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Case No.:	WR-2022-0303
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Date:	January 18, 2023

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. WR-2022-0303

REBUTTAL TESTIMONY

OF

J. CAS SWIZ

ON BEHALF OF

MISSOURI-AMERICAN WATER COMPANY

AFFIDAVIT

I, J. Cas Swiz, under penalty of perjury, and pursuant to Section 509.030, RSMo, state that I am Senior Director, Regulatory Services for American Water 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.

J. Cas Swiz

J. Cas Swiz

January 18, 2023
Dated

REBUTTAL TESTIMONY
J. CAS SWIZ
MISSOURI-AMERICAN WATER COMPANY
CASE NO.: WR-2022-0303

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REBUTTAL TESTIMONY

J. CAS SWIZ

I. Introduction

Q. Please state your name and business address.

A. My name is J. Cas Swiz. My business address is 727 Craig Road, St. Louis, Missouri 63141.

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

A. I am employed by American Water Works Service Company, Inc. ("Service Company") as Senior Director of Regulatory Services. Service Company is a wholly owned subsidiary of American Water Works Company, Inc. ("American Water") that provides services to Missouri-American Water Company ("Missouri-American", "MAWC", or the "Company").

Q. Please summarize your educational background and professional experience.

A. I am a 2001 graduate of the University of Evansville with a Bachelor of Science degree in Accounting, and a 2005 graduate of the University of Southern Indiana with a Master of Business Administration. From 2001 to 2003, I was employed by ExxonMobil Chemical as a Product and Inventory accountant. From 2003 through 2020, I was employed by Vectren Corporation and CenterPoint Energy in various accounting and regulatory roles. Most recently, I was Director, Regulatory and Rates with responsibility for leading and executing the regulatory strategy of CenterPoint Energy's Indiana and Ohio electric and gas jurisdictions. In November 2020, I was hired by the Service Company within Regulatory Services.

Q. On whose behalf are you submitting this Rebuttal Testimony?

A. I am submitting my testimony on behalf of MAWC.

Q. Did you provide Direct Testimony in this case?

A. No, I did not.

Q. Are you adopting any Direct Testimony in this case?

A. Yes. I am adopting the Direct Testimony of James Merante in this proceeding.

Q. If you were asked the same questions as those asked in Mr. Merante's Direct Testimony, would your responses be the same?

A. With one exception, yes. With respect to the role that I play regarding MAWC's debt financing, Merante DT, p. 10, lines 2-4, my responsibilities are also support focused, *i.e.,* I support MAWC's management and finance teams in the execution of MAWC's financing plan. However, in my role as Senior Director of Regulatory Services, my role is focused on rates and the ratemaking process.

Q. Are there any other modifications you would make to Mr. Merante's Direct Testimony, as adopted?

A. No. In fact, throughout this Rebuttal Testimony when I reference "my Direct Testimony," I will be referring to the Direct Testimony of Mr. Merante.

Q. Have you previously submitted testimony before regulated jurisdictions?

A. Yes. I testified on behalf of Pennsylvania-American Water Company in its most recent base rate case, Docket Nos. R-2022-3031672 and R-2022-3031673. During my prior employment, I testified on behalf of Vectren Corporation, a CenterPoint Energy Company, in Indiana before the Indiana Utility Regulatory Commission in various docketed proceedings supporting accounting and rate design requests, most recently in Cause Nos.

45378, 44429, and 44430. In addition, I testified on behalf of Vectren Corporation in Ohio before the Public Utility Commission of Ohio in various docketed proceedings, most recently in Case Nos. 20-0099-GA-RDR, 20-0101-GA-RDR, and 18-0298-GA-AIR.

Q. What is the purpose of your Rebuttal Testimony in this proceeding?

A. The purpose of my Rebuttal Testimony is to respond to recommendations of Staff witness Randall T. Jennings and OPC witness David Murray to use the consolidated capital structure of American Water Works Company, Inc. ("American Water" or "AWK"[1]) for the purpose of setting Missouri-American's rates.

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

A. My rebuttal responds to Staff and OPC's recommendation based on erroneous assumptions to use a consolidated capital structure for setting MAWC's rates. Specifically, my Rebuttal Testimony will support the use of MAWC's stand-alone capital structure for the following reasons:

- The Commission is charged with balancing the interests of all stakeholders in the ratemaking process. The use of a consolidated capital structure for setting rates in this proceeding is inconsistent with the Commission's charge, is not sound regulatory policy, and fails to satisfy the long-term best interest of customers by materially impacting MAWC's overall operations and investments in the State;
- MAWC is a stand-alone business enterprise with independent state operations, capital investments, management, and corporate governance, all of which support the use of its stand-alone capital structure for setting rates;

[1] Referenced as "AWWC" in Staff testimony.

- MAWC's stand-alone capital structure appropriately reflects its distinct risk profile, which contrary to Staff and OPC's assertions, is unlike 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 structures and returns on equity ("ROEs") for utility companies with similar risk profiles (as described by MAWC witness Bulkley);
- 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 results in the need for a higher equity return. Staff and OPC fail to recognize that investors in equity seek a return that is commensurate with the risk of that investment, not the source of the funds used to make the investment;
- 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 and is aligned with its peers;
- The use of a consolidated capital structure for ratemaking purposes would make Missouri-American an outlier among MAWC peer utilities;
- As part of the larger American Water enterprise, MAWC's customers benefit from American Water's size and scale to realize cost savings;

- Relying on the consolidated capital structure for setting rates could limit the options for Missouri-American to attract capital on a stand-alone basis; and
- If ordered to set rates on the basis of a consolidated capital structure, and as a result of the limitations this could place upon MAWC's access to capital, MAWC's ability to make continued cost-effective investments in troubled systems will cease and proactive system improvements will be greatly reduced.

II. Sound Regulatory Policy Dictates the Use of MAWC's Capital Structure for Ratemaking Purposes

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

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

> Regulators are charged with balancing the interests of investors and customers. Utility management has a fiduciary responsibility to deploy investors' capital productively. Investors recognize the importance of regulatory and stakeholder relationships and expect utility management to provide safe, reliable, and affordable service to customers in order to preserve and enhance the value of their invested capital. In many ways, the interests of investors and customers are aligned and not in conflict and can become more aligned through regulatory policy. Regulators are more effective at serving customers when they harness investors' desire to provide capital rather than constrain it.[2]

[2] "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.

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

A. The policies that are established by the Commission provide the framework for future investment in the utilities that they regulate. If the Commission does not properly balance the interests of all stakeholders in the ratemaking process, such that the financial metrics of the regulated utility are weakened, the result would likely be slowed investment in the operations in the jurisdiction. While the Company will always maintain a safe and reliable system, proactive investments in the MAWC system, as well as acquisitions of troubled water systems in Missouri cannot continue to occur at current levels if they are not supported by positive regulatory policy. MAWC's investments in infrastructure in Missouri provides positive benefits for customers, and the Missouri economy overall, including job creation.[3] In contrast, regulatory policy that directs investment out of Missouri is not in the best interest of customers or the communities served.

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

A. Only in the short run. An arbitrary adjustment that lowers the equity component of Missouri American's actual capital structure will result in a lower revenue requirement, and thus, reduce rates for customers today. However, as discussed later in my Rebuttal Testimony, and in Ms. Bulkley's Rebuttal Testimony, reducing the Company's equity ratio has other financial implications that will increase costs. Specifically, as Ms. Bulkley states, increased leverage results in increased overall financial risk that could be reflected in credit ratings and higher costs of debt issuances in the future. In addition, higher leverage

[3] Svindland DT, p. 8

increases the risk to holding equity, which increases the investor-required ROE. Therefore, over the long-run greater leverage does not necessarily result in lower costs to customers.[4] Such a trade-off does not serve the long-term best interest of customers and is not sound regulatory policy.

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

A. First, as discussed in greater detail below, 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. As Ms. Bulkley explains in detail, the application of a higher debt component of the capital structure increases overall financial risk and results in the need for a higher equity return.[5] Equity capital investors seek a return that is commensurate with the risk of that investment, not the cost of the funds used to make the investment. The risk profile of AWK differs from the risk profile of MAWC. While each individual operating company bears its own jurisdictional risk, AWK has the benefit of diversification across the system and therefore may have lower overall risk than any of the individual operating companies. Thus, it is unreasonable to suggest that the AWK capital structure, which reflects a different risk profile than MAWC, should be imposed at the operating company level. Moreover, there are other jurisdictions to consider. Those jurisdictions properly acknowledge and value the benefits of participating in the Financial Services Agreement ("FSA") for purposes of obtaining debt financing at a reasonable cost while also recognizing that this does not equate to rendering the operating

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[4] Bulkley RT, p. 24

[5] Bulkley RT, pp. 35-38.

utility's business risk equivalent to that of its parent. The cost of capital across the regulated utilities is demonstrably different. They operate in different geographic locations, with different operational characteristics (including size and customer base), and most importantly different regulatory environments.

As explained throughout this testimony, using the AWK consolidated capital structure to set MAWC's rates would ultimately increase the cost of capital for MAWC and result in higher costs to customers. It is bad policy for the Commission to start selecting aspects of the holding company structure that appear beneficial to customers in the immediate term without fully considering the likely outcome over time of a regulator-imposed fundamental shift of MAWC's risk. The Commission has recognized as much when it found in the case of Spire that where a holding company has multiple regulated utility subsidiaries operating in different states, "if the parent company's capital structure were used, regulatory policies employed by commissions in . . . other states . . . and financing practices followed by utilities or entities not regulated by the Commission, would affect the rates customers pay in Missouri."[6]

III. <u>MAWC is an Independent Operating Entity with Risks Distinct from American Water</u>

Q. Staff's recommendation is to use the consolidated capital structure of American Water based on Mr. Jennings's statements that MAWC does not operate as an independent entity. How do you respond?

A. As explained in my Direct Testimony, Missouri-American is a separate legal entity with independent state specific operations, capital investments, management and corporate

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

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

Q. Staff cites to MAWC's participation in the FSA and what Staff characterizes as "heavy integration" of MAWC's financial management with AWK's other operations in support of its recommendation to impute the consolidated capital structure for ratemaking purposes. How do you respond?

A. As explained throughout this Rebuttal Testimony, MAWC has its own risk profile and independent management and operations. Contrary to Mr. Jennings' statement that "all debt issued by American Water Capital Corporation ("AWCC") and loaned to MAWC is essentially guaranteed by AWWC[7]", AWK's assets do not secure, and AWK does not guarantee, MAWC's debt. Likewise, MAWC's assets do not secure, and MAWC does not guarantee, AWK's (or in this case, AWCC) debt.

[7] Jennings DT, page 25, lines 11-12.

Q. Staff witness Jennings further recommended the use of a consolidated capital structure based on his assertion that AWCC is the primary source of debt financing for MAWC. What, if any, impact should the source of debt financing have on the capital structure used to establish MAWC's rates?

A. The fact that AWCC is the primary source of the debt financing for MAWC is not a basis to establish the use of AWK's consolidated capital structure. As discussed in my Direct Testimony the use of AWCC debt has resulted in savings for customers from the ability to access the markets for larger scale issuances at lower costs at the AWCC level. But MAWC's stand-alone capital structure reflects how the utility is actually capitalized, and the primary use of AWCC is only because it is an efficient and lower cost way to issue debt. This benefit does not warrant the use of the consolidated capital structure.

Q. Staff asserts that MAWC's business risk is similar to the business risk of AWK.[8] Do you agree with this assertion?

A. No, I do not. A company's business risk refers to its ability to generate sufficient revenue and cash flows to cover its operational expenses and debt service requirements. MAWC operates entirely within the state of Missouri with no financial, regulatory or geographic diversity. MAWC represents approximately l0 percent of revenues from the regulated operating subsidiaries of AWK.[9] Notably, for the last decade, Missouri-American has not collected the revenues authorized by this Commission[10]. In contrast, American Water consolidated is advantaged by the diversification of financial and regulatory risk across many regulatory jurisdictions. It is also advantaged from the diversification of business

[8] Jennings DT, p. 24, lines 11-14.
[9] SEC Form 10-K, December 31, 2021, p. 5.
[10] LaGrand DT, p. 10, Table BWL-1.

risk through operations in multiple geographic locations, including cash flow positive Market-Based businesses, as part of its consolidated holdings. AWK has regulated subsidiaries across multiple regulatory jurisdictions, serving 3.4 million water and wastewater customers.[11]

The notion that AWK's overall risk is equivalent to the financial and business risk of MAWC is false. The risk across the AWK 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 one of the three largest utility subsidiaries of AWK. It is one of only 4 without access to a fully forecasted test year for ratemaking purposes[12] 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 group of companies, which in turn, support different levels of financial risk and capital structures.

Mr. Jennings acknowledges this when he states that it is reasonable to assume AWK can take on greater leverage than MAWC because of AWK's lesser financial and business risk and further notes that "it is not always appropriate to use the parent company's cost of common equity if the parent company's risk profile is significantly different from that of its regulated subsidiaries."[13] In fact, Staff's position contains several internal inconsistencies, stemming from its tendency to selectively reference consolidation. For

[11] AWK 2021 10-K, p. 4.
[12] Defined as rates that go into effect no later than the beginning of the test year.
[13] Jennings DT, p. 25, lines 6-10.

example, Staff argues on the one hand that the cost of equity is most appropriately examined with reference to comparable risk utility companies, and notes that the greater leverage present in AWK's capital structure is a result of its lesser financial and business risk, but in the same breath makes conclusory statements that the risks of AWK are similar to those of MAWC, though Staff does appear to limit this observation by the phrase "in terms of sector risk."[14] While Mr. Jennings asserts that "*if* the business risks of the parent company are similar to those of the subsidiary, then each entity should be able to incur similar amounts of financial risk [and] this *should* cause their capital structures to be fairly similar" (emphasis added)[15] he does not attempt to reconcile this with his observation that AWK has diversified equity investments in its subsidiaries and can take on greater leverage than MAWC due to its lesser financial and business risk.

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

A. These "debt capacity" or similar arguments have been repeatedly rejected in this and nearly all other jurisdictions. Their adoption would only serve to reduce investor confidence in the supportiveness of the Missouri regulatory environment. Mr. Murray acknowledges that Missouri American has its own internally managed capital structure.[16] That is true of each

[14] Jennings DT, p. 24, lines 11-12.
[15] Jennings DT, p. 24, lines 12-15.
[16] Murray DT, p. 6.

of the American Water regulated subsidiaries, and nearly all of the other regulated subsidiaries are not made to suffer the fiction of a consolidated capital structure. As described above, as a matter of financial theory and regulatory practice, it is the use to which funds will be put once they are invested, not the source of the funds, that determines the risk-required rate of return on equity. As a more practical matter, Mr. Murray's argument relies on a determination of whether the funds invested by each investor were borrowed, which is an unreasonable and unworkable approach. AWK has invested in MAWC as an equity investor, bearing the same risks as any equity investor would have in the entity, and therefore requires an appropriate return that is consistent with investments of similar risk.

Q. OPC witness Murray takes issue with what he calls a "widening divergence" between AWK's use of leverage (*i.e.,* debt) at the consolidated level and the amount of leverage reflected in MAWC's requested ratemaking capital structure. Do you agree with him that AWK's financing strategy is "an abuse of MAWC's affiliation with its parent company"?

A. No. As I have described on direct and in this rebuttal, customers benefit from MAWC's relationship with its affiliates, especially through its participation in the Financial Services Agreement with AWCC. That does not, however, change the fact that MAWC has a distinct risk profile from its parent company and from its other regulated affiliates, and the requested ratemaking capital structure is commensurate with MAWC's risk. Moreover, MAWC's projected capital structure for purposes of this case is consistent with the capital structures of similarly situated operating utilities. As shown in Figure 3 of Ms. Bulkley's Rebuttal Testimony, the mean equity ratio of the proxy group companies as of the end of

2021 was 53.42 percent. The appropriate comparison point for whether MAWC's capital structure for ratemaking purposes should reflect greater leverage is to compare to other regulated operating utilities, not the parent company.

IV. Application of the Consolidated Capital Structure as Proposed by Staff and OPC Deviates from the Stand-Alone Principle

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

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

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

A. The appropriate capital structure for MAWC is based on consideration of MAWC-specific factors, such as the future revenues and cash flows, overall scale and complexity of the utility's capital program, asset condition risk, future acquisitions, and the regulatory environment, including sufficiency and timeliness of cost and investment recovery. MAWC's capital structure is maintained to support a strong balance sheet with adequate capacity and strong credit metrics to allow MAWC to have sufficient access to low-cost financing through all financing sources, including through AWCC. It is in line with the capital structures and ROEs for utility companies with similar risk profiles, as described by MAWC witness Bulkley. Further, as shown in Figure 4 of Ms. Bulkley's Rebuttal Testimony, the MAWC capital structure is within the range established by the authorized capital structures for natural gas and water utilities over the past three years.

V. <u>Use of AWK's Consolidated Capital Structure for Ratemaking in Missouri Would Adversely Affect Missouri Customers</u>

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

A. It represents a fundamental departure from the way MAWC is actually capitalized and therefore does not accurately reflect MAWC's business risk. As I will explain in greater detail below, imposing the American Water consolidated capital structure for ratemaking will: 1) negatively impact MAWC's financial strength including reducing its cash flows, earnings, and weakening its credit metrics that will negatively impact its ability to attract low cost capital through AWCC as well as through outside sources of capital; 2) result in higher debt and equity financing costs for customers in the long-term; and 3) negatively impact ongoing and future investment in MAWC. As I described in detail in my Direct Testimony, MAWC customers benefit from MAWC's participation in the FSA. Estimated savings to MAWC customers from MAWC's participation in debt offerings under the Financial Services Agreement were quantified at $30 million through the end of 2021, including interest expense, issuance cost and administrative cost savings, as detailed in Table JSM-2 of my direct testimony. An estimated additional $87 million in total cost savings is expected to be realized by MAWC customers through the remaining term of the currently outstanding debt, and ongoing future savings to customers are expected if MAWC continues to utilize AWCC for future financings.

Q. Please explain how the use of the consolidated capital structure will weaken MAWC's

credit profile, thereby limiting its ability to attract low cost capital through AWCC and through outside sources of capital.

A. The lower equity ratio at the consolidated level would introduce more financial risk to Missouri-American. The higher leverage would both weaken Missouri-American's credit metrics and increase the Company's borrowing costs.

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

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 the Company 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.[17]

Q. OPC witness Murray recommends a cost of debt of 4.06% based primarily on AWCC's embedded cost of debt. Do you agree with his recommended cost of debt?

A. No. Mr. Murray's recommended cost of debt is based on a 97.42 percent weighting of AWCC's embedded cost of debt of 4.02 percent and a 2.58 percent weighting to the embedded cost of debt from four 3rd party debt issuances of MAWC. Mr. Murray's estimated cost of debt is unsupported and incorrectly suggests that MAWC has received a

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[17] ** **

pro-rata allocation of every AWCC debt issuance. Mr. Murray provides no evidence to support this theory. The cost of debt that is proposed by MAWC reflects the costs associated with the specific debt issuances of AWCC, and the third-party debt issuances made by MAWC that were used to fund MAWC operations. As discussed in the Direct Testimony of Mr. Merante and as shown in Figure 6 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.

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

A. Imputing the consolidated cap structure weakens MAWC's balance sheet, cash flows and credit metrics by increasing the amount of leverage to a level that MAWC cannot support based upon its independent risk profile. This could in turn weaken AWCC credit metrics and qualitative risk profile if MAWC – again as one of the largest three operating utilities of AWK – were permitted to continue to participate alongside its affiliates. It is estimated that AWCC's FFO/Debt would be negatively impacted by 20-30 basis points. In addition, it is my understanding that the credit rating agencies would view Missouri's regulatory environment as credit negative from a qualitative business risk perspective. This would unfairly deprive those other affiliates, and MAWC itself, of the benefits of participating in the financial services agreement to the tune of an estimated 15-20 basis points on future coupon rates. To mitigate the impact on AWK as a whole, Missouri-American would likely be foreclosed from using AWCC in the future and would have to raise capital on its own.

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

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

In Figure 6 of her Rebuttal Testimony Ms. Bulkley compares the yields on the Moody's utility bond indexes to the interest rates on AWCC debt issuances as of the date of issuance. As shown in that figure, in nearly all circumstances, the interest rates obtained by AWCC have been lower than the yield on the Moody's utility bond index at the time of the AWCC issuance. This analysis provides further evidence of the advantage of low-cost financing available through AWCC.

Q. Can MAWC currently access financing other than through AWCC?

A. Yes. Under the agreement with AWCC, MAWC is free to seek financing elsewhere if it can obtain more favorable terms than offered by AWCC. Although, in most cases, AWCC has been the lowest cost source of capital, this provision is an important protection for MAWC and its customers. If, however, MAWC found itself in a position where it was advantageous to seek capital from a source other than AWCC, it is my understanding that imposing the consolidated capital structure on MAWC could result in weaker credit metrics that would limit MAWC's options for access to cost-effective capital from sources other than AWCC and would result in overall higher financing costs for MAWC.[18]

Q. How would use of a capital structure that differs from Missouri-American's stand-alone capital structure affect Missouri-American's authorized ROE?

A. If the Commission were to impute a capital structure consisting of more debt than the Company's test year capital structure, as stated in the Rebuttal Testimony of Company witness Bulkley, a higher common equity cost rate related to a changed common equity ratio should be reflected in the approach to determining the ROE. It is a fundamental tenet of finance that the greater the amount of financial risk borne by common shareholders (in other words, the greater the debt ratio), the greater the return required by shareholders. If a lower equity ratio were to be imposed, the cost of equity must be adjusted to reflect the additional risk associated with the more debt-heavy imputed capital structure. In Figure 8 of her Rebuttal Testimony, Company witness Ms. Bulkley quantifies the effect on cost of equity from a reduction to Missouri-American's equity ratio. As shown in that figure, reducing the equity ratio of Missouri-American to the levels proposed by Staff and OPC would result in an equity return of 11.74 percent based on the Staff's proposal and 11.82 percent based on OPC's proposal.

Further, Ms. Bulkley's cost of equity analysis is based on a proxy group of like companies to determine the ROE for Missouri-American. The returns that are established by investors for the proxy companies take into consideration the risk related to the capitalization of those companies. To the extent that the capital structure that was authorized for Missouri-American were to deviate significantly from the range established by the proxy group used

[18] *See also* Bulkley RT, p. 29.

to determine the ROE, that risk difference must be reflected in the equity return. To do otherwise, would mismatch risk and return if the equity ratio used for Missouri-American were to differ substantially from the mean of the proxy group upon which the ROE is determined.

Q. Can you quantify the effect on ROE of imputing American Water's consolidated capital structure to MAWC for ratemaking purposes?

A. Under Staff's and OPC's capital structure recommendations, a higher ROE would be required than under MAWC's current capital structure and debt coverage levels. MAWC's current authorized ROE is 9.55 percent,[19] which, as described in the Direct Testimony of Ann Bulkley, is already too low and should be increased to 10.5 percent based on ROEs of similar regulated utility companies including AWK's other regulated subsidiaries. The proxy group relied upon in her Direct Testimony, which is a group of utilities with similar business and financial risk profiles as Missouri-American had a "mean" equity ratio of approximately 56 percent and the equity ratios of American Water's other regulated water utilities range from approximately 48 percent to 55 percent. As shown in Figure 3 of her Rebuttal Testimony, using an updated proxy group, the mean equity ratio for the proxy group was 53.42 percent in 2021 and the range was approximately 44 percent to 61 percent. MAWC's equity ratio is already on the low end of that range and is far below the proxy group average. At MAWC's current equity ratio of approximately 50 percent, its current equity return is approximately 4.78 percent (50% Equity x 9.55% ROE). Considering OPC's proposal, which is an equity ratio of 40.45 percent and an ROE of 9.00 percent the weighted ROE would be only 3.64 percent, Staff's recommended ROE and equity ratio

[19] The stated authorized ROE of 9.55% is the Company's view of the ROE authorized in its last base rate case. Neither the Stipulation nor the Order specifically identify an authorized ROE.

result in a weighted ROE of 3.96 percent. Both of these recommendations are well below the average of other American Water operating companies. Further, these equity return proposals are lower than any authorized equity ratio in Missouri and as shown in Figure 5 of Ms. Bulkley's Rebuttal Testimony, are well below any authorized equity return for a natural gas or water utility over the past three years. In order to maintain the Company's current equity return of 4.78 percent, at an equity ratio of approximately 40.5 percent, as proposed by the OPC, MAWC would need to earn an ROE of 11.80 percent. Moreover, as shown in Figure 4 of Ms. Bulkley's Rebuttal Testimony, the Company's actual equity is well within the range of recently authorized equity ratios for natural gas and water utilities over the past three years.

Q. Please explain how the use of the consolidated capital structure would negatively impact ongoing investment in MAWC.

A. While MAWC is committed to continuing to make investments required to ensure safe and reliable service for the long-term benefit of customers, its access to capital for other new investments could be chilled by a negative regulatory climate generated by abandoning the stand-alone principle and adopting arguments related to imputed capital structures or similar adjustments that have been rejected in most other jurisdictions. See also the Direct and Rebuttal Testimony of Company witness Jeffrey Kaiser regarding the planned, ongoing investment in Missouri and the Direct Testimony of Company witness Richard Svindland regarding the Company's commitment through acquisitions to improve water and wastewater service for customers currently served by troubled systems. MAWC's commitments are contingent on its ability to earn a reasonable return. As shown in Figure 5 of Ms. Bulkley's Rebuttal Testimony, the combination of the ROE and equity ratios proposed by Staff and OPC are significantly below the average equity return for all AWK operating utilities. Applying the consolidated capital structure for ratemaking purpose increases the risk of equity investment in MAWC, which will increase the financing costs incurred by MAWC and will negatively impact MAWC's proactive investments in the system and troubled systems acquisitions in Missouri.

Q. Does that conclude your Rebuttal Testimony?

A. Yes, it does.