

Exhibit No.:
Issues: Regulatory Deferral – Security AAO,
Security AAO – Accumulated Deferred
Taxes, Pension and OPEB Tracker,
Tank Painting Tracker, Rate Case
Expense, Overtime, Defined
Contribution Plan Expenses, 401k
Expenses, Low Income Tariff,
Imputation of Revenue, Interdistrict
Subsidy or Revenue Contributions,
Phase-In Plan
Witness: Dennis R. Williams
Exhibit Type: Surrebuttal
Sponsoring Party: Missouri-American Water Company
Case No.: WR-2010-0131
SR-2010-0135
Date: May 6, 2010

MISSOURI PUBLIC SERVICE COMMISSION

**CASE NO. WR-2010-0131
CASE NO. SR-2010-0135**

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 AUTHORITY TO) FILE TARIFFS REFLECTING INCREASED) RATES FOR WATER AND SEWER) SERVICE) | CASE NO. WR-2010-0131 CASE NO. SR-2010-0135 |
|--|--|

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

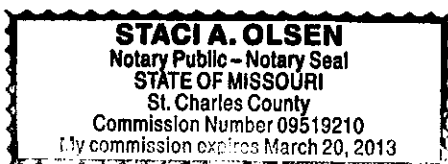
SUBSCRIBED and sworn to

Before me this 20~~th~~ day of April 2010.



Notary Public

My commission expires:



**SURREBUTTAL TESTIMONY
DENNIS R. WILLIAMS
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WR-2010-0131
SR-2010-0135**

TABLE OF CONTENTS

| | | |
|-----|---|----|
| | Witness Introduction and Purpose..... | 1 |
| 1. | Regulatory Deferral – Security AAO | 2 |
| 2. | Security AAO – Accumulated Deferred Taxes..... | 6 |
| 3. | Pension and OPEB Tracker | 11 |
| 4. | Tank Painting Tracker | 15 |
| 5. | Rate Case Expense..... | 16 |
| 6. | Overtime..... | 21 |
| 7. | Defined Contribution Plan Expenses..... | 22 |
| 8. | 401k Expenses | 23 |
| 9. | Low Income Tariff..... | 23 |
| 10. | Imputation of Revenue | 25 |
| 11. | Interdistrict Subsidy or Revenue Contributions..... | 26 |
| 12. | Phase-In Plan | 27 |

1 **SURREBUTTAL TESTIMONY**

2 **DENNIS R. WILLIAMS**

3 **WITNESS INTRODUCTION AND PURPOSE**

4

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

6 A. My name is Dennis R. Williams. My business address is 727 Craig Road, St.
7 Louis, Missouri.

8

9 **Q. BY WHOM ARE YOU EMPLOYED?**

10 A. I am employed by American Water Services Company.

11

12 **Q. ARE YOU THE SAME DENNIS WILLIAMS WHO SUBMITTED DIRECT AND**
13 **REBUTTAL TESTIMONY IN THIS PROCEEDING?**

14 A. Yes, I am.

15

16 **Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

17 A. I will address portions of rebuttal testimony filed by Missouri Public Service
18 Commission Staff ("Staff") witnesses Kimberly Bolin, James Busch, Jermaine
19 Green, and Amanda McMellen regarding: the propriety of inclusion of a
20 regulatory deferral for security AAO assets in rate base; the need for consistency
21 between deferred charges and associated deferred taxes; pension and OPEB
22 tracker mechanisms; rate case expense; overtime labor; comprehensive planning
23 study; and low-income tariffs. I will also address portions of the rebuttal
24 testimony of Office of the Public Counsel ("OPC") witnesses Ted Robertson and
25 Barbara Meisenheimer regarding the rate treatment of the unamortized security

1 AAO balance, as well as OPC's incorrect calculation and inconsistent treatment
2 of related deferred taxes; rate treatment of the tank painting tracker; revenue
3 imputation for previously approved contract rates; and OPC's suggested phase-
4 in plan.

5
6 **1. REGULATORY DEFERRAL – SECURITY AAO**

7
8 **Q. WHAT IS THE VALUE OF THE REGULATORY DEFERRAL FOR SECURITY**
9 **CHARGES AND HOW DID IT ARISE?**

10 A. Subsequent to the terrorist attacks of September 11, 2001, MAWC, working in
11 cooperation with other utilities and the Missouri Governor's Committee on
12 Homeland Security, expended over \$5.3 million over a two year period to
13 improve security of its water treatment, transmission and distribution facilities.
14 Deferral of these expenditures was determined to be appropriate by the
15 Commission in Case No. WO-2002-273, wherein an Accounting Authority Order
16 was approved allowing the Company to defer these costs for subsequent rate
17 treatment, with amortization over a ten year period to begin in January 2003.
18 The Company included in its filing in the current rate case inclusion in rate base
19 of the unamortized balance of this account at April 30, 2010 – the true-up date in
20 this case – of \$1,397,046.

21
22 **Q. WHAT ARE THE POSITIONS OF OTHER PARTIES IN THIS CASE**
23 **REGARDING RECOVERY OF THE DEFERRED SECURITY COSTS?**

24 A. Only two other parties have taken a position on this issue in the current case.
25 OPC, in its direct filing, opposed inclusion of this item in rate base. Staff

1 originally included the unamortized deferred security AAO costs in rate base, but
2 in rebuttal testimony, Staff witness McMellen indicated that Staff's position is now
3 to not allow rate base treatment.

4
5 **Q. HOW HAS STAFF JUSTIFIED THE EXCLUSION FROM RATE BASE?**

6 A. Staff Witness McMellen, at page 2 of her rebuttal testimony, states that the
7 exclusion is based on precedent established by the Commission in a Missouri
8 Gas Energy ("MGE") case (Case No. GR-98-140). She states:

9 In that case, the Commission's Order noted that by using a 10-year
10 amortization period to reflect the deferral in rates, it was recognizing a
11 shorter amortization period than the 20 years the Staff had recommended,
12 and had been approved by the Commission for MGE, in prior cases.
13 Given this reduced amortization period, the Commission deemed it proper
14 for the ratepayers and shareholders to share the effect of the regulatory
15 lag by allowing MGE to earn a return of, but not a return on, the deferred
16 balance.
17

18 **Q. DO YOU AGREE WITH MS. MCMELLEN'S CONCLUSION THAT THE**
19 **REFERENCED ORDER ESTABLISHED PRECEDENT THAT SHOULD BE**
20 **APPLIED IN THIS CASE?**

21 A. No. Ms. McMellen's own testimony points out that the Commission in the
22 referenced case excluded rate base treatment only in return for allowing the
23 Company to adopt a shorter amortization period than had originally been
24 proposed. Moreover, the Commission itself has indicated that the rate recovery
25 treatment of each AAO should be determined on its own merit and that prior
26 determinations of rate treatment are not precedential.

27
28 **Q. PLEASE EXPLAIN.**

29 A. In a more recent Aquila rate case (Case No. ER 2007-0004), the Commission

1 issued an Order dated May 17, 2007, upholding inclusion in rate base of the
2 unamortized balance of a regulatory deferred asset associated with the
3 refurbishment of one of the utility's generating plants. In that case, both the
4 Commission Staff and the utility supported inclusion in rate base. OPC took the
5 opposite point of view. In its Order, the Commission stated the following:

6 **Conclusions of Law:** The Commission has the regulatory authority to
7 grant a form of relief to a utility in the form of an accounting technique, an
8 accounting authority order (AAO). An AAO allows a utility to defer and
9 capitalize certain expenses until the time it files its next rate case, and it
10 protects the utility from earnings shortfalls and softens the blow which
11 results from extraordinary construction programs. While AAOs are to be
12 considered on a case-by-case basis, and the Commission can revisit the
13 issue and is not bound by its prior determinations, the deferred costs
14 included in the unamortized balances of the Sibley AAOs, represent major
15 capital additions to plant in service, and should be included in Aquila's rate
16 base in this case.
17

18 **Q. DID THE OPC APPEAL THE COMMISSION'S DECISION IN THAT CASE?**

19 A. Yes. Basing its argument in part on the view that the Commission's decision in
20 the Aquila case was in conflict with the same MGE decision that Staff now
21 contends is precedent setting, the OPC appealed the Commission's decision to
22 the Missouri Court of Appeals – Western District.

23
24 **Q. WHAT WERE THE FINDINGS OF THE COURT IN THAT CASE?**

25 A. The Court upheld the Commission's decision indicating that the Commission is
26 not bound by prior administrative decisions. Further, the Court held that the
27 Aquila decision was consistent with other Orders allowing rate base treatment,
28 and was distinguishable from the MGE case.

29
30 **Q. IS MISSOURI-AMERICAN WATER COMPANY'S SECURITY RELATED AAO**

1 **DISTINGUISHABLE FROM THE MGE CIRCUMSTANCES?**

2 A. Yes. The MGE accounting deferral was related to a pipeline replacement
3 program. While safety related in nature, the costs deferred by MGE were
4 associated with the replacement of long-lived assets for expenditures that could
5 be planned well in advance and were constructed and placed into service over
6 the course of a number of years. In contrast, the costs incurred by MAWC to
7 enhance its security were urgent in nature and were undertaken as a result of an
8 emergency for which MAWC had no responsibility and could not have foreseen.
9 Working in conjunction with the State of Missouri, MAWC quickly mobilized a
10 study to determine the extent of prudent security measures to be deployed and
11 incurred expenses to implement these measures. Most of the solutions involved
12 short-lived assets and other expenses such as fencing, gates and motors,
13 additional security monitoring equipment and security personnel. Without the
14 Accounting Authority Order, MAWC would have had no opportunity to recover
15 these prudently incurred costs.

16
17 **Q. WHY DO YOU BELIEVE THAT THE COMPANY SHOULD BE ALLOWED TO**
18 **EARN A RETURN ON THESE COSTS THROUGH INCLUSION OF THE**
19 **UNAMORTIZED BALANCE IN RATE BASE?**

20 A. In traditional ratemaking, expenses are normally recovered dollar for dollar as
21 they are incurred. Because of the unusual and unexpected nature of these
22 expenses, the Commission determined that it was appropriate (rather than to
23 allow no recovery or to allow recovery outside a rate case) for these costs to be
24 recorded as a deferred asset for future rate recovery. In so doing, the
25 Commission was treating these costs from an accounting perspective more like a

1 capital plant addition than as an expense. Just like a plant asset, the Company
2 was not allowed to begin recovery of the costs until after completion of its next
3 rate case; and, just like a plant asset, the Company was required to begin
4 amortizing the cost in advance of recovery. Like a plant asset, the Company
5 invested funds in advance of recovery in rates to make these necessary
6 expenditures and it will recover most, but not all, of the actual expense, over time
7 through amortization. Finally, just like a plant asset, MAWC had to use borrowed
8 and investor supplied funds in order to make these expenditures. Without rate
9 base treatment, as would be afforded a plant asset, the Company will have no
10 revenues from which to pay back lenders or investors who provided these funds.

11 12 **2. SECURITY AAO – ACCUMULATED DEFERRED TAXES**

13 14 **Q. HOW DO DEFERRED TAXES ARISE AS THE RESULT OF THE SECURITY** 15 **ACCOUNTING AUTHORITY ORDER?**

16 A. As discussed earlier, although the Commission issued an Order requiring the
17 Company to defer costs associated with the September 11, 2001 terrorist
18 attacks, MAWC still had to expend over \$5.3 million in advancing funds for the
19 study and implementation of new security measures. The Internal Revenue
20 Service recognized these expenditures as being tax deductible when made. This
21 tax benefit of about \$2.1 million was recorded on the Company's books as a
22 liability to be paid to the IRS as revenues are received over the ten year
23 amortization period.

24 25 **Q. HOW DOES MAWC TREAT THE ACCUMULATED DEFERRED TAXES FOR**

1 **RATEMAKING PURPOSES?**

2 A. Accumulated deferred income taxes represent a zero cost source of funds.
3 Therefore, the Company offsets its rate base assets with the associated
4 accumulated deferred taxes. For example, at the time of establishment of the
5 security accounting authority order discussed above, the \$5.3 million dollar asset
6 would have been offset by the \$2.1 million to arrive at an appropriate rate base
7 amount of \$3.2 million. At April 30, 2010, both the asset and liability have been
8 amortized for over seven years. The balance of the deferred asset at April 30,
9 2010 is \$1,397,046 and the balance for the related deferred liability at the same
10 date is \$533,127. The Company has included the net of these two amounts or
11 \$863,919 in rate base in this case.

12
13 **Q. IS THE APPROACH TAKEN BY OPC AND STAFF DIFFERENT FROM THAT**
14 **TAKEN BY THE COMPANY?**

15 A. Yes. In its direct testimony, OPC supported inclusion of the deferred liability as a
16 subtraction from rate base without including the related deferred asset. Initially,
17 Staff did not subtract the deferred taxes from rate base but in rebuttal testimony
18 has changed its position and adopted that of the OPC.

19
20 **Q. HOW HAS STAFF JUSTIFIED ITS CHANGE IN POSITION?**

21 A. Staff witness Bolin characterized the original position as an error and apparently
22 believes that the deferred tax liabilities are not related to the corresponding
23 deferred asset. She states “the deferred tax reserve represents, in effect, a
24 prepayment of income tax by the Company’s customers”.

25

1 **Q. DO YOU AGREE WITH THAT CHARACTERIZATION?**

2 A. No. As explained previously, the deferred tax liability is simply recognition that
3 the Company received a tax benefit for expenses made for which they have not
4 yet been reimbursed by customers. The Company will have to pay taxes when
5 those reimbursements are received from customers in future rates. In this
6 instance, the Company expects to eventually receive reimbursement through
7 rates of the \$5.3 million and has accordingly established a deferred asset. It also
8 recognizes that it has received a reduction in taxes for \$2.1 million that will have
9 to be paid back when the reimbursements are made and has accordingly booked
10 a deferred liability. The original net out-of-pocket cost to the Company was \$3.2
11 million. Customers initially paid nothing. In fact, the Company expended the
12 funds from 2001 to 2003 and didn't begin to receive recovery in rates until the
13 effective date of the Commission's order in the Company's next rate case in
14 2007. The customers did not make a prepayment of income tax as suggested by
15 Ms. Bolin. Instead, the Federal and state governments funded \$2.1 million at a
16 zero interest rate, which the Company has properly reflected in its determination
17 of rate base.

18

19 **Q. HAS THE OPC MADE THE SAME ERROR?**

20 A. Yes. OPC witness Ted Robertson also proposes that the security related
21 deferred asset be excluded from rate base, but that the related deferred tax
22 liability be subtracted therefrom. Although Mr. Robertson apparently
23 acknowledges there is a relationship between the deferred asset and associated
24 deferred tax liability, his estimation of the current accumulated deferred tax
25 balance demonstrates that he does not have a good understanding of that

1 relationship.

2

3 **Q. PLEASE EXPLAIN.**

4 A. Because the establishment of the deferred asset is directly related to the
5 establishment of the deferred tax liability, it is apparent that their amortization is
6 likewise related. As the asset is amortized, amortization expense is recorded on
7 the books of the Company that is not tax deductible. Since the annual
8 amortization expenses are not deductible, the deferred tax liability is paid back to
9 the IRS and correspondingly reduced on the books. In other words, the rate of
10 amortization for the deferred asset and deferred liability are identical. If the
11 deferred asset has been amortized down to 25% of its original balance, then the
12 deferred liability should be amortized to 25% of its original balance.

13 Mr. Robertson has incorrectly attempted to estimate the unamortized deferred
14 tax balance by multiplying the Company's effective tax rate times the total
15 amortization expense. By doing so, he has calculated the taxes already paid on
16 the amortization expense that has been booked over the past seven years, not
17 the remaining deferred tax balance. A more appropriate estimate would have
18 been to multiply the Company's effective tax rate times the unamortized deferred
19 asset balance at April 30, 2010. Mr. Robertson's estimate of the accumulated
20 deferred tax liability at April 30, 2010 is three times higher than the correct actual
21 balance.

22

23 **Q. WHAT IS THE RESULTING IMPACT OF THE OPC AND STAFF PROPOSALS**
24 **IN THIS CASE?**

25 A. Staff has included zero for the deferred security asset and subtracted the related

1 deferred tax liability of \$533,127 from rate base resulting in a **negative rate base**
2 amount for the net Security AAO issue of \$533,127. OPC has included zero for
3 the deferred security asset and subtracted an estimated \$1,539,634 accumulated
4 deferred tax liability from rate base resulting in a **negative rate base** of over \$1.5
5 million.

6
7 **Q. IS EITHER OF THESE RECOMMENDATIONS FAIR?**

8 A. No. It is not fair to exclude a deferred asset from rate base while including its
9 offsetting deferred tax liability. Consistent treatment should be followed. The
10 resulting negative rate base amount, in essence, requires the Company to pay its
11 customers for the “privilege” of advancing funds for the study and implementation
12 of appropriate security enhancements.

13
14 **Q. CAN YOU EXPLAIN THIS FURTHER THROUGH A SIMPLE EXAMPLE?**

15 A. Yes. Suppose I came to you for a loan and you advanced me \$1,000. In return I
16 agreed to pay you back \$100 a year over the next ten years. That is akin to not
17 including the Security AAO in rate base. You would get a full return of your
18 money, but I do not believe you would consider it a good deal because a) you
19 have not received any interest to replace the opportunity costs for those funds
20 advanced, and b) you are being paid back in less valuable dollars.

21
22 But the treatment that Staff and OPC is proposing goes even further. Assume
23 that the IRS says that because you loaned me the money, they are going to
24 reduce your current taxes by \$300 – although they want you to pay them back by
25 making an installment payment of \$30 each year for the next ten years. You still

1 would be loaning me \$1,000, but the cash for that loan is made up of \$700 from
2 your pocket today and \$300 that you will pay back to the IRS over the next ten
3 years.

4
5 In this example, Staff and OPC would propose that I only pay you back an
6 average of \$85 per year or only \$850 over the next ten years. You end up losing
7 \$150 for the “privilege” of lending me the money. This example is exactly what
8 the Staff and OPC are suggesting when they propose a negative rate base
9 adjustment. The only difference is that instead of providing \$1,000 in cash, the
10 Company has provided its customers with \$5.3 million in security protection. The
11 Company is being asked to give customers the carrying costs of the \$2.1 that
12 was “borrowed” from the IRS without having collected any carrying cost for the
13 \$5.3 million it has advanced, and thus has no funds from which to make the IRS
14 payment.

15 16 **3. PENSION AND OPEB TRACKER**

17 18 **Q. WHAT IS THE PURPOSE OF A TRACKER MECHANISM?**

19 A. A tracker mechanism is for the protection of both customers and the Company
20 where there is considerable volatility from year to year in a particular expense
21 category. Because of this volatility, it is difficult or impossible to normalize test
22 year expenses to reflect what can reasonably be expected to occur when rates
23 are placed into effect.

24 25 **Q. HOW DOES A TRACKER WORK?**

1 A. An estimate is made based on existing information to establish a level of
2 expense that is included in rates. To the extent that annual expense actually
3 incurred is in excess of that level, a regulatory asset is established for
4 amortization and future recovery. To the extent that annual expense actually
5 incurred is below the established tracker level, a regulatory liability is established
6 for amortization and future flow back to the customer. The asset or liability is
7 included in rate base in order to properly reflect the associated carrying costs
8 that either the Company or customers have provided funds for which they are not
9 being compensated.

10

11 **Q. IS A TRACKER MECHANISM CURRENTLY IN PLACE FOR PENSION AND**
12 **OPEB CHARGES?**

13 A. Yes. This is the third rate proceeding in which the parties have adopted a tracker
14 mechanism for Missouri-American Water pension and OPEB costs.

15

16 **Q. HAS ANY PARTY CHALLENGED THE CONTINUATION OF THIS APPROACH**
17 **IN THE CURRENT PROCEEDING?**

18 A. No.

19

20 **Q. WHAT IS THE ISSUE IN THIS PROCEEDING?**

21 A. The Company believes that this approach has been very effective and fair in
22 appropriately reflecting actual costs incurred in rates and has avoided large over
23 and under recoveries of a cost category that fluctuates widely and is hard to
24 estimate. For this reason, the Company has proposed that the tracker
25 mechanism be extended to those pension and OPEB costs that are incurred by

1 the American Water Service Company. Staff opposes this change.

2

3 **Q. WHAT IS THE BASIS FOR STAFF'S OPPOSITION?**

4 A. Staff witness Bolin indicates in her rebuttal testimony at page 6 that the Staff is
5 opposed to applying a tracker to costs of the service company because the
6 service company is a non-regulated entity and that Missouri American has no
7 control over the costs charged to them by the service company.

8

9 **Q. DO YOU AGREE WITH MS. BOLIN'S CHARACTERIZATIONS?**

10 A. No. I believe both statements are somewhat misleading. While the Service
11 Company is not directly regulated by the Missouri Public Service Commission,
12 there is a level of control available that is not reflected in Ms. Bolin's statements.
13 The Service Company is an affiliate of MAWC and, as such, it does not reflect
14 any profit in the charges made to MAWC. Payments to the Service Company are
15 not based on a market price but on actual costs incurred. Staff and other parties
16 to a rate case have the ability to review the detail costs charged to MAWC by the
17 Service Company. They can control those costs the same way they do other
18 costs – they can propose exclusions from MAWC recovery in a rate case. For
19 example, in the current case, the Staff has proposed elimination of certain labor,
20 insurance and laboratory expenses charged by the Service Company to MAWC.
21 Moreover, MAWC has the ability to control those costs in the same manner that it
22 would control the costs of any other vendor. MAWC can seek (and in the past
23 has sought) bids from other providers of service. However, because the Service
24 Company has considerable experience in the provision of accounting, tax, billing,
25 call center and the many other utility related services it provides; because the

1 Service Company possesses significant economies of scale; and because the
2 Service Company only charges actual costs incurred, it is difficult to find a more
3 competitive price for the level of services provided.

4 I do not believe the rationale provided by Staff is sufficient reason not to take
5 advantage of the benefits of a tracker mechanism for Service Company pension
6 and OPEB benefits.

7
8 **Q. ARE THERE POSTIVE REASONS YOU CAN PROVIDE AS TO WHY**
9 **EXTENSION OF THE TRACKER TO SERVICE COMPANY EMPLOYEES'**
10 **PENSION AND OPEBS IS APPROPRIATE?**

11 A. Yes.

- 12 1. The type of costs incurred by the Service Company are exactly the same as
13 those which are subject to the MAWC tracker. The only difference is that they
14 apply to Service Company employees, like myself, rather than to MAWC
15 employees.
- 16 2. Like MAWC pension and OPEB costs, those costs of the Service Company
17 are highly volatile, subject to wide variations from year to year and not subject
18 to simple estimation or normalization.
- 19 3. The costs are auditable. Unlike the costs of typical charges from true non-
20 regulated vendors that quote a market price, Service Company charges are
21 based upon actual costs. The actual pension and OPEB costs of the Service
22 Company are known and are easily auditable. In fact, since Service
23 Company employees participate in the same corporate pension and post
24 retirement benefit plans as do MAWC employees, the Staff has, in essence,
25 already audited the Service Company charges when they analyzed the

1 actuarial valuations and other support associated with MAWC direct pension
2 and OPEB costs.

3 4. Given the nature of these expense categories, it is the fair and reasonable
4 approach for both the Company and its customers.

5
6 **Q. IS THERE ANY IMPACT ON THE REVENUE REQUIREMENT IN THIS**
7 **PROCEEDING BY APPLYING THE TRACKER MECHANISM TO SERVICE**
8 **COMPANY PENSION AND OPEB EXPENSES?**

9 A. No.

10
11 **4. TANK PAINTING TRACKER**

12
13 **Q. DOES THE COMPANY HAVE A POSITION ON THE CONTINUATION OF THE**
14 **EXISTING TANK PAINTING TRACKER?**

15 A. Company witness Greg Weeks provides testimony in regard to the tank painting
16 tracker. My surrebuttal testimony is limited to addressing the associated rate
17 treatment proposed by OPC witness Robertson.

18
19 **Q. WHAT IS MR. ROBERTSON'S PROPOSAL?**

20 A. At page 7 of Mr. Robertson's rebuttal testimony, he indicates that OPC believes
21 that rate base treatment of the regulatory asset or regulatory liability associated
22 with the tank painting tracker should be excluded from rate base.

23
24 **Q. DO YOU AGREE WITH THIS VIEW?**

25 A. No. For the same reasons that the regulatory asset or regulatory liability

1 associated with the pension and OPEB tracker is included rate base, so too
2 should the tank painting regulatory asset or liability be included. Depending upon
3 whether an asset or liability exists, either the Company or the customer has
4 expended funds for which they have not been paid and the respective party
5 deserves to earn a return on those funds until payment is received.

6
7 **Q. HAS MR. ROBERTSON OBJECTED TO THE INCLUSION OF THE PENSION**
8 **AND OPEB REGULATORY ASSET AND LIABILITIES BEING INCLUDED IN**
9 **RATE BASE?**

10 A. No.

11
12 **5. RATE CASE EXPENSE**

13
14 **Q. ARE YOU FAMILIAR WITH STAFF WITNESS JERMAINE GREEN'S**
15 **REBUTTAL TESTIMONY REGARDING RATE CASE EXPENSE?**

16 A. Yes. Mr. Green presents two main points in his rebuttal testimony in regard to
17 the recovery of rate case expense from Staff's perspective:

- 18 1. Staff does not believe that the unamortized or unrecovered portion of prior
19 rate cases should be included for future recovery; and,
- 20 2. Staff believes that the Company should have the opportunity to recover all
21 prudently incurred expenses incurred in the conduct of the current case, and
22 rejects the OPC proposition that rate case expense should be reduced to
23 eliminate all outside consulting and legal expense and the remainder then
24 "shared" equally between customers and the Company.

1 **Q. DO YOU AGREE WITH MR. GREEN'S FIRST POINT?**

2 A. No. Mr. Green insists that Staff has, in the past, normalized rate case expenses
3 when, in fact, that is not the case. By arguing that these expenses are
4 normalized (which they are not), he erroneously concludes that it is unnecessary
5 to allow for the unrecovered portion of costs from prior cases.

6
7 **Q. HOW DOES MR. GREEN DISTINGUISH NORMALIZATION FROM**
8 **AMORTIZATION?**

9 A. In his rebuttal testimony at page 2, he defines the terms as follows:

10 Normalization is to restate abnormal test year results to a normal ongoing
11 level, while amortization is to provide a recovery of the expense over a set
12 time period.
13

14 **Q. HOW HAS STAFF ADJUSTED FOR RATE CASE EXPENSE IN THE PAST?**

15 A. In reviewing Staff workpapers for each of the last three rate cases, including this
16 one, Staff has reflected in its determination of revenue requirement actual rate
17 case expenses incurred to date at a point in time and then proposed a period
18 over which those costs should be recovered. Moreover, although the last two
19 rate cases were settled, the Company was assured that the rate case costs
20 actually incurred would be updated to as late a date as possible that would allow
21 an adequate audit of the actual costs incurred.

22
23 **Q. HAS STAFF MADE ANY ADJUSTMENT TO RESTATE THE TEST YEAR**
24 **RESULTS TO A NORMAL ONGOING LEVEL FOR RATE CASE EXPENSE?**

25 A. None, other than to propose an amortization period for the test year expenses
26 incurred.

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28
29
30
31
32

Q. DOES THIS APPROACH MEET MR. GREEN'S DEFINITION OF NORMALIZATION OR AMORTIZATION?

A. It is a classic example of his definition of amortization. Calling it by a different name does not change that fact.

Q. DOES MR. GREEN INDICATE THAT HIS APPROACH IS IN ACCORDANCE WITH COMMISSION PRECEDENT?

A. Yes. Mr. Green states that there are a number of past proceedings in which the Commission has agreed with Staff's approach. He then cites a single case from 27 years ago.

Q. ARE THERE OTHER COMMISSION ORDERS THAT YOU BELIEVE SERVE TO DISPUTE HIS ASSERTATION?

A. Yes. For example, in its Report and Order in Case No. GR-2006-0422 issued in March 2007, the Commission found as follows:

10. Rate Case Expense
Issue Description: What is the appropriate amount and treatment of rate case expense, including amortization of prior rate case expense, in this case?
From MGE's last rate case in 2004, the Commission authorized the company to amortize its rate case expense over three years. A balance of \$ 148,971 remains to be amortized as of March 2007. n75 MGE proposes to amortize the current rate case expense with the remaining \$ 148,971 over a three-year period. n76 Although in its pre and post hearing briefs Staff argues that to allow MGE to amortize the remaining rate case expense would constitute retroactive ratemaking, there is no mention of this argument during the hearing. [*33] In fact, Staff's position is that the rate case expense be normalized. n77 The Commission will therefore disregard Staff's argument that recovery of this expense would constitute retroactive ratemaking.

n75 Transcript, Page 1040, Lines 1-3.
n76 Transcript, Page 1044, Lines 10 -13.

The Commission resolved this issue in MGE's last rate case to allow the company to recover, what was determined to be prudent costs, through amortization over three years. The Commission will not vacate its order in that regard. Staff and MGE propose to amortize the remaining rate case expense with that incurred in this case. The Commission will grant that request and allow MGE to amortize the combined amounts over a three-year period.

10 **Q. DO YOU BELIEVE AN AMORTIZATION APPROACH IS APPROPRIATE?**

11 A. Yes. It is very difficult to estimate the level of rate case expense that will be
12 incurred and therefore very difficult to normalize those expenses, because what
13 is normal for one case will not be so for the other. Many factors vary from rate
14 case to rate case. Some cases settle and others go to hearing, which can result
15 in hundreds of thousands of dollars in difference. The number of interveners and
16 the level of data requests impact the cost of the case. The introduction of new
17 issues, such as consolidation of tariffs in the current case, can add to the
18 complexity and costs of a case. Depreciation studies are required by
19 Commission rule in some cases, but not in others. There are so many
20 differences that can impact the cost of a rate case, that an ongoing level cannot
21 be determined. It is therefore fairer, both to the Company and to the customer, to
22 establish rates based on actual costs incurred and, through amortization, allow
23 recovery of those actual costs.

24
25 **Q. OPC WITNESS ROBERTSON, AT PAGE 11 OF HIS REBUTTAL TESTIMONY,**
26 **EXPRESSES CONCERN WITH STAFF'S POSITION ON RATE CASE**
27 **EXPENSE BECAUSE STAFF HAS NOT RECOMMENDED DISALLOWANCE**
28 **OF ANY OF THE COSTS THE COMPANY HAS INCURRED IN PROCESSING**
29 **THE CURRENT CASE. DO YOU AGREE WITH HIS COMMENTS?**

1 A. No. I believe that Mr. Robertson's concerns are misplaced. During the conduct
2 of the field audit, Staff requested and was provided every contract and every
3 invoice generated in support of the expenses incurred by the Company to
4 process this case. I pointed out in my rebuttal testimony the extent to which the
5 Company has gone to control costs in this case. I also explained why Mr.
6 Robertson's belief that it would be more economical to in-source all the work of
7 developing support, taking the case to hearing and writing legal briefs was in
8 error. Staff performed a thorough review of all of the Company's costs incurred,
9 determined them to be appropriate and made no adjustment. Mr. Robertson
10 neither requested similar data nor performed a similar review. Acceptance of his
11 recommendation to exclude the costs of outside services and then recover only
12 one-half of the remaining costs to process this case would result in denying the
13 Company a fair opportunity to recover its prudently incurred costs. In fact, the
14 total costs to process this rate case have not been included in the Company's
15 proposed revenue requirement.

16

17 **Q. PLEASE EXPLAIN YOUR LAST STATEMENT.**

18 A. At the time the Company filed its rate case in October 2009, there was little data
19 on which to base an estimate of the full costs necessary to process this case.
20 The issues were not known; the number of parties was not known; whether the
21 case would settle or go to hearing was not known. The Company's estimate of
22 rate case expense was based upon the average of the past two rate cases, both
23 of which were settled. By the end of April of 2010, actual expenses were already
24 near the estimated expense level. It now appears that it is likely that this case
25 will proceed to hearing and the original Company estimate will be far exceeded.

1 This is a clear example of how it is difficult to normalize an ongoing level of rate
2 case expense and why the traditional approach to amortize actual prudently
3 incurred rate case expense is preferable.

4 5 **6. OVERTIME**

6
7 **Q. ARE YOU FAMILIAR WITH STAFF WITNESS MCMELLEN'S REBUTTAL**
8 **TESTIMONY REGARDING OVERTIME?**

9 A. Yes. Ms. McMellen indicates that Staff has revised its original overtime
10 adjustment and contrasts Staff's approach to that of the Company. I believe that
11 the two methods, although different in approach, should arrive at approximately
12 the same result, with the exception that I believe there remains an error in the
13 Staff's application of its described method. I accept the Staff's method if that
14 error is corrected.

15
16 **Q. PLEASE EXPLAIN WHAT YOU BELIEVE TO BE IN ERROR.**

17 A. Ms. McMellen states that "By doing a separate analysis of the overtime hours
18 and then applying the current average overtime rate, the Staff has accurately
19 calculated a normalized level of expense for the Company." I believe the
20 described method would achieve the appropriate described results, but my
21 review of Staff's supporting work papers indicates that the adjustment did not
22 reflect the current average overtime rate, but rather the historical average
23 overtime rate. Staff's method calculates pro forma overtime hours and then
24 multiplies those hours by an average wage rate to derive pro forma overtime pay.
25 Since the pro forma hours will actually be paid at pro forma wage rates, Staff

1 should have multiplied by its pro forma wage rates, rather than historical, to
2 properly price out overtime pay.

3
4 **7. DEFINED CONTRIBUTION PLAN EXPENSES**

5
6 **Q. HAS THE STAFF ALSO USED HISTORICAL WAGE RATES IN OTHER
7 LABOR RELATED ADJUSTMENTS?**

8 A. Yes, although to a lesser extent. For example, Staff's defined contribution plan
9 adjustment was based on existing payroll levels at the end of October 2009
10 rather than on test year data, as was utilized in the overtime adjustment. Staff's
11 adjustment did not reflect increases in wage rates or employee levels that have
12 taken place subsequently.

13
14 **Q. WHAT IS THE DEFINED CONTRIBUTION PLAN?**

15 A. For those employees who are not included in the Company's defined benefit
16 pension plan, the Company contributes 5.25% of their annual base pay towards
17 the individual's 401k Plan. These defined contributions are managed by the
18 individual employee and are intended to act as retirement resources.

19
20 **Q. DO YOU HAVE A CONCERN WITH THE MANNER IN WHICH STAFF
21 ADJUSTED DEFINED CONTRIBUTION PLAN EXPENSE?**

22 A. Yes. When paid, the 5.25% contributions will be calculated based on existing
23 wage levels and Staff's adjustment does not currently reflect the wage rates and
24 employee levels that will exist at the time rates become effective. I believe that
25 this is a true-up matter and that all labor and benefit related costs will be

1 corrected during the true-up process.

2
3 **8. 401k EXPENSES**

4
5 **Q. WHAT IS THE ISSUE REGARDING 401k EXPENSES?**

6 A. The Company is unable to ascertain the source of Staff's test year figure used in
7 the calculation of its 401k expense. The number does not agree with MAWC's
8 recorded test year 401k expense levels and the Company believes that the
9 number used by Staff in developing its pro-forma expense level is simply in error.

10
11 **9. LOW INCOME TARIFF**

12
13 **Q. IS THE COMPANY PROPOSING A LOW INCOME TARIFF IN THE CURRENT
14 PROCEEDING?**

15 A. Yes. At the time of filing, Missouri-American Water Company felt that there were
16 a number of low-income customers for whom affordability of the essential
17 resource we supply was a financial burden. Subsequent to our filing, the
18 Missouri Commission has, in other utility rate cases, expressed an interest in
19 exploring this important issue. The plan MAWC proposed was patterned closely
20 after a plan that has successfully operated in Pennsylvania for a number of
21 years.

22
23 **Q. HAVE OTHER PARTIES TO THIS CASE EXPRESSED AN OPINION
24 REGARDING THE LOW INCOME TARIFF PROPOSAL?**

25 A. To date only the Staff through the testimony of James Busch and OPC through

1 the testimony of Barbara Meisenheimer have taken a position.

2

3 **Q. WHAT IS THE STAFF'S POSITION?**

4 A. Staff is in opposition to the Company's proposal for the following stated reasons:

5 1. Lack of detail regarding the plan rationale or need;

6 2. Other customers are burdened by the current economy and should not be
7 required to bear any increase in order to support low-income customers;

8 3. The proposal is in conflict with a uniform customer charge;

9 4. Given the relative low cost of water in relation to other utility costs, a low-
10 income tariff is not currently needed; and

11 5. Assistance is currently being provided by the Company's voluntary H2O
12 program, the cost of which is borne by shareholders.

13

14 **Q. WHAT IS THE OPC POSITION?**

15 A. OPC is in opposition to the Company's proposal "at this time". Ms.

16 Meisenheimer indicated that the OPC is concerned that the Company has not
17 shown that the proposal is need based, that it has not quantified the potential
18 impact of the proposal, and that it has not specified from whom the cost of the
19 program would be recovered.

20

21 **Q. HOW DOES THE COMPANY RESPOND?**

22 A. The Company is somewhat surprised by these positions. The low-income
23 program is simple to understand and is designed to follow a program that has
24 achieved favorable reaction by customers and regulators. The rationale is based
25 on need and it appears obvious to the Company that if, as Mr. Busch testifies,

1 the economy is burdensome to customers that are not low-income, then the
2 impact and need experienced by low-income customers must be extreme. The
3 Company quantified the impact of the proposal and recovery method in its rate
4 design development. Finally, the Company believes that the low-income tariff,
5 while modest at the outset, is a good start and would be beneficial regardless of
6 other tariff issues including a uniform customer charge.

7
8 **Q. WHAT IS THE COMPANY'S RECOMMENDATION?**

9 A. It is the Company's recommendation that the proposed low-income tariff be
10 instituted, even on a trial basis, if necessary. If, however, the Commission
11 believes that such a program is premature, the Company stands ready and
12 willing to discuss with other parties implementation criteria and standards for this
13 or other similar programs that may be recommended. In the meantime, the
14 Company intends to continue pursuit of its H2O assistance program that has
15 been in place for a number of years.

16
17 **10. IMPUTATION OF REVENUE**

18
19 **Q. ARE YOU FAMILIAR WITH OPC WITNESS BARBARA MEISENHEIMER'S**
20 **TESTIMONY REGARDING REVENUE IMPUTATION TO ADJUST THE**
21 **INDUSTRIAL CLASS FOR SPECIAL CONTRACT REVENUES?**

22 A. Yes. On page 2 of her rebuttal testimony, Ms. Meisenheimer states:

23 By imputing revenues equal to the difference between the revenues that
24 would be generated under regular Industrial rates and the revenues
25 collected under the special contract, the discount given to special contract
26 customers will not adversely affect the Industrial class with respect to
27 determining revenue neutral class shifts within the St. Joseph district.

1

2 **Q. IS THE OPC RECOMMENDING IMPUTATION MERELY FOR THE PURPOSES**
3 **OF ALLOCATION OF COSTS AMONG CUSTOMER CLASSES WITHIN THE**
4 **ST. JOSEPH DISTRICT OR DOES SHE RECOMMEND IMPUTATION OF**
5 **REVENUE IN DETERMINING THE REVENUE REQUIREMENT IN THIS CASE?**

6 A. I am unable to determine that from a reading of her rebuttal testimony. If the
7 latter, is the case, however, the Company is strongly opposed to her
8 recommendation.

9

10 **Q. WHY?**

11 A. Imputation of revenue in determination of the revenue requirement in this case
12 would reduce the allowable rates and the opportunity for the Company to achieve
13 its authorized return. As was noted in my rebuttal testimony, the special contract
14 rates in effect in the St. Joseph district were approved by this Commission
15 because they assisted in attracting new customer load to the St. Joseph area.
16 Since the revenues paid under those contracts are sufficient to cover the variable
17 costs of producing water and contribute to the fixed costs of serving the district,
18 other customers in the St. Joseph district benefit. To penalize the Company
19 through imputation of revenue that is being administered in accordance with a
20 Commission Order would be grossly unfair.

21

22 **11. INTERDISTRICT SUBSIDY OR REVENUE CONTRIBUTIONS**

23

24 **Q. WHAT DO YOU UNDERSTAND THE PARTIES' POSITIONS TO BE ON THE**
25 **ISSUE OF INTERDISTRICT SUBSIDIES OR REVENUE CONTRIBUTIONS?**

1 A. The Company, in its original filing, has proposed a revenue contribution by the
2 St. Louis Metro District to mitigate the rate increases for the Brunswick, Parkville
3 Water, Cedar Hill Sewer, Warren County Water and Warren County Sewer
4 Districts. If this revenue contribution is not approved, then the increases for
5 those four districts would be 161%, 34%, 190%, 63% and 475%, respectively,
6 based on the Company's filing. By proposing the revenue contribution, the
7 percent increases for these four districts would be "capped" at 26% for all five
8 districts. The Staff has proposed a revenue contribution for the Brunswick and
9 Warren County Districts. The Missouri Industrial Energy Consumers (MIEC) is
10 opposed to any interdistrict subsidy or revenue contribution and it appears OPC
11 is proposing a phase-in of rates for Brunswick and Warren County Districts
12 instead of a revenue contribution.

13

14 **Q. WHY DOES THE COMPANY BELIEVE A REVENUE CONTRIBUTION IS**
15 **APPROPRIATE?**

16 A. A revenue contribution is appropriate in the setting of rates because it addresses
17 a number of goals including: 1) avoiding rate shock; 2) promoting gradualism
18 toward cost based rates; 3) promoting fairness; and 4) avoiding the impact of a
19 drastic change in the existing rate structure. In the current case, the Company's
20 proposal attempts to avoid rate shock and gradually move towards cost based
21 rates for these four districts.

22

23

12. PHASE-IN PLAN

24

25 **Q. DOES MS. MEISENHEIMER RECOMMEND A PHASE-IN PLAN?**

1 A. Yes. The Company's interpretation of page 8 of Ms. Meisenheimer's Rebuttal
2 Testimony is that the OPC is recommending rejection of any inter-district revenue
3 contribution and proposing a three-year phase-in of increases for Warren County
4 Water and Brunswick.

5

6 **Q. HOW DOES THE COMPANY RESPOND?**

7 A. The Company believes the proposal as currently stated is lacking in substance
8 and has some obvious flaws. First, there is an apparent inconsistency in Ms,
9 Meisenheimer's recommendation for a phase-in in the Brunswick and Warren
10 County Districts and the recommendation to mitigate rate increases in other
11 districts as a result of her class cost of service study. In Ms. Meisenheimer's
12 discussion regarding the results of her class cost of service study, she
13 recommends that the Commission move customer classes toward district-
14 specific cost of service by first implementing a revenue neutral shift among
15 classes and second, spreading any net increase or decrease in district revenue
16 to the class on an equal percentage. She then recommends that the
17 Commission "cap" class increases resulting from revenue neutral shifts to 5% of
18 a class's current revenue in order to avoid "huge shifts between classes" and to
19 mitigate the combined impact of a large district increase coupled with interclass
20 increases.

21

22 **Q. WHY DOES MS. MEISENHEIMER BELIEVE THAT IT IS IMPORTANT TO**
23 **AVOID HUGE SHIFTS BETWEEN CLASSES AND MITIGATE SUCH RATE**
24 **IMPACTS?**

25 A. She does not indicate the reasons in her testimony but I believe an appropriate

1 rationale would be for many of the same reasons that the Company supports
 2 interdistrict contributions. She does not seem to have the same level of concern
 3 for the Parkville Water, Cedar Hill Sewer, and Warren County Sewer Districts for
 4 which she believes the interdistrict contribution should be eliminated. Nor does
 5 she seem to express the same level of concern with respect to the Brunswick
 6 and Warren County Water Districts, although she has proposed a phase-in plan
 7 for those two districts. Ms. Meisenheimer acknowledges that in order to bring the
 8 latter two districts to their full cost of service based on Staff's proposed revenue
 9 requirement, it would require an increase of 65% in the rates paid by Warren
 10 County water customers and an increase of 95% in the rates paid by Brunswick
 11 water customers. Those percentage increases correspond to 63% and 161%
 12 increases, respectively, in the Company's filing had the interdistrict contribution
 13 not been proposed. Her proposal would have a particularly damaging impact on
 14 the rates already paid by those customers in districts for which the Company
 15 proposed interdistrict contributions. The following is a table of average monthly
 16 water customer bills at present rates assuming consumption of 5500 gallons per
 17 month.

| 18 | Water District | Ave. Monthly Residential Bill at Current Rates |
|----|-----------------------|---|
| 19 | St. Louis | \$ 23.68* |
| 20 | St. Charles | 23.68 |
| 21 | Warren County | 45.83 |
| 22 | Warrensburg | 29.16 |
| 23 | Joplin | 32.58 |
| 24 | St. Joseph | 31.66 |
| 25 | Jefferson City | 33.21 |
| 26 | Mexico | 38.39 |
| 27 | Parkville | 41.44 |
| 28 | Brunswick | 62.91 |
| 29 | | |

30 *St. Louis district is billed quarterly – amount is restated to reflect monthly bill

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23

A 95% increase for Brunswick customers would nearly double their current rates and price their service at rates that are simply too high when compared to other Districts.

Q. ARE THERE OTHER CONCERNS WITH PUBLIC COUNSEL’S PHASE-IN PROPOSAL?

A. Yes. The OPC proposal is for carrying costs on the uncollected balance as a result of the phase-in to be equal to the Company’s Allowance for Funds Used During Construction (“AFUDC”) rate. The OPC does not explain why it believes the Company should use its AFUDC rate for the phase-in plan rather than its authorized return. Finally, it is unfortunate, but true, that the state of the facilities in these two districts is such that there is continued need for replacement of infrastructure. Additional capital investment is likely, which may result in rate cases more frequently than a three year interval. This would likely result in rate increases on top of the OPC’s recommended phase-in rates, leaving customers in these two districts with percentage increases in the same range as what the OPC is currently trying to avoid. The Company believes that at least for the foreseeable future inter-district revenue contributions are a far better solution.

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes, it does.