

Exhibit No.:
Issues: *Report on Cost of Service;*
Overview of the Staff's Filing
Witness: *Kimberly K. Bolin*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Direct Testimony*
Case No.: *WR-2010-0131*
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

KIMBERLY K. BOLIN

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2010-0131

Jefferson City, Missouri
March 2010

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TABLE OF CONTENTS
DIRECT TESTIMONY
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KIMBERLY K. BOLIN
MISSOURI-AMERICAN WATER COMPANY
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EXECUTIVE SUMMARY 2
REPORT ON COST OF SERVICE..... 3
OVERVIEW OF STAFF’S RECOMMENDED REVENUE REQUIREMENT 4

1 **DIRECT TESTIMONY**
2 **OF**
3 **KIMBERLY K. BOLIN**
4 **MISSOURI-AMERICAN WATER COMPANY**
5 **CASE NO. WR-2010-0131**

6 Q. Please state your name and business address.

7 A. Kimberly K. Bolin, P.O. Box 360, Suite 440, Jefferson City, MO 65102.

8 Q. By who are your employed and in what capacity?

9 A. I am a Utility Regulatory Auditor for the Missouri Public Service Commission
10 (PSC or Commission).

11 Q. Please describe your educational background and work experience.

12 A. I graduated from Central Missouri State University in Warrensburg, Missouri,
13 with a Bachelor of Science in Business Administration, major emphasis in Accounting, in
14 May 1993. Before coming to work at the Commission, I was employed by the
15 Missouri Office of the Public Counsel (Public Counsel) as a Public Utility Accountant from
16 September 1994 to April 2005. I commenced employment with the Commission in
17 April 2005.

18 Q. What was the nature of your job duties when you were employed by
19 Public Counsel?

20 A. I was responsible for performing audits and examinations of the books and
21 records of public utilities operating within the State of Missouri.

1 Q. Have you previously filed testimony before this Commission?

2 A. Yes. Please refer to Appendix 1, attached to this Direct Testimony, for a list of
3 the major audits in which I have assisted and filed testimony with the Public Counsel and with
4 the Commission.

5 Q. What knowledge, skills, experience, training and education do you have in the
6 areas of which you are testifying as an expert witness?

7 A. I have received continuous training at in-house and outside seminars on
8 technical ratemaking matters both when employed by Public Counsel and since I began my
9 employment at the Commission. I have been employed by this Commission or by
10 Public Counsel as a Regulatory Auditor for over 14 years, and have submitted testimony on
11 ratemaking matters numerous times before the Commission. I have also been responsible
12 for the supervision of other Commission employees in rate cases and other
13 regulatory proceedings.

14 Q. Have you participated in the Commission Staff's (Staff) audit of
15 Missouri-American Water Company (MAWC, Missouri-American) concerning its request for
16 a rate increase in this proceeding?

17 A. Yes, I have, with the assistance of other members of the Staff. I was
18 designated as the Staff Case Coordinator for the Utility Services Division in this proceeding.

19 **EXECUTIVE SUMMARY**

20 Q. What topics are addressed in this piece of testimony?

21 A. I am sponsoring the Staff's Cost of Service Report and the Staff's
22 Accounting Schedules in this proceeding that is being filed concurrently with this testimony.
23 As was done in several other recent filings by the Staff, a "report" format is being used to

1 convey the Staff's direct case findings, conclusions and recommendations to the Commission.
2 The "report" approach to the case filing is an effort to make the Staff's filings more coherent
3 and manageable. The Staff believes that, under this approach and without sacrificing the
4 quality of the evidence presented, fewer witnesses will be required to file Direct Testimony
5 and the Staff's case will be presented more clearly.

6 I will also provide in my direct testimony an overview of the Staff's revenue
7 requirement determination. The Staff has conducted a review of all cost of service
8 components (capital structure, return on rate base, rate base, depreciation expense and
9 operating expenses) that comprise Missouri-American's revenue requirement. My testimony
10 will provide an overview of the Staff's work in each area.

11 Q. Please provide an overview of the organization of the Staff's Accounting
12 Schedules.

13 A. The Staff has filed a complete set of its accounting schedules for each of
14 Missouri-American's operating districts (12 districts). A list of the schedules is included in
15 the Staff's Cost of Service Report. The Staff has also filed a set of its accounting schedules to
16 reflect a combination of all of the water districts for Missouri American (9 water districts) and
17 another schedule to reflect a combination of all three of the sewer districts. Lastly, the Staff
18 filed a Total Company accounting schedule to reflect the results of Staff's audit for the whole
19 Company (MAWC).

20 **REPORT ON COST OF SERVICE**

21 Q. How is the Staff's Cost of Service Report (Report) organized?

1 A. The Staff's Report has been organized by topic as follows:

2 I. Executive Summary

3 II. Background of Missouri-American

4 III. Test Year/Update Period/ True-Up Recommendation

5 IV. Major Issues

6 V. Rate of Return

7 VI. Rate Base

8 VII. Allocations and Service Company Costs

9 VIII. Income Statement

10 This organizational format has been condensed for ease of explanation. The Rate Base and
11 Income Statement sections have numerous subsections which explain each specific
12 adjustment made by the Staff to the June 30, 2009 test year. The Staff member responsible
13 for writing each subsection of the Report is identified in the write-up for that section. The
14 affidavit of each Staff person who contributed to the Report is included in an appendix to the
15 Report.

16 **OVERVIEW OF STAFF'S RECOMMENDED REVENUE REQUIREMENT**

17 Q. In its audit of Missouri-American for this proceeding, Case No.
18 WR-2010-0131, has the Staff examined all of the cost of service components comprising the
19 revenue requirement for each service district within Missouri-American Water Company?

20 A. Yes.

21 Q. What are the cost of service components that comprise the revenue
22 requirement for a regulated utility?

1 twelve months ending June 30, 2009. “Annualization” and “normalization” adjustments are
2 made to the test year results when the unadjusted results do not fairly represent the utility’s
3 most current annual level of revenues and operating costs. Examples of annualization and
4 normalization adjustments are explained more fully later in this Direct Testimony.

5 2) Selection of a “test year update period.” A proper determination of
6 revenue requirement is dependent upon matching the components, rate base, return on
7 investment, revenues and operating costs at the same point in time. This ratemaking principle
8 is commonly referred to as the “matching” principle. It is a standard practice in ratemaking in
9 Missouri to utilize a period beyond the established test year for a case in which to match the
10 major components of a utility’s revenue requirement. It is necessary to update test year
11 financial results to reflect information beyond the established test year in order to set rates
12 based upon the most current information that can be subjected to audit, within the period
13 allowed, for the Commission to deliberate on a utility’s request to change its rate levels.
14 The update period that was agreed to and established for this particular case is the four
15 months ending October 31, 2009. The Staff’s direct case filing represents a determination of
16 Missouri-American’s revenue requirement based upon known and measurable results for
17 major components of the Company’s operations as of October 31, 2009.

18 3) Selection of a “true-up date” or “true-up period.” A true-up date
19 generally is established when a significant change in a utility’s cost of service occurs after the
20 end of the test year update period, but prior to the operation-of-law date, and one of the parties
21 and/or the Commission has decided this significant change in cost of service should be
22 considered for cost of service recognition in the current case. In this proceeding, the Staff is
23 recommending that a true-up audit to be performed. In Missouri-American’s direct filing, the

1 Company said it was planning on placing into service approximately \$57.7 million of plant
2 between the end of the test year and April 30, 2010. As of October 31, 2009,
3 Missouri-American has placed approximately \$20.6 million of plant into service, above the
4 test year-ending level, thus a true-up will be necessary to capture the revenue requirement
5 impact of the remaining projected \$37.1 million of plant additions, which will have a
6 significant impact on the Company's cost of service.

7 4) Determination of Rate of Return. A cost of capital analysis must be
8 performed to determine a fair rate of return on investment to be allowed on
9 Missouri-American's net investment (rate base) used in the provision of utility service. Staff
10 witness David Murray of the Financial Analysis Department has performed a cost of capital
11 analysis for this case.

12 5) Determination of Rate Base. Rate Base represents the utility's net
13 investment used in providing utility service. For its direct filing, the Staff has determined
14 MAWC's rate base as of October 31, 2009, consistent with the end of the test year update
15 period established for this case.

16 6) Determination of Net Income Required. The net income required for
17 Missouri-American is calculated by multiplying the Staff's recommended rate of return by the
18 rate base established as of October 31, 2009. The result represents net income required.
19 Net income required is then compared to net income available from existing rates to
20 determine the incremental change in the Company's rate revenues required to cover its
21 operating costs and provide a fair return on investment used in providing water and/or sewer
22 service. Net income from existing rates is discussed in the next paragraph.

1 7) Net Income from Existing Rates. Determining net income from
2 existing rates is the most time consuming process involved in determining the revenue
3 requirement for a regulated utility. The starting point for determining net income from
4 existing rates is the unadjusted operating revenues, expenses, depreciation and taxes for the
5 test year which is the twelve month period ending June 30, 2009, for this case. All of the
6 utility's specific revenue and expense categories are examined to determine whether the
7 unadjusted test year results require annualization or normalization adjustments in order to
8 fairly represent the utility's most current level of operating revenues and expenses.
9 Numerous changes occur during the course of any year that will impact a utility's annual level
10 of operating revenues and expenses.

11 8) The final step in determining whether a utility's rates are insufficient to
12 cover its operating costs and a fair return on investment is the comparison of net operating
13 income required (Rate Base x Recommended Rate of Return) to net income available from
14 existing rates (Operating Revenue less Operating Costs, Depreciation and Income Taxes).
15 The result of this comparison represents the recommended increase and/or decrease in the
16 utilities net income. This change in net income is then grossed up for income tax to determine
17 the recommended increase and/or decrease in the utilities operating revenues through a
18 rate change.

19 Q. Please identify the four types of adjustments which are made to unadjusted
20 test year results in order to reflect a utility's current annual level of operating revenues
21 and expenses.

22 A. The four types of adjustments made to reflect a utility's current annual
23 operating revenues and expenses are:

1 1) Normalization adjustments. Utility rates are intended to reflect normal
2 ongoing operations. A normalization adjustment is required when the test year data reflects
3 the impact of an abnormal event. For example, main break expense can vary from year to
4 year depending upon the number of main breaks that occur, thus an average is used to develop
5 the “normal” amount of main breaks that would occur on an annual basis.

6 2) Annualization adjustments. Annualization adjustments are the most
7 common adjustment made to test year results to reflect the utility’s most current annual level
8 of revenue and expenses. Annualization adjustments are required when changes have
9 occurred during the test year and/or update period, which are not fully reflected in the
10 unadjusted test year results. For example, if a 3% pay increase occurred on January 1, 2009,
11 the June 30, 2009 test year will only reflect six months of the impact of the payroll increase.
12 An annualization adjustment is required to capture the financial impact of the payroll increase
13 for the other seven months of the year.

14 3) Disallowance adjustments. Disallowance adjustments are made to
15 eliminate costs in the test year results that are not considered appropriate for recovery from
16 ratepayers. An example in this case is certain incentive compensation costs. In the Staff’s
17 view, these costs are incurred to primarily benefit shareholder interests, and it is not
18 appropriate policy to pass these costs onto customers in rates. Therefore, these costs should
19 not be included in cost of service for recovery from ratepayers and the Staff has proposed to
20 disallow them from recovery in rates.

21 4) Proforma adjustments. Proforma adjustments are made to reflect a
22 cost increase that results entirely from increasing or decreasing the utility’s annual revenue
23 as a result of a rate increase or rate reduction. The most common example of a

1 proforma adjustment is the grossing up of net income deficiency for income taxes.

2 The example on the following page illustrates this proforma adjustment:

3	Net Income Required based upon Staff's Rate Base and Rate of Return	\$ 1,000,000
4	Net Income Available based upon Existing Rates	\$ 600,000
5	Additional Net Income Required	\$ 400,000
6	Tax Gross Up Factor based upon a 38.39% Effective Tax Rate	<u>x 1.6231</u>
7	Recommended Revenue Requirement Increase	<u>\$ 649,240</u>

8 In this example, the utility must increase its revenues \$649,240 in order to generate an
9 additional \$400,000 in after-tax net income required to provide the return on investment
10 considered reasonable by the Staff. The example reflects \$249,240 in additional revenue to
11 pay the current income tax which applies to any increase in the utility's operating revenue.

12 Another illustration, using the same assumptions will clarify the need for this proforma
13 adjustment for additional income tax:

14	Additional Revenue Collected in Rates from Rate Increase	\$ 649,240
15	Less Income Tax Due the IRS Based Upon a 38.39% Tax Rate	\$ (249,240)
16	Additional Net Income for Return on Investment	\$ 400,000

17 The above examples represent the normal proforma factoring up for income taxes
18 associated with a Commission approved rate increase.

19 Q. What is the Staff's recommended revenue requirement for MAWC at the time
20 of this revenue requirement direct filing?

21 A. The results of the Staff's audit of Missouri-American's rate case request
22 can be found in the Staff's filed Accounting Schedules, and is summarized on
23 Accounting Schedule 1, Revenue Requirement. This Accounting Schedule shows the Staff's
24 recommended revenue requirement for Missouri-American in this proceeding ranges from

1 approximately \$19,131,801 to \$22,558,134 based upon a recommended rate of return range of
2 7.42% to 7.70%. Staff's recommended revenue requirement includes an estimated true-up
3 allowance of approximately \$5.1 million. The Staff based its true-up allowance on
4 information provided by the Company indicating the districts in which plant additions were to
5 occur before April 30, 2010 and the amount of plant additions for each. The Staff's
6 recommended revenue requirement at the midpoint of the rate of return range (7.56%) is
7 \$20,817,904 (including true-up allowance).

8 Q. What revenue increase did the Company request from the Commission in
9 this case?

10 A. Missouri-American requested that its annual revenues be increased by
11 approximately \$48,558,667 for water revenues and \$143,595 for sewer revenues.

12 Q. What return on equity range is the Staff recommending for Missouri-American
13 in this case?

14 A. The Staff is recommending a return on equity range of 8.95% to 9.55%, with a
15 midpoint return on equity of 9.25%, as calculated by Staff Witness Murray. The Staff's
16 recommended capital structure for Missouri-American is 46.21% common equity, 0.32%
17 preferred stock, 0.89% short-term debt and 52.59% long-term debt, based upon the
18 Company's consolidated actual capital structure as of September 30, 2010. With the input of
19 Missouri-American's cost of debt, cost of preferred stock and above-referenced cost of equity
20 into this capital structure, the Company's resulting cost of capital to apply to rate base is in a
21 range of 7.42% to 7.70%, with 7.56% the midpoint value. The Staff's recommended
22 weighted cost of capital is explained in more detail in Section V of the Staff's Cost of
23 Service Report.

1 Q. What items are included in the Staff's recommended rate base in this case?

2 A. All rate base items were determined as of the update period ending date of
3 October 31, 2009, either through a balance on Missouri-American's books as of that date or a
4 13-month average balance ending on October 31, 2009. These rate base items included:

- 5 • Plant in Service
- 6 • Accumulated Reserve for Depreciation
- 7 • Materials and Supplies
- 8 • Prepayments
- 9 • Customer Advances
- 10 • Contributions in Aid of Construction
- 11 • Prepaid Pension Asset
- 12 • FAS 87 Pension Tracking Regulatory Asset
- 13 • FAS 106 OPEBs Tracking Regulatory Asset
- 14 • Pension Liability
- 15 • Tank Painting Tracker
- 16 • Accumulated Deferred Tax Reserve

17 Q. What are the significant income statement adjustments the Staff made in
18 determining Missouri-American's revenue requirement for this case?

19 A. A summary of the Staff's significant income statement adjustments follows:

1 **Operating Revenues**

- 2 • Retail Revenues adjusted for customer growth and the impact of the
3 rate increase granted to Missouri-American in October 2008 in
4 Case No. WR-2008-0311.

5 **Depreciation and Amortization Expense**

- 6 • Depreciation Expense annualized based upon existing rates and plant in service
7 as of October 31, 2009.

8 **Corporate Service Company (Management) Fees**

- 9 • The Staff updated allocated the American Water Service Company payroll to
10 reflect the Service Company payroll as of October 31, 2009.

11 **Payroll and Employee Benefit Costs**

- 12 • Payroll expense annualized on that basis of employee levels and wages as of
13 October 31, 2009.
- 14 • Payroll taxes and payroll benefits annualized as of October 31, 2009.

15 **Maintenance Normalization Adjustments**

- 16 • Main Break Expense was normalized using a five-year average of the number
17 of main breaks and a three-year average of costs per break. This adjustment is
18 for the St. Louis District only.
- 19 • Staff is proposing to discontinue the tank painting tracker. Staff is proposing
20 to annualize the tank painting expense at a level of \$1,084,842 annually.

21 **Other Non-Labor Expenses**

- 22 • Property taxes calculated on a consistent basis with the plant in service balance
23 as of December 31, 2008.

- 1 • Bad debt expense calculated on the basis of a combination of yearly averages
- 2 for each district. Staff determined a three-year average appropriate to use for
- 3 each district.
- 4 • Missouri-American's estimated rate case expense normalized over two years.
- 5 • Belleville lab expenses were reduced to reflect Staff's allocation of the indirect
- 6 lab costs charged to Missouri-American by Belleville Lab Service Company

7 Q. In providing your recommendation for MAWC's revenue requirement, what
8 reliance did you place on the work or conclusions of other Staff members?

9 A. An expert determining the revenue requirement for a regulated utility must rely
10 on the work from others responsible for developing specific inputs into the cost of service
11 calculation. I, and the other assigned Staff auditors, relied on the work from numerous other
12 Staff members in calculating a revenue requirement for Missouri-American in this case.
13 Depreciation rates, normalized usage, and recommended rate of return are some examples of
14 data supplied to the Audit Department as inputs into the Staff's cost of service calculation.
15 The qualifications for all Staff members not filing direct testimony who provided input to the
16 sections to the Staff's Cost of Service Report are attached as an appendix to the Report.
17 Further, each Staff member is identified at the conclusion of each section authored and has
18 signed affidavits that are attached to the Staff's Cost of Service Report.

19 All of the work performed by the Staff participants was done through the coordination
20 and oversight of myself (Staff Services Division Case Coordinator) and/or Mr. Jerry Scheible
21 (Staff Operations Division Case Coordinator). If the Commission has questions of a general
22 or policy nature regarding the worked performed by, or the positions taken by the Staff in this
23 proceeding, both Mr. Scheible and I will be available at hearing to answer questions of this

1 nature. The Staff will make available for cross examination all witnesses authoring a
2 Report section.

3 Q. What are the biggest differences which contribute to the different rate increase
4 recommendations filed by the Company and the Staff in this proceeding?

5 A. From the Staff's perspective, there are two primary differences. The first issue
6 is the return on equity component of the rate of return calculation. Missouri-American's
7 single-point return on equity recommendation is 11.6%, while the Staff's midpoint
8 ROE recommendation is 9.25%. The dollar difference between the Company and the Staff on
9 this issue is approximately \$16.6 million.

10 The second difference is the amount of plant in service. Staff has used plant in service
11 as of October 31, 2009, while the Company has used April 30, 2010 projected plant in
12 service. The dollar impact of the difference in plant in service is approximately \$4.7 million.
13 This difference will be reduced significantly during the true-up audit procedure.

14 As a result of its audit of other areas of the Company's operations, the Staff has
15 proposed other adjustments as appropriate to either increase or decrease Missouri-American's
16 cost of service. However, these adjustments are not of the same overall magnitude as the
17 adjustments discussed above.

18 Q. Is it possible that significant differences exist between the Staff's revenue
19 requirement positions and those of other parties besides Missouri-American in this
20 proceeding?

21 A. Yes. However, the other parties are filing their direct testimony, if any,
22 concurrent with the Staff's filing. Until the Staff has a chance to examine the direct testimony

1 of other participants, it is impossible to determine what differences exist and how material
2 they may be.

3 Q. Do significant differences exist between the Staff and Missouri-American in
4 their direct filings regarding issues without a revenue requirement impact?

5 A. No.

6 Q. Please identify the Staff witness responsible for addressing each area where
7 there is a known and significant difference between the Staff and the Company that is
8 addressed in this testimony or in the Report in Section IV, Major Issues.

9 A. The Staff witness for each listed issue is as follows:

<u>Issue</u>	<u>Staff Witness</u>
Return on Equity	David Murray
Plant in Service	Paula Mapeka
Revenue	JerryScheible/Paula Mapeka
Payroll	Amanda C. McMellen
Service Company Fees	Amanda C. McMellen

16 Q. When will the Staff be filing its customer class cost of service/rate design
17 testimony and report in this proceeding?

18 A. The Staff's direct customer class cost of service/rate design recommendations
19 will be filed on March 26, 2010.

20 Q. Does this conclude your Direct Testimony in this proceeding?

21 A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

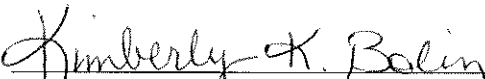
In the Matter of Missouri-American Water
Company's Request for Authority to
Implement a General Rate Increase for Water
and Sewer Services Provided in Missouri
Service Areas

Case No. WR-2010-0131

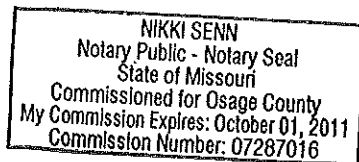
AFFIDAVIT OF KIMBERLY K. BOLIN


STATE OF MISSOURI)
)
) ss.
COUNTY OF COLE)

Kimberly K. Bolin, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Direct Testimony in question and answer form, consisting of 16 pages to be presented in the above case; that the answers in the foregoing Direct Testimony were given by her; that she has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of her knowledge and belief.


Kimberly K. Bolin

Subscribed and sworn to before me this 9th day of March, 2010.




Notary Public