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## REBUTTAL TESTIMONY

OF

CHARLES R. HYNEMAN

Submitted on Behalf of the Office of the Public Counsel

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2015-0301

February 11, 2016

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1 REBUTTAL TESTIMONY

2 OF

3 CHARLES R. HYNEMAN

4 MISSOURI-AMERICAN WATER COMPANY

5 CASE NO. WR-2015-0301

6 I. INTRODUCTION

7 Q. Please state your name and business address.

8 A. Charles R. Hyneman, PO Box 2230, Jefferson City, Missouri 65102

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

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

12 Q. Are you the same Charles Hyneman who filed direct testimony on behalf of the  
13 Public Counsel in this case?

14 A. Yes, I am.

15 Q. What is the purpose of your rebuttal testimony?

16 A. In this testimony I address some of the positions taken by Missouri American Water  
17 Company ("MAWC") witnesses in their direct testimonies in this case.

18 As it relates to MAWC witness Fran Kartmann's direct testimony, in this testimony I  
19 will:

- 20 1. Address and discuss Mr. Kartmann's position concerning  
21 basic ratemaking theory of utility expense rate recovery.  
22 2. Rebut Mr. Kartmann's representation of the utility  
23 ratemaking structure currently employed in Missouri.  
24 3. Discuss Mr. Kartmann's one-sided view of the impact of  
25 regulatory lag on price regulation of monopolies. I will offer a  
26 more transparent and comprehensive view including the problems

1 associated with the employment of single-issue ratemaking  
2 mechanisms.

3 4. Describe, not only the shift in Missouri ratemaking of risk  
4 in the ratemaking process from utilities to ratepayers, but also the  
5 apparent shift in the burden of proof from utility management to  
6 the regulatory auditor (whether it be of the Public Counsel, Staff or  
7 intervener) in rate cases in general and in cases involving single-  
8 issue ratemaking mechanisms in Missouri.

9 5. Explain why MAWC's proposal to add two new single-  
10 issue ratemaking mechanisms to its current inventory of single-  
11 issue ratemaking mechanisms should not be accepted by the  
12 Commission in this rate case.

13 In my rebuttal testimony I also will address the testimony of MAWC witness Greg  
14 Roach as it relates to MAWC's growth in revenues over the past few years.

15 Finally, I will address the method used by MAWC witness Roger Morin in the  
16 recovery of MAWC's stock issuance expenses and discuss the inconsistency between  
17 MAWC and Mr. Morin on the treatment of MAWC as a standalone entity versus a  
18 part of the consolidated parent company group.

19 Finally, I will address some changes in Public Counsel's cost of service adjustments  
20 that are a result of the technical conference held on January 26, 2016.

21 **II. REBUTTAL OF MAWC WITNESS KARTMANN**

22 **Q. Does Mr. Kartmann's testimony portray an accurate and true picture of**  
23 **ratemaking theory in general and, in particular, the current ratemaking**  
24 **structure in Missouri?**

25 **A. No. In his direct testimony Mr. Kartmann makes the following statement:**

26 We anticipate that by January 31, 2016 the Company will invest  
27 more than \$436 million in capital improvements since the last rate  
28 case without realizing any capital cost recovery or depreciation  
29 expense on \$215 million in capital investment, which represents  
30 the non ISRS qualified investments during that time. (Kartmann  
31 direct page 10 line 6).

1 This testimony ignores the basic principle of cost recovery in general ratemaking  
2 theory. This principle holds that once rates are set in a rate case by a regulatory body,  
3 those rates are deemed to be fair and reasonable until a new rate case is filed by the  
4 utility (or earnings complaint case filed by a party), and new rates are set. In rates set  
5 in a rate case, the utility is given an opportunity to earn a reasonable return on the  
6 equity dollars shareholders have invested in the utility.

7 The first step in calculating this return on equity ("ROE") is to subtract all expenses  
8 incurred in the period from the revenues received from ratepayers. The remaining  
9 revenue dollars are then classified on the income statement as net income. This net  
10 income amount is then divided by the dollar equity investment in the utility by  
11 shareholders to calculate the monetary return on this dollar equity investment. This  
12 monetary return is then referred to as the actual earned ROE and is compared to the  
13 authorized ROE granted in rate cases by regulatory bodies such as the Commission.

14 **Q. Does the calculation of actual earned ROE that is greater than zero reflect the**  
15 **fact that each and every expense incurred by the utility during that period has**  
16 **been recovered in rates paid by utility ratepayers?**

17 **A. Yes, it does reflect that fact.**

18 **Q. How does Mr. Kartmann's testimony contradict this basic principle of**  
19 **ratemaking theory?**

20 **A. Mr. Kartmann testifies that since MAWC's last rate case, the Company has not**  
21 **realized any capital cost recovery or depreciation expense on non-ISRS capital**  
22 **investment. However, since MAWC earned a positive ROE every year during this**

1 period, MAWC has recovered each and every dollar of capital costs, depreciation  
2 expense, and all other expenses it incurred during this period.

3 **Q. Why does Mr. Kartmann make a distinction between recovery of Infrastructure**  
4 **System Replacement Surcharge “(ISRS)” capital costs and other Non-ISRS**  
5 **capital costs?**

6 **A.** The majority of MAWC’s plant-related costs (depreciation expense, property taxes,  
7 interest, income taxes, and profit) are directly tracked and recovered in its single-issue  
8 ratemaking mechanism, known as an ISRS. This is an example of “direct rate  
9 recovery”, where expenses are incurred, separately identified and tracked, and  
10 recovered dollar for dollar from ratepayers through an additional charge on their  
11 monthly bills. This is the \$221 million portion of the \$436 million capital  
12 improvements referred to by Mr. Kartmann. This \$221 million is being recovered in  
13 MAWC’s ISRS.

14 MAWC’s other \$215 million portion of the \$436 million in capital costs for which  
15 MAWC does not have an approved single-issue ratemaking mechanism have been  
16 recovered and are currently being recovered in rates set in MAWC’s 2011 rate case.  
17 MAWC recovers these non-tracked ISRS capital costs under the basic ratemaking  
18 concept known as “indirect rate recovery”.

19 While MAWC has been successful in recovering all of its costs and earning a  
20 reasonable ROE since its last rate case, it has also been allowed to transfer the risk of  
21 not recovering all of its expenses and earning a reasonable ROE from its shareholders  
22 to its customers through the use of its ISRS – which can be viewed as “no risk rate  
23 recovery”. This explicit and direct shift of expense recovery risk from the utility to the

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1 ratepayers is one of the problems with the adoption and use of single issue ratemaking  
2 mechanisms.

3 **Q. Does Mr. Kartmann's testimony reflect how utility ratemaking actually works?**

4 A. No. The problem with this testimony lies in a common misunderstanding of utility  
5 ratemaking. I have experienced Missouri utility witnesses testify to the Commission  
6 that since the specific dollars of an actual incurred expense were not directly included  
7 in a revenue requirement used to set rates (such as the Staff's Accounting Schedules)  
8 in its last rate case, that these specific expenses are not being recovered in current  
9 rates. Mr. Kartmann's testimony echoes this misunderstanding of basic ratemaking  
10 theory.

11 **Q. Earlier you mentioned the concepts of "indirect rate recovery" and "direct rate  
12 recovery". Please briefly differentiate the two concepts.**

13 A. Cost of service rate regulation of public utilities has historically been based on the  
14 principle of indirect rate recovery. In a rate case, the utility's cost structure is matched  
15 with the utility's rate base investments and rates are designed based on this cost  
16 structure to recover future expenses and produce a reasonable level of profit for the  
17 company to pay shareholder dividends or for the utility to reinvest back into utility  
18 operations.

19 This rate structure created in a rate case is developed through what is referred to as the  
20 ratemaking matching principle. By matching revenues, expenses, gains and losses  
21 with plant in service and other rate base investments, the rates that are created from  
22 this matching allow for changes, up or down, in these revenue requirement

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1 components in the future and still provide the opportunity for the utility to earn a  
2 reasonable level of net income for shareholders.

3 For example, post-test year increases in the number of utility customers create  
4 additional revenues that were not included in the calculation of the utility's revenue  
5 requirement. However, these additional revenues are now available to cover potential  
6 increases in utility expenses. In addition, savings from decreases in other expenses,  
7 such as lower interest expense from debt refinancing, can be used to pay higher fuel  
8 costs. Technological advances in meter reading, which reduce the necessary number  
9 of meter reading employee positions, create cost savings in employee compensation  
10 and benefits costs that can be applied to other cost increases. Improvements in the  
11 economy may lead to lower bad debt expense and higher revenues due to increased  
12 average customer usage. Savings from decreases in gasoline prices used in utility  
13 transportation and oil costs used as a fuel source can be applied to other cost increases.  
14 All of these revenue requirement components that were matched in the rate-setting  
15 process are in a constant flux. Increases or decreases in one component offsets the  
16 increases or decreases in other components.

17 This is why the ratemaking matching principle is so important to maintain when  
18 setting utility rates. It develops a relationship or structure between the utility's balance  
19 sheet (rate base) and income statement (revenues and expenses). When one of the  
20 ratemaking components (revenues, expenses or rate base) diverges substantially from  
21 the basis of current rates, and the changes in other ratemaking components cannot  
22 sufficiently offset this one issue, then it is time for the utility to file a rate case and

1           readjust the revenue requirement components to account for the new economic  
2           conditions that caused the existing rates to no longer be just and reasonable.

3           In contrast, Mr. Kartmann and other utility witnesses in past cases before the  
4           Commission do not seem to accept the concept of indirect rate recovery. These  
5           individuals espouse a flawed concept referred to as the “direct rate recovery” view of  
6           utility ratemaking. The “direct rate recovery” concept apparently was named after a  
7           naive and self-serving belief that a cost has to be directly included in the specific  
8           revenue requirement calculation used to set current rates to be considered as actually  
9           or “directly” recovered in utility rates.

10   **Q. Can you provide a simple real-world example which proves the fallacy of the**  
11   **“direct rate recovery” concept?**

12   **A.** Yes. From about 1985 to 2006, a period of approximately 20 years, Kansas City  
13   Power & Light Company (“KCPL”) did not seek to increase its electric utility rates in  
14   Missouri. It goes without saying that during this period, when KCPL installed over  
15   800 MW of new electric capacity (Staff witness Elliott direct testimony Case No. ER-  
16   2016-0314, Exhibit No. 112), KCPL incurred millions of dollars of capital costs,  
17   depreciation expense and other expenses that were not specifically included in the  
18   calculation of KCPL’s revenue requirement in the Staff’s Accounting Schedules in its  
19   1985 rate case, KCPL’s rate case prior to its 2006 rate case.

20           However, under the “direct rate recovery” theory espoused by Mr. Kartmann, one  
21           would have to believe that KCPL did not recover any of these capital costs from its  
22           ratepayers in utility rates over this 20-year period since they were not directly included  
23           in the Staff’s accounting schedules in the 1985 rate case.

1 This simple real-world example illustrates the flaws in Mr. Kartmann's direct  
2 testimony, at page 10, where he states that MAWC did not realize any capital cost  
3 recovery or depreciation expense on its non-ISRS capital investment since its last rate  
4 case, four years ago. MAWC has not only recovered in utility rates all of its expenses  
5 since its last rate case but also earned a reasonable ROE during this period.

6 **Q. What was MAWC's actual earned ROE in 2014?**

7 A. MAWC's actual earned ROE or profit level for 2014 was 9 percent. In its Annual  
8 Report to the Commission for the calendar year ended December 31, 2014, MAWC  
9 reported net income of \$42,794,880 and a beginning equity capital amount of  
10 \$476,155,832.

11 **Q. Do the majority of ROE expert witnesses in this rate case consider 9 percent to be  
12 a reasonable ROE for MAWC?**

13 A. Yes. MAWC witness Morin is recommending a range of 10.1% to 10.7% ROE.  
14 However, if you remove his 30 basis point adder for MAWC's stock issuance costs  
15 (which have not been incurred), his range drops to 9.8% to 10.4%. Public Counsel  
16 witness Michael Gorman is recommending a range of 8.8% to 9.2% percent. Staff  
17 witness Murray is recommending a range of 8.5% to 9.5%. While Mr. Morin's range  
18 is an outlier, in my opinion, and in the opinion of the majority of experts in this rate  
19 case, the range of reasonable ROEs for this company, at this time, is consistent with  
20 what MAWC actually has been earning.

21 **Q. Is MAWC's 2014 earned ROE of 9% consistent with the earnings of its parent  
22 company, American Water Works Company?**

23 A. Yes.

1 Q. Briefly describe American Water Works Company's ("AWWC") regulated  
2 business.

3 A. AWWC is headquartered in New Jersey and is the largest, investor-owned water and  
4 wastewater utility company in the United States. AWWC's regulated utilities provide  
5 water and wastewater services in 16 U.S. states.

6 AWWC's 15 state regulated utility subsidiaries are: California American Water,  
7 Hawaii American Water, Illinois American Water, Indiana American Water, Iowa  
8 American Water, Kentucky American Water, Maryland American Water, Michigan  
9 American Water, Missouri American Water, New Jersey American Water, New York  
10 American Water, Pennsylvania American Water, Tennessee American Water, Virginia  
11 American Water, and West Virginia American Water.

12 Q. Does AWWC have substantial non-regulated business operations?

13 A. Yes. AWWC provides services through what it refers to as its "Market-Based"  
14 businesses. AWWC's nonregulated operations include three lines of business: 1)  
15 Contract Services, which provides outsourced operations and maintenance services for  
16 municipalities; 2) Military Services, which works with the United States Military to  
17 treat and supply water and to collect and treat wastewater for military installations;  
18 and 3) Homeowner Services, which provides services to homeowners and smaller  
19 commercial establishments to protect against the cost of repairing broken or leaking  
20 water pipes and clogged or blocked sewer pipes on their property.

1 Q. Explain why you believe MAWC's 2014 earned ROE of 9% is consistent with the  
2 earnings of its parent company, AWWC?

3 A. In an analyst report on AWWC, Morningstar Inc. (Morningstar) reported that  
4 AWWC's ROE for 2012 was 8.25%, 2013, 8.05% and 2014, 8.78%. It also reported  
5 that AWWC's TTM (Trailing 12 Month Yield) ROE for 2015 is 9.33%. My review of  
6 AWWC's SEC Form 10-K shows that AWWC's net income before discontinued  
7 operations resulted in an ROE of 8.82% in 2012, 8.83% in 2013 and 9.10% in 2014.

	AWWC	Ind Avg
Key Stats AWK		
Price/Earnings TTM	25	26.3
Price/Book	2.3	2
Price/Sales TTM	3.8	4
Rev Growth (3 Yr Avg)	4.1	-5.1
Net Income Growth (3 Yr Avg)	11	-17
Operating Margin % TTM	34.3	20.8
Net Margin % TTM	15.1	10.4
ROA TTM	2.9	2.4
ROE TTM	9.3	7.2
Debt/Equity	1.2	0.9

8  
9 Q. Describe Morningstar.

10 A. Morningstar is an independent investment research firm.

11 Q. Is Morningstar a widely-cited research firm in utility rate cases?

12 A. Yes. Morningstar is often cited by financial analysts in utility rate cases as an  
13 authoritative source. Morningstar is cited as an authoritative source by MAWC ROE  
14 witness Roger Morin in his direct testimony in this rate case.

1 Q. Does the Morningstar analyst report on AWWC indicate how well AWWC's  
2 current ROE of 9.3% compares to an industry average?

3 A. Yes. Morningstar's analyst report shows that AWWC's current ROE of 9.3% is  
4 significantly higher than the industry average ROE of 7.2%. Also, while the time  
5 period is not exactly the same, MAWC's 2014 ROE of 9% compares very favorably  
6 with the current industry average ROE of 7.2%.

7 Q. Did you perform an analysis of the companies included in Morningstar's  
8 industry average to see if they were directly comparable to MAWC?

9 A. No. My analysis was performed at a high level and is meant to provide an additional  
10 indication that, when compared with other evidence; MAWC currently is earning a  
11 reasonable ROE.

12 In fact, MAWC's solid utility earnings, as reflected in its earned ROE and its positive  
13 increase in revenues over the past three years, shows that MAWC is performing well  
14 in a difficult economic environment. Among other reasons, given this current solid  
15 financial performance, MAWC does not need the two additional single-issue  
16 ratemaking mechanisms it is seeking in this case, the Environmental Cost Adjustment  
17 Mechanism ("ECAM") and Revenue Stability Mechanism ("RSM").

18 Q. Do you agree with Mr. Kartmann's testimony at page 13 line 8 of his direct  
19 testimony where he states "While timely cost recovery remains a challenging  
20 proposition in Missouri's historic test year regulatory environment, ISRS has  
21 helped to reduce some of the regulatory lag that is otherwise present"?

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1 A. No. Missouri does not have a “historic test year regulatory environment” for a very  
2 high percentage of utility costs, especially much of the types of costs incurred by  
3 MAWC.

4 **Q. Please explain.**

5 A. The use of regulatory mechanisms such as trackers, fuel adjustment clauses, ISRS and  
6 others which are all too common in Missouri ratemaking do not employ the use of a  
7 historic test year. Currently, MAWC recovers significant revenues from its ratepayers  
8 in the form of pension trackers, tank painting trackers, OPEB trackers, and the ISRS.  
9 In its December 29, 2015 filing, Staff showed that MAWC currently bills its  
10 customers \$25.9 million dollars in ISRS charges on an annual basis. The ISRS single-  
11 issue surcharge mechanism that allows for these rate increases does not include a  
12 historic test year.

13 The fact that MAWC charges its customers millions of dollars in additional surcharges  
14 under its ISRS shows that, consistent with Mr. Kartmann’s expressed desire at page 10  
15 of his direct testimony, utility ratemaking in Missouri has already adapted to MAWC’s  
16 circumstances.

17 **Q. Mr. Kartmann seems to indicate a “historic test year” is a bad thing. Do you**  
18 **agree?**

19 A. No. Most assets, liabilities gains and losses and revenues and expenses of U.S.  
20 business entities are recorded at historical cost. The Financial Accounting Standards  
21 Board (“FASB”) and the Accounting profession has found that historical-cost  
22 accounting is more reliable than other forms of accounting, such as fair value  
23 accounting. The FASB has retained historical cost accounting as the basis of U.S.

1 generally accepted accounting principles ("GAAP"). GAAP are the Accounting  
2 standards that all U.S. companies, including MAWC, must comply with in the  
3 preparation of financial records. As a result, significantly all accounting for business  
4 operations, both regulated and nonregulated are based on historical costs.

5 **Q. Has any utility in Missouri proposed a method of accounting and ratemaking**  
6 **that is not based on historical cost test year?**

7 A. Not that I am aware. While Missouri utilities may have suggested the use of a future  
8 test year, and proposed recovery of certain estimated future costs, no Missouri utility  
9 to my knowledge has proposed a future test year in a rate case and explained how this  
10 future test year would be superior to the Commission's historical cost test year method  
11 which relies heavily on the ratemaking matching principle to create rates that are fair  
12 and reasonable.

13 However, as noted, none of the single-issue ratemaking mechanisms currently  
14 employed in Missouri use a historical test year as the basis for its calculation. That is  
15 just one of the reasons why these mechanisms are flawed. Some of these mechanisms  
16 are calculated under restrictions which appear to be designed to produce the highest  
17 levels of rates possible while ignoring, for the most part, other economic events  
18 experienced by the utility that would reduce the revenue increase calculation.

19 **Q. Explain how MAWC's ISRS rate increase calculation does not include any**  
20 **potential offsets to the ISRS surcharge.**

21 A. In Missouri, all relevant factors must be considered in establishing rates for a public  
22 utility. This ratemaking requirement in Missouri was put in place to make sure that  
23 rates were fair and reasonable. This important ratepayer protection, however, was

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1 significantly lessened in Missouri due to the proliferation of single-issue ratemaking  
2 mechanisms, including those with restrictions and prohibitions on what ratemaking  
3 factors may be considered by auditors in the calculation of rate increases from the  
4 mechanism.

5 For example, the ISRS prohibits all but a very limited number of ratemaking factors  
6 from being considered in establishing ISRS rates. The law authorizing a water ISRS  
7 states that:

8 The staff of the commission may examine information of the  
9 water corporation to confirm that the underlying costs are in  
10 accordance with the provisions of sections 393.1000 to  
11 393.1006, and to confirm proper calculation of the proposed  
12 charge, and may submit a report regarding its examination to  
13 the commission not later than sixty days after the petition is  
14 filed. No other revenue requirement or ratemaking issues shall  
15 be examined in consideration of the petition or associated  
16 proposed rate schedules filed pursuant to the provisions of  
17 sections 393.1000 to 393.1006. (emphasis added)

18  
19 This audit prohibition on the parties to the ISRS case from considering “all relevant  
20 factors” is clear.

21 As the chart below shows, under its ISRS MAWC collected \$44 million dollars from  
22 its customers over a short three-year period. This includes over \$23 million in 2015  
23 alone. The ISRS law and Commission Rule restrictions placed on an ISRS audit  
24 prevent any meaningful reflection of MAWC’s actual revenues needed to cover its  
25 ISRS plant investments. The ISRS revenue requirement, as currently calculated under  
26 significant ratemaking restrictions, is artificial. Revenue requirements are by  
27 definition, the amount of revenues required for the utility to earn a reasonable ROE.  
28 Under an ISRS, a utility may be earning at or above a reasonable ROE and still  
29 generate an ISRS revenue requirement.

1 Q. Given these facts about MAWC's ISRS, it is possible to give any consideration to  
2 Mr. Kartmann's complaints about Missouri utility ratemaking?

3 A. No. The ISRS law prohibits the Public Counsel and the Commission's Staff and other  
4 parties from including in its ISRS audit scope any ratemaking factor that may mitigate  
5 increased costs due to ISRS plant investments. Under this structure, a Missouri utility  
6 can earn significantly over its authorized ROE, even earn double digit ROE levels, and  
7 still be allowed to charge its customers increased utility rates for costs that they  
8 already recover in current rates.

9 So, given the fact that MAWC is charging Missouri ratepayers, in ISRS rates, \$44  
10 million dollars over three years, it is difficult for me to give Mr. Kartmann's  
11 complaints about Missouri ratemaking any legitimacy at all.

12 The following charts reflect MAWC's ISRS charges under its current ISRS:

ISRS #	Case No	MAWC Plant	ISRS Rate Increase
10	WO-2012-0401	\$32,666,495	\$4,073,205
11	WO-2013-0406	\$48,524,037	\$5,288,318
12	WO-2014-0055	\$22,302,155	\$2,389,096
13	WO-2014-0237	\$26,325,790	\$3,137,508
14	WO-2015-0059	\$53,474,342	\$11,221,435
15	WO-2015-0211	<u>\$16,595,039</u>	<u>\$1,919,991</u>
	Total	\$199,887,858	\$28,029,553

	MAWC ISRS Surcharge
2013	\$6,033,887
2014	\$14,283,168
2015 Est	<u>\$23,682,945</u>
Total	\$44,000,000

1 Q. How significant are Missouri ISRS revenues to the total ISRS revenues  
2 recognized by MAWC's parent company, AWWC's utility divisions?

3 A. AWWC's SEC Form 10-K page 52 shows that only 6 of 16 states have allowed any  
4 ISRS charges, and in only 4 of AWWC's 16 states has the regulated utility surcharges  
5 been material in amount.

6 Over the period 2012 through 2014, 4 of the 6 states that had ISRS-type surcharges  
7 accounted for 84% of AWWC ISRS, with MAWC accounting for almost 30 percent  
8 of this amount.

9 In 2012, MAWC represented \$4.2 million out of \$18.4 million in total company ISRS  
10 revenues or 22%. In 2013, MAWC represented \$7.9 million out of \$36 million or  
11 22%, and in 2014 MAWC represented \$12.7 million out of \$34.6 million or 37% of  
12 total company ISRS revenues. (AWWC 2014 Annual Report page 52).

13 Q. Mr. Kartmann states at page 9 line 12 of his direct testimony that it is important  
14 for a regulated utility to file for rate relief when its ability to earn a fair rate of  
15 return is compromised. Do you agree with that statement?

16 A. Yes. If a regulated utility is unable to earn a reasonable ROE, despite efforts to  
17 operate the utility efficiently and effectively, it should file for a rate increase.  
18 However, it should be noted that Mr. Kartmann did not say that MAWC's ability to  
19 earn a fair rate of return is compromised. I suspect the reason he did not say it was  
20 compromised is because it is not compromised.

21 MAWC in 2014 earned an ROE of 9%, which is very close to what two of the three  
22 ROE expert witnesses in this case are recommending. In addition, there is no

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1           indication that MAWC's earnings in 2015 resulted in an ROE that would not be  
2           considered reasonable.

3   **Q.   Mr. Kartmann states at page 9 line 13 of his direct testimony that if MAWC's**  
4           **ability to earn a fair return is compromised, then its ability to invest in**  
5           **maintaining and improving the water system is impaired. Please comment.**

6   **A.**Again, I noted that Mr. Kartmann did not say that MAWC has not been earning a fair  
7           rate of return. To my knowledge, MAWC provided no indication that it was not  
8           satisfied with its current earned ROE and provided no evidence in this case that its  
9           recent earned ROE levels were not fair and reasonable. It is also important to note that  
10          Mr. Kartmann provided no evidence, especially with the continuation of its ISRS that  
11          MAWC will not continue to earn a fair rate of return without the assistance of  
12          additional single-issue ratemaking mechanisms such as the proposed ECAM and  
13          RSM.

14   **Q.   Does Mr. Kartmann address the issue of revenue growth in this direct testimony?**

15   **A.**Yes. However, he does not address MAWC's actual water revenue growth or  
16          MAWC's actual earnings. His testimony on this point is that the Commission needs to  
17          change its ratemaking structure to fit MAWC's circumstances. At page 10 he makes  
18          the following statement:

19                   Ms Tinsley's testimony shows that the current ratemaking structure  
20                   is not well adapted to a declining usage, no growth, high  
21                   investment utility environment. If the Company is to have a fair  
22                   and reasonable opportunity to earn its authorized revenue  
23                   requirement, that structure must be adapted to the Company's  
24                   circumstances.

1 Q. Are MAWC's revenues decreasing?

2 A. No, data provided to the Commission from MAWC shows that revenues are increasing  
3 at an impressive level. Mr. Kartmann testimony about declining revenues does not  
4 agree with actual revenues reflected in MAWC's financial books and records.  
5 MAWC's revenues for the years 2011 through 2014 as reflected in its Annual Report  
6 are reflected below:

ANNUAL REPORT	MAWC WATER REVENUES PER MPSC ANNUAL REPORT	WATER REVENUE INCREASE
2011	\$241,414,416	-
2012	\$276,704,900	15%
2013	\$261,404,269	-6%
2014	\$266,542,507	2%
	3-year Revenue Growth	10%

7  
8 What this chart shows is that MAWC's revenue growth in the period 2011 through  
9 2014 have averaged greater than 3% per year.

10 Q. Does Public Counsel recommend that the Commission approve MAWC's ECAM  
11 proposal in this case?

12 A. No. Public Counsel witness Lena Mantle discusses this issue in her rebuttal testimony  
13 in this case. In her testimony she provides Public Counsel's recommendation that the  
14 Commission not grant MAWC an ECAM single-issue ratemaking mechanism in this  
15 case and provides support for this position.

16 Q. What support does Ms. Mantle provide in her rebuttal testimony?

17 A. In her rebuttal testimony she explains that MAWC has done little or nothing to support  
18 its need for an ECAM. She explains that MAWC has not even shown that it expects  
19 to incur costs of the nature covered by the Commission's ECAM Rule. She explains

1           that MAWC did not meet the rule requirements regarding the application for approval  
2           of an ECAM. Finally, she explains to the Commission that the ECAM proposed by  
3           MAWC lacks the details necessary for implementation.

4   **Q.    What support do you provide in this testimony to support Public Counsel's**  
5           **position that the Commission not approve MAWC's proposed ECAM?**

6   **A.    In this testimony I explain the serious negative impact on Missouri ratemaking caused**  
7           **by the many new single-issue ratemaking mechanisms being approved for use by**  
8           **Missouri utilities. I explain that due to these serious negative impacts on the ability of**  
9           **this Commission to set just and reasonable rates, the approval of new single-issue**  
10           **ratemaking mechanisms such as an ECAM should only be granted in times when the**  
11           **utility requesting the single-issue ratemaking mechanisms is in serious financial**  
12           **hardship and its ability to provide safe and adequate utility service is in question.**

13           In additions to expressing Public Counsel's concern about the serious negative impact  
14           and ratepayer detrimental impact of single-issue ratemaking mechanisms, I also  
15           provide evidence in this testimony that MAWC is currently earning a reasonable ROE.

16           Thus, there is no need to provide MAWC with an additional way to charge its  
17           customers for costs that it has and is currently recovering in utility rates that exist  
18           today. As I explain in my testimony, when a utility is already earning a reasonable  
19           ROE, any additional rate increase mechanism facilitates MAWC's double-recovery of  
20           costs and also encourages MAWC to charge its customers rates that are not just and  
21           reasonable. I do not believe the Commission has that desire and I believe a review of  
22           Public Counsel's position on this issue and the evidence it is providing to the

1 Commission, the Commission will recognize that granting an ECAM to MAWC in  
2 this case will be detrimental to MAWC's customers.

3 **Q. Does Public Counsel recommend that the Commission approve MAWC's**  
4 **Revenue Stability Mechanism ("RSM") proposal in this case?**

5 A. No.

6 **Q. Why does Public Counsel not support MAWC's RSM proposal?**

7 A. One reason as I have explained earlier is that there is no need. MAWC's revenues are  
8 strong and growing. This issue will be addressed in the Class Cost of Service Rebuttal  
9 Testimony of Public Counsel witness Geoff Marke

10 **Q. How would you characterize MAWC's RSM proposal?**

11 A. It is simply another attempt by MAWC to eliminate all shareholder risk in the running  
12 of its utility operations. By attempting to eliminate all shareholder risk, MAWC is  
13 making the intentional decision to place all risk of running the utility on its customers.  
14 As I discuss in this testimony, one of the Commission's essential roles as utility  
15 regulators is to ensure that the forces of competition exist and function as required for  
16 monopolies, such as MAWC and other Missouri utilities. MAWC's RSM and ECAM  
17 proposals seek to eliminate more risk than it has already eliminated through its ISRS  
18 and other expense trackers.

19 **Q. Should the level of risk that a utility has eliminated through single-issue**  
20 **ratemaking mechanisms be considered in the authorized ROE issued by the**  
21 **Commission in its rate case Report and Orders?**

22 A. Yes. A reading of the ROE expert witness testimonies in this case reveals that the cost  
23 of equity is based significantly on the individual company's risk in running its

1 business. MAWC has had a significant level of risk eliminated through the adoption  
2 of its ISRS and other expense trackers. If the Commission approves either MAWC's  
3 ECAM or RSM, or both, the Commission should reflect its best judgment on the level  
4 of risk eliminated through MAWC's inventory of single-issue ratemaking  
5 mechanisms. Its authorized ROE in this case should reflect the significant level of risk  
6 that has already been eliminated from MAWC's operations and any additional risk  
7 elimination from its decision on MAWC's ECAM and RSM.

8 **III. SINGLE-ISSUE RATEMAKING**

9 **Q. Describe what is meant by single-issue ratemaking.**

10 A. Single-issue ratemaking involves "singling out" certain expenses, or revenue  
11 requirement components, from a company's overall cost of service and allowing a  
12 utility to recover those single specific costs from ratepayers separately, while ignoring  
13 all other factors necessary to determine fair and reasonable rates charged to ratepayers.

14 **Q. How are utility expenses recovered under single-issue ratemaking?**

15 A. The primary means of recovery of expenses under single issue ratemaking, at least in  
16 Missouri, are customer surcharges and expense trackers.

1 Q. Has the Missouri Court of Appeals addressed the issue of single-issue  
2 ratemaking?

3 A. Yes. In a January 15, 2012 Opinion in Case No. WD74676, the Missouri Court of  
4 Appeals Western District describes how single issue ratemaking is generally  
5 prohibited in Missouri due to its inherent potential for inequitable ratemaking actions  
6 by the Commission.

7 In reliance upon § 393.270.4, Missouri courts have traditionally held  
8 that the Commission's "determination of the proper rate for [utilities]  
9 is to be based on all relevant factors rather than on consideration of  
10 just a single factor." *Midwest Gas Users'*, 976 S.W.2d at 479.

11 Thus, when a utility's rate is adjusted on the basis of a single factor,  
12 without consideration of all relevant factors, it is known as single-  
13 issue ratemaking. *See id.*

14 Single-issue ratemaking is generally prohibited in Missouri "because  
15 it might cause the [Commission] to allow [a] company to raise rates to  
16 cover increased costs in one area without realizing that there were  
17 counterbalancing savings in another area." *Id.*

18 Q. Does the utility industry consider trackers to be single-issue ratemaking?  
19

20 A. Yes, I believe it does. American Electric Power ("AEP"), one of the largest electric  
21 utilities in the country specifically refers to trackers as single-issue ratemaking on its  
22 website. The following discussion of trackers is currently included on AEP's website:  
23  
24

25 A tracker allows rapid recovery of an expenditure without waiting  
26 for a lengthy, fullblown rate case. However, it also creates a  
27 narrow, non-fungible bucket of funds that can only be used for one  
28 purpose.

29 Additionally, when costs of any expenditure are approved in a base  
30 rate case, the utility (and its ratepayers, when shared savings  
31 mechanisms are incorporated) can benefit from efficiencies. In the  
32 straight pass-through process of a tracker, this doesn't happen.

33 Not all state regulatory commissions (or legislatures) embrace the  
34 concept - some feel that single-issue ratemaking diminishes their  
35 authority and ability to regulate in a transparent  
36  
37

1 environment.(<https://www.aep.com/about/IssuesAndPositions/Financial/Regulatory/AlternativeRegulation/Trackers.aspx>)  
2  
3

4 **Q. Does AEP describe its position on how it uses trackers?**

5 A. Yes. On its website AEP describes its position on trackers as follows "*AEP has been*  
6 *a supporter of trackers in situations where immediate cash flow is an issue. However,*  
7 *we also are cognizant of the issues associated with single-issue ratemaking tools.*"

8 (<https://www.aep.com/about/IssuesAndPositions/Financial/Regulatory/AlternativeRegulation/Trackers.aspx>)  
9

10 **Q. What is the overall concern associated with the use of single-issue ratemaking**  
11 **mechanisms such as expense trackers, fuel adjustment clauses, ISRS, ECAMs**  
12 **RSMs and AAOs?**

13 A. Single-issue ratemaking as a practice is generally prohibited in Missouri because it is  
14 bad ratemaking. The overall problem with the use of single-issue ratemaking  
15 mechanisms is that they allow for the charging of utility rates that are just and  
16 reasonable, the very reason why their use in Missouri was prohibited.

17 **Q. What are the individual concerns about single-issue ratemaking mechanisms like**  
18 **trackers and surcharges?**

19 A. There are several. The National Energy and Utility Affordability Coalition (NEUAC)  
20 describes itself as a broad-based coalition of diverse organizations dedicated to  
21 heightening awareness of the energy needs of low-income energy consumers, fostering  
22 public-private partnerships and engaging in other activities to address these needs. Mr.  
23 Ralph C. Smith, CPA of Larkin & Associates, PLC, and a witness for the Public  
24 Counsel in this rate case, made a presentation entitled "Increasing Use of Surcharges  
25 on Consumer Utility Bills" to NEUAC's 2012 Conference.

1 At the end of his presentation Mr. Smith reached the following five conclusions  
2 concerning the current use of single-issue ratemaking mechanisms such as trackers  
3 and surcharges.

4 Public Counsel agrees with each of the concerns listed below. Public Counsel  
5 recommends that the Commission consider each of these concerns prior to reaching  
6 any conclusion on the additional single-issue ratemaking mechanisms proposed by  
7 MAWC in this rate case:

8 1. In the past, surcharges were only permitted in limited circumstances for costs that  
9 were substantial, volatile and uncontrollable, and that could harm the utilities'  
10 financial health if not addressed outside of a general rate case base rate proceeding.

11 2. In recent years, however, requests for surcharges and tracking mechanisms by  
12 utilities have significantly increased, for many different types of costs, including  
13 capital investments, for specific operating and maintenance expenses and even for  
14 revenue losses.  
15

16 3. The excessive use of special ratemaking mechanisms such as surcharges and other  
17 tracking mechanisms can proliferate to the point of becoming difficult and  
18 burdensome for regulators to monitor.  
19

20 4. The use of surcharges can reduce utility incentives to control costs.  
21

22 5. Whenever new or expanded utility surcharges are proposed, care must be taken to  
23 protect ratepayers.  
24

25  
26  
27 **IV. REGULATORY LAG**

28 **Q. In Mr. Smith's concern number 4 above, he states that the use of surcharges can**  
29 **reduce the utility incentives to control costs. Please discuss Public Counsel's**  
30 **concern with this particular negative effect on utility management cost control**  
31 **incentives from the use of single-issue ratemaking mechanisms.**

32 **A. In this concern, Mr. Smith was addressing a very common concern with single-issue**  
33 **ratemaking mechanisms among regulatory commissions, regulatory agencies such as**

1 the Office of the Public Counsel, and some of the leading experts in the field of utility  
2 regulation. This concern is that single-issue ratemaking mechanisms remove or  
3 significantly degrade one of the essential positive elements of regulatory lag, which is  
4 the incentive placed on utility management to control cost increases between rate  
5 cases.

6 **Q. Please describe regulatory lag.**

7 A. "Regulatory lag" has often been defined much too simply as "the time between the  
8 incurrence of a cost or revenue by a utility and the reflection of that cost or revenue in  
9 rates". A more descriptive definition is provided by Mr. Alfred E. Kahn in his book  
10 *The Economics of Regulation: Principles and Institutions*. Here, in distinct contrast to  
11 how Missouri utilities characterize regulatory lag, Mr. Kahn in refers to regulatory lag  
12 as a "positive advantage" of regulation.

13 Mr. Kahn, likely the most widely recognized and often-cited expert on the economics  
14 of regulation, provides this definition of regulatory lag:

15 The regulatory lag - the inevitable delay that regulation imposes in  
16 the downward adjustment of rate levels that produce excessive  
17 rates of return and in the upward adjustments ordinarily called for  
18 if profits are too low - is thus to be regarded not as a deplorable  
19 imperfection of regulation but as a positive advantage. (Kahn,  
20 A.E., *The Economics of Regulation: Principles and Institutions*  
21 (New York: John Wiley & Sons, 1970, Chapter 2, p.48).  
22

23 **Q. How did Mr. Kahn describe his understanding of the role of regulatory lag?**

24 A. Mr. Kahn describes how regulatory lag is a ratemaking tool by which a regulatory  
25 body (Commission) incents positive utility management behavior. In *The Economics*  
26 *of Regulation: Principles and Institutions (chapter 2, page 48)* he states that "freezing  
27 rates for the period of the lag imposes penalties for inefficiency, excessive

1 conservatism, and wrong guesses, and offers rewards for their opposites: companies  
2 can for a time keep the higher profits they reap from a superior performance and have  
3 to suffer the losses from a poor one.”

4 Roger Sherman, another well-respected expert in the field of regulation wrote an  
5 article in 2003 entitled *Restructuring Industries: The Carrot and the Stick* in which he  
6 cited William Baumol as the first economist to recognize the benefits of regulatory  
7 lag. William Baumol was a professor at New York University and an emeritus  
8 professor at Princeton University:

9 The idea of using “regulatory lag”, the delay between rate cases,  
10 for incentive benefits came from Baumol (1968). He argued that  
11 the regulated firm would have incentive to control its costs while it  
12 was stuck with unchanging prices between rate cases, the fixed  
13 prices essentially serving as a stick. So he proposed a specific time  
14 period between rate cases, such as three years or five years, when  
15 prices would remain fixed. [Review of Network Economics Vol.2,  
16 Issue 4 – December 2003]  
17

18 **Q. Does regulatory lag benefit utilities?**

19 A. Yes. Not only does regulatory lag act as a necessary incentive to prudent and efficient  
20 management behavior as described by Messrs. Kahn and Baulmol, it also allows for  
21 utility shareholders to benefit financially during periods of excessive earnings and  
22 higher-than-authorized returns on equity.

23 **Q. How do Missouri utility companies typically address regulatory lag when it is  
24 positive to its shareholders?**

25 A. It has been my experience that when utility earnings are higher than an amount the  
26 utility believes would be found reasonable by the Commission; the utility will take  
27 whatever actions are necessary to retain that high level of earnings. This is the

1 primary way utilities seek to enjoy, to the maximum extent possible, all the aspects of  
2 regulatory lag that benefit it and its shareholders.

3 In addition, it has also been my experience that when utility earnings are higher than  
4 what would be considered reasonable, utilities will oppose any attempt to lower rates  
5 to a reasonable level.

6 Finally, I have not experienced or even heard of one instance where a Missouri utility  
7 filed a for a rate decrease with the Commission stating that its rates were too high and  
8 its actual earned ROE was excessive.

9 **Q. How do Missouri utility companies typically address regulatory lag when it does  
10 not specifically benefit its shareholders?**

11 **A.** It is a completely different story. This scenario usually occurs when expenses rise  
12 faster than revenues and/or other expense reductions and faster than efficiencies from  
13 technological advancements. When this is the case, utilities in Missouri - through  
14 legislative efforts and rate case proposals - seek approval of a myriad of single-issue  
15 ratemaking mechanisms to shelter shareholders.

16 The adoption of these many single-issue ratemaking mechanisms has changed  
17 fundamentally the structure of utility ratemaking in Missouri. It also has shifted a  
18 significant amount of risk from the utility (where it belongs under traditional cost of  
19 service ratemaking) to the ratepayers.

20 Utility companies in Missouri have been successful in facilitating this transfer of risk  
21 to customers. But no matter how much risk is transferred through single-issue  
22 ratemaking mechanisms, it never appears to be enough. This is evidenced by MAWC,  
23 a company with a very one-sided and bloated ISRS charge, currently earning a

1 reasonable ROE, seeking additional single-issue ratemaking mechanisms in the form  
2 of an ECAM and a RSM from the Commission.

3 With Missouri utility companies appearing to be on the path to seeking even more  
4 single-issue ratemaking mechanisms, there is a real possibility the beneficial aspects  
5 of regulatory lag will be so distorted that utility rates will no longer be based on the  
6 utility's cost of providing service. Under this regulatory structure and the removal of  
7 critical regulatory lag cost control incentives, there is a good possibility that utility  
8 expenses and utility rates will continue to grow rapidly without the necessary  
9 incentives to keep costs down between rate cases.

10 **Q. Please continue**

11 **A.** My fear is that with the continued escalation in the adoption and use of more and more  
12 single-issue ratemaking mechanisms, utility management's focus will change  
13 dramatically. With this slide away from traditional regulation, all relevant factors  
14 principles, and regulatory lag cost control incentives, the only question that utility  
15 management will ask itself is, "why should we keep costs down and sacrifice when we  
16 can automatically pass through these costs through one of the many available single-  
17 issue ratemaking mechanisms"? The truthful answer is that there is no reason why  
18 they should seek to control costs.

19 The regulatory lag incentives, which seek to emulate the cost reduction incentives of  
20 actual business competition, are all but eliminated. In this instance, while the  
21 Commission may say that one of its roles is to act as the force of competition on utility  
22 management, it will not have the power or the authority to be that force of

1 competition. The vast array of single issue-ratemaking mechanisms that replaced  
2 traditional ratemaking in Missouri will not allow it.

3 **Q. Is it the role of the Commission to serve as a substitute for a competitive**  
4 **marketplace?**

5 A. It is incumbent on the Commission, through the use and application of ratemaking  
6 policies and procedures, to allow regulatory lag to operate as naturally as possible to  
7 ensure that a proxy for competitive pressures exist in the operation of regulated  
8 utilities in Missouri.

9 The essential purpose of rate regulation is to emulate the results that might be  
10 achieved by competitive firms in a competitive business environment. Utilities should  
11 not be shielded from experiencing lower earnings in disadvantageous environments  
12 just as utilities should be allowed to retain, for a period of time, the benefits of higher  
13 earnings in advantageous environments. That is the role of regulatory lag and it is the  
14 responsibility of the Commission to ensure that regulatory lag continues to play this  
15 role in utility regulation in Missouri.

16 **Q. Do you agree that it is important for the Commission to seek a level of balance**  
17 **and fairness both to utility ratepayers and shareholders when it addresses the**  
18 **issues of regulatory lag in a utility rate case?**

19 A. Yes. To achieve this level of balance and fairness, I believe it is important to  
20 approach the regulatory lag issues being raised by utilities today from an historical  
21 perspective. A historical perspective of how regulatory lag was allowed to operate  
22 naturally in Missouri will show that Missouri utilities enjoyed the benefits of  
23 regulatory lag during certain periods and enjoyed very high ROEs. There was no

1 negative discussion of regulatory lag by Missouri utilities during this period and they  
2 took no action to ensure ratepayers were protected from paying utility rates that were  
3 not just and reasonable. Moving forward to recent years when the very positive  
4 impacts of regulatory lag on utility earnings have somewhat dissipated, there is a very  
5 strong push by Missouri utilities to eliminate the part of regulatory lag that they do not  
6 consider shareholder-friendly. This has led to the many various single-issue  
7 ratemaking mechanisms that are in effect today. A proper perspective would allow for  
8 the recognition that there were no individual ratepayer protection mechanisms put in  
9 place during the period of time when Missouri utilities experienced very high ROE  
10 levels.

11 **Q. Were there any single-issue ratemaking mechanisms put in place by the**  
12 **Commission during the 20 year period (1985-2005) that KCPL had very high**  
13 **earnings due to regulatory lag?**

14 **A.** No, there were none. Regulatory lag has always existed in the Missouri regulatory  
15 framework. The difference now is that when the business environment in which  
16 MAWC operates no longer produces positive regulatory lag (from the shareholder  
17 perspective) and excess earnings, MAWC calls for strong and drastic regulatory lag  
18 mitigation measures, primarily single-issue ratemaking mechanisms. But during the  
19 periods when utility earnings are in excess of authorized ROEs, there were no  
20 ratemaking mechanisms to protect ratepayers. That inherent inconsistency and lack of  
21 consideration to utility customers should be addressed by the Commission.

22 If these regulatory lag mitigation measures are not carefully controlled, and if they are  
23 allowed to remain in place for the long term, they have a very high probability of

1 significantly skewing the Missouri regulatory framework, which has worked very well  
2 in the past and hopefully will continue going forward.

3 It is important to view each one of the myriad of single-issue ratemaking mechanisms  
4 with a keen awareness and understanding of the past. Taking into consideration the  
5 past regulatory environments in Missouri allows for an understanding that regulatory  
6 lag is a naturally occurring phenomenon and is the cornerstone of effective regulation  
7 of firms with monopolistic power such as regulated utilities.

8 Viewing all of these new single-issue ratemaking mechanisms with an understanding  
9 of the past helps prevent bad decisions being made in a vacuum. It allows for an  
10 understanding that regulatory lag is affected by changes in economic conditions and  
11 regulatory lag benefits, depending on the current economic and market conditions,  
12 both shareholders and ratepayers. Any attempt to adjust this symmetrical nature of  
13 regulatory lag should be done very carefully and on a very limited and short-term  
14 basis so as not to significantly alter the inherent fairness and balance in naturally  
15 occurring regulatory lag.

16 **Q. Is it in the public interest to create and approve inflexible and long-lasting single-**  
17 **issue ratemaking mechanisms during times when MAWC's earnings, as reflected**  
18 **in its actual earned ROE, are reasonable?**

19 **A.** The Public Counsel does not believe it is in the public interest to do so and it  
20 recommends to the Commission that it make this same finding. The Public Counsel  
21 believes that if the Commission compares the detriments to ratepayers of the  
22 proliferation of single-issue ratemaking mechanisms to any potential benefits, it will  
23 conclude that it is no contest.

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1 The evidence I have provided in this testimony shows that MAWC's earnings are  
2 healthy and it has been and is currently earning a reasonable ROE. MAWC's earnings  
3 are healthy in large part due to its ISRS. MAWC has made maximum use of its ISRS  
4 to the point where its annual ISRS charges have exceeded 10% of its annual revenues  
5 determined in its previous rate case.

6 **Q. Please summarize your testimony on regulatory lag.**

7 **A.** In a 2009 rate case hearing in Case No. ER-2010-0036, the Commission' Chief Staff  
8 Counsel Kevin Thompson made the following statement to the Commission:  
9 "regulatory lag is a normal and inevitable part of utility regulation. You know that  
10 regulatory lag cuts both ways, sometimes to the benefit of the customer and sometimes  
11 to the benefit of the utility." (Tr. 214-215) While I agree with Mr. Thompson, I would  
12 go further and state that regulatory lag is not only inevitable, but necessary as it plays  
13 a vital role in making rate of return regulation work fairly and equitably. This is not  
14 only my opinion but the opinion of some of the most well-respected experts in the  
15 field of utility regulation.

16 Regulatory lag is necessary and essential in setting prices for a monopoly. It is only  
17 through regulatory lag that cost reduction incentives are created and provide the most  
18 significant, if not the only, incentive for utility management to operate the utility at its  
19 lowest reasonable cost between rate cases.

20 As to the many single-issue ratemaking mechanisms that are currently in place and are  
21 currently distorting regulatory lag, the Public Counsel believes these mechanisms  
22 require great scrutiny today and in the future by the Commission. Public Counsel  
23 believes that due to the increasing number of regulatory lag mitigation measures

1 currently in place and continuously being proposed by utilities, the potential for  
2 distortion of the important role of regulatory lag and the threat to effective utility  
3 regulation is real and serious.

4 Distortion of the nature and beneficial role of regulatory lag through modification and  
5 elimination of the essential ratemaking policies and principles that have served the  
6 Missouri regulatory framework over many years is a real possibility if the constant  
7 barrage of regulatory lag mitigation measures is not given greater scrutiny and  
8 important countervailing safeguards put in place. This greater scrutiny should be  
9 given with solid understanding of the role of regulatory lag and how regulatory lag has  
10 been allowed to operate in the past, when utilities were operating in a more favorable  
11 economic environment.

12 **V. BURDEN OF PROOF**

13 **Q. What is the typical utility responses when issues are raised about the negative**  
14 **impact of single-issue ratemaking mechanisms on Missouri ratepayers?**

15 **A.** My experience has been that the utilities typically respond that Staff and other parties  
16 have the ability to do a prudence audit and that this opportunity to do a prudence audit  
17 is a sufficient ratepayer protection.

18 **Q. Do you believe that the Staff and other parties have a reasonable opportunity to**  
19 **do a prudence audit on the many rate increases passed through to ratepayers**  
20 **under single issue ratemaking mechanisms?**

21 **A.** No. I was previously employed as a Staff auditor for over 23 years. During this  
22 period I became convinced that Staff prudence audits provide little or no ratepayer

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1           protections in most if not all of the single-issue ratemaking mechanism that exist  
2           today.

3           **Q.    On what do you base this belief?**

4           A.    There are several factors, but in this testimony I will address just the primary factor.

5           The primary factor why Staff and other parties' prudence audits provide no ratepayer  
6           protection is the very subtle but real shift in the burden of proof that utility costs are  
7           reasonable and prudent. This burden of proof has shifted somehow from utility  
8           management, where it belongs, to Commission Staff and Public Counsel auditors and  
9           other regulatory auditors.

10          **Q.    Mr. Hyneman, in your experience as an auditor and expert witness with the**  
11          **Public Counsel and the Commission Staff, what types of utility cases have you**  
12          **been involved with and filed testimony before this Commission?**

13          A.    I have been involved in many utility rate cases, and other cases including merger  
14          cases, ISRS cases, fuel adjustment clause cases, rate complaint cases, affiliate  
15          transaction case complaint cases, certificate cases, accounting authority order (AAO)  
16          cases, and construction audit and prudence reviews.

17          **Q.    Given your experience, are you clear as to the standards the Commission has**  
18          **developed and enforced related to the burden of proof in these utility cases?**

19          A.    No, I am not. I have a concern that over the past several years there has been a shift in  
20          the application of the burden of proof statute. Just as there is a real and tangible shift  
21          in regulatory risk away from the utility to the ratepayer through the proliferation of  
22          single-issue ratemaking mechanisms, there also appears to be a shifting of the burden

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1 of proof of utility costs being reasonable and prudent away from the utility even in  
2 traditional utility rate cases.

3 **Q. In this testimony are you expressing any legal opinion or making any legal**  
4 **conclusions about the legal standards applicable to the burden of proof in the**  
5 **Commissions ratemaking authority?**

6 A. No, I am not. I am not an attorney and in this testimony I do not address any legal  
7 analysis or determinations. I am an experienced regulatory auditor and a Certified  
8 Public Accountant ("CPA"). My point in this testimony as a regulatory auditor and  
9 CPA is simply to express my concerns. The change in the burden of proof has affected  
10 the work of Staff auditors, has affected the design of the Staff audit scope and audit  
11 plans, and has affected decisions about whether or not to even propose utility cost  
12 adjustments in cases before the Commission.

13 **Q. What is your knowledge of the standards the Commission must apply as it relates**  
14 **to burden of proof in utility cases?**

15 A. I am aware that there is a statute that specifically addresses the burden of proof and  
16 places that burden on the utility in utility rate cases at any hearing involving a rate  
17 increase. Missouri Revised Statutes Chapter 393 Gas, Electric, Water, Heating and  
18 Sewer Companies August 28, 2015, Section 393.150.2 states that at any hearing  
19 involving a rate sought to be increased, the burden of proof to show that the increased  
20 rate or proposed increased rate is just and reasonable shall be upon the utility  
21 company.

22 393.150.2. If any such hearing cannot be concluded within the  
23 period of suspension, as above stated, the commission may, in its  
24 discretion, extend the time of suspension for a further period not  
25 exceeding six months. At any hearing involving a rate sought to be

1           increased, the burden of proof to show that the increased rate or  
2           proposed increased rate is just and reasonable shall be upon the gas  
3           corporation, electrical corporation, water corporation or sewer  
4           corporation, and the commission shall give to the hearing and  
5           decision of such questions preference over all other questions  
6           pending before it and decide the same as speedily as possible.  
7           (emphasis added)

8  
9           **Q.    Has the Commission recognized in utility rate cases that the burden of proof is on**  
10           **the utility?**

11           A.    Yes. At page 14, paragraph 7 of its April 12, 2011 Report and Order in File No. ER-  
12           2010-0355 ("2010 Report and Order"), the Commission cited Section 393.150.2 and  
13           described that the burden of proof at a rate case hearing is on the utility, in that case,  
14           KCPL, to show that the rate increase KCPL proposes is just and reasonable:

15           Burden of Proof

16                       7. At any hearing involving a rate sought to be increased, the  
17                       burden of proof to show that the increased rate or proposed  
18                       increased rate is just and reasonable shall be upon the . . . electrical  
19                       corporation . . . and the commission shall give to the hearing and  
20                       decision of such questions preference over all other questions  
21                       pending before it and decide the same as speedily as possible.  
22

23           **Q.    Have past Commissions, in your non-legal opinion, shifted the burden of proof**  
24           **away from the utility to the Staff and other parties in cases where utility rates**  
25           **were sought to be increased?**

26           A.    Yes. This has been my experience as a member of the Commission Staff. In fact, I  
27           addressed this point in my True-Up Direct testimony in Case No. ER-2014-0370,  
28           KCPL's last rate case. In this testimony I provided the standards set by the  
29           Commission on auditors in construction audits and prudence review cases, even when

1 the rate increase from the construction project is sought by the utility in a general rate  
2 case.

3 In this testimony I described the standards the Commission places on regulatory  
4 auditors to support adjustments in construction audits and prudence reviews, and  
5 explained that these standards are much more stringent than other rate case  
6 adjustments, where the burden of proof is on the utility to prove the reasonableness  
7 and prudence of costs included in proposed rate increases.

8 In its April 12, 2011 Report and Order in File No. ER-2010-0355 ("2010 Report and  
9 Order"), the Commission placed the following standards (burden) of proof on the  
10 Staff. The Commission stated that Staff must meet a specific four-pronged test in any  
11 proposed adjustment to exclude a particular construction cost from the utility's cost of  
12 service in that rate case:

- 13 1. Identify that a specific imprudent action was not based upon  
14 construction industry standards;
- 15 2. Identify that the specific imprudent action was based on the  
16 circumstances that existed at the time the decision to incur the  
17 imprudent cost was made;
- 18 3. Provide proof that increased costs resulted from the imprudent  
19 decisions;
- 20 4. Provide substantive, competent evidence that establishes a  
21 causal connection between the utility's imprudent action and the  
22 cost incurred as a result of the action.

23  
24  
25 **Q. In KCPL's 2010 rate case, were the construction costs of the Iatan construction**  
26 **project part of the cost increases that KCPL proposed to include in its rate**  
27 **increase filing in that rate case?**

28 **A. Yes. However, despite the costs being sought in a rate increase case, in its 2010**  
29 **Report and Order at paragraph 25, the Commission summarized its much higher**

Rebuttal Testimony of  
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1       burden of proof on the Staff as it applies to any proposed adjustments to utility  
2       construction audits that the utility seeks to include in its rate increase hearing:

3               25. In other words, Staff or the other parties must satisfy the  
4               following two-pronged evidentiary test to support a disallowance:  
5               1) identify the imprudent action based upon industry standards and  
6               the circumstances at the time the decision or action was made; and  
7               2) provide proof of the increased costs caused by KCP&L's  
8               imprudent decisions. To meet this standard, a party must provide  
9               substantive, competent evidence establishing a causal connection  
10              or —nexus between the alleged imprudent action and the costs  
11              incurred.  
12

13    **Q.**    Does the Public Counsel have concerns that the Commission has shifted the  
14           burden to prove that cost increases included in rate increase proposals are  
15           reasonable and prudent from the utility to the regulatory auditors who audit  
16           these cost increases?

17    **A.**    Yes. The Public Counsel recommends that the Commission review its standards on the  
18           burden of proof in various types of cases, including FAC cases, construction audits,  
19           and other rate increase cases, and issue guidelines to its Staff, Public Counsel and  
20           other parties that are clear, understandable and consistent with the requirements of  
21           Section 393.150.2.

1 **VI. REBUTTAL OF MAWC WITNESS ROACH**

2 **Q. Did you read the direct testimony of MAWC witness Greg Roach?**

3 A. Yes, I did.

4 **Q. Do you have any concerns with his direct testimony?**

5 A. Yes, I do.

6 **Q. What are your concerns?**

7 A. Mr. Roach at page 19 line 11 of his direct testimony refers to a term "allowed Total  
8 Revenue and Water Sales" and states that such levels were set in Case WR-2011-  
9 0337, MAWC's last rate case.

10 **Q. Have you ever heard of the Commission "allowing" a certain level of water sales  
11 and revenue levels?**

12 A. No. The Commission does not allow any certain revenue levels or water sales. It is  
13 not clear how Mr. Roach came up with this information. I have reviewed the  
14 Commission's Report and Order from Case No. WR-2011-0337 and did not see any  
15 reference at all to any allowed total revenues or allowed water sales. At page 19 of his  
16 direct testimony Mr. Roach refers again to a term "allowed revenue" and "allowed  
17 total water sales" with no explanation of what these terms mean.

18 **Q. Do you have any additional concerns with Mr. Roach's direct testimony?**

19 A. Yes. The revenue numbers reflected at page 20 of his direct testimony are not  
20 consistent with what MAWC reported to the Commission in its recent annual reports.

1 Q. Did you compare the water revenue numbers provided by Mr. Roach in his chart  
2 at page 20 of his direct testimony to the water revenue numbers provided by  
3 MAWC to the Commission in its annual report filings during the period 2011  
4 through 2014?

5 A. Yes. In the chart below the annual water revenues reported by MAWC in its Annual  
6 Reports to the Commission were compared to the annual water revenues for 2012,  
7 2013, and 2014 provided by Mr. Roach at page 20 of his direct testimony. It is a  
8 concern that the numbers reported by Mr. Roach do not match the numbers reported  
9 by MAWC to the Commission in its Annual Report. However, the numbers provided  
10 by Mr. Roach in his direct testimony show a greater average annual increase during  
11 the period 2012 through 2014.

12 The revenue growth numbers provided by Mr. Roach show a robust increase in  
13 revenue growth from 2011 through 2014 of 12%, with an average annual increase  
14 during this period of 4%.

ANNUAL REPORT	MAWC WATER REVENUES PER MPSC ANNUAL REPORT	WATER REVENUE INCREASE	ROACH DIRECT P. 20	MAWC WATER REVENUES ROACH DIRECT P. 20	WATER REVENUE INCREASE
2011	\$241,414,416	-	2011 **	\$241,414,416	-
2012	\$276,704,900	15%	2012	\$279,467,636	16%
2013	\$261,404,269	-6%	2013	\$264,778,072	-5%
2014	\$266,542,507	2%	2014	\$270,239,218	2%
	3-year Revenue Growth	10%		3-year Revenue Growth	12%

15  
16 Q. Did you also compare MAWC's average increase in water revenues with its  
17 parent company AWWC's average increase in water revenues?

18 A. Yes. The chart below shows that MAWC's average annual growth in revenues is  
19 consistent with AWWC's regulated utility water sales growth over the period 2010-

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1           2014. I also included a comparison with the revenue growth of a Missouri utility,  
2           KCPL. This comparison shows that water sales growth over the period 2010-2014 is  
3           almost identical with electric sales growth over the same period. While these sales  
4           growth increases are affected by several factors, they show that MAWC's revenues are  
5           solid compared to other water utility sales (other AWWC water utilities) and other  
6           Missouri utility revenue growth.

Average Revenue Growth	MAWC	AWWC	KCPL
2010 - 2014	5.8%	4.1%	5.7%
2012- 2014	3.7%	4.0%	3.6%

7  
8  
9  
10   **Q. Did Mr. Roach file Supplemental Direct Testimony on February 10, 2016, the**  
11   **day before rebuttal testimony was required to be filed in this case?**

12   **A. Yes, he did.**

13   **Q. Did you have time to review the merits of his Supplemental Direct Testimony**  
14   **prior to filing rebuttal testimony in this case?**

15   **A. No, I did not. If necessary, I plan to address Mr. Roach's Supplemental Direct**  
16   **Testimony in my Surrebuttal testimony in this rate case.**

17   **Q. Do you have any immediate concerns with Mr. Roach's Supplemental Direct**  
18   **Testimony?**

19   **A. Yes, I do. At page 4 Mr. Roach uses the term "authorized revenues". I personally**  
20   **have never heard this term used in Missouri regulation and I do not believe this term**  
21   **has any real meaning. With the exception of ROW, unless a revenue requirement**  
22   **component is a part of a tracker or another tacked single-issue mechanism, there is no**

1 authorized level issued by the Commission. Also, the chart at page 4 of his  
2 Supplemental Direct Testimony states that it includes actual revenues. However, the  
3 revenues in this his chart for 2015 are not actual revenues. As footnoted by Mr. Roach,  
4 the number in the chart for 2015 reflects revenues that are based on some historical  
5 average of prior revenues going back to 2010.  
6

7 **VII. REBUTTAL OF MAWC WITNESS MORIN**

8 **Q. Did you read the direct testimony of MAWC witness Roger Morin?**

9 A. Yes, I did.

10 **Q. Do you have any concerns with his direct testimony?**

11 A. Yes, I do.

12 **Q. What are your concerns?**

13 A. Mr. Morin, at pages 53 through 58 and in Appendix B of his direct testimony  
14 addresses the issue of a "flotation cost" adder to MAWC's ROE. A more correct term  
15 for "flotation costs" is "stock issuance expenses" and I will use that term in this  
16 testimony. My concern is that if Mr. Morin's proposal on stock issuance expense  
17 prevails, MAWC's ratepayers will pay in utility rates expenses MAWC has never  
18 incurred, and its parent company, AWWC, did not incur in the test year.

19 **Q. What are stock issuance expenses?**

20 A. Stock issuance expenses are expenses of issuing company stock to the public. These  
21 expenses are similar to other administrative and general ("A&G") expenses incurred  
22 by a utility and charged to A&G expenses in the income statement. Some of the types  
23 of expenses included in this administrative cost are:

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1           \*Professional Fees: includes those for attorneys, as well as  
2 certified public accountants.

3           \*Commissions: underwriters that place the securities with  
4 investors will charge both fees for this service as well as sales  
5 commissions.

6           \*Clerical: includes both administrative and clerical costs  
7 associated with preparing regulatory filings as well as registrations.

8           \*Filings: expenses and fees associated with filing the issue with the  
9 Securities and Exchange Commission.

10          \*Marketing: advertising, mailing, and marketing costs associated  
11 with promoting the securities to investors.  
12

13   **Q.    What is MAWC's position on stock issuance costs?**

14   A.    MAWC, through Mr. Morin's direct testimony, seeks to add 30 basis points to what  
15 MAWC witness Morin calculates to be MAWC's actual cost of equity.

16   **Q.    What is the revenue requirement impact of adding 30 basis points to MAWC's**  
17 **ROE to account for stock issuance expense?**

18   A.    Using MAWC's proposal I calculate that amount to be approximately \$3.6 million.

19   **Q.    Does MAWC as a company actually issue common stock?**

20   A.    No, the issuance of common stock is made by MAWC's parent company, AWWC.

21   **Q.    Does that mean that AWWC's cost to issue common stock would be allocated to**  
22 **all of AWWC's regulated subsidiaries and non-regulated operations throughout**  
23 **the company?**

24   A.    Yes. It is a type of expense that would be allocated to all of the Company's  
25 operations.

26   **Q.    By charging MAWC's ratepayers \$3.6 million annually through a 30 basis point**  
27 **stock issuance expense adder to ROE, how much is MAWC witness Morin**  
28 **suggesting that AWWC incurs on an annual basis?**

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1 A. I am not aware of an allocation percentage that would be most appropriate for this  
2 calculation. However, using a very conservative allocation factor of 14.24%, which is  
3 the allocation factor AWWC uses to allocate its Business Transformation Project  
4 ("BT" project) to its regulated operations, Mr. Morin's testimony suggests that  
5 AWWC incurs \$25.4 million of stock issuance expenses each and every year.

6 **Q. Why is a 14.24 percent allocation very conservative?**

7 A. This is an allocation used by MAWC to allocate what it considers a regulated project  
8 to regulated operations. The expense incurred in issuing common stock would benefit  
9 AWWC's regulated operations as well as its substantial nonregulated operations. This  
10 would make the allocation to MAWC of AWWC stock issuance expense much lower  
11 than 14.24%.

12 **Q. What level of stock issuance expense did AWWC incur in the test year in this**  
13 **case?**

14 A. AWWC, and thus MAWC, did not incur any stock issuance expenses in the test year  
15 in this case.

16 **Q. Is stock issuance expense a cost of equity that should be reflected in a cost of**  
17 **equity study?**

18 A. No. Stock issuance expense is an expense of operating a company and it should be  
19 treated for accounting and ratemaking purposes as any other expense that is deferred  
20 and amortized to future periods.

21 **Q. What is the appropriate accounting and ratemaking treatment for stock issuance**  
22 **expenses for a public utility?**

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1 A. First, the cost has to be incurred and specifically identified. Once this occurs, a  
2 reasonable allocation of the cost to the regulated operations of the utility should be  
3 determined. This cost would be deferred on the utility's balance sheet as a deferred  
4 charge and amortized to expense over a period of time that is determined by the  
5 Commission to be reasonable based on the facts and circumstances of the rate case  
6 where the expenses are addressed.

7 **Q. Does MAWC witness Morin's position on stock issuance expense contradict other**  
8 **parts of his testimony?**

9 A. Yes. At page 5 line 21 of his direct testimony Mr. Morin states that his recommended  
10 rate of return reflects the application of his professional judgment. I would question  
11 his judgment about charging MAWC's ratepayers \$3.6 million annually for an  
12 expense that was not incurred in the test year, is not known and measurable, and is  
13 clearly overstated. Mr. Morin's 30-basis point adder is arbitrary and is not based on  
14 any business operations of MAWC or its parent company, AWWC.

15 **Q. In Appendix B to his direct testimony Mr. Morin cites the studies he relied upon**  
16 **to support his 30 basis point adder for stock issuance costs. Are any of those**  
17 **current?**

18 A. No. A review of the studies cited by Mr. Morin show that most occurred more than 20  
19 years ago and some almost 40 years ago. Dates referenced were 1978, 1986, 1980,  
20 1987, 1986, 1973, 1969, 1996 and 2000. No study was conducted in the last 15 years.

21 **Q. Even if the studies relied upon by Mr. Morin were current, would they be**  
22 **relevant to this rate case?**

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1 A. No. Studies of the type Mr. Morin relies upon can only be used as a check on the  
2 reasonableness of an actual cost. That would be their only value. However, since  
3 stock issuance expense is an accounting expense – dollars paid to attorneys and  
4 underwriters to sell the company's stock to the public – and not a cost of equity, it  
5 does not belong in a calculation of ROE.

6 Stock issuance expenses should be calculated by utility personnel and proposed as an  
7 amortization adjustment to the cost of service in the same manner as many other  
8 expenses. Embedding stock issuance expense in a ROE recommendation distorts the  
9 amount of the expense and, as it does in this rate case, ignores the fact that the expense  
10 was not actually incurred in the test year.

11 Mr. Morin's testimony did not indicate that he took the time to review AWWC's  
12 actual stock issuance costs in the past. Mr. Morin does not testify that he made an  
13 attempt to calculate what a reasonable level of stock issuance costs would be for  
14 MAWC, but merely relied upon some generic studies performed 30-40 years ago.

15 **Q. What is Public Counsel's position on stock issuance expense in this case?**

16 A. Since no stock issuance expense was incurred by AWWC and none was allocated to  
17 MAWC, there should be no recognition of stock issuance expense in MAWC's cost of  
18 service in this rate case.

19 **Q. Does Mr. Morin take a position on the ratemaking treatment of MAWC's stand-  
20 alone capital structure and ROE that is different from how AWWC treats  
21 MAWC for income tax purposes?**

22 A. Yes. At page 16 of his direct testimony Mr. Morin states that an estimation of a fair  
23 and reasonable ROE should not take into account MAWC's relationship with its

1 parent company, AWWC. Public Counsel is concerned with the significant level of  
2 inconsistency between the stand-alone ratemaking treatment position taken by Mr.  
3 Morin and the position of AWWC treating MAWC on a consolidated basis for certain  
4 bonus depreciation income tax deductions.

5 Public Counsel witness Ralph C. Smith describes in his direct testimony in this case  
6 how MAWC did not opt to take available bonus tax depreciation deductions in 2011  
7 and 2013. This decision by AWWC caused MAWC's rate base and revenue  
8 requirement in this case to be higher than it would be if AWWC allowed MAWC to  
9 take these bonus depreciation tax deductions.

10 **Q. What reasons were provided by MAWC as to why it did not take the bonus**  
11 **depreciation tax deductions it was entitled to take in 2011 and 2013?**

12 **A. MAWC's response to Public Counsel data request 5038 stated:**

13 MAWC and American Water Works opted out of bonus  
14 depreciation in tax years 2011 and 2013. In 2011, the bonus  
15 depreciation allowed by the IRS to deduct was 100% of qualifying  
16 property. It was determined that because the consolidated group  
17 already had sufficient net operating losses (NOL's), adding to that  
18 would jeopardize its ability to use them in the future, even though  
19 the carryforward is 20 years. In 2013, the consolidated group had  
20 charitable contribution carryforwards that were going to expire  
21 unused if the Company was in a taxable loss position. That would  
22 have been an additional tax expense to the Company. Therefore, it  
23 was decided to opt out of taking the bonus depreciation.  
24

25 By not allowing MAWC to take the bonus depreciation tax deductions it was entitled  
26 to take on a stand-alone basis and creating a higher revenue requirement for MAWC,  
27 AWWC is treating MAWC on a consolidated basis for an isolated part of its  
28 consolidated tax operations. AWWC, for this one tax deduction, which is beneficial to  
29 shareholders, is treating MAWC as part of its consolidated tax operations. But for

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1 other deductions that were actually taken at the consolidated level that could have  
2 lowered MAWC's cost of service in this case, no such compensating ratemaking  
3 treatment was proposed by AWWC.

4 AWWC's inconsistent treatment of treating MAWC on a stand-alone basis where it  
5 likely benefits the shareholders and is detrimental to ratepayers (capital costs and  
6 capital structure) while treating MAWC on a consolidated tax basis for bonus  
7 depreciation is inconsistent ratemaking treatment that is of concern to the Public  
8 Counsel.

9 **Q. Would the fact that MAWC did not reflect bonus depreciation tax deductions**  
10 **due to its affiliate relationship with its parent company, AWWC, be considered a**  
11 **violation of the Commission's Affiliate Transaction Rules if MAWC was subject**  
12 **to those rules?**

13 **A. Yes, it would. In this case, MAWC is subsidizing the operations of its affiliate**  
14 **AWWC by not objecting to AWWC's forced increase in MAWC's cost of service by**  
15 **not reflecting bonus tax depreciation deductions that belong to MAWC in its cost of**  
16 **service in this rate case. The Commission's Affiliate Transaction Rule was created to**  
17 **prevent just the types of transactions, affiliate subsidization, that AWWC and MAWC**  
18 **are engaging in related to MAWC's bonus depreciation income tax deductions.**

19 **Q. Is Public Counsel requesting any specific action by the Commission in this case to**  
20 **address this issue?**

21 **A. Public Counsel is not proposing any specific ratemaking treatment at this time.**  
22 **Unfortunately, as explained by Public Counsel witness Smith in his direct testimony,**  
23 **if Public Counsel imputed the past bonus depreciation deductions that MAWC should**

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1 have reflected for ratemaking purposes in this case, a concern about a potential  
2 violation of the IRS' Normalization requirements would be raised. Because of this  
3 issue, Public Counsel has decided that for the purpose of this rate case, no ratemaking  
4 adjustment to reflect the imputation of the bonus depreciation deductions should be  
5 made.

6 **Q. In future rate cases, if MAWC continues to subsidize its affiliate parent company,**  
7 **what actions are available for Public Counsel?**

8 A. Public Counsel is aware that other rate jurisdictions of AWWC have adopted the  
9 calculation of income tax expense on a consolidated tax basis. There is significant  
10 justification why some form of this income tax treatment is superior from a fairness  
11 standpoint than the detriments suffered from treating income tax expense on a stand-  
12 alone basis as has been the position of the Commission Staff and the Commission for  
13 many years. This is a position that the Public Counsel will consider and evaluate in  
14 MAWC's next rate case and in other rate cases before the Commission.

15 However, Public Counsel is requesting the Commission address this issue by ordering  
16 MAWC to file a Cost Allocation Manual ("CAM") based on the requirements of the  
17 Commission's Affiliate Transaction Rule for Missouri electric and gas utilities. In  
18 addition, the Public Counsel is requesting that the Commission open a docket to  
19 address the creation of Affiliate Transaction Rules for large water companies in  
20 Missouri similar to the rules created for electric and natural gas utilities.

1 **VIII. ADJUSTMENTS TO DIRECT TESTIMONY**

2 A. **PAYROLL**

3 Q. **Did the Public Counsel propose an adjustment to MAWC's payroll in its direct**  
4 **filing in this case?**

5 A. Yes, it did.

6 Q. **Based on the technical conference session held January 26, 2016 does the Public**  
7 **Counsel propose a change to its payroll adjustment?**

8 A. Yes. Based on information obtained at the technical conference, Public Counsel  
9 adjusted its proposed payroll adjustment. Based on this adjustment the Public Counsel  
10 now supports the Staff's recommended level of payroll in Staff's direct filing. The  
11 Public Counsel recognizes that the Staff adjustment did not annualize payroll costs  
12 past the test year or true-up date in this case as proposed by MAWC in its direct  
13 testimony. The Public Counsel does not support any adjustment to payroll expense  
14 past the test year or true-up date in this rate case.

15 Q. **Does this conclude your rebuttal testimony?**

16 A. Yes, it does.

# Missouri American Water Company

Company Full Certificated Name

(Do not abbreviate and include any Commission approved AKA/DBA/Fictitious Name, if applicable)

## WATER and/or SEWER ANNUAL REPORT

LARGE COMPANY  
(with 8,000 or more customers)

TO THE

MISSOURI PUBLIC SERVICE COMMISSION

For the calendar year of  
January 1 - December 31, 2014

Please select how the company is certificated with the Commission under the Company Name as shown above (check all that apply):

Water Service Provider

Sewer Service Provider

Please choose one of the following filing options:

Public Submission (NOT Highly Confidential)

Non-Public Submission (Highly Confidential / Filed Under Seal)

For this filing to be considered Highly Confidential, additional submission of materials is required pursuant to Commission rule 4 CSR 240-3.335 and/or 4 CSR 240-3.640, Section 392.210, RSMo., and/or Section 393.140, RSMo.

Excel Issue Date: 12/17/2014

(To be used when filing under seal.)

STATEMENT OF INCOME FOR THE YEAR

Account No. (a)	Account Description (b)	Schedule Page No. (c)		Total		
				Current Year (d)	Sewer Current Year (e)	Water Current Year (f)
<b>Utility Operating Income</b>						
400	Operating Revenues	S-1	W-1	\$ 270,159,638.62	\$ 3,017,031.63	\$ 266,612,508.99
401	Operation Expense	S-3	W-6	\$ 111,315,942.95	\$ 1,811,901.00	\$ 109,604,041.65
402	Maintenance Expense	S-3	W-6	\$ 14,003,930.00	\$ 299,330.00	\$ 13,709,600.00
403	Depreciation Expense	S-7	W-11	\$ 33,077,690.22	\$ 754,373.42	\$ 32,323,216.80
404-405	Amortization of Limited Term/Other Utility Plant			\$ (4,878,207.00)	\$ 4,450.00	\$ (4,880,657.00)
406	Amortization of Utility Plant Acquisition Adjustments	F-16		\$ 6,257,427.00	\$ 12,779.00	\$ 5,244,648.00
407	Amortization of Property Losses			\$ 180,659.00	\$ 1,818.00	\$ 188,843.00
408.1	Taxes Other Than Income Taxes-Utility Operating Income	F-31		\$ 18,662,361.00	\$ 57,676.00	\$ 18,694,787.00
409.1	Income Taxes, Utility Operating Income	F-31		\$ 2,654,360.00		\$ 2,654,360.00
410.1	Provision for Deferred Income Taxes-Utility Operating Income	F-38		\$ 25,859,726.00		\$ 25,859,726.00
411.1	Income Taxes Deferred in Prior Years-Credit Utility Operating Income	F-38		\$ -		\$ -
412.1	Investment Tax Credits-Utility Operations, Deferred to Future Periods	F-33		\$ (130,410.00)		\$ (130,410.00)
412.2	Investment Tax Credits-Utility Operations, Restored to Operating Income	F-33		\$ -		\$ -
	Total Utility Operating Expenses			\$ 203,680,307.17	\$ 2,942,224.42	\$ 200,938,163.75
	Net Utility Operating Income			\$ 66,279,151.45	\$ 874,807.21	\$ 65,604,343.24
413	Income from Utility Plant Leased to Others	F-38		\$ -		\$ -
414	Gains (Losses) from Disposition of Utility Property	F-40		\$ -		\$ -
	Total Net Utility Operating Income			\$ 66,279,151.45	\$ 874,807.21	\$ 65,604,343.24
<b>Other Income</b>						
415-418	Nonutility Operating Income	F-39		\$ 208,855.00	\$ -	\$ 208,855.00
419	Interest and Dividend Income (Net)	F-39		\$ 1,067.00		\$ 1,067.00
420	Allowance for Funds Used During Construction	F-41		\$ 1,796,608.00	\$ 14,287.00	\$ 1,782,219.00
421	Miscellaneous Non-operating Income	F-41		\$ (6,092.00)		\$ (6,092.00)
422	Gains (Losses) from Disposition of Non-Utility Property	F-40		\$ 443,092.00	\$ -	\$ 443,092.00
	Total Other Income			\$ 2,444,258.00	\$ 14,287.00	\$ 2,429,971.00
<b>Other Income Deductions</b>						
425	Miscellaneous Amortization	F-41		\$ 101,650.00		\$ 101,650.00
426	Miscellaneous Income Deductions	F-41		\$ 134,323.00		\$ 134,323.00
	Total Other Income Deductions			\$ 235,973.00	\$ -	\$ 235,973.00
<b>Taxes Applicable to Other Income</b>						
408.2	Taxes Other Than Income Taxes, Other Income and Deductions	F-31		\$ -		\$ -
409.2	Income Taxes, Other Income and Deductions	F-31		\$ -		\$ -
410.2	Provision for Deferred Income Taxes, Other Income and Deductions	F-38		\$ -		\$ -
411.2	Income Taxes Deferred in Prior Years - Credit, Other Income and Deductions	F-38		\$ -		\$ -
412.3	Investment Tax Credits-Utility Operations Restored to Non-operating Income	F-33		\$ -		\$ -
412.4	Investment Tax Credits, Non-Utility Operations, Net	F-33		\$ -		\$ -
	Total Taxes on Other Income and Deductions			\$ -	\$ -	\$ -
	Net Other Income and Deductions			\$ 2,208,385.00	\$ 14,287.00	\$ 2,194,098.00
<b>Interest Charges</b>						
427	Interest on Long-Term Debt	F-41		\$ 24,800,428.00		\$ 24,600,428.00
428	Amortization on Debt Discount and Expense	F-21		\$ 945,934.00		\$ 945,934.00
429	Amortization of Premium on Debt - Credit	F-21		\$ -		\$ -
430	Interest on Debt to Associated Companies	F-41		\$ 148,284.00		\$ 148,284.00
431	Other Interest Expense	F-41		\$ -		\$ -
	Total Interest Charges			\$ 25,692,658.00	\$ -	\$ 25,692,658.00
	Income Before Extraordinary Items			\$ 42,794,880.45	\$ 889,094.21	\$ 42,106,785.24
<b>Extraordinary Items</b>						
433	Extraordinary Income			\$ -		\$ -
434	Extraordinary Deductions			\$ -		\$ -
499.3	Income Taxes, Extraordinary Items			\$ -		\$ -
	Extraordinary Items After Taxes			\$ -	\$ -	\$ -
	Net Income			\$ 42,794,880.45	\$ 889,094.21	\$ 42,106,785.24

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Indicates formula cell

Report of Missouri American Water Company		For the calendar year of January 1 - December 31, 2014			
NOTE: Please do not type over formulas. Totals will calculate automatically in this spreadsheet.					
COMPARATIVE BALANCE SHEET - UTILITY PLANT, ASSETS AND OTHER DEBITS					
Account No. (a)	Account Description (b)	Schedule Page No. (c)	Balance at Beginning of Year (d)	Balance at End of Year (e)	Increase or (Decrease) (f)
<i>Utility Plant</i>					
101-107	Utility Plant	F-16	\$ 1,857,886,534.00	\$ 1,984,196,259.00	\$ 106,509,725.00
108-113	Less: Accumulated Provisions for Depreciation and Amortization	F-16	\$ 443,651,339.00	\$ 450,784,676.15	\$ 7,143,337.15
	Net Utility Plant		\$ 1,414,035,195.00	\$ 1,513,401,582.85	\$ 99,366,387.85
114-115	Utility Plant Acquisition Adjustments (Net)	F-16	\$ 7,570,753.00	\$ 7,250,264.00	\$ (320,489.00)
116	Other Utility Plant Adjustments				\$ -
	Total Net Utility Plant		\$ 1,421,605,948.00	\$ 1,520,651,846.85	\$ 99,045,898.85
<i>Other Property and Investments</i>					
121	Nonutility Property	F-18	\$ 15,000.00	\$ 15,000.00	\$ -
122	Less: Accumulated Provisions for Depreciation and Amortization of Nonutility Property	F-18	\$ -	\$ -	\$ -
	Net Nonutility Property		\$ 15,000.00	\$ 15,000.00	\$ -
123	Investment in Associated Companies	F-19		\$ -	\$ -
124	Other Investments	F-19	\$ 429,511.00	\$ 729,066.00	\$ 299,495.00
125-128	Special Funds	F-19		\$ -	\$ -
	Total Other Property & Investments		\$ 444,511.00	\$ 744,066.00	\$ 299,495.00
<i>Current and Accrued Assets</i>					
131	Cash	-	\$ 1,142,745.00	\$ 702,803.00	\$ (439,942.00)
132-134	Special Deposits	-	\$ 5,452.00	\$ 5,452.00	\$ -
135	Working Funds	-	\$ 5,296.00	\$ 3,400.00	\$ (1,896.00)
136	Temporary Cash Investments	-			\$ -
141-143	Notes and Accounts Receivable	F-20	\$ 23,141,939.00	\$ 24,016,959.00	\$ 875,020.00
144	LESS: Accumulated Provision for Uncollectible Accounts	F-20	\$ (2,498,119.00)	\$ (2,898,936.00)	\$ (402,819.00)
145-146	Receivable from Associated Companies	F-20	\$ 901,154.00	\$ 15,010,345.00	\$ 14,109,191.00
151-157	Materials and Supplies	F-21	\$ 4,870,345.00	\$ 4,984,348.00	\$ 114,003.00
163	Stores Expense	F-21	\$ -	\$ -	\$ -
166	Prepayments	F-21	\$ 916,896.00	\$ 598,843.00	\$ (318,253.00)
171	Interest and Dividends Receivable	-			\$ -
172	Rents Receivable	-			\$ -
173	Accrued Utility Revenues	-	\$ 27,628,554.00	\$ 28,428,170.00	\$ 799,616.00
184	Miscellaneous Current and Accrued Assets	-	\$ 1,105,161.00	\$ 1,102,025.00	\$ (3,136.00)
	Total Current and Accrued Assets		\$ 57,219,423.00	\$ 71,954,207.00	\$ 14,731,784.00
<i>Deferred Debits</i>					
181	Unamortized Debt Discount and Expense	F-21	\$ 9,679,435.00	\$ 8,833,501.00	\$ (845,934.00)
182	Extraordinary Property Losses	F-21	\$ -	\$ -	\$ -
183	Preliminary Survey and Investigation Charges	-	\$ 10,868.00	\$ 10,868.00	\$ -
184	Clearing Accounts	F-22	\$ -	\$ -	\$ -
185	Temporary Facilities	-			\$ -
186	Miscellaneous Deferred Debits	F-21	\$ 36,041,868.00	\$ 42,695,357.00	\$ 6,653,489.00
187	Research and Development Expenditures	-			\$ -
	Total Deferred Debits		\$ 45,632,171.00	\$ 61,339,726.00	\$ 5,707,555.00
	Total Utility Plants, Assets and Other Debits	*	\$ 1,524,902,053.00	\$ 1,844,886,785.85	\$ 119,784,732.85
* Difference between Assets and Equity & Liabilities (from PgF-11)			\$	0	
					Indicates link to another worksheet within workbook
					Indicate formula cells

Report of Missouri American Water Company		For the calendar year of January 1 - December 31, 2014			
NOTE: Please do not type over formulas. Totals will calculate automatically in this spreadsheet.					
COMPARATIVE BALANCE SHEET - EQUITY CAPITAL, LIABILITIES AND OTHER CREDITS					
Account No. (a)	Account Description (b)	Schedule Page No. (c)	Balance at Beginning of Year (d)	Balance at End of Year (e)	Change or (Decrease) (f)
<b>Equity Capital</b>					
201	Common Stock Issued	F-24	\$ 95,894,075.00	\$ 95,894,075.00	\$ -
204	Preferred Stock Issued	F-24	\$ 1,750,000.00	\$ 1,500,000.00	\$ (250,000.00)
202, 205	Capital Stock Subscribed	F-24		\$ -	\$ -
203, 206	Stock Liability for Conversion	F-24		\$ -	\$ -
207	Premium on Capital Stock	F-25	\$ -	\$ -	\$ -
208-211	Other Paid in Capital	F-25	\$ 196,371,330.00	\$ 198,529,923.00	\$ 158,593.00
212	Installments Received on Capital Stock	F-24		\$ -	\$ -
213	Discount on Capital Stock	-		\$ -	\$ -
214	Capital Stock Expense	F-24	\$ (25,111.00)	\$ (23,690.00)	\$ 1,421.00
215, 216	Retained Earnings	F-25	\$ 192,065,538.00	\$ 192,797,509.45	\$ 10,731,971.45
217	Reacquired Capital Stock	F-24		\$ -	\$ -
	<b>Total Equity Capital</b>		\$ 476,155,832.00	\$ 488,797,817.45	\$ 10,641,985.45
<b>Long-Term Debt</b>					
221-222	Bonds LESS Reacquired Bonds	F-26	\$ 468,449,965.00	\$ 468,460,654.00	\$ 10,689.00
223	Advances from Associated Companies	F-28		\$ -	\$ -
224	Other Long-Term Debt	F-26		\$ -	\$ -
	<b>Total Long-Term Debt</b>		\$ 468,449,965.00	\$ 468,460,654.00	\$ 10,689.00
<b>Current and Accrued Liabilities</b>					
231	Notes Payable	F-25		\$ -	\$ -
232	Accounts Payable	-	\$ 22,539,518.00	\$ 30,020,900.00	\$ 7,481,384.00
233, 234	Payables to Associated Companies	F-27	\$ 42,481,540.00	\$ 101,068,889.00	\$ 58,588,349.00
235	Customer Deposits	-		\$ -	\$ -
236	Taxes Accrued	F-28	\$ (6,222,299.00)	\$ (1,284,397.00)	\$ 3,937,902.00
237	Interest Accrued	F-27	\$ 4,148,603.00	\$ 4,369,818.00	\$ 211,215.00
239	Dividends Declared	-		\$ -	\$ -
239	Matured Long-Term Debt	-		\$ -	\$ -
240	Matured Interest	-		\$ -	\$ -
241	Tax Collections Payable	-	\$ 1,325,805.00	\$ 1,330,437.00	\$ 4,632.00
242	Miscellaneous Current and Accrued Liabilities	F-27	\$ 8,931,454.00	\$ 13,877,550.00	\$ 4,746,096.00
	<b>Total Current and Accrued Liabilities</b>		\$ 74,204,619.00	\$ 149,174,197.00	\$ 74,969,578.00
<b>Deferred Debits</b>					
251	Unamortized Premium on Debt	F-21	\$ -	\$ -	\$ -
252	Advances for Construction	F-30	\$ 57,779,068.00	\$ 58,162,733.00	\$ 383,665.00
253	Other Deferred Credits	-	\$ 485,924.00	\$ 4,104,273.00	\$ 3,618,349.00
255	Accumulated Deferred Investment Tax Credits	F-33	\$ 5,380,491.00	\$ 5,172,657.00	\$ (207,834.00)
261-283	Accumulated Deferred Income Taxes	F-36	\$ 240,680,350.00	\$ 289,110,543.00	\$ 28,430,193.00
	<b>Total Deferred Debits</b>		\$ 304,325,833.00	\$ 338,550,206.00	\$ 32,224,373.00
281-285	Operating Reserves	F-37	\$ (3.00)	\$ (4.00)	\$ (1.00)
271	Contributions in Aid of Construction	F-37	\$ 201,765,807.00	\$ 203,703,915.00	\$ 1,938,108.00
	<b>Total Equity Capital, Liabilities and Other Debits</b>		\$ 1,524,902,053.00	\$ 1,644,688,785.45	\$ 119,784,732.45
	* Difference between Equity & Liabilities and Assets (from PgF-10)		\$ -	\$ (0)	
					Indicates Link to Another Worksheet within Workbook
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