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BEFORE THE PUBLIC UTILITIES COMMISSION

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OF THE STATE OF CALIFORNIA

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Application of California-American Water
Company (U210W) for Approval of the
Monterey Peninsula Water Supply Project and
Authorization to Recover All Present and Future
Costs in Rates.

A.12-04-019
(Filed April 23, 2012)

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REBUTTAL TESTIMONY OF WILLIAM D. ROGERS

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ERRATA

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**BEFORE THE PUBLIC UTILITIES COMMISSION
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Application of California-American Water Company (U210W) for Approval of the Monterey Peninsula Water Supply Project and Authorization to Recover All Present and Future Costs in Rates.

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**REBUTTAL TESTIMONY OF WILLIAM D. ROGERS
ERRATA**

I. INTRODUCTION

Q1. Please state your name, business address and telephone number.

A1. My name is William D. Rogers, and I am employed by American Water Works Service Company (the “Service Company”), a subsidiary of American Water Works Corporation (“AWW”) as Vice President and Treasurer. My business address is 131 Woodcrest Road, Cherry Hill, New Jersey 08034.

Q2. What are your responsibilities?

A2. The Treasury group is responsible for advising subsidiaries on capital structure, financial liquidity, and alternatives for permanent financing, including tax exempt and taxable debt, and then executing that capital formation on behalf of subsidiaries as directed. In addition, the Treasury group provides for the financial liquidity of AWW through long term fully committed bank revolving credit facilities and commercial paper borrowings and then lends these funds as appropriate to AWW subsidiaries. Responsibilities outside of financial liquidity and capital management include, but are not limited to, credit rating agency relations, advising the board on capital investment and capital formation, advising the board on dividend payout, financial oversight of all investments for qualified benefit plans, placement of insurance in order to transfer risk, and enterprise risk management activities.

1 Q3. Briefly describe your educational background.

2 A3. I hold an MBA in accounting and finance from Duke University. I am also a
3 distinguished graduate of the U.S. Military Academy with a bachelor's degree in
4 engineering and economics. I hold a Chartered Financial Analyst from the CFA Institute
5 and I am a Certified Treasury Professional from the Association of Financial
6 Professionals.

7
8 Q4. Please describe your professional experience.

9 A4. Prior to joining AWW in 2010, I was the chief financial officer for NV Energy, an
10 investor-owned utility in Las Vegas serving 1.5 million electric and gas customers in
11 Nevada and until 2010 in California, with annual revenues of \$3.3 billion. I previously
12 served as vice president of finance, risk and tax, as well as corporate treasurer.

13
14 Before joining NV Energy, I was a managing director of capital markets for both Merrill
15 Lynch and JPMorgan Chase in New York, providing debt and equity capital markets
16 advisory services and underwriting to electric, gas and water utilities and to various
17 segments of the energy industry.

18
19 Before beginning my finance career, I served on active duty as an engineer and officer in
20 82d Airborne and 2d Infantry Divisions of the United States Army for six years, departing
21 with the rank of captain.

22
23 Q5. What is the purpose of your testimony?

24 A5. The purpose of my testimony is to discuss the current and future financing that is provided
25 to California American Water by the American Water Capital Corporation ("AWCC") and
26 why the California Public Utilities Commission ("Commission") needs to ensure that the
27 financing proposals made by the Monterey Peninsula Water Management District
28

1 (“MPWMD”) and the Division of Ratepayer Advocates (“DRA”) do not negatively affect
2 the financial position of California American Water.

3
4 **II. CALIFORNIA AMERICAN WATER**

5 Q6. Please explain the financing relationship between California American Water and
6 AWCC.

7 A6. AWCC provides cash management services and long term and short term debt financing
8 services to California American Water. AWCC is able to achieve higher credit ratings, a
9 lower cost of capital, and access to more sources of capital than its utility subsidiaries as a
10 result of the size of American Water and the diversity of the portfolio of utility
11 subsidiaries of American Water. Fixed income investors, commercial paper lenders and
12 commercial bank lenders can look to AWCC’s broad portfolio of loans to wholly-owned
13 utility subsidiaries of American Water and with the diversification see strength. The
14 result is a rating of Baa2 by Moody’s with a credit positive outlook and a rating of BBB+
15 by Standard and Poor’s with a credit positive outlook. The strength of the access to
16 capital is demonstrated by AWCC’s recent December 2012 debt issuance with a thirty
17 year maturity (2042) and a coupon of 4.30%. Further, AWCC is able to borrow in the
18 commercial paper markets as an A2/P2 (Standard and Poor’s and Moody’s ratings,
19 respectively) credit at costs of 0.45% in current markets. Finally, AWCC is able to access
20 contractually committed bank credit facilities with its current \$1.0 billion revolving credit
21 facility maturing in October 2017. All of these borrowings and credit facilities are then
22 available to subsidiary utilities at the same rate at which AWCC borrows externally.

23
24 Q7. Please explain why the Commission must consider California American Water’s financial
25 viability when it evaluates the impact of MPWMD and DRA’s financing proposals.

26 A7. California American Water is a stand-alone water utility company operating in California,
27 and California American Water must have the financial means to raise equity and debt (at
28 reasonable rates) to invest and maintain its utility infrastructure. As long as California

1 American Water maintains a reasonable capital structure and earns a reasonable return on
2 equity, it will be able to attract debt investors at reasonable interest rates. As reviewed in
3 the prior question, AWCC provides a more efficient means for California American Water
4 to access the short-term and long-term debt capital markets and provides such capital at
5 cost to California American Water.

6
7 If California American Water and other regulated utilities do not maintain a reasonable
8 capital structure or do not earn a reasonable return, American Water's and AWCC's credit
9 quality will suffer. In addition, American Water may not be able to attract equity
10 investments, which could affect its ability and willingness to make equity investments in
11 California American Water.

12
13 **III. MPWMD**

14 Q8. Have you read the February 5, 2013 Proposal for Public Contribution of Funds?

15 A8. Yes.

16
17 Q9. Do you have any concerns regarding the public contribution proposals?

18 A9. MPWMD describes its public contribution proposals in relatively general terms.

19 However, the specifics of the financing, including the structure of the special purpose
20 entities, rating agency requirements, segregation of funds, credit rating impacts on
21 California American Water and AWW, fees and expenses to establish the structure, and
22 ongoing expenses to manage the structure are not available at this time. While American
23 Water would support California American Water in considering a public contribution, it is
24 important to ensure that the benefits to customers are significant enough to justify the
25 complexities of such a transaction. This is also addressed in the testimony of Dr. William
26 Chambers.

1 First, this is a complex transaction relative to a direct borrowing by California American
2 Water from AWCC, which itself has well known borrowing rates and reasonable ready
3 access to the debt capital markets. The complexity of the transaction may require
4 significant fees and expenses in order to structure the transaction. These fees and
5 expenses would further increase the all in costs to California American Water customers.
6 Should the entity need to fund reserve accounts or escrow funds, this would further add to
7 the cost of the transaction. MPWMD should endeavor to minimize any escrow
8 requirements, for any amount of escrow will increase costs at the margin and the greater
9 the amount of escrow required relative to the principal outstanding, the greater the costs to
10 customers as a result of the negative carry.

11
12 Second, with respect to timing, there could be potential delays from a highly structured
13 transaction. Complex financial structures or structures that require significant, albeit
14 appropriate, approvals by public agencies by definition require more time and could delay
15 access to credit markets or delay the overall timing of the project.

16
17 Third, should the financing as proposed be capitalized onto the balance sheet or be
18 imputed onto the balance sheet of California American Water, then, on the margin, by the
19 very definition of debt, this would certainly have a negative impact on the credit metrics
20 of California American Water and AWCC, either in the view of credit rating agencies or
21 fixed income investors or both. In the case of securitization, the magnitude of the secured
22 debt would have a significant impact on a company the size of California American
23 Water. The secured debt would be first priority ahead of other debt and equity, making
24 other debt and equity more risky. Should debt other than the public financing proposals
25 currently and prospectively on California American Water's balance sheet be effectively
26 structurally subordinate to the payment of interest and principal on these public financing
27 proposals, then there would be less cash flow to service this debt. Therefore the credit
28 metrics (e.g., cash flow to interest and debt to cash flow) are weaker, making this debt and

1 California American Water more risky. The impact on credit metrics would be based
2 upon the amount of the public financing proposals, but any debt that is placed in priority
3 of California American Water debt would weaken the credit metrics on the margin.
4

5 Fourth, in addition to the balance sheet and credit rating impacts, it is not clear whether
6 California American Water would need a credit rating to complete this financing.

7 Although MPWMD states that no separate rating would be needed, it is possible that this
8 could be a requirement to get the financing completed. I encourage caution prior to
9 asking for a credit rating of California American Water. A separate credit rating could
10 affect the viability of the financing if California American Water has a credit rating below
11 AWCC or, given its size and historical credit metrics, a non investment credit rating.

12 Furthermore, if the Monterey customer funds had to be segregated and the first in line in a
13 water-fall system of accounts, this could further diminish the California American Water
14 credit quality.
15

16 Last, California American Water's and AWW's cash management operations are not
17 configured to segregate the funds of Monterey customers. Should this be a requirement,
18 along with the regular deposit of these funds into a trust account, there will be meaningful
19 systems technology investments and bank system interfaces that will need to be
20 established and tested. The segregation of customer funds is not an insignificant
21 operational requirement. Again, we are spreading high one time fixed costs over a
22 relatively small number of customers. Moreover, if California American Water were
23 required to segregate the funds in its cash management operations / remittance system and
24 then regularly deposit these funds in a trust account, then the cash is not available for all
25 operations and maintenance requirements of California American Water. Therefore, the
26 segregation of funds in a priority of water-fall accounts would diminish the cash available
27 for other needs of California American Water.
28

1 Q10. Is it possible that the public financing proposals could have a negative impact on non-
2 Monterey County District customers?

3 A10. ~~Yes, this~~ [Assuming the amount is capitalized on imputed on California American Water's](#)
4 [balance sheet, this](#) is not only possible but is likely. If the public financing proposals
5 negatively impact the credit metrics or the seniority of cash flow available to service other
6 CAW debt, then the cost of debt for all CAW customers would be impacted. As I
7 reviewed earlier and as Mr. Chambers has testified in more detail, there are significant
8 credit rating issues for consideration.

9
10 Q11. You mentioned that the public financing proposals could increase the riskiness of
11 California American Water. What steps would be necessary to bring California American
12 Water's risk profile back into balance?

13 A11. Should the public financing proposals increase the risk of California American Water,
14 then it would be appropriate to add to the equity capital strength of California American
15 Water and decrease its financial leverage. Without a stronger balance sheet to offset this
16 risk, it would be appropriate to seek a higher allowed return on equity as a result of the
17 increased risk.

18
19 Q12. Mr. Larkins states that an expected securitization would be rated AA or better, and that the
20 MPWMD certificate of deposit structure would be rated in the single A category. Would
21 this provide a clear benefit?

22 A12. It is not clear that merely having a higher credit rating would result in a lower cost of
23 capital for customers. For instance, most "stranded asset financings" were priced to yield
24 the same as single A utility credit quality, despite having AAA ratings, when these
25 financing structures were in vogue earlier last decade. This is simply due to the complex
26 nature of the transactions. In much of the 2011 and 2012 capital markets, A rated credits
27 in the corporate market had a lower cost of capital than many stronger rated
28 municipalities. This was due to absolute level of yields and the nature of the tax exempt

1 markets as well as published research on the direction of credit quality of municipalities.
2 In the context of the current market, AWCC with Baa2/BBB+ (outlook positive from both
3 agencies) can borrow at 3.0% for ten year funds and 4.25% for thirty year funds.
4 California American Water would enjoy this same low cost of funds when it, in turn,
5 borrows from AWCC. Therefore, the credit rating is but one factor in the cost of debt
6 capital. Market sentiment, investor access, credit quality and corporate name recognition,
7 and investor segmentation can be equally if not more important.

8
9 Q13. Is it possible that implementation of the public contribution proposals could delay the
10 financing process?

11 A13. As I discussed earlier, the drafting of documentation, state and local agency approval
12 process, and potential credit rating process for the public contribution proposals will take
13 time relative to the ability of CAW to borrow from AWCC and AWCC's ability to take
14 advantage of its shelf registration and ready access to the credit markets. CAW and
15 American Water are committed to working closely and efficiently with MPWMD in order
16 to complete documentation and access capital markets in a timely manner to reduce risk
17 delays in the financing process as a result of the complexities in their proposed financing
18 structures.

19
20 **IV. DRA**

21 Q14. In its testimony, DRA criticizes California American Water's treatment of State
22 Revolving Fund ("SRF") loans in its financial model. Are you aware of how others states
23 direct utilities to handle SRF-type loans?

24 A14. Several of American Water subsidiaries, including our New Jersey and Pennsylvania
25 subsidiaries, are able to access state revolving funds. These borrowings are capitalized on
26 our subsidiary balance sheets as debt and the subsidiary balances its capital structures with
27 equity contributions from American Water.

1 Q15. If there were no equity offset for the SRF, could that affect California American Water's
2 current arrangement with AWCC?

3 A15. Certainly. Without an equity offset, the SRF borrowings will make CAW's credit metrics
4 more risky. If the increase in risk is material, AWCC would necessarily evaluate its
5 financing arrangement with CAW.

6
7 Q16. Does this conclude your direct testimony?

8 A16. Yes it does.
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