

Exhibit No.: _____
Issue(s): Acquisition Rate Base Valuation/
Metropolitan St. Louis
Sewer District Agreement
Witness/Type of Exhibit: Robertson/Surrebuttal
Sponsoring Party: Public Counsel
Case No.: WR-2011-0337

SURREBUTTAL TESTIMONY

OF

TED ROBERTSON

Submitted on Behalf of the Office of the Public Counsel

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2011-0337

**

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**Denotes Highly Confidential and Proprietary information
that has been redacted**

February 2, 2012

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TABLE OF CONTENTS

<u>Testimony</u>	<u>Page</u>
Introduction	1
Purpose of Testimony	1
Acquisition Rate Base Valuation	2
Metropolitan St. Louis Sewer District Agreement	12

1 SURREBUTTAL TESTIMONY
2 OF
3 TED ROBERTSON
4

5 MISSOURI AMERICAN WATER COMPANY
6 CASE NO. WR-2011-0337
7

8
9 I. INTRODUCTION

10 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

11 A. Ted Robertson, P. O. Box 2230, Jefferson City, Missouri 65102.
12

13 Q. ARE YOU THE SAME TED ROBERTSON THAT HAS PREVIOUSLY FILED
14 DIRECT AND REBUTTAL TESTIMONY IN THIS CASE?

15 A. Yes.
16

17 II. PURPOSE OF TESTIMONY

18 Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

19 A. The purpose of this Surrebuttal Testimony is to address the Rebuttal Testimonies of
20 Missouri-American Water Company (MAWC or Company) witness, Mr. Dennis R.
21 Williams, and Missouri Public Service Commission (MPSC) Staff witness, Mr. Paul R.
22 Harrison, regarding the rate base valuation and ratemaking treatment of the Loma Linda
23 Water Company (Loma Linda), Aqua Missouri, Inc./Aqua Development, Inc. &
24 Aqua/RU Inc. (Aqua) and Roark Water and Sewer, Inc. (Roark) acquisitions. I will also
25 address the Rebuttal Testimonies of Company witness, Mr. Dennis R. Williams and

1 Metropolitan St. Louis Sewer District (MSD) witnesses, Ms. Janice M. Zimmerman and
2 Mr. Keith D. Barber regarding the MSD Agreement.

3
4 III. ACQUISITION RATE BASE VALUATION

5 Q. DOES MR. WILLIAMS BELIEVE THAT COST RECOVERY FOR THE
6 ACQUISITIONS SHOULD BE BASED ON THE SELLER'S BOOKED COST?

7 A. It would appear that he does. Beginning on page 15, line 2, of his Rebuttal Testimony, he
8 states:

9
10 Retaining rate base at net original cost as the result of an acquisition
11 protects the customers and provides the Company an incentive to achieve
12 as low a purchase price as possible. It is further equitable in that it
13 balances the interest of the acquiring utility and its customers by applying
14 the same fair treatment whether the acquisition is made at a premium or
15 discount.
16
17

18 Q. DO YOU AGREE WITH MR. WILLIAMS'S RECIPROCITY POSITION?

19 A. No. The rationale for disallowing a purchaser recovery of an acquisition premium is
20 based on the fact that the only thing that changed in the transaction was ownership. The
21 plant and its usefulness did not change; therefore, ratepayers are to be protected from
22 higher rates that would occur if the acquisition premium were incorporated into the
23 development of rates. Furthermore, I believe that ratepayers should also be protected
24 from paying higher rates when assets are sold for less than book value. The acquisition

1 discount results from the seller's decision to sell their assets at a loss; thus, since gains do
2 not flow through to ratepayers neither should losses. Mr. Williams apparently believes
3 that ratepayers should be required to pay MAWC for the seller's loss. That is not
4 reciprocity; it is inappropriate recovery on and of an investment for which no cost was
5 incurred.

6
7 Q. DID MR. WILLIAMS PROVIDE ANY SUPPORTING MATERIAL TO
8 SUBSTANTIATE HIS BELIEF THAT RECIPROCITY IS THE "EQUITABLE"
9 METHODOLOGY THAT SHOULD BE FOLLOWED WHEN DETERMINING
10 RATEMAKING FOR ACQUISITION ADJUSTMENTS?

11 A. Yes. Beginning on page 13, line 19, of his Rebuttal Testimony, Mr. Williams cites the
12 Second Report and Order in Case No. EM-2000-292. The Order states, in part, "as a
13 general rule" the net original cost rule was developed in order to protect ratepayers from
14 having to pay higher rates simply because ownership of utility plant has changed, without
15 any actual change in the usefulness of the plant. It also states, "But it also means that
16 ratepayers do not receive lower rates through a decreased rate base when the utility
17 receives a negative acquisition adjustment. Even if a company acquires an asset at a
18 bargain price, it is allowed to put the asset into its rate base at its net original cost.
19 Similarly, ratepayers do not share in the gains a utility may realize from selling assets at
20 prices above their net original cost. Those gains flow only to the utility's shareholders."
21

1 Q. DO YOU BELIEVE THAT THE ORDER CITED ABOVE CORRECTLY EXPLAINS
2 THE APPROPRIATE RATEMAKING FOR ACQUISITION DISCOUNTS?

3 A. No, I do not. The Order states that because the general rule is to disallow recovery of
4 acquisition premiums; rate base should not be lowered to account for acquisition
5 discounts. Yet, in the very last sentence quoted, the Order recognizes the long-held
6 ratemaking concept that gains on assets sales do not flow through to ratepayers since they
7 do not hold any ownership rights. If gains do not flow to ratepayers neither should
8 losses. However, that is exactly what would occur if rate base were not reduced by the
9 acquisition discount. The losses of the seller would be incorporated into the rate base of
10 the buyer and the buyer would recover the losses incurred by the seller. That is
11 nonsensical. The language in the Order has mismatched the appropriate ratemaking that
12 should occur and should be treated as irrelevant with regard to ratemaking treatment of
13 acquisition discounts.

14
15 Q. DID MR. WILLIAMS CITE ANY OTHER ORDERS TO SUPPORT HIS POSITION?

16 A. Yes. Beginning on page 14, line 28, of his Rebuttal Testimony, Mr. Williams cites page
17 17 of the Report and Order, Case No. GA-2007-0168. Case No. GA-2007-0168 was a
18 request by Southern Missouri Natural Gas (SMNG) for a Certificate of Public
19 Convenience and Necessity. It was not a general rate case. On page 17, the Commission
20 is discussing a Staff condition that if the SMNG assets are sold or disposed at a value less
21 than net original cost prior to the introduction of cost based rates the new owner will

1 reflect those assets on its books at its purchase price (ironically, Staff's position in the
2 current case is the exact opposite of the Staff's position in the SMNG case).

3
4 The Commission did not approve the condition, nor did it make any ratemaking
5 authorization in the case. In fact, on page 17 of the Report and Order, as cited by Mr.
6 Williams, the Commission stated, "the Commission has stated that it will not require a
7 company to write down its rate base when the assets are sold at less than book value."
8 However, this language in the SMNG Report and Order is cited as being from the
9 Commission Second Report and Order, Case No. EM-2000-292, previously discussed.

10
11 Q. IS THE ACQUISITION DISCOUNT LANGUAGE REFERENCED IN THE SMNG
12 REPORT AND ORDER AN ACCURATE REPRESENTATION OF THE ACTUAL
13 LANGUAGE IN THE CASE NO. EM-2000-292 SECOND REPORT AND ORDER?

14 A. No, it is not. Apparently, the Judge in the SMNG case chose to paraphrase the actual
15 language (see my testimony above for the actual language as quoted by Mr. Williams
16 from, page 5, of the Second Report and Order, Case No. EM-2000-292). In Case No.
17 EM-2000-292, the Commission did not state, "the Commission has stated that it will not
18 require a company to write down its rate base when the assets are sold at less than book
19 value." It did discuss the reciprocity concept, but as I explained earlier, I believe that
20 they confused the issue entirely.

1 Q. DOES MR. WILLIAMS EXPRESS HIS OPINION ON OPC'S RATIONALE FOR ITS
2 POSITION ON THIS ISSUE?

3 A. Yes. On page 15, lines 17-18, of his Rebuttal Testimony, he states, "OPC simply appears
4 to take a "heads the customer wins, tails the Company loses" approach to rate regulation."
5

6 Q. HAS MR. WILLIAMS ACCURATELY REPRESENTED OPC'S RATIONALE FOR
7 THE POSITIONS IT HAS TAKEN?

8 A. No. Although his heads versus tails statement is somewhat comical, intermixed with a
9 tinge of despair, it is nowhere accurate. OPC's rationale for the positions taken on this
10 issue, succinctly stated, is that acquisition premiums should not be allowed rate base
11 treatment to avoid charging ratepayers higher rates when the only thing that changed in
12 an acquisition was ownership while rate base should be reduced by the amount of
13 acquisition discounts to reflect that the seller of regulated utility assets owns both gains
14 and losses and to prevent the buyer from unjust recovery of asset costs (investment)
15 which it received free of charge. The Commission should accept the OPC's position
16 because it is based on the actual facts surrounding the acquisitions and not some
17 unsubstantiated and oft misconstrued concept of reciprocity which does not exist.
18

19 The Commission has often recognized that acquisition premiums should not be recovered
20 from ratepayers while acquisition discounts are a rare occurrence which has not been, to
21 my knowledge, an issue decided in any contested general rate case in the state of

1 Missouri. However, authoritative literature does exist which describes how acquisition
2 discounts should be treated in the ratemaking process. In the ratemaking reference book,
3 Hahne & Aliff, Accounting for Public Utilities (Matthew Bender), 4.04[2], p. 4-10, 4-11,
4 it states:

5
6 On occasion, a utility may purchase used plant at a price lower than the
7 net book value in the hands of the selling utility, thus creating a negative
8 acquisition adjustment. These transactions are generally accounted for by
9 a debit to plant in service for the net original cost with a credit to the
10 acquisition adjustment account for the deficiency. In these cases, a similar
11 question arises regarding the handling of the credit acquisition
12 adjustments for ratemaking purposes. The regulatory commissions and
13 courts have varied in their opinions as to the appropriate treatment of these
14 balances and have not necessarily followed the same reasoning as
15 followed regarding ratemaking treatment for debit adjustments. In
16 general, credit balances are used to reduce the rate base and are also
17 amortized above-the-line (as a reduction of operating expenses) with what
18 appears to be greater frequency than corresponding treatment for debit
19 adjustments. However, the FERC currently treats a negative acquisition
20 adjustment as a credit to accumulated depreciation.

21
22 (Emphasis added by OPC.)
23
24

25 The Federal Energy Regulatory Commission credit methodology increases the
26 accumulated depreciation balance which offsets plant in service and effectively reduces
27 the net plant to the purchase price paid in the acquisition. Thus, OPC's rationale is based
28 on sound ratemaking concepts and not the entertaining, but meritless, colloquialism
29 provided by Mr. Williams.
30

1 Q. WHY HAS STAFF TAKEN THE POSITION TO NOT RECOGNIZE ACQUISITION
2 PREMIUMS OR DISCOUNTS IN RATE BASE?

3 A. On page 4, line 3, of Mr. Harrison's Rebuttal Testimony, he states:

4

5 Staff deems this position to be good practice.
6
7

8 Q. DOES MR. HARRISON PROVIDE ANY AUTHORITATIVE SOURCES,
9 COMMISSION ORDERS OR ANY OTHER DOCUMENTATION TO
10 SUBSTANTIATE THE MEANING OF THE TERM "GOOD PRACTICE" AND WHY
11 IT IS THE BASIS FOR NOT RECOGNIZING ACQUISITION ADJUSTMENTS IN
12 RATE BASE?

13 A. No authoritative sources, Commission orders or other documentation are included in his
14 testimony; however, he does include testimony which mostly buttresses one of the
15 reasons why acquisition premiums are not included in rate base. On page 4, lines 3-8, he
16 states:

17

18 The net original cost is the most objective and verifiable method to value
19 rate base assets. Differences in the purchase price and net book value of
20 utility assets often relate to expectations of future efficiencies or saving in
21 the utility's operations caused by the new owners of the utility assets, but
22 the existence and the amount of such efficiencies and savings are often
23 very difficult or impossible to "prove up" in rate proceedings.
24
25

1 Q. DOES HIS TESTIMONY FURTHER EXPOUND ON WHY STAFF BELIEVES
2 ACQUISITION DISCOUNTS SHOULD NOT BE RECOGNIZED IN RATE BASE?

3 A. No. It seems to me that Mr. Harrison believes if acquisition premiums are not recognized
4 in rate base, reciprocity dictates that acquisition discounts should not either.

5
6 Q. SHOULD SOUND RATEMAKING BE BASED ON AN ILLOGICAL RECIPROCITY
7 POSITION?

8 A. No. As I discussed in my Direct Testimony, the rationale for disallowance of acquisition
9 premiums is well documented and supported by Commission decisions in prior cases. As
10 such, the rationale for allowing recovery on and of an acquisition discount should be
11 documented and supported too. Staff's apparent reliance on an ambiguous "best practice"
12 and/or a simple illogical reciprocity belief does not address the actual accounting or
13 ratemaking associated with acquisition discounts.

14
15 Q. SHOULD THE COMMISSION BASE ITS DECISION ON THE RATEMAKING OF
16 AN ACQUISITION DISCOUNT ON THE FACTS ASSOCIATED WITH THE
17 TRANSACTION ITSELF AND NOT SOME ILL-ADVISED RECIPROCITY BELIEF
18 OR AMBIGUOUS "BEST PRACTICE?"

19 A. Yes, it should. The facts associated with the Roark acquisition identify that the
20 transaction resulted in a substantial acquisition discount. That is, the assets were
21 purchased far below book because the seller chose to take a loss on the sale (a loss which

1 should be reduced significantly via future tax benefits and CIAC fee recovery). Further,
2 MAWC will not be harmed in any way if it is not authorized recovery on and of the
3 assets associated with the acquisition discount since it will in all likelihood be authorized
4 recovery on and of its actual investment cost. The only party that stands to be harmed, at
5 all, is the seller, but they, of their own accord, made the decision to take a loss on the
6 sale. A loss which should not be inappropriately converted into a gain for MAWC. Even
7 if MAWC is denied recovery on and of the assets associated with acquisition discount, it
8 will benefit from the cost-free use of those revenue producing assets for their entire
9 remaining life. In essence, if the Commission accepts the OPC's recommendation, both
10 MAWC's shareholders and ratepayers benefit from the seller's decision to sell its property
11 at a loss.

12
13 Q. ON PAGE 6, LINES 4-8, OF HIS REBUTTAL TESTIMONY, MR. HARRISON
14 STATES THAT IF THE SELLERS OF THE UTILITIES HAD INSTEAD FILED RATE
15 CASES, THE RATE BASE STAFF WOULD HAVE INCLUDED IS THE SAME AS
16 THAT WHICH WAS INCLUDED FOR MAWC. IS THAT AN ACCURATE
17 REPRESENTATION OF WHAT WOULD HAVE HAPPENED HAD THE SELLERS
18 INSTEAD FILED RATE CASES?

19 A. Yes, most likely it is, but the question and answer are non sequitur as far as the instant
20 case is concerned. The prior owners did not file rate cases; they instead voluntarily sold
21 their assets for prices either higher or lower than their booked cost. On one hand Loma

1 Linda and Aqua received a gain on the asset sales and on the other Roark incurred a loss.
2 To my knowledge, the Commission does not have the authority to dictate the purchase
3 price associated with the transfers, but it does have the responsibility to determine the
4 proper ratemaking of the associated assets. Thus, the ratemaking associated with the
5 assets at issue should be based on the facts and evidence present in this case and not
6 some hypothetical case which never existed.
7

8 Q. ON PAGE 6, LINES 9- 12, OF HIS REBUTTAL TESTIMONY, MR. HARRISON
9 STATES THAT MAWC IS NOT REQUESTING RECOVERY OF THE
10 ACQUISITION PREMIUM ASSOCIATED WITH THE LOMA LINDA
11 ACQUISITION. IS HE CORRECT?

12 A. Not necessarily. Apparently, Mr. Harrison has not reviewed the Company's response to
13 OPC Data Request No. 1126 and its later update. As I discussed in my Direct Testimony,
14 page 9, the initial purchase price identified was ** **; whereas, Company
15 workpaper Schedule CAS-3-LL shows a December 31, 2010 (just prior to the closing
16 date) rate base of ** **. Based on those MAWC provided amounts the
17 acquisition resulted in an acquisition discount and Company sought recovery on and of
18 the higher booked cost rather than the purchase price.
19

20 Whereas, the update to OPC Data Request No. 1126 provided information that the final
21 purchase price was ** ** and the actual rate base, at the closing date, was

1 ** ** which results in an acquisition premium being paid for the assets. To
2 my knowledge, Company has provided no information whether it is continuing to seek
3 recovery on and of the rate base identified in its workpapers, the actual updated rate base
4 or the actual final purchase price. If Company ultimately identifies that it does not wish
5 to seek recovery on and of the acquisition premium it incurred in the transaction, then the
6 Loma Linda (and possibly the Aqua) portion of this issue will have been resolved;
7 otherwise, it remains a contested issue.

8
9 IV. METROPOLITAN ST. LOUIS SEWER DISTRICT AGREEMENT

10 Q. DOES MR. WILLIAMS BELIEVE THAT THE CURRENT COMPENSATION
11 METHODOLOGY BENEFITS RATEPAYERS?

12 A. Yes. On page 11, lines 30-33, of his Rebuttal Testimony, he states:

13
14 Missouri-American Water provides billing data services to MSD at a flat
15 fee. Revenue received is recorded above the line and therefore as long as
16 it exceeds the marginal cost of providing the services benefits other
17 customers in the St. Louis County district.
18
19

20 Q. WHY DOES PUBLIC COUNSEL DISAGREE WITH MR. WILLIAMS?

21 A. Public Counsel does not disagree entirely with the essence of Mr. Williams statement.
22 The compensation provided by MSD appears to exceed the incremental cost of MAWC
23 creating a methodology to produce the data to MSD (based on a 2007 analysis, but the

1 current incremental cost is actually unknown because MAWC has not updated the 2007
2 analysis even though its cost structure has changed as evidenced by the rate increases that
3 have occurred since). MSD's payments also provide additional funding that goes towards
4 meeting MAWC's total costs to create and provide the data. However, the issue is not
5 whether all MAWC customers in the St. Louis district benefit from the agreement. The
6 issue is whether MAWC customers who are not MSD customers are harmed by being
7 forced to pay above cost rates for the creation and production of the data to MSD
8 customers who are MAWC customers and whether the compensation provided represents
9 a fair allocation of costs. Public Counsel believes that they are.

10
11 Q. PLEASE EXPLAIN YOUR POSITION.

12 A. For illustration purposes (actual customer-related numbers and dollar amounts are
13 described in my Direct Testimony), assume that the MAWC St. Louis district has 100
14 customers, the total cost to create and utilize the billing data is \$100 and MSD does not
15 require the information. Using those criteria the 100 MAWC customers would be
16 responsible for compensating the Company for the entire \$100 it incurs to create and
17 utilize the billing data.

18
19 Now, assume 50 of those 100 customers are also MSD customers and MSD requires the
20 billing data since it has decided not to develop its own systems to capture and create the
21 information. Fairness would seem to dictate that MSD, a totally separate and unaffiliated

1 utility service, should be required to pay 50% of the \$100 total so that MAWC customers
2 would pay \$50 and MSD customers would pay \$50 (in reality the relevant MSD
3 customers are also MAWC customers and they would end up paying a total of \$75 out of
4 the \$100 (i.e., MSD specific \$50 plus 50% of MAWC's \$50)). However, since MAWC
5 also requires the data for billing its customers that are MSD customers some of those
6 costs should flow through MAWC rates.

7
8 To account for the fact that both MAWC and MSD require the data for the 50 customers
9 who are MSD customers, 50% of the total \$100 should be assigned to MAWC customers
10 who are not MSD customers and the remaining \$50 should be split evenly between
11 MAWC and MSD. MAWC customers would be responsible for \$75 (i.e., \$50 plus (\$50
12 multiplied 50%)). MSD's customers would be responsible for the remaining \$25. The
13 end result would be that MAWC customers that are also MSD customers would be
14 responsible for \$62.50 of the \$100 for the two utility services they receive (i.e., \$75
15 multiplied by 50% plus \$25) - not the \$75 a full 50%/50% assignment would yield.
16 Whereas, MAWC customers who are not MSD customers would pay the remaining
17 \$37.50. If MSD pays anything less MAWC customers who are not MSD customers are
18 harmed.
19

1 Q. PER THE AGREEMENT WITH MSD, DOES MAWC RETAIN THE RIGHT TO
2 REQUEST COMPENSATION BASED ON ANY METHODOLOGY OTHER THAN
3 INCREMENTAL COST?

4 A. ** **. On page 8, of the Water Usage Data Agreement between MAWC and MSD,
5 it states:

6
7 **

8
9
10 **

11
12
13 Q. ON PAGE 12, LINES 29-30, OF MR. WILLIAMS'S REBUTTAL TESTIMONY, HE
14 STATES, "THE RATE CAN BE CHANGED ONLY AFTER A FILING SEEKING TO
15 AMEND THE CONTRACT IN CONJUNCTION WITH THE COMPANY'S NEXT
16 RATE CASE." IS HIS TESTIMONY AN ACCURATE INTERPETATION OF THE
17 AGREEMENT?

18 A. I do not believe that it is. On page 6, of the Water Usage Data Agreement, it states:

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(Emphasis added by OPC.)

Continuing on page 8, it states:

**

**

(Emphasis added by OPC.)

It seems to me, based on the above language, that either MAWC or MSD can void the Agreement if the Tariff is modified. Furthermore, Mr. Williams would have the Commission believe its authority to review and revise rates is limited in the current case; whereas, such limitation is not applicable to either MAWC and MSD. I believe his assessment to be inaccurate due to the fact that the Commission is the regulatory body in the state of Missouri authorized to set rates and tariffs for regulated utilities; a power which neither MAWC or MSD hold. If the Commission determines, in the current case, that the MSD Agreement should be modified, I believe that MAWC and MSD would have the right to either abide by its ruling or exit the Agreement.

1 Q. REGARDING THE REBUTTAL TESTIMONIES OF THE MSD WITNESSES, MS.
2 ZIMMERMAN AND MR. BARBER, WHAT IS THE PRIMARY BASIS FOR THEIR
3 OPPOSITION TO THE OPC POSITION ON THIS ISSUE?

4 A. It appears to me that the fundamental concept they propose for opposing the OPC's position
5 is as stated on page 3, lines 10-12, of Ms. Zimmerman's Rebuttal Testimony:

6
7 MAWC would incur the cost of meter reading and other water billing data
8 development costs regardless of whether or not MSD required the
9 information for their separate billing activities.

10
11

12 And, as stated on page 8, lines 9-11, of Mr. Barber's Rebuttal Testimony:

13

14 MSD should not be required to subsidize one-half of MAWC's own data
15 collection efforts, which are necessary for MAWC's own billing purposes.

16
17

18 Q. IS PUBLIC COUNEL'S POSITION BASED ON A FULLY-DISTRIBUTED COST OF
19 ALL MAWC COSTS INCURRED TO READ ST. LOUIS DISTRICT CUSTOMER'S
20 METERS AND PROCESS READ DATA NECESSARY TO PREPARE BILLS?

21 A. No. it is not. The 2007 analysis Company had prepared identified that the total cost to
22 develop the data was ** ** or ** ** per customer; whereas, the OPC's
23 position is based on amounts identified in the analysis which are stated as excluding

1 Transformation Project). Yet, the compensation MSD provides MAWC for the services it is
2 provided has not changed.

3

4 Q. WILL ANY OTHER PUBLIC COUNSEL WITNESS BE ADDRESSING THIS ISSUE?

5 A. Yes. Ms. Barbara Meisenheimer, OPC's Chief Economist, will address the specifics of the
6 fully-distributed versus incremental cost pricing models in greater detail in her Surrebuttal
7 Testimony.

8

9 Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

10 A. Yes, it does.