Exhibit No.:	
Issues:	*Employee Benefits, Transportation Costs, Tank Painting Tracker, Tank Painting Expense, Incentive Compensation, Payroll, Overtime, PSC Assessment, Waste Disposal, Severance*
Witness:	*Jason Kunst*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Surrebuttal Testimony*
Case No.:	*WR-2015-0301*
Date Testimony Prepared:	*March 4, 2016*

MISSOURI PUBLIC SERVICE COMMISSION

COMMISSION STAFF DIVISION

AUDITING DEPARTMENT

SURREBUTTAL TESTIMONY

OF

JASON KUNST

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2015-0301

Jefferson City, Missouri
March 2016

**** Denotes Highly Confidential Information ****

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SURREBUTTAL TESTIMONY

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JASON KUNST

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2015-0301

Q. Please state your name and business address.

A. Jason Kunst, 111 N. 7th Street, Suite 105, St. Louis, MO 63101.

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

A. I am employed by the Missouri Public Service Commission as Utility Regulatory Auditor II.

Q. Are you the same Jason Kunst who sponsored direct testimony as part of Staff's Revenue Requirement Cost of Service Report ("Report") that was filed in this case on December 23, 2015, and who also filed rebuttal testimony on February 11, 2016?

A. Yes.

EXECUTIVE SUMMARY

Q. Please give a brief summary of your surrebuttal testimony.

A. My surrebuttal testimony will respond to the rebuttal testimony of Missouri-American Water Company (MAWC) witnesses Kevin H. Dunn regarding the tank painting and inspection tracker, Donald J. Petry regarding American Water Works Service Company ("Service Company") Support Services and Incentive Compensation, Nikole Bowen regarding Transportation Leases and Waste Disposal, and Jeanne M. Tinsley regarding labor and related benefits and severance costs. I will also address Staff's true-up adjustments to payroll and benefits, waste disposal, the tank painting and inspection tracker, and transportation fuel and maintenance.

TANK PAINTING AND INSPECTION TRACKER

Q. Has Staff made any adjustment to its recommended annualized amount of tank painting and inspection expense for inclusion in rates?

A. Yes. As part of its true-up audit, Staff has reviewed tank painting and inspection costs through January 31, 2016, and now recommends including $1,302,754 in rates for this item based on a five year average ending January 31, 2016.

Q. What is the current balance of the regulatory asset created by the tank painting and inspection expense tracker as of January 31, 2016?

A. $1,348,837.

Q. Has Staff changed its recommendation regarding its proposed treatment of the regulatory asset?

A. No. Staff is still recommending that the balance as of January 31, 2016, be amortized over a five-year period and that the unamortized balance be included in rate base.

Q. What recommendation for the tank painting and inspection tracker does MAWC witness Kevin H. Dunn make in his rebuttal testimony?

A. On page 6, lines 19-22, Mr. Dunn recommends allowing MAWC to continue to use the tank painting and inspection expense tracker at the current Commission authorized base level of $1,300,000 annually and to amortize the tracker balance as of January 31, 2016, over a three-year period while including the unamortized portion in rate base.

Q. Does Staff agree that MAWC should be allowed to continue using the tank painting and inspection tracker subsequent to the effective date of rates in this rate proceeding?

A. No. It is Staff's position that tank painting expenses are not significant enough to warrant the extraordinary treatment provided by continuous tracking. Staff contends the expenses are a normal and predictable maintenance cost.

Q. Is MAWC able to determine well in advance the need to perform a tank painting for any of its water storage tanks and standpipes?

A. Yes. The scheduled intervals between full removal tank painting provided as part of MAWC's response to Staff Data Request No. 231 reveals that, at a minimum, both an internal and an external tank painting will last for at least 15 years. In fact, many tank painting have lasted for over 20 years. MAWC performs routine tank painting inspections. These inspections are designed to alert MAWC officials of any potential problems with a particular paint coating among other issues, internally or externally for all of its water storage tanks. These inspections should provide MAWC with significant advanced notice of any need to perform a tank painting. With this advanced notice, MAWC can easily time its rate case filings to address any significant costs that it might incur in relation to tank painting projects, much like it plans the timing of it rate case filings around payroll and wage rate increases.

Q. Does Staff oppose the tank painting and expense tracker for any other reasons?

A. Yes. Continuous tracking does not incentivize a company to control costs because the utility is not potentially responsible for any increase to those costs. By allowing

MAWC to recover the tank painting expenses dollar-for-dollar, they have no incentive to reduce costs.

Q. MAWC witness Dunn states on page 4, lines 8-9 of his rebuttal testimony that "The cost to paint varying sizes and type of tanks is vastly different and set an annual expenditure to recover this variability is not easily accomplished." Does Staff agree with that statement?

A. No. Staff's five year average is slightly above the $1.3 million base tracker level established in the *Non-Unanimous Stipulation and Agreement* in the previous MAWC rate case, Case No. WR-2011-0337. On page 5, lines 13-15 Mr. Dunn states, "For example in the last five years, tank painting costs have ranged from a low of $828,602 in 2013 to a high of $1,762,168 in 2012." The average of those two years, approximately $1.3 million, is approximately Staff's recommended annualized amount in this proceeding.

Q. Does Staff agree with MAWC witness Dunn's rebuttal testimony assertion that the asset balance created by the tracker should be amortized over three years and the unamortized balance included in rate base?

A. No, regarding the proposed amortization period. While Staff agrees that the unamortized balance should be included in rate base, consistent with the *Non-Unanimous Stipulation and Agreement* in MAWC's last rate case, Case No. WR-2007-0216, Staff instead recommends amortizing the balance over a five-year period consistent with Staff's general and longstanding position of providing recovery of deferred regulatory assets and liability through a five-year amortization period. Additionally, Staff recommends any regulatory asset or liability created by the tracker subsequent to the true-up cutoff date in this case through the effective date of rates, be addressed in the next MAWC rate case.

MAWC LEVEL PAYROLL AND RELATED BENEFITS (OTHER THAN PENSIONS AND OPEBS)

Q. Has Staff completed its true-up review of payroll and related benefits at the MAWC level?

A. Yes. Staff has updated its annualized payroll and benefit levels to reflect the most current data as of the Commission established true-up cutoff date, January 31, 2016. Staff is now recommending the following annualized levels of expense:

- Payroll $24,631,196
- Overtime $2,614,918
- Group Insurance $4,752,703
- Employee Benefits (401k, ESPP, VEBA) $788,721
- Payroll Taxes $2,111,336

Q. What level of expenses has MAWC proposed in its true-up filings?

A. The Company has proposed the following amounts in its true-up work paper:

- Payroll $24,889,837
- Overtime $2,683,151
- Group Insurance $4,724,164
- Employee Benefits $836,838
- Payroll Taxes $2,158,232

Q. Please provide a table that quantifies the differences that exist between Staff and MAWC for these payroll and benefits categories.

A. The follow chart summarizes all differences between Staff's and MAWC's proposals:

	Staff	MAWC	Difference
Labor	$ 24,631,196	$ 24,889,837	$ (258,641)
Overtime	$ 2,614,918	$ 2,683,151	$ (68,233)
Group Insurance	$ 4,752,703	$ 4,724,164	$ 28,539
401K	$ 669,369	$ 664,883	$ 4,486
ESPP	$ -	$ 53,534	$ (53,534)
VEBA	$ 119,352	$ 118,420	$ 932
Payroll Taxes	$ 2,111,336	$ 2,158,232	$ (46,896)
Total	$ 34,898,874	$ 35,292,221	$ (393,347)

Q. In her rebuttal testimony found on page 10, lines 4-21, MAWC witness Jeanne M. Tinsley discusses wage increases to St. Louis County Union ("Local 335") and to non-union employees. Did Staff include these wage increases in its true-up calculation?

A. Yes. Staff did include the raise to Local 335 in its true up calculations, as it went into effect on January 28, 2016, just three days before the January 31, 2016, true-up cutoff point in this case. Staff did not include the March 14, 2016, merit increases that are planned for non-union MAWC employees as part of its true-up calculation.

Q. Why does Staff not recommend including the merit raises to the non-union MAWC employees in its true-up cost of service calculation?

A. Staff did not include the scheduled non-union raise to management employees as part of its true-up filing because Staff contends that the increase occurs outside of the Commission ordered true-up cut-off date and violates the matching principle.

Q. Why does Staff contend that the management increase violates the matching principle?

A. The increase is an inappropriate, isolated adjustment and does not take into account changes in other factors that will occur after the true-up date in this case. Staff historically contends that other relevant factors must be taken into account when setting rates. For instance, ** ____

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Q. Please explain Staff's reasoning and justification for using a five-year average ending December 31, 2014, when calculating overtime.

A. In the five-year period examined by Staff, MAWC endured abnormally high amounts of overtime in various districts due to flooding, extremely cold weather, and tornados. By using a five-year average, Staff is able to better "smooth" out the higher than normal years which provides a more accurate annualized amount.

Q. Please explain why Staff is opposed to the three-year average used by MAWC?

A. MAWC's three-year average includes 2012-2014, which saw the Company endure a record number of main breaks in the St. Louis Metro district. The St. Louis Metro district accounts for on average 78 percent of the overtime incurred by MAWC. Without the

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smoothing effective of the larger timeframe, the overtime percentage is skewed by the higher than average amount incurred in the test year.

Q. Is Staff aware of any significant incurrence of overtime subsequent to the test year by MAWC?

A. Yes. During October 2015, MAWC recorded the highest monthly level of overtime that it has incurred over the past ten years. MAWC has explained to Staff that this overtime related to MAWC's actions that it took in response to a widespread metering defect issue. Staff is aware that MAWC has replaced at least 22,000 defective meters since August 2015. Therefore, Staff has excluded overtime that was incurred by MAWC subsequent to the test year in Staff's overtime annualization recommendation to the Commission.

Q. Is calculation of the O&M percentage still at issue between MAWC and Staff?

A. No. Staff has reviewed additional information and has adopted the proposed O&M factor used by MAWC. This is no longer an issue between Staff and MAWC.

ALLOCATED SERVICE COMPANY SUPPORT SERVICES – PAYROLL AND BENEFITS

Q. Has Staff reexamined the level of expense related to AWWSC payroll and benefits to include in rates as part of its true-up audit?

A. Yes. Staff now recommends including $12,096,854 for annualized service company labor and related expenses based upon the true-up information through January 31, 2016, that was provided by MAWC on February 19, 2016.

Q. What level of expense does MAWC propose to include in rates?

A. In his rebuttal testimony, MAWC witness Donald J. Petry recommended including $12,953,973 as the annualized level to include in rates for allocated payroll and benefits costs.

Q. Please provide a breakdown by category for this $857,119 difference that exists between MAWC and Staff for payroll and benefits other than pensions and OPEBS:

	Staff	MAWC	Difference
Labor	$ 9,500,137	$ 10,035,089	$ (534,952)
Overtime	$ 269,962	$ 278,971	$ (9,009)
Group Insurance	$ 1,347,559	$ 1,412,658	$ (65,099)
401K	$ 233,094	$ 259,413	$ (26,319)
ESPP	$ -	$ 33,403	$ (33,403)
Payroll Taxes	$ 746,102	$ 934,439	$ (188,337)
Total	$ 12,096,854	$ 12,953,973	$ (857,119)

A. The chart above depicts a breakdown of the differences that exist between Staff and MAWC with regard to allocated Service Company payroll and benefits.

Q. What methodology does MAWC witness Donald J. Petry recommend for determining the amount of service company payroll and benefits to include in the cost-of-service calculation in this case?

A. On page 2, lines 29-30, Mr. Petry states "The Company believes that utilizing the true-up amount of actual expense is the best methodology."

Q. Does Staff have any concerns about using the actual true-up amount for this item as suggested by MAWC?

A. Yes. Mr. Petry's proposal that MAWC should simply accept an actual unadjusted true-up labor cost allocation from an affiliate cuts against long standing and traditional ratemaking techniques such as annualization and normalization. The actual true-up amount could include amounts for employees who are no longer employed by AWWSC. In response to Staff Data Request No. 298, AWWSC had 1,312 employees as of December 31, 2014, and 1,227 employees as of January 31, 2016. By using the method suggested by Mr. Petry, the ratepayers would be paying a portion of the salary and benefits for employees who are no longer employed. Going forward, based upon MAWC's response to Staff Data Request No. 117, MAWC has indicated that the projected work force level for the Service Company will continue to decrease over time. MAWC indicated that the Service Company is projected to employ an average of 1,196 employees over the next four years (2016-2019). Using the actual 2015 expense allocated down to MAWC, as proposed by MAWC witness Petry, provides even more detailed illustrations of the problem that Missouri ratepayers could possibly be paying for a portion of salaries of over 100 employees who are no longer providing any service to Missouri ratepayers in the immediate time period following this rate case. If Mr. Petry and his fellow Service Company employee colleagues were to make similar recommendations in all of the states that American Water Works, Inc., provides service, this would lead to a situation where the Service Company collected more in rates than its actual costs.

Q. How does Staff believe the allocated affiliate Service Company labor costs should be determined and adjusted?

A. Staff reviewed the Service Company payroll on an employee-by-employee basis. Staff has reflected the salaries and wages of the actual Service Company employees that existed and were employed at the end of the January 31, 2016, the Commission established true-up cutoff for this case. Therefore, Staff has excluded the costs of all vacant positions that existed as of January 31, 2016. Furthermore, Staff has annualized the Service Company payroll to include a full year of the current salary for any employees hired subsequent to February 1, 2015, as well as including a full year's impact of the increase in salary and wage rates that occurred on March 14, 2015.

INCENTIVE COMPENSATION

Q. On page 5, lines 12-13 of his rebuttal Testimony, MAWC witness Petry wrote "If the overall level of the costs is reasonable, there is no basis to 'look behind the curtain'", in regards to Staff's recommended disallowance of AWWSC incentive compensation tied to financial goals. What is Staff's response to this statement?

A. Mr. Petry's statement disregards the fact that the incentive compensation is designed to reach financial goals that if achieved can only serve to benefit the shareholder. Staff contends that there is no justification whatsoever for requiring ratepayers to fund incentive compensation payouts that are specifically designed to benefit the shareholder.

Q. In his rebuttal testimony, on page 3, lines 27-29, MAWC witness Donald J. Petry wrote, ". . . it is inappropriate to adjust Support Service charges for incentive compensation paid to Service Company employees" regardless of the fact that the incentive compensation is directly tied to earnings per share (EPS) goals that solely benefits the shareholder. How does Staff respond?

A. To reiterate, Staff believes that it is never appropriate to include incentive compensation payouts that are tied to financial performance measurements that solely benefit shareholders. This is the long-standing approach that has been taken by Staff and upheld by the Commission in previous rate cases.

Q. In his rebuttal testimony found on page 8, lines 14-27, Mr. Petry states that Staff ignores several key findings in the Southwestern Bell Telephone Company (SWBT) Case No. TC-89-14. Please respond.

A. Unlike the SWBT case, Staff is making no claim that MAWC salaries are unreasonable or imprudent. Staff's contention is that incentive compensation goals tied to the financial performance of the parent company, American Water, are entirely to the benefit of the shareholders and should not be charged to ratepayers.

Q. On page 14, lines 7-10, MAWC witness Petry states the following, “MAWC’s employees are not overcompensated relative to their peers, even with the inclusion of incentive pay. So it is not appropriate to disallow a portion of their compensation.” How does Staff respond?

A. Mr. Petry’s argument is a “red herring”; Staff’s position is not premised upon a belief that MAWC’s total compensation is unreasonable. Staff’s contention is that incentive compensation plans based on financial goals are entirely for the benefit of the shareholders and should not be bourne by ratepayers.

Q. What past cases can you point out in which the Commission indicated that incentivizing financial goals and metrics that solely benefit the shareholders should not be recovered at the expense of Missouri ratepayers?

A. The Commission noted in the *Report and Order* in Case No. GR-2004-0209, Missouri Gas Energy:

> The Commission agrees with Staff and Public Counsel that the financial incentive portions of the incentive compensation plan should not be recovered in rates. Those financial incentives seek to reward the company’s employees for making their best efforts to improve the company’s bottom line. Improvements to the company’s bottom line chiefly benefit the company’s shareholders, not its ratepayers. Indeed, some actions that might benefit a company’s bottom line, such as a large rate increase, or the elimination of customer service personnel, might have an adverse effect on ratepayers.
>
> If the company wants to have an incentive compensation plan that rewards its employees for achieving financial goals that chiefly benefit shareholders, it is welcome to do so. However, the shareholders that benefit from the plan should pay the costs of the plan. The portion of the incentive compensation plan

> relating to the company's financial goals will be excluded from the company's cost of service revenue requirement.

The Commission reaffirmed its decision on incentive compensation plans based on financial goals in the Ameren Missouri rate case, No. ER-2008-0318:

> The Commission has frequently disallowed costs relating to incentive programs that are based on measures of the financial return achieved by the utility. It has done so because such measures are based on the level of profits the utility can achieve. At best, a utility's level of profitability has little or no benefit for ratepayers. At worst, an increase in the utility's profitability may be harmful to ratepayers if that profitability is obtained by cutting customer service or system maintenance to cut costs and thereby increase earnings per share. Because eligibility for Ameren UE's long-term compensation plans are based on measures of the financial return achieved by the utility, the cost of those plans should fall on the shareholders who will primarily benefit from the company's increased financial return.

And in the Kansas City Power and Light Company ("KCP&L") rate case, Case No. ER-2007-0291:

> KCPL has the right to tie compensation to EPS. However, because maximizing EPS could compromise service to ratepayers, such as by reducing maintenance, the ratepayers should not have to bear that expense. What is more, because KCPL is owned by Great Plains Energy, Inc., and because GPE has an unregulated asset, Strategic Energy L.L.C., KCPL could achieve a high EPS by ignoring its Missouri ratepayers in favor of devoting its resources to Strategic Energy. Even KCPL admits it is hard to prove a relationship between earnings per share and customer benefits. Nevertheless, if the method KCPL chooses to compensate employees shows no tangible benefit to Missouri ratepayers, then those costs should be borne by shareholders, and not include[d] in the cost of service.

Q. Please summarize Staff's position on incentive compensation.

A. Missouri ratepayers should not be required to pay the cost of an incentive compensation plan that is solely for the benefit of the shareholders. Mr. Petry's arguments regarding total compensation levels does not address in any way Staff's true issue with the incentive compensation plan.

TRANSPORTATION LEASES AND FUEL EXPENSE

Q. Has Staff made any changes to its direct filed position in regard to transportation expenses?

A. Yes. Staff is now recommending a $1,965,840 annualized level for transportation expense.

Q. What amount of transportation expense did MAWC include in its true-up work papers?

A. In the true-up work papers provided to Staff, MAWC included $2,034,721 as an annualized level of transportation expense.

Q. Please identify the factors that cause the approximately $68,881 difference that exists between Staff and MAWC in regards to transportation related expenses.

A. The difference between Staff and MAWC exists due to Staff removing additional expired leases that MAWC failed to exclude from its true-up adjustment.

Q. Do Staff and MAWC agree on the adjustment to annualize lease-related fuel costs?

A. Yes. Staff and MAWC agree on the amount of fuel costs to include in rates and believe that certain portions of the transportation issue are settled.

Q. On pages 9-10 of her rebuttal testimony, MAWC witness Nikole Bowen describes a Staff adjustment of $66,275 to transportation expenses that she believes should not have been added to the expense. Does Staff agree?

A. The Staff has since discussed this issue with Ms. Bowen and Staff believes that this issue is now resolved.

Q. Are there any other issues regarding transportation lease expenses Staff wishes to address?

A. Yes. ** ____________________ **

WASTE DISPOSAL EXPENSE

Q. Please describe the waste disposal costs relate to MAWC's water and wastewater systems.

A. The treatment process for water and wastewater leaves behind byproducts that must be removed from the treatment facilities. The time between cleanings varies from facility to facility. To account for these costs, MAWC accrues a monthly amount based on historic and estimated costs. Some of the districts, however, are billed on a monthly or quarterly basis to have the waste treated elsewhere.

Q. What level of expense has MAWC recommended for waste disposal expense in its true-up work papers?

A. In the true-up work papers provided to Staff, MAWC has recommended $1,871,300 as the annual level of expense for inclusion in rates. This includes $140,614 of interest expense related to an amortization that MAWC proposes in connection with the Arnold sewer system acquisition and that has nothing to do with waste disposal costs. This amount has not been included in Staff's case. For a complete discussion of the Arnold system interest expense issue, please refer to Staff witness Lisa M. Ferguson's surrebuttal testimony. I will address the actual waste disposal costs for the Arnold system as well as waste disposal costs for all of MAWC's systems that totaled $1,730,686 ($1,871,300 less $140,614) in MAWC's true-up information.

Q. Has Staff reexamined the amount of waste disposal expenses to include in rates?

A. Yes. Staff has reviewed the true-up information as well as other information that has been provided since filing its direct testimony in this case and is now recommending a total company annualized waste disposal expense amount of $1,584,277 for inclusion in the cost of service calculation. Staff reviewed the historic costs for each district on a separate basis to determine the annualized and normalized amount to include in rates.

Q. Please reconcile the difference between Staff and MAWC's annualized amounts?

A. Staff based its annualized amount on actual historic costs. MAWC has proposed to include an annual accrual amount based on estimated future expenses.

Q. What problems does the Staff have with MAWC's use of the accrual method of accounting for ratemaking purposes?

A. The flaw in using the accrual method to set rates is that the accrual method uses estimated future costs. Setting rates using estimated future costs may incentivize MAWC to overestimate its costs for waste disposal expense. Rates should be set based on known and measureable amounts, which can reasonably be determined using the cash basis of accounting.

Q. Has the Commission ruled against the inclusion of future estimated expenses in other rate proceedings?

A. Yes. In GR-96-285, the Commission ruled in favor of Staff's use of cash basis ratemaking for injuries and damage expense. Missouri Gas Energy (MGE) proposed to include actual test year costs for injuries and damages as well as accrued amounts for incidents that had occurred, but had not yet been paid. The Commission stated the following in the Report and Order:

> MGE's approach to this issue is not tenable because it would include paid losses, as well as incurred but not paid losses…The Commission finds that the approach utilized by the Staff is the most reasonable one presented because it relies on the actual historical experience of MGE while operating in the State of Missouri.

<u>CAPITALIZED INCENTIVE COMPENSATION</u>

Q. Has Staff reexamined it's adjustment to plant-in-service and depreciation reserve?

A. Yes. Staff has updated its work paper to reflect actual plant-in-service and depreciation reserve through the end of the Commission established true-up cutoff date of January 31, 2016.

PSC ASSESSMENT

Q. Do Staff and MAWC agree on the amount of PSC Assessment to include in the cost of service calculation?

A. Yes. Staff and MAWC agree on the proper amount of PSC assessment expense to include in rates.

SEVERENCE EXPENSE

Q. Do Staff and MAWC agree that no severance costs for MAWC or the service company should be included in rates in this case?

A. Yes. Based upon MAWC's response to Staff Data Request No. 431, Staff and MAWC agree that no severance costs should be included in rates in this case.

Q. Does this conclude your surrebuttal testimony?

A. Yes.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri-American Water Company's Request for Authority to Implement a General Rate Increase for Water and Sewer Service Provided in Missouri Service Areas	))))	Case No. WR-2015-0301

AFFIDAVIT OF JASON KUNST

STATE OF MISSOURI)
) ss.
CITY OF ST. LOUIS)

COMES NOW JASON KUNST and on his oath declares that he is of sound mind and lawful age; that he contributed to the foregoing SURREBUTTAL TESTIMONY; and that the same is true and correct according to his best knowledge and belief.

Further the Affiant sayeth not.

JASON KUNST

JURAT

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the City of St. Louis, State of Missouri, at my office in St. Louis, on this 3rd day of March, 2016.

VIVIAN KINCAID
Notary Public - Notary Seal
State of Missouri
Commissioned for St. Louis County
My Commission Expires: June 06, 2018
Commission Number: 14893349

Notary Public