Exhibit No.:	
Issues:	Eureka Acquisition
Witness:	Brian W. LaGrand
Exhibit Type:	Surrebuttal
Sponsoring Party:	Missouri-American Water Company
Case No.:	WA-2021-0376
Date:	December 17, 2021

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. WA-2021-0376

SURREBUTTAL TESTIMONY

OF

BRIAN W. LAGRAND

ON BEHALF OF

MISSOURI-AMERICAN WATER COMPANY

AFFIDAVIT

I, Brian W. LaGrand, under penalty of perjury, and pursuant to Section 509.030, RSMo, state that I am Director of Rates and Regulatory Support for Missouri-American Water Company, that the accompanying testimony has been prepared by me or under my direction and supervision; that if inquiries were made as to the facts in said testimony, I would respond as therein set forth; and that the aforesaid testimony is true and correct to the best of my knowledge and belief.

BWL

____

Brian W. LaGrand

December 17, 2021

Dated

SURREBUTTAL TESTIMONY
BRIAN W. LAGRAND
MISSOURI AMERICAN WATER COMPANY
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SURREBUTTAL TESTIMONY

BRIAN W. LAGRAND

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Brian W. LaGrand, and my business address is 727 Craig Road, St. Louis, MO 63141.

Q. Are you the same Brian W. LaGrand who previously submitted direct testimony in this proceeding?

A. Yes.

Q. What is the purpose of your Surrebuttal Testimony?

A. I have read the Rebuttal Testimony filed in this case and will respond to certain testimony provided by Staff witnesses Amanda McMellen and Curtis Gateley.

II. NET BOOK VALUE

Q. On p. 2 of her Rebuttal Testimony, Staff witness McMellen provides a calculation of "Net book value of the City of Eureka assets." What is "net book value"?

A. Net book value is the original cost of utility plant in service investments, less the accumulated depreciation on those investments. The net book value of plant investments is an asset on a public utility's balance sheet.

Q. Do assets owned by a municipality have a "net book value"?

A. No. Municipalities do not account for plant assets in the same way as would an investor-owned utility.

Q. How so?

A. There are two primary differences that I will discuss, specifically about the City of Eureka. First, the City of Eureka does not capitalize and depreciate utility plant investments as an investor-owned utility would. Per the City's June 30, 2020 Audited Financial Statements:

> Capital outlays of the various funds are recorded as expenditures when incurred. These capital outlays represent the cost of land, buildings and improvements, and furniture and equipment. The City does not maintain a record of its capital assets for depreciation purposes.[1]

In other words, the City expenses, and does not capitalize, plant investments. It also has no applicable deprecation.

Second, because the City of Eureka does not capitalize plant investments, other types of costs that an investor-owned utility would capitalize in accordance with the Uniform System of Accounts (USOA) are also expensed. These would include items such as allowance for funds used during construction (AFUDC), labor for municipal employees working on capital projects, capitalized overheads, and other costs associated with capital project planning and execution. Other items that would be capitalized by an investor-owned utility may simply be recorded as maintenance expense by the City and would never be captured in an attempt to re-create the "net book value" of utility assets.

Q. What impact would this difference have on the Staff's calculation of "net book value"?

A. The failure to include these items would cause Staff's "net book value" calculation to be understated, perhaps significantly.

[1] June 30, 2020 Audit of Financial Statements, page 27, subpart F.

Q. Can you provide a simple example of this understatement?

A. Yes. In this example, the City has a main break that requires $1,000 of water main to replace the old, broken main. This replacement takes 3 employees, each earning $20 per hour, 4 hours to complete the job. In accordance with the USOA, an investor-owned utility would record an original cost of $1,240 for this asset, and the City of Eureka would expense all of it. When Staff reviews purchasing documentation from the City, they may see the $1,000 (or may not, depending on the quality of the records), but they won't see the $240. This will result in their estimate of "net book value" to be understated.

Q. Are you certain this is how the City of Eureka records these types of transactions?

A. Yes, I have verified this with the City's Finance department.

Q. How does the City of Eureka account for assets that were contributed?

A. Contributed property is not a consideration for a municipality. Regardless of its origin, any utility asset that is in service has value to the City.

Q. How did Staff determine its view of net book value for Eureka?

A. As did the appraisers, Staff also relied on data provided in a March 16, 2020 Flinn Engineering report. Staff generally utilized the 2019 replacement cost values developed by Flinn, then used the Handy-Whitman index to estimate an original cost based on the vintage years. From that estimated original cost, Staff depreciated the assets through the end of 2021, using MAWC's authorized depreciation rates. Staff further reduced the net book value by their estimate of contributed property.

Q. Does Staff's calculation of net book value include all assets?

A. No, it does not. The value of land and easements are not included in Staff's calculations. Page 1 of the Flinn Engineering report clearly states "the values listed in this report do not include the value of land or easements. From my review of Staff workpapers, it does not appear that land and easements were included in its purported analysis of net book value.

Q. Did you have any other concerns with Staff's net book value approach?

A. Yes, I have several. First, as I later describe in more detail, the net book value approach is not applicable to a fair market value transaction utilizing the provisions of Section 393.320, RSMo, where an appraisal is the appropriate approach. Second, there are some inconsistencies. As described above, the foundation of Staff's net book value calculation is the Flinn Engineering report dated March 16, 2020. However, Staff spends many paragraphs in the Staff Recommendation[2] disparaging the same Flinn Engineering report. On page 14, Staff notes of the Flinn Engineering report "Neither bears the seal with signature and date of the engineer responsible for the report, indicating the reports are drafts." On page 15, Staff questions the overall credibility of the Flinn Engineering report itself. On page 17, Staff describes the Flinn Engineering report as an " . . . insufficient engineering report that lacks foundation and credibility. . . " It is curious that Staff would suggest these significant shortcomings and flaws with the Flinn Engineering report, yet also use that exact same report as the basis for its net book value calculation. Lastly, on page 13 of the Staff Recommendation, the total net book value calculation of $17,806,604 is claimed to be as of August 31, 2021, however the Staff workpapers include depreciation through December 31, 2021.

Q. Given that background, how would you describe the "net book value" identified by the Staff?

[2] Attached to the Rebuttal Testimony of Curt Gately as Schedule CBG-r2

A. Staff has created a hypothetical, incomplete and erroneous net book value.

<u>III. SECTION 393.320 - FAIR MARKET VALUE</u>

Q. Given that MAWC has elected to proceed under Section 393.320, RSMo, is there any purpose for Staff to calculate a hypothetical net book value?

A. No. While I am not an attorney, I see no mention of net book value in Section 393.320. Section 393.230 mentions only purchase price and the appraised value of the assets to be purchased. This focus makes sense as the accounting performed by municipal systems, water districts, sewer districts, and privately owned utilities that are not public utilities, is far different from that utilized before the Commission, which makes the determination of a "net book value," extremely difficult, if not impossible, to determine for those entities.

Q. What does the Staff Recommendation conclude about the utilization of Section 393.320, RSMo, for this transaction?

A. On page 16, the Staff Recommendation states "It is Staff's position that the procedures outlined in Section 393.320, RSMo, have not been followed, and that there is an acquisition premium based on an inflated appraisal price based on an insufficient engineering report that lacks foundation and credibility as compared to the net book value of the utility assets."

Q. Did the Company follow the procedures outlined in Section 393.320, RSMo?

A. Yes.

Q. Does Staff provide any evidence that the procedures were not followed?

A. No, they do not.

Q. Staff alleges an acquisition premium exists. Is an acquisition premium contemplated by Section 393.320, RSMo?

A. No, it is not. Since the statute states the ratemaking rate base shall be the lesser of the appraised value or the purchase price, plus reasonable transaction costs, there would never be a difference between the purchase price and the rate base, and therefore there would never be an acquisition premium.

Q. How is this hypothetical acquisition premium calculated?

A. Staff states this acquisition premium is the difference between the appraised value, which is allegedly inflated due to reliance on an engineering report that supposedly is insufficient, and lacks foundation and credibility, and Staff's own calculation of net book value.

Q. What is the basis of Staff's net book value calculation?

A. The same engineering report Staff otherwise describes as insufficient and lacking foundation and credibility.

Q. Section 393.320.2(a), RSMo, states that the determination of fair market value shall be in accordance with Missouri law, and with the Uniform Standards of Professional Appraisal Practice. Does Staff's net book value approach for determining the value of the Eureka system comply with those professional appraisal standards?

A. No, it does not.

Q. Staff witness McMellen concludes her Rebuttal Testimony by responding to a question as to whether "Staff's estimate of net book value is a more appropriate basis to establish the value of the acquired City of Eureka properties . . . ." Is that question mentioned by Section 393.320?

A. I do not see an "appropriateness" question in the statute. I see that Section 393.320.2 states as follows:

> The procedures contained in this section may be chosen by a large water public utility, and if so chosen <u>shall be used by the public service commission</u> to establish the ratemaking rate base of a small water utility during an acquisition. (emphasis added).

Section 393.320.5(1), RSMo states, in part, that:

> "[t]he lesser of the purchase price or the appraised value, together with the reasonable and prudent transaction, closing, and transition costs incurred by the large water public utility, <u>shall constitute the ratemaking rate base</u> for the small water utility as acquired by the acquiring large water public utility…." (emphasis added).

Thus, it appears that the appraisal price, together with the reasonable and prudent transaction, closing, and transition costs incurred by MAWC <u>shall be used by the public service commission and shall constitute the ratemaking rate base</u>.

Q. Does this conclude your surrebuttal testimony?

A. Yes.