

Exhibit No.:
Issues: *Employee Expense;*
Relocation Expense;
Equipment Leases; Annual
Incentive Plan; Customer
Service Bonus; Lobbying
Expense
Witness: *Jeremy K. Hagemeyer*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Surrebuttal Testimony*
Case Nos.: *WR-2003-0500*
and WC-2004-0168
(Consolidated)
Date Testimony Prepared: *December 5, 2003*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

JEREMY K. HAGEMEYER

MISSOURI-AMERICAN WATER COMPANY

CASE NOS. WR-2003-0500 AND WC-2004-0168
(Consolidated)

Jefferson City, Missouri
December 2003

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(Consolidated)

Q. Please state your name and business address.

A. Jeremy K. Hagemeyer, 1845 Borman Ct. Suite 101, St. Louis, MO 63146.

Q. By whom are you employed and in what capacity?

A. I am employed by the Missouri Public Service Commission (PSC or Commission) as a Utility Regulatory Auditor.

Q. Are you the same Jeremy K. Hagemeyer who previously filed direct and rebuttal testimony in this case?

A. Yes.

Q. What is the purpose of your surrebuttal testimony?

A. My testimony will respond to the rebuttal testimony of Missouri-American Water Company (MAWC or Company) witness Douglas M. Lehman, regarding employee expense, relocation expense and equipment leases. My testimony will also address the rebuttal testimony of MAWC witness Cheryl E. Milton Roberts, regarding the Annual Incentive Plan and the Customer Service Bonus. My testimony will also discuss the rebuttal testimony of Company witness Edward J. Grubb, regarding lobbying expense.

EMPLOYEE EXPENSE

Q. Mr. Lehman claims that the Staff made a disallowance in the amount of \$175,383 for employee expense. Is this correct?

A. No. It seems that Mr. Lehman may be confused in his terminology. Staff witness Lisa K. Hanneken and I did propose specific disallowances in employee expenses for items that provide no benefit to the ratepayers. However, Mr. Lehman is referring to the fact that the Staff has not accepted the Company's adjustment to increase the actual test year amount. There was no \$175,383 disallowance because the Company never incurred that amount during the test year. A disallowance properly refers to the exclusion of monies spent in the test year from the cost of service.

Q. What is the Company's position regarding employee expense?

A. The Company's position is that test year employee expense should be substantially increased. However, it is difficult for the Staff to determine what level of employee expense the Company is currently proposing. The Company originally filed a proposal that included an adjustment to the test year based on a three-year average that did not include the test year. This proposal would have increased test year employee expense by \$197,543, a 66% increase above the test year. In his rebuttal testimony, Mr. Lehman advocates an increase of \$175,383 over the test year level. This is based on a five-year average and represents a 59% increase in employee expense above the test year level. This switch to a five-year average is inconsistent with MAWC's response to Staff Data Request No. 435, in which the Company had claimed that a five-year average is not appropriate because the St. Louis district had not been incorporated into MAWC in 1998.

1 Q. In his rebuttal testimony, Mr. Lehman claims that there will likely be an
2 increase in employee expense. He states that this will amount to a 25% increase over 2002
3 employee expense. Has Staff been able to verify the accuracy of this claim?

4 A. No. The actual 2003 level of employee expense is still unknown and is not
5 measurable at this point. However, even if the 25% increase can be substantiated, it would
6 not justify the 59% increase that Mr. Lehman seems to advocate in his rebuttal testimony or
7 the 66% increase Company witness Robert Maul proposed in his direct testimony. It should
8 also be reiterated that Staff has suggested disallowances amounting to \$15,032 in test year
9 employee expenses.

10 Q. Has Staff examined the 2003 employee expense level?

11 A. No. At this point, Staff has not received any information that would verify or
12 justify the 2003 employee expense levels. The Staff submitted Data Requests Nos. 472
13 through 474, issued November 13, 2003, asking for information regarding the 2003 level of
14 employee expenses. Staff reserves the right to file supplemental surrebuttal testimony based
15 on the responses to these data requests. However, it is reasonable to believe that similar
16 types of expenses, which have been disallowed by the Staff for 2002, were incurred in 2003.

17 Q. Does Staff have any other concerns regarding the method employed by the
18 Company for the calculation of employee expense?

19 A. Yes. The Company uses a number for year-end employees that does not
20 correspond to the number of year-end employee numbers provided in the Company's
21 response to Staff Data Request No. 239. The response to this data request shows a completely
22 different set of employee numbers than those used by the Company in its direct case. The
23 actual number of employees incurring employee expense in the test year is less than 50% of

1 the level used by the Company in its adjustment. In response to Staff Data Request No. 272,
2 the Company was able to show the exact number of employees responsible for incurring
3 employee expense.

4 Q. Are there any other problems with the Company's calculation of employee
5 expense?

6 A. Yes. The employee numbers used to derive a per employee expense level for
7 the five-year average are not correct. Mr. Lehman divides the five-year average of employee
8 expense for 1998 through 2002 by the year-end employee average for the three years 1999
9 through 2001. To be consistent, Mr. Lehman should have used a five-year average of year-
10 end employees that corresponds to the five-year average of employee expenses, instead of
11 using a three-year average of employees for a different time period.

12 Q. Does Staff support the use of a five-year average in calculating employee
13 expense?

14 A. No. As I stated in my rebuttal testimony, the use of an average in calculating
15 employee expense is improper, for this case, due to the steady decline in employee expense
16 levels since 1999. Staff also noted that there have been a declining number of employees
17 actually incurring these expenses since 1999. Staff also found that a decline exists in the per
18 employee amount of employee expense from 1999 to present.

19 Q. Does Mr. Maul in his direct testimony, or Mr. Lehman in his rebuttal
20 testimony, provide rationale for this proposed increase in expense?

21 A. No. The Company has never explained, either in testimony or when
22 specifically asked in a data request, the need for an increase in employee expense.

23 Q. What is Staff's position regarding employee expense?

1 A. Given obvious trends in employee expense, and no justification by the
2 Company for an increase in employee expense, Staff suggests that the proper amount of
3 employee expense to include in the cost of service is the test year amount as adjusted to
4 remove items that are not necessary for the provision of safe and adequate service.

5 **RELOCATION EXPENSE**

6 Q. Mr. Lehman claims that Staff has made a \$33,660 disallowance regarding
7 relocation expense. Is this correct?

8 A. No. This appears to be another instance where Mr. Lehman is confused by the
9 terminology. As I stated earlier in this testimony, a disallowance refers to the exclusion of
10 expense items from the cost of service, which were actually spent during the test year. The
11 Company did not incur the \$33,600 proposed by the Company during the test year.

12 Q. What is the Company's position regarding relocation expense?

13 A. The Company is proposing to increase the test year level of employee
14 relocation expense. However, the Company's level of expense for relocation is still unclear.
15 The original Company basis for an adjustment to the test year level of employee relocation
16 expense was a three-year average. This proposal would have increased relocation expense by
17 \$81,881, an increase of 61% over the Company's 2002 level. In his rebuttal testimony, Mr.
18 Lehman advocates a four-year average that would increase the per book level of relocation
19 expense by \$33,660. This is a 25% increase over the test year level.

20 Q. Did the Company, in either its direct or rebuttal testimony, ever present a need
21 for an increase in relocation expense?

22 A. No. The Company has not presented any justification for an increase in this
23 expense in either its direct or rebuttal testimony. Neither did the Company cite a need for the

1 increase in relocation expense when asked in Staff Data Request No. 429. As I pointed out in
2 my rebuttal testimony, it would seem highly unlikely that an increase in relocation expense is
3 warranted due to the fact that MAWC has a five-year lease on its current corporate
4 headquarters and there is no need to move the headquarters at any point in the near future.
5 This is in stark contrast to 2000, when the Company purchased St. Louis County Water
6 Company and moved its corporate offices to St. Louis.

7 Q. What is Staff's position on relocation expense?

8 A. Staff's position is to not adjust the test year level of relocation expense.

9 Q. How has Staff arrived at this position?

10 A. As I pointed out in my rebuttal testimony, relocation expense has been trending
11 down. The years employed by the Company in their average are highly irregular given the
12 massive changes in the Company's structure, and the Company has never presented a bona
13 fide need for an increase in relocation expense. Given these facts, Staff feels that the only
14 justifiable position on relocation expense is to not adjust the test year level.

15 **EQUIPMENT LEASES**

16 Q. In his rebuttal testimony, Mr. Lehman brings up a list of disputed items that he
17 found in Staff's equipment lease adjustment. What is Staff's position regarding the
18 equipment lease issue?

19 A. It is Staff's understanding that, other than true-up items, any disputes with the
20 Staff's adjustment have been corrected and sent to Company personnel.

ANNUAL INCENTIVE PLAN

Q. Has Staff reviewed the revised Annual Incentive Plan (AIP) that was discussed in Company witness Roberts' rebuttal testimony?

A. Yes. A copy of the plan was provided two days after rebuttal testimony was filed.

Q. Does the revised AIP adequately address Staff's concerns that were filed in direct testimony?

A. No.

Q. What concerns does Staff have regarding the revised AIP?

A. There are many factors that Staff feels warrant the exclusion of the AIP from cost of service. First, and foremost, Staff is unable to determine whether this expense can truly be classified as an on-going expense. On page four of the AIP that discusses the calculation of the awards, the following statement appears:

Note that the American Water Board reserves the right to determine whether incentives are payable to any individual or group of individuals. The Board may withhold all incentive payments in exceptional circumstances, such as failing to meet minimum financial goals.

This statement appears twice in the document detailing the AIP. As can be seen, the American Water Board may for any reason withhold payment. Presumably, if the American Water Board felt that American Water as a whole did not meet its financial goals, regardless of whether MAWC met its individual goals, the American Water Board would still be able to halt payment of any AIP award. The ability to withhold payment also would emphasize that the provision of payment for the AIP will only be allowed if the financial goals of the Company are met. This condition of meeting financial goals would be another reason for disallowing the AIP from cost of service.

1 To reemphasize the ability of the American Water Board to end or alter the AIP,
2 another troubling disclosure is included at the end of the plan description: “The Company
3 reserves the right to amend, modify, or discontinue the Plan at any time.” Taken together
4 these disclosures create significant doubt regarding the on-going nature of this expense.
5 These clauses also tie the payment of an award to an unspecified financial trigger at the
6 corporate level that is beyond the control and influence of MAWC employees.

7 Q. In the AIP description, there is a focus on the “next higher organization level.”
8 Does Staff view this as appropriate in the determination of the AIP payment?

9 A. No. The MAWC employees have no control over what occurs in the next
10 higher level of the American Water family of companies. To include any portion of the award
11 for items that are not under the direct influence of the employees of MAWC is unacceptable.
12 American Water is made up of 59 different operating entities, some of which are unregulated
13 subsidiaries. The Commission has ruled in previous cases that achieving the goals of parent
14 corporations, including their unregulated subsidiaries, does not provide a direct correlation of
15 the service provided by the Missouri utility.

16 Q. Are there any other provisions of the revised AIP that are outside the control of
17 MAWC personnel?

18 A. Yes. One of the most important factors that influence the profits of a water
19 company is the weather. Weather can push the profits of a company to either extreme highs
20 or extreme lows. This is clearly outside the power of MAWC personnel to control and could
21 prevent a payout of the AIP, regardless of whether MAWC personnel achieved the individual
22 goals that would otherwise result in award payments.

23 Q. Are there any other areas of concern regarding the revised AIP?

1 A. Yes. In the Operational Performance Section of the AIP, there is still a portion
2 dedicated to customer satisfaction. This portion of the award is still based on the results of
3 the Customer Service Survey, which was used in the determination of both the old AIP
4 awards and the Customer Service Bonus. As described in my direct testimony, there are some
5 serious flaws in the use of this survey to provide a meaningful measure of the customer
6 service provided by the personnel of any one operating district. The survey contains
7 questions that do not pertain to MAWC. The survey contains questions that provide no real
8 metrics for measurement of the actual service provided, relies on the perceptions of the
9 customer, and is only responded to in full by 391 of the approximately 440,000 MAWC
10 customers. Given all of these concerns, Staff maintains that there should be no adjustment to
11 the test year to include the expense for the AIP in the cost of service.

12 **CUSTOMER SERVICE BONUS**

13 Q. Does Company witness Cheryl E. Milton Roberts provide any justification for
14 the inclusion of the Customer Service Bonus in her rebuttal testimony?

15 A. No.

16 Q. Do Ms. Roberts' statements about the location-specific nature of the surveys
17 validate them as a basis for measuring customer service performance?

18 A. No.

19 Q. Please summarize the Staff's position related to the payment of the Customer
20 Service Bonus.

21 A. For the reasons stated earlier in this testimony and in my rebuttal testimony,
22 the Staff views the surveys used by the Company as an invalid basis for measuring customer

1 service performance. The Staff continues to contend that no recognition should be given to
2 the Customer Service Bonus in cost of service.

3 **LOBBYING EXPENSE**

4 Q. On page 33 of his rebuttal testimony, Company witness Edward J. Grubb states
5 that he believes that “governmental relations efforts are a normal business expense that
6 benefits both the ratepayers and the Company.” How do you respond to this assertion?

7 A. While the amount spent on governmental relations may be a normal business
8 expense, the value of these efforts to ratepayers, if any, are unknown. There is no way to
9 know if the passage or defeat of legislation is actually the result of the Company’s lobbying
10 efforts.

11 Q. Does the Company concede that some portion of the Governmental Affairs
12 efforts represents lobbying and that it should be removed from the cost of service?

13 A. Yes. On pages 34 and 35 of Mr. Grubb’s rebuttal testimony, he cites an
14 estimate of 5% as the amount of time the Director of Governmental Affairs spends on
15 lobbying efforts and agrees with a disallowance of the corresponding amount of expense.

16 Q. What position has the Commission taken in the past with regard to lobbying
17 expenses?

18 A. As I discussed in my direct testimony, the Commission has ruled the
19 beneficiaries of lobbying activities are usually the stockholders of a company involved in
20 lobbying. The Commission has also stated that the stockholders of a company lobbying
21 should be the ones to assume responsibility for these expenses unless the company offers
22 substantial evidence for their inclusion in rates.

1 Q. On page 34 of his rebuttal testimony, Mr. Grubb states that the Director of
2 Governmental Affairs “devotes approximately 5% of his time to actual lobbying efforts.”
3 How does the Staff respond to this?

4 A. Staff finds this statement to be unacceptable. In the original response to Staff
5 Data Request No. 264, which asked the Company to provide a percentage of time devoted to
6 the job responsibilities that Staff deemed related to lobbying, the Company responded that
7 “[t]his position does not account for its time in a fashion that allows for any meaningful
8 estimate of the time in the categories indicated in the question above.” Yet, in an updated
9 response, months later, after the Staff’s direct testimony filing the Company was able to
10 develop an estimate of only 5%.

11 Q. Does the Staff find the 5% estimate to be reasonable?

12 A. No. Considering the fact that the top five job responsibilities of this position
13 of the Director of Governmental Affairs all involve some aspect of lobbying, assigning only
14 5% of his time to lobbying efforts is unreasonable. Attached as Schedule 1 to this
15 surrebuttal testimony, is the job description for the Director of Governmental Affairs (Staff
16 Data Request No. 67). The number one job function, as stated in the position responsibilities
17 list, is to “influence proposed legislation” (lobbying). Staff finds it unreasonable to believe
18 that only 1% of the director’s time is spent on this activity as estimated by the Company.
19 Based on the duties of this position, the Staff continues to believe that a disallowance of 50%
20 of the expenses associated with the governmental affairs position is appropriate.

21 Q. Is there any other reason that Staff opposes the full inclusion of the expenses of
22 the Director of Governmental Affairs?

1 A. Yes. Staff feels that the remaining duties ascribed to this position are
2 duplicative of other Company departments and personnel. On page 34 of Mr. Grubb's
3 rebuttal testimony he lists "liaison" as the major function of the Governmental Affairs
4 position. However, MAWC currently has two Communications Managers and one Director
5 of Communications. There are also local district managers to assist in this capacity. To
6 research and monitor legal actions (legislative or otherwise), there are the Corporate Counsel
7 and the Associate Corporate Counsel. Additionally, if the Company wants to maintain direct
8 lobbying efforts, there are nine people that are registered with the Missouri Ethics
9 Commission as lobbyists representing MAWC in addition to the Director of Governmental
10 Affairs. Also, the Company belongs to the group REGFORM, which represents a multitude
11 of companies as a lobbyist and regulatory monitoring affiliation. Therefore, other personnel
12 are available to provide the liaison function for the Company. Based on the above discussion,
13 Staff feels that its disallowance is justified. Staff also feels that the Company should maintain
14 better records for time reporting in order to track the amount of time any individual spends on
15 lobbying efforts.

16 Q. Does this conclude your surrebuttal testimony?

17 A. Yes, it does.

**American Water System
JOB DESCRIPTION**

POSITION TITLE: Director, Governmental Affairs		
DEPARTMENT:		
IMMEDIATE SUPERVISOR'S/MANAGER'S TITLE:		
IMMEDIATE SUBORDINATES TITLE(S):		
TOTAL NO. SUPERVISED:	Directly:	Indirectly:
POSITION SUMMARY		
Basic Function or purpose of this position.		
Responsible for implementing and maintaining policies and procedures affecting the Company's relationship with federal, state and local governments as well as state regulatory authorities, and for implementing an effective external communications program for the Company involving media, public affairs, etc.		
POSITION RESPONSIBILITIES		
Principal responsibilities of this position.		
Monitors and provides input to positively influence proposed legislation and emerging issues that could affect the Company.		
Assists in determining action or positions regarding government matters.		
Develops and maintains effective working relationships with federal, state and local legislators, officials and members of regulatory authorities.		
Assists the President in communicating with governmental officials at all levels regarding Company positions on federal/state legislation and regulations.		
Coordinates communications and personal contacts by company management with elected and appointed officers.		
Represents the Company on government and regulatory matters at trade associations and public agencies.		
Represents the Company as spokesperson in dealing with media concerning activities affecting the Company and its operations.		
Develops an effective external communications program to ensure the Company's objectives and programs are properly understood and correctly perceived by external publics.		
May coordinate community relations activities throughout the state in conformance with the Company's goals.		

mgmt1.045

1997
Water Company

POSITION KNOWLEDGE**Specialized knowledge required for this position, including licenses and/or certifications.**

Current knowledge of government regulations and legislation pertinent to water utilities; water utility industry issues and trends; company policies and procedures; working knowledge of local and state legislative and regulatory processes. Knowledge of communications principles particularly related to print and visual media and ability to effectively and concisely represent the Company and its positions in dealing with external publics and government officials.

POSITION SKILLS**Specific expertise required for this position.**

Strong verbal and written communication skills (e.g., presentation, report writing); strong interpersonal skills (e.g., tact/diplomacy, persuasion, negotiation, ability to influence others); strong organizing and planning skills.

POSITION EXPERIENCE/EDUCATION**Experience and/or education required for this position.**

Type of Experience: Minimum of five years' experience with governmental legislative processes, preferably involving utility matters

Education: Bachelor's Degree in Political Science or Public Administration related field and ten years political/public sector related experience required.