Exhibit No.:
Issue: Depreciation Expense; Cash Working Capital; Customer Deposits; Advances for Construction; Easy Pay Brochures; Tank Painting; Regulatory Deferrals; Miscellaneous
Witness: MICHAEL G. GRUNER
Sponsoring Party: MoPSC Staff
Type of Exhibit: Direct Testimony
Case No.: WR-2000-844

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

MICHAEL G. GRUNER

ST. LOUIS COUNTY WATER COMPANY

CASE NO. WR-2000-844

Jefferson City, Missouri
November, 2000

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CASE NO. WR-2000-844

ST. LOUIS COUNTY WATER COMPANY

Q. Please state your name and business address.

A. Michael G. Gruner, 815 Charter Commons Dr., Suite 100B, Chesterfield, Missouri 63017.

Q. By whom are you employed and in what capacity?

A. I am employed by the Missouri Public Service Commission, (MPSC or Commission) as a Regulatory Auditor.

Q. Please describe your education and background.

A. I graduated from the University of Missouri-Columbia, receiving a Bachelor of Science degree in Marketing in May of 1982. I have also completed 27 hours of accounting courses from the University of Missouri-St. Louis and in May of 1989 passed the Uniform Certified Public Accountant Examination.

Q. Please describe your employment background.

A. Prior to my employment with the Commission, I was employed as an internal auditor for the Lutheran Church Missouri Synod from 1989-91, and for First Banks, Inc. from 1991-92. From 1993-97, I was employed by several temporary accounting agencies performing various accounting assignments.

Q. What has been the nature of your duties while in the employ of the Commission?

A. I have assisted with audits and examinations of the books and records of public utility companies operating within the state of Missouri. I participated in Case No. WR-97-382, St. Louis County Water Company; Case No. EO-96-14, Union Electric Company; Case No. WR-99-326, United Water Missouri, Inc.; Case No. WR-2000-281, Missouri-American Water Company and six informal water rate proceedings.

Q. With reference to Case No. WR-2000-844 have you reviewed the books and records of St. Louis County Water Company, Company. (St. Louis County Water or Company)?

A. Yes, in conjunction with other members of the Commission Staff (Staff).

Q. What are your principal areas of responsibility in this case?

A. I am principally responsible for analysis of the components of rate base with the exception of accrued pension liabilities. This item is discussed in the testimony of Staff Accounting witness Doyle L. Gibbs. I am also responsible for depreciation expense for plant in service, depreciation expenses associated with lapsing advances and contributions in aid of construction (CIAC), and the amortization related to the Infrastructure Replacement Deferral and the Informational Technology Study.

Q. What Accounting Schedules are you sponsoring?

A. I am sponsoring Accounting Schedule 8, Cash Working Capital (CWC).

Q. What adjustments to the Income Statement are you sponsoring?

A. I am sponsoring the following Income Statement adjustments:

Easy Pay Brochures - S-14.4

Interest on Customer Deposits	-	S-14.5
Depreciation Expense	-	S-16.1 - 4
Amortization of Leased Utility Plant	-	S-18.1
Tank Painting	-	S-13.2

Amortization of the:

Infrastructure Replacement Deferral	-	S-21.5
Informational Technology Study	-	S-15.9
Depreciation Reserve Deficiency	-	S-17.1

CASH WORKING CAPITAL

Q. Please discuss Accounting Schedule 8, Cash Working Capital.

A. Accounting Schedule 8 is the Staff's calculation of the cash working capital (CWC) requirement.

Q. Referring to Accounting Schedule 8, what is CWC?

A. CWC is the amount of cash that a utility company needs to pay expenses incurred, on a daily basis, to provide service to the ratepayer.

Q. Is the method you used to calculate the CWC requirement consistent with that used in previous rate cases?

A. Yes. The methods applied herein have been utilized by the Staff and adopted by the Commission in numerous rate cases.

Q. How were the amounts included in Accounting Schedule 8 calculated?

A. The Staff applied the same calculations that were employed in Case No. WR-97-382, the Company's most recent rate case. Staff used the same lags that it employed in Case No. WR-97-382. The annualized levels of expenses were updated for the current rate case.

Q. How has Staff determined the amount of CWC provided by the shareholders and ratepayers?

A. A lead/lag study indicates the cash necessary, on a day-to-day basis, for the Company to provide service to the ratepayers. The lead/lag study also indicates who has supplied this cash, ratepayer or investors. A negative CWC requirement indicates that the ratepayers have provided the CWC in aggregate during the test year and update period. This means that the ratepayers on average, have provided the necessary cash before the Company must pay for the expenses. A positive CWC requirement indicates that the shareholders have provided the CWC in aggregate during the test year and update period. This means that the Company, on average, must pay for the expenses before the ratepayers provide the cash.

Q. What was the result of your lead/lag calculation?

A. The individual calculations, when aggregated, result in a positive CWC requirement. This illustrates an excess of CWC supplied by the shareholder over the amount supplied by the ratepayer. This CWC requirement is added to rate base to compensate shareholders for the use of their funds.

MATERIALS & SUPPLIES/PREPAYMENTS

Q. Please discuss the materials and supplies balance which appear on the Rate Base schedule?

A. The Materials and Supplies and Prepayments balance reflects the Staff's calculation of a 13-month average running from December 1998 through December 1999 for these components. The 13-month average for prepayments has been adjusted to eliminate franchise tax because it is specifically addressed in the calculation of CWC, as shown in Accounting Schedule 8. Certain amounts related to insurance that are booked as prepayments in the Company's general ledger have been excluded from the Staff's calculation. These amounts represent accounting accruals and are not actual prepayments.

CUSTOMER DEPOSITS

Q. Please explain the Staff's rate base treatment of customer deposits.

A. Customer deposits represent ratepayers supplied funds. As a result, this item is a reduction to rate base. The Company informed Staff, in its response to Data Request No. 67, that it was discontinuing its policy regarding customer deposits and would be returning all existing deposits to Ratepayers. Because of this change, the level of deposits has been declining since the last rate case. The Company has provided the Staff with no justification for this change in policy. In addition, the Staff has observed no reduction in the amount of bad debt write-offs. Therefore, the balance of customer deposits that was used to establish rates in the previous case will be used to calculate the deduction from rate base.

CONTRIBUTIONS IN AID OF CONSTRUCTION (CIAC)

Q. How was CIAC determined?

A. All individual CIAC account balances at June 30, 2000, were summed and included as an offset to rate base. CIAC represents non-investor-supplied funds.

ADVANCES FOR CONSTRUCTION (Advances)

Q. Please discuss the Staff's rate base treatment of advances.

A. Advances represent non-investor supplied funds. Therefore, the advances balance at June 30, 2000 (less the associated accumulated depreciation related to prior cases) is a deduction from rate base.

Q. Please explain why advances, the net of accumulated depreciation, are used to determine rate base and describe how the net depreciated value is calculated.

A. Historically, the Staff eliminated any expense recovery for depreciation related to advances estimated to lapse. Any funds advanced to the Company, which are not recovered by the developer within a ten-year period are considered to have lapsed and are included in CIAC. Since the estimated lapsed advances represent future CIAC, it has been the Staff's position that the associated depreciation on the estimated lapsed advances should be treated in a similar fashion to the depreciation calculated on CIAC. The Staff determined the level of accumulated depreciation by which the cost of service has been reduced through the elimination of depreciation expense on lapsing advances in Case Nos. WR-89-246, WR-91-361, WR-93-204, WR-94-166, WR-95-145, WR-96-263 and WR-97-382.

The total accumulated depreciation associated with lapsed advances was calculated in the following manner. First, the depreciation expense adjustment for each of the seven cases mentioned above was determined. These amounts were then multiplied by the period of time that the rates from the respective cases were effective. This calculation was performed to arrive at the amount of depreciation that has accumulated over each effective rate period. This accumulated depreciation was subtracted from the balance of advances at June 30, 2000 to calculate the amount of advances included as an offset to the rate base.

DEFERRED INCOME TAX

Q. Please explain the Staff's treatment of Deferred Income Tax (DIT) for rate base.

A. The DIT offset to rate base represents the balance as of June 30, 2000, for deferred income taxes related to timing differences associated with tax depreciation, CIAC, bond redemption and pensions. In addition, the Staff has included a deferred tax offset associated with the unamortized balance of the Meter Reading Rerouting deferral included in rate base. This item is discussed in the direct testimony of Accounting Staff witness Stephen M. Rackers.

Income Statement Adjustments

EASY PAY BROCHURES

Q. Please discuss adjustment 14.4.

A. Adjustment 14.4 reduces expense to reflect the change in distribution regarding the Easy Pay Brochures. During the test year, this brochure was sent to all customers in three out of four of their quarterly bills. However, on an ongoing basis, the brochures will be sent out only when specifically requested by a customer.

INTEREST ON CUSTOMER DEPOSITS

Q. Please explain adjustment S-14.5 for interest on customer deposits.

A. The Staff recognizes that it is appropriate to allow recovery of the interest paid by the Company on customer deposits. The amount of the rate base offset for customer deposits is multiplied by the applicable interest rate to determine this adjustment. The rate used is the published prime interest rate at July 31, 2000, plus 1%. This rate will be trued-up at December 31, 2000.

DEPRECIATION ON LAPSED ADVANCES

Q. Please discuss adjustment S-16.3 for depreciation on plant supported by lapsed advances.

A. Advances represent funds collected by the Company from promoters (developers) for reimbursement of certain plant that is placed in service. These advances are subject to refund over a defined period of time, usually ten years, as customers are added to the system. After that period of time, any amount not refunded to the developers "lapses" and is retained by the company and subsequently transferred to CIAC. Historically, some portion of advances has lapsed and become CIAC. I examined the actual level of lapsed advances, as they related to the actual advances collected, and calculated the average "lapse" percentage over the last 27 years and the last ten years. At the time of filing for this case, the average historical lapse percentage since 1970 is 55.41%, and over the last ten years the rate has averaged 70.52%. Although the ten-year average reflects more recent results, the lower 27-year average has been used to conservatively approximate an appropriate level of lapsing advances. This lapse percentage was applied to the accumulated balance of advances collected from 1990 through 1999 to determine the estimated level of advances that will eventually become CIAC. The estimated amount of lapsed advances was then multiplied by the average depreciation rate for the associated plant that it supports. This calculation determines the depreciation expense associated with the plant supported by lapsed advances.

Q. Why is the Staff's treatment appropriate?

A. The Staff's treatment serves to prevent the ratepayer from having to supply funds to the Company for recovery of depreciation expense on plant in service supported by contributed capital.

Q. Has the Staff's treatment of the depreciation associated with lapsing advances been previously accepted by the Commission?

A. Yes. The Staff's position on lapsed advances as advocated in this case was accepted by the Commission in its Report and Order for St. Louis County Water Company, Case No. WR-95-145 and also in Case Nos. WR-91-174 and SR-91-194 for Missouri Cities Water Company.

DEPRECIATION EXPENSE

Q. Please discuss adjustment S-16.1 for depreciation expense on plant in service.

A. The Staff's annualized level of depreciation expense is calculated in Accounting Schedule 7, Depreciation Expense. The schedule presents the Staff's calculation of annualized depreciation based on plant in service at June 30, 2000 and its proposed depreciation rates. The total annual depreciation expense is compared to the test year recorded book depreciation with the difference shown as adjustment S-16.1 on Accounting Schedule 10, Adjustment to the Income Statement.

Q. Please describe adjustment S-16.2 for depreciation expense on CIAC.

A. In order to calculate CIAC depreciation expense, the Staff applied the depreciation rates to the various depreciable CIAC plant account balances as of

June 30, 2000. Adjustment S-16.2 is the total of the depreciation amounts for each CIAC plant account.

Q. Please explain the Staff's adjustment to depreciation expense for autos, trucks and heavy-duty equipment.

A. Adjustment S-16.4 reflects the amount of annualized depreciation on autos, trucks and heavy equipment in addition to the amount previously charged to operating and maintenance expense.

AMORTIZATION OF LEASED UTILITY PLANT

Q. Please explain the Staff's adjustment to annualize the amortization of leased utility plant.

A. Adjustment S-18.1 annualizes the level of amortization on leased utility plant. This adjustment is necessary because the amortization is not included in Accounting Schedule 7, Depreciation Expense.

TANK PAINTING

Q. Please explain adjustment S-13.2 to tank painting expense.

A. This adjustment represents the normalization for interior and exterior tank painting expense. The Company has shown that the average exterior paint coating lasts approximately six years, while the average interior coating has a life of approximately 12 years. The combined interior surface for all tanks is 1,293,201 square feet and the combined exterior surface is 956,041 square feet. To determine the amount of annual expense to be included, I multiplied the interior and exterior total square feet by the most current tank painting costs and divided by 12 and six, respectively

Q. How did you determine the most current tank painting cost?

A. The cost was determined by averaging the cost per square foot for all tanks actually painted in 1999, because this is most representative of current costs.

METER READING REROUTING

Q. Please describe the meter reading rerouting project.

A. The meter reading rerouting project was implemented by the Company as a result of a Staff management audit and was completed in two phases. The first phase, which began in July 1991, reorganized meter routes to increase the readers' efficiency. The Company began reading under the new routes in August 1991, although total rerouting was not completed until February1992.

The second phase was the implementation of an Automated Route Control System (ARCS) to enable the Company to easily move accounts from route to route. The first cost incurred relating to ARCS was recorded in October 1992 with the final cost outlay recorded in July 1993. The Company began amortizing these costs over a ten-year period beginning the month when rates went into effect as a result of Case No. WR-93-204 (September 1993).

Q. Have you included the unamortized balance in rate base?

A. Yes, I have included the unamortized balance as of June 30, 2000. Using the end of the update period balance for these costs matches the treatment given to other items in Accounting Schedule 2, Rate Base.

INFRASTRUCTURE REPLACEMENT DEFERRAL

Q. Please describe the infrastructure replacement deferral adjustment, S-21.5.

A. Through the Reports and Orders in Case Nos. WR-95-145 and WR-96-263, the Company was permitted to defer, through the use of an Accounting

Authority Order (AAO), certain costs associated with capital expenditures due to its main replacement program. For the purpose of facilitating the discussion of this item, the deferrals associated with plant in service from October 1, 1995, the effective date of the rates from Case No. WR-95-145, through September 30, 1996, the true-up cut-off date in Case No. WR-96-263 will be referred to as "First Order Deferrals." The deferrals associated with plant placed in service between September 30, 1996 and November 30, 1997, the true-up date for the last case, will be referred to as "Second Order Deferrals." I have reflected, in the Staff's deferred calculation, the depreciation, deferred taxes and carrying charges related to main replacement plant additions placed in service associated with the previously approved AAO's. Adjustment S-21.5 reflects the amortization of deferred charges associated with each AAO, over a period of ten years. This treatment is different from treatment proposed for this Company in past cases for Infrastructure Replacement Deferrals. The Staff's rationale for this change is discussed in the testimony of Staff Accounting witness Stephen M. Rackers.

Q. How was the deferral calculated?

A. The deferral was calculated in the following manner:

(1) the carrying charge is levied on the "net" deferred balance (the booked cost of the asset less the depreciation deferred on it);

(2) the deferral is booked net of any deferred income tax benefits associated with the infrastructure additions;

(3) the half-year convention is used in calculating the depreciation deferral; and,

(4) the carrying charges on the deferral are compounded semi-annually.

Q. Should any savings related to the capital addition being deferred also be reflected as an offset to the deferral?

A. Yes, but the timing and amount of savings are not known at this time. Therefore, the Staff may propose an offset in future rate cases to the infrastructure deferral relating to maintenance savings.

Q. What carrying charges rate was used for purposes of calculating the deferral?

A. The carrying charge is calculated using the rate of return approved by the Commission in Case No. WR-95-145 for First Order Deferrals and the rate of return approved in Case No. WR-96-263 for Second Order Deferrals.

Q. Have you included any amounts deferred after November 30, 1997?

A. No. Any infrastructure replacement deferrals calculated after November 30, 1997, has not been included in the cost of service. The rationale for the Staff's position is discussed in the direct testimony of Staff witness Rackers.

INFORMATION TECHNOLOGY STUDY

Q. Please describe the information technology study.

A. The information technology study is a plan developed by the Company, with the assistance of an outside consultant, to identify and acquire the technological investments necessary to meet the Company's operational needs over the next five years. The Company accumulated costs relating to this study over an 18-month period, from July 1995 through December 1996. The study was fully amortized by December of the test year and the implementation was fully amortized in May 2000 during the update period. Adjustment S-15.9 will remove the informational technology study amortization as an expense from the income statement.

DEPRECIATION RESERVE DEFICENCY

Q. Please explain adjustment S-17.1

A. As a result of the Report and Order in Case No. WR-95-145, the Company is recovering a $36.3 million depreciation reserve deficiency through a ten-year phased-in amortization. I have adjusted the test year expense to eliminate this item.

Q. Why is this adjustment necessary?

A. As discussed in the testimony of Staff witness Paul Adam of the Commission's Engineering and Management Services Department, the Staff is recommending new depreciation rates for St. Louis County Water Company. These rates do not include an amortization for a reserve deficiency.

MISCELLANEOUS REGULATORY DEFERRALS

Q. In addition to the Meter Reading Rerouting and Infrastructure Replacement Deferrals mentioned in your testimony, have you included any amount in the cost of service associated with other regulatory deferrals?

A. No.

Q. Does the Company have any additional items included in deferrals on its books?

A. Yes, the Company has deferred several additional items. These items include the following: the unamortized costs associated with the Information Technology Plan; expenses associated with a Depreciation Study completed for the current rate case;

expenses related to the Weston Main Replacement Study; expenses related to the legal appeal of the AAO related to main replacement infrastructure; and expenses related to the labor contract negotiations that have occurred with the Clerical and Physical bargaining units of the Company in 1999.

Q. Why hasn't Staff included these items in the cost of service?

A. The Staff has not included these items for the following reasons. First the Informational Technology Study was fully amortized in May 2000, which is included in the Staff's update period. The expenses related to the depreciation study for the current rate case should be included in rate case expense. The expenses relating to the Weston Main Replacement Study should be included in the cost of the main repairs, which are related to this study and capitalized starting in 2001 when the replacements will occur. The majority of the expenses related to the legal appeal of the AAO for to main replacement infrastructure were incurred, prior to the test year, in 1997. Also since 1997 legal expense has increased from $28,389 to $161,164 in the test year, the Staff believes this is a sufficient amount for legal expense on an ongoing basis. The Staff determines that the expenses related to the most recent labor negotiation should not be included in the cost of service because, as the Company stated in Data Request No. 101, this level of expense has not occurred in the past. In addition, there was no indication that the Company expected such a level to occur again in the future. Since this item represents a non-recurring expenditure, which does not provide any future benefit, the Staff has not included any associated amount in the cost of service.

Q. Does this conclude your direct testimony?

A. Yes it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of	)	
St. Louis County Water Company for	)	Case No. WR-2000-844
Authority to file Tariffs reflecting	)	
Increased Rates for Water Service.	)	

AFFIDAVIT OF MICHAEL G. GRUNER

STATE OF MISSOURI	)	
	)	ss.
COUNTY OF COLE	)	

Michael G. Gruner, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Direct Testimony in question and answer form, consisting of 15 pages to be presented in the above case; that the answers in the foregoing Direct Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Michael G. Gruner

Michael G. Gruner

Subscribed and sworn to before me this 17th day of November 2000.

Rosemarie Riedl

ROSEMARIE RIEDL
NOTARY PUBLIC STATE OF MISSOURI
COLE COUNTY
MY COMMISSION EXPIRES JUNE 1, 2001