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STATE OF MISSOURI
PUBLIC SERVICE COMMISSION

TRANSCRIPT OF PROCEEDINGS

Evidentiary Hearing

May 17, 2010
Jefferson City, Missouri
Volume 11

In the Matter of Missouri American)
Water Company's Request for)
Authority to Implement a General) File No. WR-2010-0131
Rate Increase for Water Service)
Provided in Missouri Service Areas)

DANIEL JORDAN, Presiding,
REGULATORY LAW JUDGE

ROBERT M. CLAYTON III, Chairman,
JEFF DAVIS,
TERRY JARRETT,
KEVIN GUNN,
ROBERT S. KENNEY
COMMISSIONERS.

REPORTED BY:
KELLENE K. FEDDERSEN, CSR, RPR, CCR
MIDWEST LITIGATION SERVICES

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P R O C E E D I N G S

(MAWC EXHIBIT NOS. 100 - 133 AND STAFF
EXHIBIT NOS. 200, 215, 216HC, 223 AND 224HC WERE MARKED
FOR IDENTIFICATION BY THE REPORTER.)

JUDGE JORDAN: The Commission is calling
file No. WR-2010-0131. This action is captioned as
follows: In the matter of Missouri American Water
Company's request for authority to implement a general
rate increase for water and sewer service provided in the
Missouri service areas.

My name is Daniel Jordan. I am the
Regulatory Law Judge assigned this action. The first
thing I'm going to do is ask everyone to turn off their
electronic communications devices, cell phones,
Blackberries, et cetera, and I'm going to set a good
example by doing so myself right now.

Are there any preliminary matters that
we want to take care of before I begin by taking entries
of appearance? Anything to precede that?

(No response.)

JUDGE JORDAN: Okay. Then we will start
with entries of appearance. Let's begin with the
applicant, Missouri American Water Company.

MR. ENGLAND: Thank you, your Honor. Let
the record reflect the appearance of W.R. England, Paul

1 Boudreau, Dean Cooper and John Reichart on behalf of the
2 Missouri American Water Company. At least Mr. Cooper,
3 Mr. Boudreau and myself, our mailing address is Brydon,
4 Swearngen & England, Post Office Box 456, Jefferson City,
5 Missouri 65102, and we've entered written entries of
6 appearance for all of us. Thank you.

7 JUDGE JORDAN: Thank you. For the
8 Commission Staff.

9 MS. HERNANDEZ: Good morning. May it
10 please the Commission? Jennifer Hernandez, Eric Dearmont,
11 Rachel Lewis and Shelley Brueggemann appearing for staff
12 of the Missouri Public Service Commission. Our address is
13 P.O. Box 360, Jefferson City, Missouri 65102.

14 JUDGE JORDAN: Thank you. For the Office
15 of the Public Counsel.

16 MS. BAKER: Thank you, your Honor.
17 Christina Baker, P.O. Box 2230, Jefferson City, Missouri
18 65102, appearing on behalf of the Office of the Public
19 Counsel and the ratepayers.

20 JUDGE JORDAN: Thank you. UWUA Local 335?
21 Is there anyone here appearing for the union? I note that
22 the union also did not file a position statement. Has
23 anyone had any communications from the union? Yes?

24 MS. BAKER: I have just been in
25 communication with them about the case, but nothing --

1 nothing specific.

2 JUDGE JORDAN: Nothing about them being
3 here today?

4 MS. BAKER: No.

5 JUDGE JORDAN: All right. Then the record
6 will reflect that the union has made no appearance today.
7 For AG Processing, Incorporated.

8 MR. CONRAD: Thank you, your Honor. Please
9 let the record show the appearance of Stuart W. Conrad and
10 David Woodsmall, both of the law firm Finnegan, Conrad &
11 Peterson. By your leave, we filled out the paperwork with
12 the reporter, so I won't bore the record with my address
13 and phone and all that.

14 JUDGE JORDAN: Thank you. For the City of
15 Warrensburg? Warrensburg had filed a request to be
16 excused from this hearing, and I have granted that.

17 St. Louis Area Fire Sprinkler Association.

18 MR. ALLEN: Terry Allen, Allen Law Offices
19 here in Jeff City. The address is on file. We will be
20 here just for the opening, and then we intend to appear
21 next week for our issues. We have nothing in the first
22 week. Mr. England had previously talked to the court
23 about that. Just for the purpose of opening we're here,
24 and we'll see you next week.

25 JUDGE JORDAN: Thank you. City of Joplin.

1 MR. ELLINGER: Mark Ellinger and Tim
2 Schwarz, law firm of Blitz, Bardgett & Deutsch on behalf
3 of City of Joplin, 308 East High, Suite 301, Jefferson
4 City, Missouri 65101. Thank you, Judge.

5 JUDGE JORDAN: Thank you. For Missouri
6 Energy Group.

7 MS. LANGENECKERT: Lisa Langeneckert of the
8 law firm of Sandberg, Phoenix & von Gontard, 600
9 Washington Avenue, 15th Floor, St. Louis, Missouri,
10 appearing on behalf of Missouri Energy Group. As I
11 mentioned briefly to you, Judge Jordan, I will be going
12 upstairs to the workshop and coming and going as necessary
13 for the hearing. Thank you.

14 JUDGE JORDAN: Thank you. For Public Water
15 Supply Districts Nos. 1 and 2 of Andrew County.

16 MR. DORITY: Thank you, Judge. Larry
17 DORITY and James Fischer, Fischer & DORITY, P.C. We have
18 filed a written entry of appearance with our information.
19 Appearing on behalf of Public Water Supply District Nos. 1
20 and 2 of Andrew County.

21 Judge, I would request to be excused from
22 the revenue requirement portion of the hearing. We do
23 have issues with the adequacy of service and other issues
24 portion as well as the rate design portion of the
25 proceeding, and we will be making opening statements at

1 that time. Thank you.

2 JUDGE JORDAN: Thank you. For the
3 Metropolitan Sewer District.

4 MR. FRANCIS: Let the record reflect the
5 entry of appearance of Byron Francis and Kent Lowery,
6 Armstrong Teasdale, One Metropolitan Square, Suite 2600,
7 St. Louis, Missouri 63102, on behalf of the Metropolitan
8 St. Louis Sewer District. And, your Honor, we have
9 requested to be excused until our issue is presented on
10 Friday, at which time we will be presenting our testimony
11 and have cross-examination.

12 JUDGE JORDAN: Thank you. For the City of
13 Riverside.

14 MR. BEDNAR: Joe Bednar and Eric Steinle of
15 Spencer, Fane, Britt & Browne, 308 East High Street, Suite
16 222, Jefferson City, Missouri 65101.

17 JUDGE JORDAN: Thank you. For the City of
18 St. Joseph.

19 MR. STEINMEIER: Thank you, your Honor.
20 Please let the record reflect the appearance of William D.
21 Steinmeier, William D. Steinmeier, P.C. of Jefferson City,
22 Missouri, on behalf of the City of St. Joseph, Missouri.
23 And as other counsel have, I too would request leave to
24 come and go.

25 JUDGE JORDAN: Thank you. For Triumph

1 Foods, LLC.

2 MR. ZOBRIST: On behalf of Triumph Foods,
3 Karl Zobrist, and Lisa Lang-- Lisa Gilbert. Pardon me.
4 Somebody asked me earlier today whether Lisa and I were
5 together. It's like, well, no, we haven't been before and
6 we're not now. My associate Lisa Gilbert, Sonnenschein,
7 Nath & Rosenthal, 4520 Main Street, Suite 1100, Kansas
8 City, Missouri.

9 JUDGE JORDAN: Thank you. For the City of
10 Jefferson? City of Jefferson had filed a request to be
11 excused, and I have granted that.

12 And finally the Missouri Industrial Energy
13 Consumers. No appearance for the MIEC. Record will
14 reflect no appearance this morning.

15 Now, as requests to be excused during
16 certain portions of this hearing, the Commission will
17 grant those motions. Of course, any party that's not
18 present during the examination of a witness for its
19 opportunity to cross-examine a witness waives the right to
20 participate in those examinations and also waives the
21 right to present evidence and argument during those
22 portions. With that understood, I will grant the motions
23 to be excused.

24 Now, we have prenumbered and -- prenumbered
25 exhibits. Does anyone want to enter any of these

1 prenumbered exhibits into the record, and are there any
2 other preliminary matters that we should take up before
3 opening statements? I'm not seeing any.

4 MR. CONRAD: Judge, if no one else does, I
5 would put ours in just simply so I don't have to carry
6 them around.

7 JUDGE JORDAN: Any objection?

8 MR. ENGLAND: Yes, sir. I know this will
9 come as great surprise to the Bench and Mr. Conrad
10 particularly, but I would ask that you reserve ruling on
11 that until his witness has taken the stand and been
12 subject to cross-examination.

13 JUDGE JORDAN: Then I will reserve ruling
14 on those motions.

15 Anything else? I have one matter, and that
16 is I have been informed that we will have to break for an
17 agenda today, an agenda meeting of the Commission. That
18 meeting takes place at 1:30 this afternoon. My IT people
19 tell me that in order to transfer the transmission from
20 here to there, we will have to take a break at 1:20. And
21 I anticipate that will last 'til about 2 o'clock. So we
22 will have a break in the afternoon. We can work that as
23 lunch break or as an additional afternoon break, however
24 it works out.

25 MR. ENGLAND: Excuse me, your Honor.

1 JUDGE JORDAN: Mr. England.

2 MR. ENGLAND: We've indicated in the joint
3 issues list that one of our witnesses, Ms. Ahern, has
4 limited availability for today only. So our hope would be
5 to get her on and off the witness stand first thing, and
6 if need be, I'd suggest perhaps we go through the lunch
7 hour in order to accomplish that and take the lunch break
8 as you indicate when the Commission takes their agenda
9 break.

10 JUDGE JORDAN: Okay. That sounds fine to
11 me. She will be appearing today as part of your case in
12 chief; is that correct?

13 MR. ENGLAND: That is correct.

14 JUDGE JORDAN: I see heads shaking in the
15 first table here.

16 MS. HERNANDEZ: We have no problem with
17 that schedule, your Honor.

18 JUDGE JORDAN: Thank you very much. I
19 understand, too, this evidentiary hearing is taking place
20 a little later in the schedule for a rate case than is
21 usual, and I've been -- I've looked at the schedule for
22 the briefing. When do the parties feel they would need
23 transcripts for this? I note that the initial briefs are
24 due on June 30th of this year. I want to make sure that
25 our reporter has no problem accommodating the briefing

1 schedule.

2 MR. ENGLAND: Your Honor, if I could have a
3 minute, I thought we maybe addressed that in our motion to
4 establish a procedural schedule. I don't have that, but I
5 have your order, I think, accepting it, so I want to take
6 a look at that.

7 JUDGE JORDAN: Please feel free.

8 MR. ENGLAND: I think we addressed it. I
9 just can't recall how.

10 MS. HERNANDEZ: I'm similarly remembering
11 that we asked for expedited transcripts. We can double
12 check with that.

13 JUDGE JORDAN: Is there going to be a
14 problem accommodating that?

15 THE REPORTER: No. We were told it was
16 three-day expedited.

17 JUDGE JORDAN: That is taken care of.

18 Good. Thank you.

19 MR. ENGLAND: Yes, sir. It is addressed in
20 your order at least issued January 13th, ordered paragraph
21 2, the transcripts of any day of the evidentiary hearing
22 shall be expedited to be available no later than the third
23 working day after such day's testimony.

24 JUDGE JORDAN: Very good. I'll take credit
25 for that bit of foresight. And if there is nothing else,

1 and I'm not seeing anything else --

2 MR. CONRAD: I guess I do have a question
3 just to follow up and to clarify what Mr. England's
4 objection, my recollection is that at least at the head
5 end of this we would mark exhibits and those have been
6 premarked, and I didn't intend -- if I misspoke and said I
7 wanted to offer the materials, I could understand
8 Mr. England's objection. I'm not sure I understand if
9 there is an agreed set of issue list and scheduling that
10 includes marking of exhibits, what the problem with that
11 is. So maybe I need some articulation on that.

12 MR. ENGLAND: My objection only went to the
13 what I perceived to be offer into evidence of the
14 exhibits.

15 JUDGE JORDAN: Right.

16 MR. ENGLAND: I have no problem with the
17 exhibits as marked by the various parties.

18 JUDGE JORDAN: My question was whether the
19 parties had stipulated to really, though I did not
20 articulate this, was whether the parties had stipulated to
21 the entries of certain exhibits already.

22 MR. CONRAD: No, sir, not that I'm aware
23 of.

24 JUDGE JORDAN: Okay.

25 MR. CONRAD: At least as I think we

1 mentioned offline, the practice seems to be to get that
2 part of the marking process out of the way and just get
3 them to the reporter, which was all I was proposing, and
4 if I misspoke and asked that they be marked and admitted
5 and offered and made a part of the record without the
6 witness being on the stand, I misspoke.

7 JUDGE JORDAN: Well, the record will so
8 reflect. Thank you for that clarification.

9 Anything else before we begin our opening
10 statements?

11 (No response.)

12 JUDGE JORDAN: Seeing nothing, we will
13 begin with opening statements, and first on my list is the
14 applicant, Missouri American Water Company. And counsel,
15 when you get to the podium, will you first begin by
16 telling us what issues we're going to address in opening
17 statements today, because I understand it's a little
18 different than in the joint list of issues.

19 MR. ENGLAND: I will, your Honor.

20 JUDGE JORDAN: Thank you.

21 MR. ENGLAND: May it please the Commission?
22 Good morning. My name is Trip England. I represent the
23 applicant Missouri American Water Company here today.

24 And Judge, as you indicated, the parties
25 have agreed to, I guess, engage in limited or mini opening

1 statements addressing the issues to be heard today, which
2 is the rate of return issues, and then as subsequent
3 issues are heard or related issues are heard, parties will
4 give a small opening statement before those issues on
5 those days.

6 As I indicated, the issues to be heard
7 today are rate of return. They involve three specific
8 issues: the appropriate return on equity, the appropriate
9 capital structure, and the appropriate cost of long-term
10 debt to be used for purposes of this case.

11 The company has two witnesses on this
12 issue. Ms. Pauline Ahern, a principal with AUS
13 Consultants, addresses the appropriate return on equity.
14 She also addresses capital structure to some degree.
15 And then there is company witness Rungren, who is adopting
16 the prefiled direct and rebuttal testimony of Ms. Chow as
17 well as his own surrebuttal testimony in this case. His
18 testimony is primarily addressing capital structure and
19 the cost of long-term debt.

20 Ms. Ahern was engaged by the company to
21 perform an analysis of the appropriate return on equity
22 for Missouri American in this proceeding. She applied
23 four well-tested market-based cost of equity models to do
24 this. She utilized the discounted cash flow or DCF model.
25 She also performed a risk premium analysis, a capital

1 asset pricing model, or a CAPM, and finally a comparable
2 earnings approach.

3 Because Missouri American is not market
4 traded, it is a wholly-owned subsidiary of American
5 Waterworks, Ms. Ahern selected two proxy groups that she
6 used for purposes of her analysis. The first was a group
7 of six water utilities that are followed by AUS Utility
8 Reports, and the second group included eight natural gas
9 distribution and transmission companies also followed by
10 AUS Utility Reports.

11 As a result of her analysis, Ms. Ahern
12 developed a range of returns that she then adjusted for
13 the greater risk that Missouri American faces in relation
14 to those companies in her proxy groups. Her risk adjusted
15 range of returns as updated in her rebuttal testimony
16 ranged from 10.51 percent to 12.22 percent, and an
17 ultimate recommendation of 11.35 percent return on equity.

18 Staff on the other hand relied primarily on
19 one model, as they have typically done. That's nothing
20 new, the DCF model. Staff's recommended range of returns
21 on equity in this case are 8.95 percent on the low end,
22 9.55 percent on the high end, with a midpoint of 9.25
23 percent.

24 Now, there are several problems with
25 Staff's approach. The first is that they only used one

1 model. Investors do not use one model when they analyze
2 returns on various investment opportunities. They used
3 all of the information available to them as well as all of
4 the models that are customarily used in this regard. So
5 Staff's approach of relying on one model is at odds with
6 the basic tenets of the efficient market hypothesis, and
7 it's also at odds with common sense.

8 The other problem with Staff's approach,
9 for the first time Staff uses a multistage discounted cash
10 flow analysis instead of the single-stage DCF that it has
11 traditionally used. Staff's rationale for this
12 significant departure is primarily based on its concerns
13 about, quote, the sustainability of projected growth
14 rates, unquote.

15 But the projected growth rates in this case
16 that Staff is referring to are actually lower than those
17 that existed in the company's prior two rate cases, and
18 Staff did not abandon the single-stage DCF at that time,
19 although it did again allege concerns regarding those
20 projected growth rates.

21 Significantly, as Ms. Ahern points out, if
22 Staff had used a single-stage DCF and the projected growth
23 rates, it would have developed an average discounted cash
24 flow cost rate of 10.86 percent.

25 One other point I'd like to make about

1 return on equity before I move to the capital structure
2 issue. For many years utilities, at least water utilities
3 were thought to be less risky than electric and gas
4 utility companies. That is no longer the case. With the
5 heavy capital needs of water utility companies to replace
6 aging infrastructure and the lower, relatively speaking,
7 depreciation rates, this has made water utilities as if
8 not more risky than electric and gas companies.

9 For example, on the capital intensity of
10 water utility companies, it's in Ms. Ahern's testimony,
11 but it takes approximately \$4 of invested capital in the
12 water company -- excuse me, four times as much invested
13 capital for a water company than an electric or gas
14 company to produce one dollar in operating revenues.

15 Water companies' composite depreciation
16 rates on average are 2.5 percent versus 3.7 percent for
17 electric and gas companies. This means that at least with
18 respect to internally generated funds from depreciation,
19 those funds are far less for the water companies than they
20 are for the electric and gas companies, putting greater
21 risk on their need to raise external capital.

22 These risks that the water companies face
23 generally are the same risks that Missouri American faces
24 specifically, and, in fact, Missouri American faces those
25 risks I think at a greater level.

1 In sum, given the greater risk facing water
2 companies generally, Missouri American specifically, given
3 the proper application of a single-stage DCF analysis as
4 well as consideration for other models and their results,
5 the record clearly supports a recommendation as offered by
6 Ms. Ahern in this case.

7 Now let me talk about the capital
8 structure. The difference here is that the company's
9 proposing to use a capital structure at April 30th of this
10 year that reflects its actual capital structure, the mix
11 of debt and equity that it actually places that supports
12 its rate base and its investment in Missouri. Staff on
13 the other hand is proposing to use the parent company
14 consolidated capital structure. That's American
15 Waterworks.

16 The difference here is significant.
17 Missouri American's capital structure at April 30th has
18 approximately 49 percent common equity. American
19 Waterworks' common equity ratio for purposes of Staff's
20 analysis is 43 percent.

21 Staff's rationale for using the parent
22 company capital structure seems to be based primarily on
23 the fact that Missouri American gets most of its debt
24 capital from its affiliate, American Water Capital
25 Corporation. Staff also notes that this Commission has

1 adopted a parent company capital structure in other cases,
2 most notably MGE.

3 What Staff fails to recognize is that
4 Missouri American, unlike MGE, is a standalone corporate
5 entity. It is a Missouri chartered corporation. It is
6 not a division of a larger company like MGE is of Southern
7 Union. Thus, Missouri American is easily distinguishable
8 from MGE because it does issue its own equity, it issues
9 its own debt for which it is contractually obligated. In
10 fact, over 50 percent of the debt outstanding on Missouri
11 American's books is issued to third-party unaffiliated
12 lenders.

13 Missouri as -- excuse me. Missouri
14 American as a standalone corporation makes its own
15 decisions as to when to finance and in what proportions.
16 It makes those decisions independent of its parent
17 company. The only reason Missouri American issues debt to
18 its affiliate, American Waterworks Capital Corporation, is
19 because its affiliate is able to offer the lowest interest
20 rate available at the time Missouri American places its
21 debt.

22 Staff's approach, if you will, is truly a
23 case of no good deed goes unpunished. Because Missouri
24 American can and does use its affiliate to get the best
25 interest rates available on debt, all to the benefit of

1 its ratepayers, Staff is going to penalize Missouri
2 American by using a parent company capital structure and
3 imputing a lower equity ratio.

4 Stated another way, the irony of Staff's
5 position is that Missouri American must place all of its
6 debt with third-party lenders, which will likely result in
7 a higher cost of debt, in order for Staff to recognize its
8 actual capital structure. This seems a perverse position
9 or extension of logic.

10 Significantly, what Staff doesn't say and
11 what it cannot say is that Missouri American's actual
12 capital structure is out of line with industry norm and,
13 therefore, unreasonable. In fact, if you look at the
14 average equity ratio for Staff's proxy group of water
15 companies, it is 51 percent or nearly 200 basis points
16 higher than the 49 percent equity ratio for Missouri
17 American.

18 The final issue under rate of return is the
19 appropriate cost of debt. In this case, the company uses
20 the actual cost of its long-term debt of 6.36 percent.
21 Here again Staff imputes the cost of Missouri American's
22 parent company debt and uses a debt cost of 6.18 percent
23 or approximately 20 basis points less.

24 Never mind that the company has sought and
25 obtained approval from this Commission to issue all of the

1 debt it currently has outstanding, and at that time it
2 sought Commission approval, it revealed interest rates,
3 amount of debt, et cetera, and no objection was made,
4 never mind that the company is contractually obligated to
5 pay its lenders the 6.3 percent that it has calculated on
6 its embedded cost of long-term debt, and never mind that
7 there is no evidence that Missouri American's debt cost is
8 not the lowest available at the time it issued this debt.
9 Staff is nevertheless going to impute a lower cost rate
10 simply because of Missouri American's affiliation with
11 American Water Capital Corporation.

12 Now, I could understand if it could be
13 shown that MAWC was paying a higher rate of interest to
14 its affiliate, that Staff would then argue we ought to use
15 the affiliate's lower return -- debt cost, if you will,
16 but that's simply not the case. Again, the affiliate has
17 allowed Missouri American to place debt at a lower cost,
18 generally speaking, than it could through third-party
19 lenders, another example of no good deed goes unpunished.

20 The logical result of Staff's position, as
21 I mentioned earlier, is to force Missouri American to go
22 to the third-party lender to place all of its debt, likely
23 incur higher interest rates, all so that it can use its
24 own capital structure and its own cost of debt in a rate
25 proceeding. I believe that is an improper incentive and a

1 perverse result.

2 In sum, the undisputed evidence in this
3 case is that Missouri American's use of its affiliate to
4 borrow money has been a clear benefit to its ratepayers,
5 and it should not be punished for impute -- by imputing
6 parent company capital structure and parent company debt
7 costs in determining its overall rate of return. Thank
8 you.

9 JUDGE JORDAN: Thank you. Opening
10 statement from Staff. Opening statement from Staff.

11 MR. DEARMONT: Good morning, and may it
12 please the Commission?

13 As is often the case, the largest
14 difference in dollars between the revenue requirement
15 position of the company and that of the Staff can be
16 attributed to the issues of capital structure and rate of
17 return. Per the reconciliation filed by Staff on May 10th
18 of this year, the value of these differences is
19 approximately \$19 million.

20 Staff has performed a detailed analysis of
21 the company's cost of equity capital and recommends that
22 the Commission authorize a return on equity for Missouri
23 American in the range of 8.95 to 9.55 percent. Staff
24 recommends a corresponding overall rate of return for
25 Missouri American of 7.39 to 7.65 percent.

1 Staff's ROE recommendation is driven
2 primarily by a single-stage and multistage discounted cash
3 flow analysis which Staff believes contribute to a
4 reasonable estimate of Missouri American's cost of equity
5 capital. Staff strongly disagrees with the company's use
6 of equity analyst five-year EPS estimates as proxies for
7 dividend growth into perpetuity and believes that it is
8 unreasonable to expect a company's long-term growth to
9 outpace that of the larger economy.

10 As in the recent AmerenUE rate case, Staff
11 has again corroborated the reasonableness of its
12 recommendation by reviewing information from independent
13 financial practitioners and outside investment sources.
14 In addition, Staff believes that the reasonableness of its
15 recommendation is supported by documents generated by the
16 company and which form the basis of American Water
17 financial statements filed with the SEC.

18 As far as capital structure is concerned,
19 it is Staff's position that the Commission should apply
20 Staff's recommended rate of return to the consolidated
21 capital structure of American Water for five reasons.
22 One -- four reasons. Excuse me. One, because it is the
23 cost of debt received by Missouri American, that cost is
24 based on the consolidated credit quality of American
25 Water; two, because the business risks of American Water

1 and Missouri American Water are substantially similar;
2 three, because American Water regularly invokes a concept
3 of double leverage; and four, because the debt issued by
4 American Water Capital Corporation and loaned to Missouri
5 American is essentially guaranteed by American Water.

6 These factors clearly demonstrate that
7 Missouri American is not operating as an independent
8 entity from a financial procurement perspective, and that
9 a consolidated capital structure which has previously been
10 approved by the Commission is therefore appropriate for
11 ratemaking purposes in this case.

12 For the Commission's information, Staff and
13 the company also disagree on the cost of long-term debt,
14 though that debate is largely a function of the
15 disagreement regarding the use of a consolidate versus a
16 standalone capital structure.

17 That's all I have. Thank you.

18 JUDGE JORDAN: Thank you. Opening
19 statement from the Office of Public Counsel?

20 MS. BAKER: Public Counsel has no testimony
21 on these issues. However, it would ask that the
22 Commission keep in mind the current economic times and its
23 effect on the ratepayers while making a decision on this
24 issue. Thank you.

25 JUDGE JORDAN: Thank you. Next on the list

1 was Jefferson City. That party has been excused. City of
2 Joplin?

3 MR. ELLINGER: Thank you, Judge, members of
4 the Commission.

5 The City of Joplin has not filed testimony
6 on this issue. Much in the vein of what the Office of the
7 Public Counsel has said, we would ask the Commission to
8 keep in mind the current economic environment. There are
9 some serious concerns about rate of return on equity,
10 capital structure and cost of debt for Missouri American
11 Water.

12 I would ask everyone to keep in mind that
13 American Waterworks is the largest publicly traded water
14 utility in the U.S. and that Missouri American Water
15 really is a wholly-owned subsidiary. They are for all
16 intentional purposes one and the same. And therefore, we
17 believe that to evaluate Missouri American Water you have
18 to look at American Waterworks.

19 We think that in light of the current
20 economic conditions, there are even questions as to
21 whether Staff's return of equity is too large at this
22 time. And I think the testimony we will hear today will
23 elicit the facts that the market conditions are far
24 different than those that have been in other cases that
25 have been before this Commission revolving around Missouri

1 American Water.

2 For those purposes, we ask the Commission
3 to seriously take into consideration the economic
4 conditions, the impact upon ratepayers, particularly those
5 in the City of Joplin, and to understand that in this
6 difficult economic environment, a large rate of return is
7 simply not realistic. Thank you.

8 JUDGE JORDAN: Thank you. City of
9 Riverside.

10 MR. BEDNAR: May it please the Commission?
11 I too share and City of Riverside shares the opinion and
12 position of the OPC as well as the City of Joplin and the
13 concern about the economic times of today and would take
14 this opportunity as we consider the proper rate of return
15 in this case that was not mentioned in the opening
16 statements today is the adequacy of service that should be
17 considered by this Commission, and adequacy of service
18 should not be considered 1985 as adequate or the state of
19 system in the '70s as adequate.

20 We applaud the company's approach of common
21 sense in risk, but the ultimate risk is borne by the
22 ratepayers, and their risk is today, next month and this
23 fall when their rates go up, and their risk is to their
24 food, their pharmacy bills, their rent. So we would hope
25 that the Commission also looks closely at the adequacy of

1 service in each district, each and every district.

2 Thank you.

3 JUDGE JORDAN: Thank you. City of

4 St. Joseph.

5 MR. STEINMEIER: Thank you, your Honor. I

6 would simply state that the city shares the concerns

7 expressed by OPC and the other cities on this specific

8 issue, but we'll reserve our opening statement until next

9 week when the issues of rate design and adequacy of

10 service are heard.

11 JUDGE JORDAN: Thank you. AG Processing,

12 Incorporated.

13 MR. CONRAD: Your Honor, we did not submit

14 testimony on this exhibit. I think we would endorse the

15 indication that Public Counsel has made with respect to

16 the economic conditions. They impact large industrial

17 users also as well as providers.

18 So beyond that, we will have something, I

19 think, when we get to the revenue issues specifically, and

20 then probably more, your Honor, when we get to the issues

21 for next week. Thank you.

22 JUDGE JORDAN: Thank you. Next on my list

23 is City of Warrensburg. City of Warrensburg has been

24 excused from this.

25 MEG? No one here from Missouri Energy

1 Group. MIEC? No one here from MIEC. Next on my list is
2 the water districts. Water districts have an opening
3 statement? Triumph Foods, LLC?

4 MR. ZOBRIST: Good morning. May it please
5 the Commission?

6 We do not have an expert on this issue,
7 and we don't have a position on this issue. With regard
8 to the revenue issues that are before the Commission at
9 this segment, we do support the company on Issue 17, which
10 is later this week, on the economic development riders.
11 And from that standpoint, I do echo the statements that
12 were made by the cities and by Mr. Conrad with regard to
13 the interests that those who employ persons should have,
14 and we believe that it's very important to keep these
15 contracts that have been submitted to the Commission and
16 approved by the Commission under the economic development
17 rider intact until they show that they're no longer
18 useful.

19 And then I will be back as some of the
20 other parties next week with the rate design issues when
21 our witness Mr. Gorman will testify. Thank you.

22 JUDGE JORDAN: Thank you. Next on my list
23 as originally prepared was the union. The union's made no
24 appearance this morning. So we'll skip to Metropolitan
25 Sewer District. Does Metropolitan Sewer District have an

1 opening statement on this issue?

2 MR. FRANCIS: Your Honor, Metropolitan
3 St. Louis Sewer District filed no testimony with respect
4 to this issue and takes no position with respect to this
5 issue and will reserve its opening statement on its issue
6 on its contract with Missouri American Water Company until
7 Friday. Thank you.

8 JUDGE JORDAN: Thank you. And then finally
9 the Fire Sprinkler Association? Fire Sprinkler
10 Association is absent, so it has no opening statement on
11 this issue. And just to clarify for everyone in the room,
12 this list of opening statements was prepared for a greater
13 set of issues than we'll actually be dealing with today.

14 And with that, I believe we're ready for
15 the applicant's case in chief on the issue of rate of
16 return.

17 MR. BOUDREAU: Judge, I'd like to call
18 Ms. Ahern to the stand, please.

19 JUDGE JORDAN: Ma'am, just let me know when
20 you're ready to take the oath. I'll be administering
21 that.

22 THE WITNESS: I'm ready.

23 (Witness sworn.)

24 MR. BOUDREAU: Judge, if I might suggest we
25 go off the record for just a brief moment. I think it

1 might be helpful. I want to mark a few additional
2 exhibits and provide an explanation to the parties about
3 the purpose for it. I'll do it again on the record. I
4 think it will help everybody understand what I'm trying to
5 accomplish if we go off the record real quick.

6 JUDGE JORDAN: Five minutes? Ten minutes?

7 MR. BOUDREAU: I think it will take maybe
8 two or three minutes. I'm going to mark three exhibits
9 and then explain to the parties what I'm going to try and
10 accomplish. Then I'll go back on the record and make it
11 official.

12 JUDGE JORDAN: We'll go off the record for
13 five minutes.

14 (A BREAK WAS TAKEN.)

15 (MAWC EXHIBIT NOS. 134, 135 AND 136 WERE
16 MARKED FOR IDENTIFICATION BY THE REPORTER.)

17 JUDGE JORDAN: We're back on the record.
18 Counsel?

19 MR. BOUDREAU: Thank you.

20 PAULINE AHERN testified as follows:

21 DIRECT EXAMINATION BY MR. BOUDREAU:

22 Q. Good morning. Would you please state your
23 name for the record.

24 A. Good morning. My name is Pauline M. Ahern,
25 A-h-e-r-n.

1 Q. And by whom are you employed and in what
2 capacity?

3 A. I'm principal with AUS Consultants.

4 Q. And on whose behalf are you testifying
5 today?

6 A. On behalf of Missouri American Water
7 Company.

8 Q. And you are addressing the topics of?

9 A. Cost of common equity and, in rebuttal, a
10 small portion of capital structure.

11 Q. Are you the same Pauline Ahern who has
12 caused to be filed or previously filed prepared direct,
13 rebuttal and surrebuttal testimony which have been marked
14 as Exhibits 102, 103, 103NP and 103HC, which would
15 collectively comprise your direct, rebuttal and
16 surrebuttal testimony?

17 A. Yes.

18 Q. I want to direct your attention to -- let
19 me ask you this at this point: Do you have any
20 corrections you'd like to make to your direct testimony at
21 this point?

22 A. Yes, I do. The corrections I have to the
23 direct testimony relate to the Exhibits 134 and 135.

24 Q. Okay. Let me ask you, have those exhibits
25 been prepared by you, then?

1 A. Or under my supervision, yes.

2 Q. Very good. Please explain those changes.

3 A. Okay. On -- in the exhibit -- in the
4 testimony or the 134 and 35?

5 Q. Either way you want to handle it. If you
6 have some changes to your testimony, please proceed.

7 A. On page 6, line 13, in the first column
8 under proxy group of six AUS Utility Reports water
9 companies, the 13.50 should be stricken and replaced with
10 13.75.

11 JUDGE JORDAN: I'm sorry to interrupt.
12 Which exhibit number are you referring to?

13 THE WITNESS: I believe it's 101, my direct
14 testimony.

15 JUDGE JORDAN: Thank you.

16 BY MR. BOUDREAU:

17 Q. And your page reference again?

18 A. Page 6, line 13.

19 Q. And the number again?

20 A. 13.50 should be 13.75.

21 Q. Okay. Thank you.

22 A. And on page 62, line 20, the fifth word in,
23 17 should read 16. Page 63, line 17, the fourth word from
24 the right, 17 should read 16.

25 Page 65, line 5, 13.50 percent should read 13.75 percent.

1 And the final correction is on page 67, line 12, again the
2 13.50 should read 13.75. And that's the extent of my
3 corrections to the testimony.

4 Q. And you have corrections to the exhibits
5 that accompany that testimony; is that correct?

6 A. Correct. Those --

7 Q. Which would be with reference to what have
8 been marked now for identification as Exhibits 134 and
9 135; is that correct?

10 A. Correct. And I can point to the changes --

11 Q. Please do.

12 A. -- on those schedules. On 134, line 4, the
13 comparable earnings model for the proxy group of six AUS
14 Utility Reports water companies, is 13.75.

15 Q. And that was previously 13.50?

16 A. Correct. And on pages 1 and 2 of 135, we
17 discovered that one of the companies was in there twice.
18 We deleted that company, so the title had to change from
19 117 to 116 companies. Some of the Footnote 3s were
20 misplaced, so we corrected that, and by eliminating that
21 company on page 2, the very, very bottom conclusion
22 changed from 13.5 to 13.75. And on the line average, the
23 only two changes were to the residual standard regression
24 and standard deviation of beta. And on page 3 of 135 --

25 Q. Which is page 4 of 4 of the schedule?

1 A. Which is page 4 of PMA-13. In Footnote 1,
2 about the middle of the line, 117 was changed to 116. And
3 none of those changes in any way affect my original
4 recommended cost of equity.

5 Q. Just as a housekeeping matter, I'm not sure
6 that I asked you one of the preliminary questions, was all
7 the testimony that you've prefiled was prepared by you or
8 under your direct supervision?

9 A. Yes, it was.

10 Q. I want to move on -- does that complete any
11 changes that you have to your direct testimony?

12 A. Yes, it does.

13 Q. I want to move on to rebuttal testimony,
14 which has been marked for identification as Exhibit 102.
15 Do you have any changes to make in your rebuttal testimony
16 at this time?

17 A. I have a couple of typos. On page 29,
18 line 7, in the middle, there is a reference to PMA-4. It
19 should read PMA-21. And on line 13, in the parenthetical
20 it says .0 -- 0.37 percent. It should be 0.38 percent.

21 Q. Do you have any other changes to make in
22 your testimony?

23 A. No.

24 Q. Okay. I want to ask you about the
25 schedules that were filed along with your rebuttal

1 testimony.

2 A. Okay.

3 Q. And we have -- or I have caused to be
4 marked for identification Exhibit 136, which is identified
5 as schedules to your rebuttal testimony. Would you please
6 explain the purpose for -- or would you please explain
7 that schedule?

8 A. Okay. I discovered after receiving a copy
9 of the as-filed version of the rebuttal exhibit that some
10 of the schedule headings had been eliminated, as you
11 stated earlier. You notice on the table of contents there
12 should be Schedules PMA-15 through PMA-23, and they are
13 not marked as such in the originally as-filed rebuttal
14 exhibit.

15 Q. So one of the purposes here is to correctly
16 identify the exhibits that accompany your rebuttal
17 testimony?

18 A. One of the purposes, yes.

19 Q. And this packet, this exhibit that we're
20 looking at, this is a complete packet of schedules?

21 A. Yes.

22 Q. Are there any corrected schedules within
23 that packet?

24 A. Yes.

25 Q. And would you please direct the

1 Commission's attention to what those changes are?

2 A. Schedule PMA-23, pages 3 and 4, without
3 reading all of the changes, I can tell you the cause of
4 the change. On page 4, we discovered in reviewing -- I
5 discovered in reviewing for attending hearings that in
6 column 4 the market prices were referenced incorrectly,
7 and that resulted in changes to columns 4, 5 and 6, and
8 revisions to the numbers on page 3, none of which change
9 my updated recommendation in any way.

10 Q. So the only corrected schedule in here is
11 page 3 of 15 --

12 A. Well, that's the original designation. It
13 would be 3 and 4 of 49 of Schedule PMA-23.

14 Q. Okay. 3 and 4 of 49. Do you have any
15 changes that you would like to make in your surrebuttal
16 testimony at this time?

17 A. No, I don't. May I ask a question? That
18 is 103, correct?

19 Q. I believe your surrebuttal testimony has
20 been marked --

21 JUDGE JORDAN: I have it as 103NP and
22 103HC.

23 MR. BOUDREAU: That's correct.

24 THE WITNESS: Thank you.

25 BY MR. BOUDREAU:

1 the same as the original, if I'm looking at the right,
2 page 4 of 4, Footnote 1.

3 THE WITNESS: Right. Does the top say
4 Schedule PMA-13, page 4 of 4 corrected?

5 MR. BEDNAR: Yes, it does.

6 THE WITNESS: Mine says 16. I don't know
7 how that happened. Does everyone's say 15?

8 COMMISSIONER JARRETT: Mine says 115.

9 THE WITNESS: It should read 16.

10 MR. BOUDREAU: Okay. Let's go ahead and
11 correct the record.

12 THE WITNESS: Okay. Thank you.

13 BY MR. BOUDREAU:

14 Q. Direct -- if you would direct the
15 Commission and the parties to the -- to the information
16 that you sought to correct, direct the parties to where
17 we're looking at.

18 A. Okay. In Exhibit 135 --

19 Q. Yes. Page 4 of 4?

20 A. It says page 4 of 4, but it's really
21 page 3 of 135, designated PMA-13, page 4 of 4 corrected.

22 Q. Yes.

23 A. In Footnote 1.

24 Q. Yes.

25 A. Apparently yours reads 115, and it should

1 read 116.

2 Q. That will be the fourth line down? No,
3 first?

4 A. No. I see. Fourth line down also should
5 read 116. You found a correction that I didn't catch. So
6 in both first line and fourth line should read 116.

7 MR. BEDNAR: For the record, my first line
8 does say 16. I was focused on the fourth line, too.

9 THE WITNESS: Well, in the global correct.
10 We globally corrected 17, and 15 didn't show up. Thank
11 you. I apologize for that. Apologize for the confusion.

12 JUDGE JORDAN: Does that conclude your voir
13 dire of this witness?

14 MR. BEDNAR: Yes, your Honor.

15 MR. BOUDREAU: I apologize for that. I
16 believe I have offered those exhibits into the record.

17 JUDGE JORDAN: They've been offered, and I
18 was -- I had asked if there were objections. I have heard
19 no objections.

20 MR. DEARMONT: No objection.

21 MR. ELLINGER: No objection.

22 JUDGE JORDAN: I will receive those
23 exhibits into the record.

24 (MAWC EXHIBIT NOS. 101, 102, 103NP, 103HC,
25 134, 135 and 136 WERE RECEIVED INTO EVIDENCE.)

1 MR. BOUDREAU: I believe I've tendered the
2 witness for cross.

3 JUDGE JORDAN: You have. My list on
4 proposed order of cross-examination is more comprehensive
5 than we will probably need for two reasons. No. 1, as
6 originally proposed, we were going to address more issues
7 today. No. 2, several of the parties have asked to be
8 excused and have been excused from this list.

9 So I'm going to read a foreshortened list,
10 and if I miss someone -- I'm going to try to go through
11 without reciting absent parties. If I miss someone,
12 please feel free to jump up and correct me, because my
13 eyesight is failing and I might not be seeing everyone in
14 the room. And when I say failing, don't be alarmed. It's
15 just a little bit defective.

16 So on my list of cross-examination I have
17 first Triumph, LLC. They are not here. And so we will go
18 to Riverside.

19 MR. BEDNAR: Thank you, your Honor. Just a
20 couple of questions.

21 CROSS-EXAMINATION BY MR. BEDNAR:

22 Q. In your analysis, you didn't review the
23 adequacy of service on a district-by-district basis, did
24 you?

25 A. No, I did not.

1 Q. Nor did you calculate a rate of return on a
2 district-by-district basis, did you?

3 A. No.

4 MR. BEDNAR: Thank you. No further
5 questions.

6 JUDGE JORDAN: City of St. Joseph? Not
7 present. City of Joplin?

8 MR. ELLINGER: Thank you, Judge.

9 CROSS-EXAMINATION BY MR. ELLINGER:

10 Q. Ms. Ahern, do you have Missouri American
11 Water Exhibit 101 in front of you? It's your direct
12 testimony.

13 A. Yes, I do.

14 Q. I've got a few questions on a couple of
15 pages. I have the page cites. If we could just walk
16 through the page cites. When I reference a page, I'm
17 referring to Missouri American Water Exhibit 101. Found
18 that?

19 A. (Witness nodded.)

20 Q. Okay. If you could first of all turn to
21 page 13 of your testimony.

22 A. Yes.

23 Q. Starting on line 19, you have some
24 reference to the Congressional Budgeting Office. Do you
25 see the language I'm talking about?

1 A. Yes.

2 Q. And I note that this study by the CBO is
3 dated November of 2002; is that correct?

4 A. Correct.

5 Q. And it covers a -- basically a 20-year
6 period; is that correct?

7 A. Correct.

8 Q. We are halfway through that 20-year period;
9 is that correct?

10 A. Approximately, yes.

11 Q. Do you know how much has already been
12 invested as of the midway point based upon their study?

13 A. As -- as aggregate, no.

14 Q. Do you know whether Missouri American
15 Water's capital investment needs are reflected in this CBO
16 study?

17 A. I do not know for a fact. I'm assuming
18 they are.

19 Q. Did you do any independent inquiry to
20 determine whether Missouri American Water capital needs
21 were included in this study?

22 A. No.

23 Q. If you could turn to page 15, please. At
24 the beginning of page 15, line 1, my understanding is the
25 question there has something to do with the size of the

1 company bearing on business risk. Is that your
2 understanding of that testimony?

3 A. Yes, it is. Yes, it does.

4 Q. And I believe you have some reference in
5 here saying that smaller companies simply have a higher
6 risk factor; is that correct?

7 A. All else equal. If all other risks, when
8 you compare a small company to a larger company, if all
9 the risks are equal, size in and itself indicates greater
10 risk.

11 Q. Can you tell me what Missouri American
12 Water Company's actual market capitalization is?

13 A. They do not have an actual market
14 capitalization.

15 Q. Can you tell me what American Waterworks
16 Company's actual market capitalization is?

17 A. Not right off the bat. No, I don't have
18 those figures to calculate at the moment.

19 Q. Do you know whether it is a large market
20 capitalization compared to other water utilities?

21 A. It is the largest compared to other
22 utilities.

23 Q. It is the largest?

24 A. Yes, both on book and market cap.

25 Q. Thank you. Would you turn to page 21,

1 please. My understanding of your testimony on page 21
2 deals with the proxy groups you selected. Is that your
3 understanding also?

4 A. 21 deals with the proxy groups of water
5 companies. 22 and 23 deal with the group of gas
6 companies.

7 Q. Let's start with the water company group.
8 You selected six water companies, I believe; is that
9 correct?

10 A. Yes.

11 Q. Do any of those water companies have a
12 market capitalization equal to American Waterworks?

13 A. No.

14 Q. Are there any other water companies that
15 you could have selected based upon your parameters except
16 for these six?

17 A. No.

18 Q. In the course of developing your proxy
19 group, did you select parameters with the intent of coming
20 up with a small finite number of proxies?

21 A. No. What I did was I looked at essentially
22 the universe of publicly traded water companies. There
23 are only approximately 11 of them, and based on these
24 parameters, determined that these six were appropriate for
25 this analysis. American Waterworks didn't have a

1 ValueLine beta at the time. Pennichuck I deemed
2 inappropriate because it was under condemnation
3 proceedings from the City of New Hampshire -- I'm sorry --
4 City of Nashua in New Hampshire. Southwest Water was
5 under some -- restating its financials and under some
6 severe distress, plus they also have revenues, water
7 revenues under 60 percent. And Artesian, I did not
8 include Artesian because they are 75 percent family owned,
9 and the stock that's traded is non-voting, so their market
10 price doesn't really reflect the operations of the other
11 publicly traded companies.

12 I did not seek to choose a small number of
13 companies. It happens because the universe from which to
14 choose is small.

15 Q. I notice you have a total of, I believe,
16 seven categories or seven criteria that were used to
17 winnow this list down; is that correct?

18 A. Yes.

19 Q. No. 4 is they have a ValueLine adjusted
20 beta. Do you see that?

21 A. Yes.

22 Q. Is that the reason that you excluded
23 American Waterworks?

24 A. At the time, yes.

25 Q. Had they had an adjusted beta, you would

1 have included them?

2 A. Yes. And they are now -- I believe
3 ValueLine's now included a beta for them and they are
4 included in my analysis.

5 Q. Thank you.

6 A. As long as they meet the other criteria as
7 well.

8 Q. Could you turn to page 42, please?

9 A. Okay. I'm there.

10 Q. And I notice there's some language in here
11 starting on line 10 and going down for a couple of lines,
12 talking about risk factors when you're doing your RPM. Do
13 you see that?

14 A. Yes.

15 Q. Do you factor in when there's a monopoly
16 that makes return less risky?

17 A. No, I don't, because what I'm doing is
18 looking at the market data of publicly traded utility
19 holding companies, the majority of which, because of my
20 revenue level criteria, are engaged in the ownership of
21 operating regulated utilities. I do not make the
22 comparison with non-utility companies for the DCF, the
23 risk premium and the CAPM.

24 Q. With respect to those other companies you
25 looked at, do you know what their regulated approved rate

1 of return was?

2 A. No.

3 Q. For any of them?

4 A. I can -- based on my knowledge of them, I
5 can estimate that it's approximately 10.2.

6 Q. You have not --

7 A. But no, I do not. I have that information
8 in my office. I do know it, but I can't recall it right
9 now.

10 Q. If you could turn to page 48, I believe on
11 line 4 you said the average median expected price
12 appreciation is 61 percent. Do you see that?

13 A. Yes.

14 Q. And is it your opinion that utility stocks
15 will increase by 61 percent in the future, in the
16 near-term future?

17 A. No. And I'll explain why. This 61 percent
18 refers to the universe of ValueLine's 1,700 companies. I
19 utilized it to derive a forecast of equity risk premium
20 which I averaged with a historical equity risk premium.
21 Then I applied the beta of the water utilities and the gas
22 utilities to that equity risk premium.

23 Q. So you're basing --

24 A. Since that beta is below the one of the
25 market, no, I would not expect utility stocks to continue

1 to increase 61 percent over the next five years.

2 Something less, but I can't quantify it.

3 Q. But your understanding of this data point
4 then is that you're basing your testimony on an expected
5 price appreciation of 61 percent on ValueLine's entire
6 pool of stock; is that correct?

7 A. Right, which essentially mirrors the
8 market. That is a total return for five -- over five
9 years. It translates into an approximate 12.64 percent
10 return as of the time of the preparation of this testimony
11 on an annual basis.

12 Q. Do you know what the Dow Jones Industrial
13 Average was as of the date you executed your testimony?

14 A. No, I don't.

15 Q. Do you know approximately where it is at
16 today?

17 A. About 10,600.

18 Q. What would 61 percent price appreciation be
19 on the Dow Jones Average?

20 A. Over five years?

21 Q. Over five years, what number would that put
22 the market at five years from now, just ballpark?

23 A. Put it at about 16.9.

24 Q. Has the market ever been at 16,900?

25 A. No, but it has appreciated 50 percent over

1 a six-month period. I mean, we have seen that over the
2 recent economic crisis.

3 Q. And what has its appreciation been over the
4 last three-year period?

5 A. I don't have the appreciation of the Dow
6 Jones, but I can tell you the appreciation of the S&P 500,
7 which in 2007 appreciated 5.5 percent, in 2008 declined
8 37 percent and in 2009 appreciated 26 percent, which --

9 Q. Results in a three-year average of
10 depreciation and not appreciation; is that correct?

11 A. Correct, and that's why one expects
12 significant appreciation going forward, because there is
13 expectation that the market will -- market and the economy
14 will recover.

15 Q. And that's -- you're making an assumption
16 based upon significant economic expansion and dramatic
17 recovery?

18 A. Not really. The 61 percent that you see
19 here over the next five years, that is what --
20 approximately what it typically was for several years
21 prior to August/September of 2008. 61 percent is more
22 norm. It ranged between 40 and 61 percent on a historical
23 basis through the middle of 2008.

24 Q. So your assumption is that the market
25 recovery going forward, the -- let me rephrase that.

1 Excuse me.

2 Your assumption is that the basic market
3 conditions going forward are the same as they were prior
4 to August/September of 2008?

5 A. It's not my assumption. It's ValueLine's
6 assumption based on its hypothesized economic model. It's
7 the assumption investors are looking at in the marketplace
8 and that they're evaluating in determining their
9 expectation. It's the assumption of ValueLine upon which
10 Staff and I have relied our betas and growth rates.

11 Q. And if the market return was significantly
12 less over the five-year period, what impact would that
13 have on your yearly rate of return?

14 A. Excuse me. On my what?

15 Q. If the 61 percent appreciation was, say,
16 20 percent over the next five years, what impact would
17 that have on your rate of return calculation?

18 A. The projected appreciation or the actual
19 realized appreciation?

20 Q. The projected.

21 A. The projected? Because that is also highly
22 unusual, I may not give as much weight as I would the
23 61 percent that I gave. But it would lower the projected
24 equity risk premium in both the risk premium model and
25 the CAPM model. That in the risk premium model is

1 coupled with -- both of them are coupled with a historical
2 model -- I'm sorry -- a historical risk premium and
3 they're both multiplied by beta.

4 It would lower the risk premium -- all else
5 equal, it would lower the risk premium and the capital
6 asset pricing model results, all else equal, likely
7 minimally. And the reason I say all else equal is if we
8 all of a sudden received a market projection of 20 percent
9 total return or total appreciation over five years, I
10 think the market would roil at that.

11 And we may see the prices changing
12 dramatically for all companies, including utilities,
13 which would affect your discounted cash flow. We would
14 see possible changes in beta, even though beta lags. We
15 would see increased volatility in the market and, in
16 general, the other components of the model may change to
17 offset it, which is why I said all else equal. The math
18 is, if you put 20 percent in there, you're going to get a
19 lower premium.

20 MR. ELLINGER: I have no further questions.
21 Thank you very much, ma'am.

22 THE WITNESS: Thank you.

23 JUDGE JORDAN: The next on my list are FSA,
24 who I believe is absent, and Metropolitan Sewer District
25 also. MEG. MIEC. AG Processing, Incorporated?

1 MR. CONRAD: Your Honor, we have no
2 questions for the witness.

3 JUDGE JORDAN: Office of the Public
4 Counsel?

5 MS. BAKER: We have no questions. Thank
6 you.

7 JUDGE JORDAN: Cross-examination from
8 Staff?

9 MR. DEARMONT: Judge, as a preliminary
10 matter, I wanted to let you know that I plan to discuss
11 some material that Staff has filed previously as highly
12 confidential. Therefore, it might be appropriate to go
13 in-camera at that time.

14 JUDGE JORDAN: Thank you. Just let me know
15 when you need us to go in-camera.

16 CROSS-EXAMINATION BY MR. DEARMONT:

17 Q. Good morning, Ms. Ahern.

18 A. Good morning.

19 Q. Am I pronouncing that correctly, Ahern?

20 A. Yes, you are.

21 Q. I'd like to ask you to turn to what has
22 recently been marked as Exhibit 134, representing a, I
23 believe, corrected schedule to your direct testimony.

24 A. Okay.

25 Q. Do you have that in front of you?

1 A. Yes.

2 Q. And that table as corrected represents the
3 initial results of your cost of capital analysis not
4 subject to the update in your rebuttal?

5 A. Correct.

6 Q. And that table shows that you applied four
7 cost of capital models to two proxy groups, correct?

8 A. Correct.

9 Q. One of those proxy groups consists of water
10 utilities, the other consists of gas LDCs?

11 A. Yes.

12 Q. And to these models you added a business
13 risk adjustment and a credit risk adjustment to each proxy
14 group; is that correct?

15 A. Yes. A financial slash credit risk
16 adjustment, yes.

17 Q. And that is similar to the type of
18 adjustment made by Staff, correct?

19 A. Correct.

20 Q. But this business risk adjustment is
21 essentially a size adjustment?

22 A. It's entirely based on size, yes.

23 Q. And you reached a recommendation of
24 11.60 percent in your direct, which was updated to
25 11.35 percent in your rebuttal, correct?

1 A. Correct.

2 Q. And your current recommendation for a
3 return on equity is 11.35 percent?

4 A. Correct.

5 Q. Is it safe to say that you agree in general
6 that water utilities are more capital intensive than the
7 electric industry?

8 A. It's not a belief, it's a fact, yes.

9 Q. Do you have any belief how the capital
10 expenditure budget of Missouri American compares to
11 electric utilities in the state of Missouri?

12 A. No, I don't, and --

13 Q. That's fine. Thank you. I'd like to
14 discuss your natural gas proxy group with you, gas LDCs.
15 And it appears to me, looking at Exhibit 134, that there's
16 quite a disparity in some of the results produced by the
17 methods that you applied to the two groups. Specifically,
18 on line No. 1, is it true that your DCF analysis indicates
19 that the cost of equity capital for your LDCs is
20 approximately 300 basis points lower than it is for your
21 water utilities?

22 A. That's correct.

23 Q. And that would imply that the natural gas
24 group is substantially less risky than the water group?

25 A. Based on the DCF, yes.

1 Q. Thank you. But the gas group, the LDCs,
2 that group has a lower average credit rating according to
3 both S&P and Moody's, correct?

4 A. Minimally lower, one notch lower. They're
5 both in the A category.

6 Q. I think you discuss it in your surrebuttal
7 at page 5, the -- the gas group has a rating of A2 from
8 Moody's as opposed to A3 for the water utilities?

9 A. In my direct, it was A2 for the water and
10 A3 for the gas. In my rebuttal as well it was A2 for the
11 water and A3 for the gas. Can you point me to a page in
12 my surrebuttal?

13 Q. I think it's page 5.

14 A. There too it also says it's A2 for the
15 water and A3 for the gas. I believe you said A3.

16 Q. Switched them. I apologize.

17 A. Okay.

18 Q. And that fact -- I understand it's in
19 isolation, but that fact would imply that the natural gas
20 group is more risky than the water group?

21 A. It is minimally more credit risky based on
22 the bond ratings.

23 Q. I'd like to discuss the size adjustment or
24 the business risk adjustment. That's the same thing,
25 correct?

1 A. Correct.

2 Q. In your direct testimony at page 6, I
3 believe you state that, in an effort to be conservative,
4 you adjusted a level of the size adjustment from .37 for
5 the water group and .90 for the gas group, down .05 for
6 water and .15 for gas; is that correct?

7 A. Correct.

8 Q. And those numbers are the numbers that are
9 reflected on your Schedule 134, correct?

10 A. Correct.

11 Q. But you haven't provided any direct support
12 for those specific adjustments, have you?

13 A. No. It's my informed expert judgment, and
14 it's based on reviewing authorized returns, some size
15 adjustments I've seen authorized in other cases. Very
16 often the business risk adjustment that comes out of my
17 analysis is 250 or 400 basis points.

18 Q. Okay. Great. Can you identify your
19 current recommendation without a business risk adjustment?

20 A. It would range -- hang on a second. It
21 would range from 10.36 to 12.17, with a midpoint of
22 11.265.

23 Q. Missouri American is the largest water
24 utility in the state of Missouri?

25 A. Correct, but it's extremely small compared

1 to the companies upon whose market data both Staff and
2 myself have --

3 Q. Sure. Can we talk about the state of
4 Missouri just for a second? Is that fine?

5 A. Okay.

6 Q. It's the largest water utility in number of
7 customers and in size of rate base, correct?

8 A. Correct.

9 Q. Now, more expansively, Missouri American is
10 the third largest subsidiary of American Water?

11 A. I'll accept that subject to check.

12 Q. It's behind Pennsylvania American and New
13 Jersey American?

14 A. Correct.

15 Q. How does the capitalization of Missouri
16 American compare to other American Water subsidiaries that
17 have had litigated ROEs recently?

18 A. I don't know.

19 Q. You're the principal of AUS Consulting,
20 correct?

21 A. I'm a principal.

22 Q. A principal?

23 A. Yes.

24 Q. Have you filed rate of return testimony in
25 cases involving other American Water subsidiaries?

1 A. Yes.

2 Q. Which ones?

3 A. Ohio American, Illinois American, Iowa, and
4 in the past I filed on behalf of New Jersey and also
5 California. I was the cost of capital witness for the RWE
6 acquisition.

7 Q. Now, for subsidiaries upon which you have
8 not filed cost of capital testimony in the past, do you
9 generally still follow the returns of those subsidiaries?

10 A. In general.

11 Q. Would you be surprised if I told you
12 that Arizona American recently had a litigated ROE of
13 9.0 percent?

14 A. No.

15 Q. Would you be surprised if I told you that
16 West Virginia American recently had a litigated ROE of
17 10.0 percent?

18 A. No.

19 Q. How does the size of Missouri American
20 compare to Arizona American?

21 A. It's larger.

22 Q. How does the size of Missouri American
23 compare to West Virginia American?

24 A. It's larger.

25 MR. DEARMONT: Judge, at this time we

1 probably need to go in-camera.

2 JUDGE JORDAN: We'll do that.

3 (REPORTER'S NOTE: At this point, an
4 in-camera session was held, which is contained in
5 Volume 12, pages 88 through 98 of the transcript.)

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1 JUDGE JORDAN: We're back from in-camera.

2 BY MR. DEARMONT:

3 Q. Would you agree that utility equity
4 investors consider utility stocks as long-term
5 investments?

6 A. In theory, all investors consider any
7 common equity investments a long-term investment.

8 Q. Including utility investors?

9 A. Absolutely.

10 Q. Would you agree that the goal of the DCF as
11 used in ratemaking is to estimate the cost of capital into
12 perpetuity?

13 A. Yes.

14 Q. Your DCF estimates were driven primarily by
15 the earnings per share estimations of equity analysts,
16 correct?

17 A. Correct.

18 Q. And you use those earnings per share
19 estimates because you believe that they represent
20 reasonable proxies for future dividend growth?

21 A. Yes, and I believe that based on a wealth
22 of academic and empirical research that supports them.

23 Q. And these EPS projections are generally for
24 three to five years, right?

25 A. Generally for five years.

1 Q. Five years. Okay. Mr. Murray in his
2 testimony referenced a few nontraditional sources. Will
3 you accept that?

4 A. Yes.

5 Q. How about MOSERS? Mr. Murray referenced
6 MOSERS, state employee retirement system funds.

7 A. Yes, he has.

8 Q. You criticize Mr. Murray's reference to
9 MOSERS data because you state that the returns expected by
10 MOSERS are expected over, quote, a relatively short
11 duration compared to the infinite investment horizon
12 implicit in the standard DCF. Will you accept that?

13 A. That's one reason.

14 Q. How long is that relatively short duration?
15 If I told you ten years, would you accept that?

16 A. Yes.

17 Q. That's five years longer than your EPS
18 projection?

19 A. Correct.

20 Q. What are average EPS growth rates for your
21 water proxy group?

22 A. On -- in direct, they were 8.13 on average.
23 In rebuttal they were about 7.81, and they have since
24 dropped to about 6.2, 6.25.

25 Q. Dropped as in the current level is

1 reflected --

2 A. Right.

3 Q. -- in your current recommendation?

4 A. No. The current level reflected today, not
5 in the recommendation. In here, my recommendation was
6 prepared about a month ago.

7 Q. So today the EPS projections are lower?

8 A. Correct.

9 Q. What are the perpetual growth rates used by
10 Mr. Murray in his multistage DCF?

11 A. Well, his first stage he uses --

12 Q. Stage 3. Sorry.

13 A. Okay. It's an estimation of GDP, GDP
14 terms.

15 Q. Four and a half percent?

16 A. Yeah. Yeah. 4.5 percent.

17 Q. And Mr. Murray justifies the use for these
18 lower growth rates based in part on information contained
19 in equity analyst research reports issued by firms such as
20 Goldman Sachs and McQuerry Research, correct?

21 A. It's my understanding that he used them
22 to -- he determined 4.5 was appropriate based on some
23 forecasts of GDP that he saw, and he used those reports as
24 corroboration, correct.

25 Q. And Goldman Sachs and McQuerry Research

1 conducted valuation analyses on American Water last year?

2 A. Correct.

3 Q. And these analyses are attached to Dave
4 Murray's rebuttal testimony filed in this case?

5 A. Correct.

6 Q. Now, McQuerry, they also conducted
7 evaluation analysis on Aqua America, right?

8 A. Correct.

9 Q. And Aqua America is one of your proxy
10 companies?

11 A. Yes.

12 Q. I believe it's also one of Mr. Murray's
13 proxy companies.

14 A. I believe so, too.

15 Q. I'd like to ask you to turn to the
16 valuation analysis of Aqua America conducted by McQuerry
17 Research. I believe it's attached to Dave Murray's --
18 David Murray's rebuttal testimony at page 27 of
19 Attachment B.

20 MR. BOUDREAU: What was that reference
21 again?

22 MR. DEARMONT: I apologize. It's Murray
23 rebuttal, Attachment B, page 27.

24 MR. BOUDREAU: Thank you.

25 BY MR. DEARMONT:

1 Q. Got it?

2 A. Yes.

3 Q. Now, Staff agrees that this report clearly
4 states that McQuerry Research expects Aqua America's
5 earnings per share to grow at 8 to 9 percent in the
6 long-term. Would you agree with that?

7 A. That's what it says, yes.

8 Q. And in line with your position, that's
9 similar to the perpetual growth rate used for Aqua America
10 in your analysis in this case, correct, 9.3?

11 A. Right.

12 Q. If you flip a few pages to Attachment B,
13 page 35, under the heading valuation and recommendation,
14 would you agree that McQuerry Research states that a key
15 assumption in performing this valuation analysis is a 5 to
16 7 percent dividend growth from 2009 to 2015 and a
17 4.5 percent long-term dividend growth?

18 A. I'll agree that's what it says, yes.

19 Q. And that 4.5 long-term dividend growth is
20 the same perpetual growth rate used by Mr. Murray?

21 A. Coincidentally, it is.

22 Q. He used 4.4 and 4.5?

23 A. Yes.

24 Q. The goal of a valuation analysis is to
25 determine a fair stock price?

1 A. Correct.

2 Q. And the analysts use a dividend discount
3 model to do this?

4 A. McQuerry does.

5 Q. And the dividend discount model is the same
6 thing as a DCF?

7 A. Yes, dividend yield plus growth. And I
8 noticed it doesn't appear to be multistage either.

9 Q. And again, still on page 35, you see that
10 McQuerry Research came up with an appraised share price
11 for Aqua America of \$21.50, correct?

12 A. Correct.

13 Q. Can you identify if the appraised price
14 shown on that page is based on the present value of the
15 projected dividends shown on that page?

16 A. I apologize. Yes, you're right. Yes, it
17 is. But it is only -- it is only based on projected
18 dividends through 2015.

19 Q. Does it appear to you that the growth rate
20 that is applied to those dividends is based upon a growth
21 of 5 to 7 percent from 2009 to 2015 and 4.5 percent into
22 perpetuity?

23 A. I would say based on everything, subject
24 to -- without doing the math, based on everything on the
25 page, yes. What they've done with the 4.5 percent is to

1 determine a terminal -- the 17.66, a terminal value, which
2 in effect is a terminal price. They've used a finite
3 horizon model.

4 Q. We essentially use a finite horizon model
5 too. We just push it out long enough to call it
6 perpetual, don't we?

7 A. Well --

8 Q. Answer. Excuse me.

9 A. The -- his multistage calculated dividends
10 in perpetuity. As I understand, there was no finite --
11 perpetuity being 200 years, no finite price. In this
12 case, they assumed, yes, a constant growth with a finite
13 price. They could have used any finite price.

14 Q. How long do you think it would take you to
15 get to their finite price, though, 17.66?

16 A. What do you mean how long? Infinity.

17 MR. DEARMONT: May I have one second,
18 Judge?

19 JUDGE JORDAN: Yes. Do we need go off the
20 record or in-camera?

21 MR. DEARMONT: No. Should be just really a
22 few seconds.

23 BY MR. DEARMONT:

24 Q. Would you agree that the valuation analysis
25 conducted by McQuerry Research on Aqua America is, in

1 fact, a two-stage analysis?

2 A. Yes.

3 Q. What were the level of public utility bond
4 yields in November of 2009?

5 A. The average A-rated public utility bond was
6 yielding 5.64, and an average BAA was yielding 6.18.

7 Q. How does that compare to today?

8 A. The average April was 5.81 for As and
9 6.19 for triple Bs. Recent, 5.59 for As. This would be
10 as of 5/5. 6.03 for triple Bs after 5/5.

11 Q. What about risk-free rates in November of
12 2009 compared to today? And I probably don't even need
13 the numbers. Were they higher in 2009?

14 A. I can get you close.

15 Q. Lower? About the same?

16 JUDGE JORDAN: Counsel, while the witness
17 is searching for that answer, I note that we are into the
18 second hour. We've passed the second hour of this hearing
19 and I want to know if this is a good stopping point.

20 MR. DEARMONT: Yes, there is. Two more
21 questions.

22 THE WITNESS: What risk-free rate, may I
23 give you the 30-year treasury bonds as risk-free rate?

24 BY MR. DEARMONT:

25 Q. Sure.

1 A. In November the average was 4.33. In
2 March it was 4.64. The latest I have here as an actual
3 April 23rd -- I'm sorry. I have it over here. The latest
4 I have for treasuries, again, is 5.5. It's 4.39. 4.31 in
5 November. It's now -- the latest spot date is 4.39.

6 Q. What about various equity indices such as
7 the Dow Jones Industrial Average?

8 A. As I said earlier, the Dow Jones is at
9 10.6.

10 Q. What was it in November of 2009?

11 A. It was lower, but I don't have -- I can't
12 give you exact number. I have a chart here that tracks it
13 over the last couple of years. It is below what it is
14 now.

15 MR. DEARMONT: I have no further questions.
16 Thank you very much.

17 JUDGE JORDAN: We'll take a short break,
18 ten minutes and we will resume. We will resume with
19 questions from the Bench. Off the record.

20 COMMISSIONER GUNN: I have another meeting
21 at 11:30 that I have to step out for a little bit. So I
22 don't know if we could go -- I have maybe five minutes. I
23 don't know if you --

24 COMMISSIONER JARRETT: I just have a couple
25 of questions.

1 COMMISSIONER GUNN: If people wouldn't
2 mind, we can finish with questions and go right back, if
3 that's okay.

4 JUDGE JORDAN: Yes, I was planning to take
5 questions from the Bench next.

6 COMMISSIONER GUNN: I'm talking about
7 before the break.

8 JUDGE JORDAN: Oh, you want to do that now?

9 COMMISSIONER GUNN: I want to do that now,
10 because I have to step out at 11:30, and I don't know how
11 long everybody else is going to be.

12 JUDGE JORDAN: We'll do that now, then.

13 QUESTIONS BY COMMISSIONER JARRETT:

14 Q. Good morning.

15 A. Good morning. I just have a couple of
16 questions. Do you know what the average ROE for a
17 regulated water company has been awarded from all
18 50 states over the past year?

19 A. It's approximately 10.4.

20 Q. Okay. And what was it last year, do you
21 know?

22 A. Actually, it was lower. It has been rising
23 lately.

24 Q. And why would you -- why would it be
25 rising?

1 A. I think two reasons. I think there's a
2 recognition of the riskiness of water companies relative
3 to other utilities that the -- not necessarily that the
4 riskiness has been increasing, but there is finally a
5 recognition and an acknowledgement of the pressure that
6 they are under due to their capital intensity, the low
7 depreciation rates. Water utilities even to a greater
8 extent than the energy utilities find it -- are
9 under-earning, are not able to earn their ROE. They are
10 generally perpetually in negative cash flow position.

11 They have, as a percent of rate base, I
12 don't know the exact percentage, but their CAPX on
13 absolute terms is significantly lower because they're
14 smaller companies, their rate bases are smaller.

15 But they constantly have to invest in
16 repair and replacement and meet environmental quality
17 standards, which the other utilities have to do as well.
18 In my opinion, it's a little more critical for water
19 companies, water is ingested, electric and gas is not, and
20 I think there's an increasing recognition of that.

21 The second factor is that, notwithstanding
22 the fact that we are now coming out of the great
23 recession, the market is still extremely volatile. The
24 indicators I've seen recently for the economy is that,
25 yes, employment is improving, but it is still about 9.9 on

1 a nominal basis and real employment is up to around 16.
2 There's some jobs that have been lost that we'll never get
3 back. The unemployment picture will recover slowly
4 because companies are increasing productivity, and we
5 haven't really maxed out on that with people yet.
6 Inventories are finally beginning to be replenished.

7 Retail spending is beginning to turn
8 around. Whether that is in response to people feeling a
9 little better or the fact that they haven't spent anything
10 over the last year and a half and now have to replace
11 clothes and things like that, I'm not sure.

12 But the market is still extremely volatile.
13 The futures index of the S&P is on a relative base about
14 half as volatile as it was maybe eight or nine months ago,
15 but it is still twice as volatile as it was before we went
16 into the crisis. So I think coupled with that, it's still
17 very risky investing out there.

18 Interest rate levels are still rather --
19 short-term interest rate levels are extremely low relative
20 to historical levels. The long-term risk-free rate and
21 the public utility bond yields are coming back into a more
22 normal level. It's also kind of conventional wisdom that
23 you're not really going to see a real recovery from a
24 recession until you start seeing some of those fed rates,
25 the low interest rate, the fed funds and things like that

1 begin to rise. Recovery from a recession usually means a
2 rise in interest rates, but you have to be very careful
3 that the rise doesn't get too high and stalls it.

4 We're also still very influenced -- we like
5 to think we're not, but we're very influenced by what is
6 going on in foreign markets. It's a global economy now
7 and we can be very affected. We ourselves, our country
8 has enormous -- no matter what political side you're on,
9 we have an enormous deficit. We're incurring an enormous
10 amount of debt. Our G&P -- GDP has shrunk. We're talking
11 about growth rates and GDP. Well, 4.5 percent
12 hypothetically, say, on \$100 billion is a lot bigger than
13 4.5 on 50 million.

14 We have a very high -- not as high as
15 foreign companies -- proportion of debt to GDP. So the
16 markets are still reacting to that and will continue to
17 react to that. Even though interest rates are low and
18 everybody says we're coming back, it's still faltering.

19 Q. Right. Back when the global financial
20 crisis first hit, I guess the credit markets for utilities
21 and all businesses basically kind of dried up for a while?

22 A. Correct.

23 Q. How has the -- what is the access to
24 capital for water utility companies?

25 A. My clients are telling me that they can

1 access capital now. The pool of capital is increasing,
2 access in terms of debt financing. I'm not sure, I don't
3 know how many equity financings we've seen, but they are
4 beginning to go back into the long-term markets. They
5 used a lot of short-term debt at that point, and their
6 short-term debt ratios went significantly high because
7 they were just waiting. Now, if you continue to use a
8 significant amount of short-term debt, you run a great
9 risk of interest rates. Those are the rates that are
10 going to start rising first.

11 Q. Right. And do you know Missouri American
12 Water's infrastructure, how it compares to other water
13 utilities? Are they going to have to do more maintenance
14 and new construction than the average?

15 A. Based on -- I believe so. Based on my --
16 in my direct testimony, I did have a figure on how much
17 CAPX they were going to -- they were expecting. It's on
18 page 11, lines 12 through 15. It was in response to the
19 NARUC best practices statement, I think, from 2005 -- I'm
20 sorry -- well, maybe 2006, talking about the need for
21 sufficient earnings because of the -- and a sufficient
22 rate of return because of the CAPX coming up that, at the
23 time I prepared my testimony, they were projecting about
24 574 million in CAPX for 2009 through 2014, and that
25 represents an increase over their gross plant, not --

1 never mind net plant or rate base -- of 41 percent over a
2 five-year period.

3 That's significant. In many of my other
4 cases I'm seeing increases of -- I've seen it as high as
5 57 percent for one client, and anywhere from about
6 15 percent to about 25. So 41 is one of the ones that's
7 high and has jumped out at me.

8 COMMISSIONER JARRETT: Thank you. I don't
9 have any further questions.

10 JUDGE JORDAN: Commissioner Gunn had a
11 couple of questions he wanted to get in.

12 COMMISSIONER GUNN: I don't know if
13 Commissioner Davis has any.

14 COMMISSIONER DAVIS: I pass.

15 QUESTIONS BY COMMISSIONER GUNN:

16 Q. Thank you. I just had a couple of
17 clarifying questions. You just said in response to
18 Commissioner Jarrett that the average for water companies
19 last year was 10.4 ROE?

20 A. What I was looking at was really -- I just
21 did a calculation, the average for 2008 through -- and
22 through early 2009.

23 Q. But of public --

24 A. I'm sorry. 2009, 2010.

25 Q. But of publicly traded water companies?

1 A. No. These would be the regulated operating
2 subsidiaries. I looked at rate cases.

3 Q. Okay.

4 A. Representative rate cases, yeah.

5 Q. Okay. So similarly situated companies?

6 A. To Missouri American.

7 Q. To Missouri American?

8 A. Correct.

9 Q. Got an average ROE awarded of 10.4?

10 A. Approximately 10.4.

11 Q. So your range is 10.51 to 10.22. It's a
12 range of about 171 basis points; is that correct? That's
13 what you're saying in your testimony?

14 A. On an updated basis, yes.

15 Q. With a -- right. With a midpoint of 11.35?

16 A. Correct.

17 Q. And that's what your recommended ROE case
18 is in this case?

19 A. As of April, yes.

20 Q. And that's despite some of the things that
21 you said, that there's no problem accessing capital.
22 Capital markets have, in fact, increased substantially.
23 They still have -- they are higher rated, their bonds are
24 higher rated than other utilities?

25 A. Minimally, their --

1 Q. But they're higher?

2 A. Right.

3 Q. Okay. So I just want to be clear that

4 you're advocating -- and along that, you don't have -- do

5 you have similar storm risks as utilities, as electrical

6 utilities --

7 A. You don't --

8 Q. -- that water companies do?

9 A. You don't have the power outages, but you

10 do have flooding and storm sewer breaks and things.

11 Q. Are they equal?

12 A. Equal in terms of what, like

13 quantification?

14 Q. Yeah. Is the risk the same? Is the risk

15 of outages based on weather the same for electrical

16 utilities as it is for a water utility?

17 A. I don't know. I would have to compare the

18 frequency. I don't know.

19 Q. You didn't do that analysis when you said

20 that the water companies -- there's a recognition that

21 water companies' risks is approaching electrical

22 utilities?

23 A. No. I based it on the factors I mentioned.

24 Q. Oh, so just economic factors?

25 A. Correct.

1 Q. Okay.

2 A. Well, economic, capital intensity,
3 depreciation.

4 Q. But you didn't look into the fact that
5 there's no Cold Weather Rule, for example, that allows --
6 that would not allow Missouri American Water to shut off
7 service based on water?

8 A. Correct, I did not.

9 Q. Okay. Yet we're still 125 basis points
10 higher than what the average was of similarly situated
11 companies last year?

12 A. Right. And there may be many reasons for
13 that. That 10.4 includes settlement, fully litigated
14 cases. It -- I don't have the common equity ratios that
15 were associated with that, the financial risk. I don't
16 have the average size of those companies either relative
17 to Missouri American, though as I testified in response to
18 Staff, Missouri American is significantly larger than even
19 your -- probably your average regulated utilities.

20 Q. Okay. I want to go to your increase, the
21 range of the appreciation. So you say -- stated that you
22 based yours on a 61 percent appreciation of the price of
23 stocks. Now, just to be clear, that's of water -- that's
24 of similarly situated companies but based on appreciation
25 of stock market as a whole?

1 A. Let me explain how it fits in in order. I
2 looked at that 61 percent appreciation, converted it to an
3 annual appreciation.

4 Q. Which is 12?

5 A. 12 something, 12.64, 12.84. Added a
6 dividend yield, what ValueLine is expecting at the time,
7 the average total return for the stocks in its universe,
8 which is approximately for the market. So I used that as
9 an expected market return, derived two equity risk
10 premiums for it, one to use in my risk premium, one in my
11 capital asset pricing model, averaged that with the
12 long-term historical arithmetic mean equity risk premium,
13 applied betas to that average. So I -- I didn't rely
14 exclusively upon it. I relied in part upon it.

15 Q. Did you make any adjustments for actual
16 rates for the past three years?

17 A. I used the arithmetic mean return, total
18 return rate for -- on the market for 81 years. And then I
19 took the market premium, adjusted it by the beta, which
20 would reflect the beta of these water utilities, and the
21 gas utilities would reflect in part their returns.

22 Q. But you've looked -- you looked at the
23 broad spectrum of 81 years or -- to make those
24 adjustments, right?

25 You just said you looked back 81 years in

1 order to do that. I'm talking about because the sense I
2 get is that you're taking kind of a macro approach to
3 this, and I think it's -- it may be perfectly acceptable,
4 but we've had unprecedented activity in the stock market
5 and in other markets over the past three years. Would you
6 agree to that?

7 We haven't really seen with the modern
8 stock prices -- let's take post-depression issues. We
9 haven't seen movements like this in the stock market over
10 the last three years that -- we haven't seen that in the
11 past 80 years.

12 A. I don't believe we've seen the volatility.

13 Q. Volatility?

14 A. The extensive volatility. We may have seen
15 the percentage drops and increases.

16 Q. Now, have these publicly traded water
17 stocks seen that same volatility?

18 A. Yes. Their stock movement has been
19 tracking the market. They were -- I think it was
20 between -- just before the market fell in March of 2009,
21 early 2009 through August of 2009, the Dow Jones utilities
22 outpaced the Dow Jones industrials. Since then, they have
23 been lower. They are now under-performing the market.

24 Q. But that would make sense because if --
25 because in a -- in the kind of boom/bust cycles that we've

1 been seeing, the extreme volatility, they didn't lose as
2 much, so they're not going to gain as much because they
3 are not as volatile as other stocks?

4 A. Right. But even from the down of March
5 2009 through the upswing of August, they -- they were
6 higher. They did better. Now that the market is sort
7 of stabilized, they are now under-performing. They are
8 not --

9 Q. As compared to what?

10 A. The Dow Jones utilities.

11 Q. Again, from a macro standpoint, from all
12 the other companies that make up the Dow Jones industrial,
13 they are under-performing?

14 A. Uh-huh. Yes.

15 Q. Whereas, they were over-performing during
16 kind of the --

17 A. When it tanked. When it tanked.

18 Q. They did better?

19 A. They did better.

20 Q. Didn't fall as much?

21 A. They didn't fall as much. They fell. I
22 mean, the pattern is identical.

23 Q. Right.

24 A. But now the line is below and has been
25 since last summer. And you asked before how I took it

1 into account. It is taken into account in all of the
2 models in the prices. The betas are beginning to reflect
3 the -- we are now two and a half years into this. Betas
4 are calculated based on five years' worth of price
5 volatility relative to the market, so we're beginning to
6 pick that up in the betas. And in part, that's why the
7 water betas are falling is because they are most closely
8 tracking the market. A couple of years ago they were up,
9 you know, they were up to one. There were a few companies
10 that exceeded one.

11 It's also reflected in that historical
12 81-year period, because we are now seeing 2009 -- I think
13 I said it earlier, there was a decline of 37 percent in
14 the Missouri American Water Company as a whole as measured
15 by the S&P, an increase of 26 percent in 2009. We are
16 beginning to pick this volatility up. You have to look at
17 the long term, though, so that that volatility, which is
18 aberrational, doesn't inflate your recommendation. The
19 61 percent you talked about before and I said is now
20 more normal, back in late 2008, early 2009, that was up to
21 200 percent, 254 percent, that was extremely high back
22 then, and I didn't use it at that time.

23 Q. But you're still talking about a five
24 year -- you're talking about a 12 and a half percent
25 increase over five years?

1 A. Right.

2 Q. Okay.

3 A. That's -- looking back over the 84 years,
4 the arithmetic mean return, total return has been 11.8.

5 Q. I want to go back. I just want to clarify
6 something that you said. So the 10.4 is based on
7 different size companies?

8 A. Different sizes.

9 Q. So smaller, riskier companies would also be
10 included in that 10.4?

11 A. They would be included, and there may or
12 may not be a size adjustment included in that.

13 Q. Well, think -- okay. But the 10.4 --

14 A. When authorized. If it's rejected, it's
15 not directly comparable to my 11.35.

16 Q. Right.

17 A. Because of the size adjustment in one case
18 or --

19 Q. But the 10.4 is an average of awarded ROEs,
20 right?

21 A. Right.

22 Q. And that includes smaller, riskier
23 companies than Missouri American because Missouri American
24 is -- compared to some of the other states that were
25 mentioned here before, is substantially bigger?

1 A. Correct.

2 Q. And was Missouri American the largest, the
3 largest American Water subsidiary?

4 A. No, I believe it's Pennsylvania American.
5 We're third.

6 Q. So we're third? Missouri's third. All
7 right. Okay. On this packet of things, and I think this
8 is the right one that Mr. Boudreau handed out earlier, on
9 page -- it's Schedule PMA-16 and PMA -- it's this. I just
10 have a couple clarifying questions. I'm almost finished.
11 PMA-16 and PMA-17.

12 A. Uh-huh.

13 Q. Page 1 of 3 on PMA-17 and PMA-16. These
14 say, correction of MoPSC Staff single stage DCF using only
15 projected EPS growth rates. Now, is this -- what does
16 correction mean?

17 A. What -- every number on there is from
18 Staff's schedule, their DCF calculation, except for New
19 York Water Company, and I'll come back to that. I used
20 column 1, 2 and 3. That's Staff's expected annual
21 dividend, Staff's price and Staff's dividend yield.

22 Q. Okay. So --

23 A. I'm sorry. Calculated according to my
24 growth rate.

25 Q. This is your chart?

1 A. This is my chart.

2 Q. Which indicates a cost of the common
3 equity, a range of 10.10 to 12.65?

4 A. Right. Using the data that was in the
5 Staff report relative to the dividend, the average price
6 and the projected growth rate.

7 Q. So this single-stage DCF -- and granted, it
8 is one modeling --

9 A. Correct.

10 Q. -- would justify a range of the cost of
11 common equity anywhere from 10.10 to 12.65?

12 A. Based on this schedule, yes.

13 Q. Based on this schedule, which is your
14 schedule?

15 A. Calculated --

16 Q. Based on their numbers?

17 A. -- based on their numbers, his way except
18 for the growth rate, correct.

19 Q. So just to be clear, this is a -- this
20 range is a legitimate range supported by the numbers in
21 this case?

22 A. Without any adjustment for size or
23 financial risk difference.

24 Q. Okay. So then let's go to what's on the
25 back, which in my packet is on the back.

1 A. Okay.

2 Q. So again, this is a corrected traditional
3 CAPM and an empirical CAPM model, correct?

4 A. Correct.

5 Q. And they're corrected by you?

6 A. Yes.

7 Q. Could you tell me how it was corrected?

8 A. Okay. I used in column 1, I believe it's
9 incorrect to use the historical risk-free rate. I used a
10 projected risk-free rate as of March 1st because Staff's
11 analysis was as of the end of February. I used the betas
12 which are equivalent. They are the ValueLine betas as of
13 January, it was January 2nd, which are the betas which he
14 used. I calculate the market risk premium looking only at
15 the arithmetic mean historical risk premium. Staff
16 included -- inappropriately included the geometric mean.
17 But I also calculated it using the ValueLine appreciation
18 potential, which we talked about, the 61 percent.

19 Q. Okay.

20 A. And column 4 is just the beta times
21 column 3. And I also believe that one must use empirical
22 CAPM trends to understate or have betas below zero. The
23 line isn't as steeply sloped, et cetera.

24 Q. Okay. So that leaves you with -- under the
25 traditional -- under your analysis, using Staff numbers,

1 the traditional CAPM model has a 10.37 cost of common
2 equity?

3 A. Uh-huh.

4 Q. And the empirical CAPM has a 10.92 percent
5 cost of common equity for an average of 10.65?

6 A. Correct.

7 Q. Once again, so we have -- would you say
8 then there is a range of 10.37 to 10.92 under the cap
9 analysis?

10 A. No. I would recommend averaging them, and
11 if you want to look at a range of DCF and CAPM, I would
12 average the 10.65 with the low end, the 10.10 on the DCF,
13 and the 12.65 on the high end.

14 Q. Okay.

15 A. Based on if I were using these two models
16 calculated this way, that would be the basis of my -- the
17 range I would recommend based on the information shown in
18 these two schedules.

19 Q. I've never liked this term and I hesitate
20 in asking it, but I'm going to anyway, at my peril. Have
21 you heard of this concept called the zone of
22 reasonableness?

23 A. Yes.

24 Q. What's your understanding of the zone of
25 reasonableness?

1 A. The zone of reasonableness is a zone within
2 which, I guess specifically relative to cost of common
3 equity, the common equity cost rate may fall. It's
4 because -- the reason there's a zone of reasonableness is
5 because the estimation of the cost of common equity is not
6 a science. We like to say it's an art, not a science.
7 That's another cliché, because you see a lot of experts
8 come through here and we all do things differently.

9 We cannot be -- the cost of common equity
10 is not directly observable in the market. We have to use
11 simplifying -- we use mathematical models with simplifying
12 assumptions which don't necessarily hold in reality trying
13 to emulate, trying to get inside the heads of multiple
14 investors collectively, and there are many ways to do
15 that, many models to use, many ways to apply those models.

16 Therefore, that's why I use multiple models
17 and would say that the zone of reasonableness lies -- I
18 picked a point estimate as my recommendation, but the zone
19 of reasonableness lies between, as my update shows, in my
20 opinion, base risk adjusted zone of reasonableness is
21 between 10.51 and 12.22.

22 Q. With a recommendation of 11.35?

23 A. Yes. But the zone of reasonableness is the
24 lower and the upper bounds.

25 Q. We've defined -- it's been defined in this

1 as 200 basis points either way from --

2 A. Okay.

3 Q. -- the average.

4 A. 200 on either end or 100?

5 Q. I think it's 200 on either. Am I right or
6 is it 100?

7 COMMISSIONER JARRETT: I thought it was
8 100.

9 BY COMMISSIONER GUNN:

10 Q. That's even better. So 100 on either end
11 of the average, right, so that 10.4 -- maybe I'm wrong and
12 somebody can correct me. So it will be 100 basis points
13 either way of that 10.4?

14 A. And that would encompass my 10.51.

15 Q. It barely --

16 A. Lower on the -- on the low end. You would
17 be lower, but --

18 Q. So -- right. So your -- the 11.35 is
19 95 basis points higher than the 10.4?

20 A. Correct.

21 Q. All right. So if we -- if that's how it
22 was defined here, there's almost 100 basis points of your
23 range outside of that zone of -- outside of that zone of
24 reasonableness. You go almost --

25 A. Oh.

1 Q. -- from the 10.4 to the 12.22 --

2 A. You're going to put the zone of
3 reasonableness on 10.4, is that what you're saying?

4 Q. I could be wrong, but I think that's how we
5 defined it. We averaged -- we averaged and, like I said,
6 I've never liked it because I think the numbers are the
7 numbers and what -- what -- it shouldn't matter --
8 shouldn't matter what a zone of reasonableness is if your
9 analysis is correct, and that could theoretically fall
10 outside.

11 A. Right. That's assuming the 10.4 is
12 correct. I will agree the 10.4 is what water utilities
13 are authorized, I believe. First quarter this year for
14 electric is about 10.66 and 10.24 for gas, but one needs
15 to know everything that went into authorizing those
16 numbers. Those are -- in my mind, they can represent sort
17 of benchmark to look at. And as you said, can you attract
18 capital with that? Yes. How does the equity -- are
19 equity investors still investing in water companies? How
20 do bond rating agencies look at it? They are a
21 corroboration.

22 Q. The 10.4 may include smaller, riskier
23 companies which would lower that 10.4 for companies of a
24 comparable size as well. That's possible, would you agree
25 with that?

1 A. It depends on whether that risk is
2 reflected, whether the Commission's reflected the
3 increased risk in their authorization, whether they
4 accepted the adjustments that were recommended.

5 Q. Okay. I get your point.

6 A. So therefore, to me it's -- it can be a
7 guideline. And they represent different times, too.
8 They're authorized anywhere from January -- I remember
9 when my client -- I recommended 11.45 in January '09 and
10 they got 11.93 in January '09. Another client, you know,
11 got like 10.8 some three or four months later. It kind of
12 depends on the timing, the minds of the Commission,
13 everything else in the rate case, not just the ROE being
14 isolated.

15 Also depends on the time we do our methods.
16 I went from 11.65 as of September '09 to down to 11.35,
17 and my studies today, they're showing a decrease. I said
18 that the earnings forecasts have dropped 200 basis points
19 since September, and that has an effect. If I were doing
20 an ROE today, I would like it to be lower than 11.35.

21 Q. So say that again. So if you were to do
22 the same analysis today of this, you're doing a cutoff in
23 April when you submitted your rebuttal testimony, it would
24 likely be lower than 11.35?

25 A. It would likely be based in part on those

1 growth rates. Betas are going down a little bit. The
2 interest rate forecasts are not -- have not appreciably
3 changed.

4 Q. As an -- we'll put all the caveats you want
5 on this, all of the back of the napkin, not holding you to
6 it, but if you had to off the top of your head make an
7 estimate as to it, how much lower would your estimate be
8 today?

9 A. It would be below 11. 11.75 to 11,
10 including --

11 Q. 10?

12 A. I'm sorry. yes.

13 Q. 10.75 to 11, if it was done today?

14 A. That's what I'm finding for similarly
15 situated companies.

16 Q. So in just a short period of time, we've
17 dropped --

18 A. And that --

19 Q. -- 35 to 65 basis points?

20 A. A lot of that was driven by ValueLine. Not
21 the ValueLine appreciation, because that's around 55 now.
22 It's driven by the fact that both Staff and I used
23 ValueLine information that was available in June, earnings
24 forecasts and any of the other forecasts Staff used, and
25 the betas that ValueLine was projecting or was reporting

1 in January, now the April. They come out only once a
2 quarter.

3 COMMISSIONER GUNN: I appreciate the
4 indulgence in letting us go before we took a break.

5 THE WITNESS: I appreciate your indulgence
6 too.

7 COMMISSIONER GUNN: I know you've been
8 going a long time, so I appreciate it. I don't have
9 anything further.

10 JUDGE JORDAN: Okay. Then nothing further?
11 I have nothing further. Nothing further from the Bench,
12 so I think it's a good time for a break. Will ten minutes
13 be enough for our reporter?

14 THE REPORTER: Yes.

15 JUDGE JORDAN: We'll resume in ten minutes.

16 (A BREAK WAS TAKEN.)

17 JUDGE JORDAN: We are back on the record,
18 and we had concluded questions from the Bench, and we are
19 ready for recross. According to my list, first would be
20 Triumph. Any cross-examination for this witness?

21 MR. ZOBRIST: No questions.

22 JUDGE JORDAN: Let's see. The union is not
23 in the room. Jefferson City is excused. Anything from
24 Riverside?

25 MR. BEDNAR: Just a couple of questions.

1 RE-CROSS-EXAMINATION BY MR. BEDNAR:

2 Q. Ms. Ahern, did you review the
3 infrastructure investments of Missouri American Water
4 Company district by district?

5 A. No.

6 Q. And do you have any idea what the capital
7 investment of Missouri American was for 2009? In your
8 testimony you referred to the 545 million number. I think
9 it's on page 21.

10 A. No. I looked at it relative to 2008 gross
11 plant above 1.4 billion. I don't know what 2009 is.

12 Q. You don't know whether the projected
13 capital expenditures were actually met?

14 A. For that year, no. And I was looking at a
15 five-year projection.

16 Q. The 2009 through 2014, but all you have is
17 projection, but you don't have actuals for obviously the
18 years that have passed?

19 A. Correct.

20 MR. BEDNAR: Thank you. No further
21 questions, your Honor.

22 JUDGE JORDAN: Next on my list is
23 St. Joseph. I don't see counsel for Joseph here.
24 Warrensburg, excused. Water districts, not here. City of
25 Joplin, any recross?

1 MR. ELLINGER: Just a few questions,
2 please, Judge.

3 RE-CROSS-EXAMINATION BY MR. ELLINGER:

4 Q. Ms. Ahern, I think you made a comment
5 during testimony that the current volatility in the market
6 is aberrational?

7 A. I meant that the volatility that we've
8 seen, we had seen in the past. It is still extremely
9 volatile by historic standards, but I think when I use the
10 word aberrational, I was talking about what we saw in late
11 2008 through mid to third quarter '09.

12 Q. And 2010 where we're at now, we've seen
13 continued extreme volatility?

14 A. We are seeing by historic standards, but it
15 is not anywhere near what it was during that time frame.

16 Q. And the recent volatility, let's just go
17 into kind of just a micro --

18 A. Excuse me. I was talking about the
19 projected volatility measured by the volatility of S&P
20 futures, which is a measure of investors' expectations of
21 volatility.

22 Q. And what has the S&P futures done, for
23 example, in the last few days, do you know?

24 A. Well, as of Friday, they were at, like I
25 said, a level of 40. Back in their height during the

1 turmoil, they were at a level of about 80, and at their
2 low, probably just prior to the beginning of the turmoil,
3 they were at about 10.

4 Q. Okay.

5 A. I know they were higher the last time I
6 looked, the futures were higher. They were pointing to
7 hopefully a better day today on the market.

8 Q. Would it surprise you if the market was
9 down 150-plus points already?

10 A. I saw one that said, you know, the global
11 economy's not boding well, but that's -- some retail
12 information was boding well, and at one point the Dow
13 futures were extremely -- this is before the market
14 opened, were down significantly, then all of a sudden they
15 were positive and the S&P's were positive. And that shows
16 you -- that is the proof of it, that that's the
17 volatility.

18 Q. You made a comment about the global -- the
19 new world economy?

20 A. Uh-huh.

21 Q. The issues going on, for example, in the
22 European union --

23 A. Yes.

24 Q. -- is that going to have significant effect
25 on our markets?

1 A. I think it already has, yes, because we are
2 participants in the global economy. We have a lot of
3 companies which are -- either have operations in other --
4 and I'm talking not just utilities, companies that operate
5 have subsidiaries in other companies. We have companies
6 which are owned by foreign companies. We have utilities
7 which are owned by foreign companies.

8 And every one, including Missouri American,
9 including regulated operating utilities, are competing for
10 market, competing for money, competing for investments,
11 not just from other utilities or their sister subsidiaries
12 if they're part of a holding company, but also with
13 non-regulated utilities and with everybody out there in
14 the market seeking financing.

15 Q. Do you follow what's been going on recently
16 in the European union?

17 A. In general.

18 Q. Do you -- wouldn't you agree that the
19 increasing economic turmoil, for example, in Greece,
20 Portugal, England, Italy, those countries looks to
21 continue to have negative impact upon our market?

22 A. All else equal. If there are no other
23 impacts on our market. Our market does react to them. We
24 are not insulated from the effects.

25 Q. And it reacts negatively to them?

1 A. If the effects are significantly negative.

2 Q. A couple of real quick questions about
3 ValueLine. You had talked about the April ValueLine
4 report in response to some questions from the Commissioner
5 Gunn.

6 A. Yes.

7 Q. Do you recall?

8 A. ValueLine published new ratings reports for
9 the water utilities in late April.

10 Q. And they were significantly down on their
11 rates of return -- or excuse me -- betas and on their --

12 A. The betas were not significantly down.
13 They were lower somewhat. The growth rates, as I said,
14 were 100 basis points below the ones they were reporting
15 for my companies in January, which were 100 basis points
16 below the ones that I used in my direct testimony, which
17 were published the end of July.

18 Q. So we're seeing significant downward
19 pressure?

20 A. Well, we're seeing significant downward
21 estimates in earnings growth for the water utilities.

22 Q. And when does ValueLine's next report come
23 out?

24 A. July.

25 Q. That would be, to your understanding,

1 before this Commission would issue any type of final
2 determination on this case?

3 A. I'll accept your word, yes.

4 Q. In the last 45 days, have you seen anything
5 that would discount that the next ValueLine quarterly
6 report will continue that downward trend?

7 A. I don't have a crystal ball. I don't know.
8 I have no idea what the market is going to do or what the
9 effects on -- the earnings forecasts in ValueLine. I
10 think those are the ones you're specifically talking,
11 correct?

12 Q. Yes, ma'am.

13 A. They, as I said earlier, are based on the
14 hypothesized economic environment, this huge macro model
15 that ValueLine has, and they plug all the numbers in and
16 out comes their estimate of earnings and from -- earnings
17 per share, and from that they calculate a projected growth
18 rate.

19 I'm also -- I should clarify it's not just
20 the growth rate that has fallen 200 basis points. It's
21 not just the ValueLine ones because I also use those
22 published by Reuters. They come out almost every day.
23 You might see a different growth rate number. So it's not
24 just driven by ValueLine.

25 Q. And Reuters has dropped also, haven't they?

1 A. Yes. Yes. But I'm saying it's not a -- I
2 don't have to wait three months to see what Reuters is
3 currently projecting for growth. But there are many other
4 factors that affect the earnings of a company other than
5 what is happening, you know, in the global stock markets,
6 in the global investments community.

7 Q. In the last 45 days, Reuters has continued
8 to show downward movement also, hasn't it?

9 A. Yes. I gave you -- when I gave you the
10 200 basis points, I was giving you the average of the two.

11 MR. ELLINGER: Thank you very much. No
12 further questions, Judge.

13 JUDGE JORDAN: Next on my list are FSA,
14 MSD, MEG, MIEC. None of those appear to be present. So
15 AG Processing, Inc., any recross for this witness?

16 MR. CONRAD: No, sir, nothing.

17 JUDGE JORDAN: Okay. Office of the Public
18 Counsel?

19 MS. BAKER: I have just a couple of
20 questions.

21 REXCROSS-EXAMINATION BY MS. BAKER:

22 Q. In response to Commissioner Jarrett's
23 questioning, you stated that average ROE for a regulated
24 water company is 10.4 this year. Do you remember that?

25 A. 2008 through probably either end of March,

1 early April.

2 Q. Early April of what year?

3 A. 2010. I'm sorry.

4 Q. Whenever you reviewed this information, did
5 you look at what the low ROE during this time frame was?

6 A. I have that information. I can't recall.
7 I do know the high is the 11.93 I cited, but I have seen
8 some lows. Some have been authorized. I believe there
9 was a company Aqua Florida last summer was authorized, I
10 believe it was 9.75, and then they were penalized and
11 ended up getting authorized 8.75. That's a case where
12 there's something other than the investment risk, the
13 market risk going in. It was an adjustment to penalize
14 them for some reason by 100 basis points.

15 Q. Is that one that you just remember or do
16 you remember that as being the low?

17 A. I think -- the best of my recollection, I
18 believe that's the lowest.

19 Q. So commissions out there or regulators out
20 there are giving ROEs that are below 10?

21 A. Generally, with deductions for either
22 efficiency or something like that.

23 Q. Generally but not always, correct?

24 A. They are few and far between. The
25 preponderance, the median I would say is up north of 10.

1 Q. But you say the average is 10.4?

2 A. Correct.

3 Q. So there are a significant amount that are
4 below 10.4?

5 A. Not --

6 Q. To make an average?

7 A. Not necessarily. They could all be 10.4,
8 or there could be a preponderance between 10 and 10.4.

9 Q. Right. But if your high is up around 11,
10 to balance that then there is a significant amount that
11 make it below 10.4?

12 A. I cannot say that there would be a
13 significant amount. There may be. I just point out that
14 the midpoint of the 8.75 and the 11.73 is 10.24. There
15 could just be those are and could also be the other way.

16 Q. Let me rephrase it. There are some to
17 balance?

18 A. Yes.

19 Q. To balance out an 11 there are some?

20 A. And there are some between 10.4 and 11.57
21 as well. There's 11.16 out there as well.

22 Q. But again, I just want to be clear on it.
23 If you had done your calculations today, your numbers
24 would be lower, correct?

25 A. That's correct.

1 MS. BAKER: That's all the questions I
2 have. Thank you.

3 JUDGE JORDAN: Okay. Recross from Staff?

4 MR. DEARMONT: Just a few questions.

5 RE-CROSS-EXAMINATION BY MR. DEARMONT:

6 Q. I'd like to continue on that same line of
7 questioning, if you don't mind. I believe that you have
8 indicated that 10.4 percent is the average awarded return
9 on equity for both litigated and settled cases in the last
10 year or so. Would you agree with that?

11 A. Correct.

12 Q. Will you agree that the return on equity
13 awarded in litigated cases is often lower than the return
14 on equity awarded in settled cases?

15 A. No, I would not.

16 Q. Do you have a copy of Mr. Murray's
17 rebuttal -- or excuse me -- surrebuttal testimony?

18 A. Yes. And the reason I say that is, in the
19 settlements that I have been a party to, the
20 recommendation is -- the Staff's recommendation has
21 generally been below the settlement. If the settlement
22 position falls -- if the settlement falls through, the ROE
23 that has been authorized has been below the settled
24 position.

25 Q. Will you please turn to Attachment A to

1 Mr. Murray's surrebuttal testimony?

2 A. Yes.

3 Q. In this case, in Data Request 115 and
4 follow-up Data Request 115.1, Staff requested of the
5 company essentially the authorized ROEs for other
6 American Water subsidiaries. Will you accept that
7 Attachment A represents the answer to that line of Data
8 Requests?

9 A. Yes.

10 Q. And there are a number of columns on
11 Attachment A. One of those columns includes a line
12 indicating whether that subsidiary had an ROE that was
13 awarded after litigation or settlement, correct?

14 A. Correct.

15 Q. Can you identify any awarded returns on
16 equity that were the product of a litigated case and which
17 are 10.4 or larger?

18 A. Not for American, any of the American subs.

19 MR. DEARMONT: I have no further questions.

20 THE WITNESS: Thank you.

21 JUDGE JORDAN: Have the questions generated
22 any redirect?

23 MR. BOUDREAU: Yes, please, just a few. Is
24 it all right if I just handle them from here? I've just
25 got three or four questions.

1 JUDGE JORDAN: That's fine by me.

2 REDIRECT EXAMINATION BY MR. BOUDREAU:

3 Q. Ms. Ahern, just following up on the
4 question that you were just talking about, Attachment A to
5 Mr. Murray's surrebuttal, do you recall that?

6 A. Yes.

7 Q. The tabulation, it's not water utilities
8 generally, these would be American Waterworks subsidiary
9 water companies; is that correct?

10 A. Specifically, yes.

11 Q. Okay. So the 10.4 figure you were given
12 was a different universe of numbers; is that correct?

13 A. Correct.

14 Q. Just a few others. I think you -- I know
15 that you have, and I think some of the other attorneys may
16 have used the term CAPX. Just for clarification for the
17 record, CAPX is an abbreviation for what?

18 A. Capital expenditures. First two syllables
19 of the words.

20 Q. Thank you. Also kind of in the nature of
21 clarification, and it may just be me that's confused. In
22 an exchange with Commissioner Gunn, you were talking --
23 you were having a conversation about how utility stocks, I
24 believe, tracked the market during some period of time,
25 they out-performed and another period of time they

1 under-performed. And the clarification I want to ask is,
2 I think there was some dialog where somebody was talking
3 about Dow Jones industrials and somebody else talked about
4 Dow Jones utilities. I just wanted to clarify, when you
5 were talking about how those -- how those one group of
6 stocks track another, would you clarify what the
7 comparison was?

8 A. What I was talking about was a comparison
9 of the Dow Jones Utilities Index versus Dow Jones
10 Industrial Index.

11 Q. Thank you. In response to -- I think you
12 were asked by Staff counsel, I believe it was in a
13 discussion about risk, and one of the categories that you
14 talked about was capital expenditures?

15 A. Right.

16 Q. And you mentioned that that -- that the --
17 I believe the context of the discussion was that there was
18 becoming a recognition that water utilities were going to
19 have, you know, larger capital demands on them than
20 perhaps other categories of utility. Do you recall that?

21 A. Yes.

22 Q. I believe you were asked by counsel for
23 Staff whether you had compared Missouri American's
24 situation with respect to capital expenditures
25 expectations to Missouri electric utilities. Do you

1 recall that?

2 A. Yes.

3 Q. And I believe your answer was no. But did
4 you take a look at capital expenditures by other utility
5 groups in some context in framing your testimony?

6 A. Yes, I did. If my memory serves me
7 correctly, I believe the question was relative to the
8 absolute amount of capital expenditures, which given the
9 size of electric versus water utilities, is not an
10 apples-to-apples comparison. So there is a calculation
11 called capital intensity, which is the dollar of revenues
12 that it takes to support -- or I should say the dollar of
13 investment that it takes to produce a dollar of revenue.

14 And on pages 9 and 10 of my direct
15 testimony, I did such a comparison of the water utility
16 industry versus electric, gas, as well as others, and
17 Missouri American itself, combos, telephone companies.
18 And for example, it took -- for the water industry as a
19 whole, it took \$3.44 -- this is 2098 (sic) -- of net
20 utility plant to produce a dollar of revenue. For the
21 electric companies, it only look \$1.87, for combination
22 electric and gas, \$1.36. For gas distribution companies
23 it took \$.89. For Missouri America itself, it took \$5.63
24 of net utility plant for every dollar in operating
25 revenue. They were even -- they're even historically more

1 capital intensive than the industry in which they operate.

2 MR. BOUDREAU: I don't believe I have any
3 further questions. Thank you.

4 JUDGE JORDAN: That concludes the
5 questioning on this witness?

6 MR. BOUDREAU: Yes. Just as a matter of
7 order, may Ms. Ahern be excused now from the hearing?

8 JUDGE JORDAN: She may be as far as I know.
9 There's no subpoena holding her here. She may stay or she
10 may go.

11 THE WITNESS: Thank you.

12 JUDGE JORDAN: You're welcome. Next
13 witness?

14 MR. BOUDREAU: I'd like to call Mr. Scott
15 Rungren to the stand, please.

16 (Witness sworn.)

17 JUDGE JORDAN: You may proceed.

18 MR. BOUDREAU: Thank you.

19 SCOTT RUNGREN testified as follows:

20 DIRECT EXAMINATION BY MR. BOUDREAU:

21 Q. Would you state your name for the record,
22 please, sir.

23 A. My name is Scott Rungren.

24 Q. And by whom are you employed and in what
25 capacity?

1 A. I'm employed by American Waterworks Service
2 Company as a Financial Analyst 3.

3 Q. Are you the same Mr. Rungren who has caused
4 to be prepared and prefiled surrebuttal testimony which
5 has been marked for identification as Exhibit 117?

6 A. Yes, I am.

7 Q. And I believe in your surrebuttal testimony
8 you state that you are adopting the testimony previously
9 filed by company witness Michi Chao which have been
10 identified -- the direct testimony's been identified as
11 Exhibit 104 and the rebuttal testimony as 105; is that
12 correct?

13 A. Yes, it is.

14 Q. Have you reviewed those two items of
15 testimony to familiarize yourself with what is contained
16 in those two documents?

17 A. Yes, I have.

18 Q. And you've satisfied yourself that the
19 information that was previously filed is accurate and that
20 you're prepared to testify today about the questions and
21 answers contained in those two documents?

22 A. Yes, I am.

23 Q. So is the testimony true and correct to the
24 best of your information, knowledge and belief?

25 A. Yes, it is.

1 Q. If I were to ask you the same questions as
2 are contained in those three exhibits, that's 104, 105 and
3 117 today, would your answers be substantially the same?

4 A. Yes, they would.

5 Q. Do you have any corrections to make to any
6 of those items of testimony today?

7 A. I have no corrections.

8 MR. BOUDREAU: With that, I would offer
9 into the record Exhibit 104, 105 and 117, and tender this
10 witness for cross-examination.

11 JUDGE JORDAN: 104, 105 and 117; is that
12 correct?

13 MR. BOUDREAU: That's correct, yes.

14 JUDGE JORDAN: Any objections?

15 (No response.)

16 JUDGE JORDAN: I am seeing and hearing no
17 objections, so I will receive those into the record.

18 (MAWC EXHIBIT NOS. 104, 105 and 117 WERE
19 RECEIVED INTO EVIDENCE.)

20 JUDGE JORDAN. And we're ready for
21 cross-examination, are we? We will begin with our cross
22 then. Any cross-examination from Triumph?

23 MR. ZOBRIST: No questions.

24 JUDGE JORDAN: Questions from Riverside?

25 MR. BEDNAR: No questions, your Honor.

1 JUDGE JORDAN: St. Joseph is not here.
2 Warrensburg is excused. Water districts are absent.
3 Cross-examination from the City of Joplin?

4 MR. ELLINGER: Very briefly, Judge.

5 CROSS-EXAMINATION BY MR. ELLINGER:

6 Q. Good morning, Mr. Rungren.

7 A. Good morning.

8 Q. I'm sorry. Good afternoon.

9 A. Good afternoon.

10 Q. I have just a couple of very quick
11 questions. In your surrebuttal testimony, on page 6 -- do
12 you have a copy of that in front of you? I believe that's
13 Exhibit MAWC 117; is that correct?

14 A. Yes, page 6.

15 Q. Page 6. Starting on line 6, right at the
16 end, I'll just call your attention to what I want to
17 inquire about.

18 A. Yes.

19 Q. Do you see where I'm at? Starts with, MAWC
20 will exercise rights which it considers an obligation. Do
21 you see that?

22 A. Yes.

23 Q. Is it my understanding Missouri American
24 makes independent decisions on whether to issue debt and
25 in what amount to issue debt?

1 A. Absolutely.

2 Q. And that those decisions are not
3 controlled, influenced or in any manner governed by
4 American Waterworks Company or any of the hierarchy within
5 American Waterworks Company?

6 A. That's true.

7 Q. And can you tell me what person makes the
8 decision to issue long-term debt on behalf of Missouri
9 American?

10 A. Ultimately I suppose it would be the
11 combination of finance director, Michi Chao, I guess
12 ultimately it could be approved by Jim Jenkins, who's the
13 western division of finance vice-president.

14 Q. Western division finance?

15 A. No. For the western division.

16 Q. Of?

17 A. Of American Waterworks.

18 Q. So the --

19 A. Of the company.

20 Q. The decision would be approved by American
21 Waterworks; is that correct?

22 A. In theory, yes.

23 Q. Real quick, Mr. Chao, I know you've adopted
24 his testimony.

25 JUDGE JORDAN: No. It's not Mr. Chao.

1 MR. ELLINGER: I'm sorry. Mr. Chao's
2 testimony you --

3 THE WITNESS: Ms. Chao.

4 BY MR. ELLINGER:

5 Q. I'm sorry. I apologize. Ms. Chao's
6 testimony you've adopted; is that correct?

7 A. Correct.

8 Q. Is there any reason she could not be
9 present to testify, that you know of?

10 A. Well, the decision to have me adopt her
11 testimony was based on the fact that she is -- in her role
12 as finance director, she has numerous monthly internal
13 reporting responsibilities. So at the time the decision
14 was made to ask me to adopt her testimony, the thinking
15 was that either she would not be able to make the
16 hearings, make it to the hearings, or if she did come to
17 the hearings, she would be letting some responsibilities
18 slide that she had to take care of at the office. So to
19 avoid that conflict, they just asked me to adopt the
20 testimony.

21 Q. Do you know whether she would have the
22 knowledge of who makes determinations to whether debt is
23 issued or not issued on behalf of Missouri American?

24 A. I'm sure she would. Like I said, I believe
25 it's Michi Chao.

1 Q. And you do not work for Missouri American,
2 do you?

3 A. No, I do not.

4 Q. You work for the parent company, American
5 Waterworks; is that correct?

6 A. No. I work for American Waterworks Service
7 Company.

8 Q. You work for the Service Company. I'm
9 sorry.

10 A. Uh-huh.

11 MR. ELLINGER: No further questions, Judge.

12 JUDGE JORDAN: Cross-examination from AG
13 Processing?

14 MR. CONRAD: Nothing for this witness, your
15 Honor.

16 JUDGE JORDAN: Cross-examination from the
17 Office of the Public Counsel?

18 MS. BAKER: No questions. Thank you.

19 JUDGE JORDAN: Any cross-examination from
20 Staff?

21 CROSS-EXAMINATION BY MR. DEARMONT:

22 Q. I have a few questions for you,
23 Mr. Rungren. In addition to capital structure, the
24 company and Staff disagree about the appropriate cost of
25 long-term debt, correct?

1 A. That's correct.

2 Q. Is it your understanding that Staff's
3 position on cost of long-term debt is derived from the
4 embedded cost of long-term debt at American Water and
5 Missouri American, but not the embedded costs issued by
6 American Water's other subsidiaries?

7 A. If I recall Mr. Murray's spreadsheet, I
8 think it includes all the debt issued by American Water
9 Capital Corp, all the debt of Missouri American Water
10 Company, but the debt that was issued by Missouri American
11 Water Company to Cap Corp was subtracted so it wouldn't be
12 double counted. So I believe that's all the debt that's
13 included in the total.

14 Q. And how does that differ from the company's
15 position?

16 A. The -- well, I'm recommending that the debt
17 cost be calculated using just the debt on the books of
18 Missouri American Water Company.

19 Q. And not the Capital Corporation?

20 A. Well, that includes debt that Missouri
21 American has issued through Cap Corp but, no, not other
22 debt that Cap Corp has.

23 Q. Not debt issued by Cap Corp on behalf of
24 other subsidiaries?

25 A. Correct.

1 Q. From a financial perspective, do you agree
2 that the Commission's decision regarding capital structure
3 should control the resolution of this issue also?

4 A. Yes, they are related.

5 Q. It's a function of a larger disagreement,
6 is it not?

7 A. Yes.

8 Q. Missouri American doesn't issue all of its
9 own debt directly to third-party investors, does it?

10 A. It does not.

11 Q. Most of the debt held by Missouri American
12 is issued by the Capital Corporation and then loaned to
13 Missouri American through an internal loan agreement,
14 right?

15 A. Right. The debt that Cap Corp issues on
16 behalf of Missouri American is -- there is a promissory
17 note that Missouri American signs with Capital
18 Corporation.

19 Q. Is that the same thing as the internal loan
20 agreement or is that something different?

21 A. It's a promissory note, yes. It's probably
22 the same thing.

23 Q. When was the last time Missouri American
24 issued its own debt to a private third-party investor?

25 And I'll qualify that by stating that by private

1 investors, I don't mean a state revolving fund or through
2 EIERA or any of those vehicles.

3 A. Okay. I believe it was in April of 2002.

4 Q. Does Missouri American plan to issue any
5 debt to those private third parties, say, in the next year
6 or so?

7 A. I don't know.

8 Q. To the best of your knowledge, they don't
9 plan to issue debt to a private third party in the known
10 future?

11 A. To the extent the company plans to issue
12 debt in the next year, it could issue debt to private
13 third parties.

14 Q. When was the last time Missouri American
15 issued preferred stock?

16 A. 1991.

17 Q. Missouri American does not have a
18 standalone credit rating, does it?

19 A. It doesn't currently.

20 Q. According to the 10K filed with the SEC by
21 American Water, about 90 percent of AmerenUE's revenues
22 are derived from the operation of regulated utilities.
23 Would you agree with that?

24 A. Yes.

25 Q. As contained in your surrebuttal,

1 Standard & Poor's noted in a recent American Water report
2 that the operating risks associated with American Water's
3 non-regulated operations are, quote, fairly low. Does
4 that sound familiar?

5 A. Yes, it does.

6 Q. S&P, in fact, rates the credit quality of
7 American Water on a consolidated basis, does it not?

8 A. It does. It also issues credit ratings for
9 some of the subsidiaries as well, like Pennsylvania
10 American, and I believe New Jersey American has its own
11 rating because they issue debt on their own.

12 Q. What are those ratings? Are they the same
13 ratings -- excuse me. Let me clarify. New Jersey
14 American and Pennsylvania American, are those ratings the
15 same as that of American Water?

16 A. Well, the rating for Pennsylvania American,
17 the credit rating is the same, but it recently issued debt
18 with an A-minus rating or A-plus rating, but that was a
19 secured issuance. So it's not apples to apples.

20 Q. What about -- what about Pennsylvania?

21 A. That was Pennsylvania.

22 Q. Okay. What about New Jersey?

23 A. Again, they have a higher bond rating than
24 the parent, American Waterworks Company.

25 Q. What is their current bond rating, do you

1 know?

2 A. It's A-something. I forget if it's A-plus
3 or A-minus.

4 Q. New Jersey American accounts for 25 percent
5 of American Water's revenues, you agree with that, roughly
6 a quarter?

7 A. I'll accept that.

8 Q. Pennsylvania American accounts for
9 21 percent of American Water's revenues?

10 A. I don't know that for sure, but I'll accept
11 that.

12 Q. Sound correct?

13 A. Uh-huh. Close.

14 Q. And then those two are the biggest
15 subsidiaries, correct?

16 A. Yes.

17 Q. So they both account for more revenues than
18 does Missouri American?

19 A. Yes.

20 Q. American Water receives debt from the
21 Capital Corporation in the same manner that its
22 subsidiaries do, right?

23 A. I'm sorry. I didn't follow that.

24 Q. The Capital Corporation issues debt on
25 behalf of Missouri American Water, correct?

1 A. It issues debt on behalf of American
2 Waterworks and the regulated water companies.

3 Q. And American Water uses this debt to make
4 investments into its subsidiaries, including Missouri
5 American, right?

6 A. That's one use of it, yes.

7 Q. Does American Water record these
8 investments as equity on its books?

9 A. Yeah, the parent infuses equity into the
10 operating companies.

11 Q. If Missouri American -- if Missouri
12 American received an investment in equity infusion, it
13 would tend to increase the percentage of equity in
14 Missouri American's capital structure if we viewed that on
15 a standalone basis, right?

16 A. It's equal, yes.

17 Q. In the alternative, American Water Capital
18 Corporation could issue debt directly to Missouri American
19 or for Missouri-American?

20 A. Typically what happens is Capital Corp will
21 issue debt on behalf of a handful of operating companies
22 at the same time. So Missouri American would be allocated
23 a certain portion of that issuance and, in turn, there
24 would be a promissory note from Missouri American to Cap
25 Corp.

1 Q. I guess what I'm getting at is when
2 Missouri receives that allocation, that's recorded as debt
3 on their books, correct?

4 A. On Missouri's books?

5 Q. On Missouri's books.

6 A. Yes.

7 Q. And viewed on a standalone basis, that
8 obviously alters the ratio of debt to equity?

9 A. Sure.

10 Q. Do you think Missouri American could refuse
11 an equity infusion from its parent?

12 A. Absolutely.

13 Q. Who at Missouri American would make that
14 decision?

15 A. Again, there's not really a need to refuse
16 it, because the request for an infusion would come from
17 Missouri American. It would not -- I can't envision a
18 scenario where the parent would try to impose an equity
19 infusion on Missouri American. That's not how it would
20 work.

21 Q. But it could work that way, couldn't it?

22 A. No.

23 Q. As a general principle, what's more
24 expensive, debt or equity?

25 A. Generally speaking, equity is.

1 Q. Here's a scenario. Say that American Water
2 has subsidiaries in 20 states, regulated subsidiaries.
3 And as a matter of fact, the ROEs in some of those states,
4 the awarded ROEs are higher than the awarded ROEs than
5 some other states.

6 A. Sure.

7 Q. Now, American Water would have an incentive
8 to invest equity in states that have higher awarded ROEs,
9 correct, all else being equal?

10 A. I would think so, yes.

11 Q. Now, what if one of those subsidiaries had
12 a capital structure that was borderline unreasonable,
13 let's say. With me so far?

14 A. I don't know what you mean by unreasonable.

15 Q. Let's say that an equity infusion from the
16 parent to that subsidiary could throw their capital
17 structure out of whack. It would now have way more equity
18 than it does debt.

19 A. Okay.

20 Q. Okay. Is that a possible scenario?

21 A. Again, the decision-making for that would
22 come from the subsidiary but, yeah, could an equity
23 infusion result in a -- in an equity ratio that the
24 regulator views too high or too low? Yes.

25 Q. That's a potential conflict, don't you

1 think, between a parent and a subsidiary?

2 A. I'm not sure what you mean.

3 Q. I mean, the parent has an incentive to
4 invest that equity in the subsidiary, but under my
5 hypothetical, the subsidiary could risk a disallowance if
6 their capital structure becomes out of whack. Is that
7 plausible?

8 A. Utility -- a regulated utility is the
9 entity that's responsible for managing its capitalization.
10 It will do so in a way that's consistent with the
11 regulatory environment in which it works, capital market
12 conditions, business risk its facing. That's generally
13 how it is, how the equity infusions occur.

14 Q. So they could refuse that? Missouri
15 American could refuse an equity infusion?

16 A. Again, it's not a matter of refusing one.
17 We -- Missouri American performs -- develops a financial
18 plan as part of the annual budget. It includes -- could
19 include debt financing, equity financings. The parent has
20 the discretion to make the equity infusion if there's one
21 in the plan or not make it.

22 Q. Okay. Do you work for Missouri American --
23 or you stated that you work for the Services Company,
24 right?

25 A. Yes.

1 Q. What is the treasury and risk management
2 department of Services Company, does that exist?

3 A. There's a treasury function certainly. I
4 don't know that it's part of Service Company. I'm not
5 sure what that is you're speaking of.

6 Q. How long have you worked for the Services
7 Company?

8 A. Three years.

9 Q. Specifically when did you start?

10 A. May 7th, 2007.

11 Q. You've been with the Services Company that
12 whole time?

13 A. Yes.

14 MR. DEARMONT: May I approach the witness,
15 your Honor?

16 JUDGE JORDAN: Yes.

17 BY MR. DEARMONT:

18 Q. Hand you a document there.

19 JUDGE JORDAN: And for the record, no one
20 has to ask permission to approach witnesses unless
21 somebody objects for the purpose of handing them
22 documents. You don't have to ask me.

23 BY MR. DEARMONT:

24 Q. Now, I've handed you a Data Request labeled
25 Data Request 0258, agreed?

1 A. Yes.

2 Q. Issued in WR-2007-0216?

3 A. Yes.

4 Q. And it was requested on May 21st, 2007?

5 A. Yes.

6 Q. Okay. That's just after you started?

7 A. Yes.

8 Q. So I made it, but barely. Now, this
9 request requests American Water company's corporate
10 governance standards for the procurement of financing,
11 right?

12 A. That's correct.

13 MR. DEARMONT: And, Judge, I just noticed
14 that the response has been designated highly confidential.
15 It would probably be appropriate to go in-camera, just for
16 a brief period.

17 JUDGE JORDAN: We'll do that now then.

18 (REPORTER'S NOTE: At this point, an
19 in-camera session was held, which is contained in
20 Volume 12, pages 164 through 166 of the transcript.)

21

22

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24

25

1 JUDGE JORDAN: Okay.

2 BY MR. DEARMONT:

3 Q. In your role at the Service Company, you
4 provide professional services to both American Water and
5 its subsidiaries, correct?

6 A. I would say more to the subsidiaries.

7 Q. But at times you provide services to the
8 parent?

9 A. I would -- no, I wouldn't say that.

10 Q. You issue debt on behalf of the parent?

11 A. The American Water Capital Corp does that.

12 Q. Is it your position that being subject to
13 more regulatory diversity lowers risk?

14 A. Yeah. The more jurisdictions within which
15 you operate, generally speaking, regulatory risk goes
16 down, all else being equal.

17 Q. Do you think Missouri has a good regulatory
18 environment?

19 A. Missouri American?

20 Q. Missouri. State of Missouri. Am I doing a
21 good job?

22 A. Honestly, I'm not that familiar with the
23 Missouri Public Service Commission to answer that.

24 Q. Would you agree, though, that it could be
25 advantageous to be less geographically diverse if you

1 operate in a state with a favorable regulatory climate?

2 A. That depends what level of diversification
3 you're talking about. I mean, if Missouri has a good
4 regulatory environment and you diversify into another
5 state that doesn't, then obviously your diversification
6 didn't work. If you're talking about a number of states,
7 generally speaking that's going to give you more
8 diversity, diversification.

9 MR. DEARMONT: Okay. I have no more
10 questions.

11 JUDGE JORDAN: Questions from the Bench.
12 Commissioner Davis?

13 COMMISSIONER DAVIS: No questions.

14 JUDGE JORDAN: I have no questions, and so
15 we can skip recross and proceed to any redirect.

16 MR. BOUDREAU: Yes, thank you, just a few
17 questions.

18 REDIRECT EXAMINATION BY MR. BOUDREAU:

19 Q. Mr. Rungren, I believe that the counsel for
20 Staff asked you about the last time that Missouri American
21 Water Company issued debt to private parties. Do you
22 recall that?

23 A. Yes.

24 Q. And your testimony was April of 2002?

25 A. Right.

1 Q. But you defined private parties as
2 excluding EIERA or other governmental conduits for tax
3 advantaged financing. Do you recall that?

4 A. Yes, I do.

5 Q. Has the company issued bonds using EIERA as
6 a conduit for tax exempt financing -- let me ask you this:
7 When is the last time they did so -- or it did so?

8 A. It was in December of 2006.

9 Q. And do you recall whether that issuance
10 took place before or after the Commission authorized
11 Missouri American to do long-term debt financing through
12 American Waterworks or American Water Capital Corp? Do
13 you have a sense of context?

14 A. That was a number of years after the
15 financial services agreement was approved.

16 Q. And there's nothing under the financial
17 services agreement that you've just referenced that would
18 prohibit the company from issuing long-term debt to third
19 party -- to third parties other than American Capital; is
20 that correct?

21 A. Right. And, in fact, the company will as a
22 matter of routine practice, when it issues debt, it will
23 pursue opportunities through tax exempt agencies like
24 that.

25 Q. I also believe in response to -- I believe

1 you were asked the question that -- and I may have
2 misunderstood the question, so I apologize if I did, but I
3 believe counsel for Staff asked if most of the debt that's
4 issued by Missouri American is through American Water
5 Capital Corp. Do you remember that?

6 A. Yes, I do.

7 Q. And I believe your answer was yes; is that
8 correct? I mean, was that your answer, I guess?

9 A. I think you're correct.

10 Q. Now, was that answer correct? Isn't it
11 true, sir, that most of the long-term debt it has on its
12 books right now is through parties other than Capital
13 Corp?

14 A. Yes. I'm trying to find the reference in
15 my testimony. I actually have the percentage. If you
16 look at page 16 of my rebuttal, which is actually filed by
17 Michi Chao, the company has approximately \$410 million of
18 debt outstanding as of April. About 212 million of that
19 or about 52 percent will come from sources other than Cap
20 Corp.

21 Q. You were asked, I think, some questions
22 about calculation of interest rate for long-term debt in
23 this case.

24 A. Yes.

25 Q. Okay. Now, is the interest -- well, what

1 is the interest -- the effective interest rate that Staff
2 is recommending the Commission approve for the company's
3 long-term debt?

4 A. I believe they're recommending
5 6.18 percent.

6 Q. Okay. But one can and, in fact, you have
7 calculated the actual interest rate that this company has
8 in terms of debt obligations to various parties; isn't
9 that correct?

10 A. Right. It's a overall embedded cost of
11 debt.

12 Q. And that figure is what?

13 A. 6.36.

14 Q. So no matter how Staff calculates its cost
15 of long-term debt, the figure that they've come up with
16 doesn't track with the company's actual cost of debt under
17 its contractual obligations to lenders; isn't that
18 correct?

19 A. Well, that along with the fact they're
20 using a different capital structure, which further
21 compounds the probability the company will be able to meet
22 the obligation to the bond holders, yes.

23 MR. BOUDREAU: I have no further questions
24 for this witness. Thank you.

25 JUDGE JORDAN: Then that concludes the

1 questioning for this witness. And unless he is under
2 subpoena and such party objects, this witness may go.

3 MR. BOUDREAU: Thank you.

4 THE COURT: We have a good half an hour
5 before our scheduled lunch break, so we may begin with the
6 questioning of Staff witness David Murray next on my list
7 for this issue. I'll issue the oath as soon as counsel is
8 ready. Just let me know.

9 (Witness sworn.)

10 DAVID MURRAY testified as follows:

11 DIRECT EXAMINATION BY MR. DEARMONT:

12 Q. Please state your name for the record.

13 A. My name is David Murray.

14 Q. And by whom are you employed, Mr. Murray,
15 and in what capacity?

16 A. The Staff of the Missouri Public Service
17 Commission, Acting Utility Regulatory Manager in the
18 financial analysis department.

19 Q. Are you the same David Murray who prepared
20 and caused to be filed the rate of return portion of the
21 Staff Cost of Service Report marked as Exhibit 200?

22 A. Yes, I am.

23 Q. Are you the same David Murray who prepared
24 and caused to be filed the capital schedules attached as
25 Appendix 2 to Exhibit 200?

1 A. Cost of capital schedules, yes, that's
2 correct.

3 Q. Do you have any corrections to your portion
4 of the Staff Cost of Service Report or those capital
5 schedules?

6 A. Yes, I have a few changes I need to make.
7 On page 6 of the Staff Cost of Service Report, line 20, it
8 indicates that Staff has prepared two, as far as what's
9 spelled out, attachments. That should be nine
10 attachments. I believe that's all the changes I have to
11 the Staff's Cost of Service Report.

12 Q. Are you the same David Murray who prepared
13 and caused to be filed in this case rebuttal testimony
14 regarding rate of return marked as public Exhibit 215 and
15 HC Exhibit 216?

16 A. Yes, I am.

17 Q. Do you have any changes or corrections to
18 your rebuttal testimony that have not been addressed
19 subsequently?

20 A. I do have a change on page 4, line 2,
21 indicates while Staff does object per se. It should say
22 Staff does not object per se. That one's fairly key.

23 And then as far as -- this is going to be
24 more substantive as far as the recommendation, but I
25 realized in the Cost of Service Report I had indicated if

1 I received information from Missouri American on the
2 construction work in progress balances, that I could give
3 that some consideration as to the amount of short-term
4 debt that should be reflected in my recommended capital
5 structure.

6 Subsequent to the filing of the Staff's
7 Cost of Service Report, they have provided information on
8 construction work in progress balances for -- for
9 September 30th of 2009 and also for March 30th of 2010.
10 It was already reflected in the 10K which was not released
11 at the time. But as a result of reviewing that
12 information, it does appear that the construction work in
13 progress balances are significantly exceeding short-term
14 debt balances at the consolidated level. So I have
15 decided to exclude short-term debt from my capital
16 structure recommendation, and that would affect the
17 schedule -- corrected Schedule 7 attached to my rebuttal
18 testimony.

19 And once you eliminate the short-term debt
20 from the capital structure, of course, all the -- all the
21 percentage that was in short-term debt gets portioned into
22 the other three capital components. And so the common
23 equity balance is now 43.36 percent, the preferred stock
24 balance is .3 percent, and the long-term debt balance is
25 56.34 percent.

1 And then if you go to corrected
2 Schedule 22, of course this will flow through into the
3 individual cost components that are applied to those
4 ratios, and as a result, the common equity weighted cost
5 is 3.88 at the 8.95 percent, 4.01 to 9.25 percent,
6 4.14 percent at the 9.55 percent. The preferred stock is
7 .03 percent all the way across. The long-term debt is
8 3.48 percent all the way across. And that results in a
9 final rate of return indication of 7.39 percent for
10 8.9 -- excuse me -- 8.95 percent cost of equity, 7.52
11 percent for 9.25 percent cost of equity and a 7.65 percent
12 rate of return for a 9.55 percent cost of equity.

13 Q. So what is -- just to be clear, what is
14 your current recommendation on overall rate of return?

15 A. A range of 7.39 to 7.65, midpoint 7.52.

16 Q. I believe that that is the range that was
17 reflected on the Staff's position statement, correct?

18 A. I believe it was. That's correct.

19 Q. Do you have any other changes to your
20 rebuttal testimony?

21 A. No.

22 Q. Are you the same David Murray who prepared
23 and caused to be filed in this case surrebuttal testimony
24 regarding rate of return?

25 A. Yes.

1 Q. Marked as public Exhibit 223 and highly
2 confidential Exhibit 224?

3 A. Yes.

4 Q. Do you have any corrections to that
5 surrebuttal testimony?

6 A. No.

7 Q. Mr. Murray, is the testimony that you have
8 filed in this matter, subject to the corrections that you
9 just mentioned, true and accurate to the best of your
10 knowledge and belief?

11 A. Yes.

12 Q. If you were asked the same questions today
13 as are contained in your testimony in this case, would
14 your answers be the same?

15 A. Yes.

16 MR. DEARMONT: At this time I move for
17 admission of Mr. Murray's portion of the Staff Cost of
18 Service Report and related schedule marked as Exhibit 200,
19 as well as Exhibits 215, 216, 223 and 224, representing
20 the public and HC versions of Mr. Murray's rebuttal and
21 surrebuttal testimony.

22 JUDGE JORDAN: And you've offered into
23 evidence Nos. 200, 215, 216, 223 and 224?

24 MR. DEARMONT: Yes, Judge.

25 MR. BOUDREAU: I don't know that I have an

1 objection, just an observation on the Staff Report. I'm
2 not objecting to it. I'm a little bit uncertain about
3 offering bits of the report piecemeal. I'm wondering if
4 maybe it wouldn't be better to reserve offering it until
5 everybody that's testified to the various portions of the
6 report testified. I mean, like I said, I'm not lodging an
7 objection. I'm just thinking it makes some sense to hold
8 off on the ruling of the admission of the Staff Report
9 either in whole or in part until things have played
10 themselves out.

11 JUDGE JORDAN: That just goes to Exhibit
12 No. 200; is that correct?

13 MR. BOUDREAU: Yes, whatever it is.

14 JUDGE JORDAN: Staff Cost of Service
15 Report.

16 MR. CONRAD: Judge Jordan, we had talked
17 about that earlier, I think, and I don't know if we came
18 to a conclusion, but despite the fact I don't have a dog
19 in this fight, I kind of agree with my colleague who's
20 representing the company here that it does make it more
21 efficient to just hold the offer until the last time the
22 witness is on the stand. Then as you had pointed out, you
23 don't have the situation of going for a week and a half
24 with something pending approval. Counsel can move
25 admission whenever counsel sees fit to do so, but that's

1 my two cents.

2 MR. DEARMONT: Staff has no objection to
3 that alternative proposal either.

4 JUDGE JORDAN: You want to hold off on
5 offering these exhibits?

6 MR. DEARMONT: That's fine, yeah.

7 MR. BOUDREAU: I said I had two
8 observations. The other observation I have is -- again,
9 it's not lodging an objection, but I would ask the Bench
10 to reserve ruling on Mr. Murray's surrebuttal testimony.
11 As I understand that comes in two exhibits, a
12 nonproprietary and HC, which is 223 and 224, until I have
13 a chance to cross-examine him, and depending on how that
14 cross-examination goes, I may have an objection to a
15 portion of that testimony. In other words, it gives me
16 the opportunity to voir dire the witness on some of the
17 matters that are contained in his testimony.

18 JUDGE JORDAN: Okay. Hold on a second
19 while counsel is consulting, please.

20 And how would Staff like to respond?

21 MR. DEARMONT: Judge, it's been offered.
22 I've heard no objection, so --

23 MR. BOUDREAU: Well, I can make the
24 objection now, but I think you're probably going to want
25 to hear -- excuse me. I can make the objection now if

1 that would please the Bench and please counsel, I'll go
2 ahead and launch into it. I was just thinking that it
3 would give an opportunity to better develop the basis for
4 the objection.

5 JUDGE JORDAN: Is your objection going to
6 require a voir dire of the witness? Because if it is, we
7 can simply wait 'til your cross.

8 MR. BOUDREAU: That's what I'm suggesting
9 is that you reserve ruling on admission of the exhibit
10 until I go through cross-examination, at which point I may
11 or may not make a motion to strike a portion of the
12 testimony. It just depends on how things play out.

13 JUDGE JORDAN: Okay.

14 MR. BOUDREAU: Does that make sense?

15 JUDGE JORDAN: It does to me.

16 MR. DEARMONT: It's fine with us.

17 JUDGE JORDAN: What we'll do as to Exhibit
18 No. 200, we'll hold off on the offer, is that correct,
19 Staff counsel?

20 MR. DEARMONT: Correct.

21 JUDGE JORDAN: And as far as the Exhibits
22 No. 223 and 2224, I will reserve ruling until the end of
23 cross-examination.

24 Having heard no objections to Nos. 215 and
25 216, I will admit them into the record.

1 (STAFF EXHIBIT NOS. 215 AND 216 WERE
2 RECEIVED INTO EVIDENCE.)

3 MR. DEARMONT: I have no further questions,
4 and I tender the witness for cross.

5 JUDGE JORDAN: Cross-examination, Staff's
6 witness, would begin with the union, if they were here.
7 They are not. Jefferson City? Riverside?

8 MR. BEDNAR: No questions, your Honor.

9 JUDGE JORDAN: St. Joseph and
10 Warrensburg. Excuse me. City of Joplin?

11 MR. ELLINGER: No questions, Judge.

12 JUDGE JORDAN. Metropolitan Sewer District
13 is not here. AG? MIEC? Triumph?

14 MR. ZOBRIST: No questions.

15 MR. CONRAD: No, sir, thank you.

16 JUDGE JORDAN: Any cross-examination from
17 Office of Public Counsel?

18 MS. BAKER: No, thank you.

19 JUDGE JORDAN: Then we will have
20 cross-examination from Missouri American Water Company.

21 MR. BOUDREAU: I'm sorry. I may have
22 missed that.

23 JUDGE JORDAN: That's because my microphone
24 was not on. And that's cross-examination from Missouri
25 American.

1 MR. BOUDREAU: Yes, I do have some
2 cross-examination. And I don't know whether this makes
3 sense or not. I've probably got more than 15 minutes
4 worth of cross-examination. I'd just offer that maybe
5 now would be a good time to take a lunch break so that I
6 can -- I would hate to interrupt the piercing flow of my
7 cross-examination with a break in the middle of it.

8 JUDGE JORDAN: I understand. Since we were
9 asked to break at 1:20 for a 1:30 agenda, which I was told
10 would last a half an hour, then we could start now with a
11 one-hour lunch break. We should be ready to go back on
12 the record and start rebroadcasting one hour from now. So
13 we'll go ahead and take our lunch break unless somebody
14 else has a better idea.

15 No? Okay. We'll begin our one-hour lunch
16 break.

17 (A BREAK WAS TAKEN.)

18 (AGP EXHIBIT NOS. 450 THROUGH 453 WERE
19 MARKED FOR IDENTIFICATION BY THE REPORTER.)

20 JUDGE JORDAN: We're on the record. And,
21 Counsel, you want to give me an update on what's going on?

22 MS. HERNANDEZ: Yes, your Honor. Thank
23 you. The parties have just recently resumed some
24 discussions that may resolve the outstanding issues of
25 this case. So we would respectfully ask for 30 minutes to

1 continue those discussions and then update you as to
2 whether we foresee the need to continue cross-examination
3 of Mr. Murray or what other information we have at that
4 time.

5 JUDGE JORDAN: Okay. Does anyone else
6 present have anything else to say about that?

7 MR. ELLINGER: Are we going to have
8 something to come back in 30 minutes, do you think,
9 Jennifer?

10 MR. BOUDREAU: I think we'll probably have
11 better guidance for the Commission in 30 minutes.

12 MS. HERNANDEZ: I think we will have better
13 guidance, and maybe at that time, if we could ask for you
14 to indulge us in maybe a status of where we're at and if
15 we think we need a certain amount of additional time, we
16 can let you know and then we can make a decision at that
17 time.

18 JUDGE JORDAN: Okay. We'll take a break
19 for 30 minutes.

20 (A BREAK WAS TAKEN.)

21 JUDGE JORDAN: We're back on the
22 record. Counsel would like to update me.

23 MR. ENGLAND: Thank you, your Honor. The
24 parties have been discussing, well, actually for quite a
25 while now, for many days leading up to the hearing, the

1 possibility of settling the case. We think there is a
2 real opportunity of being able to do that for virtually
3 all of the issues, but we need some time to put some
4 finishing touches on that settlement, if you will.

5 My suggestion would be that as long as
6 Mr. Murray, I understand, may be available tomorrow
7 afternoon, that we postpone his cross-examination, shut
8 down the hearings for today to give the parties an
9 opportunity to try to finalize the settlement, and if that
10 doesn't work, then we'll pick up tomorrow where we were
11 scheduled to and move forward.

12 And we can either let you know hopefully by
13 the end of the day today or certainly first thing in the
14 morning where we are.

15 JUDGE JORDAN: Okay. Does anyone have
16 anything to add to that?

17 MR. CONRAD: We concur with counsel's
18 statement. I just simply would add, and I think counsel
19 made this point earlier, that getting sometimes the
20 details of these things down can be -- can be challenging
21 to do that in just a few minutes, if well not impossible.
22 So I think the time would be useful.

23 JUDGE JORDAN: Okay. Anything else from
24 anyone?

25 All right, then. Now, my joint list of

1 issues and order of witnesses did not suggest a starting
2 time for tomorrow. For the other starting times the
3 suggestion was 8:30. If we need hearing or anything else
4 tomorrow, what time would the parties like to begin?

5 MR. ENGLAND: I would suggest that if we
6 haven't notified you before then, it would be helpful if
7 we show up at 8:30, if for no other reason to tell you
8 where we are. As I mentioned to you off the record, we
9 really only have one issue scheduled for tomorrow because
10 of some availability issues with counsel and witnesses.
11 So the only issue scheduled is depreciation, which
12 involves two witnesses and really two parties. I would
13 think it wouldn't take very long to try it, and if we had
14 to bring Mr. Murray back, certainly we could fit in his
15 cross-examination well within that day as well.

16 Again, it's a longwinded way of saying I
17 suggest we get back at 8:30, if for no other reason to
18 give you an update on where we are and/or begin the
19 hearing.

20 JUDGE JORDAN: That sounds all right with
21 me. Does anyone else have anything to add to that?

22 (No response.)

23 JUDGE JORDAN: Then here's what we'll do.
24 We'll adjourn for today. The parties will discuss further
25 their ideas for settlement, a very good use of time, and

1 we will plan on being back here at 8:30 in the morning.
2 And if the parties can update me before then, say the end
3 of the day, as to what progress they're making, I'd be
4 glad to hear that also.

5 MS. HERNANDEZ: Certainly, your Honor.

6 JUDGE JORDAN: Anything else before we go
7 off the record?

8 (No response.)

9 JUDGE JORDAN: Hearing nothing, then we
10 will be adjourned and we're off the record. Thank you
11 very much.

12 WHEREUPON, the hearing of this case was
13 recessed until May 18, 2010.

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C E R T I F I C A T E

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

I, Kellene K. Feddersen, Certified
Shorthand Reporter with the firm of Midwest Litigation
Services, do hereby certify that I was personally present
at the proceedings had in the above-entitled cause at the
time and place set forth in the caption sheet thereof;
that I then and there took down in Stenotype the
proceedings had; and that the foregoing is a full, true
and correct transcript of such Stenotype notes so made at
such time and place.

Given at my office in the City of
Jefferson, County of Cole, State of Missouri.

Kellene K. Feddersen, RPR, CSR, CCR