

Exhibit No.:
Issues: *Working Capital,*
Advertising Expense
Witness: *Roberta A. McKiddy*
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

ROBERTA A. MCKIDDY

MISSOURI-AMERICAN WATER COMPANY

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

Jefferson City, Missouri
December 2004

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Q. Please state your name and business address.

A. My name is Roberta A. McKiddy and my business address is 1845 Borman Court, Suite 101, St. Louis, Missouri 63146.

Q. Are you the same Roberta A. McKiddy who filed direct testimony in this proceeding on behalf of the Staff of the Missouri Public Service Commission (Staff)?

A. Yes, I am.

Q. What is the purpose of your surrebuttal testimony?

A. The purpose of my surrebuttal testimony is to respond to the rebuttal testimony of Missouri-American Water Company (MAWC or Company) witnesses Edward J. Grubb and Douglas M. Lehman with regard to Company's position on cash working capital and advertising expense, respectively. I will specifically respond to Mr. Grubb's recommendation to include deferred taxes and depreciation expense in cash working capital. I will also respond to Mr. Grubb's recommendation regarding the appropriate expense lag to use for management fees (i.e., service company charges). In addition, I will respond to the rebuttal testimony of Mr. Lehman with regard to the inclusion of institutional advertising expense in the cost of service.

WORKING CAPITAL

Q. Why is the Company proposing to include depreciation expense and deferred incomes taxes in the cash working capital requirement (CWC)?

A. Mr. Grubb states at page 5 of his rebuttal testimony, lines 25 through 31:

Depreciation and deferred taxes are both recognized by this Commission in the setting of utility rates, both under operating expense and as a rate base reduction through the accumulated balance sheet accounts. The issue that must be addressed and appropriately recognized in the rate making process is that the Company experiences a considerable delay in the recovery of the depreciation and deferred tax expense from the customers. Because of this delay, a zero lag for depreciation and deferred taxes is required to correctly calculate the Company's rate base.

Q. Do you agree with this rationale?

A. No. The Commission has defined CWC as the amount of cash necessary for a utility to pay its day-to-day expenses, which are incurred to provide service to its ratepayers. In the Report and Order for Southwestern Bell Telephone, Case Nos. TC-89-14, TC-89-21, TO-89-29 and TO-89-10, decided June 20, 1989, the Commission states:

The Commission has addressed this issue before in several cases. See Exhibit 94, p. 10. The Commission has consistently held that the purpose of the CWC calculation using lead/lag studies is to determine the cash necessary on a day to day basis to provide service and to determine who supplies this cash. A positive CWC requirement indicates that, in the aggregate, the shareholder provided the CWC and a negative CWC requirement indicates that, in the aggregate, the ratepayer provided the CWC.

Q. Does this definition include non-cash items such as depreciation expense and deferred taxes?

A. No. Although revenues received from ratepayers are designed to provide recovery of items such as deferred income taxes and depreciation expense, these expenses do not require a current outlay of cash by the utility.

1 Q. Has this Commission ever expressed an opinion on the treatment of
2 depreciation and deferred taxes as it relates to a cash working capital study?

3 A. Yes, numerous times. In the Report And Order for GTE North Incorporated,
4 Case Nos. TR-89-182, TR-89-238 and TC-90-75, decided February 9, 1990, the Commission
5 states:

6 One of the areas of disagreement concerns the Staff's exclusion of
7 depreciation and amortization, deferred taxes and return on common
8 equity. The Commission has a long history of excluding from cash
9 working capital the enumerated items because, while they may be
10 recorded on the Company's books, the accounts do not require any cash
11 for current outlay. Since there is no requirement of cash outlay, the
12 items do not fall within the definition of cash working capital and there
13 is no more persuasive reason for their inclusion than there has been in
14 many instances in the past when the items have been excluded.

15 In the Report And Order for Union Electric, Case No. ER-82-52 decided
16 July 2, 1982, the Commission states:

17 Depreciation and deferred taxes are similar in that the Staff proposes to
18 deduct from cash working capital any amount of expense under the
19 contention that they require no cash outlay by the Company although
20 they are booked as expenses. The two items are also similar in that the
21 Company, in its brief, refers to them as "so-called 'non-cash' items."
22 The Company feels that the two items are similar to any other item of
23 expense in that the utility does not enjoy the benefit of the payment
24 until it is actually received. It is the Company's contention that there is
25 simply no logical reason to ignore these items in calculating cash
26 working capital.

27 In the Commission's opinion the logic of ignoring these items in a cash
28 working capital allowance has been established in numerous rate cases.
29 The function of cash working capital is not to be received by the utility
30 but to be paid by the utility for expenses incurred in rendering service.

31 There is no contention by the Company, and there could be none, that
32 there is any actual outlay of cash for either depreciation or deferred
33 taxes.

34 When the definition of cash working capital is considered it can be seen
35 that amounts booked for depreciation and deferred taxes do not qualify.
36 Since no expenditure actually occurs on the booking of an expense, the

Commission is of the opinion that it should follow its long-standing policy of disallowing depreciation and deferred taxes as a portion of cash working capital allowance.

In Case No. ER-81-43, St. Joseph Light & Power Company, the Commission stated the following:

...The Company is allowed a rate of return on its funds invested. To try to equate the artificial timing differences of when costs are incurred, e.g., depreciation, and when the Company receives its return with the situation where day-to-day operation expenses are supplied by a utility, is to create a new format for determining rate base. The Company is being compensated for depreciation, deferred taxes, cost of common equity, and preferred stock, and to include these again under working capital would be inequitable.

In Case No. ER-81-42, Kansas City Power and Light, the Commission states the following:

Although depreciation and amortization are booked as expenses, no cash payment is required of the Company. Deferred taxes represent a bookkeeping entry for a tax expense that will not be incurred until a later point in time. The Commission has consistently held that since these expenses require no actual cash outlay, their inclusion in cash working capital is inappropriate...

Q. Are you aware of any case where Staff has proposed or the Commission has accepted the inclusion of depreciation expense and deferred income taxes in the calculation of the revenue requirement impact associated with cash working capital?

A. No.

Q. In Case No. WR-2000-844 for St. Louis County Water Company, now the St. Louis operating district of MAWC, were depreciation expense and deferred income taxes included in the Company's calculation of CWC?

A. No. I have included a copy of Company Witness Steven M. Hanneken's Schedule SMH-1, page 4, as Schedule 1 to this surrebuttal testimony. Schedule 1 shows that

1 when St. Louis County Water Company operated as a separate entity, it did not include
2 depreciation expense and deferred income taxes in the calculation of CWC.

3 Q. How do you respond to Mr. Grubb's example in his Schedule EJG-2?

4 A. Mr. Grubb misrepresents the purpose of cash working capital. First, cash
5 working capital measures the difference between when revenues are received from ratepayers
6 and disbursements are made for day-to-day expenses that require cash. Cash working capital
7 is not designed to measure when revenues are received for items in the cost of service that do
8 not require cash payments. Schedule EJG-2 graphically illustrates the effect of depreciation
9 expense on an asset, yet fails to acknowledge that depreciation is not a cash outlay of the
10 Company. Mr. Grubb recognizes this concept with other items included in the cost of service,
11 such as uncollectibles. In the Company's CWC calculation for this case, the expense lag for
12 uncollectibles was set equal to the revenue lag. This results in a zero CWC requirement. This
13 was done to recognize the fact that uncollectible expense is a non-cash item.

14 Q. What is the appropriate expense lag for management fees for purposes of this
15 proceeding?

16 A. During the Staff's fieldwork for this proceeding, Company provided
17 information to Staff in response to Staff Data Request Nos. 43 and 345, that suggested
18 MAWC paid for services provided by its affiliates after service was received. During
19 prehearing discussions, however, Company provided new information that suggested MAWC
20 paid for services provided by its affiliates in advance of receiving service. The Staff believes
21 it is inappropriate for MAWC to prepay its affiliate for services not yet rendered. Therefore,
22 consistent with the rationale presented by Staff witness John P. Cassidy in his surrebuttal

1 testimony regarding payments to affiliates, Staff is assigning the expense lag associated with
2 cash vouchers to management fees for purposes of this proceeding.

3 **ADVERTISING EXPENSE**

4 Q. Does the Company disagree with Staff's proposed adjustment to cost of service
5 for advertising expense?

6 A. Yes. However, the Staff is unclear as to the Company's rationale for its
7 disagreement. In Mr. Lehman's rebuttal testimony, he states:

8 Q. Does MAWC dispute the categories Ms. McKiddy assigned to
9 its advertisements?

10 A. No. The primary issue here relates to expense documentation.
11 Staff disallowed a large number of paid invoices in allowable
12 categories because an audiotape, videotape, or hard copy of the
13 advertising items was not easily obtainable. MAWC was unable to
14 obtain a number of radio ads, television ads, and magazine inserts.

15 Staff Data Request No. 471 has been submitted to Mr. Lehman in an attempt to clarify
16 MAWC's position on this issue.

17 Q. Is Mr. Lehman's statement that the Staff disallowed a large number of paid
18 invoices in allowable categories correct?

19 A. No. The Company was unable to produce a copy of the advertisements for 59
20 items. Staff, therefore, classified these advertisements based on the descriptions provided by
21 the Company and the narrative portion of the invoice. Of the 59 disallowed items, 58 were
22 classified as institutional, a category that the Commission has accepted as providing no
23 benefit to ratepayers. Based on the invoice description, the Staff classified one advertisement
24 as general, but since Staff was unable to verify this classification, the ad was disallowed. This
25 advertisement cost \$140 and does not represent a disallowance of a large expenditure. The

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1 Staff's disallowance of these advertisements is partially based on the exact standard by which
2 Mr. Lehman asserts should be used in his rebuttal testimony.

3 Q. Has the Staff offered to examine any data the Company has in its possession
4 that may clarify the content of the advertisements?

5 A. Yes. The Staff made this offer to the Company at the prehearing conference.
6 As yet, the Company has provided no additional documentation.

7 Q. Does this conclude your surrebuttal testimony?

8 A. Yes, it does.

ST. LOUIS COUNTY WATER COMPANY
CASH WORKING CAPITAL
TEST YEAR ENDED 12/31/99
CASE NO. WR-2000-

LINE NO.	DESCRIPTION	NORMALIZED TEST YEAR EXPENSE	REVENUE LAG	EXPENSE LAG	CASH WORKING CAPITAL LAG (C) - (D)	CASH WORKING CAPITAL FACTOR (COLE/365)	CASH WORKING CAPITAL REQUIREMENT (B) x (F)
	(A)	(B)	(C)	(D)	(E)	(F)	(G)
1	BASE PAYROLL	\$14,536,902	62.0870	8.2112	53.8758	0.147605	\$2,145,719
2	TAX WITHHOLDING	\$7,589,510	62.0870	13.4709	48.6161	0.133195	\$1,010,885
3	BENEFITS	\$3,584,827	62.0870	44.9994	17.0876	0.046815	\$167,824
4	ELECTRIC	\$5,750,158	62.0870	35.4723	26.6147	0.072917	\$419,284
5	TELEPHONE	\$306,643	62.0870	6.9101	55.1769	0.151170	\$46,355
6	OFFICE RENTS	\$699,506	62.0870	-14.2083	76.2953	0.209028	\$146,216
7	INTERCOMPANY BILLING	\$1,082,906	62.0870	48.5988	13.4882	0.036954	\$40,018
8	UNCOLLECTIBLE ACCOUNTS	\$343,306	62.0870	62.0870			
9	PSC ASSESSMENT	\$646,672	62.0870	-30.0000	92.0870	0.252293	\$163,151
10	EXPENSE ALLOCATIONS		62.0870	62.0870			
11	CASH VOUCHERS	<u>\$21,885,199</u>	62.0870	26.1000	35.9870	0.098595	<u>\$2,157,771</u>
12	TOTAL O & M EXPENSES	<u>\$56,425,629</u>					
13	(LESS DEPRECIATION)						
14	O&M CASH W/C REQUIREMENT						\$8,297,223
15	FICA - EMPLOYER PORTION	\$1,656,385	62.0870	13.3092	48.7778	0.133638	\$221,356
16	UNEMPLOYMENT TAXES	\$43,041	62.0870	76.3750	(14.2880)	(0.039145)	(\$1,685)
17	PROPERTY TAXES	\$6,569,915	62.0870	182.5000	(120.4130)	(0.329899)	(\$2,167,408)
18	GROSS RECEIPTS TAXES	\$5,712,765	62.0870	94.9089	(32.8219)	(0.089923)	(\$513,709)
19	CORPORATE FRANCHISE TAXES	\$146,991	62.0870	-77.5000	139.5870	0.382430	\$56,214
20	SALES TAX	<u>\$1,273,984</u>	62.0870	66.5811	(4.4941)	(0.012313)	<u>(\$15,687)</u>
21	TAX CASH W/C REQUIREMENT	<u>\$15,403,081</u>					<u>(\$2,420,919)</u>
22	TOTAL CASH W/C REQUIREMENT						<u>\$3,876,304</u>
23	INTEREST OFFSET TO RATEBASE	\$9,661,781	62.0870	91.2500	(29.1630)	(0.079899)	(\$771,967)
24	FIT OFFSET TO RATEBASE	\$3,519,499	62.0870	60.2500	1.8370	0.005033	\$17,714
25	SIT & CIT OFFSET TO RATEBASE	\$553,064	62.0870	62.1700	(0.0830)	(0.000227)	(\$126)
26	GROSS CASH W/C REQUIREMENT						<u>\$3,121,925</u>