

1 STATE OF MISSOURI
2 PUBLIC SERVICE COMMISSION

3
4
5 TRANSCRIPT OF PROCEEDINGS

6 Hearing

7 December 16, 2003
8 Jefferson City, Missouri
9 Volume 13
10

11 In the Matter of) Case No.: WR-2003-0500
12 Missouri-American Water) Tariff Nos. YW-2003-2012
13 Company's Tariff to Revise) YW-2003-2013
14 Water and Sewer Rate) YW-2003-2014
15 Schedules.) YW-2003-2015

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

18 CONNIE MURRAY,
19 BRYAN FORBIS,
20 ROBERT CLAYTON,
21 COMMISSIONERS.

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1 P R O C E E D I N G S

2 (EXHIBIT NOS. 2 THROUGH 10; 12 THROUGH 25; 28,
3 29; 32 THROUGH 50; 52; 54, 55; 58; 61 THROUGH 83; 86;
4 89 THROUGH 91, AND 94 WERE MARKED FOR IDENTIFICATION BY
5 THE COURT REPORTER.)

6 (Witness sworn.)

7 JUDGE THOMPSON: Thank you. You may be
8 seated. Let me get my video going here.

9 You may inquire.

10 DOYLE L. GIBBS testified as follows:

11 DIRECT EXAMINATION BY MR. SCHWARZ:

12 Q. Would you state your name for the record,
13 please.

14 A. Doyle L. Gibbs.

15 Q. By whom are you employed and in what capacity?

16 A. I'm employed by the Missouri Public Service
17 Commission as an auditor.

18 Q. And did you pre-file testimony in this case --
19 direct testimony that's been marked as Exhibit 16, and
20 surrebuttal testimony that's been marked Exhibit 66?

21 A. Yes, I have.

22 Q. Do you have any corrections to make to those?

23 A. No, I do not.

24 Q. If I asked you the same questions today as are
25 asked in your testimony, would your answers be the

1 same?

2 A. Yes, they would.

3 Q. Are the answers that -- in your testimony true
4 and correct to the best of your information, knowledge
5 and belief?

6 A. Yes, they are.

7 MR. SCHWARZ: I would offer Exhibits 16 and 66
8 at this time, subject to the parties being able to
9 cross-examine Mr. Gibbs at a later date when he comes
10 back on issues other than pensions, and tender him for
11 cross on pensions at this time.

12 JUDGE THOMPSON: Thank you, Mr. Schwarz.

13 Do I hear any objections to receipt of
14 Exhibit 16 or 66?

15 (No response.)

16 JUDGE THOMPSON: Hearing no objections,
17 Exhibits 16 and 66 are received and made a part of the
18 record of this proceeding.

19 (EXHIBIT NOS. 16 AND 66 WERE RECEIVED INTO
20 EVIDENCE.)

21 JUDGE THOMPSON: Now, I need to call roll to
22 see who is here of all of the various parties. I guess
23 we'll do that now.

24 Industrial Energy Consumers?

25 (No response.)

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1 JUDGE THOMPSON: I don't see them.
2 Missouri Energy Group?
3 (No response.)
4 JUDGE THOMPSON: I don't see them.
5 City of Riverside?
6 (No response.)
7 JUDGE THOMPSON: Water Rate Coalition?
8 (No response.)
9 JUDGE THOMPSON: Empire District?
10 (No response.)
11 JUDGE THOMPSON: City of Joplin?
12 (No response.)
13 JUDGE THOMPSON: Public Water Supply
14 District?
15 (No response.)
16 JUDGE THOMPSON: City of Warrensburg?
17 (No response.)
18 JUDGE THOMPSON: City of Jefferson?
19 (No response.)
20 JUDGE THOMPSON: Local 35 (sic)?
21 Ms. Bond?
22 MS. BOND: Yes, sir.
23 JUDGE THOMPSON: You're first.
24 CROSS-EXAMINATION BY MS. BOND:
25 Q. Good morning, Mr. Gibbs.

1 A. Good morning.

2 Q. I think, as you know, I'm Jan Bond, and I
3 represent Utility Workers Local 35. And I have a few
4 questions for you, please.

5 To pick up on what Commissioner Clayton was
6 asking Mr. Grubb yesterday afternoon, can you tell me
7 what is Staff's number on what should be allowed for
8 pensions, please?

9 A. The total cost that the Staff has included for
10 pensions is 46-- \$466,177.

11 Q. And is that -- are those calculations included
12 in your testimony anywhere?

13 A. I don't know that the calculations are
14 included in the testimony. The -- the results are --

15 Q. Okay.

16 A. -- reflected in our accounting schedules and
17 exhibits.

18 Q. Can you tell me how you came up with this
19 number, please?

20 A. That number is actually a combination of the
21 allocated portion of -- of the minimum ERISA from
22 American Water to the Company, Missouri-American, and
23 it also includes an allocation of the service company,
24 as well as additional actual cash payments the Company
25 has made for supplemental pensions to former active

1 employees.

2 Q. When you say the minimum ERISA, are you
3 talking about the minimum ERISA contribution that is
4 actually required to be made under federal law as
5 discussed by Mr. Williamson yesterday?

6 A. Yes.

7 Q. Okay. And when you're talking about the
8 minimum ERISA contribution, am I correct that you are
9 taking your number from the \$12.4 million actual
10 contribution that the Company was required to make for
11 plan year 2002?

12 A. When you say plan year 2002 -- it's the latest
13 available known contribution that the Company has
14 made -- had to make under minimum ERISA.

15 Q. You are familiar, are you not, with
16 Mr. Grubb's Schedule EJG-4 that was attached to his
17 surrebuttal testimony -- the letter from Mr. Williamson
18 that was discussed yesterday?

19 A. Yes.

20 Q. Okay. And if you could look at that for me,
21 please. Do you have that?

22 A. Yes, I do.

23 Q. Okay. We see on the first page of
24 Schedule EJG-4 that Mr. Williamson calculated his
25 projections for what the minimum pension contribution

1 would be for American Water under ERISA going out to
2 the year 2007, correct?

3 A. Yes, that is correct.

4 Q. And for 2003 he estimated 15.1 million; for
5 2004 he estimated 76.6 million, et cetera, correct?

6 A. Yes. And those -- those are years beginning
7 on July 1 of those particular years.

8 Q. And that's -- when I say plan year, I -- I
9 believe the plan year for this particular pension plan
10 runs from July 1st through June 30th, correct?

11 A. That's correct.

12 Q. Okay. Now, am I correct that your
13 calculations on behalf of the Staff do not include any
14 of these estimated numbers prepared by Mr. Williamson?

15 A. No, they do not. Those -- for -- for purposes
16 of the Staff, those are not known and measurable, so
17 they would not be incorporated in our -- our filing.

18 Q. So that yesterday when there were questions
19 from the Bench concerning a concern, a confusion,
20 something when it seemed to people, and perhaps it
21 seemed to me as well, that the ERISA contributions
22 would actually be higher than FAS 87. That's not
23 correct under Staff's position?

24 A. Not under our known and measurable criterias
25 (sic) as it currently exists.

1 Q. So you're relying on -- on your
2 calculations -- solely on the \$12.4 million, which is
3 the last -- that's the last figure that is known and
4 measurable; is that correct?

5 A. That is correct.

6 MS. BOND: Okay. I don't have anything
7 further.

8 JUDGE THOMPSON: Thank you, Ms. Bond.

9 Ms. O'Neill?

10 MS. O'NEILL: No questions.

11 JUDGE THOMPSON: Mr. Cooper?

12 MR. COOPER: Yes, Your Honor.

13 CROSS-EXAMINATION BY MR. COOPER:

14 Q. Good morning.

15 A. Good morning.

16 Q. We hashed this out pretty good I think
17 yesterday, but would you agree with me that -- that the
18 essence of this pension expense issue in the rate case
19 is whether to follow a FAS 87 methodology as proposed
20 by Missouri-American Water Company or to base pension
21 expense on the minimum contribution under ERISA?

22 A. That's how the issue has been described, yes.

23 Q. Would you agree with that?

24 A. Not entirely.

25 Q. Why not?

1 A. Well, call it cynicism. You know, based on
2 27 years of regulation, I think what it really equates
3 down to is in any given time frame, it's what the
4 bottom time is to the Company. And currently the FAS
5 87 is in -- in excess of ERISA.

6 Q. And, on the other hand, for Staff the ERISA
7 number is less than the FAS 87 number proposed by the
8 Company, correct?

9 A. That is correct.

10 Q. Okay. And to follow up on what Ms. Bond was
11 asking you about, that's a snapshot description of
12 those numbers as they exist today for purposes of this
13 case, correct?

14 A. Are you referring to the estimated future
15 ERISA?

16 Q. Well, I think what I'm referring to is the
17 fact that the number that has been discussed that --
18 that the Company has proposed for pension expense, as
19 well as the number that the Staff has proposed for
20 pension expense, are both based upon known and
21 measurable items, meaning things that have already
22 occurred -- we're not looking into the future for
23 either one of those numbers, are we?

24 A. Yeah, you're -- that -- that's correct. If --
25 if you want to characterize it as a snapshot in time,

1 that'd be correct.

2 Q. Now, would you agree with me that FAS 87 is an
3 accrual accounting method, isn't it?

4 A. Yes, it is.

5 Q. And would you agree -- well, let me back up.
6 Were you here yesterday for all of Mr. Williamson's
7 testimony?

8 A. Yes, I was.

9 Q. Would you agree with Mr. Williamson that
10 there's been no Financial Accounting Standards Board
11 amendment to FAS 87 since FAS 87 became effective
12 around the year 1987?

13 A. I believe that's correct.

14 Q. And were you also here for the opening
15 statements yesterday, Mr. Gibbs?

16 A. Yes, I was.

17 Q. I believe Mr. Snodgrass in his opening
18 statement described FAS 87 as an accrual -- accrual
19 method that does not match actual payments.

20 Do you remember that?

21 A. Not the exact language, but I seem to recall
22 him making something to that remark.

23 Q. Would you agree with that description of
24 FAS 87?

25 A. In any given year, that would be correct.

1 Q. Is there anything new about that?

2 A. No.

3 Q. And that's been true since FAS 87 was adopted,
4 correct?

5 A. Yes.

6 Q. And I believe you state in your -- in your
7 surrebuttal testimony that pension expense is an
8 evolving issue.

9 Do you remember that?

10 A. Yes.

11 Q. Now, we've talked about the fact that -- that
12 FAS 87 itself hasn't changed since it became effective,
13 correct?

14 A. Not the FAS 87, you know, as it was written,
15 no. I mean, it's --

16 Q. As it's been established by the Financial
17 Accounting Standards Board, it hasn't changed?

18 A. That -- that's correct.

19 Q. So it's -- it's not FAS 87 that's -- that has
20 evolved over time, is it?

21 A. No. It -- it's not the FAS 87. It's the
22 methodologies employed in the ratemaking arena
23 associated with FAS 87. FAS 87 does give some
24 variations, I guess, to treat the unrecognized gains
25 and losses.

1 As Mr. Williamson had indicated yesterday,
2 there is a minimum amortization that needs to take
3 place, which is typically referred to as the corridor
4 approach. But the amortization is not limited to that.

5 And that is where the Staff has taken
6 exception to what is normally in the FAS 87 calculation
7 where we have in the past used a -- a quicker
8 amortization of the gains and loss for purposes of
9 ratemaking.

10 Q. Okay. So would you agree with me that what
11 has evolved is not FAS 87 itself, but the Commission
12 Staff's approach to applying FAS 87?

13 A. And I -- I think that was the connotation that
14 was supposed to be in my testimony. I mean, the FAS 87
15 is an evolving ratemaking issue, not that FAS 87 has
16 evolved.

17 Q. Now, going back to I -- I believe the year
18 1987, you -- you state in your testimony was when FAS
19 87 became effective for most companies; that's --
20 that's correct, isn't it?

21 A. Yes.

22 Q. Did the Commission Staff immediately use FAS
23 87 in its pension cost recommendations immediately
24 after FAS 87 became effective for companies?

25 A. No, the -- the Staff, I believe, still

1 continued to advocate the use of minimum ERISA. It
2 wasn't until FAS 106 through legislation we were
3 required to adopt FAS 106 for ratemaking purposes that
4 we adopted the FAS 87.

5 Q. Okay. And is the statute you're referring to
6 Missouri Statute Section 386.315?

7 A. I'll -- I'll take that, subject to check.

8 Q. I think it's in -- it's in your testimony,
9 isn't it, but --

10 JUDGE THOMPSON: I think I heard that once
11 yesterday. We -- we don't like the use the phrase
12 "subject to check," because that's basically saying
13 I'll guess -- I don't know, but I'll guess. So --

14 THE WITNESS: Well --

15 JUDGE THOMPSON: -- either you know or you
16 don't know.

17 THE WITNESS: Well, I don't -- I didn't commit
18 the -- the numbers to memory.

19 JUDGE THOMPSON: Then -- then you may tell
20 Mr. Cooper that you don't know.

21 MR. COOPER: Let me return to my seat for just
22 a moment, Your Honor.

23 JUDGE THOMPSON: Absolutely.

24 BY MR. COOPER:

25 Q. Mr. Gibbs, if I were to hand you a copy of a

1 statute, do you think that you would recognize the
2 statute that you're referring to that required FAS 106
3 treatment for OPEBs?

4 A. Yes. It's included in my direct testimony.
5 It was House Bill 1405, Section 386.315 of the Revised
6 Statutes of Missouri.

7 Q. And in what year did that become effective --
8 the portion of that statute that -- that required FAS
9 106 treatment?

10 A. It was passed in 1994.

11 Q. Would you agree with me that what that statute
12 states in part as to the FAS 106 treatment is that the
13 actual level of expenses for utility is required by
14 Financial Accounting Standard 106 to record for
15 post-retirement employee benefits for all -- wait.
16 Excuse me. Let me back up.

17 That the Commission must utilize for
18 ratemaking purposes the actual level of expenses the
19 utility is required by Financial Accounting
20 Standard 106 to record for post-retirement employee
21 benefits for all of the utilities -- employees
22 including retirees?

23 MR. SCHWARZ: The Staff will stipulate to
24 the -- to the contents of -- of the statute. I think
25 there's also a requirement that in order to obtain such

1 treatment, the utilities must actually pay those monies
2 into segregated funds that will be used only for those
3 purposes.

4 And I think that's a significant aspect, and
5 also bears on the pensions on this issue that's
6 currently pending. So I would ask that -- that the
7 entire language of the statute be addressed here.

8 JUDGE THOMPSON: Well, the -- the statute says
9 what it says, and -- and we'll have opl-- ample
10 opportunity on redirect to bring out any additional
11 statutory language you want.

12 Please proceed.

13 BY MR. COOPER:

14 Q. Now, Mr. Gibbs, has the Staff utilized FAS 106
15 in this case to address the category of retirement
16 benefits entitled other post-retirement employee
17 benefits or -- or OPEBs?

18 A. Yes, it has.

19 Q. And if we -- if you think back for a moment to
20 386.315, there's no mention of -- of FAS 87 in that
21 statute, is there?

22 A. I don't know.

23 Q. Okay. Just don't remember?

24 A. That's correct.

25 Q. Would you agree with me that the Commission

1 first used FAS 87 to set rates for MAWC in Case
2 No. WR-95-205 decided around November of 1995?

3 A. I believe that is correct.

4 Q. Would you agree with me that since that time
5 some form of FAS 87 has been utilized in -- in every
6 Missouri-American Water Company case to establish
7 pension expense?

8 A. Yes. And I think that's -- that's drawn out
9 in my direct testimony that we have used FAS 87 or some
10 form of FAS 87 since -- since its adoption in 1994.

11 Q. Well, since the adoption of 386.315 in 1994,
12 correct?

13 A. Correct.

14 Q. Now, do you recall in Missouri-American Water
15 Company's last rate case -- I believe it's
16 WR-2000-281 -- that Missouri-American stipulated that
17 it would file its pension expense in the next case
18 utilizing FAS 87?

19 A. I'm not aware of the specific language that
20 was in -- in the -- in the stipulation, but if it was
21 there --

22 MR. COOPER: Well, let's -- let's go down that
23 road just for a moment.

24 Your Honor, may I approach the witness?

25 JUDGE THOMPSON: You may.

1 MR. COOPER: Your Honor, I'm -- I'm handing
2 the witness a copy of this Commission's report and
3 order in Case No. WR-2000-281 issued August 31, 2000.

4 BY MR. COOPER:

5 Q. And, Mr. Gibbs, if you'll look -- I believe
6 we're on page 21. Do you see a subcategory -- well, a
7 Category E that's represented on that page?

8 A. Yes. It's titled pension and other
9 post-retirement employee benefits.

10 Q. Okay. Would you read the sentence that
11 follows that -- that title?

12 A. MAWC agrees to make adjustments and determine
13 revenue requirement in future rate cases using the
14 methodology proposed by the Staff for pension and other
15 post-retirement employee benefit expenses, which
16 amortize unrealized gains and losses.

17 Q. Now, as we mentioned before, the methodology
18 proposed by Staff in that case would be a FAS 87
19 methodology, correct?

20 A. That is correct.

21 Q. Okay. Now, would you agree with me that the
22 Commission first used FAS 87 in setting rates for
23 St. Louis County Water Company in Case No. WR-94-166,
24 which would have been issued around July of 1994?

25 A. That would be reasonable.

1 Q. Okay. It wouldn't surprise you if -- if the
2 Commission Staff started using FAS 87 in that 1994 time
3 frame, would it?

4 A. No, it would not.

5 Q. Okay. And I guess similar to what you -- you
6 stated previously, would you assume and -- or is it
7 your knowledge that the Commission Staff has utilized
8 some form of FAS 87 for St. Louis County Water Company
9 since 1994?

10 A. It would surprise me if we didn't.

11 Q. Now, do you know Mr. Charles R. Heineman?

12 A. Yeah.

13 Q. Who is Mr. Heineman?

14 A. He's an auditor out of our Kansas City office.
15 The name Charles threw me.

16 Q. Is he referred to as Chuck quite often?

17 A. Yes.

18 Q. Okay. And do you know approximately how long
19 Mr. Heineman may have worked for your office, that
20 being, I guess, the Commission Staff?

21 A. No, I -- I wouldn't want to venture a guess.

22 Q. Many years?

23 A. He's been with us for a while, yes.

24 Q. More than five years?

25 A. Yes.

1 Q. More than ten years?

2 A. I don't know.

3 Q. Okay. Would it surprise you to know that
4 Mr. Heineman has testified on behalf of the Commission
5 Staff in regard to pension expenses?

6 A. Well, I -- I think the issue has been
7 presented by a number of Staff employees from between
8 cases, so it would not surprise me.

9 Q. It wouldn't surprise you that Mr. Heineman
10 would have testified on behalf of the Commission Staff?

11 A. No.

12 Q. Okay. Perhaps more than once?

13 A. I don't know.

14 Q. Okay. I want to read to you a couple of
15 passages from testimony Mr. Heineman provided in
16 Commission Case No. ER-97-394 and see if I can get your
17 reaction to that.

18 A. What -- what was that case number again?

19 Q. It's ER-97-394.

20 And what I'm gonna read to you is a passage
21 from Mr. Heineman's direct testimony, and then a -- a
22 very short passage from his surrebuttal testimony in
23 that same case.

24 Now, Mr. -- Mr. Heineman's testimony was as
25 follows in his direct: The Commission is required by

1 Missouri law to allow the recovery of OPEB expense as
2 calculated under FAS 106 if certain conditions are met.

3 Given that the methods of accounting for OPEB
4 expense under FAS 106 and pension expense under FAS 87
5 are virtually identical, the Staff's position is that
6 if FAS 106 OPEB expense is recognized for ratemaking
7 purposes, then consistency dictates that FAS 87 pension
8 expense be recognized as well. That's the first
9 passage.

10 The second passage from his surrebuttal
11 states: While ERISA has been an accepted method of
12 determining pension expense in the past, the situation
13 has changed. Full accrual accounting is now the
14 standard ratemaking treatment for employee retirement
15 costs such as pensions and OPEBs.

16 Now, would you agree with me that that's a
17 pretty good summary of the Staff's position as to
18 pension expense from about 1994 certainly up through
19 about 2000 when -- when I think you say in your
20 testimony that the Staff in all major rate cases
21 recommended the use of FAS 87?

22 A. Yes. And as I -- I indicated, you know, that
23 FAS 87 is for ratemaking has been an evolving issue.
24 It's -- it's more recent history brought on by concerns
25 voiced from various utilities that the Staff has taken

1 a -- a second look, so to speak, at our FAS 87
2 methodologies that we use for ratemaking.

3 And we -- we've found from most utilities that
4 even FAS 87, particularly with -- with regards to the
5 amortization of the gains and loss, that it was just
6 extremely too volatile to -- for setting rates on.

7 Q. But during that time period -- that '94 to
8 2000 time period that I think you refer to in your
9 testimony -- the Staff's position as to pension expense
10 was adopted by the Commission and the major rate cases
11 you refer to, wasn't it?

12 A. Yes, I believe that's correct.

13 Q. And see if you agree with this. I would
14 allege that the Commission has utilized FAS 87 to
15 determine pension expense in every major litigated rate
16 case after the amendment of Section 386.315 in 1994.

17 Would you agree with that as well?

18 A. I wouldn't be 100 percent certain. I'd have
19 to see all the -- all the var-- all the various cases.
20 But I don't think the FAS 87 was an issue so much in
21 those cases.

22 The Company was -- the companies, I'm sure,
23 was filing on a FAS 87 basis, as was the Staff.
24 Normally what issue would arise out of FAS 87 would be
25 the amortization process of the gains and losses that's

1 included in the FAS 87 calculation.

2 Q. With that being the case, FAS 87 was utilized
3 in all of the cases that you're aware of, correct?

4 A. Yes.

5 Q. Now, in your surrebuttal testimony, and -- and
6 if you want to take a look at this, it's on page 9,
7 lines 19 through 22.

8 A. Could you say that again?

9 Q. Yeah, I need -- hold on just a second. Let me
10 figure a reference here.

11 A. I just wondered where line 22 went.

12 Q. Let's go back to -- to page 6, Mr. Gibbs --
13 actually I'm gonna point you to line 14. This is
14 another spot. I think you say this in a couple of
15 places generally.

16 But on page 6, line 14, you have a statement
17 that starts, at the time of Staff's adoption of FAS 87,
18 most pension funds were overfunded and substantial
19 unrecognized gains existed.

20 Do you see that?

21 A. Yes.

22 Q. Now, as a result of that situation that's
23 overfunding, would you agree with me that in many
24 cases, pension expense using FAS 87 ended up being a
25 negative expense for utilities?

1 A. I think that there were instances where FAS 87
2 did create a negative expense. And that's another
3 reason why I think the Staff's methodologies now that a
4 negative pension expense even under FAS 87 is not a
5 reasonable level of pension expense to include it on an
6 ongoing basis for a utility.

7 Q. But in many cases the -- the Commission Staff
8 did propose a negative pension expense, didn't --
9 didn't it?

10 A. That may be the case, yes.

11 Q. And by negative expense, we mean that rather
12 than increasing the revenue requirement as a normal
13 expense would -- it would serve to reduce that revenue
14 requirement, correct?

15 A. Yes, it would. And in -- and in turn create a
16 pension asset that would be included in rate base. The
17 opposite currently exists at the Missouri-American
18 level where there's approximately a \$9 million
19 liability on the books of the Company associated with
20 the difference between ERISA and FAS 87.

21 Q. Now, you -- you indicate in your surrebuttal
22 testimony that -- that FAS 87 costs may differ from
23 those shown in Mr. Williamson's projections, because
24 actual experience may not match the assumptions that
25 Mr. Williamson used.

1 Do you remember that?

2 A. Yes.

3 Q. Is that premise equally correct for the ERISA
4 actual minimum required contributions? And by that, I
5 mean that actual experience may not match the
6 assumptions that Mr. Williamson used.

7 A. I think his -- his history bears that out.

8 Q. Now, you also state in your surrebuttal
9 testimony that there's a compounding effect of
10 experience not matching assumptions as to FAS 87, I
11 believe; is -- is that correct?

12 A. Yes.

13 Q. And would an example of that be that -- that
14 if the actual investment return is less than it was
15 assumed in -- in the first year or Year X that this
16 lower-than-assumed return will have an effect on the
17 FAS 87 cost going forward in -- in the year -- one year
18 past X, two years past X --

19 A. Yeah.

20 Q. -- et cetera?

21 A. Yeah. The compounding effect goes both ways.
22 I mean, if -- if it actually earns less than what was
23 expected, it's gonna to have a negative effect. If it
24 had earned more than it was expected, it's gonna have a
25 positive effect.

1 Q. Okay. Would you agree with me that that
2 compounding effect -- the question of whether future
3 experience matches or doesn't match the assumptions --
4 also has a compounding effect in future years ERISA
5 minimum required contributions?

6 A. Yeah, any -- any time you're gonna have a
7 difference between actual and -- and estimated, I mean,
8 it's -- it's gonna carry forward.

9 Q. If you would, could you turn to Schedule 1 of
10 your surrebuttal testimony?

11 Have you located that?

12 A. Yes, I have.

13 Q. Now, that's a description of both ERISA costs
14 and FAS 87 costs for American Water, correct?

15 A. Yes, it is.

16 Q. Okay. And it -- and it includes actual
17 numbers for the years 1992 through 2003, correct?

18 A. For FAS 87. I didn't -- I don't think that I
19 had the information prior to 1995 for ERISA.

20 Q. Okay. So the actual numbers for the minimum
21 ERISA columns start in 1995, correct?

22 A. Yes.

23 Q. Okay. And then the same schedule also
24 includes projected numbers for both FAS 87 and minimum
25 ERISA contributions for the years 2004 through 2008,

1 correct?

2 A. Yes. Those numbers come straight from the
3 correspondence that's -- from Mr. Williamson that's
4 attached to Mr. Grubb's rebuttal testimony.

5 Q. Now, let's focus for a minute on the projected
6 numbers -- the numbers that are in -- from years 2004
7 to 2008. And if I look near the bottom of that
8 schedule, I have on the left side there a 2004 through
9 2008 description.

10 Do you see that?

11 A. Yes.

12 Q. Okay. And if I go over to the right of the
13 2004 through 2008 description, I get a total number in
14 the June 30 minimum ERISA column.

15 Do you see that?

16 A. You speaking of the 179 million?

17 Q. No. I'm -- I'm right before that. I'm sorry.
18 I'm on the minimum ERISA column.

19 A. Okay. Yes. The 258 million?

20 Q. Yeah. So that number is 258.2 million,
21 correct?

22 A. That is correct.

23 Q. And that represents the total of the minimum
24 ERISA cash contribution projections for the years 2004
25 through 2008, correct?

1 A. Yes.

2 Q. Now, if I step over to where you were a second
3 ago, one more column, which is to the right of the 2004
4 through 2008 description and below the FAS 87 column, I
5 get a number of 179 million, correct?

6 A. That is correct.

7 Q. And that represents the projected costs under
8 FAS 87 for the years 2004 through 2008, correct?

9 A. Yes, but that -- these numbers are total
10 American Waterworks. They're not Missouri-American.
11 Missouri-American just gets a piece of this.

12 Q. Correct. Correct. And I agree with you.

13 These are total -- total American Waterworks
14 numbers. And to get actual company-specific numbers
15 we'd have to apply some sort of allocation to that; is
16 that correct?

17 A. Yes.

18 Q. Okay. Now, if I look at these two numbers, it
19 appears to me that while using the ERISA minimum in
20 this case results in a lower revenue requirement for
21 Missouri-American Water Company that if we utilized
22 ERISA minimum cash contribution approach for the years
23 2004 through 2008, that ERISA minimum would exceed the
24 cost of FAS 87 by about 79.2 million.

25 Would you agree with that?

1 A. Yes, that is correct.

2 Q. If those projections would prove to be
3 correct, would you be comfortable stating that the
4 Commission Staff would continue to utilize ERISA
5 minimum cash contributions over that time period?

6 A. I certainly would. And No. 1 -- I mean,
7 when we -- when we're looking at 2004 through 2008 and
8 we're seeing that minimum ERISA exceeds FAS 87, you
9 also have to keep in mind that the present day for on
10 the books of Missouri-American, ERISA has been
11 overshadowed by the tone of 9 -- a little over \$9
12 million by FAS 87.

13 So the Company has, in essence, over this
14 period of time since the utilization of FAS 87 for
15 rates collected over \$9 million in excess of what their
16 cash contributions were required to be.

17 So -- and I think Mr. Grubb even stated in his
18 testimony on the stand yesterday that it's gonna take
19 'til sometime in 2007 before that turns around.

20 Q. Well, let's back up, though for a second,
21 to -- to 1995. I believe that you told me that
22 Missouri-American Water Company -- or the Commission
23 Staff began to use FAS 87 for Missouri-American Water
24 Company in approximately 1995, correct?

25 A. That is correct.

1 Q. Okay. If we look at this same schedule,
2 Schedule 1, in 1995 was the minimum cash contribution
3 under ERISA greater or the FAS 87 costs greater?

4 A. In 1995 -- for the year 1995 the FAS 87 cost
5 was 7.5 million. The minimum ERISA -- and that would
6 be for a 12-month period ending June of 1995 was 9.2
7 million.

8 So depending on how that test year fell, you
9 know, that -- you can't take the 9 million on its own
10 or the 2 million by its own. It was -- would probably
11 be a combination of the two, as well as the -- the FAS
12 87 costs.

13 Q. Right. But the numbers we have available to
14 us seem to indicate that the ERISA minimum cash
15 contribution would be gre-- was greater in '95 than the
16 FAS 87 costs, correct?

17 A. Yes, it was.

18 Q. Now, in your surrebuttal testimony I think you
19 also indicate that the Staff is -- is moving to the
20 ERISA minimum cash contribution methodology because FAS
21 87 does not adequately address the volatility of
22 pension expense.

23 Do you remember that?

24 A. Yes.

25 Q. And you made mention of that a little bit

1 earlier here today, correct?

2 A. Yes. It's pretty much a generic statement for
3 all the utilities that operate. I mean, what we
4 have -- what the Staff have found with regards to
5 pensions and the FAS 87 versus ERISA issue, yes.

6 Q. Okay. Let's -- let's take a look, then, at --
7 at Schedule 1 again. And if we look at the ERISA cash
8 contribution column again on this -- this document for
9 the projected years of 2004 through 2008, would you
10 agree with me that ERISA -- the minimum cash
11 contribution under ERISA is projected to increase by
12 over \$60 million from the year 2004 to 2005?

13 A. Based on the -- the methods and assumptions
14 from Mr. Williamson, yes. I think we've already stated
15 some certain reservations associated with those,
16 because it's not really known and measurable. I mean,
17 it's based on his best estimate, and I wouldn't want to
18 second guess Mr. Williamson as to -- as to his
19 assumptions.

20 However, we are -- we do know the history that
21 is -- that's in place pretty much indicates that what
22 happens in reality is often quite different from what
23 the assumptions are that's in those calculations.

24 Q. But -- but the reason you state that -- well,
25 is one of the reasons that you state that you wouldn't

1 want to second guess Mr. Williamson that you're not a
2 credentialed actuary like Mr. Williamson is?

3 A. No, I'm not an actuarial.

4 Q. And in terms of assumptions, of course,
5 Mr. Williamson described at length I think some of the
6 assumptions that -- that roll into the ERISA
7 calculations. But you would agree with me that those
8 assumptions similar -- if not the same assumptions,
9 similar assumptions also roll into the FAS 87
10 projections as well, correct?

11 A. Yes, they do.

12 Q. Okay. Now, also I'm gonna go -- take you back
13 to that same column, the minimum cash contribution
14 projections under -- under ERISA. And we identified, I
15 think, that there is a over \$60 million jump between
16 2004 and 2005.

17 Would you look at -- at years 2007 and 2008?
18 Would you agree with me that -- that we then have about
19 a \$40 million decrease?

20 A. Yes.

21 Q. Now, I want to compare those numbers to the
22 costs -- the FAS 87 costs that are represented just to
23 the right of -- of the percentages on that same sheet.

24 If we start from 1992 and look at those actual
25 numbers through 2003 -- also look at the projected

1 numbers, 2004 through 2008, would you agree with me
2 that the largest change from any one year to another
3 during that time period would be the slightly less than
4 \$16 million change between years 2002 and 2003?

5 A. In terms of absolute numbers, yes.

6 Q. The -- the actual pension costs, right?

7 A. Yes.

8 Q. That being the case, the fact that we see this
9 \$60 million jump, this \$40 million fallback on the
10 ERISA minimum cash contribution side -- and the largest
11 swing we see in -- in actual FAS 87 costs being
12 16 million, would you agree with me that ERISA minimum
13 cash contribution is projected to be more volatile over
14 the next four years than the FAS 87 actual costs have
15 been or are projected to be?

16 A. Based on the assu-- assumptions inherent in
17 his calculations. In terms of absolute dollar
18 movement, there's less movement in the FAS 87 than
19 there is in the minimum ERISA. But we really don't
20 know what those will be.

21 And I think the -- the -- the positive side of
22 the ERISA is -- if nothing else, the Company will be
23 funding its pension plan in compliance with federal
24 guidelines. And -- and that would be what would be
25 reflected in -- in rates.

1 Q. But on this day, with the best information we
2 have available to us, it looks as if that ERISA cash
3 contribution will swing far more wildly than the actual
4 FAS 87 costs, correct?

5 A. There is more movement in -- in dollars. And
6 how that affects the companies as far as the rates, the
7 Company, to a certain extent, can control that by the
8 timing of -- of filing of rate cases.

9 Q. So in the end what actually works its way
10 into -- to rates will depend upon that timing of rate
11 cases, right?

12 A. To a large degree that -- that timing of when
13 a case files and -- and when things occur, yes.

14 Q. Combined with whatever position the Commission
15 Staff, and I guess ultimately the Commission, will take
16 in setting a pension expense in those cases as well,
17 correct?

18 A. Well, ultimately it's gonna be the
19 Commission's decision.

20 MR. COOPER: That's all I have at this time,
21 Your Honor.

22 JUDGE THOMPSON: Thank you, Mr. Cooper.

23 The nice thing about having the Commissioners
24 up at agenda is I get to ask questions right away. And
25 then when you come back for their questions, I get to

1 ask questions again when they're done. So I'm going to
2 indulge myself, Mr. Gibbs.

3 QUESTIONS BY JUDGE THOMPSON:

4 Q. How much was the actual cash distribution of
5 the Company, Missouri-American, for pensions during the
6 test year, if you know?

7 A. The actual cash contribution was \$466,177.

8 Q. And that is, in fact, the amount that Staff
9 suggests that the Commission recognize in the revenue
10 requirement in this case; is that correct?

11 A. That is correct.

12 Q. Okay. And that's based on the year ending
13 December 31st, 2002; isn't that correct?

14 A. Updated through June of 2003, our known and --
15 our known and measurable period.

16 Q. Okay. So for the year 2003, what will the
17 Company's actual cash contribution be, if you know?

18 A. I do not know.

19 Q. Is there any way for us to say with any
20 reasonable degree of certainty what it's likely to be?

21 A. I think Mr. Williamson hit on it yesterday in
22 his testimony that they're about to finalize the 2003
23 actuarial report. And hopefully that will be available
24 to the Staff during our true-up process.

25 Q. Okay. Do you have any reason to expect it to

1 be the same as the amount for 2002?

2 A. I -- I expect it to be reasonably close.

3 Because what's -- what's in the test year right now are
4 contributions based on the actuarials estimate earlier
5 in year, and I don't anticipate that the actual
6 actuarial report to probably vary too much from -- from
7 his original estimate.

8 Q. Okay. Are you familiar with the -- the
9 testimony filed by Mr. Grubb?

10 A. I have read his testimony, yes.

11 Q. And have you seen the chart that he has on
12 page 11 of his rebuttal testimony? I don't know if you
13 have that there or not.

14 A. Yes, I have it.

15 Q. Okay. And in the right-most two columns, one
16 headed FAS 87 and the other headed ERISA, he sets out
17 figures for Missouri-American; isn't that correct?

18 A. Yes, that is correct.

19 Q. Now, am I correct in understanding that what
20 this exhibit is saying -- and I'm not asking you if you
21 agree with it or not -- but this exhibit is telling me
22 that in the year 2004 Mr. Grubb, at least, expects that
23 they will make a minimum contribution of \$5.7 million?

24 A. That's what this table projects, yes.

25 Q. Okay. And so -- and for 2005 it would be a

1 minimum contribution of 10.1 million?

2 A. That is correct.

3 Q. Okay. So I -- I do understand that column
4 correctly?

5 A. Yes, you do.

6 Q. Very well.

7 And now my question is: Do you agree or
8 disagree with those projected figures?

9 A. I have reservations in that history has shown
10 that what's in those calculations -- the actuarial
11 assumptions what actually occurs is quite frequently
12 substantially different from -- from those assumptions.
13 That's where those gains and losses actually come from.

14 Q. So that's the source of the unrecognized gains
15 and losses?

16 A. Yes, it is.

17 Q. That is the -- the difference form -- of
18 reality from the projection made by the actuary?

19 A. That is correct.

20 Q. Okay. But nonetheless it is a job -- the
21 profession of the actuary to make these projections; is
22 that correct?

23 A. Yes, it is.

24 Q. And is there -- is there any way to make them,
25 that is, more accurate or more reliable than the way

1 the actuary does it?

2 A. I don't know.

3 Q. Okay. So if the Commission puts \$466,000 into
4 revenue requirement to represent pension expense and
5 the Company actually makes cash contributions on the
6 order of 5.7 million in 2004 and 10.1 million in 2005
7 and 9.6 million in 2006, what would the effect on the
8 Company be, if you know or have any opinion, of making
9 contributions that are so very greatly in excess of the
10 revenue stream that's supposed to fund them?

11 A. Well, I think I hit on that where if -- it's
12 the Company's responsibility that -- you know, that
13 they can file a rate case, if necessary, to be
14 compensated for any change in their -- their operating
15 costs.

16 Also I want to emphasize that currently this
17 liability of \$9 million that's on the books represents
18 cash that they've already collected from the ratepayers
19 with regard to the difference between FAS 87 and
20 minimum ERISA.

21 Q. So -- so you're saying they've already got
22 9 million saved up, so to speak?

23 A. Yes.

24 Q. And that will help them defray these future
25 contributions if, in fact, they're larger than the

1 revenue stream?

2 A. The money has already been provided to the
3 tune of \$9.2 million to the Company.

4 Q. Okay. Now, why shouldn't the Commission
5 simply add the four figures in this column and then
6 divide that by four and put that number into revenue
7 requirement?

8 A. First off, those four numbers represent
9 estimates. They're not known and measurable; however,
10 I wouldn't be an advocate of doing that. But that --
11 that wouldn't prevent the Commission from doing so.

12 Q. Well, I understand that.

13 Now, this actuarial projection is done every
14 year, isn't it?

15 A. Yes, it is.

16 Q. And every year essentially they're looking for
17 it and saying, based on the money that's in the pot now
18 and the earnings that it received in the past year, how
19 much money is needed to fund this plan, looking
20 forward, right -- isn't that essentially what the
21 actuary is doing?

22 A. Yes.

23 Q. And I know I didn't state that very well.

24 And so that prediction changes from year to
25 year?

1 A. Yes, it does.

2 Q. And -- and, in fact, it can change fairly
3 significantly?

4 A. That's obvious from my Schedule 1, the
5 unrecognized gain and loss column. You can indic-- it
6 indicates the variance in estimated -- the assumptions
7 included in the calculations versus what the actual
8 occurrences.

9 Q. For example, in the year 1996, you have
10 percent change in the far right column of minus
11 2,929.89 percent; is that correct?

12 A. Yes. That particular year, I think, was --
13 was certainly an anomaly. You'll notice that the prior
14 year the unrecognized gain balances is a little over a
15 half a million dollars.

16 Q. Yes, sir.

17 A. In the following year it became a -- almost a
18 \$16 million loss. Now --

19 Q. Does -- does that mean the pension fund lost
20 \$16 million in that year?

21 A. Well, you know, that's -- that's very
22 interesting, because in the -- in the -- in going from
23 a half-a-million-dollar gain to a \$16 million loss, the
24 pension fund asset actually earned 33-and-a-half
25 percent.

1 Q. It earned 33-and-a-half percent?

2 A. It earned 3-- 33-and-a-half percent on its
3 assets, yet turned a half-a-million-dollar gain into a
4 \$16 million loss. And the -- and the only explanation
5 you can have for that are other assumptions that have
6 changed that have turned -- totally wrapped -- you
7 know, turned the whole thing around.

8 And that -- that's another reason, when you're
9 taking a look at these -- these gains and losses, how
10 they can affect the overall calculation of FAS 87.

11 Q. Well, your column would suggest that the
12 actuary doesn't do a very good job in projecting that
13 expense out. Is that a conclusion you would draw from
14 looking at those numbers?

15 A. Well, I would certainly say that the actual
16 results are considerably different from the
17 assumptions. Now, I think part of that -- part of that
18 is that Mr. Williamson indicated -- and it's in his
19 schedule -- that the -- at least on the re-- expected
20 return on the assets, they're not attempting in their
21 calculation to determine what those assets are gonna
22 earn during that year. They're looking at a long-range
23 projection.

24 And when the stock market was way up here and
25 they're way down here, that's gonna have a tremendous

1 effect on those return on assets -- the difference in
2 that calculation.

3 Q. Okay. So, in other words, the longer a view
4 you take, the more accurate the actuarial prediction
5 is? In other words, he may be right over 30 years, but
6 not year to year?

7 A. Yes.

8 Q. Okay. Now, Mr. Williamson made the statement
9 that one approach makes the Company stronger and thus
10 better able to make those contributions, but I can't
11 say which is which.

12 Did you hear him make that statement?

13 A. I seem to recall that someone asked him that
14 question. I'm not sure that he really responded.

15 Q. Assuming hypothetically that he did, in fact,
16 say what I say he said, do you know which is which, in
17 terms of making the Company stronger?

18 A. I think in terms of what's built into the
19 rates, whatever gives you the highest level of expense
20 that comes down into your bottom-line revenue
21 requirement is the most beneficial to the Company.

22 Q. And which approach is that?

23 A. Under the current scenario, as it currently
24 stands, FAS 87 does that.

25 Q. Okay. So if the Commission switches to

1 minimum ERISA for this case, do you expect that Staff
2 will be arguing for minimum ERISA in the next rate case
3 or do you expect another switch?

4 A. I would hope that we would stay with minimum
5 ERISA. If you want to call it the FAS8-- the switch to
6 FAS 87, you know, a 10-year experiment we've -- we've
7 come to realize that -- that the methodology that we've
8 employed over the last 10 years is -- is -- is not --
9 has not been -- not been appropriate really for setting
10 rates going forward.

11 Q. Would you say the same thing with respect to
12 the use of FAS 106 for OPEBs?

13 A. I don't think you have much choice in that
14 matter.

15 Q. I understand there's no choice, but do you
16 feel that it's appropriate for setting rates?

17 A. Considering that under the legislation they
18 have to fund what FAS 106 comes -- is calculated, FAS
19 106 -- if you want to put FAS06 -- FAS 106 on the same
20 basis of -- of 87 and compare it to ERISA, FAS1-- FAS
21 106 and ERISA would be the same every year, because
22 whatever comes out of FAS 106 they have to fund.

23 Q. I see.

24 Okay. So ERISA controls what the Company
25 actually has to put into its pension fund every year?

1 A. That is correct.

2 Q. And it's a matter of federal law?

3 A. That is correct.

4 Q. They have a little bit of choice but not much;
5 is that correct?

6 A. Yes.

7 Q. There's a certain zone between the minimum
8 required contribution and the maximum where you incur
9 an excise tax; is that correct?

10 A. There -- there is a minimum ERISA that has to
11 be fund -- that has to be placed in the fund. I think
12 there's a calculation that there is what they call a
13 maximum ERISA that they can con-- contribute without
14 incurring penalties.

15 Q. And nonetheless for the -- for the purposes of
16 generally accepted accounting principles as they're
17 used in the United States, the Company has to report a
18 FAS 87 amount on its financial reports; is that
19 correct?

20 A. Yes. I think there are exceptions. I mean,
21 we -- I can't recall the actual FAS -- FAS number, but
22 there is one that applies to regulatory that allows
23 deviations from certain FAS -- like the FAS 87 or
24 whatever.

25 Q. And do you know how this Company reports

1 pension expense on its financial reports?

2 A. Based on FAS 87.

3 Q. Okay. And that does not accurately represent
4 what, in fact, they contribute, does it?

5 A. No, it does not.

6 Q. Is there some particular reason why the
7 Accounting Standards Board would want financial
8 statements that don't accurately reflect what's been
9 contributed?

10 A. I don't have an answer for that.

11 Q. Okay. Is it -- is it helpful for management
12 to have financial statements that don't reflect the
13 actual contribution, do you believe?

14 A. I don't have an answer.

15 Q. Okay.

16 A. I'm sorry.

17 JUDGE THOMPSON: You're an accountant. I
18 thought I'd ask you these accounting questions.

19 I think that's all the questions I have for
20 you right now. Why don't you go ahead and step down.
21 And when the Commissioners appear, we'll let them ask
22 their questions, and then we'll go to recross based on
23 questions from the Bench and redirect.

24 (Witness excused from the stand.)

25 JUDGE THOMPSON: And so I think at this point

1 we will take a five-minute recess, and then we will
2 begin with the next witness. So we are in recess at
3 this time.

4 Thank you.

5 (A RECESS WAS TAKEN.)

6 JUDGE THOMPSON: If you would please spell
7 your last name for the reporter, and you can remain
8 seated.

9 MS. AHERN: Okay. A-H-E-R-N.

10 JUDGE THOMPSON: Raise your right hand.

11 (Witness sworn.)

12 JUDGE THOMPSON: Thank you.

13 You may inquire.

14 MR. ENGLAND: Just a second, Your Honor.

15 Thank you, Your Honor.

16 PAULINE AHERN testified as follows:

17 DIRECT EXAMINATION BY MR. ENGLAND:

18 Q. Ms. Ahern, would you please turn your
19 attention to Exhibit No. 6, which is your prepared
20 direct testimony filed in this proceeding?

21 A. Okay.

22 Q. Are there any changes or corrections that need
23 to be made to that testimony at this time?

24 A. I have one. On page 3, line 5, after the
25 first word "rate," the phrase "of 11 percent" should be

1 inserted.

2 Q. Okay. Any other changes or corrections to
3 that testimony or the schedules attached to the
4 testimony?

5 A. No.

6 Q. Okay. Turn your attention, then, to what I
7 believe has been marked for purposes of identification
8 as Exhibit No. 40, which is your rebuttal testimony.

9 A. Okay.

10 Q. Are there any changes or corrections which
11 need to be made to that testimony?

12 A. I have one correction to the testimony and one
13 correction to the exhibit.

14 Q. Okay.

15 A. On page 5, line 16 the acronym MAWC should
16 read American Water.

17 Q. And then --

18 A. Yes. Schedule PMA-15, page 3 is not the
19 correct page, and I've provided a corrected page.

20 Q. Excuse me. This is 3 of 3 --

21 A. Page --

22 Q. -- of your Schedule PMA-15 attached to your
23 rebuttal testimony?

24 A. Exactly.

25 MR. ENGLAND: Your Honor, we've prepared a

1 corrected Schedule PMA-15, page 3 of 3, and have copies
2 for the court reporter, as well as the parties. And I
3 propose the easiest thing to do would be to mark it as
4 an exhibit.

5 JUDGE THOMPSON: I think -- I think so. I was
6 going to suggest that. This would be Exhibit 98.

7 The corrected PMA-15, page 3.

8 (EXHIBIT NO. 98 WAS MARKED FOR IDENTIFICATION
9 BY THE COURT REPORTER.)

10 MR. ENGLAND: Okay.

11 MR. SNODGRASS: What was that number on that
12 earnings guide, Judge?

13 JUDGE THOMPSON: 98.

14 MR. SNODGRASS: 98.

15 MR. ENGLAND: Okay.

16 BY MR. ENGLAND:

17 Q. I think that takes care of corrections to the
18 rebuttal testimony and schedules; is that right?

19 A. Yes.

20 Q. Okay. How about your surrebuttal testimony --

21 A. I have none.

22 Q. -- which I believe has been marked for
23 purposes of identification as 7-- as No. 76 -- you have
24 no corrections?

25 A. No corrections.

1 MR. ENGLAND: Okay. Thank you. With that
2 taken care of, Your Honor, I would offer Exhibits 6,
3 40, 76 and 98 and tender the witness for
4 cross-examination.

5 JUDGE THOMPSON: Very well.

6 Do I hear any objections to the receipt of
7 Exhibit 6, Exhibit 40, Exhibit 76, or Exhibit 98?

8 (No response.)

9 JUDGE THOMPSON: Hearing no objections, those
10 exhibits are received and made a part of the record of
11 this proceeding.

12 (EXHIBIT NOS. 6, 40, 76 AND 98 WERE RECEIVED
13 INTO EVIDENCE.)

14 JUDGE THOMPSON: Okay. Let's see. I guess we
15 have to call roll again.

16 Missouri Industrial Energy Consumers?

17 (No response.)

18 JUDGE THOMPSON: No one is here.

19 Missouri Energy Group?

20 Ms. Langeneckert, any questions?

21 MS. LANGENECKERT: Yes, a couple.

22 CROSS-EXAMINATION BY MS. LANGENECKERT:

23 Q. Hi, Ms. Ahern -- Ahern; is that correct?

24 A. Ahern. Right.

25 Q. I'm Lisa Langeneckert.

1 A. Nice to meet you.

2 Q. And I represent the Missouri Energy Group,
3 which comprises three hospitals in the St. Louis area
4 and Emerson Electric.

5 A. Okay.

6 Q. Could you please go to Exhibit 40, which is
7 your rebuttal testimony?

8 A. Yes.

9 Q. Page 33.

10 A. Okay.

11 Q. In lines 3 through 5 you state, that a
12 significant number of the companies used in the proxy
13 groups utilized by the rate-of-return witness in the
14 current proceeding either have a surcharge in place or
15 have one available if requested.

16 Is that a proper paraphrasing of your
17 testimony?

18 A. Yes.

19 Q. What companies in the proxy group that were
20 used have an ISRS in place?

21 A. Okay. In my groups, American States Water,
22 Artesian Resources, Philadelphia Suburban Corp -- most
23 of their subsidiaries have one in place. And for the
24 rest, California Water Service does not one -- have one
25 in place, but it is available in California.

1 Middlesex Water does not have one available;
2 however, in New Jersey the effects are mitigated by a
3 partially forecasted test year. Southwest Water does
4 not have one available; however, they do not -- or, I'm
5 sorry. They do not have one in place, but they have
6 one available in California.

7 York Water in Pennsylvania -- Pennsylvania has
8 one for all water companies. York has not availed
9 itself of their -- they call it a disk surcharge
10 because of the cost involved, but it is available to
11 them.

12 Q. And that comprises all of the companies in the
13 proxy group?

14 A. In mine, yes. One, two, three, four, five,
15 six, seven. And I believe the proxy groups of the
16 other witnesses are subgroups of mine.

17 Q. Okay. Do you believe that the ISRS is
18 beneficial to the Company?

19 A. Yes, I do.

20 Q. How is that so? How do you believe that it
21 is?

22 A. Well, it helps to mitigate regulatory lag in
23 that they can recover the cost of addi-- capital
24 additions between rate cases. However, it's beneficial
25 as well to all the proxy companies and, therefore, it

1 really doesn't alter Missouri-American's risk relative
2 to those companies.

3 Because the cost of common equity cost rates
4 that come out of our models, based on market prices of
5 these proxy groups, already reflect the fact that
6 investors are aware that these companies have an ISRS
7 or an ISRS-type surcharge or they have it available to
8 them and that it is coming down the pike in those
9 states where it is not currently available.

10 So it's already inf-- reflected in the common
11 equity cost rates of all the witnesses here, and
12 there's no need to reduce or go to a lower end of the
13 range for Missouri-American, because they will have an
14 ISRS in place.

15 Q. Do you believe the ISRS is beneficial to the
16 ratepayers?

17 A. Yes, because it helps mitigate rate shock
18 in -- from rate case to rate case.

19 Q. So it just moves the shock up?

20 A. No. No. No. No. No. No. It helps them
21 stay smooth. It allows Missouri-American or any water
22 company that has such a surcharge in place to request a
23 lower increase in a future rate case, because they
24 are -- the -- the -- the capital additions are already
25 being recovered between rate cases.

1 Q. If none of the companies in the proxy group
2 had an ISRS, would you rec-- reduc-- recommend a
3 reduction in -- in Missouri-American's return on
4 equity?

5 A. If -- if none?

6 Q. Correct.

7 A. Not necessarily. Because you would have to --
8 in order to do that, you would have to assume that all
9 else is equal. And in this particular case, all else
10 is not equal. The economy of Missouri-American is
11 significantly more troubled than that on -- of average
12 for the proxy group companies.

13 Missouri-American has at least its -- its --
14 well, even -- even Mr. Murray's recommended common
15 equity ratio, the actual common equity ratio of
16 Missouri-American is slightly lower than the average
17 for any of the proxy groups that we have used and,
18 therefore, it has greater financial risk.

19 So unless I did an analysis and -- and came to
20 the conclusion that in every other aspect, every other
21 risk factor except for ISRS, Missouri-American was
22 equal in risk to the proxy companies.

23 I -- I cannot say that because of ISRS I would
24 recommend a -- a decrease return on equity.

25 Q. Thank you.

1 A. Uh-huh.

2 JUDGE THOMPSON: Thank you, Ms. Langeneckert.

3 Mr. Swensen?

4 MR. SWENSEN: No questions.

5 JUDGE THOMPSON: Thank you.

6 Ms. Bond?

7 MS. BOND: No, thank you, Your Honor.

8 JUDGE THOMPSON: Ms. O'Neill?

9 MS. O'NEILL: Thank you, Your Honor.

10 CROSS-EXAMINATION BY MS. O'NEILL:

11 Q. Good morning, Ms. Ahern.

12 A. Good morning.

13 Q. My name is Ruth O'Neill. I'm from the Office

14 of the Public Counsel. Just want to follow up a little

15 bit on some of the testimony you just gave.

16 The customers in the area served by

17 Missouri-American, which are subject to ISRS as a

18 result of ISRS will likely have more frequent rate

19 increases than they would if the Company was only

20 allowed to incorporate those capital improvements in

21 rate cases; is that true?

22 A. True.

23 Q. And if Missouri-American was experiencing cost

24 savings in another area of their operations, either in

25 St. Louis County or elsewhere, the ISRS does not

1 capture that; is that correct?

2 A. To the best of my knowledge, no.

3 Q. And so the ISRS only causes rate increases, it
4 won't cause rate decreases between cases; is that true?

5 A. Correct. But if based on the surveillance
6 reports or reports that come in from Missouri-American
7 to the Commission, if there are such significant cost
8 decreases in other parts of the service territory or
9 even within the ISRS service territory, I'm sure that
10 Staff would quickly issue a Show-Cause Order and bring
11 them in to prove that they are not overearning.

12 Q. And that's a -- that's a device that is not
13 unique to the Commission Staff in Missouri; is that
14 correct?

15 A. If you mean it's not unique -- it -- it occurs
16 in other states as well?

17 Q. It occurs in other states?

18 A. Yes.

19 Q. Occurs -- other people can file earnings
20 investigations in Missouri as well, can't they, such as
21 my office?

22 A. I believe so.

23 Q. I'm gonna turn right now to your direct
24 testimony, which is Exhibit 6. You have some
25 discussion -- I think it begins on page 7 -- where

1 you're discussing a Standard & Poor's article. And you
2 discuss business risk in the water industry. And that
3 article talks about business risk related to statutory
4 requirements, among other things; is that correct?

5 A. Correct.

6 Q. Now, according to the 1999 article that you
7 relied on in this portion of your testimony, most of
8 the water industry's business risks regarding some
9 statutory requirements, such as the Safe Drinking Water
10 Act, are behind the industry; is that correct?

11 A. According to this article -- yeah, most of the
12 regulatory risk associated with it. Yes.

13 Q. The article indicated the industry still faces
14 business risks related to infrastructure replacement?

15 A. Yes.

16 Q. And again, this is a risk statute that was
17 enacted in Missouri this year addresses that business
18 risk; is that correct?

19 A. Correct.

20 Q. And I think you've already explained with
21 Ms. Langeneckert that this reduces regulatory lag
22 related to this element of -- of rates?

23 A. This one element of it, yes.

24 Q. Now, the mere fact that the water business is
25 more capital intensive than other utilities regulated

1 by the Commission doesn't necessarily mean that the
2 water business is riskier venture than say electricity?

3 A. In my opinion, it does.

4 Q. It does?

5 A. Relative to the capital intensity fact.

6 Q. Is it a riskier business venture, then,
7 electricity?

8 A. I believe it is becoming riskier relative to
9 the electric industry, especially those electric
10 companies which are deregulating generations and then
11 taken out of the regulatory mix. The -- you know,
12 its's riskier than those companies, which are strictly
13 transmission distribution at this point.

14 Q. You would recognize that the articles you've
15 attached in your Schedule PMA-2 suggest that water --
16 the water utility industry is less risky than
17 electricity?

18 A. In general, yes, I would recognize it -- that
19 the schedule says that; however, when it talks about
20 the electric industry, it's talking about it in
21 general, which is the deregulated portion of it, as
22 well as the regulated.

23 There are many states in which deregulation
24 has not gone forward and generation is still regulated.

25 Q. So potentially more risky than electricity?

1 A. More risky than the pure transmission and
2 distribution electric companies.

3 Q. Not more risky than natural gas, water?

4 A. Oops. Let me backtrack. In my opinion, the
5 risk of electric transmission distribution industry,
6 the natural gas distribution industry and the water
7 industry are so similar that you -- you -- you -- you
8 almost can't quantify the difference in risk.

9 So when you say more risky -- I -- I can't
10 talk about it in terms of like percentages or how much
11 more risky. If you look at the betas of all of these
12 companies, they're all rather similar, on average, now.
13 And based on that, I would say that the -- the risk is
14 so similar that it's very difficult to differentiate on
15 an industrywide basis which is riskier, which is not.

16 Q. So you would not agree that water utilities
17 are consi-- considered to have a lower business risk
18 than these other types of utilities?

19 A. I believe that there are those who do believe
20 that they do have a -- a lower business risk.

21 Q. But --

22 A. I'm --

23 Q. -- you're not among them?

24 A. I am not an -- no.

25 Q. Would you agree that according to the

1 Standard & Poor's utilities and perspectives article
2 from June 1999 that you have contained in your Schedule
3 PMA-2, pages 11 and 12 --

4 A. Yes.

5 Q. -- that water utilities are generally required
6 to meet less stringent targets than those set for other
7 utilities, as far as financial targets?

8 A. Usually -- based on this June 21st 1999
9 article?

10 Q. Yeah.

11 A. Not for the same bond rate. An A bond rating,
12 for example -- it has certain target -- financial
13 target, benchmark ratios as shown on page 12 of
14 Schedule PMA-2. And those apply whether you're talking
15 about an electric company, a gas distribution company
16 or a water company, which is rated A.

17 Q. I want to draw your attention to page 11 of
18 that schedule for a moment.

19 A. Okay.

20 Q. And if you look at the -- I believe it's the
21 second-to-the-last sentence, first column. Do you see
22 where it starts, for example, a water utility which can
23 expect to have a lower business risk profile than a
24 typical, for example, integrated electric utility would
25 be required to less -- meet less stringent financial

1 targets for any given rating category?

2 A. Yes. An integrating electric utility are
3 those transmission distribution generations I was
4 speaking about before.

5 Q. Okay. And are you aware of whether or not
6 electric utilities in Missouri are integrated?

7 A. I would have to check. I don't have that
8 information with me.

9 Q. All right. Now, in your testimony -- I think
10 it's in your rebuttal testimony -- you criticize
11 Mr. Burdette's recommendation regarding return on
12 equity because of -- of the level of pretext interest
13 coverage. Is that -- which his recommended
14 ROE provides 2.77 times such coverage; is that right?
15 I think it's at 32 of your rebuttal.

16 A. Yes.

17 Q. And you -- you feel that's inadequate?

18 A. Yes.

19 Q. And again, you rely on the data from this
20 article that we've just been talking -- and it's
21 probably at page 12 instead of 11 at this point?

22 A. Yes.

23 Q. And there's a -- and there is a section
24 regarding pre-tax interest coverage; is that correct?

25 A. Yes. On -- on page 12, yes.

1 Q. Okay. Your testimony suggests that
2 Missouri-American should strive for an A bond rating in
3 either Category 2 or Category 3; is that right?

4 A. I have not said that in my testimony. I think
5 it's appropriate to compare the -- the coverage to the
6 A bond rating category with either a 2 or a 3 business
7 profile, because that is typical of the water utility
8 industry.

9 Q. And you're -- you're recommending that there
10 be pre-tax coverage that at least meets that standard;
11 is that correct?

12 A. I'm recommending that one use pre-tax interest
13 coverage as a test of reasonableness of a recommended
14 rate of return, but not that the pre-tax interest
15 coverage be set -- be used to -- to determine the rate
16 of return just to check on the reasonableness and
17 the -- the common sense nature of the recommendation.

18 Q. Okay. Well, let's do some of that checking.
19 In your testimony you refer to this chart. And if
20 you'd look at page 12 of your schedule PMA-2 under
21 pre-tax business -- or interest coverage. And I think
22 it's the third group of blocks down --

23 A. Yes.

24 Q. -- on the page.

25 Under Category 2, what's the range?

1 A. For an A? 2 --
2 Q. For an A.
3 A. 2.3 to 2.9.
4 Q. Okay. 2.77 is toward the top of that range;
5 is that correct?
6 A. Yes.
7 Q. And what's 3 -- what's the range on 3?
8 A. 2.8 to 3.4.
9 Q. And 2.77 is very close to 2.8, would you
10 agree?
11 A. Yes. But as I say in my testimony, the 2.77
12 is merely an opportunity, because we're setting an
13 opportunity for this company to earn a particular rate
14 of return. It's not guaranteed. And it may be eroded
15 due to attrition.
16 Q. And, in fact, it's not the Commission's job to
17 set a guaranteed rate of return; is that correct?
18 A. No, it's not.
19 Q. So it -- it's only the Commission's duty to
20 provide an opportunity -- determine what a -- what a
21 fair opportunity to earn; is that correct?
22 A. Correct.
23 Q. And the Company, if it is reasonable and
24 prudent and uses sound business judgment, should be
25 able to attempt to reach that without undue difficulty?

1 A. If what has been set is indeed a fair, just
2 and reasonable rate of return.

3 Q. Now, you are recommending authorizing an
4 ROE that would result in pre-tax coverage of 3.36 to
5 3.41; is that right?

6 A. What I was saying is that capital market
7 conditions at the time that my testimony was prepared
8 would indicate that the cost of equity for this company
9 is such that it would result in a 3.36 to 3.41 times
10 interest coverage; however, the Company is requesting
11 11 percent.

12 Q. So it would be lower than that?

13 A. Correct.

14 Q. But still higher than the 2.77 Mr. Burdette
15 recommends?

16 A. Yes. In fact, it would be, based on the
17 originally proposed capital structure, 3.21 times.

18 Q. Now, you said this really isn't something that
19 is a component of -- of determining what the
20 appropriate return on equity is, it's just -- it's just
21 a device that you can use to check reasonableness?

22 A. Correct.

23 Q. It's a -- and looking at bond ratings and
24 whether something might be a an A bond or a triple B or
25 a trim B plus is a separate exercise that's done by a

1 non-regulatory body, as opposed to this Commission?

2 A. Correct.

3 Q. And when considering what return a regulated
4 utility company is authorized to earn, the rate of
5 return approved by the Commission is a ceiling on the
6 Com-- that the Company's earnings should exceed and not
7 a floor, would you agree with that?

8 A. In general, yes.

9 Q. And, in fact, as I think you alluded to
10 briefly earlier, if the Company earns more than the
11 authorized return, it could be subject to an
12 overearnings investigation?

13 A. Correct.

14 Q. It could be said that the Company is
15 overearning, based on the current rates and that they
16 would need to be adjusted down?

17 A. Overearnings relative to the authorized rate
18 of return, yes.

19 Q. And a higher authorized return than what is
20 necessary to attract capital in the market would offer
21 the Company, however, some protection from those
22 overearnings allegations, would you agree with that?

23 A. Would you repeat that, please?

24 Q. If the Commission were to authorize a higher
25 rate of return than the market would require for

1 investment purposes, that would offer some protection
2 from an -- from an overearnings complaint being filed?

3 A. Well, I think the way I would phrase it would
4 be that the higher the authorized rate of return is
5 set, the less chance there is for an earn--
6 overearnings investigation.

7 Q. Okay. Would you also agree that at least in
8 theory what may be a reasonable rate of return under a
9 certain set of business conditions could actually
10 result in a rate of return that's set too high, based
11 on a change in conditions at a later date?

12 A. Absolutely.

13 Q. In your testimony you've been somewhat
14 critical about relying on the -- this kind of cashflow
15 method for determining cost of equity; is that correct?

16 A. You -- I wouldn't characterize it as critical.
17 I do spend a significant amount of time pointing out
18 some of the limitations and the tendency that it has to
19 misspecify when market to book ratios are greater than
20 one.

21 The reason I do spend so much time on it is
22 because of the significant reliance-- sole exclusive
23 reliance given to the DCF by many witnesses, as well as
24 many regulatory commissions.

25 All of the models, as I say in my direct

1 testimony, have both theoretical and practical
2 application problems with them. And the reason I
3 pointed out with the DCF is to support the need to look
4 to multiple models and rely on multiple models.

5 Not just look to other models as a -- a check
6 on the DCF result, but that one should emulate investor
7 behavior consistent with the efficient market
8 hypothesis, which says that one should use all
9 available information.

10 All available information includes multiple
11 models. I don't criticize it to debunk it or to rely
12 on it in any less. In fact, as I believe my
13 surrebuttal testimony says, if you calculate an average
14 of my four models, I -- my recommended range is
15 actually below what the average would be, which
16 indicates that I give greater reliance to the DCF
17 results than to that of -- those of the other
18 three models.

19 Q. You -- you said that it's below. Now, you
20 did -- in your DCF calculations you -- with your proxy
21 group, that resulted in an average for your proxy group
22 of 10 percent return on equity; is that correct?

23 A. Yes.

24 Q. Now, when you filed your direct test-- and
25 that was in your direct testimony?

1 A. Yes.

2 Q. When you filed your direct testimony with the
3 Commission, the ISRS statute had not yet become law in
4 Missouri; is that correct?

5 A. No.

6 Q. It's not correct?

7 A. I'm sorry. No, it had not come -- yes, it is
8 correct.

9 Q. And 10 percent is the top of Mr. Burdette's
10 DCF calculation range and top of his recommendation
11 range; is that correct?

12 A. Yes.

13 Q. I want -- just one other matter I'd like to
14 talk to you about.

15 A. Okay.

16 Q. In your rebuttal testimony at -- I think it's
17 page 32. I'd like to direct your -- you to the
18 sentence at lines 17 through 21.

19 Are you there?

20 A. Yes.

21 Q. Okay. In that sentence you suggest that
22 Mr. Burdette's recommended rate of return is influenced
23 greatly by MAWC's low imbedded debt cost rate of
24 6.23 percent.

25 Do you see that?

1 A. Uh-huh.

2 Q. Would you agree that Mr. Burdette's imbedded
3 cost of debt rate is -- is correct and -- and
4 corresponds to the Company's imbedded cost of debt as
5 they propose?

6 A. I believe the Company's original proposal was
7 6.22.

8 Q. And in Mr. Burdette's surrebuttal, do you
9 recall that he has also adopted 6.22?

10 A. I will agree with you, subject to check, yes.

11 Q. Okay. Now, that cost of debt --

12 JUDGE THOMPSON: Let me -- let me jump in on
13 the subject to check.

14 THE WITNESS: Oh, okay. Well, let me check.

15 JUDGE THOMPSON: Either you know, you don't
16 know --

17 THE WITNESS: Oh, let me check.

18 JUDGE THOMPSON: -- or you can go --

19 THE WITNESS: -- okay.

20 JUDGE THOMPSON: -- ahead and check, ma'am.

21 THE WITNESS: Okay. Let me check. Bear with
22 me, okay?

23 MS. O'NEILL: Sure.

24 THE WITNESS: Let me check.

25 JUDGE THOMPSON: Otherwise we have a whole

1 record that may be right.

2 THE WITNESS: Okay. I just know that 6.22 and
3 6.23 have been going about. Not being tanti but, yes.

4 BY MS. O'NEILL:

5 Q. Okay.

6 A. He's adopted 6.22.

7 Q. And, in fact, would you agree that in
8 Mr. Burdette's surrebuttal testimony the capital
9 structure that he proposes is -- is almost identical
10 to the -- to the one that has been proposed by the
11 Company?

12 A. It's similar -- very similar. Almost, yes, it
13 is.

14 Q. All right. And so he doesn't -- Mr. Burdette
15 doesn't use any bizarre or fancy little tricks when
16 he's calculating and determining the overall rate of
17 return in the way he gives long-term debt, as opposed
18 to equity, does he, that you can see?

19 A. Not that I can see, no.

20 Q. Okay. In fact, he performs his calculation in
21 the traditional fashion?

22 A. Yes.

23 Q. The difference between Mr. Burdette's
24 recommended overall rate of return is based on the
25 difference between the Company's proposed return on

1 equity and his return on equity; is that correct?

2 A. Correct. And with minor differences for the
3 two different -- slightly different capital structures,
4 but essentially the same.

5 Q. Yet in your testimony you said that you
6 believe that recommending an overall rate of return
7 that properly weights the Company's actual imbedded
8 costs of long-term debt is Mr. Burdette's recommended
9 return on equity penalizes the Company for what you
10 call its prudent and significant use of low-cost debt
11 financing?

12 A. No. What I mean is -- and I apologize if I
13 wasn't clear in my testimony. Because of their prudent
14 and significant use of low-cost debt, the coverage is
15 that -- that falls out -- that's implied, implicit in
16 Mr. Burdette's recommendation is higher than it
17 otherwise would be for a similarly situated A-rated
18 company with a business position of 2 or 3.

19 The Company's imbedded cost of debt --
20 long-term debt is 6.22 percent. But currently based on
21 the -- the December 1st Blue Chip financial forecasts,
22 it can be derived that a forecasted A rated yield for
23 the next year is approximately 7.1 percent.

24 Q. So using -- so it's your testimony, then, that
25 this penalization is based on the fact that the actual

1 cost of debt used in this case and adopted by the
2 Company and Mr. Burdette is not fair; is that a correct
3 statement?

4 A. Would you -- would you repeat that, please?

5 Q. Is it -- do you believe that the penalty
6 you're referring to is that the actual cost of debt
7 being used by the Company and Mr. Burdette is not a
8 fair number to be using in calculating overall rate of
9 return?

10 A. No. I believe it is a fair calculation;
11 however, I believe because the cost of debt is lower
12 than, as I said, is typical for other A -- for A rated
13 public utilities, that the coverage implies that the
14 rate of return recommended by Mr. Burdette is --
15 correctly reflects the risk of the common equity
16 investor. And I don't believe it does.

17 Q. Okay. Without going back into the discussion
18 we've previ-- had -- previously had about -- about
19 those figures, just to -- just to refresh my memory,
20 those are just checks, that's not what you're -- what
21 you're setting here in determining rate of return?

22 A. No. But they are checks that are used to
23 determine whether or not the return is fair and just
24 and meets the Hope and Bluefield re-- mandates of
25 maintaining financial integrity and capital attraction.

1 Q. And Hope and Bluefield, again, don't guarantee
2 a rate of return or a particular bond rating; is that
3 correct?

4 A. Correct.

5 Q. So the penalties you're talking about are
6 based on forecasts of what might be expected returns in
7 the future, as opposed to setting basis on a -- rates
8 on a going-forward basis under the traditional methods
9 that are used in the State of Missouri; is that
10 correct?

11 A. I would have to say yes and no. You're -- you
12 said that they're based on forecasts going forward of
13 what it might be, well, that's precisely what our cost
14 of common equity models determine, too -- precisely
15 what it might be.

16 I believe if one did a DCF or, indeed, any
17 cost of common equity model a year ago could not have
18 predicted what the market has done this year. That a
19 cost -- and the cost of equity is an estimate. It's a
20 perspective estimate.

21 Q. And again, you're -- you're characterizing
22 this recommendation of Mr. Burdette's as a penalty
23 against the Company in your testimony; is that correct?

24 A. I'm saying that if Mr. Burdette's recommended
25 common equity cost rate is adopted, then the

1 shareholders will be penalized. Because when looking
2 at the coverage of the 2.77 to 2.86, I think it gives a
3 false sense of reasonableness to a range of 9.5 to 10,
4 because it is based on the significant use and prudent
5 use of low-cost tax-exempt debt.

6 Q. Despite the fact that your own DCF
7 calculations also came up with a 10 percent; is that
8 correct?

9 A. My DCF did come up with a 10 percent.

10 Q. Thank you.

11 A. But my recommendation --

12 MS. O'NEILL: No further questions.

13 THE WITNESS: -- is based on more models than
14 the DCF.

15 MS. O'NEILL: No further questions.

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

17 Mr. Snodgrass?

18 CROSS-EXAMINATION BY MR. SNODGRASS:

19 Q. Good afternoon, ma'am.

20 A. Oh, good afternoon? Okay. Good morning.

21 JUDGE THOMPSON: I think it's still morning,
22 Mr. Snodgrass.

23 MR. SNODGRASS: Well, to me maybe it is the
24 afternoon.

25 THE WITNESS: I didn't think I was here that

1 long.

2 Q. Ms. Ahern, I'm still having troubles with the
3 idea that these models determine precisely what might
4 be.

5 A. When I said that, I said that in the context
6 of what they -- they do measure investor expectations.
7 They in-- they measure investor expectations of what
8 they expect the return that they're going to earn on
9 their investment. That is a -- a might be.

10 When I invest in a common stock or I put my
11 money in a mutual fund or my 401K, based on possibly
12 using these models, I might expect a return of -- I'm
13 gonna be hypothetical and say 20 percent. I expect my
14 401K to make 20 percent next year, because that's what
15 the models are saying.

16 Something happens. And next year I don't earn
17 20 percent. I might earn 15, might earn negative, so
18 that's what I mean by -- in terms of what -- what
19 return they -- they expect as what might be in the
20 future.

21 Q. I -- I appreciate that response. And really
22 wasn't meant to be a cross-examination question.

23 A. I'm sorry.

24 Q. I have a conflict between price -- precisely
25 and what might be in my own mind.

1 A. Oh, okay. I'm sorry.

2 Q. Ma'am, do you have the testimony of Mr. Murray
3 with you --

4 A. Yes, I do.

5 Q. -- handy?

6 And you have your testimony, too, would that
7 be correct?

8 A. Yes.

9 Q. Okay. Thank you.

10 I'd ask you if you'd take a moment to go to
11 page 6, lines 27 and 28 of your surrebuttal, please.

12 A. That was 27 and 28?

13 Q. Yes, ma'am.

14 A. Okay.

15 Q. You say there that there's no proof that
16 American Water has manipulated the capital structure of
17 Missouri-American Water Company?

18 A. What I say is that Mr. Murray has provided no
19 evidence.

20 Q. It's true, isn't it, that in March of 2000 and
21 April of 2002 American Water purchased new shares of
22 common stock in MAWC?

23 A. Yes.

24 Q. Now, the stock purchase by American Water
25 increased the percentage of the common equity in MAWC's

1 capital structure, did it not?

2 A. Unless there was a concurrent debt or
3 preferred issuance, yes.

4 Q. When you put money -- you know, I'm not much
5 of a financial wizard as you'll find out as you go
6 along, Ms. Ahern, but --

7 A. Okay.

8 Q. When you put your money in a savings account
9 at a bank, that increases the amount of money you can
10 earn interest on; is that right?

11 A. Yes.

12 Q. Similarly, when you increase the percentage of
13 equity in a capital structure, that increases the
14 weighted return of equity that a regulated utility can
15 earn in rate base, does it not?

16 A. Only after it has been approved -- after the
17 capital structure and the rate base have been approved.

18 Q. Assuming it's been approved, then the answer
19 would be yes?

20 A. Yes.

21 Q. All right. Now, typically the cost of equity
22 capital is higher than the cost of debt capital; is
23 that right?

24 A. Correct.

25 Q. And switching gears here, ma'am. I apologize.

1 Now, would you look at page 14 of your direct
2 testimony, please, lines 6 through 9?
3 A. Yes.
4 Q. You indicate that no single common equity cost
5 rate model should be relied upon in determining the
6 cost of common equity, correct?
7 A. Correct.
8 Q. That's been your test-- that's been your
9 position throughout your testimony; is that fair?
10 A. Yes.
11 Q. You -- you say the results of multiple equity
12 models should be taken into account --
13 A. Yes.
14 Q. -- correct?
15 Now, you read Mr. Murray's testimony?
16 A. Yes.
17 Q. With interest, no doubt?
18 A. Yes.
19 Q. With regard to comparable companies, isn't it
20 true that Mr. Murray used both -- both the risk premium
21 and capital asset pricing model in checking the
22 reasonableness of the results in his DCF model?
23 A. Yes. He used them as a check. He did not --
24 in my mind relying on them would be to --
25 MR. SNODGRASS: Ma'am, I don't --

1 Judge, I don't think that's --

2 THE WITNESS: Okay.

3 MR. SNODGRASS: -- responsive to my question.

4 I'm asking did he use them as a check.

5 THE WITNESS: He used them as a check, yes.

6 BY MR. SNODGRASS:

7 Q. Yes.

8 Now, directing, ma'am, your attention to
9 page 16 of your direct testimony, and if you'd look at
10 that, I'd appreciate that.

11 A. Okay.

12 Q. And about the middle of the page you begin
13 discussing the theoretical basis for the DCF model,
14 correct?

15 A. Correct.

16 Q. And you discussed that model in the context of
17 establishing the cost of common equity, do you not?

18 A. Yes.

19 Q. Now, then going generally to the bottom of
20 page 16 and the first paragraph of page 17 of your
21 direct testimony -- did I -- did I go by that a little
22 too fast?

23 A. No.

24 Q. Okay. In response to a question regarding the
25 applicability of the DCF model in establishing costs of

1 common equity you indicate, among other things, that
2 the DCF model has a tendency to misspecify the
3 investors required rate of -- return rate when the
4 market value of common stock differs significantly from
5 book value.

6 Is that a correct statement?

7 A. Yes.

8 Q. That's part of your testimony?

9 A. Correct.

10 Q. Now, in your capacity as a financial
11 consultant you've studied the decisions of regulatory
12 commissions regarding cost of equity issues?

13 A. Yes, I have.

14 Q. And, in fact, part of your value as a
15 consultant is based on your knowledge of those various
16 commission or agencies' approaches to these cost of
17 equity issues; is that fair?

18 A. Yes.

19 Q. Now, you've looked at this Commission's
20 approach to equity issues when you began this
21 consulting assignment, did you not?

22 A. Yes.

23 Q. And you read Commission -- you've read some
24 Commission decisions on cost of equity issues, have you
25 not?

1 A. Yes.

2 Q. Are you aware, ma'am, specifically of any case
3 decided by this Commission that allowed for an
4 adjustment to cost of equity based on market to book
5 differences and the application of the DCF model to
6 costs of common equity issues?

7 A. No, I'm not. And I'm not recommending any
8 sort of adjustment either.

9 Q. Could we move on to page 24 of your direct
10 testimony?

11 A. Okay.

12 Q. You mention a -- a Pennsylvania Commission
13 decision that re-- that relates to market versus book
14 value, correct?

15 A. Yes.

16 Q. Now, you use this decision as support for the
17 proposition and market to book value difference and
18 that it should be taken into account in determining
19 costs of equity, would that be fair?

20 A. No. I used this to support my statement that
21 the DCF tends to misspecify when market to book values
22 are either above or below one and, therefore, one
23 should use multiple cost of equity models.

24 Q. All right. When you -- when you did use the
25 Pennsylvania decision, though, that you quote in your

1 testimony -- you've quoted some language from that
2 decision in your testimony, correct?

3 A. Yes.

4 Q. Did you -- did you determine whether or not
5 they used a historical test year or some other
6 measuring device in that testimony that was offered by
7 the Pennsylvania Commission?

8 A. No. And if memory serves me correctly, I
9 believe they use the future test there in Pennsylvania.

10 Q. Now, if you use a future test, you're --
11 that -- that impacts the way your rate of return is
12 calculated, does it not -- does it not?

13 A. Not -- if by rate of return you mean the way
14 in which the cost of equity models are applied, no. If
15 you mean rate of return in terms of the overall cost to
16 capital, I would say yes, because the capital structure
17 is forward looking.

18 The -- you know, may be pro forma for proposed
19 equity or debt issuances and the costs -- the costs
20 that are disoc-- associated with the debt and preferred
21 are adjusted accordingly.

22 Q. All right. Thank you, ma'am.

23 You have indicated in your testimony that
24 other Commissions throughout this country have said the
25 DCF models should not be relied on exclusively; is that

1 a fair statement?

2 A. At times, yes.

3 Q. Whether -- whether that's true or not, isn't
4 it also true that the DCF approaches the basic model
5 that is used by the majority of Commissions in
6 determining the costs of common equity?

7 A. I would say it's one of the models used by the
8 majority of the Commissions, but there are a
9 significant number of Commissions that do use other
10 models as well.

11 Q. Would you say the majority of Commissions use
12 the DCF model?

13 A. Yes, but not necessarily exclusively.

14 Q. Well spoken. Thank you.

15 Now, again, you've studied the Missouri
16 Commission approach to cost of equity issues?

17 A. Yes.

18 Q. Now, typically that -- this Commission uses a
19 DCF model, does it not?

20 A. Yes.

21 Q. Now, it's also true typically that the CAPM
22 and -- and risk premium model are used in this State
23 primarily as a check on the reasonableness of the
24 results of the DCF model; would that be fair?

25 A. Yes, to -- to the -- what I've read, yes.

1 Q. Going into this thing called an efficient
2 market hypothesis.

3 A. Okay.

4 Q. I direct your attention to page 12 of your
5 direct testimony.

6 A. Okay.

7 Q. At page 12 you indicate that the cost of the
8 common equity models you use are market based, and
9 based on the -- let's call it the EMH, meaning the
10 efficient market hypothesis.

11 A. Okay.

12 Q. Now, both the DCF model and the CAPM model are
13 also based, in part, on the efficient market
14 hypothesis, are they not?

15 A. As well as the risk premium and comparable
16 earnings model.

17 Q. But you would agree the -- that EMH is -- is
18 a -- isn't a part of -- is a part of the DCF model
19 assumptions?

20 A. Absolutely, yes.

21 Q. Okay. Now, really when we're talking about an
22 efficient market hypothesis, we're really using that
23 in -- in connection to stock prices, are we not?

24 A. Yes.

25 Q. And most costs of equity models depend to some

1 degree on the stock prices, do they not?

2 A. Yes.

3 Q. All right. The theory of the EMH is that the
4 stock market is efficient, and thus reflects the
5 incorporation of all relevant and ascertainable --
6 ascertainable information at a stock's price; is
7 that -- is that a fair statement?

8 A. Could you say the last phrase, please?

9 Q. Yeah. Forgive me. I -- sometimes my lips
10 get --

11 A. After ascertainable.

12 Q. Yeah. I'm sorry. The theory of EMH is that
13 the stock market is efficient, and thus reflects the
14 incorporation of all relevant and ascertainable
15 information in a stock's price?

16 A. Yes.

17 Q. All right. Or as you put it in a much shorter
18 way, the efficient market is one in which stock prices
19 reflect all relevant information all the time?

20 A. Correct. In theory.

21 Q. Now, let me ask you this as -- as an
22 experienced analyst, Ms. Ahern: Do you believe that
23 strict adherence to the underlying assumptions in these
24 various models is essential for a financial model to be
25 considered a valid tool?

1 A. No. I believe it is essential in order to
2 apply the models in order to simplify them into the
3 form -- the -- the mathematical formulas that we use.

4 Q. All right. Isn't it true, based on that, that
5 the overall validity of these models isn't necessarily
6 raced -- based upon the assumptions that underlie them,
7 but whether or not they're -- they're able to predict
8 certain things?

9 A. No. I believe the validity of the models
10 comes from whether or not investors are aware of them,
11 investors use them.

12 Q. All right.

13 A. As you can see from my application of the
14 models and even the other witnesses' applications, they
15 don't always come to the same conclusion. And that's
16 because the assumptions don't always -- the underlying
17 assumptions don't always hold, which is why you need to
18 look at all of them and then make -- use informed
19 expert judgment and then determine from the array of
20 results what investors are likely to expect.

21 Q. Well, let me ask that question a different
22 way. Perhaps I didn't phrase it the right way. Excuse
23 me.

24 Would you agree with me that the true test of
25 these various models that we talk about here is their

1 proven ability to predict, rather than the validity of
2 their underlying assumptions?

3 A. Put that way, yes.

4 Q. Thank you, ma'am.

5 I would like, if you would, to -- to take a
6 minute and go back to your direct testimony at page 10,
7 lines 14 through 16.

8 A. Okay.

9 Q. And I notice that you acknowledge, and -- and
10 I appreciate your candor, that there is no single proxy
11 such as a bond rating or common stock ranking by which
12 one can differentiate common equity risk between
13 companies. You said that?

14 A. Yeah, that's my testimony.

15 Q. However, you go to say lines 16 through 19 on
16 that page that bond rating provides a useful means to
17 compare or differentiate common equity risk between
18 companies; is that a fair statement?

19 A. Compare and differentiate. Not quantify, yes.

20 Q. All right. Now, while we're on the subject of
21 bonds, I'm gonna ask you to pick up -- well, I guess
22 I'll do it this way.

23 Asking you to go to page 15, lines 27 and 28,
24 and page 16, line 1 of your rebuttal testimony.

25 A. Could I have those line numbers again, please?

1 Q. I'm sorry.

2 A. Just the line numbers.

3 Q. Page 15 --

4 A. Okay.

5 Q. -- lines 27 and 28, and page 16, line 1.

6 A. Okay.

7 JUDGE THOMPSON: Is this rebuttal?

8 MR. SNODGRASS: That's rebuttal, yes.

9 BY MR. SNODGRASS:

10 Q. You indicate in there that it was
11 inappropriate for Mr. Murray to use the historical
12 yield on the 30-year U.S. treasury bond as the
13 risk-free rate in the CAPM model, because it -- it --
14 because that bond is no longer issued; is that correct?

15 A. In part because it's no longer issued, and
16 also, in part, because it is a historical yield, and
17 prospective yields are available.

18 Q. I understand.

19 Now, isn't it true, though, ma'am, that the
20 30-year bond is still trading on the secondary market?

21 A. Yes.

22 Q. And that trading means -- it means it's still
23 being bought and sold; isn't that right?

24 A. Yes.

25 Q. And so would you have any reason to doubt that

1 its ticker symbol is TYX?

2 A. No, I wouldn't.

3 Q. Now, it's -- it's true, isn't it, that the
4 Chicago Board Options -- Options Exchange publishes
5 information about this bond on its website?

6 A. Yes.

7 Q. And, in particular, this website information
8 relates to the yields being earned on such bonds, does
9 it not?

10 A. Yes.

11 Q. Since this bond is still being traded in the
12 secondary market, there's still a market for it; isn't
13 that true?

14 A. Yes.

15 Q. And since it's still being traded and the
16 results of its yield are still being published, isn't
17 it fair to say that some investors still regard this
18 bond as a viable risk-free inves-- investment?

19 A. I would -- yes, some investors would.

20 Q. Now, there's an interesting term in all of
21 this financial literature, and I'm not quite sure I
22 know what it means. And the term is "double leverage."

23 A. Okay.

24 Q. And I'm gonna ask you a few questions about
25 that just to clarify what that concept is.

1 A. All right.

2 Q. Now, generally double leverage exists when

3 one company is owned by another company when both the

4 parent and the subsidiary issue debt; is that fair?

5 A. I would say that's fair.

6 Q. Leverage exists at two levels in this

7 situation, because the parent company's investment is

8 financed with the combination of its own debt and

9 common equity?

10 A. It may or may not be.

11 Q. Now, one of the recognized criteria for

12 determining whether to use a utility versus parent

13 capital structure is whether the regulated subsidiary's

14 capital structure is independent of its parent; is that

15 correct?

16 A. That's one of several criteria.

17 Q. Right. I --

18 A. It's comparabil--

19 Q. I didn't mean to say that that was the only

20 one. That is --

21 A. Okay.

22 Q. -- what that -- that is one of the criteria,

23 though, correct?

24 A. Yes.

25 Q. Now, you have examined Standard & Poor's

1 information in preparing your testimony in this case,
2 have you not?

3 A. Yes.

4 Q. Now, Standard & Poor's basically is a credit
5 rating agency, is it not?

6 A. Correct. Credit and bond rating.

7 Q. Thank you, ma'am.

8 And let's call it S&P.

9 A. Okay.

10 Q. S&P you indicate on page 4, lines 11 through
11 16 of your rebuttal testimony -- you indicate that you
12 looked at an S&P piece of information on August
13 the 1st, 2003, correct?

14 A. Correct.

15 Q. Now, when you looked at that information,
16 had -- had S&P assessed the creditworthiness of
17 American Water Capital Corporation?

18 A. Yes.

19 Q. And creditworthiness -- it's a -- it's a fair
20 statement to say it's very helpful in tracking debt
21 capital, is it not?

22 A. Yes.

23 Q. When S&P assessed the creditworthiness of
24 AWCC, it used American Water as a yardstick in rating
25 AWCC, did it not?

1 A. It looked at American Water, as well as RWE.

2 Q. All right. But it didn't mention

3 Missouri-American Water Company, did it?

4 A. No, it did not.

5 Q. Didn't mention any other subsidiaries, did it?

6 A. No.

7 Q. Now, ma'am, again, shifting to your rebuttal

8 testimony, page 3 --

9 A. Okay.

10 Q. -- lines 26 through 27, and at page 4,

11 lines 1 through 3.

12 A. Okay.

13 Q. Are you there?

14 A. Yes.

15 Q. You indicate that there is a support agreement

16 between American Water and AWCC that assures that AWCC

17 will be able to meet its -- its debt obligations,

18 correct?

19 A. Correct.

20 Q. Now, you indicate the agreement is silent on

21 the operating subsidiaries, which include MAWC --

22 A. Correct.

23 Q. -- fair?

24 Now, MAWC is one of American Water's

25 properties, isn't it?

1 A. Yes.

2 Q. Now, generally owners of property tend to want
3 to keep it, do they not?

4 A. If they're performing properly and if they're
5 earning a -- an appropriate rate of return, yes.

6 Q. All right. Now, so even if there are no
7 financial guarantees in place, are you suggesting to
8 the Commission and American Water would stand by and do
9 nothing if MAWC was in some kind of financial distress?

10 A. I can't speculate what American Water would
11 do. I do know that Missouri-American is the obligor of
12 all of its debt, whether it be to Capital Corp or it'd
13 be to the State -- to a third party.

14 There is no explicit agreement between
15 American Waterworks and MAWC that states that American
16 Waterworks would come in and guarantee that debt. The
17 support agreement is -- is completely silent on it.

18 The support agreement also indicates that
19 unlike what Mr. Murray has classified as an
20 unconditional guarantee, that that support may be in
21 the form of either cash, equity to American Water
22 capital or possibly a loan.

23 Q. All right. Now, isn't it true, though, ma'am,
24 that AWCC, American Water, and MAWC are all part of the
25 same corporate family?

1 A. MACC and MAWC, yes.

2 Q. They're all subsidiaries of American Water?

3 A. Yes.

4 Q. American Water wholly owns both of those

5 companies --

6 A. Yes.

7 Q. -- does it not?

8 A. Except for a small portion of preferred stock

9 at MAWC.

10 Q. I understand.

11 Now, looking at your rebuttal testimony again,

12 Ms. Ahern, at page 3, you say that Missouri-American's

13 long-term debt is secured by its own assets?

14 A. Correct.

15 Q. And looking at your surrebuttal testimony at

16 page 8, line 4, you say that Missouri-American's

17 long-term debt including that received from AWC is

18 secured by its own assets; is that fair?

19 A. If it's in the form of a mortgage bond, yes.

20 Q. Now, before you made that statement, you

21 studied MAWC's long-term debt structure, did you not?

22 A. Yes.

23 Q. And the long-term debt, for us novices in the

24 business, is a debt obligation that extends for a year

25 or more; is that right?

1 A. Correct.

2 Q. Now, MAWC has a financing arrangement with
3 AWCC, does it not?

4 A. Yes.

5 Q. And MAWC receives debt financing from AWCC,
6 does it not?

7 A. Currently it receives 10 percent of its total
8 capital from AWCC.

9 Q. Now, if you recall, Mr. Murray made mention of
10 Commission Case No. WF-2002-1096 in his surrebuttal
11 testimony, did he not?

12 A. Yes.

13 Q. Around page 10, lines 14 through -- through
14 21?

15 A. Yes.

16 Q. Now, since that case was mentioned in his
17 testimony, I assumed you looked it over, did you not?

18 A. Yes.

19 Q. All right. I'm gonna show you what's
20 already -- well, you've already -- I have -- you have
21 in front of you Exhibit No. 5?

22 A. Yes.

23 Q. I mean, 95. Pardon me.

24 A. I'm sorry. Yes.

25 Q. Now, did -- did you have a chance to look at

1 that exhibit?

2 A. Yes.

3 Q. Now, is that a copy of the financing
4 application filed by Missouri-American Water Company in
5 Case No. WF-2002-1096?

6 A. Yes, it is.

7 Q. Now, the application itself contains details
8 of the nature of the financing, does it not?

9 A. Yes.

10 Q. Would you be kind enough to go to page 9 of
11 that application towards the top of the page? And let
12 me read a line to save you the trouble. At -- at
13 paragraph 21, page 9.

14 A. Okay.

15 Q. Does it say, first as described above
16 AWCC will provide applicant with access to long-term
17 taxable debt?

18 A. First as -- yes.

19 Q. And going down to paragraph 22 looking at the
20 first three lines -- the first two lines. Would you be
21 kind enough to read those two lines into the record for
22 us, ma'am?

23 A. I'm sorry. Refer me again, please.

24 Q. Paragraph 22, page 9, the first four lines.

25 JUDGE THOMPSON: Is this in the rebuttal?

1 MR. SNODGRASS: Yes -- well, it's -- it's --
2 no. It's in the application, Exhibit 95.

3 JUDGE THOMPSON: Oh, thank you.

4 THE WITNESS: Where it begins, applicant's
5 debt obligation?

6 BY MR. SNODGRASS:

7 Q. Yeah. Just read the first two complete
8 sentences, if you would.

9 A. Applicant's debt obligations to AWCC under the
10 agreement will be evidenced by notes. The notes will
11 not be secured by mortgage, lien or incumbrance on
12 applicant's properties in the State of Missouri.

13 Q. All right. I'm gonna -- you've -- directing
14 your attention away from that exhibit just for a moment
15 and referring your -- directing your attention to
16 what's already been marked Staff Exhibit 96.

17 That looks like a Data Request, would that be
18 fair?

19 A. Yes.

20 Q. No. 3817?

21 A. Yes.

22 Q. But it's marked Exhibit 96, correct?

23 A. Correct.

24 Q. One of the questions in that Data Request is,
25 has Missouri-American issued any of its own long-term

1 debt since the financial service agreement was
2 established between it and American Water Capital
3 Corporation on June 15th, 2000; is that correct?

4 A. Yes.

5 Q. It says, if yes, please identify this
6 issuance, correct?

7 A. Correct.

8 Q. And one of the responses to the -- by the
9 Company to this Data Request was that the Company
10 issued one of its debt issues through AWCC. This issue
11 is the 5.65 percent, \$56 million issue; it says that?

12 A. Yes.

13 Q. And this Data Request is directed towards the
14 long-term debt, is it not?

15 A. Right. But it also says that future debt
16 issues will be either through the EI ERA or American
17 Water Capital, as also indicated in this financing
18 application.

19 This is not just -- the financing application
20 doesn't just apply to any debt from American Water
21 Capital.

22 MR. SNODGRASS: Judge, I'm gonna ask that the
23 witness be instructed to just respond to my question.

24 MR. ENGLAND: Your Honor, I believe the
25 witness was responding to the question and qualifying

1 the answer, which is entirely appropriate.

2 JUDGE THOMPSON: Could you read back the
3 question and the response, please?

4 (THE COURT REPORTER READ BACK THE REQUESTED
5 PORTION.)

6 MR. SNODGRASS: I think that's more of the
7 answer than it is the question, Judge.

8 JUDGE THOMPSON: Yeah, I need -- I need to
9 have the question and then the whole answer, so that I
10 can see if, in fact, she's not responsive.

11 Why don't we take a five-minute break, and
12 then the reporter can organize the question and the
13 answer and -- and we'll resume.

14 MR. SNODGRASS: Thank you.

15 (A RECESS WAS TAKEN.)

16 JUDGE THOMPSON: Why don't we go ahead and go
17 back on the record.

18 Okay. Now, we are going to rule on your
19 objection.

20 MR. SNODGRASS: I'd like the -- the original
21 question read back to start with, Judge, if I may.

22 JUDGE THOMPSON: Here's what I have: And this
23 data is long-term debt; Answer, but it also, something,
24 that future debts will be through the EI ERA. Also I
25 understand this financing application.

1 See, the -- the Livenote doesn't give us
2 English exactly.

3 THE REPORTER: Would you like me to read it
4 back, Judge?

5 JUDGE THOMPSON: Yeah, why don't you do it.
6 I -- it might be more successful than I was.

7 (THE COURT REPORTER READ BACK THE REQUESTED
8 PORTION.)

9 JUDGE THOMPSON: I would have to say that much
10 of your answer is, indeed, not responsive to the actual
11 question, which is, and this Data Request was directed
12 at long-term debt.

13 So I will admonish the witness to please try
14 to limit your answers to the question asked, which
15 often on cross-examination or yes/no questions the --
16 the attorney is asking you to agree with something that
17 you would rather not agree with that -- and you have to
18 say, yes, no, or I don't know.

19 Your attorney will have an opportunity in what
20 we call redirect to get you to give those interpretive
21 comments that are necessary for the Commission to
22 understand the original answer fully, okay?

23 THE WITNESS: Okay.

24 JUDGE THOMPSON: Thank you very much.

25 MR. ENGLAND: Your Honor?

1 JUDGE THOMPSON: Yes, sir.

2 MR. ENGLAND: As -- just as a point of
3 interest and clarity for purposes of the future
4 proceedings, are witnesses allowed to qualify their
5 answers perhaps if its's not entirely a yes or no
6 answer, or do we have to wait until redirect to get
7 that qualification?

8 JUDGE THOMPSON: That's a very fair question,
9 Mr. England. And I think that some -- some questions
10 call for a straight yes, no, I don't know, and some
11 questions do not.

12 And I think that if -- if it's not possible to
13 answer the question accurately with a bare yes, no, I
14 don't know, then -- then perhaps that should be the
15 first part of your answer.

16 I cannot just give you a yes or no because,
17 and -- and then proceed. I -- we simply have to take
18 it question by question.

19 MR. ENGLAND: Thank you, Your Honor.
20 That -- that -- that's satisfactory.

21 JUDGE THOMPSON: Thank you.

22 BY MR. SNODGRASS:

23 Q. All right. Let's -- getting -- getting down
24 to my bottom line on this particular exhibit,
25 Ms. Ahern, would you agree that this Data Request

1 indicates that Missouri-American Water Company has
2 taken a debt issuance from American Water Capital
3 Corporation on a long-term basis?
4 A. Yes.
5 Q. And that's occurred since the financing
6 agreement was put in place in June 15 of 2000?
7 A. Yes.
8 Q. Okay. Thank you, ma'am.
9 Going to what's already been marked as Staff's
10 Exhibit No. 97, 3802.
11 A. Oops. Okay.
12 Q. Is that a Staff Data Request to -- directed to
13 Mr. Ed Grubb?
14 A. Yes, it is.
15 Q. And, to your knowledge, is he the assistant
16 treasurer for the Company?
17 A. Yes.
18 Q. In its answer to -- in Mr. Grubb's answer to
19 the -- to the Data Request, he included a table of
20 calculations that was attached to DR3802?
21 A. Yes.
22 Q. And that's Exhibit 97, correct?
23 A. Correct.
24 Q. Looking at line 28 in that table -- looking at
25 line 28 in the table itself, it indicates -- first of

1 all, the table tak-- is entitled Missouri-American
2 Water Company imbedded costs of long-term debt; is that
3 correct?

4 A. Yes.

5 Q. And it's dated December 31st, 2002?

6 A. Yes.

7 Q. And line 28 indicates a -- a coupon rate of
8 5.650 percent?

9 A. Yes.

10 Q. And an original amount issued of 56 million?

11 A. Yes.

12 Q. An issue date of June 12th, 2002?

13 A. Yes.

14 Q. And a maturity date of 6/12/2007, correct?

15 A. Yes.

16 MR. SNODGRASS: Now, Judge, at this time I
17 seek to admit into the record Staff Exhibits 95, 96 and
18 97.

19 MR. ENGLAND: No objection, Your Honor.

20 MS. O'NEILL: No objection.

21 JUDGE THOMPSON: I didn't even get a chance to
22 ask for objections.

23 MR. ENGLAND: Just thought I'd help you out on
24 that one.

25 JUDGE THOMPSON: Well, I appreciate that.

1 MS. O'NEILL: We're trying to move it along,
2 Judge.
3 MR. SNODGRASS: One last question.
4 JUDGE THOMPSON: Wait just a moment, sir.
5 MR. SNODGRASS: Oh, I'm sorry. Forgive me.
6 JUDGE THOMPSON: Hearing no objections --
7 MR. SNODGRASS: Oh, sorry, Judge.
8 JUDGE THOMPSON: -- the receipt of
9 Exhibits 95, 96 and 97 -- those are received and made a
10 part of the record of this proceeding.
11 (EXHIBIT NOS. 95 THROUGH 97 WERE RECEIVED INTO
12 EVIDENCE.)
13 JUDGE THOMPSON: You may proceed.
14 MR. SNODGRASS: Thank you, Judge. I
15 apologize.
16 BY MR. SNODGRASS:
17 Q. You said in your remarks here under
18 questioning by me, Ms. Ahern, if I'm not mistaken that
19 Mr. Murray classified the support agreement between
20 American Water and American Water Capital Corporation
21 as an unconditional guarantee; is that right? Did you
22 make that statement? Do you remember ma'am?
23 A. Something similar to that, yes.
24 Q. And where in Mr. Murray's testimony did he
25 make that statement, to your knowledge?

1 A. Bear with me, please.

2 Q. Sure. I know that's a big --

3 A. It wouldn't help if I could look in my
4 testimony, would it? Okay. Let's see.

5 Q. It would shorten things up --

6 A. There, it is. No, I found it.

7 Q. All right. Go ahead. Sorry.

8 A. Yes. What he says on page 12 of his
9 surrebuttal testimony is -- he quotes from the American
10 Water 2002 annual report at lines 17 through 18.

11 Q. And would you re-- would you state what that
12 testimony is, please? I'd appreciate it.

13 A. It says, American Water has also indicated in
14 its 2002 report that it has "fully and unconditionally
15 guaranteed the securities of AWCC."

16 And if I may also go back to what else I've
17 said at that time, I believe I said that the support
18 agreement because the -- the way in which American
19 Water would support AWCC was either through cash equity
20 or a loan. That -- in my mind, that's not an
21 unconditional gaunt.

22 Q. All right. Now, isn't it true that Mr. Murray
23 is citing what -- what someone else has said?

24 A. True.

25 Q. And he's not saying that directly, now, is he

1 in his testimony? He doesn't say that specifically,
2 does he, ma'am?

3 A. No, he doesn't say it specifically.

4 MR. SNODGRASS: That's all I have. Thank you,
5 Judge.

6 JUDGE THOMPSON: Thank you, Mr. Snodgrass.

7 QUESTIONS BY JUDGE THOMPSON:

8 Q. Now, then, what is the ratio, in your opinion,
9 of the long-term debt forming part of the capital
10 structure of Missouri-American?

11 A. Assuming that -- of Missouri-American?

12 Q. Of Missouri-American.

13 A. Missouri-American.

14 Assuming, you know, based on Mr. Burdette's --
15 it's his surrebuttal testimony where he used the
16 Company actual information at November 30th, 2003, the
17 proportion of long-term debt is 55.53 percent.

18 Q. Okay. I think the Company elsewhere has
19 suggested a figure of 56.38. Is the Company now
20 willing to accept Mr. Burdette's figure, do you know,
21 or are you the wrong witness to ask that question?

22 A. I am the wrong witness. I bel-- believe the
23 56.38 was an estimated ratio.

24 Q. Okay. And if I were to ask you about the
25 ratio or proportion of preferred stock, would you have

1 that figure?

2 A. Yes. Again, based on Mr. Burdette's
3 surrebuttal and actual figures at November 30th, 2003,
4 the percent of preferred stock is .53.

5 Q. Okay. And it's your position, is it not, that
6 no amount of short-term debt should be reflected in the
7 capital structure; isn't that correct?

8 A. That is correct.

9 Q. And what about the proportion of common
10 equity, do you have a figure for that?

11 A. Again, based on Mr. Burdette's surrebuttal
12 testimony and actual figures at November 30th, 2003,
13 the percent of common stock equity is 43.94 percent.

14 Q. Okay. Now, Staff uses rather different
15 figures, don't they?

16 A. Yes.

17 Q. Okay. If I suggested to you that Staff is
18 using the figure of 63.92 percent for long-term debt,
19 does that sound like -- would you agree with that?

20 A. Just a minute, please.

21 Could you please repeat the figure?

22 Q. 63.92.

23 A. As the --

24 Q. For long-term debt.

25 A. I believe that was Mr. Murray's original

1 recommendation, which he updated in his rebuttal
2 testimony.

3 Q. I guess they didn't update it in their
4 position statement. Perhaps you could give me the
5 updated figure.

6 A. In Mr. Murray's rebuttal as of June he updated
7 to June 30th, 2003, the long-term debt percentage is
8 41.25 percent.

9 Q. That's quite a significance difference.

10 A. Yes. And if I may, that's due to a rather
11 large preferred stock issuance of American Water
12 capital during the first six months.

13 Q. Okay. And what -- what is Mr. Murray's
14 updated figure, then, for preferred capital?

15 A. 21.08 percent.

16 Q. For -- and does he include any short-term
17 debt?

18 A. Yes.

19 Q. How much?

20 A. 2.39 percent.

21 Q. Okay. And how about common?

22 A. 35.28 percent.

23 Q. Very well.

24 Now, is it true that Mr. Murray's figures are,
25 in fact, not figures for Missouri-American?

1 A. Correct. It is based on American
2 Water cap-- I'm sorry -- American Waterworks.

3 Q. And do you have an opinion or a comment on
4 whether or not the figures for American Waterworks
5 should be used, rather than the figures for
6 Missouri-American?

7 A. Yes. I've stated so in my -- both my rebuttal
8 and surrebuttal. I don't believe that American Water
9 Work's capital structure consolidated is appropriate to
10 use for ratemaking purposes for Missouri-American.

11 Common equity rate -- and if I may--

12 Q. You may?

13 A. -- may give the reason.

14 The -- a common equity ratio of approximately
15 35 percent is not consistent with the equity ratios of
16 the proxy ba-- maintained by the water industries
17 evidenced by all our proxy companies.

18 It also doesn't represent the capital, which
19 is financing Missouri-American's jurisdictional rate
20 base. I believe rate base is around 500 million.

21 The June 30th cap-- capital of American
22 Waterworks is something on the order of 9 billion.
23 There's a lot of excess money there that is not
24 financing Missouri-American's rate base.

25 It also includes a significant amount -- a

1 greater amount of financial risk than that proposed by
2 the Company -- or Missouri-American's actual capital
3 structure.

4 Q. Wouldn't financial risk have the effect of
5 driving up the cost to be assigned to common equity?

6 A. Yes, it would.

7 Q. So would that be beneficial for the Company?

8 A. Not on a weighted basis -- not on the overall
9 rate of return basis. Based on financial theory,
10 it's -- the financial risk indicates that both the debt
11 costs should be higher and the equity costs should be
12 higher. And it really dr-- it -- it drives up the
13 overall rate of return.

14 However, in this case the overall rate of
15 return is going to be applied to Missouri-American's
16 actual capital structure. The debt, which I believe I
17 was shown in Exhibit 97 -- was it 97 -- the debt
18 schedule -- debt schedule, which I was shown.

19 Q. In Exhibit 98, do you mean schedule?

20 A. No. It was 97. Yeah. Yes.

21 This is the debt. And at the bottom there's
22 the preferred. That's the -- the debt which will have
23 to be serviced. That's the interest which will have to
24 be paid by the Company when one applies Mr. Murray's
25 overall rate of return to the Company's actual capital

1 structure, the return af-- after paying for that debt
2 and that preferred, the return is substandard.

3 Q. Okay. And, if you know, could you summarize
4 for me the reason that Mr. Murray chose to use the
5 consolidated American Waterworks capital structure?

6 A. He gave several reasons throughout his several
7 testimonies. I believe he began -- the primary reason
8 is because he -- AWCC, the American Water Capital Corp,
9 exists, and in his opinion, it would be the primary
10 funding vehicle.

11 Nothing in the -- I think it's Exhibit 95,
12 which is the financing agreement -- nothing in there
13 indicates that AWCC will be the sole funding source.
14 They can go to the EIERA as well.

15 Q. But -- but his opinion, you believe, is that
16 American -- AWCC would be?

17 A. Right. Plus he gave some other -- other
18 reasons in his follow-up rebuttal and surrebuttal
19 concerning, you know, possible manipulation of the
20 structure and he raised this issue of double leverage
21 in a later testimony.

22 But the original reason was the -- that AWCC's
23 existence and it being the primary funding vehicle for
24 Missouri-American.

25 Q. Okay. And -- and do you have an opinion as to

1 the validity of those reasons?

2 A. Yes.

3 Q. And what is that opinion?

4 A. I have seen nothing which indicates that
5 American Water capital will be the primary funding
6 vehicle. The interview, which Mr. Murray has cited, as
7 well as the financing agreement, indicates that
8 Missouri-American will avail itself of long-term debt
9 either through the state tax-exempt funds or through
10 American Water capital at whichever is the lowest cost.

11 To date they've only availed themselves of the
12 56 million, which represents that 19 percent of total
13 debt and 10 percent of total capital. They also are
14 able, according to the finance agreement, to get out of
15 that debt, you know, on a 10-day notice. They --
16 and -- and there's no obligation in the financing
17 agreement to -- to use the AWCC debt.

18 In fact, there's a non-exclusivity cause --
19 clause, which states that nothing in this agreement
20 prohibits or restricts the Company from borrowing from
21 third parties or obtain services described in this
22 agreement from third parties whenever and on whatever
23 terms it deems appropriate.

24 Q. Okay. Now, let me pose you something of a
25 hypothetical question.

1 A. Okay.

2 Q. Let's assume that it's true that AWCC is, in
3 fact, going to be the primary -- in fact, the only
4 source of capital, do you have an opinion on the
5 propriety in that case of the use of the capital
6 structure that Mr. Murray has proposed?

7 A. Yes. So long as Missouri-American's
8 capital -- water -- capital structure is consistent
9 with that maintained in the industry's reasonable --
10 compared with other companies of comparable risk --
11 then I would use the Missouri-American actual capital
12 structure.

13 Q. So even --

14 A. So --

15 Q. Even in that case, you would not use the A--
16 the AWW Consolidated?

17 A. Correct.

18 Q. Okay. And, in fact, as far as you know, it's
19 Missouri-American that's the regulated entity that's
20 before the Commission here?

21 A. Absolutely.

22 Q. Okay. Now, what is the imbedded cost figure
23 that you would suggest -- or, if you know, for the
24 long-term debt?

25 A. 6.22 percent.

1 Q. Okay. Now --

2 A. For Missouri-American.

3 Q. For Missouri-American. That's the one I'm

4 concerned with.

5 A. Right.

6 Q. When I -- when I look at Exhibit 97, it seems

7 to have a 6.23 figure, and this evidently is data

8 provided by the Company to Staff in response to a data

9 request.

10 A. Uh-huh.

11 Q. Would that change your answer?

12 A. No. I believe the 6.23 -- the difference

13 between 6.23 and 6.22 is the timing. The --

14 Q. I see.

15 A. -- response to the Data Request is at

16 12/31/02, and the 6.22 is at June 3-- I'm sorry --

17 November 30th, 2003.

18 Q. Okay. Is there any particular reason, in

19 terms of timing, why you would choose one moment over

20 the other?

21 A. One should choose the latest date

22 available -- the latest possible if you're looking at

23 historical information.

24 Q. So from that point of view, December 31 might

25 be preferred?

1 A. No, this is December 31, 2002.

2 Q. Oh, I see. I'm sorry.

3 A. Right.

4 Q. The November was in 2003?

5 A. Right.

6 Q. See why we ask these questions?

7 A. Okay.

8 Q. To clear up these confusions. Great.

9 And with respect to the imbedded costs of the

10 preferred stock, what's the figure you have for that?

11 A. I have to find his testimony.

12 That is 9.12 percent at November 30th, 2003.

13 Q. Okay. Now, I understand that for common

14 equity, you have proposed a range of 11.75 to 12.0; is

15 that correct?

16 A. Correct. As of May 2003, yes.

17 Q. Well, has that changed with later information

18 or --

19 A. Yes.

20 Q. What -- what would be the number you would

21 propose today?

22 A. Not much different. Because the economy has

23 improved and because capital markets have increased --

24 we've seen the Dow go up significantly since May -- my

25 recommendation now -- capital markets indicate that

1 11.5 to 11.75 would be appropriate.

2 Q. Okay. Now, the Company asked for 11; isn't
3 that correct?

4 A. Correct.

5 Q. Did they do that on the basis of your
6 expertise or did they do that -- did they reach that
7 number all by themselves?

8 A. I think it -- well, a little bit of both. I
9 think based on my recommendation and what capital
10 market conditions indicated, as well as -- and this is
11 my speculation to, you know, avoid significant rate
12 shock and -- and to be conservative and reasonable --
13 they requested something lower.

14 Q. Okay. And yet the Commission's task with
15 respect to this figure is to predict what this common
16 equity would trade at if, in fact, it were traded;
17 isn't that correct?

18 A. Not exactly. In my opinion, the Commission's
19 task is to set a fair and reasonable rate of return,
20 balancing all stakeholder interests.

21 Q. Okay. Well, -- well, that's -- that's
22 certainly our ultimate --

23 A. Right.

24 Q. -- chore.

25 If Missouri-American was a publicly traded

1 company rather than a company all of whose common
2 equity is owned by another company --

3 A. Uh-huh.

4 Q. -- if I -- well, not me. But if -- if
5 someone -- that hypothetical someone could go out and
6 buy shares of Missouri-American, would we not simply
7 plug in the market price of that stock into this
8 calculation?

9 A. Correct. Right. One would use
10 Missouri-American's market data, right.

11 Q. And -- and so in setting that reasonable rate
12 that's just and reasonable to -- for rateholders and
13 ratepayers and other stakeholders, we'd still be stuck
14 with that market rate?

15 A. Right.

16 Q. Okay. So, again, our job now is to try to
17 predict what a market rate would be, is it not?

18 A. Right. As your first step to --

19 Q. For the first step.

20 A. Right.

21 Q. Exactly. That's the step I'm focused on here.

22 Okay. And in doing that, you performed
23 four different tests; is that correct?

24 A. Four costs of equity models, yes.

25 Q. Okay. First let me ask this: Why -- why is

1 the imbedded cost -- or the cost -- why is that
2 expressed as a percentage, rather than as a dollar
3 figure?

4 A. Because it's -- it's meant to be expressed as
5 a return on investment.

6 Q. Oh, very good. That's all I need to know.

7 A. Okay.

8 Q. So the DCF method you came up with 10?

9 A. Correct.

10 Q. And that's a percent?

11 A. Yes.

12 Q. Okay. And the RPM method you came up with
13 12.4, right?

14 A. Right.

15 Q. And for CAP you came up with 12.3?

16 A. Correct.

17 Q. And for CEM you came up with 13.6?

18 A. Right.

19 Q. And it is your position that -- that we need
20 to consider all four, and not mechanically rely on
21 simply one of these tests; is that not correct?

22 A. Correct. And then also not mechanically rely
23 on the four either. You must apply some judgment.

24 Q. So it is an art not a science?

25 A. Definitely.

1 Q. And so there -- there -- is there a
2 mathematical technique that you use to translate the
3 results of these four models into the range that you
4 propose?

5 A. No. But I can tell you what I did do. I did
6 look at what the average was, which is something
7 slightly higher than 12 percent. I looked at the
8 range, looked at the midpoint, and then I determined
9 that the -- because it is not precise, that the
10 appropriate cost of common equity at that time was
11 within the range of 11.75 to 12.

12 Q. And I understand you've -- you've revised that
13 opinion?

14 A. Right now 11.5 to 7 -- I'm sorry. 11.75.

15 Q. A little bit lower?

16 A. A little bit lower.

17 Q. Okay. Now, to your knowledge, did Staff
18 perform a DCF model?

19 A. Yes.

20 Q. And what number did they come up with?

21 A. Just bear with me.

22 The DCF result ranged for Staff from 7.93 to
23 8.93 percent.

24 Q. Now, is it common for that model to result in
25 a range?

1 A. It depends on how you apply the model, what
2 types of growth rates one uses. Mine actually was a
3 range, too, and I -- I chose to average those to get to
4 the 10 percent.

5 Q. Very good.

6 Did Staff perform an RPM model?

7 A. Yes.

8 Q. And what was the result?

9 A. 9.23 percent.

10 Q. So a single number, not a range?

11 A. Correct.

12 Q. Okay. How about a CAP model?

13 A. They -- Staff had two results. Didn't
14 classify them as a range, though. 8.66 percent and
15 4.73 percent.

16 Q. Okay. And a CAM model?

17 A. CEM, no. Staff did not do that.

18 Q. Okay. How come Staff's results on these
19 models are different than yours?

20 A. Several reasons. In the DCF, one of the
21 reasons is that Staff all -- included negative growth
22 rates, and Staff also double counted analysts'
23 forecasts using both IBIS and S&P.

24 In the capital asset pricing model Staff used
25 a current yield on the 30-year treasury bond. And on a

1 forecasted yield, I believe that Staff miscalculated
2 the historical equity risk premium.

3 Staff also failed to include a forecasted risk
4 premium in the capital asset pricing model, which is
5 inconsistent with Staff's use of forecasted growth
6 rates in the DCF.

7 And Staff also failed to use something called
8 the empirical capital asset pricing model, which
9 corrects for some misspecification of the traditional
10 CAPM.

11 In the risk premium model, again, Staff used
12 the current yield on the -- on the 30-year T-bond
13 rather than a forecasted yield, and also did not use a
14 forecasted risk premium.

15 Q. So -- so would I be correct, then, as a naive
16 onlooker to say that it's your opinion Staff did not do
17 the models correctly?

18 A. I -- I believe that would be fair to say, yes.

19 Q. Okay. Now, how about Public Counsel, did they
20 do a DCF?

21 A. Yes.

22 Q. And what was the result they have taken?

23 A. Between a range of 9.48 percent to
24 9.98 percent.

25 Q. 9.48 to 9.98?

1 A. Correct.

2 Q. And, in your opinion, did Public Counsel do
3 that one correctly?

4 A. In general, yes. The application is different
5 from mine, but I don't have any quarrel with it.

6 Q. Okay. And how about RPM, did Public Counsel
7 do one of those?

8 A. Yes.

9 Q. And what was the result they obtained?

10 A. Staff -- I'm sorry -- Public Counsel actually
11 performed two. There was an original in his direct
12 testimony, and then there was a correction in the
13 surrebuttal.

14 The original CAPM range was 9.05 to 9.33. And
15 I believe the corre-- in the correction -- when he said
16 there was a midpoint or an average of 9. -- back up.
17 I'm wrong on the 9.05 to 9.33.

18 Q. Okay.

19 A. In his surrebuttal says overall CAPM --
20 original CAPM was 9.97 and corrected it is 11.15.

21 Q. And this is RPM?

22 A. CAPM. C-A-P-M.

23 Q. So this is a different type of test?

24 A. This is equivalent to my CAPM.

25 Q. Okay.

1 A. I'm sorry. Did you ask me about the R--
2 risk --
3 Q. I did. But that's okay.
4 A. I'm sorry.
5 Q. I'll just put it in a different place.
6 A. I'm just remembering what he did and didn't.
7 Okay. I apologize.
8 Q. Tell me about his RPM. Did he do one?
9 A. No, he did not.
10 Q. Okay. And his CAPM, did he do that right or
11 not?
12 A. I don't believe so. He did not -- he used
13 intermediate -- or intermediate risk-free rate rather
14 than a long term. Relied solely on a historical risk
15 premium. Also did not do the empirical CAPM.
16 Q. Okay. What about a CEM, did he do one of
17 those?
18 A. No, he did not.
19 Q. Okay. And you do this sort of thing all the
20 time for a living, right?
21 A. Yeah.
22 Q. Okay.
23 A. Yes.
24 Q. Now, with respect to your group of proxy
25 publicly traded water companies --

1 A. Okay.

2 Q. -- could you tell me what is the range that

3 you found that their common equity was trading at, at

4 whatever's point of time would be an appropriate one to

5 look at?

6 A. What do you mean range of the market. To book

7 ratio or I'm kind --

8 Q. Well, what I want to know is I want to know a

9 percentage for their common equity, whether it's a

10 single number, a range?

11 A. You mean, common equity ratio?

12 Q. Yes.

13 A. Oh, okay.

14 Q. Not -- not ratio in like how much of its in

15 their capital structure --

16 A. Oh, no.

17 Q. -- but the -- the -- the percentage that would

18 show me cost.

19 A. It would be the -- the -- the cost rates I

20 just gave you. You mean, the return on investment?

21 Q. Yeah.

22 A. Yeah. It would be --

23 Q. So it's -- in other words, it's the four

24 figures you gave me --

25 A. It -- it would be the ra--

1 Q. -- from your models?

2 A. Correct. Because that is based on the market

3 data of those companies, yes.

4 Q. Okay. But in each case you've taken a range

5 and reduced it to a single number?

6 A. Right.

7 Q. Okay.

8 A. Right. I've not --

9 Q. All right. That's all --

10 A. I've not --

11 Q. -- I need to know.

12 A. -- calculated each individual one.

13 Q. Very good.

14 So the highest result you got was 13.6. How

15 come the Company is not asking for 13.6?

16 A. Because my conclusion, based on the

17 four models, is a lower range. And then, again, to

18 mitigate rate shock, I believe.

19 Q. Well, it's our job to mitigate rate shock. By

20 that I mean the Commission. It's your job to tell us

21 what the value --

22 A. Okay.

23 Q. -- of this common equity is, right?

24 A. Uh-huh.

25 Q. Okay. So could it be 13.6?

1 A. It could be.

2 Q. Okay. And -- andy your CEM model would

3 support that result?

4 A. Correct. I wouldn't recommend 13.6 but, yes,

5 the model -- model indicates that.

6 Q. Okay. And it could be 10?

7 A. Could be.

8 Q. If we went with your DCF result?

9 A. Correct.

10 Q. Okay. Now, you talked about how the DCF model

11 is inaccurate when there is a difference between book

12 value and market value?

13 A. Yes.

14 Q. Okay. And at the present time, would you say

15 that the DCF model would understate value or overstate

16 value?

17 A. It understates, because the market to books

18 ratios of these companies average about 230,

19 240 percent.

20 Q. And -- and would that -- again from a naive

21 vantage point, would that explain why it's the lowest

22 of your four results?

23 A. Not necessarily. I believe it's the lowest --

24 would -- would you like for me to explain?

25 Q. You -- of course.

1 A. Okay.

2 Q. When I'm asking questions, you can explain all
3 you want.

4 A. Okay. Thank you. Thank you.

5 I believe it's the lowest of the results
6 because we analysts are constrained to using accounting
7 proxies for our growth measures -- you know, growth in
8 earnings per share, growth in dividends per share,
9 growth in like the -- sustainable growth, the
10 BR retention method.

11 These are the proxies for the market
12 appreciation that investors expect -- the long-term
13 market appreciation. We're using short-term growth
14 forecasts, and I believe that is why the D-- DCF is
15 lower.

16 Q. Okay. And my last question for you, you --
17 professionally you would be content if the Commission
18 values this equity anywhere between 11.5 and 11.75? I
19 mean, that was the range --

20 A. The orig--

21 Q. -- the corrected range you gave me today.

22 A. Okay. That's -- yes. 11.5 and 11.75, yes, I
23 think that is an appropriate range today.

24 Q. Okay. So if we gave the Company what they're
25 asking for on 11, in your opinion, that would actually

1 be a little low?

2 A. It would be low relative to the -- to the
3 market standard, yes.

4 JUDGE THOMPSON: Okay. Thank you very much.

5 We're going to save the rest of the questions
6 for the -- from the Bench until the rest of the Bench
7 is here to question.

8 So we will break for the lunch recess at this
9 time. It's 12:10 according to the computer clock.
10 We'll be back at 1:15. And thank you. We are in re--
11 recess.

12 (A RECESS WAS TAKEN.)

13 JUDGE THOMPSON: We will begin.

14 Okay. Are we ready for Mr. Jenkins?

15 Spell your last name -- will you please sit
16 down, sir.

17 Spell your last name for the reporter, please.

18 MR. JENKINS: J-E-N-K-I-N-S.

19 JUDGE THOMPSON: Let me get my television
20 production going here.

21 Okay. Raise your right hand, Mr. Jenkins.

22 (Witness sworn.)

23 JUDGE THOMPSON: Thank you.

24 You may inquire.

25 MR. ENGLAND: Thank you, Your Honor.

1 JAMES JENKINS testified as follows:

2 DIRECT EXAMINATION BY MR. ENGLAND:

3 Q. Mr. Jenkins, turning your attention to what
4 has been marked for purposes of identification as
5 Exhibit 47, that is your rebuttal testimony filed in
6 this case.

7 Do you have any changes or corrections to make
8 to that testimony at this time?

9 A. No, I do not.

10 Q. And now turning your attention to what has
11 been marked for purposes of identification as
12 Exhibit 79, which is your surrebuttal testimony, do you
13 have any changes or corrections to that testimony at
14 this time?

15 A. No, I do not.

16 MR. ENGLAND: Thank you, sir.

17 I have no other questions. Would tender the
18 witness for cross-examination, and also offer
19 Exhibits 47 and 79.

20 JUDGE THOMPSON: Thank you, Mr. England.

21 Do I hear any objection to the receipt of
22 Exhibit No. 47?

23 (No response.)

24 JUDGE THOMPSON: Do I hear any objection to
25 the receipt of Exhibit 79?

1 (No response.)

2 JUDGE THOMPSON: Hearing no objections, those
3 exhibits are received and made a part of the record of
4 this proceeding.

5 (EXHIBIT NOS. 47 AND 79 WERE RECEIVED INTO
6 EVIDENCE.)

7 JUDGE THOMPSON: Now, I'm gonna have to take
8 roll, I guess, again to see who's here.

9 Industrial Energy Consumers?

10 (No response.)

11 JUDGE THOMPSON: Missouri Energy Group?

12 MS. LANGENECKERT: No questions.

13 JUDGE THOMPSON: Okay. Let's see.

14 Riverside Water Rate Coalition?

15 MR. SWENSEN: No questions.

16 JUDGE THOMPSON: Mr. Swensen, no questions.

17 Thank you.

18 And I don't see Joplin. I don't see
19 Mr. Fischer. I don't see Mr. Curtis. I don't see
20 Mr. Comley, and Ms. Bond has left; is that correct?

21 (No response.)

22 JUDGE THOMPSON: Okay. So Ms. O'Neill?

23 MS. O'NEILL: Your Honor, on this particular
24 topic I don't have any cross-examination of Mr. Jenkins
25 at this time. Thank you.

1 JUDGE THOMPSON: Very well.
2 Mr. Snodgrass?
3 MR. SNODGRASS: Okay. Thank you, Judge.
4 These will be very brief questions.
5 CROSS-EXAMINATION BY MR. SNODGRASS:
6 Q. Good afternoon, Mr. Jenkins.
7 A. Good afternoon.
8 Q. You and I have gone down some of the same
9 highways in Illinois, have we not?
10 A. That's correct.
11 Q. All right. Would you take a look at -- would
12 you pick up your rebuttal testimony for me, please,
13 sir?
14 A. I have it.
15 Q. All right. Would you please look at page 4 of
16 your rebuttal, lines 5 through 8.
17 A. Yes.
18 Q. You say in part there that Staff's recommended
19 costs of equity after taking into its consolidated
20 capital structure it's 6.96 percent midpoint, correct?
21 A. That's correct.
22 Q. Now, you've read Mr. Murray's testimony, did
23 you not?
24 A. I have.
25 Q. And he recommends the cost of common equity in

1 the range of 8.26 to 9.26 percent, does he not?

2 A. That's correct.

3 Q. Now, can you explain how the Company came up
4 with the figure of 6.96 percent when Mr. Murray's cost
5 of equity range was 8.26 to 9.26?

6 A. Yes. What we did was we took a look at the
7 pre-tax rate of return that Mr. Murray's calculation
8 for rate of return computed to under a consolidated
9 capital structure at the American Water parent level.

10 Then I applied that pre-tax calculation and
11 ran what I would call an effective equity rate, based
12 on the -- the actual Missouri-American capital
13 structure, which would deliver that at a -- at the
14 6.96 level -- at the midpoint level.

15 Q. It's true, though, that Mr. Murray used
16 American -- American Water's capital structure in his
17 cost of equity recommendation, did he not?

18 A. That's correct.

19 Q. And by inserting MAWC's capital structure in
20 this calculation, are you already assuming the
21 Commission would adopt that capital structure?

22 A. No, I'm not.

23 Q. Well, you're using a different capital
24 structure replacing an apple in an equation where an
25 orange was used originally, are you not?

1 A. I don't understand.

2 Q. Aren't you substituting a different capital
3 structure than the one used by Mr. Murray?

4 A. Yeah. What I'm doing is -- is taking the
5 capital structure that we have at Missouri-American and
6 saying this is ultimately the effective cost of equity
7 rate that we would achieve on our local capital
8 structure here in Missouri.

9 Q. All right. Just a few real quick basic
10 questions perhaps would help. A percentage of a
11 company's capital structure that consists of common
12 equity is used as a multiplier to the cost of equity to
13 determine the weighted cost of equity; is that correct?

14 A. That's correct.

15 Q. And it's the weighted cost of equity that's
16 added in with other weighted capital costs to determine
17 a fair rate of return or total cost of capital; is
18 that -- is that correct?

19 A. That's correct.

20 MR. SNODGRASS: That's all the questions I
21 have, Judge.

22 JUDGE THOMPSON: Thank you, Mr. Snodgrass.

23 We'll go ahead and take up questions from the
24 Bench for Mr. Jenkins at this time.

25 Commissioner Murray?

1 COMMISSIONER MURRAY: Judge, I have to
2 inquire, since we've been in agenda all morning and I
3 missed the first part of it -- this afternoon's first
4 few minutes and I'm a little puzzled as to where we
5 are.

6 JUDGE THOMPSON: We -- we will tomorrow start
7 with Mr. Gibbs with questions from the Bench. He was
8 the Staff witness and the last witness in the area of
9 pension, and we are putting him over to tomorrow
10 because Mr. Schwarz is unavailable today -- this
11 afternoon because his child has a -- a doctor's
12 appointment that could not be changed.

13 We have taken the direct of -- direct and
14 cross-examination of Ms. Ahern, the Company's first
15 witness, in the area of capital structure and return on
16 equity, and we are waiting to begin questions from the
17 Bench for her.

18 This is the Company -- Mr. Jenkins is the
19 second witness for the Company in the area of capital
20 structure and return on equity. And since he's already
21 on the stand, I thought we would simply proceed through
22 questions from the Bench for him, and then we would
23 return to Ms. Ahern.

24 COMMISSIONER MURRAY: All right. Thank you
25 for clarifying that.

1 JUDGE THOMPSON: Yes, ma'am. I know it's
2 confusing.

3 COMMISSIONER MURRAY: Unfortunately that's the
4 way we often have to attend these hearings is in bits
5 and pieces.

6 QUESTIONS BY COMMISSIONER MURRAY:

7 Q. Mr. Jenkins, good mor-- good afternoon,
8 rather.

9 A. Yes.

10 Q. Somehow I got down here without the testimony
11 of yours that includes this issue, I believe. Which --
12 from which testimony did you file?

13 A. On this particular issue I've -- I've only got
14 two or three pages of testimony.

15 Q. And that is in which testimony?

16 A. It's in my direct -- direct -- or the rebuttal
17 testimony, Exhibit 47.

18 Q. All right. And that's what I ended up
19 downstairs without for some reason.

20 JUDGE THOMPSON: Here, Commissioner
21 (indicating).

22 COMMISSIONER MURRAY: Thank you.

23 THE WITNESS: It begins on page 1 and extends
24 through page 4.

25 COMMISSIONER MURRAY: Unfortunately this copy

1 doesn't have any questions of mine written on it, since
2 this isn't my copy.

3 All right. Well, let me just see if I can
4 wing it.

5 JUDGE THOMPSON: Would you like to have an
6 opportunity for Dan to bring it down?

7 COMMISSIONER MURRAY: That's all right. I'll
8 just try to figure out if I can remember what I wanted
9 to ask you.

10 BY COMMISSIONER MURRAY:

11 Q. The capital structure that you want to use is
12 based on Missouri-American, rather than American
13 Waterworks; is that right?

14 A. That's correct.

15 Q. And what capital structure has -- was used in
16 the last rate case?

17 A. The -- the last rate case used that
18 Missouri-American stand-alone capital structure.

19 Q. And what is standard for -- or is there such a
20 thing as standard -- is -- is there a -- a variation
21 between rate cases in different jurisdictions as to
22 which structure is used or are there -- is there one
23 theory that's applied more than one another or --

24 A. It's been my experience that the -- the
25 stand-alone capital structure or the individual

1 operating unit is the standard regulatory practice.

2 Q. And is there an ideal -- what might be
3 considered an ideal capital structure?

4 A. Typically the capital structure that you see
5 within the utility industry is a capital structure
6 that's weighted 60 percent debt/40 percent equity.
7 It's -- it's in the ballpark of that type of weighting.

8 And then the -- the security analysts measure
9 your degrees of risk in terms of -- of what your actual
10 capital structure ratio is.

11 Q. And what is the capital structure of
12 Missouri-American currently?

13 A. The capital structure of Missouri-American
14 is -- comprises of about 43 percent equity/56 percent
15 long-term debt, and then the balance is preferred
16 stock.

17 Q. And what is the current capital structure of
18 American Waterworks?

19 A. The -- I don't have that in front of me.
20 Our -- our witness before me addressed -- addressed
21 that, and I don't have that information from him.

22 Q. I'll have the opportunity to ask that later
23 then.

24 Is there or do you know -- is there a
25 rationale for using a hypothetical capital structure

1 that's not -- not either one -- not either the parent
2 company or the subsidiary, but something closer to an
3 "ideal"?

4 A. I think our other witness who deals with
5 capital structures in the regulatory setting much more
6 frequently than I do could address that better.

7 Q. All right. And what is the difference in
8 this -- to -- to American's bottom line -- the
9 difference between Staff's position and the Company's
10 position?

11 A. The -- the capital structure issue is around
12 \$2 million in the revenue requirement, and then the
13 return on equity issue is around \$5.7 million,
14 according to the reconciliation in the case.

15 COMMISSIONER MURRAY: And are you -- are we
16 taking the ROE issue right now or is -- is that --

17 JUDGE THOMPSON: We're taking the capital
18 structure and return on equity issues together.

19 COMMISSIONER MURRAY: Right now?

20 JUDGE THOMPSON: Yes, ma'am.

21 BY COMMISSIONER MURRAY:

22 Q. Now, can you give me -- and you may have
23 already done this, but can you summarize your rationale
24 for the ROE that the Company has calculated?

25 A. Our other witness really directly addressed

1 the return on equity calculation and did the supporting
2 calculations to support the -- the return on equity.
3 What I -- what I'm testin-- what I'm testifying to is
4 the financial implications of the -- the Commission
5 Staff's position as a whole and the impact that it
6 would have on the -- the Company.

7 Q. All right. And it sounds like those
8 two issues together amount to a difference of
9 \$7 million?

10 A. That's right. I think it would be offset by
11 Staff's intersynchronization adjustment.

12 Q. And how much would that offset it?

13 A. Around \$2.8 million.

14 Q. And that's not an issue of which you provided
15 any testimony; is that correct?

16 A. No.

17 COMMISSIONER MURRAY: All right. I guess
18 that's all I have. Thank you.

19 THE WITNESS: Thank you.

20 JUDGE THOMPSON: Thank you, Commissioner
21 Murray.

22 Commissioner Clayton?

23 COMMISSIONER CLAYTON: No questions.

24 QUESTIONS BY JUDGE THOMPSON:

25 Q. My one question for you, Mr. Jenkins, is, if

1 you know, how was the cost of the capital structure
2 issued that's shown on the reconciliation -- how was
3 that cost developed?

4 A. On the Staff's reconciliation?

5 Q. Yeah. I guess what I'm trying to understand
6 is how does the different -- how do the different
7 positions with respect to capital structure and
8 imbedded costs -- how do those translate into
9 dollars -- how do we translate those into dollars?

10 A. I generally know theoretically. In this case
11 I didn't prepare this, so I don't --

12 Q. Okay.

13 A. -- know.

14 Q. Do you have any idea who I could ask that
15 might know the answer to that question?

16 A. Yeah, either -- probably Mr. Grubb on our
17 Staff could answer the question or a Staff witness.

18 JUDGE THOMPSON: Okay. Thank you very much.

19 COMMISSIONER MURRAY: Judge?

20 JUDGE THOMPSON: Yes, ma'am.

21 COMMISSIONER MURRAY: I have another question.

22 JUDGE THOMPSON: Always.

23 Commissioner Murray?

24 FURTHER QUESTIONS BY COMMISSIONER MURRAY:

25 Q. Mr. Jenkins, you indicated that in

1 Missouri-American's last rate case that the Commission
2 used Missouri-American stand-alone cost of capital?

3 A. That's correct.

4 Q. And was that Staff's recommendation at that
5 time or --

6 A. That's correct.

7 Q. And what was the result of that capital
8 structure being used versus American Water's capital
9 structure at that time? Do you know if -- what the
10 difference would have been?

11 A. I -- I don't recall.

12 Q. And you don't know if it would have been in
13 Missouri-American's favor?

14 A. I don't recall on that.

15 COMMISSIONER MURRAY: All right. Thanks.

16 JUDGE THOMPSON: Further questions from the
17 Bench?

18 (No response.)

19 JUDGE THOMPSON: Okay. Recross.

20 Ms. Langeneckert?

21 MS. LANGENECKERT: None.

22 JUDGE THOMPSON: Mr. Swensen?

23 MR. SWENSEN: No questions.

24 JUDGE THOMPSON: Ms. O'Neill?

25 MS. O'NEILL: No questions.

1 JUDGE THOMPSON: Mr. Snodgrass?

2 MR. SNODGRASS: Yes, just briefly.

3 RECROSS-EXAMINATION BY MR. SNODGRASS:

4 Q. Mr. Jenkins, in response to Commissioner
5 Murray's questions you indicated in the last rate case
6 Missouri-American Water Company's stand-alone capital
7 structure was used; is that correct?

8 A. That's correct.

9 Q. Now, that last rate case occurred before the
10 creation of American Water Capital Corporation, did it
11 not?

12 A. That's correct.

13 Q. And that last rate case occurred before
14 American Waterworks was purchased by RWE; isn't that
15 correct?

16 A. That's correct.

17 MR. SNODGRASS: That's all the questions I
18 have.

19 JUDGE THOMPSON: Thank you, Mr. Snodgrass.
20 Mr. England, redirect?

21 MR. ENGLAND: Thank you, Your Honor.

22 REDIRECT EXAMINATION BY MR. ENGLAND:

23 Q. Mr. Jenkins, you have some experience with
24 St. Louis County Water Company, one of the predecessors
25 to the Missouri-American Water Company that now exists

1 today, correct?

2 A. I do.

3 Q. And in the St. Louis County water rate case

4 in -- in the last rate case, do you recall if a

5 stand-alone structure -- capital structure was used or

6 a consolidated parent company capital structure?

7 A. A stand-alone capital structure was used.

8 Q. And St. Louis County was a subsidiary in a

9 holding company structure --

10 A. That --

11 Q. -- to your recollection?

12 A. That's correct.

13 Q. Okay. In your prior experience with

14 St. Louis County Water Company in rate cases before

15 this Commission what capital structure was used?

16 A. Stand alone.

17 Q. And what -- what capital structure was

18 recommended by the Company throughout that history?

19 A. The Company always recommended a stand-alone

20 capital structure.

21 Q. Mr. Snodgrass asked you what had changed since

22 the Company's last rate case, whether you consider

23 St. Louis County's last rate case or

24 Missouri-American's last rate case as the last rate

25 case.

1 A. Right.

2 Q. And I believe you indicated that American

3 Water Capital Corporation had, I guess, been created;

4 is that right?

5 A. That's correct.

6 Q. And -- and Missouri-American -- or excuse

7 me -- American Waterworks had been acquired by RWE?

8 A. That's correct.

9 Q. Is there any other change that you know of

10 that has occurred?

11 A. I'm not aware of any.

12 Q. The way in which Missouri-American receives

13 its equity -- the capital from its parent, has that

14 changed?

15 A. No.

16 Q. The way in which American -- excuse me --

17 Missouri-American issues debt to third-party

18 non-affiliated lenders, such as the Missouri

19 EIERA program, has that changed?

20 A. No, that has not.

21 Q. You were also asked some questions by

22 Mr. Snodgrass regarding the effective return on equity

23 that you were discussing in your testimony.

24 Do you recall that?

25 A. Yes.

1 Q. Is that an attempt to determine what the
2 return on actual invested equity in Missouri-American
3 would be given Staff's overall recommended return on
4 rate base in this case?

5 A. Yes.

6 MR. ENGLAND: Thank you, sir.

7 I have no other questions.

8 JUDGE THOMPSON: Thank you, Mr. England.

9 You may step down, Mr. Jenkins.

10 After he steps down, Ms. Ahern, why don't you
11 come back up.

12 (Witness excused from the stand.)

13 JUDGE THOMPSON: Thank you.

14 I will remind you, Ms. Ahern, you're still
15 under oath.

16 MS. AHERN: Okay.

17 JUDGE THOMPSON: And we are ready for
18 questions from the Bench.

19 Commissioner Murray?

20 PAULINE AHERN, having been previously sworn, testified
21 as follows:

22 QUESTIONS BY COMMISSIONER MURRAY:

23 Q. Good afternoon.

24 A. Good afternoon.

25 Q. I assume you heard the questions that I asked

1 Mr. Jenkins about a hypothetical capital structure?

2 A. Yes.

3 Q. And something approaching what might be
4 considered an ideal?

5 A. Right.

6 Q. What do you -- is a 60/40 what would be
7 considered an ideal capital structure?

8 A. It's a typical average or 55/45. Somewhere in
9 245 range, yes. That's based on industry standards --
10 what is typically maintained by companies in the water
11 industry.

12 Q. I just read something and I just -- I assume
13 it's probably totally unrelated, but that some of the
14 energy companies that have had a -- a natural problem
15 of late because -- well, for several reasons, but one
16 of which is that they had a very high debt ratio?

17 A. Uh-huh.

18 Q. And that the financial community is looking to
19 them to have a 50/50 ratio before their investment rate
20 again, does that sound -- wait.

21 Is -- is -- is that something that the
22 investment community would expect a lower debt ratio if
23 there had been problems experienced in the past?

24 A. No. I think that the -- those energy
25 companies have increased their debt ratio as they got

1 into more and more deregulated operations, energy
2 marketing and trading and things like that.

3 Typically in the past they had ratios more in
4 line with 50/50, and now, as their bonds have been
5 downgraded, the rating agencies are looking for them to
6 reduce their leverage in order for them to get back
7 into the investment grade.

8 Q. All right. But they're looking at a 50/50
9 versus a 55/45 or a 60/40?

10 A. Right. But it's typical for water companies,
11 which are so capital intensive, to have a little bit
12 more --

13 Q. Oh.

14 A. -- be more highly leveraged.

15 Q. Is a part of that because the -- the debt is
16 cheaper than equity and -- I -- a capital intensive
17 company would -- such as a water company would -- it's
18 pretty expensive to provide all that infrastructure,
19 right?

20 A. Correct.

21 Q. So that if you have a little bit higher debt
22 ratio, it makes the overall costs reduced?

23 A. It can, but a higher overall debt ratio also
24 increases the -- the cost of debt and the cost of
25 equity. Because the more leveraged you are, the

1 greater your financial risk.

2 The advantage that water companies have is
3 that in most states they can avail themselves of
4 tax-exempt financing, so they experience a lower debt
5 cost rate than would be typical of a firm with that
6 kind of leverage.

7 Q. In -- in looking at Missouri-American Water
8 Company's capital structure as compared to American
9 Waterworks, which of those two would more closely
10 approximate a hypothetical ideal structure for the
11 water industry?

12 A. I would say Missouri-American Water's
13 stand-alone capital structure, because it is consistent
14 with the water industry on average.

15 Q. And what is the capital structure of American
16 Waterworks?

17 A. American Waterworks?

18 Mr. Murray has provided the capital structure
19 at June 30th, 2003. Common stock equity 35.28 percent,
20 preferred stock 21.08, long-term debt 41.25, short-term
21 debt 2.39.

22 Now, excuse me, the prior question you asked
23 me which approached the ideal, correct?

24 Q. Correct.

25 A. Okay.

1 Q. So in breaking that down, where do you place
2 the preferred stock in that breakdown?

3 A. I'm not sure I understand.

4 Q. Well, you said 21.08 preferred stock, I
5 believe?

6 A. Uh-huh.

7 Q. And -- and in Missouri-American's stand-alone
8 it was -- preferred was --

9 A. It's about .5.

10 Q. Uh-huh. Where does that go in the -- in the
11 calculation? Does that show as equity?

12 A. It is equity, but when one is considering the
13 financial risk of an operation, it is considered senior
14 capital.

15 Therefore, it would be included in any -- any
16 calculation of increased financial risk, because the
17 Company is legally obligated to pay its preferred stock
18 dividends and its interest on its short- and long-term
19 debt before anything to -- any dividends to common
20 shareholders.

21 Q. A few days ago when I read your testimony, I
22 thought I had several questions for you, but I'm having
23 trouble locating them right now.

24 A. Okay.

25 Q. If you'd just give me a minute or two.

1 Your testimony covers the return on equity
2 issue also; is that right?

3 A. Yes.

4 Q. And did you do a -- a comparison of ROE for
5 comparable water companies?

6 A. In my rebuttal I did mention that the -- the
7 water companies which are covered by Value Line for
8 whom -- those are the only ones that have a projected
9 ROE published.

10 Q. Where is that in your rebuttal?

11 A. I'm looking.

12 Q. Is it one of your schedules?

13 A. No. Page 27, lines 3 and 4. Currently Value
14 Line is expecting an ROE for American States Water of
15 10 percent, 10.5 percent for California Water and
16 15 percent for Philadelphia Suburban over the next
17 three to five years, which average 11.8 percent.

18 Q. And yet there's quite a range in there --

19 A. Uh-huh.

20 Q. -- between those to come up with that average,
21 right?

22 A. Right.

23 Q. How would you explain the range?

24 A. Well, Value Line might be able to explain it
25 better. I know that the Cal-- two California

1 companies, American States Water in California are -- I
2 believe they are both currently in -- in for rates, and
3 there have been delays in their decisions.

4 They've also had wetter than normal weather in
5 the recent past, and I think that's factored into Value
6 Line's projections.

7 American States has three major base rate
8 cases in front of the California Commission.

9 Q. I'm sorry. Which ones are these -- which --
10 what are their ROEs?

11 A. American States is 10 point -- well, the --
12 the current one is 10.5. That wasn't available at the
13 time I did my rebuttal. California Water is 10.5 and
14 now Philly Suburban has been updated to 14.5.

15 Philadelphia Suburban, I believe, they're
16 higher ROE is because they are growing through
17 acquisition. They just recently acquired Aqua Source.
18 And they also just received -- they're getting higher
19 water rates in Pennsylvania, New Jersey, Ohio and
20 Maine.

21 Q. And these are the rates that Value Line
22 expects them to earn in the next three to five years?

23 A. On average, yes.

24 Q. And that doesn't say anything about the rates
25 that their jurisdictions have told them that they're

1 going --

2 A. No, other than for Pennsylvania American that
3 they -- they do have high authorized returns in
4 Pennsylvania, New Jersey, Ohio and Maine. And they are
5 currently in -- they have a rate filing in Pennsylvania
6 and just recently filed in New Jersey.

7 Q. Does Philadelphia Suburban have an authorized
8 rate much higher than 14.5?

9 A. I don't know.

10 Q. And I believe, if I recall your testimony
11 correctly, you said the DCF analysis is not -- as a
12 stand-alone basis is not an appropriate way to
13 determine the cost of equity; is that right?

14 A. I wouldn't classify it as not appropriate.
15 I -- I believe that because all of the models have some
16 theoretical problems with them with the assumptions
17 underlying them and they have some practical problems
18 in the application of the models, that one should not
19 rely on the DCF or any model exclusively. And one
20 should look to the results of multiple market models.

21 Q. Okay. And it seems, as I was reading the
22 testimony, that most of the parties would agree with
23 that, even though Staff appears to use the DCF model to
24 arrive at its -- its -- Staff's result; is that right?

25 A. Correct.

1 Q. But I thought I understood even Staff to say
2 that, yes, there should be some -- at least some
3 checking through the other models to see if that model
4 comes up with a reasonable figure?

5 A. Right. And where we disagree is Staff uses
6 the other models as a check. I think that investors
7 look to the results of all of the models and consider
8 them collectively.

9 Q. Do you think that Staff's use of the other
10 models to check its DCF analysis provided a reasonable
11 conclusion that the DCF analysis results were within
12 reason?

13 A. No, because I don't believe that Staff applied
14 those models correctly or -- or consistently.

15 Q. All right. And a part of your reasoning,
16 let's say the capital asset pricing model, how did they
17 misapply that in your --

18 A. Staff used a current yield as the risk-free
19 rate and not a forecasted bond yield, which are
20 available to investors. I believe Staff miscalculated
21 the historical return -- I'm sorry -- not the return,
22 the historical equity risk premium.

23 And they failed to use a forecasted return or
24 equity risk premium, which to me is inconsistent with
25 their use of forecasted growth rates in the DCF. And

1 they also failed to use something called the empirical
2 CAPM, which adjusts for a -- the tendency of the
3 traditional CAPM to either under or overstate the
4 capital asset pricing model result.

5 Q. And in the discounted cash flow model they
6 used the project -- they used forecast?

7 A. I believe so. I believe they used historical
8 and projected earnings growth -- or, well, earnings and
9 dividend growth. And, yeah, they used IBIS and
10 Standard & Poor's projected growth, as well as some
11 Value Line projected growth rates.

12 Q. But then in the discounting -- I mean, in the
13 capital asset pricing model, they did not use
14 projected, they used current yields; is that what you
15 said?

16 A. Correct.

17 Q. And you think for there to be an apples to
18 apples comparison, they should be using one or the
19 other or both?

20 A. Yes, but they also should be using a
21 forecasted equity risk premium as well.

22 Q. Okay. In the discounted cash flow model
23 there's no equity risk -- risk premium calculation, is
24 there?

25 A. Correct.

1 Q. And then in the risk premium analysis, is a
2 part of the -- your objection to Staff's use of that
3 as a -- as a check being that they don't adjust for the
4 difference in risk between what they're saying should
5 be used for capital structure; that is, Missouri -- or
6 that is the parent's capital structure versus the risk
7 associated with Missouri-American Water Company?

8 A. Right. That's not just an objection I have to
9 the risk premium model as applied by Staff. That is an
10 objection that I have to Staff's overall
11 recommendation. I don't believe that the 33 basis
12 points, which Staff added to its recommended ROE, is
13 sufficient to compensate for the difference in
14 financial risk between the American Waterworks common
15 equity ratio and Missouri-American Water's common
16 equity ratio.

17 The data which Staff used in its risk premium
18 CAPM and -- and DCF, based on a proxy group of
19 companies also whose -- whose common equity ratio
20 averaged 45.95 percent -- that market data reflects the
21 financial risk embodied in a 45.95 percent equity ratio
22 and not the financial risk of American Waterworks much
23 lower common equity ratio. And, therefore, an
24 adjustment needs to be made.

25 Q. But Staff wants to use the capital structure

1 of the parent, correct?

2 A. Yes.

3 Q. And is Staff applying the correct risk premium
4 analysis to the parent?

5 A. Staff applied the risk premium to a group of
6 comparable companies that it felt was comparable to
7 Missouri-American Water Company.

8 Q. Okay. And you're saying that those companies
9 were not efficiently comparable?

10 A. They're comparable to Missouri-American on a
11 stand-alone basis, but their financial risk is not
12 comparable to American Waterworks capital structure,
13 which is the capital structure he then took the return
14 on equity and applied it to.

15 Q. The -- the differences in the methodology used
16 here to determine ROE and how they're applied, amounts
17 to fairly substantial monet-- monetary difference
18 between Staff's position and the Company's position; is
19 that correct?

20 A. Yes.

21 Q. And it -- in your experience with the various
22 jurisdictions, is the -- is the Company's stand-alone
23 cost of capital generally employed or is it generally
24 the parent's that -- that is applied?

25 A. In -- in my experience the majority of the --

1 of the vast majority of conditions use the stand alone,
2 as long as it is reasonable and not out of line with
3 the industry, on average.

4 Q. And how many -- have you experienced
5 jurisdictions where they apply some hypothetical that
6 is -- is neither?

7 A. Yes. And I -- and I've been involved in some
8 cases, say, where a stand-alone capital structure may
9 be 100 percent equity or might possibly be 75 or
10 80 percent debt. They -- then they would use a
11 hypothetical of possibly 60/40, 55/45.

12 In those cases you might look to the parent --
13 to the consolidated. But, again, you have to judge
14 whether the consolidated capital structure is
15 reasonable in light of industry standards.

16 Q. And it's your testimony that Missouri-American
17 capital structure is reasonable in light of the
18 standards?

19 A. Yes -- yes, it is.

20 COMMISSIONER MURRAY: I -- I believe that's
21 all I have for you. Thank you.

22 THE WITNESS: Thank you.

23 JUDGE THOMPSON: Thank you, Commissioner
24 Murray.

25 Commissioner Clayton?

1 COMMISSIONER CLAYTON: No questions.

2 FURTHER QUESTIONS BY JUDGE THOMPSON:

3 Q. I think I have a couple of additional
4 questions for you. I know I had a -- one series of
5 questions for you already.

6 Why is it not appropriate to include
7 short-term debt in the capital structure?

8 A. It's not -- well, it's not appropriate -- one
9 has to talk about whether CWIP is included in the rate
10 base. Short-term debt typically finances CWIP. And
11 when CWIP is not in the rate base, short-term debt is,
12 therefore, not financing the rate base to which the
13 rate of return allowed would be applied.

14 Short-term debt can also be used as bridge
15 financing to be replaced with long-term debt, because
16 of timing differences. But the majority is because
17 short-term debt typically does not finance the -- the
18 rate base which is allowed.

19 JUDGE THOMPSON: Okay. Thank you. That's all
20 the questions I have.

21 Any further questions from the Bench?

22 (No response.)

23 JUDGE THOMPSON: Very well. Recross.

24 Ms. Langeneckert?

25 MS. LANGENECKERT: None, Your Honor.

1 JUDGE THOMPSON: Thank you.
2 Mr. Swensen?
3 MR. SWENSEN: No questions.
4 JUDGE THOMPSON: Ms. O'Neill?
5 MS. O'NEILL: I think just one.
6 RECROSS-EXAMINATION BY MS. O'NEILL:
7 Q. Ms. Ahern, is Philadelphia Suburban a holding
8 company with a number of regulated subsidiaries?
9 A. Yes, it is.
10 Q. And -- okay. Well, it wasn't one question.
11 And does it also have unregulated components?
12 A. It has some, but not very much.
13 Q. All right.
14 A. Less than American Waterworks.
15 MS. O'NEILL: All right. Thank you.
16 No further questions.
17 JUDGE THOMPSON: Mr. Snodgrass?
18 MR. SNODGRASS: Yes.
19 RECROSS-EXAMINATION BY MR. SNODGRASS:
20 Q. Ms. Ahern, in -- in response to questions from
21 Commissioner Murray dealing with preferred stock and
22 leveraging issues --
23 A. Yes.
24 Q. -- would -- would you be kind enough to direct
25 your attention to your Schedule PMA-13, page 2 of 5 of

1 that schedule?

2 A. Yes.

3 Q. And -- and if you would, ma'am, would you look
4 towards the bottom of page 2?

5 A. Yes.

6 Q. You say at the bottom of that page that
7 American Waterworks financial profile is relatively
8 weak for the current rating. And I assume you mean
9 S&P rating?

10 A. Yes.

11 Q. And that -- you indicate further that debt
12 leverage has improved dramatically after the merger
13 with RWE was completed dropping to under 50 percent
14 from just under 70 percent at year end 2002; is that
15 accurate?

16 A. Correct.

17 Q. Now, what would that cause that debt leverage
18 to de-- to decrease from 70 to 50 percent?

19 A. It was the preferred stock issuance during the
20 first six months of 2003.

21 Q. Now, you've indicated to Commissioner Murray,
22 as I understand your response, that the majority of the
23 Commissions use regulated utility stand-alone capital
24 structures?

25 A. It's been my experience, yes.

1 Q. But it's also true that not all of those
2 companies have the same parental structure that
3 MAWC has; isn't that correct?

4 A. It is true, but a great many operating --
5 regulated operating water companies do exist as a
6 subsidiary of one or more holding companies.

7 Q. Well, that -- they don't have the same parent
8 capital structure exactly, do they not?

9 A. Well, every single one of American Waterworks
10 subsidiaries have the same parent companies.

11 Q. I'm asking about the other regulated
12 utilities, not --

13 A. United -- United Water Utilities do.

14 Q. But is that the only one you can think of?

15 A. Some of Philadelphia Suburban's property.
16 There's an intermediate level. Consumer's Water
17 Company.

18 Q. Does that end your memory of that issue, I
19 hope?

20 A. Pardon me? Yeah. Yes.

21 MR. SNODGRASS: All right. And I have no
22 further questions.

23 JUDGE THOMPSON: Thank you, Mr. Snodgrass.
24 Redirect.

25 Mr. England?

1 REDIRECT EXAMINATION BY MR. ENGLAND:

2 Q. Ms. Ahern, in a relatively recent response to
3 a question from Judge Thompson you used the term
4 "CWIP," could you for the record --

5 A. Oh, I'm sorry.

6 Q. -- identify that, please?

7 A. It's construction work in progress.

8 Q. Or the acronym, CW--

9 A. CWIP, yes.

10 Q. Back to some cross-examination, I believe,
11 from both Ms. Langeneckert and Ms. O'Neill regarding
12 the infrastructure replacement surcharge. I believe
13 you were asked whether or not the infrastructure system
14 replacement surcharge resulted in more rate increases
15 for the utility or for the water company in this case.

16 Do you recall that question?

17 A. Yes.

18 Q. And -- and what was your answer, please?

19 A. I believe I said more increases, but not
20 more -- more rate cases, I believe.

21 Q. So it -- the --

22 A. But --

23 Q. The frequency may be greater, but not
24 necessarily the qual-- quantitative amount of rate
25 increases over the same period of time?

1 A. Correct.

2 Q. And then I think you were also asked a
3 question about the benefits to ratepayers of having an
4 infrastructure system replacement surcharge in place.

5 Do you have an opinion as to whether or not an
6 ISRS provides any incentive to the Company to spend
7 more on its infrastructure than it otherwise would?

8 A. Yes, it -- it would provide the Company with
9 an incentive to replace infrastructure pro-actively --
10 to replace it before it needed repair. It may --
11 repairs may be costly.

12 It would give it an incentive to replace on
13 a -- on -- on an even stream ra-- at -- at today's
14 dollars, rather than at tomorrow's dollars, which
15 invariably will be more expensive.

16 Q. Does it have any impact on rate case expense
17 associated with large rate increase requests or
18 generate rate increase requests?

19 A. It shouldn't, no.

20 Q. Will the implementation of an infrastructure
21 system replacement surcharge allow a company to perhaps
22 postpone its need for a generate rate increase request?

23 A. Yes, because it will be allowed recovery of
24 intra-- infrastructure replacement and capital
25 expenditures on a smoothed basis, rather than putting

1 rate base in place and then waiting until it accrues
2 and not earning on it, and then needing to come in for
3 a large rate cre-- rate increase and incur significant
4 expenses.

5 Q. To the extent a company can, therefore -- or
6 can then postpone its general rate increase requests,
7 would that have an impact on rate case expenses?

8 A. Yes.

9 Q. What would that impact be?

10 A. Oh, the impact, it would -- it would decrease.
11 You would not have as many rate case -- general --
12 general rate cases and, therefore, you would not have a
13 number of rate case expenses related with them.

14 Q. Thank you.

15 With respect to the capital structure -- and I
16 think it was Ms. O'Neill with the Office of Public
17 Counsel -- at least the capital structure that the
18 Company proposes --

19 A. Uh-huh.

20 Q. -- does is the Company have any material
21 difference of opinion with Public Counsel in this case
22 regarding the appropriate capital structure?

23 A. No.

24 Q. And -- and do we have any material differences
25 of opinion with respect to the imbedded costs of

1 long-term debt and preferred stock?

2 A. No.

3 Q. Do we have any material differences with
4 regard to the way in which short-term debt should be
5 handled for purposes of the capital structure?

6 A. Any differences with Public Counsel?

7 Q. Correct.

8 A. No.

9 Q. I think it was in response to some questioning
10 from Mr. Snodgrass for the -- for the Staff. You were
11 asked about some notes that were issued to AWCC,
12 American Waterworks Capital Corporation?

13 A. Correct.

14 Q. Do you recall that line of questioning?

15 A. Yes.

16 Q. I think there was some reference to the fact
17 that these notes are unsecured?

18 A. Yes.

19 Q. What impact does that have or effect, if you
20 will, on AWCC as a creditor of Missouri-American Water
21 Company?

22 A. That puts AWCC last in line behind the holders
23 of the EI ERA funds, because those are mortgage bonds.

24 Q. And are the holders of those funds
25 unaffiliated third-party lenders?

1 A. Yes, they are.

2 MR. ENGLAND: Thank you, Ms. Ahern.

3 THE WITNESS: Thank you.

4 MR. ENGLAND: I have no other questions.

5 Thank you, Judge.

6 JUDGE THOMPSON: Thank you, Mr. England.

7 There being no further questions, you may step

8 down, ma'am.

9 THE WITNESS: Thank you.

10 JUDGE THOMPSON: Thank you for your testimony.

11 (Witness excused from the stand.)

12 JUDGE THOMPSON: Call your next witness,

13 Mr. England.

14 MR. ENGLAND: Yes, sir. But before I do, may

15 I inquire as to whether or not Ms. Ahern may be excused

16 for purposes of the remainder of the proceeding? I

17 think she'll be here for the remainder of the day, but

18 I believe she has to catch a plane tomorrow.

19 JUDGE THOMPSON: You are excused.

20 MS. AHERN: Thank you.

21 MR. ENGLAND: Thank you.

22 Okay. Judge, let me call Ed Grubb to the

23 witness stand, please.

24 JUDGE THOMPSON: Very well.

25 Good afternoon, Mr. Grubb. I'll remind you

1 that you are still under oath.

2 You may inquire, Mr. England.

3 MR. ENGLAND: Thank you.

4 ED GRUBB, having been previously sworn, testified as
5 follows:

6 DIRECT EXAMINATION BY MR. ENGLAND:

7 Q. Mr. Grubb, I believe you've filed direct,
8 rebuttal and surrebuttal in this case that has been
9 marked for purposes of identification as Exhibits 1, 41
10 and 83; is that right?

11 JUDGE THOMPSON: And I believe it's all
12 been -- already offered and received.

13 MS. O'NEILL: Yeah, it's all in.

14 MR. ENGLAND: That -- that's correct. That
15 was gonna be my next question to the Judge.

16 Thank you.

17 BY MR. ENGLAND:

18 Q. But you do have some testimony somewhere
19 tucked in all this testimony regarding capital
20 structure, I believe, correct?

21 A. Yes, in my direct testimony.

22 MR. ENGLAND: Well, I don't have to offer the
23 testimony, but I will offer the witness for
24 cross-examination.

25 JUDGE THOMPSON: Thank you, Mr. England.

1 Cross-examination.

2 Ms. Langeneckert?

3 MS. LANGENECKERT: A couple of questions.

4 CROSS-EXAMINATION BY MS. LANGENECKERT:

5 Q. Good afternoon, Mr. Grubb.

6 A. Good afternoon.

7 Q. Why did the Company choose an 11 percent
8 ROE instead of the amount recommended by their expert
9 witness?

10 A. After we received the -- the recommendation
11 from Ms. Ahern of the 11.75 to 12 percent, the Company
12 evaluated the impact to our customers of that level of
13 an equity return, circumstances surrounding the last
14 rate case in St. Joe and -- and the rate impact to the
15 St. Joe customers.

16 We met with Industrial Group in
17 St. Joe. We met with the sale for resale customers in
18 St. Joe. And -- and based upon those discussions and
19 internal discussions within the organization, the
20 Company made a decision to recommend a -- an 11 percent
21 return on equity in -- in the case.

22 Q. Why not 10 or 10.5 or some other number?

23 A. We -- we felt that in making the decision
24 to -- to reduce it below Ms. Ahern's range of 11.75 to
25 12 percent that the decision was the 11 percent was --

1 was appropriate.

2 Q. When did you join American Waterworks Company?

3 A. I joined the American Water system back in
4 1978.

5 Q. Okay. And when did you join Ameri--
6 Missouri-American Water?

7 A. As the assistant treasurer and director of
8 rates in October of 2000.

9 Q. You were never an employee of St. Louis County
10 Water; is that correct?

11 A. That -- that's correct.

12 Q. In your capacity as the director of rates for
13 Missouri-American, you have had occasion to look over
14 old St. Louis County rate case decisions from this
15 Commission?

16 A. The last one or two maybe, but nothing in real
17 depth detail going back to the mid-'90s.

18 Q. Okay. Well, it just so happens my question
19 relates to the mid-'90s, so bear with me. On
20 December 31st, the Commission issues its report and
21 order in the County Water Case No. WR-96-263.

22 And in that report and order the Commission
23 gave the following description for regulatory lag:
24 "The lapse of time between a change in revenue
25 requirement and the reflection of that change in

1 rates."

2 Do you agree that regulatory lag creates more
3 risk for a company, all other things being equal?

4 A. Can you repeat that again, please?

5 Q. The whole thing or just the question?

6 A. Just -- just -- just the question would be
7 fine.

8 Q. Do you agree that regulatory lag creates more
9 risk for a company, all things being equal -- all other
10 things being equal?

11 A. It -- regulatory lag can -- can create more
12 risk and less risk, depending on which way the
13 regulatory lag will go.

14 Q. So if the regulatory lag helps the Company, in
15 that there are costs that aren't being -- or I guess
16 val-- when you have a higher earning than you would
17 have expected and the regulatory lag keeps you from
18 having to refund that to the customers until you have
19 the next case, correct?

20 A. That's correct.

21 Q. That would be the positive --

22 A. Yeah.

23 Q. -- for the Company?

24 Okay. Now, I'm gonna give you an additional
25 quote from the '98 St. Louis County water case,

1 WO-98-223.

2 And the Commission said in its report and
3 order, the Company contends the regulatory lag causes
4 the investment of large amounts of new capital to
5 replace worn out mains to be unattractive to its
6 shareholders and to investors in general.

7 Would you consider the Commission analysis
8 accurate as it relates to the Company's feelings on
9 regulatory lag?

10 A. What was the case number again, WO?

11 Q. WO-98-223.

12 A. And the WO -- what wa-- what was that
13 proceeding for? I'm just trying to get a feel for what
14 the proceeding -- was it a rate case, was it --

15 Q. Well, let's see. The O means other. This
16 says it was a spinoff docket from WR-97-382, and it
17 related to the accruing infrastructure replacement
18 costs and an accounting authority order.

19 So this is -- the Commission was unwilling to
20 agree to the AAO in that case, so they spun it off into
21 this separate case.

22 A. Okay. Can -- can you rep-- repeat the quote,
23 please? I'm sorry.

24 Q. Sure.

25 The Company contends that regulatory lag

1 causes the investment of large amounts of new capital
2 to replace worn-out mains to be unattractive to its
3 shareholders and to investors in general.

4 A. Well, I'm hesitant to comment on that, knowing
5 that I was not part of that case.

6 Q. Do you feel the Company feels that way now?

7 A. The -- the -- the Company believes that making
8 substantial -- substantial amounts of infrastructure
9 replacements requires some special treatment to allow
10 quicker recovery of the costs for infrastructure.

11 And -- and that was the basis for the ISRS to
12 try and recover those costs quicker than through
13 general rate increases.

14 Q. Okay. And the AAO process was not working for
15 the Company, and that's why they chose the ISRS process
16 instead?

17 A. As a result of the AAO process, the Company
18 was required to write off a substantial amount of
19 money. And so, therefore, the -- the Company made the
20 decision to -- to -- to -- to look at the ISRS -- the
21 infrastructure surcharge methodology, yes.

22 Q. Okay. That risk still exists, though, in the
23 ISRS process, doesn't it?

24 A. I'm not sure what you mean by the risk.

25 Q. The risk of having to write off some of your

1 infrastructure or having that all not approved or --

2 A. There will always be a prudence issue of any
3 expenditure the Company makes, that's -- that's
4 correct.

5 Q. Okay. Now, the Commission has not yet ruled
6 on your ISRS application, is that correct, or at least
7 they haven't yet?

8 A. Seven days -- seven days from today, I
9 understand, there's an order to be issued.

10 Q. If the Commission does not approve your ISRS
11 or does not approve it in the amount that you're
12 requesting, the 3.6 million, what does the Company plan
13 to do to recover that amount?

14 Will they just wait until this order goes into
15 effect and hope that it is included in that or --

16 A. Well, the -- the -- all the ISRS property is
17 included in this -- or will be included in this case,
18 being the true-up is November. The -- the plan in the
19 current ISRS is as of August.

20 So the ISRS, which will go into effect
21 December 31st, assuming Commission approval, will then
22 be set back to zero on April 16th when these new rates
23 in this case are set by the Commission.

24 Q. But if the Commission does not approve the
25 ISRS at all, though, or approves it at a lesser amount

1 than you requested, the Company will just wait until
2 April when this order goes into effect?

3 A. That -- that, I believe, would be our option,
4 yes.

5 Q. Okay. When the Company filed for a
6 3.6 million ISRS in the St. Louis County District, in
7 your words at the hearing you said that the ISRS would
8 cut down or reduce the regulatory lag on those costs
9 associated with the infrastructure system replacement
10 specific to those infrastructure system replacements.

11 Does that sound like an accurate --

12 A. That -- that correct.

13 Q. -- quote?

14 How did you quantify the effect of the ISRS
15 upon earnings?

16 A. I don't believe I -- I've done that
17 calculation. The earn-- the earnings obviously for the
18 year 2004 will be improved by having the ISRS versus
19 not having it.

20 Q. But you don't know to what extent?

21 A. I -- I can ballpark it. If -- if the
22 Commission authorizes the 3 million 8 -- the
23 \$3.8 million that the Company requested and it's in
24 effect for 111, 112 days, that's approximately \$800,
25 \$900,000 -- if you tax affect that calculation, that

1 would be the improvement to the Company's earnings for
2 the year 2004.

3 Q. And would you say the effect on lag is the
4 same or --

5 A. Well, the regulat-- regulatory lag is -- is
6 reduced, because we're getting the -- the rates into
7 effect December 31st of this year versus April 16th of
8 next year. And -- and that was the purpose of the ISRS
9 to -- to allow the Company to address its
10 infrastructure by wrapping up and -- and addressing the
11 issue more pro-actively.

12 Q. Okay. Did the Company take the ISRS into
13 consideration when choosing an ROE that is one
14 percentage pitch point below their expert witness's
15 recommendations?

16 A. I -- I don't believe that discussion took
17 place. The main part of the discussions for the
18 Company's 11 percent recommendation was the impact
19 of -- of the last Missouri-American rate case and its
20 impact on the -- the St. Joe customers.

21 Q. Why did you not take the ISRS into
22 consideration? Why was that not one of the factors in
23 determining your proper ROE?

24 A. I -- I believe Ms. Ahern's recommendation took
25 that into consideration. She was aware of it. At the

1 time she -- she believed that there was a -- a very
2 strong possibility that the ISRS would be approved.

3 We filed a case on mid-May and -- and -- and
4 there was a good indication that the Legislature was
5 moving towards approval. But that was just not one of
6 the -- the factors that we discussed.

7 It was mainly the St. Joe rates and -- and the
8 impact from the last case that we -- we -- we took into
9 consideration.

10 Q. Okay. Now, you filed your case, but --
11 although the Legislature had approved the ISRS, but the
12 Governor had not signed it; is that correct?

13 A. That -- that's correct.

14 Q. But --

15 A. We -- we were hinging on that.

16 Q. Was there inside information or --

17 A. No. No. No. No.

18 Q. Okay.

19 A. We -- we believed that the -- the Legislature
20 passing it would give us a -- a -- a -- an even better
21 opportunity to -- to have the legislation signed by the
22 Governor.

23 Q. I think they have to pass it before it's
24 signed, don't they?

25 A. Yeah.

1 MS. LANGENECKERT: Okay. Thank you.

2 JUDGE THOMPSON: Mr. Swensen?

3 MR. SWENSEN: No questions.

4 JUDGE THOMPSON: Ms. O'Neill?

5 MS. O'NEILL: Thank you.

6 CROSS-EXAMINATION BY MS. O'NEILL:

7 Q. Good afternoon, Mr. Grubb.

8 A. Afternoon.

9 Q. Actually I think that Ms. Langeneckert has
10 taken most of my questions. I just want to clarify.
11 As far as the Company's perspective, the reduction of
12 regulatory lag related to the ISRS is -- is a benefit
13 to your company, would that be a fair statement?

14 A. It's a -- I believe it to be a benefit to our
15 Company and a benefit to our ratepayers.

16 Q. And we -- you've talked a little bit about
17 the -- the current ISRS filing that you have. But
18 after the ISRS is reset to zero when this order comes
19 out, the Company will be allow to apply for further
20 ISRS surcharge treatment in the future on a fairly
21 regular basis; is that correct?

22 A. That -- that's correct.

23 Q. Okay.

24 A. There's certain restrictions within the -- the
25 legislation that would -- we would obviously have to

1 meet.

2 Q. Assuming the adequate number or -- or adequate
3 amount of infrastructure investment and meeting all
4 those thresholds, you could make those applications as
5 met-- often as twice a year?

6 A. That -- that's correct.

7 Q. So conceivably could have as many five or six
8 of those filings between rate cases?

9 A. I -- I think five or six, assuming we are --
10 are at the \$25 million per year level for -- for
11 investment, yes.

12 Q. Okay. And that could conceivably mean five or
13 six increases in the rates for your St. Louis County
14 customers between rate cases?

15 A. It would be five or six small rate increases
16 for the St. Louis County versus three rate increases
17 for all of the customers within the Company. To be
18 able at the \$25 million lever -- level of an
19 infrastructure for St. Louis, the Company would have to
20 file annual general rate increases, and that's what we
21 wanted to avoid using the ISRS mechanism.

22 Q. And at the end of the three-year period when
23 you filed for your next general rate case, there'll be
24 no guarantee that St. Louis County customers wouldn't
25 receive any further additional rate increases in that

1 filing -- it would depend on other factors, right?

2 A. Yes. All the factors that go into a general
3 rate increase.

4 Q. And again, the primary driver in your
5 company's decision to seek an 11 percent ROE in this
6 proceeding, instead of a higher ROE as proposed by
7 Ms. Ahern, had mostly to do with the situation in
8 St. Joe, as opposed to the situation in St. Louis
9 County; is that right?

10 A. That -- that -- that's -- yes, that's correct.

11 MS. O'NEILL: Okay. No further questions.

12 Thanks.

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

14 Mr. Snodgrass?

15 MR. SNODGRASS: Thank you, Judge.

16 CROSS-EXAMINATION BY MR. SNODGRASS:

17 Q. Just -- just one question for you, Mr. Grubb.
18 On the subject of seeking an 11 percent return on
19 equity versus an 11.75 versus 12 percent return -- on
20 that issue, was there analysis -- was there any
21 analysis done to determine how the Company's reduced
22 return on equity based on this recommendation would
23 affect the Company's ability to attract capital?

24 A. No. The only determination that -- basically
25 was the discussions that we had of the impact with our

1 customers in St. Joe.

2 MR. SNODGRASS: All right. I have nothing
3 else.

4 JUDGE THOMPSON: Thank you, Mr. Snodgrass.

5 Questions from the Bench.

6 Commissioner Murray?

7 COMMISSIONER MURRAY: I don't believe I have
8 any, Judge.

9 JUDGE THOMPSON: Commissioner Clayton?

10 COMMISSIONER CLAYTON: No questions.

11 JUDGE THOMPSON: I only have one question for
12 you, Mr. Grubb.

13 QUESTIONS BY JUDGE THOMPSON:

14 Q. When I look on the reconciliation, it tells me
15 that capital structure imbedded costs is worth
16 \$1.975 million.

17 Do you see that?

18 A. I -- I don't have the -- is that the Staff's
19 reco-- reconciliation?

20 JUDGE THOMPSON: Here (indicating).

21 MR. ENGLAND: I've got it.

22 JUDGE THOMPSON: That's it.

23 BY JUDGE THOMPSON:

24 Q. Have you seen that before?

25 A. I received it from the Staff about a week ago,

1 and -- and I reviewed it real quickly.

2 Q. All I want to know is how the -- the different
3 positions translate into dollars. How is that done, do
4 you know -- if you know?

5 A. I -- I -- I think I had a discussion with
6 Staff -- Mr. Gibbs and they have a -- a -- an Excel
7 spreadsheet model that they -- they use to develop
8 their revenue requirement.

9 And so what Mr. Gibbs does, I believe -- he
10 goes down each of the issues and removes out of the
11 model the -- the issue. So, for example, a return on
12 equity -- I believe he -- he changes the Staff's return
13 on equity to the Company's re-- recommended level, and
14 that produces a change in the revenue requirement. And
15 that change would be what we see right there.

16 Q. I see.

17 So Mr. Gibbs would be the best person to ask
18 about this?

19 A. I -- I believe so.

20 JUDGE THOMPSON: Okay. Thank you.

21 Those were all I hade.

22 Other questions from the Bench?

23 (No response.)

24 JUDGE THOMPSON: Very well. Recross.

25 Ms. Langeneckert?

1 MS. LANGENECKERT: No questions.

2 JUDGE THOMPSON: Mr. Swensen?

3 MR. SWENSEN: No questions.

4 JUDGE THOMPSON: Ms. O'Neill?

5 MS. O'NEILL: No questions.

6 JUDGE THOMPSON: Mr. Snodgrass?

7 MR. SNODGRASS: No questions.

8 JUDGE THOMPSON: Mr. England, redirect?

9 MR. ENGLAND: Very briefly, Your Honor.

10 REDIRECT EXAMINATION BY MR. ENGLAND:

11 Q. By electing to file the case on an 11 percent

12 return of equity, rather than that was indicated by

13 Ms. Ahern's analysis, I think you indicated that that

14 mitigated the revenue requirement impact on the

15 St. Joseph District; is that right?

16 A. That's correct.

17 Q. Would it also mitigate the impact on all other

18 districts as well?

19 A. Ev-- everybody. We do not attempt to -- to

20 single out St. Joe. And by putting in an -- an

21 11 percent on the entire Company's rate base, all

22 districts' revenue requirement was reduced.

23 Q. Did you also give consideration to whether the

24 11 percent would be fair and reasonable from the

25 shareholders' perspective?

1 A. I -- I believe there's a range, you know,
2 involved in -- in -- in setting a level of an equity.
3 I -- I've seen re-- returns being authorized in some
4 other states. And -- and the 11 percent was not out of
5 the -- the realm of reasonableness.

6 Q. And then finally, with respect to that
7 reconciliation, we intend -- excuse me -- it was a
8 leading question.

9 Do you intend to work with Staff to refine
10 that and provide revised reconciliation as necessary as
11 this proceeding progresses?

12 A. That -- that's correct.

13 MR. ENGLAND: Thank you. No further
14 questions, Your Honor.

15 JUDGE THOMPSON: Thank you, Mr. England.

16 You may step down, Mr. Grubb. Thank you.

17 (Witness excused from the stand.)

18 JUDGE THOMPSON: Now, we are just about at the
19 time where we need a break for the reporter, so we will
20 take a five-minute break at this time and return with
21 the next witness.

22 We are in recess.

23 (A RECESS WAS TAKEN.)

24 JUDGE THOMPSON: Have a seat, Mr. Murray, and
25 spell your last name for the reporter, if you would.

1 MR. MURRAY: M-U-R-R-A-Y.
2 JUDGE THOMPSON: Raise your right hand.
3 (Witness sworn.)
4 JUDGE THOMPSON: You may inquire.
5 MR. SNODGRASS: Thank you, Your Honor.
6 DAVID MURRAY testified as follows:
7 DIRECT EXAMINATION BY MR. SNODGRASS:
8 Q. Good afternoon, Mr. Murray.
9 A. Good afternoon.
10 Q. Did you have occasion to prepare the pre-filed
11 testimony in this case, which has been previously been
12 marked as Exhibit No. 1 (sic), direct testimony of
13 David Murray?
14 A. Yes.
15 Q. Exhibit No. 38, rebuttal testimony of David
16 Murray?
17 A. Yes.
18 Q. Exhibit No. 71, surrebuttal testimony of David
19 Murray?
20 A. Yes.
21 Q. Do you have any corrections or additions to
22 make to that testimony at this time, sir?
23 A. Just to the direct testimony. That's
24 Exhibit 1.
25 Q. Yes, sir.

1 A. On --

2 Q. That's Exhibit 21.

3 A. Exhibit 21. I'm sorry. On page 19, line 2 in

4 parentheses there's a citation for Standard & Poor's

5 corporations rating criteria 2001. That entire

6 citation should be deleted.

7 JUDGE THOMPSON: What page is that? I'm

8 sorry.

9 THE WITNESS: Page 19.

10 JUDGE THOMPSON: Of your direct?

11 THE WITNESS: Of my direct. It's line 2.

12 JUDGE THOMPSON: Just delete the entire

13 citation?

14 THE WITNESS: Yeah. Correct.

15 JUDGE THOMPSON: Okay.

16 THE WITNESS: And the second one is on

17 Schedule 22 at the bottom of the page, the heading,

18 water utility financial medians. That should indi--

19 indicate water utility financial targets.

20 BY MR. SNODGRASS:

21 Q. And what part of your testimony is

22 Schedule 22, Mr. Murray?

23 A. It's -- schedule 22 is -- it's at the back of

24 the direct testimony. There's no specific page number

25 to it.

1 MR. SNODGRASS: All right. Thank you. That's
2 all I -- I was asking.

3 MR. ENGLAND: May I -- I'm sorry. May I ask
4 for the witness to indicate again the correction on
5 Schedule 22?

6 MR. SNODGRASS: I'm sorry. Go ahead.

7 THE WITNESS: On Schedule 22 at the very
8 bottom of the pa-- page below line 9, there's a heading
9 that indicates water utility financial medians. That
10 should actually indicate water utility financial
11 targets.

12 BY MR. SNODGRASS:

13 Q. Is that all your corrections at this time,
14 Mr. Murray?

15 A. Yes, it is.

16 MR. SNODGRASS: At this time, Judge, I would
17 offer Exhibits 21, 38 and 71 into the record, and
18 tender the witness for cross-examination.

19 JUDGE THOMPSON: Okay. Do I hear any
20 objection to the receipt of Exhibits 21, 38, 71?

21 MR. ENGLAND: Yes, Your Honor. I have an
22 objection with respect to the surrebuttal testimony.

23 JUDGE THOMPSON: Okay. Hang on just a moment.
24 That's Exhibit 38; is that right?

25 MR. ENGLAND: Yes -- well, I'm sorry.

1 JUDGE THOMPSON: Or 71?

2 MR. ENGLAND: It's the -- the highest of those
3 three numbers.

4 JUDGE THOMPSON: Okay. Well, let's take
5 Exhibit 21. There's no objections to that exhibit; is
6 that correct?

7 MR. ENGLAND: That's the direct?

8 JUDGE THOMPSON: That's the direct.

9 MR. ENGLAND: You are correct.

10 JUDGE THOMPSON: Exhibit 21, then, is received
11 and made a part of the record of this proceeding.

12 (EXHIBIT NO. 21 WAS RECEIVED INTO EVIDENCE.)

13 JUDGE THOMPSON: Exhibit 38 is the rebuttal.
14 Is there any objection to the rebuttal?

15 MR. ENGLAND: No objection.

16 JUDGE THOMPSON: Exhibit 38 is received and
17 made a part of this proceeding -- or the record
18 thereof, I should say.

19 (EXHIBIT NO. 38 WAS RECEIVED INTO EVIDENCE.)

20 JUDGE THOMPSON: Now, Exhibit 71 is
21 Mr. Murray's surrebuttal. Now, I understand you have
22 an objection. What is your objection?

23 MR. ENGLAND: My objection is to the
24 testimony -- there are two portions.

25 JUDGE THOMPSON: Just a moment. If you could

1 use the microphone.

2 Thank you.

3 MR. ENGLAND: Sorry, Your Honor.

4 JUDGE THOMPSON: That's quite all right.

5 MR. ENGLAND: The first objection -- or the

6 first portion of the testimony to which I have an

7 objection begins on page 10 --

8 JUDGE THOMPSON: Yes.

9 MR. ENGLAND: -- line 6. Continues through

10 the entire page to the bottom over to the top of

11 page 11, lines 1 through 11. And then --

12 JUDGE THOMPSON: Page 10, line 6 through

13 page 11 line 11?

14 MR. ENGLAND: Yes.

15 JUDGE THOMPSON: Is that correct?

16 MR. ENGLAND: Yes, sir.

17 JUDGE THOMPSON: Okay.

18 MR. ENGLAND: And --

19 JUDGE THOMPSON: And your objection is?

20 MR. ENGLAND: My objection is that this is a

21 legal conclusion. He's testifying to the difference

22 between a guarantee and a support agreement. And I

23 don't believe this witness is qualified to offer that

24 opinion.

25 And, secondly, it is not the best evidence of

1 what the support agreement is or is not.

2 JUDGE THOMPSON: Okay.

3 MR. ENGLAND: I have essentially the same
4 objection to a second portion of his surrebuttal that
5 begins at the top of page 12, line 1 and --

6 MR. SNODGRASS: I didn't hear that. Excuse
7 me, Trip. Would you repeat that?

8 MR. ENGLAND: Certainly.

9 Page 12, line 1 through line 12.

10 JUDGE THOMPSON: Same objections?

11 MR. ENGLAND: Correct.

12 JUDGE THOMPSON: Okay. Okay. Let's take up
13 the first passage.

14 Do we have a response, Mr. Snodgrass?

15 MR. SNODGRASS: Yes, Your Honor.

16 I believe that this particular objection would
17 go to the -- to the weight of the testimony, rather
18 than whether or not it's admissible. And if -- if Trip
19 would be happy with this, we would change the question,
20 to your knowledge.

21 We would stipulate that Mr. Murray's not an
22 attorney. But I believe, again, it goes to the weight,
23 not admissibility. As a matter of fact, the Company's
24 witness has mentioned support agreement and guarantees
25 in her testimony also.

1 JUDGE THOMPSON: Excuse me?

2 MR. SNODGRASS: The Company's witness,
3 Ms. Ahern, has also used that same terminology in her
4 testimony, I believe.

5 JUDGE THOMPSON: Okay.

6 MR. ENGLAND: The -- the difference, I
7 believe, is that Ms. Ahern testifies as to what
8 third-party, I believe, rating agencies have said about
9 this support agreement and is not offering an opinion
10 as to the "legal definition of a guarantee" as compared
11 to the "support agreement."

12 JUDGE THOMPSON: The other difference being
13 that it came in without objection.

14 MR. ENGLAND: That, too, Your Honor. But
15 I -- I didn't want to rub that in.

16 MR. SNODGRASS: Yes.

17 JUDGE THOMPSON: Well, first of all, the --

18 MR. ENGLAND: And -- and ordinarily -- I -- I
19 appreciate the qualification that the witness is not
20 a -- not a lawyer. And I realize that a lot of stuff
21 gets into the record for what it's worth, if you will.

22 And there is a great deal of testimony besides
23 what I've objected to regarding Mr. Murray's opinion on
24 the support agreement. So I'm not sure that this is
25 critical to his position or the rest of his testimony

1 as he discusses it.

2 I just felt this was a little bit above and
3 beyond what needed to be said by this witness, given
4 his background.

5 MR. SNODGRASS: I would respond to that to say
6 that if Mr. England is that concerned over this portion
7 of testimony, he can test that under cross-examination,
8 Judge.

9 JUDGE THOMPSON: Does the objection as to
10 the -- the legal opinion -- do you feel that goes to
11 all of the passage?

12 MR. ENGLAND: Yes, sir.

13 JUDGE THOMPSON: Okay. Well, I'm going to
14 sustain the objection and strike the passage starting
15 on page 10 at line 6 and continuing on to page 11
16 through line 11.

17 The support agreement, or whatever it is, I
18 think is itself in the record, is it not?

19 MR. ENGLAND: No, sir, it's not.

20 JUDGE THOMPSON: I thought it came in as one
21 of your exhibits -- but simply discussed in that
22 application?

23 MR. SNODGRASS: It's mentioned in testimony,
24 Judge. It's already in the record. The agreement
25 itself is not in the record.

1 JUDGE THOMPSON: Okay. Very well.

2 I -- I think you're free to argue whatever you
3 want in your brief concerning it, since there is
4 testimony about it here. And you can supply me
5 definitions you feel are necessary. Legal definitions
6 you can simply put in your brief.

7 Let's look at the second passage. Now, you
8 raised the same two objections for the second passage?

9 MR. ENGLAND: Yes, sir.

10 JUDGE THOMPSON: And it's because he's
11 offering essentially a legal opinion as to the
12 collective -- collectibility of the debt or --

13 MR. ENGLAND: Yes, sir. And -- and again, the
14 best evidence of what the support agreement is or is
15 not is the agreement itself, which is not in the
16 record.

17 MR. SNODGRASS: Reference to the support
18 agreement is in the record in testimony. And if you
19 look at the testimony being objected to by Mr. England,
20 that particular section, that particular testimony goes
21 to this witness's financial expertise.

22 It's not really a legal opinion if you -- if
23 you read it carefully. It talks about parent company
24 relationships and capital structure and that sort of
25 thing.

1 JUDGE THOMPSON: Do you have a response to
2 that, Mr. England?

3 MR. ENGLAND: I agree it's not quite as
4 egregious as the prior passage that we -- we talked
5 about or objected to. I still think it gets to some
6 degree to some legal opinion, if you will.

7 Perhaps we can avoid striking this if Staff
8 has no objection to putting the actual document --
9 support agreement into the record.

10 MR. SNODGRASS: Your Honor, I've discussed
11 this with Staff, and Staff has no objection to putting
12 the support agreement in the record at this time, as
13 long as it's subject to cross-examination.

14 JUDGE THOMPSON: Fine. We will overrule the
15 objection, then, with respect to the second passage
16 cited by Mr. England. We will reserve -- and so we
17 will then receive Exhibit No. 71, except for the
18 passage from page 10, line 6 through page 11 line 11,
19 which has been stricken. And we receive it over
20 objections with respect to the other passage.

21 (EXHIBIT NO. 71 WAS RECEIVED INTO EVIDENCE.)

22 JUDGE THOMPSON: And we will reserve Exhibit
23 No. 99 for the support agreement.

24 And when can we expect to receive that?

25 MR. ENGLAND: Your -- Your Honor, I've got a

1 clean copy of it. I just don't have sufficient copies
2 for purposes of the parties and the reporter, but
3 certainly can have it first thing tomorrow.

4 JUDGE THOMPSON: Very good. I'll -- I'll give
5 you that as homework, then, to bring that tomorrow.

6 Very well. Okay. Let's see. Ms. Vuylsteke
7 is not here.

8 Ms. Langeneckert?

9 MS. LANGENECKERT: No questions of this
10 witness.

11 JUDGE THOMPSON: Mr. Swensen?

12 MR. SWENSEN: No questions, Your Honor.

13 JUDGE THOMPSON: Ms. O'Neill?

14 MS. O'NEILL: Thank you, Your Honor.

15 JUDGE THOMPSON: You're welcome.

16 MR. SNODGRASS: Just for clarification, Your
17 Honor, Exhibit No. 71 was admitted into the record with
18 the stricken portions noted; is that correct?

19 JUDGE THOMPSON: That's correct.

20 CROSS-EXAMINATION BY MS. O'NEILL:

21 Q. Good afternoon, Mr. Murray.

22 A. Good afternoon.

23 Q. Mr. Murray, would you say that there have been
24 any major structural changes in Missouri-American Water
25 Company in the last five years?

1 A. I'd say that -- as far as Missouri-American
2 Water Company specifically, they've made acquisitions
3 such as St. Louis County Water. I -- I believe some
4 other acquisitions as well, so that they've been
5 performing acquisitions within the State of Missouri.

6 Q. How about from -- that's from, like,
7 Missouri-America down. How about upwards towards
8 parent companies, have there been major structural
9 changes there well?

10 A. Yes, there has.

11 Q. What have those been?

12 A. Basically the creation of American Water
13 Capital Corporation. Also as of January 10th, 2003,
14 American Waterworks was acquired by RWE.

15 Q. Okay. And that's -- that's the German company
16 with the English -- that tends water in between there,
17 too; is that right?

18 A. The theme's water, that's correct.

19 Q. Okay. And are you aware of whether the water
20 industry in general has experienced some structural
21 changes in the last five years?

22 A. Not that I'm aware of.

23 Q. Okay. You don't know if there's been a lot of
24 acquisitions or mergers or anything like that?

25 A. There's been acquisitions and mergers, but I

1 don't know if that would be a structural change in the
2 industry.

3 MS. O'NEILL: Okay. Now, when you -- actually
4 I think that's all the questions I have of you.

5 JUDGE THOMPSON: Thank you.

6 Mr. England?

7 MR. ENGLAND: Thank you, Your Honor.

8 I'm gonna get my stuff together.

9 Thank you.

10 CROSS-EXAMINATION BY MR. ENGLAND:

11 Q. Good afternoon, Mr. Murray.

12 A. Good afternoon.

13 Q. I note in your prepared testimony that you
14 have several sections entitled economic and legal
15 rationale for regulation, historical economic
16 conditions and economic projections --

17 A. Yes.

18 Q. -- correct?

19 And it appears that these sections are very
20 similar, if not identical to other sections that you
21 have included of the same title in other testimony
22 you've filed since your time here with the Commission,
23 correct?

24 A. The -- the legal rationale is pretty similar
25 to what's been filed in -- in past cases. The economic

1 conditions obviously is updated with the economy --

2 Q. Sure.

3 A. -- on an ongoing basis.

4 Q. Sure.

5 But with the -- with the updates aside, which
6 do occur over time, would you agree with me that -- or
7 would you -- be fair to characterize this part of your
8 testimony as -- as somewhat boilerplate?

9 A. I'd say we have standardized language within
10 our direct testimony.

11 Q. To the extent that testimony in these sections
12 is identical to testimony that you've placed in other
13 testimonies that you've presented to this Commission,
14 you wouldn't be placing any more or less significance
15 on it for purposes of Missouri-American than you would
16 for Missouri Gas Energy or Missouri Public Service,
17 correct?

18 MR. SNODGRASS: Judge, I'm gonna object to
19 that question. It's got -- it's a compound question.
20 It has a multitude of parts.

21 JUDGE THOMPSON: Well, I thought he asked to
22 the extent that he included this standardized language,
23 that he wasn't placing any more emphasis on it than he
24 would with respect to his use of it in cases involving
25 other utilities; isn't that essentially the question?

1 MR. ENGLAND: Yes, sir.

2 JUDGE THOMPSON: I don't think that's a
3 compound question. I overrule the objection.

4 Please proceed.

5 THE WITNESS: I think as far as the -- the
6 legal language within our -- within our testimony, the
7 relevance of Hope, Bluefield, Pennsylvania and Munn --
8 those are all cases that are relevant in every rate
9 case that we deal with.

10 As far as the economic conditions, obviously
11 discussion of historical economic conditions are what
12 they are. The current economic conditions, for
13 example, interest rates is -- is very applicable to any
14 new case that comes in here.

15 BY MR. ENGLAND:

16 Q. Let me be more specific. For example, in your
17 direct testimony, page 6, lines 33 and 34, you have a
18 phrase where you reference "in the case of inefficient
19 management."

20 Do you see that?

21 A. Yes, I do.

22 Q. And I am hoping that you were speaking
23 hypothetically, and that you have no evidence in this
24 case of any inefficient management?

25 A. That's correct.

1 Q. Okay. Thank you.

2 Let's talk for a while about capital
3 structure, if we can. For purposes of your direct
4 testimony you used American Waterworks consolidated
5 capital structure at December 31st, 2002 as the
6 appropriate capital structure for Missouri-American; is
7 that right?

8 A. Yes, that's correct.

9 Q. And at that time, that is December 31st, 2002,
10 the American Waterworks consolidated capital structure
11 had approximately -- well, I guess it's exactly
12 31.85 percent common equity; is that right?

13 A. That's correct.

14 Q. Looking at your Schedule 7 attached to your
15 direct testimony, which as I understand it is the
16 consolidated capital structure for American for the
17 last five years ending 2002.

18 Would you agree with me that the equity ratio
19 shown for 2002 is the lowest for that five-year period
20 of time?

21 A. That's correct.

22 Q. And it's lowest by a significant amount when
23 compared to the prior four years, is it not?

24 A. I don't know if I would define it as -- as
25 significant.

1 Q. Well, it -- it appears that it's maybe

2 31 percent 2002 and average maybe 35 percent for the
3 prior four years?

4 A. Like I said, I don't know that I would define
5 4.5 percent as significant.

6 Q. Did you make any inquiry at the time you were
7 preparing your testimony as to why American's equity
8 ratio at the end of 2002 was so low as compared to the
9 prior four years?

10 A. I didn't make any specific observations as to
11 why it was so low, as you say it is.

12 Q. So you went ahead, then, and -- and used that
13 31.85 percent equity ratio at least for purposes of
14 your direct testimony?

15 A. That's correct.

16 Q. Now, would you agree with me that
17 Missouri-American's actual equity ratio as used by the
18 Company and Public Counsel for purposes of this case is
19 approximately 44 percent?

20 A. I believe I seen figures of 43 to 44 percent.
21 That was based on Ms. Ahern's November 30th pro forma,
22 I believe.

23 Q. And I believe Mr. Burdette in a schedule
24 attached in -- I think the last schedule attached to
25 his surrebuttal testimony also shows about 43 to

1 44 percent?

2 A. Let me take a look at that --

3 Q. Sure.

4 A. -- just to verify that.

5 Did you say that was attached to his
6 surrebuttal?

7 Q. I believe it's his last -- very -- the very
8 last page, because I don't believe there was a -- an
9 indicator as to the schedule.

10 A. I don't have that on his surrebuttal.

11 Q. You don't suppose he gave us different
12 versions, do you, Mr. Murray?

13 A. You know, when you print them off of Efus,
14 you -- you never know what you're gonna get sometimes.

15 MR. ENGLAND: May I approach the witness?

16 JUDGE THOMPSON: You may.

17 BY MR. ENGLAND:

18 Q. Mr. Murray, this is my copy of the surrebuttal
19 testimony. That was my last page, so if you would,
20 take a look at that.

21 A. He recognized a 43.94 percent equity ratio,
22 that's correct.

23 Q. Okay. Thank you.

24 Now, the updated equity ratio -- oh, excuse
25 me. The equity ratio for your proxy group of companies

1 is 45.95 percent, and I believe that's shown on
2 Schedule 21. Am I correct?

3 A. That is correct.

4 Q. The updated equity ratio that you use for
5 purposes of your rebuttal testimony for American
6 Waterworks consolidated capital structure now is
7 35.28 percent? I believe that's your updated
8 Schedule 24.

9 A. That's correct.

10 Q. So you'd agree with me that even your updated
11 equity ratio for American Waterworks is more than
12 10 full percentage points less than the average equity
13 ratio for your proxy group, right?

14 A. That's a fair estimate.

15 Q. In updating the American Water Company's
16 consolidated capital structure you note at page 3 of
17 your rebuttal testimony -- I believe it's lines 19
18 through 22 -- that the major cause for the change in
19 your capital structure was the issuance by American
20 Water of approximately \$1.75 billion in preferred stock
21 after December 31st, 2002, correct?

22 A. Yes.

23 Q. And do you know when that stock was
24 actually -- that preferred stock, excuse me, was
25 actually issued?

1 A. No, I wasn't given that information. I just
2 know it occurred between December 31st, 2002 and the
3 update period.

4 MR. ENGLAND: Excuse me a second, Your Honor.

5 JUDGE THOMPSON: Certainly.

6 BY MR. ENGLAND:

7 Q. In cross-examination of Ms. Ahern, your
8 counsel referred to her Schedule PMA-13 attached to
9 rebuttal testimony, which is an August 1, 2003 Standard
10 & Poor's publication, I guess, for lack of a better
11 description.

12 I think you've seen that, haven't you?

13 A. Yes, I have.

14 Q. Okay. And I believe in his cross-examination
15 he referenced the fact that American Waterworks capital
16 structure had changed fairly significantly since the
17 end of 2002, correct?

18 A. There was some reference to debt leverage
19 and -- and that was the indication in the S&P's report.

20 Q. And so that information regarding the major
21 change in the capital structure certainly was available
22 through public information on August 1 of 2003, was it
23 not?

24 A. Yes, it was.

25 Q. And you were unaware of it at the tim you

1 filed your prepared testimony in October of this year?

2 A. I did not have any specific financial
3 information from Missouri-American on American
4 Waterworks. I don't rec-- think I received the updated
5 information until after I filed direct testimony, so
6 there was no way that I could have put that in my
7 testimony until rebuttal.

8 S&P does not say the amount of preferred stock
9 that was issued in that report.

10 Q. Let me switch gears a little bit on you.
11 Would you agree with me for at least the last several
12 rate cases involving Missouri-American Water Company or
13 its predecessor, St. Louis County Water Company, that
14 the Staff has used Missouri-American's or as the case
15 may be St. Louis County Water Company's actual or
16 stand-alone capital structure as it's been referred t
17 in this proceeding?

18 A. I would say that as far as my knowledge of the
19 last couple of rate cases that the subsidiary capital
20 structure was used for those cases.

21 Q. Okay. And at page 21 of your direct
22 testimony, lines 13 and 14, you indicate that you did
23 not use Missouri-American's capital structure in this
24 case, I believe, because the creation of the AWCC --
25 which I think we've referred to previously as American

1 Water Capital Corp -- had caused a change to the way in
2 American Water's subsidiaries received their debt
3 financing; is that right?

4 A. That is one of the reasons. That's the reason
5 specifically stated here in my direct testimony for
6 that -- like I said, as far as one of the
7 considerations, that's correct.

8 Q. Well, at the time you filed your direct
9 testimony, and I've looked pretty carefully, I don't
10 find any other reason, other than what's stated right
11 here on page 21.

12 Can you --

13 MR. SNODGRASS: Judge, I think that's
14 argumentative.

15 MR. ENGLAND: I haven't finished the question.

16 JUDGE THOMPSON: You finish the question.
17 Then we'll rule on the objection.

18 MR. ENGLAND: Thank you.

19 BY MR. ENGLAND:

20 Q. Can you show me any other reason contained in
21 your direct testimony why you chose to use American
22 Waterworks capital structure?

23 A. Well, if you look at --

24 JUDGE THOMPSON: Just a moment. We have to
25 rule on the objection.

1 THE WITNESS: Oh, I'm sorry.
2 JUDGE THOMPSON: That's all right.
3 THE WITNESS: Too anxious.
4 JUDGE THOMPSON: Okay. Why don't you read the
5 question back to me?
6 THE REPORTER: The original question, Judge,
7 or the second question?
8 JUDGE THOMPSON: The one that has been
9 objected to -- the second question. Is that not the
10 one that's been objected to?
11 MR. ENGLAND: I think the objection came in
12 between --
13 THE REPORTER: Yeah.
14 MR. ENGLAND: -- two.
15 (THE COURT REPORTER READ BACK THE REQUESTED
16 PORTION.)
17 JUDGE THOMPSON: I believe that that question
18 is within the appropriate bounds of cross-examination.
19 I will allow it.
20 Please proceed.
21 THE WITNESS: Okay. Please repeat the
22 question, if you would --
23 BY MR. ENGLAND:
24 Q. Yes.
25 A. -- Mr. England.

1 Q. Is there -- is there any other reason in the
2 prepared direct testimony that you've submitted why
3 you've chosen to use American Waterworks consolidated
4 capital structure, other than the fact that AWCC has
5 caused a change in the way in which American Water
6 subsidiaries receive their debt financing?

7 A. That is specifically stated in -- on those
8 lines that you referred to earlier. Obviously, you
9 know, this is -- this is what I put in my direct
10 testimony. On lines 17 through 20 the sentence reads,
11 Staff's objective was to -- as far as the interview. I
12 should, you know, read the first sentence before, so
13 line 15 through line 20.

14 In order to obtain additional information,
15 Staff conducted a transcribed interview of both
16 Missouri-American Water Company and American Water
17 personnel on September 10th, 2003.

18 Staff's objective was to obtain additional
19 information in order to make an informed decision on
20 whether to utilize Missouri-American Water Company's
21 capital structure or American Water's capital structure
22 for purposes of determining the rate of return to apply
23 to Missouri-American Water Company's rate base.

24 So although I specifically state that the
25 creation of AWCC -- that change has caused us to

1 consider -- you know, to -- to take a look at whether
2 or not it's appropriate to use Missouri-American Water
3 Company's capital structure or -- or American -- excuse
4 me -- American Waterworks consolidated capital
5 structure or Missouri-American's capital structure,
6 there were other things that we were thinking about, as
7 far as -- as far as making that determination.

8 Q. But apparently not of enough significance that
9 you would put them in your direct testimony; is that
10 right?

11 A. Not significance to make the determination to
12 use that -- the parent consolidated capital structure
13 as American Water Company's capital structure.

14 And -- and I did explain it fully in my
15 rebuttal and surrebuttal testimony.

16 Q. And -- and we'll -- we'll touch on that as
17 well, Mr. Murray.

18 Would you agree with me that the American
19 Waterworks Capital Corporation or Corp was created in
20 June of 2000?

21 A. That sounds approximately correct.

22 Q. At page 22 of your direct testimony, lines 1
23 through 14, you quote from that transcribed interview
24 that you mentioned a minute ago between you and
25 representatives of the Company.

1 Do you see that?

2 A. Yes.

3 Q. All right. Cuz I'm gonna read to you from a
4 portion of that quote. At lines 1 through 4 there on
5 page 22 you quote Mr. Hartnett (phonetic sp.) as
6 stating that "American Water Capital Corp was created
7 for the purpose of aggregating all of the financing
8 needs of American Water and its utility subsidiaries in
9 order to obtain the lowest cost of capital possible."

10 Do you see that?

11 A. Yes, I do.

12 Q. Now, do you have any reason to dispute the
13 accuracy of that statement?

14 A. No, I do not.

15 Q. Okay. In fact, you're not aware of any debt
16 issuances which Missouri-American has made to
17 AWCC where Missouri-American could have received a
18 lower interest rate through another lender, correct?

19 A. Let me take a look at response to DR3802.

20 Q. Certainly.

21 A. Please repeat the question.

22 Q. Certainly.

23 You were not aware of any debt issuances which
24 Missouri-American has made to AWCC where
25 Missouri-American could have received a lower interest

1 rate through a different third-party lender?

2 A. Well, first let me disagree with how you
3 classify Missouri-American's debt to AWCC. I do not
4 classify that as a debt issuance. I classify that as
5 debt being received by AWCC.

6 Missouri-American Water Company is not issuing
7 debt to a third party, other than it's, you
8 know, having an inter-- internal loan agreement with
9 its affiliate. So I do not classify that as a debt
10 issuance.

11 But as -- as I see in response to DR3802,
12 there was one loan, albeit it was prior to the loan
13 that was received from AWCC, debt that was actually
14 issued by Missouri-American Water Company through the
15 EIERA program at an interest rate of 5.2 percent, which
16 was less than the 5.65 percent.

17 Q. And at what time was that loan made?

18 A. That was after the creation of the AWCC, but
19 before the loan that was received from AWCC.

20 Q. Correct.

21 And I'm comparing interest rates at the time
22 the loan was made to AW-- excuse me -- the loan was
23 made from AWCC to Missouri-American. At that point in
24 time you have no evidence that that was the lowest
25 interest rate on debt available to Missouri-American?

1 A. I have no evidence of that. The reason why I
2 brought up the EIERA loan is it was within two months
3 of the -- of the debt that was received from AWCC. So
4 it's -- it's in relative close approximation.

5 Q. And do you understand that EIERA debt --
6 borrowings are capped by the State?

7 A. I believe, you know, they're supposed to be
8 qualifying projects, as far as a specific cap amount
9 on -- on the EIERA debt that's issued to the specific
10 company. I'm not aware of that.

11 Q. You're not aware that there is just so much
12 money available to borrowers, such as
13 Missouri-American, under that program?

14 A. I would presume it's like any other -- in any
15 other type of account there's not a never-ending
16 supply.

17 Q. Then you wouldn't know whether or not this
18 debt that Missouri-American placed through EIERA may
19 have qualified for or used up its allowance under that
20 program?

21 A. No, I'm not aware of that.

22 Q. Okay. Would you agree with me that
23 AWCC provides debt financing only to Missouri-American?

24 A. I agree that they provide debt financing to
25 M-- MAWC and that's it. Just short-term debt. Well,

1 let -- let me -- and let me back up on that.

2 There -- there is an agreement with AWCC that
3 they will manage their cash -- that the cash, the
4 disbursements and receipts on a daily basis for
5 Missouri-American Water Company -- that is part of that
6 agreement that Missouri-American Water Company entered
7 into with AWC.

8 So there is other things that go on with
9 AWCC besides just the debt issuances that they
10 receive -- both short-term and long-term debt.

11 Q. I was trying to draw a distinction between
12 providing debt financing, as opposed to providing
13 preferred stock or common stock financing -- or common
14 equity financing.

15 AWCC only provides the debt financing to
16 Missouri-American, correct?

17 A. That's correct.

18 Q. Okay. And is it your understanding that, as
19 of this point in time, Missouri-American has only made
20 one debt issuance to American Water Capital Corp for
21 approximately \$56 million?

22 A. Once again, I would say that Missouri-American
23 Water Company received debt -- a debt issuance -- part
24 of a debt issuance from American Water Capital
25 Corporation in the amount of \$56 million.

1 Missouri-American Water Company did not make that debt
2 issuance. It's part of the larger debt issuance that
3 was issued at the American Water Capital Corporation
4 level.

5 Q. And perhaps for purposes of the remainder of
6 this cross-examination you and I are gonna have a -- an
7 entirely different understanding of whether
8 Missouri-American issues debt based on your response.

9 So I'm not trying to -- I'm not trying to get
10 you to necessarily admit that, but that's the way I
11 characterize it. And I'll understand that maybe you
12 don't necessarily agree, so --

13 A. Just as long as that's clear for the record.

14 Q. I understand.

15 Now, let's talk a little bit about equity
16 financing for a minute. Missouri-American issues its
17 equity directly to its parent, correct -- that's
18 American Waterworks?

19 A. Yes, as far as I'm aware of Missouri-American
20 Water Company is a wholly owned subsidiary of American
21 Waterworks. And any equity that Missouri-American
22 Water Company receives is from its parent company.

23 Q. Okay. And would you agree that the total
24 amount of long-term debt outstanding on
25 Missouri-American's books is approximately

1 \$290 million?

2 A. Is that stated in -- where -- where are you
3 referring to that at?

4 Q. Well, I got it from your response to our Data
5 Response No. 1030?

6 A. 1030.

7 Yes. And -- and 1030 -- in response to that
8 Data Request -- part A indicates, please provide the
9 total dollar amount of Missouri-American Water
10 Company's reference debt funds.

11 The answer from me was, as indicated, the
12 Missouri-American Water Company's response to Staff
13 Data Information Request 3802, the principle amount
14 outstanding of Missouri-American Water Company's
15 long-term debt is 290,130,000.

16 Q. So -- so the answer to my question would be
17 yes that Missouri-American currently has approximately
18 \$290 million in long-term debt outstanding?

19 A. According to the response I received from
20 Missouri-American Water Company, that's correct.

21 Q. And you have no reason to believe that's
22 inaccurate or --

23 A. Well, I think in some DR responses that are
24 received from the Company, there's been some -- some
25 dispute as to whether or not the -- the -- the

1 56 million that is received from American Water Capital
2 Corporation is held at Missouri-American or whether its
3 withheld in American Water Capital Corporation.

4 I'd have to pull out the specific DR response.
5 But I think that one of those DR responses indicated
6 that the 56 million was held at America Water Capital
7 Corporation.

8 MR. ENGLAND: Your Honor, excuse me a second.

9 JUDGE THOMPSON: Certainly.

10 BY MR. ENGLAND:

11 Q. Let's look at Data Request No. 3802, which is
12 Exhibit 97 offered by your counsel in this case.

13 A. Yes, I'm looking at that.

14 Q. And that is the source of the information
15 regarding the \$290 million outstanding in the long-term
16 debt. It's roughly the middle column right under
17 principle amount at 12/31/02. Column G -- I see an
18 identifier there.

19 A. Yes, it indicates 290,130,000.

20 Q. Okay. And the \$56 million that you say is --
21 there's some question as to whether it's -- where it's
22 held or not -- at least for purposes of Data Request
23 response indicate it's held at the Missouri-American
24 level and, in fact, it's part of the 290 million,
25 correct?

1 It's the very last line -- the line --

2 A. I -- I understand. I'm trying to find a
3 DR response from -- from Missouri-American Water
4 Company that indic-- that indicated that 56 million was
5 held at AWCC.

6 Q. That's not my question, sir. My question is,
7 with respect to Data Request 3802 there's no question
8 that the \$56 million issued to AWCC is part of the
9 \$290 million outstanding, as shown by this exhibit,
10 that you've offered and put into the evidence, correct?

11 A. That's correct. That 56 million is shown on
12 that DR response.

13 Q. Okay. Thank you, sir.

14 And 56 million of 290 million is roughly
15 19 percent, correct?

16 A. I believe that's correct.

17 Q. Would you also agree with me that
18 Missouri-American's total capitalization, debt plus
19 equity, is -- and preferred stock is approximately
20 \$501 million for the same period of time?

21 A. I believe I saw that figure, that's correct.

22 Q. So the \$56 million dollars of debt from
23 AWCC to Missouri-American is approximately 11 percent
24 of Missouri-American's total capitalization of
25 501 million, right?

1 A. I believe that's correct.

2 Q. At page 22 of your direct testimony,
3 line 17 you state that MAWC is a subsidiary of American
4 Water, correct?

5 A. Yes.

6 Q. And, in fact, would you agree with me that
7 Missouri-American is a Missouri corporation?

8 A. Yes.

9 Q. And I believe you indicated a minute ago that
10 you would agree with me that all of Missouri-American's
11 common stock or equity is owned by American Waterworks,
12 correct?

13 A. Yes.

14 Q. Thus would you agree with me that
15 Missouri-American is a subsidiary corporation of
16 American Waterworks?

17 A. Yes.

18 Q. Now, let's go back to page 22 of your direct
19 testimony, again beginning on line 17. You state, "if
20 MAWC were a subsidiary that issued all of its own debt,
21 then you may have used MAWC's capital structure for
22 purposes of this case."

23 Do you see that?

24 A. Yes.

25 Q. Okay. And here's where I think you and I are

1 gonna have a major disagreement.

2 Missouri-American does, in fact, issue its own
3 debt and equity, does it not?

4 A. This is where we're gonna have a disagreement.
5 Missouri-American Water Company receives \$56 million
6 from AWCC. And I -- I -- hopefully I'll be able to get
7 to -- a chance to read it into the record in the
8 future, but there's a DR response from
9 Missouri-American Water Company that indicates that
10 that 56 million is held at AWCC.

11 So as far as that debt amount,
12 Missouri-American Water Company does not actually issue
13 the debt. American Water Capital Corporation is doing
14 an aggregate debt issuance to the capital markets -- in
15 this case it was RWE -- and then allocating these funds
16 down to its subsidiaries on -- based on internal loan
17 documents.

18 Q. Let -- maybe we can narrow our -- our
19 disagreement. Let's take this 56 million and set it
20 aside for a second. With respect to the remainder of
21 the Company's capitalization -- the remainder of its
22 long-term debt, all of its common equity and its
23 preferred stock. Would you agree with me that all of
24 that is issued by Missouri-American Water Company?

25 A. No, I don't have any reason to dis-- to

1 dispute that.

2 Q. Okay. So we're -- then we're just arguing
3 about this 56 million; is that right?

4 A. That's correct.

5 Q. Okay. I believe --

6 A. I'm sorry. Let me -- let me clarify something
7 on -- on that. There is a short-term debt agreement
8 that Missouri-American Water Company has with AWCC, so
9 a -- Missouri-American Water Company does receive
10 short-term debt from AWCC as well.

11 Q. Okay.

12 A. I just thought it was important to clarify
13 that.

14 Q. Well, for purposes of this case and long-term
15 financing, so we can exclude the short term --

16 A. Okay.

17 Q. -- the only dispute we have with regard to
18 whether or not Missouri-American issues its own debt
19 and equity is this \$56 million to American Waterworks
20 Capital --or America Water Capital Corp, correct?

21 A. For purposes of preferred stock, common equity
22 and long-term debt, that's correct.

23 Q. Now, you've looked at the Company's indenture
24 of mortgage for purposes of calculating interest
25 coverage ratios, correct?

1 A. Yes.

2 Q. And would you agree with me that that
3 indenture also has restrictions on the amount of debt
4 Missouri-American can have outstanding on its books as
5 a percent of its total capitalization?

6 A. I believe there's a restriction to 35 per --
7 it has to have at least 35 percent equity, so
8 65 percent debt; that's correct.

9 Q. In fact, I believe that's contained in the
10 financing -- or at least a synopsis of that requirement
11 is contained in the financing application, which I
12 believe is Exhibit 95 now in this proceeding -- hold on
13 a second. I'll see if I can get that.

14 Paragraph 7, page 4 of Exhibit 95, if you have
15 it.

16 A. Paragraph 7, page 4. I guess that's down
17 into -- into the paragraph?

18 Q. It's the very last sentence of the paragraph
19 there at the top of that page.

20 A. I'm there.

21 Q. Okay. Cuz my next question is gonna work off
22 of that.

23 In -- in addition to having a limit on debt to
24 capital of 65 percent, the indenture also requires the
25 Company to take into consideration future debt

1 issuances, correct? In other words, it cannot exceed
2 65 percent total debt to capital based on existing debt
3 on the books plus any debt they propose to issue in the
4 immediate future?

5 A. Let me -- let me read over this real quick
6 here.

7 Q. Certainly.

8 A. It specifically states here the provision of
9 203, 204 of Article II of the indenture mortgage are
10 applicable to the issuance of additional general
11 mortgage bonds. And such bonds are issual (sic)
12 pursuant, et cetera, et cetera, so it refers to
13 additional issuances.

14 Q. Okay. Now, this indenture is for the benefit
15 of third-party independent lenders and not AWCC,
16 correct?

17 A. Yes.

18 Q. As a result lenders -- unaffiliated
19 third-party lenders who loan money under this indenture
20 to Missouri-American have control to some degree over
21 the capital structure of Missouri-American, do they
22 not?

23 A. I mean, ul-- ultimately any capital structure
24 that -- that's -- it's under the management's control.
25 But if the -- if the Company wishes to receive

1 additional debt through this -- whoever this indenture
2 mortgage -- indenture of mortgage is held with, then in
3 order to receive that additional debt, then they have
4 to comply with that indenture of mortgage.

5 Q. To the extent the Company wants to issue
6 additional debt, I think you've agreed they have to
7 comply with the requirements of this indenture
8 regarding total debt to capital, right?

9 A. Yes.

10 Q. And my point is that this indenture, as it
11 controls the Company's ability to issue debt, has been
12 negotiated -- issued, if you will, to third-party
13 independent lenders who, in essence, have the benefit
14 of that control, correct?

15 A. I would say that there's a -- there's a -- a
16 floor, if you will, put on the Company, as far as the
17 maximum amount of debt that they can have in
18 their -- and when I say Company, I'm talking
19 Missouri-American Water Company -- that as far as the
20 maximum amount of debt that they could have in their
21 capital structure.

22 And this relates to the -- the issuance of
23 additional general mortgage bonds, as far as their
24 capital structure is concerned, whether that be through
25 another third-party lender or not.

1 Q. And that floor, as you call it, or perhaps I'd
2 call it a ceiling on total debt is dictated by
3 independent third-party lenders, not by any affiliate
4 company of Missouri-American?

5 A. It's a third party, that's correct.

6 Q. Excuse me.

7 Let's talk about that \$56 million. With
8 respect to that \$56 million of long-term debt, would
9 you agree with me that Missouri-American is the primary
10 obligor on that debt?

11 MR. SNODGRASS: Judge, I think he's asking for
12 a legal opinion here.

13 MR. ENGLAND: That's rich.

14 Your Honor, he apparently wasn't constrained
15 about offering it for purposes of prepared testimony,
16 and I am not seeking a legal opinion. I -- I think
17 it's a term of art that's also used in the financial
18 community.

19 JUDGE THOMPSON: I will overrule the
20 objection.

21 You may answer if you're able.

22 THE WITNESS: There's an internal loan
23 document, and I believe it's been established that
24 AWCC if Missouri-American Water Company ever defaulted
25 on, you know, these debt financings that

1 Missouri-American Water receives from AWCC, that
2 AWCC will continue to try to pursue that.

3 At least that's been represented in the
4 interview to us that we conducted on September 10th.

5 BY MR. ENGLAND:

6 Q. Is that a yes or no that Missouri-American is
7 the primary obligor on this \$56 million of debt?

8 A. They're the primary obligor to AWCC, yes.

9 Q. Okay. And, in fact, that's consistent with
10 what Mr. Hartnett told you in that transcribed
11 interview, isn't it?

12 A. Could you refer me to the specific page that
13 you're looking at?

14 Q. You bet. Page 20, lines 12 through 13 -- make
15 that 12 through 14.

16 JUDGE THOMPSON: Page 20 of --

17 MR. ENGLAND: This is an interview --
18 transcribed interview that was conducted between the
19 parties.

20 JUDGE THOMPSON: Very well.

21 THE WITNESS: Yes, he's -- he's very clear in
22 his statement there.

23 BY MR. ENGLAND:

24 Q. Okay. And the fact that Missouri-American is
25 a primary obligor on that debt is also evidenced by the

1 fact that it issues a note to American Water Capital
2 Corp, correct?

3 A. Yes, that's correct.

4 Q. And the form of those notes, whether it's
5 short-term or long-term borrowing are attached as
6 exhibits to the financing application, Exhibit 95?

7 A. Yes.

8 Q. And it's still your opinion that although
9 Missouri-American is the primary obligor on this debt
10 that it issues promissory notes evidencing this debt,
11 that it does not issue this debt?

12 A. Yes.

13 Q. Well, then let me ask you this: If it does
14 not issue its own debt -- at least this particular
15 debt, then why does it seek authority from -- and --
16 and obtain authority from this Commission to do so?

17 A. That's a legal question I'm not sure I can
18 answer.

19 Q. Okay. But that's certainly what they sought
20 in the application that is now Exhibit 95, right --
21 authority to issue and sell these bonds -- or excuse
22 me -- promissory notes?

23 A. I -- I think that was part of their
24 application, that's correct.

25 Q. Have you reviewed the Staff recommen--

1 memorandum -- actually I believe it was an amended
2 memorandum -- that recommends Commission approval in
3 the financing case, WF-2002-1096?

4 A. I believe I browsed over that recommendation.

5 MR. ENGLAND: Your Honor, I'd like to take
6 official -- or rather ask that you take official
7 notice, if you will, of that memorandum. It was filed
8 in Case WF-2002-1096.

9 And I have copies for the record.

10 JUDGE THOMPSON: You have copies?

11 MR. ENGLAND: Yes.

12 JUDGE THOMPSON: Okay. Is there any objection
13 to taking official notice of the Staff memorandum filed
14 in Case WF-2002-1096?

15 (No response.)

16 JUDGE THOMPSON: In fact, why don't we just go
17 ahead and mark this as an exhibit, which will be
18 Exhibit 100.

19 (EXHIBIT NO. 100 WAS MARKED FOR IDENTIFICATION
20 BY THE COURT REPORTER.)

21 JUDGE THOMPSON: Okay. We've marked the
22 amended Staff recommendation as Exhibit 100.

23 Do I hear any objections to the receipt of
24 Exhibit 100?

25 (No response.)

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1 JUDGE THOMPSON: Hearing none, the same is
2 received and made a part of the record of this
3 proceeding.

4 (EXHIBIT NO. 100 WAS RECEIVED INTO EVIDENCE.)

5 BY MR. ENGLAND:

6 Q. Mr. Murray, would you agree with me that
7 neither American Waterworks or AWCC guarantees the debt
8 that Missouri-American issues to independent
9 third-party lenders, such as the Missouri EIERA?

10 A. Yes.

11 Q. Would you agree with me that American
12 Waterworks does not guarantee the debt that
13 Missouri-American has with American Waterworks -- or
14 excuse me -- American Water Capital Corporate?

15 MR. SNODGRASS: Judge, I'm gonna object again.
16 He's already said that this witness is not qualified to
17 issue opinions on what constitutes a guarantee.

18 MR. ENGLAND: I'm not asking for a legal
19 definition. I'm asking if he's aware of any guarantee
20 that Missouri-American -- excuse me -- American
21 Waterworks has made to AWCC on behalf of
22 Missouri-American for the debt that Missouri-American
23 has with AWCC.

24 MR. SNODGRASS: He'd have to know -- he'd have
25 had to offer an opinion of what a guarantee consists

1 of.

2 MR. ENGLAND: No. The witness just has to be
3 aware of the financing documents that have been filed
4 in this case, and that he -- he himself has referred
5 to.

6 JUDGE THOMPSON: Objection is overruled. The
7 witness may answer, if he can.

8 THE WITNESS: Well, I think the -- there's
9 been representations from the Company itself that this
10 is a -- this was something that is fully and
11 unconditionally guaranteed by American Waterworks in
12 its annual report in 2002.

13 BY MR. ENGLAND:

14 Q. Let -- let's be clear. What you're referring
15 to is the support agreement that American Waterworks
16 has with AWCC, correct?

17 A. That is correct.

18 Q. I'm talking about debt that Missouri-American
19 issues to AWCC. There is no guarantee or support
20 agreement, is there, sir, to your knowledge?

21 A. Because the debt is received by
22 Missouri-American Water Company from AWCC, and whether
23 the Company wants to refer to it as a guarantee or a
24 support agreement from American Waterworks, there's an
25 indirect guarantee on a debt that is allocated down the

1 Missouri-American Water Company.

2 MR. ENGLAND: Your Honor, there was another
3 legal opinion. But more importantly, the -- the answer
4 was not responsive to my question.

5 I asked if there was a guarantee from American
6 Waterworks to AWCC on behalf of Missouri-American for
7 the debt it borrows from AWCC.

8 MR. SNODGRASS: He's opened the door to this
9 line of questioning.

10 MR. ENGLAND: Well, I've opened the door, but
11 I'd like a responsive answer to my question, not a
12 gratuitous statement that's not -- not related to it.

13 JUDGE THOMPSON: You're talking about debt
14 issued by Missouri-American to AWCC?

15 MR. ENGLAND: Correct. And you're answering
16 about debt issued by AWCC to Missouri-American
17 or -- or --

18 THE WITNESS: Well, I -- I'm referring to debt
19 that is allocated down from AWCC through internal loan
20 documents to Missouri-American Water Company. That
21 debt that is -- that is allocated down from American
22 Water Capital Corporation to Missouri-American Water
23 Company is guaranteed by American Waterworks.

24 JUDGE THOMPSON: And I don't think that's the
25 same thing that he's asking about.

1 MR. ENGLAND: You're absolutely right.

2 BY MR. ENGLAND:

3 Q. Do -- do I need to restate the question or can
4 I get an answer?

5 A. Please restate the question.

6 Q. American Waterworks has not guaranteed or
7 otherwise provided support to Missouri-American for the
8 debt that it issues to AWCC, has it?

9 A. There is no direct support from American
10 Waterworks to MAWC.

11 Q. Now, with respect to these "internal loan
12 documents" that you've referenced between AWCC and
13 Missouri-American -- are you with me?

14 A. I'm with you.

15 Q. Which -- which -- what are these internal loan
16 documents? Identify them for me, please.

17 A. Actually they're attached to the application.

18 Q. Fair enough.

19 So all of those internal loan documents are
20 contained in the four corners of this application and
21 the exhibits attached to it?

22 A. Yes, they are.

23 Q. Okay. And please specify by title what those
24 documents are.

25 A. Okay. Exhibit A, promissory note for

1 short-term loans.

2 Q. And that's actually part of Appendix 2
3 attached to the application?

4 A. That is correct.

5 Q. Okay.

6 A. Exhibit B, promissory note for long-term
7 borrowings.

8 Q. Okay. Anything else?

9 A. There's just some other general documents
10 on -- on Tab 2 that indicates some information about
11 the financial services agreement.

12 Q. Okay. So we've identified, for purposes of
13 internal loan documents between AWCC and
14 Missouri-American, the financial services agreement
15 which is the first document in Appendix 2; the
16 specimen -- what I'll call specimen promissory note for
17 short-term loans, which is Exhibit A; and the specimen
18 promissory note for long-term borrowings, which is
19 Exhibit B, correct?

20 A. That's correct.

21 Q. And is that -- that it?

22 A. That -- that's all that's under Tab 2, that's
23 correct.

24 Q. Okay. And do you see any reference or have
25 you seen any reference in either one -- since I've got

1 three, it's not either -- in any one of those
2 three documents that makes American Waterworks primary,
3 secondarily, direct, indirect -- responsible for loans
4 from AWCC to Missouri-American?

5 A. There is nothing in these loan documents.

6 Q. Thank you, sir.

7 Now, I think we've discussed previously that
8 the fact that Missouri-American does not issue all of
9 its own debt was the only stated reason in your
10 prepared direct testimony for using the parent
11 company's consolidated capital structure, correct?

12 A. Yes.

13 Q. And this position is consistent with ones
14 taken by you in testimony involving Missouri Gas
15 Energy, Case No. GR-2001-292, and Missouri Public
16 Service, Case No. ER-2001-672, correct?

17 A. It's consistent that the -- the divisions in
18 those cases, which those are -- the structures were a
19 little built different. They had operating divisions,
20 but the -- the financings were received from the parent
21 company.

22 Q. Okay. I'd like to ask a couple of questions
23 about those cases. Do you happen to have them -- have
24 your testimony with you?

25 A. No, I do not.

1 MR. ENGLAND: I do have copies, if I may --

2 JUDGE THOMPSON: You may.

3 MR. ENGLAND: -- approach.

4 And rather than burden the record with
5 exhibits, because they're rather lengthy, I'd just like
6 to ask him some questions and have him read from them,
7 if I may.

8 JUDGE THOMPSON: You may.

9 MR. ENGLAND: Your Honor, the first document
10 I'm gonna hand the -- had the witness his -- his direct
11 testimony in the Missouri Gas Energy case, Case
12 No. GR-2001-292.

13 JUDGE THOMPSON: Very well.

14 BY MR. ENGLAND:

15 Q. And my first question -- and I hope the answer
16 will be affirmative -- that this is a true and accurate
17 copy of the testimony from that case?

18 A. Yes, it is.

19 Q. Thank you.

20 Would you look at page 20 of that testimony,
21 please? Beginning at line 10, would you please read,
22 for the record, the question and answer appearing -- or
23 beginning on line 10 and continuing through line 15?

24 A. Question, why didn't you use Missouri Gas
25 Energy's capital structure? Answer, Missouri Gas

1 Energy is div-- is a division of Southern Union
2 Company. Because the debt and equity are generated
3 from the parent company, Southern Union Company,
4 MGE relies on Southern Union Company to -- to finance
5 its investment in MGE assets.

6 Because MGE does not issue its own debtor
7 equity, the actual capital structure for Southern Union
8 Company was used for MGE.

9 Q. Thank you.

10 Now, as I understand it, MGE is a division of
11 Southern Union Company; is that correct?

12 A. That is correct.

13 Q. And I -- I draw that distinction because it is
14 not a separate corporate subsidiary, correct?

15 A. That's correct.

16 Q. As a division, it does not issue its own debt
17 and equity, correct?

18 A. That's correct.

19 Q. It is -- or it receives, I believe, as you've
20 testified in your testimony, it's debt and equity
21 directly from its parent?

22 A. That's correct.

23 Q. Okay. And in that regard, you chose to use
24 the parent company's capital structure as the
25 appropriate capital structure for ratemaking purposes?

1 A. That's correct.

2 MR. ENGLAND: Okay. Now, let's look at the
3 Missouri Public Service case if we can.

4 Again, Your Honor, I'm gonna hand the witness
5 his direct testimony from that case, Case
6 No. ER-2001-672.

7 JUDGE THOMPSON: Very well.

8 BY MR. ENGLAND:

9 Q. And again, I hope it's a --

10 A. I --

11 Q. -- true and correct -- or accurate copy of
12 that testimony?

13 A. Yes, it is. And I can probably tell you what
14 page you're gonna to already, too.

15 Q. Ironically it's the same page --

16 A. Yeah.

17 Q. Would you read that question and answer,
18 please, at page 21, lines 10 through 14?

19 A. Question, why didn't you use MPS's capital
20 structure? Answer, MPS is a division of UtiliCorp.
21 Because the debt and equity are generated from the
22 parent company, UtiliCorp, MPS relies on UtiliCorp to
23 finance its investment and MPS assets.

24 Because MPS does not issue its own debt or
25 equity, the actual capital structure for UtiliCorp was

1 used for MPS.

2 Q. And again, similar to MGE and Southern Union,
3 in this case MPS or Missouri Public Service is a
4 division of UtiliCorp; is that correct?

5 A. That's correct.

6 Q. And not a corporate subsidiary?

7 A. That's correct.

8 Q. And as with MGE, MPS obtains its debt and
9 equity directly through its parent, UtiliCorp?

10 A. That's correct.

11 Q. Turning again to the page 21 of that testimony
12 in the M-- MPS case, Missouri Public Service.

13 A. Yes.

14 Q. Lines 15 through 16. Do you see that?

15 A. Yes, I do.

16 Q. You say, "in addition, UtiliCorp's
17 consolidated capital structure is not extraordinary for
18 a typical electric utility."

19 Do you see that?

20 A. Yes, I do.

21 Q. So apparently in the UtiliCorp or -- or
22 MPS case you also determined that the parent company
23 capital structure was, I guess, typical for the
24 electric utility industry?

25 A. I believe it was -- it was within a range of

1 reasonableness, that's correct.

2 Q. Thank you.

3 Now, I'd like to show you your rebuttal
4 testimony in that same case, Case No. ER-2001-672.
5 Confirm for me, if you would please, that that's a true
6 and accurate copy that I've handed you?

7 A. Yes, it is.

8 Q. First I'd like you to read from page 5 of that
9 testimony beginning at line 17 -- the sentence
10 beginning because.

11 A. Because MPS does not issue its own debt or
12 equity, I relied upon the actual capital structure for
13 UtiliCorp to calculate the rate of return for MPS.

14 If MPS were a subsidiary of UtiliCorp and
15 issued its own debt and capital, then the debt -- then
16 the MPS capital structure would be a reliable capital
17 structure, because MPS would have its own capital
18 structure.

19 Staff has recommended subsidiary capital
20 structures in the past. Most recently in St. Louis
21 County Water, Case No. WR-2000-844, where a subsidiary
22 issues its own debt.

23 Q. Thank you, sir.

24 And I think we've established -- or you would
25 agree with me that in this case Missouri-American

1 Company "has its own capital structure," doesn't it?

2 A. I don't think we've established that
3 Missouri-American Water Company has its own capital
4 structure.

5 Q. Would you agree with me --

6 A. No -- no, I would not.

7 Q. Okay. Then what is the capital structure that
8 Mr. Burdette and Company witnesses have been able to
9 identify and show in their exhibits and testimony in
10 this case?

11 A. I believe they relied on some balance sheet
12 information from Missouri-American Water Company -- at
13 least Mr. Burdette did, as far as the actual as a -- as
14 a test year update and true-up for his capital
15 structure for Missouri-American Water Company.

16 And Ms. Ahern must have done some projections
17 of what she thought Missouri-American Water Company's
18 balance sheet would -- the capital structure would
19 represent as of November 30th, 2003.

20 Q. So even though we've established that
21 Missouri-American does issue its own debt to third
22 parties and it issues equity to its parent -- and we do
23 have a disagreement with respect to the \$56 million
24 with the AWCC evidenced by these internal loan
25 documents -- you maintain that Missouri-American does

1 not have a capital structure; is that right?

2 A. I -- I maintain that Missouri-American does
3 not have appropriate capital structure for
4 ratemaking purposes in this case.

5 Q. Now, that's not quite my question. My
6 question is: Does it have an identifiable capital
7 structure?

8 A. There are -- there's a balance sheet created
9 for -- for Missouri-American Water Company in which a
10 capital structure can be calculated, that's correct.

11 Q. That capital structure can be calculated from
12 that information that's filed with the Commission on an
13 annual basis, correct -- the annual report?

14 A. That's correct.

15 Q. Okay. And that capital structure has been
16 used in the past for Missouri-American for ratemaking
17 purposes, has it not?

18 A. That's correct.

19 Q. And it has for its predecessor, St. Louis
20 County Water Company, has it not?

21 A. That's correct.

22 Q. And so it has an identifiable capital
23 structure -- at least has had for purposes of
24 ratemaking for the last several cases, correct?

25 A. Tho-- those capital structures were identified

1 and -- and -- and recommended by even Staff in those
2 last couple rate cases, that's correct.

3 Q. Thank you, sir.

4 And, in fact, the capital structure of
5 Missouri-American that has been identified for purposes
6 of this case with approximately 44 percent equity is
7 very similar to the average equity ratio for the proxy
8 companies you used for purpose of your analysis, the
9 45 percent, correct?

10 A. That's correct.

11 Q. Thank you.

12 I'm turning now to your rebuttal testimony,
13 page 2, lines 6 through 7. In responding to Company's
14 and OPC's use of Missouri-American's actual capital
15 structure, you characterize Missouri-American's capital
16 structure as consisting of "allocated debt issuances --
17 issuances, excuse me, and parent company infusions."

18 Do you see that?

19 A. Parent -- parent company equity infusions,
20 that's correct.

21 Q. You're right. I'm sorry. I omitted a word.

22 JUDGE THOMPSON: What page are we on,
23 Mr. England?

24 MR. ENGLAND: Page 2 of the rebuttal
25 testimony, lines 6 and 7.

1 JUDGE THOMPSON: Thank you.

2 BY MR. ENGLAND:

3 Q. And as far as equity infusions are concerned,
4 I think we've established they've always been made by
5 American Waterworks to Missouri-American, correct?

6 A. Yes.

7 Q. For as long as Missouri-American has existed,
8 it has issued and sold all of its equity to its parent,
9 American Waterworks, and that has been the case for as
10 many rate cases as you and I are familiar with,
11 correct?

12 A. Well, I -- I assume as long --

13 Q. Well, that you're familiar with anyway.

14 A. I assume as long as they've been 100 percent
15 owned by American Waterworks that that's the case.
16 That's --

17 Q. Fair enough.

18 A. -- correct.

19 Q. Fair enough.

20 Would you agree with me that a portion of
21 Missouri-American's equity capital is retained earnings
22 from operations?

23 A. Yes, I would.

24 Q. And would you also agree with me that these
25 retained earnings are not "infused" by the parent

1 company, but rather generated by the earnings at the
2 subsidiaries level?

3 A. I -- I think that's why they're referred to as
4 retained earnings. They're -- they're retained by the
5 Company.

6 Q. Okay. Are you aware of the amount of retained
7 earnings on Missouri-American Water Company's balance
8 sheet?

9 A. I'd have to refer to the response that I have
10 here.

11 Q. Okay. I think that information is in response
12 to your Data Request No. 3819, if you have that
13 available.

14 A. Okay. I have that in front of me. If you can
15 tell me the amount again, please.

16 Q. I don't have it in front of me. I just have a
17 note to myself that it's approximately 55 percent of
18 total equity.

19 A. Well, I'd say it's -- it's a -- it's a little
20 le-- actually it's a little more than 50 percent,
21 you're correct.

22 Q. Can you tell from that?

23 A. Yes.

24 Q. What -- what is it, please?

25 A. Well, it's a -- the retained earnings is

1 122,955,389. That -- that's out of a total equity of
2 221,714,180.

3 Q. Okay. So at least a portion of
4 Missouri-American's equity -- the retained portion --
5 or retained earnings portion is not infused by American
6 Waterworks, correct?

7 A. That's correct.

8 Q. Okay. And -- and the remainder of the common
9 equity is actually evidenced by sales of common stock
10 from Missouri-American to its parent, American,
11 correct?

12 A. I don't know that for sure. It -- there may
13 be -- it -- it -- I don't know if -- if American
14 Waterworks has -- making -- is making every infusion
15 with the -- the issuance of equity actual shares or
16 else -- or, you know, there's another possibility.

17 They -- they may be -- just be making dollar
18 equity infusions without issuing additional shares. So
19 I don't know either way, but regardless there is equity
20 infusions.

21 Q. Okay. It -- for purposes of the latest
22 financing where they sought Commission appro-- specific
23 approval, if you will, to issue common equity, which I
24 believe was part of that application that has been now
25 marked as Exhibit 95?

1 A. Yes.

2 Q. That was evidenced by the sale of addition--
3 additional common stock, correct?

4 A. Yes.

5 Q. And as I understand your prior answer, you
6 don't draw a distinction whether common stock is issued
7 to the parent or whether the parent company simply
8 contributes equity capital for purposes of your word --
9 your use of the word "infuse"?

10 A. Yes.

11 Q. Okay. And while we still have an agreement --
12 or disagreement with respect to this \$56 million of
13 debt, we do agree that the remaining long-term debt on
14 the Company's balance sheet has been issued to
15 third-party lenders, correct?

16 A. Yes.

17 Q. And Missouri-American is the primary obligor,
18 correct?

19 A. Yes.

20 Q. Okay. Now, when you testified that Southern
21 Union allocates debt to its MGE division and UtiliCorp
22 allocates debt to its MPS divi-- division -- excuse
23 me -- that's not the case here is it?

24 The same sort of "allocation of debt" is not
25 going on between American and Missouri-American as it

1 is in those instances?

2 A. Well, I -- I know in those cases the Company
3 claims that they assign debt to various divisions,
4 whether or not there's any internal loan documents or
5 what have you. I'm not aware of -- if that's how they
6 execute their assignments.

7 Their allocation method is quite confusing
8 and -- but I -- I'm not aware if they have any internal
9 loan documents or any type of internal tracking of that
10 allocation method that they use.

11 Q. To your knowledge, there's no evidence, either
12 promissory notes or sales of stock evidencing the
13 equity and debt allocations from the parent company
14 down to those -- or not the parent -- down to those
15 divisions, correct?

16 A. I've never seen any.

17 Q. Okay. And in that respect, then,
18 Missouri-American is quite different from MGE and MPS,
19 in as much as its equity and debt are all evidenced by
20 either stock or debt issued by Missouri-American?

21 A. Yes. I've seen official documents that are
22 submitted with finance cases for these internal
23 financings that occur at -- at American Waterworks with
24 Missouri-American Water Company.

25 Q. And, in fact, you've seen executed copies as

1 well, have you not?

2 A. I believe that's part of the follow up to
3 finance cases.

4 Q. Again, in your rebuttal testimony page 5,
5 line 19 you say MAC no longer issues all of its own
6 debt?

7 A. Yes.

8 Q. And I think we've established that you're just
9 referring now to the debt it issues to American
10 Waterworks Capital -- American Water Capital Corp,
11 correct?

12 A. Yes. I'm referring to the debt that's
13 received from American Water Capital Corporation,
14 that's correct.

15 Q. So that's not the case with respect to the
16 approximate \$235 million of debt on the books of the
17 Company, Missouri-American?

18 A. To my knowledge, that's correct.

19 Q. Okay. At pages 6 and 7 of your rebuttal
20 testimony you have some lengthy quotes there from the
21 financing application, which I believe is now
22 Exhibit 95 in this case?

23 A. Yes.

24 Q. Do you see that?

25 A. Yes.

1 Q. And I believe you quote that for support for
2 your statement that AWCC consolidates the borrowing
3 needs of all of its subsidiaries, correct?

4 A. I -- I think it's -- obviously the question is
5 describe the financing arrangement with AWCC in more
6 detail. It's -- it's intended to give a little more
7 information as to how this financing arrangement is --
8 is arranged -- how this is set up with AWCC and
9 Missouri-American Water Company.

10 Q. But it is your testimony that AWCC
11 consolidates the borrowing needs of all of the
12 subsidiaries?

13 A. That -- that's correct.

14 Q. Okay. Now, we've talked about the financial
15 services agreement, which is attached to the financing
16 application as Appendix 2?

17 A. Yes.

18 Q. With respect to that financing -- or
19 finance -- excuse me -- financial services agreement,
20 Paragraph No. 5 on page 2, would you take a moment to
21 read that to yourself, sir? I have a couple of
22 questions. It -- the title of this paragraph is
23 obligations not joint.

24 Do you see that?

25 A. Yes, I do.

1 Q. Okay. And let me know when you're done,
2 please.

3 JUDGE THOMPSON: This is page 2 of the --

4 MR. ENGLAND: The financial services
5 agreement, Appendix 2 to Exhibit 95.

6 THE WITNESS: I've read it.

7 BY MR. ENGLAND:

8 Q. Okay. Would you agree with me, sir, that the
9 obligation of MAWC and the other subsidiaries that
10 borrow from AWCC are several and not joint?

11 A. Yes, I would.

12 Q. In other words, MAWC is not responsible for
13 any other subsidiary or AWC for any amounts in excess
14 of MAWC's own borrowings?

15 A. That's correct.

16 Q. Okay. And I think we've established that
17 those borrowings of MAWC are evidenced by the specimen
18 notes that are attached to this financial services
19 agreement, correct?

20 A. Yes.

21 Q. Yeah.

22 So while AWC may -- AWCC -- excuse me -- may
23 consolidate the debt financing needs of its
24 subsidiaries for purposes of AWCC's borrowings, each
25 subsidiary is only liable for that portion of debt

1 which it borrows from AWCC?

2 A. That's correct.

3 Q. And no subsidiary is responsible for the debt
4 of any other subsidiary?

5 A. That's correct.

6 Q. I think you've also either testified in -- in
7 your prepared testimony or perhaps indicated previously
8 that Missouri-American does not have to use AWCC as a
9 sort of debt financing, correct?

10 A. That's correct.

11 Q. MAWC is free to pursue borrowings from
12 independent, non-affiliated third-party lenders such as
13 the Missouri EIERA?

14 A. Yes.

15 Q. In fact, the financial services agreement
16 specifically permits that in paragraph 7, does it not?

17 A. Yes it does.

18 Q. If suc-- excuse me -- if subsidiaries, such as
19 Missouri-American, are free to pursue independent,
20 non-affiliate lenders for their debt, then AWCC would
21 have no control over nor can it dictate the loan
22 requirements of the operating subsidiaries, can it?

23 A. No.

24 Q. Each subsidiary has its own decision to make
25 whether it wants to borrow money from AWCC or borrow

1 from an independent third-party lender?

2 A. Yes.

3 Q. And it's free to borrow entirely from an
4 independent third-party lender if it wants?

5 A. Yes.

6 Q. And -- and not borrow anything from AWCC?

7 A. Yes.

8 Q. Now, there was some testimony previously
9 today -- and correct me if I'm wrong -- but the only
10 thing that has changed since the last case involving
11 Missouri-American Water Company is the way
12 Missouri-American Water Company finances its operations
13 through debt issuances to AWCC, correct?

14 A. Yes. From debt received from AWCC, that's
15 correct.

16 Q. Missouri-American still issues equity to
17 American in the same fashion that it did in the last
18 case and the case before that?

19 A. Yes.

20 Q. And it still issues debt to third-party
21 lenders such as EIERA -- EIERA as it has in the past,
22 correct?

23 A. Yes.

24 Q. Let me ask you this hypothetical: If the
25 subsidiary chooses to borrow all of its money from

1 independent, non-affiliate third-party lenders and,
2 therefore, borrow nothing from AWCC, then there would
3 be no basis for consolidated capital structure,
4 correct, under your reasoning?

5 A. Not with the statements that have been made by
6 the Company that AWCC will be the primary source of
7 financing for subsidiaries going forward. I think that
8 that's something that would have to be taken into --
9 into consideration if I am going to be trying to decide
10 what is the appropriate capital structure.

11 Q. Well, no, I'm asking you a hypothetical
12 situation. If you -- if a subsidiary chooses not to do
13 any debt financing through AWCC -- chooses to do it all
14 through independent third-party lenders, then there'd
15 be no basis for the consolidated capital structure that
16 you've proposed in this case, right?

17 A. I wouldn't say that there wouldn't be no basis
18 just because of the fact that if they don't have the
19 debt -- if they don't have debt received from AWCC on
20 their books, that there is no basis for consolidated
21 capital structure.

22 I -- I think I've brought that up -- brought
23 up a few points -- quite a few points in -- in my
24 rebuttal and surrebuttal testimony that just because
25 Missouri-American Water Company is receiving debt from

1 AWCC is not the only factor the consider.

2 There's the factor of whether or not the
3 capital structure is truly independent, which one of
4 those considerations is double leverage; whether or not
5 the ameri-- whether or not the parent company's
6 operations are predominantly the same as the
7 subsidiary's operations, which that is another
8 consideration.

9 Another consideration would be whether
10 or not -- and I know we have some, you know,
11 disagreements on this is in this case -- in this
12 specific instance, as far as whether or not the, you
13 know, parent company guarantees any of the debt that
14 the subsidiary has.

15 And I believe there's one other -- you know,
16 whether -- whether or not they issue all their own debt
17 is what -- and that's what you're getting at.

18 But there are other considerations that have
19 to be thought about when you're determining whether or
20 not to recommend a consolidated capital structure or a
21 subsidiary capital structure. This is not -- I'm not
22 looking at this in a vacuum.

23 Q. But at least for purposes of your direct
24 testimony, that was the only reason you identified
25 as -- as -- for you -- for you using the American

1 Waterworks consolidated capital structure was this
2 existence of AWCC?

3 A. That was the -- that was the only thing I
4 identified. Definitely is not the only thing that --
5 that we considered when we decided to recommend a -- a
6 consolidated capital structure.

7 Q. Let me ask you this: If Missouri-American
8 wants to avoid the imposition of a consolidated capital
9 structure, would you agree with me that all it needs to
10 do is to refuse to borrow money from its affiliate,
11 AWCC?

12 A. That's an option that American Water Company
13 can choose to -- to do to go ahead and cancel their
14 agreement with AWCC and -- and no longer have
15 consolidated debt financing type of operation.

16 Q. It -- it's an option that Missouri-American
17 has, isn't it, sir, not that American has?

18 A. Yes. It's an option Missouri-American Water
19 Company has, that's correct.

20 Q. And if Missouri-American refuses to borrow
21 from AWCC, would you go back to advocating the
22 Missouri-American stand-alone capital structure for
23 ratemaking purposes?

24 A. As with every case, we'd have to evaluate, you
25 know, the specific circumstances of that -- of the

1 Company in that -- in that rate case that's filed -- or
2 complaint case, whatever the situation may be.

3 Like I said, there are many factors that go
4 into -- into considering whether or not a parent
5 capital structure is appropriate or a subsidiary
6 capital structure.

7 I do know that in the last -- as been -- as
8 has been pointed out several times out today -- that in
9 the last couple rate cases the -- the subsidiary
10 capital structure is the capital structure that was
11 recommended by Staff.

12 Q. But you can't commit to that being the case in
13 the future, if we simply get ourself out from under any
14 borrowings with AWCC; is that right?

15 A. Like I said, there's -- there's other
16 considerations that have to be, you know, thought about
17 when determining whether or not to propose a
18 consolidate or a subsidiary capital structure, which --
19 which I discussed in detail in my rebuttal and
20 surrebuttal testimony.

21 Q. Well, let's talk about some of that testimony
22 appearing in rebuttal and surrebuttal, and let's
23 specifically talk about double leverage.

24 I believe you mentioned the term "double
25 leverage" for the first time in your surrebuttal

1 testimony; is that right?

2 A. In my surrebuttal testimony?

3 Q. Yes, sir.

4 A. I think you're correct that that's the first
5 time that I actually used the specific term "double
6 leverage." There is a general description of -- of --
7 of what occurs with double leverage in my rebuttal
8 testimony.

9 Q. Right. But -- but double leverage,
10 particularly for ratemaking purposes, is a very
11 specific term of art, is it not?

12 A. It's a -- it's a very specific term, and it's
13 within the cost of capital utility reference --
14 references that we utilize.

15 Q. Right. And for purposes, I mean, of your
16 testimony in this proceeding, the very first time that
17 that term is referenced is in your surrebuttal
18 testimony -- or let me state it another way.

19 You did not mention double leverage in your
20 direct testimony, and you did not mention double
21 leverage in your rebuttal testimony, did you?

22 A. Not the specific term.

23 Q. Okay.

24 JUDGE THOMPSON: Got a page reference,
25 Mr. England?

1 MR. ENGLAND: The first -- or the only
2 evidence or reference I see of the term "double
3 leverage" is in surrebuttal page 9, lines 15 through
4 19; page 13, lines 11 and 12, and then 17 and 20.

5 JUDGE THOMPSON: Thank you.

6 MR. ENGLAND: You're welcome.

7 BY MR. ENGLAND:

8 Q. Would you define for me what you understand
9 double leverage to be, Mr. Murray?

10 A. Yes. The -- double leverage is the existence
11 of debt at both the parent company level and the -- and
12 the subsidiary level, and that parent company invests
13 in the equity of its wholly owned subsidiary in this
14 case.

15 Q. Double leverage exists virtually in every
16 holding company situation, does it not?

17 A. I wouldn't say that I necessarily think that's
18 the case. As far as I understand, there is -- and this
19 is something I took from Dr. Morin's book that the
20 amount of -- well, I -- the -- the -- it doesn't say
21 necessarily double leverage is resisted, but PUHCA has
22 restrictions on the type of -- on -- on the type of
23 double leverage or how much double leverage or whether
24 double leverage can -- can exist at all with electric
25 companies and -- and gas companies, I believe, where

1 that restriction is not on telephone and -- and water
2 companies.

3 Q. Well, let me with -- I'll just try to be
4 maybe a little more specific with my question. But
5 double leverage pretty much exists in a holding company
6 structure involving a water or a telephone company,
7 correct?

8 A. I think that's clear from my reference, yes.

9 Q. Okay. And double leverage, for purposes of
10 Missouri-American as a member of the American
11 Waterworks system, has always existed, as long as it's
12 been a wholly owned subsidiary, correct?

13 A. As long as they've been holding debt at both
14 levels, that's correct. And --

15 Q. So -- so the existence of double leverage is
16 nothing new -- that didn't just occur since the last
17 rate case, did it, sir?

18 A. No, it's nothing new.

19 Q. Okay. And there was never up to this point in
20 time a reason for Staff to utilize a consolidated
21 capital structure for purposes of Missouri-American,
22 correct?

23 A. A consolidated capital structure, that's
24 correct.

25 Q. I think what you're saying now in surrebuttal

1 testimony is that your use of a consolidated capital
2 structure is also supported by the existence of double
3 leverage, correct?

4 A. Yes.

5 Q. And at page 13, lines 17 through 24 you note
6 that the author David Parcel (phonetic sp.) cites the
7 existence of double leverage as one reason for using a
8 consolidated capital structure.

9 Do you see that?

10 A. He indicates that double leverage is one of
11 the considerations as to determining whether or not a
12 subsidiary's capital structure is independent from its
13 parent.

14 Q. Would you agree with me that Mr. Parcel
15 neither advocates nor endorses-- endorses the concept of
16 double leverage in his book?

17 A. I think generally throughout his book he
18 doesn't advocate or endorse any specific methodology.
19 He just -- it's a -- it's an informative textbook for
20 practitioners that recommend cost of capital.

21 Q. And, in fact, I believe it's contained in a
22 disclaimer on the cover page of the book, is it not?

23 A. I think you're correct.

24 Q. Okay. It's my understanding this book was
25 prepared as a study guide and reference manual for

1 certified rate of return -- or the certified rate of
2 return analyst -- I think that's CRRA program; is that
3 right?

4 A. Yes, I think it's part of becoming a --
5 receiving -- taking -- studying for the test to receive
6 the designation of CRRA, which is, yes, certified rate
7 of return analyst to give yourself some more
8 credibility when it comes to testifying in -- in rate
9 of return proceedings.

10 Q. Are you a CRRA?

11 A. No, I'm not.

12 Q. Okay. You've referenced Dr. Morin most
13 recently in a response to a question just a few minutes
14 ago. And you've also quoted him in your testimony, I
15 believe, as an authority in this area, correct?

16 A. Could you refer me to specifically where I
17 quoted him in the testimony?

18 Q. Well, you -- you mentioned his name just a
19 minute ago in response to one of my questions, but you
20 also specifically quote from his book in your rebuttal
21 testimony, pages 27 and 28, and in your surrebuttal
22 testimony at pages 6 and 29.

23 A. Yes, I cite Dr. Morin in -- in those two
24 areas.

25 Q. Okay. And he obviously is an authority in

1 this area, is he not, or you wouldn't be citing him?

2 A. He -- he, just like David Parcel, provides
3 material for rate of return witnesses to -- to consider
4 and review when making rate of return recommendations.

5 Q. That's not quite my question. He is an
6 authority in this area, is he not, or you wouldn't have
7 cited him?

8 A. He is an authority in the area, that's
9 correct.

10 Q. Thank you.

11 And unlike Mr. Parcel -- I hope I'm not
12 insulting him. Is it Mr. or Dr. Parcel?

13 A. I believe it's Mr. Parcel for him.

14 Q. Okay. Unlike Mr. Parcel, Dr. Morin actually
15 advocates various positions, does he not?

16 A. Yes.

17 Q. Okay. Do you have a copy of his book --

18 A. Dr. Morin's book?

19 Q. -- with you?

20 Yes.

21 A. Not with me.

22 Q. Okay. If I show you my witness's copy, can
23 you identify and indicate if that's a true and accurate
24 copy of his book -- or I guess not copy -- if that is
25 his book?

1 A. That's his book.

2 Q. Okay. And if you would, please, turn to
3 Chapter 20 entitled, double leverage, which I believe
4 begins on page 471 of that book.

5 A. Yes.

6 Q. Would you please read for the record the very
7 first paragraph, please?

8 A. The purpose of this chapter is to critically
9 address the double leverage approach to determining the
10 cost of capital of a regulated utility. The double
11 leverage approach has serious conceptual and practical
12 limitations, and is not consistent with basic financial
13 theory and a nota-- notion of fairness.

14 Assumptions and logic underlying the method
15 are questionable. The double leverage argument
16 violates the core notion that investor -- investment's
17 required return depends its particular risk.

18 The chapter concludes that the double leverage
19 approach has no place in regulatory practice and should
20 be discarded. The chapter is divided into
21 two sections, Section 20 point -- or just the first
22 paragraph. I'm sorry.

23 Q. That's quite all right.

24 I guess you'd agree with me that you and
25 Dr. Morin disagree on the appropriateness of using

1 double leverage for purposes of ratemaking, wouldn't
2 you?

3 A. I'd have to review the -- the chapter. I know
4 there's a couple of approaches for, you know, the
5 consideration of double leverage. One of them is -- is
6 a double leverage adjustment, and that's not what I'm
7 recommending in this case.

8 Q. I understand.

9 But you told me a minute ago that double
10 leverage was considered by you as support for
11 the us-- for your use of a consolidated capital
12 structure in this case, correct?

13 A. I used that -- the existence of double
14 leverage as a support for the consolidated capital
15 structure.

16 Q. And Dr. Morin later discusses that
17 consolidated capital structure is a form of recognizing
18 double leverage for the ratemaking process, correct?

19 A. Could you refer me to that specifically?

20 MR. ENGLAND: Yeah. I believe it's on page
21 474, the consolidated approach.

22 And for purposes of the record, Your Honor,
23 I'd like to have an exhibit marked, which is the entire
24 chapter from Dr. Morin's book on double leverage.

25 JUDGE THOMPSON: We're -- we're relieved you

1 didn't want to mark the entire book.

2 MR. ENGLAND: Can't afford it, Your Honor.

3 JUDGE THOMPSON: That will be Exhibit 101.

4 This will be Exhibit 101.

5 (EXHIBIT NO. 101 WAS MARKED FOR IDENTIFICATION
6 BY THE COURT REPORTER.)

7 THE WITNESS: I've -- I've read through that
8 section.

9 BY MR. ENGLAND:

10 Q. I guess my -- I think my outstanding question
11 was that a consolidated capital structure is one way in
12 which to recognize double leverage, correct?

13 A. Well, it's -- I -- I've read through that --
14 you know, through that section, and there's some
15 distinctions made in -- in the consolidated approach
16 between a double leverage capital structure and a
17 consolidated capital structure.

18 For instance, the -- the last line on the
19 first paragraph indicates before the divestiture of
20 AT&T the bell system supported the use of a
21 consolidated capital structure, rather than a double
22 levered capital structure.

23 And then I think there's another indication in
24 here. It says, third, a consolidated capital structure
25 is equivalent -- is equivalent to a double levered

1 capital structure when all parent subsidiaries have the
2 same amounts of leverage. And I don't know that that's
3 necessarily the case here.

4 So there -- it's -- it's not clear that this
5 is exactly the same thing as -- as a double leverage
6 adjustment. It's strong distinctions.

7 Q. Well, let me ask you in the general sense
8 without splitting hairs on the way in which you
9 consolidate a capital structure at the parent company
10 level.

11 But in -- in a general sense, a consolidated
12 capital structure is a way in which regulatory
13 witnesses have addressed or attempted to address double
14 leverage, correct?

15 A. I think that's correct.

16 Q. Thank you.

17 And as I understand, again, double leverage is
18 one of the reasons that you have identified now in your
19 surrebuttal testimony as proposing a consolidated
20 capital structure in this case, correct?

21 A. It's one of the considerations, that's
22 correct.

23 Q. Okay. To your knowledge, has this Commission
24 ever used a consolidated capital structure to reflect
25 the existence of double leverage?

1 A. Just in general discussions I -- I've been
2 told that South -- there was a Southwestern Bell case
3 where double -- where a consolidated capital structure
4 was used. But as far as specific cases and whatnot, I
5 don't -- I don't know the specific cases on that.

6 Q. And as far as your personal knowledge is -- is
7 concerned, you're -- you're not aware of that situation
8 occurring; is that right?

9 A. As far as, you know, personal experience with
10 the cases that I have worked on, both of those -- like
11 you just brought up the MGE and the -- and the
12 UtiliCorp case.

13 Those are divisional structures so
14 obviously -- obviously double leverage is not a -- is
15 not an issue there. And then the other major rate case
16 I worked on was Empire, and they're not in the same
17 structure as well, so that's correct.

18 Q. As I understand to your knowledge, the only
19 instances where the Missouri Public Service Commission
20 has recommended a parent company capital structure as
21 the appropriate capital structure for the regulated
22 utility or subsidiary are the two cases that we've
23 previously discussed, the MPS case and the MGE case; is
24 that right?

25 A. From my personal experience, that's correct.

1 Q. Okay. And would you agree with me that in
2 those cases, as we've previously discussed, Staff's
3 consolidated capital structure was predicated on the
4 fact that MPS and MGE, the operating divisions of
5 UtiliCorp and Southern Union respectively, did not
6 issue their own debt or equity?

7 A. That's correct.

8 Q. There was no mention of double leverage in
9 your testimony in those cases, was there?

10 A. No. I don't think in any of the pieces of
11 testimony in that case, that's correct.

12 MR. ENGLAND: Your Honor, I'd like to offer
13 into evidence Exhibit 101, please.

14 JUDGE THOMPSON: Any objections to the receipt
15 of Exhibit 101 -- I think the Staff attorney is out of
16 the room.

17 MR. ENGLAND: That's why I offered it, Your
18 Honor. I'll be happy to --

19 MS. O'NEILL: Your --

20 MR. ENGLAND: I'll be happy to wait.

21 MS. O'NEILL: Your Honor, I'm gonna object.
22 This appears to be opinion -- the opinions of a person
23 who's not a witness here, and is not subject to
24 cross-examination.

25 And, you know, we're up to 101 already. I'm

1 not sure how many more exhibits Mr. -- Mr. England has,
2 but Mr. Morin is not available to be cross-examined
3 regarding his opinions contained in -- in this exhibit,
4 so we would object.

5 JUDGE THOMPSON: So your objection is that
6 it's hearsay?

7 MS. O'NEILL: It's hearsay.

8 JUDGE THOMPSON: Mr. England?

9 MR. ENGLAND: Your Honor, I'm offering it as
10 rebuttal, if you will, or -- or in response to this
11 witness's position. He recognizes Mr. -- or excuse
12 me -- Dr. Morin as an authority in the area.

13 In fact, has cited him for other reasons in
14 his testimony. And I think it's entirely appropriate
15 to see what Dr. Morin has to say about double leverage,
16 since he's a recognized expert and recognized by this
17 witness as an authority --

18 JUDGE THOMPSON: Can you --

19 MR. ENGLAND: -- and, therefore, it's an
20 exception to the hearsay rule.

21 JUDGE THOMPSON: Can you point to his
22 references to Dr. Morin in his testimony?

23 MR. ENGLAND: Sure can.

24 He references Dr. Morin in his rebuttal,
25 pages 27 to 28, and his surrebuttal, pages 6 and 29.

1 JUDGE THOMPSON: Okay. Rebuttal 27 and 28,
2 surrebuttal 6 and 29?

3 MR. ENGLAND: Uh-huh.

4 JUDGE THOMPSON: I think we're gonna have to
5 wait until Mr. Snodgrass comes back and rule.

6 MR. ENGLAND: Fair enough.

7 JUDGE THOMPSON: Are you done at this point?

8 MR. ENGLAND: I'm sure -- no, but I'm at a
9 breaking -- I mean, I'm gonna change gears a little
10 bit, so if you want to break now, it'd be probably a
11 good time to do so.

12 JUDGE THOMPSON: Okay. The Commission IT
13 staff wants to get into this room before 5, so I think
14 what we're gonna do is adjourn for the day at this
15 time.

16 We'll come back tomorrow at 8:30 in the
17 morning. You'll be on the stand, and we'll pick up at
18 this point. And we'll let Mr. Snodgrass weigh in on
19 this issue, and we'll go from there.

20 Thank you very much.

21 MR. ENGLAND: Fair enough.

22 JUDGE THOMPSON: So we are in recess at this
23 time.

24 WHEREUPON, the hearing of this case was
25 adjourned until 8:30 a.m., Wednesday, December 17,

1 2003.

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2		MARKED	RECEIVED
3	Exhibit No. 19	270	
	Macias Direct		
4	Exhibit No. 20	270	
	McKiddy Direct		
5	Exhibit No. 21	270	453
6	Murray Direct		
7	Exhibit No. 22	270	
	Merciel Direct		
8	Exhibit No. 23	270	
9	Patterson Direct		
10	Exhibit No. 24	270	
	Rackers Direct		
11	Exhibit No. 25	270	
12	Staff Accounting Schedules		
13	Exhibit No. 28	270	
	LaConte Direct		
14	Exhibit No. 29	270	
15	LaConte, App. A		
16	Exhibit No. 32	270	
	Busch Direct		
17	Exhibit No. 33	270	
18	Hubbs Direct		
19	Exhibit No. 34	270	
	Meisenheimer Direct		
20	Exhibit No. 35	270	
21	J. Hagemeyer Rebuttal		
22	Exhibit No. 36	270	
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23	Exhibit No. 37	270	
24	Macias Rebuttal		
25	Exhibit No. 38	270	453
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4	Exhibit No. 40 Ahern Rebuttal	270	316
5	Exhibit No. 41	270	
6	Grubb Rebuttal		
7	Exhibit No. 42 Van Den Berg Rebuttal	270	
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10	Exhibit No. 44 Baryenbruch Rebuttal	270	
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12	Spitznagel Rebuttal		
13	Exhibit No. 46 Kartmann Rebuttal	270	
14	Exhibit No. 47	270	396
15	Jenkins Rebuttal		
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17	Exhibit No. 49	270	
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25	Exhibit No. 58 LaConte Rebuttal	270	

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3	Bolin Surrebuttall		
4	Exhibit No. 62	270	
	Burdette Surrebuttall		
5	Exhibit No. 63	270	
6	Busch Surrebuttall		
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11	Exhibit No. 67	270	
12	J. Hagemeyer Surrebuttall		
13	Exhibit No. 68	270	
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14	Exhibit No. 69	270	
15	Macias Surrebuttall		
16	Exhibit No. 70	270	
	McKiddy Surrebuttall		
17	Exhibit No. 71	270	459
18	Murray Surrebuttall		
19	Exhibit No. 72	270	
	Rackers Surrebuttall		
20	Exhibit No. 73	270	
21	Cassidy Surrebuttall		
	NP & HC		
22	Exhibit No. 74	270	
23	Hubbs Surrebuttall		
24	Exhibit No. 75	270	
	Patterson Surrebuttall		
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1 E X H I B I T S I N D E X (CONTINUED)

2		MARKED	RECEIVED
3	Exhibit No. 76 Ahern Surrebuttal	270	316
4	Exhibit No. 77 Lehman Surrebuttal	270	
5	Exhibit No. 78	270	
6	Spitznagel Surrebuttal		
7	Exhibit No. 79 Jenkins Surrebuttal	270	396
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10	Exhibit No. 81 Spanos Surrebuttal	270	
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1	E X H I B I T S I N D E X (CONTINUED)		
2		MARKED	RECEIVED
3	Exhibit No. 98	315	316
4	Schedule PMA-15		
5	Exhibit No. 100	492	493
6	Amended Staff Recommendation		
7	Exhibit No. 101	529	
8	Regulatory Finance:		
9	Utilities' Cost of Capital		
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