Exhibit No.:	
Issues:	Rate Case Test Year, Accounting Authority Orders Related to the Tax Cuts and Jobs Act, Ratemaking Treatment for MAWC's LSRL Program, Rate Case Expense, Cloud Computing, Affiliate Transactions, Inclining Block Rates, Consolidated Tariff Pricing, Revenue Stabilization Mechanism
Witness:	James M. Jenkins
Exhibit Type:	Surrebuttal
Sponsoring Party:	Missouri-American Water Company
Case No.:	WR-2017-0285 SR-2017-0286
Date:	February 9, 2018

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. WR-2017-0285
CASE NO. SR-2017-0286

SURREBUTTAL TESTIMONY

OF

JAMES M. JENKINS

ON BEHALF OF

MISSOURI-AMERICAN WATER COMPANY

Exhibit 21
WR-2017-0285
Surrebuttal Testimony of James M. Jenkins

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

IN THE MATTER OF MISSOURI-AMERICAN WATER COMPANY FOR AUTHORITY TO FILE TARIFFS REFLECTING INCREASED RATES FOR WATER AND SEWER SERVICE	)))))	CASE NO. WR-2017-0285 CASE NO. SR-2017-0286

AFFIDAVIT OF JAMES M. JENKINS

James M. Jenkins, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Surrebuttal Testimony of James M. Jenkins"; that said testimony was prepared by him and/or under his direction and supervision; that if inquiries were made as to the facts in said testimony, he would respond as therein set forth; and that the aforesaid testimony is true and correct to the best of his knowledge.

James M. Jenkins

James M. Jenkins

State of Missouri
County of St. Louis
SUBSCRIBED and sworn to
Before me this 8th day of February 2018.

Mary Beth Hercules
Notary Public

My commission expires:

MARY BETH HERCULES
Notary Public - Notary Seal
STATE OF MISSOURI
St. Louis County
My Commission Expires April 26, 2020
Commission # 96546828

SURREBUTTAL TESTIMONY
JAMES M. JENKINS
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WR-2017-0285
CASE NO. SR-2017-0286

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SURREBUTTAL TESTIMONY

JAMES M. JENKINS

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is James M. Jenkins and my business address is 727 Craig Road, St. Louis, Missouri 63141

Q. Are you the same James M. Jenkins who previously submitted direct and rebuttal testimony in this proceeding?

A. Yes.

II. OVERVIEW

Q. What is the purpose of your surrebuttal testimony in this proceeding?

A. The purpose of my surrebuttal testimony is to address arguments in the rebuttal testimony regarding:

1. the appropriate test year to be used in setting rates in this proceeding;
2. tax rate changes arising from the Tax Cuts And Jobs Act ("TCJA"), especially in light of the Commission's rejection of an accounting authority order ("AAO") that would have permitted the Company to recovery extraordinary property tax increases;
3. the Company's proposed Rate Stabilization Mechanism ("RSM").
4. cost recovery and accounting for Missouri-American Water Company's ("MAWC") lead service line replacement ("LSLR") program;

5. why it is appropriate for MAWC to recover the full amount of its just and reasonable rate case expense;
6. accounting treatment for cloud computing investments;
7. recommendations to adopt affiliate transaction rules for MAWC;
8. inclining block rate structure;
9. consolidated tariff pricing ("CTP"); and

III. RATE CASE TEST YEAR

Q. Do witnesses from Staff and OPC address MAWC's proposed use of a future test year in this proceeding?

A. Yes. The rebuttal testimonies of Commission Staff (Staff) witness Mark L. Oligschlaeger and Office of the Public Counsel ("OPC") witness Geoff Marke address and object to the Company's use of a future test year based on various criticisms. I addressed many of the criticisms raised in their direct testimony or in Staff's Report in my rebuttal testimony. To the extent that they expand on those claims or raise new claims in their rebuttal testimony, I address them here. As I explained in my rebuttal testimony, those criticisms are misplaced and, in many cases, actually serve to demonstrate why the future test year is a particularly appropriate ratemaking mechanism for a water company, as opposed to an historical test year.

Q. Does Staff witness Oligschlaeger properly characterize how MAWC constructed its future test year?

A. No. Mr. Oligschlaeger testifies as follows:

> For revenues, MAWC applied an estimated annual sales decrease assumption to the adjusted level of customer sales through use of a regression analysis. MAWC's projected revenues calculation is being addressed by Staff witness Robertson.
>
> For plant in service, depreciation reserve, accumulated deferred income tax reserve and most other rate base items, the Company has projected monthly balances for the period of June 2018 through May 2019 (the "rate year"), and taken a thirteen-month average of those balances for inclusion in its future rate base. The value of assumed future plant in service additions were obtained from MAWC's 2018 - 2022 "Strategic Capital Expenditure Plan."
>
> For operating expenses, MAWC performed a few discrete analyses of individual expense items to determine their projected level. However, for many expense items, MAWC simply applied a general inflation factor to the adjusted test year balance in order to project these amounts into the future. (Reb. p. 9, l. 1-12)

As Mr. Oligschlaeger defers a discussion of test period revenue to Staff witness Robertson, I will defer to MAWC witness Roach on this subject. I will note, however, that, as with every other subject, our future test year projections of revenue proceeded from normalized test year historical data. With respect to his discussion of future test year rate base and expenses, as I will show below for each of the categories, Mr. Oligschlaeger has made certain incorrect assumptions, misunderstandings or mischaracterizations that do not properly consider or portray the degree of carefully considered and justifiable projections that MAWC has made to audited, normalized historical data in order to project them properly to the future test period.

Q. Mr. Oligschleager contends (Reb., p. 9) that "[t]he value of assumed future plant in service additions were obtained from MAWC's 2018 - 2022 'Strategic Capital Expenditure Plan.'" Is this entirely accurate?

A. Not entirely. It is accurate to say that the future test year plant in service projections are consistent with our "Strategic Capital Expenditure Plan," but, as Company witness

Bruce Aiton explains in his surrebuttal testimony, they were not simply lifted from that plan and inserted into our future test year. The 13-month plant balances for the future test year are based on our most recent view of the discrete construction projects and activity levels that we project for the first year new rates will be effective.

Q. At page 10 of his rebuttal, Mr. Oligschlaeger appears to criticize the rate of increase to plant by comparing the future test year growth in plant to the year to year growth in plant for the period 2010 to 2016. Is this an appropriate way to look at the projected growth in plant?

A. No, it isn't. The plant in service in the future test year should be based on the appropriate level of construction necessary to provide, safe, adequate and reliable service to our customers. Mr. Aiton discusses future plant additions in his surrebuttal testimony.

Q. Mr. Oligschlaeger lists two concerns with respect to rate base additions that he interposes as objections to the use of a future test year. Are you familiar with them?

A. Yes, I am and I will address each of them.

Q. What is his first concern?

A. Mr. Oligschlaeger states that the future test year would:

> put to an end the Commission's "used and useful" standard for valuation of plant in service in rates that has been in place for many decades. Staff's position is that the used and useful standard is still an appropriate ratemaking policy under almost all circumstances. Nowhere in MAWC's direct testimony do Mr. Jenkins or other MAWC witnesses even address a scenario where plant additions assumed for purposes of setting rates are not actually placed in service within the timeframe

> forecasted by the utility, much less propose any remedies for that situation. (Oligschlaeger Rebuttal, Pg 6 Line 6-12)

Aside from the fact that claiming an "end to the used and useful standard" is hyperbolic, at the very least, the truth is that I proposed a solution in my rebuttal testimony that would directly address and remedy the very situation posited by Staff. I stated that, if a future test year were to be adopted, the Company would be willing to reconcile its plant projections with its actual plant placed into service for the first year that rates are in effect and that the rate consequence of any shortfall between projected and actual plant could be deferred for our customers' benefit and preserved to be returned in the next rate case. Therefore, Mr. Oligschlaeger's concern on this score has been fully met. In this regard, I also find troubling Staff's failure to look at the other side of the coin, i.e., that under the existing paradigm the Company's customers are getting the benefit of using plant that is actually providing service to them without paying any of the costs supporting that plant until the conclusion of the next rate case, when a return on plant and depreciation expense can finally be recognized. Even with ISRS plant in St. Louis County, on which the Company is provided recovery between rate cases, there is still regulatory lag and customers enjoy the benefit of property that is in service prior to paying for it. We know, however, that under a regulatory system based on historical costs, customers are not paying rates to support plant added during the six months before, as well as throughout, the rate year. This is undeniably so because there are no rate base additions that would be included in rates beyond December 2017, under the current ratemaking policy. Our future test year addresses this infirmity and restores the balance of fairness between the Company and its customers.

Q. Does your point fully address Mr. Oligschlaeger's concerns about timing?

A. The timing issue is largely addressed by the use of a 13 month average, under which only a portion of plant is reflected in rates so as to replicate the addition of plant ratably over the entire year. To be clear, the plant in the future test year is based on a 13-month average so that customers are not being asked to support plant for an entire year when that plant will go into service over the course of the rate year. This is fair to our customers; while refusing to recognize plant that we know will be serving those customers is not fair to the Company. Again, although I have confidence in our plant projections, in order to address Staff's concerns, we have proposed a mechanism to "true up" our plant projections to those actually placed in service in the rate year, preserving the revenue requirement associated with any shortfalls for our customers.

Q. What was Mr. Oligschlaeger's second concern about future test year plant additions?

A. The second concern voiced by Mr. Oligschlaeger (Reb., p.11-12) is that use of forecasted plant additions to set rates could potentially "provide inappropriate incentives for utility management in some circumstances." He claimed that:

> Under traditional regulation, there should be no direct impacts on ratepayers from these types of budget adjustments. With use of future test years, however, complications arise from budget priority changes as the cost of projects included in customer rates may be cancelled or postponed as a result. This may lead to a utility reluctance to change the priority of its budgeted plant additions in light of unforeseen circumstances because of the perceived inconsistency with its capital budget reflected in its rates, even if a change in priority would be the most prudent course of action.

As I noted previously, "under traditional regulation" there are "no direct impacts on ratepayers from these types of budget adjustments" for the simple reason that ratepayers are not paying anything for plant installed six months before and throughout the rate year, even though that plant will be serving them directly. So in this regard, the argument is a more than a bit beside the point. In fact, Section 393.270.4, RSMo, states as follows:

> In determining the price to be charged for gas, electricity, or water the commission may consider all facts which in its judgment have any bearing upon a proper determination of the question although not set forth in the complaint and not within the allegations contained therein, with due regard, among other things, to a reasonable average return upon capital actually expended and to the necessity of making reservations out of income for surplus and contingencies.

Given that the rate year includes plant that will be installed in that year, the 13-month average of plant installed in the future test year is consistent with the statutory requirement of providing "a reasonable average return on capital actually expended" in that year.

Moreover, if I understand his argument correctly, Mr. Oligschlaeger tries to have it both ways. On one hand, he worries that we might not install all the plant we project under the future test year, while on the other hand, he is concerned that we might be reluctant to deviate from those projections even if prudence would dictate another course. If unforeseen circumstances arose such that prudence counseled either a greater or lesser level of capital investment in the rate year, I would assume that Staff would agree that we should follow the prudent course. This is true whether our rates are set on a historical or a forecasted rate year. What Staff really appears to be expressing, however, is a concern that we might not actually install the level of plant that we projected if the Commission decided to adopt a future test year. Again, as I mentioned, we would be willing to track our plant additions in the future test year and provide that information to Staff, as well as develop a mechanism to ensure that customers are not paying for plant that was not installed in the rate year.

Q. Does Staff voice similar concerns with use of future test years for expenses?

A. Yes, Staff witness Oligschlaeger compares year to year expense increases in employee count, inflation impacts and efficiency improvements in an attempt to show that the future test year expenses are overstated.

Q. Mr. Oligschlaeger points to the increase in employees in the future test year as an example of why the future test year expense increase is higher than the increase in past years. Is this a valid concern?

A. No, and the Staff witness curiously concedes this point. Mr. Oligschlaeger claims (Reb., p. 14) that "[o]ne reason for this increase is that MAWC is projecting a significant increase in the number of employees compared to the recent past in this proceeding. MAWC's case is based upon a full time employee level of 696 positions, while MAWC only had 642 employees at year-end 2016." Yet, on the very next line, he concedes that:

> However, MAWC has also stated that it expects to reach its target level of employees by year-end 2017, and is not projecting a further increase in employee numbers through May 2019 for ratemaking purposes. For that reason, the increase in the number of MAWC's employees from the test year does not appear to be specifically a future test year issue at this time.

In other words, the "issue" with the future test year turns out to be a non-issue. In fact, as of year-end 2017, the Company's employee count was already at 694, with two hires in process. That number, coupled with the 12 temporary summer positions, reinforces the accuracy of the Company's future test period projections for our employee complement.

Q. Does Staff level any other expense-related criticism against the Company's future test year?

A. Yes, Staff witness Oligschlaeger also takes aim at the alleged use of inflation for "many" of the expense categories, claiming (Reb., p.14) that:

> Another reason for MAWC's forecast of rapidly growing expense levels is its approach of applying "inflation factors" to adjusted test year expense levels. In this case, MAWC applied an inflation factor to the adjusted test year balances of many of its expense items, and assumes that the dollar value of these expenses will increase at an annual rate of 2.1% for the period January 2018 through May 2019.

Here, too, Mr. Oligschlaeger is engaging in hyperbole in his opposition to the future test period. I addressed the issue of inflation in my rebuttal testimony. Let me simply reiterate that Staff's arguments about the extent to which we used inflation are overblown. Our large categories of expenses have been forecasted individually and normalized, based on known changes in activity and cost levels, informed by things such as vendor contracts and pricing information and other verifiable data as discussed in Company Witness Bowen's direct testimony. More telling, however, is the fact that the Company's inflation adjustments to O&M and general tax for the 12 months ended May 31, 2018 totaled $1.21 million which is just 0.74% of the total expenses ($1.21/$161.83). Inflation adjustments to O&M and general tax for the 12 months ended May 31, 2019 totaled $0.418 million which is 0.25% of the total expenses ($.41/$163.35). In other words, the effect of inflation adjustments on our future test year is small adjustment. Moreover, there are certain categories of expenses that are simply too small or contain elements that are too numerous to warrant forecasting them individually. In such cases, it makes sense to apply an inflation factor. After all, inflation simply provides a measure of how prices are increasing for all businesses and people. And, although some elements might escalate faster, or slower, than the inflation rate, on average, inflation provides a reasonable guide to price escalation into the future. If Mr. Oligschlaeger is suggesting that there will be no price escalation, the weight of the economic evidence is against him. If all inflation were removed from MAWC's revenue requirement, the revenue requirement would only be reduced by $1,627,489. In short, it is entirely rational to inflate some items of expense by inflation rather than by making discrete adjustments. Nevertheless, even if all inflation were removed from the case, the effect is very small.

Q. Staff witness Oligschlaeger further states that "if MAWC has shown the ability consistently to 'beat' the results of general inflation factors in the past in its cost control efforts, why would it be reasonable to now use this type of escalation factor for ratemaking purposes as a proxy for expected growth in MAWC expenses?" (Reb., p. 17, l. 9-12) How do you respond to that query?

A. We did not project the majority of our expenses based on inflation. We looked at activity levels and input prices. Our forecasting methodologies are included in the direct testimony of Company Witness Bowen. An example is our plan to exercise more valves and flush mains. This improves service immeasurably. As discussed by Company Witness Clarkson (Clarkson Reb., p. 9), when MAWC has deemed additional resources devoted to preventative maintenance are warranted to better serve the long term interests of our customers, simple reference to our past activity levels is not a reasonable guide to appropriate levels going forward

Q. Staff witness Oligschlaeger claims that the Company has not forecasted any productivity or efficiency improvements in its future test year amount, citing MAWC's water loss percentage and main break expenses as examples where the Company aspires to improvement but does not forecast such improvement. (Reb., p. 17-20) Are these examples valid?

A. No. With respect to the water loss percentage, Mr. Oligschlaeger's example ignores the fact that reducing water loss is a very complex issue with many contributing factors, some of which are beyond the Company's control. Staff, recognized, for example, that non-revenue water ("NRW") is not due only to leaks but also to other factors such as "theft or unauthorized use, unmetered authorized use, or other unaccounted for water." (Staff Report - COS, p. 74.) Staff also ignores the fact that, as water sales fall, as they have done, and will continue to do, all other things being equal, the percentage of water losses will increase against the total declining sales. Furthermore, water leak experience is not a static phenomenon but is highly influenced by weather conditions, as Messrs. Aiton and Clarkson explain in their rebuttal testimony, e.g., these weather systems producing the "polar vortex," delivered record-setting low temperatures resulting in increased water main and service line breaks and NRW (Aiton Reb., p. 5-7; Clarkson Reb., p. 3-4). Therefore, improvements in addressing NRW might be masked by increases in weather generated main breaks. In this regard, Staff's attempt to "normalize" the effect of weather on main breaks, by eliminating the "number of main breaks per month for January, February, and March 2014 due to the 'Polar

Vortex' weather phenomenon" from its main break expense calculation (Staff Report-COS, p. 69) does nothing more than eliminate the effect of abnormally cold weather by ignoring the effect of warmer winter weather on main break expense. So Staff on one hand removes historical, actual costs for rate recovery (main break expense) while imputing a future efficiency gain that ignores history and appears to rely on equally unrepresentative data (non-revenue water percentage).

MAWC has a goal of reducing water losses, in part through a combination of enhanced leak detection efforts, increased preventative maintenance and accelerated main replacement, but the suspension of ISRS did not help this cause and the gains will be realized more slowly as a result. While our goal might be to reduce water losses by 4% over the next three years,[1] there is no reason to impute such gains into the future test year at this time. As Mr. Aiton points out on page 3 of in his rebuttal testimony, "[a] decades long problem cannot be corrected in a few years. . . . All else being equal, achieving and maintaining a 100-year replacement rate will simply allow the Company to maintain its existing infrastructure going forward. It does not account for the Company having to catch up and replace the aging infrastructure." In his rebuttal testimony, Mr. Aiton goes on to discuss a variety of other factors, many of which are out of the Company's control, that also contribute to main break activity, and consequently a portion of the Company's NRW percentage. Any expected improvement in reducing water loss is not linear but rather one of slow improvements. Unfortunately, for example, Missouri was once again plagued with an extremely cold

[1] Company Witness Clarkson, Direct Testimony, pg 16, L 10-13

January this year, experiencing 1209 main breaks in January alone. Additional detail around main break analysis can be found in the surrebuttal testimony of Company witness, Nikole Bowen. (Bowen SR. P. 8-11) Consequently, while the Company's goal is appropriate and it will continue to strive to achieve it, it is difficult to say with any level of certainty that the Company will be able to achieve any reduction in its water loss percentage during the course of the rate year given the various external factors that contribute to the Company's water loss percentage.

Q. Is Staff witness Oligschlaeger's main break example valid as a criticism of the future test year?

A. No, I do not believe so. Mr. Oligschlaeger presents a chart of main breaks in St. Louis County from 2012 to 2016 and claims that the Company's use of a three year average masks a trend of declining numbers of breaks which, he states, should point to a trend of declining main break expense. (Rebuttal p. 18-19) The flaw in Mr. Oligschlaeger's argument is his concession that the data in 2014, the highest level of breaks at 1,118, was caused by the Polar Vortex in that year, which led to a higher incidence of main breaks. This flaw is being addressed by Company witnesses Bowen and Roach in surrebuttal testimony. Furthermore, an attempt to "normalize" the numbers of main breaks would be done irrespective of whether we were using a historical or a fully forecasted year. In fact, I think that Staff is tacitly conceding that normalizing historic data is simply an effort to forecast it – exactly what we are doing with the future test year, except that, as Mr. Oligschlaeger further concedes, the future test year matches the data with other expenses, revenue and rate base.

Q. Mr. Oligschlaeger speculates (Reb., p. 20-22) about why MAWC uses a different approach for its budgeting process than the process by which the future test year is established. Is this relevant?

A. No. First, Mr. Oligschlaeger recognizes that the Company explained that "it was not practical to have the same processes for the annual budget and for rate cases, since the annual budget process is tied to calendar year operations while MAWC's proposed "rate year" (the first twelve months new rates will be in effect from this case) is not be [sic] a calendar year." This is important because, for example, the 2018 budget was prepared in 2017 and the 2019 budget process is only now underway and will not be completed until well after this case has ended.

There is, however, an even more fundamental reason why the budget process is not appropriate to be transported wholesale for ratemaking purposes. Mr. Oligschlaeger recognizes (p. 22) that "[a]s shown in the response to Staff Data Request No. 0211, in year one the MAWC budget personnel rely on detailed "bottoms-up estimates" put together by subject matter expert employees for many operating expense categories." Budgets and rate case forecasts are prepared at different times, cover different periods, and have different objectives. Typically, the first year of the Company's operating budget is developed at a level that is sufficiently detailed to operate the business in the coming year. Years two through ten of the operating plan (the "outer years" plan), however, are developed at a high level (using general inflation factors and assumptions) to provide directionally accurate guidance for planning purposes (again, to plan for operating the business). Generally those types of directional forecasts, used in the budget process for the outer years, would not be deemed acceptable for rate case purposes.

In contrast, for example, MAWC general rate case forecast:

- starts with a "Base Year" that reflects actual revenues and expenses from the most recent twelve month period prior to the preparation of the rate case filing – e.g., the actual revenue and expenses for the twelve months ending December 31, 2016.

- In order to advance to the forecasted rate year, we consider known and measurable changes and reasonably probable projections to those cost elements (e.g., O&M expense increases based on existing contracts, collective bargaining agreements, etc.)

- through a verifiable link period (12 months ending May 31, 2018) and

- then continue that extrapolation process through the future test year (12 months ending May 31, 2019).

In contrast, budgets, certainly in the outer years, lack the rigor of general rate case forecasts. As I mentioned, and as Staff was informed, MAWC's outer year budget (years 2018-26) is developed using high-level global assumptions to inflate or deflate cost." This type of directional process would not be considered sufficient for rate case purposes and is used in our business only to give planners a sense of budgetary directions and considerations in the outer years. Consequently, many regulatory commissions have either refused to consider budgets, at all, or required that they be tethered to historical data. [2]Furthermore, developing a budget simply to match the

[2] For example, the New York PSC, which was the first regulatory commission to adopt the future test year back in 1977 stated:

> The forecast material should be developed from the historical base. For example, for operation and maintenance expenses, changes in prices and in activity levels should be fully and separately detailed by functional groups and elements of cost. For revenues, taxes and rate base, a suitable analysis of the change between the historical and forecast period should be made which similarly distinguishes between volume and price changes to the extent that is practicable. All assumptions of changes in price inputs because of inflation or other factors or changes in a c t i v i t y levels due to modified work

period of our future test year – which is the only way a valid comparison could be made - would be manifestly duplicative and create more work than necessary.

Q. In the light of the above, is Mr. Oligschlaeger's general belief that "while there may be some differences in approach within the two budgeting procedures, Staff would expect they be generally consistent" (Reb., p. 21) a fair statement about the respective rate case forecasting and budget processes?

A. Yes, they are "generally consistent." They use consistent approaches (methodologies of forecasting year revenues, year one expenses, capital plan) but they are not the same and should not be the same. They are similar because they involve views of the requirements of the business. They are different, however, because rate case forecasts do not, and should not, replicate budgets. This is also the reason why, although a few, limited expense categories are forecasted using inflation in the rate process, general directional trends inform the budget process in the outer years. Instead, links to historical, normalized information is required with links through the future test year using carefully explained escalation assumptions – just as MAWC did in preparing its future test year presentation.

> practices or other reasons should be separately developed. Our staff and other parties in rate cases should be able to retrace projections back to their historical source. All assumptions, escalation factors, contingency provisions and changes in activity levels should be quantified and properly supported. *Ordinarily, the format used in presenting company budgets of future operations produced for a utility's internal purposes will not meet these requirements without substantial modification.*

Case 26821, Statement of Policy on Test Periods in Major Rate Proceedings, November 23, 1977, pp. 7-8. Similarly, the New Mexico PUC, which more recently adopted a future test year cautioned utilities that, if budgets were used, they must still comply with rules requiring the use of forecasts based on historical information with links to the future test year and that "[i]f budget estimates are used, the estimates shall still be fully supported, explained and justified in the context of this rule, with full budget process documentation.". In Re Proposed Rule Governing Pub. Util. Rate Application Based on A Future Test Period, 301 PUR4th 547 (Nov. 29, 2012). Clearly, therefore, raw budgets are not generally held to be appropriate for rate case purposes.

Q. Should the RSM proposal and the future test-year proposal be mutually exclusive as Mr. Oligschlaeger suggests? (Reb., 25-26)

A. No. Mr. Oligschlaeger claims that the declining sales, and concludes that the mechanisms are mutually exclusive and should not be approved together. Mr. Oligschleager ignores problem that future test year and RSM address stems from the same issue, certain important facts and concepts in formulating his opinion:

- Regulators have implemented both revenue stabilization mechanisms and future test years for the same utility.
- Future test years are not a new regulatory tool and have been in use since the 1970s.

The RSM and FTY address two related but distinct issues. The RSM is a revenue mechanism designed to provide for more certain fixed cost recovery *based* on the proper costs defined by the test year approach. The FTY is designed to address the concerns over unit cost increases, capital investment and the inability of past data to accurately reflect future operating conditions. While it is true that unit costs are affected by quantity sold, that is only half the equation; the other half is the cost escalation and capital attraction.

Q. Staff witness Oligschlaeger also claims that the ISRS is antithetical to the future test year process. Is this correct?

A. No, and there are many regulatory commissions that allow both.[3] The future test year covers only one year. Because the Company has projected net plant additions in that year, there is no need for ISRS collections in that year because to do so would result in

[3] E.g., IN, IL, NY, PA, TN, VA

a double recovery. That is precisely why, as Mr. Oligschlaeger has recognized, the Company would not file for any new ISRS to begin until after the rate year if a future test year were to be adopted. After that first year, the Company will not earn any return on new net plant additions and the ISRS mechanism will be utilized by the Company which is to address some of the regulatory lag that occurs between rates cases. This regulatory lag exists anytime the Company does not have a rate case in the first year of the rate effective period. Consequently, it would make sense to restore the ISRS mechanism at the conclusion of the rate year. Doing so will also help the Company in avoiding having to file a rate case immediately after the expiration of the future test year in order to recover a return on certain net plant additions after the rate year. So, not only is the restoration of the ISRS following the end of the future test year appropriate, but it will also likely will help lengthen the time between rate case filings.

Q. Mr. Oligschlaeger notes that there are practical concerns related to the implementation of the future test year. (Reb., 2629). How do you respond?

A. Staff's concern is the change in focus from auditing a known set of data in the historical period to auditing a forecast for a future period. The Company is sensitive to this concern and has provided sufficient data and other information to assist Staff, and the other parties, in evaluating this proposal. It is important, however, to review carefully Staff's conclusion on this issue. Staff is not suggesting that this change in focus should prevent the Commission from approving a future test year, Staff, quite properly, notes that the Commission should make this decision based on "policy considerations, such as what approach is most likely to lead to setting just and reasonable rates for customers." (Reb. p. 28).

Mr. Oligschlaeger, however, goes on to suggest that the rate case is not the place to implement a future test year approach. Here we disagree. If the rate case is not the place to litigate the test year, then Staff must be contemplating that there is some other appropriate forum in which the test year is litigated yet provides the Commission with no guidance as to what forum is appropriate to litigate the test year.

Q. Mr. Oligschlaeger suggests that policy should dictate this decision. (Reb. p. 28). Are there good policy reasons to approve a future test year?

A. Yes. In a July 27, 2005 resolution entitled *Resolution Supporting Consideration of Regulatory Policies Deemed as "Best Practices"* the National Association of Regulatory Utility Commissioners ("NARUC") members reviewed a summary report from the 2005 Water Policy Forum in which stakeholders reviewed policies to address the water-specific issues and identified "the use of prospectively relevant test years" as one regulatory policy, among others policies including decoupling, capital trackers, and consolidated tariff pricing, that could promote sustainable regulation of water utilities. In 2013, NARUC recognized that water utilities continued to face a particularly challenging environment because:[4]

- "...compared to other regulated utility sectors, significant and widespread discrepancies continue to be observed between commission authorized returns on equity and observed actual returns on equity among regulated water and

[4] Resolution Addressing Gap Between Authorized Versus Actual Returns on Equity in Regulation of Water and Wastewater Utilities, Adopted by the NARUC Board of Directors, July 24, 2013

wastewater utilities"; "Ratemaking that has worked reasonably well in the past for water and wastewater utilities no longer addresses the challenges of today and tomorrow. Revenue, driven by declining use per customer, is flat to decreasing while the nature of investment (rate base) has shifted largely from plant needed to serve new customers to non-revenue producing infrastructure replacement"

- "Deficient returns present a clear challenge to the ability of the water and wastewater industry to attract the capital necessary to address future infrastructure investment requirements necessary to provide safe and reliable service, which could exceed one trillion dollars over a 20-year period;"

In recognition of these problems and concerns, NARUC endorsed the innovative polices found in the 2005 resolution and encouraged regulators to "carefully consider and implement appropriate ratemaking measures as needed so that water and wastewater utilities have a reasonable opportunity to earn their authorized returns within their jurisdictions." (Id.)

It is no accident that NARUC, which has vast experience in the regulation of all utilities, pointed out the unique situation of water and wastewater companies and recommends innovative ratemaking tools including those proposed by the Company in this case including the use of future test years.

Q. How should the Commission view Mr. Oligschlaeger's concern about the change in focus of the analysis it would have to undertake to review a future test year?

A. The Commission should take his concern seriously, as does the Company. The Commission, however, cannot ignore the unmistakable evidence that water utilities, even more so than other utilities, face a challenging environment and that adaptation of some regulatory practices to the changed environment will be necessary. To alleviate Staff's concern that moving to a future test year is risky, the Company has proposed a reconciliation process for projected plant as noted elsewhere in this testimony. This reconciliation process will assure the Commission that, even if this first attempt at a future test year has some maladies, those maladies can be addressed after the fact and will not harm consumers. Moreover, I note that the future test year proposal by the Company is not a *one-shot game*. If the Company purposefully or by mistake overestimates future costs it will quickly become apparent to all stakeholders and the Company will be held accountable for those mistakes. It is, therefore, in our own best interest to attempt to provide an unbiased forecast of future costs. We do expect, however, that as the Company, the Commission, and all stakeholders become more familiar with the process that improvements will be made. Indeed, regulatory bodies in many jurisdictions have implemented future test year ratemaking and parties and the regulators quickly become adept at addressing any issues that may arise. We are open to working with Staff, and other stakeholders, between rate cases to assure that everyone understands the process going forward and can provide useful and critical analysis of the process in the next rate case.

Q. Does Staff witness Oligschlaeger's discussion of the impacts of the TCJA (Reb., p. 30-31) provide an interesting contrast and context for its discussion of the future test year?

A. Indeed, it does. As I have explained previously, our future test year has been revised to take into account the tax law rate and normalization changes that will affect the rate year. This is entirely reasonable because the TCJA will be in effect in our future test year. In rather dramatic contrast, the historical test year was based on the old tax law, when, among other things, corporations were taxed at the 35% rate, not the new 21 % rate.

Q. Mr. Oligschlaeger argues (Reb., p. 31) that "TCJA impacts [are] known and measurable in the context of MAWC's current rate case." Is this correct?

A. No. In the context of the current ratemaking regime of a normalized historical test year with updates to December 31, 2017, he is mistaken. He notes correctly, for example, that "[t]he TCJA is effective January 1, 2018 [and t] he true-up period in this rate case runs through December 31, 2017." He, then, implausibly argues that "[t]he tax law change is effective concurrent with the end of the true-up period in this case." The true-up period ends December 31, 2017 and does not apply to all, or even most elements of the Company's cost of service. The TCJA, however, did not become effective until January 1, 2018 – *after the close of the true up period.* The new tax rates apply to revenues, expenses and rate base in 2018 – just like MAWC's future test period. In contrast, the provisions of the new tax law are mismatched if they are applied to the historical test period, even if it's updated. Consequently, the effect of the new tax law is different than the tax law that applied to the historical test year. It is not "known and measurable" because it is mismatched. In contrast, the Company's future test year is perfectly matched to the new TCJA.

Q. Have you reached a conclusion about how the potential federal tax benefits in the period January 1, 2018 to the start of the rate year should be treated?

A. Yes, and I explained it in my rebuttal testimony. We were willing to flow those benefits to our customers if, and only if, they are offset by the unexpected and extraordinary increased property taxes that MAWC was forced to absorb when the Commission refused to let us defer them via an AAO.

Q. Does the Commission's decision to deny rehearing of that denial affect that outcome?

A. Yes, with the Commission's rejection of the AAO for property taxes, that option has been foreclosed for federal income taxes. Trying to apply the tax savings in the period before new rates are implemented in this case would be retroactive ratemaking, which we were willing to accept if we were permitted the offset. Given the Commission's denial of the Company's request for a property tax AAO, it would not be appropriate to recognize only the tax law change in the period January 1, 2018, to June 1, 2018, when new rates commence, without investigating all other elements of the Company's cost of service that had changed. Elementary fairness requires no less. Now, as I explain above, the most appropriate thing for the Commission to do if it wants to take into account the effects of the TCJA, is to adopt the proposed future test year, which properly matches this 2018 tax law change with our 2018 and early 2019 revenue, expenses and rate base.

Q. Have you reviewed OPC witness Marke's rebuttal testimony with respect to the future test year?

A. Yes, I have. As an initial matter, I note that OPC witness Marke's claim in his direct testimony that the future test year violates the matching principle is refuted by Mr.

Oligschlaeger who finds (Reb., p. 8) that "[i]n a future test year scenario, if the forecasts of major elements of the utility's revenues, expenses and rate base are calculated at the same point in time, then the matching principle would seem to be maintained…," thus confirming my testimony on this matter.

Q. OPC witness Marke also claims that utilities benefit from information asymmetries in a future test year, arguing that they can project costs, such as employee count and then shed employees at a later date. (Reb., p. 5) Is this a valid concern?

A. This could happen regardless of whether a company uses an historical or future test period. It is, at best, a theoretical concern that has no nexus to the case at hand. It is telling that we have projected 696 employees and 12 summer positions and we have already reached an actual employee count of 694. So OPC witness Marke's point in that regard is misplaced. As far as information asymmetry is concerned, there is fundamentally no difference between the information provided for a historical test year and a future test year. Both the normalized, historical numbers and the projections from those numbers have to be analyzed. In both cases, the Company is obligated to supply Staff and the interveners with all the information they seek with respect to the process. The future test year changes nothing in this regard.

Q. OPC witness Marke states that there is nothing preventing the Company from earning its authorized rate of return in the future. Is he correct?

A. No. OPC witness Marke concedes (Reb., p. 6) that "[a] prudent utility should have a fair chance of earning its authorized rate of return" but he abjectly fails to enunciate what would constitute such a "fair chance." If, in fact, rates are set on a historical test year when it is known that (1) plant is being added, (2) expenses are increasing and (3) revenue is declining, then it is a virtual certainty that the utility will not have a fair chance to earn its authorized rate of return. The fact is MAWC has only earned its authorized return one time in the last fourteen years. *See* Figure 1 below.

As NARUC has recognized, the unique position of water utilities makes them particularly appropriate candidates for both the future test year and infrastructure clauses such as ISRS, along with revenue stabilization mechanisms. The Commission should not be led astray by hyperbole and exaggerated claims. Staff witness Oligschlaeger (Reb., p. 4) recognizes that: "at least 15 and possibly up to 20 state public utility commissions (PUCs) use future test year approaches as a matter of general policy[and that o]ther public utility commissions may use future test years in some circumstances, but not necessarily as consistent policy." The use of a future test year is neither novel nor especially daunting. The Commission should not hesitate to employ the future test year for MAWC because it would properly match revenue, expenses and rate base in the period for which rates are being set.

IV. <u>TAX CUTS AND JOBS ACT</u>

Q. Does Staff witness Oligschlaeger also address the ratemaking related to the TCJA?

A. Yes, and one of his observations in this regard is revealing and telling. He notes (Reb., p.30) that "Staff expects the TCJA to result in a lowering of revenue requirement in a material amount for large Missouri utilities, *all other things being equal.*" (emphasis supplied). I find it telling that Mr. Oligschlaeger tacitly concedes that the impact of the TCJA is only properly evaluated if "all other things are equal." As I noted with regard to the previous discussion of the appropriate test year to use, all other things are *not* equal if the tax rate for 2018 is matched to a historical test year that includes data from 2016 and 2017. For it to make sense to evaluate the effects of the new tax law, which includes many other things besides simply a change to the effective corporate income tax rate, one must consider the revenue, expenses and plant that will be in effect when the TCJA became effective. If the TCJA were to be applied to the historical test year or indeed, any other period that is not fully evaluated, it would constitute single issue ratemaking and a distorted picture of the effects of the new tax law on the Company's rates.

Q. Does the Company's future test year fully capture the effects of the TCJA?

A. To the extent that they reasonably can be predicted to occur during the rate year, the answer is "yes." This appears to be the case for the calculation of the effect of the federal income tax rate change from 35% to 21%. For other, more complicated, effects of the law, such as on deferred taxes, we propose the use of a projection with a deferral mechanism that will true up the effects of deferred taxes when they more reasonably can be predicted. The TCJA contains many provisions that substantially modify the Internal Revenue Code, and these matters are quite complicated and it will take time to fully understand and quantify. Nevertheless, with the adoption of our future test year, customers will see the benefits of the new tax law translated into a lower rate requirement for federal income taxes upon the adoption of new rates. And, as I said, any additional benefits will be deferred and kept for the ratepayers' benefit as they can be more accurately ascertained.

Q. Would it be appropriate for the Commission to try to capture the benefits of the TCJA prior to the implementation of MAWC's new rates?

A. No. As I stated previously, not only would it be an inappropriate use of single issue ratemaking without examining fully all the other effects of changes in revenue, non-federal income tax expenses and rate base but it would, moreover, be an improper exercise of retroactive ratemaking in my view because it would change the rates set in the last case based on matters that only became known subsequent to the decision of that rate order.

Q. Would it be appropriate to use the tax law changes from the TCJA with a historical test year?

A. I do not believe it would. As I said, the tax law applies to 2018 and beyond. The historical test year applies to 2016 and 2017. This would be a fundamental mismatch of the matching principle. Moreover, the effects of the TCJA are not "known and measureable" when applied to a period prior to its effectiveness.

Q. OPC witness Riley contends (Reb., p. 5-6) that:

> **The new income tax rate is a calculation change where the actual expense flows from the combined cost of service. It has to be considered in the true-up period because actual income tax adjustments for the effective date will be predicated on a known and measureable calculation as opposed to a static expense adjustment like updated insurance or rate case expense.**

Is he correct?

A. That's an opinion, not a fact. As I explained, the future effects of the TCJA are not simply "calculations." Some, however, can be reasonably predicted and then applied to the revenue, expenses and rate base in existence at the time rates are being set. Our future test period does this. A hybrid test period, involving historical data augmented by some, but not all, updated data, does not, rendering the tax law changes imprecise and, hence, not known and measurable. Again, as Mr. Oligschlaeger conceded, the future test period matches all elements of the ratemaking calculus in the period for which rates are being set. Moreover, as I explained above, when the more complicated elements of the TCJA are known, any benefits will be preserved for our customers. Clearly our combination of the future test period with a deferral mechanism to preserve benefits when ascertainable is preferable to the method proposed by the OPC witness.

Q. Please explain how the TCJA adversely impacts the Company's ability to achieve funding levels that best serve the long-term interests of its customers?

A. MAWC has a multi-decade-long investment need that is funded up front by shareholders and lenders and recovered from customers over 40+ year time frame. As I will demonstrate later in my surrebuttal testimony, under Missouri's traditional ratemaking approach, Missouri-American already is facing persistent revenue shortfalls from declining use per customer and the need to rebuild legacy infrastructure. Our future test year filing has been revised to take into account the lower tax rate and the normalization changes that will affect the rate year. This lower tax rate alone reduces our revenue requirement request by $20.3M (Wilde Reb 4:5-7). As a result, the effects of the TCJA tax rate change will lower MAWC cash flows relative to those expected prior to the passage of the TCJA in late December. Additionally, the TCJA eliminates bonus depreciation for regulated utilities, further eroding cash flow.

MAWC's significant capital needs and reduced cash flows will place additional strains on the Company's ability to attract capital. (See Aiton, Dir 4:10-17; Bulkley, Sur 23-24; Norton, Sur 8-10) While we have proposed to include the tax rate change in our future test year filing, we would ask the Commission to take a longer term view of its role in assuring timely cost recovery. The future test year properly recognizes the expense levels and plant that will be serving Missouri-American's customers when the new rates take effect, while the RSM provides the Company a realistic opportunity to collect its authorized revenue requirement mitigating the persistent regulatory lag that has constrained the Company for more than a decade.

Q. Are there any other considerations that should be taken into account by the Commission in evaluating MAWC's request to address the ADIT remeasurement assets in our next general rate proceeding?

A. Yes. Company Witness Wilde explained in detail why MAWC will be unable to fully estimate the exact amount of the TCJA's ADIT balance. (Wilde Reb. 5:3-16). Given the complexity and uncertainty in measuring the ADIT balance we have recommended the expected excess balances be addressed in our next rate case. The Company, however, notes that while the tax implications for the Company's remeasured DIT balance are likely to work in the favor of customers, which is entirely proper, the regulatory approach to other deferrals on our balance sheet has the effect of working against cost recovery for the Company and burdens future customers with decisions from the past. For example, the National Call Center and Shared Services Center project costs ($6.8m) remain on the Company's books. These projects were for the purpose of reengineering and startup activities for the consolidated call center in Alton, IL and our shared services center. The costs were incurred in the early 2000s and are being amortized over 50 years. *See* Report and Order in Case No. WR-2007-0216 *et al.*, Effective October 14, 2007. We propose that these costs be recovered over a shorter amortization period and reconciled a long with the TCJA ADIT remeasurement. Accelerating cost recovery National Call Center and Shared Services Center provides a balanced approach to decisions that are external to the Company. Tax law changes were introduced by the Federal government and the decision to defer recovery of the above items over an extended period was ordered by the Commission. It also would mitigate rate volatility. The TCJA provides a unique opportunity for the Commission to reduce the recovery period of the above project costs in a manner that is less disruptive to the rates customers pay, which presumably was part of the intention in deferring recovery initially. The Company's proposal provides an equitable balance.

V. <u>REVENUE STABILIZATION MECHANISM</u>

Q. Would you please summarize the Company's position on its proposed revenue stabilization mechanism ("RSM")?

A. The normalization process for determining water sales systematically creates an insurmountable impediment to the Company's fair opportunity to recover its costs. Importantly, this impediment is not an error in the application of the normalization process, rather it is a function of changing customer attitudes toward conservation, changes in the stock of efficient water-using fixtures and appliances due to regulations, as well as a number of other factors that affect the demand for water which are outside of the control of the Company. (Roach Dir., p. 20). Unlike the parties opposing the proposed RSM, the Company has provided evidence that the RSM is necessary to balance the interests of the parties.

Q. Would you please summarize the evidence provided by the Company in support of its RSM proposal?

A. The Company has shown that over the last decade the process for normalizing sales has led to actual sales being significantly lower than what was assumed in rate cases for the purpose of setting rates, which in turn leads to a systematic under-recovery of its prudent and reasonable costs as determined by the Commission. (*See e.g.,* Roach Dir., Sch. GPR-6; Watkins Dir., Sch. JMW-3, Sur., Updated Sch. JMW-3 and Sch. 4). For the most part, this systematic inability to meet expected revenues has reduced the Company's ability to recover its fixed costs since the volumetric charges recover not only the variable costs of operation but also the fixed cost of the production and delivery systems. (*See e.g.,* LaGrand Dir, Sch. BWL-3; Heppenstall Dir., Sch. F). The RSM provides a well-used tool by regulatory bodies to address the facts associated with operating a modern water utility system in the face of changing circumstances. (Jenkins, Dir., p. 23-25)

Q. Some parties have argued that the RSM is an unnecessary mechanism that is not consistent with the regulatory process. (Busch Reb., p. 3-4; Meyer Reb., p. 5). How do you respond?

A. The regulatory process is not a fixed formula or a set principle. The standard for rates is "just and reasonable," which has always been interpreted as a balancing of the interests of the parties. In effect, it is the *end result* that is judged just and reasonable, not necessarily the process that leads to that end. At a high level, the balance that must be struck is between the legitimate concern that customers be provided safe and adequate service while being protected from paying excessive rates and the equally legitimate concern that the utility have a fair opportunity to recover its prudently incurred costs of managing the system, including the cost of obtaining capital to meet its service obligations. Since rates are set prospectively, traditionally, that balance was achieved, in part, by using a sales normalization process, based on the assumption that any random fluctuations in historical water sales are effectively smoothed out thereby providing the utility with an opportunity, if it managed its system efficiently, to recover its prudent and reasonable costs *including* its cost of capital. That system worked well for many years because the assumption that the normalization process fairly represented, at least on average, the actual results in the rate-effective period tended to hold (i.e., the *errors* were effectively smoothed out). That assumption no longer holds because of factors that are beyond the control of the Company as has been documented in this case. (*See e.g.,* Roach Dir., p. 19-23; Watkins Dir., p. 16, 27,).

Q. Are you suggesting that MAWC should expect to be protected against any circumstances that would cause future sales and revenues to be different from the levels established in this case for the test year?

A. No. I am not suggesting that any utility expects some "perfect world" where test year revenues exactly match actual results. That is not the assumption behind the test year concept, nor is it particularly relevant to the issue in this case. The assumption behind the test year concept is that, on balance, the estimates that are used to determine final rates are *unbiased* in the sense that there is no systematic downward or upward bias in the rate effective period. For example, if the Company were simply allowed to choose its level of expected sales there could be a concern that would bias rates, and in turn revenue recovery, upward. To mitigate this potential bias the Commission attempts to do the best job it can in deciding on sales normalization. Equally important, however, if the normalization process cannot produce an unbiased result then another method needs to be devised to maintain the proper balance.

Q. Is the RSM the only possible approach to address the problem with normalization?

A. No. A substantial portion of the Company's cost structure in the test year are fixed costs, i.e., costs that do not change as consumption changes. If the Company's rates were set to recover fixed costs through fixed charges and variable costs through volumetric rates, then sales forecasts, while still important to set rates, would be less likely to bias revenue recovery one way or the other. The Company proposed the RSM as an alternative approach to address the balancing of the interests of the Company and its customers while at the same time not radically changing the rate structure.

Q. Does the RSM unfairly guarantee a level of revenue going forward? (Busch Reb., p. 3-4; Meyer Reb., p. 3, 4; Marke Reb., p. 6, 13)

A. No, it does not, just as straight fixed variable rate design does not unfairly guarantee a level of revenue going forward. The RSM provides a way to re-establish the balance that was intended by the normalization process. Utilities have a duty to manage their operations in an efficient way, which includes both fiscal and physical management of the system. Neither an unbiased normalization process nor the RSM relieve the utility of that duty in any way. If the normalization process is unbiased then the utility can expect, on average over the long term, to recover the revenues allowed by the Commission. (Jenkins Dir., p. 17). I would not call that a guarantee, but I would call it a reasonable expectation. When that expectation is no longer reasonable under the traditional normalization process, an alternative method must be used to reestablish the balance. (*Id.*). Schedule JMW-4, attached to Mr. Watkins surrebuttal testimony, shows that actual consumption levels met or exceeded Staff's projected rate case usage levels only once in the last eleven years. As Mr. Watkins points out in his surrebuttal, over the past eleven years, the Company has sold over 48 billion gallons less than what Staff predicted, which is an average deficit of approximately 4.4 billion gallons in sales per year. This clearly shows that the forecast of consumption historically proposed by Staff has not been reasonable to obtain. Simply put, under an unbiased normalization process and under the RSM the Company has a reasonable expectation that it will have a fair opportunity to recover costs. In this way the RSM restores the balance intended by the traditional normalization approach.

Finally, I disagree completely with OPC witness Marke that allowed returns and revenues are but a "ceiling" and because the Company has maintained positive earnings, the Company has recovered its costs and has earned some sort of return on its investment. (Marke Reb., p. 6). This is completely inconsistent with the fundamental notion of how the regulatory process should work. An authorized rate of return is not an upper limit, a ceiling, or a "stretch goal". Witness Marke provides no authoritative citation in support of this newly formed notion of "ceiling regulation." A utility's returns are necessary to pay for the capital that it has borrowed from its equity holders. Under OPC witness Marke's view, if the Company earned $1 of positive earnings then the Company has recovered its costs and appropriately compensated its equity holders. Such a view does not meet the *Hope* and *Bluefield* standards for evaluating a fair return. (*See* Bulkley Dir. and Sur.). Moreover, if allowed returns and revenue are a "ceiling" then what incentive would utilities ever have to lower their costs? This view of regulation as a "heads I win tails you lose" game is an uninformed view of the regulatory process.

Q. OPC witness Marke ties the need for an RSM to conservation efforts. (Marke Reb., p. 13). Is this a relevant consideration for adopting an RSM?

A. It is a relevant consideration but it is by no means the only, or even the most important, consideration.

Q. Please explain.

A. OPC witness Marke's mistrust of efficiency programs and his misguided claims that resources are abundant are entirely beside the point. As MAWC witness Roach has explained, several nationwide federal statutes mandate significant water use reduction standards in new appliances, toilets and other water using items such as shower heads which, when adopted by current homeowners and introduced through replacements and home renovations, produce conservation increases. (Roach Dir., p. 19-30). Water conservation measures are a reality in Missouri and the Company has demonstrated that fact in its testimony. No party has realistically disputed the Company's testimony on this issue because no party can do so. Federal standards are applicable nationwide, and, as a result of those standards and other factors, Mr. Roach has documented a systemic reduction in customers' use of water by roughly two (2) percent per year. (Roach Dir., p. 7-8). OPC witness Marke's musing about whether water conservation is useful or effective is entirely beside the point.

Lest there be any doubt about this matter, Figure 1 (also Schedule JMW-4 in Mr. Watkins' surrebuttal testimony) illustrates that both Staff and MAWC's consumption projections demonstrate the trend of declining use. (Forecasts are taken from previous rate cases.) The effect of non-normal weather on consumption is indicated by the spike in consumption correlated with the hot, dry summer of 2012. Given the equally clear variability of actual consumption, due largely to non-normal weather, the RSM will provide an assurance to customers and the Company, alike, that the revenue collected by the Company will be consistent with the revenue authorized in the rate order.

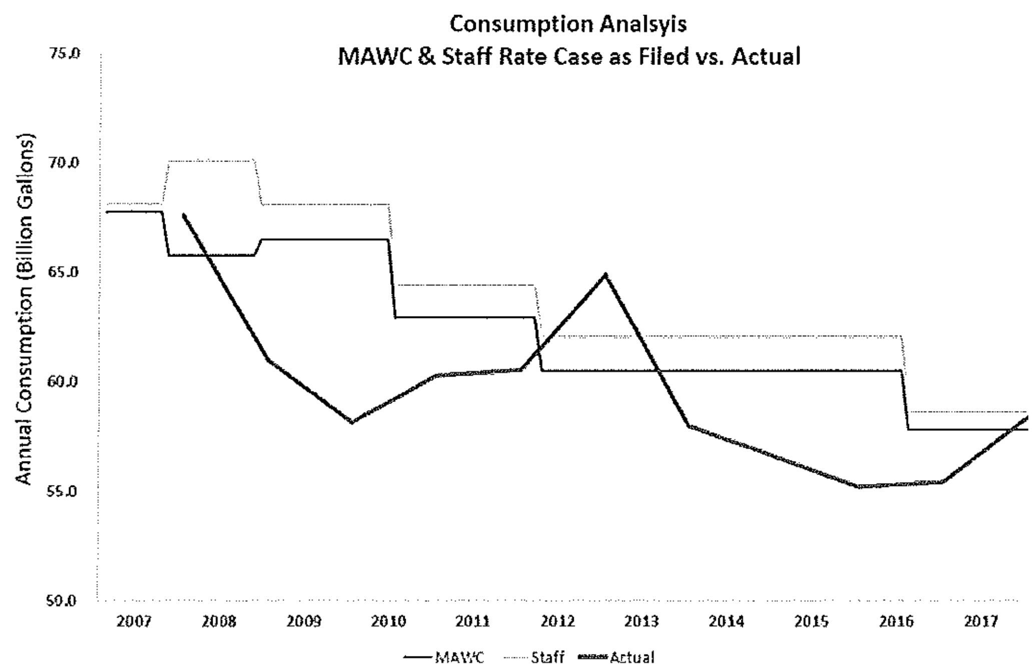


Figure 1: Forecast of Water Usage vs. Actual Usage 2006-2017

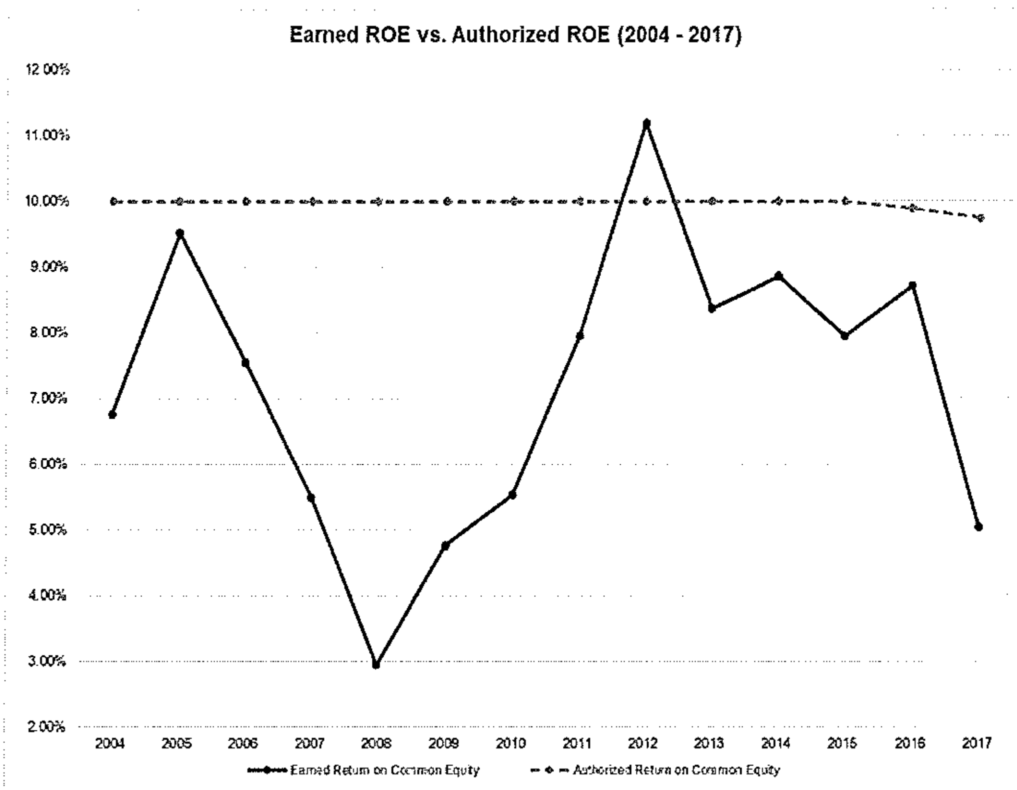
Q. DE witness Hyman also ties the need for the RSM to the existence of Company-sponsored demand-side efficiency programs (Hyman Reb., p. 2-3). How do you respond to Mr. Hyman?

A. DE witness Hyman ties the reasonableness of the RSM directly to specific efforts that MAWC could be taking now or in the future to help customers reduce water consumption, with the implication that an RSM <u>might</u> be reasonable only to the extent that MAWC can prove that MAWC programs are the direct cause of declining usage. Interestingly enough, OPC witness Marke suggests that these very same programs are unnecessary and should not be undertaken (Marke Reb., p. 11-12).

My response to Mr. Hyman is that he is fails to recognize or acknowledge the undisputed facts: (1) that water consumption per customer for residential and commercial classes has been declining for several years, (2) that it will continue to do so for the foreseeable future, and (3) that the majority of the continuing decline in water consumption will still come from sources other than MAWC. Moreover, Mr. Hyman places the cart before the horse. Approval of an RSM removes a disincentive for MAWC to more actively promote demand-side efficiency programs. So it is the approval of an RSM that should be the prerequisite to us undertaking a large scale customer funded water conservation program of the type DE witness Hyman describes; it should not be the other way around.

Q. If conservation is not the primary reason for the RSM, as OPC witness Marke suggests, what is the main reason?

A. The main reason for the adoption of an RSM is that it is a ratemaking tool that helps to ensure that a utility collects an appropriate amount of revenue from the ratemaking process to support the prudent and reliable management of the system. MAWC witness Roach has explained how weather variability and the pernicious trend of declining use per customer have a significant effect on our revenue. (Roach Dir., p. 28-29. It appears OPC witness Marke believes that utility earnings should be driven by the inability of the regulatory process to properly account for weather, rather than the utility's efforts at providing safe, adequate and reliable service to its customers. Comparing Figure 1 above and



below illustrates that MAWC's earnings are closely related to the effects of weather in any given year and longer-term trends of declining usage. Only once in the last fourteen years has MAWC earned a rate of return higher than the authorized rate of return. That year was 2012, which was the hottest year in the service territory since 1935 and the driest year since 1990. MAWC's earned return on equity peaked in the hot, dry year of 2012 and declined in other years. Moreover, as usage trends declined over the longer time frame the Company's ability to attract funding has been seriously constrained.

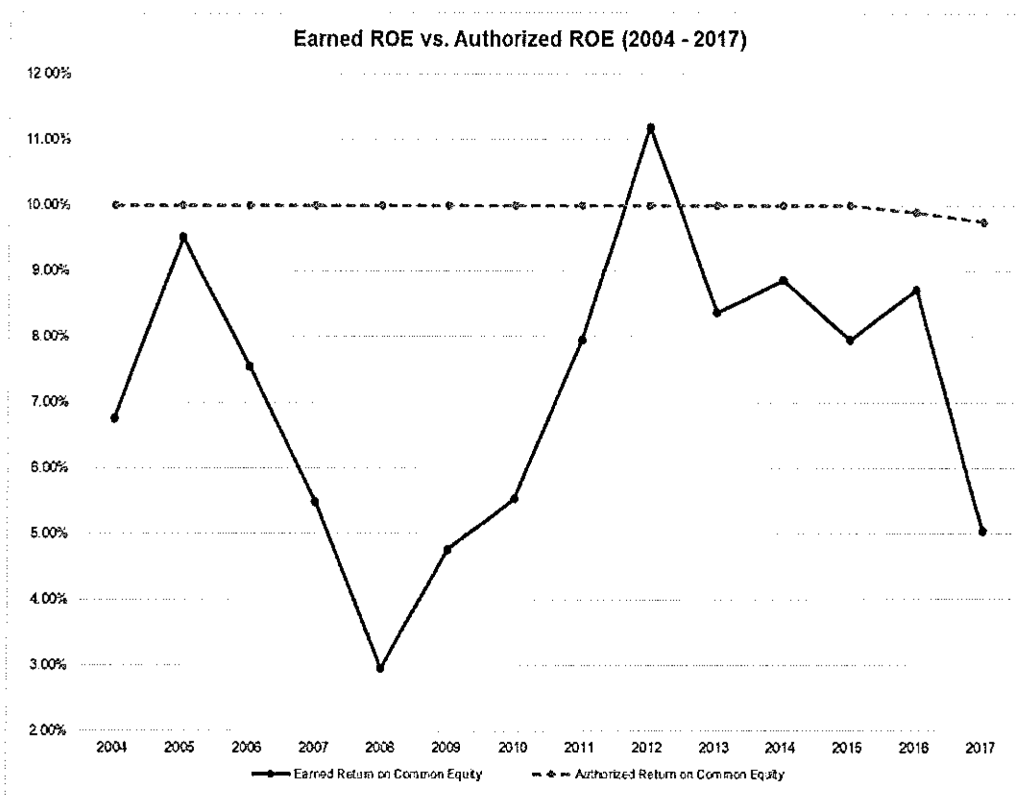


Figure 2: MAWC Earned vs. Authorized ROE – 2004-2017

Q. Does ensuring that actual revenue is consistent with revenue projected in the Commission's rate orders guarantee that the Company will earn its authorized rate of return? (Marke Reb., p. 8-11)

A. Of course not. The cost of owning and operating the system, which is something the Company can and should efficiently manage, is just as important to the Company earning its authorized rate of return as the revenues the Company collects, which is something largely outside of the Company's control. It is a fundamental tenet of utility regulation that efficient companies should earn or exceed their allowed rates of return while inefficient companies will fall short of earning their allowed returns. Again, all that MAWC is asking is that it be given a reasonable chance to meet its allowed rate of return. An RSM provides that chance. Sales forecasts that ignore weather and declining use per customer do not.

Q. Is MAWC asking the Commission to shield it from the consequences of ineffective management by guaranteeing certain levels of revenue and thereby guaranteeing a certain level of return as some of the parties seem to suggest? (*See e.g.,* Meyer Reb., p. 3)

A. No. It is MAWC's responsibility, not the Commission's, to efficiently manage its operations and if it does so, it should expect to be able to earn a rate of return consistent with that authorized by the Commission. The Company is given a fair opportunity to earn its authorized rate of return when the factors that affect its returns can be efficiently managed. MAWC should not be subject to the possibility of not earning its return because of flaws in the process used to set rates in the first place, i.e. the process used to set sales projections upon which rates are built and the sales normalization processes used by Staff.

Q. Is MAWC asking the Commission to provide it a "perfect result" in terms of ongoing revenue that would otherwise be unattainable by any other company in a normal market situation? (Busch Reb., p. 3-4; Marke Reb., p. 13)

A. No. What MAWC is asking for an unbiased approach to normalizing sales and an unbiased attempt at determining the sales levels upon which rates are set. Stated differently, the utility and its investors should have a reasonable expectation that sales and revenues at some future point could just as easily exceed the assumptions used to set rates as they could fall short of those assumptions. Mr. Busch makes a salient point by noting that sales fluctuations may be a result of numerous factors and the "regulatory process smooths out these fluctuations through the process of normalization." (Busch Reb., p. 4). I agree that is the *purpose* of normalization, what Mr. Busch does not address is whether that is the *result* of normalization. Again, rates are just and reasonable if the results are just and reasonable not just that the *purpose* is to produce just and reasonable rates. The results can only be determined by reviewing the facts of how the normalization process has worked in practice. These facts must have a bearing on whether the outcome is reasonable. Please refer back to Figure 1 or to Schedule JMW-4 to see Staff's forecast and actual results compared. The Company has provided ample evidence that the normalization process no longer provides a reasonable *smoothing* of the random fluctuations of sales and has proposed the RSM as one method to address this issue. What MAWC seeks is a remedy to that systemic condition. The proposed RSM provides that remedy.

Q. Do you agree that implementation of the RSM will create undue rate volatility? (*See e.g.,* Busch Reb., p. 10-11)

A. No. In fact, implementation of the RSM will have the opposite effect and will increase rate stability over the long run. Given that water consumption for residential and commercial customers is declining over time with no real end in sight, MAWC anticipates that absent large swings in weather, the RSM surcharge amount will increase gradually over time once implemented until the next rate case. This means that at the time of the next rate case, increases in customer bills and overall rates would be smaller than they otherwise would have been. This is gained in return for smaller effective increases in water rates along the way. The status quo alternative is to have flat volumetric water rates for a period of time with larger periodic bill increases, which increases volatility due to addressing multiple years of declining sales in a single case versus addressing the issue annually through a true-up mechanism like RSM.

Q. Do you believe that implementation of the RSM unduly shifts risks to customers and away from MAWC (Busch Reb., p. 9; Marke Reb., p. 10)?

A. No. This is an argument that is often leveled at revenue stabilization mechanisms and is completely without merit when properly understood. (Jenkins Dir., p. 33; Jenkins Reb., p. 17-18). It is important to remember that the RSM is effectively a surrogate for more economic pricing methods that recover fixed costs in fixed charges and volumetric rates recover only those costs that change with changing consumption. Under MAWC's current rate structure and the proposed rate structure (absent the RSM), the entire cost of owning, operating, and maintaining the water distribution system, which does not change based on increases or decreases in water consumption, is paid for through revenues that are completely tied to increases or decreases in water consumption. (*See* Heppenstall, Dir.). Under a more commercially responsive pricing scheme, fixed costs would be included in fixed charges and variable costs would be included in variable charges, with all customers paying an equal amount for contributions to the fixed costs of prudently managing the system.

If rates were set in this fashion, then customers pay a higher fixed rate and obtain a bill reduction when their activity reduces the costs to serve the customer. In effect, the RSM recovers fixed costs that otherwise *should have been* recovered in fixed charges but does not increase the costs that are properly recovered through rates. Moreover, if customers undertake conservation that is not captured in the normalization process, the regulatory process currently has a method to address this issue—the rate case. That process has failed to work properly as documented in the Company's testimony.

I also disagree with OPC witness Marke's conclusion that an RSM "distorts the free market proxy" by ensuring recovery of "the Company's profits irrespective of market behavior or inefficient utility behavior." The RSM is a revenue adjustment mechanism and does not shield the Company from maintaining efficient operations. If the Company's costs are not managed properly it will be harmed through lower net income. The Company has a strong incentive to maintain and expand its net income by deploying efficient management. Suppose, for example, the Company's administrative costs are not properly managed. This would result in lower net income between rate cases and the Commission would disallow some of those costs in the next rate case. This is exactly what occurs now under traditional regulation and provides the Company an incentive against allowing those costs to inefficiently expand. Moreover, whatever conditions might affect the revenues and expenses of a utility, e.g., increases in the market wage of labor or the market cost of materials or declining sales, are incorporated into the traditional regulatory process through the normalization process. This does not change under the RSM proposal. The RSM addresses a specific malady in the normalization process which mimics the process as it was intended to work. There is no "distortion" of the regulatory process or shifting of risk to customers when the RSM is properly understood.

Finally, the issue of the proper accounting for risks, from a financial perspective, is also addressed by Ms. Bulkley in her surrebuttal testimony.

Q. Do you believe that implementation of the RSM will lead to intra-class subsidies? (Busch Reb., 8:19-9:4)

A. No. It is important to note that MAWC's proposed residential rates are already slightly below residential cost of service (Heppenstall Direct, Schedule A), so residential customers are already being subsidized based on cost of service by other classes. The RSM does not introduce any more significant subsidies among and between residential customers that doesn't already exist in the original proposed rate design.

Q. Would you please respond to the connection between the RSM and investment spending? (Busch Reb., p. 5; Meyer Reb., p. 4)

A. The parties bring up two separate issues on investment spending. Staff claims that the RSM will do nothing to "prevent future capital additions." Mr. Meyer criticizes the Company for not committing to capital investment but then argues that the RSM will increase investment which will increase rates.

As to Staff's claim that the RSM would not avoid capital investment that is, in some sense, not accurate but in a boarder sense not relevant. It is true that I cannot point to a specific piece of capital that will be avoided by the RSM, yet, how could I? The RSM is a revenue-mechanism used to address rate design maladies. Therefore, Mr. Busch is technically correct that the RSM does not avoid capital directly, but that misses the point that the RSM can help enable efficiency by removing barriers to improving efficiency and needed investment.

MIEC witness Meyer's argument is more muddled and aimed not at avoiding investment but enhancing investment. He criticizes the Company for not providing any "analysis or "commitments" to increasing investment if the RSM is approved. That is quite true, but irrelevant. Rates are designed, in part, to support future investment, yet one would not criticize a rate design proposal because there is no commitment to investment spending. One could criticize, however, a rate design that tended to decrease the ability of the Company to invest. This is the point Mr. Meyer seems to be struggling to understand. My confusion with Mr. Meyer's claim lies in the statement that "[A]n increase in investment levels, as a result of the RSM, will lead to an increase in cost of service." (Meyer Reb., 413-14). It is unclear if Mr. Meyer now thinks that the RSM *will* lead to higher investment and is concerned that such investment will increase rates. This too is quite irrelevant, no matter what it might mean. As a rate design mechanism, the Commission should be concerned that the process provides a regulatory environment supportive of the necessary investment. The type and amount of capital allowed into rates will still be addressed in the traditional manner through ISRS and the process to address those capital additions, as well as any other capital additions (i.e., future rate cases).

The RSM is but one of several important ratemaking mechanisms. But it is vitally important because it is a mechanism that ensures that the legal test of appropriate ratemaking – that a company be given a reasonable opportunity actually to earn the allowed revenue requirement – can be met. The evidence I've offered demonstrating conclusively that MAWC has not been given such a reasonable opportunity is unassailable and should be deeply troubling to the Commission. Given the pernicious, systemic failure of the existing normalization process to afford the Company any reasonable opportunity to earn its authorized rate of return (once in 14 years is hardly reasonable), it should be clear that a change is in order. The RSM, coupled with the use of a future test year, is the only ratemaking mechanism offered by any party in this case that addresses that manifest inequity.

VI. RATEMAKING TREATMENT FOR MAWC'S LSLR PROGRAM

Q. OPC witness Marke continues to claim that allowing recovery of lead service line replacement ("LSLR") costs is illegal in addition to being imprudent. (Reb., p. 2-3) Does his position withstand scrutiny?

A. No. First, neither OPC witness Marke nor I are attorneys, so I will defer to our attorneys the task of addressing his inexpert (and incorrect) claims with respect to legality. Second, as far as the prudence of the costs, he is clearly mistaken. As stated in my rebuttal testimony, MAWC recommends recording these costs consistent with the guidance found within the Uniform System of Accounts ("USOA") to account 345 – Services. In accordance with the USOA account 345, capitalized mains include the installation cost of pipes and accessories. (Jenkins Reb. Rev., p. 37). Because this account covers "installation costs" it logically includes other restoration cost items such as disturbed pavement, cutting and replacing pavement, pavement base, sidewalks, curbing, that are intrinsically associated with main installation. Restoration costs also generally include costs related to damages to the property of others, and other general costs relating to restoring areas to a safe or prior condition. The replacement of customer-owned lead service lines is similar to the restoration of other customer property. There is absolutely nothing imprudent about this expense. Indeed, how can it be imprudent when it fosters the public's health and safety? These restoration expenditures should be capitalized to plant as part of overall project costs. (Jenkins Reb. Rev. p. 37)

Q. OPC witness Roth claims that the inclusion of customer-owned lead service lines in rate base as plant in service does not align with the NARUC USoA Utility Plant in Service since it is not plant that the Company owns. (Reb., p. 12) Do you agree with OPC witness Roth's interpretation of the NARUC USoA?

A. No. The Company recommendation has remained consistent the - costs associated with replacing customer-owned lead service lines are similar to the costs incurred in restoration of the customers' property. As I stated on page 39 of my revenue requirement rebuttal testimony,

> MAWC (and other utility companies) routinely capitalize and recover infrastructure costs associated with restoring other entities' assets that it disturbs or damages as part of its aging infrastructure replacement programs. While water utilities do not own the roads, sidewalks, curbing and driveways, water infrastructure replacement projects can disturb or damage these nearby assets, and the cost to restore these assets is properly included in the utility's rate base.

As such, recovery of LSLR costs as plant in service recorded to NARUC USoA Account 345.0 Services aligns with how costs have been recorded to that account in the past.

Q. Is Staff proposing to include any costs for the LSLR AAO in this rebuttal filing?

A. Yes. Staff witness McMellen has included the June 30, 2017 balance of the AAO for LSLR costs of $1,071,559, in rate base and testified that these costs should be amortized over a ten-year period beginning with the effective date of the Report and

Order issued in this case. The rate base balance of these costs will be updated as part of the true-up audit in this case. (McMellen, Reb., p. 3)

Q. Has Staff included any amounts in this rate case for any future LSLR replacements?

A. No. Staff argues that any recovery of future replacements should be considered in future rate cases and recommends that the Commission authorize MAWC to record these costs going forward, with the same accounting treatment approved in the Report and Order in Case No. WU-2017-0296. (McMellen, Reb., p. 3)

Q. Do you agree with Staff's recommendation to defer collection of current LSLR costs?

A. No. There is no basis for a continuing deferral of these known costs. They are recoverable costs in this case and should be collected as a current expenditure. The denial of current cost recovery for these expenses – which the Commission has acknowledged are necessary and desirable - would simply increase costs and safety risks for customers.

Furthermore, the Company does not find the continued use of a deferral mechanism to be in the best interests of its customers. If, for example, the Company were required to request a deferral for on-going LSLR costs, this could materially affect the Company's ability to continue the program over the longer term. As the Commissions noted, the LSLR is a public health issue. (Report and Order in Case No. WU-2017-0296, ¶14, p. 7). Moreover, the ratemaking treatment of deferred costs is determined in the rate case. (*Id.*, ¶18, p. 8). Staff has determined that the deferred costs should be recognized for inclusion in rates, presumably because they are convinced that such costs are reasonably incurred by the Company. If the Company were to request an AAO for its on-going LSLR program this would cause an unnecessary administrative burden on both the Company and the Commission. In addition, as the Commission has noted the AAO process has requirements such as the extraordinary nature of the cost and materiality. (*Id.* p. 9). The AAO process creates regulatory uncertainty, on top of the administrative burden, that could create hurdles to the on-going replacement of the lead service lines. The Company considers this an important public health issue, as we know the Commission does. To avoid any potential roadblocks to an important on-going program to replace lead service lines, the Company's proposed accounting approach should be approved, and any on-going costs should be recognized as normal services-related investment. (Jenkins Rev. Req. Reb. 37:6-15; LaGrand Dir., 22:14-16)

Q. Do you agree with Staff witness Merciel's recommendation that MAWC should be required to report annually their program LSL replacement plans?

A. The Company would not oppose providing Staff with pertinent information related to its LSLR activity but I defer to Company witness Aiton surrebuttal testimony for the details of the reporting.

VII. <u>RATE CASE EXPENSE</u>

Q. Has Staff changed its calculation of rate case expense?

A. Yes. Staff witness Newkirk has increased Staff's "Percentage proposed vs percentage requested" adjustment "from 8.05% to 23.68% due to Staff's most currently revised revenue requirement calculation." (Reb., p. 2)

Q. Do you agree with Staff witness Newkirk's revised adjustment?

A. No. We continue to maintain that MAWC is entitled to its entire rate case expense as a matter of law and basic fairness. In fact, I would point out the manifest unfairness of the effect that the TCJA would have on this adjustment as an example of its inherent arbitrariness. The TCJA was enacted into law during the pendency of this case and it has the effect of lowering the federal income tax expense. Although this tax law change was not foreseeable at the time we filed our case and will produce manifest benefits to our customers, Staff witness Newkirk's rate case adjustment would harm us by reducing the "percentage proposed vs percentage requested" simply because the tax law changed and our revenue requirement decreased by approximately $20 million. This is the very definition of an arbitrary adjustment having nothing to do with any action taken or not taken by MAWC. Moreover, the Company takes seriously its duty to provide the Commission with the best evidence it can to enable the Commission to have sufficient information to make its conclusions. When we fulfill that obligation by providing the Commission and the parties with our best evidence, discovery responses and legal analysis, we should not be penalized through an arbitrary disallowance.

Q. Are there other examples of the inherent arbitrariness and unfairness of this proposed "sharing" of rate case expense?

A. Yes. I am aware, for example, that certain "carve outs" have been allowed such as for certain "required" studies, such as depreciation studies. How one can argue that a study that identifies a certain depreciation rate is somehow more "pure" than a study of the required rate of return on equity is beyond comprehension. Regulated utilities are obligated to provide the Commission with the best and most comprehensive evidence they can muster to help the Commission properly decide the myriad issues in a rate case. To allow recovery of the associated costs of presenting that evidence based on a crude yardstick arbitrarily removes costs that are reasonably related to the requirements of Missouri law, Commission rules of practice and the historical approach to regulation.

Q. Does OPC's rebuttal address this topic?

A. No. OPC witness Conner addresses the collection of rate case expense amortized in the last case, but doesn't discuss the current rate case expense.

Q. Is a 50/50 sharing of rate case expense any more reasonable than the percentage allowed versus the percentage requested?

A. No. It is just as arbitrary and untethered from the reality that preparing, filing and litigating rate cases is a necessary element of regulation and that the utility should be fully compensated for the reasonable and prudent costs of doing so.

VIII. <u>CLOUD COMPUTING</u>

Q. **Staff witness Bolin relies primarily on Accounting Standards Update (ASU) No. 2015-05, Subtopic 350-40 regarding the appropriate approach to cloud computing investments. (Bolin, Reb., p. 3). Does this address the issue the Company has raised?**

A. No. The Company's request is related to a ratemaking issue not accounting for financial reporting purposes. Financial reporting and ratemaking are two fundamentally different processes. Financial reporting is aimed at providing transparency of data for the purposes of understanding the financial or commercial health of a company. These reports are primarily for the owners or potential owners of the company as well as other entities, such as the taxing authorities, financial regulators, and prospective and current debtholders. Ratemaking is an economic regulatory function. While I would never suggest that economic regulators ignore accounting rules, that should be *one* piece of information that is considered. There are clearly other issues that economic regulators must consider in setting rates that are just and reasonable. Strict adherence to financial accounting rules with respect to cloud computing can lead to unintended ratemaking results that are not likely to support just and reasonable rates. (Jenkins, Dir., p. 52-55).

Q. Ms. Bolin suggests that one option for recovering cloud computing cost is to rely on the normalization process for expenses. (Bolin Reb., p. 4). Does this approach address the Company's proposal?

A. No. Unfortunately, examining several years of history to establish a normalized level of expense would not work for three reasons.

First, cloud computing investments have the lumpy, periodic nature of capital projects and would not hit the ledger over time in consistent amounts. Any average derived by looking at multiple years would overstate or understate the costs in subsequent periods. For example, if all of the cost was incurred in one year, averaging over additional periods would erroneously decrease the true expense.

Second, ASU 2015-05 has only been effective for two years. The cloud computing issue is current and prospective, not historic. In my opinion a ratemaking treatment for off-premise cloud computing investments that is the same as the treatment for on-premise investments would effectively remove barriers to the efficient deployment of new technologies and innovations. As discussed in my direct testimony (Jenkins, Direct, pp 56, l-3), the Company recommends capitalizing cloud-based technology implementation services, internal labor, and other fees (such as licenses, maintenance, and support) that were necessary to bring the asset into service. As information technology solutions move increasingly to the cloud, the Company will experience more one-time deployment costs. Not addressing this issue now and allowing this issue to fester is a non-solution.

Q. Ms. Bolin alternatively suggests that cloud computing costs could be addressed through the creation of a regulatory asset but that should be done on a case-by-case basis. (Bolin Reb., p. 4). Would this alternative be effective?

A. A case-by-case approach is not a viable alternative since it does not address the fundamental concern of removing the barriers to cloud solution deployment. (Jenkins Dir., p. 52-53). On the contrary, a "case by case" solution would create or reinforce the barriers to smooth implementation of more efficient cloud computing applications. The Company is not aware of an existing mechanism, other than a rate case or perhaps an AAO application, which could allow for case-by-case approval of cloud computing projects. Moreover, this is a decision that the Company management must make in its role as the manager of the utility system, with, of course, proper oversight by the Commission. Since the Commission does not play the role of utility manager, it would be cumbersome, and inappropriate, for the Commission to be put in the position of approving on-going capital expenditures in real time. The Company needs to be able to plan and deploy capital for information technology every year and on a consistent and timely basis. Waiting several years for a rate case or filing obtaining AAO approval before deciding how to proceed with an information technology program would put the Company in a constant state of obsolescence which does not

Q. Does Witness Bolin's suggestion to align the amortization of cloud computing investments with the period of benefit (Bolin, Reb.,p.4:10) have any merit?

A. Yes. The same amortization proposal would apply to cloud expenditures recorded to NARUC account 303, intangible plant. To be clear cloud based investments should be amortized over the length of the service life.

Q. OPC witness Riley claims the Company "requests the transition of a portion of MAWC's primary software applications to vendor managed cloud computing instead of using their own computer servers." (Riley Reb., p. 2). Is this correct?

A. No. The Company has been transitioning information technology solutions to the cloud for some time now. The Company is not requesting approval to manage its technology and innovation program.

Q. Is the Company requesting "pre-authorization for multiple projects yet to be imagined?" (Riley Reb., p. 3)

A. No. The Company is not asking for approval of its software investments. The Company is asking for approval of an accounting methodology that best aligns cost recognition with appropriate regulatory treatment for cloud-based investments. (Jenkins Dir., p. 55-56).

Q. OPC witness Riley claims that this request has no place in this case because there is no revenue requirement adjustment. (Riley Reb., p. 3). Do you agree?

A. No. Revenue requirement is but one issue that the Commission routinely addresses in a rate case. For example, the Company is requesting a revenue stabilization mechanism in this proceeding, based on an identified problem for which a change to accounting and ratemaking treatment would be required. Likewise, the Company has identified an issue related to cloud computing accounting *policy* and is requesting a change to accounting and ratemaking treatment for these investments.

Q. Mr. Riley claims that there are details of the Company's proposal that are lacking which can only be remedied by submitting such details to the Commission. (Riley Reb., p. 3). Do you agree?

A. No. The Company is asking for approval of an accounting methodology. It is not asking for recovery of a particular set of assets or a particular project, and therefore, there are no details to provide regarding either. Capitalizing costs which have a multi-year benefit, and spreading those costs over multiple years of recovery, is a core ratemaking principle that underlies recognition of costs at a regulated utility company. It is not a principle that must be considered every time a new project with multi-year benefits is contemplated, and it is certainly not a concept that is applied on an asset by asset basis.

IX. AFFILIATE TRANSACTIONS

Q. Staff witness Bolin voices her support for OPC witness Marke's request that a proceeding be commenced to consider a rulemaking to establish affiliate transaction rules for water companies and that a cost allocation manual for MAWC be developed pursuant to that rulemaking. (Reb., p. 4) What is the Company's position with respect to this recommendation?

A. Affiliate transaction rules for water utilities similar to those the Commission currently has for electric and gas utilities are unnecessary and inappropriate. First, they are unnecessary. Ms. Bolin recommends the development of affiliated transaction rules for "large water utilities" such as MAWC. (Bolin Reb., p. 4) It is my understanding that current statutory and rule definitions provide that a large water utility is one that serves over 8,000 customers. It is also my understanding that MAWC is the only "large" water utility in Missouri. Consequently, developing a rule for one company would be a waste of Company, Commission and other parties' time, particularly when concerns regarding affiliate transactions can and should be addressed in the context of a company-specific rate proceeding.

Second, as I noted in my rebuttal testimony (p. 47), the affiliate transaction rules in the gas and electric industry are not appropriate for MAWC's situation. In many cases, the gas and electric companies have transactions with affiliates that compete with other, unregulated entities in the marketplace. For example, these transactions may consist of natural gas and power purchases and sales, including electric power supply agreements, capacity supply agreements, energy swaps and energy products, and transmission services. MAWC is not in a similar situation. The vast majority (if not all) of MAWC's transactions with affiliates are its purchases of professional services from the Service Company and its access to debt markets through its financing affiliate. The overwhelming evidence shows that MAWC is procuring these services from its affiliates at costs that are well below what it would otherwise incur if it had to purchase those services from unaffiliated, third parties or employ full-time employees to provide those services to MAWC. MAWC's relationship with its affiliates has been scrutinized in rate cases as long as I can remember and, at no time, has Staff, OPC or an intervener raised credible objection to, or more importantly, has the Commission found any abuses as a result of, those affiliate relationships. OPC's proposal to establish a separate rulemaking for large water utilities is nothing more than a solution in search of a problem.

X. INCLINING BLOCK RATES

Q. Are there any comments on the inclining block rates found in the rebuttal testimony of the parties that you wish to address?

A. Yes. OPC witness Marke concludes that inclining block rates are not acceptable to the Office of the Public Counsel for the same reasons he does not support a revenue stabilization mechanism, namely that water is abundant and capital spending is not needed in the near term. (Marke, Reb., p. 7-8).

Mr. Hyman also addresses inclining block rates. (Hyman Reb., p. 8-14). Mr. Hyman recommends that implementing inclining block rates should only be done if such a rate design would not cause unduly adverse bill impacts on customers, but that he has concerns about implementing such a design in this case given other issues in this case that could affect customer bills. (Hyman Reb., p. 9). Mr. Hyman further recommends that if inclining block rates are not implemented as a result of this proceeding, the Company should provide billing frequency data along with alternative inclining block rate designs in its next rate case to which the parties may respond. (Hyman Reb., p. 14).

Q. In the last MAWC rate case, the Commission asked parties to file information in the next rate case (this case) on inclining block rates so the Commission can

consider the information in setting just and reasonable rates. Has MAWC addressed the issue of inclining block rates in this case?

A Yes. I direct the Commission to my rebuttal testimony as well as the Company witness Heppenstall's surrebuttal testimony. (Jenkins Reb., p. 2-7). Specifically, the Company has proposed a residential inclining block rate pilot program in Joplin to address the issues raised generally about inclining block rates and specifically about the issues I raised concerning investment and water constraints in the Joplin area. (Jenkins, Reb., 6:1-7:2). The Commission has asked for data and information concerning the implementation of including block rates and a pilot program is a low-risk method of obtaining useful information concerning this rate structure.

Q. Has MAWC made multiple rate design proposals for the inclining block rate pilot proposal in Joplin and has MAWC provided information that supports those proposals?

A. Yes. Company witness Heppenstall lays out three alternative rates designs for the Commission to choose from in her rebuttal testimony (Heppenstall Reb., p. 8-9). In that rebuttal testimony, Schedule CEH-6 provides the basis for determining how blocks for the inclining block rate structure could be defined, Schedule CEH-7 provides three options for the prices that would make up the inclining block rate structures, and Schedule CEH-8 demonstrates that each inclining block option is revenue neutral relative to the flat rate structure proposed in this docket absent any changes in consumption that might result from customers reacting to the inclining block rates. Schedule CEH-9 shows the level of increases that customers in the Joplin area can expect to see from current rates to proposed rates, and from current rates to each of the three inclining block rate options absent any changes in consumption. These schedules provide the information that Mr. Hyman references (Hyman Reb., p. 10.).

XI. CONSOLIDATED TARIFF PRICING

Q. What is Staff witness Busch's conclusion concerning the Company's proposal to further consolidate tariffs?

A. Mr. Busch does not support further consolidation at this time due primarily to notions of gradualism and timing. (Busch Reb., p. 13). Mr. Busch's concern is that the Company has only been operating under the three-district approach for roughly two years and making the change to a fully consolidated tariff may raise concerns over rate stability. (Id.) Mr. Busch is also concerned that capital spending under consolidated pricing is not fully understood. (Id.).

Q. What is your response to Staff witness Busch's concerns regarding gradualism and timing?

A. Mr. Busch is correct that the Company has been operating under the three-district approach since the last rate case. The Company is also concerned about rate stability. My main concern with his rate stability issue is that such an objection could be raised at any time and does not depend on how long the Company has been operating under the three-district approach. Of course, we would prefer that rates be as stable as practical but in a changing environment stability cannot be the only issue that holds up moving to full CTP.

Q. Will long term affordability of the water system be enhanced and improved under CTP?

A. Ultimately, yes. The primary benefit of CTP is being able to spread the costs of future investment needs in the system over a larger group of customers, thus smoothing out the cost for everybody and mitigating the risk that any particular group of customers will be hit with large investment costs that affect just them.

Q. Does Mr. Busch agrees with this point?

A. Yes. Mr. Busch agrees (Busch Reb., p. 15) that spreading out costs over a larger customer base will tend to lower rates.

Q. Staff witness Busch states (Busch Reb., p. 13) that "the Commission just approved consolidation in the previous rate case. Those rates have not been in effect for two years. With a major change in rate design, it makes sense to allow time for the effects of that change to flow through and allow for customers to become accustomed to the new structure." Do you agree that CTP is a major change in rate design from current rates?

A. No, I do not. The structure of the rates themselves between the current three-district approach and CTP will not change. Under each approach, fixed monthly charges will be based on meter size and will be identical in price. Volumetric charges will be a flat charge per 100 hundred gallons for the residential, non-residential, resale, and Rate J rates. The rate design itself is no different with or without CTP.

The only difference in the rates between the current three-district approach and CTP is the prices for the volumetric components of the rates themselves. I would note that the prices will already change in this case as a result of the increase in revenue requirements and changes in sales assumptions. The only question CTP raises in terms of rates paid by customers is what will the volumetric charges be. The answer will be different (higher for some, lower for others) depending on whether CTP is implemented or not, but the rate design remains the same.

Q. What is your response to Mr. Busch's concerns regarding capital spending and over-investment?

A. As for the issue of capital spending under CTP, with or without a future test year and with or without CTP, the Company's capital spending will be fully vetted under the normal ratemaking process in future rate cases. MAWC assumes all of the risk that some portion of future capital spending will be disallowed in future rate cases due to it not being used or useful, being imprudent or for any other reason. Moving to CTP at this time does not remove any protection from customers that they otherwise would have had, and does not pass any risk to customers of overbuilding or "gold plating" the system for the reasons mentioned above. I have also fully addressed that issue in my rebuttal testimony as well. (Jenkins, Reb., p. 13-15).

Q. Staff witness Busch also address some of the benefits you suggest exist for further consolidation. (Busch Reb., p. 15). How do you respond?

A. All of these issues have been addressed in the past cases as well as my direct and rebuttal testimonies in this case. (Jenkins, Dir and Reb.). I do not see any new information to suggest that such benefits would not be enhanced under further consolidation.

Q. Staff witness Busch agrees that there are cost-spreading benefits to consolidation yet maintains that the Company is sufficiently large to capture those benefits such that further consolidation is not necessary at this point. (Busch Reb., p. 15-16). Do you agree?

A. Not entirely. I agree that the cost-spreading effect is present currently, but I also conclude that the effect could be enhanced by further consolidation. (Jenkins; Reb. P. 12). I would further say that maintaining separate districts, two of which are quite small compared to the total service territory, significantly reduces the benefits of having a large footprint in the state for those particular districts. If separate cost of service and rates are to be maintained for District 2 and District 3, both of which have less than 40,000 residential customers, the size of investments that can be made in those districts to maintain and improve service is limited by the ability of those separate districts to carry the cost. For common costs that are allocated to districts, it is true that cost-spreading works to everyone's advantage given MAWC's size.

Q. Does this conclude your surrebuttal testimony?

A. Yes, it does.