

Exhibit No.:
Issues: Rate Design
Prudence
Witness: James M. Jenkins
Exhibit Type: Rebuttal
Sponsoring Party: Missouri-American Water Company
Case No.: WR-2000-281
SR-2000-282
Date Prepared: May 4, 2000

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. WR-2000-281

CASE NO. SR-2000-282

REBUTTAL TESTIMONY

OF

JAMES M. JENKINS

ON BEHALF OF

MISSOURI-AMERICAN WATER COMPANY

JEFFERSON CITY, MISSOURI

FILED³
MAY 04 2000
Missouri Public
Service Commission

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

FILED³

MAY 04 2000

Missouri Public
Service Commission

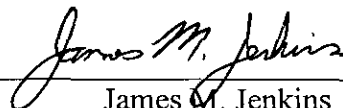
IN THE MATTER OF MISSOURI-AMERICAN)
WATER COMPANY FOR AUTHORITY TO)
FILE TARIFFS REFLECTING INCREASED RATES)
FOR WATER AND SEWER SERVICE IN THE)
MISSOURI SERVICE AREA OF THE COMPANY)

CASE NO. WR-2000-281


CASE NO. SR-2000-282

AFFIDAVIT OF JAMES M. JENKINS

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


James M. Jenkins

State of Missouri
County of St. Louis
SUBSCRIBED and sworn to
before me this 3rd day of May 2000.


Notary Public, Sharon K. Lee

My commission expires:

SHARON K. LEE, NOTARY PUBLIC
STATE OF MISSOURI, ST. LOUIS COUNTY
MY COMMISSION EXPIRES FEBRUARY 21, 2003

**REBUTTAL TESTIMONY
JAMES M. JENKINS
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WR-2000-281
CASE NO. SR-2000-282**

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1 **WITNESS INTRODUCTION**

2 **Q. STATE YOUR NAME AND BUSINESS ADDRESS?**

3 A. James M. Jenkins, 535 N. New Ballas Rd., St. Louis, Missouri.

4 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

5 A. I am Vice President and Treasurer for Missouri-American Water Company, St. Louis
6 County Water Company and Jefferson City Water Works Company, Inc. (formerly
7 known as United Water Missouri Inc.).

8 **Q. STATE YOUR QUALIFICATIONS AND EXPERIENCE IN THE FIELD OF**
9 **ACCOUNTING IN GENERAL, AND IN THE FIELD OF UTILITY**
10 **ACCOUNTING AND RATE REGULATION IN PARTICULAR?**

11 A. My background and qualifications are summarized in Schedule JMJ-1 to this testimony.

12 **PURPOSE AND SCOPE**

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

14 A. I will address the financial impact a plant disallowance and a rate phase-in plan will have
15 upon Missouri-American Water Company ("MAWC"). Plant disallowances and rate
16 phase-in plans have been proposed by the Missouri Public Service Commission Staff
17 ("Staff"), the Office of the Public Counsel ("Public Counsel"), and a number of
18 Intervenors.

19 **Q. WHAT PLANT DISALLOWANCES HAVE BEEN PROPOSED IN THIS**
20 **PROCEEDING?**

21 A. Practically speaking, two plant disallowances have been proposed in this proceeding
22 related to the new St. Joseph Treatment Plant and related facilities ("SJTP"). The Public
23 Counsel position results in an approximate \$40 million plant disallowance while the St.
24 Joseph Industrial Water Users "high-end" recommendation results in an approximate \$30
25 million plant disallowance. The Staff has a \$1.26 million AFUDC accounting
26 disallowance related to SJTP. This disallowance is not based on prudence and will be
27 addressed by MAWC Witness Salser.

1 **Q. PLEASE QUANTIFY THE PUBLIC COUNSEL RECOMMENDATION.**

2 A. Public Counsel Witness Biddy has recommended that MAWC's existing plant in St.
3 Joseph should have been upgraded at a total cost of \$36,307,591 and, after applying the
4 excess capacity adjustment calculated by Public Counsel Witness Trippensee asserts that
5 only \$30,728,404 should be included in rate base. This Public Counsel proposal results
6 in a SJTP disallowance of approximately \$39.95 million.

7 **Q. PLEASE QUANTIFY THE ST. JOSEPH INDUSTRIAL WATER USERS'**
8 **RECOMMENDATION.**

9 A. St. Joseph Industrial Water Users Witness Morris has recommended that MAWC's
10 existing plant in St. Joseph should have been upgraded in several phases at a total cost of
11 \$40,300,000. Mr. Morris goes on to preface his recommendation as "high end" which
12 leaves the door open for a lower cost proposal. The St. Joseph Industrials "high end"
13 proposal results in a SJTP disallowance of approximately \$30.4 million.

14 **Q. WHAT PHASE-IN PROPOSALS HAVE BEEN PROPOSED IN THIS**
15 **PROCEEDING?**

16 A. Two parties have proposed phase-in plans directly related to the new SJTP. Also, two
17 parties have recommended a rate design phase-in plan.

18 Staff Witness Rackers proposed a five-year phase-in plan while St. Joseph
19 Industrials Witness Harwig proposed a three-phase plan. One important distinction does
20 exist between the two plans. The Staff plan allows the Company to recover its total SJTP
21 revenue requirement by capitalizing a deferral for any amount not currently recovered in
22 rates. In effect, Staff's proposal allows MAWC to earn a carrying charge at a return equal
23 to the authorized rate of return on all amounts recorded in the deferral. The St. Joseph
24 Industrial Water Users' plan does not recognize any such deferral; therefore, no attempt
25 has been made to make the Company whole during the three-phase approach.

26 Public Counsel Witness Busch and Intervenor Witness Harwig have each
27 proposed a rate design phase-in plan. Mr. Busch's rate design phase-in plan would cap

1 rate increases to no more than 15% per district, while Mr. Harwig's would cap rate
2 increases to no more than 35% per district. Neither plan would guarantee MAWC a 15%
3 or 35% increase in revenues each year because not all districts will be receiving such an
4 increase under each rate design proposal. Mr. Busch and Mr. Harwig do not address the
5 issue of carrying charges on any deferred balance resulting from their proposal. The
6 length of each plan is not defined but is directly related to the final rate design and
7 revenue requirement order by the Commission.

8 **Q. WHAT IMPACT IS THE CONSTRUCTION OF THE SJTP HAVING ON THE**
9 **FINANCIAL STATEMENTS OF MAWC?**

10 A. This SJTP is currently expected to cost approximately \$70,684,000, which represents an
11 86% increase in MAWC's rate base. This is a substantial commitment of capital that has
12 the affect of essentially doubling MAWC's existing rate base. In fact, as of the quarter
13 ended March 31, 2000, AFUDC accruals exceeded reported earnings by approximately
14 47%. This means MAWC's first quarter earnings quality has deteriorated to the point
15 that non-cash earnings now exceed reported net income. This erosion in earnings quality
16 highlights the negative impact plant disallowances and phase-in plans will have upon the
17 financial health of MAWC.

18 **Q. WHAT DO YOU MEAN BY AN EROSION OF "EARNINGS QUALITY"?**

19 A. The quality of a company's earnings is often measured by what level of net income is
20 represented by cash. The fact that for the first quarter of 2000 MAWC's non-cash
21 income related to AFUDC represents 147% of quarterly net income is not an indicator of
22 strong financial performance.

23 **Q. HAS MAWC PREPARED FINANCIAL PROJECTIONS WHICH REFLECT THE**
24 **PLANT DISALLOWANCES AND RATE PHASE-IN PROPOSALS IN THIS**
25 **PROCEEDING?**

26 A. Yes. Five-year projections reflecting the applicable plant disallowances and rate phase-in
27 plans are included on Schedules JMJ 2-1, JMJ 2-2 and JMJ 2-3. Schedule JMJ 2-1

1 reflects Public Counsel's \$40 million plant disallowance and a 15% per year phase-in
2 increase. Schedule JMJ 2-2 reflects the St. Joseph Industrials \$30.4 million plant
3 disallowance and a three-year phase-in plan attributable to treatment plant improvement
4 phases. Schedule JMJ 2-3 reflects Staff's \$1.26 million AFUDC accounting
5 disallowance not related to prudence and a five-year phase-in plan.

6 The negative risk profiles resulting from each of the above proposals will be
7 directly addressed by MAWC Witness Walker.

8 **PLANT DISALLOWANCES**

9 **Q. WHAT IMPACT WOULD A PLANT DISALLOWANCE AS RECOMMENDED**
10 **BY THE ST. JOSEPH INDUSTRIAL WATER USERS AND PUBLIC COUNSEL**
11 **HAVE UPON THE FINANCIAL CONDITION OF MAWC?**

12 A. Statement of Financial Accounting Standards No. 90 ("SFAS 90"), entitled "Regulated
13 Enterprises-Accounting for Abandonments and Disallowances of Plant Costs" requires an
14 immediate write-off of any portion of cost related to the SJTP not included in rate base.
15 A required write-off of approximately \$30 to \$40 million would immediately impair the
16 financial integrity of MAWC. That is, the impact of either disallowance would drive
17 MAWC's retained earnings balance negative, result in negative interest coverage ratios
18 and increase debt leverage ratios to unacceptable levels beyond 60%. In my opinion,
19 MAWC would immediately be prohibited from (a) issuing any long-term debt and (b)
20 paying dividends on its Capital Stock. Company Witness Walker addresses the negative
21 financial consequences such a plant write-off would have on the risk profile of MAWC.

22 **Q. PLEASE DEFINE FINANCIAL INTEGRITY AND WHY YOU BELIEVE AN**
23 **IMPAIRMENT WOULD RESULT.**

24 A. In my opinion, "financial integrity" for a public utility means that such an enterprise must
25 be able to attract capital at reasonable rates and terms at all times. A public utility must
26 have the ability to raise such capital on an ongoing basis in order to meet its unavoidable
27 service obligation. MAWC, like any other water utility, does not enjoy the freedom of

1 raising new capital only under favorable market conditions. Therefore, it is critical
2 MAWC be able to raise capital in the least costly manner in order to meet ongoing capital
3 requirements and withstand unforeseen risks.

4 As stated above, a required write-off between \$30 to \$40 million would
5 immediately prohibit MAWC from obtaining additional secured debt or attracting other
6 capital at reasonable rates and terms. Therefore, MAWC would be in violation of those
7 restrictive covenants found within its mortgage indenture that provide a safety cushion to
8 current lenders and protect MAWC from defaulting on its obligations. In my opinion,
9 such a situation would impair MAWC's financial integrity.

10 **Q. DOES MAWC'S AFFILIATION WITH AMERICAN WATER WORKS ("AWK")**
11 **MITIGATE THE FINANCIAL IMPACT OF ANY SUCH DISALLOWANCE?**

12 A. No. MAWC's ability to access capital is strictly based on its assets, earnings, and cash
13 flow. AWK provides no guarantees of MAWC's securities and is under no obligation to
14 advance funds to MAWC. In fact, as its sole shareholder, AWK demands that each of its
15 subsidiaries, including MAWC, demonstrate an independent ability to service its debts
16 and to pay a competitive common stock dividend to warrant new common equity
17 investment. To date, AWK has advanced equity funds solely at its discretion based, in
18 part, on its expectation that MAWC will receive a full and fair return on investment,
19 enabling it to support its traditional dividend policy.

20 **PHASE-IN PROPOSALS**

21 **Q. WILL A PHASE-IN PLAN NEGATIVELY IMPACT THE FINANCIAL**
22 **POSITION OF MAWC?**

23 A. Yes. Statement of Financial Accounting Standards No. 92 ("SFAS 92") prohibits
24 capitalization of costs deferred for future recovery under phase-in plans relating to plants
25 constructed after January 1, 1988. Since the construction of the SJTP did not commence
26 until after January 1, 1988, under generally accepted accounting principles any related
27 phase-in plan deferrals must be expensed for accounting and reporting purposes.

1 Therefore, MAWC's financial statements will be negatively impacted for most of the
2 deferral period. Specifically, earnings each year will be reduced by the amount of the
3 revenue deferral, net of taxes. A phase-in plan such as the one recommended by Staff
4 would cause MAWC to under-earn its allowed return on equity ("ROE") in the deferral
5 period and over-earn its allowed ROE when higher revenues were permitted in future
6 years. Schedule JMJ 2-3 demonstrates this concept by using Staff Witness Rackers'
7 phase-in proposal and an overall Staff rate increase of \$12 million. The Staff's five-year
8 phase-in plan would result in equity returns that begin approximately at 3.7% in Year
9 2000 and escalate to approximately 13.5% in Year 2004. Such a plan would immediately
10 have a negative impact on reported revenues, earnings and cash flow. MAWC Witness
11 Walker addresses the negative financial consequences such a phase-in plan would have
12 on the risk profile of MAWC.

13 **Q. DOES THE COMPANY SUPPORT A PHASE-IN PROPOSAL IN THIS RATE**
14 **PROCEEDING?**

15 A. No. The financial impact of not being permitted to recognize for accounting and
16 reporting purposes any phase-in cost deferrals will result in a weakened MAWC
17 financial position in the early years of any phase-in period. A phase-in would
18 require MAWC to recognize a loss in any period full cost recovery was not
19 provided for in rates. Reported equity returns as low as 3% is simply
20 unacceptable and not fair to our investors. However, MAWC is also very mindful
21 of the large percentage increases attributable to this rate filing and the impact it
22 will have on consumer rates. Accordingly, MAWC Witness Stout will address
23 the applicable affordability issues surrounding the overall rate increase in this
24 proceeding.

25 **Q. DOES THIS COMPLETE YOUR TESTIMONY?**

26 A. Yes, it does.

SCHEDULE JMJ-1

Background and Qualifications of James M. Jenkins

My name is James M. Jenkins and I live at 253 Beacon Point Lane, Wildwood, Missouri 63040. I am Vice President and Treasurer for Missouri-American Water Company, St. Louis County Water Company and Jefferson City Water Works Company, Inc.

I graduated from the University of Illinois, at Urbana/Champaign in 1983 with a Bachelor of Science Degree in Accounting and in 1992 received a M.B.A. Degree, with highest honors, from the University of Illinois, at Springfield. I have been a Certified Public Accountant since 1985, and currently hold a license to practice in the States of Illinois and Missouri.

Between 1983 and 1984 I was employed by McGladrey and Pullen as a staff accountant participating in financial audits and completing tax returns for firm clients.

Between 1984 and 1993 I was employed by the Illinois Commerce Commission and worked on a wide range of regulatory issues in the electric, gas, telephone and water industries. I joined the Illinois Commerce Commission's Accounting Department as a staff accountant in November 1984. In April 1987, I was promoted to the position of Auditing Section Chief responsible for directing the Auditing Staff's review of rate case filings, fuel reconciliation clauses and miscellaneous regulatory accounting issues. In November 1989, I was promoted to Director of Accounting responsible for all administrative, policy and supervisory functions within the Accounting Department. I held the position of Director of Accounting until joining St. Louis County Water Company in June 1993.

I began my career with St. Louis County Water Company in June, 1993 as an Assistant Manager in the Corporate Accounting Department. In December 1994, I was promoted to Manager of Rates within the Rates and Operations Analysis Department. At St. Louis County Water Company, I was responsible for the numerous accounting and financial areas contained within Company rate case filings, performing both technical and supervisory functions.

I was elected Vice President and Treasurer for both Missouri-American Water Company and St. Louis County Water Company in June 1999. I was elected Vice President and Treasurer for Jefferson City Water Works Company, Inc. in May 2000. I am currently responsible for directing the finance, treasury, business development and rate administration functions of all three companies.

I am a member of the American Institute of Certified Public Accountants and past member of the NARUC Staff Subcommittee on Accounts. Also, I am currently the Vice-Chairperson of the Rates and Revenue Committee of the National Association of Water Companies.

MISSOURI-AMERICAN WATER COMPANY
PUBLIC COUNSEL PROPOSAL
FINANCIAL IMPACT ANALYSIS
(IN THOUSANDS DOLLARS)

	2000	2001	2002	2003	2004
Return On Avg Common Equity	-47.09%	4.78%	9.14%	-8.03%	4.87%
Common Stock Dividends	2,419	0	0	0	1,299
Preferred Stock Dividends	183	0	0	0	1,033
Debt to Equity Ratio					
Debt	93,089	92,623	92,157	91,691	91,225
Preferred Stock	2,716	2,690	2,678	2,666	2,654
Common Stock	55,094	55,094	55,094	55,094	55,094
Retained Earnings	(11,618)	(9,490)	(5,124)	(841)	433
	<u>139,281</u>	<u>140,917</u>	<u>144,805</u>	<u>148,510</u>	<u>149,406</u>
Ratios					
Debt	66.8%	65.7%	63.6%	61.7%	61.1%
Preferred Stock	1.8%	1.9%	1.8%	1.8%	1.8%
Common Equity	<u>31.2%</u>	<u>32.4%</u>	<u>34.5%</u>	<u>36.5%</u>	<u>37.2%</u>
	100.0%	100.0%	100.0%	100.0%	100.0%
Maximum Debt Issue	0	0	1,966	4,840	5,889
Short-Term Debt Balance	14,849	11,045	5,925	14,562	10,023
Interest Coverage Ratio - per indenture					
Income:					
Operating Revenue	31,865	35,276	37,414	38,373	38,767
Other Income	(37,826)	(37)	(101)	264	261
AFUDC	2,219	210	104	662	24
Total	<u>(3,743)</u>	<u>35,450</u>	<u>37,417</u>	<u>39,299</u>	<u>39,052</u>
Expenses:					
O&M	14,528	15,095	15,702	16,351	17,037
Depreciation	3,307	4,278	4,469	4,859	5,231
General Taxes	2,979	2,979	2,979	2,979	2,979
	<u>20,814</u>	<u>22,352</u>	<u>23,150</u>	<u>24,189</u>	<u>25,247</u>
Income Less Exp	(24,556)	13,097	14,267	15,110	13,805
Annual Interest Charge	5,495	5,922	5,922	5,922	5,922
Times Interest	(4.5)	2.2	2.4	2.6	2.3

Witness: J. M. Jenkins
Schedule: JMJ 2-1

**MISSOURI-AMERICAN WATER COMPANY
ST. JOSEPH INDUSTRIALS PROPOSAL
FINANCIAL IMPACT ANALYSIS
(IN THOUSANDS DOLLARS)**

	2000	2001	2002	2003	2004
Return On Avg Common Equity	-32.30%	5.03%	7.92%	8.03%	7.20%
Common Dividends	2,419	0	1,276	3,788	3,486
Preferred Dividends	183	0	547	243	243
Debt to Equity Ratio					
Debt	93,089	92,623	92,157	91,691	91,225
Preferred Stock	2,716	2,690	2,678	2,663	2,654
Common Stock	55,094	55,094	55,094	55,094	55,094
Retained Earnings	(5,816)	(3,274)	243	1,182	2,020
	<u>145,083</u>	<u>147,133</u>	<u>150,172</u>	<u>150,633</u>	<u>150,993</u>
Ratios					
Debt	64.2%	63.0%	61.4%	60.9%	60.4%
Preferred Stock	1.9%	1.8%	1.8%	1.8%	1.8%
Common Equity	<u>34.0%</u>	<u>35.2%</u>	<u>36.8%</u>	<u>37.4%</u>	<u>37.8%</u>
	100.0%	100.0%	100.0%	100.0%	100.0%
Maximum Debt Issue	1,215	3,013	5,455	6,220	6,920
Short-Term Debt Balance	14,812	10,234	5,056	16,333	12,760
Interest Coverage Ratio - per Indenture					
Income:					
Operating Revenue	31,901	35,317	37,249	38,197	38,591
Other Income	(28,255)	71	7	361	261
AFUDC	<u>2,219</u>	<u>210</u>	<u>104</u>	<u>662</u>	<u>24</u>
Total	<u>5,865</u>	<u>35,598</u>	<u>37,360</u>	<u>39,220</u>	<u>38,876</u>
Expenses:					
O&M	14,528	15,095	15,702	16,351	17,037
Depreciation	3,438	4,541	4,732	5,122	5,494
General Taxes	<u>2,979</u>	<u>2,979</u>	<u>2,979</u>	<u>2,979</u>	<u>2,979</u>
	<u>20,945</u>	<u>22,615</u>	<u>23,413</u>	<u>24,452</u>	<u>25,510</u>
Income Less Exp	(15,080)	12,983	13,947	14,768	13,366
Annual Interest Charge	5,495	5,922	5,922	5,922	5,922
Times Interest	(2.7)	2.2	2.4	2.5	2.3

Witness: J. M. Jenkins
Schedule: JMJ 2-2

MISSOURI-AMERICAN WATER COMPANY
STAFF PROPOSAL
FINANCIAL IMPACT ANALYSIS
(IN THOUSANDS DOLLARS)

	2000	2001	2002	2003	2004
Return On Avg Common Equity	3.77%	4.55%	8.98%	11.42%	13.52%
Dividends	2,054	2,738	5,061	6,453	7,772
Debt to Equity Ratio					
Debt	93,089	92,623	92,157	91,691	91,225
Preferred Stock	2,716	2,890	2,678	2,668	2,654
Common Equity	55,094	55,094	55,094	55,094	55,094
Retained Earnings	12,438	13,026	14,388	16,216	18,483
	<u>163,337</u>	<u>163,433</u>	<u>164,318</u>	<u>165,667</u>	<u>167,456</u>
Ratios					
Debt	57.0%	56.7%	56.1%	55.3%	54.5%
Preferred Stock	1.7%	1.6%	1.6%	1.6%	1.6%
Common Equity	<u>41.3%</u>	<u>41.7%</u>	<u>42.3%</u>	<u>43.0%</u>	<u>43.9%</u>
	100.0%	100.0%	100.0%	100.0%	100.0%
Maximum Debt Issue	13,080	13,609	14,650	15,992	17,621
Short-Term Debt Balance	15,404	11,835	8,013	17,501	11,588
Interest Coverage Ratio - per Indenture					
Income:					
Operating Revenue	32,262	36,970	40,732	44,799	49,203
Other Income	872	380	315	670	261
AFUDC	961	210	104	662	24
Total	<u>34,095</u>	<u>37,560</u>	<u>41,152</u>	<u>46,131</u>	<u>49,488</u>
Expenses:					
O&M	14,528	15,095	15,702	16,351	17,037
Depreciation	3,858	5,376	5,567	5,958	6,330
General Taxes	2,979	2,979	2,979	2,979	2,979
	<u>21,365</u>	<u>23,451</u>	<u>24,249</u>	<u>25,288</u>	<u>26,346</u>
Income Less Exp.	12,732	14,109	16,903	20,843	23,142
Annual Interest Charge	5,495	5,922	5,922	5,922	5,922
Times Interest	2.3	2.4	2.9	3.5	3.9

Witness: J. M. Jenkins
Schedule: JMJ 2-3