

Exhibit No.:
Issues: Security Costs-AAO, Deferred Taxes
Relating to the Security AAO Asset
Witness: Tyler T. Bernsen
Exhibit Type: Surrebuttal
Sponsoring Party: Missouri-American Water Company
Case No.: WR-2008-0311
SR-2008-0312
Date: October 16, 2008

MISSOURI PUBLIC SERVICE COMMISSION

**CASE NO. WR-2008-0311
CASE NO. SR-2008-0312**

SURREBUTTAL TESTIMONY

OF

TYLER T. BERNSEN

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)	CASE NO. WR-2008-0311
RATES FOR WATER AND SEWER)	CASE NO. SR-2008-0312
SERVICE)	

AFFIDAVIT OF TYLER T. BERNSEN

Tyler T. Bernsen, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Surrebuttal Testimony of Tyler T. Bernsen"; that said testimony was prepared by him and/or under his direction and supervision; that if inquiries 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.



Tyler T. Bernsen

State of Missouri
County of St. Louis
SUBSCRIBED and sworn to
Before me this 15th day of October 2008.



Notary Public

My commission expires:

Staci A. Olsen
Notary Public - Notary Seal
State of Missouri
St. Charles County
Commission # 05519210
My Commission Expires: March 20, 2009

**SURREBUTTAL TESTIMONY
OF
TYLER T. BERNSEN
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WR.2008.0311
SR.2008.0312**

TABLE OF CONTENTS

I.	Witness Introduction and Purpose.....	1
II.	Security Costs - AAO.....	1
III.	Deferred Taxes Relating to the Security AAO Asset	6

SURREBUTTAL TESTIMONY

OF

TYLER T. BERNSEN

I. WITNESS INTRODUCTION AND PURPOSE

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Tyler T. Bernsen, and my business address is 727 Craig Road,
St. Louis, Missouri 63141.

**Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THIS
PROCEEDING?**

A. Yes, I have submitted direct and rebuttal testimony in this proceeding.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. The purpose of my surrebuttal testimony is to discuss on behalf of MAWC:

- 1) The appropriate rate base treatment of the unamortized balance of the regulatory asset associated with security costs; and,
- 2) Deferred taxes related to the unamortized balance of the regulatory asset associated with security costs.

II. SECURITY COSTS - AAO

**Q. DOES MAWC BELIEVE THAT IT SHOULD BE ALLOWED TO EARN A
RETURN ON THE UNAMORTIZED BALANCE OF THE SECURITY AAO?**

1 A. Yes. Due to the nature and need for the AAO in question, the Company
2 believes that there is sufficient reason for the Commission to allow MAWC to
3 be allowed the opportunity to earn a return on the AAO asset. Due to GAAP,
4 MAWC was not afforded the luxury of capitalizing a significant portion of its
5 security expenditures. Due to the circumstances surrounding the
6 expenditures, the Company had no choice but to react to the terrorist attacks
7 on 9-11 by increasing the security at its facilities. It is neither fair nor
8 reasonable to deny the Company the opportunity to earn a return on the
9 security expenditures due to nature of the expenditure. A significant portion
10 of MAWC's expenditures were recovered only due to the AAO order, but the
11 Commission has yet to make a ruling on the rate base treatment of the
12 unamortized portion of this security AAO.

13
14 **Q. HAS THE COMMISSION HISTORICALLY TREATED ALL AAO'S THE**
15 **SAME?**

16 A. No.

17
18 **Q. STAFF WITNESS KIMBERLY BOLIN SUGGESTS THAT THE**
19 **UNAMORTIZED PORTION OF THE SECURITY AAO SHOULD NOT**
20 **RECEIVE RATE BASE TREATMENT BECAUSE OF WHAT SHE**
21 **BELIEVES TO BE PAST COMMISSION TREATMENT OF SUCH**
22 **DEFERRAL BALANCES. ARE YOU AWARE OF ANY COMMISSION**
23 **RULES THAT DIRECT THIS RESULT?**

24 A. No.

1
2 **Q. WHAT SHOULD THE COMMISSION TAKE INTO ACCOUNT IN**
3 **DERTERMINIG WHETHER AN UNAMORTIZED DEFERRAL BALANCE**
4 **SHOULD RECEIVE RATE BASE TREATMENT?**

5 A. The nature of the AAO asset as well as the circumstances under which an
6 AAO is requested must be taken into consideration when determining the
7 rate base treatment of an AAO asset.
8

9 **Q. STAFF WITNESS BOLIN SUPPORTS HER ARGUMENT BY**
10 **REFERENCE TO MGE CASE NO. GR-98-140. WHAT IS THE NATURE**
11 **OF MGE'S SERVICE LINE REPLACEMENT PROGRAM ("SLRP")**
12 **AAO?**

13 A. In Case No. GR-98-140, the Commission granted MGE an AAO to
14 address its Service Line Replacement Program (SLRP) expenditures.
15 The expenditures to be deferred per the Report and Order on Rehearing
16 were: 1) depreciation expense; 2) property tax expense; and 3) carrying
17 costs associated with the installed SLRP plant after the actual plant was
18 placed in service, but prior to these related expenses being recovered in
19 rates. The AAO asset composition is a direct result of replacing assets in
20 MGE's system.
21

22 **Q. IS THIS ANY DIFFERENT THAN THE AAO ASSET GRANTED BY THE**
23 **COMMISSION IN DOCKET NO. WO-2002-273?**

1 A. Yes. The Company's security AAO asset granted in Docket No. WO-
2 2003-273 is composed of 1) depreciation expense, 2) carrying costs
3 associated with assets placed into service, and 3) expenditures related to
4 increased security. The depreciation and carrying costs are quite small in
5 comparison to the additional security expenditures provided by the
6 Company and its Shareholders to protect its customers, employees and
7 assets. The amount of these expenditures in the security AAO is an
8 important factor that should be taken into consideration when determining
9 the rate base treatment of the unamortized AAO asset.

10
11 **Q. WHAT WAS THE CIRCUMSTANCE UNDER WHICH MGE REQUESTED**
12 **THE SERVICE LINE REPLACEMENT PROGRAM ("SLRP") AAO?**

13 A. MGE was replacing service line assets at a high rate as ordered by the
14 Commission. The associated costs were depreciation expense, property
15 tax expense and carrying costs on the assets. These associated costs
16 were not being recovered in rates at the time they were being incurred.
17 This is an example of regulatory lag. MGE's AAO was implemented in
18 order to mitigate the regulatory lag by allowing MGE to defer the
19 depreciation expense, property tax expense and carrying costs and collect
20 them in rates over time.

21
22 **Q. HAS THE COMMISSION ADDRESSED THE SUBJECT OF RATE BASE**
23 **TREATMENT OF AAO'S MORE RECENTLY THAN THE CASE CITED**
24 **BY STAFF WITNESS BOLIN?**

1 A. Yes. In Commission Case No. Case No. ER-2007-0004, while considering
2 the issue of AAO rate base treatment, the Commission reiterated that AAOs
3 are to be considered on a case-by-case basis, and that the Commission can
4 revisit the issue and is not bound by its prior determinations.

5
6 **Q. ON PAGE 11 OF HIS REBUTTAL TESTIMONY, PUBLIC COUNSEL**
7 **WITNESS REBERTSON SUGGESTED THAT THE SECURITY AAO**
8 **“EFFECTIVELY ELIMINATED THE DETRIMENTAL EFFECTS OF THE**
9 **REGULATORY LAG”. DO YOU AGREE WITH MR. ROBERSON'S**
10 **STATEMENT?**

11 A. No. While there was a small amount of regulatory lag that was mitigated,
12 Mr. Robertson's statement assumes that the security AAO's only purpose
13 was to mitigate regulatory lag. This is inaccurate in that regulatory lag
14 was not an issue in MAWC's security AAO case. The Company did invest
15 in some security assets and was allowed to defer the associated
16 depreciation expense and carrying costs, but the majority of the AAO
17 deferral is composed of operating expenses. The security related
18 operating expenses could have been considered by the Commission to be
19 one-time, non-recurring costs. While MGE would have suffered the effect
20 of a few years of regulatory lag on depreciation, carrying costs, and
21 property taxes on the new assets put into place, Missouri-American may
22 have received zero recovery on the majority of their expenditures. The
23 different reasons for granting an AAO are important and must be

1 considered when comparing the Company's security AAO and the prior
2 AAOs granted by this Commission.

3
4 **Q. DO YOU AGREE WITH MR. ROBERTSON'S ASSERTION THAT THE**
5 **COMPANY IS ALREADY EARNING A RETURN ON THE UNAMORTIZED**
6 **AAO BALANCE?**

7 **A.** No, I do not. On page 11, lines 4 through 11 of his rebuttal testimony, Mr.
8 Robertson claims that the Company is already earning a return on the
9 unamortized balance of the AAO. He gives four factors on which a historical
10 test period is focused. In no instance has a return on the unamortized
11 balance of MAWC's security AAO been ruled upon by the Commission, nor
12 has the Commission ever identified the unamortized balance of the AAO
13 asset as fulfilling the four factors listed in OPC testimony, let alone any one of
14 these factors.

15
16
17 **III. DEFERRED TAXES RELATING**
18 **TO THE SECURITY AAO ASSET**

19 **Q. HAS STAFF REFLECTED A DEFERRED TAX LIABILITY ASSOCIATED**
20 **WITH THE SECURITY ASSET?**

21 **A.** Yes.

22
23 **Q. WHAT CREATED THE DEFERRED TAX LIABILITY ASSOCIATED WITH**
24 **THE SECURITY AAO ASSET?**

1 A. The deferring of the security costs made by the Company created the
2 deferred tax liability.

3
4 **Q. WHAT IS THE IMPACT OF THIS DEFERRED TAX LIABILITY?**

5 A. The deferred taxes are used to reduce the Company's rate base.

6
7 **Q. IS IT REASONABLE THAT THE COMPANY'S RATE BASE BE REDUCED**
8 **BY THE DEFERRED TAXES ASSOCIATED WITH THE SECURITY AAO**
9 **ASSET?**

10 A. Not unless the Company is allowed to earn a return on the unamortized
11 balance of the AAO asset. If the Commission does not allow a return on the
12 unamortized portion of the AAO asset, the Company should be allowed to
13 reduce, for ratemaking purposes, the amount of deferred income tax liability
14 by the appropriate amount.

15
16 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

17 A. Yes.