

DIRECT TESTIMONY
OF
KIMBERLY K. BOLIN

MISSOURI-AMERICAN WATER COMPANY
AND CEDAR HILL UTILITY COMPANY

CASE NO. SM-2004-0275

1 **Q. PLEASE STATE YOUR NAME AND ADDRESS.**

2 A. Kimberly K. Bolin, P.O. Box 2230, Jefferson City, Missouri 65102.

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

4 A. I am employed by the Office of the Public Counsel of the State of Missouri (OPC or Public
5 Counsel) as a Public Utility Accountant I.

6 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

7 A. I graduated from Central Missouri State University in Warrensburg, Missouri, with a Bachelor of
8 Science in Business Administration, major in Accounting, in May, 1993.

9 **Q. WHAT IS THE NATURE OF YOUR CURRENT DUTIES WITH THE OFFICE OF**
10 **THE PUBLIC COUNSEL?**

11 A. Under the direction of the Chief Public Utility Accountant, I am responsible for performing audits
12 and examinations of the books and records of public utilities operating within the state of Missouri.

13 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE MISSOURI PUBLIC**
14 **SERVICE COMMISSION?**

15 A. Yes. Please refer to Schedule KKB-1, attached to this direct testimony, for a listing of cases in
16 which I have previously submitted testimony.

1 **Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?**

2 A. The purpose of my direct testimony is to express the Public Counsel's position regarding the
3 acquisition premium that exists in this transaction.

4 **Q. WHAT IS THE PURCHASE AMOUNT?**

5 A. ** _____.**

6 **Q. IS THE PURCHASE PRICE THE SAME AS CEDAR HILL UTILITY**
7 **COMPANY'S RATE BASE?**

8 A. No.

9 **Q. WHAT IS RATE BASE?**

10 A. Rate base is the investor-supplied plant and other investments required to supply utility service to
11 customers.

12 **Q. HOW IS RATE BASE CALCULATED?**

13 A. Rate Base is calculated by taking the original cost of plant first devoted to public service minus
14 accumulated depreciation to arrive at net plant in service. Then various other items are added or
15 deducted from net plant in service to arrive at rate base. One of the items deducted is contributions
16 in aid of construction (CIAC).

17

1 **Q. WHAT IS CIAC?**

2 A. CIAC is monies contributed to the utility through its customers or others for the express purpose of
3 reimbursing the company for the investment necessary to serve the customer. CIAC represents
4 plant paid for by the customer and not the utility itself. The utility does not receive a return on the
5 plant since no investment was made by the utility in that plant.

6 **Q. PLEASE PROVIDE A BREAKDOWN OF CEDAR HILL UTILITY COMPANY'S**
7 **RATE BASE.**

8 A. The following is as of March 31, 2004:

9	Original Plant in Service	\$437,716
10	Less: Depreciation	<u>\$131,427</u>
11	Net Plant in Service	\$306,289
12	Less: Net CIAC	<u>\$292,981</u>
13	Rate Base	\$13,308

14 This amount would be then included in the determination of rate base.

15 **Q. HAVE YOU EXAMINED THE CEDAR HILL UTILITY COMPANY'S FINANCIAL**
16 **RECORDS TO DETERMINE IF OTHER ITEMS SHOULD BE INCLUDED IN THE**
17 **DETERMINATION OF RATE BASE?**

18 A. Yes I have. I reviewed the Cedar Hill Utility Company's (Cedar Hill Utility) annual report for 2003
19 that was filed with the Missouri Public Service Commission (Commission). There are no other
20 assets of Cedar Hill Utility, which would be included in rate base. The only other listed assets of
21 Cedar Hill Utility include Cash (\$172,688) and Other Assets (Accounts receivable, etc.) (\$20,890).

1 These items are not included in rate base as they are either cash or are easily convertible to cash
2 and thus require no investment by the stockholder in order to provide utility service.

3 **Q. IF THE COMMISSION APPROVES THIS TRANSATION SHOULD THE RATE**
4 **BASE CHANGE?**

5 A. No. The commission should only approve this acquisition if any premium paid is excluded from
6 rate base.

7 **Q. WHAT IS THE PREMIUM YOU REFERRED TO IN THE PREVIOUS ANSWER?**

8 A. A premium, commonly referred to as an acquisition adjustment for ratemaking purposes refers to
9 the method a regulated utility uses to account for an amount paid, in excess of net book value, by
10 the acquiring company. Net book value is the original cost of the property when the property is first
11 placed in public service minus accumulated depreciation, amortization and CIAC. Original cost, as
12 applied to utility plant, means the cost of the property to the utility devoting it to public service. In
13 addition, the cash value of other assets such as cash or cash equivalents (accounts receivables,
14 materials and supplies) would also be included in the net book cost of the utility being sold.

15 If the utility property is purchased by another utility, the purchaser must record the acquisition in
16 the appropriate plant and property accounts at the selling utility's original cost. Any difference
17 between the original cost and the actual price paid by the subsequent purchaser is recorded as the
18 acquisition adjustment. An acquisition adjustment recognizes that a purchase price that differs from
19 net book value does not represent a contribution of capital (i.e., neither cash or new investment) to
20 the public service. This adjustment merely represents a purchase of the legal interest in the
21 properties that were possessed by the seller.

1 **Q. WHAT DOES THE ACQUISITION PREMIUM REPRESENT?**

2 A. The acquisition premium merely represents a financial transaction among shareholders. A portion
3 of the acquisition premium actually represents the procurement of additional shareholder value (a
4 control premium) that exceeds the market price of the selling utility investment. The resulting
5 financial gain to the seller has nothing to do with the determination of the value of the actual plant
6 and service necessary to operate the system and provide services to utility customers. As far as
7 those investments are concerned, the purchase transaction itself changes nothing. The investment in
8 plant in service and thus rate base will remain fixed until the new owners invest in additional plant
9 in service.

10 **Q. DOES AN ACQUISITION PREMIUM PROVIDE ANY ADDITIONAL BENEFITS**
11 **TO MISSOURI RATEPAYERS?**

12 A. No. The acquisition premium is merely that part of the financial purchase price that exceeds the net
13 original cost value of the acquired utility. Acquisition premiums do not provide any additional
14 benefits to Missouri ratepayers; therefore, allowing the purchasing company to recover the premium
15 through a return on rate base or as an expense related to the cost of providing service unjustly
16 penalizes the customers. Acquisition premiums result in additional earnings (i.e., profit from the
17 sale) to the seller.

18 **Q. HOW WOULD THE RECOVERY OF THE ACQUISITION PREMIUM PENALIZE**
19 **THE CUSTOMERS OF CEDAR HILL UTILITY?**

20 A. The current rate base of Cedar Hill Utility is derived from the original cost of the property when it
21 was first dedicated to public use, plus any additional investments which Cedar Hill Utility financed
22 less depreciation. The purchase of Cedar Hill Utility's assets does not affect the property's net

1 original cost. A substitution of owners does not establish a new utility company. The assets
2 transferred will continue to be used to provide the same services to the same ratepayers and those
3 assets will remain subject to the same ratemaking jurisdiction of the Missouri Public Service
4 Commission. If any recovery of the acquisition premium through rates would increase costs to
5 Missouri customers, the acquisition premium is a detriment. The reason it is a detriment to
6 customers is their rates would be higher than if the sale had not occurred, for no other reason than a
7 change of ownership.

8 **Q. HAVE THE RATEPAYERS ALREADY PAID FOR THE VAST MAJORITY OF**
9 **PLANT IN SERVICE OF CEDAR HILL UTILITY?**

10 A. Yes they have. As previously stated, the rate base of Cedar Hill Utility shows that the ratepayer has
11 paid for 97% of the original cost of the plant in service via depreciation expense and CIAC. To
12 include an acquisition adjustment in future rates related to the acquisition of plant that is already
13 97% paid for would effectively require ratepayers to pay for this plant twice.

14 **Q. ARE THE CONNECTION FEES THAT CEDAR HILL UTILITY CUSTOMERS PAY**
15 **CONSIDERED CIAC?**

16 A. Yes. The connection fees or tap-on fees as they are sometimes called are listed in the Cedar Hill
17 Utility's tariff sheets. Cedar Hill Utility collects a connection charge from a new customer at a new
18 location. The connection fees enable Cedar Hill Utility to provide service to the customer without
19 the Cedar Hill Utility investing any additional money.

20 **Q. ARE CONNECTION FEES INCLUDED IN THE COMMISSION APPROVED**
21 **TARIFFS FOR CEDAR HILL UTILITY?**

22 A. Yes.

1 **Q. PLEASE PROVIDE THE USOA (UNIFORM SYSTEM OF ACCOUNTS)**
2 **DEFINITION OF CONTRIBUPTIONS IN AID OF CONSTRUCTION.**

3 A. Account 271. Contributions in Aid of Construction.

4 A. This account shall include donations or contributions in cash, services, or
5 property from states, municipalities, or other governmental agencies,
6 individuals, and others for construction purposes.

7 B. The credits to this account shall not be transferred to retained earnings or
8 to any other account without the approval of the Commission.

9 C. The records supporting the entries to this account shall be so kept that the
10 utility can furnish information as to the purpose of each donation, the
11 conditions, if any, upon which it was made, the amount of donations from
12 (a) states, (b) municipalities, (c) customers, and (d) others, and the amount
13 applicable to each utility department.

14 **Q. HOW MUCH OF CEDAR HILL UTILITY'S PLANT IS CLASSIFIED AS CIAC?**

15 A. \$292,981.

16 **Q. WHERE DID YOUR CIAC NUMBER COME FROM?**

17 A. I obtained my CIAC number from the Missouri Public Service Commission Staff's
18 Recommendation filed in this case on May 5, 2004.

19 **Q. SINCE THIS PROPOSED ACQUISITION INCLUDES A PURCHASE PRICE THAT**
20 **EXCEEDS RATE BASE, WOULDN'T IT BE EASIER TO SIMPLY REJECT THE**
21 **APPLICATION?**

22 A. No. Public Counsel does not know the current levels of cash or cash equivalents as of March 31,
23 2004. However to the extent the purchase price exceeds the rate base plus cash or cash equivalents
24 included in the purchase, the Commission could approve the asset transfers with the clear directive
25 that any acquisition premium related to the purchase shall **not** be included in future ratemaking
26 procedures.

1 | **Q. WHY WOULD AN ACQUIRING COMPANY PAY AN ACQUISITION PREMIUM FOR**
2 | **A REGULATED UTILITY?**

3 | A. Some reasons include the potential for customer growth in a given area, economies of scale that
4 | may be available if one utility acquires a neighboring utility, or a company's long-term acquisition
5 | and market strategies.

6 | **Q. DOES CEDAR HILL UTILITY ALSO HAVE AN UNUSUAL CIAC SITUATION?**

7 | A. Yes. One of Cedar Hill Utility's customers, Northwest High School, paid approximately 60 % of
8 | the Company's Sand Creek wastewater treatment facility in order for Cedar Hill Utility to provide
9 | service to the school.

10 | **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

11 | A. Yes.