Exhibit No. 37

MAWC – Exhibit 37
J. Cas Swiz
Surrebuttal Testimony
File No. WR-2022-0303

Exhibit No.:	
Issues:	Capital Structure and Cost of Capital
Witness:	J. Cas Swiz
Exhibit Type:	Surrebuttal
Sponsoring Party:	Missouri-American Water Company
Case No.:	WR-2022-0303
Date:	February 8, 2023

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. WR-2022-0303

SURREBUTTAL 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

February 8, 2023
Dated

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

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SURREBUTTAL 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. Are you the same J. Cas Swiz who previously adopted direct and submitted Rebuttal Testimony in this proceeding on behalf of Missouri-American Water Company ("MAWC", "Missouri-American", or the "Company")?

A. Yes.

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

A. The purpose of my Surrebuttal Testimony is to respond to the Rebuttal Testimony of Staff witness Randall T. Jennings and OPC witness David Murray, recommending the use of 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 surrebuttal?

A. Both Mr. Jennings and Mr. Murray recommend the use of the AWK consolidated capital structure for ratemaking purposes in this case, claiming that the use of MAWC's actual capital structure is unreasonable. Each have stated that MAWC should be regulated using a consolidated capital structure because MAWC utilizes AWCC for its financing needs to the financial benefit of its customers[2]. This reasoning is inconsistent with (1) the actual

[1] Referenced as "AWWC" in Staff's testimony.
[2] Merante DT, page 13.

financing of MAWC's Missouri rate base, (2) the risk profile of MAWC as a Missouri utility, and (3) peer utilities who MAWC competes with for necessary financing. In addition, both Mr. Murray and Mr. Jennings erroneously opine that because MAWC is not separately rated by S&P and Moody's, the consolidated profile of American Water is the only evaluation point for credit analysis. The Company continues to support that the business and financial risk of MAWC is different than the diversified structure of AWK. To utilize AWK's consolidated capital structure for ratemaking purposes in this case would impute regulatory policies and practices of other states on MAWC customers, increase the risk of investing in MAWC, and ultimately increase costs for customers.

As demonstrated in both direct and rebuttal testimony (1) MAWC is a stand-alone business enterprise, with independent state operations, capital investments, management, and corporate governance; (2) MAWC's customers benefit from American Water's size and scale to realize cost savings in securing necessary financing; (3) MAWC's stand-alone capital structure appropriately reflects its distinct risk profile, which is unlike the business and financial risks of American Water; (4) MAWC's capital structure is in line with the capital structures and return on equity expectations for utility companies with similar risk; and (5) deviating from the stand-alone principle would create adverse impacts to customers.

II. MAWC Operates as an Independent Entity with a Financing Structure that Benefits Customers

Q. Both Mr. Jennings[3] and Mr. Murray[4] have claimed that MAWC is not an

[3] Jennings RT, pages 19-21.
[4] Murray RT, page 9.

independent operating entity under the current financing structure with AWCC. Please respond.

A. As reflected in MAWC direct and rebuttal testimony by multiple witnesses in this proceeding, MAWC is a separate legal entity with independent Missouri-specific operations, management, and corporate governance. MAWC has Missouri-specific rate base and investment needs which required cost-effective financing specific to those assets that serve Missouri customers. As discussed further below and in my Rebuttal Testimony, MAWC has a distinct risk profile consistent with its state-specific operations. To ignore the position that MAWC is an independent entity results in an outcome that deviates from the stand-alone principle.

Q. Mr. Jennings states that "MAWC does not need to manage its financial risk to appease potential debt investors."[5] Mr. Murray further states that "American Water is managing MAWC's capital structure for ratemaking purposes rather than for purposes of achieving a lower-cost of capital."[6] How does MAWC manage its capital structure?

A. MAWC manages its capital structure through consideration of state-specific operating factors, including future revenues and cash-flows, overall scale and complexity of the capital program, conditions and risks of assets, and future acquisitions. MAWC management also looks at the Missouri regulatory environment, specifically the ability to achieve sufficient and timely recovery of the costs incurred to serve its customers. The overall goal is to maintain a strong balance sheet with financial-based metrics that will

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[5] Jennings RT, page 21.
[6] Murray RT, page 17.

allow MAWC to obtain low-cost financing through all sources, including AWCC.

MAWC's financing also requires reporting that dictates the measurement and use of MAWC's actual book capital structure. Specifically, MAWC is required to produce audited financial statements in accordance with GAAP under the Company's existing mortgage bonds. Therefore, MAWC's book capital structure and financial risk is and will continue to be relevant regardless of how MAWC secures its financing.

Ms. Bulkley in her Rebuttal Testimony also supports the fact that MAWC's capital structure is consistent with the authorized level for entities that it ultimately competes with for this low-cost financing.[7] To deviate from this reasonable level for ratemaking purposes would increase MAWC's overall financial risk, weaken its financial metrics, and ultimately increase the cost of financing its Missouri rate base.

Q. Mr. Murray states in his Rebuttal Testimony that "American Water funds equity infusions through inter-company borrowing from AWCC, not through equity issuances."[8] Is this an accurate statement?

A. Mr. Murray's statement incorrectly assumes that cash available to American Water is segregated in a manner to define specifically where the source of the funds originated. However, this statement ignores the fact that American Water also receives dividends from each of its operating subsidiaries.

Q. Should the source of the funds received and invested by the investor impact how MAWC, the receiver of such funds, is regulated?

A. No.

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[7] Bulkley RT, pages 25-28 (Figures 3, 4, and 5).
[8] Murray RT, page 13.

Q. Should investments in MAWC made by any entity be segregated in a way that defines how those funds were originally obtained?

A. No.

Q. Should an equity investor in MAWC expect a different return on their investment based on how that investor generated its funds?

A. No. The return expected by an investor is and should be commensurate with the risk of the investment. As discussed in Ms. Bulkley's Rebuttal Testimony, there are differences in the risk profile of MAWC and the risk profile of American Water.[9] American Water is a diversified holding company with regulated operations across 13 regulatory jurisdictions with a more diversified customer base across all the regions. In contrast, the operations of MAWC are consolidated in the customer base in Missouri and the regulatory oversight of this Commission. Therefore, the risks associated with MAWC should be based on the risks of the MAWC operations, not the parent company risk profile. In determining the investor-required return on equity, it is reasonable to compare the risk of MAWC to the risk of other similar utility operating company investments. An investor should only be willing to invest in MAWC if the return offered is comparable to the return that can be received on an investment in another risk-comparable utility. It is the purpose of the Commission to balance the interests of these investors with all stakeholders by allowing the utility an opportunity to earn a fair and reasonable return on the investments made to serve its customers.

Using a very simplified example, assume an individual takes out a second mortgage to invest in a mutual fund to build retirement savings. That individual investor would expect

[9] Bulkley RT, pages 20-21.

the market to provide a return in line with all other investments in the mutual fund, subject to the risk profile of that mutual fund. The cost of the money invested would represent nothing other than a hurdle rate for this individual investor. In no way would the investor evaluate the mutual fund return as anything different than what the market would dictate; similarly, the mutual fund return would not be limited to the originating cost of the proceeds used to invest by the individual investor.

Q. Do you agree with the position of both Mr. Jennings[10] and Mr. Murray[11] whereby they opine that the majority of long-term debt financing for MAWC is sourced from AWCC therefore, MAWC's state-specific capital structure is unreasonable for ratemaking purposes?

A. No. These positions ignore that the financing structure in place with AWCC results in the lowest cost financing for customers. As I detailed in my Direct Testimony, this financing structure has generated nearly $30 million of savings to date, with an expectation of continued savings on outstanding debt of an additional $87 million through the end of term. Both parties acknowledge that MAWC is not precluded from seeking financing from other sources if there are more cost-effective solutions. As stated in the Company's application for approval of the Financial Services Agreement ("FSA") in Case No. WF-2002-1096, this financing structure was implemented to "creat[e] larger and more cost-efficient debt issues at more attractive interest rates and lower transaction costs than would otherwise be available."

Q. Mr. Murray presents information that shows the embedded cost of debt is higher for

[10] Jennings RT, page 21.
[11] Murray RT, page 6.

MAWC than its Missouri peer utilities.[12] **Is this an accurate comparison when considering the value and intent of the FSA?**

A. No, it is not. The embedded cost of debt is a product of the timing, tenor, and overall magnitude of the totality of long-term debt financing secured by the utility. Each of these affects the coupon rate and ultimate issuance costs of each note. Ms. Bulkley demonstrates in her Rebuttal Testimony that MAWC's financing through AWCC is low-cost financing, comparing the interest rate obtained by AWCC against the 30-day average yield on Moody's A-rate Utility Bond Index and Moody's Baa-rated Utility Bond index as of the date of each debt issuance.[13] Outside of the differences in the coupon rate and timing of issuance, it is important to highlight the differences in the discount and issuance costs, which continue to demonstrate the benefit to customers from the consolidated borrowing of AWCC. Using a recent example, in May 2021 both Spire and MAWC issued long-term debt, with Spire issuing senior secured and MAWC issuing senior unsecured. The discount and issuance costs per dollar of principal issued for Spire is approximately 33 percent higher than MAWC for debt with the same term.

	Spire	MAWC
Principal	$ 305,000,000	$ 73,000,000
Term	30-year	30-year
Issuance Date	5/20/2021	5/14/2021
Coupon	3.300%	3.250%
Discount and Issuance Costs	$ 4,333,156	$ 778,818
Discount and Issuance Costs per $ of Principal	$ 0.0142	$ 0.0107

[12] Murray RT, page 11.
[13] Bulkley RT, pages 33-34 (Figure 6).

III. MAWC Should be Evaluated Consistent with its Peers

Q. Mr. Murray claims that, under his evaluation, MAWC would be able to issue its own secured general corporate debt at a level ultimately lower than AWCC could issue to MAWC.[14] Do you agree with this conclusion?

A. No. Mr. Murray's erroneous conclusion rests on his view that MAWC secured debt would be rated "two to three notches higher"[15] than AWCC's current rating would dictate. Mr. Murray has presented no evidence that demonstrates that MAWC would achieve higher ratings. Further, it is not possible to validate these assumptions, as they would be dependent upon multiple factors at the time of issuance. As Ms. Bulkley has testified, MAWC would have to seek this secured financing in the private placement market, which would not be directly comparable to how AWCC issues its debt currently.[16]

In addition, Mr. Murray's analysis does not consider the administrative fees and issuance costs that would be fully absorbed by MAWC. The use of AWCC allows MAWC to reduce its administrative costs, which do not deviate by the size of the issuance. As demonstrated earlier in testimony using the Spire example from May 2021, those administrative fees and issuance costs are 33% higher than MAWC has incurred for similar debt.

Q. Mr. Jennings quotes one of the principles set forth in the *Bluefield* and *Hope* cases arguing that an appropriate return is a "return that allows the utility to attract capital in the capital market."[17] Would the recommended return of Staff and OPC allow MAWC to attract capital in the capital market?

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[14] Murray RT, page 17.
[15] Murray RT, page 17.
[16] Bulkley RT, page 33.
[17] Jennings RT, page 24.

A. No. As discussed in detail by Ms. Bulkley in her Rebuttal Testimony,[18] the proposed returns – represented as the weighted average cost of equity – are significantly below MAWC's peers, below those authorized for electric and gas utilities, and below what the market ultimately expects. It is an improper implication that the market would not react unfavorably to MAWC receiving a return well below its peers, which would limit MAWC's ability to secure cost-effective financing in the market to support its necessary investments in Missouri.

Q. Is there an example of negative reactions to a preliminary Commission evaluation to align the utility ratemaking to the consolidated capital structure?

A. Yes. In Spire Missouri's ("Spire") base rate case in Case No. GR-2017-0215 and -0216, the Commission's public agenda discussion on January 31, 2018 resulted in significant investor reactions to the initial view of using Spire, Inc.'s consolidated (or parent company) capital structure. As noted in Spire's Closing Statement in that proceeding, "[f]rom the time the Commission began deliberations at 9:30 a.m. on January 31, through the next 5 ½ hours of trading, Spire lost roughly $125 million in market value."[19] Spire also included (as Exhibit 73) the analyst report from Moody's discussing the potential negative impact of this decision, which stated "[t]his would be credit negative for Spire Missouri Inc., Spire Inc.'s largest gas utility, because it would reduce Spire Missouri's ability to generate earnings and cash flow and negatively affect the company's ratio of cash flow from operations pre-working capital changes to debt."[20]

Q. What was the difference in the equity component of the capital structure at issue in

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[18] Bulkley RT, pages 25-58 (Figures 3, 4, and 5).
[19] Case No. GR-2017-0216, Spire Missouri's Closing Statement (2/6/2018).
[20] Case No. GR-2017-0216, hearing Exhibit No. 73.

the Spire Missouri case?

A. Spire Missouri's recommended equity weighting on the over $800 million of rate base was approximately 54%, and the weighting recommended by intervenors in that case was approximately 48%-49%.[21]

Q. What is the difference in the equity component of the capital structure at issue in this (MAWC's) rate proceeding?

A. MAWC's recommended equity weighting on the over $2.3 billion of rate base is approximately 50%, and the weighting recommended by Staff and OPC in this case is approximately 40%.

IV. Other Issues

Q. Mr. Murray recommends that the Commission order all of MAWC's CWIP to be capitalized through the allowance for funds used during construction ("AFUDC") formula based on short-term debt costs.[22] Please respond.

A. Mr. Murray's recommendation is inconsistent with how MAWC currently calculates its AFUDC[23] and with how utility AFUDC is calculated for all other utility entities in accordance with the Federal Energy Regulatory Commission ("FERC") Uniform System of Accounts ("USoA"). As approved by the Commission in MAWC's last base rate case, MAWC's AFUDC calculation applies the short-term borrowing rate to all construction work in progress ("CWIP"), provided that the actual balance of CWIP does not exceed the actual short-term debt balance. Any amount above is subject to the long-term borrowing rate. Although MAWC is not subject to the FERC USoA, it provides a reasonable baseline

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[21] Case No. GR-2017-0216, hearing Exhibit No. 73.
[22] Murray RT, page 4.
[23] Case No. WR-2020-0344, Stipulation and Agreement, Attachment F (3/5/2021).

for comparison when considering how AFUDC is calculated for utility investments. All balances within the FERC calculation reflect actual book balances, and nowhere in the instructions or otherwise does it call for arbitrary modifications to those book balances as Mr. Murray suggests.

Q. Does that conclude your Surrebuttal Testimony?

A. Yes, it does.