

Exhibit No.:
Issue: *Rate of Return/Capital Structure*
Witness: *David Murray*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Rebuttal Testimony*
Case Nos.: *ST-2003-0562 and*
WT-2003-0563
(Consolidated)
Date Testimony Prepared: *January 9, 2004*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

DAVID MURRAY

OSAGE WATER COMPANY

CASE NOS. ST-2003-0562 and WT-2003-0563
(CONSOLIDATED)

Jefferson City, Missouri
January 2004

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In The Matter of Sewer and Water Tariff
Filings made by Osage Water Company

) Case No. ST-2003-0562 and
) Case No. WT-2003-0563
(Consolidated)

AFFIDAVIT OF DAVID MURRAY

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

David Murray, being of lawful age, on his oath states: that he has participated in the preparation of the following Rebuttal Testimony in question and answer form, consisting of 4 pages to be presented in the above case; that the answers in the following Rebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.



David Murray

Subscribed and sworn to before me this 8th day of January 2004.





Notary

TONI M. CHARLTON
NOTARY PUBLIC STATE OF MISSOURI
COUNTY OF COLE
My Commission Expires December 28, 2004

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REBUTTAL TESTIMONY

OF

DAVID MURRAY

OSAGE WATER COMPANY

CASE NOS. ST-2003-0562 & WT-2003-0563

(Consolidated)

Q. Please state your name.

A. My name is David Murray.

Q. Are you the same David Murray who filed direct testimony in this proceeding for the Staff of the Missouri Public Service Commission (Staff)?

A. Yes, I am.

Q. In your direct testimony, did you recommend a fair and reasonable rate of return for the Missouri jurisdictional water and sewer utility rate base for Osage Water Company?

A. Yes, I did.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to respond to the direct testimony of Mr. William P. Mitchell. Mr. Mitchell sponsored rate-of-return testimony on behalf of Osage Water Company.

Cost of Common Equity, Capital Structure and Embedded Cost of Long-Term Debt

Q. Is there agreement between Staff and Osage Water Company on the embedded cost of long-term debt?

1 A. No. Mr. Mitchell did not indicate his recommended embedded cost of
2 long-term debt in his direct testimony. He is recommending an overall rate of return of
3 18 percent. His overall rate of return recommendation is not based on Osage Water
4 Company's actual capital structure, which includes specific loans related to Osage Water
5 Company's water and sewer systems. Based on information that Staff retrieved from an
6 audit of Osage Water Company's books, I discovered that the cost of the loans associated
7 with Osage Water Company's investment in its water and sewer system was 6 percent.
8 This is the cost of long-term debt that is reflected in my rate of return recommendation,
9 which is based on Osage Water Company's actual capital structure as of June 30, 2003.

10 **Mr. Mitchell's Recommended Rate of Return for Osage Water Company**

11 Q. What is Mr. Mitchell's recommended rate of return for Osage Water
12 Company?

13 A. Mr. Mitchell is recommending a rate of return of 18 percent for Osage
14 Water Company.

15 Q. Does Mr. Mitchell provide any analysis and/or support for this
16 recommended rate of return?

17 A. No. Mr. Mitchell did not analyze any publicly-traded water and/or sewer
18 utility companies in order to arrive at his recommended rate of return. He subjectively
19 recommends a rate of return of 18 percent without any supporting analysis. It is
20 important to analyze a comparable group of publicly-traded water and/or sewer utility
21 companies in order to determine a reasonable rate of return to be applied to a private
22 water and sewer utility company. This is exactly what I did in my direct testimony. An
23 analysis of publicly-traded water and/or sewer utility companies, such as I performed,

1 allows the witness to apply the Discounted Cash Flow Model, which is the model that
2 this Commission prefers, in determining an appropriate cost of common equity to apply
3 to the subject company's common equity ratio in its capital structure.

4 Q. What is Mr. Mitchell's implied recommended return on common equity if
5 he had utilized Osage Water Company's actual capital structure as of June 30, 2003?

6 A. If Mr. Mitchell had utilized Osage Water Company's actual capital
7 structure as of June 30, 2003, he would have to recommend a return on common equity of
8 19.70 percent in order to arrive at an overall rate of return of 18 percent, which includes
9 the debt capital that is appropriately included in the rate of return calculation. This
10 recommended return on common equity would be the highest recommendation that I
11 have ever encountered in a utility rate case and is extremely high considering that the cost
12 of capital is quite low because of the current low interest rate environment.

13 **Summary and Conclusions**

14 Q. Please summarize the conclusions of your rebuttal testimony.

15 A. My conclusions regarding the capital structure and cost of common equity
16 are listed below.

- 17 1. Mr. Mitchell's rate of return recommendation of 18 percent is
18 inappropriate. It is not supported by any analysis and it is not
19 based on Osage Water Company's actual capital structure, which
20 includes low cost debt.
- 21 2. My cost of common equity stated on Schedule 20 attached to my
22 direct testimony, which is 7.93 percent to 8.93 percent, would
23 produce a fair and reasonable rate of return of 7.69 percent to

1 8.57 percent for the Missouri jurisdictional water and sewer utility
2 rate base for Osage Water Company.

3 Q. Does this conclude your rebuttal testimony?

4 A. Yes, it does.