

Exhibit No.:
Issues: Hourly Wages Accrued in a Year,
Pension Tracker, Billing Services,
Allocation of Belleville Lab Costs, MSD
Contract, Acquisition Premiums and
Discounts, Business Transformation
Accounting Treatment
Witness: Dennis R. Williams
Exhibit Type: Rebuttal
Sponsoring Party: Missouri-American Water Company
Case No.: WR-2011-0337
SR-2011-0338
Date: January 19, 2012

MISSOURI PUBLIC SERVICE COMMISSION

**CASE NO. WR-2011-0337
CASE NO. SR-2011-0338**

REBUTTAL TESTIMONY

OF

DENNIS R. WILLIAMS

ON BEHALF OF

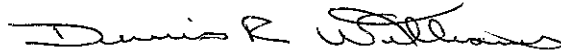
MISSOURI-AMERICAN WATER COMPANY

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-2011-0337
RATES FOR WATER AND SEWER)	CASE NO. SR-2011-0338
SERVICE)	

AFFIDAVIT OF DENNIS R. WILLIAMS

Dennis R. Williams, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Rebuttal Testimony of Dennis R. Williams"; 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.



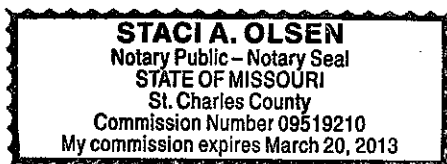
Dennis R. Williams

State of Missouri
County of St. Louis
SUBSCRIBED and sworn to
Before me this 17th day of January 2012.



Notary Public

My commission expires:



**REBUTTAL TESTIMONY
DENNIS R. WILLIAMS
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WR-2011-0337
SR-2011-0338**

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1 **REBUTTAL TESTIMONY**

2
3 **DENNIS R. WILLIAMS**

4
5 **WITNESS INTRODUCTION AND PURPOSE**

6
7 **Q. PLEASE STATE YOUR NAME, TITLE AND BUSINESS ADDRESS.**

8 A. My name is Dennis R. Williams, and my title is Senior Manager - Rates and
9 Regulation for the Western District of American Water Works. My business
10 address is 727 Craig Road, St. Louis, Missouri 63141.

11
12 **Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THIS PROCEEDING?**

13 A. Yes, I have submitted direct testimony in this proceeding on behalf of Missouri
14 American Water Company ("Missouri-American", "MAWC", or "Company").

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 and/or the
18 direct testimony of OPC and Intervenors as to the following issues:

- 19 1) Hourly Wages Accrued in a Year;
20 2) Pension Tracker;
21 3) Billing Services;
22 4) Allocation of Belleville Lab Costs;
23 5) MSD Contract;
24 6) Acquisition Premiums and Discounts; and
25 7) Business Transformation Accounting Treatment

26
27 **1) HOURLY WAGES ACCRUED IN A YEAR**

28
29 **Q. PLEASE EXPLAIN THIS ISSUE.**

30 A. In preparing pro forma levels of wages for hourly employees, both Staff and the
31 Company identify all hourly employees and their respective hourly wage level.
32 This wage level is multiplied times the number of work hours in a year to
33 determine pro forma hourly wages before overtime. The only difference between

1 Staff and Company methods is that Staff assumes there are 2080 base work
2 hours in a year and the Company utilizes 2088 hours. This results in a reduction
3 in the Staff calculation of revenue requirement of about \$102,242.
4

5 **Q. ISN'T DETERMINATION OF THE NUMBER OF HOURS IN A YEAR AS**
6 **SIMPLE AS LOOKING AT A CALENDAR?**

7 A. Yes. It seems that such a determination should be that simple and straight-
8 forward but this has been an ongoing issue for numerous rate cases.
9

10 **Q. CAN THE NUMBER OF ANNUAL WORK HOURS IN A YEAR VARY?**

11 A. Yes. The number of base work hours in any twelve month period can vary from
12 a low of 2080 hours to as high as 2096 work hours. Any twelve month period
13 that begins on a Saturday or Sunday will have 2080 work hours, except in a leap
14 year, which will have 2088 hours. Any twelve month period that begins on a
15 Monday through Friday will have 2088 work hours, except in a leap year, which
16 will have 2096.
17

18 **Q. IF THE HOURS VARY FROM PERIOD TO PERIOD, WHY DO YOU BELIEVE**
19 **THAT 2088 IS THE CORRECT NUMBER TO USE?**

20 A. Every four year period has the same number of work hours because leap years
21 and the limited number of months that begin on Saturdays and Sundays are
22 equalized over a four-year period. As shown on Rebuttal Schedule DRW-1, over
23 any four year period, more than 75% of every consecutive 12 month period will
24 contain either 2088 or 2096 hours. More importantly, the weighted average
25 annual base work hours is 2087.33 or approximately 2088 hours. On Rebuttal
26 Schedule DRW-1 is a listing of the business work days for the calendar years
27 2010 through 2014 and the derivation of the weighted average annual base work
28 hours discussed earlier. This is the information that was developed in support of
29 utilizing 2088 hours in the Company's direct case.
30

31 **Q. HAS THE STAFF CALCULATED SIMILAR WEIGHTED AVERAGE ANNUAL**
32 **BASE HOURS?**

33 A. Yes. Data request 0282 submitted to Staff by Company, asked "Please explain

1 Staff's rationale for utilizing 2,080 hours in its payroll adjustment as the number
2 of annualized hours for which an hourly worker will be paid on a pro forma basis.
3 Please provide copies of any studies or analysis that address this issue." In
4 response, Staff supplied calendars from January 2006 through December 2011.
5 Staff summarized these calendars to show that most calendar years reflected
6 only 2080 annual base work hours in a year. However, due to errors in the
7 calendars originally provided (exclusion of July 15 and July 29 from the 2008
8 calendar and exclusion of October 31 from the 2010 and 2011 calendars), Staff
9 provided a revised set of calendars with a new summary of data as reflected on
10 Rebuttal Schedule DRW-2. That schedule now reflects data that is consistent
11 with the Company developed data – that is, on average, twelve month periods
12 contain approximately 2088 base annual work hours.

13 14 **2) PENSION TRACKER**

15 16 **Q. DOES THE COMPANY HAVE IN PLACE A PENSION EXPENSE TRACKING** 17 **MECHANISM?**

18 **A.** Yes. The pension expense tracker was first approved in Case No. WR-2007-
19 0216. It has subsequently been renewed without significant change in Cases
20 WR-2008-0311 and WR-2010-0131.

21 22 **Q. HOW DOES THE PENSION TRACKER CURRENTLY WORK?**

23 **A.** There are two parts to the pension tracker. First, a level of pension expense is
24 established in the revenue requirement in setting rate based upon the FAS 87
25 pension expense that is estimated to be incurred annually while rates are in
26 effect. The calculation of FAS 87 pension expense is governed by generally
27 accepted accounting principles. At the time the next rate case is trued-up,
28 actual FAS 87 pension expense is compared to the amount that has been
29 collected in rates. The difference is recorded as a deferred regulatory asset or
30 liability and amortized over five years. This part of the mechanism reconciles
31 actual expenses accrued to rates paid by customers and insures that the
32 Company receives a return of the exact amount of pension expense incurred.
33 A second part of the pension trackers is a comparison of the FAS 87 expense to

1 cash contributions made to the pension fund. Cash contributions are generally
2 governed by the Employee Retirement Income Security Act (“ERISA”) and may
3 differ in a given year from the FAS 87 expense level, although over time they
4 should be equal. Because the actual cash paid by the Company may be more or
5 less than the recorded expense, the difference is tracked and a pension asset or
6 pension liability is included in rate base. This part of the mechanism is similar to
7 the establishment of prepaid assets or deferred tax reserves in rate base. It
8 insures that the Company receives a return on its funds if it has contributed more
9 than the expense level allowed in rates, but gives credit to customers for a return
10 on their funds if the amount they have paid in rates exceeds the contributions
11 made by the Company.

12
13 **Q. HAS THE STAFF RECOMMENDED THAT THE PENSION TRACKER BE**
14 **ELIMINATED?**

15 A. No. A tracking mechanism is appropriate for expense items that are volatile and
16 therefore may vary greatly from test year levels to levels during the period that
17 rates are in effect. Staff recommends keeping the tracker, but dramatically
18 changing the mechanism.

19
20 **Q. WHY HAS THE STAFF RECOMMENDED THIS CHANGE?**

21 A. The Staff’s Report on Cost of Service at page 31 states that Staff identified a
22 “flaw” in the operation of the current tracker mechanism. Staff explains this “flaw”
23 through a fairly lengthy passage that I will attempt to break down into its various
24 parts. First, the Staff states that the:

25 problem in the operation of the current FAS 87 tracker mechanism is that
26 it is based upon fluctuations in the Company’s ongoing FAS 87 expense
27 compared to the amount of FAS 87 included in MAWC’s rate levels.
28 However, if the amounts of MAWC’s annual trust fund contributions are
29 not based upon a FAS 87 expense measurement (and, as explained, they
30 currently are not), then there is no cash investment required of either
31 MAWC or its ratepayers associated with annual fluctuations in booked
32 FAS 87 pension.

33
34 **Q. DO YOU AGREE THAT THIS IS A “FLAW” IN THE CURRENT MECHANISM?**

35 A. No. All this says is that the expense recorded on the Company’s books under
36 generally accepted accounting principles may be different than the actual cash

1 expended in a specific year. That is nothing unusual as there are often
2 differences between actual cash expenditures and accrual accounting. For
3 example, a company may prepay for services that it has not yet received. An
4 expense would not be recorded until those services are provided even though
5 cash has already been expended. Similarly, taxes may be expensed on a
6 company's books even though cash payments for those taxes may be deferred
7 for several years. Ratemaking typically follows the generally accepted
8 accounting principles of accrual accounting in setting ongoing expense levels,
9 while giving recognition through adjustments to rate base to recognize the time
10 value of money for differences between those expense levels and actual cash
11 expenditures.

12
13 **Q. PLEASE CONTINUE WITH YOUR REVIEW OF THE STAFF'S DESCRIPTION**
14 **OF THE "FLAW" IN THE CURRENT MECHANISM.**

15 A. The discussion on page 31 of the Staff Report continues as follows:

16 A financial accounting difference that has no impact on a Company's or its
17 customers' cash investment requirements should not be included in utility
18 rate base. The "pension asset/liability" also included in MAWC's rate
19 base, is a more appropriate surrogate calculation of the Company's or
20 customers' cash requirements arising from the difference between the
21 results of a FAS 87 expense calculation on the Company's books and the
22 amount of its minimum ERISA trust fund contributions.
23

24 **Q. DO YOU AGREE THAT THIS IS A "FLAW" IN THE CURRENT MECHANISM?**

25 A. No. The first sentence in the quote above implies that no rate base treatment
26 should be afforded to the pension asset/liability. As previously explained, the
27 pension asset/liability does have an impact on cash investment requirements.
28 Inclusion of an item in rate base is to correctly compensate for the return on that
29 cash investment. If rate base exclusion was correct, then similarly, rate base
30 treatment should not be given to prepaid assets where the Company has
31 expended cash but not recorded an expense. Nor should rate base be reduced
32 for deferred taxes that have been expensed, but for which no cash has been
33 expended.

34 The second sentence in the Staff testimony quoted above seems to be
35 contradictory to the first. It states that the pension asset/liability is more

1 appropriate for calculating cash requirements for the difference between FAS 87
2 recorded expense and actual cash contributions. That is exactly the intent of the
3 second component of the pension tracker mechanism as described earlier in my
4 testimony. This is not a “flaw”. It is working correctly and exactly as intended.
5

6 **Q. HOW DID THE STAFF REPORT CONCLUDE ITS DESCRIPTION OF THE**
7 **CURRENT MECHANISM’S - “FLAW”?**

8 A. The paragraph concluded that “Given American Water’s current funding
9 practices, inclusion of both a FAS 87 rate base difference and a pension
10 asset/liability in rate base will most likely result in either an overstatement or an
11 understatement of MAWC’s actual pension’s rate base investment.”
12

13 **Q. DO YOU AGREE THAT THIS IS A “FLAW” IN THE CURRENT MECHANISM?**

14 A. No. I believe that it may demonstrate a lack of understanding that when the
15 tracker mechanism was designed several rate cases ago that there were two
16 distinct factors in the calculation – one for tracking the estimated expense level to
17 the actual expense level, and the other for tracking the time value of money
18 related to differences in the recorded expense level and actual cash
19 contributions. The two factors work together to compute correctly the return of
20 and return on components as designed.
21

22 **Q. STAFF HAS HAD THE OPPORTUNITY TO REVIEW THIS MECHANISM IN**
23 **PRIOR CASES. DO YOU HAVE ANY KNOWLEDGE AS TO WHY IT HAS**
24 **SUGGESTED A CHANGE ONLY AT THIS POINT IN TIME?**

25 A. No. I am aware that in the previous rate cases, the pension asset/liability was in
26 a negative position. In other words, cash contributions were less than the actual
27 recorded pension expense so rate base was reduced to give credit to customers
28 for the time value of money for the excess. It is apparent that at the time of true-
29 up this factor, which Staff has decided in this case is a “flaw”, will be added to
30 rate base because the Company contributions are in excess of recorded
31 expense. Eliminating this factor would reduce total revenue requirement in this
32 case, which would not have been the result in prior cases.
33

1 **Q. HOW DOES STAFF INTEND TO “CORRECT” THE PENSION TRACKER?**

2 A. Staff recommends that in the future the tracker should look at only the pension
3 cash investment. In other words, for ratemaking purposes, pension costs would
4 be put on a cash basis rather than an accrual basis.

5

6 **Q. DO YOU AGREE WITH THIS RECOMMENDATION?**

7 A. No. There is no good reason to set rates based upon cash accounting for one
8 item when rates are based on accrual accounting for other accounts. Accrual
9 accounting more accurately reflects cost causation and more fairly associates
10 revenue requirements with the parties who have created those costs. Moreover,
11 prior to the establishment of FAS 87, there were no clarified accounting rules
12 governing the accounting treatment of pension costs. At times there were valid
13 reasons for companies to make cash contributions to their pension funds in
14 excess of the ERISA minimum. On the other hand, companies could influence
15 earnings to some extent by making larger contributions than might otherwise be
16 necessary. This resulted in a number of contentious regulatory disagreements
17 as to the proper level of pension cost to be included in rates. There is no reason
18 to risk re-introducing these potential disputes that can arise under the vagaries of
19 cash accounting, when a generally accepted, standardized method for recording
20 pension expense levels has been established.

21

22

3) BILLING SERVICES

23

24 **Q. DOES MAWC PROVIDE BILLING SERVICES TO MUNICIPALITIES IN THE**
25 **DISTRICTS IN WHICH IT OPERATES?**

26 A. By law, the Company is required to provide water billing information to
27 municipalities and special sewer districts that rely upon water consumption to
28 charge their customers for wastewater services. For over twenty-five years,
29 MAWC or its predecessor companies, as a service to the communities it serves,
30 has also provided billing services for city operated services such as sewer and
31 trash collection. However, MAWC has notified all its municipal customers that it
32 will no longer provide these billing services.

33

1 **Q. DO YOU AGREE WITH THE STAFF'S RECOMMENDATION THAT ALL**
2 **BILLING SERVICE REVENUE DURING THE TEST YEAR SHOULD BE**
3 **REFLECTED AS OPERATING INCOME?**

4 A. No. First, this revenue is generated at little or no incremental cost. Customers
5 are paying their actual cost of service and are not disadvantaged by the service
6 provided to municipalities.

7 More importantly, it is a known and measureable certainty that the Company is
8 exiting this business and that no billing services revenue will be generated after
9 that exit is complete in 2012. Revenue from the provision of billing services to
10 municipalities will be negligible during the time that new rates are in effect. The
11 only other revenue generation will be the minimal amount associated with the
12 provision of meter reading information to municipalities and sewer districts as
13 required by law.

14
15 **Q. IS THE AMOUNT OF OTHER REVENUE FROM PROVISION OF METER**
16 **READING INFORMATION KNOWN AND MEASUREABLE?**

17 A. No. The revenue generated is expected to be relatively minor. There is no
18 definition of what constitutes a reasonable cost so each contract must be
19 individually negotiated. Municipalities and sewer districts are free to refuse to
20 enter into any contract and, in some cases, may have no need to contract for this
21 data. To date, the Company has successfully negotiated only one new contract.
22 That is with the City of Jefferson and should generate \$3,000 in revenue
23 annually. Whether the Company will be able to reach agreement with other
24 entities is unknown at this time.

25
26 **4) ALLOCATION OF BELLEVILLE LAB COSTS**

27
28 **Q. STAFF PROPOSES A REDUCTION OF MAWC'S EXPENSE TO**
29 **REALLOCATE THE INDIRECT PORTION OF THE BELLEVILLE LAB**
30 **SERVICE COMPANY COSTS BASED ON AN AVERAGE OF THE NUMBER**
31 **OF TEST ANALYSES PERFORMED AS OPPOSED TO AN ALLOCATION OF**
32 **COSTS BASED ON THE NUMBER OF CUSTOMERS. WHAT IS THE**
33 **BELLEVILLE LAB SERVICE COMPANY?**

1 A. The Belleville Lab is a water quality testing facility located in Belleville, Illinois that
2 is operated by American Water Works Service Company. This facility performs
3 sample testing for the American Water operating companies including MAWC.
4

5 **Q. DOES THE USE OF THE BELLEVILLE LAB PROVIDE SAVINGS FOR MAWC
6 AND ITS CUSTOMERS?**

7 A. Yes. The Belleville Lab conducts a survey to compare its testing costs to those
8 of outside testing laboratories. Outside labs have been found to be from 6% to
9 52% more expensive. Also, outside testing labs will charge higher fees for
10 evaluation of “rush” samples. The Belleville Lab does not.
11

12 **Q. HOW DOES THE BELLEVILLE LAB ALLOCATE COSTS TO MAWC?**

13 A. Those costs directly attributable to MAWC are charged accordingly. The indirect
14 costs are allocated to each of the operating companies based on the number of
15 customers they serve.
16

17 **Q. HOW DOES STAFF PROPOSE TO ALLOCATE THE INDIRECT COSTS FOR
18 RATEMAKING PURPOSES?**

19 A. The Staff Report proposes an adjustment that would represent an allocation of
20 the indirect costs based on an average of the number of test analyses performed
21 on all samples that were submitted to the Belleville Lab over the last five
22 calendar years.
23

24 **Q. WHY DOES STAFF ALLEGE THAT NUMBERS OF TESTS IS A MORE
25 APPROPRIATE METHOD FOR THE ALLOCATION OF THESE INDIRECT
26 COSTS?**

27 A. Staff is concerned that MAWC is receiving an allocation of indirect costs of
28 approximately 14.24% (based on customer count), while MAWC’s portion of test
29 analyses represents about 5.29% of the total tests performed.
30

31 **Q. ARE THESE PERCENTAGES LIKELY TO BE THE SAME EVERY YEAR?**

32 A. No. An operating company’s total samples can vary from one year to the next
33 because of source water conditions, contamination events and regulations.

1 Thus, an operating company's portion of Belleville Lab costs could vary widely
2 from one year to the next. I will discuss this later in my rebuttal testimony.

3
4 **Q. IS THE USE OF CUSTOMER COUNTS MORE STABLE?**

5 A. Yes. Customer counts are much less variable and do not change dramatically
6 from year to year on a system-wide basis.

7
8 **Q. DOES AWW ALLOCATE COSTS DIFFERENTLY FROM STATE TO STATE?**

9 A. No. It is system-wide policy to allocate Service Company expenses that cannot
10 be direct charged to operating companies on the basis of the number of
11 customers. Doing so makes practical sense, as it is easy to manage and
12 administer and it provides for system-wide consistency over multiple jurisdictions.
13 Customer numbers are currently used to allocate service company costs related
14 to accounting, administration, communications, corporate secretarial and legal,
15 customer services, engineering, financial human resources, information systems,
16 operations, rate and revenues and risk management. If each of these services is
17 examined on a Missouri-only basis for an alternative allocation methodology, I
18 suspect that some alternatives would increase costs currently allocated to
19 MAWC.

20
21 **Q. WHY IS CONSISTENCY FROM STATE TO STATE IMPORTANT?**

22 A. Applying different allocation methods from one jurisdiction to another will
23 undoubtedly lead to a situation where American Water is unable to recover all of
24 its Belleville Lab costs. Such a loss would either drive up the cost of service to
25 operating companies or, in the alternative, encourage the use of outside labs
26 whose costs, while higher, would likely be recovered in total.

27
28 **Q. ARE THERE SIGNIFICANT SWINGS IN THE LEVEL OF TEST ANALYSES
29 PERFORMED BY THE VARIOUS STATES THAT HIGHLIGHT THE NEED FOR
30 CONSISTENCY?**

31 A. Yes. Attached is Rebuttal Schedule DRW-3, which shows the percentage of test
32 analyses for each state as compared to the total AW system by year since 2003.
33 The minimum and maximum percentage values for each state over the five year

1 period are identified and a percentage variance is calculated. As shown, the
2 percentage variances are extremely significant. For example, MAWC's minimum
3 and maximum percentages vary by 38.14%. For the state of New Mexico, the
4 percentage variance in the minimum and maximum is over 1,800%. In fact, there
5 are eight out of the total of 17 states that have a percentage variance calculated
6 that exceeded 80%.

7
8 **Q. DOES THE USE OF TEST SAMPLES INCENT ANY OTHER BEHAVIOR?**

9 A. Focusing on the number of samples could create a situation where an operating
10 company would have the opportunity to directly reduce its costs by reducing the
11 number of sample tests it asks to be performed. Such an operating incentive is
12 not in the best interests of public safety and one that is discouraged by allocating
13 costs based on customer counts.

14
15 **Q. WHAT IS THE CONSEQUENCE OF STAFF'S BELLEVILLE LAB
16 REALLOCATION?**

17 A. Staff's reallocation would reduce MAWC's expense by about \$448,000.

18
19 **Q. WHAT IS YOUR RECOMMENDATION?**

20 A. The current allocation method for Belleville Lab costs is functioning effectively
21 and is widely accepted by regulators. Any perceived benefits from changing to
22 multiple allocation methods would be offset by the overall impact on a service
23 company system that is providing benefits for MAWC's customers. The
24 Commission should not accept Staff's proposal to reallocate Belleville Lab costs
25 based on test analyses performed.

26
27 **5) METROPOLITAN SEWER DISTRICT ("MSD") CONTRACT**

28
29 **Q. PLEASE EXPLAIN THE CONTRACT BETWEEN MSD AND MAWC?**

30 A. Missouri-American Water provides billing data services to MSD at a flat fee.
31 Revenue received is recorded above the line and therefore as long as it exceeds
32 the marginal cost of providing the services benefits other customers in the St.
33 Louis district.

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Q. HAS THE COMPANY PREPARED AN INCREMENTAL COST STUDY PERTAINING TO THE MSD CONTRACT?

A. Yes. The only incremental cost study prepared by the Company was in connection with Case No. WR-2008-0311, as ordered by the Commission.

Q. WHAT WAS THE TREATMENT OF THE MSD CONTRACT IN THE LAST RATE CASE?

A. No party objected to a settlement between MSD and MAWC leaving the contract rate constant.

Q. WHAT IS MAWC’S PROPOSAL IN THIS CASE?

A. MAWC is proposing no change in the existing amount it charges to MSD for the provision of water usage and customer billing data. For purposes of this case, MAWC has included the full contract price in annualized revenues.

Q. HAVE PARTIES IN THIS CASE TAKEN ISSUE WITH THE MSD CONTRACT?

A. OPC believes the annual amount should be based on an allocation of fully distributed cost, not incremental or negotiated costs to produce the information. They would have the rate increased from \$350,000 per year to \$545,535.

Q. WHAT IF THE COMMISSION DETERMINES THAT MSD SHOULD BE CHARGED SOMETHING DIFFERENT THAN IT IS CURRENTLY BEING CHARGED FOR THESE SERVICES?

A. If the Commission believes that the MSD contract rate is inappropriate, it should indicate that to be the case, but should make no adjustment to revenue requirement in this case. The contractual amount established and currently being paid is appropriately included in the revenue requirement request in this case. The rate can be changed only after a filing seeking to amend the contract in conjunction with the Company’s next rate case. Of course, MSD would also have the option not to renew the contract.

Q. WHY DO YOU BELIEVE THAT ADDITIONAL REVENUE SHOULD NOT BE

1 **IMPUTED TO MAWC IF THE COMMISSION BELIEVES THE CONTRACT**
2 **SHOULD BE AMENDED AND THE RATE INCREASED?**

- 3 A. The Company entered into this contract only after receiving authority to do so
4 from the Commission. It cannot be amended except through application to the
5 Commission. Currently, the contract provides for revenue greater than the cost of
6 providing billing services to MSD, thereby providing benefit to all other St. Louis
7 County customers. Finally, I believe that MSD has alternatives to the contract
8 that is in place with MAWC and if it chooses not to renew the contract, MAWC
9 customers would bear additional cost currently being covered by the MSD
10 revenues.

11
12 **6) ACQUISITION PREMIUMS AND DISCOUNTS**

13
14 **Q. WHAT ARE ACQUISITION PREMIUMS AND DISCOUNTS?**

- 15 A. Simply stated, premiums occur when the purchase price of an acquired property
16 is more than the net book value of the assets acquired and discounts occur when
17 the purchase price is less than the net book value of assets acquired.

18
19 **Q. HAS THE MISSOURI COMMISSION PREVIOUSLY INDICATED HOW**
20 **ACQUISITION DISCOUNTS AND PREMIUMS SHOULD BE TREATED FOR**
21 **RATEMAKING PURPOSES?**

- 22 A. Yes. The clearest statement of past Commission treatment of this issue is found
23 in the Second Report and Order in Case No. EM-2000-292, related to the
24 acquisition of St. Joseph Light & Power Co. by UtiliCorp United Inc. That Order
25 stated:

26 As a general rule, only the original cost of utility plant to the first
27 owner devoting the property to public service, adjusted for depreciation,
28 should be included in the utility's rate base. That principle is known as the
29 net original cost rule.

30
31 The net original cost rule was developed in order to protect
32 ratepayers from having to pay higher rates simply because ownership of
33 utility plant has changed, without any actual change in the usefulness of
34 the plant. If a utility were allowed to revalue its assets each time they
35 changed hands, it could artificially inflate its rate base by selling and
36 repurchasing assets at a higher cost, while recovering those costs from its
37 ratepayers. Thus, ratepayers would be required to pay for the same utility

1 plant over and over again. The sale of assets to artificially inflate rate
2 base was an abuse that was prevalent in the 1920s and 1930s and such
3 abuses could still occur.
4

5 An acquisition adjustment can be either positive or negative. In
6 other words, when a utility purchases an asset, it may pay more or less
7 than the net original cost of the asset. When the utility pays more than net
8 original cost, it is said to have paid an acquisition premium. But, in some
9 circumstances, a utility may be able to purchase assets at less than net
10 original cost. In that situation, the utility has a negative acquisition
11 adjustment.
12

13 Missouri has traditionally applied the net original cost standard
14 when considering the ratemaking treatment of acquisition adjustments.
15 That means that the purchasing utility has not been allowed to recover an
16 acquisition premium from its ratepayers. But it also means that ratepayers
17 do not receive lower rates through a decreased rate base when the utility
18 receives a negative acquisition adjustment. Even if a company acquires
19 an asset at a bargain price, it is allowed to put the asset into its rate base
20 at its net original cost. Similarly, ratepayers do not share in the gains a
21 utility may realize from selling assets at prices above their net original
22 cost. Those gains flow only to the utility's shareholders.
23

24 In other words, if recovery of an acquisition premium is not allowed, then
25 conversely, an acquisition discount or negative acquisition adjustment should not
26 be used to reduce the net book value for rate base and rate making purposes.
27

28 This principle was cited more recently by the Commission in a certificate case
29 (Case No. GA-2007-0168, concerning Southern Missouri Natural Gas "SMNG").
30 In that case, Staff proposed a condition that stated that if before SMNG had cost
31 based rates, it disposed of its assets at a fair value less than net original cost,
32 that the new owner would be expected to reflect those assets on its books at its
33 purchase price or the fair value of the assets rather than net original cost. The
34 Commission declined to impose this condition, stating in part:

35 The Commission also observes that there are strong precedents against
36 allowing acquisition premiums to be reflected in rates when the assets are
37 purchased at more than book value. For example, the Commission has
38 stated that it will not require a company to write down its rate base when
39 the assets are sold at less than book value. In addition, Mr. Oligschlaeger
40 testified that the Uniform System of Accounts requires that the use of "net
41 original cost" for ratemaking, and that it would require a waiver if a public
42 utility requested the accounting treatment now being advocated by Staff.
43

1 **Q. DO YOU AGREE WITH THIS POLICY?**

2 A. Yes. Retaining rate base at net original cost as the result of an acquisition
3 protects the customers and provides the Company an incentive to achieve as low
4 a purchase price as possible. It is further equitable in that it balances the interest
5 of the acquiring utility and its customers by applying the same fair treatment
6 whether the acquisition is made at a premium or discount.

7
8 **Q. WHAT POSITION HAS THE OFFICE OF PUBLIC COUNSEL (“OPC”) TAKEN
9 IN REGARD TO ACQUISITION PREMIUMS AND DISCOUNTS?**

10 A. OPC indicates that MAWC should not be allowed to earn a return on a valuation
11 of purchased assets that exceeds the amount of net original cost. At the same
12 time, it states that MAWC should not benefit by a purchase of assets that is
13 below net original cost. In other words, the utility should not benefit whether a
14 purchase is made at a premium or a discount.

15
16 **Q. DOES OPC PROVIDE RATIONALE FOR ITS OPINION?**

17 A. No. OPC simply appears to take a “heads the customer wins, tails the Company
18 loses” approach to rate regulation.

19

20 **7) BUSINESS TRANSFORMATION ACCOUNTING TREATMENT**

21

22 **Q. IN YOUR DIRECT TESTIMONY, YOU DISCUSSED THE PROPER
23 ACCOUNTING TREATMENT FOR ANNUAL (“SAP”) LICENSE FEES. HAS
24 ANY OTHER PARTY TAKEN AN OPPOSING VIEW TO YOUR
25 RECOMMENDATION?**

26 A. Yes. My recommendation was to expense these annual license fees, even
27 during the period that the new system was being developed, because they are
28 recurring in nature and under generally accepted accounting principles should be
29 reflected as a system maintenance expense. The direct testimony of Staff
30 witness Kimberly K. Bolin, at page 12, states the Staff position that according to
31 the Stipulation and Agreement filed in Case No. WR-2010-0131, all costs
32 associated with the Comprehensive Planning Study and the Business
33 Transformation Project were to be included in construction work in progress and

1 then transferred to Utility Plant when the assets were placed into service.

2
3 **Q. DO YOU HAVE AN ISSUE WITH ACCEPTING THE STAFF**
4 **RECOMMENDATION IN THIS REGARD?**

5 **A.** No. So long as the Commission orders this treatment, the Company, applying
6 FAS 71, can accept this variance from what would otherwise constitute generally
7 accepted accounting principles. However, the Company does not believe that it
8 would be fair or reasonable in the future for any party to argue that these costs
9 should not be recoverable because they should have been expensed previously.

10
11 **Q. HAS THE STAFF MADE ANY OTHER RECOMMENDATIONS REGARDING**
12 **THE TREATMENT OF BUSINESS TRANSFORMATION AND**
13 **COMPREHENSIVE PLANNING STUDY COSTS?**

14 **A.** Yes. Beginning at page 15 of her direct testimony, Ms. Bolin indicates that the
15 Company's recommendation for special ratemaking treatment of these costs was
16 under review. She stated, "In order for Staff to agree to or accept such special
17 ratemaking treatment for these costs, MAWC should be required to help
18 establish and follow parameters and conditions to allow Staff, and other parties in
19 this case, adequate review of the management of the project, the costs
20 associated with it, and the budget expended for such costs."

21
22 **Q. IS THE COMPANY WILLING TO ALLOW STAFF AND OTHER PARTIES TO**
23 **REVIEW MANAGEMENT OF THE PROJECT, ITS BUDGET AND COSTS?**

24 **A.** Yes. In fact, both Staff and the OPC have met with senior management
25 responsible for documenting not only the associated budget and costs, but also
26 the support for the business decisions to establish the scope, the selection of
27 vendors, contract developments and all other facets of these projects. A
28 dedicated computer-based source library containing all of the cost information
29 and support for the Comprehensive Planning Study and Business Transformation
30 Project has been created. Both Staff and the OPC have been given unrestricted
31 access to this information and can drill down from monthly cost summaries to
32 detailed support for each cost item, including the capitalization of internal costs.
33 The Company understands the desire on the part of Staff and the OPC to be able

1 to access this information on an ongoing basis, outside the pendency of this rate
2 case. If MAWC is granted the recommended accounting treatment outlined in
3 the Company's direct case, the Company is certainly willing to grant continued
4 access to all support for the costs and conduct of these system implementations
5 after this rate case is completed, and to grant reasonable access to management
6 to discuss and explain all decisions surrounding the projects' strategy, design
7 and implementation.

8
9 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

10 **A.** Yes, it does.

Missouri American Water Company			
	Normal	12 Month	Cumulative
	Work Days	Cumulative	Hours
January-10	21		
February-10	20		
March-10	23		
April-10	22		
May-10	21		
June-10	22		
July-10	22		
August-10	22		
September-10	22		
October-10	21		
November-10	22		
December-10	23	261	
January-11	21	261	2088
February-11	20	261	2088
March-11	23	261	2088
April-11	21	260	2080
May-11	22	261	2088
June-11	22	261	2088
July-11	21	260	2080
August-11	23	261	2088
September-11	22	261	2088
October-11	21	261	2088
November-11	22	261	2088
December-11	22	260	2080
January-12	22	261	2088
February-12	21	262	2096
March-12	22	261	2088
April-12	21	261	2088
May-12	23	262	2096
June-12	21	261	2088
July-12	22	262	2096
August-12	23	262	2096
September-12	20	260	2080
October-12	23	262	2096
November-12	22	262	2096
December-12	21	261	2088
January-13	23	262	2096
February-13	20	261	2088
March-13	21	260	2080
April-13	22	261	2088
May-13	23	261	2088
June-13	20	260	2080
July-13	23	261	2088
August-13	22	260	2080
September-13	21	261	2088
October-13	23	261	2088
November-13	21	260	2080
December-13	22	261	2088
January-14	23	261	2088
February-14	20	261	2088
March-14	21	261	2088
April-14	22	261	2088
May-14	22	260	2080
June-14	21	261	2088
July-14	23	261	2088
August-14	21	260	2080
September-14	22	261	2088
October-14	23	261	2088
November-14	20	260	2080
December-14	23	261	2088
Sum of 48 12-month Periods			100,192
# of Years in average			48
Weighted Average Hours			<u>2087.33</u>

Missouri American Water Company
Belleville Labs - Five Year Review
Summary of Test Analyses by Operating Company
Showing % Minimum and Maximum of Test Analyses

Schedule DRW-3

State	2006	2007	2008	2009	2010	Min.	Max.	% Var
Arizona	6.06%	4.29%	5.59%	6.88%	7.95%	4.29%	7.95%	85.36%
California	17.86%	11.48%	14.46%	19.13%	16.27%	11.48%	19.13%	66.64%
Iowa	0.88%	0.69%	0.52%	0.66%	0.38%	0.38%	0.88%	131.81%
Illinois	6.31%	5.87%	7.37%	5.73%	7.74%	5.73%	7.74%	35.12%
Indiana	3.78%	7.33%	6.85%	7.52%	5.70%	3.78%	7.52%	98.94%
Kentucky	1.64%	1.65%	4.07%	1.89%	3.75%	1.64%	4.07%	148.17%
Maryland	0.32%	0.31%	0.29%	0.21%	0.30%	0.21%	0.32%	52.38%
Michigan	0.07%	0.05%	0.21%	0.10%	0.06%	0.05%	0.21%	320.00%
Missouri	6.04%	6.02%	5.51%	4.63%	4.72%	4.63%	6.04%	30.45%
New Jersey	34.89%	33.06%	34.13%	33.48%	24.21%	24.21%	34.89%	44.14%
New Mexico	0.42%	0.25%	0.60%	0.23%	0.79%	0.23%	0.79%	244.25%
New York	2.21%	2.04%	1.82%	1.56%	1.68%	1.56%	2.21%	41.67%
Ohio	1.93%	4.15%	3.53%	2.93%	2.68%	1.93%	4.15%	115.03%
Pennsylvania	11.70%	15.06%	9.44%	11.21%	16.36%	9.44%	16.36%	73.35%
Puerto Rico	0.93%	0.00%	0.00%	0.00%	0.00%	0.00%	0.93%	
Tennessee	1.05%	1.50%	1.12%	1.99%	1.23%	1.05%	1.99%	89.52%
Texas	0.03%	0.08%	0.00%	0.01%	0.01%	0.00%	0.08%	
Virginia	1.18%	3.35%	1.84%	1.84%	4.58%	1.18%	4.58%	288.50%
West Virginia	2.70%	2.82%	2.65%	0.00%	1.57%	0.00%	2.82%	
	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>			