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Witness:	John M. Watkins
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Sponsoring Party:	Missouri-American Water Company
Case No.:	WR-2020-0344
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MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. WR-2020-0344

**REBUTTAL TESTIMONY
REVENUE REQUIREMENT**

OF

JOHN M. WATKINS

ON BEHALF OF

MISSOURI-AMERICAN WATER COMPANY

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**REBUTTAL TESTIMONY
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JOHN M. WATKINS**

I. INTRODUCTION, PURPOSE OF TESTIMONY AND RECOMMENDATIONS

Q. Please state your name and business address.

A. My name is John M. Watkins. My business address is 1 Water Street, Camden, NJ 08102.

Q. On whose behalf are you submitting this testimony?

A. Missouri-American Water Company (“MAWC” or “the Company”).

Q. Did you previously provide direct testimony in this proceeding?

A. Yes.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my revenue requirement rebuttal testimony is to respond to the criticisms raised by others in their direct testimony regarding MAWC’s proposed future test year and to reaffirm the appropriateness of utilizing a future test year for ratemaking purposes.

II. RATE CASE TEST YEAR

Q. Do witnesses from Staff and intervenors address the Company’s proposed use of a future test year in this proceeding?

A. Yes. Office of the Public Counsel (“OPC”) witness Geoff Marke, Missouri Industrial Energy Consumers (“MIEC”) witness Greg R. Meyer, and the Staff Report – Cost of Service (“COS Report”), as sponsored by Staff witness Kimberly K. Bolin, all address and object to the Company’s use of a future test year based on various criticisms. Those

1 criticisms are misplaced and, in many cases, actually serve to demonstrate why the future
2 test year is a particularly appropriate ratemaking mechanism for a water company, as
3 opposed to a historic test year.

4 **Q. Do witnesses from Staff and intervenors address any of the specific adjustments**
5 **included in the Company’s proposed future test year?**

6 A. No, they do not. Staff witness Bolin addressed the future test year concept as a theory and
7 discussed specific items for the Commission to consider if it elected to implement a future
8 test year. Staff indicated it will provide specific comments regarding the details of the
9 Company’s future test year proposal in rebuttal testimony. The Company will respond to
10 any such testimony, if filed, in its surrebuttal testimony.

11 **Q. Staff’s COS Report indicates that a future test year relies on “speculative data” that**
12 **is an “inherently less reliable foundation for ratemaking purposes”. (COS Report, p.**
13 **6). Do you agree with this statement?**

14 A. No. I fundamentally disagree with the claim that our data is “speculative.” Our future test
15 year is no more “speculative” than stale historical information that we know to be
16 unrepresentative of trends that occur immediately after the conclusion of the historic test
17 year. The National Regulatory Research Institute October 2013 Report, also referenced in
18 the Staff’s COS Report, is instructive when it states:

19 “6. How do commissions determine the accuracy of forecasts, which after all is the
20 most important and difficult challenge they face with an FTY? Are the forecasts,
21 for example, reasonably accurate and compatible with prudent utility
22 management?”

23 * * * * *

24 As part of standard reporting in rate cases, commissions may require a utility to
25 provide a verifiable link or bridge between an historical and a future test year as a
26 point of reference. Without this benchmark, parties reviewing a utility’s filing
27 would find it more difficult to review the forecasts. As an example, the historical

1 test year can represent the baseline. (p.2 and FN 6)
2

3 The historical test year is the baseline that, along with the updates, provide a verifiable link
4 or bridge between an historical and a future test year as a point of reference. The base year
5 (historical test year - December 31, 2019) update and true up periods (June 30, 2020 and
6 December 31, 2020) are “Calibration points” that can be used to gauge the accuracy and
7 reasonableness of the forecast.
8

9 The Company carefully projected the adjusted, normalized test year data based on either
10 known increases or demonstrable cost trends that are fully explained by MAWC witness
11 Nikole Bowen and other MAWC witnesses. In the case of revenue, we have years of data,
12 informed by national trends and local conditions, all of which are fully explained by
13 MAWC witness Roach. For rate base, our plant in service projections are, fully
14 demonstrated by individual projects and known levels of blanket activity, all of which are
15 explained by MAWC witnesses Kaiser and LaGrand. The Company has no incentive to
16 overstate these cost elements, and they are laid out with full transparency. Moreover, if
17 this were a problem it would have long been manifested in the jurisdictions that employ
18 future test periods. To the best of my knowledge, it has not been so proven.

19 **Q. OPC witness Marke similarly testified that a future test year “unnecessarily**
20 **increase[s] uncertainty for ratepayers”. (Marke DT, p. 7). Is this an accurate**
21 **assessment?**

22 A. No. Witness Marke stated in his direct testimony that the Commission uses ratemaking
23 principles that “ensure utility rates are set at a level no more than necessary to provide safe
24 and adequate service at a just and reasonable price.” (Marke DT, p.7). This is exactly what

1 the Company has requested using the matching principle with known and measurable
2 adjustments that accurately reflect the revenues and expenses that the Company will incur
3 during the first year rates are authorized, in other words, the future test year.

4 **Q. Staff witness Bolin further criticized a future test year stating “that the incentives for**
5 **a utility to minimize increases in its cost of service over time will inherently be less**
6 **when forecasts of an increasing cost of service are used to set rates”. (COS Report,**
7 **p. 6-7). Is this an accurate assessment by Staff?**

8 A. No. As far as the tendency of the future test year to minimize the Company’s incentive to
9 control costs, I would point out that cost control is a company-wide endeavor at American
10 Water and is not limited to MAWC. Given that many of our utilities operate in jurisdictions
11 using a future test year, this claim that we would ignore cost control under a future test year
12 regime is incorrect. Staff’s claim that “the Commission’s directive to set just and
13 reasonable rates must be “fair to both the utility and its customers”” appears to ignore the
14 fact that the historical test year regime followed to date has not been fair to the Company
15 because it has produced consistently lower earnings for MAWC than were anticipated in
16 the Commission’s orders. (COS Report, p.7). This is especially vexing when one considers
17 the acknowledged fact that the Company has carefully and successfully controlled its O&M
18 expenses. (Dewey DT, p. 9). Given the Company’s demonstrated efficiency, the fault lies
19 with the ratemaking method, not the Company’s management.

20 **Q. Do any other parties to the case address the Company’s proposed future test year?**

21 A. Yes. MIEC witness Meyer also addresses the future test year theoretically and offers
22 various criticisms to the use of a future test year in this case.

1 **Q. In the Direct Testimony of MIEC witness Meyer, he claims that “MAWC proposes a**
2 **future test year in order to inflate costs and investments and to reflect reduced usage.”**
3 **(Meyer DT, p. 4). Do you agree with this statement?**

4 **A.** No. The rate case test year should produce rates that most accurately reflect the costs
5 during the period the rates are to be effective. Revenues, expenses, capital structure and
6 rate base all will change beyond the true up period and prior to rates actually taking effect.
7 Therefore, they should be an allowed adjustment to ensure that the revenues generated for
8 the future test year match the expenses, revenues, capital structure and rate base for the
9 same period. Contrary to MIEC witness Meyer’s contention, the investments made in rate
10 base and supported by the capital structure are actual projects which Mr. Kaiser supports
11 in his testimony. Those projects will be used and useful during the future test year. They
12 are not representative of some artificial or inflated dollar amount, but rather actual
13 investments that are planned and will be in service during the time rates will be in effect.

14 The same is true of the Company’s expenses. A future test year in no way incentivizes the
15 Company to overspend. Rather, as detailed further in the rebuttal testimony of Company
16 witness Kaiser, when MAWC can reduce operating expenses, it can increase investment in
17 infrastructure without increasing rates, because every dollar of operating expenses saved
18 can fund over \$8 of investment.

19 **Q. MIEC witness Meyer also claims that adopting a future test year as proposed by the**
20 **Company would “violate many of the regulatory principles this Commission has**
21 **historically relied on to set just and reasonable rates including the ‘used and useful’**
22 **standard for rate base additions and the ‘known and measurable’ standard for**

1 **calculating expenses and revenues.” (Meyer DT, p. 5). Do you agree with his**
2 **conclusion?**

3 **A.** No. As Company witness Mr. Roach has shown, declining usage will continue into the
4 future, which therefore makes it a known and measurable adjustment. Union increases,
5 which are part of a union’s contract, are also known and measurable and should be
6 recognized through the future test year. These are just two examples of changes that will
7 occur in the future test year. To ensure all areas of the revenue requirement match the
8 future test year, the Company proposed to make adjustments to ensure the matching
9 principle is followed and that the future test year has adjustments to expenses, revenues,
10 capital structure and rate base.

11 **Q.** **MIEC witness Meyer further claims that “Given that future events cannot be known**
12 **and that the cost implications cannot be measurable, the known and measurable**
13 **standard necessarily does not contemplate the use of forecasts and inflation factors as**
14 **proposed by MAWC.” (Meyer DT, p.8-9). Do you agree with this conclusion?**

15 **A.** No. The Company has calculated a future test year by normalizing a fully historical base
16 year (12 months ended December 31, 2019), continued to make adjustments through a
17 verifiable link period (through May 2021), and then made adjustments to the first year that
18 new rates are expected to be in place (12 months ending May 31, 2022). As discussed in
19 my direct testimony (Watkins, p. 25, lines 22-25):

20 A future test year solves the fundamental unfairness of “forcing a utility to operate
21 with outdated numbers” that differ disproportionately from their historical test year
22 levels - because it properly aligns the traceable forecast of a utility’s revenue,
23 expenses and investment with the first year for which rates are being set.

1 The Company has demonstrated through its development of the future test year that the
2 historical levels will continue to change through its forecast and that the future test year is
3 the best period of time to reflect the revenue requirement for this case.

4 **Q. MIEC witness Meyer further states that “MAWC has not proposed a reduction in its**
5 **recommended return on equity in the event that the Commission accepts its proposed**
6 **future test year.” (Meyer DT, p. 19). Do you believe that such a reduction is**
7 **appropriate?**

8 A. Company witness Bulkley will address this issue in her rebuttal testimony in this case.

9 **Q. In your Direct Testimony you conclude that a future test year is the most appropriate**
10 **time period for setting rates. In light of the criticisms raised by the parties to this case**
11 **discussed above, has your conclusion changed?**

12 A. No. As outlined in my direct testimony, the year in which rates will be effective is the
13 appropriate time period to be used in setting revenues, expenses, capital and rate base.
14 (Watkins DT, p. 21-22). Using those investments, expenses and revenues that will be
15 experienced during the period rates will be in effect is critical to just and reasonable
16 ratemaking. None of the criticisms raised by Staff or others in this case support deviating
17 from this principle.

18 **Q. Why is a future test period more appropriate than the historic test year relied on by**
19 **Staff and others in this case?**

20 A. A number of factors weigh in favor against using a historic test year for setting forward-
21 looking rates. First, declining usage, as supported by the direct testimony of Mr. Roach,
22 will continue to impact the Company during the period rates resulting from this case will

1 be in effect. This means that the use of any historical period for the setting of rates will
2 not produce the amount of revenue the Company will incur in the future. In addition,
3 merely updating the current case through December 31, 2020 ignores not only the five
4 months between the update and the actual rate effective date, but also the future test year
5 period of 12 months, which represents the first year the rates will be in effect. The same
6 is true for expenses, rate base and capital investments to finance the additional rate base.
7 The increases, which are known and measurable, between January 2021 and May 2021
8 should not be ignored. Likewise, new investment projects that are known and measurable
9 should not be ignored once placed in service.

10 **Q. Will any utility plant in service (“UPIS”) be added prior to the effective date of rates**
11 **that is not included in Staff’s revenue requirement?**

12 A. Yes. There will be \$72,974,395 of UPIS that will be used and useful prior to June 1, 2021.

13 **Q. Will this \$72.9 million of UPIS be used and useful prior to rates becoming effective?**

14 A. Yes, it will. The \$72.9 million of UPIS, will be placed into service after the true-up period,
15 but before rates are anticipated to become effective in this case.

16 **Q. If the declining usage adjustment, expenses and rate base were all set as of the**
17 **operation of law date, what would you describe that period as being?**

18 A. My direct testimony describes that as a current test year. A current test year allows all
19 adjustments up to the day before the rate increase becomes effective. This effectively
20 allows rates to be set on the current business trends.

21 **Q. Does Staff’s position support a current test year?**

1 A. No. Staff’s position goes up to December 31, 2020. This matches what I describe as a
2 historical test year in my direct testimony. Staff does make adjustments from the base year
3 (twelve months ended December 31, 2019) to reflect known and measurable changes
4 through June 30, 2020, and projects changes through December 31, 2020. But there is a
5 5-month gap between that period and the actual effective date of rates.

6 **Q. What do you recommend if a future test year is not approved in this case?**

7 A. I would recommend that a current test year be used. This would include all proposed
8 changes through May 2021 and would more accurately reflect rates for the day rates became
9 effective.

10 **Q. Do you believe this is the best period of time to use?**

11 A. No. I do not think the current test year is the best period of time to use, as it will
12 immediately be out of date the day after rates go into effect, but it is still more accurate
13 than a historical period or even the use of a historic true-up period ending December 31,
14 2020.

15 **Q. What is the most appropriate period of time to use?**

16 A. A future test year is the most appropriate period of time to use because it matches all of the
17 factors in the revenue requirement for the year for which rates are set.

18 **Q. Has Staff or other intervenors addressed the Revenue Stabilization Mechanism
19 (“RSM”) that the Company proposed in this case?**

20 A. No, Staff stated that they “will address the specifics of MAWC’s proposal, Staff’s thoughts
21 on MAWC’s proposal, and any alternative to MAWC’s proposal; in Staff’s rebuttal

1 testimony.” (Busch DT, page 14,). Therefore, the Company reserves the right to address
2 RSM in surrebuttal testimony. MIEC witness Meyer addressed the RSM in his rate design
3 testimony, therefore the Company will address the RSM in rate design rebuttal testimony.

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

5 A. Yes.