| Exhibit No.: | |
|---|---|
| Issues: | Capital Structure |
| Witness: | Nicholas Furia |
| Exhibit Type: | Rebuttal/Surrebuttal/Sur-Surrebuttal |
| Sponsoring Party: | Missouri-American Water Company |
| Case No.: | WR-2024-0320 |
| Date: | January 24, 2025 |

**MISSOURI PUBLIC SERVICE COMMISSION**

**CASE NO. WR-2024-0320**

# REBUTTAL/SURREBUTTAL/SUR-SURREBUTTAL TESTIMONY

**OF**

**NICHOLAS FURIA**

**ON BEHALF OF**

**MISSOURI-AMERICAN WATER COMPANY**

** DENOTES CONFIDENTIAL INFORMATION**

*** DENOTES HIGHLY CONFIDENTIAL INFORMATION***

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# AFFIDAVIT

I, Nicholas Furia, under penalty of perjury, and pursuant to Section 509.030, RSMo, state that I am the Vice President & Treasurer of American Water Works Service Company, Inc., that the accompanying testimony has been prepared by me or under my direction and supervision; that if inquiries were made as to the facts in said testimony, I would respond as therein set forth; and that the aforesaid testimony is true and correct to the best of my knowledge and belief.

*Nicholas Furia*

Nicholas Furia

January 23, 2025
Dated

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**REBUTTAL/SURREBUTTAL/SUR-SURREBUTTAL TESTIMONY**
**NICHOLAS FURIA**
**MISSOURI AMERICAN WATER COMPANY**
**CASE NO.: WR-2024-0320**

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## REBUTTAL/SURREBUTTAL/SUR-SURREBUTTAL TESTIMONY

## NICHOLAS FURIA

1 **I. INTRODUCTION**

2 **Q. Please state your name and business address.**

3 A. My name is Nicholas Furia and my business address is 1 Water Street, Camden NJ 08102.

4 **Q. Are you the same Nicholas Furia who previously submitted Direct Testimony in this**

5 **proceeding?**

6 A. Yes.

7 **Q. Can you please provide an overview of your rebuttal?**

8 A. My rebuttal responds to Staff and OPC's recommendations that are based on erroneous

9 assumptions to use a consolidated capital structure for setting MAWC's rates. My rebuttal

10 further responds to OPC's recommendation to use American Water Capital Corporation's

11 ("AWCC") consolidated cost of debt and Staff's recommendation to use the AWK

12 consolidated cost of debt. Specifically, my Rebuttal/Surrebuttal/Sur-Surrebuttal

13 Testimony will support the use of MAWC's stand-alone capital structure and cost of debt

14 for the following reasons:

15 - The Commission is charged with balancing the interests of all stakeholders in the

16 ratemaking process. The use of a consolidated capital structure for setting rates in

17 this proceeding is inconsistent with the Commission's charge, is not sound

18 regulatory policy, and fails to satisfy the long-term best interest of customers by

19 materially impacting MAWC's overall operations and investments in the State;

20 - MAWC is a stand-alone business enterprise with independent state operations,

21 capital investments, management, and corporate governance, all of which support

the use of its stand-alone capital structure for setting rates;

- MAWC's stand-alone capital structure appropriately reflects its distinct risk profile, which contrary to Staff and OPC's assertions, is different from the business and financial risks of American Water;
- MAWC's stand-alone capital structure allows MAWC to maintain access to low-cost financing through all financing sources and it is in line with the capital structure and return on equity ("ROE") for utility companies with similar risk profiles (as described by MAWC witness Bulkley);
- Staff and OPC fail to recognize that equity investors seek a return that is commensurate with the risk of that investment, not the source of the funds used to make the investment. The relevant consideration in determining the appropriate capital structure supporting the overall return on capital is the risk associated with the use of funds, not the source of those funds. Application of a higher debt component of the capital structure increases overall risk and the need for a higher equity return.
- Staff's and OPC's position deviates from well-established guiding principles for determining a utility's cost of capital, in particular the stand-alone principle. MAWC's stand-alone capital structure represents the actual debt and equity capital used to finance MAWC's business, including its capital investments, and is aligned with its peers and proxy group as discussed by Ms. Bulkley;
- The use of a consolidated capital structure for ratemaking purposes will make Missouri-American an outlier among MAWC peer utilities;

1 - As part of the larger American Water enterprise, MAWC's customers benefit from
2 American Water's size and economies of scale to realize cost savings. These
3 benefits are placed in jeopardy if the Staff and OPC's recommended capital
4 structures are implemented;
5 - Relying on the consolidated capital structure for setting rates could limit the options
6 for Missouri-American to attract capital on a stand-alone basis;
7 - If rates are set on the basis of a consolidated capital structure, and the limitations
8 this could place on MAWC's access to capital, MAWC's ability to make continued
9 cost-effective investments in troubled systems will cease and proactive system
10 improvements will be greatly reduced; and
11 - MAWC's cost of debt is the only relevant cost of debt in this case as it is the only
12 one that encompasses costs related to the AWCC issuances it participated in as well
13 as the other externally sourced debt by MAWC.

14 **II. SOUND REGULATORY POLICY DICTATES THE USE OF**
15 **MAWC'S CAPITAL STRUCTURE FOR RATEMAKING PURPOSES**

16 **Q. What is the Commission's role in setting rates?**

17 A. The Commission is charged with balancing the interests of all stakeholders in the
18 regulatory process. "The rate-making process...i.e., the fixing of 'just and reasonable
19 rates', involves a balancing of the investor and the consumer interests." Moreover, a recent
20 National Association of Regulatory Utility Commissioners (NARUC) report found that:

21 Regulators are charged with balancing the interests of investors and
22 customers. Utility management has a fiduciary responsibility to
23 deploy investors' capital productively. Investors recognize the
24 importance of regulatory and stakeholder relationships and expect
25 utility management to provide safe, reliable, and affordable service

1 to customers in order to preserve and enhance the value of their
2 invested capital. In many ways, the interests of investors and
3 customers are aligned and not in conflict and can become more
4 aligned through regulatory policy. Regulators are more effective at
5 serving customers when they harness investors' desire to provide
6 capital rather than constrain it.[1]

7 **Q. Why is sound regulatory policy important in the ratemaking process?**

8 A. The policies that are established by the Commission provide the framework for future
9 investment in the utilities that they regulate. If the Commission does not properly balance
10 the interests of all stakeholders in the ratemaking process, such that the financial metrics
11 of the regulated utility are weakened, the result would likely be slowed investment in the
12 operations in the jurisdiction. While the Company will always maintain a safe and reliable
13 system, doing so will come at a greater cost and proactive investments in the MAWC
14 system, as well as acquisitions of troubled water systems in Missouri, cannot continue to
15 occur at current levels if they are not supported by positive regulatory policy. MAWC's
16 investments in infrastructure in Missouri provide positive benefits for customers, and the
17 Missouri economy overall, including job creation.[2] In contrast, regulatory policy that
18 directs investment out of Missouri is not in the best interest of customers or the
19 communities served.

20 **Q. Does Staff's and OPC's recommended consolidated capital structure result in lower**
21 **rates for customers?**

22 A. Only in the short run. An arbitrary adjustment that lowers the equity component of
23 Missouri American's capital structure for ratemaking purposes will result in a lower

[1] "A Cost of Capital and Capital Markets Primer for Utility Regulators," National Association of Regulatory Utility Commissioners, April 2020 (published for review by the U.S. Agency for International Development), at 8.

[2] Svindland DT, p. 7

1 revenue requirement in this case, and thus, reduce rates for customers today. However, as
2 discussed later in my Rebuttal Testimony, and in Ms. Bulkley's Rebuttal Testimony,
3 reducing the Company's equity ratio has other financial implications that will increase
4 costs. Specifically, as Ms. Bulkley states, increased leverage results in increased overall
5 financial risk that could be reflected in credit ratings and higher costs of debt issuances in
6 the future. In addition, higher leverage increases the risk to holding equity, which increases
7 the investor-required ROE. Therefore, over the long-run greater leverage does not
8 necessarily result in lower costs to customers.[3] Such a trade-off does not serve the long-
9 term best interest of customers and is not sound regulatory policy.

10 **Q. Can you summarize why you believe the use of American Water's consolidated**
11 **capital structure for MAWC for ratemaking purposes is not sound policy?**

12 A. First, as discussed in greater detail below, the relevant consideration in determining the
13 appropriate capital structure supporting the overall return on capital is the risk associated
14 with the use of funds, not the source of those funds. As Ms. Bulkley explains in detail, the
15 application of a higher debt component of the capital structure increases overall financial
16 risk and results in the need for a higher equity return.[4] Equity capital investors seek a return
17 that is commensurate with the risk of that investment, not the cost of the funds used to
18 make the investment. The risk profile of AWK differs from the risk profile of MAWC.
19 While each individual operating company bears its own jurisdictional risk, AWK has the
20 benefit of diversification across the portfolio of operating jurisdictions and thus has a lower
21 overall risk than any of the individual operating companies. Therefore, it is not correct and
22 unreasonable to suggest that the AWK capital structure, which reflects a different risk

[3] Bulkley RT/ST/SST, p. 29.
[4] Bulkley RT/ST/SST, pp. 32-34.

1 profile than MAWC, should be imposed at the operating company level. Moreover, there
2 are other jurisdictions to consider. Those jurisdictions properly acknowledge and value the
3 benefits of participating in the Financial Services Agreement ("FSA") for purposes of
4 obtaining debt financing at a reasonable cost, at rates lower than they would likely achieve
5 on their own, while also recognizing that this does not equate to rendering the operating
6 utility's business risk equivalent to that of its parent. The cost of capital across the
7 regulated utilities is demonstrably different. They operate in different geographic
8 locations, with different operational characteristics (including size and customer base), and
9 most importantly different regulatory environments.

10 As explained throughout this testimony, using the AWK consolidated capital structure to
11 set MAWC's rates would ultimately increase the cost of capital for MAWC and result in
12 higher costs to customers. It is bad policy for the Commission to start selecting aspects of
13 the holding company structure that appear beneficial to customers in the immediate term
14 without fully considering the likely outcome over time of a regulator-imposed fundamental
15 shift of MAWC's risk. The Commission has recognized as much when it found in the case
16 of Spire that where a holding company has multiple regulated utility subsidiaries operating
17 in different states, "if the parent company's capital structure were used, regulatory policies
18 employed by commissions in . . . other states . . . and financing practices followed by
19 utilities or entities not regulated by the Commission, would affect the rates customers pay
20 in Missouri."[5]

[5] *In Re Laclede Gas Co. d/b/a Missouri Gas Energy*, 2018 WL 1315107 (Mo. PSC Feb. 21, 2018), at *27.

1 **III. MAWC IS AN INDEPENDENT OPERATING ENTITY WITH RISKS DISTINCT**
2 **FROM AMERICAN WATER**

3 **Q. Staff and OPC's recommendations to use the consolidated capital structure of**
4 **American Water are at least in part based on Mr. Murray and Ms. Malki's statements**
5 **that MAWC does not operate as an independent entity.[6] How do you respond?**

6 A. Missouri-American is a separate legal entity with independent state specific operations,
7 capital investments, management and corporate governance. Missouri-American's
8 President, Richard Svindland described in his Direct Testimony his duties as President of
9 MAWC, all of which are carried out independently. It is Mr. Svindland who oversees
10 management of MAWC, including hiring and retention of key personnel and achievement
11 of MAWC's business plan. Moreover, Missouri-American has an independent Board of
12 Directors responsible for authorizing the Company to enter contracts, issue debt and make
13 dividend payments. As a separate legal and operational entity, MAWC is regulated
14 separately. The utility operations the Commission regulates are unique to Missouri and the
15 facilities located in Missouri. The oversight of MAWC under Mr. Svindland and the
16 management team is conducted through a "Missouri-centric" lens. The investment needs
17 are unique to Missouri and the physical systems in Missouri. The customers are
18 Missourians. The challenges and risks, regulatory and financial, are also unique to
19 Missouri.

20 **Q. Staff cites to MAWC's participation in the FSA and what Staff characterizes as**
21 **"heavy integration"[7] of MAWC's financial management with AWK's other**
22 **operations in support of its recommendation to impute the consolidated capital**

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[6] Murray DT/RT, pp. 46-47 and Malki DT/RT pp. 24-25
[7] Malki DT/RT, p. 28, line 3



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1 **structure for ratemaking purposes. How do you respond?**

2 A. MAWC's decision to exercise its option to source its debt financing needs through the
3 Commission Approved FSA[8] with AWCC, an arrangement this Commission has
4 repeatedly recognized as beneficial to MAWC's customers, is yet another example of the
5 management and board of directors of MAWC exercising discretion to act in the best
6 interests of MAWC's customers. In fact, as I have demonstrated in my Direct Testimony,
7 if MAWC did not use AWCC's services it would have subjected its customers to
8 significantly higher debt costs. A fact that neither Staff nor OPC have disputed and one
9 that is recognized throughout the other regulatory jurisdictions in the AWK portfolio with
10 the acknowledgement of the value and benefits of the FSA. And importantly, these other
11 jurisdictions do not find that the FSA renders the operating utility's business or financial
12 risk equivalent to that of the parent. The fact that AWCC has been the primary source of
13 debt financing for MAWC is because it has been the lowest cost source of debt available
14 to MAWC. Using this fact as a basis for concluding that the AWK consolidated capital
15 structure is the appropriate capital structure is at best erroneous and at worst punitive.

16 **Q. Staff asserts that MAWC's business risk is similar to the business risk of AWK.[9] Do**
17 **you agree with this assertion?**

18 A. No, I do not. A company's business risk refers to its ability to generate sufficient revenue
19 and cash flows to cover its operational expenses and debt service requirements. MAWC
20 operates entirely within the state of Missouri with no financial, regulatory or geographic
21 diversity. MAWC represents approximately 11 percent of revenues from the regulated

[8] Case No. WF-2002-1096, *Order Approving Financing*, p. 7

[9] Malki DT/RT, p. 29, lines 3-6.

operating subsidiaries of AWK.[10] Notably, for the last decade, Missouri-American has not collected the revenues authorized by this Commission.[11] In contrast, American Water consolidated is advantaged by the diversification of financial, regulatory and business risk across many regulatory jurisdictions, including cash flow positive Market-Based businesses, as part of its consolidated holdings. Moreover, AWK's regulated utilities operate in approximately 1,700 communities in 14 states in the United Sates, with approximately 3.5 million active water and wastewater customers.[12]

The notion that AWK's overall risk is equivalent to the financial and business risk of MAWC is false. The risk across the AWK portfolio of operating subsidiaries is diverse. The regulated utilities are of varying size, located in distinct geographic areas, experience different operational circumstances in their respective states, and perhaps most importantly, face distinct challenges in the regulatory environments in which they operate. For example, MAWC is the third largest utility subsidiary of AWK. It is one of only 4 without access to a fully forecasted test year for ratemaking purposes[13] and if Staff and OPC's position were adopted it would be an outlier within the states in which AWK operates. Therefore, there are significant differences in business risk between MAWC and the consolidated portfolio of companies, which in turn, support different levels of financial risk and capital structures.

Ms. Malki acknowledges this when she states that "it is reasonable to assume AWWC can take on greater leverage than MAWC because of its lesser financial and business risk"[14]

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[10] SEC Form 10-K, December 31, 2023, p. 4.
[11] LaGrand DT, p. 21, Table BWL-1.
[12] AWK 2023 10-K, p. 4.
[13] Defined as rates that go into effect no later than the beginning of the test year.
[14] Maki DT/RT, p. 29, lines 18-20.

1 and further notes that "it is not always appropriate to use the parent company's cost of
2 common equity if the parent company's risk profile is significantly different from that of
3 its regulated subsidiaries."[15] In fact, Staff's position contains several internal
4 inconsistencies, stemming from its tendency to selectively reference consolidation. For
5 example, Staff argues on the one hand that the cost of equity is most appropriately
6 examined with reference to comparable risk utility companies, and notes that the greater
7 leverage present in AWK's capital structure is a result of its lesser financial and business
8 risk, but in the same breath makes conclusory statements that the risks of AWK are similar
9 to those of MAWC, though Staff does appear to limit this observation by the phrase "in
10 terms of sector risk."[16] While Ms. Malki asserts that "*if* the business risks of the parent
11 company are similar to those of the subsidiary, then each entity should be able to incur
12 similar amounts of financial risk [and] this *should* cause their capital structures to be fairly
13 similar" (emphasis added)[17] she does not attempt to reconcile this with her observation that
14 AWK has diversified equity investments in its subsidiaries and can take on greater leverage
15 than MAWC due to its lesser financial and business risk.

16 **Q. Do credit rating agencies recognize the importance of diversification when assessing**
17 **risk profiles?**

18 A. Yes. Moody's in their most recent AWK February 23, 2024 credit opinion states:

19 **______________________________________
20 ______________________________________
21 ______________________________________
22 ______________________________________
23 ______________________________________
24 ______________________________________

[15] Malki DT/RT, p. 29, lines 6-10 and p. 30, lines 1-2.
[16] Malki DT/RT, p. 24, lines 11-12.
[17] Malki DT/RT, p. 24, lines 12-15.

1 ______________________________**[18]

2 **Q. OPC witness Murray argues that his recommended capital structure best represents**
3 **the amount of debt capacity American Water considers reasonable and appropriate**
4 **for its regulated utility assets, including those of MAWC. He also suggests that his**
5 **recommended capital structure would ensure that MAWC ratepayers receive credit**
6 **for their contribution to AWK's debt capacity, which he says AWK uses to purchase**
7 **equity in its subsidiaries[19]. How do you respond?**

8 A. These "debt capacity" or similar derivatives of "double leverage" arguments have been
9 repeatedly rejected in this and nearly all other jurisdictions. Their adoption would only
10 serve to reduce investor confidence in the supportiveness of the Missouri regulatory
11 environment. Mr. Murray acknowledges that Missouri American has its own internally
12 managed capital structure.[20] That is true of each of the American Water regulated
13 subsidiaries, and nearly all of the other regulated subsidiaries are not made to suffer the
14 fiction of a consolidated capital structure. As described above, as a matter of financial
15 theory and regulatory practice, it is the use to which funds will be put once they are
16 invested, not the source of the funds, that determines the risk-required rate of return on
17 equity. As a more practical matter, Mr. Murray's argument relies on a determination of
18 whether the funds invested by each investor were borrowed, which is an unreasonable and
19 unworkable approach. AWK has invested in MAWC as an equity investor, bearing the
20 same risks as any equity investor would have and therefore requires an appropriate return
21 that is consistent with investments of similar risk.

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[18] **______________________________**

[19] Murray DT/RT, p. 34, lines 25-27, p. 35, lines 1-2.

[20] Murray DT/RT, p. 6.

1 **Q. Does the capital structure proposed by MAWC align with Commission ordered**
2 **capital structures?**
3 A. Over the past 5 years, there have been 2 litigated cases of major utilities in Missouri,
4 Central States (50% authorized equity ratio) and Spire (49.9% authorized equity ratio).
5 Based on the equity ratios authorized in these proceedings, I would expect MAWC's
6 proposed capital structure, including approximately 50% common equity, to fall within the
7 Commission's "zone of reasonableness".
8 **Q. Mr. Murray states "MAWC does not issue its own debt or equity to third parties"**
9 **and "MAWC's capital structure is not optimized to minimize its cost of capital.**
10 **However, American Water's capital structure is optimized because its capital**
11 **structure is a function of arms-length financing transactions (whether through**
12 **American Water's direct common equity issuances or the AWCC debt issuances its**
13 **credit quality supports)"[21]. Is the existence of an "arm's length" transaction**
14 **indicative of an optimal capital structure?**
15 A. No. As discussed below, the calculation of an optimal capital structure "is not a useful tool
16 to fine tune a company's capital structure", and a more practical approach is a proxy group
17 comparison; however, while it would not be prudent or advisable, it would be quite simple
18 for an entity to set a capital structure utilizing "arm's-length" transactions that is not
19 comparable to other similarly situated entities either intentionally or by error and thus more
20 costly.
21 **Q. Are you aware of any publications that address a utilities optimal capital structure?**

[21] Murray DT/RT, p. 3, lines 24-5, p. 4, lines 1-2.

1 A. Yes, NARUC's Cost of Capital and Capital Markets: A Primer for Utility Regulators says:

> 2 Financial theory indicates that an optimal capital structure range
> 3 exists that will minimize the WACC, but, in practice, it is very
> 4 difficult to pinpoint optimal capital structure ratios with any degree
> 5 of accuracy. To begin with, academic references about optimal
> 6 capital structure are relatively vague and do not offer any empirical
> 7 evidence to pinpoint one. In the real world practical corporate
> 8 finance environment, academic theoretical references are interesting
> 9 and may be thought-provoking, but do not provide a useful tool to
> 10 fine tune a company's capital structure

11 And goes on to say:

> 12 capital structure ratios cannot be deemed to be inappropriate unless
> 13 the ratios greatly diverge from sound industry practice and cause a
> 14 lack of financial flexibility that may lead to higher overall costs.[22]

15 **Q. Has any evidence been presented to show that Missouri-American's stand-alone**
16 **capital structure is inappropriate or that the ratios greatly diverge from sound**
17 **industry practice?**

18 A. No. As shown in Figure 6 of witness Ann Bulkley's rebuttal testimony, MAWC's capital
19 structure is not out of line with the capital structures of other regulated utilities.

20 **Q. OPC witness Murray characterizes AWK's financing strategy as "an abuse of**
21 **MAWC's affiliation with its parent company."[23] Do you agree?**

22 A. No. As I have described in my direct and rebuttal testimony, customers benefit from
23 MAWC's relationship with its affiliates, especially through its participation in the FSA
24 with AWCC. Mr. Murray himself recognizes this when he says "the consolidation of
25 American Water's financing needs at AWCC has allowed for economies of scale."[15] The
26 ability to leverage economies of scale for the benefit of customers does not, however,

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[22] John D. Quackenbush, CFA, *Cost of Capital and Capital Markets: A Primer for Utility Regulators*, National Association of Regulatory Utility Commissioners (December 2019) at 12.
[23] Murray DT/RT, p. 37, lines 15-16.

1 change the fact that MAWC has a distinct risk profile that is different from its parent
2 company and from the other regulated affiliates in the AWK portfolio, and MAWC's
3 capital structure is commensurate with MAWC's risk. Moreover, MAWC's capital
4 structure for purposes of this case is consistent with the capital structures of similarly
5 situated operating utilities. As shown in Figure 6 of Ms. Bulkley's Rebuttal Testimony,
6 the mean equity ratio of the proxy group companies as of the end of 2023 was 54.72
7 percent. The appropriate comparison point for whether MAWC's capital structure for
8 ratemaking purposes should reflect greater leverage is to compare it to other regulated
9 operating utilities, not the parent company.

10 **Q. Mr. Murray claims American Water's financing strategy allows it to "earn a margin**
11 **over its costs"[24] on its equity investments. Is he correct?**

12 A. No. Mr. Murray attempts to compare the equity returns AWK would earn, based on his
13 opinion of an assumed Commission authorized return on equity over its cost of debt. As I
14 have stated in this rebuttal and as witness Bulkley further testifies to in her direct and
15 rebuttal testimonies, the source of the funds should not determine the return on those funds;
16 rather, it is the risk posed by an investment that determines the return.

17 **Q. Mr. Murray claims "MAWC is requesting the Commission allow American Water a**
18 **margin of 7% over American Water's cost of funds as of December 31, 2023.[25]" Is he**
19 **correct?**

20 A. No. MAWC is requesting that the Commission allow it to earn a return that is equivalent
21 to returns earned on investments with similar risk as any other investor would expect.

[24] Murray DT/RT, p. 37, lines 17-24.
[25] Murray DT/RT, p. 64, lines 26-27.

1 **Q. Is there Academic research to support the view that the risk of the investment should**
2 **be the determining factor in the capital structure and the return on investment?**

3 A. Yes, there is. The topic has been examined extensively over the years and there is much
4 academic literature that discusses it, and the flaws associated with Mr. Murray's arguments.
5 In particular, the literature responded to the concerns that the parent company is financing
6 the operating subsidiary with a greater percentage of equity than it has in its capital
7 structure. As discussed by Beranek and Miles (1988),[26] the "excess return" argument was
8 shown to be flawed, and the stand-alone ratemaking method was determined to be a
9 superior approach.

10 Beranek and Miles concluded that one of the major flaws in the argument is the direction
11 of causality. Using financial theory, the authors of this article demonstrate that the only
12 conditions where the stand-alone ratemaking method may be invalid is if the parent has
13 only one operating subsidiary or if the parent's operating subsidiaries are regulated and
14 have identical equity costs. In the current case, it is clear that the first of these scenarios is
15 not met. In addition, there has been no evidence presented that demonstrates that the equity
16 cost rates of the operating subsidiaries of AWK are identical. AWK has operating
17 subsidiaries in a number of different regulatory jurisdictions, and the cost of equity for each
18 of the subsidiaries is not equivalent leading to the conclusion that the "excessive return"
19 argument is invalid in this case.

20 **Q. **______________________________________________________________**
21 **_________________**

[26] William Beranek and James A. Miles, *The Excess Return Argument and Double Leverage*, The Financial Review, Vol. 23, No. 2, May 1988.

1 A. **______________________________**

2 **Q.** **__________________________________________

3 _____**

4 A. **_______________**

5 **Q.** **__________________________________________

6 ____**

7 A. **_______________**

8 **Q.** **__________________________________________

9 ______________________________**

10 A. **__________________________________________

11 __________________________________________

12 __________________________________________

13 __________________________________________

14 __________________________________________

15 __________**

16 **Q.** **__________________________________________

17 __________________________________________

18 __________________________________________

19 __________________________________________

20 ________________**

21 A. **__________________________________________

[27] Malki DT/RT, p. 23, lines 1-4.



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1 ________________________________________________

2 ________________________________________________

3 ________________________________________________

4 ________________________________________________

5 ________________________________________________

6 ________________________________________________

7 ________________________________________________

8 ________________**

9 **Q. Is a public credit rating a requirement for issuing long-term debt?**

10 A. No. In fact, as included in my direct testimony, since MAWC does not issue the amount
11 of long-term debt that would be required to access the investment grade public bond
12 market, it would be limited to the private placement market which does not require a public
13 credit rating. The absence of a public credit rating does not prohibit MAWC from issuing
14 debt outside of AWCC and, therefore, it only depends on AWCC because it can issue lower
15 cost debt than MAWC could on its own.

16 **Q. Staff summarizes the *Bluefield and Hope* case as stating a requirement for an**
17 **appropriate return to be one which "allows for the utility to attract capital in the**
18 **capital market (emphasis added)"[28] Does the case define "capital market" to be a**
19 **public capital market?**

20 A. No. There is no language that ties a capital market to a public capital market.

21 **Q. Does access to debt capital through AWCC then qualify as a capital market?**

[28] Malki DT/RT, p. 24, lines 17-19.

1 A. Yes, that is a valid interpretation of the term capital market in context of the case.

2 **Q. If MAWC issued debt on its own, how would that affect its current cost of long-term**
3 **debt and thus its overall cost of capital?**

4 A. All things being equal, as I have included in my Direct Testimony, if MAWC issued debt
5 on its own, other than potential State Revolving Fund debt opportunities, its cost of debt
6 would be greater than it is today.

7 **Q. Should the prudent financial management decision by MAWC's management and**
8 **board of directors to access lower cost debt through AWCC be a basis for concluding**
9 **that it is not a "financially independent operating company"?**

10 A. No. Given the benefits to MAWC customers, to do so, in whole or in part, would be
11 erroneous or otherwise biased in nature.

12 **Q. Has there been any recent updates from the other rating agencies?**

13 A. Yes. ** ______________________________________________
14 ______________________________________________ **[29]

15 **Q.** ** ______________________________________________ **

16 A. ** ______________________________________________
17 ______________________________________________
18 ____________ **

19 **Q.** ** ______________________________________________ **

20 A. ** ______________________________________________
21 ______________________________________________

[29] ** ______________________________________________ **



**P**

1 __________**

2 **Q.** **______________________________________________________________

3 ___________**

4 A. **______________________________________________________________

5 _______________________________________________________________

6 ______________________________________________________**

7 **Q.** **______________________________________________________________

8 _______**

9 A. **____________________________________**

10 **Q. What is the FFO/Debt downgrade threshold?**

11 A. 16%.

12 **Q.** **_______________________________________________**

13 A. **____**

14 **Q.** **______________________________________________________________

15 ______________________________**

16 A. **______________________________________________________________

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[30] Murray DT/RT, pg. 39, lines 3-12

1 **IV. APPLICATION OF THE CONSOLIDATED CAPITAL STRUCTURE AS**
2 **PROPOSED BY STAFF AND OPC VIOLATES**
3 **THE STAND-ALONE PRINCIPLE**

4 **Q. Can you explain what you mean by the stand-alone principle?**

5 A. The stand-alone principle is a well-established regulatory principle providing that the rate
6 of return (both return on equity and overall cost of capital) for a regulated utility should be
7 set as if the utility were seeking to attract capital in financial markets based on its own
8 individual merits and risk profile. The misuse of AWK's consolidated capital structure for
9 ratemaking purposes violates this basic financial theory.

10 **Q. What factors does MAWC consider when establishing its capital structure for**
11 **ratemaking purposes?**

12 A. The appropriate capital structure for MAWC is based on consideration of MAWC-specific
13 factors, such as the future revenues and cash flows, overall scale and complexity of the
14 utility's capital program, asset condition risk, future acquisitions, and the regulatory
15 environment, including sufficiency and timeliness of cost and investment recovery.
16 MAWC's actual capital structure is maintained to support a strong balance sheet with
17 adequate capacity and strong credit metrics to allow MAWC to have sufficient access to
18 low-cost financing through all financing sources, including through AWCC. It is in line
19 with the capital structures and ROEs for utility companies with similar risk profiles, as
20 described by MAWC witness Bulkley. Further, as shown in Figure 7 of Ms. Bulkley's
21 Rebuttal Testimony, MAWC's actual capital structure is within the range established by
22 the authorized capital structures for natural gas and water utilities over the past three years.

1 **V. USE OF AWK'S CONSOLIDATED CAPITAL STRUCTURE FOR RATEMAKING**
2 **IN MISSOURI WOULD ADVERSELY AFFECT MISSOURI CUSTOMERS**

3 **Q. What would be the likely consequences of the Commission ordering use of the**
4 **consolidated capital structure of the American Water companies for MAWC**
5 **ratemaking purposes?**

6 A. It represents a fundamental departure from the way MAWC is actually capitalized and
7 therefore, does not accurately reflect MAWC's business risk. As I will explain in greater
8 detail below, imposing the American Water consolidated capital structure for ratemaking
9 purposes will: (1) negatively impact MAWC's financial strength including reducing its
10 cash flows, earnings, and weakening its credit metrics that will negatively impact its ability
11 to attract low cost capital through AWCC as well as through outside sources of capital;
12 (2) result in higher debt and equity financing costs for customers in the long-term; and
13 (3) negatively impact ongoing and future investment in MAWC. As I described in detail
14 in my Direct Testimony, MAWC customers have seen significant benefit from MAWC's
15 participation in the FSA and will continue to benefit from ongoing future savings if MAWC
16 continues to utilize AWCC for future financings.

17 **Q. Please explain how the use of the consolidated capital structure will weaken MAWC's**
18 **credit profile, thereby limiting its ability to attract low-cost capital through AWCC**
19 **and through outside sources of capital.**

20 A. The lower equity ratio at the consolidated level would introduce more financial risk to
21 Missouri-American. The higher leverage would further deteriorate Missouri-American's
22 cash flows, weaken its credit metrics, and increase the Company's borrowing costs.

23 **Q. How would imposing a consolidated capital structure on Missouri-American increase**
24 **its borrowing costs?**

1 A. Imposing a consolidated capital structure for ratemaking purposes will result in higher cost debt for customers for several reasons. First, imputing a lower equity ratio on Missouri-American, one of the largest three operating utilities of AWK, will unfairly impose costs on other utility affiliates that also obtain debt financing through AWCC. Second, imputing the consolidated capital structure of AWK on MAWC would further lead to credit rating downgrades (as a result of weakened credit metrics from the higher leverage in the capital structure than MAWC would be able to sustain on its own due to its individual business risk), higher debt financing costs, and higher required ROE.[31]

**Q. OPC witness Murray recommends a cost of debt of 4.13% based primarily on AWCC's embedded cost of debt.[32] Do you agree with his recommended cost of debt?**

A. No. Mr. Murray's recommended cost of debt is based on a 97.86 percent weighting of AWCC's embedded cost of debt of 4.07 percent and a 2.14 percent weighting to the embedded cost of debt from four 3rd party debt issuances of MAWC. The cost of debt that is proposed by MAWC reflects the costs associated with the specific debt issuances of AWCC, which are the exact rates and costs paid by AWCC without any markup or other adjustment, and the third-party debt issuances made by MAWC that were used to fund MAWC operations and investments. As discussed in my Direct Testimony and as shown in Figure 9 of Ms. Bulkley's Rebuttal Testimony, comparing the costs of these issuances were determined to be reasonable based on market benchmarks and represent significant savings to MAWC customers and should therefore be recovered in MAWC's rates.

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31 **______________________________**

32 Murray DT/RT, p. 40.

1 **Q. Mr. Murray provides that in his opinion MAWC's first mortgage bonds would**
2 **receive an "A1 rating from Moody's and A+/AA- by S&P"[33]. Did he provide any**
3 **analysis or data that supports this assumed rating would result in lower borrowing**
4 **costs than AWCC has provided for MAWC?**

5 A. No.

6 **Q. Is a higher credit rating and or security indicative of a lower borrowing cost?**

7 A. No. I provided a detailed comparison of AWCC's most recent issuance with that of DTE's
8 which shows that a higher credit rating and security do not equate to lower borrowing costs.

9 **Q. Mr. Murray compares AWCC's and MAWC's embedded cost of long-term debt to**
10 **other large Missouri utility companies.[34] Does he provide details as to the tenor or**
11 **vintage of those Missouri utility companies debt?**

12 A. No.

13 **Q. Can a reliable conclusion be drawn about the comparison of AWCC/MAWC**
14 **embedded cost of long-term debt to "other large Missouri utility companies"**
15 **embedded cost of long-term debt be made without consideration of tenor or vintage?**

16 A. No. Tenor and vintage of debt can significantly impact the interest rate of the debt even if
17 we assume that the credit spread included in the interest rate was identical among all the
18 utilities compared, which is a gross oversimplification that would not hold in actuality,
19 even if all had the exact same credit scores from Moody's and/or S&P.

20 **Q. Can you further explain tenor and how it impacts a piece of debt's interest rate?**

21 A. Yes. The tenor affects the interest rate charged by debt investors. Longer tenors typically
22 command higher interest rates as compensation for the increased risk and time value of

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[33] Murray DT/RT, p. 48, line 17.
[34] Murray DT/RT, p. 50.



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1 money. Which means, if the tenors of the debt compared are not identical, a comparison
2 is not possible or credible.

3 **Q. Can you further explain vintage and how it impacts a piece of debt's interest rate?**

4 A. Yes. Vintage refers to the date debt was issued. Interest rates are highly variable and even
5 a day or two could have a significant impact on the interest rate paid by a firm. As an
6 example, if a firm that issued 10-year bonds in September 2024 (10-year treasury rate was
7 approximately 3.60 percent) had waited just 3 months and issued in December 2024 (10-
8 year treasury rate was approximately 4.60 percent) it would have a different interest rate
9 of about 100 basis points or 1 percent.

10 **Q. OPC witness Mr. Murray states "American Water's debt assignment process shows**
11 **a bias toward assigning lower-cost, shorter-tenor debt to American Water as**
12 **compared to MAWC."[35] Why might an operating company such as MAWC choose**
13 **to utilize longer tenor debt vs short tenor debt?**

14 A. The reasons for choosing longer tenor debt over short tenor include, but are not limited to,
15 (1) managing refinancing risk; (2) matching debt tenor with asset lives; and (3) minimize
16 issuance costs.

17 **Q. Can you further explain refinancing risk?**

18 A. Refinancing risk is the risk that borrowers will not be able to replace existing debt at a
19 future date under reasonable terms and prevailing market conditions. The effect is to incur
20 increased costs in the future that could have been mitigated by issuing longer tenor debt in
21 the present. As a holding company with different sources and uses of capital, AWK may
22 be able hold shorter term debt without incurring the same level of refinancing risk as a

[35] Murray DT/RT, p. 51, lines 20-21.



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1 utility with long lived assets such as MAWC.

2 **Q. Can you explain the impact issuance costs have on choosing a debt tenor?**

3 A. Yes. To simplify, assuming only 10- and 30-year debt options are available and both have
4 issuance cost of 1% of debt issued. To finance a $10 million asset with a 30-year life, if
5 10-year debt was chosen, that same asset would have to be refinanced 3 times over the total
6 life of the asset for a total issuance cost of $300,000. If 30-year debt was utilized instead
7 the issuance cost would be just $100,000 for a savings of $200,000 over the life of the
8 asset.

9 **Q. Staff witness Malki recommends a cost of debt of 4.22 percent based on AWK's**
10 **consolidated embedded cost of debt as of June 30, 2024.[36] Do you agree with her**
11 **recommended cost of debt?**

12 A. No. In addition to the arguments included here and in my direct testimony as well as in
13 witness Bulkley's testimony on the inappropriateness of using AWK's consolidated capital
14 structure as the capital structure in this proceeding, the use of AWK's consolidated cost of
15 debt is also inappropriate as it includes debt procured by other operating subsidiaries of
16 AWK, including low and zero interest financings made available to them through their
17 respective state financing authorities. Also, her recommendation incorrectly suggests that
18 MAWC has received a pro-rata allocation of every AWCC debt issuance. That is not the
19 case, and Ms. Malki provides no evidence to support this theory. The cost of debt that is
20 proposed by MAWC reflects the costs associated with the specific debt issuances of
21 AWCC, and the third-party debt issuances made by MAWC that were used to fund MAWC

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[36] Malki DT/RT, p 3.

1 operations and investments.

2 **Q. Staff witness Malki states "Estimating COD involves embedded COD methodologies,**
3 **such as calculating the weighted average cost of debt, analyzing interest rates on**
4 **existing debt instruments, evaluating credit ratings, and comparing borrowing costs**
5 **to industry benchmarks."[37] Before concluding that the Commission should authorize**
6 **AWK's consolidated embedded cost of debt as the cost of debt in this proceeding, did**
7 **staff present any analysis?**

8 A. No, staff did not present nor reference any such analysis in its testimony.

9 **Q. What do you mean when you say imputing a lower equity ratio on Missouri-American**
10 **would unfairly impose costs on other utility affiliates that also obtain debt financing**
11 **through AWCC?**

12 A. Imputing the consolidated capital structure weakens MAWC's balance sheet, cash flows
13 and credit metrics by increasing the amount of leverage to a level that MAWC cannot
14 support based upon its independent risk profile. This will in turn weaken AWCC credit
15 metrics and qualitative risk profile if MAWC – again as one of the largest three operating
16 utilities of AWK – were permitted to continue to participate alongside its affiliates. It is
17 estimated that AWCC's FFO/Debt would be negatively impacted by 20-30 basis points. In
18 addition, it is my understanding that the credit rating agencies would view Missouri's
19 regulatory environment as credit negative from a qualitative business risk perspective. The
20 combination could lead to a credit downgrade. Credit downgrades have a long-lasting
21 negative impact for any company and its customers. Further, once a downgrade occurs, it
22 takes many years to turn around. Providing essential utility services is an extremely capital-

[37] Malki DT/RT, p. 57, lines 3-8.

1 intensive process and a higher cost of capital will cost customers more to maintain the
2 system. Even if a downgrade did not occur, investors may demand higher interest rates to
3 compensate them for the increased risk. This would unfairly deprive those other affiliates,
4 and MAWC itself, of the benefits of participating in the FSA. To mitigate the impact on
5 AWK as a whole, Missouri-American would likely be foreclosed from using AWCC in the
6 future and would have to raise capital on its own, thus increasing MAWC's debt costs.

7 **Q. If Missouri-American is excluded from participating in debt financing through**
8 **AWCC, how will this affect MAWC and its customers?**

9 A. This will lead to higher debt costs including transaction costs for separate financings (i.e.,
10 legal, audit, securities registration fees, costs for additional treasury resources dedicated to
11 Missouri financings and other costs attendant to a separate financing). Such a capital
12 structure could also limit MAWC's access to capital in the form of private placements and
13 bank loans. If MAWC were forced to seek financing on its own, this separation would
14 limit future access to AWCC's liquidity resources and the loss of the credit support through
15 AWCC. All of the above increased financing costs would be passed on to customers.

16 In Figure 9 of her Rebuttal Testimony, Ms. Bulkley compares the yields on the Moody's
17 utility bond indexes to the interest rates on AWCC debt issuances as of the date of issuance.
18 As shown in that figure, in nearly all circumstances, the interest rates obtained by AWCC
19 have been lower than the yield on the Moody's utility bond index at the time of the AWCC
20 issuance. This analysis provides further evidence of the advantage of low-cost financing
21 available through AWCC.

22 **Q. What would be the likely outcome if the Commission adopted Staff and OPC's**
23 **recommendations to use AWK's consolidated capital structure for ratemaking**

1 **purposes in this case?**

2 A. **______________________________________________

3 ______________________________________________

4 ______________________________________________

5 ______________________________________________

6 ______________________________________________

7 ______________________________________________

8 ______________________________________________**

9 **Q. Could a Commission decision to use the consolidated capital structure impact**

10 **AWK/AWCC's credit rating?**

11 A. As the third largest subsidiary of American Water, it is hard to imagine there would be no

12 impact, even if the FFO/Debt metric remained above downgrade threshold. It is possible

13 that qualitative aspects would outweigh quantitative and lead to a rating action, either

14 change in outlook or change in rating or perhaps both.

15 **Q. Even if no rating agency action is taken, could there still be an impact on the cost of**

16 **capital?**

17 A. Certainly, equity and debt investors are highly sophisticated firms that utilize their own

18 internally generated credit assessments. An order to use the consolidated capital structure

19 will have a negative impact on the investors view of the riskiness of Missouri-American as

20 well as AWK/AWCC, which will lead to a higher cost of capital for all jurisdictions that

21 participate in the AWCC financings.

22 **Q. How would use of a capital structure that differs from Missouri-American's stand-**

23 **alone capital structure affect Missouri-American's authorized ROE?**

1 A. If the Commission were to impute a capital structure consisting of more debt than the
2 Company's test year capital structure, as stated in the Rebuttal Testimony of Company
3 witness Bulkley, a higher common equity cost rate related to a changed common equity
4 ratio should be reflected in the approach to determining the ROE. It is a fundamental tenet
5 of finance that the greater the amount of financial risk borne by common shareholders (in
6 other words, the greater the debt ratio), the greater the return required by shareholders. If a
7 lower equity ratio were to be imposed, the cost of equity must be adjusted to reflect the
8 additional risk associated with the more debt-heavy imputed capital structure. In Figure
9 11 of her Rebuttal Testimony, Company witness Ms. Bulkley quantifies the effect on cost
10 of equity from a reduction to Missouri-American's equity ratio. As shown in that figure,
11 reducing the equity ratio of Missouri-American to the levels proposed by Staff and OPC
12 would result in an equity return of 11.22 percent based on the Staff's proposal and 10.87
13 percent based on OPC's proposal to achieve the same weighted average ROE as AWK's
14 subsidiaries, which is 4.89 percent based on an average equity ratio of 50.04 percent.

15 Further, Ms. Bulkley's cost of equity analysis is based on a proxy group of comparable
16 companies to determine the ROE for Missouri-American. The returns that are established
17 by investors for the proxy companies take into consideration the risk related to the
18 capitalization of those companies. To the extent that the capital structure that was
19 authorized for Missouri-American were to deviate significantly from the range established
20 by the proxy group used to determine the ROE, that risk difference must be reflected in the
21 equity return. To do otherwise, would mismatch risk and return if the equity ratio used for
22 Missouri-American were to differ substantially from the mean of the proxy group upon
23 which the ROE is determined.

1 **Q. Please explain how the use of the consolidated capital structure would negatively**
2 **impact ongoing investment in MAWC.**
3 A. While MAWC is committed to continuing to make investments required to support the
4 provision of safe and reliable service for the long-term benefit of customers, its access to
5 capital for other new or proactive investments could be curtailed by a negative regulatory
6 climate generated by abandoning the stand-alone principle and adopting arguments related
7 to imputed capital structures or similar adjustments that have been rejected in most other
8 jurisdictions. See also the Direct Testimony of Company witness Derek Linam regarding
9 the planned, ongoing investment in Missouri and the Direct Testimony of Company
10 witness Richard Svindland regarding the Company's commitment through acquisitions to
11 improve water and wastewater service for customers currently served by troubled systems.
12 MAWC's commitments are contingent on its ability to earn a reasonable return. As shown
13 in Figure 10 of Ms. Bulkley's Rebuttal Testimony, the combination of the ROE and equity
14 ratios proposed by Staff and OPC are significantly below the average equity return for all
15 AWK operating utilities. Applying the consolidated capital structure for ratemaking
16 purpose increases the risk of equity investment in MAWC, which will increase the
17 financing costs incurred by MAWC and will negatively impact MAWC's proactive
18 investments in the system and troubled systems acquisitions in Missouri.

19 <u>**VI. RESPONSE TO OPC WITNESS DAVID MURRAY'S**</u>
20 <u>**CROSS-REBUTTAL TESTIMONY**</u>

21 **Q. Mr. Murray claims that MAWC's capital structure witness in its 2022 rate case**
22 **argued that imputing MAWC's capital structure with a lower equity percentage**
23 **similar to American Water's would "cause MAWC's financial profile to be consistent**
24 **with a non-investment grade credit rating." How do you respond?**



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1 **A.** Mr. Murray does not provide a citation, so it is unclear to which testimony he is referring, however, it would ultimately be the rating agencies that would make such a determination.

3 **Q. Is it possible that MAWC's credit profile could be determined to be 'non-investment grade' if the Commission were to impute MAWC's capital structure with a lower equity percentage than its historical actual (interpreted authorized) percentage?**

6 A. It is possible. **______________________________

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11 ______________________________**

12 **Q.** **______________________________

13 ______________**

14 A. ** ______________________________

15 ______________________________

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18 ______________________________

19 ______________________________

20 ______________________**

21 **Q.** **______________________________

22 ______________________________

23 ______________________**

24 A. **______________________________

25 ______________________________

26 ______________________________

1 ________________________________________________________________

2 ________________________________________________________________

3 ____________________________** (2) Both Moody's and S&P view transparency and

4 predictability in both a regulatory jurisdiction and cash flows to be 'credit positives' a shift

5 like OPC and Staff's recommendation could certainly be viewed as less predictable and

6 transparent and therefore a 'credit negative'. Due to the qualitative nature of this shift, it's

7 not possible to analyze the exact impact it would have on an alphanumeric credit rating,

8 this assessment would be up to the interpretation of the analysts forming the credit opinion.

9 **Q. Has S&P recently found orders similar to those proposed by OPC and staff approved**

10 **by other commissions to be 'less credit supportive"?**

11 A. Yes. In their Industry Credit Outlook 2025 for North American Utility Regulated Utilities

12 states **_____________________________________________________________

13 ________________________________________________________________

14 ________________________________________________________________

15 ________________________________________________________________

16 ________________________________________________________________

17 ____________________________________________**

18 **Q. Mr. Murray asserts that an analysis of business risk and credit metrics is fundamental**

19 **to determining the types and/or terms of capital American Water invests in its**

20 **subsidiaries and that this type of analysis is fundamental to determining an optimal**

21 **capital structure. How do you respond?**

22 A. First, when AWCC lends to MAWC or any of the AWK subsidiaries, as is prescribed by

23 the FSA, it does so at the same costs and terms as it incurs, therefore, a "credit analysis to

1 determine rate, tenor and terms to assign to the loan"[38] as suggested by Mr. Murray would
2 be irrelevant and doing so would be a waste of resources. Second, as previously referenced
3 and stated in NARUC's Cost of Capital and Capital Markets: A Primer for Utility
4 Regulators, "In the real world practical corporate finance environment, academic
5 theoretical references (to optimal capital structure) are interesting and may be thought-
6 provoking, but do not provide a useful tool to fine tune a company's capital structure".
7 Finally, a far better approach to determining a reasonable capital structure and associated
8 returns is to evaluate them against a proxy group, just as every analyst in this case has done.

9 **Q. Mr. Murray claims that MAWC's response to staff's data request MoPSC 0041 which**
10 **states "MAWC develops its financing plans to support its operating and capital plans,**
11 **while considering its cash flows and liquidity needs in order to maintain a capital**
12 **structure and overall cost of capital that is consistent with its business risk profile.**
13 **MAWC's capital structure is reflective of the way MAWC has been operated and**
14 **financed, including maintaining a consistent equity ratio at or above 50% since 2012"**
15 **is "inaccurate". Does he provide any evidence to prove that the statement is**
16 **inaccurate?**

17 A. No credible or independently supportable evidence was provided. He does point out that
18 MAWC's management presentation does not include a specific capital structure analysis
19 he deems prudent and one he would expect for an "independent company".

20 **Q. Does Mr. Murray provide references to other "independent companies" for which he**
21 **has reviewed the type of analysis he is seeking to support his view?**

[38] Data Request OPC 3058 and 3059



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1 A. No.

2 **Q. Does Mr. Murray include an 'Educational and Employment Background and**
3 **Credentials attachment to is direct/rebuttal testimony?**

4 A. Yes. His career is in state government, starting with the Missouri Department of Insurance,
5 he then spent several years with the Missouri Public Service Commission before joining
6 his current employer, the Office of the Public Council.

7 **Q. Does Mr. Murray provide any evidence to suggest that AWCC has not been the most**
8 **economical and prudent option for MAWC's debt capital?**

9 A. No.

10 **Q. Has evidence been presented in this case that demonstrates that AWCC has been the**
11 **most economical and prudent source of debt capital for MAWC?**

12 A. Yes. In my direct testimony I provide 3 proxies that can be used to prove that AWCC has
13 been the most economical and prudent choice for MAWC's debt capital which has resulted
14 in significant savings to MAWC and its customers.

15 **Q.** ***________________________________________________
16 ____________________________________________________
17 ________________________________________***

18 A. ***________________________________________________
19 _____________________________________________***

20 **Q. Does the fact that both PPL and MidAmerican have higher ratings and issued secured**
21 **debt further rebut Mr. Murray's erroneous assertion that if MAWC issued secured**
22 **debt it would have a 2 notch higher rating and result in lower cost debt than AWCC?**

1 A. Yes, the ratings for PPL and MidAmerican were equivalent to or higher than what Mr. Murray proports in his direct/rebuttal testimony would be MAWC's rating on a first mortgage bond and as noted the spreads were not meaningfully better than AWCCs.

4 **Q. Mr. Murray suggests that your role as the capital structure witness in this case should be interpreted as meaning you manage the capital structure for MAWC. How do you respond?**

7 A. I was assigned the role of capital structure witness in this case because of my expertise in finance and capital markets. As the Vice President and Treasurer of American Water I work with MAWC's management and other company experts in a consultancy capacity to identify a capital structure that is reasonable and balances the interests of all stakeholders. It is MAWC's board of directors that approves the final capital structure and all debt and equity capital transactions necessary to achieve their desired targets.

13 **Q. Mr. Murray notes that on a slide titled "*__As a reminder__* (emphasis added)– 2024 Approved Financing Plan" that American Water's management's requested equity infusions into its subsidiaries had ***______________________________**

16 **______________________________________________________________**

17 **____________________________________________________________*****

18 **and he would have expected ***________________________________**

19 **______________________________________________________________**

20 **______________________***[39] Why is his expectation wrong?**

21 A. The slide was part of a 2024 Financing Plan and Debt Issuance Recommendation that focused on management's desire and justification to accelerate the timing of the 2024

[39] Murray CRT, p. 6.

1 planned debt issuance from May to February and the impacts to the already approved plan.

2 Specifics on the equity investments were not relevant to the discussion.

3 **Q.** **Mr. Murray states ***______________________________________________**

4 **________________________________________________________________**

5 **____________________________________________________________*** Is**

6 **this conclusion stated in the referenced presentation?**

7 A. No.

8 **Q.** **Mr. Murray states that "As I testified in the recent Liberty Utilities (Missouri Water)**

9 **LLC rate case, Liberty Utilities Co. ("LUCo") … LUCo's bonds were more costly due**

10 **to additional risk caused by uncertainty related to the determination and execution**

11 **of Algonquin Power & Utilities Corp's acquisition and divestment strategies." Does**

12 **he provide any evidence or notes from conversations he had with the bond investors**

13 **of the LUCo bonds?**

14 A. No.

15 **Q.** **Is it possible for him to know the motivations for all the bonds investors if he did not**

16 **directly speak with all of them?**

17 A. No.

18 **Q.** **Mr. Murray states that he agrees with Staff in that American Water's diversified**

19 **portfolio of operating companies allows it to have a higher degree of leverage than its**

20 **non-diversified operating companies, but that it "certainly does not justify a**

21 **consistent 5-10% difference in…common equity ratios." Does Mr. Murray provide**

22 **any analysis to quantify the amount of difference in common equity ratios that he**

23 **deems would be acceptable?**

1 A. No.

2 **Q. Does Mr. Murray make any adjustment in his recommended capital structure for this**
3 **recognized benefit of diversification?**

4 A. No.

5 **Q. Do other regulatory jurisdictions in the AWK portfolio of operating companies**
6 **recognize this difference?**

7 A. While it may not directly be called out, nearly all of them have capital structures that are
8 independent of American Water's and specifically, as Mr. Murray details in his testimony,
9 the two largest AWK operating companies, New Jersey-American and Pennsylvania-
10 American, which combined account for approximately 50 percent of the total AWK
11 regulated utility business, have authorized common equity ratios of approximately 55
12 percent, based on their respective stand-alone capital structures. Compared to Mr. Murray's
13 recommended 45 percent common equity ratio in this preceding, it would seem, that the
14 Commissions in those two states assigns at least a 10 percent difference to the
15 diversification.

16 **Q. Mr. Murray states that American Water's 2025 financing plan does not anticipate**
17 **issuing new common equity. What does American Water's 2025-2029 financing plan**
18 **include?**

19 A. Per the American Water 2024 Third Quarter Earnings & 2025 Outlook Conference Call
20 presentation dated October 31, 2024, the 5-year financing plan includes ~$27 billion of
21 capital sources. ~$10.5 billion or ~39 percent is from debt sources the remaining ~$16.5
22 billion or ~ 61 percent is from equity sources.

23 **Q. Mr. Murray says that MAWC's BOD does not act in the sole interest of MAWC and**



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1 **its ratepayers. Is he correct?**

2 A. Yes. MAWC's board members have a fiduciary responsibility to all stakeholders, including

3 customers, regulators/policymakers, and shareholders.

4 **Q. Mr. Murray references the** **______________________________

5 ______________________________

6 ______________________________

7 ______________________________

8 ______________________________**

9 **A. No. S&P is a global 150-year-old institution that provides investors with research and**

10 **"Independent" ratings. Its assessment is its own and its findings are documented in**

11 **its reports.**

12 **Q. Mr. Murray claims "because AWCC does not directly own any assets other than its**

13 **affiliate loans, AWCC could not pledge American Water's assets (which are its equity**

14 **ownership in its subsidiaries)." Is he correct?**

15 A. No. If AWCC wanted to utilize secured financings, a vehicle it believes is suboptimal to

16 unsecured financings, it could pledge its assets which as Mr. Murray noted are the affiliate

17 loans.

18 **Q. Ms. Malki states she agrees with Mr. Murray's reasoning behind his recommended**

19 **capital structure as it follows the Society of Utility and Regulatory Analysts four**

20 **guidelines for determining when to use a parent company's capital structure. Does**

21 **Mr. Murray reference the SURFA guidelines as part of his reasoning for his**

22 **recommendation?**

23 A. No.

1 **Q. Has staff directly provided explanations of how the guidelines apply to MAWC?**

2 A. No.

3 **Q. Is the Commission required to follow the suggestions in the SURFA handbook?**

4 A. No.

5 **Q. Can you please comment on each of the four guidelines and their application in this**
6 **proceeding?**

7 A. Yes, I will address each guideline in turn.

8 (1.) Whether the subsidiary utility obtains all of its capital from its parent, or issues its own
9 debt and preferred stock.

10 As explained by Mr. Murray and Ms. Malki and myself this does not apply to MAWC
11 as it has historically issued its own debt. Additionally, as included in the Supplemental
12 testimony of witness LaGrand, and authorized by the Commission MAWC intends to
13 issue $150 million of its own debt via State Revolving Fund loans. MAWC is also
14 exploring additional opportunities for State Revolving Fund loans that could be for as
15 much as an additional $150 million of debt.

16 (2.) Whether the parent guarantees any of the securities issued by the subsidiary.

17 AWK does not guarantee any of the securities issued by MAWC and will not guarantee
18 the potential $300 million of State Revolving Fund loans. The existence or lack of an
19 economic benefit of a parent guarantee does not change this fact.

20 (3.) Whether the subsidiary's capital structure is independent of its parent (i.e., existence of
21 double leverage, absence of proper relationship between risk and leverage of utility and
22 non-utility subsidiaries)



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1 As referenced above, Beranek and Miles (1988) have found that the only condition
2 where a parent consolidated capital structure adjustment may be valid is if the parent
3 has only one operating subsidiary or if the parent's operating subsidiaries are regulated
4 and have identical equity costs, which is obviously not the case for **________
5 ________________________________________________________________
6 ____________________________________________________**

7 (4.) Whether the parent (or consolidated enterprise) is diversified into non-utility
8 operations.
9 AWK's non-regulated utility operations account for ~15 percent of its 2023 revenues.

10 **Q. Can you please summarize your Rebuttal/Surrebuttal/Sur-Surrebuttal Testimony?**

11 A. Missouri-American's stand-alone capital structure is the appropriate capital structure for
12 determining the overall cost of capital and setting rates in this proceeding. As I have
13 demonstrated it keeps with the Commission's charge to balance the interest of all
14 stakeholders, recognizes MAWC's distinct risk profile, allows MAWC to maintain access
15 to low cost financing, is in line with the capital structures and returns on equity for utility
16 companies with comparable risk profiles and most importantly, it maintains sound
17 regulatory policy all of which give confidence to investors which allows MAWC continued
18 access to cost efficient capital, enabling it to execute on its mission to deliver safe, reliable
19 and clean water and wastewater services to its Missouri customers.

20 **Q. Does this conclude your Rebuttal/Surrebuttal/Sur-Surrebuttal Testimony?**

21 A. Yes.