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TRANSCRIPT OF PROCEEDINGS

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December 15, 2003
Jefferson City, Missouri
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In the Matter of Missouri-American)
Water Company's Tariff to Revise) Case No. WR-2003-0500
Water and Sewer Rate Schedules.)

KEVIN A. THOMPSON, Presiding,
DEPUTY CHIEF REGULATORY LAW JUDGE.

CONNIE MURRAY,
BRYAN FORBIS,
ROBERT M. CLAYTON, III,
COMMISSIONERS.

REPORTED BY:

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P R O C E E D I N G S

JUDGE THOMPSON: Good morning. My name is Kevin Thompson. I'm the Regulatory Law Judge assigned to preside over this matter, which is Case WR-2003-0500, in the matter of the tariff filings of Missouri-American Water Company.

At this time we will take oral entries of appearance. Why don't we begin with the company?

MR. ENGLAND: Thank you, your Honor. Let the record reflect the appearance of W.R. England, Dean Cooper, Rich Ciottone and David Abernathy, all on behalf of Missouri-American Water Company. Our mailing address is Post Office Box 456, Jefferson City, Missouri 65102.

JUDGE THOMPSON: Thank you. Why don't we take Staff next?

MR. SNODGRASS: Yes. Good morning, Judge. My name is Cliff Snodgrass. I'm the lead attorney in this case today for the Staff of the Commission, but in addition, Keith Krueger, Tim Schwarz and Bruce Bates will also be appearing as representatives of the Staff in this case. My address is Governor's Office Building, Box 360, here in the big town of Jefferson City, Missouri. Thank you, Judge.

JUDGE THOMPSON: Thank you, Mr. Snodgrass.

Office of the Public Counsel?

MS. O'NEILL: Good morning, your Honor. Ruth

O'Neill on behalf of Office of the Public Counsel and the public. John Coffman, of my office, will also be involved in this case, particularly in the area of rate design. Our mailing address is P.O. Box 2230, I think, Jefferson City, Missouri 65102. We've just changed it.

JUDGE THOMPSON: Thank you.

Now let's begin with the Intervenors, starting with Mr. Finnegan, working back that column, work up through the middle and then down on the other side. It's like choreography.

MR. FINNEGAN: Appearing on behalf of the City of Riverside and the Platte County District, Jeremiah Finnegan, Finnegan, Conrad & Peterson, 3100 Broadway, Suite 1209, Kansas City, Missouri 64111.

And also in this case is Stewart W. Conrad, appearing on behalf of AG Processing. However, he is on his way to Washington. I believe he's informed the Judge about that.

JUDGE THOMPSON: Thank you, Mr. Finnegan.

Mr. Fischer?

MR. FISCHER: James M. Fischer, Fischer & Dority, PC, 101 Madison Street, Suite 400, Jefferson City, Missouri 65101, appearing today on behalf of the Public Water Supply Districts 1 and 2 of Andrew County and the Public Water Supply District No. 1 of DeKalb County.

JUDGE THOMPSON: Thank you.

Yes, ma'am?

MS. BOND: Good morning, Judge. I'm Jan Bond. I'm here of behalf of Utilities Local 335. My address is 7730 Carondelet, Suite 200, St. Louis, Missouri 63105.

JUDGE THOMPSON: Thank you, ma'am.

MR. ELLINGER: Good morning. Marc Ellinger and Jim Deutsch on behalf of the City of Joplin. Our address is 308 East High, Suite 301, Jefferson City, 65101. Thank you.

JUDGE THOMPSON: Thank you, sir.

MS. LANGENECKERT: Lisa Langeneckert, appearing on behalf of the Missouri Energy Group, with the law office of Robert Johnson, 720 Olive, 24th Floor, St. Louis, Missouri 63101.

JUDGE THOMPSON: Thank you.

MR. CURTIS: Good morning, your Honor. Leland B. Curtis on behalf of the City of Warrensburg, Missouri. The law firm is Curtis Oetting, et al, 130 South Bemiston, Suite 200, St. Louis, Missouri 63105.

And, your Honor, in making my entry, I would like to state for the record that we will be appearing only this morning for the opening statements and request to be excused. Our only issue is rate design, which comes up later.

JUDGE THOMPSON: Thank you, Mr. Curtis, and thanks for reminding me. For all of you, you need only be here when the issues you're interested in are being tried. Of course, anything you miss you miss, right? That's how it goes.

Mr. Comley?

MR. COMLEY: Thank you, Judge. Mark W. Comley, Newman, Comley & Ruth, 601 Monroe Street, Jefferson City, Missouri 65101, on behalf of the City of Jefferson.

JUDGE THOMPSON: Thank you, Mr. Comley.

Mr. Zobrist?

MR. ZOBRIST: Carl Zobrist, Timothy Swensen, Blackwell, Sanders, Peper, Martin for the St. Joseph Water Rate Coalition. Our mailing address is Suite 1100, 2300 Main Street, Kansas City, Missouri 64113.

JUDGE THOMPSON: Mr. Stewart?

MR. STEWART: Charles Brent Stewart and Jeffrey Allen Keevil, the law firm of Stewart & Keevil, LLC, 4603 John Garry Drive, Suite 11, Columbia, Missouri 65203, appearing on behalf of the Empire District Electric Company.

JUDGE THOMPSON: Thank you.

Is there any other counsel that we have neglected?

(No response.)

JUDGE THOMPSON: No? Okay. We'll go ahead and take a five-minute recess at this time and then we'll go back on the record at the end of that. Thank you.

(A recess was taken.)

JUDGE THOMPSON: Let's have the first witness. I believe that's Mr. Thornburg.

MR. ENGLAND: Yes, your Honor.

JUDGE THOMPSON: Go ahead and state your name, sir.

THE WITNESS: My name is Eric W. Thornburg.

JUDGE THOMPSON: Could you spell your last name for the reporter, please?

THE WITNESS: Yes. It's T-h-o-r-n-b-u-r-g.

JUDGE THOMPSON: Would you raise your right hand.

(Witness sworn.)

JUDGE THOMPSON: You may inquire.

MR. ENGLAND: Thank you, your Honor. Before I begin, let me state for the record that I believe the parties have agreed that we will waive the traditional introductory questions and foundation questions regarding the witness and the testimony that they've prepared and sponsored and simply move straight into identification of any corrections that need to be made and simply offer them for cross-examination.

JUDGE THOMPSON: Is that acceptable to all parties? Do I hear any objections?

MS. O'NEILL: No objection.

JUDGE THOMPSON: Hearing no objections, we will proceed with that understanding. Thank you, Mr. England.

MR. ENGLAND: Thank you.

ERIC W. THORNBURG testified as follows:

DIRECT EXAMINATION BY MR. ENGLAND:

Q.   Mr. Thornburg, turning your attention to Exhibit 51, which is your rebuttal testimony, are there any corrections that you need to make to that testimony at this time?

A.   Yes, there are. On page 8 of my testimony, line No. 28, the word "cases" should be deleted and the word "costs," c-o-s-t-s, inserted in its place. And that is the only correction I have.

Q.   Thank you.

MR. ENGLAND: With that change, your Honor, I would offer Exhibit 51 into evidence and tender the witness for cross-examination.

JUDGE THOMPSON: Thank you, Mr. England. Do I hear any objections to receipt of Exhibit 51?

(No response.)

JUDGE THOMPSON: Hearing no objections, Exhibit 51 is received and made a part of the record of this proceeding.

(EXHIBIT NO. 51 WAS RECEIVED INTO EVIDENCE.)

JUDGE THOMPSON: Let's see. I believe it is MIEC that is inquiring first, and that would be Ms. Vuylsteke, who I don't believe is here.

Very well. Missouri Energy Group, Ms. Langeneckert?

MS. LANGENECKERT: No questions.

JUDGE THOMPSON: Okay. Mr. Finnegan?

MR. FINNEGAN: No questions.

JUDGE THOMPSON: Water Rate Coalition, Mr. Zobrist?

MR. ZOBRIST: No questions, your Honor.

JUDGE THOMPSON: Empire District, Mr. Stewart?

MR. CONRAD: No questions.

JUDGE THOMPSON: Joplin?

MR. ELLINGER: No questions, your Honor.

JUDGE THOMPSON: Public Water Supply Districts, Mr. Fischer?

MR. FISCHER: No, thank you, your Honor.

JUDGE THOMPSON: Warrensburg, Mr. Curtis?

MR. CURTIS: No questions, thank you.

JUDGE THOMPSON: Jefferson City, Mr. Comley?

MR. COMLEY: No questions.

JUDGE THOMPSON: Local 35, Ms. Bond?

MS. BOND: I have nothing.

JUDGE THOMPSON: Thank you. Ms. O'Neill?

MS. O'NEILL: Thank you, your Honor.

CROSS-EXAMINATION BY MS. O'NEILL:

Q. Good morning, Mr. Thornburg.

A. Good morning, Ruth.

Q. How are you doing?

A. I'm doing very well, thank you.

Q. I just want to touch a couple of things here in your testimony so we can get moving on. But one thing, at page 10 of your testimony, it looks like you're criticizing the Commission's decision to exclude the remaining undepreciated balance related to the retired St. Joe water treatment plant from rates in the last case.

Does Missouri-American Water Company currently own that property?

A. The property that the old St. Joe plant was on has, in fact, been sold.

Q. And was sold for about $115,000; is that right?

A. I believe that is correct.

Q. And in the company's original filing in this case, was that $115,000 accounted for in any way?

A. Ruth, you'll need to check with one of our other witnesses on that.

Q. Okay. And would I also have to check with another witness to see whether or not your company reduced anything regarding treatment of that old plant balance by any amount as a result of that sale?

A. Would you repeat your question? I'm not sure I understand it.

Q. Would I also have to ask another witness whether or not your company reduced its requested depreciation by the amount of the sale? Would you know that?

A. The old plant was, in fact, retired, taken out of utility plant in service, so I'm assuming there would have been a corresponding reduction in the reserve account.

Q. For any specifics, I should ask somebody else, though, who's actually participated in that?

A. Someone who's prepared that particular adjustment.

Q. Okay. Now, on page 11 of your testimony, you state that the Commission rejected ten years' worth of attempts by Missouri-American and County Water to develop some processes to fund infrastructure replacement only to have them rejected. Do you see that? Or do you recall that -- do you recall that testimony?

A. So that we're on the same page, what line in my testimony are you referring to?

Q. I think it starts at -- on the copy I have, it starts on line 22.
A. Okay. I'm with you.
Q. Okay. Are you aware that the Commission twice granted County Water Accounting Authority Orders to defer costs related to infrastructure replacement?
A. I'm aware of those AAOs, yes.
Q. Okay. And are you also aware that the primary reason the Commission rejected the third requested infrastructure AAO was that County Water failed to ramp up its infrastructure replacement program to meet the expectations under the prior two AAOs?
A. Deferring of costs, Ruth, doesn't really address an issue, and so the fact that we received the AAOs and the third effort was rejected out of hand, you know, we understand the Commission's decision, but we just don't feel that it addressed the issue.
Q. You are aware of what rationale the Commission had for rejecting that third AAO; is that correct?
A. Yes, I am.
Q. So those would be three occasions in ten years where the Commission addressed issues and heard requests from your company or from County Water, which was a predecessor of your company, to address infrastructure replacement issues, is that right, and that's three times,

three AAO requests?
A. Again, what I said, Ruth, was that we understand the Commission granted AAOs, but whether or not it truly addressed the issue, my testimony is I don't believe that it did.
Q. Okay. Are you also aware that in the last County Water case, that's 2000-844, the primary reason that the Commission gave for adopting the company's proposed depreciation treatment was to increase cash flows in the hope that it would generate funds that could be used to begin to address infrastructure issues?
A. I am aware of the last case and the considerable discussion about depreciation expense. However, it was the Staff's recommendation to reduce depreciation, not give us any additional. So that really wasn't going to address the matter.
Q. But you are aware of the fact that the Commission stated as its rationale for adopting the company's depreciation proposals that it would generate funds that could be used to begin to address infrastructure issues?
A. That would begin to address is probably the operative word.
Q. So while the Commission didn't specifically grant every request that County Water, your predecessor

company, made regarding addressing this infrastructure, there were orders granted that attempted to deal with this problem; isn't that correct?

A. Ruth, again, what I'm testifying to is there were AAOs set up, but that really didn't address the problem, Ruth. It set aside for a future date such that we still were waiting for what was going to be the decision of the Commission in terms of addressing the issue.

Deferring costs, keeping depreciation expense at a level consistent with what it had been was not addressing the problem in our minds.

Q. So although the Commission made these decisions at least in part to assist the company with this infrastructure issue, the company did not ramp up the infrastructure replacement to the levels that it initially had proposed to do in each of those filings; is that correct?

A. We had proposed to ramp up, Ruth, based upon the outcome that we had sought in the case. We're still pro-- in fact, next year we're set up to go up to 14 million in pipeline replacement in St. Louis County. So we're prepared to move forward now that we have the solution in place through House Bill 208.

Q. Also in your testimony you talk about House Bill 208, which is the ISRS statute; is that right?

A. Yes, that is correct.

Q. And one of the reasons that the company was so anxious to get this ISRS, or ISRS, statute in place was to address problems related to regulatory lag; is that right?

A. Certainly regulatory lag was one of the issues that we were concerned about.

Q. In fact, in your testimony also there on page 11 you describe regulatory lag as having a punitive effect. Is it your testimony that regulatory lag always acts as a means of punishing a regulated company?

A. That's not my testimony here, Ruth.

Q. On page 11 at line 26 you talk about the punitive effect of regulatory lag; is that right?

A. I do talk about that in this line.

Q. But you don't believe that it always -- that regulatory lag's purpose is to punish companies?

A. No, I don't believe that it is always the case.

Q. And isn't it a fact that regulatory lag is simply a label used to recognize the fact that between rate cases events can occur which either increase or decrease a company's returns relative to its earnings or its revenues?

A. In a hypothetical, yes.

Q. So regulatory lag can work in a company's favor or to a company's detriment, depending on what change

has occurred; is that right?
A. In a declining cost industry or in one where you're not investing in capital in that industry, then that could certainly happen.
Q. Or if a company implements some procedure that saves a lot of cost in between rate cases?
A. If you do implement a procedure and save a lot of costs, as you characterize it, that can help offset other costs that have increased.
Q. So it's --
A. So lag can work.
Q. Lag can work in a company's advantage in some situations?
A. What do you mean by advantage?
Q. Can work to the benefit of the company, can increase earnings in some situations. There is positive regulatory lag and negative regulatory lag?
A. I guess it's not the lag that's positive or negative. It's what's gone on in between time. It's whether you have, in fact, had costs fall and have not invested in plant. Then, in fact, there could be a case in that circumstance where earnings would -- could increase for the business.
Q. So it could be a positive effect or negative effect?

A. In that particular hypothetical.
Q. But not a device created by commissions to punish companies in between rate cases?
A. Is that a question?
Q. Yeah.
A. Could you repeat?
Q. But it's not something that was created by commissions to punish companies in between rate cases, is it?
A. Well, commissions didn't create lag. Lag is inherent in the process. My testimony here is, in regards to the ISRS case, in the State of Missouri, the Staff and Public Counsel were very much opposed to this being put into place because they wanted the lag process to be in place. They did not want to eliminate that. We worked hard. We did finally resolve our differences there to a great extent.
Q. Now, Missouri-American is not the only regulated subsidiary of your parent company; is that correct?
A. That's correct.
Q. Okay. And other regulated affiliate companies, your sister companies if you will, also must seek approval from public utility commissions for changes in their rates; is that correct?
A. That is correct.

Q. And the prudence of financial decisions are reviewed at some level of scrutiny by those commissions; is that correct?
A. Yes, that's correct.
Q. And whether those jurisdictions allow things like the ISRS or other mechanisms to help out a company's situation in between rate cases, there's still some regulatory oversight over those capital projects, such as infrastructure replacement, isn't there?
A. Yes, I believe so.
Q. Or any other capital projects that a company might undertake, major capital expenditures?
A. I believe that's the U.S. model.
Q. And isn't it also true that one of the central rationales for regulation of monopolies like Missouri-American is to create business conditions that mimic competition?
A. Yes, that is correct.
Q. And competitive businesses can't just raise their prices when some costs go up without regard to what competitors are doing, is that right; they have to look at the market as a whole?
A. I believe they have to look at the market as a whole.
Q. And in difficult economic times, businesses

that face competition may have to live with reduced returns on investment rather than simply raising your prices if raising prices would cause them to lose market share or would otherwise be detrimental; is that correct?

A. That sounds like a reasonable proposition.

Q. But because Missouri-American Water is a monopoly, it doesn't normally face this type of competitive pressure regarding keeping prices down; is that fair to say?

A. I think it's fair to say we don't compete for water sales in a community, but certainly we do face competition.

Q. Now, there are some places in your testimony where you suggest that if the Commission does not issue a favorable decision in this case, your parent company might be reluctant to make investments in Missouri. Do you recall making statements on that topic?

A. Again, so we're on the same page, what section of my testimony are you referring to?

Q. There are several of them throughout. Is that a concern that you have?

A. I'm concerned that after having invested 146 million in the State of Missouri to replace infrastructure over two to three years, depending on the area, that a large rate decrease -- a rate decrease will send the wrong message to the investment community, and that would include my equity investors, as well as debt investors.

Q. And your equity investors were all -- your equity investor is American Water and its parent companies; is that correct?

A. Yes. We -- and I mentioned debt, and, of course, we have some preferred stockholders as well.

Q. And you get most of your financing through an American Water subsidiary, is that correct, and EIERA?

A. In the last year we've used a subsidiary of our parent, Capital Corp, but historically we've funded our debt through private placement memoranda.

Q. Do you expect to continue the activities of the last year regarding the other affiliated subsidiary of American Water or are you looking at going back into the open market with your debt after this case?

A. Well, what we'll always try to do is find the lowest cost debt. The Capital Corp allows us to essentially consolidate that effort across all of our sister organizations and eliminate the cost of private placement.

But clearly we're also concerned about some of the positions taken in this case in regards to that, and if that's being misunderstood, then we might need to revisit that.

Q. Well, let's talk about some things related to your parent corporation and affiliates. Have you received word from your parent company that it's going to be reluctant to make investments in Missouri or is this just an assumption on your part?

A. Actually, I have a board of directors meeting today, and I keep my board well informed, and there is great concern about the current position of the Staff in this case.

Q. Is that a board of American Water or Missouri-American?

A. It's the board of Missouri-American Water, and my board -- my owner, as you know, is American Water, and so my board members represent American.

Q. Now, you're the president of Missouri-American Water; is that right?

A. Yes, that's correct.

Q. And as president of Missouri-American Water, you have a responsibility to Missouri-American Water to do what you can to make sure that that company is successful; is that right?

A. Absolutely, both in terms of operating and financial success.

Q. And as far as operating success, that would include making sure that your company continues to provide safe and adequate service in the State of Missouri; is that

correct?
A. And I'll -- I do everything in my power to make sure that that is never in jeopardy, the safe and reliable, adequate service, and that's not what I'm referring to in my testimony.
Q. Part of providing safe and adequate service means keeping the system in repair and updating worn-out infrastructure mains; would you agree with that?
A. That's certainly a part of the long-term investment in the utilities infrastructure, the timely rehabilitation of assets, that is correct.
Q. So as president of Missouri-American, are you saying that you would not advocate to your parent company to obtain the necessary capital for Missouri-American to continue to be a successful company?
A. No, that's not my testimony.
Q. And you're not here to testify to this Commission that you don't have the persuasive ability to advocate for adequate financing for your company; is that correct?
A. No. It's my testimony that we would continue to invest in what is necessary to maintain safe and reliable service, but it's also my testimony that incremental capital to, in fact, ramp up projects like significant main replacement projects in St. Louis County and otherwise in

the state, and -- well, let me finish that thought.

I can continue to fix mains in St. Louis County in a sense a little bit like a pothole in the road. You know, you can fix the pothole, and more potholes arise and you fix those potholes. That's maybe not the right thing to do for 50 years from now. A pipe needs to be replaced.

And my testimony, I think, clearly shows we're on a 400-year replacement cycle, and that's probably a lower cycle than most major cities in Missouri, but it's not necessarily the right replacement cycle.

Q. But as president of Missouri-American, your job is to make sure that your company does the right thing; isn't that correct?

A. My job is to do the right thing and balance my stakeholders, and I have many.

MS. O'NEILL: I don't have any further questions.

JUDGE THOMPSON: Thank you, Ms. O'Neill.

Mr. Snodgrass?

CROSS-EXAMINATION BY MR. SNODGRASS:

Q. Good morning, Mr. Thornburg.

A. Good morning, Mr. Snodgrass.

Q. Looking at your Schedule EWT-1 in your rebuttal testimony, it indicates you've been president of

the company since 2000; is that about right, sir?
A. Yes, sir, June of 2000.
Q. Now, you were president of Missouri-American during the last rate case; is that correct?
A. Which case?
Q. WR-2000-281.
A. Is that the St. Louis County?
Q. That's St. Joseph.
A. St. Joseph?
Q. Yes, sir.
A. Mr. Snodgrass, I believe that decision came down in October of 2000.
Q. Uh-huh.
A. So I was here when the decision was rendered, but the record was largely closed when I did take over in this position.
Q. Did you monitor that case? Did you look over the results of that case?
A. Yes, I did.
Q. Okay.
A. I looked over the results.
Q. And you read the Report and Order in that case; is that right?
A. Yes, I have.
Q. Now, just refreshing my memory, the company

had constructed a new water and sewer facility in the St. Joseph, Missouri operating district; is that correct?

A. That is correct.

Q. And that new plant replaced an old plant located near the Missouri River; is that right?

A. That's correct.

Q. And that new facility relied on a groundwater supply rather than Missouri River water; isn't that correct?

A. Yes. It still does.

Q. Now, costs related to this new facility amounted to about $80 million; is that a fair statement?

A. About 70 million.

Q. All right. Assuming that's correct, in that case, WR-2000-281, the company was seeking to get that $70 million of plant placed into rate base, was it not?

A. Yes, we were.

Q. $70 million is a lot of money, isn't it?

A. It sure is.

Q. It's more than your annual salary, isn't it, Mr. Thornburg?

A. Yes, but I'm working on it.

(Laughter.)

I have a long way to go.

Q. Now, inclusion of $70 million in rates created quite a stir in the press, did it not, to your knowledge?

A. That's my testimony. There was a lot of angst in the last case, we'd all agree.

Q. Public hearings were held about this new plant going into rates, were they not, as far as you know?

A. Oh, yes.

Q. And Missouri ratepayers spoke out against higher rates in these areas, did they not?

A. They do at most.

Q. And the Office of the Public Counsel, or OPC, represents the ratepayers of Missouri; is that your understanding?

A. Yes.

Q. And OPC opposed inclusion of these costs of the new plant itself, did they not?

A. I believe a portion of the cost they sought to eliminate.

Q. I think you'd be correct. Let me rephrase my question.

OPC sought inclusion of costs related only to repairing and refurbishing the old plant; would that be closer to being accurate?

A. Subject to check, I believe that is correct. That, I believe, was the basis for their adjustment.

Q. Thank you, sir.

Now, there were St. Joseph intervenors in that

case, were there not?
A. There were intervenors.
Q. And they followed a position of OPC, that being that they preferred costs in rate base being related more to repairing that old plant rather than using the costs of the new plant; is that a fair statement?
A. I can't answer that.
Q. All right. Now, we're talking about a $70 million new plant. With the exception of an excess capacity issue, Staff supported inclusion of that new plant, did it not?
A. I believe that's correct. I think there was an AFUDC adjustment as well.
Q. But in general they supported the construction of that new plant, did they not?
A. Yes. I believe Mr. Merciel testified that that was a prudent investment.
Q. Now, this was despite -- Staff's position was despite opposition from OPC, isn't that correct?
A. I believe that's right.
Q. And it was despite the notoriety of the case in the community; isn't that true?
A. In this case.
Q. Now, inclusion of that new plant into rate base meant somebody was going to have an increase in rates,

did it not?

A. Yes.

Q. I'd ask you to look at your rebuttal testimony, if you would, Mr. Thornburg.

A. What page would that be?

Q. Lines 22 through 23. I knew you'd ask that question.

A. On page?

Q. Page 1. I'm sorry.

A. Okay. 20, 21 and 22.

Q. Are you there?

A. I'm there.

Q. Now, you say in part there, do you not, that you're deeply troubled by the Staff's consistently aggressive posture toward the company; isn't that right?

A. That is correct.

Q. Haven't you just indicated in that last rate case when about $70 million was at stake, that Staff offered its support on that plant?

A. That's correct. That was three years ago.

Q. Look at your rebuttal testimony, page 6, lines 11 through 12.

A. I'm there.

Q. Thank you, sir. You say in part that the only conclusion you can reach is that Missouri-American Water

Company is being punished; is that correct?

A. That's what I state.

Q. And again, in this last rate case when millions of dollars were at stake over this plant, Staff supported that plant, did they not?

A. They supported the plant in that case.

Q. You welcomed that support at that time, did you not?

A. In hindsight, I welcomed their support of that investment.

Q. I'd ask you to look at page 10 of your testimony, please, and I'd ask you, sir, if you'd be so kind to look at lines 8 through 9.

A. I'm there.

Q. Hang you, sir. Isn't it true that that particular statement reads, the Staff's disallowance of the company's unrecovered investment in its old St. Joseph water plant clearly sends a negative signal to investors? Is that your statement?

A. That is my statement.

Q. However, isn't it true, sir, that the disallowance of the unrecovered investment in the old St. Joseph plant was the result of the Commission accepting OPC's recommendation rather than the Staff's?

A. I'm referring to this case, sir.

Q. But I'm talking about in the last rate case. To your knowledge, isn't it true that the Commission adopted OPC's position on the unrecovered investment in St. Joe? I'm not talking about this case.

A. My recollection is that the Public Counsel's position in the last case was the disallowance of the unrecovered investment in the old St. Joe plant.

In this case, the Staff has adopted that same position, and that's my testimony.

Q. Isn't it true, though, again, that the Commission accepted OPC's position on that issue in the last case?

A. Yes, it is.

Q. In fact, OPC's recommendation, according to your testimony at lines 10 through 13, was that $3.2 million of the old plant should be written off as the old plant had been retired and was to be taken out of service; is that accurate?

A. That's correct.

Q. And as you point out on page 10 of your rebuttal testimony, it was the Staff in the 1997 case that specifically brought to the Commission's attention the fact that the old St. Joe plant would be coming out of service in approximately three years and that there would be a substantial amount of unrecovered investment there; isn't that right?

A. That's my testimony, yes.

Q. In fact, it was Staff's proposal that the company be allowed a special amortization of that anticipated unrecovered investment in the old plant, was it not?

A. That's correct.

Q. The bottom line, sir, Staff's approach on the old St. Joe plant was more favorable to the company than OPC's approach, because it allowed an amortization of the unrecovered cost to the plant rather than a straight writeoff; isn't that right?

A. In the last case, that was your proposal.

Q. Would your answer be yes or no to that question?

A. My answer would be yes, in the last case. My testimony refers to this case.

Q. You've used the word consistently aggressive posture of Staff towards this company, have you not?

A. Absolutely, in this case.

Q. That wasn't the case in the last case WR-2000-281 now, was it?

A. That's not the last case.

Q. That wasn't the case in that case, was it?

A. In that case, the Staff did, in fact, endorse the $70 million investment in the St. Joe plant.

Q. So on that $70 million issue, you didn't feel like Staff was punishing the company at that time, did you?

A. Again, it's my testimony I got here in June of 2000. Getting the Order, we felt like we -- we survived a very difficult and challenging case there. Wasn't entirely what we expected. There were some very difficult rate designs that were ultimately implemented. But on the whole, the company got through that, and there are some remaining issues, though, that we think still need addressed.

Q. Well, then, just going back to that case one last time and we'll leave that issue, on WR-2000-281, you didn't feel like the Staff was being consistently aggressive towards MAWC at that time, did you?

A. I wasn't involved throughout the heart of that case. I came in, the record was closed. So I don't have quite as much experience to draw from as I do in this case.

Q. All right. Let's move along. Also in connection with the new St. Joseph plant issue, regarding the excess capacity part of that issue, you say that the excess capacity adjustment adopted by the Commission appears to have been accepted out of apparent pragmatism.

Would you define what apparent pragmatism means?

A. What I meant by that was that we seem to have had the need for an adjustment in terms of the capacity of that case.

Q. Who is we?

A. The capacity of that plant.

Q. Who is we?

A. The Staff and the Commission. There was an adjustment made and proposed financially in regards to that case, but I don't find any engineering rationale for that adjustment. So the pragmatism was that there was the need for -- it was felt that there was a need for a financial adjustment on the size of the plant.

Q. That's your view of the Commission's decision on that issue?

A. That's correct.

Q. Okay. But you do agree, Mr. Thornburg, do you not, that the Commission accepted the Staff's adjustment regarding excess capacity at the new St. Joe self plant in the last case involving that issue?

A. Yes, I do agree.

Q. Thank you, sir.

Mr. Thornburg, you indicate throughout your testimony that Staff's position is extreme and punitive. You use those words, do you not?

A. I do use those words, yes.

Q. And do you believe your company is being punished with this overearnings complaint?

A. Well, the filing of the complaint certainly brings a focus like a laser to the case and certainly has confused a lot of customers.

Q. But I'm asking you, do you think your company's being punished? That's my question.

A. My testimony is that it certainly feels that way.

Q. All right. And do you think your company is being unreasonably singled out with the Staff's complaint, sir?

A. That's not my testimony.

Q. Now, would it be a fair statement that the Staff has filed excess earnings complaints against other utilities in the past?

A. My recollection is in the Ameren case, but beyond that, I don't recall any.

Q. Well, if they did file a complaint against Ameren, your utility would not be the only utility they filed a complaint against; is that right?

A. That is correct.

Q. Now, at page 2 of your testimony, line 2, or in that area generally, you say in several places that Staff's positions again are punitive and extreme; is that right?

A. You're saying page 2 line 2?

Q. Page 2, line 7 through 8. Excuse me, sir.

A. Examples of Staff's negative response?

Q. I think I've confused myself. Let's just disregard that issue. Let me ask you a different question.

Then again at page 2 of your testimony, line 7 through 8, let me be more specific. Pardon me. You make a reference to the Commission's apparent endorsement of the Staff's objectives and the message that is being sent. Is that your statement?

A. That's a -- that's a title, the Commission's apparent endorsement of Staff's objectives and message that is sent.

Q. And that's your choice of words in that testimony, is it not?

A. Yes.

Q. By this choice of words, are you suggesting that the Commission has already adopted or accepted the validity of the Staff's overearnings complaint?

A. Oh, no.

Q. Are you saying the Commission's already prejudged this case in some way?

A. Absolutely not.

Q. Looking again at page 10 of your testimony, you talk about inadequate depreciation rates on that page,

do you not?
A. You're referring to the St. Joe plant?
Q. Yes, sir. You say at lines 19 through 22 that the Commission, however, in the 1997 rate case chose to reject Staff's proposal for special amortization of that unrecovered investment and continued on with the obviously inadequate depreciation rates. Is that your statement?
A. That is correct.
Q. Are you saying the Commission ignored these inadequate depreciation rates? Is that your inference?
A. It's my testimony that the Commission adopted the Public Counsel's position in that case and not ours, but clearly at the end of the day the rates were inadequate. We know that.
Q. Now, looking at page 4 of your testimony, Mr. Thornburg, where you discuss in the con-- you discuss working relationships with other commission and staffs, and that you indicate that Missouri-American has honored and fully complied with each state's ex parte requirements. Did you make that statement?
A. In this statement I'm referring to my experience in Pennsylvania and in Indiana.
Q. Now, compliance with ex parte rules in each state is required, it's not optional, is it?
A. That's correct.

Q. Now, you say in part at lines 4 through 7 on page 4 that economic development was a public policy goal for both states that you worked with; is that right?

A. That is right.

Q. And by both states you're talking about Indiana and PA?

A. Uh-huh. That's correct.

Q. You indicated that, pursuant to that goal, the company acquired some troubled utilities to help achieve the goal of economic development; is that right?

If I'm talking too fast, forgive me. Just tell me and I'll slow down.

A. Yes, that's correct.

Q. Now, Mr. Thornburg, acquisition of troubled utilities sometimes represents an opportunity for a purchaser to buy at a more attractive price, does it not?

A. It can, hypothetically.

Q. And acquisition of other utilities creates synergies and efficiencies to reduce cost, correct?

A. Frankly, usually when you acquire a troubled utility there's not many synergies to be found, but there's a lot of investment to be made. That's why they're troubled.

Q. But you use that word synergies and efficiencies regarding acquisition in your testimony, do you not?

A. I don't recall that I used it in the context of troubled utilities.

Q. All right. You would agree that acquisition creates economies of scale?

A. That's a reasonable supposition.

Q. So, in fact, while acquisition of these troubled companies may foster economic development, the acquisition still has benefit to the companies and its shareholders in the long run, does it not?

A. That assumes a lot. I think it can with proper regulatory treatment and good execution.

Q. And I assume since you are the president of the company, you're obligated to act in the best interests of the company; is that right?

A. That is one of my obligations.

Q. Well spoken. So when you buy a utility, I assume you've made a decision that purchasing that utility is in the best interests of the company; isn't that right?

A. Frankly, I've brought some utilities where it probably wasn't in my best interests.

Q. But the assumption has to be that it's in the best interests of the company, does it not?

A. Not necessarily. I'll give you an example. I've been asked by regulators to buy small troubled utilities in other states to help solve a problem for the state, for the people there, and required me to invest some money into it and spend a lot of time and energy on it, and the greater good was accomplished, but from the company's financial standpoint probably wasn't the best thing for us to do.

Q. I have no reason to doubt that statement, but due to your -- due to the company, when you assess buying another company, one of the criteria has to be does that purchase benefit the company, does it not?

A. One of the criteria I'd consider, yes. There could be also, you know, strategic benefits to it.

Q. All right. You indicate at page 6 of your testimony, lines 30 through 31 -- are you there, sir?

A. I am there, yes.

Q. Thank you. You indicate there that Staff's recommended return on equity is conspicuously inadequate by any reasonable standard; is that right?

A. That is correct.

Q. You say at page 7, lines 1 and 2, that Staff's midpoint recommended return on equity is 6.96 percent; is that right?

A. After taking into account consolidated capital structure adjustment, correct.

Q. Now, which capital structure did you use, MAWC or American Water?

A. Well, MAWC's is the only one really relevant in this case.

Q. But you didn't use Mr. Murray's consolidated capital structure in making that calculation, did you?

A. Mr. Murray's capital structure?

Q. Which was American Water.

A. Like I said, this is a Missouri-American case, so no, I would not have done that.

Q. Mr. Murray, in fact, used American Water's capital structure on a consolidated basis, did he not?

A. He may well have. I don't recall.

Q. Did you read his testimony?

A. Yes.

Q. You don't recall what his capital structure choice was?

A. I'm not the cost of capital witness here in terms of the detail and technical nature of it. I invite you to talk to some of the other witnesses.

Q. Thank you, sir.

Now, Staff's position on depreciation you've also characterized as extreme, have you not, on page -- at page 7 of your testimony? I'm sorry.

A. That's all right. Line 6 and 7. Yes, that is correct.

Q. Now, in this case, I assume you've studied Staff's depreciation statement, Mr. -- depreciation evidence?
A. Yes, to some extent.
Q. And is it fair to say that Staff has proposed a change in the way depreciation rates are set by eliminating an allowance for cost of removal which lengthens certain service lives and eliminates an existing reserve amortization? That's a long question, but would you say that's fair?
A. I think that's the majority of their adjustments, yes.
Q. By characterizing this position as extreme, you mean far from what is usual or normal; is that how you characterize that?
A. I think it's extreme in it's -- in the case of the water industry, I don't believe that this Staff's approach to this is the proper approach for a rising cost, capital intensive business such as the water industry. Why would you want to go in that direction?
So I believe it is extreme when you talk about reducing $12 million of depreciation expense on a base of $26 million. That strikes me as extreme.
Q. All right. As president of a regulated utility, you keep abreast of Commission decisions on

depreciation issues, do you not?

A. If it's brought to my attention from staff. I wouldn't say I seek out information on depreciation decisions across the country.

Q. I can understand that. But it's true, isn't it, that you have a legal staff that reports these developments to you, do they not?

A. We keep track of commission decisions around the country, yes.

Q. Well, because you've indicated you understand the Staff's Commission -- the Staff's position in this case and you do on occasion follow commission approaches to depreciation issues, isn't it true that this Commission has accepted the current Staff's position in this case on depreciation in other cases?

A. Involving water?

Q. Just the position. I didn't mention water.

A. I don't believe they've accepted it on any other water utility.

Q. Have they accepted it on other utilities, to your knowledge?

A. Searching my memory, I -- what I recall specifically is that under settlement with stipulated agreements, it has been. I don't recall a specific Commission order to that effect.

Q. Well, if the Commission agreed to that particular depreciation approach in the stipulation, is it fair to call that approach now extreme?

A. It is for a water utility, I believe. We're different. I have three to four dollars of capital investment per dollar of revenue. Electric and gas might have a dollar. We're different.

Q. If we can change focus here just for a minute, Mr. Thornburg, can we go to the call center issue?

A. We can.

Q. All right. May I direct your attention to page 7, lines 27 through 28 of that testimony?

A. I'm there.

Q. All right. You characterize the Staff's position on the call center cost as egregious; is that right?

A. I am.

Q. How would you define egregious?

A. Egregious is very extreme. It strikes of unfairness.

Q. Now, you indicate in that company at page 7 that Staff was involved in the transition of the call center; is that right?

A. If I may be clear, I'm not suggesting there was any preapproval or anything of that sort, so -- but they were clearly involved in the process.

Q. All right. As a matter of fact, in terms of all center costs, the Staff has no authority to preapprove any of those, do they?

A. No, they don't have that authority.

Q. That comes from the Commissioners, is that right, that authority to approve those costs?

A. I believe that is right.

Q. That would be a Commissioner item?

A. Yes.

Q. All right. The company seeks to recover these call center and its related transition costs, do they not?

A. That is correct.

Q. Those costs would go into rate base or go into the rate structure; is that right?

A. They would.

Q. And ultimately the ratepayers would be responsible for those costs, would they not?

A. If so approved by the Commission.

Q. Now, have you read Mr. Cassidy's testimony on the call center issue?

A. I have, yes.

Q. He seeks to disallow a certain amount of those costs, does he not?

A. It's his recommendation.

Q. Thank you. You're correct. But his position is some of those costs should be disallowed; that fair? That's his position?
A. I think it's his position on all of them.
Q. Now, in looking over Mr. Cassidy's testimony, one of his positions is that the company didn't establish a need for this call center service before it went ahead with it; is that a fair amount?
A. Do you have a copy of his testimony? I'd like to read that again, make sure I'm with you on it.
Q. Let me state the question another way. Do you believe Mr. Cassidy said there was no cost justification study done for the transition costs before they were incurred?
A. A cost justification study just on the transition costs?
Q. Right. Or the call center, either one.
A. I'm having a hard time recalling his testimony --
Q. All right.
A. -- in that regard.
Q. Do you think a customer should bear the cost of a consolidated call center without being asked whether they're willing to help pay for it?
A. The costs in this case in regards to the call

center, not just costs related to its consolidation. When we -- we were faced with an issue of having three different call centers in Missouri, the remnants of three different companies. And so we took action to bring those three centers, upgrade the information systems used, the customer information system used, and brought those together and provided now 24/7 service.

We do make decisions, I think all of us do, that have an impact on our customers. We made this decision knowing that there would be in the call centers case an incremental increase in costs, but at the same time knowing full well we were getting an entirely new platform IT-wise and customer-information-wise plus now providing a 24/7 service. There was a moment in time that we could do that.

Now, if you're suggesting that I should have gone out and asked 400,000 customers their opinion on it, I suggest that's not something that any of us really could reasonably expect to do. At the same time, we felt that this was the time to improve service and improve the technologies that we have at our disposal.

Q. Well, you bill your customers on a regular basis, do you not?

A. Yes, we do bill our customers on a regular basis.

Q. It's conceivable you could have put some inquiries regarding costs of the new call center on that bill, is it not?

A. You're saying a survey on my bills?

Q. Yes.

A. I don't think there's sufficient space on a bill to provide the customer with enough information to expect them to make an informed decision on such a matter.

Q. You could have put an insert with the bill regarding the call center and inquired about customer desires for such a center, could you not?

A. I guess just as I could whether they want softened water or not. We could ask our customers a lot of things.

Q. You made some testimony at page -- you've talked about the St. Joe area and attracting a new employer at about page 13 of your testimony, have you not, Mr. Thornburg?

A. Yes, I did, line 14.

Q. Thank you. You indicate you believe available water capacity was essential in attracting this particular employer; is that right?

A. Premium Pork Processing, Mr. Snodgrass, indicated that they needed about 2.7 million gallons a day of water to situate in St. Joe or in the community in Minnesota that we were competing with. So water supply was important.

Q. Taking that as a given, while water may be important in attracting employers, you would agree that the cost of that water is important, too, in relocation decisions, is it not?

A. The cost of water was in this case very important.

Q. Hypothetically, you would agree if water capacity in a certain area is sufficient but if the cost was unreasonable in comparison to other areas, that would be a factor in relating a new plant in a particular area, would it not?

A. The price of the raw materials certainly would be a factor, and in this case, as you well know, we did, in fact, work together to resolve that.

Q. I think I have one last area of inquiry, Mr. Thornburg, and that's on the American Water Resources water line protection program.

A. Very good.

Q. Directing your memory to that issue. Now, you're familiar with American Water Resources, are you not?

A. Yes, I am familiar with American Water Resources.

Q. They are wholly owned by American Water, are they not?

A. I believe that's correct, yes.
Q. And let's say AWR, let's call it, is an unregulated affiliate company, is it not?
A. AWR is an affiliate company but unregulated you mean?
Q. It's not regulated by the Commission?
A. Yes, that's correct.
Q. I'm sorry. American Water Resources offers a water line protection program, does it not?
A. Yes, it does.
Q. And with the exception of its customers in the St. Louis district, Missouri-American Water Company helped AWR introduce that program, did they not?
A. I guess by characterization of help, I did sign a letter that went out to our customers, and the addresses of our customers were provided.
Q. And so in essence you provided AWR with your customer list; is that correct?
A. That would be correct.
Q. Now, this letter that was sent out had Missouri-American's name and address at the top, did it not?
A. You need to excuse me. I think I have a copy of it. Okay. I have a copy of the letter.
Q. Thank you, sir. I'll reask the question. The letters that were sent out had Missouri-American's name and

address at the top, did they not?
A. Yes, it does say Missouri-American Water Company, and it has our St. Louis address.
Q. And the letter had your signature at the bottom, did it not?
A. It sure did, yes.
Q. And that signature block indicated you're the president of Missouri-American Water Company; is that right?
A. Yes, it did.
Q. The water line insurance program was not offered to customers in the St. Louis district; am I correct?
A. Not by us.
Q. And that's because that particular county offers a water line insurance program of its own; isn't that right?
A. Yes. The Missouri Legislature decided that that was the right thing to do for St. Louis County for both water and sewer line protection, and so the County, in cooperation with us, we've assisted in setting up that same fund for the water line protection fund in St. Louis County. The City of St. Louis also has that fund.
Q. Now, the cost of the program in St. Louis County is a dollar a month; is that right?
A. It's a dollar a month. It's a mandatory

charge in St. Louis County, as opposed to ours is a voluntary program here, or AWR's.

Q. Thank you, sir.

Now, Mr. Thornburg, your knowledge of business, would you agree with me that customer lists give an enterprise a ready-made potential customer base, do they not?

A. A ready-made customer list?

Q. Customer list gives a business a potential customer base, does it not?

A. I would guess any list, even if we just sent it to current resident, that's a potential customer.

Q. But a customer list has specific names and addresses of customers, does it not?

A. It does. Look, Mr. Snodgrass, this -- Staff is feeling like this is something sinister. We did this for the good of our customers.

MR. SNODGRASS: Judge, I object. That's not in response to my question.

JUDGE THOMPSON: Mr. Thornburg, please confine yourself to answering the questions asked. Your attorney will be able to elicit any necessary explanation on recross, redirect.

THE WITNESS: Very good. My apologies.

BY MR. SNODGRASS:

Q. Again, revisiting the issue of customer lists, Mr. Thornburg, they have value, do they not?
A. Yes, it has some value.
Q. Your experience in business, customer lists aren't just given away as a matter of course to other companies, are they?
A. I suspect that they're not. I don't have a lot of firsthand experience with it. We've provided our list free of charge to non-governmental organizations for more of a charitable use, that type of thing.
Q. But in this case, isn't it true, Mr. Thornburg, that Missouri-American Water Company received no monies for this customer list it furnished to AWR?
A. No, we did not receive any monies for this.
Q. Now, who made the decision to furnish this list to AWR, do you know?
A. That was my decision.
Q. Now, did Missouri-American provide AWR With its customer list on more than one occasion or only on one occasion, do you recall?
A. I believe just on the initial mailing effort we did provide them with the address list. You know, our customers get a lot of mail these days from all sorts of different water-related businesses.
Q. Do you know who drafted that letter?

A. I don't know exactly who made the initial draft. I -- but it was drafted on my behalf by someone with the AWR group, and then I was given the opportunity to review that and edit that such that I'd be comfortable signing that letter.
Q. In conjunction with this transaction or this letter, did you discuss with anyone what price AWR would charge Missouri-American's customers for this service?
A. I did not at any point in the process think about charging AWR for this list, because I viewed this as a service to my customers.
Q. Did you ever consider whether the company should be compensated for use of its customer lists to AWR?
A. Again, I viewed this as a service to my customers, so I did not think to charge an affiliate for the list. I knew it worked very well in St. Louis County and St. Louis City. We had also done this in Pennsylvania as a part of the regulated utility there, and I'd seen it work as well there.
Q. Sir, do you know how many customers have signed up for the AWR water line protection program?
A. In Missouri or --
Q. Yes, in Missouri.
A. No, I don't.
Q. Okay. Do you know what revenues AWR has

experienced in relation to this MAWC customer list?

A. I don't, but I'm sure we can provide that information for you, if you've not asked for it already.

Q. Is the company concerned with protecting the privacy rights of its customers?

A. Yes, we are.

Q. Were they asked in advance before their names were sent to AWR?

A. Were my customers asked?

Q. Yes.

A. No, they were not.

Q. Now, once Missouri-American distributed this list to AWR, it was in AWR's control, was it not?

A. No.

Q. How so?

A. Well, the mailing was sent from -- from our center that has the full control over the list. So the list was just added to the envelopes and mailed. So there wasn't the ability to use that list again and again without coming back to me.

MR. SNODGRASS: I'd like to approach and have an exhibit marked, Judge.

(EXHIBIT NO. 92 WAS MARKED FOR IDENTIFICATION BY THE REPORTER.)

BY MR. SNODGRASS:

Q. Mr. Thornburg, I've shown you what's been marked by the court reporter as Staff's Exhibit No. 92. Do you recognize that document?

A. Yes, I do.

Q. Would you tell the Commission what it is?

A. This letter is a letter -- in this case it's to Mr. Robert Schallenberg, located in Jefferson City, and Mr. Schallenberg received a letter that I signed introducing him to a service line -- water service line protection program.

You know, just like we have infrastructure problems, so do customers. They have a water line buried in their front yard. Most have no idea it's theirs and that they own it. If it fails, they no longer have access to water service until it's fixed, and it often costs thousands of dollars.

Q. Is this a type -- is this the type of letter that was sent to Missouri-American Water Company's customers?

A. Yes, it is.

MR. SNODGRASS: I have no further questions, Judge. I'd seek to introduce Exhibit 92 in the record at this time.

JUDGE THOMPSON: Do I hear any objections to the receipt of Exhibit No. 92?

MS. O'NEILL: No objection.

JUDGE THOMPSON: Hearing no objections, Exhibit 92 is received and made a part of the record of this proceeding.

(EXHIBIT NO. 92 WAS RECEIVED INTO EVIDENCE.)

JUDGE THOMPSON: Do you tender the witness, Mr. Snodgrass?

MR. SNODGRASS: I'd like to retract. You know, Judge, you can never get an attorney to be quiet. I've got just a few more brief questions, very briefly.

JUDGE THOMPSON: Okay.

BY MR. SNODGRASS:

Q. Mr. Thornburg, you mentioned $146 million of new investment in facilities while being cross-examined by Ms. O'Neill; is that right?

A. That's correct.

Q. Now, that amount, that's a gross investment amount, is it not?

A. Yes, that is a gross amount.

Q. That 146 million does not take into account over $40 million of depreciation collected from ratepayers, does it?

A. On the prior invested capital?

Q. Yes.

A. That's probably correct, subject to check.

Q. That $146 million does not consider other offsets for contribution in aid of construction, advances from promoters and reimbursements from governmental authorities, does it?
A. Caused me to pause on the --
Q. That's a long question.
A. -- contributions part. We don't have a lot of those, but I suspect that's probably a gross figure, the 146.
Q. Thank you.
A. 146 million.
MR. SNODGRASS: Thank you, sir. No questions.
JUDGE THOMPSON: Thank you, Mr. Snodgrass.
I think we've been going long enough to give the reporter a break at this time. We'll take a five-minute recess and return with questions from the Bench for Mr. Thornburg.
(A recess was taken.)
JUDGE THOMPSON: We're ready for questions from the Bench at this time. Commissioner Murray?
COMMISSIONER MURRAY: Thank you.
QUESTIONS BY COMMISSIONER MURRAY:
Q. Good morning, Mr. Thornburg.
A. Good morning, Commissioner Murray.
Q. I wanted to go back a little and ask you some

questions about WR-2000-281 which you were asked some questions on the stand earlier.

In that case, did Staff also propose a drastically different methodology for the treatment of depreciation and particularly the inclusion of the cost -- reversal of the inclusion of the cost of retirement net of salvage and accumulated depreciation, or do you know since you weren't involved in that case?

A. You're referring to WR-2000-281?

Q. Yes.

A. The Missouri-American case. Commissioner Murray, I don't recall any substantive change in depreciation in that case.

Q. And you don't recall what Staff was proposing for the treatment of depreciation in that case?

A. I do not.

Q. All right. Then I won't pursue that with you.

I don't think I have many questions for you. I will ask you, though, since you were asked about your statement regarding a decision being made based on pragmatism, do you think that sometimes Commission decisions are made based on social and perhaps political considerations as well as or in place of economic decisions?

A. I know the Commission has a very great challenge in balancing interests, and I know you go out to communities and get public input and you hear the difficulties that some customers have, and I know that you take that into account and you-all read that testimony. And so I suspect when you make your decisions you're weighing all of that evidence provided to you.

Q. Okay. How many, if you know, total contested issues in this case are there?

A. There's nearly 40 major contested issues.

Q. All right. And of those, do you know how many Staff is proposing a methodology that differs from the methodology applied in Missouri-American's last rate case?

A. You know, I've not totaled them up, but simply in terms of rate base and pensions and depreciation alone, if they adopted the same approach in the last Missouri-American case in this case, we would have a dramatically different set of positions here. Just been consistent with their positions in that case.

Q. When a company files for a rate case in a particular jurisdiction, it along with that filing presents a whole list of numbers to show why the company needs a certain revenue requirement; is that correct?

A. That's correct.

Q. And in doing that, the company applies a methodology to the calculation of all of the issues that are involved in the case, has to apply a certain methodology to

each one of those issues, does it not?
A. That would be correct, yes.
Q. And in determining what methodology to use, does the company look to the past, the accepted methodology within that particular jurisdiction?
A. Yes, we would. We'll often take guidance from past Commission decisions affirming certain practices and guidelines, and then while we will propose different approaches at times, based upon perhaps new information or concern we had, we still try to take some guidance from past Commission orders, if that's the accepted approach and a preferred approach by the Commission.
Q. And in determining the investments that a company is going to make within the jurisdiction and other methods of operation within a particular jurisdiction, the company has to look at the or consider the regulatory treatment that they are likely to receive; is that correct?
A. That's correct.
Q. And is it important to a company to be able to look at some consistency within a jurisdiction to predict what kind of treatment it will receive?
A. Well, we -- we certainly will invest in a state like Missouri expecting consistency and fairness in treatment on that investment. And so we would rely heavily on our experience, knowledge of the state and past orders.

We also understand that there can be change, but certainly we would rely on an expectation of consistency over time.

Q. And if there is change, is it important that there be a rational support for making a change in policy?

A. Oh, absolutely. Then that would allow us to make informed decisions going forward.

Q. And would you assume that if one methodology had been applied up to a certain point in time, and then at the time of a current rate case methodology were changed, would you assume in your next rate case that it would be the methodology that was last used that would be applied?

A. Absolutely.

Q. And would it be fair to assume that changing back and forth between methodologies between rate cases would not allow any consistency, would not allow the company to determine how they might be treated in the next rate case?

A. Absolutely. It's very difficult to constantly be chasing an approach. Mr. Grubb has quite a bit of testimony about just pension treatment and how every case that seems to change, and now in this case again, and the numbers are alarming, impact on the company in the next year or two if we adopt the Staff's approach. And Mr. Grubb can testify on that as well as others.

It's -- if we can if we can get something set and understood, then we can make informed business decisions from there. But if it's just going to change every time, then the company's in a state where it really is unsure how to approach.

And I testified a bit about the Joplin water treatment plant project that's out there. It's a fast-growing area and we're nearly at capacity there. I struggle today with making that decision to invest in that facility, because I really don't know how to size it. And so that's one thing we would like to get understood in this case, is what are the Commission's expectations in terms of sizing facilities like the St. Joseph plant or the Joplin plant.

COMMISSIONER MURRAY: That's all I have, at least for right now. Thank you.

JUDGE THOMPSON: Thank you, Commissioner Murray. Commissioner Forbis?

QUESTIONS BY COMMISSIONER FORBIS:

Q. Mr. Thornburg, good morning.

A. Good morning, Commissioner Forbis.

Q. Just a couple of maybe some general questions. I'm intrigued by your rebuttal testimony. It's something kind of unusual, I think.

When you were in Pennsylvania or Indiana, did you ever have the occasion to write something sort of along these lines?

A. I testified in both Pennsylvania and Indiana as an officer of the company, but I will say I've never testified quite like this. And that, frankly, took a lot of contemplation and a bit of soul searching because I recognize that it can be controversial, but I know as a chief executive in a company, I value candid and direct information and viewpoints so I can make the best decision, and that's what I felt I needed to do as a president of this utility.

Q. American Water Company, they're aware of the testimony, they're aware of the testimony, they saw it? Did you review it with them? Did they have any input in it?

A. Well, I'm smart enough to get some viewpoints on my testimony before I file it. There are people that I trust -- I did not review this with any, quote, superiors in the organization if that's your interest, but I did seek counsel from people that I've been in the business with who have -- who've made a living in the regulatory regime.

Q. Okay. Is this sort of statement unusual for the company as a whole, American Water, or have you seen anything like that other places?

A. I would -- I'm confident that this is unusual.

Q. Okay. And your intent is what?

A. My testimony I think is very candid. It's not designed to threaten the Commission. But I am just very concerned that if my organization commits itself to investing the kind of dollars that we have in the state of Missouri, 146 million less some depreciation, but a clearly large net increase in utility plant and rate base, to have made what we view as dramatic improvements in customer service and many other initiatives that we think are fitting and proper, and then to potentially come out of this with a $20 million reduction in rates, $10 million in writeoffs, this will have a dramatic negative impact on this enterprise, and we serve 20 percent of the state's population.

So I felt like I needed to come forth and provide testimony that expressed my concern for this, and that's why I chose to testify in the rebuttal capacity. I didn't file direct testimony, but I hadn't seen the Staff's case.

Had Staff put a case together similar to the last Missouri-American case where we had a large capital investment and chose to be consistent in terms of pension and depreciation, I wouldn't be here.

Q. So your attempt to express your frustration, your concern, is that safe?

A. It's concern. I clearly feel that we just -- the water business, water industry is different. And I know we're large like other utilities in the state, but the capital needs in relationship to the size of water utilities today is quite different from other utilities.

And I mentioned earlier the capital intensity of the water business. We're the only utility that has a product that is ingested. It's a public trust. There's a treasure involved with drinking water in the U.S. And I just want to make sure that we make good decisions today such that in the years ahead we can continue to maintain that trust.

Q. You mentioned on examination from Staff counsel that the filing of the complaint case has confused a lot of customers. Could you explain that statement a little more?

A. Well, in my mind, the filing of the complaint case and the wording that came out at every public input meeting was that we are overearning. I mean, that was essentially what customers concluded from those statements, plus any media treatment of that case, and yet the complaint case is solely based on the outcome of this case and if the Staff were successful. So the burden of proof, if you will, is really on the Staff and achieving their case, and certainly --

MS. O'NEILL: Your Honor, I'm going to object. I'm sorry to interrupt, but the discussion about burden of proof is beyond the expertise of this witness, and it's an opinion and improper.

JUDGE THOMPSON: Thank you, Ms. O'Neill. The objection is overruled. You may continue your answer.

THE WITNESS: So as we go through this process, customers now are sensing that the company has somehow overcharged them in this past year and perhaps before that. And clearly, you know, the Staff's case rests on achieving a rate reduction through depreciation and other methodologies to drive about that overearnings case.

So I think it's just done nothing but confuse people and, frankly, perhaps put a lot of pressure on the Commissioners.

BY COMMISSIONER FORBIS:

Q. That's sort of the process, though. I mean, Staff files a complaint, we do public hearings. It's not necessarily unique to this particular event, right?

A. I guess in my experience it's certainly unique. I mean, if you achieve the -- if the Staff were to carry the day and we would get a rate reduction, a lower revenue requirement, then I presume we'd come forth and implement those tariffs and move on and deal with that.

And so what happened, the filing of the complaint case, you know, essentially implies that we're overearning today, and we're not achieving our authorized return, and we submit our information monthly and annually like all utilities.

So I think it's done -- it's certainly confused the public. I've got neighbors who come to me and have asked me questions about it. So it's out there.

Q. Has the company gotten phone calls, letters, inquiries that you can sort of base that on or your neighbors mostly?

A. Well, certainly my firsthand experience with neighbors, but folks commented at a lot of the public input hearings about it. So there's evidence in the record that there's confusion about that.

COMMISSIONER FORBIS: I'll stop there. Thank you very much.

JUDGE THOMPSON: Thank you, Commissioner Forbis.

Commissioner Clayton?

QUESTIONS BY COMMISSIONER CLAYTON:

Q. Good morning. Just a couple of topics that were discussed in the cross-examination earlier.

I want to be clear on, in your opinion -- and I know you've only been with Missouri-American or back with Missouri-American for about three or four years. In your opinion, when did the consistently aggressive posture begin that Staff had against the company, in your opinion? Is it just in this case or did it begin prior to this case?

A. I would answer, Commissioner, that I think it's really peaking in this case. We've had concerns throughout -- as long as I've been in Missouri I've had -- I have had concerns, but clearly I think they've reached a crescendo in this case.

Q. Can you tell me when they began, if you know?

A. I guess I -- I could not. I don't have a point in time that I would point to. I'm concerned that I don't feel that Staff understands the specific and unique challenges that we face in the water business comparatively speaking to other utilities.

Q. And as you -- this has been a crescendo of disagreement or is this something that occurred overnight in one particular case?

A. You know, in the last St. Louis County case, which was, of course, a predecessor company, the Staff filed for a rate reduction in that based on depreciation.

Q. What year would that have been?

A. The decision was rendered in May of 2001, and so I believe that was filed in probably June of 2000. And in that case the Staff recommended a similar massive reduction in depreciation. The Commission chose not to adopt that in that case.

And so that was, I guess, in my mind perhaps the first real dramatic suggestion that the Staff wasn't -- wasn't understanding, I think, the unique nature of the water business.

Now, in this case, of course, we're talking about many issues, and in my 21 years I've just never seen that substantial of a difference between the company and the Staff of the Commission.

Q. So it's your testimony that it began prior to the year 2000 at the very least?

A. Certainly in the 2000 case that was filed we saw evidence.

Q. When did Missouri-American come into Missouri?

A. Sir, we've been in Missouri over a hundred years.

Q. Hundred years. And I assume at some point there was not an aggressive posture, but you're not -- you can't testify to a point in time when things changed?

A. I guess I really don't know a specific point in time. I just know that in this case we have filed for a $20 million increase and the Staff started perhaps as high as $24 million decrease. That's a dramatic difference.

Q. In your assessment of this treatment by the Staff, I assume that you have reviewed other rate cases and positions taken by Staff in other rate cases for other utilities?

A. I certainly review other decisions as they come along, but again, I'm focusing on my own instant case and the water business in general.

Q. Do you believe it's just a failure to understand the water business or is it your company in particular that you feel is being treated improperly?

A. I don't think the Staff understands the unique nature of the water business, or at least, you know, it could be a case that some members of Staff do and others don't.

As to whether it's specifically designed to approach Missouri-American with that posture, I don't really know if it's just me or not. I mean, I am clearly the only major water utility in the state. So there's not a lot of material there that I could refer to.

Q. Okay. You stated earlier that there are numerous examples of inconsistency from rate case to rate case in positions that Staff has taken. Is that a correct statement? I want to make sure I get your testimony.

A. Is there a page number specifically?

Q. No.

A. Just in general?

Q. I'm referring just to the dialog that's gone on this morning.

A. Yeah, I think there's clearly some -- some dramatic changes in my mind from one case to the other I cited.

Q. Of the 38 issues, has the company changed any of its methodologies, in any of the contested 38 issues?

A. Have we changed our methodologies from what?

Q. In comparison to past rate cases?

A. I know we've brought different proposals back to the Commission, compared to proposals that were not accepted in the past. So we have attempted to adapt to past Commission decisions, but I couldn't give you, you know, a number of cases where we've changed that methodology.

Q. Okay. Well, I'm just talking general issues, because I don't want to belabor any specific issue because we're going to hear a lot about that later on.

Generally speaking, Missouri-American Water has a board of directors here in the state. Would you characterize it as a -- its members being Missouri residents? Is it a regional board, a national board, an international board?

A. There is -- there are Missouri residents as part of the board. There are primarily people that represent American Water, the stockholders.

Q. How large is the board for Missouri-American?

A. It recently changed, Commissioner. We had as many as eight board members. Because we are not publicly traded in the U.S. now, there's been a change in the composition of our board. So right now we have four board members.

Q. Who are those members?

A. There is myself. There is a gentleman by the name of Jim McGivern. There is a gentleman by the name of Dan Kellaher. There is a woman Ellen Wolf who recently, just recently resigned, and tomorrow at our meeting we will elect a replacement for her.

Q. Will that be a Missouri resident or will that be a -- someone from the parent company that you think will replace her?

A. That will be somebody in the financial area of expertise replacing her. The individual up for election is not currently a Missouri resident.

Q. And is it true, 100 percent of the stock of Missouri-American is owned by American Waterworks; is that correct?

A. That is correct.

Q. Okay.

A. Of its common stock.

Q. Is American Water Resources a subsidiary of Missouri-American?

A. No, it is not.

Q. It is owned by American Waterworks; is that correct?

A. That is correct.

Q. Do any of the board members of Missouri-American also serve on the board of American Water Resources, AWR?

A. I don't recall. I don't know who the board members are for AWR.

Q. You don't sit on the board of AWR?

A. No, sir.

Q. Are you aware of whether Missouri-American has shared its customer list with any other companies, whether affiliated or not with American Waterworks, other than AWR?

A. I don't believe that we've shared our customer list with any other companies.

Q. Have you sold it to any other companies or entities?

A. No. What we -- the only thing really remotely close is we've offered to put stuffers in our bills from others, and primarily charities, or there was a case of searching for missing children and we allowed them to put stuffers in our bills. That's been some time ago.

Q. But that's included with your mailing?

A. That's correct.

Q. You're not distributing a list to anyone else?

A. That's correct.

Q. Regarding acquisitions that Missouri-American has made in the past, in the recent past, or acquisitions that are in negotiations right now, are those part of the strategic planning for Missouri-American? Do they have a place strategically in the overall business plan of the company?

A. Acquisitions are a part of our growth strategy for Missouri-American. We seek to grow through the addition of customers in the state of Missouri.

Q. And the way rates are designed right now, you see those acquisitions in a positive business light, that they are attractive to the company?

A. Under the right circumstances, an acquisition can be positive for the company.

Q. Is it your testimony that in the future that may be called into question in light of the disagreements between Staff and the company on a number of different issues in this rate case?

A. Well, yes. I believe that if we were to come out of this case with a dramatic rate reduction, deployment of capital in Missouri becomes more difficult for us to attract, and so that could, in fact, be an impediment to us purchasing other utilities in the state of Missouri.

Q. Do you sit on the board of American Waterworks?

A. No, sir, I do not.

Q. No such luck.

COMMISSIONER CLAYTON: I don't have any further questions. Thank you.

JUDGE THOMPSON: Thank you, Commissioner Clayton.

Commissioner Murray?

FURTHER QUESTIONS BY COMMISSIONER MURRAY:

Q. Mr. Thornburg, I just wanted to ask you briefly about something that came up at a local public hearing. I believe you were at the hearing, if I recall properly. It was in St. Charles.

And there was a gentleman who testified that he had some billing problems. He referenced the charge for fire hydrant service that's adjusted annually, and he said that the adjustment was made at a time which allowed a charge to be in effect one month longer than it should have been. The new charge was reduced. So there was an absence of one month's reduction that should have occurred for the customers.

And he stated that he had contacted the company and his bill was adjusted, but he had a concern that other customers' bills may not have been. Do you know if that was followed up on after the local public hearing?

A. I do recall that customer, Commissioner

Murray. I think it was in the St. Louis --

Q. Was it?

A. -- County public hearing, just to make sure we're on the same customer. And I'm confident that we have checked into that, but I don't recall, I haven't been told yet whether there was additional corrections to be made there.

Q. Assuming that he was correct and that the bills of the other customers reflected an additional month of higher charge, would the company go back and make that adjustment for everyone?

A. Absolutely.

Q. And then he also mentioned that there was sales tax on his bill. Do you recall that?

A. I do recall that. This customer was from Florissant, and that was one of the companies that we -- or one of the municipal utilities that we had acquired, and there were some data integrity problems when we transferred over the data from the city of Florissant to ours.

As a result, there were apparently some residential customers that came through the translation process as being commercial, and so -- so they apparently were caught fairly quickly and corrected and customers received a credit. Does that answer the question?

Q. It does, except that I would ask you the same question about that, if the company has investigated that and found that there were other residential customers who were improperly given a charge for sales tax, would the company be in the process of correcting that?

A. Absolutely. Absolutely. If, in fact, there were additional, we would make a credit adjustment or refund to those customers if they were improperly charged.

Q. All right. And since it has been brought to our attention, could you get us documentation as to what the result of the investigation on those two items --

A. Absolutely.

Q. -- is?

A. Absolutely.

COMMISSIONER MURRAY: Thank you.

JUDGE THOMPSON: Thank you, Commissioner Murray. Commissioner Forbis, further questions? Commissioner Clayton?

QUESTIONS BY JUDGE THOMPSON:

Q. Good morning, Mr. Thornburg.

A. Good morning.

Q. I have a question for you with respect to the sizing of plant. In the 281 case, there was a new plant in St. Joseph, Missouri which cost, if I recall, $70,097,840 to build. Does that sound correct to you?

A. That's correct.

Q. And I believe that the Commission in that decision, based on the testimony of Mr. Merciel, concluded that approximately $2,271,756 represented overbuilding or capacity that was not used and useful. Do you recall that?

A. I do.

Q. And that works out to about 3.2 percent of the cost of constructing that plant, as I calculate it. Does that sound reasonable?

A. That sounds reasonable.

Q. Okay. Now, first of all, I notice that there is a capacity issue in the present case, and when I look at the reconciliation I see that it's worth $272,190, or at least the difference between company position and Staff position is worth that. Does that sound accurate?

A. It does.

Q. Okay. Now, is it the company's position that some portion of the capacity that was not used and useful in the year 2000 has now become used and useful?

A. It's the company's testimony that -- well, what we're trying to divine here is whether or not we build for a peak capacity required in the year a project goes into service or should we do some planning so that we don't have to expand again in the near term. And in that last case, it appears to us that the signal sent is design for current year peak.

And we also had concerns that it didn't appropriately factor in-house water use in its sizing, and so we want to get clarity to that. We think the whole plant is used and useful, and it's been -- allowed us as well to attract a significant new customer to the community.

Q. Okay. So when I hear you say that it's the company's position that the entire St. Joseph plant is used and useful, that's actually a fact disagreement?

A. That is a disagreement, yes.

Q. But it's factual in nature rather than legal? In other words, if, for example, the company's position was that you only build new plant so often and it's the practice in the industry to build it with X percentage of capacity beyond what you're using as of the moment it goes into service because, after all, you're not going to build another one very soon, and then that would be a legal disagreement, would it not, as to whether or not the Commission, in fact, can put extra capacity into rate base?

But you're telling me the company's position is that the entire plant is used and useful today, a factual disagreement?

A. That sounds like the case, yes.

Q. Okay. And can you tell me, is there, in fact, a practice in the industry with sizing plants in terms of excess capacity or should I say capacity for future growth?

A. There is a -- there are standards, and they can vary slightly, but for the most part, for example, like ten-state standards, a compact between the regulatory agencies that regulate water facilities, typically would look to a ten-year planning horizon, such that the day it goes into service plus ten years you're going to be adequately sized. And there are definitions on rated capacity and firm capacity. So there are some other issues to take into account.

In our case, we used essentially, I believe it was a nine-year planning horizon. And so we feel that we followed regulatory guidelines on sort of one side of the house but come before the Commission and had a different -- different ruling on that. So it causes us to be unsure of what is the approach we should take going forward.

Q. When you talk about a nine-year planning horizon, am I correct in understanding that to mean you build a plant that would not need to be expanded for nine years?

A. That's correct.

Q. Okay. And based on your experience in other states, do you believe that a plant that would not need to be expanded for nine years, a plant such as you built in St. Joseph, is it your opinion that that plant would have all been recognized as used and useful in the other states where you work?

A. That's been my experience.

Q. Thank you.

With respect to regulatory climate, how would you rate the regulatory climate in Missouri?

A. How would I rate it?

Q. Yes, sir.

A. I think the decisions of the Commission in the past I found to be fair.

Q. Okay. With respect to acquisition of troubled water companies, are there any such acquisitions that are before the Commission in this case?

A. If I may, let me make sure we understand the terminology I used. Fair doesn't mean like fair, poor and good or anything. I mean, I believe that you have been fair in the past.

(Laughter.)

Q. You meant just?

A. I beg your pardon?

Q. You meant just, the Commission has been just?

A. I believe the Commissioners have rendered fair and just decisions in the past. This is televised, too, right?

Q. The members of your board are watching this.

A. I know how this must seem. Again, like I said before to Commissioner Forbis, I know in my position that I value direct and candid communication, and you may choose to disagree with what I'm communicating to you, but I just felt that I needed to indicate how strongly I was concerned about the position of Staff in this case, and to have such a dramatic rollback in rates with the considerable, I think, good work that we have done is cause for concern.

Q. I understand that, sir. I'm just trying to make sure I understand your testimony, and from my perspective I'm interested in knowing what a company that operates nationally, how they perceive their experience in Missouri compared to how they perceive their experience elsewhere.

A. And my testimony, having worked personally in Pennsylvania and Indiana, I felt that in those states, working with the Staff, that there was a greater understanding of the unique challenges in the water business.

And while, again, it's my testimony we didn't always agree on the outcome or the Staff's position, I was able to step back and say, okay, it's -- it's a matter of perspective and that the company would be able to adapt to those conditions.

It's my testimony here that if Staff's case in its entirety is approved and endorsed by the Commissioners, that that's going to have a dramatic impact on our organization. To invest $146 million new capital flowing in and then have your rates reduced 10 or 15 percent and have that flow through to income, that's a dramatic impact on your business, unprecedented.

Q. Okay. Back to the troubled water companies. Are there any such acquisitions before the Commission in this case?

A. Yes. There's the Warren County project, of course. I think that's the only one before the Commission.

Q. That's not in this case, though, is it? That's not part of this case, that's a separate case, is it not?

A. That would be correct.

Q. So with respect to the acquisition of St. Louis County Water Company, Jefferson City, the former United Water Missouri, I believe it was called, were those acquisitions of troubled companies?

A. I wouldn't characterize Jefferson City Waterworks as troubled, nor St. Louis County. Clearly there were infrastructure issues in St. Louis County, as all utilities there are.

I guess the closest I could come to perhaps is Webster Groves requires a lot of attention, but I guess I wouldn't characterize it as troubled.

Q. Okay. Thank you very much. Oh, one last question. Are there -- to your knowledge, are there any uncontested issues in this case?

A. I do believe there's a few items that have been resolved, at least with some of the parties, but very few.

JUDGE THOMPSON: Thank you. I have no further questions. Other questions from the Bench?

Hearing none, recross based on questions from the Bench. Let's see. Is Mrs. Vuylsteke here yet? I don't see her. Ms. Langeneckert?

MS. LANGENECKERT: None, your Honor.

JUDGE THOMPSON: Mr. Finnegan?

RECROSS-EXAMINATION BY MR. FINNEGAN:

Q. Just a short question to follow up from a question from Commissioner Clayton. You indicated that American -- Missouri-American Water Company is owned by American Waterworks Company; is that correct?

A. That's our equity holder, yes.

Q. And who owns American Waterworks Company?

A. The stock of American Waterworks is now owned by RWE Thames Water.

Q. That is a British corporation?

A. Thames Water is based in London, and RWE is based in Essen, Germany.

Q. So it's a combination ownership, then?
A. No. It's through RWE Thames, but it's essentially held by Thames Water.
MR. FINNEGAN: Thank you.
JUDGE THOMPSON: Is that all your questions?
MR. FINNEGAN: That's all my questions.
JUDGE THOMPSON: Mr. Zobrist?
MR. LUMLEY: No questions.
JUDGE THOMPSON: Mr. Stewart?
MR. KEEVIL: No questions.
JUDGE THOMPSON: Mr. Deutsch? Mr. Ellinger?
MR. ELLINGER: Just a very brief couple of questions.
RECROSS-EXAMINATION BY MR. ELLINGER:
Q. Mr. Thornburg, related to some comments you made regarding the City of Joplin, what kind of time frame are you-all looking at for a new plant in Joplin?
A. We have not decided on a specific construction timeline. We are, however, feeling that there are urgent needs for the City of Joplin. We are coming very close to the rated capacity of the plant in Joplin, and as well that facility is nearing, I want to say, 85 to 100 years of age.
So it will be a project that will need initiated I would say within the three to five-year planning horizon and probably closer to the three year.

Q. And would you use the same type of sizing strategy you discussed earlier, looking at something like a nine or ten-year horizon for building that plant?
A. Well, that's just it, isn't it? I mean, that's what we would find to be a guideline issued by environmental regulatory groups and agencies, that would be the criteria they would typically look at. However, I think clearly the company would have to evaluate that very carefully.
Q. And is it possible that that plant could be rebuilt, refurbished, or would it really require a new plant?
A. That review is ongoing.
MR. ELLINGER: No further questions. Thank you.
JUDGE THOMPSON: Thank you, Mr. Ellinger. Mr. Fischer?
MR. FISCHER: Yes.
RECROSS-EXAMINATION BY MR. FISCHER:
Q. Good morning, Mr. Thornburg. I'm Jim Fischer, and I represent some water districts around the St. Joseph area.
In your conversations with the Commissioners, you did indicate that you felt past decisions were fair and just, and you're concerned about the current case and the

Staff's recommendation; is that correct?
A. Yes, that is correct.
Q. Is it true, though, if I understood your testimony earlier, that the company does have significant concerns about some of the rate structure issues in this case that came out of that last case?
A. Yes, we would. There are, and many of you -- I guess it was Chairman Gaw who was in St. Joe -- some considerable challenges faced by large water users in St. Joe as a result of the approach taken on rate design in St. Joe.
Q. Would that include your sales for resale customers in that area?
A. Yes. They received a very dramatic increase in the last case.
Q. Does it make sense from your perspective that sales for resale customers would pay two or three times a residential customer for the price of water?
A. In unit price?
Q. Yes.
A. It's been my experience that large users and the cost pressure that they put on a utility, that they would -- they would receive a lower cost per unit.
MR. FISCHER: Thank you. That's all I have.
JUDGE THOMPSON: Thank you, Mr. Fischer.

Mr. Curtis?

MR. CURTIS: No questions. Thank you.

JUDGE THOMPSON: Mr. Comley?

MR. COMLEY: No questions. Thank you.

JUDGE THOMPSON: Ms. Bond?

MS. BOND: Yes, sir. And I don't have a microphone. I'm hoping that I can be heard. Mr. Thornburg, Jan Bond here.

JUDGE THOMPSON: Would you like to come up to the podium? Because there are actually viewers who will be unable to hear anything you say.

RECROSS-EXAMINATION BY MS. BOND:

Q. You know that I represent Utility Workers Local 335, and I just wanted to follow up on a question of Commissioner Clayton's.

On your board members, sir, just for the record, can you tell us who Jim McGivern is, please?

A. Jim McGivern is the chief operating officer for American Water.

Q. Okay. And Dan Kellaher, please?

A. Dan Kellaher is now the vice president of external affairs.

Q. For what company?

A. For American Water.

Q. Okay. And I'm sorry. I put an N on that, didn't I? And Ellen Wolf, who has resigned, what position did she hold?

A. She was the chief financial officer of American Water.

MS. BOND: Okay. Fine. Thank you very much.

JUDGE THOMPSON: Thank you. Ms. O'Neill?

MS. O'NEILL: Yes, just briefly.

RECROSS-EXAMINATION BY MS. O'NEILL:

Q. To follow up on Ms. Bond, those -- the three people other than yourself who were on the board until Ms. Wolf resigned, they did not reside in Missouri, right?

A. They did not reside in Missouri.

Q. Okay. And then just another follow-up on some questions from Judge Thompson, regarding the plant in St. Joseph and capacity issues, your company has lost at least one major industrial customer in the St. Joseph area since the decision in the 2000-281 case; is that correct?

A. I know -- I know that Frisky's has made a decision to relocate a facility, but, Ruth, I frankly can't recall if they've done that yet.

Q. Okay. And you've had discussion with the Commissioners about Premium Pork, but Premium Pork is not currently using water in the St. Joe area; is that correct?

A. That's correct, although they made the decision to come to St. Joe.

Q. They haven't begun their production capacity at all?

A. No. Construction is now beginning.

Q. And it will be at least a year or more before they begin to produce anything out of that plant once it's built, is that correct, from the timetable I understand?

A. I don't know the exact timetable for construction, but I think that's a reasonable estimate, about a year or so.

Q. So as far as what current usage is in St. Joseph, Premium Pork would represent a future possible use as opposed to actual current use; is that right?

A. Well, they've contracted now to buy all of their water from us when they're online.

Q. In the future?

A. Yes, when construction's complete and production has begun.

MS. O'NEILL: No further questions.

JUDGE THOMPSON: Thank you. Mr. Snodgrass?

MR. SNODGRASS: Just briefly, your Honor.

RECROSS-EXAMINATION BY MR. SNODGRASS:

Q. Mr. Thornburg, directing your memory back to some questions from Commissioner Clayton, did I understand your testimony in connection with those questions to be that you would not have filed this testimony if the Staff was consistent in its approach to the issues in rate cases? Is that a fair statement?

A. I believe it was my testimony that had the Staff filed in this case their approach that they took with the St. Joe treatment plant pension expenses in that case, and depreciation, I would not have needed to.

Q. Well, isn't it a fact, Mr. Thornburg, that the Staff's depreciation approach in this case is consistent with the approach that Staff took in the last St. Louis County rate case?

A. It's consistent with what you proposed in the last case.

Q. Now, in response to some questions from Judge Thompson regarding capacity issues, sir, is it your position on capacity that ratepayers should pay for capacity before it's actually needed or used?

A. I think it's -- I think our customers should expect us to make good planning decisions and build a plant in a fashion that one year later we're not expanding it and then the next year and the next year. I think it's fully reasonable when you're looking at a 100-year-lived asset and a 9-year planning horizon is quite reasonable, and I think customers should, in fact, have that included in their cost of service.

Q. But it's true, is it not, that if a facility needs new capacity, that capacity can be constructed to meet customer needs, is it not?

A. In the St. Joe case, the capacity adjustments are taking a storage vessel from a million gallons to 750. You can't expand from 750 to a million once you put that vessel in the ground. You have to build a whole new vessel. And so there's some additional costs incurred in having to do that.

Q. I understand that, but if a -- let's say a plant is built to capacity to meet a need in 2003 and in 2004 additional need occurs, that plant can be updated to meet that need?

A. You can expand the plant after the need is incurred, but you wouldn't have been able to meet the needs. And I didn't want to put a plant in service and then ask people to conserve water. That doesn't make a lot of sense.

If you can't meet capacity requirements in a given year, you ask your customers to cut back, then you go design the project, construct it so that the next year you're now able to meet last year's capacity, and I don't think that's good planning.

MR. SNODGRASS: I don't have any other questions, Judge. Thanks.

JUDGE THOMPSON: Thank you, Mr. Snodgrass. You may step down, Mr. Thornburg.

MR. ENGLAND: Your Honor, may I?

JUDGE THOMPSON: I'm sorry. I forgot you.

MR. ENGLAND: Notwithstanding the fact that I think my witness did a wonderful job.

JUDGE THOMPSON: I don't know how I could have neglected you. I apologize.

MR. ENGLAND: That's okay. I'm used to it, your Honor.

REDIRECT EXAMINATION BY MR. ENGLAND:

Q. Mr. Thornburg, going back to, I believe, your first opportunity of cross-examination from Ms. O'Neill with Public Counsel, you had a discussion regarding regulatory lag, and I think you made a comment to the effect that if a company was experiencing or was -- excuse me -- involved in a declining cost industry and not investing in plant, that regulatory lag may work to its benefit. Do you recall that line of questions?

A. Yes, I do.

Q. Is Missouri-American Water Company involved in a declining cost industry and is it not investing in plant?

A. Clearly, we are not in a declining cost industry, and that's well known in -- in really all the sectors surrounding the water business, that it is a rising cost industry and that today there's really insufficient investments.

Now, we're making a great deal of investment in our -- in our systems in Missouri, but the general feeling from those in government and outside of government is that, in fact, there needs to be more.

Q. With respect to the investments that your company has made, at least during your tenure as president, have they been more than, equal to or less than your annual depreciation accruals?

A. They have been in many multiples of my depreciation accruals.

Q. In response to some questions from Mr. Snodgrass, attorney for the Staff, I believe you were questioned as to Staff's -- at least your characterization of Staff's aggressive posture in this case. Do you recall that line of questions?

A. Yes, I do.

Q. And I believe you started with what I call the old Missouri-American rate case or the one involving all of the districts other than St. Louis County. Do you recall that?

A. Yes, I do.

Q. Since that case, did you notice a more aggressive posture in the St. Louis County rate case filed shortly after that case?

A. I mentioned to -- in the line of questioning from Commissioner Clayton, in the St. Louis County case, which was decided in May of 2001, that in that case the Staff filed for a rate decrease as well for my company.

Q. And I believe in response to a recent question on recross, I'm not sure who posed it, was Staff's depreciation proposal in St. Louis County consistent with or different from the position it had taken in Missouri-American?

A. It was different from what was taken in the Missouri-American case.

Q. Since the St. Louis County Water rate case, to your knowledge, has Staff supported the company in its application to create or to seek an Accounting Authority Order for purposes of deferring security costs associated with investments and costs it has incurred to increase security at its plant and other facilities?

A. No. We had quite a contentious issue there.

Q. How about the company's effort to implement the first infrastructure system replacement surcharge in accordance with House Bill 208, was the company met with support or opposition from Staff on that?

A. The Staff has taken a very aggressive posture, in my mind, on that, quite a different interpretation than historically has been applied across the country and in -- well, no history in Missouri, but obviously quite a different approach from what we had thought we had worked together on.

Q. How about the company's efforts to acquire Warren County Water and Sewer, was Staff supportive of that, to your knowledge?

A. No. In my mind, we had a project there that was really going to solve the problems for the community, for the state, had approached Staff up front about it, and it was only after we really were prepared to move forward then that the Staff came in and obviously has taken an aggressive position in that case in terms of the original cost of that community system.

And it's made our decision in that case, although the dollars are not great, understanding what the Staff's position is in terms of small troubled water utilities, we really want to get a better idea about what that is so we can make informed decisions going forward.

Q. Now, let me switch gears and direct your attention to the call center. I believe you were questioned about that. Do you recall that?

A. Yes, I do.

Q. One of the questions, I believe, was whether or not you have polled or surveyed your customers regarding whether they -- and I may be paraphrasing this -- wanted the new call center. Do you recall that?

A. Yes, I do.

Q. Does Missouri-American regularly survey its customers?

A. Yes, we were surveying our customers quarterly. We slowed that down in 2003, but we were measuring overall customer satisfaction on a quarterly basis.

Q. What types of questions, if you know, did you ask your customers in those surveys?

A. We asked them whether they were satisfied with the quality of their drinking water, whether or not they believed that their -- they received a fair value in their water supply, whether they understood their bill, and a lot of basic service-oriented questions and an overall satisfaction question.

Q. And what has the response to those surveys been, at least during your tenure at Missouri-American?

A. We've exceeded or come close to world-class levels, that being defined as 85 percent overall customer satisfaction.

Q. And how do you compare with other subsidiaries in the American system?

A. We've been ranked No. 1 or No. 2.

Q. Let me turn your attention now to the American Water Resources line protection plan and questions that you received regarding that.

First, I believe you wanted to explain why you assisted American Water Resources in its mailing to your customers and were not given that opportunity. Would you please explain? Not why you weren't given the opportunity, but why you participated in the program.

A. I started to describe why I made the decision to pen my name to the letter. It's been my experience that when these -- when the customer's infrastructure fails, it does create a hardship for many customers. It costs thousands of dollars to replace that service line, and while they're waiting for it to be replaced or to come up with the financing to replace it, now our water's leaking.

And so in St. Louis County and the City of St. Louis, the Legislature had approved a technique to allow them to participate in an arrangement where they were essentially able to get the cost of that covered through, quote, an insurance fund. It's really not an insurance fund, but it covered that. And so that was clearly working in St. Louis County.

As we watched our customers who would have a leak be able to get that fixed quickly, water wasn't laying in the street, not icing up, and they were able to do so, really at no cost to them at that point in time. And so that was what we viewed as a clear public service, and so we endorsed that program for the rest of our customers. And so we were excited to be in a position to offer that, even though the Legislature hadn't set up a similar endeavor for the rest of the state.

Q. With respect to the customer list that was made available to AWR, is that physically given to AWR or how is that handled, sir?

A. No, it's not physically given to them. We have a billing operation that we control, and through our -- through a company called American Waterworks Service Company that we have a contract with, and so the bills are -- our water bills are sent out by American Waterworks Service Company, and AWR simply would have the service company send out these same or a -- an envelope, if you will, with the invitation to join this water line protection fund.

Q. So that water list -- or excuse me. That customer list was not sold or otherwise given to AWR; is that right?

A. That's correct.

MR. ENGLAND: Thank you, sir. I have no other questions.

JUDGE THOMPSON: Thank you, Mr. England.

Now we're done with you. You may step down.

Okay. We have about 20 minutes before noon. We will begin with opening statements. The parties, by agreement, are limiting themselves to no more than 10 minutes, and I believe the lineup is company, Staff, Public Counsel, MIEC, MEG, St. Joseph Water Rate Coalition, Riverside, Jefferson City and Joplin. And I understand that Ag Processing is reserving until such time as Mr. Conrad is able to be here. Therefore, we'll begin with you, Mr. England.

MR. ENGLAND: Thank you. May it please the Commission, my name is Trip England. I represent the Missouri-American Water Company, the applicant in this rate case. It's a little unusual to begin opening statement after at least one witness has been heard, but in this case maybe it's more helpful and perhaps can put my comments a little more in perspective.

The decision you have in this case is not an easy one, I'll grant you that. The company has filed for a request of approximately $20 million on an annual basis. Staff is proposing an approximate $20 million decrease.

I'd like to first put the company's request in perspective. A $20 million increase represents an approximate 12 percent increase in the company's annual level of revenues.

It has been over 3 1/2 years since this Commission issued its last rate order involving this company, at least all of its properties other than St. Louis

County, and with respect to St. Louis County it's been almost 3 years, at least at the time the decision is expected in this case.

During this 3 to 3 1/2 year period of time, the company has invested nearly $150 million, as you've heard from Mr. Thornburg. Inflation during this period of time was in the 2 to 3 percent range, and that's in schedules attached to Staff Witness Murray's rate of return testimony.

This request, in my opinion, and I think in the opinion of the public, was by all accounts fairly reasonable. And what has been the response? We've been hit with a complaint case alleging overearnings to the tune of $20 million.

Interestingly, and I think significantly, even after the Staff filed its complaint case and issued its press releases and despite the confusion of a few people at the public hearings, the response of the public in this case has been remarkably low key. When you consider the fact that this company serves over 400,000 customers in the state, the public participation in the local hearings, the nine local hearings that we had in this case, was extremely limited with little, if any, real complaints regarding the quality of service that this company provides.

Despite the company's efforts to improve, replace, upgrade its system, provide quality service to its customers, it finds itself fighting for its financial livelihood. I'm reminded of the adage "no good deed goes unpunished."

And what about Staff's recommendation? First, I would submit to you that it isn't supported by common sense. How can a company that has invested nearly $150 million in new plant since its last rate case now require $20 million of less revenue on an annualized basis to finance that construction? Staff has embarked on a systematic, unprecedented, unwarranted adjustment process through the company's test year rate base, revenues and expenses that either manufactures revenues, disallows expenses, in some cases disallows expenses entirely, to manufacture their $20 million rate reduction.

For example, simply with the stroke of a pencil, Staff has proposed reductions in the company's existing annual depreciation accruals of nearly $13 million a year. Staff has proposed a hypothetical capital structure and a return on equity that is less than that recommended by Public Counsel. Staff's effective return on equity when you couple it with their consolidated capital structure is in the 7 percent range.

By doing this Staff has affected a reduction in revenues from the company's case of approximately

$7.5 million.

Staff proposes yet another way to calculate pension expense. You'll hear from witnesses that will describe how Staff has tinkered with the pension expense for the last several rate cases, continually adjusting downward the Financial Accounting Standards Statement 87 pension expenses until this case when they finally throw it out altogether and move to the ERISA contribution method, and by doing so, Staff has, with the stroke of a pen, eliminated $3.2 million from our cost of service.

These three adjustments alone, 13 million, 7.5 million, 3.2 million, are over $23 million of the difference between Staff and company. Stated another way, if Staff had simply adopted the same rates or methodology used by the Commission in the company's last rate case for these three items, there would be no complaint because there would be no overearnings.

But Staff doesn't stop there. Staff proposes to disallow all transition costs that the company has incurred in moving to its centralized call center and its centralized shared service facility. It also proposes to disallow on a going-forward basis significant expenses associated with the call center and the Bellville laboratory testing facility.

With respect to the call center, I think the unreasonableness of Staff's position is underscored by the fact that Staff Witness Bernsen praises the new features of the national call center and, in fact, argues that the company needs to be providing, continue to provide existing mechanized reports that that call center generates, as well as provide new reports in the future.

Staff Witness Cassidy, on the other hand, says, in essence, we shouldn't have built or participated in the new call center and maintained the old antiquated system that was located at St. Louis County Water Company's headquarters in St. Louis.

And so you have a dichotomy where Staff is only going to allow expenses associated with the as-was operation, but yet Staff Witness Bernsen wanting you to order us to provide records from the new call center that Staff doesn't recognize any costs for. I don't think these two positions can be reconciled, and I hope you'll agree with me.

There are another 20 or so other contested issues where Staff has either reduced or disallowed entirely costs -- actual costs incurred by the company in providing service to its company -- or excuse me -- to its customers. Taken in isolation, each one of these items has some facial support based on some regulatory technique that Staff will tell you about, but the case law will tell you that it is not the method that is applied that counts, but rather the end result. In this case, the end result does not pass the straight-face test.

It is the regulatory equivalent of death by 1,000 cuts. Quite frankly, I believe Staff has lost sight of its statutory charge, and that is to balance the interests of the ratepayers and the investors.

I think when you examine what the Staff has done in this case, you can not reasonably conclude that there is any balance in that position. This is no more evident than in the recommended return on rate base -- or recommended return on equity, excuse me, proposed by Staff, which is substantially below that recommended by Public Counsel, whose only constituency is the ratepayers. This issue alone speaks volumes, not only about the Staff's approach but the credibility of its resulting recommendation.

As I said, your decision is not an easy one, because the right decision will require you to tell your Staff that they are wrong and they are wrong in a number of respects. But the right decision is one that results in a financially sound water company, promotes the health and welfare of the public, and also promotes economic development. None of these goals are at odds with or mutually exclusive of the protection of the ratepayers. In fact, they are consistent with protection of the ratepayers.

The right decision in this case is a reasonable increase in the existing rate levels of this company. There is ample evidence in this case to make that right decision, and I believe if you fairly consider it and truly seek to balance the interests of the ratepayers and the investors in this company, you will reach that right decision. Thank you.

JUDGE THOMPSON: Thank you, Mr. England.

Any questions for Mr. England before he leaves?

(No response.)

JUDGE THOMPSON: No. You may step away.

Mr. Snodgrass?

MR. SNODGRASS: Thank you, Judge. May it please the Commission. You know, for some reason when I was thinking about this case, I kept thinking about Charles Dickens' novel, A Tale of Two Cities. The opening line in that particular novel goes something like this: It was the best of times, it was the worst of times. By taking some creative license here, from Staff's point of view, it's the best of times for the company because it's earning too much. From the company's point of view, it's the worst of times because it's not earning enough.

So that's the important and serious task before the Commissioners today, and everyone recognizes that it is a serious task. I agree with Trip in that regard. It's your job and it's your charge to determine from the evidence presented whether it's the best of times for the company or, in fact, it's the worst of times for the company.

Now, in terms of the issues list, you may have seen that there are about 39 contested issues in this case. I will not go over all 39 of those issues hopefully. I will only hit the high spots. I'll just mention a few of the primary drivers in this case from Staff's point of view. Rate design issues are not going to be discussed at this time.

The first big battleground in this case is capital structure, which one to use. A part of that is return on common equity. That's another battle within the capital structure idea. Now, Staff's evidence will show that Staff chose not to use Missouri-American Water's capital structure. Staff chose to use a consolidated capital structure of American Waterworks as the appropriate capital structure for ratemaking purposes.

Now, what I mean when I say it chose to use American Waterworks capital structure, that has nothing to do with the rate base. Missouri-American Water Company's rate base will still be used to determine a fair rate of return. It's only the capital structure, from Staff's point of view, that should be looked at differently. And that goes to American Waterworks Company.

Now, it's undisputed in this case that American Water wholly owns Missouri-American Water Company. The evidence will show that Staff's decision to use American Water's capital structure, rather than the company's capital structure, was based on several significant criteria. Among those was the change in the way American Water subsidiaries received their debt financing, and coupled with follow-up interviews with Missouri-American Water Company and American Water Company personnel concerning that change in subsidiary financing.

Staff's evidence in sum on that issue will show that there is an interdependence between the capital structures of American Water, the parents, and Missouri-American Water Company that precludes the use of Missouri-American's capital structure on a stand-alone basis for ratemaking purposes.

The cost of common equity is another big skirmish in this war. The evidence will show that the Staff used the discounted cash flow method, a tried and true and accepted methods as the primary tool to determine the appropriate cost of equity for comparable company groups.

The evidence will show that Staff performed a check on its DCF model results by using a risk premium and capital asset pricing model. The evidence will show after using a DCF model and checking its reasonableness through these other models, that Staff recommended a return on common equity of 8.26 percent to 9.26 percent, and that this cost of common equity would produce a fair and reasonable rate of return of 6.67 percent to 7.03 percent.

Another battle in this war is pensions. Now, pensions are classified, as you all know, as an expense, and they're included in the company's cost of service. Staff's evidence will show that the Staff's method of looking at pensions uses only the amount actually required to be part -- to be paid into the pension fund. The cash payment is determined based on the requirements of the Employee Retirement Income Security Act of 1974, otherwise known as an ERISA.

Staff's evidence will show that use of Financial Accounting Standard 87, or FAS 87, is an accrual method that does not match actual cash payments. Staff's evidence is that ratepayers have paid more in rates through the use of FAS 87 than has been required to be paid to the pension fund under ERISA.

I'll go on to the national call center and transition call center costs. Staff's position or evidence is that the appropriate amount to include in the cost of service associated with the customer service function provided by the national call center should reflect no more than the amount previously incurred by Missouri-American to operate its own call centers. Staff's evidence will go to the point that the need for such a center -- the need for such a center and its associated costs was not established before the company went down that call center road.

Staff's evidence will show that the call center was a cost savings situation for the parent company, American Water, and that when it was initiated, each operating company was supposed to get a decrease in costs. Staff's evidence shows that Missouri-American is not receiving a fair recognition of the cost savings enjoyed by the parent, American Water. Staff's evidence also basically goes to the point that Missouri-American has received no savings from the transition to the call center, and under those circumstances, transition costs should not be passed on to the ratepayers.

Now, I think the Commission has seen this issue many times before. It's the acquisition premium that the regulated utility pays when it acquires other utilities. In this particular case the company acquired United Water, Florissant, Webster Groves and Valley Park water systems. They're asking the Commission to include those acquisition premiums in the rates in this case.

Staff's position has been consistent on that issue, and that issue goes something like this: Acquisitions by companies are made in their own best interests. They benefit the shareholders. Because they benefit the shareholders, Missouri ratepayers shouldn't have to pay those costs. That's essentially Staff's position.

On the security AAO, Staff's evidence will show that the amount of security AAO deferrals, less legal costs and AFUDC in excess of Staff's rates, should be amortized over ten years, and that the unamortized balance should not be included in rate base. Staff's evidence is that the deferred income taxes reflecting the timing difference associated with the AAO should be included as an offset to rate base.

As to the undepreciated investment and net cost of removal associated with the old St. Joe Civil War plant, we might call it, Staff's evidence will show that the undepreciated investment and the investment in net cost of removal associated with the old St. Joe plant should not be recognized in the company's cost of service. And that was ordered in Commission Case WR-2000-844. The Commission has already passed on that issue.

As far as the excess capacity at the new St. Joseph plant, Staff's evidence will show that there was excess capacity to the tune of about $2,271,756, and that was -- that was taken as a reduction in the cost of that plant.

Essentially Staff's position is that excess capacity adjustment is based upon the idea that the ratepayers should not be paying for assets that are not actually serving them. That's the basis of that position, that they're not fully used and useful and serving the ratepayer.

As to depreciation, that's a very, very large issue in this case, and I'll try to do it justice here with the summaries that have been provided to me.

In terms of what the appropriate depreciation rates to be applied to MAWC's depreciable assets are, Staff's evidence is that it undertook a separate study for the St. Louis County district, which is the largest MAWC customer district, and that Staff recommends depreciation rates for the St. Louis County district contained within that study. In other words, they want to use the study for that district in determining St. Louis County depreciation rates.

In addition, because the data from the eight smaller operating divisions had certain problems connected with that data, Staff has used its general generic small water company depreciation rates for all the other Missouri-American operating subsidiaries.

Regarding the appropriate way to account for cost of removal net of salvage, Staff's evidence will show that the cost of service should reflect the expensing of the ongoing level of cost of removal and salvage based on recent historical actual amounts experienced, based on real-life results.

Staff's evidence will show that the appropriate asset lives to be used in prescribing depreciation should be based on the depreciation study done in the St. Louis County district and in Staff's general experience with other smaller Missouri water systems.

In closing, I guess I'd just like to say that the issues I have mentioned and your determination of them, based on the evidence presented today, is a monumental task facing this Commission. Obviously there is no common ground between these two -- between these two, Staff and the company. The existence of controversy is surely inevitable when a party says, you're earning way too much, and the other party says, we're not earning nearly enough. Hopefully, at least, I've highlighted the areas where the Commission can concentrate its attention in deciding these important issues that are before it today.

Thank you very much.

JUDGE THOMPSON: Thank you, Mr. Snodgrass. Any questions from the Bench for Mr. Snodgrass?

(No response.)

JUDGE THOMPSON: None. Thank you.

We will take a lunch recess at this time and be back at 1:15. Thank you.

(A BREAK WAS TAKEN.)

JUDGE THOMPSON: I'm reminded the parties need to give copies of their exhibits to the reporter. If they're not marked yet, then perhaps we can wait a few moments at the end of the day for that, but make sure that she does get a copy. She only needs one. If you have extra hard copies, those of you who haven't given any to me, I'll be happy to take them.

Okay. Ms. O'Neill?

MS. O'NEILL: Thank you, and good afternoon. Public Counsel's purpose here in this case is to advance the interest of the customers of Missouri-American Water Company. In this case, the interest of those customers will best be served by careful winnowing of the rhetoric from the facts and by framing this case not behind the protective glass of stockholder desires, but the concrete reality of serving Missouri customers.

To decide this case, you don't have to abandon sound regulatory policy, nor should you ignore fiscal realities. You've already received some evidence regarding fiscal realities from the customers who testified at the local public hearings in this case and who brought a crucial issue in this case starkly to the forefront, whether safe and adequate service will be available to them at just and reasonable rates.

If a rural water reseller must set its rates so high that its customers start digging their own wells, are those rates reasonable, and will sprouting a bunch of new wells really help the company provide safe and adequate service to its remaining customers? If residential rates are set so high that its customers, as one woman testified in Joplin, are afraid to run their dishwashers more than once a month, is that a rate that's just and reasonable?

If a community's economically depressed and losing businesses since the last rate increase, is a large rate increase reasonable for those customers? If the cost of living for senior citizens and the disabled is low, 1 percent, maybe 2 percent a year, is a double-digit rate increase reasonable for them?

Now, admittedly these are only pieces of a puzzle that you'll be called on to solve in this case, but Public Counsel believes that these are pieces of a puzzle that, while small, are too important to be lost in the shuffle.

The ultimate issue in this case is what rates really will compensate the water company for its reasonable and prudent costs, provide them an opportunity to earn a reasonable return, without setting rates that are unreasonable to the customers. In answering that question, we hope you will look at all of the evidence from all of the hearings in this case.

I would also ask you to carefully weigh the testimony regarding capital structure and rate of return in this case. Mark Burdette was able to determine Missouri-American's actual capital structure, and we'll ask that you consider and adopt his proposal.

Mr. Burdette's also performed a detailed analysis of the cost of equity in this case, and his recommended range includes results that are shared, at least in part, by nearly all of the other rate of return witnesses in this case, even Ms. Ahern for the company, and her discounted cash flow analysis yielded an average ROE of 10 percent, which is the top number in Mr. Burdette's range.

In this case, Mr. Burdette did not rely only on DCF, which is a tried and true method that this Commission has used and relied on in the past. He also tested his results with other methodology, and he considered the effect of a new law, the statute providing for an infrastructure replacement surcharge applicable to the St. Louis County area, the company's largest service territory, to see if this new law affects

Missouri-American's business risk.

Mr. Burdette, Ms. LaConte, Mr. Murray, Mr. Wurtzler and even Ms. Ahern agree that, at least in the absolute sense, according to Ms. Ahern, the ISRS reduces the company's business risk by reducing regulatory lag. The combination of Mr. Burdette's analysis of the appropriate range of cost of equity and his analysis of business risk reduction associated with the ISRS has resulted in Public Counsel's recommendation that the overall rate of return in this case should be set at 7.68 percent, including a 9.5 percent return on equity.

I ask you to keep this reduced business risk in mind as you receive testimony regarding depreciation issues in this case. In the St. Louis County Water case, the Commission made a conscious decision not to order depreciation changes proposed by the Staff and other parties because the Commission recognized the water company's need to increase its investment in infrastructure. In fact, the Commission expressly announced that now is the time for the company to begin its infrastructure replacement program. That now was in May of 2001.

Commission noted in that case that it was providing the company with its requested favorable depreciation treatment because the company's depreciation proposals generate funds that can be used to begin to address the infrastructure issues. The Commission then decided to order the company to set a certain level of those funds aside in a depreciation fund, expend them only for main replacement.

The Commission required the company to segregate depreciation expense recoveries in a depreciation fund sufficient to fund main replacements, the average level proposed by Company Witness Salzer in that case. County Water, which is now a major part of Missouri-American, got extra cash flow to address its infrastructure problems, but still did not make the level of investment expected.

Now the company has an ISRS to relieve it of the effects of regulatory lag for infrastructure main replacement. It is no longer necessary to provide special depreciation rates to this company as well.

I want to go into one other area briefly, because it illustrates the company's somewhat unrealistic expectations regarding some issues in this case. In the St. Joseph district, Missouri American retired its old river treatment plant when the new plant was placed in service. You already heard about some of that this morning.

In the case involving -- the last rate case involving St. Joe, WR-2000-281, the Commission, after weighing all of the evidence, decided to allow the vast majority of costs of that very expensive new treatment plant into rates.

The Commission also reasonably decided to balance the effect of that decision on customers by disallowing two items from rates on the grounds that those items were not used or useful in providing service; one, the excess capacity of the new plant over and above peak usage, and two, the undepreciated balance of the remaining old treatment plant which was no longer being used to provide service to customers.

The Commission decided it would be unfair to customers to pay for these two elements of plant that were not being used to provide them with water service. Those issues are again before you in this case. We believe that the reasons for excluding these components of the plant were valid then and remain valid today.

However, there's an additional reason to exclude the old treatment plant that didn't exist in the prior case. Missouri-American sold that old treatment plant for $115,000. Not only is it not being used to provide service, it's not even owned by the company.

We believe that the positions taken by Missouri-American in proposing this rate increase fail to reasonably consider the effects of their request on its customers in the state of Missouri. We believe the evidence will show that on issue after issue, this company has requested levels of compensation above that necessary to cover its cost of service.

In fact, a review of all relevant factors in this case, including the evidence in support of the Staff's complaint, Public Counsel believes will show you that on a company-wide basis Missouri-American's current earnings exceed what is necessary for a fair opportunity to earn a reasonable rate of return. Therefore, we ask the Commission to correct this imbalance between cost and revenues and reduce the company's rates accordingly.

Thank you.

JUDGE THOMPSON: Thank you, Ms. O'Neill. Any questions for Ms. O'Neill?

(No response.)

JUDGE THOMPSON: I see none. Thank you.

Is there anyone here for the Missouri Industrial Energy Consumers?

(No response.)

JUDGE THOMPSON: Evidently not. Missouri Energy Group, Ms. Langeneckert?

MS. LANGENECKERT: May it please the Commission? My name is Lisa Langeneckert and I represent the Missouri Energy Group in this matter.

With reference to the company's revenue requirement, there are two issues in which Missouri Energy

Group has filed testimony and positions. The first relates to the cost of capital and return on equity of the company.

It is the position of the Missouri Energy Group that the infrastructure system replacement surcharge, or ISRS, which is now in effect, reduces the detrimental effect of regulatory lag, thereby lowering the necessary return on equity for the company.

The second issue on which the Missouri Energy Group has filed testimony and positions is revenue -- I'm sorry -- is the appropriate treatment of the transaction costs in premium that the company incurred to acquire the United Water, Florissant, Webster Groves and Valley Park water systems. It is the position of the MEG that the return on the acquisition adjustments, if permitted at all, should not be allowed until the company has proven that there is a measurable benefit to its customers for acquiring these properties.

While the MEG has addressed issues relating to rate design in its testimony, I shall wait until the January 5th rate design opening statements to address that issue.

JUDGE THOMPSON: Thank you, Ms. Langeneckert. Questions?

(No response.)

JUDGE THOMPSON: Okay. St. Joseph Water Rate

Coalition, Mr. Zobrist?

MR. ZOBRIST: Thank you. May it please the Commission. My associate Tim Swenson and I represent the St. Joseph Water Rate Coalition. I'd like to spend just a few minutes and tell you who these folks are. We represent 14 industrial and commercial users in the City of St. Joseph and its surrounding areas, and we represent 4 other public authorities. The OPAs include the St. Joseph School District, Buchanan County, the City, and Missouri Western State College.

Among the commercial members of the coalition are the Heartland Health Center, which is the largest employer and the major medical center between Kansas City and Omaha. It's the largest employer in the St. Joseph area, having over 2,800 employees.

We represent Phoenix Scientific, which is an animal health pharmaceutical products manufacturer, and the Hilliard Companies, which are found in both the commercial and industrial classes. They've been doing business in St. Joseph since 1907. They're a manufacturer of janitorial supplies.

We represent a number of industrial consumers, including Nestle, Purina Pet Care, Artesian Cold Ice and Storage, Wire Rope and Prime Tanning. All told, when you total the number of employees that these groups have on their payroll, it's over 5,500. Those folks are also ratepayers, but they look to these employers for their livelihood.

The issues that the St. Joseph Water Rate Coalition has presented testimony in this case really have their history in the 2000 water rate case, and although I don't want to talk about rate design today, it's an important part of the background to this case.

The two major ramifications for the St. Joseph area were the decision by the Commission to place the new -- the majority of the new water plant into rate base. The folks in St. Joseph expected that that would raise their rates, and they accepted that because clearly the old plant was obsolete and was subject to Missouri River flooding. And it was generally -- not unanimously but generally supported by the St. Joseph business community, the majority of which did not oppose its inclusion in rate base.

However, this Commission's shift from single tariff pricing to district-specific pricing was not expected, and that is what really caused the rate shock that we are here and hope that this Commission will address in the current case.

As I believe you know, the Commission, in a 3-to-2 decision departed from its recent history where it did recognize that infrastructure heavy water utility industry should spread its cost among all rate bases, even though not interconnected. This helped to avoid rate shock and it also helped to avoid some of the complex rate design issues we'll be dealing with in January.

The result of the decision in 2000 was rate shock for a number of the rate classes. The commercial increase was for 63 percent. The industrial class increase was 171 percent. The sale for resale customers, which you'll hear about from Mr. Fischer, I'm sure, were 233 percent. With all due respect to Mr. Thornburg, that was not a fair decision. It was an irrational decision, and my clients look to you to rectify that in this case.

We have presented several positions which I'd like to briefly summarize. We believe that Missouri-American should be evaluated under a fair financial structure and given a reasonable rate of return.

Our expert who we presented in this case is Mr. Steven Wurtzler. He's the former chief financial officer of Wire Rope Corporation in St. Joseph. He is now the chief financial officer of Fairbanks Scales in Kansas City. He will testify that it makes most sense for the Commission to adopt Missouri-American's capital structure.

And in that regard we agree with the company and we agree with the Office of the Public Counsel. We believe that a moderate return on equity in the range of

9.25 to 9.75 should be awarded the company. We believe that's not generous, but not punitive. We believe it is fair. And again, we're roughly aligned with the Office of the Public Counsel in that regard.

We do agree with Staff and with Public Counsel that there should be no acquisition adjustment, because frankly, although there may be theories to permit that recovery in some parts of the state, those are not found in the St. Joseph district. We have no specific testimony on the St. Joseph plant, but we have offered the testimony of Mr. Scott VanMeter, the Buchanan County assessor, which advises you as to the assessed -- pardon me -- the appraised values of property in Andrew County and Buchanan County. For the record, that is roughly $31 million.

We will present our rate design testimony, of course, in January.

In conclusion, I would ask that you remember that businesses, medical centers, educational and governmental institutions of St. Joseph and their employees look to the Commission to help rectify and smooth out the errors and the mistakes that occurred in the last case. Frankly, we believe that they were forgotten in the last case and we believe that that has contributed in part to the economic pressures that have been pressed upon that community.

We believe that you should structure the rate base sensibly, that the company's finances should be set so that the institutions and businesses of St. Joseph can be competitive and can serve their customers. In that regard, I would just urge all of you to read the public hearing that occurred on October 15th, 2003. Chair Gaw, I believe, was the only Commissioner there. I think it sets out eloquently the positions of the members of the coalition.

Thank you.

JUDGE THOMPSON: Thank you, Mr. Zobrist. Any questions for Mr. Zobrist?

Commissioner Clayton?

COMMISSIONER CLAYTON: Mr. Zobrist, just one quick question. You may have mentioned this when I was taking notes. Do your clients take a position on depreciation?

MR. ZOBRIST: We do not.

COMMISSIONER CLAYTON: You do not. Thank you.

JUDGE THOMPSON: Very well. Mr. Finnegan?

MR. FINNEGAN: May it please the Commission. I represent the City of Riverside, which is in the Platte County district of Missouri-American Water Company.

Since we had intervened on behalf of Riverside, we've had support from the cities of Parkville, Lake Lacomas, Public Water Supply District No. 6, and several other customers in the Platte County district.

Our concern in this case basically is with rate design, and so I will make my statement then. Basically, there's two points on rate design is that, one, we don't want to subsidize any other districts, and we don't want any other districts subsidizing us. That's why we're happy that we got the district-specific pricing in the last case.

The other issue in the rate design is the issue of the unreasonable and discriminatory rate design which came out of the last case, which was completely unnecessary. Instead of just starting with the one rate for all customers in 4 blocks, we ended up with 20 blocks, 4 blocks for each of the 5 customer classes with no definition of what a customer class is and with no distinction between customer classes.

In that respect, I'll just briefly cite you to the case of State ex rel Laundry Ink vs. Public Service Commission. It's a case older than I am. 34 SW 2nd 37 Missouri 1931, and there is a -- the court goes at length and quotes at length from a former Commissioner Eugene McQuillan, who wrote McQuillan on Municipal Corporations, who was a commissioner who wrote an opinion in a prior case that the Supreme Court of Missouri cited at length about rate design, about the need for having nondiscriminatory rates.

Coming to the issue of revenue requirements, as in all cases, intervenors are heavily reliant upon Missouri Public Service Commission Staff. We are -- at the risk of increasing the company's paranoia and going on the enemies of the company list, we want to say we are here to support the Public Service Commission Staff's revenue requirement proposals, and we are grateful that they do the job that they do.

Thank you.

JUDGE THOMPSON: Thank you, Mr. Finnegan. Questions for Mr. Finnegan?

(No response.)

JUDGE THOMPSON: Hearing none, you're excused. Thank you.

Mr. Comley?

MR. COMLEY: May it please the Commission. My name is Mark Comley and I represent the City of Jefferson in this case.

Jefferson City intervened in this case for a discrete issue regarding the nature of Missouri-American's facilities in the capital city on their adequacy for purposes of fire suppression. Like several other cities in this state, Jefferson City is the location of a number of State-owned properties and facilities, but unlike those other cities, Jefferson City is the site of the preeminent public buildings of the State, and in those buildings is found the hub of State government.

For many years, the local privately owned and the Jefferson City Fire Department have been in and continue to be in a civic partnership, the object of which is not only the protection of the property held privately in this city, but also the protection of property of the State of Missouri itself. That relationship has been a good and productive one, and I want to make clear from the outset that our presentation to you in this case should not be construed as a sign of any grim dissatisfaction.

Rather, it is an example of the vigilance with which the City, as part of its duty and responsibility, addresses fire protection within its borders.

The City has filed the testimony of two of the Fire Department's officers. One witness, Chief Robert Rennick, has appeared before you in earlier cases involving Missouri-American's predecessor in title to the Jefferson City assets. His testimony can be divided into four points. He questions the absolute reliability of the power supplies for the company's main pumping operation. He also questions the reliability of backup pumping if a main pump should fail.

He is concerned about the storage levels of water and the available volume of water now that the company's agreement with an adjacent public water supply district has lapsed. Chief Rennick reports on the success of the hydrant replacement program in town, but he also reminds the Commission of the many narrow-dimension water mains that still serve many areas of the City.

Finally, he brings to your attention a question on the adequacy of the company's shallow water pumping equipment that is used during the lower Missouri water levels, which are destined to continue.

Chief Rennick and his assistant chief, Dennis Horn, the other witness from Jefferson City in this case, testify regarding a water pressure loss that was experienced in early September of this year. They also testify about the procedures they followed in trying to find out the cause of that pressure loss. The company's witness has testified that there is no record of this pressure loss at the company, but nevertheless, the incident is firmly in the memory of these two fire officers.

Chief Rennick has also testified that with the lapse of the agreement with Cole County Public Water District No. 2, the company has lost approximately 3 million gallons of storage. It's true the company's new 1.5 million -- 1.5 million gallon plant helps narrow the margin, but there is still a 1.5 gallon margin shortfall from pre-year 2001 levels.

The Chief also registers his concern that growth in the City is continuing and, therefore, storage and volume available for fire protection are valid concerns.

Regarding the narrow dimensions of the water mains in areas of the city, the Chief has directed the Commission to a color-coded map on the back of his testimony which shows the extent of 3- and 4-inch mains in the City. Chief Rennick points out that these narrow mains compromise adequate fire protection.

And finally Chief Rennick adds his observation that the area should expect more low levels of the Missouri River with new rulings on upstream releases having been implemented or finalized.

These low levels mean more challenges to the company for high pumping operations. New contingencies may be in order when the river reaches such low levels that the company's regular pumping operations are only partially operable.

Briefly, Chief Rennick has proposed that the company improve the reliability of its main pumping operations so that pressure losses are virtually eliminated. He addresses the storage issues, and we ask that the Commission address those storage issues, to investigate and implement a program of small main replacement, and ask the

Commission to investigate adequate preparation for lower levels of the Missouri River.

In sum, I would characterize the City's participation in this case as part of our ongoing process of informing the company and the Commission alike of places where facility improvements are needed for the highest public safety. We are fortunate to have at the capital's disposal highly qualified and committed firefighters and officers, and we are justifiably confident in their skills and sufficiency.

The City has appeared here to elevate its concerns to your attention so that together the company, the City and the Commission can undertake the investigations and programs necessary to promote the best kind of fire protection for the capital city, its citizens and the State of Missouri. Thank you.

JUDGE THOMPSON: Thank you, Mr. Comley. Questions for Mr. Comley?

(No response.)

JUDGE THOMPSON: I see none. You're excused. Mr. Ellinger?

MR. ELLINGER: May it please the Commission, my name is Mark Ellinger. Along with Jim Deutsch, we represent the City of Joplin. Our main issues relate to rate design and arise, as has been already mentioned before, from the issue of revenue contribution that came out of the last St. Joe -- last Missouri-American Water rate case; specifically, the revenue contribution to support other districts was taken and levied upon the ratepayers within the City of Joplin.

In specific terms, the City of Joplin opposes revenue contribution between districts and we support the initial concept of district-specific pricing, and I'll defer the rest of my comments 'til we get to the rate design portion of this hearing. Thank you.

JUDGE THOMPSON: Thank you, Mr. Ellinger. Questions for Mr. Ellinger?

(No response.)

JUDGE THOMPSON: There are none. Thank you.

Okay. We'll begin the pension.

Mr. Fischer, did I miss you?

MR. FISCHER: If everybody was going to just make a brief statement, I'm reserving most of my time 'til the rate design, but I guess I was off the list this morning.

JUDGE THOMPSON: You're not on the list that was supplied for opening in the first part of the case, but please step up. I was concerned as to why not all the parties were on there. Thank you.

MR. FISCHER: Go ahead, Lee.

MR. CURTIS: I'll address it briefly, and thank you, your Honor. My name is Lee Curtis. I represent the City of Warrensburg. The City of Warrensburg is primarily interested in the rate design issues. We have not sponsored a witness, and we are deferring our opening statement to the rate design portion of the case. Thank you.

JUDGE THOMPSON: Thank you, Mr. Curtis.

Mr. Fischer, please.

MR. FISCHER: Very briefly, your Honor, my name is Jim Fischer. I represent three public water supply districts around the St. Joseph area. They're not-for-profit subdivisions that serve right outside of the St. Joseph area. They serve rural residential customers for the most part. I'm going to be reserving most of my time for the January 5th opening, where I think we're going to be specifically talking about rate design.

That's the critical issue, though, for the customers I represent. They received an unprecedented 239 percent increase in their water rates as a result of that last Missouri-American case. There were two aspects to that. The decision to abandon single-tariff pricing and go to district-specific pricing, that part of the case my clients won't be challenging. However, they are asking the Commission to reconsider changes in the rate structure that came out of that case.

Now, if you look at the current rate structure, wholesale customers like mine are paying more than twice and in some cases three times the rates that residential ratepayers pay in that same area. It just makes no sense from an economic standpoint, and we're going to be asking you to take a very hard look at that in the current case. And I'll give you the details of that on January 5th. Thank you.

JUDGE THOMPSON: Mr. Fischer, before you step away, any questions for Mr. Fischer?

I have one. You're not presenting any testimony?

MR. FISCHER: No, your Honor, we're not, unfortunately. With the kind of increases we couldn't afford an expert.

JUDGE THOMPSON: If the Commission should have any questions, factual questions?

MR. FISCHER: I will be advocating on behalf of my clients and I'll be glad to answer questions that you might have, but we don't have any -- any experts to take the stand. There are experts in the case, though, that can address a lot of the questions on rate structure, that can probably answer historical questions.

JUDGE THOMPSON: I was thinking more of

factual questions such as what sort of costs the water districts have, what sort of revenue they have, what sort of markup they supply to the water.

MR. FISCHER: If the Commission has any questions along that line, I will endeavor to get you that information.

JUDGE THOMPSON: Okay. Thank you very much. Commissioner Clayton?

COMMISSIONER CLAYTON: Mr. Fischer, I had one question kind of along those lines, but on behalf of your clients, from how many sources would they -- could they choose from in purchasing their water?

MR. FISCHER: Well, they have several connections, but they are all Missouri-American Water Company connections. Now, they do have a choice of trying to drill wells, and that's been referenced here today, but they do receive all of their water from Missouri-American at the present time.

COMMISSIONER CLAYTON: And with current hookups, there are no other -- no other providers of water?

MR. FISCHER: They have -- they have looked at some other sources, but at the current time they have long-term contracts with Missouri-American Water Company, and that will continue to be the case.

COMMISSIONER CLAYTON: So basically they have one choice?

MR. FISCHER: That's correct.

COMMISSIONER CLAYTON: Thank you.

JUDGE THOMPSON: Further questions?

(No response.)

JUDGE THOMPSON: Hearing none, you can step down. Thank you.

Anyone else want to give an opening statement before we move on? Yes, ma'am, please step forward. I don't understand why --

MS. BOND: Judge, I think everybody in this back row are just --

JUDGE THOMPSON: I do apologize.

MS. BOND: That's quite all right. I think we're just hidden from view. I'm Jan Bond. I represent Utility Workers Local 335, and I would like to advise the Commission that Local 335 has not sponsored any witnesses and we are not taking any position on any of the remaining issues, so to let you know that there have been at least a few issues that have been resolved before we got this far.

However, Local 335 is vitally concerned with the issue of pensions on behalf of its members. So even though we have not taken a formal position on this, I may participate in the cross-examination. Thank you very much.

JUDGE THOMPSON: Thank you. Questions?

COMMISSIONER CLAYTON: I have a question.

JUDGE THOMPSON: Commissioner Clayton?

COMMISSIONER CLAYTON: Just so I understand what type of partici-- what level of participation that you'll be taking in these hearings, you say that you don't have a position on the pension question. I mean, why are you here, then, if you don't have a position?

MS. BOND: We aren't taking a position between Staff and the company, but we are vitally interested in understanding what Staff's position is, what the company's position is, how this -- how these positions will be developed in this hearing. And I have probably a list of four or five questions to ask one of the company witnesses to clarify.

COMMISSIONER CLAYTON: Will your clients be taking a position after all of this evidence is developed on what your clients would support in terms of a pension expense, pension cost?

MS. BOND: Commissioner Clayton, I don't anticipate that they would be filing a brief, although that would be possible. They are very interested in funding of the pension plans, and at this point, there are two. How those pension plans are treated for purposes of rates is not as vital a concern to them as is the actual funding mechanism.

So that I anticipate particularly from one of the company witnesses that that will be discussed and clarified, and I'm interested in hearing what that testimony is.

COMMISSIONER CLAYTON: Will your clients be affected if we choose one -- when we choose one way over the other, one method over the other?

MS. BOND: I would certainly hope not. I would -- I would hope that no matter what method the Commission chooses in this, that the company -- or actually Missouri-American would be funding its pension plans appropriately under law.

However, as we have seen in many, many situations recently, there are many pension plans that have failed that the Pension Benefits Guarantee Corporation has had to assume control over. So we're interested in getting as much information about the pension plans as possible.

COMMISSIONER CLAYTON: As evidence is developed, will the company -- or excuse me -- will your clients be in a position to choose among the varying methods on which method would provide your clients with the most protection?

MS. BOND: Possibly. And that's -- I don't know because I don't know what my clients will have me do on this. One thing, as with other situations, my clients have very limited resources as well.

COMMISSIONER CLAYTON: Okay. Thank you.

MS. BOND: I'm sorry. That doesn't help your questions, it doesn't give you any comfort, and I apologize for that. I don't anticipate that we will be filing a brief, but I would hope that the information would be sufficient so that the union can take any other appropriate steps even outside of this hearing.

COMMISSIONER CLAYTON: With all the different parties that are here, I just -- I want to know which parties are going to be taking a position on whatever issues are involved. And certainly the employees affected in this question should be a very important part of the Commission's discussion, and certainly your client's taking a position one way or the other, I think, would be helpful. But if you're not going to take a position, I just question why you're participating.

MS. BOND: And it's for informational purposes.

COMMISSIONER CLAYTON: Well, I mean, it's none of my business, but if it's just informational purposes, is that worth your client's money?

MS. BOND: Because of information that we gather here, then perhaps the union will hire its own actuary, that that actuary can take a look at the pension plan. The St. Louis County bargaining unit pension plan is going to be merged into the larger American Waterworks plan as of the first of the year, so we don't know much about the American Waterworks plan.

Most of the testimony here -- in fact, I would assume virtually all of the testimony here would be focused to American Waterworks plan. So in terms of getting information about that plan, an actuary hired by the union to examine that plan after the merger perhaps would be helpful.

COMMISSIONER CLAYTON: Okay. Thank you.

JUDGE THOMPSON: Thank you.

MR. ZOBRIST: Judge Thompson, could I just --

JUDGE THOMPSON: Please.

MR. ZOBRIST: It's not a continuation of my opening statement. Just Mr. Fischer probably will remember this, but I happen to have a copy of the local public hearing, but in answer to Commissioner Clayton's questions, two representatives from the water districts were at the St. Joseph local hearing, and Helen Price from Public Water Supply District No. 2 in Andrew County, and a gentleman from the DeKalb County water supply district did testify at that local hearing. Mainly it was the coalition members and, I think, a couple of residential ratepayers, but there were -- there is something in the record on that --

MR. FISCHER: That's correct.

MR. ZOBRIST: -- and I just wanted to make sure the Commission was aware of that.

JUDGE THOMPSON: Thank you. Okay. We're ready for pension.

MR. COOPER: Missouri-American will call Mr. William J. Williamson at this time.

JUDGE THOMPSON: Mr. Williamson.

MR. COOPER: I will supply a marked copy of Mr. Williamson's testimony to the court reporter.

JUDGE THOMPSON: Thank you.

Mr. Williamson, go ahead and spell your last name for the reporter if you would.

THE WITNESS: W-i-l-l-i-a-m-s-o-n.

(Witness sworn.)

JUDGE THOMPSON: Please take your seat. You may inquire.

MR. COOPER: In accordance with what I understand to have been mentioned this morning, your Honor --

JUDGE THOMPSON: Would you like to move the admission of --

MR. COOPER: -- we'd like to move for the admission of Exhibit 89.

JUDGE THOMPSON: Do I hear any objections to the receipt of Exhibit 89?

(No response.)

JUDGE THOMPSON: Hearing no objections, Exhibit 89 is received and made a part of the record of this proceeding.

(EXHIBIT NO. 89 WAS RECEIVED INTO EVIDENCE.)

MR. COOPER: And we would tender Mr. Williamson for cross-examination.

JUDGE THOMPSON: Thank you. Industrial Energy Consumers, still not here.

Missouri Energy Group, no longer here.

Mr. Finnegan, not here.

Water rate coalition. Don't see them.

Mr. Stewart? Also not here.

Mr. Ellinger? Not with us.

Mr. Fischer? Mr. Curtis? Mr. Comley? Ms. Bond? Ms. O'Neill?

Ah, Ms. Bond. Good. Thank you.

MS. BOND: I have to earn my keep.

JUDGE THOMPSON: Please do.

WILLIAM J. WILLIAMSON testified as follows:

CROSS-EXAMINATION BY MS. BOND:

Q.   Mr. Williamson, I'm Jan Bond. I represent Utility Workers Local 335, which is the union that represents certain bargaining unit employees in the

St. Louis County district.

Are you aware of the existence of a separate pension plan covering the union employees in St. Louis County?

A. Yes, I am.

Q. Okay. And are you aware that this separate pension plan will be merged into the American Waterworks plan as of the beginning of the year?

A. Yes, I'm aware that the -- I think it's a common benefit formula will be in place as of January 1, '04.

Q. Okay. And you're also aware that approximately 300 union employees who currently participate in the separate St. Louis County plan will become participants in the American Waterworks plan?

A. Yes.

Q. Okay.

A. Yes. I -- I think there's a minor technical distinction, but I think maybe the plan has actually been merged in, but the plan structure changes as of 1/1/04.

Q. But those people will -- for future benefit accrual, they will become participants in that plan, correct?

A. That is correct.

Q. Okay. And do your assumptions and

calculations as presented in your testimony and as an exhibit to Mr. Grubb's testimony take that merger into account?

A. Yes, they do.

Q. And --

A. I should clarify, too, for projection purposes. In other words, the costs that we showed for any past history do not -- for the American Water plan do not include the St. Louis County plan because it was not part of the American plan. For 2004 and beyond, our cost projection does include the St. Louis County water plan.

Q. And that would be correct as well, your assumptions and calculations take these additional 300 participants into account for the future?

A. That's correct.

MS. BOND: I have nothing further.

JUDGE THOMPSON: Thank you, Ms. Bond. Ms. O'Neill?

MS. O'NEILL: No questions.

JUDGE THOMPSON: Mr. Schwarz?

CROSS-EXAMINATION BY MR. SCHWARZ:

Q. Good afternoon, sir. What's the Pension Benefit Guarantee Corporation?

A. Pension Benefit Guarantee Corporation is a quasi-public entity set up, in effect, as the insurer of last resort for private pension plans. It was set up in 1974.

Q. And has it been experiencing financial difficulties or financial strain of late, given the pension failures that have been alluded to earlier?

A. The PBGC has -- is undergoing financial strain right now, yes.

Q. And in the schedules accompanying your testimony, you refer to some changes to ERISA in the areas of return on assets and the discount rate. Do you recall?

A. Could you tell me where that is?

Q. On Schedule 2, pages 1 and 2.

A. This is my rebuttal testimony?

Q. Yes.

A. Okay. And the question? I'm sorry.

Q. Is that -- there on the -- for instance, on page 1, down at the bottom, you note that the assumed rates are declining; is that correct?

A. The interest rate that we're using for the current liability approach is declining.

Q. Right. And the same is true for the -- on the next page for the investment return?

A. That's correct. That's not -- I would say that's not a PBGC issue, but that's a true statement that these interest rates are projected to decline.

Q. And is it -- if I recall from your testimony, you suggest that the -- those declines contribute significantly to the increase in the CL approach under ERISA; is that correct?
A. The decline in those interest rates contributes significantly to the increased contribution, the increased minimum contribution that we've projected.
Q. Okay.
A. That's correct.
Q. One more background question. There's a minimum required contribution under ERISA?
A. Yes, there is.
Q. And could you describe that a little bit for the Commission? What is it, first of all? Let's start there.
A. I'll try to start at a very high level. You tell me if I need to go deeper.
Q. Well, let me preface my remarks by saying that the Commission doesn't actually often get hands on an actuary. We can't afford -- Staff can't afford to hire actuaries to have actuarial studies done. So, yes, if you could give the Commission from a high level approach what the minimum contribution is.
A. At the highest level, I would characterize the minimum required contribution as the annual amount that

needs to be contributed to a pension plan that is equal to the sum of the benefits that are deemed to be earned in that year, plus a portion of the unfunded past service obligation.

Q. All right. And could you ex-- is there a full funding limit with respect to ERISA?

A. There is a maximum amount that you can put in and take a tax deduction for in any given year.

Q. Okay. So that the -- you could still make contributions in excess of the full funding limit, they simply wouldn't be deductible for income tax purposes?

A. That's a true statement in general. I think there's an important addition. If you contribute more than that limitation -- and I'm simplifying here the rules, but the key point is what if you contribute more than your maximum deductible contribution, not only do you not get a deduction, the plan sponsor must pay an excise tax on that extra amount.

Q. Do you have your schedule --

A. Yes, I have it right here.

Q. -- in front of you?

What kind of -- let me ask you this: Towers Perrin does the actuarial reports for pension purposes for American Water?

A. Yes, we do.

Q. Have you been involved specifically in the American Water pension calculations?

A. Yes, I have. The ultimate responsibility for those numbers rests with me.

Q. For the benefit of the Commission, what's the purpose of the discount rate that you set forth on page 1 of Schedule 2?

A. The discount rate is an interest rate that we use to develop the present value -- I should say the actuarial present value of future plan benefits. In other words, we project the benefits that every single person will receive who's currently a participant in the plan out in the future, and then we discount them. We figure out the present value of those benefits on the calculation date.

Q. And that's done, I want to say, as a stream; that is, you calculate either by month or by year those payments and then discount that entire stream back?

A. We discount the entire stream. We will project for each participant what benefits he or she is expected to receive in the future, beginning whenever they're projected to begin and ending at the individual's death.

Q. So that for purposes of these calculations, you can consider and calculate mortality rates for the employee population. Do you also calculate an amount or a number of employees who may start with the company but for one reason or another never reach vesting or be in a position to collect benefits?

A. We use quite a myriad of actuarial assumptions that address all these issues. The two that you addressed in particular, we have assumptions about when people will pass away and we have assumptions about when people will terminate with the company prior to becoming eligible for retirement.

Q. And payroll levels are a factor because of the way the pension plan structures the payments?

A. That's correct. The benefit formula in the plan is a function of each individual's pay, and we have -- and it's their pay and their years prior to retirement. So yes, we project pay increases into the future.

Q. And that's exactly what the actuarial science does, is it not?

A. That is what we do for pension plans.

Q. On the next page you talk about investment return. How was that used in your calculation?

A. The American Water pension plan is a funded plan. By that I mean there's a pool of assets set aside, and one aspect of the calculation is to project what investment return those assets will earn, and that's the assumption you see there on page 2 of our schedule.

Q. And I guess we've already talked about the compensation increases, that's part of the payroll projection?

A. That is the payroll projection. Compensation increase is the payroll projection.

Q. And amortization periods on your -- on the last item there for the unfunded past service obligations, would you explain that?

A. Sure. I mentioned earlier that the -- each year's annual cost is essentially the sum of two items; the value of benefits deemed to be earned in that year, plus a portion, an amortization of the unfunded past service obligation. And for the various purposes that we have here, there are different requirements about how fast you amortize those unfunded past service obligations. That's what I describe on page 3.

Q. And the -- would you explain for the Commission what is Financial Accounting Standard 87 or statement of financial accounting statement?

A. Sure.

Q. Again, high level if you would.

A. Absolutely, yeah, high level. Financial Accounting Standards Board Statement No. 87 is the accounting standards which prescribed how actuaries are to calculate the annual cost that is to be reported in an organ-- a plan sponsor's -- pension plan sponsor's financial statements.

Q. And how does that differ from ERISA?

A. The first comment is the FAS 87 cost is an accounting cost to be recorded in your statements. On the other hand, the ERISA minimum required contribution is the cash required under ERISA to be contributed to a pension plan each year, and at a -- in concept, they're the same. As in what I've said before, they are the value of benefits earned in a year plus the -- an amortization of the unfunded obligation, but the actual methodology to develop those pieces differs.

Q. And does -- are the ERISA calculations used for income tax purposes, for pension expense for income tax purposes?

A. The actual -- I'm not a tax expert, but one of the things that we calculate is the maximum tax deductible contribution, and the cash that's contributed is generally the amount that is -- is generally the amount that is deducted on our client's tax returns.

Q. On page 2 of your testimony, down -- lines 24 through 27, you talk about the required contributions. Are those required contributions before the sponsor would reach the full funding limit?

A. One of those is what we typically call the full funding limit. The -- what I term the ERISA AAL approach is zero. If plan assets -- let me step back. In simplified terms again, if plan assets equal the ERISA actuarial accrued liability, then the plan has reached the full funding limitation.

Q.   And that's when additional contributions would not only be not deductible, but would entail an excise tax --

A.   Yes.

Q.   -- on the sponsor?

A.   In essence, that's a true statement.

Q.   So if I understand it, the pension obligation in whole is equal to -- strike that.

What are the sources of cash to pay for pension obligations as they come due? If I suggest to you that it's from contributions to the plan and the earnings on the plan, would you agree with -- that those are the sources of cash to pay obligations?

A.   Right. One of the statements I make in my testimony is that all dollars to pay benefits to plan participants come from one of two sources; either contributions to the plan or investment return on assets in the plan.

Q.   So that -- so would you say that the pension obligation, if everything works as planned and designed, that the pension obligation would be equal to the contributions plus the earnings on the contributions on the assets?

A. Pension obligation is a little bit of an ambiguous term. I would -- it could mean different things to different people. I would say, I guess, what I said already, but benefit payments come from one of two sources; either cash contributions or investment earnings. Am I answering your question?

Q. Well, I may not be asking it correctly, and I'm not sure that I necessarily understand the distinction that I think you may have just drawn. Why would the pension obligation -- from the inception of the plan to the end of the plan, why would the pension obligation not equal the -- the contributions and earnings, assuming that the calculation -- that the projections had been made accurately?

A. I would phrase it this way: I think if we're defining the pension obligation as the benefit payments that need to be made to plan participants, then I agree 100 percent with your statement. That has to be true. There's no other source of payments.

Q. I should sit down now, but I can't.

If during the life of the plan or at any particular point in time, if earnings have exceeded projected earnings and you're going to keep that equation equal, that would mean that contributions would need to be reduced; would that be correct?

A. Well, that equation that I described is a -- is the life of the plan equation.

Q. I understood that.

A. Until the plan is shut down, you will -- the plan will not be in balance. You will either have assets exceeding the past service obligation or the past service obligation exceeding the assets. So at any given point in time, while the plan is a living entity, that equation will not hold true.

Q. Can we go back to your the schedule attached -- Schedule 2 attached to your --

A. Certainly.

Q. Under the -- if the row, does American Water smooth assets for this purpose, under FAS 87 you indicate they do not, but that they do under ERISA.

A. Yes.

Q. Could you explain why they do not under FAS 87?

A. I honestly do not know why. I have been involved as the actuary for the plan for about three years. FAS 87 was introduced back in the mid to late '80s, and I don't know the answer.

Q. Thank you.
A. So that decision basically would have been made back then.
Q. Under the current liability approach that we talked about earlier on that page for the discount rate, you indicate that for the plan year beginning July 1, 2002, the interest rate is 6.8 percent; is that correct?
A. That's correct.
Q. That's a historical figure?
A. Yes.
Q. Has the 2000 -- has the plan year 2003 been calculated yet?
A. We're finalizing that right now.
Q. So it's -- the report hasn't been completed, turned over to the company yet; is that correct?
A. The report's been turned over in draft form.
Q. Right, but it's not final?
A. The report is not final.
Q. Well, is it safe to say that the 6.45 percent for 2003 has been finalized?
A. I don't think it has been finalized, but that was -- that was based on the assumptions that we put together when we prepared those projections, and those were, I believe, in March of this year.
Q. Well, explain for me, if you will, how the

assumed rates are derived.

A. Under ERISA, the rate that we use for this purpose must be no less than 90 percent, and right now depends on the plan year, no more than 120 percent of the 4-year weighted average of 30-year Treasury Bond yields. That 120 percent actually drops to 105 percent as of next July 1 for this plan.

Q. And who prescribes that percentage?

A. That's prescribed in the Internal Revenue Code.

Q. In the IRC itself?

A. Right, Section 412 of the Internal Revenue Code.

Q. Excuse me. I'm sorry. I didn't mean to cut you off. When was the -- this change in rates added to the code?

A. Which change is that?

Q. The change from 120 to 105 percent as the high end of the range.

A. Well, actually, it was 105 percent for several years, and in early 2002 Congress passed a special change in the law which boosted the 105 to 120 just for 2002 and 2003 years.

Q. Okay. So the -- these assumed rates, how did you, for instance, strike upon 5.39 percent for the plan

year 2004?
A. I need to check something. We took a rate -- when we put these numbers together, a 30-year Treasury Bond yield, and we -- here we are. The average 30-year Treasury Bond yield in March 2003 was 4.95 percent. We assumed that that -- and that's roughly the time frame when we prepared these projections, actually a little after that.
Q. For use in 2003?
A. Probably better if I can --
Q. Go ahead.
A. We took that 4.95 percent and just assumed that it would stay level for the foreseeable future throughout this projection period, and then applied the -- it's a 48-month weighted average. We applied the appropriate weightings to determine then what would be the appropriate interest rate at the highest level at July 1, '03, July 1, '04, July 1, '05, July 1, '06 and '07.
Q. And the weighting formula weights recent 30-year bonds more heavily than older?
A. Yes. In rough terms it's 40 percent, 30, 20, 10 percent weighting, so the -- when I say 48 months in some respects it's easier to think of it as a four-year average. You take a 40 percent weighting to the averages over the most recent 12 months, a 30 percent weighting to the prior 12 months, and a 20 percent weighting to the prior 12 months

and a 10 percent weighting to the most distant 12 months.

Q. And the same holds true for the investment return calculations on the following page?

A. Yes, the same holds true because ERISA slash the Internal Revenue Code mandate the same rate.

Q. And did you use those same figures in making the calculations that you included in the letter to Mr. Grubb that he's included in his --

A. Yes, these calculations are the same calculations.

Q. Right. And you used Moody's AA bond yields on FAS 87?

A. Yes, we did.

Q. And that is to comply with FASB's requirements that you use a representative corporate bond rating?

A. That really stems from September 1993 when the Security and Exchange Commission announced that if plan sponsors used discount rates significantly higher than Moody's AA bond yields, that the SEC may be requesting justification for those higher discount rates.

Q. There's the SEC and the IRS. Are there any other alphabet agencies?

A. I could be here for a while if you'd like me to list those.

Q. No, that's fine.

I notice that for the accrued -- actuarial accrued liability approach that the best estimate of anticipated experience under the plan by Towers Perrin is 9 percent; is that correct?

A. Yes, that's correct.

Q. And the same is true for the investment return, is it not?

A. That's correct.

Q. I read that to indicate that as an actuary, you expect the -- both the discount rate and the investment return to be higher than those specified by the code for the current liability approach; is that correct?

A. That's absolutely correct. The reason for that is that the current liability interest rate is mandated under the code, the Internal Revenue Code to be based on the 30-year Treasury Bond yield, whereas the investment return, the discount rate under ERISA for the other purpose, actuarial accrued liability approach is mandated to reflect the investment return on plan assets which captures where the money is invested in corporate bonds, corporate stocks, government bonds.

Q. Right. Okay. So is it safe to say that you would expect the performance of American Water's pension assets for the next five years to exceed those that are projected for purposes of the current liability approach under ERISA?

A. I would not say that.

Q. Why not?

A. I would say that over the long haul, much longer time horizon, we expect the return on plant assets to be 9 percent. And I would say that as mandated by the Internal Revenue Code, we are using for this purpose an interest rate and investment return for the current liability purposes that's no more than 120 percent for these two years or 105 percent of the 48-month weighted average.

Q. Understood, but it seems to me that for purposes of calculating the actuarial accrued liability approach for plan year 2003, you will be using a discount rate of 9 percent and an investment -- expected investment return of 9 percent, whereas you will be using substantially lower percentages for purposes of current liability approach; is that correct?

A. That's correct, but I would use a much higher rate for the current liability purpose if I was allowed to, but I have no choice.

Q. Right. I understand. I'm not suggesting that it's any of your doing, but that's just the way the calculations need to be made?

A. That's a true statement.

Q. Would you turn to page 5 of your testimony, please. You have a table there?

A. Yes, I do.

Q. And you have the center column is -- reflects the plan, that's American Water's plan under the ERISA CL approach?

A. That's correct, those are project -- an actual number as of July 1, '02 and projections for 2003 beyond for the American Water pension plan.

Q. Right. Would those numbers be different for the AAL approach?

A. Yes, they would be.

Q. And would they be higher or lower?

A. Would they be higher or lower? Honestly, off the top of my head, I don't know for sure, because there's two fundamental differences between the current liability approach and the AAL approach and they offset each other.

I'm not sure which is more powerful from one year to the next. I don't know if I have that information. I could absolutely find it out, but I don't know if I have it with me.

Q. Well, the explain countervailing balances.

A. Sure, I could do that. On the one hand, the current liability approach uses a lower interest rate, as we've been discussing.

Q. Yes.

A. That interest rate is lower; therefore, that produces a higher present value. If that was the only difference, the current liability would be higher.

On the other hand, the actuarial accrued liability approach projects pay out to people's projected retirement date. So there's a projected pay increase in the development of the actuarial approved liability; whereas, as I mentioned earlier, under the current liability approach we have no projected pay.

So AAL approach has pay increases, currently I believe it does not, which makes AAL higher, but current liability has a lower interest rate, which makes current liability higher.

Q. Well, but the AAL has a higher discount rate, does it not?

A. But that is the interest rate I'm talking about, yes,

Q. Well, it also has a higher investment return, does it not?

A. It does, but those are one and the same. That's still part of the same distinction that I'm making. There are two fundamental distinctions that drive the funded percentage here. If we're focusing on funded percentage, one approach is a higher interest rate than the other -- and I'm using that a little loosely -- higher discount rate than the other, and the other has assumed pay increases in it and the other one does not.

Q. Well --

A. This may be a little helpful. When I talk in the table in my testimony about interest rate, I'm talking about the -- I'm sorry -- the investment return, I'm talking about the investment return we expect to earn on assets in the future and does not affect the funded percentage at any given point in time.

That doesn't come into play when we determine funded percentage at a given point in time. It's the discount rate and the compensation increase that come into play in determining the funded percentage at a given point in time.

Q. But isn't it -- let me assume that -- for the moment that the asset value in the American Water plan on the date you're making your calculation is $50 million. For the next year, would not the value of that asset at the end of the plan year be larger under the AAL investment return than under the CL investment return?

A. I understand the question. There's a very critical distinction to make here, and it's very challenging to explain. In these -- at any given point -- let's take a point. Let's say we're in 2004. Let me step back. Maybe this will be easier.

Throughout these entire projections, in order to develop these projections we're looking at here on page 5, we assume throughout that entire period that the actual assets as we go from one date to another to another to another would earn a consistent investment return, and that was, I believe -- I'm trying to remember. It was either 8.75 percent or 9 percent. If it would be helpful, I can find it.

Q. Yeah.

A. Okay.

Q. I mean, relatively --

A. Let's say it was 8.75 percent. Let's focus on 2004. To get to 2004 from 2002, we assume that the plan assets earned 8.75 percent in that two-year period. Then we're pretending that we're standing there in 2004 and we're determining the minimum required contribution for that year. Now, for that year we apply the ERISA rules, and the ERISA rules would say for the current liability approach you use the -- that weighted average of the 30-year Treasury Bonds. They would say for the AAL approach, you use the 9 percent that we used, and for the accounting approach, we use the 8.57 percent.

So at that point in time, to develop that particular year's costs, sitting there in 2004, we use the investment return assumption that's appropriate for that method, but to get to that point in time from today, we assume that the assets earned 8.75 percent. That's a challenging distinction.

Q.   Under the AAL?

A.   Under all three approaches. We assume that that's how we would get there. Otherwise -- we felt that was the best way to indicate, otherwise we would get to 2007 and we would have a vastly different set of presumptions about where we stood at that point in time. One other -- maybe this would help to explain.

Q.   Well, no. Let me --

A.   Sure. Go ahead.

Q.   -- interrupt with a question.

I mean, when you get to 2004 you don't have to make any assumptions about where you are, because when you get to 2004, you have the actual numbers, don't you?

A.   Not in these projections. Not to develop these projections. When we get to 2004, yes, we will. It might be helpful if I was real specific. For example, when we get to January 1 of 2-- let me pick a different -- January 1 of 2007, our projections presume that there are $588 million of plant assets under all these approaches. So to develop cost numbers for '07, we assume that at -- we're projecting that at 1 -- January 1, 2007, there will be $588 million in plant assets.

Q. And is this on a work paper that you have?
A. I think this was sent to --
Q. It's not in anybody's testimony?
A. -- Mr. Gibbs.
Q. Oh.
A. I think it was sent to Mr. Gibbs. I think that's -- I can tell from here, that's the right piece of paper.
Q. You have better eyes than I have.
A. The one in the right hand.
MR. SCHWARZ: May I approach the witness?
JUDGE THOMPSON: You may.
MR. SCHWARZ: Thank you. Could I have a brief recess?
JUDGE THOMPSON: I think a brief recess would help everyone right now. We'll go ahead and take ten minutes.
(A recess was taken.)
(EXHIBIT NO. 93 WAS MARKED FOR IDENTIFICATION.)
JUDGE THOMPSON: Let's go ahead and go back on the record. You may inquire, Mr. Schwarz.
MR. SCHWARZ: May I approach the witness?
JUDGE THOMPSON: You may.
BY MR. SCHWARZ:

Q. Mr. Williamson, we've discussed this sheet of paper that's been marked Exhibit 93 and labeled as Williamson work papers. Is that a fair statement?

A. Yes.

Q. And was this work paper prepared at your direction and under your supervision?

A. Yes, it was.

MR. SCHWARZ: I would offer Exhibit 93 at this time.

JUDGE THOMPSON: Do I hear any objections to the receipt of Exhibit No. 93?

MR. COOPER: No, your Honor.

JUDGE THOMPSON: Hearing no objections, Exhibit 93 is received and made a part of the record of this proceeding.

(EXHIBIT NO. 93 WAS RECEIVED INTO EVIDENCE.)

BY MR. SCHWARZ:

Q. Mr. Williamson, this work paper is the source of the $588,431,000 figure for FY 2007 you referred to earlier?

A. Yes, it is. Yes, it is. That's the projected value of plan assets as of January 1, 2007.

Q. Right. Which -- but -- and that figure, in turn, is dependent on the number on the same line from FY 2006 being 487,687?

A. That is correct.
Q. So if the number, the actual number in FY 2006 was 600 million, that would affect future years, would it not?
A. Yes, it would.
Q. And if it were 300 million, it would affect future years?
A. Yes, it would.
MR. SCHWARZ: I think that's all that I have.
JUDGE THOMPSON: Thank you, Mr. Schwarz. Questions from the Bench, Commissioner Murray?
COMMISSIONER MURRAY: I hope I don't butcher this.
QUESTIONS BY COMMISSIONER MURRAY:
Q. The exhibit that you were just handed, the Williamson work papers, Exhibit 93, if you look at the column for FY 2007, under the fair value of the assets which was 588,431, there's a negative figure for funded status of 186,645?
A. Yes.
Q. What does that negative figure represent?
A. At the first level, Commissioner, it's the -- it's the difference between the 775 above it and the 588, and in words, that's -- that's the funded status or funded position of the plan where we're saying that the projected

value of plan assets as of January 1, 2007 is $588 million.

These numbers are in thousands, so that's $588 million, and the projected benefit obligation, which is a measure under the accounting rules of the plan's past service obligation, saying that the plan's service obligation is 775 million. So, therefore, we're saying that the plan's past service obligation is projected to exceed the plan's assets by
$186 million as of the beginning of '07.

Q. And is that calculated in accordance with FAS 87 accounting?

A. That's correct. That's correct.

Q. And that would indicate that the company would fund -- for the year 2007, the cost to fund the pension fund would be -- is that the 30 million?

A. Right. You're hitting at the heart of one of the key distinctions here, and that is this page, being a FAS 87 page, is strictly the accounting charge that would be recorded on the financials of the -- financial statements of the company regardless of whether the cash is zero or 50 million or 2 billion. I'm exaggerating to make the point. So the 30.657 million that you pointed out at the bottom would be the projected accounting cost that would be recorded on the plan's -- recorded on the company's financial statements for the year.

Q. And what effect would that recording of that 30 million have?

A. That would just go into in the company's financial statement. So if it was all taken as an expense, that would drive down the company's net income for the year. But it would have no impact on cash. That's the key comment. It would not result in a bigger cash contribution or a smaller cash contribution to the pension plan.

Q. Okay. And what -- is there something that shows what the cash contribution to the pension plan would be?

A. I have that in my testimony. If you're interested, there's a comparable work paper, but it's also in my -- I guess it's actually -- it's attached to Mr. -- Mr. Grubb's testimony, I guess, but it's a number that we projected.

Q. And is that in his Schedule EJG-4?

A. Have to take a quick look. Yes, that's it. Yes. I have it, yes.

Q. So for 2007, the required cash contribution would be 25.6 million?

A. Yes, that's the -- that's the projection of the minimum required cash contribution for the plan year beginning July 1st of 2007.

Q. And that is the minimum required under what?

A. Under ERISA. Under the federal government rules for pension plans.

Q. Okay. And that is the contri-- that is what you will base -- the company will base its cash contributions on, regardless of the accounting for the financial statements?

A. That's right. So when we get to July 1, 2007, we will look at the actual assets in the plan at that point and the actual plan obligations and we will apply the rules under ERISA and we'll come up with a number. And if between now and then all of our assumptions are met, then the number will be 25.6 million.

Q. All right. Now, distinguish that from what Staff is saying that you should do.

A. My understanding is that Staff is saying that that the minimum required -- that the cash contribution should be reflected -- I'm not sure of the right terminology here, I apologize -- in rate base; is that the right --

Q. Uh-huh.

A. That the cash contribution should be reflected in the rate base, as opposed to the FAS 87 accounting cost. Over the last ten years or so, the item for pension cost has been the FAS 87 accounting cost. My understanding is that Staff is proposing to use -- to switch from the approach that's been used for the last 10 or so years from the accounting cost to the cash contribution.

Q. Okay. So the calculations under ERISA do not -- they're short of actually funding the projected obligations; is that correct?

A. I'm not sure what you mean by short --

Q. Let me see if I can phrase that better. Under the FAS 87 accounting, it appears that -- and maybe this is just coincidental, and you can tell me if that's so, but it appears that the funded status over the years -- well, that's not the case either. I thought that the funded status under the FAS 87 accounting would indicate that the obligation would more closely match the value of the assets as the years progressed, but that's not necessarily so, is it?

A. That's not necessarily so.

Q. Is there a general statement that you can make regarding FAS 87 accounting in terms of the relationship between the projected benefit obligation and the fair value of the assets?

A. I'm not sure if this hits at where you're headed. I can say that, in general, if that unfunded -- the bigger the unfunded obligation, the higher the FAS 87 cost. So if we compare on the exhibit that we're looking at right now, the work paper exhibit, if we look -- where is the funded status, where is the most unfunded position, it's at fiscal year 2004, the 289 million?

Q. Yes.

A. And then we shift to the bottom row on the page and we look at the accounting cost.

Q. Yes.

A. You can say where is that accounting cost largest? The same year, it's 44 million, which is higher than any other year in the projection period. And that is not a coincidence. That is a link. The funded status of the plan is very closely linked to the accounting cost of the plan. Let me phrase that more precisely. The funded status of the plan for FAS 87 purposes is very closely linked to the accounting cost under FAS 87.

Q. All right. Now, let's look at the ERISA calculations, and is there -- what is the relationship between the cash contri-- minimum cash contributions required under ERISA to the funded status of the plan?

A. Again, there's a very close relationship. My rebuttal testimony, page 5, this is one major answer to the question. I think this is the most helpful answer. The table on page 5.

Q. Yes.

A. You can see that there's a very direct relation between the funded percentage under the ERISA current liability approach and the amount of the minimum required contribution under the ERISA current liability approach. When that funded percentage is at its lowest point, which is at July 1, '04 and it's 72 percent, that's when the cash contribution is the highest over the next -- in the projection period, 76.6 million, and when that funded position is at its highest, 109 percent at July 1, '02, under this approach, the ERISA CL approach, there's no contribution required.

So it's a similar concept to what we talked about under the accounting, but it's not the same numbers because it's measured in --

Q. Now, I'm not sure I'm understanding correctly, exactly the cash contribution that the company makes each year, but is it accurate to say that the company actually makes the cash contribution calculated under ERISA?

A. Almost. I would say it's accurate to say that the company actually makes a cash contribution that is at least equal to the minimum required contribution under ERISA.

Q. Okay. And for purposes of the years in question here, is the company making those cash contributions equivalent to the minimum ERISA or more?

A. Equal to. Now, we have assumed that these exact contributions will be made as we march through. Now, what happens in practice is we collect information as of every single July 1, and in the months -- give or take the six-month period following that July 1, we calculate the specific minimum required contribution for that year beginning on that July 1.

For example, right now it's December of '03. We are finalizing the required cash contribution for the plan year beginning July 1, 2003. A year from now we will be finalizing the minimum required contribution for the plan year beginning July 1, 2004.

Q. And in the past, the ratemaking treatment that the company has been given for these cash contributions to the pension plan?

A. I don't know the full answer. I can tell you what I do know. What I do know is that it's -- that in the rate base in the last ten or so years, it has not been the cash contribution that's gone into the rate base, it's been the FAS 87 cost.

Q. And what would be the rationale for including the FAS 87 cost if that's not the actual outlay?

A. I can tell you my understanding from others' testimony that I've read, and that is that there's a Missouri law that requires the FAS 106 cost on the -- FAS 106 is the comparable accounting standard for retiree medical benefits, and there's a Missouri law that says you will contribute the amount that is reflected in your accounting statements under FAS 106. So those are linked together. You will contribute that amount and that's the amount that will go into your rate base.

Q. But that is the actual contribution?

A. Yeah. They -- they are sort of, as I understand it, forced to be the same under Missouri law. Now, there's an important distinction here. Under -- under -- this is Missouri law operating sort of under federal law for benefit plans. Federal law for benefit plans has very strict restrictions on what you can put into a pension plan, with a minimum and a maximum. We don't have a comparable set of rules for federal purposes under -- for retiree medical benefits.

Q. All right. And if --

A. So maybe one quick closing comment on that point would help. As an employer, you have an awful lot of flexibility under federal law when it comes to determining how much money you want to put into your retiree medical trusts. You don't have that flexibility unless you want to pay excise taxes for pension purposes.

Q. Okay. So if the company were apt to contribute -- let's take the year 2007.

A. Okay.

Q. And if the company were to contribute, make a cash contribution of 30.6 million, would there be a penalty?

A. That's a good question. I don't know the answer to that, even under these projections, and the reason I don't know is because what we focused on calculating here is the minimum required contribution. Every year we calculate not only a minimum required, but a maximum deductible contribution as well, and I just don't know if we -- if we look at my projections for the minimum to be 25.6, I don't know what the comparable maximum is in that year. I just don't know.

Q. What is the maximum for deduction, do you know?

A. That is the answer. I don't know the answer. That's what I don't know.

Q. Okay.

A. We didn't calculate that, in all honesty, because that hasn't been the company's approach. The company's approach has been to contribute the minimum required contribution.

Q. Now, is Staff's position in this case -- would the result of accepting Staff's position cause the company to contribute a different amount or the same amount that the company would contribute under ERISA?

A. I can't answer that totally. It would not force anything from my perspective as a professional actuary. My understanding is the issue is not how much the company contributes, but it would be what goes into the rate base. So the Staff -- the Staff, as I understand it, is making the position -- stating a position that indicates what will go into the rate base, regardless of what the company actually contributes. That's what my understanding is.

COMMISSIONER MURRAY: All right. Thank you for your testimony.

JUDGE THOMPSON: Thank you, Commissioner.

Commissioner Forbis?

QUESTIONS BY COMMISSIONER FORBIS:

Q. One question. I'm looking at this chart on page 5, and then this Exhibit 93 again. When my eyes go back in my head, I'll probably just stop. Okay. But go back to 2004.

A. Okay.

Q. Under the FAS 87 approach, what the company would show on its books is $44.4 million?

A. That's correct.

Q. Under ERISA, the company would have to contribute $76.6 million?

A. That's correct.

Q. Okay. Would that $76.6 million be -- is that what goes into rate base?

A. As I understand it, that's what would go into the rate base under the Staff's proposal.

Q. Okay.

A. I should clarify that, because -- I should clarify my answer, because I do not know the exact mechanism. I'm just -- I'm a qualified pension actuary under ERISA.

Q. Maybe we should -- are we better waiting to ask those questions of some of the other folks, do you think, that sort of thing?

A. I think some of that, those questions, exactly how the rate base stuff works, would be better answered by people who are closer to the rate base calculations.

COMMISSIONER FORBIS: Okay. I'll do that. Thank you.

JUDGE THOMPSON: Thank you, Commissioner. Commissioner Clayton?

QUESTIONS BY COMMISSIONER CLAYTON:

Q. On Exhibit 93 there are the figures for FAS 87 amounts beginning fiscal year 2003. Do we know what it is for fiscal year 2002?

A. Yes.

Q. What is that amount?

A. Commissioner, which -- comparable to the 32.6 million, for example, at the bottom of the page?

Q. Yeah, the accounting cost down at the bottom.

A. Sure. Sure. 17.4 million.
Q. Just considering the -- I don't know how many figures you have there. Do you have years prior to 2002? You have 2001, and I don't want to go back any further than that.
A. I do.
Q. And if you don't have it, that's fine.
A. I do have it. It might take me 20 seconds to find. I just said 17.4 million for 2002. 10.8 million for 2001.
Q. Okay. Now, just so I understand these principles -- and I love saying this. I'm not an accountant, but the way I review this, you have an accounting cost in the year 2001 of $10.8 million, and can you tell me what the actual cash outlay of the company was in 2001?
A. Zero.
Q. It was zero. And in 2002?
A. 2002, the company resumed contributions for the plan year beginning July 1 of '02. So in the last six months of calendar year '02, they actually put in a shade over $6 million.
Q. $6 million. Okay. When a company makes that contribution, there are different standards for accounting and there are different standards for requirements of

maintaining a pension plan under ERISA, correct?
A. That's correct.
Q. There could be different standards. And the $6 million, obviously, was within the minimum and maximum amount of contribution that the company could make?
A. That's correct.
Q. For fiscal year 2003, you have a FAS 87 amount of 32.6 million. Now, is there any way to determine what the actual cash outlay would be for that same period?
A. For the first six months of 2003, it's the second half of the 6 million for the 12 million, and then the projection going forward. And we've projected $15 million for the plan year beginning 2003, so it would be -- the first half of '02 was about 6.2 million and the second half was about 7.5, so the total for 2003 of about $13.5 million.
Q. 7.5.
A. And I believe that -- that's all I should say.
Q. I asked a question of one of the attorneys, much to the chagrin of one of the attorneys, about whether or not if I were a worker, someone who was a pensioner or a potential pensioner of the company about which method were we to adopt at the Commission. Would it make any difference?
A. No.

Q. Basically we're talking about an accounting standard. The company has to make the cash contribution required by law, and we're talking about simply the accounting method?

A. That's right. I mean, the bottom line, if you presume that the company will continue to satisfy the minimum funding standards under ERISA, and I have no reason not to assume that, then it won't make any difference. The only -- if one approach makes the company stronger than the other -- and I'm not in a position to say which one would do that -- but if one approach makes the company stronger, then that gives it a greater ability to make those contributions.

Q. In your testimony, you make the statement that if we were to see the plan all the way out to the end, the death of the last pensioner, that in the long-term, which could mean many, many years, that regardless of the type of accounting method that you use, they will end the same way, zero and zero in the columns and the plan would be over; is that correct?

A. There's a yes, but.

Q. Okay. Give me the but. I mean, this is over the Internet.

A. Yes, as long as you start from the beginning of time. So if you go from the beginning of time to the end of time for that pension plan, from the day it was born until the day it died, then any of these approaches, if you add up all the costs, you will get the same number.

Q. Is there a rule in accounting or in your industry about looking over a set amount of time, whether it be 5 years, 10 years, 15 years or more, where the two methods would also be zero? If you were to pick two points out of a time, is there a rule where -- where they become the same over time?

A. There is not.

Q. There is not?

A. No.

Q. So we couldn't pick, say, a 10-year period and make a determination about which is high, which is low or anything?

A. That's correct.

Q. There's no way to do that?

A. That's correct. We could not do that.

Q. Can you give me a perspective -- well, you've been managing this plan for how many years?

A. I've been involved directly for three years. Our firm has been involved for decades.

Q. Okay. Are you familiar with the plan prior to your employment? I mean, have you reviewed records back before the three years that you've been working at Towers --

A. Towers Perrin.

Q. -- Perrin?

A. Yes. Some of them, yes.

Q. Just looking at a handful of years, it appears that the cash contributions have been significantly less than the accounting costs that has been set out. I reference specifically '02. It appears again in '03. Do you anticipate in '04 where the cash contributions more closely resemble the accounting expense?

A. Well, our projections show that the cash contribution will significantly exceed the accounting cost for '04, '05, '06.

Q. Beginning in '04 --

A. Yes.

Q. -- '05?

Now, in reading the testimony, I want to make sure that I -- that I accurately am going over these numbers. There are -- under ERISA, there are two different methods, one being the accrued method, one being the current liability?

A. Yes.

Q. The major difference is basically the difference in the discount rate?

A. I would pick two differences.

Q. Okay. What's the second? Or the first and the second?

A. I would say you just hit the first, the discount rates. The other would be projected pay increases in the actuarial accrued liability approach. When we look at the past service obligation, we base it on people's service to date, but their pay projected out to retirement. When we look at the current liability approach, we look at their service to date, just like the actuarial accrued liability, but they're paid to date as well.

Q. Is that considered in FAS 87 at all?

A. FAS 87 also includes a projection of payout to retirement. And that's -- I don't know if it's helpful, but that is in my rebuttal testimony. That's Schedule 2.

Q. Could you explain to me the smoothout language that's in here, exactly what that means?

A. Sure.

Q. That's part of ERISA?

A. Yes. It's probably best explained with an example. If -- if plan assets are $100 million and we assume -- let's just, to keep it simple, pretend that our assumption is a 10 percent assumption for the year. It's not that, but --

Q. A 10 percent assumption for what?

A. A 10 percent investment --

Q. Return?

A. -- return assumption --

Yes.

Q. Okay. Okay.

A. -- for the year, our assumption is the plan will earn $10 million in investment return over the next 12 months. What if we earn instead 15 million? The following year the plan asset value that we use will not be 115 million. It will be the 100 that we started with, plus the 10 that we thought we were -- assumed we were going to earn, plus 1/5 of that extra 5 million, so it would be 100 plus 10 plus 1. So we would say, then -- a year from now, we would say our plan assets for ERISA purposes are 111 million, when the underlying market value is 115 million. So -- and each of --

Q. Is that based on unrecognized gains?

A. That is, in effect, an unrecognized gain, because we are smoothing out that unrecognized gain.

Q. Does that work the same way on losses?

A. Under ERISA, parallel treatment for losses. If instead of earning 100-- instead of earning 10, I had earned 5, I would have only recognized 1/5 of that sort of $5 million loss.

Q. Looking at -- on Exhibit 93, we talked about '01, '02, and '03. In '04 and '05, where the minimum required contributions are going to go up significantly, are you able to determine or estimate what your cash outlay would be in those years?

A. Cash outlay as in the contribution to the plan?

Q. Yes.

A. Our estimate is those contribution numbers.

Q. It's the 44 million, 404?

A. No. I'm sorry. What I had elsewhere, the 76.6 million for the plan year beginning July 1 and the 73.8 million for the plan year beginning July 1 of '05.

COMMISSIONER CLAYTON: Okay. Well, then that answers my question. I don't believe I have any further questions. Thank you.

JUDGE THOMPSON: Thank you, Commissioner Clayton.

I have a couple questions for you, sir.

QUESTIONS BY JUDGE THOMPSON:

Q. Am I correct in understanding that no matter what the Commission does with respect to this question, what the company is actually going to contribute in terms of cash into its plan is going to be determined by ERISA?

A. I would probably just refine that statement a little bit.

Q. Please.

A. But I would say we will calculate for each year the minimum required contribution under ERISA and the maximum contribution under ERISA, and the company will contribute, unless they do something very surprising to me, something between those two numbers, regardless of what happens here.

Q. And historically that's what they have been doing, as far as you know?

A. Yes. Yes.

Q. Okay. And regardless of what the Commission does here, for the purposes of the company's financial statements, is FAS 87 going to govern the expression of pension expense on those statements?

A. There's no such thing as a simple answer.

Q. Particularly with pensions.

A. I'm afraid, yes. For U.S. accounting purposes, the answer is yes. Now that the company has a British and a German parent, for those ultimate corporate purposes, there's another accounting standard that's used.

Q. Okay. So that at least on American financial statements, for 2004 they're going to report pension expenses of roughly 44.3 million, although they will have, in fact, contributed something like 76.6 million?

A. Again, that's correct. Those numbers don't quite match up. There's a little six-month difference of a year, but yes, that's correct.

Q. Looks a lot like my checkbook, in fact. Move the decimal points.

So what the Commission is actually determining in terms of rate base -- and I know that's not an area of your expertise -- is the company's revenue stream attributable to pensions?

A. That is my understanding of exactly the issue.

JUDGE THOMPSON: Thank you very much. Any further questions from the Bench?

COMMISSIONER CLAYTON: Just one.

JUDGE THOMPSON: Absolutely. Commissioner Clayton?

FURTHER QUESTIONS BY COMMISSIONER CLAYTON:

Q. Now, when you administer the plan for American Waterworks, is that correct, the parent company, or just Missouri-American?

A. No. The parent company, yes.

Q. So you work on the pension for the company nationwide?

A. That's correct.

Q. How about above that? Do you also administer the pension for the British parent or the German holding company?

A. At this time, no.

Q. You don't. I was going to ask you how the benefits differ, but that may be for a different day.

A. I don't know.

JUDGE THOMPSON: Commissioner Murray?

FURTHER QUESTIONS BY COMMISSIONER MURRAY:

Q. Yes. You indicated earlier about the various approaches, and you said they all get to the same place in the end if they begin with the beginning. Now, I want to make sure that I understand what you're saying there.

Are you saying that if you begin with calculations based on the FAS 87 approach and stay with that until the last pensioner is no longer around, the fund is at zero, that that would give you the same result as if you begin with either ERISA calculation and follow it all the way through until the last pensioner is gone and the fund is zero?

A. That's right. If we started with -- when the plan was born and before and it had no plan assets in it at all, and we followed it all the way through and it grows and lots of money's put in and lots of money comes out, then the cumulative cost from day zero until 80 years later -- I'm just pulling a time frame out of my head -- when the last dollar is paid, the cumulative cost will be the same under accounting purposes or under cash contribution purposes. But that is important.

If we started halfway through and looked forward for the last 40 years, in my example, then they would not have the same cost because we have cumulative contributions -- sorry, poor choice of words -- cumulative costs to date that are not the same. So one has to catch up to the other in the future.

Q.   Okay. And I know you don't -- you're not into the ratemaking issues, but if we were to change for ratemaking purposes the methods that we have been recognizing for contributions to the plan --

A.   Right.

Q.   -- midstream, it would not come out the same in the end?

A.   That's correct.

Q.   Even for ratemaking purposes?

A.   That's correct.

Q.   And if we switched back and forth, depending upon whether the actual contributions were greater than the FAS 87 calculations or less than the FAS 87 calculations, we would create even more of a disparity there, would we not?

A.   If they came out the same, it would be purely coincidence.

COMMISSIONER MURRAY: Thank you.

JUDGE THOMPSON: Further questions from the Bench? There appear to be none.

Recross, Ms. Bond?

RECROSS-EXAMINATION BY MS. BOND:

Q. Mr. Williamson, you have all of these projections, but for each plan year -- just trying to summarize -- starting, say, in July and then computing forward with the data you have as of July 1, you compute what the actual contribution will be for that year, correct?
A. I'd say that's well said.
Q. Okay. And that's done through a 5500,500 form; is that correct?
A. At the end of the plan year, the formal form on which these results are filed to the federal government is a schedule that's attached to Form 5500.
Q. Okay. And as Commissioner Clayton has said and as Judge Thompson has said, that no matter what the Commission does, that assuming that American Water will comply with federal law, as it has done in the past, that those contributions -- at least the minimum ERISA contribution will be made every year, correct?
A. That's correct.
Q. So that's a requirement of federal law, and no matter what this Commission does, that does not change, correct?
A. That's correct.
Q. All right. You said, I believe, that the -- for plan year 2002, that that's when American Water had to start making ERISA minimum contributions again, correct?

A. The plan year beginning July 1, 2002, that's correct.

Q. Before that, the ERISA minimum contribution had been zero for several years; is that correct?

A. That's correct.

Q. All right. And let's just say for purposes of total oversimplification that that's because we had a roaring stock market, correct?

A. The roaring stock market was a key factor.

Q. Okay. Now --

A. But not the only factor, but a key factor.

Q. Given the state of the law currently and the state of the economy, in your professional opinion, do you think that there is any reasonable likelihood that American Water's minimum ERISA contributions for, say, the next three to four years will be close to zero per year?

A. I guess my answer would be, I would be surprised if the minimum turned out to be zero, but there's so many factors that affect it.

Q. Hypothetically what changes would have to occur in the economy or in law or in participation level in order for the minimum ERISA contributions for the next three to four years to be zero annually?

A. There's two key inputs that would drive it, that would -- that could drive it to zero; a tremendous investment return on plan assets.

Q. A soaring stock market?

A. Would almost have to be driven by a soaring stock market, or interest rates -- if we could use a higher interest rate for calculating the plan's past service obligation.

Q. And how is that -- how could that interest rate be changed?

A. How could the interest rate be changed?

Q. Yes.

A. Well, right now it's -- that's the key one that's driving the contribution is the one that's driven by the 48-month weighted average of Treasury Bond yields.

Q. So for Treasury Bond yields to change dramatically, then?

A. Yes.

Q. Now, do you know -- and I think my perception is that this may be a key to the confusion. I know it was at least a key to my confusion, so maybe others share it. Do you know, is Staff accepting your projections for the future for these large numbers on contributions that in 2004, for example, the minimum contribution under ERISA will be $76.6 million?

A. I don't know Staff's reaction.

Q. Okay. So you simply don't know?

A. That's correct. I don't know. I can -- the only thing I can say is that I know that, from my perspective, I could detail the key assumptions that you made to develop those numbers, and I think those are very reasonable assumptions.

Q. Can you tell me this: Why do you expect the return on plan assets to be 9 percent? I understand that that's a long-term estimate, but why 9 percent?

A. I'd say the key answer is that six -- the plan assets are roughly invested in the following matter: About 60 percent of plan assets are invested in equities, in stocks, about 40 percent in fixed income investments, and historically that kind of an asset mix has produced a return in the neighborhood of 9 percent over an extended long period of time, 10, 15, 20 years.

Q. So notwithstanding the recent if you want to say correction in the markets?

A. That's correct. If you -- 2000, 2001, 2002 were very poor returns in the stock markets -- in the stock market, but if you look at 2003, as well as '99, '98, '97, '96, these averages have held for long periods of time.

MS. BOND: Thank you.

JUDGE THOMPSON: Thank you, Ms. Bond. Ms. O'Neill?

MS. O'NEILL: No questions.

JUDGE THOMPSON: Mr. Schwarz?
RECROSS-EXAMINATION BY MR. SCHWARZ:
Q. Just a couple of clarifications, if I might. The letter that you sent to Mr. Grubb in November that's attached to his schedules, and what's Exhibit 93, your work papers, and your testimony as well, those numbers are all American Waterworks numbers?
A. That's correct.
Q. So none of them reflect Missouri-American's portion of American Waterworks?
A. I would say, I mean, they're not specifically Missouri-American numbers, but --
Q. Missouri-American gets a share of these costs; is that correct?
A. That is a correct statement.
Q. And with respect to Exhibit 93, I think you were going over it with Commissioner Murray, and I -- my attention wavered for a moment. And on Exhibit 93, you have the projected benefit obligation, there is the line under reconciliation of funded status?
A. Yes.
Q. Did I hear you to say that that was the projected past service obligation?
A. Yes.
Q. So those two terms are interchangeable?

A. I use the term past service obligation. That's not a defined term in actuarial science. I use it to try to capture any of these measures of the present value of benefits earned to date. The -- under -- in each of these, we're sort of talking about three approaches to cost. The FAS 87 approach has its own measure of the past service obligation, and that is the projected benefits obligation. The current liability has its own measure of past service obligation. That is current liability. And the actuarial accrued liability approach has its own measure and that is the actuarial accrued liability.

Q. So you use projected benefit obligation because this is a FAS 87?

A. Yes, projected benefit obligation is a defined term under FAS 87, that's correct.

Q. Okay. And you haven't translated these into deutschmarks yet?

A. That is also a true statement.

MR. SCHWARZ: Thank you.

JUDGE THOMPSON: Thank you, Mr. Schwarz. Mr. Cooper?

MR. COOPER: Yes, your Honor.

REDIRECT EXAMINATION BY MR. COOPER:

Q. Mr. Williamson, quite some time ago when you started your testimony, there was discussion about the

discount rate and investment returns I think as a part of ERISA methodology. Do you remember that?
A. Yes, I do.
Q. Do those both, the discount rate and investment return, also impact the FAS 87 methodology?
A. Yes, they do.
Q. In your rebuttal testimony, I believe it's Schedule 2, if you could turn to the first page with me.
A. I'm there.
Q. There was a question to you about I think it's that category that says does American smooth assets for this purpose? And just to the right of that under FAS 87, the word no is there. Do you see that?
A. Yes, I do.
Q. You had a question about that and said you did not know why American Water did not smooth assets for this purpose. Are there other smoothing-type effects that are a part of the FAS 87 that don't qualify for this category?
A. The answer is yes, there are other aspects of FAS 87 cost and investment returns that are smoothed.
Q. Do you have any example you can give us?
A. Maybe if I go back to the same company that I used with Commissioner Clayton. If -- where we said if we had $100 million in the plan and we assumed that we were going to earn $10 million this year, and instead we earned

15. So now we have an investment return for the year of $15 million. $10 million is what we expected to earn. The additional 5 under the accounting rules, FAS 87, is characterized as an unrecognized gain, and that goes -- I phrase it as that 5 million of good news goes into a bucket, and the dollars in that bucket get smoothed in two ways.

First of all, unless they exceed a certain threshold for certain purposes, we ignore that $5 million. Whether it's $5 million of good news or $5 million of bad news, we ignore the 5 million unless it exceeds a certain threshold. So that's one level of smoothing.

A second level of smoothing is even if all the dollars that go into this bucket, such as this investment return dollars, if they exceed the threshold, then we only recognize a portion of the amount that exceeds the threshold.

So there is a double layer of smoothing. It's not technically asset smoothing, but does smooth the impact of investment return and other -- and in general, I should make a more -- I'm sorry -- I should make a broader statement. Any experience that differs from the actuarial assumptions.

Quick example: If 10 percent of our population passed away this year and we assumed 2 percent would, that's a huge reduction in plan obligations. That, quote, strictly from the plan's perspective, good news that unexpected reduction in the obligation goes into this bucket. I wish I'd picked a better example.

Q. As a matter of clarification on a different subject, I think you referred more than once to all three approaches. In terms of all three approaches, were you referring to the three columns that you have on Schedule 2, the FAS 87 approach, and then the two approaches under ERISA?

A. Yes, I am.

Q. I think there was a question of you that asked what would happen if earnings exceed projected earnings, okay, in a given year? For the company, what is the implication of that in a single year? Let's say in 2004 earnings exceeded the projected earnings. Can the company do anything with that amount of, I guess I'll call it excess earnings or overfunding?

A. That will do two things. If I earn excess earnings in one year, in the following year that means two things in very basic terms: I will have a lower expense, lower accounting cost under FAS 87 than I otherwise would have, and I will have a lower contribution than I otherwise would have.

Q. If the cash contribution is zero, will it do anything to the cash contribution?

A. No, the cash -- that's a good point. The cash contribution cannot go lower than zero.

Q. There were several questions in regards to your statement that ERISA and FAS 87 over the long term should both end up in the same place. Do you recall those?

A. Yes, I do.

Q. And just for clarification purposes, I think what you were responding is that that assumes that you pick one or the other, correct?

A. I would -- for rate case purposes, yes. What I was saying was if -- if we tracked the FAS 87 cost from the day the plan is born to the day that the last dollar is paid out and we added up that FAS 87 cost from day zero to end, time end, we would get a number. If we did the same thing for the cash contributions from day zero to day end, we would get the same number.

Any given time period in between -- and I think this is what the one Commissioner, I think, was getting at this issue -- we would not get the same thing. We would not get the same. But over the entire lifetime of the plan, we would have the same cumulative total.

Q. So if you were to go utilizing one methodology for a 10-year period and then another methodology -- the other methodology for the second 10-year period, would you get to the same spot at the end?

A. No, you would not. If that was the basis for ratemaking, for example, then the cumulative cost would either be greater or less than the true cumulative cost, but it would not be the same.

MR. COOPER: That's all the questions I have, your Honor.

JUDGE THOMPSON: Thank you, Mr. Cooper. There being no further questions of this witness, you are excused, sir.

COMMISSIONER CLAYTON: Can I ask one question, please?

FURTHER QUESTIONS BY COMMISSIONER CLAYTON:

Q. How long has Financial Accounting Standard 87 been in existence?

A. It was published in December of 1985 and adopted by companies either in 1986 or 1987.

Q. Is this pension plan older or younger than FAS 87?

A. It's older than FAS 87.

Q. So we can't really track FAS 87 from beginning to end to get to -- we can't track it from the inception of the plan and track all the way through like we just talked about, correct?

A. Not in that perfect form. The longer the time period you go, the better you do at tracking it.

JUDGE THOMPSON: Okay. Is there any additional recross based on questions from the Bench?

Ms. Bond?

MS. BOND: No, sir. Thank you.

JUDGE THOMPSON: Ms. O'Neill?

MS. O'NEILL: No, sir.

JUDGE THOMPSON: Mr. Schwarz?

MR. SCHWARZ: No, thank you.

JUDGE THOMPSON: Any additional redirect, Mr. Cooper?

MR. COOPER: Yes.

FURTHER REDIRECT EXAMINATION BY MR. COOPER:

Q. I believe, Mr. Williamson, you said that FAS 87 was published first when?

A. Published in December of 1985.

Q. Was there any additional guidance that was provided by the Financial Accounting Standards Board after the initial publication?

A. In 1986, the Financial Accounting Standards Board published some questions and answers to provide the actuarial and accounting communities with some additional guidance.

Q. Since 1986 and the publication of that document, has the Financial Accounting Standards Board provided any additional rules or changes to those rules in any way?

A. No.

MR. COOPER: Thank you, your Honor.

JUDGE THOMPSON: Thank you, Mr. Cooper. You are excused, sir. You may step down. Thank you for your assistance.

Little bit of housekeeping before we go forward. Mr. England, you had spoken to me about taking some time to make sure exhibits were marked and copies provided to the reporter. We can do that now or do that tomorrow morning at nine o'clock. Anybody have any preference? Perhaps you don't want to carry them away with you.

MR. ENGLAND: My understanding is the room's locked at night anyway, isn't it?

JUDGE THOMPSON: It will be locked.

MR. ENGLAND: We can do it now or we can do it in the morning.

JUDGE THOMPSON: I would prefer to do it in the morning, if that's all right.

MR. ENGLAND: That's fine. I don't know if this needs to be on the record, but the parties have discussed the possibility of subsequent days of hearing convening at 8:30 and possibly going 'til 6. Now, I don't know if anyone's had a change of heart or not, but -- and, of course, that also depends on the Commission's availability, but at the very least, even if we're just going to go to 5, if we could start at 8:30 on each of the hearing days.

JUDGE THOMPSON: I'll take that under advisement and discuss it with the Commissioners. I'm certainly prepared to reduce my lunch period to a mere 60 minutes, if necessary. It's no occasion for merriment. There's also a possibility of some days becoming available in January after the last week that we presently have scheduled for this case. I didn't want to reveal that possibility too early for fear that the pace of questioning would become even slower than it has already. But that is a possibility. We're going to go 'til about 10 minutes to 5 today, and so why don't we begin with the next witness?

MR. COOPER: Your Honor, company would call Edward Grubb.

JUDGE THOMPSON: Mr. Grubb, can you please come forward. Mr. Grubb, would you please spell your last name for the reporter.

THE WITNESS: Grubb, G-r-u-b-b.

JUDGE THOMPSON: Thank you.

(Witness sworn.)

JUDGE THOMPSON: Thank you, sir. Please take your seat.

You may inquire.

EDWARD GRUBB testified as follows:

DIRECT EXAMINATION BY MR. COOPER:

Q. Mr. Grubb, are you sponsoring what has been marked as Exhibits 1, 41 and 83, which is direct testimony, rebuttal testimony and surrebuttal testimony?

A. Yes, I am.

Q. Do you have any changes that you need to make to those exhibits?

A. Yes, I do. To the direct testimony, which is Exhibit -- Mr. Cooper --

Q. Exhibit No. 1?

A. Exhibit No. 1. On page 6, line 2, it says generally accepted accounting principles. Principles should be spelled p-r-i-n-c-p-l-e-s. And that's all the changes I have to my direct. On my rebuttal testimony --

Q. Which would be Exhibit 41?

A. -- Exhibit 41, on page 10, on line 18, the number 450,061 should be 90,016.

JUDGE THOMPSON: Which line is this?

THE WITNESS: Line 18 on page 10.

JUDGE THOMPSON: 90,018.

THE WITNESS: 016. And the 200 percent should be 40 percent.

And then on rebuttal Schedule EJG-3, under the second footnote at the bottom of the page, on the second line of that footnote the same 450,061 should be 90,016.

BY MR. COOPER:

Q. I think mine says 450,081 perhaps.

A. I'm sorry. And on that same second footnote, on the third line down, after the 15,000,904, please insert divided by 5 and.

Q. So it would be read divided by 5 and multiplied by?

A. That's correct.

Q. Is there anything else on your rebuttal testimony?

A. That is all the changes I have.

Q. You have no changes on your surrebuttal testimony?

A. No, I do not.

MR. COOPER: Your Honor, we would offer Exhibits 1, 41 and 83.

JUDGE THOMPSON: Okay. Do I hear any objections to the receipt of Exhibit 1?

(No response.)

JUDGE THOMPSON: Hearing none, Exhibit 1 is received and made a part of the record of this proceeding.

(EXHIBIT NO. 1 WAS RECEIVED INTO EVIDENCE.)

JUDGE THOMPSON: Do I hear any objections to the receipt of Exhibit 41?

(No response.)

JUDGE THOMPSON: Hearing none, Exhibit 41 is received and made a part of the record of this proceeding.

(EXHIBIT NO. 41 WAS RECEIVED INTO EVIDENCE.)

JUDGE THOMPSON: And last one is 83. Do I hear any objections to the receipt of Exhibit 83?

(No response.)

JUDGE THOMPSON: Hearing none, Exhibit 83 is received and made a part of the record of this proceeding.

(EXHIBIT NO. 83 WAS RECEIVED INTO EVIDENCE.)

MR. COOPER: We would tender Mr. Grubb for cross-examination.

JUDGE THOMPSON: Thank you, Mr. Cooper. Ms. Bond?

CROSS-EXAMINATION BY MS. BOND:

Q. Mr. Grubb, I'm Jan Bond and I represent the union.

On your rebuttal testimony, please, Schedule EJG-4, the letter from Mr. Williamson.

A. Yes, I have it.

Q. Okay. And perhaps you don't know the question either, but is it your understanding that Staff is not accepting Mr. Williamson's projections of the actual minimum ERISA contributions to the pension fund as listed on that first page of Schedule EJG-4?

A. That is correct. I don't know if Staff agrees or disagrees. I did not read anything necessarily in any testimony to date that would agree or disagree with the information.

Q. My understanding of your testimony -- and I'm sorry, I thought I had this marked -- was that you said that Staff's position was that the future ERISA contribution would remain at zero or near zero. That's not contained in your testimony here?

A. I think in my rebuttal testimony what I'm addressing is Staff has recommended that for rate recovery starting in this case, that pension expense be based upon the ERISA calculation for pension, and that the company's recommendation in the case was based upon FAS 87.

Q. All right. Why does the company have a problem with that, with Staff's position?

A. Well, as stated by Mr. Williamson and discussed earlier, that if you go from Point A to Point B at the beginning and end of a time period for pension under either method, you come to the same end results. We've been using FAS 87 since about the '93 or '94 time frame, and to start changing methodologies will only exacerbate the differences that could end up taking place as a result of switching from one method to another.

I also feel very concerned on page -- on page 11 of my rebuttal, at lines 11 through 15, I show a comparison for Missouri-American for the years 2004 to 2007, the impact of ERISA versus FAS 87. And based upon the information, the projections from Mr. Williamson's firm, the ERISA contributions far exceed the FAS 87 projections. And what that does is it's just going to add onto the cost of providing service to our customers.

Q. But once again, no matter -- you would agree that no matter what the Commission does here, the company -- and by the company in this case I mean American Water -- will continue to make at least the minimum funding contribution required by ERISA, correct?

A. That is correct.

MS. BOND: Okay. Thank you.

JUDGE THOMPSON: Thank you, Ms. Bond. Ms. O'Neill?

MS. O'NEILL: Your Honor, I don't have any cross for Mr. Grubb on this issue, but expect he will be back and I reserve my right to cross-examine him later.

JUDGE THOMPSON: I think we're going to see Mr. Grubb several times. Mr. Schwarz?

CROSS-EXAMINATION BY MR. SCHWARZ:

Q. Good afternoon, sir.

A. Good afternoon.

Q. Would you agree that one of the items on which the company and Staff agree is that the company has accrued a pension liability on its books of about $9 million?

A. That is correct, and that same $9 million as was discussed by Mr. Gibbs in his direct testimony is serving to reduce rate base of our customers.

Q. And that's the treatment that both the company and the Staff propose for that pension liability?

A. That's correct, yeah.

Q. So that's two areas of agreement?

A. There you go.

Q. Can you tell me how that $9 million accrued?

A. It accrued as a result of recovering in rates pension expense under the FAS 87 methodology starting in, I believe, '93, maybe '94 time frame.

Q. And that is the FAS 87 pension expense that the company collected in rates that was in excess of ERISA contributions?

A. For that --

Q. For that period?

A. For that 10-year period, that's correct.

Q. So, in effect, the company has borrowed the money that was provided as a pension expense and used for whatever purposes, but it is still recording that pension liability on its books; is that a fair statement?

A. As a liability, and as you can see now, looking at page 11 of the -- my rebuttal testimony, we're getting ready to pay some enormous amounts of contributions that will reverse that liability off the books by the end of 2007.

Q. Okay.

A. Assuming we continue FAS 87 for rate recovery.

Q. The ERISA contributions will be whatever they're determined to be under ERISA, though, that's correct? They have no relation to FAS 87 calculations?

A. I'm not an actuary here. There are two different methodologies which use -- uses similar assumptions and similar calculations, but different methodologies. Some of the assumptions are different.

Q. But the FAS 87 pension expense is not directly -- it's not the same as the ERISA contribution, is it?

A. They're two different.

Q. Two separate?

A. Two separate calculations, that's correct.

Q. And the calculation that governs the cash requirements of the company to pay into its pension fund is the ERISA calculation; is that correct?

A. That's correct.

MR. SCHWARZ: Thank you.

JUDGE THOMPSON: Thank you, Mr. Schwarz. Questions from the Bench, Commissioner Murray?

QUESTIONS BY COMMISSIONER MURRAY:

Q. Good afternoon, Mr. Grubb.

A. Good afternoon.

Q. I believe Mr. Schwarz just asked you something about a $9 million -- I don't know exactly what he called it -- funding in excess in the pension fund. Is that what he was talking about?

A. Since the mid '90s, '93, '94 time frame, this Commission has authorized the company to include in rates pension expense using the FAS 87 methodology. For the accounting for that, we collect the money in revenues, we record the expense as an expense on the company's income statement, and because there is no -- or were no cash contributions during much of that time period, the company records the other side of FAS 87 expense as a liability on the company's books.

Starting in 2003, the company has incurred -- or has made contributions so we would write a check to the pension trust, and we would reduce the liability that's on the books at this time. So in a previous comment on page 11, we see that the contributions are now going to exceed the FAS 87 costs. So over the next four to five years, that liability that sits on the company's books for pension will slowly disappear and go to zero, or actually maybe go to a debit balance, which would create a rate base addition in a future rate case.

Q. So the effect of the liability being present as it has for the past several years, what is the effect of that on revenue requirements for the company?

A. It's reducing the revenue requirements of our customers as a rate base deduction.

Q. And now that the situation has changed and the liabilities will be -- projected liabilities are going down, if you continued with the same ratemaking treatment that you've had in the past, how would that affect the revenue requirement for the company?

A. If we continue with the FAS 87, we would -- and I'll just look at page 11 -- for 2004, we would collect in rates 6.1 million, 5.5, 4.8 million, 4.2 million, assuming annual rate increases. The ERISA contributions will be made by the company, and as that contribution exceeds the FAS 87 costs, the rate base deduction will decrease, which then, in effect, basically increases the company's rate base and gets back to a zero level at the end of this five-year period. There would be no or very little rate base impact for the pension liability on the books.

Q. Okay. So treatment under FAS 87 has acted to reduce the company's earnings for the past few years; is that correct?

A. Under FAS 87 there was an expense to the company and earnings were reduced only to the extent that it was not captured in the revenue requirement in the previous rate case.

Q. And going forward, FAS 87 would tend to offset that to some degree anyway?

A. Well, we would continue the FAS 87 in rates if the Commission rules in that sense, and that the company outside the bounds of a rate case would continue to make the contributions to the pension trust.

Q. Okay. Would it be fair to say that if you use FAS 87 consistently over time, that in some years it results in a benefit to the company and in some years it results in a lowering of revenue for the company, versus if we were going with looking at the ERISA calculations?

A. I'm not sure I'm following you, Commissioner, on that question.

Q. I'm not sure I'm asking the question right. The ratemaking treatment that you have received for pension plans in the past is under FAS 87 calculations?

A. That's correct.

Q. And that treatment in some years results in a lower revenue requirement for the company than recognition

of calculations under ERISA would result in that year?
A. That would be true for the years 2005, 2006 and 2007. For the last couple years, last number of years it's actually the ERISA exceeded the contribution, and that's what has created the liability on the company's books.
Q. So now it would work to the company's benefit, the Staff is suggesting changing the methodology; is that right?
A. I think -- I think no. I think it would -- we should stay on the FAS 87 costs.
Q. I'm asking what Staff is recommending.
A. Oh, I'm sorry. Yeah, Staff is recommending to move to the ERISA, which over the next four to five years would exceed the FAS 87 cost similar to what has been over the last four to five years where the FAS 87 exceeded ERISA contribution.
Q. So it appears that the Staff is recommending that whichever methodology results in the lowest revenue requirements for the company at the time is the methodology that should be used for that particular rate case. Would you say that's how it appears?
A. They're recommending that in this case. I don't know what Staff would recommend in the future.
Q. In the last rate case, though, it would have

been more beneficial to the company to have used the ERISA calculations, would it not?

A. Because ERISA was lower, that's correct.

Q. But Staff didn't recommend it at that time?

A. That's correct. That's correct. They recommended FAS 87 in every case back to the 1994-'95 time frame.

Q. And I believe Ms. Bond was asking you if you knew whether Staff was disagreeing with the ERISA numbers, and I think you said you didn't know. Have you looked at Mr. Gibbs' testimony?

A. I've read through it yesterday afternoon.

Q. Would you look at his Schedule 1?

A. I have it.

Q. And are those numbers for the years 2003 through 2008 equivalent to the numbers in your testimony on your -- I believe it was EJG-3 or 4, wasn't it? Am I getting confused where I saw those numbers?

A. I think it's EJG-4.

Q. Do they look like they're equivalent numbers?

A. If we're talking about page 12 of EJG-4, the letter from Mr. Williamson had estimated minimum required contributions. And the actual 2002 number, that's an actual number, so that would agree to the column labeled June 30, minimum ERISA for 2003, 12.4, and then you would go down and the numbers all do agree. And then on the second page of EJG-4, under the column December 31, FAS 87, starting in 2003, those numbers agree on Mr. Gibbs' Schedule 1.

COMMISSIONER MURRAY: Okay. Thank you. That's all I can think of right now.

THE WITNESS: Thank you.

JUDGE THOMPSON: Thank you, Commissioner. Commissioner Clayton?

QUESTIONS BY COMMISSIONER CLAYTON:

Q. Mr. Grubb, can you help me identify exactly where the company and Staff disagree? And I believe your testimony was that your difference was a total of $3.8 million; is that accurate?

A. In terms of simply FAS 87 costs versus ERISA costs, I believe the difference is about 3.6 million. I may be off a little bit there.

Q. 3.6 million?

A. 3.6 million.

Q. Can you point me to either a chart, whether it be on page 11 of your testimony or any of the schedules, that I could see that $3.6 million?

A. I believe those numbers would be contained in some work papers of Mr. Gibbs and of the company.

Q. But no summaries?

A. It would just be in the current work papers that are supporting the -- the Staff's filing and the company's filing.

Q. I thought I had a pretty good handle on what we were talking about here, and I -- now I'm a little confused, so I need your help in getting me straightened out. Okay?

A. I'll try.

Q. We're talking about the difference -- we have accounting costs and then we have actual cash outlays to make the pension work. And what I'm confused about is that Staff is recommending using ERISA figures rather than using FAS 87.

Would it not be to the company's advantage -- considering the higher numbers that will have to be contributed under ERISA, wouldn't it be to the company's benefit to use those higher numbers in establishing that cost?

A. No, I don't think so. I think what's important is that the company recover in rates the cost for FAS 87 that it records for financial reporting so that the revenue stream matches the expense for that item, and that as the -- as the contributions occur -- and they are occurring today -- those contributions will be made from the company's financial capability resulting from prior collections in rates under FAS 87.

Q. But as we look forward, the actual FAS 87 figure will be less than ERISA, and you want the number to be as high as possible, correct? I mean, from your company's perspective?

A. We want to reflect in rates to our customers the FAS 87 costs, and by doing that, because FAS 87 is a -- is not the contribution, the company records that 87 because -- as a liability because they know their contribution's going to be coming in the near future. As the contribution comes, we pay down that liability that's on the company's balance sheet.

Q. How long have you been with the company?

A. Missouri-American or American System?

Q. Take your pick.

A. Okay. I'll give you both. American System, I started in 1978, and I've been with Missouri-American as a Missouri-American employee since October of 2000. I was with the service company back in '94 to '98, where I worked on Missouri-American rate cases.

Q. Okay. What has been the company's position over the last four rate cases? There's been a lot of discussion about the Staff's position. What has the company's position been over the course of those four rate cases?

A. Those cases, the last four cases, including this one, have been filed using FAS 87 methodology for pension re-- recovery of rates.

Q. Okay. Prior to FAS 87 what method did the company use?

A. I don't know. That was before my --

Q. Before you?

A. I was living in West Virginia at the time.

Q. Lucky you. I know that the testimony states that Staff made some modifications to the FAS 87 numbers in the last rate cases --

A. That's correct.

Q. -- correct?

But the company's position was to use those FAS 87 numbers?

A. The company's position in those cases was to use the straight FAS 87 without any modifications.

COMMISSIONER CLAYTON: I've got to look at one more thing. I don't think I have any other questions.

JUDGE THOMPSON: Thank you. Commissioner Murray?

FURTHER QUESTIONS BY COMMISSIONER MURRAY:

Q. Mr. Grubb, would you look at your Schedule EJG-3, please?

A. That's part of my rebuttal testimony?

Q. Yes.

A. Okay. I have it.

Q. I'd like to go through that, because I think it illustrates what you're saying here about how the application of these different methodologies affect the bottom line of the company. Under the rate case -- the 1995 rate case, which is the first column there, there were un-- unrecognized -- were these unrecognized gains or losses at that time, that 562,000?

A. That was an unrecognized gain.

Q. All right. Meaning that the pension fund, there was more in the pension fund than -- I'm sorry. Tell me why that was a gain.

A. As the pension plan experiences returns on its investments and as those investments either go up or down within the pension fund, they have either unrecognized gains or unrecognized losses.

Q. And because the earnings on the fund had been good at that particular time period, it amounted to some gains that were unrecognized; is that right?

A. That's correct.

Q. And in the rate case, those gains were considered?

A. Yes. The Staff utilized the 562,000 and divided by 5 to recognize a five-year average of the number and then multiplied, and that resulted in the 112,400. And then they took Missouri-American's portion of that, which was 2.9 percent, and reduced the company's expense by a resulting $3,260. So in the sense of a pure FAS 87 cost, Missouri-American's piece would have been 282,594, and what was included in rates was 279,334.

Q. Okay. And the reason they did not allow you to expense the full 282,594 that year was because they considered those unrecognized gains?

A. Yeah. They included the unrecognized gains as parts of the determination of the FAS 87 cost.

Q. Okay. Now, the next rate case, the '97 rate case in the next column there was a loss of 15.9?

A. That's correct.

Q. And that was million?

A. And what this schedule was meant to do is to say, had the Staff used the same methodology in the '95 case and used it in the '97 case, they would have increased our expense by about $90,000.

Q. Okay. And they did not include it, they did not recognize the -- they did not even consider that unrecognized loss in that rate case?

A. That's correct. They used what I'll refer to as the pure FAS 87 cost or they recommended the pure FAS 87 cost in that case.

Q. And is the Staff -- was the Staff's

recommendation in each of these cases what the Commission actually decided?

A. I believe as a result of either stipulation or litigation, the ultimate numbers included in rates were the Staff's recommendations.

Q. Okay. So the first rate case, because of Staff's recommendations and its treatment of the FAS 87 costs, the company recognized -- are these -- I'm sorry. Is this million, this --

A. These are in dollars.

Q. Okay. So $3,260 less --

A. Yeah. Uh-huh.

Q. -- in expenses?

A. That's correct.

Q. And in the next case, the company recognized a little over $100,000 less in expenses than it would have if the unrecognized losses had been considered; is that right?

A. Well, the Staff in the '97 case -- that case there, they actually recommended what the company was recommending in terms of methodology, pure FAS 87 costs.

Q. Okay. So the company was not wanting to include the calculation of the unrecognized loss?

A. That's correct. We don't believe that that's the appropriate way to calculate and record in rates the FAS 87 cost. The FAS 87 cost including rates should be the pure cost as a result of doing the actuarial study.

Q. Okay. Then go to the 2000 rate case, and there again, there was an unrecognized gain. Pretty large unrecognized gain; is that correct?

A. That's correct.

Q. And at that time, being a gain rather than a loss, the Staff said it should be considered?

A. At that point, they took a five-year, a five-year average of the gains and losses over the last five years, rather than just taking the last year and dividing it by five. So this is sort of a different kind of averaging calculation, and the result was a reduction in the expense of about $22,000.

Q. Okay. And when there is a reduction in the expense, that reduces the revenue requirement overall, correct?

A. That's correct.

Q. And let me go back to year '97, the '97 rate case again for a couple minutes. The $90,000 difference there, if there had been a recognition of the -- or consideration of the unrecognized loss, would that have added $90,000 to the expense figure for the company that year?

A. Yes. That's correct.

Q. Which would have meant an increase in revenue requirement?

A. That's correct.

Q. But it was not considered, and there was no increase in revenue requirement based on unrecognized loss?

A. That's correct.

Q. But every time there is an unrecognized gain, it appears that that is considered to reduce the revenue requirement of the company?

A. In the '95 case and the 2000 case, that was the time when that was recognized.

Q. Okay. How is what Staff is recommending in this case different from those applications of -- or recognition of -- let's see -- consideration of unrecognized gain under FAS 87 in those previous rate cases?

A. They're not doing anything in this case. In this case, the very last column for Case 2003-0500, they're using the ERISA calculation and not taking into consideration any part of the FAS 87 calculation.

Q. Okay. Did you do a calculation under FAS 87, including unrecognized gains or losses?

A. In the company's filing, as part of the last rate case, the company agreed to file its case using the Staff's methodology in the 2000 case. By doing that, it would have increased and it did increase the company's filed position by the $229,000 at the bottom of that page.

Q. That was an increase to the expense amount?
A. That's correct. Over the last few years there have been losses, as noted by Mr. Williamson earlier.
Q. Okay. And to get there, you just simply applied the methodology that Staff used in the 2000 rate case?
A. That's correct.
Q. In other words, you recognized or you showed -- you showed unrecognized losses?
A. A five-year average.
Q. A five-year average. Which was exactly the way the Staff treated the unrecognized gains in the 2000 case?
A. That's correct.
Q. And then you -- the next line, you use the FAS 87 costs?
A. That's correct, the 6.2 million.
Q. And subtracted from that number the unrecognized losses?
A. If it's unrecognized loss, you'd be adding to the FAS 87 cost.
Q. Okay. And bottom line was that there were $229,334 additional that should have been expensed?
A. Or recovered in rates using the Staff methodology in the 2000 case, and that's what was in our

recommendation in the current proceeding.

Q. Okay. So this is not the -- it appears, in looking at this, that this is not the first time that Staff has vacillated between methodologies from rate case to rate case; is that correct?

A. That's correct.

Q. And whether Staff chooses to use unrecognized gains or losses depends, it seems, purely upon whether it was a loss or a gain?

A. I guess I'll let the schedule talk for itself.

Q. But you're not aware of any times in which the Staff has recommended considering unrecognized losses?

A. In a way, in the last, the 2000 case they did, in the $4.162 million, that's an average, I believe. When I looked at the calculation, three or four of the years had gains and maybe one or two years had losses, but when you add them together, it sort of netted down. So in a way, in that case, they did take into consideration prior year gains. It's just that -- or prior losses. It's just that when you net them altogether you end up with a, quote, net gain.

Q. A really large net gain it looks like, comparatively speaking?

A. When compared to the '95 case, yes.

Q. You wouldn't assume that's purely

coincidental, would you?

A. I don't know how to answer that.

COMMISSIONER MURRAY: Okay. I do think that's all I have. Thank you.

THE WITNESS: You're welcome.

JUDGE THOMPSON: Thank you, Commissioner. Commissioner Clayton?

FURTHER QUESTIONS BY COMMISSIONER CLAYTON:

Q. Can you give me the dollar amount that is the position of the company on this issue?

A. I believe just in terms of -- I mentioned it earlier -- their expense versus our expense. It's in the 2.6 --

Q. Can you give me -- no. I want to know what the company's cost, the FAS 87 number that is part of this case in determining the revenue requirement. Do you know that?

A. Not right offhand. It's in the $4 million range. I don't have our company accounting schedules with me. I apologize.

COMMISSIONER CLAYTON: I don't have any other questions.

QUESTIONS BY JUDGE THOMPSON:

Q. Okay. That was going to be my first question, too, is what is the amount of pension expense that the company had during the test year?

JUDGE THOMPSON: Mr. Cooper, do you have any accounting schedules?

MR. COOPER: Your Honor, we do have, if we may approach the witness.

JUDGE THOMPSON: You may approach the witness.

MR. COOPER: And I believe what we've handed him, your Honor, has been identified as Exhibit 10.

JUDGE THOMPSON: Okay.

THE WITNESS: During the test year, the company had pension expense of $1,277,952.

BY JUDGE THOMPSON:

Q. Okay.

A. The company's pro forma pension expense, using FAS 87, was 4,139,534, and included in that number is, using the Staff's methodology in the last case, we added to that and included in that number is added the 229,000 that is shown at the bottom of Schedule EJG-3 of my rebuttal testimony.

Q. Okay. Now, the test year pension expense of $1,277,952, do you know, does that equal the cash contribution during the test year?

A. That is the FAS 87 accounting cost.

Q. So that's the accounting cost?

A. That's correct.

Q. Do you know what the cash contribution was in the test year?

A. It was approximately $180,000. Since Mr. Williamson stated that the cash contribution came back in July of 2002, the first annual -- full annual contribution, about 370-some thousand, it's about 180,000 on a six-month basis during the test year.

Q. Okay. So the amount that the company is asking the Commission to include in revenue requirement in this case is the 4.1 million figure?

A. That's correct. That includes what the Commission Staff asked us to do as part of the stipulation in the last rate case, to include their methodology from the last rate case.

Q. Okay. And how do you calculate that? How do you arrive at that from the FAS 87 amount for the test year, or do you?

A. The amounts in our rate case was based upon the estimate of the actual -- or the estimate of FAS 87 actuarial reports provided to the company by Towers Perrin. Now, they have the actual FAS 87 costs, which I believe will be a little bit different, since they've been finalized, and that's going to be part of our true-up that we're going to give to the Staff here in the next week or two.

Q. Okay.

A. So the number that we're asking for ultimately before the Commission is the actual current Fas 87 cost that we have available to us today.

Q. The 4.1 million?

A. Approximately that number. It won't be exactly that because of some changes.

Q. But am I correct in understanding you are not able to tell me the relationship of that figure to the test year pension expense figure of 1.2 million?

A. They're based on two different actuarial studies. An actuarial study is done every calendar year, so 2002 would have been based on the 2002 actuarial report.

JUDGE THOMPSON: Thank you very much. That's all the questions I have.

COMMISSIONER CLAYTON: I'm sorry to keep coming back.

FURTHER QUESTIONS BY COMMISSIONER CLAYTON:

Q. On the figures that you've just used in answering the Judge's question, how would we find those as a part of the figures on Exhibit 93, or can we, which is the total American Water pension plan where you're using the large numbers? Do these operate as a percentage of the overall pension plan or are they completely derived in a different -- in a different fashion?

A. The company takes the overall actuarial study and whatever that number is and allocates a portion of those costs to each of the subsidiaries within that study, and the actual allocation is based upon payroll. So if Missouri-American represented 12, 13 percent of the payroll within the market system, then 10 to 12 percent of that FAS 87 cost would be recorded as an expense on the company's books.

Q. And -- I'm sorry. That 10 to 12 percent is what?

A. I'm just estimating.

Q. What Missouri-American's share of the overall pension plan would be?

A. That's correct.

Q. Do you know what that figure is? I know you're estimating and I don't need an exact figure.

A. No. It could be 13 or 14 percent.

COMMISSIONER CLAYTON: Okay. Thank you.

JUDGE THOMPSON: Further questions?

(No response.)

JUDGE THOMPSON: Okay. We're going to go ahead and shut down for today at this time, about 10 minutes before I had anticipated. We will begin with recross based on questions from the Bench, but why don't we come back tomorrow at 8:45 and begin marking exhibits, do whatever we need to do with the exhibits and then we will start with recross.

Sir?

MR. SCHWARZ: I do not have any recross.

JUDGE THOMPSON: Bless you.

MS. O'NEILL: I don't either.

MS. BOND: Nor do I.

JUDGE THOMPSON: We've just hit a homerun here. It's absolutely unprecedented, in my experience. But Mr. Grubb will be here anyway, because he figures in every issue as far as I can tell, but nonetheless, I appreciate that. Yes, they do get redirect.

Can you finish tonight, approximately eight minutes?

MR. COOPER: Yes, your Honor.

JUDGE THOMPSON: Well, have at it.

MR. COOPER: Mr. England only wants me to promise to finish if I really can finish, and I would remind everyone that that probably depends upon what questions I spur on from the Commissioner here, so there is a large unknown in that.

MR. SCHWARZ: And we are going to revisit this issue of true-up, right?

THE WITNESS: If Mr. Williamson comes back, I'll come back.

REDIRECT EXAMINATION BY MR. COOPER:

Q. A couple of things, Mr. Grubb. In your -- I think I left it back in my seat. In your rebuttal testimony, I believe it's EJG-3, one of the columns or one of the rows, I guess more accurately, that you were asked to describe is the row entitled allocation of unrecognized gains slash losses that for the WR-95-205 case was the figure 3,260, and then for the WR-2000-281 case has the figure of 22,061. What happens to those amounts, I guess, after 1995 and after 2000? Does the company ever recover those?

A. They're lost forever. Speaking with Mr. Williamson, any adjustments made in the revenue requirement for FAS 87 costs are never recovered in the future.

Q. Let's try one other item here. I believe Commissioner Clayton kind of had some confusion as to why the company was proposing FAS 87 -- FAS 87 methodology when, I guess, the company's own projections show that the ERISA minimum contribution will actually exceed the FAS 87 numbers in the next several years. Do you remember that?

A. Yes, I do.

Q. What -- and it's my memory that it's about $377,000 that the Staff proposes to include in the revenue requirement utilizing the ERISA contribution method. Is that close?

A. Yes, it is.
Q. Where does that $377,000 come from?
A. That comes basically from the ERISA calculation performed by Towers Perrin of about 12 million, and a piece of that is allocated to Missouri-American.
Q. Does that 377 include anything for the year after or the year after or the year after that?
A. You're saying like 2004, 2005?
Q. Correct.
A. No. There will be separate actuarial studies done in the future on both ERISA and FAS 87, which will recalculate what the contributions should be, the minimum required contributions and the FAS 87 costs.
Q. If the Commission agrees to utilize the $377,000 number as a part of revenue requirement in this case and indeed the ERISA minimum cash contribution amount increases, as the company believes it will, what will happen to the company from a rate perspective between now and the company's next rate case?
A. On a going-forward basis, if you're collecting in rates 377 as a -- in terms of a contribution and you're recording that as the expense on a going-forward basis, if you should get up to the levels of $5 and $10 million that are not in rates, obviously there's a very extreme detrimental impact on the company's financials.

Q. And there's a shortfall between now and when you can get back in for the next rate case, correct?

A. That's correct.

Q. Okay. Now let's look ahead to that next rate case. Let's say we're three years down the road. Let's say during that time period what the company has suggested will happen has happened, and that is the ERISA minimum cash contribution has increased and now exceeds FAS 87 costs. Let's say at that point the Staff comes back in and says, oh, let's go back to FAS 87. What happens to the company in that scenario?

A. Well, first of all, it's another change, which maybe exacerbates the issue that Mr. Williamson talked about and what is ultimately collected in rates. I'm afraid what may happen is either it's collected in rates as either greater than or less than from the ratepayers. Without really going into and looking at the financial impact going out in time, I just don't know, Mr. Cooper.

Q. Is it possible that if at that point, indeed, the ERISA minimum cash contribution exceeds FAS 87 costs, that then the company would again be short on pension expense on a going-forward basis?

A. That is a possibility, yes.

MR. COOPER: That's all the questions I have, your Honor.

JUDGE THOMPSON: Thank you, Mr. Cooper. Hearing no further questions, you may step down.

THE WITNESS: Thank you.

JUDGE THOMPSON: Okay. We will be in recess until tomorrow morning at 8:45. See you-all then.

WHEREUPON, the hearing of this case was recessed until December 16, 2003.

I N D E X

EXHIBITS INDEX

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*Premarked exhibit.