long-term debt in 2024. The $3.5 million of additional debt was not issued in July but will be issued on October 25, 2024, and the amount is now $8 million. There will also be an additional capital contribution of $5 million on that day. These permanent financing transactions all reduced, or will reduce, Missouri Water's short-term debt to achieve a more balanced fixed rate permanent capital structure. This was described in detail in the Company's financing application approved by the Commission.

Q. Did Mr. Murray propose to use Missouri Water's March 31, 2024, capital structure?

A. No, he did not. But he did provide, in his Schedule DM-R-4, Schedule 8 of Missouri Water's updated revenue requirement model, my updated capital structure as of April 30, 2024 for Missouri Water (see also Cochrane Rebuttal Schedule JC-1).

Q. What does Mr. Murray's Schedule DM-R-4 show?

A. The schedule shows Missouri Water's updated common equity ratio of 52.99% as of April 30, 2024.

Q. Did Mr. Murray provide a reason for not providing his typical APUC calculations, or using the results of his LUCo calculations, or using the results for Missouri Water from his Schedule DM-R-4?

A. No. Similar to his direct testimony, he does not, despite the fact he requested APUC's calculations in OPC data request 3005 (**<u>Confidential Surrebuttal Schedule JC-4</u>**). The results for APUC shown in that response show common equity ratios in the 60%s for the quarters December 2021 through December 2023. I continue to conclude he did not include APUC's calculations or reference the LUCo calculations that he performed in Schedule DM-D-3, or use the April 30, 2024 updated Missouri Water results because these actual results, as I showed above for LUCo (and included in my direct and rebuttal testimonies for Missouri Water and APUC), do not support his 47.5% common equity ratio recommendation. Therefore, he resorts to referencing a seven-year-old, out of date, irrelevant fixed income presentation to support his interpretation of what Missouri Water's common equity ratio should be. Rather than presenting any new factual information or calculations to support his recommendation in his direct and rebuttal testimonies, he instead offers many misleading, inaccurate, and irrelevant statements, which he claims support his recommendation and his incorrect assertion made in both his direct and rebuttal testimonies that "Missouri Water's capital structure is not market-based."

Q. Can you comment on OPC witness Murray's references to the Commission decisions in Midstates Gas's 2014 rate case, Missouri Water's 2018 rate case and The Empire District Electric Company's 2019 rate case?

A. Yes. In all those cases, which it should be noted are 5, 6 and 10 years old, the Commission looked at LUCo's adjusted capital structure to determine the common equity ratio for the Liberty Missouri utility. In this case, instead of following similar analysis, which in some cases Mr. Murray himself used, Mr. Murray ignores the actual results of his only analysis for LUCo in Schedule DM-D-3. As I discussed above, Mr. Murray does not perform any analysis for APUC even though he requested and received the necessary information in OPC 3005 (see **<u>Confidential Surrebuttal Schedule JC-4</u>**) and ignores the results for Missouri Water shown in Schedule DM-R-4. <u>If the same decision-making process is followed by the Commission as they did in the previously referenced cases, then my 52.99% updated recommended ratio should be approved and Mr. Murray's recommendation should be disregarded.</u>

Q. Please address Mr. Murray's additional statements on pages 2-4 of his rebuttal testimony.

A. I will begin with page 2, line 13, where he poses the question, "Do the affiliate financing transactions [that] LUCo executes with Liberty Water have a legitimate economic purpose other than creating an internally assigned capital structure and cost of debt?"

Q. Did Mr. Murray explain what this question means, and can you comment on it?

A. No, he did not, but his response was "No," and he clearly believes affiliate financing transactions do not serve a legitimate economic purpose. I struggle to understand the purpose of and his belief in that statement. Clearly, intercompany debt, evidenced by

Commission-approved promissory notes and equity transactions between LUCo and its subsidiaries have an economic purpose. That simple purpose is for LUCo to provide additional funding for Missouri Water and other LUCo subsidiaries' working capital and cash flow needs in excess of their capital expenditure spending. That is the purpose of LUCo. LUCo provides external funding to its subsidiaries at market interest rates, whether long or short-term. LUCo is the entity that accesses the third-party investor market with its BBB/Baa2 credit ratings to provide lower cost financing than the subsidiaries could achieve on their own given their small size and limited investor universe. That clearly serves an economic purpose as well as provides benefits for Missouri Water and the other LUCo subsidiaries' customers.

Q. What does Mr. Murray say is LUCo's main purpose for executing affiliate financing transactions?

A. On page 3, line 9-13, he states that the purpose is "to support its requested ROR in this rate case. LUCo executed the affiliate promissory notes to reclassify a portion of the affiliate payables as long-term debt with the other portion reclassified as common equity. LUCo determines the amount of affiliate payables to reclassify as promissory notes and common equity based on its desired ratemaking capital structure of approximately 53% common equity and 47% long-term debt".

Q. How do you respond to this statement?

A. First, I would state that Mr. Murray continually refers to "affiliate payables" as if they are unusual transactions. The affiliate payables he refers to are actually short-term debt incurred through the Commission approved intercompany money pool with LUCo. Missouri Water initially meets its working capital and other funding needs in excess of cash flow through short-term floating rate borrowings from LUCo at LUCo's actual commercial paper or bank facility rates. This structure is very common amongst utility holding companies with multiple subsidiaries. The alternative for Missouri Water, if even available, would be some type of bank or other financing that would be very expensive. Second, the common practice for utilities is to initially fund through short-term debt until they reach a level that needs to be permanently refinanced with long-term debt and common equity. Long-term assets need to be financed with long-term securities. That is the role LUCo performs and was clearly laid out in the initial merger application for Missouri Water and the role it fills for all its subsidiaries. LUCo provides access to BBB/Baa2 long-term debt rates and common equity that the subsidiaries could not raise on their own. This structure allows customers to save money. There is nothing unusual about it. It appears that Mr. Murray believes it would be better for Missouri Water to finance directly with third parties at higher costs, which makes no sense for customers.

Q. What were Mr. Murray's next statements and how do you respond?

A. On page 3 in his question on lines 18-19 he states that he could demonstrate the insignificance and lack of continuity of APUC's internal bookkeeping through analyzing Missouri Water's quarterly financial statements. Missouri Water does not prepare quarterly financial statements, only annual statements. Despite that, Mr. Murray purports to be able to determine from Staff Data Request 0059 the quarterly balances of short-term debt, long-term debt and common equity for Liberty Water for December 31, 2021, through March 31, 2024 in Schedule DM-R-3. I have already addressed Schedule DM-R-3 above in my testimony. I did not see any further references, statements or facts in support of Mr. Murray's statement regarding the "insignificance and lack of continuity of APUC's internal bookkeeping."

Q. Were there any statements by Mr. Murray on page 4 of his rebuttal testimony to which you want to respond?

A. Yes, on page 4, lines 10-13, he mentions the additional pro forma $3.5 million of long-term debt and $13 million of common equity included in my April 30, 2024 update provided in Schedule DM-R-4. He suggests the $3.5 million note final terms and conditions were not filed with the Commission, which was a requirement of its order. He is correct that they were not filed for the simple reason that the note has not been issued. However, the $13 million of additional common equity was contributed by LUCo to Missouri Water in July 2024 and an $8 million note will be issued as well as an additional $5 million capital contribution on October 25, 2024.

Q. Mr. Murray suggests that you used the wrong interest rate for the $12 million note issued by Missouri Water to LUCo (6.3% versus 5.875% shown in the updated Company revenue requirement workpapers and Schedule DM-R-5). (Murray Rebuttal, p. 5, lines 1-14). How do you respond?

A. My direct testimony was filed on March 13, 2024, while the $12 million note was issued on April 1, 2024, so my initial rate was an estimate based on interest rates at the time. I provided an update to my capital structure and cost of debt schedules as of April 30, 2024, in Rebuttal Schedule JC-1.

Q. OPC witness Murray indicates that issuance expenses of $96,000, or 80 basis points, were assigned to the 5.875% notes. (Murray Rebuttal, pp. 5-6). How were those issuance costs determined?

A. The support and explanation for the 80 basis points was provided in Schedule DM-R-6, which was a response to Staff data request 0017 in the WF-2024-0315 Missouri Water financing application. Mr. Murray goes on to reference a number of other bond issues including the 2021 Missouri Water note, which had 92 basis points of issuance expenses, but there appears to be no conclusion reached or recommendation based on these issuances.

Q. OPC witness Murray assumes that Liberty Water was "assigned a debt cost that he determined was influenced by APUC's current financial instability and uncertainty related to its investments and divestments." (Murray Rebuttal, p. 6, line 20 through p. 7, line 17). What actions does Mr. Murray propose based on this assumption?

A. He makes a 50-basis point adjustment to LUCo's 5.869% ten-year bond issued January 12, 2024, to determine his cost of debt. He goes on to state that if the Commission were to adopt my recommended cost of debt, then the 5.875% note should be reduced by 50 basis points also. He then states that he does not know why Liberty Water was not assigned LUCo's debt cost of 5.59% for the 5-year note it issued on January 12, 2024, reduced by Mr. Murray's 75 basis point adjustment to 4.84%. He then states that if the Commission adopted my recommended cost of debt, then the cost of the new debt should be 5.06%, which is a weighted average of LUCo's January 12, 2024 bond issuances reduced by his 50 and 75 basis point reductions from the actual 5.875% market quoted rate on April 1, 2024.

Q. How do you respond to this assumption and these recommendations?

A. I responded extensively in my rebuttal testimony to Mr. Murray's mistaken belief and statements as to APUC's financial instability as well as his recommended 50 and 75 basis point reductions to LUCo's recent January 12, 2024 bond issuances. As I stated in my rebuttal testimony, his statements are incorrect and his conclusions on these two matters are wrong. As to why the Liberty Water note issued April 1, 2024 was not priced at LUCo's January 12, 2024 bond rates, the answer is quite simple. Missouri Water and LUCo followed the pricing mechanism contained in its financing application File No. WF-2024-0135 and received LUCo market pricing on April 1, 2024. Mr. Murray's Schedule DM-R-5 provides the evidence for the 5.875% market determined rate. Ten years was the chosen maturity date for the note based on the expertise of the APUC treasury experts. Mr. Murray appears to want Liberty to just pick the lowest rate regardless of input from the Liberty treasury experts as to what is the right maturity date.

Q. Do you have any further observations on Mr. Murray's comments on these pages 6 and 7 mentioned above?

A. Yes, I do. Mr. Murray seems to be acknowledging that a long-term debt financing took place between LUCo and Missouri Water. His focus is the interest rate on the note, but his comments also seem to acknowledge that a current rate of interest on the Missouri Water note should be used rather than a LUCo embedded cost of debt.

Q. OPC witness Murray takes issue with the timing of APUC's long-term debt assignment process and alleges that it is not consistent with market-based financing decisions. (Murray Rebuttal, p. 7, line 18 through p. 9, line 8). What is the basis for Mr. Murray's allegation?

A. His inaccurate statement is based on Liberty Water not issuing a long-term affiliate promissory note on February 1, 2022, which was the date of the $20 million acquisition of the Bolivar water and wastewater system. He states that rates were much lower at that time, compared to today.

Q. How do you respond to Mr. Murray's position?

A. The financing order of the Commission in Case No. WF-2021-0016, issued April 14, 2021, with an effective date of May 14, 2021, indicated that the second promissory note would be issued in an amount up to $12.69 million for a term matching the tenor of the next debt issuance of Liberty Utilities Finance GP1 (GP1), at a yield to maturity rate equal to the yield to maturity of GP1's next debt placement (New Note) (see **Surrebuttal Schedule JC-5**). GP1 did not issue any new long-term debt after May 14, 2021, so a note could not have been issued per the application and Commission Order.

Q. What action did Missouri Water take instead?

A. As I stated earlier, Missouri Water filed a $30 million debt financing application in October 2023 to refinance its short-term debt outstanding and recapitalize its balance sheet to achieve a more appropriate long-term capital structure of long-term debt and common equity to match the long-term nature and recovery period of its fixed assets. The financing application laid out that the proceeds were going to be used to pay down short-term money pool debt, a large part of which is related to the Bolivar acquisition.

Q. Did Mr. Murray make any final statements on page 9, lines 9-22?

A. Yes. First, he refers to a March 16, 2023 APUC board of Directors meeting and provides in Schedule DM-R-7 a page entitled Executive Summary from a presentation at that meeting. He makes no statements regarding Schedule DM-R-7 except that it supports his recommendation in his direct testimony to make an adjustment to the cost of LUCo's debt issued in January 2024. Second, in the following question and answer he makes a statement that the OPC discovered past instances in which APUC's debt assignment process violated affiliate transaction rules.

Q. Can you comment on his first statement?

A. Yes. I reviewed Schedule DM-R-7 and the date on the page was February 21, 2023. Mr. Murray believes that pricing in February 2023 for long-term debt is relevant to pricing long-term debt in January 2024. A February 2023 credit spreads graph is not applicable to debt issued in January 2024, which is almost a year later.

Q. Regarding his following question and answer, can you provide background on The Empire District Electric Company ("Empire") case (Case No. ER-2019-0374) referenced by Mr. Murray on page 9 of his rebuttal testimony?

A. On June 1, 2018, a $90 million intercompany note was issued to LUCo to replace a similar amount of long-term debt at Empire that had matured. The note was based on LUCo's most recent long-term financing, which was March 24, 2017. The Commission in its Order in Case No. ER-2019-0374 concluded that: (1) no market pricing was performed at the time of the issuance; and that (2) the overall rate on the LUCo March 2017 financing of 4.53% was not appropriate because short-term debt had been borrowed by LUCo to fund the intercompany note. Therefore, because of reasons (1) and (2), the $90 million note was treated as short-term debt.

Q. How have Liberty's Missouri utility companies priced intercompany long-term debt with LUCo since the 2019 decision in Case No. ER-2019-0374?

A. In subsequent Liberty Missouri utility company financing applications and most recently in Missouri Water's financing application in Case No. WF-2024-0135, all new intercompany debt issuances are priced at LUCo's market rates, based on pricing provided by investment banks, for the appropriate term of the debt on the day of issuance. This pricing mechanism has been approved by the Missouri Commission, as well as several other state Commissions, and was most recently utilized by Missouri Water on April 1, 2024, as evidenced by Mr. Murray in Schedule DM-R-2. Therefore, Mr. Murray's mention of the Empire 2019 case and the debt pricing issue is out of date and wholly irrelevant.

Q. At page 10, lines 1-6, of his rebuttal testimony, Mr. Murray states that the best methodology to ensure Missouri Water's customers are not charged a cost of capital that exceeds the lesser of cost or market is to use LUCo's cost of debt of 4.29% and apply it to his recommended debt ratio of 52.5%. How do you respond?

A. Mr. Murray decides that the lower of cost or market standard should now be applied to the cost of debt and capital structure for Missouri Water and of course he states that his recommendations satisfy that standard. He does not provide any accurate statements or evidence as to why this standard should be applied nor why it has been violated. He also does not state which of the standards his analysis supports. My capital structure recommendation is based on Missouri Water's actual capital structure, while Mr. Murray's 47.5% common equity (52.5% debt ratio) recommendation is solely based on his interpretation of a 2017 fixed income investor presentation that is seven years old. It seems very clear that Mr. Murray's evidence doesn't support any standard nor the appropriate common equity ratio for Missouri Water. He ignores his own analysis for LUCo's capital structure results for 2020, 2021, 2022, and 2023 in Schedules DM-D-3 and DM-R-1, which supports my recommendation, as well as the results for APUC he requested in OPC data request 3005 (see **Confidential Surrebuttal Schedule JC-4**) and Missouri Water in Schedule DM-R-4, which shows my updated recommended results as of April 30, 2024 and follows what was historically calculated and reviewed and approved by the Commission in the cases he referenced within his rebuttal testimony and historically used in his testimony in other cases. As to his cost of debt recommendation, the same statements as above can be made. His cost of debt recommendation is based on his calculations of LUCo's entire long-term debt outstanding at March 31, 2024, where the $2 billion plus of proceeds had already been used. My direct and rebuttal testimonies show why Mr. Murray's cost of debt recommendation is incorrect and is not representative of Missouri Water's cost of long-term debt based on its recently approved financing application. Therefore, the Commission should reject his recommendations and his statements on page 20 and adopt my 52.99% common equity and 4.97% cost of debt recommendations.

Q. Mr. Murray does not change his 4.29% cost of debt recommendation from his direct testimony. How do you respond?

A. As presented in his direct testimony, the 4.29% is based on his calculation of LUCo's embedded cost of debt on March 31, 2024, and includes adjustments to LUCo's January 2024 note issuances. He provides no support or evidence for this recommendation outside of the matters I addressed above. I instead presented multiple explanations in my rebuttal and surrebuttal testimonies as to why Mr. Murray's recommendation to use LUCo's embedded cost of debt is inappropriate. The 4.29% includes (1) debt actually issued directly by several LUCo utility subsidiaries to investors and the proceeds directly used only by these same utility subsidiaries, (2) a substantial amount of LUCo and GP1 debt issued prior to APUC's acquisition of Missouri Water, (3) the 4.29% is based on LUCo's total debt outstanding of approximately $2.95 billion, not the $17.7 million currently outstanding at Missouri Water, $12 million of which was issued on April 1, 2024, and (4) the actual pricing mechanism for the $12 million of debt issued on April 1, 2024, as well as the $5 million May 2021 note, were approved by the Missouri Commission prior to the filing of this rate case. The resulting cost of Missouri Water's long-term debt was based on market pricing on the date of issuance and was provided by either a third-party investment bank or evidenced by an actual LUCo issue as stated by Mr. Murray in his rebuttal testimony.

IV. RETURN ON COMMON EQUITY

Q. What was your return on common equity (ROE) recommendation for Missouri Water?

A. My recommended ROE range in my direct testimony was 10.19% to 10.94%, with the midpoint and my recommendation of 10.62%. In my rebuttal testimony, my updated range and midpoint were higher, but the Company has decided movement to 10.0% is more appropriate in an effort to reduce issues in the case and lessen the overall rate increase impact on customers. The 10.0% is below the low end of my recommended range and closer to the high end of Mr. Walters' range (9.9%).

A. Response to Staff's Rebuttal Testimony on my Recommended Return on Common Equity

Q. Staff witness Walters takes issue with your ROE recommendation asserting the low-end of your recommended range (10.19%) exceeds the highest average authorized ROE (10.18%) for water utilities over the last 15 years. (Walters Rebuttal, p. 4). How do you respond to such criticism?

A. First, Mr. Walters' recommended range is 9.0% to 9.9% and his midpoint is 9.45%. His range is based on constant growth DCF results ranging from 9.63% to 9.89%, DCF results based on sustainable growth rates of 8.13% to 8.21%, multi-stage DCF results of 8.02% to 8.18%, CAPM results of 8.79 to 11.52% and risk premium results of 9.93% to 10.20%. When you exclude the results of his sustainable growth rate DCF and multi-stage DCF, his range becomes 8.79% to 11.52% with a mid-point of 10.16%. These results are closer to my original recommendation and even closer to the Company's proposed 10.0% return on equity in my rebuttal testimony. Second, Mr. Walters Workpaper CCW-6 Confidential contains Water Utility rate case data for Jan. 1, 2010-March 31, 2024, which is the footnoted source referred to for Tables CCW-1 and CCW-2 in his direct testimony and in footnote 1, on page 4 of his rebuttal testimony. After examining the results from the authorized ROE column of the report from his Workpaper CCW-6 (see **Surrebuttal Schedule JC-6**), I found twenty-five cases where the ROE decision was greater than 10.19% and in addition, I observed another twenty-one cases where decisions ranged from 10.0% to 10.19%. Based on this evidence it is unclear how Mr. Walters supports his statement regarding the low end of my ROE range.

Q. Why are you excluding Mr. Walters' sustainable growth and multi-stage DCF results?

A. Mr. Walters criticizes my range, specifically the low end and some of my specific results for being too high, which I showed above is factually incorrect. Correspondingly, I take issue with some of his results for being too low. As discussed in my rebuttal testimony, Mr. Walters' 8.13% to 8.21% sustainable growth DCF and 8.02 to 8.18% multi-stage DCF results are lower than every state commission authorized ROE for a water distribution utility over the last 14 years, except for one. This includes 213 water utility cases. There is also data provided in Mr. Walters' direct testimony in Table CCW-1 (Distribution of Authorized ROEs 2016 through March 31, 2024) that further support a finding that the results of these two DCF analyses are too low. The lowest average annual ROE result was 9.04% and the range was 9.04% to 9.74%. The average over the eight year and three-month period is 9.53%. These are all well above the results of his sustainable growth rate and multi-stage DCF results. Mr.

Walters should put more weight on the high end of his range, 9.9%, which is only 10 basis points below the Company's proposed 10.0%.

Q. Mr. Walters criticizes your constant growth DCF results. What are the sources for your and Mr. Walters' earnings growth rates?

A. My median growth rates were 5.35%, 6.57% and 7.75% for my low, mid and high averages range. Mr. Walters' average and median growth rates were 6.01% and 6.09%. I used Zacks, Value Line and Yahoo Finance for my water proxy group, while Mr. Walters used Zacks, MI and Yahoo Finance for his sources for his multi-utility proxy group. My Value Line median growth rate was 6.50% with a range of 5.0%-8.0%, Yahoo 5.65% with a range of 2.7% to 10.8% and Zacks 6.3% with a range of 5.6% to 7.8%. Mr. Walters results for Zacks were 6.22% with a range of 5.0%-8.0%, MI 6.61% with a range of 3.0% to 9.0% and Yahoo Finance 5.66% with a range of 2.8% to 10.8%. Mr. Walters and I both used Zacks and Yahoo Finance and one different additional source. I will note that Mr. Walters used Value Line as the source for a number of his inputs in his sustainable growth rate DCF analysis, multi-stage and CAPM but for some reason didn't use Value Line as one of his sources for projected earnings growth rates in his constant growth DCF analysis, but rather MI.

Q. Is Value Line widely used by investors as a source?

A. Yes, as is Zacks and Yahoo.

Q. What can you conclude in terms of the different sources?

A. That there are many sources for investors to utilize for future earnings growth rate estimates. The range of estimates for each water utility is quite wide and there is no basis to conclude that one reputable analyst's estimate is any better or worse than another's. Finally, in terms of methodology, Mr. Walters simply averaged all his estimates and didn't take into consideration the range of variability in the estimates, which I did through my low, mid and high.

Q. How do you address Mr. Walters' comment on your constant growth rates exceeding a projected GDP growth rate of 4.14%?

A. Mr. Walters compares my growth rates to a projected GDP growth rate of 4.14%, which I assume should be the 4.24% from his multi-stage analysis in his direct testimony. As to his specific statement regarding growth rates not being sustainable if they exceed the growth rate of GDP, that statement is subject to substantial debate. However, if you accept his premise that 4.14% is the proper long-term growth rate, which I do not, then that should be used as the growth rate in his constant growth analysis as well as mine since his average growth rates (6.01%-6.09%) as well as my low, mid, high average growth rates all exceed the 4.14%. His multi-stage results, which use the 4.24%, are clearly too low (8.02%-8.18%) and if the 4.14% were used in his constant growth DCF analysis they would also produce results that are too low, 7.49%-7.81% (**Surrebuttal Schedule JC-7**). These results are even lower than his multi-stage and sustainable growth DCF results and clearly lower than any state authorized ROE for a water utility in the last 14 years.

Q. Why do you think Mr. Walters asserts you should give more weight to your low estimate?

A. Simply because the low estimated average constant growth rate for my proxy group per Mr. Walters is 5.07% (the actual median low end growth rate I used was 5.35%), which is below his average growth rates for his multi-utility proxy group of 6.01%-6.09%. My low-end results using my 5.35% (8.09%) are below his constant results (9.63%-9.89%). The fact remains there are many different sources and estimates available to investors for projected earnings growth rates and they all should be taken into account including the highs, lows, and mid-points.

Q. What are Mr. Walters' criticisms of your CAPM analysis?

A. He disagrees with my sole reliance on current 5-year beta estimates published by Value Line, and he is concerned with my expected market return, which is used to derive my risk premium. In his rebuttal testimony, Mr. Walters states "all beta estimates over a 5-year historical period (i.e. *Value Line* betas) will include the unprecedented volatility and market prices caused by the onset of Covid-19 pandemic in early 2020. It is unreasonable to assume that those prices and resulting volatility resemble investor expectations going forward" (Walters Rebuttal, p. 8). Mr. Walters then goes on to compare his and my proxy group betas over three year and five year periods in Table CCW-3R. (Walters Rebuttal, p. 9).

Q. How do you respond to Mr. Walters on your selection of beta?

A. For my beta selection, I used a source that is accessible to most investors: Value Line. Their betas are based on a five-year historical period, and investors make decisions today based on reporting made by Value Line. Investors are not concerned with whether the data covers 5 years, 3 years, or any other time frame. The simple response to Mr. Walters' criticism of my beta is that he prefers a lower beta to align with his lower CAPM results. However, if you look at the results in his Table CCW-3R you see that the adjusted 5-year betas for my water proxy group are 0.83 for the average and median and the 3-year betas are 0.80 and 0.79. They are approximately the same while the 5-year betas for Mr. Walters water/gas/multi-utility proxy group drop from 0.85 for 5 years to 0.74 and 0.73 for three years with the decline driven by his gas and multi-utility companies which are not comparable to water. Further, if you look at Direct

Schedule CCW-14, page 2 Value Line betas have been at or above 0.80 all the way back to the first quarter of 2020, which is over four years ago and is enough time to clearly demonstrate a new market level for Value Line betas. His criticism should be disregarded by the Commission.

Q. Mr. Walters suggests that your expected market return for the S&P 500 of 13.96%, as of January 11, 2024, results in risk premiums that are too high, 9.77%, 9.43%, and 9.70%. (Walters Rebuttal, p. 7). Please respond to Mr. Walters' criticism of your expected market return.

A. Mr. Walters feels a range of 5.0% to 8.0% is supported by empirical evidence and cites Dr. Morin's Modern Regulatory Finance book published October of 2021 (Walters' Workpaper). Dr. Morin actually says there is a slight preference for the upper end of the range, i.e. 8%, and the actual range cited on page 190 of the book says 6-8% not 5%-8%.

However, my market return was calculated as of January 11, 2024, when the S&P 500 was at $4,780. For three of his CAPM calculations, Mr. Walters calculated S&P 500 market returns as of May 31, 2024, when the S&P 500 stood at $5,278, an increase of over 10%. His expected market returns are lower at 12.69% and 12.79% than my 13.96% but given the increase in the S&P 500 and also the fact that I do not exclude any stocks in my CAPM calculations of the expected market return that is not surprising. His resultant market risk premiums of 8.40% and 8.50% are also high by his definition.

Q. What additional comments does Mr. Walters make on your expected market return calculation?

A. Mr. Walters takes issue with the expected growth rate portion of my expected market return, 12.46%. He says that "12.46% is far too high to be a rational outlook for sustainable long-term market growth. This growth rate is 3.0x the growth rate of the US GDP long-term growth outlook of 4.14%. It simply is not reasonable to believe individual companies can sustain growth rates as high as I have assumed into perpetuity". (Walters Rebuttal, p. 11).

Q. Please respond to Mr. Walters criticisms.

A. Mr. Walters long-term growth rates were 10.90% and 11.10% from his FERC S&P 500 DCF analyses used in his CAPM analysis. His results are also very high when compared to the same 4.14%. He criticizes my long-term growth rate as being too high, but his own results are also very high by his own statements, but he still uses them. For some reason he seems to believe that no long-term growth rate can exceed 4.14% (4.24% in multi-stage DCF analysis). As I demonstrated earlier in my criticism of his multi-stage results and through a recalculation of his constant growth results using 4.24% as the constant growth rate, the results are illogical.

Q. Mr. Walters criticizes the historical period you selected to measure the risk premium as too short and suggests you did not explain why that date was selected. (Walters Rebuttal, p. 12). Can you respond to his criticism?

A. Yes. As explained in my direct testimony, a 13-year historical period is more than long enough to provide a meaningful relationship to determine an appropriate risk premium. Mr. Walters went back to 1986, an additional 23 years, but the result was still very similar to mine. His risk premiums compared to 30-year treasury rates ranged from 5.63% to 5.68%. My risk premiums ranged from 5.52% to 5.78%. The results are very close so Mr. Walters' criticism of my Bond Yield Plus Risk Premium (BYPRP) analysis should be ignored by the Commission.

Q. Staff witness Walters suggests that your flotation cost adjustment is not based on the recovery of prudent and reasonable flotation expenses for Missouri Water. (Walters Rebuttal, p. 13). How do you respond to Mr. Walters' criticism of the flotation cost adjustment?

A. Perhaps Mr. Walters does not realize that it is not Missouri Water that issues common stock to the public, but rather its ultimate parent, APUC. Therefore, Missouri Water would not demonstrate issuance expenses. To represent an approximate flotation cost for APUC, I used the same proxy group that determined my recommended ROE. The proxy group costs were not generic information but rather actual costs for actual common stock issuances by the companies.

B. <u>Response to OPC's Rebuttal Testimony on my Recommended Return on Common Equity</u>

Q. What is OPC witness Murray's first criticism of your recommended return on common equity and how do you respond?

A. Mr. Murray discusses small size risk premium adjustments as I did in my direct testimony. However, he concludes that my DCF COE estimates do not corroborate the need for a generic small-size risk premium. I presented the empirical and literature support behind the theory of small-size risk premium adjustments in my direct testimony. This having been said, I do not include a specific adjustment in my recommended return on common equity. Therefore, I am unclear why Mr. Murray thinks it is relevant.

Q. OPC witness Murray generally criticizes your ROE, cost of debt and capital structure recommendations on pages 13, line 3 through page 14, line 16 of his rebuttal testimony. Can you comment on Mr. Murray's criticism?

A. Yes. Mr. Murray begins by asserting that Missouri Water has an affiliate gas distribution company based in New Brunswick, Canada ("LUNB"), that is small in size and raises third-party capital based primarily on its stand-alone risk profile. Mr. Murray states LUNB's ROE of 9.8%, common equity ratio of 45%, cost of debt of 3.315%, with a maturity date of February 14, 2050, and that LUNB's parent company, LUCA, is rated BBB. From this set of irrelevant facts for a Canadian regulated gas distribution utility, which is also irrelevant as a comparator to a Missouri water utility, he concludes that LUNB's common equity ratio of 45% "is consistent with the common equity ratios LUCo had communicated to investors and is consistent with the low business risk of its regulated utilities. Despite its small size, more leveraged capital structure and a 9.8% authorized ROE, LUNB was able to issue third-party debt at a reasonable cost consistent with its credit rating." (Murray Rebuttal, p. 14). He goes on to say "LUNB's market-based capital structure and cost of debt parameters refute not only Mr. Cochrane's argument for a small size premium adjustment, but also his equity-rich ratemaking capital structure and unreasonably high affiliate cost of debt." (*Id.*).

Q. How do you respond to Mr. Murray's statements?

A. First, LUNB is subject to regulation in Canada in the province of New Brunswick, Canada, which is not comparable to Missouri Water. In addition, Mr. Murray fails to account for the differences in Canadian utility regulation versus US state Commissions and more specifically Missouri regulation. He has provided no explanation on how ratemaking and cost of service work in Canada. Second, Missouri Water is a water utility not gas, so it is not particularly comparable to LUNB. Third, he mentions the cost of debt of LUNB is 3.315% and matures in February 2050. Mr. Murray neglects to mention that the debt was issued on February 11, 2020, by LUCA, the parent, and a non-utility company, not LUNB, and was used to finance the original acquisition of LUNB by APUC on October 1, 2019. The debt was issued four years and seven months ago - not recently. There has not been any debt issued by LUCA since that February 2020 issuance. LUNB has never issued long-term debt to third party investors, so Mr. Murray's statement that LUNB raises third-party debt based on its stand-alone credit profile is not correct. The LUNB/LUCA intercompany debt relationship is exactly the same as the LUCo/Missouri Water's. In summary, Mr. Murray's comparison of a small Canadian regulated affiliate gas distribution company to Missouri Water for purposes of determining ROE, capital structure and cost of debt is not reasonable or appropriate.

Q. What other criticisms does Mr. Murray have of your ROE recommendation?

A. First, he takes issue with my constant growth DCF analysis because the analyst growth rates I used are assumed to be constant into perpetuity. He specifically states in Q&A on page 15, lines 8-9 of his rebuttal testimony that he personally is not aware of any equity analyst that would assume a utility's DPS can grow in perpetuity at the same rate as their own projected 3-to-5-year CAGR in EPS.

Q. How do you respond to Mr. Murray's criticism?

A. Mr. Murray's criticism seems to come back to the position that his COE calculations of 7.5% to 8.5% are the only answer. Any long-term growth rate selected, even if from a group of analyst earnings projections, has to be low enough to achieve a result close to his COE, otherwise, in his view, it makes no sense. As I discussed and demonstrated in my rebuttal testimony, that assumption is inappropriate when you compare his results to authorized ROEs by state Commissions for water utilities over the last 14 years. The fact that Mr. Murray states that he isn't aware of any equity analysts that assume a DPS can grow in perpetuity at the same rate as their own projected 3-to-5-year CAGR in EPS is not supported since he provides no facts or empirical evidence from equity analysts that say whether they do or do not.

Q. What is Mr. Murray's criticism of your CAPM results?

A. He states my CAPM results are too high because my expected market return is not rational. (Murray Rebuttal, p. 15). My expected market return calculation result, based on the S&P 500 index as of January 11, 2024, is 13.96% and includes a 12.45% growth rate. The resulting market risk premiums based on Treasury rates at the time are 9.43% to 9.77%. He then states that he knows of no authoritative, academic, or practical source that uses my way of estimating market returns. He then refers to a 2010 curriculum for Level III of the CFA, which states that earnings growth rates = GDP growth rate + excess corporate growth (for the index companies). (Murray Rebuttal, pp. 16-17). He offers this as his sole empirical support in rebuttal testimony despite the fact that earlier he states that he does not agree with GDP as a representative measure for a long-term growth rate. He then goes on to state on page 16, line 29 though page 17, line 2, that based on a June 30, 2024 dividend yield for the S&P 500 of 1.32% and a projected US nominal GDP of around 4% (no source provided), "it seems that investment professionals' forecasts of long-term returns for the S&P 500 of around 7% may be a bit optimistic based on current market valuation levels." The referenced 7% is from Mr. Murray's direct testimony (p. 37, line 4).

Q. How do you respond to Mr. Murray's criticisms?

A. My method is similar to the FERC methodology, which uses the S&P 500 index and performs a constant growth DCF analysis. The FERC method excludes non-dividend paying stocks and stocks with growth rates above 20% and below 0%. In my CAPM, I do not exclude any stocks because the beta I use in my CAPM represents the entire market index, so I do not want to mix apples and oranges. Staff witness Walters also uses the FERC CAPM methodology in his ROE testimony. Mr. Walters does exclude non-dividend paying stocks and companies outside the 0%-20% band but his projected growth rates as of June 21, 2024 were 10.90% to 11.10%, which are much closer to mine, but still high compared to Mr. Murray's benchmark.

Regarding Mr. Murray's final statements on page 16, line 29 through page 17, line 2, I think his current 1.32% dividend yield plus 4% growth rate resulting in a 5.32% expected market return versus his stated investment professionals' forecasts for S&P 500 long-term returns of 7% just shows how the 4% growth rate is an unreasonably low number.

Q. Does Mr. Murray criticize your BYPRP analysis?

A. Yes, he does. He states my approach is circular, but he does not address the actual results, which, as I demonstrated earlier in my surrebuttal testimony, are comparable to Staff witness Walters' BYPRP results. OPC witness Murray also states that the investment community recognizes that authorized ROEs did not decline along with COE. I addressed that statement in my rebuttal testimony, but again, Mr. Murray postulates that COE is actually lower than authorized ROE's by State Commissions even though the resulting authorized ROEs are based on the same methodologies and assumptions.

Q. Mr. Murray criticizes your flotation cost adjustment and suggests (1) at page 18 of his rebuttal testimony, that "the only common equity contributions Liberty Water has received since 2021 was in 2023 for Liberty Water's acquisition of the Bolivar water and sewer system" and (2) on page 19 that "APUC's current strategy is to avoid issuing common equity because the market value of its common equity has declined significantly since the end of 2022 and if anything plans to buy back common shares if it believes it can do so without having its credit rating downgraded from BBB." Does Mr. Murray provide any cites supporting his criticisms?

A. No, there are no cites on page 19 showing that APUC made any of those statements. Regarding his statements on page 18 of his rebuttal testimony, Missouri Water received a $17 million equity contribution in December 2023, $13 million in July 2024 and will receive $5 million on October 25, 2024, so his statements are incorrect. APUC's issuances of common stock benefit all the utility subsidiaries of LUCo so they should all share in the cost. My flotation cost adjustment recognizes the cost of that benefit.

V. <u>CONCLUSIONS</u>

Q. Please state your conclusions.

A. The Commission should accept my recommended (1) common equity ratio of 52.99% based on my April 30, 2024 update for Missouri Water, (2) cost of debt of 4.97% based on a Commission approved pricing mechanism and actual market priced debt issuances on April 1, 2024 for Missouri Water, and (3) a return on equity of 10.0% as proposed by the Company.

Q. Does this conclude your surrebuttal testimony?

A. Yes, it does.

VERIFICATION

I, John Cochrane, under penalty of perjury, on this 24th day of October, 2024, declare that the foregoing is true and correct to the best of my knowledge and belief.

/s/ John Cochrane