

EXHIBIT

Exhibit No.: OPC-1NP
Issue(s): Revenue Requirement
Witness/Type of Exhibit: Robertson/Rebuttal
Sponsoring Party: Public Counsel
Case No.: WA-2012-0066

Filed
July 11, 2012
Data Center
Missouri Public
Service Commission

REBUTTAL TESTIMONY
OF
TED ROBERTSON

Submitted on Behalf of the Office of the Public Counsel

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WA-2012-0066

** **

Denotes Highly Confidential Information that has been redacted

May 11, 2012

OPC Exhibit No. 1NP
Date 6-28-12 Reporter KF
File No. WA-2012-0066

NP

**REBUTTAL TESTIMONY
OF
TED ROBERTSON**

**MISSOURI-AMERICAN WATER COMPANY
CASE NO. WA-2012-0066**

1 | **I. INTRODUCTION**

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

3 | A. Ted Robertson, PO Box 2230, Jefferson City, Missouri 65102-2230.

4 |

5 | Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

6 | A. I am employed by the Missouri Office of the Public Counsel (OPC or Public
7 | Counsel) as the Chief Public Utility Accountant.

8 |

9 | Q. WHAT IS THE NATURE OF YOUR CURRENT DUTIES AT THE OPC?

10 | A. My duties include all activities associated with the supervision and operation of
11 | the regulatory accounting section of the OPC. I am also responsible for
12 | performing audits and examinations of the books and records of public utilities
13 | operating within the state of Missouri.

14 |

15 | Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND OTHER
16 | QUALIFICATIONS.

1 A. I graduated in May, 1988, from Missouri State University in Springfield, Missouri,
2 with a Bachelor of Science Degree in Accounting. In November of 1988, I
3 passed the Uniform Certified Public Accountant Examination, and I obtained
4 Certified Public Accountant (CPA) certification from the state of Missouri in 1989.
5 My CPA license number is 2004012798.
6

7 Q. HAVE YOU RECEIVED SPECIALIZED TRAINING RELATED TO PUBLIC
8 UTILITY ACCOUNTING?

9 A. Yes. In addition to being employed by the Missouri Office of the Public Counsel
10 since July 1990, I have attended the NARUC Annual Regulatory Studies
11 Program at Michigan State University, and I have also participated in numerous
12 training seminars relating to this specific area of accounting study.
13

14 Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE MISSOURI PUBLIC
15 SERVICE COMMISSION (COMMISSION OR MPSC)?

16 A. Yes, I have testified on numerous issues before this Commission. Please refer
17 to Schedule TJR-1, attached to this testimony, for a listing of cases in which I
18 have submitted testimony.
19

20 **II. PURPOSE OF TESTIMONY**

21 Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

1 A. The purpose of my testimony is to address the amount of rate base for net plant
2 in-service used by Missouri-American (Company) witness Mr. Brian LaGrand in
3 the financial analysis attached to his Direct Testimony, and the reliance on that
4 rate base for purposes of recommending rates to the Missouri Public Service
5 Commission in the Direct Testimony of Company witness Mr. Dennis Williams.
6

7 Q. DOES THE COMPANY RECOMMEND RATES TO BE CHARGED TO
8 SADDLEBROOKE WATER AND SEWER CUSTOMERS PURSUANT TO
9 COMMISSION APPROVAL OF THE APPLICATION FOR A CERTIFICATE OF
10 CONVENIENCE AND NECESSITY?

11 A. Yes. According to Mr. William's Direct Testimony, page 7, the Company
12 proposes that water rates for Saddlebrooke customers be set in accordance with
13 Rate Schedule A for service in Stone and Taney Counties, Missouri. (P.S.C.
14 MO. No 14, 4th Revised SHEET NO. 1). Adoption of the Company proposed
15 rates would result in a customer charge of \$22.06 per month and a commodity
16 charge of \$2.37 per 1000 gallons. The Company proposes that sewer rates for
17 customers in Saddlebrooke be set in accordance with Rate Schedule B for
18 service in Stone and Taney Counties, Missouri (P.S.C. NO. 14, 2nd Revised
19 SHEET NO. 1a). Adoption of the Company proposed rates would result in a
20 customer charge of \$36.69 per month and commodity charge of \$4.04 per 1000
21 gallons.

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Q. WHAT IS THE COMPANY'S RATIONALE FOR RECOMMENDING THOSE RATES?

A. The Company's recommendation is based upon the consolidation of several smaller communities into consolidated districts for water rates pursuant to a Non- Unanimous Stipulation and Agreement that was entered into in the Company's most recent rate case, Case No. WR-2011-0337. Company witness Mr. Williams states on page 10, lines 14-16, of his Direct Testimony:

Creating a new rate district for 81 residences seems to be counter-productive when an existing small-system rate that results in a reasonable return is available for use.

Q. DOES THE COMPANY PROVIDE ANY ANALYSIS THAT INDICATES ADOPTION OF THE PROPOSED RATES RESULTS IN A REASONABLE RETURN?

A. Yes. On page 2 of Schedule BWL-1 attached to his Direct Testimony Mr. LaGrand provides the estimated operating income the Company proposed rates would generate. His analysis shows that the proposed water and sewer rates would generate annual revenues of ** ** and ** ** respectively, and ** ** in total. Furthermore, the analysis indicates those revenues, coupled with the estimated expenses to provide service, would generate a return

1 on investment of ** ** for water, ** ** for sewer and ** ** for
2 water and sewer combined.
3

4 Q. DOES PUBLIC COUNSEL HAVE CONCERNS WITH THE ESTIMATED COST
5 OF SERVICE USED IN MR. LAGRAND'S ANALYSIS?

6 A. Yes. OPC disagrees with the estimated rate base that is included in the cost of
7 service calculation, which then impacts the earned return and revenue
8 requirement.
9

10 Q. WHAT IS THE ISSUE?

11 A. OPC believes the estimated rate base is overstated. First, the rate base includes
12 an acquisition adjustment, which I will speak to in greater detail shortly. Second,
13 the rate base includes the estimated cost of future improvements to plant totaling
14 \$31,000 that are not yet in-service, thus are not currently used and useful. It
15 should also be noted that the analysis includes depreciation in the cost of service
16 calculation on this future plant investment totaling \$740.
17

18 Q. WHAT IS AN ACQUISITION ADJUSTMENT?

19 A. Simply stated, an acquisition adjustment arises when the acquiring company's
20 (Missouri-American Water in this case) purchase price either exceeds or is less
21 than the net book value of the assets acquired. An acquisition premium occurs

1 when the purchase price of the acquired property is greater than the net book
2 value of the assets acquired. Conversely, an acquisition discount occurs when
3 the purchase price of the acquired property is less than the net book value of the
4 assets acquired.

5
6 Q. WILL MISSOURI-AMERICAN'S PURCHASE OF SADDLEBROOKE RESULT IN
7 AN ACQUISITION ADJUSTMENT?

8 A. Yes. Utilizing the estimated costs provided by the Company, there is an
9 acquisition ** of **. According to the asset purchase
10 agreement, Missouri-American's purchase price for the Saddlebrooke net assets
11 is **. However the estimated net book value of the acquired assets
12 (including the offset for contributions in aid of construction (CIAC)) is **
13 ** as summarized in the following table:

14 **

15 **

16 Thus, the acquisition ** can be calculated as:

17

1	Purchase price of assets	**	**
2	Net book value of acquired assets	**	**
3	Acquisition adjustment (discount)	**	**
4			
5			

6 Q. HOW DOES PUBLIC COUNSEL BELIEVE ACQUISITION ADJUSTMENTS
7 SHOULD BE TREATED FROM A REGULATORY PERSPECTIVE?

8 A. As a general rule Public Counsel believes acquisition adjustments (whether a
9 premium or a discount) resulting from a change in ownership should not flow
10 through to ratepayers, but rather should be borne by shareholders. In other
11 words, ratepayers should not and do not share in gains on asset dispositions, nor
12 should they share in losses on asset dispositions. OPC believes this consistent
13 treatment of acquisition adjustments yields the fairest result to both ratepayers
14 and utilities.

15
16 For example, in the case of an acquisition premium, ratepayers should not bear
17 the cost of an increased rate base where the acquirer decides to purchase
18 assets for a price in excess of their net book value. To include the acquisition
19 premium in rate base would effectively flow the gain on the disposition of assets
20 realized by the seller through to ratepayers rather than to shareholders. Further,
21 historical abuses within the utility industry in the early 20th century where rate
22 base was artificially inflated by utility asset sales at an acquisition premium, led

1 regulators to generally conclude that ratepayers should not be burdened with the
2 increase or "write-up" of the rate base in such situations.

3
4 When assets are acquired (or sold) at a discount, OPC contends the purchase
5 price should be used to establish the rate base, rather than the net book value of
6 the acquired assets. To utilize the recorded net book value as rate base would
7 effectively flow the loss realized by the seller to ratepayers rather than
8 shareholders. Shareholders of the acquiring company are fairly compensated for
9 their investment in the acquired plant at the actual purchase price, as opposed to
10 their investment plus the loss on the disposition of the assets realized by the
11 seller (who for a variety of reasons decided to dispose of the property at a loss
12 and who may also realize tax benefits from that loss). The acquiring company
13 also obtains the benefit of the future use of the discounted portion of the assets
14 purchased at no cost.

15
16 Q. IS PUBLIC COUNSEL AWARE OF ANY AUTHORITATIVE LITERATURE
17 REGARDING REGULATORY TREATMENT OF ACQUISITION DISCOUNTS?

18 A. Yes. In the ratemaking reference book, Hahne & Aliff, Accounting for Public
19 Utilities (Matthew Bender), 4.04[2], p. 4-10, 4-11, it states:

20
21 On occasion, a utility may purchase used plant at a price lower than
22 the net book value in the hands of the selling utility, thus creating a
23 negative acquisition adjustment. These transactions are generally

1 accounted for by a debit to plant in service for the net original cost
2 with a credit to the acquisition adjustment account for the
3 deficiency. In these cases, a similar question arises regarding the
4 handling of the credit acquisition adjustments for ratemaking
5 purposes. The regulatory commissions and courts have varied in
6 their opinions as to the appropriate treatment of these balances and
7 have not necessarily followed the same reasoning as followed
8 regarding ratemaking treatment for debit adjustments. In general,
9 credit balances are used to reduce the rate base and are also
10 amortized above-the-line (as a reduction of operating expenses)
11 with what appears to be greater frequency than corresponding
12 treatment for debit adjustments. However, the FERC currently
13 treats a negative acquisition adjustment as a credit to accumulated
14 depreciation.

15
16 (Emphasis added by OPC)
17
18

19 The Federal Energy Regulatory Commission (FERC) credit methodology
20 increases the accumulated depreciation balance which offsets plant in-service
21 and effectively reduces the net plant to the purchase price paid in the acquisition.
22

23 Q. DOES THE UNIFORM SYSTEM OF ACCOUNTS (USOA) ENABLE
24 ACQUISITION ADJUSTMENTS TO BE RECORDED AND EXCLUDED FROM
25 RATE BASE?

26 A. Yes. Acquisition adjustments are to be recorded in Account No. 114 which
27 includes the difference between a) the cost of the plant acquired (purchase price)
28 and b) the original cost of the property at the time of acquisition, less amounts
29 credited to the accumulated reserve for depreciation and amortization and
30 contributions in aid of construction with respect to the acquired property. The

1 USOA further indicates that the amounts recorded in this account are to be
2 amortized, or otherwise disposed of, as the Commission may approve or direct.

3
4 Q. IS PUBLIC COUNSEL AWARE OF ANY COMMISSION DECISION INVOLVING
5 TREATMENT OF AN ACQUISITION DISCOUNT?

6 A. Yes. The Second Report and Order from Case EM-2000-292, issued February
7 26, 2004, which was a case involving treatment of an acquisition premium does
8 reference treatment of an acquisition discount. On page 5 of the Second Report
9 and Order the Commission stated:

10
11 Missouri has traditionally applied the net original cost standard
12 when considering the ratemaking treatment of acquisition
13 adjustments. That means that the purchasing utility has not been
14 allowed to recover an acquisition premium from its ratepayers. But
15 it also means that ratepayers do not receive lower rates through a
16 decreased rate base when the utility receives a negative acquisition
17 adjustment. Even if a company acquires an asset at a bargain
18 price, it is allowed to put the asset into its rate base at its net
19 original cost. Similarly, ratepayers do not share in the gains a utility
20 may realize from selling assets at prices above their net original
21 cost. Those gains flow only to the utility's shareholders.
22
23

24 Q. DOES PUBLIC COUNSEL BELIEVE THE COMMISSION SHOULD
25 RECONSIDER THE ACQUISITION ADJUSTMENT LANGUAGE AS STATED
26 ABOVE?

1 A. Yes. In OPC's opinion, the rationale used by the Commission is contradictory
2 and not actually supported by the utilization of the original cost standard or any
3 other regulatory or accounting rule, procedure or practice. The Commission's
4 stated reliance on reciprocity has no basis in fact for the regulatory treatment of
5 acquisition adjustments.

6
7 The last two sentences of the Second Report and Order language referenced
8 imply that the Commission believes it is treating gains (when assets are sold at a
9 premium) similar to losses (when assets are sold at a discount). Yet as stated by
10 the Commission, gains flow only to the utility's shareholders. But under the
11 Commission's misinterpretation of the original cost standard in that case, losses
12 do not flow to the utility's shareholders but rather are borne by the acquiring
13 utility's ratepayers. To illustrate the point, assume the following:

14
15

Selling price of net assets	\$500
Net plant in-service at time of sale	<u>\$750</u>
Loss on sale incurred by seller	<u>\$250</u>

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20 By setting the rate base at \$750 (the net original cost of the plant) rather than
21 \$500, the Commission is allowing the loss of the seller to flow into the rate base
22 of the acquiring company post acquisition.

23

1 As stated earlier, it is Public Counsel's belief that consistent treatment of
2 acquisition adjustments is the standard that should be adopted, as it treats the
3 gains (acquisition premium) and losses (acquisition discount) consistently for
4 utility ratepayers and shareholders (i.e., shareholders who sell their regulated
5 properties receive the benefit of gains and the burden of losses). The net original
6 cost standard as referenced in the Second Report and Order appears to try to
7 retain consistency in valuing rate base by the usage of a reciprocity methodology
8 which has no basis in fact or the circumstances of the actual transaction between
9 the buyer and seller of the assets. Therefore, Public Counsel urges the
10 Commission to reject the oversimplified and inaccurate guidance it expressed in
11 Case EM-2000-292.

12
13 Q. DOES MISSOURI-AMERICAN REFLECT CAPACITY ADJUSTMENTS TO THE
14 NET PLANT BALANCES DUE TO EXCESS CAPACITY OF THE SYSTEM?

15 A. Yes. According to Mr. LaGrand's Direct Testimony both the Company and the
16 Missouri Public Service Commission Staff (Staff) propose capacity adjustments
17 for the water tank, pump and sewer system. The impact of these capacity
18 adjustments on net plant in-service is to temporarily reduce rate base by
19 ** ** for the water system and ** ** for the sewer system.

1 Q. DO THE PROPOSED CAPACITY ADJUSTMENTS OFFSET THE ACQUISITION
2 ** **, THUS ELIMINATING THE NEED FOR AN ACQUISITION
3 ADJUSTMENT?

4 A. No. Even with the capacity adjustments, and eliminating the \$31,000 of the
5 estimated cost of future plant investment, the total estimated net plant-in-service
6 (rate base) for both water and sewer totals ** **. Therefore, even with
7 the capacity adjustments, the estimated net plant-in-service exceeds the
8 purchase price by over ** **. Further, as the number of new customers
9 come online, it is expected that the capacity adjustments will be reduced in future
10 rate cases thus increasing the rate base on which MAWC seeks to earn a return
11 on and return of.

12
13 Q. WILL CAPACITY ADJUSTMENTS BE NECESSARY IF THE COMMISSION
14 ADOPTS OPC'S RECOMMENDATION THAT THE RATE BASE BE SET AT
15 THE PURCHASE PRICE?

16 A. No. If the rate base is set at the purchase price of ** ** no capacity
17 adjustments would be necessary because MAWC would be authorized to earn a
18 return on and a return of its actual investment which is less than the rate base
19 proposed by Company with capacity adjustments.
20

1 Q. HOW SHOULD RATE BASE BE CALCULATED GIVEN THAT THE PURCHASE
2 PRICE REPRESENTS THE COMBINED WATER AND SEWER SYSTEMS?

3 A. OPC suggests allocating the acquisition adjustment to the water and sewer
4 systems based upon the ratio of each system's estimated net plant-in-service
5 balances to the total net plant-in-service balance. Therefore the acquisition
6 adjustment of ** ** would be allocated as follows:

7 **

8 **
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10
11 Q. IS THERE ANOTHER COMPELLING REASON WHY THE PURCHASE PRICE
12 SHOULD BE USED TO ESTABLISH THE RATE BASE, RATHER THAN USE
13 OF THE IDENTIFIED NET ORIGINAL COST OF THE PLANT?

14 A. Yes. Staff and Missouri-American have acknowledged that in several instances
15 the original cost of the plant-in-service had to be estimated due to the lack of
16 substantiating records. The estimates are not inconsequential as summarized in
17 the following table:
18

Estimated Costs	Water	Sewer	Total
Gross Plant	\$55,000	\$45,000	\$100,000
Accumulated Depreciation	\$ 5,888	\$ 3,000	\$ 8,888
Net Plant	\$49,112	\$42,000	\$ 91,112
Estimated Net Plant as a % of Capacity Adjusted Plant	19.7%	25.5%	22.0%

Note: The table excludes CIAC (which also had to be estimated) and uses the Company's calculation of capacity adjusted net plant for the acquired assets, which is the amount Missouri American recommends should be reflected in rate base.

Further, at the time the plant was constructed, Saddlebrooke was not a regulated entity. Therefore, there was not an opportunity for Staff or Public Counsel to review the investments to determine if the costs incurred were reasonable, prudent and necessary. Given that the net original cost of the plant is not known with certainty, OPC recommends the Commission adopt a rate base for the acquired assets equal to the purchase price of ** ** which is known and measurable and not subject to dispute.

Q. WOULD THE RATES PROPOSED BY THE COMPANY IN MR. WILLIAM'S
DIRECT TESTIMONY BE REASONABLE GIVEN A RATE BASE OF

** **?

A. No. Assuming a weighted average cost of capital at 7.59%, the revenue
requirement would be substantially reduced. OPC calculated the combined

1 revenue requirement for water and sewer to be \$30,131 less than the revenue
2 that would be generated using the Company's proposed rates. See the attached
3 Schedule TJR-2 for the water system's revenue requirement schedules and
4 Schedule TJR-3 for the sewer system's revenue requirement schedules.

5
6 Using the rates proposed by the Company in conjunction with OPC's rate base
7 would yield a combined return on investment of ** ** (** ** for
8 water and ** ** for sewer) which is substantially more than the
9 recommended cost of capital of 7.59%. However using rates that generate the
10 revenue requirement as documented in Schedules TJR-2 and TJR-3 yield a total
11 return on Missouri-American's investment of 7.59% (see the attached Schedule
12 TJR-4 for a summarization of the relevant costs and returns).

13
14 Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

15 A. Yes.

**CASE PARTICIPATION
OF
TED ROBERTSON**

<u>Company Name</u>	<u>Case No.</u>
Missouri Public Service Company	GR-90-198
United Telephone Company of Missouri	TR-90-273
Choctaw Telephone Company	TR-91-86
Missouri Cities Water Company	WR-91-172
United Cities Gas Company	GR-91-249
St. Louis County Water Company	WR-91-361
Missouri Cities Water Company	WR-92-207
Imperial Utility Corporation	SR-92-290
Expanded Calling Scopes	TO-92-306
United Cities Gas Company	GR-93-47
Missouri Public Service Company	GR-93-172
Southwestern Bell Telephone Company	TO-93-192
Missouri-American Water Company	WR-93-212
Southwestern Bell Telephone Company	TC-93-224
Imperial Utility Corporation	SR-94-16
St. Joseph Light & Power Company	ER-94-163
Raytown Water Company	WR-94-211
Capital City Water Company	WR-94-297
Raytown Water Company	WR-94-300
St. Louis County Water Company	WR-95-145
United Cities Gas Company	GR-95-160
Missouri-American Water Company	WR-95-205
Laclede Gas Company	GR-96-193
Imperial Utility Corporation	SC-96-427
Missouri Gas Energy	GR-96-285
Union Electric Company	EO-96-14
Union Electric Company	EM-96-149
Missouri-American Water Company	WR-97-237
St. Louis County Water Company	WR-97-382
Union Electric Company	GR-97-393
Missouri Gas Energy	GR-98-140
Laclede Gas Company	GR-98-374
United Water Missouri Inc.	WR-99-326
Laclede Gas Company	GR-99-315
Missouri Gas Energy	GO-99-258
Missouri-American Water Company	WM-2000-222
Atmos Energy Corporation	WM-2000-312
UtiliCorp/St. Joseph Merger	EM-2000-292
UtiliCorp/Empire Merger	EM-2000-369
Union Electric Company	GR-2000-512
St. Louis County Water Company	WR-2000-844
Missouri Gas Energy	GR-2001-292
UtiliCorp United, Inc.	ER-2001-672
Union Electric Company	EC-2002-1
Empire District Electric Company	ER-2002-424

**CASE PARTICIPATION
OF
TED ROBERTSON**

<u>Company Name</u>	<u>Case No.</u>
Missouri Gas Energy	GM-2003-0238
Aquila Inc.	EF-2003-0465
Aquila Inc.	ER-2004-0034
Empire District Electric Company	ER-2004-0570
Aquila Inc.	EO-2005-0156
Aquila, Inc.	ER-2005-0436
Hickory Hills Water & Sewer Company	WR-2006-0250
Empire District Electric Company	ER-2006-0315
Central Jefferson County Utilities	WC-2007-0038
Missouri Gas Energy	GR-2006-0422
Central Jefferson County Utilities	SO-2007-0071
Aquila, Inc.	ER-2007-0004
Laclede Gas Company	GR-2007-0208
Kansas City Power & Light Company	ER-2007-0291
Missouri Gas Utility, Inc.	GR-2008-0060
Empire District Electric Company	ER-2008-0093
Missouri Gas Energy	GU-2007-0480
Stoddard County Sewer Company	SO-2008-0289
Missouri-American Water Company	WR-2008-0311
Union Electric Company	ER-2008-0318
Aquila, Inc., d/b/a KCPL GMOC	ER-2009-0090
Missouri Gas Energy	GR-2009-0355
Empire District Gas Company	GR-2009-0434
Lake Region Water & Sewer Company	SR-2010-0110
Lake Region Water & Sewer Company	WR-2010-0111
Missouri-American Water Company	WR-2010-0131
Kansas City Power & Light Company	ER-2010-0355
Kansas City Power & Light Company	ER-2010-0356
Timber Creek Sewer Company	SR-2010-0320
Empire District Electric Company	ER-2011-0004
Union Electric Company, d/b/a AmerenUE	ER-2011-0028
Missouri-American Water Company	WR-2011-0337
Union Electric Company, d/b/a AmerenMO	EU-2012-0027
Missouri-American Water Company	WA-2012-0066

Schedules TJR 2 through TJR 4
have been deemed
“Highly Confidential”
in their entirety.