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Witness: James A. Merciel, Jr.
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Case No.: WR-2006-0425
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY OPERATIONS DIVISION

REBUTTAL TESTIMONY

OF

JAMES A. MERCIEL, JR.

ALGONQUIN WATER RESOURCES OF MISSOURI, LLC

CASE NO. WR-2006-0425

**Jefferson City, Missouri
December 2006**

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

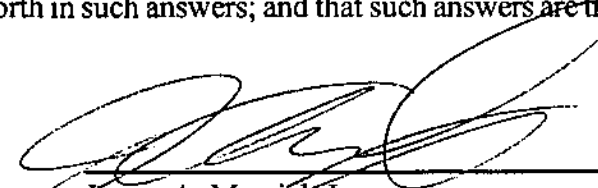
In the Matter of the tariff filing of Algonquin)
Water Resources of Missouri, LLC to implement)
a general rate increase for water and sewer)
service provided to customers in its Missouri)
service areas.)

Case No. WR-2006-0425

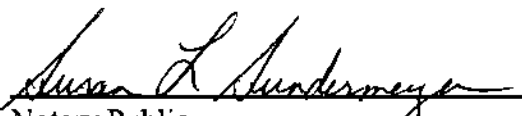
AFFIDAVIT OF JAMES A. MERCIEL, JR.

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

James A. Merciel, Jr., of lawful age, on his oath states: that he has participated in the preparation of the following Rebuttal Testimony, in question and answer form, consisting of 7 pages, to be presented in the above case; that the answers in the following Rebuttal Testimony were given by him, that he has knowledge of the matters set forth in such answers; and that such answers are true to the best of his knowledge and belief.


James A. Merciel, Jr.

Subscribed and sworn to before me this 27th day of December 2006.


Notary Public

My commission expires 9-21-10



SUSAN L. SUNDERMEYER
My Commission Expires
September 21, 2010
Callaway County
Commission #06942086

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1 then has the opportunity to recover the expenses associated with all of these subdivision
2 facilities by including the cost of the amenities in the prices of the lots that are sold.

3 Since this case involves Algonquin Water Resources, Inc. (Algonquin) which
4 provides water and sanitary sewer utility service, I will focus on water and sewer facilities in
5 this testimony. Of course, when considering subdivision development in general terms, there
6 are many, many various situations. Sometimes water and/or sewer utility entities are already
7 in existence when a developer begins a project, in which case the developer can work with
8 existing utilities; sometimes the developer must form a new utility entity in order for the
9 project to proceed, which is how most of the small Commission-regulated water and sewer
10 utilities got their start, as well as some of the larger ones; and, often, for whatever reason, the
11 development proceeds without a clear and adequate plan as to how water and sewer utility
12 service will be provided.

13 However, in general, I, along with the rest of the Water and Sewer Department (W/S
14 Dept.) staff, believe that regulated water and sewer utilities have the best chance of being
15 viable entities if the utility owners invest in the central facilities such as wells, storage tanks,
16 sewage treatment facilities, and, for larger systems, perhaps major feeder pipelines or trunk
17 sewers, and then developers or customers contribute the distribution pipelines and collecting
18 sewers, which are located among the lots being served. However, with this combination of
19 utility investment and customer contribution a developer may well need to make a “temporary
20 contribution” to the construction of the central facilities, because there are not enough
21 customers to financially support the utility at first. But, ultimately, the utility would be
22 responsible for the central capacity, while customers and developers have to bear the capital
23 cost of extending the pipelines as needed. Additionally, the resulting level of investment by

1 the utility provides the owners with a reasonable revenue stream, while keeping rates low
2 enough that they are generally considered to be reasonable. While this arrangement is neither
3 a regulation nor a strict policy, I believe this balance of investment versus contribution is
4 important, and the W/S Department promotes structuring rates for almost all newly
5 certificated water and sewer utilities in this manner.

6 Q. Are there reasons to make exceptions to this balance of investment and
7 contribution?

8 A. Yes, as with most general principles there are often situations that could justify
9 exceptions. For example, there might be a situation where the central facilities are unusually
10 expensive for some reason, in which case it may be desirable for the developer to make a
11 contribution to the cost of the central facilities. One disadvantage to this means of financing
12 might show up some years later as the utility needs to spend money to replace expensive
13 facilities, resulting in a substantial rate impact upon the customers.

14 But, on the other hand, an advantage to this means of financing might just as easily
15 occur if the utility has the opportunity to convey and/or connect the system to a larger utility
16 such as a municipality, when neither the buyer nor the seller could afford such a deal if it
17 involved an extraordinarily large investment by the utility.

18 Another example could involve smaller facilities that might be outdated, old and
19 depreciated, in which case the developer might contribute the entire value of the facility to the
20 utility, with the idea that the utility will spend money in the future on upgrades, expansions,
21 and facility consolidations.

22 Yet another example, mostly applying to larger water and sewer utilities, is that the
23 utility could choose to invest some funds in the distribution or collection pipelines. In some

1 cases, competition between municipalities, public-owned water or sewer districts, and
2 regulated companies becomes a factor with regard to investment in pipelines.

3 Q. Would it be accurate to say that exceptions and challenges to the typical
4 financing arrangement are more likely to occur when older, existing facilities are the subject
5 of a utility certification or acquisition?

6 A. Yes, financing and accounting when utilities certificate or acquire pre-existing
7 facilities is absolutely more of a challenge than financing and accounting for newly
8 constructed facilities. The new ones can usually be set up with known plant costs properly
9 booked from the beginning, but when older facilities are involved it is sometimes difficult or
10 impossible to determine what the original costs were, and how the capital costs were handled
11 by the entity that constructed the facilities. Trying to estimate a level of rate base and
12 depreciation reserve is guesswork at best, if adequate records do not exist. Among some of
13 the regulated water and sewer utilities, it is not unusual to find that much of the utility plant
14 values do not even appear in the utilities' plant records, because the details are unknown.
15 While it is desirable for the original costs of facilities to be recorded on the utilities' books,
16 such records needed to do this often are simply not available. From a practical standpoint and
17 from a ratemaking standpoint, these unrecorded facilities would normally have been
18 contributed, so there is no rate impact and it is really not an issue that needs the Commission's
19 attention.

20 **SPECIFIC DEVELOPER-RELATED FACILITIES**

21 Q. With regard specifically to Algonquin's situation, was this utility set up using
22 your recommended investment/contribution method?

1 A. Yes, it was. The utility systems in all three of Algonquin's service areas,
2 Timber Creek, Holiday Hills, and Ozark Mountain Resorts, already existed before they were
3 first operated by regulated utilities. Ascension Resorts, Ltd. (ARL, later operating under the
4 names Resort Utilities and Silverleaf Resorts) obtained certificates to operate the water and
5 sewer systems in Case Nos. WA-94-60, WA-94-246, and WA-98-129. I worked on these
6 cases, and I recall that the general concept was that the utility would invest in central facilities
7 to the extent that the utility could show that it had unrecovered funds invested, and with the
8 developer contributing the distribution and collection pipelines. ARL also filed a tariff, which
9 the Commission approved, with rules providing that extensions of pipelines would be paid for
10 by developers or customers. As these were existing systems, there may have been issues with
11 regard to determining the original costs and appropriate depreciation of some of the facilities.
12 Additionally, I recall that the W/S Department did some field work assisting in properly
13 booking some newly constructed facilities. So I would not be surprised, and it would not be
14 unusual among utilities, if there are apparent inaccuracies or inconsistencies with regard to
15 plant accounts.

16 Q. Do you agree with the proposal of Algonquin's witness Mr. Larry W. Loos, to
17 include in rate base any type of utility plant that was in service, before the Commission
18 certificated the utility but was either excluded from plant-in-service accounts or improperly
19 booked?

20 A. No, I do not agree, for several reasons. First and foremost, I believe that the
21 parties in the certificate cases intended, and the Commission found, generally, that the
22 pipelines were to be considered as contributed plant that was funded by the developer and
23 contributed to the utility. There was no issue in the certificate cases that would support a

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1 basis to do otherwise. Furthermore, the failure of the utility to record that plant does not
2 justify allowing the utility to come back later and try to estimate the capital costs, and then
3 assume that the utility originally invested stockholder funds in it, as opposed to treating it as a
4 developer-funded expense. There must be support in the records for any legitimate rate base.

5 Additionally, I believe that including older, pre-certificate plant in rate base, as
6 Algonquin proposes to do here, would set a precedent that could create a mess with regard to
7 rate treatment of utility plant throughout Missouri, since there are a number of water and
8 sewer utilities, and perhaps other types of utilities, that have acquired utility plant with poor or
9 non-existent records, and will continue to do so in the future.

10 Q. Do you believe that if Algonquin is permitted to include its estimated
11 unrecorded plant in rates as it proposes, it would serve to reward utilities for their failure to
12 maintain adequate records?

13 A. Yes. If a utility whose records are not adequate to support plant investment
14 sells its assets, as in the case of the Silverleaf properties being sold to Algonquin, and the
15 acquiring company is permitted to include in its rate base some type of estimated costs even
16 though there is not sufficient documentation of the cost, then both the acquiring utility and the
17 seller would be rewarded for the seller's poor record-keeping. The buyer should have
18 discovered the inadequate records during its due diligence review of the seller's property. The
19 buyer should have taken this into account in determining its offer price when it was
20 negotiating with the seller.

21 In addition for this situation, Algonquin had the benefit of being informed about the
22 quality of Silverleaf's books and records during the sale case in Case No. WO-2005-0206,
23 where Staff explained in detail the problems with regard to plant records involving each of the

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1 | three Missouri utility properties. In fact, much of the analysis that Staff provided in the
2 | present case was also provided to Algonquin in the sale case. Algonquin knew in advance
3 | that there were problems with the plant values that Silverleaf provided to the buyer for its
4 | review of these properties.

5 | Additionally, in this particular situation, this involves utility plant for which even if
6 | proper and adequate records did exist, the particular plant should properly be considered as
7 | contributed plant, and not included as rate base.

8 | Q. Does this conclude your Rebuttal Testimony?

9 | A. Yes.