

Exhibit No.:
Issues: Comparison of Staff and Company
Costs of Service Model, Rate Base
Witness: Dennis R. Williams
Exhibit Type: Surrebuttal
Sponsoring Party: Missouri-American Water Company
Case No.: WA-2012-0066
Date: June 5, 2012

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. WA-2012-0066

SURREBUTTAL 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 A CERTIFICATE) OF CONVENIENCE AND NECESSITY) AUTHORIZING IT TO INSTALL, OWN,) ACQUIRE, CONSTRUCT, OPERATE,) CONTROL, MANAGE AND MAINTAIN) WATER AND SEWER SYSTEMS IN) CHRISTIAN AND TANEY COUNTIES,) MISSOURI)	CASE NO. WA-2012-0066
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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 "Surrebuttal Testimony of Dennis R. Williams"; that said testimony was prepared by him and/or under his direction and supervision; that if inquires were made as to the facts in said testimony, he would respond as therein set forth; and that the aforesaid testimony is 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 1st day of June 2012.



Notary Public

My commission expires:



**SURREBUTTAL TESTIMONY
DENNIS R. WILLIAMS
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WA-2012-0066**

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DENNIS R. WILLIAMS

I. WITNESS INTRODUCTION AND PURPOSE

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

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

Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THIS PROCEEDING?

A. Yes, I have submitted direct and rebuttal testimony in this proceeding on behalf of Missouri-American Water Company (“Missouri-American”, MAWC”, or “Company”).

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. I will respond to the rebuttal testimony of Missouri Public Service Commission (“PSC” or “Commission”) staff members James Merciel, Paul Harrison and John Robinett. Primarily, I will focus on the differences in the results in the Staff’s cost of service model as compared to that prepared by the Company. These models were used to support the recommendations for the establishment of rates in connection with the request for certificates of convenience and necessity to provide water and sewer service to the Saddlebrooke area. I will also respond to comments made by Office of the Public Counsel witness Ted Robertson regarding the appropriate initial level of rate base that should be recognized by the PSC.

II. COMPARISON OF STAFF AND COMPANY COST OF SERVICE MODELS

1 **Q. PLEASE SUMMARIZE THE COMPANY'S POSITION REGARDING THE**
2 **ESTABLISHMENT OF RATES IN THIS PROCEEDING.**

3 **A.** MAWC has proposed that the rates to be charged in the newly certificated
4 area be based on the same rate sheets that are applicable to the subdivision
5 of Stonebridge Village. Those rate sheets were provided along with the filing
6 of my rebuttal testimony. My rebuttal testimony also sets out the Company's
7 rationale for utilization of existing tariff rates rather than developing new rates
8 specific to Saddlebrooke.

9
10 **Q. DOES THE STAFF AGREE THAT IT IS APPROPRIATE TO APPLY THE**
11 **EXISTING PSC APPROVED STONEBRIDGE VILLAGE RATE SHEETS TO**
12 **CUSTOMERS IN THE SADDLEBROOKE SUBDIVISION?**

13 **A.** No. Staff calculated a cost of service that resulted in substantially different
14 revenue requirements per customer than that reflected by the Company's
15 model. Its resulting rate recommendation is reflected on page 10 of the
16 rebuttal testimony of Staff witness James Merciel. Mr. Merciel based his
17 recommendation on the Staff Cost of Service Model (or EMS run) that is
18 attached as Schedule PRH-2 to the testimony of Staff witness Paul Harrison.

19
20 **Q. WHAT ARE THE MAJOR COMPONENTS OF THAT EMS RUN?**

21 **A.** The EMS run supported by Mr. Harrison appears to utilize the same model
22 that Staff consistently applies to other rate cases. It provides detail of
23 accounts comprising rate base, pre-tax revenues and operating expenses,
24 calculates income tax expense, and applies a cost of capital to determine the
25 necessary revenue requirement.

26
27 **Q. ARE ANY OF THESE COMPONENTS ESTIMATES?**

28 **A.** Yes. Many of the costs are supported directly by accounting records and/or
29 invoices. The Company, however, reviewed the same cost information,
30 memorandums and correspondence from the current provider of service, and
31 correspondence from suppliers and contractors, that was reviewed by Staff,

1 and ultimately agreed with Staff estimates of capital and operating expense,
2 where estimates were required. The Company agrees with Staff's statements
3 (Harrison rebuttal at Page 5, lines 9 – 16; Merciel rebuttal at Page 3, line 20 –
4 Page 4, line 6 and Page 6, lines 5 - 12) that in a certificate case, as much
5 plant, reserve, revenue and expense information as is available should be
6 utilized, but that reasonable estimates are sometimes required and that these
7 estimates will be reviewed in the context of the Company's next rate case.

8

9 **Q. DOES THE COMPANY AGREE WITH THE STAFF'S DETERMINATION OF**
10 **RATE BASE?**

11 **A.** Yes. After applying three adjustments to its plant valuations, Staff arrived at a
12 rate base valuation of \$445,628, with which the Company concurs.

13

14 **Q. DO YOU AGREE WITH MR. MERCIEL'S STATEMENT THAT YOU**
15 **ERRORED IN YOUR DETERMINATION OF THE MAXIMUM AMOUNT OF**
16 **CONNECTION FEES THAT COULD POSSIBLY BE COLLECTED AS A**
17 **RESULT OF THE COMPANY'S PROPOSAL TO COLLECT A ONE-TIME**
18 **CHARGE WHEN A NEW WATER CONNECTION IS MADE?**

19 **A.** Yes. The amount I used was in regard to an earlier proposal that was later
20 modified. The correct maximum connection fee would be \$1,120,000 as
21 asserted by Mr. Merciel. This correction does not impact the Company's
22 calculation of rate base or its recommendation. Moreover, the Company has
23 no objection to using the term "Contribution in Aid of Construction (CIAC)
24 fees" as proposed by Staff in lieu of the term "connection fee".

25

26 **Q. DOES THE COMPANY AGREE WITH THE STAFF'S DETERMINATION OF**
27 **PRE-TAX OPERATING EXPENSE?**

28 **A.** Yes. Although there may be some very minor differences in pre-tax operating
29 expenses between the Company and Staff cost of service models, the
30 Company accepts the Staff determination of pre-tax operating expense.

31

1 **Q. DOES THE COMPANY AGREE WITH THE RECOMMENDATIONS OF**
2 **STAFF WITNESS JOHN ROBINETT REGARDING MAINTENANCE OF**
3 **PLANT RECORDS AND DEPRECIATION RATES?**

4 **A.** Yes, the Company agrees to apply to the Saddlebrooke assets the
5 depreciation rates approved by the PSC in the Company's last rate - Case
6 No. WR-2011-0337. Those depreciation rates currently are applied to all the
7 Company's existing plant, including plant assets in Stonebridge.

8

9 **Q. IF THE COMPANY AGREES WITH STAFF'S DETERMINATION OF RATE**
10 **BASE, DEPRECIATION AND PRE-TAX OPERATING EXPENSE, WHY DO**
11 **SUBSTANTIAL DIFFERENCES EXIST BETWEEN THE TWO MODELS'**
12 **DETERMINATION OF REVENUE REQUIREMENT?**

13 **A.** The Company believes there are flaws in the input to Staff's model in regards
14 to cost of capital and Federal tax rate.

15

16 **Q. WHAT COST OF CAPITAL DOES THE STAFF MODEL UTILIZE?**

17 **A.** Staff utilized a 9.45 percent return on equity and an overall cost of capital of
18 7.582 percent.

19

20 **Q. HOW DID STAFF DERIVE THESE PERCENTAGES?**

21 **A.** According to Mr. Harrison's rebuttal testimony, the cost of capital is the same
22 as was developed by Staff in the last Missouri-American rate case.

23

24 **Q. DID STAFF PROVIDE A WITNESS TO SUPPORT THE DEVELOPMENT OF**
25 **COST OF CAPITAL IN THIS CASE?**

26 **A.** No.

27

28 **Q. IS IT LIKELY THAT THE COMPANY'S COST OF CAPITAL HAS**
29 **CHANGED SINCE ITS LAST RATE CASE?**

30 **A.** Yes.

31

1 **Q. DID OTHER PARTIES MAKE DIFFERENT RECOMMENDATIONS AS TO**
2 **THE COST OF CAPITAL IN THE COMPANY’S LAST RATE CASE?**

3 **A.** Yes. The Company and other parties made recommendations that differed
4 from the Staff recommendation. In fact, the Company’s recommendation was
5 much higher than that recommended by Staff.

6

7 **Q. DID THE COMPANY UTILIZE IN ITS MODEL THE COST OF CAPITAL**
8 **RECOMMENDATION IT MADE IN THE LAST RATE CASE?**

9 **A.** No. While that rate case resulted in a “blackbox” settlement that was
10 approved by this Commission and therefore no specific rate of return was
11 stated as appropriate, the parties did agree that a 10 percent return on equity
12 and the Company’s capital structure at December 31, 2011 should be used
13 for future Infrastructure System Replacement Surcharge filings. This resulted
14 in a rate order effective April 1, 2012 that established an overall cost of capital
15 of 8.17 percent for ISRS purposes. The Company utilized in its model an
16 8.17 percent cost of capital as being the best reasonable estimate of an
17 appropriate cost of capital.

18

19 **Q. IS IT APPROPRIATE TO USE AN ESTIMATED COST OF CAPITAL FOR**
20 **MODELING PURPOSES?**

21 **A.** Yes. The reasons discussed earlier in this testimony as to when it is
22 appropriate to estimate plant and operating expenses, also support the use of
23 a reasonable estimate for cost of capital.

24

25 **Q. COULD THE COMPANY HAVE HIRED A WITNESS TO SUPPORT A NEW**
26 **COST OF CAPITAL TO BE UTILIZED IN THIS CASE?**

27 **A.** Yes. That was an option, but it was an option that made little common sense
28 in this case. As several parties have pointed out, this is a certificate, not a
29 general rate case, and while new rates will be established, the typical rate
30 case approach simply does not apply. This case is one to decide whether it is
31 in the public interest for Missouri-American to acquire certain assets and as a

1 result serve 81 new combination water and sewer customers. At the local
2 public hearing, those customers testified overwhelmingly in support of the
3 acquisition and many supported the Company's rate proposal. It simply made
4 no sense to spend the tens of thousands of dollars that would be necessary
5 to employ witnesses to argue a cost of capital issue in this proceeding when a
6 reasonable alternative already existed.

7
8 **Q. WHAT ISSUE DO YOU HAVE WITH THE FEDERAL INCOME TAX RATE**
9 **USED BY THE STAFF IN ITS EMS RUN?**

10 **A.** According to Schedule PRH-2 attached to the rebuttal testimony of Mr.
11 Harrison, the Staff reflected an effective Federal income tax rate of 14.13%.
12 The Company believes that an effective Federal rate of 33.18% should have
13 been used.

14
15 **Q. DO YOU KNOW HOW THE STAFF DERIVED THE RATE THAT WAS**
16 **USED?**

17 **A.** The statutory Federal tax rate for taxable net income of \$50,000 and below is
18 15%. After deducting state income taxes at the state statutory rate of 6.25%,
19 an effective Federal rate of 14.13% for that level of net income is derived.
20 The Staff's model apparently assumes that the Saddlebrooke net income will
21 be taxed at the minimum rate.

22
23 **Q. WOULD THAT BE A CORRECT ASSUMPTION?**

24 **A.** No. Once the assets of Saddlebrooke are acquired by Missouri-American,
25 any earnings will become a part of the Company's consolidated tax return and
26 subject to Federal tax at the maximum rate.

27
28 **Q. IF EARNINGS ARE NOT CURRENTLY BEING TAXED AT THE MAXIMUM**
29 **RATE, WHY SHOULD THE MAXIMUM TAX RATE BE INCLUDED IN**
30 **DETERMINING NEW RATES?**

1 **A.** Because every dollar of earnings of the newly acquired properties will be
2 taxed as a part of the consolidated return from the first day that new rates are
3 in effect. To properly develop revenue requirements, it is necessary to match
4 rates with expenses that will be incurred at the time those rates are in effect.
5 As noted previously, this case includes some expenses that require
6 estimation because the Company is proposing to provide a service that it is
7 not currently providing and thus not yet incurring any expenses. Even if the
8 Company was acquiring an existing unregulated operation where expenses
9 could all be identified, at least some expenses of the new entity would be
10 different in amount. Future expenses that will be incurred are required to be
11 addressed in determining rates. As far as the Federal tax rate goes, this is
12 not even an estimate. It is a known fact that Saddlebrooke earnings will be
13 taxed as part of a consolidated return and, as such, there should be no
14 question as to the appropriateness of reflecting the tax rate that will be in
15 effect after Missouri-American acquires ownership.

16

17 **Q. IF THE COST OF CAPITAL AND FEDERAL INCOME TAX RATE FLAWS**
18 **YOU DESCRIBED ARE CORRECTED, HOW WOULD THE REVENUE**
19 **REQUIREMENT DETERMINED BY THE STAFF MODEL AND THE MODEL**
20 **SUPPORTED BY THE COMPANY COMPARE?**

21 **A.** They would be almost identical.

22

23 **Q. MR. MERCIEL STATES ON PAGE 9 OF HIS REBUTTAL TESTIMONY**
24 **THAT THE PRIMARY REASON IT DID NOT AGREE TO THE COMPANY'S**
25 **PROPOSAL WAS THAT THE RATES DETERMINED BY STAFF WOULD**
26 **ALLOW THE COMPANY TO EARN A REASONABLE RETURN. DO YOU**
27 **AGREE?**

28 **A.** No. Unless the corrections I discussed are made, I do not agree. If those
29 corrections are made, I believe that the Staff's revenue requirement
30 determination would be consistent with the Company's and would be further

1 support for the reasonableness of applying the existing Stonebridge tariffs to
2 Saddlebrooke.

3
4 **III. RATE BASE**

5
6 **Q. ACCORDING TO YOUR EARLIER STATEMENTS, STAFF AND THE**
7 **COMPANY AGREE AS TO THE LEVEL OF SADDLEBROOKE RATE**
8 **BASE. WHAT ISSUES EXIST REGARDING RATE BASE LEVELS?**

9 **A.** Two issues have been raised by Office of the Public Counsel witness Ted
10 Robertson, each of which would serve to reduce the rate base level.

11
12 **Q. PLEASE EXPLAIN THE FIRST OF THOSE TWO ISSUES.**

13 **A.** The current Saddlebrooke operator has received two non-compliance letters
14 in regard to the existing facilities at Saddlebrooke. Improvements must be
15 made in order to comply with environmental regulations or to provide safe and
16 reliable service. These improvements include a spare well pump to be
17 available should there be an equipment failure, an additional groundwater
18 monitoring well for the sewage effluent area, and security fencing for the
19 water well, water tank site, and sewage treatment facility. The estimated cost
20 of these required improvements is \$31,000. Mr. Robertson objects to
21 inclusion of the \$31,000 expenditure in rate base for purposes of setting an
22 initial rate because they are not currently in service.

23
24 **Q. HOW DO YOU RESPOND TO MR. ROBERTSON'S CONCERN?**

25 **A.** The capital expenditures in question relate to plant items that should have
26 been undertaken by the current owner both for safety and compliance
27 reasons. If the owner had already invested the required \$31,000, ostensibly
28 the purchase price would have increased and Mr. Robertson would have no
29 problem with inclusion of those capital items in rate base. The current owner,
30 however, has either been unwilling or unable to make the necessary capital
31 investment and, as a result of the certification in this case enabling the

1 acquisition, the Company would immediately be required to undertake the
2 capital investment itself. This is not a case of the Company having the ability
3 to manage the timing of its capital investment. As a result of the acquisition,
4 the Company is required to effectuate the required improvements and must
5 do so rapidly. With the exception of approximately a month, during which
6 time construction will be in progress, the capital investment that Mr.
7 Robertson challenges will have been in service essentially the entire time that
8 rates resulting from this case are in place.

9

10 **Q. ARE YOU SURE THAT \$31,000 IS THE EXACT AMOUNT THAT WILL BE**
11 **INVESTED?**

12 **A.** No. The final investment may be slightly below or slightly above the \$31,000
13 estimate. However, that estimate is based on engineering estimates
14 performed by the Company and reviewed by the Staff. The estimate is
15 certainly more accurate than Mr. Robertson's estimate of zero and should be
16 utilized in evaluating the appropriate level of rates to be charged.

17

18 **Q. IN A RATE CASE, HAS THE COMPANY EVER REQUESTED INCLUSION**
19 **IN RATE BASE OF PLANT PLACED IN SERVICE BEYOND THE END OF**
20 **THE TRUE-UP PERIOD?**

21 **A.** Although I can conceive of unusual circumstances where the Company might
22 make such a request, I do not recall that such a request has been made. But
23 the question serves to accentuate an important point. This is not a rate case.
24 There is no true-up period. The Company cannot impact the timing of this
25 required investment. The Company is not in a position to make the required
26 improvements to the system prior to its ownership of that system. The
27 Company is not willing to advance the existing owner funds for capital
28 projects that may not be completed by him and for a system MAWC may or
29 may not ever own. For all these reasons, certificate cases are different than
30 rate cases. They require feasibility studies and estimates of investment and

1 operating expenses in order to determine a reasonable level at which rates
2 should be established.

3
4 **Q. PLEASE EXPLAIN MR. ROBERTSON'S SECOND RATE BASE**
5 **REDUCTION?**

6 **A.** Through its negotiation efforts, Missouri-American entered into an Agreement
7 that provided for the purchase of assets, subject to certain conditions and
8 satisfactory regulatory treatment, at a price about \$64,600 below the
9 estimated net book value of assets being acquired. As a result, generally
10 accepted accounting principles would allow the Company to record a one-
11 time net of tax gain of about \$38,800 as a result of the acquisition. Mr.
12 Robertson believes that the \$64,600 level of acquisition discount should be
13 used to reduce rate base instead. In addition, he believes that capacity
14 adjustments to rate base of \$278,450 (as explained in my rebuttal testimony)
15 should be made permanent whether or not additional capacity comes onto the
16 system in the future.

17
18 **Q. WHAT ARE ACQUISITION PREMIUMS AND DISCOUNTS?**

19 **A.** Simply stated, premiums occur when the purchase price of an acquired
20 property is more than the net book value of the assets acquired and discounts
21 occur when the purchase price is less than the net book value of assets
22 acquired.

23
24 **Q. HAS THE MISSOURI COMMISSION PREVIOUSLY INDICATED HOW**
25 **ACQUISITION DISCOUNTS AND PREMIUMS SHOULD BE TREATED FOR**
26 **RATEMAKING PURPOSES?**

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

1 As a general rule, only the original cost of utility plant to the first
2 owner devoting the property to public service, adjusted for
3 depreciation, should be included in the utility's rate base. That
4 principle is known as the net original cost rule.
5

6 The net original cost rule was developed in order to protect
7 ratepayers from having to pay higher rates simply because ownership
8 of utility plant has changed, without any actual change in the
9 usefulness of the plant. If a utility were allowed to revalue its assets
10 each time they changed hands, it could artificially inflate its rate base
11 by selling and repurchasing assets at a higher cost, while recovering
12 those costs from its ratepayers. Thus, ratepayers would be required to
13 pay for the same utility plant over and over again. The sale of assets
14 to artificially inflate rate base was an abuse that was prevalent in the
15 1920s and 1930s and such abuses could still occur.
16

17 An acquisition adjustment can be either positive or negative. In
18 other words, when a utility purchases an asset, it may pay more or less
19 than the net original cost of the asset. When the utility pays more than
20 net original cost, it is said to have paid an acquisition premium. But, in
21 some circumstances, a utility may be able to purchase assets at less
22 than net original cost. In that situation, the utility has a negative
23 acquisition adjustment.
24

25 Missouri has traditionally applied the net original cost standard
26 when considering the ratemaking treatment of acquisition adjustments.
27 That means that the purchasing utility has not been allowed to recover
28 an acquisition premium from its ratepayers. But it also means that
29 ratepayers do not receive lower rates through a decreased rate base
30 when the utility receives a negative acquisition adjustment. Even if a
31 company acquires an asset at a bargain price, it is allowed to put the
32 asset into its rate base at its net original cost. Similarly, ratepayers do
33 not share in the gains a utility may realize from selling assets at prices
34 above their net original cost. Those gains flow only to the utility's
35 shareholders.
36

37 In other words, if recovery of an acquisition premium is not allowed, then
38 conversely, an acquisition discount or negative acquisition adjustment should
39 not be used to reduce the net book value for rate base and rate making
40 purposes.
41

42 This principle was cited more recently by the Commission in a certificate case
43 (Case No. GA-2007-0168, concerning Southern Missouri Natural Gas

1 “SMNG”). In that case, Staff proposed a condition that stated that if before
2 SMNG had cost based rates, it disposed of its assets at a fair value less than
3 net original cost, then the new owner would be expected to reflect those
4 assets on its books at its purchase price or the fair value of the assets rather
5 than net original cost. The Commission declined to impose this condition,
6 stating in part:

7 The Commission also observes that there are strong precedents
8 against allowing acquisition premiums to be reflected in rates when the
9 assets are purchased at more than book value. For example, the
10 Commission has stated that it will not require a company to write down
11 its rate base when the assets are sold at less than book value. In
12 addition, Mr. Oligschlaeger testified that the Uniform System of
13 Accounts requires that the use of “net original cost” for ratemaking, and
14 that it would require a waiver if a public utility requested the accounting
15 treatment now being advocated by Staff.
16

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

18 A. Yes. Retaining rate base at net original cost as a result of an acquisition
19 protects the customers and provides the Company an incentive to achieve as
20 low a purchase price as possible. It is further equitable in that it balances the
21 interest of the acquiring utility and its customers by applying the same
22 treatment whether the acquisition is made at a premium or discount.
23

24 **Q. WHAT POSITION HAS THE OFFICE OF THE PUBLIC COUNSEL TAKEN**
25 **IN REGARD TO ACQUISITION PREMIUMS AND DISCOUNTS?**

26 A. At page 7, of his rebuttal testimony, Mr. Robertson states:

27 As a general rule Public Counsel believes acquisition adjustments
28 (whether a premium or discount) resulting from a change in
29 ownership should not flow through to ratepayers, but rather should be
30 borne by shareholders. In other words, ratepayers should not and do
31 not share in gains on asset dispositions, nor should they share in
32 losses on asset dispositions. OPC believes this consistent treatment
33 of acquisition adjustments yields the fairest result to both ratepayers
34 and utilities.
35

36 **Q. DO YOU AGREE WITH MR. ROBERTSON'S STATEMENT?**

1 **A.** On its face, I do. Mr. Robertson’s statement seems to indicate that regulatory
2 treatment of acquisition premiums should be the same or consistent with
3 acquisition discounts and that this consistent treatment is what is fair to both
4 ratepayers and customers. My interpretation of this statement would be that
5 whether an acquisition discount or premium is paid, rate base is predicated
6 upon the existing net book value of the assets acquired. This is consistent
7 with the net original cost standard identified above in the Commission’s
8 Report and Order in Case No. EM-2000-292. Thereby, the ratepayer is
9 unaffected by a contract negotiated by two outside parties. The rate base,
10 from which their rates are determined, is unchanged as a result of the
11 transaction.

12

13 **Q. IS THIS WHAT MR. ROBERTSON HAS PROPOSED?**

14 **A.** No. Mr. Robertson’s interpretation of “consistent treatment” is far from what I
15 would have imagined. His “consistent treatment” approach is one that does
16 not allow the purchasing utility to recover an acquisition premium, but at the
17 same time requires the Company to hand over any acquisition discount to its
18 customers. His statement that “...ratepayers should not and do not share in
19 gains on asset dispositions, **nor should they share in losses on asset**
20 **dispositions**” (emphasis added) is contradicted by his recommendation in
21 this case that any gain achieved by the purchaser and any loss sustained by
22 the seller of assets should flow to ratepayers.

23 OPC simply appears to take a “heads the customer wins, tails the Company
24 loses” approach to rate regulation.

25

26 **Q. DOES MR. ROBERTSON ADMIT THAT THE COMMISSION HAS**
27 **PREVIOUSLY DISAGREED WITH HIS INTERPRETATION OF THE NET**
28 **ORIGINAL COST STANDARD?**

29 **A.** Yes. He basically states that the Commission got it wrong and should revise
30 the language of its Report and Order in the case quoted.

31

1 **Q. WHAT IS THE PRACTICAL IMPACT OF MR. ROBERTSON'S**
2 **SUGGESTION?**

3 **A.** In every acquisition of an existing utility, there are two parties, purchaser and
4 seller. Assume in this example that the purchaser is a utility regulated by the
5 Missouri Public Service Commission and is acquiring utility assets from the
6 seller. If the acquiring utility pays in excess of the net book value recorded
7 on the seller's books, it is paying an acquisition premium. Mr. Robertson
8 argues that the PSC should apply the net original cost standard of regulation,
9 establish rate base at the seller's existing net book value of assets and ignore
10 the premium paid by the purchaser. As a result, the purchasing utility would
11 evaluate for impairment and likely record a loss. The seller, on the other
12 hand, would likely record a gain. Mr. Robertson says that the purchaser
13 should bear the loss and that the PSC should ignore the gain recorded by the
14 seller. The Company agrees with this approach because the ratepayer is left
15 in the same position as prior to the acquisition. The purchasing utility
16 negotiated the purchase price and should absorb any loss as a result thereof.

17
18 On the other hand, if the acquiring utility pays less than the net book value for
19 the assets acquired, it is paying an acquisition discount. Under the net
20 original cost standard the purchasing utility would typically record a gain and
21 the seller would normally book a loss. However, Mr. Robertson now argues
22 that the PSC should not apply the net original cost standard, should not
23 establish rate base at the seller's existing net book value of assets and should
24 not ignore the discount paid by the purchaser. Instead, Mr. Robertson says
25 that the purchaser should forfeit any gain, that the PSC should look to the
26 books of the seller and flow any loss that the seller has incurred back to the
27 benefit of the ratepayer.

28
29 Through a roller coaster of logic, Mr. Robertson asserts that in the former
30 instance, the Commission should look to the purchaser's books. The
31 purchaser is required to record a loss because under the net original cost

1 standard it cannot pass along the acquisition premium to its customers.
2 However, in the latter instance, Mr. Robertson suggests that the Commission
3 should ignore the books of the purchaser – the regulated utility - and instead
4 note that there is a loss recorded on the books of the seller, which he
5 suggests should flow to the ratepayer.

6

7 **Q. DOES THIS FIT YOUR INTERPRETATION OF CONSISTENT**
8 **TREATMENT?**

9 **A.** No. In either example above, there is a loss on the part of one party and a
10 gain on the part of the other. Consistent treatment is to ignore the gains or
11 losses of both parties to the acquisition and establish rates based upon the
12 existing net original cost less depreciation. This leaves the ratepayer un-
13 impacted by the sale/purchase of assets, a transaction in which they were not
14 directly involved and from which they should be insulated. This is the
15 purpose of the net original cost standard as stated by the PSC in Case No.
16 EM-2000-202 and reflects consistent treatment. Public Counsel's proposal
17 does not.

18

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

20 **A.** Yes, it does.

21