

Exhibit No: _____
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Witness: Michael J. McGarry, Sr.
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Sponsoring Party: Joint submission: Cities of St. Joseph,
Jefferson City, Warrensburg
Case No: WR-2017-0285, et al.

BEFORE THE PUBLIC SERVICE COMMISSION

STATE OF MISSOURI

SURREBUTTAL TESTIMONY

OF

MICHAEL J. MCGARRY, SR.

CITIES OF ST. JOSEPH, JEFFERSON CITY, WARRENSBURG, MISSOURI

FEBRUARY 9, 2018

**

**

Denotes Confidential Information
that has been redacted

PUBLIC VERSION

*Coalition
of Cities* Exhibit No. 331P
Date 3-8-18 Reporter mm
File No. WR-2017-0285
SR. 2017-288

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri-American Water Company's)
Request for Authority to Implement a General Rate) Case No. WR-2017-0285, et al.
Increase for Water and Sewer Service Provided in)
Missouri Service Areas)

AFFIDAVIT OF MICHAEL J. McGARRY, SR.

STATE OF SOUTH CAROLINA)
) ss.
COUNTY OF Greenville)

I, Michael J. McGarry, Sr., of lawful age, and being duly sworn, do hereby depose and state:

1. My name is Michael J. McGarry, Sr. I am principal of MJM Consulting, LLC.
2. Attached hereto and made a part hereof for all purposes is my surrebuttal testimony.
3. I hereby swear and affirm that my answers contained in the attached surrebuttal testimony to the questions therein propounded are true and correct to the best of my personal knowledge, information and belief.



Michael J. McGarry, Sr.

Subscribed and sworn to before me, a Notary Public, this 9th day of February, 2018.

My Commission expires:

7/25/27



Notary Public

7/25/27

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1 **I. INTRODUCTION AND QUALIFICATIONS**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Michael J. McGarry, Sr. My business address is 105 Chariot Lane,
4 Simpsonville, South Carolina 29681.

5 **Q. ARE YOU THE SAME MICHAEL MCGARRY WHO SUBMITTED**
6 **DIRECT AND REBUTTAL TESTIMONY IN THIS CASE?**

7 A. I am.

8 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING?**

9 A. I am appearing on behalf of the joint coalition of the cities of St. Joseph, Jefferson
10 City, and Warrensburg. I refer to this group as the "Coalition Cities" or "Cities."

11 **Q. HAS THERE BEEN A CHANGE TO THE JOINT COALITION?**

12 A. Yes. On February 6, 2018, I was notified that the City of Joplin was no longer part
13 of the coalition.

14 **Q. ARE YOU SPONSORING ANY EXHIBITS IN CONNECTION WITH**
15 **YOUR TESTIMONY?**

16 A. Yes. I am sponsoring EXHIBIT MJM-SR-2. It is Missouri-American's response
17 to the City of St. Joseph's Data Request No. 4 in this case.

18 **Q. WAS THIS SURREBUTTAL TESTIMONY PREPARED BY YOU?**

19 A. Yes.

20 **II. PURPOSE OF SURREBUTTAL**

21 **Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

1 A. The purpose of my surrebuttal testimony is to reply to several comments made in
2 rebuttal by Missouri-American Water Company (“Company”) witness Heppenstall.

3 **III. SUMMARY OF FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS**

4 **Q. PLEASE SUMMARIZE YOUR FINDINGS, CONCLUSIONS, AND**
5 **RECOMMENDATIONS.**

6 A. After reviewing the testimony of Company witnesses in rebuttal, I have made the
7 following determinations:

- 8 • I did not intend that the offset would reimburse the Cities’ customers for 100%
9 of their investment in major capital investments that would be part of the offset.
10 Rather, the offset would be no greater than the annual revenue requirement cost
11 (i.e., return on plant plus depreciation expense) of any similar project from
12 another district or city within a district (e.g., Platte County).
- 13 • I maintain that the Eight-District approach is a reasonable alternative to both
14 the Company’s CTP and the Staff’s Three-District approaches; it affords
15 customers with the proper cost signals and is fair and balanced. However, if the
16 Commission chooses either the Company’s or Staff’s approach, an offset is
17 needed to provide the Cities’ customers with some semblance of fairness for
18 having shouldered major plant investment for themselves and now being
19 required to bear such investments for other cities and districts.
- 20 • The offset would be used for historical projects and would be finite (i.e., of
21 limited duration).

- 1 • A working group or collaborative should be formed to determine the particulars
2 of the offset.
- 3 • The Commission should consider a district/city-specific capital investment cost
4 tracker to allow cost causation and benefit principles to be reflected in major
5 capital investments.

6 **IV. COMPANY'S CRITICISM OF MJM'S PROPOSED OFFSET**

7 **Q. WHAT IS THE COMPANY'S CRITICISM OF YOUR PROPOSED**
8 **OFFSET?**

9 A. Company Witness Heppenstall states in her rebuttal that my proposed concept of
10 the rate offset would be "neither workable nor appropriate."¹

11 **Q. ON WHAT BASIS DOES MS. HEPPENSTALL MAKE THIS**
12 **STATEMENT?**

13 A. Ms. Heppenstall relied on a part of my direct testimony wherein I stated that the
14 offset for the Cities would include "the depreciated capital investment since 2000
15 for each of the four cities in total and divide that amount by the estimated
16 consumption for the period of the offset. That amount would be applied as a credit
17 to the Coalition Cities on their customer's bills" ² She claims that this approach
18 would provide an annual credit for all the Cities' customers for all the investment
19 made in facilities each year.³

¹ Constance E. Heppenstall Rebuttal Testimony at page 16, lines 2–3.

² See my Direct Testimony at MJM-14 to MJM-15.

³ Heppenstall Rebuttal testimony at page 15, lines 19–21.

1 **V. RESPONSE TO COMPANY’S CRITICISM**

2 **Q. WHAT IS YOUR RESPONSE TO THE COMPANY’S CRITICISM?**

3 A. Clearly, my general statement about this conceptual offset mechanism appeared
4 overly broad, and I did not intend to have the Cities be credited for 100% of their
5 capital investment in infrastructure plant. My intent—and the goal of this offset—
6 is to protect the Cities from having to incur the capital investment costs
7 (depreciation and return on net plant) for investment by other districts, cities, and
8 systems in major infrastructure when they themselves have already paid for similar
9 plant without other districts or cities contributing to the cost. The amount of the
10 offset would have to be measured against what was being proposed to be included
11 in rate base from these similar projects for the test year that is being requested by
12 the Company. Therefore, the offset could never exceed the revenue requirement
13 amount of a proposed increase in rate base (and its related depreciation expense)
14 for specific projects in which the Cities have already invested. In this way, the
15 Cities would be paying for similar plant only one time and not shouldering the cost
16 of plant investment that has nothing to do with them. Obviously, the offset related
17 to historical cost is finite. When the time comes that everyone in a district is on
18 equal footing having had similar plant invested and the inequity of having to pay
19 twice is no longer present, the offset would be removed and no longer applied.
20 However, the offset would have to remain in place for major plant investments that
21 provide no benefit to the Cities. This reasoning is why moving away from CTP and
22 allowing the districts to return to the Eight-District rates is so significant. In my
23 opinion, when weighing all the factors, the long-standing, widely accepted

1 principles of cost-causation should be the primary concern as they promote the
2 financial health of the Company, send clear and accurate price signals to the
3 customers, and promote efficient use of resources (i.e., invested capital). The issue
4 of affordability (which is the central theme of a CTP approach) can be ensured in
5 other ways, such as a rate phase-in, possible use of a regulatory asset, or project
6 cost trackers.

7 **VI. CONDITIONS UNDER WHICH OFFSET WOULD BE APPLIED**

8 **Q. UNDER WHAT CONDITIONS WOULD THE OFFSET BE APPLIED?**

9 A. I want to reemphasize that the purpose of the offset for the Cities is to ensure
10 fairness to the Cities' water users so that they do not pay for major capital projects
11 twice or for major investments in other cities/districts that bring no benefit to the
12 Cities. Again, this offset is needed only **IF** the Commission determines that it is
13 going to approve the Company's proposed CTP or the Staff's Three-District
14 approach. I am told that the Cities would not request the offset if the former Eight-
15 District approach is approved.

16 **Q. PLEASE DESCRIBE THE OFFSET PROCESS.**

17 A. The first point in the process would be to establish which major historical project(s)
18 the Cities request that the offset reflect. Since each City is unique, their projects
19 would differ. This determination would involve the Company and Cities jointly
20 determining which major project(s) should be included. The following is a list of
21 the projects and the original in-service dates for each project that would make up
22 an initial list.

1

| Table 1 Preliminary Project List | | | |
|-------------------------------------|------------------------------------|-------|----------------|
| City | Project(s) | Cost | Inservice Date |
| St. Joseph's | St. Joseph's Water Treatment Plant | \$70M | 1999 |
| | | | |
| Jefferson City | Water Plant Intake Pipe Upgrades | \$11M | 2011 |
| | | | |

2

3 Part of the offset would then be specific to these projects. The other part would be
4 from projects which have no benefit to the Cities. This second part would be
5 established in consultation with Staff and approval of the Commission during the
6 rate case process.

7 Once established, the Cities' projects' average annualized depreciation expense and
8 return on net plant from its in-service dates would have to be calculated. This result
9 could be computed on a per customer basis and shown as a credit on the customer's
10 bill. The offset could be calculated as a volumetric credit if the project is clearly
11 impacted by usage/volume. This credit would continue for as long as MAWC's
12 project has a balance that has not been depreciated. Obviously, going from case to
13 case, the list of projects will become long. For that reason, separating back to Eight
14 Districts is important and appropriate. That said, MAWC customers in the Cities
15 should not be burdened with having to pay both for the major investments that
16 affect them and the burden of others. That is not just and reasonable.

17 **VII. EXAMPLE OF OFFSET**

18 **Q. DO YOU HAVE AN EXAMPLE OF AN OFFSET CALCULATION?**

1 A. I have prepared a conceptual example. However, there are many nuances with
2 respect to timing, cost allocation, and rate design that need to be worked out.
3 Because of this, if the Commission found this option attractive to provide a balance
4 of fairness, appropriate cost causation principles, and its desire to provide
5 affordable water to all of MAWC's customers including the Cities, I would
6 recommend a working group or collaborative process to establish the details and
7 report back to the Commission. Issues include which projects would qualify, from
8 which start date, what are the exact costs (i.e., return of investment, depreciation
9 expense, etc.) that have been collected in rates, how to allocate the offset to rate
10 classes, and whether it's a volumetric offset or an offset to the customer charge.
11 These issues would need to be resolved. However, in the end, the Commission
12 could assure itself that it had offered an opportunity for its CTP policy to be fair
13 and balanced.

14 **Q. HAVE YOU DEVELOPED AN ILLUSTRATION OF HOW THE OFFSET**
15 **MECHANISM WOULD BE EMPLOYED?**

16 A. Yes. The following Schedule, MJM-SR1, is a high-level example of how the offset
17 would be developed as applied uniformly to all customers across all customer
18 classes. After reviewing the dollar magnitude of several projects, I chose the City
19 of St. Joseph 2000 Water Treatment Plant as it is one of the highest cost projects
20 for which that City has shouldered the burden while now being asked to share the
21 cost of another similar project in other service areas (Platte County, St. Louis, and
22 others). To be clear, this example demonstrates methodology and is not meant to
23 be a precise calculation. Items such as the impact on revenue requirements,

1 allocation to customer classes, taxes, and others would have to be resolved. With
2 that said, it would be possible that each of St. Joseph's customers could possibly be
3 entitled to an offset of \$193.06 per year against the cost of the Platte County water
4 treatment work or the work planned for St. Louis Metro District. This \$193.06
5 amount represents the average annual amount that they have invested in the water
6 treatment plant, which would be applied against what they would have to pay for
7 other similar major projects (e.g., Platte County).

Schedule MJM-SR1

| Missouri-American Water Company Case No. WR-2017-0285 Coalition Cities Proposed Example of Proposed Offset | | | | | | |
|---|--|------------------------------|--------------|---------------|--------------------------|---------------------------|
| | Project | Initial Investment (\$000's) | In Service | Case Approved | Weighted cost fo capital | Depreciation Expense Rate |
| | STJ Water treatment | 70000 | 1999 | WR-2000-0285 | 8.16% | 0.02 |
| (\$000's) | | | | | | |
| Line No. | Year | Return | Depreciation | Total | Net Plant | # of Customers |
| | (A) | (B) | (C) | (D) | (E) | (F) |
| 1 | 2000 | \$ 5,712.0 | \$ 1,400.0 | \$ 7,112.0 | \$ 68,600.0 | 31027 |
| 2 | 2001 | \$ 5,597.8 | \$ 1,400.0 | \$ 6,997.8 | \$ 67,200.0 | |
| 3 | 2002 | \$ 5,483.5 | \$ 1,400.0 | \$ 6,883.5 | \$ 65,800.0 | |
| 4 | 2003 | \$ 5,369.3 | \$ 1,400.0 | \$ 6,769.3 | \$ 64,400.0 | |
| 5 | 2004 | \$ 5,255.0 | \$ 1,400.0 | \$ 6,655.0 | \$ 63,000.0 | |
| 6 | 2005 | \$ 5,140.8 | \$ 1,400.0 | \$ 6,540.8 | \$ 61,600.0 | |
| 7 | 2006 | \$ 5,026.6 | \$ 1,400.0 | \$ 6,426.6 | \$ 60,200.0 | |
| 8 | 2007 | \$ 4,912.3 | \$ 1,400.0 | \$ 6,312.3 | \$ 58,800.0 | |
| 9 | 2008 | \$ 4,798.1 | \$ 1,400.0 | \$ 6,198.1 | \$ 57,400.0 | |
| 10 | 2009 | \$ 4,683.8 | \$ 1,400.0 | \$ 6,083.8 | \$ 56,000.0 | |
| 11 | 2010 | \$ 4,569.6 | \$ 1,400.0 | \$ 5,969.6 | \$ 54,600.0 | 32004 |
| 12 | 2011 | \$ 4,455.4 | \$ 1,400.0 | \$ 5,855.4 | \$ 53,200.0 | |
| 13 | 2012 | \$ 4,341.1 | \$ 1,400.0 | \$ 5,741.1 | \$ 51,800.0 | |
| 14 | 2013 | \$ 4,226.9 | \$ 1,400.0 | \$ 5,626.9 | \$ 50,400.0 | |
| 15 | 2014 | \$ 4,112.6 | \$ 1,400.0 | \$ 5,512.6 | \$ 49,000.0 | |
| 16 | 2015 | \$ 3,998.4 | \$ 1,400.0 | \$ 5,398.4 | \$ 47,600.0 | 32001 |
| 17 | 2016 | \$ 3,884.2 | \$ 1,400.0 | \$ 5,284.2 | \$ 46,200.0 | 32002 |
| 18 | 2017 | \$ 3,769.9 | \$ 1,400.0 | \$ 5,169.9 | \$ 44,800.0 | 32005 |
| 19 | Totals | \$ 85,337.3 | \$ 25,200.0 | \$ 110,537.3 | | |
| 20 | Average Annual Co | \$ 4,741.0 | \$ 1,400.0 | \$ 6,141.0 | | |
| 21 | Average Number of Customers | | | | | 31808 |
| 22 | | | | | | |
| 23 | Potential Offset per customer per year | | | \$ 193.06 | | |

8

1 **Q. PLEASE BRIEFLY EXPLAIN SCHEDULE MJM-SR1.**

2 A. Using some basic information that was available from Case WR-2000-0281 I took
3 the initial investment of \$70 million made by the City in 1999 and applied a
4 simplified equation to determine the return on the plant balance (Column B). I used
5 the approved, weighted cost of capital from Case WR-2000-0281 of 8.16%. In
6 Column C, I estimated a straight-line depreciation expense of 2.0% per year. The
7 depreciation rate is an estimate as I did not have access to the Company's
8 depreciation rates for a major facility, such as a water treatment facility. Therefore,
9 knowing that the rates would vary by the building, types of equipment, and other
10 factors, I picked a composite rate for illustrative purposes that I believed would be
11 representative. I recognize that the Company's books and records could produce a
12 more accurate amount.

13 That said, I summed the two columns (B and C) to arrive at an estimated annual
14 total outlay by customers toward the repayment of and return on the investment in
15 the St. Joseph water treatment facility. Column E shows a hypothetical net plant
16 balance which keeps a running total of the initial plant investment less the
17 accumulated depreciation expense for the period to date. Again, the Company's
18 books and records could show a more precise amount. The last column shows the
19 City of St. Joseph's number of customers at various points in the rate case cycles
20 over the years. From this information, the City's customer base is pretty stable at
21 around 32,000.

22 I summarized and averaged the columns at the bottom and then calculated the
23 potential offset per customer by dividing the average annual cost (\$6,141,000) by

1 the Average Number of Customers (31,808) to arrive at the annual offset of
2 \$193.06.⁴ This number would be compared to the average annual cost included for
3 the similar plant that is being proposed to be included in rate base. Only the lower
4 number would be the credit to the Cities' customers. For example, if the Platte
5 County project costs are only \$75 per customer per year, only the \$75 per customer
6 would be credited to St. Joseph's customers. This way, St. Joseph's customers are
7 credited no more than the share of the similar plant for which they have already
8 paid.

9 As I mentioned, a working group or collaborative process to determine the
10 particulars would be beneficial to provide the Commission with the assurance that
11 the offset is accurate, fair, and balanced and serving the purpose of balancing the
12 various issues and policies already mentioned here and by others.

13 **VIII. OTHER PROJECTS WITH NO DIRECT BENEFIT TO THE CITIES**

14 **Q. YOU MENTIONED THAT THIS OFFSET IS FOR HISTORICAL**
15 **PROJECTS FOR WHICH THE CITIES HAVE ALREADY SHOULDERED**
16 **THE BURDEN. WHAT ABOUT PROJECTS FOR WHICH THE CITIES'**
17 **CONSTITUENTS RECEIVE NO BENEFIT?**

18 **A.** Projects for which the Cities' constituents receive no benefit are planned projects
19 in which one district would be expected to pay without receiving any benefits.
20 Again, the Platte County water treatment plant is a good example. It is a stretch to
21 say that any district or city, other than those in Platte County, would benefit from

⁴ One nuance would include time value of money.

1 the new treatment plant there. Likewise, much of the Metro St. Louis work will
2 have no benefit to Jefferson City, Warrensburg, St. Joseph, or others.

3 **Q. ARE THERE ANY OTHER PLANNED MAJOR CAPITAL PROJECTS**
4 **THAT MAWC HAS INFORMED THE COMMISSION ABOUT THAT**
5 **WILL HAVE NO BENEFIT TO THE CITIES?**

6 A. Yes. In response to a data request (St. Joseph's Data Request No. 4 to MAWC dated
7 October 12, 2017), the Company provided a schedule it designated as highly
8 confidential. It is titled **Strategic Capital Expenditure Plan 2017 through 2021**.
9 The document is dated October 21, 2016. That document includes a list of projects
10 by district including the three Cities. The document shows that, in 2017, the
11 Company planned on spending the following in districts that would have no benefit
12 to the Cities:

13 * *

14
15 * *

16 Further, this same document shows that over the plan period of 2017–2021, the
17 Company plans to spend over ** ** on projects in St. Louis County.

18 I am hard pressed to see which if any of these projects will provide a direct or
19 indirect benefit to the Cities. I have included the full document as a HIGHLY
20 CONFIDENTIAL EXHIBIT MJM-SR-2.

1 **Q. WHAT DID YOU CONCLUDE FROM YOUR REVIEW OF THIS LIST OF**
2 **PROJECTS?**

3 A. As I examined the list in this data request response and reviewed the arguments in
4 direct and on rebuttal, what became clear to me is that what is needed is a capital
5 cost tracker for major capital project investments of greater than \$2 million. The
6 cost tracker would be specific to a district, and could be specific to a city, if the
7 Commission would so choose. I do not typically like the idea of cost trackers, but
8 in this case (and with the diversity of the districts and cities and my desire to
9 encourage cost causation matching and efficient use of resources), a capital cost
10 tracker may be the best alternative.

11 **Q. WHAT IS A COST TRACKER AND WHAT ARE THE BENEFITS?**

12 A. By way of overview, a capital project cost tracker is a rate mechanism that allows
13 the Company to complete projects, keep track of the project costs, and then, at
14 specific intervals in between rate cases, begin collecting them in customer bills,
15 usually as a separate line item on the bill. The benefits include a way to more
16 closely track major invested capital projects and smooth out rate increases.
17 Companies like it because cost tracker proceedings require fewer resources than a
18 full-blown rate case, and they start earning a return on the invested plant sooner
19 (mitigating regulatory lag). Further, the cost tracker mechanism could be designed
20 in such a way as to mitigate rate shock as project costs would already have started
21 to be recovered when other traditional rate case costs hit the rates. There are
22 disadvantages to cost trackers including dis-incentive to manage project costs and
23 more frequent changes in customer bills.

1 I recognize that proposing this capital project cost tracker idea at this late stage may
2 present a problem for the parties. Therefore, I would recommend that the
3 Commission direct the parities—led by Staff—to study the issue via a working
4 group or collaborative process and submit a recommendation prior to the
5 Company’s next rate case. In this way, customers from each system, city and
6 district will be served by arriving at a process and rate mechanism that balances the
7 needs of everyone. Rate shock can be mitigated and cost-causation principles and
8 efficient use of resources can be encouraged. There are other ways to address each
9 party’s concerns, we just have to be creative.

10 **IX. SUMMARY AND RECOMMENDATION**

11 **Q. PLEASE SUMMARIZE YOUR SURREBUTTAL AND RELATED**
12 **RECOMMENDATIONS?**

13 **A.** After reviewing the testimony of Company witnesses in rebuttal, I have made the
14 following determinations:

- 15 • I did not intend that the offset would reimburse the Cities’ customers for 100% of
16 their investment in major capital investments that would be part of the offset.
17 Rather, the offset would be no greater than the annual revenue requirement cost
18 (i.e., return on plant plus depreciation expense) of the similar project from another
19 district or city within a district (e.g., Platte County).
- 20 • I maintain that the Eight-District approach is a reasonable alternative to both the
21 Company’s CTP and the Staff’s Three-District approaches; it affords customers
22 with the proper cost signals and is fair and balanced. However, if the Commission

1 chooses either the Company's or Staff's approach, an offset is needed to provide
2 the Cities' customers with some semblance of fairness for having shouldered major
3 plant investment for other cities and districts.

4 • The offset would be used for historical projects and would be finite (i.e., of limited
5 duration).

6 • A working group or collaborative process should be formed to determine the
7 particulars of the offset.

8 • The Commission should consider a district/city-specific capital investment cost
9 tracker to allow cost causation and benefit principles to be reflected in major capital
10 investments.

11 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

12 **A. Yes.**

WR-2017-0285
McGarry Surrebuttal

Exhibit MJM-SR-2

has been deemed

"Confidential"

in its entirety