

Exhibit No.:
Issues: Bad Debt Expense, Insurance Other
Than Group, Fuel &
Power/Chemicals/Purchased Water,
Property Taxes, Waste Disposal
Witness: Donald J. Petry
Exhibit Type: Rebuttal-CORRECTED
Sponsoring Party: Missouri-American Water Company
Case No.: WR-2008-0311
SR-2008-0312
Date: October 3, 2008

MISSOURI PUBLIC SERVICE COMMISSION

**CASE NO. WR-2008-0311
CASE NO. SR-2008-0312**

REBUTTAL TESTIMONY

OF

DONALD J. PETRY

ON BEHALF OF

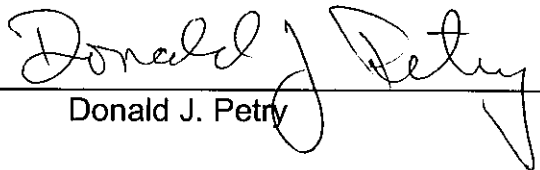
MISSOURI-AMERICAN WATER COMPANY

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

IN THE MATTER OF MISSOURI-AMERICAN)	
WATER COMPANY FOR AUTHORITY TO)	
FILE TARIFFS REFLECTING INCREASED)	CASE NO. WR-2008-0311
RATES FOR WATER AND SEWER)	CASE NO. SR-2008-0312
SERVICE)	

AFFIDAVIT OF DONALD J. PETRY

Donald J. Petry, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Corrected Rebuttal Testimony of Donald J. Petry"; that said testimony and schedules were prepared by him and/or under his direction and supervision; that if inquires were made as to the facts in said testimony and schedules, he would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his knowledge.



Donald J. Petry

State of Missouri
County of St. Louis
SUBSCRIBED and sworn to
Before me this 3rd day of October 2008.



Notary Public

My commission expires:

Staci A. Olsen
Notary Public - Notary Seal
State of Missouri
St. Charles County
Commission # 05519210
My Commission Expires: March 20, 2009

**CORRECTED REBUTTAL TESTIMONY
DONALD J. PETRY
MISSOURI-AMERICAN WATER COMPANY
CASE NO.WR-2008-0311
CASE NO.SR-2008-0312**

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3 **CORRECTED REBUTTAL TESTIMONY**
4

5 **DONALD J. PETRY**
6

7 **WITNESS INTRODUCTION**
8

9 **Q. PLEASE STATE YOUR NAME, TITLE AND BUSINESS ADDRESS.**

10 A. Donald J. Petry, Financial Analyst III for American Water, 727 Craig Road, St.
11 Louis, Missouri 63141.
12

13 **Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THIS PROCEEDING?**

14 A. Yes, I submitted direct testimony in this proceeding.
15

16 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

17 A. The purpose of my rebuttal testimony is to respond to the Staff Report regarding
18 the following issues on behalf of MAWC:

- 19 1) Bad Debt Expense
20 2) Insurance Other than Group
21 3) Fuel and Power
22 4) Chemicals
23 5) Purchased Water
24 6) Property Taxes; and,
25 7) Waste Disposal
26

27 **(1) BAD DEBT EXPENSE**
28

29 **Q. WHAT IS THE ISSUE REGARDING BAD DEBT EXPENSE?**

30 A. There are two issues between Staff and Company regarding bad debt expense.
31 First, there is the method by which bad debt expense is normalized for purposes
32 of the test year. Second, there is an issue as to whether or not there should be a
33 bad debt expense attributable to the additional revenues that result from a rate

1 increase in this case.

2

3 **Q. HOW DO COMPANY AND STAFF DIFFER REGARDING THE CALCULATION OF**
4 **BAD DEBT EXPENSE?**

5 A. Staff calculates a five year average of bad debt expense for all districts except St.
6 Louis, Warren County Water, and Cedar Hill. For St. Louis, a four year average was
7 used. And for Warren County Water and Cedar Hill, a three year average was used.

8

9 **Q. HOW DID THE COMPANY COMPUTE BAD DEBT EXPENSE?**

10 A. The Company took its bad debt expense for the last three years (i.e., 2005, 2006 and
11 2007) and divided that total by billed revenues for the same three years to arrive at a
12 three year average percentage of bad debts to billed revenues, or a bad debt ratio.
13 This ratio, or percentage, was then applied to the proforma revenues at present rates
14 to arrive at a normalized bad debt expense.

15

16 **Q. WHY DOES THE COMPANY PROPOSE THE USE OF A THREE YEAR**
17 **AVERAGE?**

18 A. Bad debts have been trending upward, as shown below, for the years 2003
19 through 2007. The exception is 2007 which is attributed mainly to a change in
20 the methodology for calculating the uncollectible provision.

Year	2003	2004	2005	2006	2007
Bad Debt					
Ratio	0.8232%	1.0891%	1.1972%	1.3730%	0.7113%

21

22

23 Of significance is the fact that the bad debt ratio for the first eight months of 2008 is
24 1.2172%. Clearly, the use of data from years 2003 and 2004 in a five year average
25 will understate the actual level of bad debt expense the Company is currently
26 experiencing and will experience in the future. Thus, the three year average used by
27 the Company more accurately reflects the increasing trend in bad debt expense.

28

29 **Q. HAS STAFF UTILIZED A THREE YEAR PERIOD IN THE PAST?**

1 A. It is my understanding that Staff used a three year average in the Company's 2004
2 rate case, Case No. WR-2003-0500 and WC-2004-0468.

3
4 **Q. DID STAFF CALCULATE A BAD DEBT EXPENSE ASSOCIATED WITH THE**
5 **ADDITIONAL REVENUES TO BE RECEIVED AS A RESULT OF A RATE**
6 **INCREASE IN THIS CASE?**

7 A. No.

8
9 **Q. WHY DOES THE COMPANY APPLY A BAD DEBT RATIO TO THE PROFORMA**
10 **REVENUES AT PROPOSED RATES?**

11 A. There is a direct relationship between revenues and bad debt expense. In other
12 words, as revenues increase, bad debt expense increases as well. Attached is
13 Rebuttal Schedule DJP-1, prepared and provided to me by Staff, which demonstrates
14 this direct relationship in all but one of the past five years. The 2006 to 2007 trend
15 was impacted due to a change in the methodology for calculating the uncollectible
16 reserve and a one time write off of accounts over 180 days. By applying the bad
17 debt ratio to proforma or anticipated revenues resulting from this case, the bad debt
18 expense will be more accurately reflected for the period of time rates set in this case
19 will be in effect.

20
21 **Q. HAS THE COMMISSION PREVIOUSLY RECOGNIZED THE RELATIONSHIP OF**
22 **BAD DEBTS TO REVENUES?**

23 A. Yes. In its Report & Order, issued December 21, 2006, in Case No. ER-2006-0314
24 (Kansas City Power & Light), the Commission found it "more probable, and therefore
25 just and reasonable, that an increase in the amount of revenue that KCPL is allowed
26 to collect from its Missouri retail ratepayers will result in a corresponding increase in
27 bad debt expense."

28
29 **Q. WHAT IS THE IMPACT OF THE COMPANY'S METHOD OF CALCULATING BAD**
30 **DEBT EXPENSE OVER THAT UTILIZED BY STAFF?**

31 A. Staff's bad debt adjustment of \$303,421 would increase by \$648,149 to \$951,570
32 using the Company's method.

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1 **(2) INSURANCE OTHER THAN GROUP**

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Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY REGARDING INSURANCE OTHER THAN GROUP?

A. The Company has two issues with the Staff's calculation of its level of proforma Insurance Other Than Group expense.

First is the exclusion of the allocated cost of the Directors & Officers ("D & O") and the Kidnap & Ransom ("K & R") coverage. Second is the application of the payroll O&M percentage, or the allocation between expense and capital.

Q. WHAT IS THE ISSUE WITH THE EXCLUSION OF THE COST FOR THE DIRECTORS & OFFICERS AND KIDNAP & RANSOM COVERAGES?

A. The Staff Report – Cost of Service states on page 42 that Staff proposed an adjustment to annualize insurance expense to reflect the premiums paid through March 31, 2008, however, D & O and K & R coverages have been excluded. The Staff Report does not include an explanation of why the expense associated with this coverage was excluded.

Q. IS D&O INSURANCE A NECESSARY AND CUSTOMARY BUSINESS EXPENSE FOR AWW AND ITS SUBSIDIARIES?

A. Yes. Without a policy of insurance to indemnify and defend its Board of Directors and its corporate officers, AWW would find it extremely difficult to recruit qualified persons to serve on its Board of Directors or in the capacity of executive management.

Q. WHY WOULD IT PRESENT A PROBLEM FOR AWW?

A. As a publicly traded company, AWW, its directors and officers are subject to the Securities Exchange Commission Act (SEC) and the Sarbanes Oxley Act (SOX), as well as many other federal and state regulations. The SOX legislation establishes new or enhanced standards for all U.S. public company boards, management, and public accounting firms. SOX contains 11 titles, or sections, ranging from additional Corporate Board responsibilities to criminal penalties,

1 and requires the SEC to implement rulings on requirements to comply with the
2 new law. SOX also covers issues such as auditor independence, corporate
3 governance, internal control assessment, and enhanced financial disclosure.
4 Prospective internal and external candidates, who are invited to a company, are
5 subject to potential litigation in civil and criminal courts. These many complex
6 and demanding corporate governance obligations are accompanied by potential
7 fines and penalties and possible civil and even criminal liabilities. Any individual
8 taking on such risks will expect and demand insurance coverage for claims that
9 may be lodged in connection with the performance of these and other
10 responsibilities.

11
12 **Q. WHAT ABOUT K&R INSURANCE COVERAGE?**

13 A. K&R insurance is also considered to be a necessary and customary expense for
14 AWW. This type of insurance coverage provides protection against kidnapping
15 and extortion threats against senior officials of AWW, here or abroad.
16 Additionally, AWW and the water industry have been designated as part of the
17 United States critical infrastructure by the Department of Homeland Security. As
18 such, the concerns about risks to senior Company officials are heightened by the
19 possible threat of terrorist acts of extortion against the Company.

20
21 **Q. HAVE D&O AND K&R INSURANCE COVERAGE PREVIOUSLY BEEN
22 INCLUDED IN MAWC'S COST OF SERVICE?**

23 A. In case WR-2003-0500, both coverages were included in the Staff's calculation
24 of cost of service.

25
26 **Q. SHOULD THAT PORTION OF AWW'S D&O AND K&R COVERAGE EXPENSE
27 ALLOCATED TO MAWC BE INCLUDED IN MAWC'S COST OF SERVICE?**

28 A. Yes. The Directors and Officers and Kidnap and Ransom coverages in the
29 amount of \$18,228 are prudent business expenditures and should be allowed.
30 This type of expense is crucial to the Company's ability to recruit and maintain
31 qualified individuals to serve on its Board of Directors and in the capacity as
32 senior Company officers. These expenses are considered customary,
33 particularly for large, publicly traded corporations.

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Q. WHAT IS THE ISSUE REGARDING THE APPLICATION OF THE O&M PERCENTAGE TO THE VARIOUS INSURANCE COSTS?

Staff has taken the position that a portion of the expense associated with all insurance policies should be capitalized. In order to allocate insurance policy costs between expense and capital, Staff uses a three year average of the allocation of labor to Operation & Maintenance (O&M) expense and capital, which results in approximately 60% of the insurance cost going to O&M expense and 40% being capitalized. The Company does not believe that Staff's method properly allocates enough Insurance Other Than Group costs to expense (or stated another way, the Company believes that Staff's method improperly capitalizes too much of the Insurance Other Than Group expense).

Q. WHAT TYPES OF INSURANCE COVERAGE SHOULD HAVE A PORTION OF THEIR COST CAPITALIZED BASED ON O&M PAYROLL ALLOCATION?

A. Workers compensation and auto liability insurance have a significant correlation to the activity of the Company's labor force. Therefore, an allocation of those insurance costs between capital and expense based on a payroll O&M allocation factor makes sense. The remaining insurance policies, such as general liability and property, are not related to the activities of the labor force and therefore should not be allocated between capital and expense based upon a labor O&M allocation factor. For example, the largest cost, insurance policy is for general liability insurance. For purposes of this case, and based on discussions with Missouri-American operations personnel, it was estimated that 90% of the liability claims relate to either main breaks or trip and fall accidents and that only 10% was related to capital projects. In fact, when the Company became aware that this was still an issue at the prehearing conference, the Company performed an analysis of claims for years 2005 through 2007. Based on this review, the Company determined that 96.38% of the claims were O&M related and only 3.62% were related to capital. Therefore, the Company's proposed allocation of 90% to O&M and 10% to capital for liability and property insurance coverage is conservative and ought to be adopted. Finally, the broker service fee O & M allocation was based on a composite O & M rate applied to all the Insurance Other Than Group coverages.

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Q. WHAT IS THE DIFFERENCE BETWEEN STAFF AND COMPANY ON EACH OF THE ISSUES RELATING TO INSURANCE OTHER THAN GROUP?

A. Staff's total cost of Insurance Other Than Group is \$3,360,252. Based on my rebuttal, the revised level of insurance cost should be \$4,346,866, or \$986,614 greater than Staff's cost as shown below.

Staff Recommended Level			\$ 3,360,252
Capitalization	\$	968,386	
Directors & Officers and Kidnap & Ransom	\$	18,228	\$ 986,614
Company Recommended Level			\$ 4,346,866

8
9

(3, 4, 5) FUEL & POWER/CHEMICALS/PURCHASED WATER

11

Q. WHAT IS THE ISSUE REGARDING THESE EXPENSES?

A. The Company and Staff disagree on the proper level of fuel, power, chemical and purchased water expense as a result of other disagreements they have regarding 1) the proper level of test year sales; 2) Staff's adjustment to limit the amount of non-revenue sales; 3) Company's adjustment to reflect increased fuel power and chemical costs associated with new treatment process; and 4) increased power and chemical costs occurring after March 31, but prior to the true-up (i.e., September 30, 2008).

20

Q. PLEASE EXPLAIN EACH OF THE DIFFERENCES AS YOU UNDERSTAND THEM.

A. The Company and Staff disagree on the appropriate level of sales for the test period. Company witnesses Grubb and Spitznagel address this issue. To the extent the Commission agrees that the Company's proposed level of sales is appropriate, then the Company's corresponding fuel power chemical and purchased water expenses would be appropriate as well. Staff has proposed to limit the amount of non-revenue water in each district to no more than 15%. Company witness Kartmann addresses

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1 this issue at length in his rebuttal testimony. To the extent the Commission agrees
2 with the Company on this issue, then the Company's fuel power, chemical and
3 purchased water expense would also be appropriate. The Company also anticipates
4 changes in its treatment process on a go-forward basis. Company witness Kartmann
5 addresses this in his rebuttal testimony. To the extent the Commission agrees with
6 the Company on this issue, then Company's associated fuel power, chemical and
7 purchased water expense is appropriate. Finally, the Company is experiencing
8 increased fuel power and chemical costs that have occurred after March 31, 2008,
9 but prior to the true-up date (i.e., September 30, 2008). We believe Staff will be
10 picking up these increased costs in their true-up. However, to the extent that is not
11 the case, then we would have an issue in that regard as well.

12
13 **(6) PROPERTY TAXES**
14

15 **Q. WHAT IS THE ISSUE REGARDING PROPERTY TAX EXPENSE?**

16 A. Staff used per books utility plant at December 31, 2007 for the calculation of the
17 property tax expense. The Company believes that property tax should be
18 updated through March 31, 2008 and ultimately trued-up through September 30,
19 2008.

20
21 **Q. DOES STAFF'S METHOD ACCURATELY REFLECT THE PROPERTY TAXES
22 THAT WILL BE EXPERIENCED BY MAWC?**

23 A. No. Since December 31, 2007, MAWC has placed an additional \$133,164,911 of
24 plant in service. Staff's approach makes no provision for this additional plant,
25 and the additional property taxes that will be generated by the plant.

26
27 **Q. WHAT IS THE IMPACT OF STAFF'S APPROACH ON THE REVENUE
28 REQUIREMENT IN THIS CASE?**

29 A. As of March 31, 2008, this creates a difference between the Company and Staff
30 cases in the amount of \$119,687. This difference will increase as of the true-up
31 date, September 30, 2008.

1 **Q. WHEN WILL MAWC BEGIN TO INCUR THE PROPERTY TAXES**
2 **ASSOCIATED WITH THE PLANT THAT IS PLACED IN SERVICE DURING**
3 **2008?**

4 **A.** MAWC will incur the property tax expenses associated with this property on its
5 books as of January, 2009.

6

7

(7) WASTE DISPOSAL

8

9 **Q. WHAT EXPENSES DOES MAWC HAVE ASSOCIATED WITH WASTE**
10 **DISPOSAL?**

11 **A.** The sludge/waste is removed from lagoons and hauled away by contractors, or
12 the waste is treated by a municipal sewer system.

13

14 **Q. IN WHAT DISTRICTS DOES MAWC INCUR THIS EXPENSE?**

15 **A.** MAWC incurs this expense associated with its water systems in St. Louis, St.
16 Joseph, Mexico, Joplin and Brunswick. It also incurs this expense for its sewer
17 systems in Parkville, Cedar Hill and Warren County. Parkville is the only area
18 that has the waste treated by a municipal sewer. The remaining water and sewer
19 systems have the lagoons cleaned and the waste hauled away.

20

21 **Q. HOW DID STAFF CALCULATE ITS ADJUSTMENTS FOR WASTE**
22 **DISPOSAL?**

23 **A.** Staff utilized a two-year average for St. Louis, St Joseph, and Cedar Hill; test
24 year expense for Mexico and Warren County; and, a three-year average for
25 Joplin, Brunswick and Parkville Sewer.

26

27 **Q. DOES MAWC DISAGREE WITH THE STAFF'S ADJUSTMENTS?**

28 **A.** Yes. MAWC disagrees with the adjustment used by Staff for Warren County.

29

30 **Q. WHY DOES MAWC DISAGREE WITH THE WARREN COUNTY ADJUSTMENT?**

31 **A.** In Warren County, Staff used test year expense, which at that time was thought
32 to be the only information available. MAWC has since discovered that these
33 waste disposal costs were being charged to another account than was provided

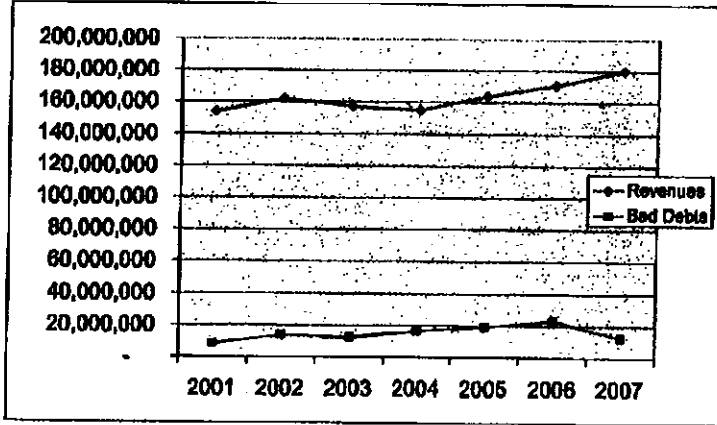
1 to Staff. Attached as Rebuttal Schedule DP-4, is a schedule showing the
2 applicable invoices. Those invoices total \$26,395, for the test year. Utilizing this
3 correct amount would result in an increase over Staff's adjustment in the amount
4 of \$24,795.

5

6 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

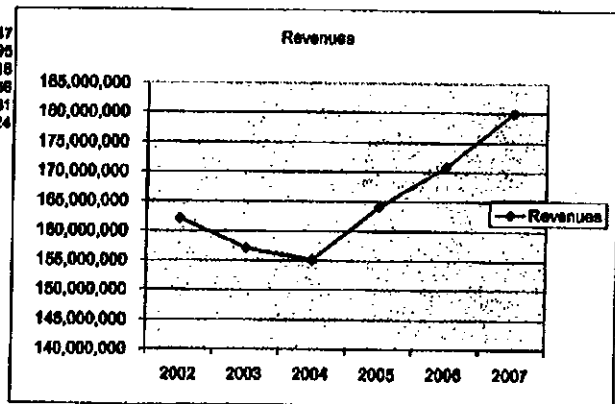
7 **A. Yes.**

	Revenues	Bad Debts	
2001	153,904,878	8,759,230	5.68%
2002	162,036,847	14,047,760	8.67%
2003	158,986,965	12,824,480	8.23%
2004	154,586,918	16,878,080	10.99%
2005	164,047,266	19,636,690	11.97%
2006	170,853,331	23,458,160	13.73%
2007	179,899,724	12,796,690	7.11%



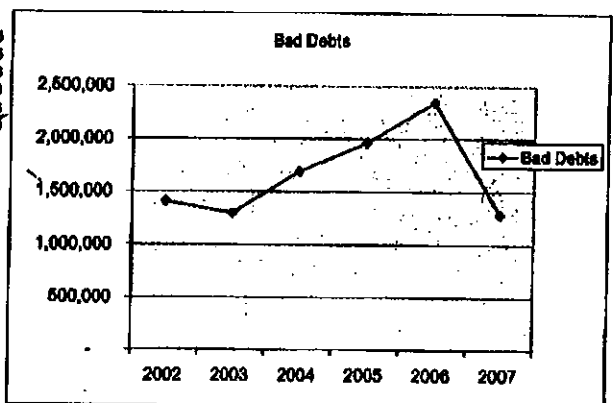
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	Revenues
2002	162,036,847
2003	158,986,965
2004	154,586,918
2005	164,047,266
2006	170,853,331
2007	179,899,724



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	Bad Debts
2002	1,404,775
2003	1,282,445
2004	1,687,806
2005	1,963,689
2006	2,345,818
2007	1,279,690



Missouri-American Water Company
Waste Disposal Warren County Sewer
Invoice Listing for Test Year

Sum of Amount										
BU	Account	Transaction	Document	Description	Month	Year	Grand Total			
WARNWW-Field Services	535000	PV	41487569	B J Septic and Excavation	1	390	390			
			41487575	B J Septic and Excavation	1	390	390			
			41492110	B J Septic and Excavation	1	750	750			
			41492800	Wentzville, City of	1	280	280			
			41528664	Wentzville, City of	2	1600	1600			
			41572267	B J Septic and Excavation	4	1365	1365			
			41582835	B J Septic and Excavation	5	1580	1580			
			41583409	Wentzville, City of	5	1232	1232			
			41585773	Wentzville, City of	5	1408	1408			
			41619438	B J Septic and Excavation	6	500	500			
			41629742	B J Septic and Excavation	6	390	390			
			41639378	Wentzville, City of	7	352	352			
			41641307	Wentzville, City of	7	352	352			
			41657254	B J Septic and Excavation	7	390	390			
			41669135	B J Septic and Excavation	8	780	780			
			41669138	Wentzville, City of	8	1056	1056			
			41693213	B J Septic and Excavation	9	1365	1365			
			41696283	B J Septic and Excavation	9	1365	1365			
			41702661	Wentzville, City of	9	1056	1056			
			41702665	B J Septic and Excavation	9	975	975			
			41711073	B J Septic and Excavation	9	390	390			
			41722338	B J Septic and Excavation	10	780	780			
			41722340	B J Septic and Excavation	10	338.8	338.8			
			41731953	Wentzville, City of	10	1408	1408			
			41742639	B J Septic and Excavation	11	390	390			
			41742647	B J Septic and Excavation	11	1170	1170			
			41758291	B J Septic and Excavation	11	195	195			
			41758415	B J Septic and Excavation	11	355	355			
			41765245	B J Septic and Excavation	11	1580	1580			
			41767912	Wentzville, City of	12	704	704			
			41772126	B J Septic and Excavation	12	50	50			
			41791480	B J Septic and Excavation	12	760	760			
			41796141	Wentzville, City of	12	704	704			
			WARNWW-Field Services Total						26361	26361
			Grand Total						26361	26361