

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  
Sponsoring Party: Missouri-American Water Company  
Case No.: WR-2008-0311  
SR-2008-0312  
Date: September 30, 2008

**MISSOURI PUBLIC SERVICE COMMISSION**

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

**REBUTTAL TESTIMONY**

**OF**

**DONALD J. PETRY**

**ON BEHALF OF**

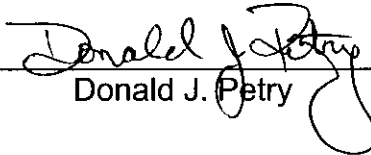
**MISSOURI-AMERICAN WATER COMPANY**

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

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

**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 "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 24<sup>th</sup> day of September 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

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

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1  
2  
3 **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

increase in this case.

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

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

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

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

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

A. Bad debts have been trending upward, as shown below, for the years 2003 through 2007. The exception is 2007 which is attributed mainly to a change in 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%

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

**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 \$177,123 to \$480,554  
32 using the Company's method.  
33

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

2  
3 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY REGARDING**  
4 **INSURANCE OTHER THAN GROUP?**

5 A. The Company has two issues with the Staff's calculation of its level of proforma  
6 Insurance Other Than Group expense.  
7

8 First is the exclusion of the allocated cost of the Directors & Officers ("D & O")  
9 and the Kidnap & Ransom ("K & R") coverage. Second is the application of the  
10 payroll O&M percentage, or the allocation between expense and capital.  
11

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

14 A. The Staff Report – Cost of Service states on page 42 that Staff proposed an  
15 adjustment to annualize insurance expense to reflect the premiums paid through  
16 March 31, 2008, however, D & O and K & R coverages have been excluded.  
17 The Staff Report does not include an explanation of why the expense associated  
18 with this coverage was excluded.  
19

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

22 A. Yes. Without a policy of insurance to indemnify and defend its Board of Directors  
23 and its corporate officers, AWW would find it extremely difficult to recruit qualified  
24 persons to serve on its Board of Directors or in the capacity of executive  
25 management.  
26

27 **Q. WHY WOULD IT PRESENT A PROBLEM FOR AWW?**

28 A. As a publicly traded company, AWW, its directors and officers are subject to the  
29 Securities Exchange Commission Act (SEC) and the Sarbanes Oxley Act (SOX),  
30 as well as many other federal and state regulations. The SOX legislation  
31 establishes new or enhanced standards for all U.S. public company boards,  
32 management, and public accounting firms. SOX contains 11 titles, or sections,  
33 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.



1  
2 **Q. WHAT IS THE ISSUE REGARDING THE APPLICATION OF THE O&M**  
3 **PERCENTAGE TO THE VARIOUS INSURANCE COSTS?**

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

13  
14 **Q. WHAT TYPES OF INSURANCE COVERAGE SHOULD HAVE A PORTION OF**  
15 **THEIR COST CAPITALIZED BASED ON O&M PAYROLL ALLOCATION?**

16 A. Workers compensation and auto liability insurance have a significant correlation to  
17 the activity of the Company's labor force. Therefore, an allocation of those insurance  
18 costs between capital and expense based on a payroll O&M allocation factor makes  
19 sense. The remaining insurance policies, such as general liability and property, are  
20 not related to the activities of the labor force and therefore should not be allocated  
21 between capital and expense based upon a labor O&M allocation factor. For  
22 example, the largest cost, insurance policy is for general liability insurance. For  
23 purposes of this case, and based on discussions with Missouri-American operations  
24 personnel, it was estimated that 90% of the liability claims relate to either main  
25 breaks or trip and fall accidents and that only 10% was related to capital projects. In  
26 fact, when the Company became aware that this was still an issue at the prehearing  
27 conference, the Company performed an analysis of claims for years 2005 through  
28 2007. Based on this review, the Company determined that 96.38% of the claims  
29 were O&M related and only 3.62% were related to capital. Therefore, the Company's  
30 proposed allocation of 90% to O&M and 10% to capital for liability and property  
31 insurance coverage is conservative and ought to be adopted. Finally, the broker  
32 service fee O & M allocation was based on a composite O & M rate applied to all the  
33 Insurance Other Than Group coverages.

1  
2 **Q. WHAT IS THE DIFFERENCE BETWEEN STAFF AND COMPANY ON EACH OF**  
3 **THE ISSUES RELATING TO INSURANCE OTHER THAN GROUP?**

4 A. Staff's total cost of Insurance Other Than Group is \$3,360,252. Based on my  
5 rebuttal, the revised level of insurance cost should be \$4,346,866, or \$986,614  
6 greater than Staff's cost as shown below.  
7

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  
10 **(3, 4, 5) FUEL & POWER/CHEMICALS/PURCHASED WATER**  
11

12 **Q. WHAT IS THE ISSUE REGARDING THESE EXPENSES?**

13 A. The Company and Staff disagree on the proper level of fuel, power, chemical and  
14 purchased water expense as a result of other disagreements they have regarding 1)  
15 the proper level of test year sales; 2) Staff's adjustment to limit the amount of non-  
16 revenue sales; 3) Company's adjustment to reflect increased fuel power and  
17 chemical costs associated with new treatment process; and 4) increased power and  
18 chemical costs occurring after March 31, but prior to the true-up (i.e., September 30,  
19 2008).  
20

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

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

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.  
32

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?**

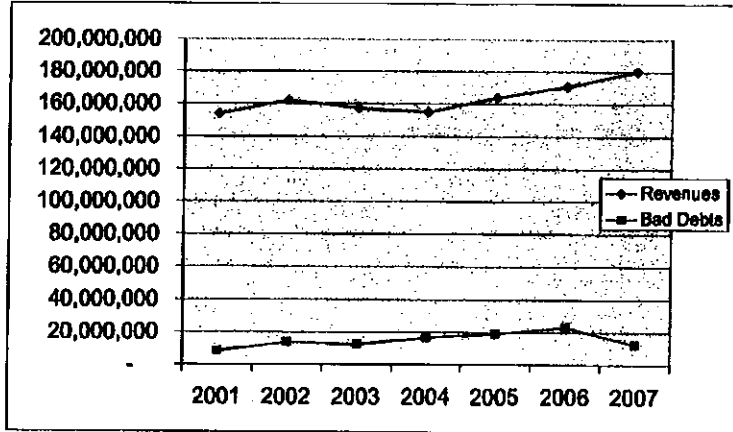
31 A. In Warren County, Staff used test year expense, which at that time was thought  
32 to be the only information available. MAWC has since discovered that these  
33 waste disposal costs were being charged to another account than was provided

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 \$1,600.

5  
6 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

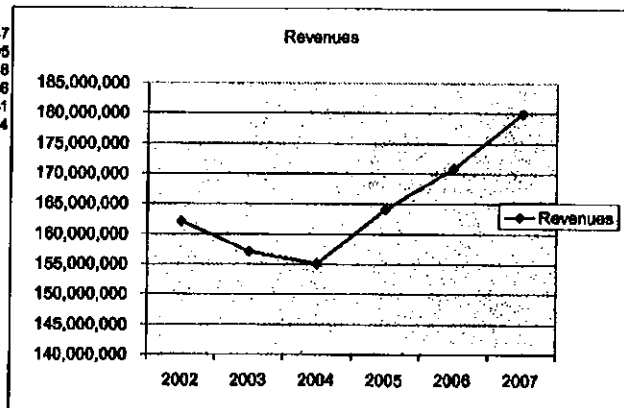
7 **A. Yes.**

	Revenues	Bad Debts	
2001	153,904,876	8,739,250	5.69%
2002	162,035,847	14,047,750	8.67%
2003	158,998,995	12,924,450	8.23%
2004	154,968,918	16,878,080	10.89%
2005	164,047,256	19,639,890	11.97%
2006	170,853,331	23,458,160	13.73%
2007	179,899,724	12,796,690	7.11%



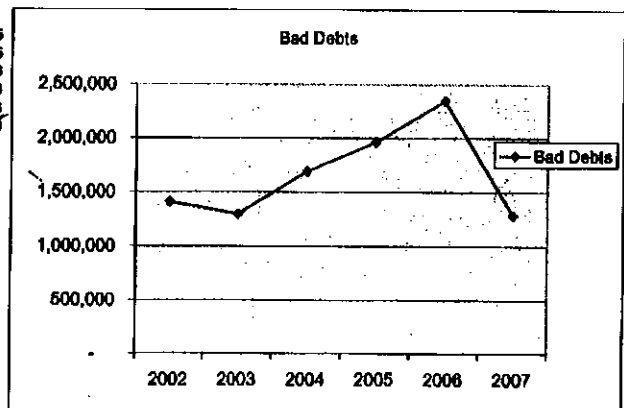
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	Revenues
2002	162,035,847
2003	158,998,995
2004	154,968,918
2005	164,047,256
2006	170,853,331
2007	179,899,724



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	Bad Debts
2002	1,404,775
2003	1,292,446
2004	1,687,808
2005	1,963,989
2006	2,345,816
2007	1,279,669



Sum of Amount						Year				
BU	Account	Transaction	Document	Description	Month	2007	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			
			41526664	Wentzville, City of	2	1600	1600			
			41572257	B J Septic and Excavation	4	1365	1365			
			41582835	B J Septic and Excavation	5	1560	1560			
			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			
			41702685	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	1560	1560			
			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