BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

TRANSCRIPT OF PROCEEDINGS

Order Concerning Test Year and True-Up, Resetting Evidentiary and True-up Hearings, Adopting Procedural Schedule and Concerning Local Public Hearings

December 17, 2003
Jefferson City, Missouri
Volume ??

In the Missouri-American Water)
Company's Tariff to Revise Water) Case No.
And Sewer Rate Schedules) WR-2003-0500

KEVIN THOMPSON, Presiding,
Deputy Chief Regulatory Law Judge

REPORTED BY:
Jennifer L. Leibach
ASSOCIATED COURT REPORTERS

A P P E A R A N C E S

W.R. ENGLAND, III, Attorney at Law
DEAN L. COOPER, Attorney at Law
RICHARD T. CIOTTONE, Attorney at Law
Brydon, Swearengen & England, P.C.
312 East Capitol
P.O. Box 456
Jefferson City, Missouri 65102-0456
(573)635-7166

DAVID P. ABERNATHY, General Counsel
Missouri-American Water
535 North New Ballas Road
St. Louis, MO 63141-6875
(314)996-2276

FOR: Missouri-American Water Company.

MARK W. COMLEY, Attorney at Law
Newman, Comley & Ruth
601 Monroe, Suite 301
P.O. Box 537
Jefferson City, Missouri 65102
(573)634-2266

FOR: City of Jefferson.

CHARLES BRENT STEWART, Attorney at Law
Stewart & Keevil
Southampton Village at Corporate Lake
4603 John Garry Drive, Suite 11
Columbia, Missouri 65203
(573)499-0635

FOR: The Empire District Electric Company.

LELAND B. CURTIS, Attorney at Law
Curtis, Oetting, Heinz, Garrett & O'Keefe
130 South Bemiston, Suite 200
Clayton, Missouri 63105-1913
(314)725-8788

FOR: City of Warrensburg.

A P P E A R A N C E S (con't)

JAMES M. FISCHER, Attorney at Law
Fischer & Dority
101 Madison, Suite 400
Jefferson City, Missouri 65101
(573)636-6758

FOR: Public Water Supply District No. 1 and 2 of Andrew County.
Public Water Supply District No. 1 of DeKalb County.

JEREMIAH D. FINNEGAN, Attorney at Law
Finnegan, Conrad & Peterson
3100 Broadway
1209 Penntower Office Center
Kansas City, MO 64111
(816)753-1122

FOR: City of Riverside, Missouri.

STUART CONRAD, Attorney at Law
Finnegan, Conrad & Peterson
3100 Broadway
1209 Penntower Office Center
Kansas City, MO 64111
(816)753-1122

FOR: AG Processing.

LISA C. LANGENECKERT, Attorney at Law
720 Olive Street, Suite 2400
St. Louis, MO 63101
(314)345-6441

FOR: Missouri Energy Group.

KARL ZOBRIST, Attorney at Law
TIMOTHY SWENSEN, Attorney at Law
Blackwell, Sanders, Peper, Martin, LLP
2300 Main Street, Suite 1100
Kansas City, MO 64113
(816)983-8171

FOR: St. Joseph Water Rate Coalition.

A P P E A R A N C E S (con't)

MARC ELLINGER, Attorney at Law
JIM DEUTSCH, Attorney at Law
Blitz, Bardgett & Deutsch
308 East High Street, Suite 301
Jefferson City, MO 65101-3237
(573)634-2500

FOR: City of Joplin

JAN BOND, Attorney at Law
7730 Carondelet, Suite 200
St. Louis, MO 63105
(314)727-1015

FOR: Utility Workers Union of America
Local 335, AFL-CIO.

RUTH O'NEILL, Assistant Public Counsel
P.O. Box 2230
200 Madison Street, Suite 650
Jefferson City, Missouri 65102-2230
(573)751-4857

FOR: Office of the Public Counsel
and the Public.

KEITH R. KRUEGER, Deputy General Counsel
THOMAS R. SCHWARZ, JR., Deputy General Counsel
CLIFF E. SNODGRASS, Senior Counsel
BRUCE H. BATES, Associate General Counsel
P.O. Box 360
Jefferson City, Missouri 65102
(573)751-3234

FOR: Staff of the Missouri Public
Service Commission.

PROCEEDINGS

JUDGE THOMPSON: Okay. Mr. England, I think you're up here at the podium.

MR. ENGLAND: Thank you, your Honor.

JUDGE THOMPSON: We were cross-examining the Staff's witness, David Murray, and I believe that as we closed yesterday, Mr. England offered a chapter from a book, Regulatory Finance Utility Cost of Capital by Roger A. Morin. We had an objection, a hearsay objection from Ms. O'Neill, and Mr. Snodgrass was not here, so at this time, I will ask Mr. Snodgrass if he has any objection to the receipt of that item.

MR. SNODGRASS: Absolutely, I believe it's a hearsay document, should not go into the record.

JUDGE THOMPSON: Very well, and I've had an opportunity to research this matter over the break, and I believe that it falls into the learned treatis exception to the hearsay rule, especially since Staff has itself cited this document as a learned treatis in its filed testimony; therefore, I'm going to overrule the objection. Exhibit No. 101 is received and made a part of the record in this proceeding.

Proceed, Mr. England.

MR. ENGLAND: Thank you.

CROSS-EXAMINATION

QUESTIONS BY MR. ENGLAND:

Q. Good morning, Mr. Murray.

A. Good morning.

Q. I want to switch gears on you and talk about the support agreement, which I handed out copies before, and I'm not sure that I put one up there for you. Do you have one on your own?

A. No, I don't, and I believe it's been marked Exhibit 99.

Q. Mr. Murray, at Page 11 of your rebuttal testimony, Lines 13 through 15. Are you there?

A. Yes.

Q. You state the subsidiary's use of debt financing that is backed by the parents -- excuse me, by the parent supports the Staff's recommendation to use American Water's consolidated capital structure. Do you see that?

A. Yes, I do.

Q. My first question is: Which subsidiary or which sub -- well, singular, which subsidiary are you talking about there, AWCC or MAWC?

A. I think we talked about this a little bit yesterday as far as the direct support agreement, that's with the AWCC.

Q. Okay.

A. Of course, I've maintained that Missouri-American Water Company by receiving debt from AWCC, that that's indirectly supported.

Q. Okay. But the direct support is to AWCC, not to MAWC; correct?

A. Direct support, that's correct.

Q. Okay. And I believe what I've handed you is Exhibit 99, is a copy of that support agreement. Do you have that in front of you?

A. Yes, I do.

Q. Okay. And prior to today or yesterday, have you seen that support agreement?

A. No, I haven't.

Q. Okay. But yet you testified about it at length and what it purports to be in your testimony as direct rebuttal and surrebuttal, correct, sir?

MR. SNODGRASS: I object to that characterization.

JUDGE THOMPSON: Read back, please.

MR. ENGLAND: I think maybe the words

at length are the offending words. I'll remove those from the question.

Q. (By Mr. England) You testify about it in your testimonies, do you not, sir?

A. I testify about documents that were in the finance application, WF-2002-1096, I believe. There were some documents in there regarding the financial services agreement, the promissory notes, the discussion about the type of cash management that will occur at American Water Capital Corporation, that's what I testified about.

Q. Well, but I mean, you quote from the company's annual report, and I believe you respond to some testimony from company witness Ahern regarding this very document, the support agreement; do you not?

A. Like I said, I testify as to mentions of the support agreement within various documents, which include the financing application; also the mention of the support agreement in the annual report; and also mention of the support agreement within S&P's write-up of research report on American Water Capital Corporation.

Q. Let me come at it this way, if I can, then. Other than the internal loan documents that we talked about yesterday that were attached to the financing application and this support agreement that has been marked as Exhibit 99, are you aware of any other documents that purport to provide support or guarantee between American and any of its subsidiaries?

A. I would presume this is the support agreements referred to in the application WF-2002-1096.

Q. That wasn't quite my question. Are you aware of any other agreements other than this in the internal loan documents that we talked about attached --

A. No, I am not.

Q. Thank you.

MR. ENGLAND: Your Honor, I'd like to offer Exhibit 99.

JUDGE THOMPSON: Do I hear any objections to receipt of Exhibit 99?

MS. O'NEILL: Your Honor, I'm not sure this is an objection, except maybe to foundation. I'm not sure that Mr. Murray ever testified that he was able to identify this document. If he can't identify the document, then there's no foundation.

MR. SNODGRASS: Staff would join in

that.

MR. ENGLAND: I recognize I have a problem with that, your Honor, but the witness has testified, can I --

JUDGE THOMPSON: I think he testified that he had never seen it before.

MR. ENGLAND: Correct, but he has also testified, I think for purposes of my argument I can say at length, in his testimony, and I submit that this is the best evidence if -- if you want, we can put a witness on later to identify this and lay a foundation.

JUDGE THOMPSON: I think we're going to have to do that.

MR. ENGLAND: All right.

JUDGE THOMPSON: Thank you.

THE WITNESS: If I could clarify something, within the application of WF-2002-1096, I'm not aware that the support agreement was filed with that application.

Q. (By Mr. England) I agree with you.

A. You agree with me. Okay.

Q. I'm not the one that introduced it into this proceeding, Mr. Murray.

A. Just wanted to clarify. Thank you.

Q. Let's talk about the EIERA for a second. In your surrebuttal testimony, Page 8, Lines 27 through 28, I believe, I need to get there myself to verify this. I'm sorry. It's at Lines 25 through 27.
A. Yes.
Q. Are you there?
A. Yes.
Q. And I'm going to kind of start in the middle there. You say because the EIERA funds are used to pay off short-term loans at AWCC comma the actual funds loaned by EIERA may be used for some purpose other than investment in MAWC. Do you see that?
A. Are you referring to my rebuttal or my surrebuttal testimony?
Q. I'm in your surrebuttal.
A. I thought you said rebuttal, I'm sorry.
Q. I'm sorry.
JUDGE THOMPSON: Page 8, what line?
MR. ENGLAND: It begins on Line 25, roughly in the middle.
JUDGE THOMPSON: Okay. Thank you.
THE WITNESS: Yes.
Q. (By Mr. England) Did I correctly quote

from the Lines 25 through 27 there?

A. You indicated however because EIERA funds are used to pay off short-term loans at American Water Capital Corporation, the actual funds loaned by EIERA may be used for some purpose other than investment by Missouri-American Water Company; that's correct.

Q. Okay. Would you agree with me that as a general matter, Missouri-American Water Company borrows on a short-term basis primarily to finance its construction work in progress?

A. That's what I've been -- that's what was indicated in the interview that was done September 10th.

Q. Okay. And in fact, that sort of forms the basis for your inclusion, if you will, of short-term debt in the capital structure only to the extent that short-term debt on average exceeds the average balance of construction work in progress, right?

A. That's correct.

Q. Okay. Would you also agree with me that EIERA funds are only available for specific purposes such as the planning, design, and construction of qualifying facilities?

A. I would indicate the amount to those funds are only available for certain qualifying projects.

Q. In other words, the company has to have spent money on qualifying facilities, as defined by the EIERA, before it is eligible to borrow money from the EIERA to fund that construction, right?

A. As far as my understanding of the EIERA program, it can occur in two different ways. As far as Missouri-American Water Company is concerned, I think typically they are actually expending the funds on certain projects that will qualify under EIERA and then go into the EIERA to receive a debt issuance from that program to fund that -- those projects after the fact, but there's also the possibility that certain -- certain EIERA loans will be given before projects actually occur.

Q. With the idea in mind that those funds, if provided prior to construction, will only be used for qualifying facilities, correct?

A. The amount of those funds, that's correct.

Q. Okay. You mentioned -- maybe I misunderstood you, did you mention the two loan programs of the EIERA in your answer?

A. The two loan programs?

Q. Right.

A. Can you clarify?

Q. Actually, what I'm referencing is the Staff memorandum, which is Exhibit 100, excuse me, it's the Staff's -- amended Staff recommended -- amended Staff recommendation in Case No. WF-2002-1096, which was marked as purposes of this proceeding as Exhibit No. 100.

A. I have a copy.

Q. Do you? May I approach?

A. I have quite a few papers up here now.

JUDGE THOMPSON: You may.

Q. (By Mr. England) And I'm interested in Page 2 of 7 of that memorandum or recommendation. It's in the middle of the page, sort of.

A. Yes.

Q. And it appears to me that Staff recites or kind of reviews the State Loan Program, the two loan programs. Do you see that?

A. You indicated Page 2 of 7?

Q. Correct.

A. And what paragraph are you referring to specifically?

Q. I'm sorry, the recommendation attached.

A. Okay.
Q. Take a minute, if you would, please.
A. Yes.
Q. I thought in one of your prior answers you made reference to two loan programs, and my question really was after reviewing that Staff memorandum where they discuss the two loan programs of the Missouri EIERA, if that's what you were referring to, and we may be on totally different wave lengths, but that's what spurred my question.
A. As far as the two loan programs that you just referred to, what I was indicating, I mean, I was not referring to the State revolving fund. There are two loan programs; one through the EIERA program through revenue bonds that may be issued to an underwriter if there are underwriter purchases or they may be issued through an agent.
And you're right, there is a second program, a state revolving fund. All I was indicating was with EIERA, there's two different -- they don't necessarily require that the construction not be started in order for them to release funds under any program, as far as I know. That was the distinction I was trying to make.
Q. I'm sorry, you were talking about the

timing of the funding --
A. Exactly.
Q. -- whether they get it before construction or after construction?
A. Exactly.
Q. And I'm more interested in the purpose of the funding, and I don't think you disagree with me that the purpose of the funding, whether it's through the two loan programs or whether you get it before construction or after construction, that has to be -- that money has to go to pay for qualifying facilities, correct?
A. Like I said, the amount of the money is the concern.
Q. Fair enough. I'm going to switch gears, again, on you, but we're still going to be in the surrebuttal testimony; Page 14, Lines 3 through 5, you describe Schedule 1 to your surrebuttal testimony, which shows American Water Capital structure since 1990 as well as Missouri-American's purported capital structure for the same time period. Do you see that?
A. Yes, I do.
Q. And if I look at your Schedule No. 1, and I'm more interested, I guess, in Schedule 1-2

where you have percentages, it appears that the source of your information for American is its annual reports; is that right?

A. The annual reports that are on file with the Missouri Public Service Commission, that's correct.

Q. For American?

A. No, for -- the Missouri-American Water Company's annual reports?

Q. No, I'm sorry, I was focusing first on the American Water Works.

A. American Water Works, that information is based on their annual reports --

Q. Okay.

A. -- to the shareholders.

Q. Okay. And then you got to my next line of questioning, the Missouri-American information is taken from the annual reports that are filed with this Commission; is that right?

A. That's correct.

Q. Okay. Now, I'm interested by your use of the word purported. Are you somehow saying that these are -- excuse me, are you saying that these annual reports that the company files with the Commission contain this information are somehow

inaccurate?
A. Can you refer me to where I used the word purported?
Q. Yeah, back on Lines 3 through 5 of Page 14, the very end of Line 4.
A. The annual reports that are filed with the Missouri Public Service Commission for Missouri-American Water Company, I think we discussed this a little bit yesterday, obviously you can calculate a capital structure from those annual reports, but as far as whether or not the capital structure is appropriate for rate-making purposes is what is the issue in this case.
Q. Well, let's put that aside -- that issue, if you will, aside. I'm more interested with the accuracy of these numbers. These are not purported numbers, these are actual numbers that the company has filed with the Commission under oath for these -- for this ten-year period of time, correct?
A. These are actual numbers that include equity investments from the parent company, which could include all sources of financing from that parent company, so my position is that you have to take into consideration the fact that the equity that Missouri-American Water Company purports to have in

its capital structure is based on investments in the common equity of the subsidiary by the parent company.

Q. I don't believe that was my question, Mr. Murray.

MR. ENGLAND: Could I have it read back, please?

(THE PENDING QUESTION WAS READ BACK BY THE COURT REPORTER.)

Q. (By Mr. England) Can I have an answer to that question?

A. Those are actual numbers that they have filed.

Q. And you have no reason to dispute the accuracy of those numbers, do you, sir?

A. The accuracy of how those numbers were calculated; no, I do not.

Q. And we've also established in response to your earlier answer, that was not responsive, that part of this equity is actually internally generated funds, over 50 percent of it, correct?

A. We discussed that yesterday, that's correct.

Q. Which is not infused by the parent as you state?

A. That's correct.

Q. Okay. Apparently this comparative analysis that you show on Schedule 1 on these two pages of Schedule 1 is significant to you and your recommendation to use a consolidated capital structure; is that correct?

A. That is correct.

Q. Okay. Yet, you did not make this comparison for purposes of your direct or rebuttal testimony in this case, did you, sir?

A. That's correct.

Q. In fact --

A. Excuse me. I didn't make a comparison back to 1990 through 2002. As far as in the rebuttal testimony, I discussed American Water's -- American Water Works' capital structure for the previous five years and compared that to what Missouri-American Water Company is requesting in this rate case, so even though I didn't do the extensive capital structure comparison, I did my surrebuttal testimony all the way back to 1990.

I did reference the fact that American Water Works has consistently been financed with equity right around the 35 percent level and that compares to the approximately 43 to 44 percent that

Missouri-American Water Company is requesting as its capital structure.

Q. I'm sorry, say that again, please. The 35 percent average equity ratio at American compares with what?

A. Compares with what is requested by Missouri-American Water Company that the 43 to 44 percent, I can't remember a specific number, but that's in, I think, Ms. Ahern's testimony.

Q. I'm sorry, when you say compares, it doesn't necessarily equal, they're just --

A. No, they don't equal, it's just to give an idea as to what the difference is.

Q. Okay. Now, you looked at -- for purposes of your direct testimony, you looked at five years of capital structures for purposes of American, correct?

A. For purposes of American, that's correct.

Q. And for all but the one you used, the equity ratio averaged 35 percent, but you chose to use December 31st, 2002, which was 30 or 31 percent, right?

A. I believe that's the equity ratio that was in the comparison on historical capital structures. The actual common equity ratio that I used in my direct testimony is 31.85 percent.

Q. Fair enough. Your proxy group has roughly 45 percent equity, right, on average?

A. That's correct.

Q. Now, for purposes of comparison at the time you prepared your direct testimony and at the time you prepared your rebuttal, you were not aware of the capital structure for Missouri-American for that same five-year period of time, were you, sir? You had not done that analysis.

A. Other than looking at the prior case as far as the, I think the last, was it WR-2000 -- I don't recall specific case number, but as far as what the equity ratio was in that case, no, I didn't do a five-year analysis.

Q. In fact, when I specifically asked that information in the data request for five years of capital structures for Missouri-American, you objected through counsel saying that that was unduly burdensome as I recall, correct?

A. Yes, because I felt that that was information that Missouri-American Water Company had available to itself, since they filed those reports with the Commission, and that's information that they have at their company.

Q. But apparently sometime between the filing of your rebuttal and surrebuttal testimony, you decided that that information was significant and would burden yourself to prepare that; is that right, to make that comparison?

A. I felt it was significant because looking at the annual reports for American Water, I realized that the actual mix of capital financing on a consolidated basis was showing more leverage than Missouri-American Water Company had at its subsidiary level.

Q. That has existed for ten years, though, hasn't it?

A. What has existed for ten years?

Q. More leverage at the parent level than at the subsidiary level.

A. Yes, it's existed for over ten years.

Q. Right, and we've had a number of rate cases over that period of time, yet this is the first time you've decided to make something of it and propose a consolidated capital structure as opposed to using Missouri-American's actual capital structure, correct?

A. Things have changed since the last rate case, which includes the American Water Capital Corporation formation, so there's another twist, if you will, with how this company's receiving its financing.

Q. Well --

A. And there's so there's several considerations that have to be taken that have to be thought about in whether or not to recommend a consolidated versus subsidiary capital structure; and one of those is existence of double leverage, and now, the other consideration that was not considered in the other cases because this situation was not in existence at that time is the fact that American Water Capital Corporation has been formed and American Water Capital Corporation is issuing debt on an aggregate basis, providing that information to the subsidiaries of its operation, and so there's just one more thing to look at to determine whether or not this is appropriate to use Missouri-American Water Company's capital structure.

Q. The only thing that's changed is the American Water Capital Corporation's come into existence since the last rate case, right?

A. That's the only thing that has changed since the last rate case, that's not the only consideration to think about.

Q. Okay. But the leverage at the parent level versus the leverage at the subsidiary level has remained the same, fairly constant, as shown by your ten-year average there on Schedule 1, correct?

A. Over a ten-year average; that's correct.

Q. And we've determined that American Water Capital was formed for the purposes of consolidating the debt needs of all the subsidiaries so they can have access to the debt market at lower rates than they otherwise would on an individual subsidiary basis, right?

A. That's correct.

Q. So by forming American Water Capital Corporation, the parent company has tried to provide a source of debt funds to the subsidiaries that is less than they could otherwise obtain on their own, correct?

A. That's the intention of forming American Water Capital Corporation, that's correct.

Q. And your primary response to that is to propose a capital structure to this Commission for rate-making purposes that has only 35 percent debt as opposed to an actual capital structure that has 43 to

44 percent, correct?
A. 35 percent equity, that's correct, and the reason why that is recommended is because that is what, based on considerations that we've made, this truly reflects the cost of capital that this company is incurring.
Q. Well, let's talk about the effect of your consolidated capital structure. I've got a difficult question I need to ask you, so I'm going read it to you.
Would you agree that your recommended overall return of 6.67 percent to 7.03 percent will produce a return on equity for Missouri-American that is less than your recommended return on equity in this case of 8.36 percent to 9.26 percent, if your overall return is applied to Missouri-American's capital structure as shown in Mr. Burdette's surrebuttal testimony?
A. First, the range that I recommended was 8.26 to 9.26, not 8.36 to 9.26, and I'm aware of the calculation that the company has done to back into a number that indicates a 6.96 percent return on common equity. That is a backed into number assuming that Missouri-American Water Company's capital structure is the appropriate capital structure for rate-making

purposes, and obviously that's where we disagree.

Q. Well, let me stop you there, then. For a hypothetical, assume that Missouri-American capital structure is the appropriate one for rate-making purposes. Would you agree with me, then, that we'll not be able to achieve the 8.26 to 9.26 return on equity that you have proposed if it's only going to be applied to 35 percent equity as opposed to 45 percent equity?

A. If you want to assume that that's the appropriate capital structure; however, I'm concerned with the way this -- and I'll have to pull out the testimony that backs into this number, I'm actually kind of concerned about how this number was achieved.

Q. I'm not asking you -- I'm just asking you in relative terms to comparative terms.

A. In order to be able to indicate whether or not I agree with the 6.96 number, I have to tell you that --

Q. I'm sorry, I'm not asking you to agree, I know you don't agree to the 6.96 number, I'm just saying in relative terms, it's going to -- the return on equity is going to be less as a practical matter than your recommended range, if we use your -- only use 35 percent equity in the capital structure.

A. If you want to assume that Missouri-American water Capital -- excuse me, Missouri-American water Company's capital structure is appropriate.

Q. Okay. That was my assumption. Thank you, sir.

A. Okay.

Q. Now let's talk about short-term debt. At surrebuttal, Pages 23 -- or excuse me, Page 23, you have a discussion of it, but I'm focusing on Lines 13 and 14.

A. Yes.

Q. You stated that you used American Water's consolidated short term debt and CWIP information for purposes of determining the appropriate amount of short-term debt to put into the capital structure, correct?

A. That's correct.

Q. Okay. And I want to make sure I understand what's going on here. So in other words, you looked at all of the short-term borrowings of the subsidiary operating companies on a consolidated basis, compared that to all of their construction work in progress balances on a consolidated basis, am I --

A. That's correct.

Q. -- correct so far? Compared those and to the extent the short-term balance exceeded the construction work in progress balance for all those subsidiaries, utilized the excess, if you will, of short-term debt over construction work in progress.

A. That's their typical procedure for determining the short-term balance, that's correct.

Q. Except your typical procedure for doing that is using the company's -- individual company's specific short-term debt and the individual company in this case, Missouri-American's, specific CWIP?

A. If the circumstance is appropriate, that's correct.

Q. Also, I want to understand that do you disagree with, I believe, Mr. Burdette's surrebuttal testimony, that if you look at Missouri-American only, and at the balance of short-term debt versus the balance of construction work in progress for the most recent twelve-month period of time, short-term debt does not exceed construction work in progress?

A. I assume that's correct, but I'm focused on, obviously, American Water's consolidated capital structures, those are secondary issues for me.

Q. Okay. But you don't have any reason to believe that that's an inaccurate statement or fact scenario, correct?
A. I assume Mr. Burdette analyzed that information and determined that to be reasonable.
Q. Okay. You also assume he's using correct numbers in making a correct analysis?
A. Obviously as far as the short-term debt.
Q. Yes, let's limit it to that.
A. Because there's other things in this case.
Q. I understand. After I asked that question, I need to be a little bit more focused, I just was talking about the short-term debt.
A. I assume with the short-term debt that he has a standard policy that he uses to determine whether or not he wants to -- or he feels it's appropriate to include short-term debt, and I presume he's been consistent with his methodology there.
Q. My question is: Is it accurate or do you have any reason to believe it's not accurate?
A. I don't have any reason to believe it's not accurate.
Q. Now, the way in which he does it is

essentially the same way Staff does it, you've just applied it at the consolidated level, and he's done it at the company specific level?

A. No, we don't do it the same way as far as -- let's say, for instance, that we agreed on the appropriate capital structure as far as what subsidiary consolidated.

I believe a lot of times Mr. Burdette will look at some averaging method, and I believe he's indicated before that if short-term debt is less than two percent, that he'll go and exclude it. Our typical procedure is if short-term debt exceeds CWIP, we'll include whatever amount, so we're not -- we don't agree on the specific methodology on how to do that.

Q. Would it be fair to say you agree on the theory, but the way in which you apply it may vary a little bit between the two?

A. When you indicate that, I assume you're talking about CWIP and short-term debt.

Q. To the extent short-term debt exceeds CWIP, you believe it's appropriate?

A. Yes, I believe we agree with that.

Q. Let me get back to them, what you've done here. Would you agree with me that to the extent the other operating subsidiaries, other than Missouri-American, use greater amounts of short-term debt in the financing of their operations and that exceeds their construction work in progress balances, you have imputed by the use of the parent company capital structure, in this case, that excess, if you will, of short-term debt that essentially has been borrowed by the other subsidiaries?

A. Yes, that's consistent with using a consolidated capital structure.

Q. Even though Missouri-American specifically may not have short-term debt in excess of construction work in progress?

A. Yes, I'm not focused on Missouri-American Water Company's individual financial circumstances.

Q. Let me move to another subject. Is it fair to say that one of the tests, not necessarily the test, but one of the tests you used to test the reasonableness or sufficiency of your recommended return is to perform an interest coverage calculation?

A. That's correct.

Q. And I believe you did that on Schedule 22 to your direct testimony.

A. That's correct.
Q. Would you agree with me that the calculations shown on Schedule 22 entitled Proforma Pre-Tax Interest Coverage Ratios for Missouri-American Water Company is actually a calculation using American Water Works' information?
A. I'm using American Water Works' consolidated common equity information to develop a pre-tax interest, along with the interest expense of American Water Works in order to approximate what a pre-tax interest coverage ratio would be for Missouri-American Water Company.
JUDGE THOMPSON: Is that a yes?
THE WITNESS: Yes.
Q. (By Mr. England) And so it would be fair to say that you have not performed an interest coverage calculation specific to Missouri-American, have you?
A. Not specific to the capital structure information that Missouri-American provides to the Missouri Public Service Commission.
Q. Okay. Would you agree with me that for purposes of its indenture -- Missouri-American's indenture interest coverages must be calculated on Missouri-American's specific information?

A. I believe that's what those indenture agreements indicate.

Q. Now, let me take -- I need to give you a copy, may I have a second?

JUDGE THOMPSON: You may.

Q. (By Mr. England) I want to go back to the Staff recommendation in the financing case. I think it's Exhibit 100, unless you found yours, there's one.

I'm interested in Staff's recommendation where I guess it -- the memorandum that's attached, if you will, to the recommendation, so we're clear, Page 5 of 7, the very last paragraph. Take a minute to just kind of review that, if you would, please. I have a couple of questions.

JUDGE THOMPSON: What page are we at, Mr. England?

MR. ENGLAND: It's the memorandum attached to the recommendation Page 5 of 7, last full paragraph.

JUDGE THOMPSON: Okay. Thank you.

THE WITNESS: I've read that.

Q. (By Mr. England) Okay. Would you agree with me that for purposes of Staff's review of that proposed financing, it first calculated the effect of the proposed financing on Missouri-American's specific capital structure and that's discussed briefly at the bottom of Page 5 of 7, and also the calculation is performed on Attachment A?

A. Yes.

Q. Okay. For purposes of its recommendation, there's no mention, is there, of American Water Works' capital structure, and the effect this financing might have on American?

A. I don't even see any specific mention of American Water Works.

Q. Also, as part of Staff's analysis and described briefly there in that last paragraph on Page 5 of 7, Staff discusses a calculation of coverage ratios that it performed on Missouri-American specific information, and I believe that is more specifically detailed in Attachment B, correct?

A. That's correct.

Q. Would you agree with me that Staff's proforma ratio shown there on Attachment B is an attempt to show what the purposed financing or the effect, if you will, the proposed financing will have on Missouri-American's existing revenues and earnings?

A. That's what that analysis shows, it's looking at Missouri-American specific information.

Q. Okay. And based on the information that existed at the time the application was made?

A. Yes.

Q. In other words, it didn't proforma in any additional revenues, nor did it proforma in any decrease in revenues, correct?

A. That's correct.

Q. Okay. And the proforma interest coverage calculation using Missouri-American specific information at that time with no proforma increase or decrease in revenues or increase or decrease in earnings was 2.07 times, correct?

A. That's correct.

Q. So here's my question.

MR. SNODGRASS: Judge, I'm going to object to this line of questioning. I don't understand the relevance of it.

JUDGE THOMPSON: Mr. England.

MR. ENGLAND: It's extremely relevant, your Honor. This witness has tested the reasonableness of his recommended return on equity using interest coverages performed at the parent company level and not at the subsidiary company regulated company level, and I think I'm entitled to inquire regarding that, and I think it goes to the overall recommendation and the sufficiency or lack thereof, if he has not performed an interest coverage calculation for the specific regulated company.

JUDGE THOMPSON: Mr. Snodgrass.

MR. SNODGRASS: I believe Staff's procedure on recommendation and finance cases is that those recommendations are specifically conditioned that they're not related for rate-making purposes. There is a condition usually placed on those Staff recommendations that they should not be used for rate-making purposes.

MR. ENGLAND: I will stipulate that that recommendation is in this -- that that recommendation is in Staff's pleading, I believe, and if it's not in its pleading, it's certainly in the Order that was issued in this case.

I'm not trying to bind Staff or anyone else with what they did here, I'm just trying to show that for purposes of financing, Staff has no problem, and in fact, apparently believes it is appropriate to look at the regulated company's earnings and interest coverage ratios, yet for purposes of rate-making, all of a sudden, this is no longer relevant or of significance.

JUDGE THOMPSON: Objection is overruled, proceed.

Q. (By Mr. England) I think I had an answer to my question, so my next question was if Staff was projecting coverages of 2.07 in August of 2002 based on revenues and earnings at that time, wouldn't those coverages be even less based on Staff's recommendation in this case that the company reduced its revenues and earnings by 20 million dollars?

A. I'd have to do an analysis of that. I don't know that I could just, you know, without looking at specific numbers and looking at this in some more detail.

Q. You indicated intuitively come to that conclusion that with 20 million dollars less revenue, that's got to have a downward impact on coverages?

A. This is proforma capitalization ratio calculations here were done as of May 31st, 2002. We are -- we're much beyond that, and as far as specific financial type of changes that have occurred since that point in time, I don't know that, like I said, without looking at some specific numbers, I can affirm that.

Q. Okay. The fact of the matter, though, I think you would agree, is that we do not know based on the record in this case, what effect Staff's proposed 20 million dollar rate reduction will have on the company's ability to cover its interest requirements, correct?

A. I don't believe that's correct, and let me point out this proforma capitalization analysis was done as of May 31st, 2002. The American Water capital corporation debt financing that was allocated down to Missouri-American Water Company has occurred after this point in time, so while this was something that was done as of May 31st, 2002, that was before the debt was received by AWCC, but as far as coming up with an approximation of interest coverage calculation for Missouri-American Water Company, I do believe that Schedule 22 reflects that.

Q. I thought we decided Schedule 22 only has American information, it has no Missouri-American specific information.

A. We established that that doesn't have Missouri-American specific information, but we didn't establish that this is not a reasonable approximation as to what the coverage might be.

Q. Okay. Well, let me go back and correct a couple of things you said or think need to be corrected. First of all, the Staff's memorandum was prepared, it appears, on August 14th, 2002, rather than that May date you referenced.

A. Yes, but the financial information is as of May 31st, 2002.

Q. And secondly, Staff takes into consideration in the proforma interest coverage calculation the very debt you were talking about, correct, that's the whole purpose?

A. That's correct.

Q. Okay.

A. I don't disagree with that.

Q. And then, finally, I'm not sure that I got an answer to this question, but there is nothing in the record that shows what coverages will be specific to Missouri-American, if the company is required to reduce revenues and earnings by 20 million dollars, correct?

A. I did not use Missouri-American Water Company's specific information in the pre-tax coverage calculation.

Q. And therefore, there was nothing in this record that shows the impact of the Staff's proposed 20 million dollar rate reduction on the --

on this company's interest coverages, correct?

A. I disagree, this is an approximation of what the interest coverage would be for Missouri-American Water Company, whether or not you want to, you know, indicate that the company's specific information was used or not. If it wasn't -- if it wasn't something to give some type of approximation as to what the coverage would be, I wouldn't include it as a schedule.

Q. Well, let's do a rough analysis here. The common equity for American Water Works as shown on Schedule 22 is 1.8 billion dollars; is this right?

A. That's correct.

Q. What's the common equity for Missouri-American?

A. As provided in response to DR 3819 from Missouri-American Water Company, the common equity of Missouri-American Water Company, or at least the alleged common equity of Missouri-American Water Company, is 220 million -- two hundred twenty-one million, seven hundred fourteen thousand, one hundred and eight.

Q. Right. Those two numbers, 1.8 billion and 220 million, are certainly not comparable, are they, sir?

A. It's a significant difference.

Q. And then you claimed that was the alleged, why do you say that, sir?

A. I think we've talked about some of these issues, as far as the double leverage issue, that's one of the reasons why -- that's one of the considerations in determining whether or not to utilize consolidated capital structure, and because of the fact that American Water has debt at its level and Missouri-American Water Company has debt at its level, there's double leverage because of the fact that American Water invests in the equity of Missouri-American Water Company that -- I know you've pointed out already that there's a certain amount that's retained earnings, but there's also no doubt that a certain amount of that is equity infusions from the parent company, so the reason why I indicate that that is alleged purported capital structure is because of the fact that there's -- debt financing can be used to invest in the equity of Missouri-American Water Company.

Q. You're not saying that that isn't the amount of equity in -- the actual amount of equity on the books and records of Missouri-American Water Company, are you?

A. I'm not -- that's the actual amount of equity that's shown in the balance sheets that are filed with the Missouri Public Service Commission.

Q. And that's also the amount of equity that's shown on the books and records of the company, correct?

A. As far as the books and records of the company, no -- the only information I've received from Missouri-American Water Company is the statements that are filed with the Missouri Public Service Commission.

I don't even know any other entity that Missouri-American Water Company files its financial statements with besides us, so if Missouri-American Water Company's internal financial statements are the same as what is filed with Missouri Public Service Commission, then I have to assume that that's correct.

Q. And doesn't the company file with an officer's signature under oath that the information contained in those annual reports is true and correct to the best of their knowledge, information, and belief?

A. I'll agree with you.

Q. As you can understand, I'm having a

little problem with your term allege because it -- it appears that you are challenging the accuracy of these numbers that have been filed with the Commission for a number of years.

A. No, I'm not challenging the accuracy of the numbers. I'm just challenging whether or not that can be considered truly common equity because of all the things that are going on with this company.

Q. Let me get back to Schedule 22, so we've established that there's a wide disparity between the common equity of the parent company at the consolidated level and that of the Missouri-American subsidiary level, right?

A. Yes.

Q. How about Line No. 7, annual interest cost, American Water Works' annual interest appears to be in the neighborhood of 227 million dollars. Do you see that?

A. Yes, I do.

Q. What's the comparable figure for Missouri-American Water Company?

A. I'm going to have to rely on a response from Missouri-American Water Company to give you this interest cost amount, and the reason why I say I have to rely on, and I hope it's all right that I qualify this, I assume it is, the reason why I say that the reliance on this is a concern of mine is I notice that the -- the debt issuance that's allocated down from American Water Capital Corporation is accosted at 5.65 percent, and I had come across something in the American Water's annual report, and also in the DR response from Missouri-American Water Company that indicated that s of the issue date of June 12th, 2002, that only 40 million of the aggregate amount had been closed on as of that date.

However, within the response to Missouri-American Water Company's DR 3802 from Staff, there's a total amount of indicated of 56 million that's accosted at 5.65 percent, I'm not sure where that other 16 million -- what that cost should be because it appears from reading of American Water's annual report and DR responses from the company that that 16 million at 5.65 percent was not indeed available to be given to Missouri-American Water Company, so I indicate that because I just think that these interest costs need to be taken with a grain of salt, but the interest cost that is indicated in response to DR 3802 is sixteen million, seven hundred twenty thousand, five hundred forty, which includes that allocated debt issuance amount of 56 million, which I'm not even sure at this point of time whether 5.65 percent is even the appropriate cost to assign to that.

Q. Is that an I don't know the actual interest cost of American or you believe it to reasonably be the 16 million dollar figure the company provided to you in response to a data request?

A. My answer is I doubt that that's the accurate number. The amount that's indicated in response to DR 3802 is sixteen million, seven hundred twenty thousand, five hundred forty, but like I said, that 16 million over the 40 million, which was actually closed on, as of June 12, 2002, I don't know where they got that money from.

Q. In fact, you don't know what the annual amount of interest company pays is, do you?

A. I don't have confidence in the numbers that they provided to me, that's correct.

Q. When I asked that information in response to a data request, do you recall objecting on the grounds that that was unduly and unnecessarily burdensome?

A. Once again, I think what I indicated was this is information that I received from the company. I have to perform discovery from the company to get this information, so obviously this information is in possession of the company. If I have information that's in my possession, I don't ask the company to provide me that information.

Q. The fact of the matter is you don't know what interest expense is for this company, correct?

A. I said I'm not confident in that number.

Q. Okay. You don't know what it is?

A. I don't know what it is.

Q. Okay. As a result, you don't know what interest coverages are for this company today or what they would be with the projected 20 million dollar rate decrease, do you?

A. The approximation was given on Schedule 22, and that's what I used as my test of reasonableness.

Q. Which we established is American's figures and not Missouri American?

A. We have established that.

Q. So you don't know what the affect will be on Missouri-American, do you, sir?

A. No, I don't agree with that, the

approximation I give in Schedule 22 indicates that for a triple B rated water utility is going to fall within those targets shown on the triple B rating of 1.8 to 2.8, that these coverage ratios comfortably fall within that range.

Q. This is the only information you have in your testimony, in any one of your three testimonies, that you believe demonstrates the effect of your recommended returns on the interest coverages of this company; is that right?

A. This is not the only information.

Q. On interest coverages, sir.

A. No, as far as on interest coverage, I'm addressing interest coverage, as with the 696 number, Ms. Ahern backed into some other numbers for what she thought that the interest coverage would be for Missouri-American Water Company, and based on her numbers, it's actually higher than what I estimated based on American Water's information.

Q. But apparently you're not confident in anybody else's numbers because they are examining Missouri-American Water Company and you're not, right?

MR. SNODGRASS: I'm going to object to that I think that's argumentative.

MR. ENGLAND: It probably is, I'll withdraw the question.

JUDGE THOMPSON: Sustained. Move on, please.

Q. (By Mr. England) I think my original question, and I'm not sure I got an answer to it was that the only information you have, and I'm talking about you, Mr. Murray, regarding interest coverages for this company are based on the data that you have in Schedule 22 of your direct testimony, there's no other interest coverage calculations other than that, are there?

A. That's the analysis I have done, that's correct.

Q. Okay. Thank you, sir.

MR. ENGLAND: I have no other questions.

JUDGE THOMPSON: Thank you, Mr. England.

MR. ENGLAND: And I need to check and see what my exhibits are that are outstanding, I know that I have one that I need to lay a foundation for.

JUDGE THOMPSON: Okay. Let's see here. The support agreement you need to lay a foundation for, that was offered and there was an objection and we decided you were going to put a witness on to prove the foundation, 100 has been offered and received, 101 has been offered and received, 98 was offered and received.

MR. ENGLAND: I think that covers them, your Honor. One other matter, perhaps to shorten the proceeding, Counsel reminds me that as part of my objection to a portion of Mr. Murray's testimony yesterday --

JUDGE THOMPSON: Right.

MR. ENGLAND: -- I thought I had agreement among the parties, or at least Staff, to make the support agreement part of the record. Is it necessary for me to go through the -- lay the foundation for that?

JUDGE THOMPSON: That's my memory, too, as a matter of fact.

MR. SNODGRASS: I don't believe OPC took part in that agreement.

MR. ENGLAND: Well, maybe I could eliminate --

MR. SNODGRASS: They're making the objection. They're the primary objector.

JUDGE THOMPSON: Let's go ahead and put on the witness to identify the support agreement.

MR. ENGLAND: I'm not sure that I have them here in the room right now, we may have to do that later.

JUDGE THOMPSON: We have several days left, and I'm sure he'll be here eventually or everyone will be worn down at the end that the objection will dissipate.

Okay. We're ready for questions from the bench. Commissioner Murray.

COMMISSIONER MURRAY: Thank you, Judge.

QUESTIONS BY COMMISSIONER MURRAY:

Q. Good morning, Mr. Murray.

A. Good morning.

Q. I just have a few questions for you. My first one is just a very basic question. Because debt is cheaper -- well, first of all, would you agree debt is cheaper than equity?

A. Yeah, most cases it usually is.

Q. And in this case it is; is that correct?

A. Yes, it is.

Q. And because debt is cheaper than equity, capital structure that uses less equity or shows less equity would result in a lower weighted cost of capital; is that right?

A. That's what is occurring in this case, that's correct.

Q. And that results in a lower revenue requirement overall?

A. That's correct.

Q. And the reason that you apply that calculation using the consolidated structure this year, as I understand it, is simply that AWCC has come into the picture since the last rate case; is that right?

A. That's what prompted the consideration. There were several other issues that we looked at in addition to that. It just added one more item to look at to determine whether or not consolidated capital structure is appropriate versus the subsidiary capital structure.

Q. Although you keep mentioning several other things that you looked at, that is, indeed, the only change, is it not?

A. That's the only change since the last rate case, that's correct.

Q. And then you were requested yesterday, I believe, about your -- I think it was some testimony that you had filed in another case related to a consolidated capital structure versus a -- an individual company's capital structure.

A. I believe that those were the UtiliCorp and Southern Union company's, and they have the different -- they have divisional -- it's a divisional operation, so they -- they call their capital structures allocated capital structures, which I think this Commission is fairly familiar with now after the Aquila case.

Q. And with regard to the testimony that you made in that case, you were asked to read from yesterday, and your statements about the fact that if a, I believe -- well, anyway in one of those cases, you said that if the regulated company had been a subsidiary versus a division of the parent, then the individual capital structure would have been appropriate. Do you remember that?

A. I believe what I stated is if the -- if the sub -- if it was a subsidiary that issued its own debt, that, you know, that it -- it might be appropriate to go with a -- with a subsidiary capital structure.

Q. And was it not established here in cross-examination that Missouri-American issues its own debt?

A. That was established, but one of the

considerations that I had to look at is whether or not the subsidiary actually issued all of its own debt, and that's actually the point of contention here.

This subsidiary does not issue all of its own debt. American Water Capital Corporation is an aggregate financing mechanism for American Water Works subsidiaries; therefore, as of this point in time, Missouri-American Water Company, at least in my mind, because it does not go out to the public debt markets and issue debt specifically in its name, that things are changing for this company, and that's why we had to take some of those things into consideration as to whether or not a consolidated capital structure should be used versus a subsidiary capital structure.

Q.   And the results of issuing the debt by AWCC is that they get a cheaper rate; is that correct?

A.   They can get a cheaper rate, that is the idea is of trying to aggregate the financing of all their subsidiaries at the financing arm.

Q.   You are the only -- Staff is the only party in this case that is recommending a consolidated capital structure; is that correct?

A. That's correct.

Q. I'd like to -- for you to look at your testimony on your direct testimony on Pages 18 -- rather, it's the top of Page 19. You made a correction in that testimony when you were first on the stand yesterday.

A. Yes.

Q. Do you recall that?

A. Yes.

Q. And what you did, it appears, was take out the citation, take out the support for the statement, and the statement is in quotes, so who's being quoted there?

A. If you go to the first line on -- actually Line 18 on Page 18 of the first paragraph, excuse me, of that paragraph. It says on July 15th, 2003, Standard & Poors affirmed its A plus long-term corporate credit rating on Thames Water PLC. Standard & Poors also subcites support from its parent, RWE, so these statements are from Standard & Poors.

Q. All right. And the citation you took out was from Standard & Poors, was it the fact that you had cited the wrong date or the wrong document from Standard & Poors? Why was the citation removed?

A. It's because I cited the wrong date. The date of the Standard & Poors research report is July 15th, 2003.

Q. Okay. So it's simply -- rather than taking it out, wouldn't it have been better to have just changed the date?

A. Could have done that.

Q. Okay. On your exhibit -- your Schedule 9 to your direct testimony, the amount that you show -- I'll let you go there first.

A. I'm there.

Q. The amount that you show for short-term debt and this is the consolidated -- or no, let's see --

A. This is consolidated.

Q. Okay. Is it -- is that amount the amount that short-term debt exceeds the CWIP balance?

A. Yes, it is.

Q. And -- and by the way, that was the CWIP balance -- that was the short-term debt and the CWIP balance were all at the --

A. Consolidated operations, that's correct.

COMMISSIONER MURRAY: I think that's all I have. Thank you.

THE WITNESS: Thank you.
JUDGE THOMPSON: Thank you, Commissioner. Commissioner Forbis.
QUESTIONS BY COMMISSIONER FORBIS:
Q. Good morning.
A. Good morning.
Q. Just some overview questions, which might tax my ability to comprehend some of these things, but in this vault of material, do you have any information or knowledge what other states are doing with regard to ROR and ROE, the kind of numbers the last year or two that they've been allowing water companies in similar cases?
A. Other than some general knowledge, no.
Q. General knowledge, would your sense be that it's -- that what other states are doing are greater or less than what's being recommended here, if you got that?
A. I'm really not sure.
Q. Okay. We've talked some about ISRS, too. I don't think -- you didn't make any adjustments for ISRS in your calculations, right?
A. No, and I didn't even address it in my testimony.
Q. Okay. Some other witnesses in their

testimony have suggested that with ISRS, perhaps you might want to move to, say, the lower range of -- the lower end of the range, but not really change the calculation. Would you see anything happening with ISRS in your suggestion or just wouldn't even be a part of it?

A.   No, when you do a proxy group analysis, there are all sorts of different nuances and risk factors and situations going on with each and every company. You can focus on one issue on all these companies, but there may be a variety of issues that are going on in any regulatory jurisdiction at any given point in time, and our position is that's why you do a proxy group analysis.

When you do a proxy group analysis, the most important thing is the fact that all these utilities are in the water utility industry, and to try to get into all the specifics of what's going on in, say, 50 different jurisdictions can be pretty overwhelming, so if you pull a proxy group that's within that industry, then we have confidence that that reflects the general risk level of water utility companies.

Q.   So you wouldn't make any adjustment then?

A. No, I'm not recommending any adjustment.

Q. Okay. The numbers that Staff's recommending, you're confident that that would be sufficient to continue to spur investment in the company or do you think investors might choose to go elsewhere?

A. I'm recommending that they be able to recover their cost of capital, and in my mind, that is my responsibility to recommend to the Commission what is the cost of capital to Missouri-American Water Company and, you know, commonly understood finances, if a company can recover its cost of capital, then it will invest in its operations.

MR. SNODGRASS: Just a point of clarification. Do you mean investors will invest?

THE WITNESS: Yes.

MR. SNODGRASS: I thought you said the company.

THE WITNESS: Oh, did I? Investors, I'm sorry.

Q. (By Commissioner Forbis) If the company recovers its cost, then investors will be attracted to it?

A. Yes, because that is the required rate of return of investors.

Q. Okay.

A. Cost of capital and required rate of return are synonomous.

Q. And when other jurisdictions make similar decisions with regard to their regulated utilities, that's the same argument they would use if the company is recovering its cost of capital, then investors will come to it. Do they build any other kind of incentive in other than that?

A. I believe most jurisdictions are looking at cost of capital analysis in determining whether or not that's a fair and reasonable rate of return. Of course, there may be a difference as to what that cost of capital is, just like even with a company in OPC here, there's differences in the various jurisdictions.

Q. Okay.

COMMISSIONER FORBIS: That's all I've got. Thank you.

THE WITNESS: Thank you.

JUDGE THOMPSON: Commissioner Clayton.

QUESTIONS BY COMMISSIONER CLAYTON:

Q. Good morning, Mr. Murray.

A. Good morning.

Q. As the new kid on the block, I need some historical perspective, if you could help me with that. How long have you been with the Commission?
A. Three and a half years now.
Q. Three and a half years. Are you familiar with past cases involving Missouri-American Water?
A. I'm more familiar with their last case, vaguely familiar with two or three cases prior.
Q. What year was the last case?
A. 2000.
Q. Okay. And before that?
A. I believe there was a case in 1997, case in 1995, and when I say Missouri-American, I'm talking specifically about Missouri-American. I know St. Louis County Water was recently acquired by Missouri-American.
Q. Okay. And the last rate case for Missouri-American Water, their capital structure was organized as a stand alone corporation rather than the consolidated method, correct?
A. Yes, it was based on the subsidiary structure, that's correct.
Q. Are you aware of what was used in the

'97 case?
A. I believe the subsidiary capital structure was used in the '97 case as well.
Q. And the case prior to that?
A. I believe in the case prior to that, the subsidiary capital structure was used.
Q. Okay. Are you familiar with the capital structure of other utilities operating in the state of Missouri?
A. Yes, I am.
Q. We've discussed or you all have discussed the structure of MGE and its parent company and it uses a consolidated capital structure, correct?
A. We recommend a consolidated capital structure, that's correct.
Q. What was actually Ordered by the Commission?
A. The Commission has decided that the -- at least as far as the UtiliCorp case, which --
Q. Well, let's take -- hold on now.
A. I'm sorry.
Q. Hold on now. Let's take one at a time. We started out with MGE, what did Staff recommend and what did the Commission order?

A. With MGE, the Southern Union case, the last case was settled, so the Commission didn't order anything on that capital structure.
Q. Then what was the structure as part of the Order?
A. I don't believe the Order addressed that because it was a settled case.
Q. Okay. Well, what was used in determining rates?
A. As far as the Staff's recommendation, the consolidated capital structure was used in determining what the --
Q. Okay. And it was agreed to by the company?
A. No, no, the company normally doesn't agree with the consolidated capital structure.
Q. And then how about in the UtiliCorp case?
A. The UtiliCorp, I can tell you -- I worked on the last UtiliCorp case, and that was also settled, so there wasn't any specific comment, I believe, in the Order as result of the stipulation agreement, but I do know in the 1997 case in UtiliCorp, that the Commission specifically Ordered that the consolidated capital structure was

appropriate.

Q. How about in the case of AmerenUE, are you aware?

A. That's a good question. AmerenUE, the Staff recommended the subsidiary capital structure. I think it's important to point out with AmerenUE that it is an electric company and Ameren is subject to PUHCA, which has limitations on leverage that can occur in a parent and subsidiary level.

Also, it's important to point out in the AmerenUE case that AmerenUE actually files its own financial statements with the SCC and also that AmerenUE actually has its -- it issues its own debt to the public markets and has a credit rating assigned to that debt that is issued to the public market, so Ameren has found it important enough for Ameren, because AmerenUE issues its own debt without a doubt, to assign a credit rating to that debt that's issued by AmerenUE.

Q. I want to make sure that in the comparison with AmerenUE that I write down each of these differences that you just referenced. I wrote down that it issues its own debt, has its own credit rating, restrictions on leverage with PUHCA. What other items did you have?

A. It files its own reports with the SCC.
Q. Okay.
A. Where with American Water Works, the -- well, actually American Water Works, because it's a requirement of RWE, doesn't even file financial statements with the SCC anymore, but when it was filing its reports with the SCC, there were not distinctions in the subsidiary capital structures.
And I think another point to make is with AmerenUE, when I indicate it issues its own debt, it -- the reason why AmerenUE wants a credit rating assigned to it is because it issues its own debt to the public markets.
The debt investors -- the reason why companies want a credit rating assigned and pay for that service is because they want some outside source to do a detailed analysis of their creditworthiness, and this gives debt investors some confidence in what they're investing in as far as if they decide to loan proceeds to that entity.
Q. In the prior rate case, did Missouri-American Water issue its own debt? Did it have its own credit rating, did it -- I guess it wouldn't have any PUHCA restrictions, did it file its own reports in prior cases?

A. With prior cases with the Missouri-American Water Company, it -- when I say issued its own debt, and that's been a point of contention here, when I say it truly issued its own debt, it issued its debt, actually through private placements and through EIERA, but it was to some third party, and it did not have a credit rating assigned to it.

The only entity that has a credit rating assigned to it, except for maybe there still may be some credit ratings assigned to New Jersey American or Pennsylvania American, but the only entity that has a credit rating assigned to it with American Water Works is AWCC, because AWCC is the entity that is actually issuing the debt to third parties, and these third parties are relying on S&P's analysis of --

Q. Well, I am -- you've confused me. Let me ask these questions one at a time. In the last rate case, did Missouri-American Water have a credit rating, have its own credit rating?

A. No.

Q. Okay. So that hasn't changed since the last case, correct?

A. No.

Q. Did it have third-party debt -- did Missouri-American Water have third-party debt in the last rate case?
A. Yes.
Q. Does it have third-party debt now?
A. It has some, but like I said, it has some that is not third-party debt.
Q. So some is third party, some is with AWCC?
A. That's correct.
Q. Okay. Did Missouri-American file its own reports with the SCC like Ameren in the last rate case?
A. No.
Q. Okay. Are there any other differences with the Ameren case that you can identify for me?
A. I think we've touched on the main differences.
Q. Okay. Your testimony has included, so far the last couple of days, that what spurred Staff to change its position on this capital structure was the creation or the existence of AWCC, and that you've looked at other considerations other than that in making this recommendation to the Commission. Is that an accurate statement?

A. That's accurate.
Q. Okay. Other than the existence of AWCC and the existence of some debt between Missouri-American Water and AWCC, what other considerations have you looked at?
A. Well, I've looked at --
Q. And I'd like you to list these off one at a time so I can write them down. You speak very quickly, so.
A. I'm sorry, I apologize for that. I am going to go ahead and refer to surrebuttal testimony.
Q. Uh-huh.
A. Since -- if I speak too quickly, that way you have something specifically to refer to.
Q. Rebuttal or surrebuttal?
A. Surrebuttal.
Q. This will be fine. I've been through this testimony several times, and it doesn't do me any good, so why don't we -- tell me where you are and on what page.
A. Okay. I go ahead and summarize all the considerations that we looked at in determining consolidated capital structure. On Page 20 of my surrebuttal testimony, it starts with Line 8. Okay?
Q. Uh-huh.

A. And as I point out, Ms. Ahern, who is the company witness in this case, had identified three considerations in David C. Parcell's book, The Cost of Capital Practitioner's Guide. Let me just give you a little incite on that book. That book, as it's been pointed out, is supposed to be objective and not advocate any specific positions as far as what a Commission or Staff or rate of return witness should do. It indicates specific considerations that may come into play in determining what an appropriate recommendation is.
Q. Is Mr. Parcel a witness in this case?
A. No, he's not.
Q. Will he be testifying in this case?
A. No, he won't.
Q. Okay. Let's focus on what considerations you use rather than what's in a book, so let's go through, if you don't mind, go through these considerations here.
A. Okay. Well, I mean, the considerations are based on those four items that I mentioned, whether -- as far as the double leverage, whether the subsidiary issues its own -- all of its own debt, whether there's an independent capital structure, whether or not the parent company is in the same

operations as Missouri-American Water Company.
As far as considerations of my own specifically, these are -- I developed my considerations based on or my recommendation based on those considerations, based on my own thoughts and my boss's thoughts when we looked at the circumstances of American Water, but another thing that we looked at, as was pointed out by Mr. England earlier, is on Schedule 2 -- 1-2 attached to my surrebuttal testimony, I show the average capital structures for American Water and Missouri-American Water Company --
Q. Which schedule was that?
A. Schedule 1-2.
Q. Okay.
A. And I show the average capital structures from 1990 through 2002 for both American Water and Missouri-American Water Company, and the reason why I attached that -- the schedule is to inform the Commission as to what the mix of capital has been at Missouri-American and American Water and the reason why I think it's important to point out the mix of capital that has, you know, that has been maintained at American Water is because American Water -- its predominant operations are water utility, regulated water utility distribution

operations, and that's important because we've talked about the double leverage issue, that debt can be -- debt financing can be used to purchase equity in Missouri-American.

Well, that allows for a higher equity ratio. With -- when you look at the consolidated capital structure of American Water, you see that American Water, on a consolidated basis, has determined that an average equity ratio of 36.7 percent, preferred stock of 3.02 percent, and a long-term debt ratio of 60.27 percent is the appropriate mix of capital to use in financing all of its -- in all of its water utility subsidiaries, and the reason why that's important is because every company is constantly trying to determine what is the appropriate mix of capital to be able to obtain the lowest cost of capital, and my opinion is if you use Missouri-American Water Company's capital structure, which includes the double leverage and now these debt allocated debt financings from American Water Capital Corporation, that doesn't truly reflect how American Water thinks -- or what American Water thinks is the appropriate mix of capital for financing water utility operations.

And then also, after I talked about

that, I did mention --

Q. Is this list inclusive to determine that a company is -- to find that we're going to use a consolidated capital structure, do each of these four points on Mr. Parcell's list, is it an and or is it or on any of them or is it any mix of them? Do you have to meet all four tests to use the consolidated capital structure?

A. It doesn't specify that all four tests need to be met. It just lists items of consideration, and that is the entire list of the items of consideration, all four of those listed there, that are listed in his textbook.

Q. Would you agree that on Item No. 1 is not met in this case?

A. Actually, no, I don't agree that that's -- I mean, I think that that lends support for consolidated capital structure, and once again, this gets into some of the disagreements we've had with the company.

Q. Well, let's ask the question. Does this subsidiary obtain all of its capital from its parent or issues its own debt in preferred stock? Does it obtain all of its capital from its parent?

A. No, it does not.

Q. Okay. So it doesn't meet that test.
A. The first part of that test, that's correct.
Q. It does issue its own debt?
A. Some of its own debt.
Q. Okay. Well, it doesn't --
A. But it doesn't say -- or does it issue all of its own debt or some of its own debt. In that first part when it says whether a subsidiary utility obtains all of its capital from its parent, that includes equity and debt, and then it goes on to a second part and indicates or does it issue its own debt in preferred stock, so my reading of that is the first part indicates if the subsidiary obtains all of its capital, which includes common equity and debt, then there really shouldn't be much question as to whether or not to use the consolidated capital structure, but then it goes on to say but if it issues its own debt, then -- then it's receiving part of its financing on its own, which is its debt financing, but with Missouri-American Water Company, it's issuing some of its own debt, not all of its own debt, and actually, the company has come out and the annual report and interviews and DR responses that indicate that American Water Capital Corporation will

be the primary source of financing for its subsidiary on a going-forward basis.

Q. On Item No. 2, did we establish yes or no whether the parent guarantees any of the securities issued by the subsidiary?

A. Again, that's a, I think, a point of disagreement. That hasn't been established in my mind. Okay. Let me just -- there was a -- there was discussion yesterday about the internal loan documents that Missouri-American Water Company has with AWCC, and the discussion yesterday was whether or not that internal loan document indicated if AWCC guaranteed the debt that is, you know, given to the subsidiary, and the reason why that was brought up is because American Water Works, there's three entities here, there's American Water Works, there's AWCC, and then there's Missouri-American Water Company. AWCC is wholly owned by American Water Works.

The discussion yesterday had to do with whether or not AWCC directly guarantees the debt to Missouri-American Water Company t-- hat AWCC provides to Missouri-American Water Company. The example I can think of is if you throw AWCC out of the picture and American Water Works is the actual entity that is doing the consolidated debt financing for this company and for its subsidiaries, once American Water Works goes out and procures this -- issues debt in capital markets and receives this debt, and then on an aggregate basis and then allocates it down through internal loan documents, they make it official internal loan documents for this, there is really no need for American Water Works to guarantee debt to its -- that's allocated down to its subsidiaries. It's, again, to a lender guaranteeing the money it's loaning to the borrower. It doesn't make sense. Why would you guarantee a loan that you give to your own subsidiary.

Q. Let me ask the question this way. Regarding Missouri-American's third-party debt, it's debt to entities outside of AWCC, do you have proof that the parent guarantees that debt?

A. The AWCC debt?

Q. The third-party debt.

A. The third-party debt of Missouri-American Water Company? Can you repeat the question? I'm sorry.

Q. Yes, I'll repeat the question. Regarding third-party debt of Missouri-American Water, do you have proof that the parent company, American Water Works, guarantees any of that

third-party debt?
A. No, there's no proof of that.
Q. Okay. So then Item No. 2 isn't met?
A. I don't agree with that, because it's -- there's -- when Parcell says guarantees in here, he doesn't -- he doesn't go out -- he doesn't come out and give a -- he doesn't put into context as far as whether or not it's a legal guarantee.
The whole idea of that is -- let's say, for instance, Missouri-American Water Company issued debt to the public market and American Water Works guaranteed that debt. The idea there is that whoever is loaning that money to Missouri-American Water Company, and then there's that legal guarantee given by American Water Works for that debt, the creditors that loan that money are going to be concerned with the American Water Works' consolidated financial situation, their financial health, and my point here is when AWCC issues the debt on an aggregate basis, now while there may not be a legal --
Q. Yeah, but I'm not talking about the AWCC debt, you keep going back to that, and I'm not talking about that debt. We've already discussed and I think you've agreed that there is AWCC debt and there's outside third-party debt that American Water

had -- or Missouri-American Water has, correct?
A. Correct.
Q. So let's not talk about AWCC. Let's talk about the third-party debt. Has the parent company guaranteed that third-party debt on behalf of Missouri-American Water?
A. The answer to that is no.
Q. Okay. What other definition of guarantee is there that I'm missing as part of this Item No. 2?
A. That's an interesting question because American Water Works, itself, in its annual report to its shareholders indicates that American Water fully and unconditionally guarantees the debt of AWCC; however, they want to dispute with me that no, that's not their intention, they're not --
Q. That's AWCC, that has nothing to do with my question, doesn't it? I mean, we're talking about the third-party debt excluding AWCC, correct?
A. That's correct.
Q. So what you're talking about is the other type of debt. It has nothing to do with Item No. 2 here.
A. I disagree, it has everything to do with Item No. 2 because of the fact that AWCC issues

the debt, the creditors are concerned with consolidated operations of American Water Works, which is the same thing that would occur if Missouri-American Water Company issued the debt and that was guaranteed by American Water Works, the same thing would occur. The creditors would be concerned about the consolidated operations of American Water Works. That's my point from a financial perspectives -- from financial perspective, creditors are concerned about the consolidated operations if there is a legal guarantee or if AWCC issues that debt. That's the distinction I'm trying to draw.

I'm not a legal person. I'm a financial person. I'm trying to relate what creditors will be concerned about in both of these situations, and I think that's what is -- what needs to be focused on here.

Q. Okay. How about Item No. 3, tell me how that one is satisfied.

A. Okay. As far as whether the subsidiary's capital structure is independent of its parent, we've had some, you know, extensive discussion on double leverage and Parcell specifically; i.e., that is existence of double leverage.

The situation here is that the subsidiary capital structure issues debt, the parent company issues debt, the parent company invests in the equity of the subsidiary; therefore, you really don't know what type of financing that parent company is using to invest in the equity of the -- of the subsidiary; therefore, that draws into -- that calls into question whether or not you can truly consider the equity at that subsidiary level through equity financing, and so that's why there's a question as of independency.

And then also as I indicated with -- since the creation of American Water Capital Corporation, there are allocations of debt financings that are being given to the subsidiaries, and as I pointed out earlier, it's not even clear if the full 5.65 percent, 56 million that was allocated down to Missouri-American Water Company was even available to be allocated down at that 5.65 percent.

There's 16 million missing, so what my point is is that the independency, the ability to determine whether or not this is their true capital structure, is getting cloudier and cloudier.

Q. Yesterday, there was an exhibit, and I was looking for the exhibit that, I think, was

offered by -- by another quote-unquote expert in the field saying that the existence of double leverage is not a reason to go to the consolidated capital structure. Do you recall that?
A. I recall that.
Q. So there's a disagreement in the field among experts?
A. Obviously. They are quite often opposing parties in the same cases that they file testimony against each other.
Q. And neither one of them are subject to cross-examination?
A. Not at this point, no.
Q. Okay. Is American Water Works diversified into non-utility operations?
A. I wouldn't -- they have non-regulated water utility operations. I wouldn't classify them as a diversified company.
Q. Okay. But they do have non-utility operations?
A. Yeah, they have non-regulated utility operations.
Q. Let me move on beyond this list, which I was hoping to get through faster and I apologize for taking so long on those. When determining a

capital structure in this case, is this question a financial question or is it a management question?

A. I am a rate of return witness, so to me, it's definitely a financial question.

Q. So would it make any difference at different levels of debt that would be in-house or with third parties or would it simply be the existence of one dollar lent by AWCC to the subsidiary, and that would be sufficient to use the consolidated capital structure or is it a matter of weighing the ratio between the two by Missouri-Americans?

A. I'm sorry, I'm not sure I understand your question.

Q. Does -- if, for example, and this is a -- this is an example that has no basis in reality, but if we were to assume that Missouri-American Water had one dollar in debt issued to AWCC, would that be sufficient to use the consolidated capital structure or does there need to be a significant amount or a significant ratio of its overall debt?

A. It depends on, like I said, the intent of the company. It's been, you know, repeated several times in various documents that the intent of AWCC is to be the primary source of debt financing to

Missouri-American Water Company.

Q. Do you know the ratio of debt to AWCC versus debt to third parties by Missouri-American?

A. It's right around 20 percent.

Q. Twenty percent to AWCC?

A. It's -- the AWCC debt that represents the debt that's at Missouri-American Water Company is approximately 20 percent.

Q. Okay. So one-fifth of its debt is to the, basically, the financing arm --

A. That's correct.

Q. -- of American Water Works? So you're saying 20 percent is sufficient to use the consolidated capital structure?

A. In a combination with the other factors that I considered, yes.

Q. Okay. Did you consider any other factors than the four items we discussed earlier?

A. We discussed this item before we discussed those four items was the fact that consolidated capital structure shows that it's more leveraged versus its subsidiary capital structure and then --

Q. Does it make a difference? I believe there was some testimony, and I know that there's some testimony regarding the management of cash of Missouri-American Water.

A. That draws into, like I said, that kind of begs the question as far as what -- when you have all this money coming in and out of a financing arm, with the cash management, you have the disbursement and receipt functions going on at AWCC, that all this -- all this -- all these funds become commingled, if you will, and that's the whole idea behind a treasury is the treasury can receive debt financings, can receive payments of short-term debt from -- whether it be divisions or subsidiaries.

Q. So shared services in that nature would be sufficient to use a consolidated capital structure?

A. In consideration with all the other considerations, that's something that we looked at, yes.

Q. Okay. Does it make any difference if the subsidiary corporation -- if it were to experience financial difficulty, do the -- at the subsidiary corporate level, does it make a difference if -- for example, if you would have a default at the subsidiary level, the treatment of the subsidiary corporation versus treatment of the parent

corporation? I may not have phrased that very well.
A. They would be in default. There is an internal loan document as far as what American Water Works would do as a result of that default, I don't know. There are internal loan documents. There are documents, and there -- then there's also what a corporation I know will do.
Q. Well, if you had a default by Missouri-American on a third-party debt, would the parent company be on the hook for that debt in the event of default?
A. No, they don't guarantee any of that debt.
Q. Okay. I asked you whether you thought it was a financial question or management question. Does control of the subsidiary corporation play a part in your recommendation, or in your opinion, does it play a part in which capital structure that is used?
A. Can you clarify what type of control?
Q. Management control.
A. Management of just the operations or?
Q. General operations management, does that play a part?
A. General operations management, no.

Q. It would not, so having a Board of Directors that is made up of the officers of the parent company would not play a role --
A. No.
Q. -- in that? Okay. Stock ownership of the actual company being -- well, that was --
A. No.
COMMISSIONER CLAYTON: I don't believe I have any further questions. Thank you.
THE WITNESS: Thank you.
JUDGE THOMPSON: Thank you, Commissioner. We're at the point where we need to take a break for the Reporter, so we'll take five minutes and then return.
(A BREAK WAS HAD.)
QUESTIONS BY JUDGE THOMPSON:
Q. Good morning, Mr. Murray.
A. Good morning.
Q. I have some questions for you, which I'll attempt to run through quickly. First of all, let me make sure that I understand the ratios in the capital structure that you recommend the Commission use, which I think have been updated since your direct testimony was filed. It's my understanding that you are advocating 41.25 percent long-term debt;

is that correct?

A. Yes.

Q. Twenty-one point zero eight percent preferred equity?

A. Yes.

Q. Two point three nine percent short-term debt?

A. Yes.

Q. Thirty-five point two eight percent common equity?

A. Yes.

Q. With respect to the long-term debt, what is the cost that you are proposing?

A. Actually, right next to that ratio, I assume you're looking at the same schedule, it's 5.95 percent.

Q. Actually, I'm looking at my notes from yesterday.

A. It's 5.95 percent.

Q. And is that referred to as an embedded cost?

A. Yes.

Q. And what does the word embedded mean in that context?

A. Embedded cost means that as far as the outstanding debt issuances, it's not -- it does not only just include the interest rate associated with that debt, it includes the cost of the issuances of that debt, any premiums, discounts, and those -- those amount are deducted from the net proceeds and because those are all historical costs, those are embedded into the net proceeds of the debt issuances to determine what an embedded cost of debt is.

Q. Okay. And with respect to the preferred equity, what is the embedded cost that you advocate?

A. The embedded cost is 5.94 percent.

Q. And with respect to short-term debt, what is the preferred -- excuse me, the embedded cost?

A. One point nine zero percent.

Q. Okay. And you are presently advocating a return on common equity, as I understand it, between 8.26 to 9.26; is that correct?

A. That's correct.

Q. Okay. And in all cases, all the numbers we're talking about, the ratios and the costs, this is all based on American Water Works' consolidated; is that correct?

A. In my analysis, that's correct.

Q. In your analysis. Very well. Now, I know that there is a dispute among the parties as to whether the figures you advocate should be used. Is there a dispute among the parties, as far as you know, as to whether your figures are accurate insofar as they represent American Water Works' consolidated?

A. I have not heard from any of the parties that they are inaccurate.

Q. So whether or not we use them is a matter of dispute, but no one is saying that you calculated them wrong or that you picked them from the wrong time period or anything like that?

A. I haven't seen any testimony to that affect.

Q. Very well. Now, do you have any idea, and I know this is a legal question, but do you have any idea whether it is lawful for the Commission to use AWW's consolidated capital structure as opposed to Missouri-American's?

A. I would believe it's lawful because, and I don't know the case in detail, but there is a case back in 1985 that I came across in some of our files that actually was -- it went to Appellate Court, I believe, that upheld the lawfulness of using a consolidated capital structure.

Q. Are you able to give me the citation to that?
MR. SNODGRASS: I'll be glad to provide that, I have that right upstairs.
JUDGE THOMPSON: Okay. Great. That would be fine. I would appreciate having that.
Q. (By Judge Thompson) And I believe you testified that MAWC does not have a credit rating.
A. That's correct.
Q. Okay. Now, yesterday it was brought out that you had given similar testimony with respect to other rate cases each of which happened to involve a division operating in Missouri; is that correct, Southern Union Company operating in Missouri as --
A. MGE.
Q. As MGE, thank you; and UtiliCorp operating in Missouri as Missouri Public Service, correct?
A. Yes.
Q. Do you know can a corporate division have a stand alone capital structure?
A. We don't think so.
Q. It's simply the same corporation, isn't it?
A. Exactly.

Q. Okay. And as I understand the rationale that underlies your suggestion or your position that the commission should use AWW's consolidated capital structure, tell me if I'm right or wrong. As I understand your rationale, the basic rationale is that you simply cannot be confident that the capital structure represented for Missouri-American and the cost of the elements of that capital structure are, in fact, true or accurate?

A. I'm not confident that represents the true cost of capital to Missouri-American Water Company.

JUDGE THOMPSON: Thank you very much, that's all the questions I had.

Other questions from the bench? Okay. Let's move on, then, to Recross based on questions from the bench, and Ms. Langeneckert is not here with us today, so Mr. Zobrist, you're first up.

MR. ZOBRIST: No questions.

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

MS. O'NEILL: Thank you.

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FURTHER RECROSS-EXAMINATION

QUESTIONS BY MS. O'NEILL:

Q. Mr. Murray, I just want to clarify a couple of things that I think you -- couple of statements that I think you made in response to some questions from the bench.

You testified that you would not recommend to adjust American Water Works' consolidated capital structure to recognize the ISRS; is that correct?

A. That's correct.

Q. And when you did your financial analysis in this case, you focused on American Water Works as opposed to Missouri-American Water Company, right?

A. When I did my financial analysis, I was focused on Missouri-American Water Company, I used a proxy group of companies to determine what I thought was a reasonable cost of equity to be applied to Missouri-American Water Company. As far as the capital structure information, I did focus on American Water Works.

Q. And you did not, as part of your analysis, consider whether the ISRS reduces Missouri's American business risk as a general

matter. Is that fair to say?
A. I didn't take that into specific consideration.
Q. And have you had participated in any analysis of ISRS as it relates to business risk for Missouri-American for the Staff in this or any other case?
A. No.
Q. So while you may have an opinion, it's based on -- it's not based on financial analysis you've done in connection with this case?
A. With specific ISRS, I have not done any specific financial analysis.
Q. Okay. Now, you also made a comment, and I think it was when you were talking to Commissioner Forbis, but it might have been Commissioner Murray, referring to a required rate of return, you used that phrase, and I just want to clarify, you were discussing what investors expect when they're looking at the cost of making a decision whether or not to invest in a company; is that right?
A. Investors have a required rate of return, sometimes investors may expect a return to be higher than that required, but as far as the cost of capital, that's what -- that's why some investors

think they know more than the market, because they feel like the company can earn more than what, you know, what they'll require, but that is the baseline consideration what a fair rate of return would be.

Q. Okay. But when you use that phrase required rate of return, you're not suggesting that this Commission sets a required rate of return in a rate case, they authorize an opportunity to earn a rate of return?

A. Exactly.

Q. Oh, okay. That was the clarification I was wondering about. Thank you.

MS. O'NEILL: No further questions.

JUDGE THOMPSON: Let's see. I'm sorry, I was somewhere else. Mr. England, I believe it's your turn.

MR. ENGLAND: Thank you.

FURTHER RECROSS-EXAMINATION

QUESTIONS BY MR. ENGLAND:

Q. Hopefully just a few brief questions to follow-up, I think, on some questions from Commissioner Clayton. First of all, you were discussing prior rate cases involving Missouri-American, and I think Commissioner Clayton asked about the 2000, the '97, and prior to the '97 rate case, and your recollection was that the stand alone capital structure was used in each of those three cases, wasn't it?

A. Yes.

Q. Would you agree with me that, in fact, in the '95 case, which proceeded the '97 case, Case No. WR-95-205, the Commission specifically rejected both the notion of double leverage and consolidated capital structure in using the company's stand alone capital structure?

A. They rejected a double leverage adjustment, which is not the same thing as consolidated capital structure recommended by Staff, and then they did reject the consolidated capital structure approach that was recommended, I believe, by an intervenor.

Q. Correct, both of those were rejected, though, in that case?

A. They were.

Q. Okay. And then I was interested in a response you made to Commissioner Clayton, something to the affect that you were concerned or thought it was important to know where American Water Works obtained its capital. Do you recall that line of question and answering, or at least that answer?

A. I don't know that I said I was concerned as far as American -- where American Water obtained its cost of capital, or excuse me, its capital. I think I just observed that they have various sources of capital available to them.

Q. And what -- of what significance is that for purposes of your determination of an appropriate return on equity for Missouri-American Water Company?

A. It has to do with the capital structure as far as what is appropriate. I think what we were discussing had to do with the double leverage issue, the fact that American Water has debt at its level, Missouri-American Water Company has debt at its level, and American Water buys equity, purchases equity, or makes equity infusions into Missouri-American Water Company, which the source of the capital to do that is from the parent company.

Q. Is the parent company's cost of capital significant to you in your determination of the appropriate return on equity for the subsidiary operating company?

A. Yes, it is.

Q. Okay. Well, let me ask you a hypothetical. Let's assume that I win Powerball, which by the way --

A. That's a big assumption.

Q. I know. One can always hope.

JUDGE THOMPSON: You're not going to win the Powerball, Trip, because I'm winning it.

Q. (By Mr. England) And it just so happens to be up to a hundred million, for purposes of my hypothetical, and I win that money, would you agree with me that my cost is pretty much zero in that hundred million? I haven't had to go out and borrow it, I haven't taken it out of any other investment stream, it's a windfall, my cost is zero, isn't it?

A. It depends on what you do with that money. There's an opportunity cost once you receive that money.

Q. Well, receiving it costs me nothing other than the cost of the Powerball ticket, right?

A. Yes.

Q. Okay. Now, I want to take that money, and for some unknown reason, I want to buy Missouri-American Water Company, and for an equally unknown reason, American decides to sell it to me for a hundred million dollars. What's Missouri-American's cost of equity? Is it zero because that's the cost to me as a new owner or is it something else?

MR. SNODGRASS: Judge, I'm going to object to that question. I don't understand the relevance of the question in this case.

JUDGE THOMPSON: Read back the question, please.

(THE PENDING QUESTION WAS READ BACK BY THE COURT REPORTER.)

JUDGE THOMPSON: I'll allow the question, objection overruled.

THE WITNESS: Obviously, there's risk involved with getting, you know, purchasing any operation. The whole idea of the cost of capital is that you look at what those risks are and the opportunity cost of capital, and you indicate that you received these funds, you know, for free, and there's going to be different things that you can do with that money besides invest in Missouri-American Water Company, and so the cost, you will expect a return with that, which is considered a cost of capital, you will expect a return on that investment that you make.

Q. Commence --

A. So I wouldn't -- if you invested in Missouri-American Water Company with your hundred million dollars that you assumed to win, then I would not recommend a zero percent return for you.

Q. Would you agree with this statement that's in Dr. Morin's Cost of Capital book, Chapter 20, Page 476, marked as Exhibit 101, at the very top of the page, second line, Dr. Morin states financial theory clearly establishes that the cost of equity is the risk-adjusted opportunity cost to the investors and not the cost of specific capital sources employed by investors. Do you agree or disagree with that statement?

A. I agree with that statement.

Q. Okay. Fine.

A. I agree with that statement as long as the appropriate mix of capital is appropriate for the operations that -- that are being used to invest in that operation.

Q. It's not -- as long as you agree with it, then it's not really important where American gets its capital, correct?

A. The capital structure is important for what is an appropriate rate of return.

MR. ENGLAND: I have no further questions. Thank you.

JUDGE THOMPSON: Thank you, Mr.

England. Let's see, I think Redirect, Mr. Snodgrass.

MR. SNODGRASS: All right. That you, Judge.

FURTHER REDIRECT EXAMINATION

QUESTIONS BY MR. SNODGRASS:

Q. I haven't talked to you in a while, have I, Mr. Murray?

A. I think it's been a few hours.

Q. Now, in response to some questioning by Mr. England and others regarding the financial relationship between American Water Works and AWWC, Mr. England asked you about the various relationships between AWW and its subsidiaries.

A. Yes.

Q. What documents, if any, have you consulted to obtain an understanding of the relationship between American Water Works and AWCC?

A. The documents that I've seen as far as the relationship between American Water Works and AWCC are the information that was provided in response to -- or that was in the application of WF-2002-1096; however, most of those documents really dealt with the relationship Missouri-American Water Company had with AWCC, but it did describe generally the support agreement that American Water Works has with AWCC.

Q. Did you have occasion to consult the annual report of American Water?

A. Yes, I did.

Q. May I approach the Court Reporter.

JUDGE THOMPSON: You may. I'd like to have this exhibit marked, please.

(EXHIBIT NO. 102 WAS MARKED FOR IDENTIFICATION BY THE COURT REPORTER.)

Q. (By Mr. Snodgrass) Mr. Murray, I'm showing you what's been marked Staff's Exhibit 102, do you recognize that exhibit?

A. Yes, I do.

Q. What is it?

A. It's American Water's 2002 Operational and Financial Report Management Discussion and Analysis, in essence, their annual report.

Q. Did you review that document?

A. Yes, I did.

Q. Directing your attention to Page 26 of that document.

A. Yes.

Q. Note 15.

A. Yes.

Q. Would you read the first paragraph note into the record, please?

A. In June 2000, the company completed the formation of a new wholly-owned subsidiary, American Water Capital Corporation, parenthesis AWCC, a special corporation that serves as the primary funding vehicle for American Water Works Company and its regulated subsidiaries. American Water Works has fully and unconditionally guaranteed the securities of AWCC.

Q. Now, Mr. Murray, how would you characterize or interpret the phrase in that paragraph that AWCC serves as the primary funding vehicle for American Water Works Company?

MR. ENGLAND: Objection, your Honor, this witness is qualified to interpret the statements of another party.

JUDGE THOMPSON: You have to use the -- do you have the microphone there?

MR. ENGLAND: No, I'm sorry, I don't have it on.

JUDGE THOMPSON: Could you repeat it so that I could hear it?

MR. ENGLAND: Yeah, I think he's asking the witness to state what company believes it was saying in this annual report, and I don't think he's qualified to do that.

MR. SNODGRASS: That's incorrect, I'm asking for his interpretation of what that statement means.

MR. ENGLAND: I also find this line of questioning curious, since the actual document that's at issue, Staff has objected to its admission into evidence, but continues to nip around the edges with its own opinion of a document it's never seen until today.

JUDGE THOMPSON: Well, I think there's been ample testimony that Mr. Murray relied upon this statement in this document in preparing and giving his expert testimony in this proceeding, and consequently, I'm going to overrule the objection and allow this to come in for whatever it's worth.

Please proceed.

Q. Do you want me to repeat the question, Mr. Murray?

A. Yes.

Q. What is your interpretation in the phrase in that paragraph that AWCC serves as the primary funding vehicle for American Water Works Company and its regulated subsidiaries?

A. Primary would mean, to me, that they

are going to provide -- it's going to be the main source of debt financing going forward for its subsidiaries.

Q. All right. I'd like to ask you, sir, directing your memory back as you were preparing your testimony, what other financial information did you review regarding the relationship between AWW and AWCC? Did you review data requests from the company?

A. Yes, I did.

Q. Some of those data requests, actually, made the -- the relationship even more confusing to me because of the fact that I believe it was in DR 3811 --

Q. Mr. Murray, I'm going to get to that DR in a moment.

A. Okay. I'm sorry.

Q. Did you receive data request 3811 from the company?

A. Yes, I did.

MR. SNODGRASS: May I approach the Court Reporter?

JUDGE THOMPSON: You may.

(EXHIBIT NO. 103 WAS MARKED FOR IDENTIFICATION BY THE COURT REPORTER.)

Q. (By Mr. Snodgrass) Mr. Murray, you have

Staff's Exhibit 103 in your hand.
A. Yes, I do.
Q. Have you had a chance to look it over?
A. Yes, I have.
Q. Do you recognize what it is?
A. Yes, I do.
Q. What is it?
A. It's a data request that I issued on July 14th, 2003, to Mr. Ed Grubb. The question specifically states in response to Staff data information request 3803, Missouri-American Water Company provided embedded cost of long-term debt for Missouri-American Water Company. Which issuances in this embedded cost of debt calculation were issued and held by Missouri-American Water Company, and which issuances or allocations of debt issuances from American Water Capital Corporation? Answer provided by the company: The only issue that is held by American Water Capital Corporation is the 5.65 percent issue for 56 million.
Q. All right. What is the significance of the company's response in that data request as it relates to your testimony in this case?
A. I think it gets into the dispute as to who is actually issuing this debt. There are

internal loan documents between American Water Capital Corporation and its subsidiaries and I'd like to emphasize those are internal loan documents.

This indicates that AWCC is actually the one issuing this debt as part of a larger aggregate, but they do recognize that AWCC is the entity that holds this debt.

Q. All right. Thank you, sir.

MR. SNODGRASS: Judge, at this time, I'd like to have that exhibit put into the record.

JUDGE THOMPSON: 103.

MR. ENGLAND: No objection.

JUDGE THOMPSON: Okay. Exhibit --

MR. SNODGRASS: All right.

JUDGE THOMPSON: Just a moment, please. Exhibit No. 103 is received and made a part of the record in this proceeding. How about 102, I don't show that offered or received?

MR. SNODGRASS: 102.

JUDGE THOMPSON: It's the annual report.

MR. SNODGRASS: Yes, at this time, I move to have that introduced into the record.

JUDGE THOMPSON: Any objection?

MR. ENGLAND: Which one was that?

JUDGE THOMPSON: 102, the annual report.

MR. ENGLAND: Despite my better judgment -- or excuse me, my better judgment is no, I have no objection.

JUDGE THOMPSON: Thank you. Exhibit 102 is received and made a part of the record in this proceeding.

Q. (By Mr. Snodgrass) All right. Mr. Murray, you've had a lot of questions here today on the fact that in the past Staff has recommended a Missouri-American Water Company stand-alone capital structure.

A. Yes.

Q. Is that correct? Now, let me ask you this basic question. Why are you now using American Water Works' capital structure rather than Missouri-American's? Can you put that in simple terms, please?

A. Because things have changed. Since the last rate case, there's been the creation of American Water Capital Corporation, which goes out and issues debt on behalf of its subsidiaries. There may be internal loan documents, and I assume that every company has some type of internal tracking, even companies such as UtiliCorp and Southern Union with their divisions, I'm sure there's some internal accounting tracking going on within those operations as well, but the bottom line is is there is a consolidated financing situation now for American Water and through American Water Capital Corporation, and it's just -- like I said, it's becoming more and more confusing as to what the actual capital structure should be for Missouri-American Water Company, and as far as what the cost of debt should be, based on the fact that, as I pointed out, 40 million of the 56 million was only closed as of June 12th, 2002; however, American -- Missouri-American Water Company is reflecting the full 56 million, so there was 16 million that I don't know where that came from.

That could have been from some other debt issuance that American Water Capital Corporation issued, it could have been from some -- any other short-term debt. I don't know. It's not clear, and so in a combination with that and all the other things that Staff, you know, actually even considered in some prior cases, and looking at Parcell's book and feeling that all four of those items that I referenced in my testimony provide support for utilizing a consolidated capital structure.

Now, I do recognize that Mr. Parcell just lists these items and doesn't advocate any position on that to leave the decision of what to do up to the expert witness.

Q. All right. Now, let's just talk a little bit about this Roger Morin's position on double leveraging. Now, based on your knowledge and experience in the utility financial area, how is Roger Morin's position accepted in that community?

A. Mr. Morin tends to be an advocate of the companies. I think I've stated before that actually, Mr. Morin -- Dr. Morin and Mr. Parcel will quite often be witnesses in the same case and oppose each other, and Dr. Morin definitely does take -- advocates positions in his book, and I think I pointed out in my testimony that in regards to some of his discussions on market-to-book ratios and how that -- how that affects the applicability of the DCF model, how I indicate that I'm not sure exactly what he's saying, so obviously, because I feel like he contradicts himself, so obviously, as with any -- any textbook, there's going to be parts of this that I agree with and there's going to be parts of it that I disagree with, but when I present testimony and when

I rely on references, I look at, you know, what makes sense, and in this case, it makes sense to recommend American Water Capital -- or excuse me, American Water Works' consolidated capital structure as the appropriate capital structure for Missouri-American Water Company.

Q. All right. It's fair to say, then, that there's certain amount of controversy on use of double leveraging in the financial community. Is that a fair statement?

A. That is a fair statement.

Q. By controversy, some think it should be used some, don't think so. Is that fair?

A. That's fair.

Q. Now, we've -- we've talked a lot about issuing debt, and sometimes that's kind of a -- those two words are sometimes difficult to, at least for me, to understand. Let me try to outline how that fits into this particular case.

And this is kind of in response to questions from Commissioner Clayton. Now, does American Water Capital Company borrow money in the capital market?

A. American Water Capital Corporation issues aggregate data issuances to usually third party -- third-party creditors and last couple cases, it's been RWE, but AWCC actually issues that debt.

Q. When you say issue, to the common man like myself, does that mean they borrow the money from someone?

A. It doesn't necessarily mean that they're borrowing the money. You can draw distinctions as to whether or not someone's issuing debt in the public market versus borrowing money, personally or through an internal affiliated transaction.

Q. American Water Capital Corporation performs what function in obtaining debt?

A. It performs the function of aggregating the debt needs of all of its subsidiaries, and in doing that, it actually goes out and issues the debt to whatever party is willing to purchase the debt of American Water Capital Corporation.

Q. What I'm getting is American Water Capital Corporation goes into the equity markets and obtains money from lenders. Is that a fair statement?

A. American Water Capital Corporation goes out to the debt markets, not the equity markets, to obtain debt financing.

Q. They obtain money from lenders in the market?
A. That's correct.
Q. And then your position is that when Missouri-American Water Company obtains monies from AWCC under an internal loan agreement, how do you classify that transaction?
A. I classify that as them receiving debt financing from American Water Capital Corporation. There is an internal loan document, but they are not the entity actually going out to a third party, and actually, they are not even the entity that is named on the loan document that AWCC has with whichever lender it issues its debt financing to. Largely, Missouri-American Water Company is of no significance to whatever entity that -- that American Water Capital Corporation actually issues the debt to.
Q. All right. When you use your term American Water Company Capital Corporation is issuing debt to MAWC, when that occurs, how does that fit into the scenario wherein AWW supports the debt of AWCC? What's the significance of that relationship?
A. The significance of that relationship, of American Water Works supporting the debt that AWCC allocates down to Missouri-American Water Company

through an internal loan document, is that, once again, the lenders, and this is obvious from the fact that American Water Works has deemed it necessary to have a credit rating assigned to AWCC, that the lenders to AWCC are concerned with the consolidated operations of American Water Works and the consolidated financial condition of American Water Works because that is who is providing the support, so that debt that has been received by Missouri-American Water Company is indirectly supported by American Water Works.

Q. Let me pose a simple hypothetical. If I went to the bank and took out a loan to buy a house, how would a creditor look at that transaction?

A. If you went to -- into the bank to buy a house, they would look at your financial circumstance, whether or not you are creditworthy in order for them to give you a loan to purchase that house.

Q. Now, let's change the hypothetical a little bit, and let's say that my dear old dad went to the bank and borrowed the money -- borrowed money, and then gave me that money pursuant to a note, and I bought that house. How would a creditor look at that transaction?

A. A creditor is not going to be concerned about your financial condition. They're going to be concerned about your father's financial condition because they did not issue the debt to you directly. It's his financial situation that is going to drive whether or not they expect to receive the -- you know, the payment on that debt.

Q. Now Mr. England discussed the concept of double leverage with you. Is that true?

A. Yes.

Q. And it almost sounds like a WWF wrestling lock of some kind to me. He mentioned that concept of double leverage in a rate-making context. How did you use the concept of double leverage in this case?

A. I used the concept of double leverage in evaluating Mr. Parcell's four considerations and his third consideration is whether or not Missouri-American Water Company has an independent capital structure; i.e., whether or not double leverage exists.

I did not make a specific double leverage adjustment in this case. The only reason why I was looking at whether or not there is double leverage in existence is to help solidify whether or not Missouri-American Water Company had an independent capital structure, and that is one of the -- one of the many factors that I considered in determining whether or not it is appropriate to use Missouri-American Water Company's capital structure or to consolidate American Water capital structure.

Q. Now, along those, perhaps a little different line, talking about Missouri-American Water Company here for a moment. What, if any, equity does it issue on the equity market?

A. It don't issue any equity to the public markets.

Q. Now, what significance is that fact? What significance does that mean, does that fact mean to you?

A. Investors are not concerned about Missouri-American Water Company. Investors would be concerned about the publicly traded company when they're purchasing shares in the consolidated operations of whatever they're investing in.

Q. All right. I think it's fair to say that that Mr. England questioned you about MAWC's position as a capital structure. What other entities are you aware of that recognize MAWC's capital structure?

A. Because there's not a credit rating on MAWC, I'm not aware of any, you know, any investors that are evaluating their capital structure.

Q. What position does S&P take on MAWC's capital structure?

A. S&P does not even mention Missouri-American Water Company's capital structure.

Q. What position does Valu-Line take on MAWC's capital structure?

A. Valu-Line does not mention Missouri-American Water Company's capital structure.

Q. What's the significance of the fact that these agencies don't recognize MAWC's capital structure?

A. The significance of the fact is that investors largely are concerned about, and appropriately so, the consolidated operations of American Water Works because that is what is going to, you know, drive whether or not they decide to invest in a company. And let me clarify, American Water Works is no longer publicly traded either, so in order to purchase an interest in American Water Works, you have to purchase interest in RWE.

MR. SNODGRASS: Can I have a five-minute recess, Judge?

JUDGE THOMPSON: Sure, we'll take five minutes.

MR. SNODGRASS: Thank you.

THE COURT: And I mean five minutes this time.

MR. SNODGRASS: Yes, sir.

(A BREAK WAS HAD.)

JUDGE THOMPSON: We'll go back on the record then.

Please proceed.

Q. (By Mr. Snodgrass) Yes, Mr. Murray, how does American Water Works recognize MAWC's capital structure, does it do so in its annual report?

A. No, it doesn't.

Q. Now, have you read doctor -- or David Parcell's book on the Cost of Capital Practitioner's Guide?

A. I wouldn't say -- I've read it at one time, usually it's a reference source.

Q. What I'm holding up, is that the book that we're talking about?

A. Yes, it is.

Q. Now, what stature does Mr. Parcell have in the utility and financial analyst community?

A. He's an authoritative source.

Q. How has his book been regarded in that community?

A. It's actually -- it's used -- the title is a practitioner's guide, so it is intended to be used by rate of return witnesses; both on the company's side, the Public Counsel, or the rate payer/advocate's side, the Staff's side, in determining what type of recommendation they think is appropriate for whatever given proceeding that you're testifying in?

Q. Does Mr. Parcell discuss double leverage in that text?

A. Yes, he does.

Q. All right. May I approach the Court Reporter?

JUDGE THOMPSON: You may.

(EXHIBIT NO. 104 WAS MARKED FOR IDENTIFICATION BY THE COURT REPORTER.)

Q. (By Mr. Snodgrass) Mr. Murray, I've shown you what's been marked as Staff's Exhibit 104, do you recognize that exhibit?

A. Yes, I do.

Q. Is it an excerpt from Mr. Parcell's book dealing with double leverage?

A. Yes, it is.

Q. Is that the part of the book you consulted in formulating your testimony?
A. Specifically, the section right above double leverage, yes, but as far as definition of double leverage, that's correct.
MR. SNODGRASS: I'd like to put that into the record, Judge, at this time.
JUDGE THOMPSON: Any objections?
MR. ENGLAND: No objection.
JUDGE THOMPSON: Hearing no objections, Exhibit 104 is received and made a part of the record in this proceeding.
MR. SNODGRASS: I have no further questions, Judge.
JUDGE THOMPSON: Thank you, Mr. Snodgrass.
You may step down, Mr. Murray.
THE WITNESS: Thank you.
JUDGE THOMPSON: Our next witness will be Mr. Wurtzler.
(THE WITNESS WAS SWORN.)
JUDGE THOMPSON: You may inquire.

DIRECT EXAMINATION

QUESTIONS BY MR. ZOBRIST:
Q. Please state your name and address.

A. Stephen D. Wurtzler, 2306 Edgewater Drive, St. Joseph, Missouri.
Q. And Mr. Wurtzler, did you prepare rebuttal testimony on behalf of the St. Joseph water rate coalition, which has been marked by the Judge or the Court Reporter as Exhibit 90?
A. I did.
Q. And I believe that we've --
MR. SNODGRASS: We have stipulated those basic questions.
MR. ZOBRIST: So I will move the admission of Exhibit 90 at this time and tender him for cross-examination.
JUDGE THOMPSON: Thank you, Mr. Zobrist.
One question, Mr. Wurtzler. Do you have any corrections to that exhibit?
THE WITNESS: No, sir, I do not.
JUDGE THOMPSON: Very well. Are there any objections to receipt of Exhibit 90?
MS. O'NEILL: No.
JUDGE THOMPSON: Okay. Hearing no objection, the exhibit is received and made a part of the record of this proceeding. Cross-examination, Ms. O'Neill.

MS. O'NEILL: No questions, your Honor.
JUDGE THOMPSON: Mr. Snodgrass.
MR. SNODGRASS: Yes, I do, Judge, thank you.

CROSS-EXAMINATION

QUESTIONS BY MR. SNODGRASS:
Q. Hello, Mr. Wurtzler.
A. Good morning.
Q. Mr. Wurtzler, is it a fair statement that your testimony deals in large part with your opinion as to the fair rate -- fair and reasonable rate of return on the utility rate case known as Missouri American Water Company?
A. Yes.
Q. Now, you use MAWC's capital structure as a starting point in that analysis; do you not?
A. That's correct.
Q. However, you state on Page 6 of your testimony, Lines 12 through 16, that some consideration should exist in the structure for short-term debt utilization since utilization of a short-term financing facility, known as MAWCC appears ongoing, did you make that statement?
A. Yes.
Q. Would you interpret what that means in

plain language?
A. In looking at the capital structures of both the Missouri-American Water Company and the funding mechanism, American Water Capital Corporation, it just seemed like short-term debt came into play at times, and while it wasn't there at this point in time for Missouri-American Water Company, it probably would be in the future, so there should be some consideration given to that.
Q. All right. Now, if American Water Capital Company was a long-term lender, would that affect your position?
A. If Missouri --
Q. If AWCC was a long-term lender to Missouri-American Water Company, would that have any affect on your view of the capital structure to select? Pardon me, I didn't phrase that well.
A. I still think they might go to the short-term market on occasion.
Q. Okay. You go on to state on Page 6, Lines 14 through 16, that in accessing the capital markets, American Water Works company capital structure is the appropriate basis for an analyst view of the pricing of any prospective investment, did you say that?

A. Yes.

Q. Would you clarify what that statement means?

A. Well, I didn't see any reason to use another structure. It seemed like the structure to be used. I didn't see a reason for another.

Q. Do you have your rebuttal testimony with you, sir?

A. Yes.

Q. Looking at Page 4, Lines 5 through 6, I indicate that you averaged historical and projected growth rates in order to provide the investor with a more conservative basis for evaluation.

A. Yes.

Q. In your experience, is it appropriate to average historical and projective growth in arriving at an estimated growth rate?

A. Yes, it is.

Q. And on Page 3, Lines 3 through 5 of your testimony, you indicate that some of your work experience includes being a trustee of the Wire Rope Company's pension trust; is that right?

A. That is correct.

Q. And in that position, you indicated you worked with investment professionals.

A. Yes.
Q. And that you monitored their performance.
A. I employed an organization that monitored the performance and I monitored that organization.
Q. I see. And in working with -- with these professionals through that structure, were there investment goals formulated and objectives defined?
A. There were.
Q. And in monitoring a performance of these goals and objectives, did you take into consideration the negative returns on investments that were under management -- under the professionals management?
A. We had criteria that dealt with less than acceptable positive returns, too, so all returns were considered, yes.
Q. So you did consider negative returns?
A. Negative returns also, yes.
Q. Now, you've reviewed Ms. Ahern's schedule, have you not, in putting your testimony together?
A. Yes.

Q. Did you look at her PMA-23, which is attached to her surrebuttal?
A. Yes, I did. I'm sure I did.
Q. Now, that schedule goes to market-to-book ratios going back to 1947, does it not? Is that a fair statement? Do you have any reason to doubt that that's not accurate?
A. No.
Q. All right. Would you agree that based on information in that historical schedule, it's fair to say that the current stock market is at a high evaluation level compared to the historical norm shown in Ms. Ahern's schedule?
MR. ENGLAND: Objection, your Honor, and I guess maybe it goes to a continuing line of questioning. It appears to me that the counsel is eliciting what I would consider to be friendly cross-examination from the witness. We don't have an opportunity to respond, and commenting on testimony that was filed after his testimony, I think, puts us in a bit of a prejudicial position.
JUDGE THOMPSON: Well, the ban on friendly cross that was formally observed in proceedings before this Commission was contained in the hearing memorandum that was prepared by Staff in

those days. There no longer is a hearing memorandum, and there is no ban on friendly cross in the procedural schedule, which imposes conditions on the proceeding, neither is there a ban on friendly cross in the Commission's regulations, so --

MR. ENGLAND: And to make it clear, I'm not invoking any purported or actual ban. I think it's a more matter of prejudice, your Honor.

JUDGE THOMPSON: And I was getting to that aspect. I was getting to that aspect. With the -- to the extent that the testimony is unduly prejudicial, then of course, I will be happy to entertain any motion from any party who wants to put a witness back up to ask a series of questions in order to attempt to dispel that prejudice, okay.

I will also -- what's the right word, admonish, warn the parties that the decision in this case is not based on a show of hands or on how many people adopt or espouse or agree with any particular position, and consequently the value of friendly cross is extremely limited, and there's not any particular point to put it on, so with that being said, I will overrule the objection and allow you to continue.

MR. SNODGRASS: Would you repeat the

last question, please?

(THE PENDING QUESTION WAS READ BACK BY THE COURT REPORTER.)

Q. (By Mr. Snodgrass) Would you answer that question?

A. I don't recall the specifics of the schedule, but the stock market is a high relative of historical standards.

Q. Are you familiar with the theory of mean reversion?

A. No.

Q. On Page 7, Lines 1 through 6, and in paraphrasing your testimony, if I may, for a moment, you indicate that in the scenario where the parent company does not guarantee the debt of its subsidiary to a lender, the investor or lender would be considering the capital structure of the subsidiary, not the parent, in the pricing of the debt or investment in the subsidiary. Is that true?

A. Correct statement, yes.

Q. So hypothetically, if the scenario were changed and the parent company was providing a guarantee on the debt of the subsidiary to a lender, would that change your view on which capital structure the investor would look at for the pricing of the investment?

A. Based on my experience in banking and that type of lending, the guarantee sheds a different light on it, yes, I would look at it differently.

Q. And how would you look at it differently?

A. Well, to the extent that the guarantee was credible and could be exercised, I would believe that the lender would offer lower rates because they could count on the better credit rating of the parent, assuming that rating is better.

Q. In using the risk premium model, you indicate on Page 5, Lines 1 through 2, that you projected a 12-percent market rate of return on equity.

A. Yes.

Q. And what holding period did you estimate for that kind of market rate of return on equity?

A. More like a 20 or 30-year holding period.

Q. You indicate that in applying a risk premium model, you use a risk-free rate of 6.30 percent.

A. Yes.

Q. And at Triple A bond yield in that context; is that right?
A. Yes, that's correct.
Q. What is the basis of a 6.30 percent Triple A bond yield that you use for a risk-free rate? What's the basis of that choice?
A. Where did I get the rate --
Q. Yes.
A. -- or why did I choose?
Q. Why did you choose the rate?
A. That is normally the way -- if you go back to Ibittson's book, that's their starting point for evaluation is the Triple A bond rate.
Q. Okay. Now, your final return on equity recommendation was in the range of 9.25 to 9.75. Am I correct?
A. Yes.
Q. Ms. Ahern's return on equity recommendation was 11.75 to 12 percent, correct?
A. Yes.
Q. Mr. Burdette's equity recommendation was nine and a half percent, correct?
A. I think that's correct, yes.
Q. Now, Ms. Ahern's return on equity is higher than anyone else's. Isn't that true?

A. Yes.

Q. Can you briefly explain the difference between Ms. Ahern's position on return on equity and yours?

A. Yes. I think you need to talk about the three factors or the three methodologies that have been used. There were differences in each of those, and just quickly summarizing what those differences might be.

In risk premium area, she used a rate of 18.6 percent as her rate, where I was using 12. I think she went back to a Valu-Line basis. Instead, I discussed this matter with some colleagues and we felt 12 percent was a more appropriate rate.

As you mentioned before, in the DCF model, I used an averaging of historical rates against the perspective rates, and it was somewhat more conservative, so that affected that, and then on the capital asset pricing model, I don't know that there was a lot of difference there, other than she questioned whether I should have advanced my rate from 4.8 percent, which I used, to a more current rate, and beyond that, to a more speculative rate of what that risk rate might be over, I believe it was a three-year time frame or something like that, and I chose the more conservative rate.

I'm not inclined to go with a lot of projections. My experience has been that those projections are often wrong and I'm more inclined to look back in time rather than forward in these kinds of projections.

MR. SNODGRASS: Thank you, sir. That's all the questions I have.

JUDGE THOMPSON: Thank you, Mr. Snodgrass. Mr. England.

MR. ENGLAND: Yes, your Honor.

CROSS-EXAMINATION

QUESTIONS BY MR. ENGLAND:

Q. Good morning still, Mr. Wurtzler.

A. Good morning to you.

Q. Hopefully we'll get you off before afternoon. The capital structure that you have on Page 7 of your testimony, with the short-term debt that Mr. Snodgrass inquired about --

A. Yes.

Q. -- but I'm more interested, first of all, just the general capital structure, where did you obtain that information?

A. Well, I obtained that from reviewing information submitted by the other witnesses, and I made an adjustment in there for short-term debt and so I got a slightly different result.

Q. Where did you get your short-term debt figure?

A. I believe it was from Mr. Burdette's work.

Q. Okay. And you understand, I think, having been here this morning, and perhaps reading the testimony, that Staff and Public Counsel's use of short-term debt, generally speaking, their methodologies may change, but their theory is to only use short-term debt in the capital structure for rate-making purposes to the extent it exceeds construction work in progress.

A. I've heard that testimony, yes.

Q. Okay. Do you agree or disagree with that position?

A. It seems logical that that would be the way to do it, yes.

Q. And this number here that you have is not netted against any construction work in progress?

A. No, it is not.

Q. So to the extent there is some construction work in progress, you would agree to net that figure?

A. It would be a smaller number, yes.

Q. Okay. Well, and I think Public Counsel actually eliminated it from its updated capital structure, because CWIP now exceeds short-term debt balances, right, did you see that in the surrebuttal?

A. I'm not sure I reed that, no.

Q. Okay. Looking at the total capital structure that you have here, apparently it wasn't very difficult for you to ascertain a capital structure for Missouri-American Water Company, was it?

A. I chose to go with the information that I had seen in the other testimony, yes.

Q. And to the extent you know, would you -- do you have an opinion as to whether or not this capital structure is representative of capital structures of publicly traded water companies?

A. I have no opinion on that.

Q. Okay. Let me ask you a hypothetical. Your proposed or recommended return on equity is 9.25 to 9.75, correct?

A. Correct.

Q. And I believe Mr. Snodgrass inquired of you regarding Ms. Ahern's, which is 11.75 to 12, at least for purposes of her direct testimony.

A. Yes.

Q. Okay. Now, I want you to hold everything else equal. I want to think of two states, and I want you to put yourself in a position as an investor or person responsible for investments of monies for pension funds.

A. Uh-huh.

Q. And in state A authorizes its water utility companies an opportunity to earn 9.25 to 9.75, and state B offers its water utility companies the opportunity to earn 11.75 to 12. What state are you going to invest in as far as water utility investments?

A. The one that offers the higher return.

Q. Fair enough. Thank you.

MR. ENGLAND: No other questions.

JUDGE THOMPSON: Thank you, Mr. England. Commissioner Murray.

COMMISSIONER MURRAY: Just briefly, thank you, Judge.

QUESTIONS BY COMMISSIONER MURRAY:

Q. Good morning.

A. Good morning.

Q. If you were to eliminate the short-term debt from your calculation, do you know or are you able at this time to come up with a final figure that would result in --

A. No, I'd have to do the math.

Q. All right. But you -- I believe you said that you thought it sounded reasonable to you to net the short-term debt figure against the CWIP?

A. Yes, it did.

Q. Okay.

COMMISSIONER MURRAY: And I think that's all. Thank you.

JUDGE THOMPSON: Thank you, Commissioner. Commissioner Clayton.

QUESTIONS BY COMMISSIONER CLAYTON:

Q. Just a few questions. Just to make sure I understand that if it is true that construction work in progress exceeds short-term debt, that you would agree that it should be excluded in the capital structure? There was just an exchange and I want to make sure I accurately --

A. Could you state that again?

Q. Mr. England asked you a -- or suggested to you that construction work in progress exceeds short-term debt, and if that assumption is true, then would you eliminate the short-term debt percentage in your capital structure?

A. And what you're saying is the amount of the expenditure is greater than the short-term debt?

Q. Yes.

A. Okay. Well, would I eliminate that excess from the structure?

Q. I want to make sure I'm asking the question --

COMMISSIONER CLAYTON: Mr. England, that's what you just suggested in your examination, correct?

MR. ENGLAND: Yes, your Honor.

Q. (By Commissioner Clayton) So if it is found to be true that construction -- that the level of construction work in progress exceeds short-term debt, then it would be excluded from the capital structure, in your opinion, if that assumption were true?

A. That level of construction, yes.

Q. Okay. Didn't know it was going to be so difficult, I apologize. Give me just a second. I couldn't tell from reading your testimony, did you consider the existence of an infrastructure replacement surcharge in the state of Missouri in your calculations for a return on equity?

A. No, I did not.

Q. Were you not aware of that or is there a reason why it wasn't?

A. I was not aware of that.

Q. You were not aware of it. Would it play a part in your calculations in perhaps the reduction of risk?

A. It might. I'd have to know more about how it worked. I'm just not familiar with it.

Q. Okay. Mr. England asked you a question in which he asked for you to choose between two states based on levels of returns in those two states. Do you recall that question?

A. Yes.

Q. Would your calculations be different in a circumstance where the stock is actually publicly traded versus where it's owned entirely by one or two parent companies?

A. That's a big if. There's an awful lot of other risks that comes in, and I don't think I can answer that.

Q. On Page 7 of your testimony where you have Table 1, you set out the capital structure with your cost -- your cost rates and your rate of return. If there was an elimination of short-term debt, where would that percentage be redistributed?

A. To the long-term debt.

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

JUDGE THOMPSON: Thank you, Commissioner.

QUESTIONS BY JUDGE THOMPSON:

Q. Good morning, Mr. Wurtzler. I have some questions for you. With respect to your proposed capital structure, that is based on what company? Is it based on Missouri-American?

A. Missouri-American, yes.

Q. Okay. And it's based on Missouri-American as of what date?

A. I received the information back in October, so I was relying on other's testimony from whatever period that they drew it from.

Q. Okay. So you based your testimony about capital structure on the testimony that you received from the other witnesses we heard here?

A. Yes, I didn't do any fundamental analysis on that.

Q. And you didn't send any data requests of your own?

A. No, I did not.

Q. So any difference between your proposed ratios, for example, and those that I might find in the testimony of Ms. Ahern or in Mr. Murray's testimony or in that of Mr. Burdette, those are based on adjustments you made?

A. And possibly time periods, I think they came through later with an adjusted debt equity number, there's time in there, too.

Q. Okay. Very good.

A. Yes.

Q. Now, did you perform a discounted cash flow model analysis?

A. Yes.

Q. And what was the result you reached?

A. Well, as far as the calculations on that, I got my testimony, just the result, and that's on Page 4. Would you like me to go through that or --

Q. All I want are the figures that you reached.

A. Okay. I suggested using a 5.9 growth factor, which yielded a range of 9.30 to 9.44 percent, and I used the dividend yields that were similar to what the other parties had.

Q. Okay.

A. So my difference was in the growth

factor.

Q. And so this is compared to Ms. Ahern's results of 10.0, Staff's result of 7.9 to 8.93 --

A. Yes.

Q. -- Mr. Burdette's response -- result of 9.48 to 9.98, correct?

A. Yes.

Q. Okay. Now, is it your opinion that Ms. Ahern performed or used the direct discounted cash flow analysis correctly?

A. She assumed a different growth rate.

Q. I understand that. What I want to know is whether you consider her to have been mistaken to have used the analysis correctly or not correctly.

A. Her calculation was correct, and she used a growth rate of 7.3 percent, which I didn't think was appropriate. I used a rate of 5.9 percent.

Q. Okay. So in that, she used a growth rate that you believed was inappropriate, you would say she is in error; is that correct?

A. She used a perspective growth rate, I chose not to do that. I used averages, so from my point of view, she was in error.

Q. Absolutely. That's what I was trying to get to. What about a risk premium model, did you do one of those?

A. Yes, I did.

Q. What was the number you received, the result you obtained?

A. My return using the risk premium model was 9.89 percent return on equity.

Q. Okay. Now, again, Ms. Ahern performed an analysis of risk premium analysis, didn't she?

A. Yes, she did.

Q. And do you believe that she erred?

A. She chose an 18.6 percent forecasted market return and I used a 12 percent. I thought 12 percent was more appropriate, so yes, I would say she erred in my opinion.

Q. Okay. What about Staff who achieved 9.23 on that model, did they err?

A. They used different numbers than I did, so yes, I guess I draw that conclusion, too. This was my best opinion.

Q. So to shortcut this, to the extent that your numbers differ from those of the other witnesses where they used the same model you did and your net results are different, then you believe that they used some input that was inappropriate and therefore were in error?

A. Yes.
Q. Okay. That makes it easy and quick. Now, how about the capital asset, the CAP model, did you do one of those?
A. Yes, I did.
Q. What was your result?
A. I produced a 9.21 percent return.
Q. Okay. And what about a CEM model, did you do one of those?
A. No, I didn't.
Q. Okay. Very good.
JUDGE THOMPSON: And that's all the questions I have for you. Thank you.
Any other questions from the bench? Hearing none, Recross, Ms. O'Neill.
MS. O'NEILL: No questions, your Honor.
JUDGE THOMPSON: Mr. Snodgrass.
MR. SNODGRASS: Nothing.
JUDGE THOMPSON: Mr. England.
MR. ENGLAND: Yes, your Honor.

RECROSS-EXAMINATION

QUESTIONS BY MR. ENGLAND:
Q. As I hate to quibble with the Law Judge's characterization of your analysis versus others.

JUDGE THOMPSON: You know, you're quibbling with me and you're coming into the lunch hour. I'm just telling you you're in dangerous grounds.

MR. ENGLAND: I understand I'm on thin ice. I'll try and make it quick and get off.

Q. (By Mr. England) Would it be a more fair description to say that you relied -- you may have relied on some of the same information but you applied different judgment than the other witnesses as to what an appropriate growth factor is or other element of these models?

A. One might say that also.

Q. Okay. Thank you, sir.

MR. ENGLAND: I'm out of here.

JUDGE THOMPSON: Thank you, Mr. England. A wise attorney. Mr. Zobrist, Redirect.

MR. ZOBRIST: I will be about one or two minutes, Judge.

JUDGE THOMPSON: I appreciate that.

REDIRECT EXAMINATION

QUESTIONS BY MR. ZOBRIST:

Q. Mr. Wurtzler, in response to the questions from the Administrative Law Judge and Mr. England, would it be fair to say that you did not have a disagreement in the models that were used by the witnesses here?

A. No, it's a standard way of doing things.

Q. Your disagreement was in terms of the numbers that were used?

A. The assumptions, yes.

Q. And that's where you exercised your independent judgment in conducting your review of the other witnesses' testimony?

A. That's correct.

Q. Mr. Snodgrass asked you very briefly about the existence of a guarantee from American Water Works company to Missouri-American Water Company. Do you remember that question?

A. Yes.

Q. And I believe you said in your testimony you did not find any such guarantee in place, correct?

A. I'm not aware of a guarantee.

Q. Now, based upon the testimony that you heard today and yesterday, have you changed your opinion in any regard?

A. No.

Q. Okay. Thank you.

MR. ZOBRIST: Nothing further.

JUDGE THOMPSON: Thank you, Mr. Zobrist. Before I release you, Mr. Wurtzler, I just want to note that you were also a witness on the acquisition premium issue.

THE WITNESS: Yes.

JUDGE THOMPSON: And I understand you oppose that.

THE WITNESS: Yes.

JUDGE THOMPSON: This is your chance to cross-examine Mr. Wurtzler on the issue of acquisition premium. Any takers?

MR. ENGLAND: We understand that I think we're the party most adverse to Mr. Wurtzler's testimony in that regard, and we have agreed to waive cross-examination on that portion of his testimony.

JUDGE THOMPSON: Okay. Any questions from the Bench with respect to acquisition of premium? He has one page on it where he says don't do it.

MS. O'NEILL: Public Counsel has no questions, either.

MR. SNODGRASS: Staff has no questions.

JUDGE THOMPSON: Thank you, sir.

And there are other witnesses on

acquisition premium, I believe.

MS. O'NEILL: Yes.

MR. ENGLAND: I certainly hope so.

JUDGE THOMPSON: Okay. I just want to make sure we'll get a chance to beat this issue to death before we're done.

You are excused, Mr. Wurtzler. You can go home to St. Joseph and forget about this experience. We will take the lunch recess now, but I want to know what we're going to come back and do at 1:15. Are we going to take up Mr. Gibbs then or are we going to launch into something else?

MS. O'NEILL: If we could do Mr. Burdette, he's got other cases he's working on and he's been sitting here patiently waiting, and I understand that.

JUDGE THOMPSON: That's exactly the kind of input I want to hear.

MR. ENGLAND: I have no objection to taking Mr. Burdette next.

JUDGE THOMPSON: Okay.

MR. SNODGRASS: Staff has no objection, either.

JUDGE THOMPSON: Then we'll come back and hear from Mr. Burdette. Have a nice lunch.

We're in recess.

(A LUNCH RECESS WAS HAD.)

JUDGE THOMPSON: One thing I'd like to remind counsel is that remember you need to produce one copy of every exhibit to the reporter. We've had a number of exhibits that we've admitted today and we need to make sure the Reporter has a copy of each of those.

For example, we have Exhibit 104, The Cost of Capital extract or excerpt from Parcell's book, I don't think she has that. 103, which was DR 3811; 102, which was the 2002 annual report of AWW; 101, Chapter 20 from Morin's book; 100, the Staff memo filed in Case No. WF-2002-1096.

Now, that one, I think we first started using yesterday, so perhaps a copy was provided to the Reporter that day, I don't know, but you need to make sure the Reporter has one. The support agreement, she has a copy of, but of course, that has not yet been admitted, so there was some additional items yesterday.

We have the 98, the corrected PMA-15, Page 3; data request 3802 and table, Exhibit 97; data request 3817, Exhibit 96; the financing application WF-2002-1096, Exhibit 95; and finally, the AWR service line letter to Mr. Shallenberg, Exhibit 92, so the Reporter will need to have a copy, one copy of each ever those exhibits please.

Ms. O'Neill.

MS. O'NEILL: Yes.

DIRECT EXAMINATION

QUESTIONS BY MS. O'NEILL:

Q. Good afternoon, Mr. Burdette.

A. Good afternoon.

JUDGE THOMPSON: I guess I need to swear him. I apologize.

(THE WITNESS WAS SWORN.)

JUDGE THOMPSON: Now you may inquire.

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

Q. (By Ms. O'Neill) Mr. Burdette, did you prepare for filing direct testimony that's been marked as Exhibit 11, rebuttal testimony that has been marked as Exhibit 53, and surrebuttal testimony that's been marked as Exhibit 62 in this case?

A. Yes.

Q. And other than any updates or corrections that might appear in those pieces of pre-filed testimony, do you have any corrections to any of those at this time?

A. No.

MS. O'NEILL: Your Honor, I would offer Exhibit 11, Exhibit 53, and Exhibit 62 into the record.

JUDGE THOMPSON: Thank you, Ms. O'Neill. Any objections to the receipt of Exhibits 11, 53, or 62?

MR. ENGLAND: No.

JUDGE THOMPSON: Hearing no objections, Exhibits 11, 53, and 62 are received and made a part of the record in this proceeding. Do you tender the witness?

MS. O'NEILL: Yes, I do.

JUDGE THOMPSON: Thank you.

Mr. Zobrist.

MR. ZOBRIST: No questions.

JUDGE THOMPSON: Thank you.

Mr. Snodgrass.

MR. SNODGRASS: Just a few.

CROSS-EXAMINATION

QUESTIONS BY MR. SNODGRASS:

Q. Good afternoon, Mr. Burdette.

A. Good afternoon.

Q. Do you have your testimony with you, sir?

A. I do.

Q. All right. I direct your attention, please, to Page 8, Lines 22 through 26.
A. Of?
Q. Of your direct, pardon me.
A. Page 8?
Q. Yes.
A. Lines?
Q. 22 through 26.
A. Okay.
Q. You described the equation for the DCF models calculation for the cost of equity there.
A. Yes.
Q. Now, some of the expected sustainable growth rate plus the quotient of the current dividend yield divided by the stock price equals the cost of equity capital. Is that correct?
A. Yeah.
Q. All right. In your direct testimony, again, sir, directing your attention to Page 10, Lines 20 through 21.
A. Okay.
Q. You described a sustainable growth rate as the dividend growth rate investors expect to continue into the indefinite future, correct?
A. Correct.

Q. And further on Page 10, Lines 25 through 26 of your direct testimony, you state that sustainable growth is determined by analyzing various historical and projected growth rates for the company, correct?

A. Correct.

Q. Because Missouri-American company is not publicly traded, you used the data from three comparable companies to determine a growth rate for Missouri-American. Is that accurate?

A. Correct.

Q. Okay. Do you use the historical growth rates of these three companies as part of your calculation of estimated sustainable growth rates from AWC -- did you use those?

A. I calculated a variety of historical and projected and looked at all of them.

Q. Did any of these three companies have a year and a time frame used that we've talked about in which they experience negative historical growth rates?

A. Yes. For example, California Water Services had a negative earnings per share of compound growth.

Q. Would you agree that some comparable

utility stocks experience negative growth rates from time to time?

A. Yes.

Q. Would you agree that it would be reasonably to assume that investors in utility sector would expect to see negative growth rates from time to time?

A. I don't think they would be surprised by seeing negative growth.

Q. Did you use negative growth rates in your calculations of overall historical averages for the three comparable companies?

A. No.

Q. And would the inclusion of negative growth rates produce a lower historical average?

A. Yes.

Q. Can you explain why you've excluded the negative historical growth rates?

A. Generally, I think looking forward, investors are looking for growth to be growth. If a company is experiencing negative growth, they're probably partially -- I don't think I would even use them as a comparable company if I seriously expected that company to be declining going forward.

Q. Directing your attention to your

Schedule MB-6 presented on Page 16 of your direct testimony. In there, it indicates the range of historical growth rates calculated for the various models is 1.06 to 5.19 percent with an average of 3.69 percent. Is that accurate?

A. You said the historical, can you repeat?

Q. The range of historical growth rates.

A. Yes.

Q. Okay. I'm sorry. According to that same summary, the range of projected growth rates calculated is 2.83 to 6.3 with an average of 6.44 percent; is that correct?

A. Correct.

Q. All right. You recommend the sustainable growth rate for Missouri-American Company to be in the range of six to six and a half percent. Am I accurate?

A. Yes.

Q. From this percentage, it's apparent that you gave more rate to projected growth rate in determining your file recommendation; is that right?

A. Correct.

Q. Now, on Page 8 of your rebuttal testimony, Lines 12 through 15, sir, if I direct your

attention to that section of your testimony, you indicate that on Lines 12 through 15, Page 8, of calculations of projected growth rate show deviation from historical growth rates, then the analyst should place a greater emphasis on the projected rates. Did you make that statement?
A. Correct.
Q. What's the source that you use to support that statement? What's the basis?
A. Experience, as well as basic finance, and there's also the quote in Mr. Murray's testimony from Mr. Morin's book that says that historical growth is only beneficial to the extent that it's going predict the future. If the future is going to be different than the past, then historical growth doesn't have any relevance.
Q. Going to Page 10, Lines 23 through 25 of your direct testimony, Mr. Burdette.
A. I'm sorry, which lines?
Q. Page 10.
A. Okay.
Q. Lines 23 through 25.
A. Okay.
Q. You state, I think, in general, that Mr. Murray's DCF growth rate calculation utilized for

his recommendations are biased downward due to the fact that he placed equal emphasis on historical and projected growth rates. Did you make that statement?

A. Correct.

Q. Does that statement accurately reflect your position?

A. I believe so.

Q. Now, you've read studies in books concerning growth rate calculations, have you not?

A. Yes.

Q. And are you familiar with David Parcell's book, Cost of Capital?

A. I am.

Q. Is this book a recognized book on capital issues related to utility rate proceedings?

A. Yes.

Q. Analysts use it as a source on cost of equity capital issues, do they not?

A. Yes.

Q. Isn't it true that Mr. Parcell's book makes reference to a study by Conroy and Harris?

A. I don't have any idea.

Q. Okay. What I'm showing you, is this Mr. Parcell's book, Cost of Capital, as far as you know?

A. Yes.

Q. I'd like to read something from Page 8.28 from that book. Conroy and Harris found that analyst's forecast were better predictors than historic growth over the very short-term, but the advantage declined steadily over time. They conclude that combination of analyst's forecast and historic growth provide the best forecasting results.

Do you agree or disagree with that statement in Parcell's book?

A. Oh, I believe it can be true at times.

Q. Based on that -- based on what I just read to you, do you feel that you've given enough weight to historical growth rates in your calculation?

A. I think the industry has changed enough in the past with mergers and acquisitions, and there's fewer water companies than there were and they're cutting costs, and I think I did my analysis as I believe is appropriate.

Q. It appears that the growth rate you've calculated from EPS, VPS, and VVPS range from 1.06 to 6.44 percent. Is that generally accurate earnings per share of dividends? They range from 1.6 to 6.44, would that be correct?

A. Are you talking about historical again?
Q. Growth rates.
A. Well, Page 16 of my direct has an earnings per share of 6.83.
Q. All right.
A. But let's see.
Q. I'm sorry.
A. 6.83 is the high.
Q. All right. Would you explain how you arrive at that growth rate?
A. The 6.83.
Q. Uh-huh.
A. It is -- it is the average of the three companies earning per share Valu-Line and First Call, so it's projected growth and earnings per share for the three companies, for Valu-Line and First Call, and all of those numbers averaged.
Q. I'd like to direct your attention briefly, Mr. Burdette, to the dividend yield you discuss in your testimony.
A. Yes.
Q. Would you explain your thought process, sir, behind your decision to use 3.48 percent as the appropriate dividend yield for Missouri-American Water Company rather than, say, an average of 3.48

and 3.04?

A. The two other companies Middle Sects and Southwest Water that went into the 3.04 percent did not have as much information, did not have as good financial coverage, and I felt the other three were just covered better.

Q. You mention a risk-free rate in your testimony. Do you not?

A. I do.

Q. And could you identify the source of that risk-free rate for me, please? I'm not sure I recall seeing it in your testimony.

A. I think, if I remember, the 5.6 percent is the intermediate term from Ibittson's book.

Q. And what was your rationale for choosing this particular risk-free rate over other available options?

A. I think that generally with the fact that the 30-year is no longer issued, and the fact that how quickly the market changes anymore, I have read in the literature that it's not simply my opinion, that there is a shift that the risk-free rate could be considered 10, 20, 30 year; not just the 30-year as it used to be.

Q. It's true, though, isn't it, that the

30-year treasury bond is still being traded in the secondary market?
A. It is.
Q. And information about that 30-year bond is published by the Board Options Exchange website?
A. I know it's published, I don't know the specific website.
Q. And that instrument is still being bought and sold, is it not?
A. Yes.
Q. Now, going to the I-S-R-S, or otherwise known as ISRS issue, are you familiar with what ISRS is?
A. Yes.
Q. Has it been implemented yet, to your knowledge?
A. What do you mean by implemented?
Q. Has it been put into affect or the statutory provision in ISRS in effect now?
A. I believe it's law.
Q. Has the Commission enacted any ISRS, is there a case pending dealing with ISRS at this time?
A. I think there's ISRS issues, but I don't know the specifics.
Q. All right. You mention in your

rebuttal testimony, Page 12, Lines 25 through 26, that ISRS does not allow for reduction in earnings. A company's earnings can only go up.

A. Yes.

Q. Did you say that? You also say in your rebuttal on Page 12 that ISRS reduces Missouri-American Water Company's business risk. Did you make that statement?

A. Yes.

Q. As a general principle, Mr. Burdette, when a company's business risk is reduced, its cost of obtaining capital is also reduced. Isn't that a fair statement?

A. If you're looking only at business risk, everything else equal financial risk, et cetera, yes.

MR. SNODGRASS: That's all I have.

JUDGE THOMPSON: Thank you, Mr. Snodgrass.

Mr. England.

MR. ENGLAND: Thank you, your Honor.

CROSS-EXAMINATION

QUESTIONS BY MR. ENGLAND:

Q. Good afternoon, Mr. Burdette.

A. Good afternoon.

Q. Let me start, first, with that quote from Parcell's that Mr. Snodgrass read to you. Is that 8.28?

MR. SNODGRASS: Let me look. Yes, it is.

Q. (By Mr. England) Do you have a copy of Mr. Parcell's book in front of you?

A. No, I do not.

MR. SNODGRASS: I can furnish him a copy.

Q. (By Mr. England) If I was listening clearly, I think Mr. Snodgrass was reading to you from the top half of that Page 8.28.

A. I think so.

Q. And I want to focus on the sentence, I believe, that was part of his quote, and I quote they conclude that combinations of analyst's forecast and historic growth provide the best forecasting results, end quote. Do you see that?

A. Yes.

Q. It's my understanding you did consider historical growth rates, didn't you, in your analysis?

A. Yes, I calculated a total of 11 combination of historical and projected.

Q. And you simply decided or determined in your own judgment to, perhaps, give more weight or emphasis to projections as opposed to historical rates, correct?

A. Correct.

Q. So don't believe that what you did is inconsistent with what's stated here, do you?

A. No, I analyzed historical growth, in fact, more historical growth rates than I did projected, but I think once you analyze the growth rates, then the job becomes interpreting the results.

Q. Thank you. By the way, you are a certified rate of return analyst, are you not?

A. Yes.

Q. And I assume, then, that you are familiar with Mr. Parcell's work as part of your certification?

A. Yes.

Q. Let's talk about the ISRS for a moment, if we may. I think it is indicated in an answer to cross-examination, and also specifically indicated -- I think it's in your direct testimony or at least my reference is direct testimony, Page 22, Lines 1 through 3, I think you identify or note that the existence of an ISRS reduces business risk, do you not?

A. Yes.

Q. And business risk is reduced, and this is my understanding, because the lag on recovering a return on these investments has been reduced, the regulatory lag in recovering the --

A. Correct.

Q. Okay. Would you agree with me that regulatory lag has not been eliminated, however, it's only been reduced from the eleven months for a general rate case to four months under the ISRS statute?

A. Not eliminated, correct.

Q. Okay. Would you also agree with me that other rate-making techniques, such as the use of forward looking test years and the allowance of construction work in progress in rate base, all other things being equal, reduces business risks for water utilities?

A. I don't have an opinion on construction work in progress in rate base. It's not anything I've ever discussed. In terms of future test year, I know there's debate on that. I also know that to get to a future test year, you have to start with a solid historical year, and I'm not sure that I believe there's a whole lot of difference between a solid historical test year with updates and true-ups than there is in what you might call a true future test year.

Q. Then let me qualify my question a little bit better. If by using a forward looking test period or by allowing construction work in progress, you have advanced the date for inclusion of plant into your rate setting analysis beyond what it would be under historical test year, you've at least reduced regulatory lag and the recovery of those costs, have you not?

A. If you -- if you would include them in this case and not have to wait and file another case, yes, you've reduced lag.

Q. And you mentioned, I think, in response to Mr. Snodgrass something about financial risk, that's different from business risk, is it not?

A. Correct.

Q. That has to do with the amount of leverage a company employs in its financing of capital or financing of facilities?

A. Yes.

Q. Have you done any analysis to determine the extent to which your proxy group of water

companies have employed an ISRS mechanism?
A. No, I heard Ms. Ahern testify to that, but I did not specifically look into there.
Q. Similarly, do you know if they have available to them other rate-making techniques, such as forward looking test periods or allowance for construction work in progress?
A. No, I don't know the specifics of all the regulations in those states.
Q. Thank you. Let's talk about capital structure for a second, if we may. Your rebuttal testimony, I believe, Page 4, Lines 1 through 4. I've given you a bum steer. It's rebuttal, Page 4, Lines 12 through 14. And -- are you there?
A. Yeah, I think so.
Q. It begins because MAWC.
A. Line 10.
Q. Let me show you.
MR. ENGLAND: May I approach the witness?
JUDGE THOMPSON: You may.
Q. (By Mr. England) It's the red underline there in the middle of the page.
A. Okay. It's my Line 10.
Q. Yeah, that happens with these

electronic things.

A. Must be an EFAS thing.

Q. We used to blame it on the Bossonova, now we blame it on EFAS, but hopefully we're on the same line.

A. Yes.

Q. The quote is because MAWC has long-term debt issued under its own name, I believe the company's actual debt rather than American Water's consolidated debt is appropriate to use to calculate the embedded cost of debt.

A. Correct.

Q. Do you see that? And I take it from that statement that you do not dispute the fact that MAWC issues its own debt; is that right?

A. I do not dispute that fact.

Q. Even the debt that it issues to AWCC?

A. In the future, if American Water would shift so that its subsidiaries were receiving substantially all or most of its debt internally from another subsidiary, then I would question whether I would really call that third-party debt. At this point, the fact that there is debt outstanding to a third party, then I believe -- I believe this is an appropriate capital structure.

Q. Okay. And that wasn't quite my question. Whether Missouri-American issues debt to an outside third party or it issues debt internally to AWCC, do you draw a distinction for purposes of the term issues?

A. If Missouri-American is the entity, the legal entity, that is obligated for the debt, then yes, I believe they issued the debt.

Q. Okay. Regardless of who they get it from?

A. Correct.

Q. Thank you. Now, Mr. Murray has recommended a range of returns on equity in this proceeding from, I believe, 8.26 to 9.26 percent. Is that your understanding or recollection?

A. Yes.

Q. And then he applies that recommended return on equity to the parent company consolidated capital structure with its embedded costs of long-term preferred, and I think some short-term debt, to arrive at an overall return -- rate of return, as I call it; is that right?

A. Yes.

Q. My understanding is that rate of return is 6.67 percent to 7.03 percent. Does that ring a bell with you?

A. Yeah, that's familiar.

Q. Okay. Now, for the rate-making purposes, that is the return that is applied to a utilities rate case to determine that element of cost to service, correct?

A. Correct.

Q. Okay. Now, by comparison, you recommend a return on equity, at least in your surrebuttal, of 9.5 percent.

A. Correct.

Q. But you recommend that on Missouri-American's capital structure, that is somewhat different than American's consolidated capital structure, correct?

A. Correct.

Q. And in fact, you've got approximately 44 percent equity in your capital structure?

A. Yes.

Q. Versus American consolidated, which I believe updated is around 45 percent, somewhere in that neighborhood.

A. Based only on Mr. Murray's numbers, yes.

Q. Okay. When you apply your recommended return on equity, 9.5 percent, in the Missouri-American specific capital structure, you produce a recommended return -- over all the return, if you will, overall return of 7.68 percent, correct?

A. Yes.

Q. And again, that's the number that's applied to rate base?

A. Correct.

Q. Okay. Now, would you agree with me that if Mr. Murray used your capital structure, in other words, the company's capital structure as shown in your surrebuttal testimony, and still recommended an overall rate of return of 6.7 to 7.03 percent, that would result in a return on equity in the range of approximately 7.2 to 8 percent?

A. If you took -- if I understand your question, you're talking about taking the rate of return he calculated using overall -- the consolidated capital structure in his ORE.

Q. Right.

A. Apply that to the Missouri-American capital structure and back out a cost of equity.

Q. That's it.

A. Yeah, the cost of -- the equity cost would drop.

Q. In other words, when you look at Missouri-American's capital structure and you take care of the debt that Missouri-American has to take care of and you take care of the preferred stock that they have to take care of and pay for, that the -- what's left is a return on equity, if you will, but it is less than is indicated return on equity in this proceeding?

A. Correct.

Q. Okay. I have taken the liberty, Mr. Burdette, of doing that calculation, and would like your review and comments on that. And if I may add -- or ask that an exhibit be marked for purposes of identification.

(EXHIBIT NO. 105 WAS MARKED FOR IDENTIFICATION.)

MS. O'NEILL: Mr. England, do you have a calculator that Mr. Burdette could use if you're going ask him to do calculations?

JUDGE THOMPSON: Proceed.

Q. (By Mr. England) And I guess in response to that, you can trust your view to confirm that I've totally screwed it up or I did it somewhat correctly?

A. You took an overall rate of return,

6.67, 7.03, you subtracted out the weighted cost of debt of 3.45, you subtracted out the weighted cost of preferred stock of .05, and what you were left with would have to be the weighted cost of equity, which you then divided by the percent of equity to get an equity cost rate.

Q. Correct.

A. Yes, I can trust that.

Q. And you can confirm that, at least for purposes of the amounts of capital and the capital structure, and the percents, which is the second column, they are taken from your surrebuttal exhibit, correct?

A. Yes.

Q. The cost rate for preferred and long-term debt also taken from your exhibit?

A. Yes.

Q. And the weighted cost for those two as well taken from your exhibit?

A. Yes.

Q. And I think you just confirmed that if you back into an effective cost of equity using Staff's overall rate of return, this capital structure, your embedded cost, the cost rates there for common equity of 7.21 and 8 percent are roughly appropriate or accurate?

A. That looks correct, yes.

Q. Okay. Thank you, sir. So if we get Staff's rate of return of 6.67 to 7.03, and after we pay off our long-term debt holders and after we pay off our preferred stock holders, the company is left with an opportunity to earn return on equity of its invested equity 7.21 to 8 percent, correct?

A. Given all the assumptions, yeah, the way you have set this up, that is correct.

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

JUDGE THOMPSON: Thank you, Mr. England. Were you going to move for the entry of this, Trip?

MR. ENGLAND: Yes, I was.

JUDGE THOMPSON: Do I hear any objection to the receipt of Exhibit 105?

MS. O'NEILL: No.

JUDGE THOMPSON: Hearing no objections, Exhibit 105 is received and made a part of the record in this proceeding.

Questions from the bench, Commissioner Murray.

COMMISSIONER MURRAY: Give me a moment,

Judge.

JUDGE THOMPSON: Yes, ma'am.

COMMISSIONER MURRAY: I don't think I have any questions for Mr. Burdette. Thank you.

JUDGE THOMPSON: Yes, ma'am.

Commissioner Forbis.

QUESTIONS BY COMMISSIONER FORBIS:

Q. How are you doing?

A. Good.

Q. Glad to hear it. I won't require you to have a calculator. Just so my mile-wide and inch-deep questions here, again, this is kind of where I am right now on this, and I asked this earlier, too. Do you have any idea how other states generally are approaching this sort of question? Are your numbers in line with what other states are doing on ROE or ROR? Are they high, low? Do you have a sense of that?

A. My sense is Missouri is considered a relatively regulated state. There are other states that seem to be a little more liberal with granted returns on equity.

Q. How about your specific -- your numbers, the 9.5 to 10 on ROE and 7.68 on ROR, where would that put -- where would those numbers fall?

A. In my opinion for regulated water, I think those are pretty much in line, and I'm not saying Missouri is out of line --

Q. Okay.

A. -- but I think they're in line with -- with what's out there.

Q. You were approached -- we talked about other cases, have you worked on other cases in the past and recommended things -- or OPC, of course, has made the recommendations, you may be aware of it. Is your approach in this case consistent with what you've taken in other cases?

A. Generally.

Q. Same approach using the subsidiary capital structure, for example, and the way you calculated using all that, that's --

A. Yes.

Q. -- basically the same, you're consistent?

A. Yes.

Q. Okay. When you do your DCF calculation and then you figure others as well, you sort of use the others as a guideline, right, there's some other approach you can make. How do you make all those fit together, just give me a quick overview of that.

A. If the utility in question has publicly-traded stock, then you can do a DCF analysis directly on that company. You use a comparable group to make sure that the single company result is not some sort of aberration, that it's not heavily influenced by an out of the ordinary dividend yield or out of the ordinary growth yield.

If you perform an analysis on the specific company and also look at several other similar companies and you get DCF results or whatever the model is, ROE results, generally in a zone of reasonableness or a ballpark, then you just have a little more comfort in the results.

Q. And you stay with the DCF results but you have a better comfort level, generally speaking?

A. Well, you can do that with any model, you can do that with the DCF or CAPM or any model you would choose. You can analyze the single company or a group of companies to look for some corroboration.

Q. I think you've explained your approach on using MAWC as a result of parents, I'll let that go.

COMMISSIONER FORBIS: That's it for me. Thank you.

THE WITNESS: Thank you.

COMMISSIONER CLAYTON: No questions.
JUDGE THOMPSON: Thank you, Commissioner.
QUESTIONS BY JUDGE THOMPSON:
Q. Mr. Burdette.
A. Yes.
Q. Looking at Schedule MB-11 updated on your surrebuttal testimony, does that represent your current position with respect to the ratios or percentages of each element in the capital structure of MAWC?
A. Yes, that is based on information that I got directly from the company dated November 30, 2003.
Q. Okay. And the embedded costs that you show on that schedule, are those also your present position as to the cost that should be used?
A. Correct.
Q. So, in other words, 6.22 for long-term debt?
A. Yes.
Q. 9.12 for preferred?
A. Yes.
Q. Okay. And then 9.5, as I understand it, is your suggestion as a return on equity figure?

A. Correct.

Q. Okay. And, now, did you perform a DCF?

A. I did.

Q. Using the November 2003 figures?

A. I'm not sure I understand your question.

Q. In other words, I'm going to ask you what results you got using the Discounted Cash Flow model?

A. Okay.

Q. And did you have to redo that based on updated financial information from the company or did you only have to do that once?

A. No, if you were going update the DCF, what you would update is most likely stock price. There wouldn't be anything associated with capital structure, necessarily, that would cause you to update a DCF.

Q. Okay. I understand. So with your DCF, what were the results that you obtained?

A. Assuming a dividend yield of 3.4 percent, growth of 6 to 6.5 percent, leads to a DCF cost of equity to 9.48 to 9.98.

Q. Okay. Did you do a risk premium model?

A. I did not.

Q. Okay. Did you do a CAPM model?
A. Capital Asset Pricing Model, yes.
Q. And what were the results that you obtained?
A. I did two different methods; one was an average for the comparable companies of 9.69 percent, the other was an average, and granted, this would be expected to be a much higher number, 11.15 percent, that's assuming a much larger market premium.
Q. Okay. And did you do a CEM model?
A. Did not.
Q. Did not. So you used two models?
A. Correct.
Q. Okay. And so the range that you defined using these two different models extends from 9.45 at the low end to 11.15 at the high end?
A. 9.48.
Q. 9.48, excuse me, okay. So that's the range?
A. Yes.
Q. And within that range, you selected the figure of 9.5 for your selection, right?
A. Correct.
Q. Okay. And why did you choose that point within that range?

A. In my direct testimony, I had had a range of 9.5 to 10 percent. I believe the existence of the ISRS is definitely lowered business risk. Also, from overall analysis of utilities in general, including analysis of electric and gas, I believe the 9.5 is better representative of the cost of equity for a water company.

Q. Okay. Let's talk about this ISRS. Now, this is the statutorily created surcharge for infrastructure replacement, correct?

A. Correct.

Q. And it applies only to the St. Louis County district; is that correct?

A. Correct.

Q. And it essentially creates -- or would you agree that it essentially creates a little rate case dealing only with that issue?

A. I wouldn't call it a rate case unless you want to call it a single-issue rate case.

Q. A single-issue rate case.

A. Okay.

Q. And the purpose of that is to provide return for capital investments in infrastructure replacement, you know, on a much more rapid basis; is that correct?

A. Correct.
Q. And if you recall, how often is that figure updated?
A. I believe it's every six months.
Q. Every six months. And then when a general rate case comes along, what's the effect?
A. Let me check direct real quick --
Q. Sure.
A. -- so I don't give you a wrong answer. I believe when a rate case comes along, the past ISRS is up for prudency review, I believe, to be accepted or not accepted, and then the ISRS amount is reset back to zero.
Q. Okay. And the amount of capital investment that's been made in infrastructure during that ISRS period, is that then recognized in the general rate case as an addition at that rate base?
A. I believe that's how it works, yes.
Q. Okay. That only applies to one district out of nine or ten?
A. St. Louis area, yes.
Q. Okay. What -- if you any idea, what's the annual amount of capital investment involved?
A. I am not sure.
Q. I guess what I'm aiming at is there's

been a lot of discussion of the ISRS as reducing risk for this company and therefore having a depressing effect, if that's the right phrase, certainly from the company's point of view, on the return on equity; is that correct?

A. Correct.

Q. Okay. But is the amount of money involved such that there really should be a significant effect?

A. Well, that's the reason that my recommendation was that the Commission should consider it. I did not make a quantified adjustment to ROE. I didn't say we should drop it by 25 basis points or 50 basis points. Simply pointing out the existence of the ISRS, depending on the level that it's operating at, at any particular time, it could be important for the Commission to consider the effects.

Q. Okay. Now, if I turn around, turn what you just said around, is it fair to say that you don't believe the ISRS has a significant enough effect to quantify?

A. I think we could probably do studies and get economists involved and run all kinds of statistics and probably argue about a whole lot of things concerning what the quantifying number would be, not that somebody could not come up with a number, but I'm sure it would be up for vigorous debate.

Q. Well, let me ask you this. In the absence of the ISRS, do you believe that 9.6 would be a better suggested value for return on equity?

A. Well, that would be -- that would be attempting to quantify.

Q. That's exactly what I'm trying to get to you do.

A. No, I wouldn't really -- I would leave it at I believe it's up for the Commission to take it under consideration.

Q. Okay. Fair enough. Now, to the extent that the other experts who did a Discounted Cash Flow model analysis and a Cost of Asset Premium Model analysis, if that's, in fact, the correct name, to the extent that they reached different results than you have and employed different assumptions, is it your opinion that they are in error?

A. Compared to the judgment that I exercised, yes.

Q. Okay. What is your opinion, if you have one, of Staff's proposal to use the AWW consolidated capital structure in place of MAWC's capital structure?

A. I think it's a -- an issue to watch. I think that if American Water is altering its overall method of financing and subsidiaries so that all of its financing eventually is going to become internal, I think it's something to consider. I think at this point, with the levels we're talking about, it's still appropriate to use Missouri-American's stand alone subsidiary capital structure.

JUDGE THOMPSON: Thank you, Mr. Burdette, that's all the questions I have for you. Any further questions from the bench? Commissioner Murray.

COMMISSIONER MURRAY: Thank you.

QUESTIONS BY COMMISSIONER MURRAY:

Q. The Judge was asking you about the range of between 9.48 and 11.15, and the fact that you came up with the recommendation of 9.5. Do you remember that?

A. Yes.

Q. And then in terms of the consideration of the ISRS, which I understand you to say that it's appropriate for the Commission to consider any effect of the ISRS, but in your choosing the, really, the low end of your range to recommend, did you include that consideration?

A. When I filed direct, I had a range of 9.5 to 10. Within the recommendation 9.5 to 10, I said that I believe it would be important for the Commission to consider the ISRS and perhaps look at the lower end of that range. Between the time I filed direct and the time I filed surrebuttal, I made the determination to drop the range and just recommend the 9.5.

Q. And in that determination, were you considering --

A. The existence of the ISRS, yes.

Q. So it's already been calculated into your number?

A. For my number, correct.

Q. Okay.

COMMISSIONER MURRAY: Thank you.

JUDGE THOMPSON: Further questions from the bench? There appear to be none.

Mr. Zobrist.

RECROSS-EXAMINATION

QUESTIONS BY MR. ZOBRIST:

Q. Just briefly, Mr. Burdette. Your recommendations as far as return on equity and cost of capital were generally in agreement with those of Mr. Wurtzler from the St. Joseph Water Rate Coalition; is that correct?

A. I would say that his were in agreement with mine, he did no fundamental analysis.

Q. And I would not quibble with that. He reviewed your testimony and that of other parties, correct?

A. Yes.

Q. And he did generally agree with your recommendations, correct?

A. It seems so, yes.

Q. And I apologize, I did not mean to zing one by you. I paid for what I got out of my client. And is it also correct that Mr. Wurtzler's recommendations on capital structure also agreed with your opinions?

A. He retained short-term debt. My methodology on short-term debt is a little different than Staff. Staff takes a snapshot of short-term debt. Because short-term debt can be so variable over a year, I look more at an average, and when I look at the previous 12 months, it was obvious that the company had gone back to a condition of short-term debt was less than CWIP, so I believe that it's appropriate to exclude short-term debt from capital structure, and he retained short-term debt.

Q. Was that the only difference that you could recall between his opinion and your opinion?

A. For the most part. He didn't provide the dollar amounts, and in fact, in surrebuttal, I thought about doing it, but he didn't provide the dollar amounts in order to back out his percentages, so I couldn't do a direct comparison, but that seemed to be the largest difference.

MR. ZOBRIST: Thank you very much.

JUDGE THOMPSON: Thank you, Mr. Zobrist.

Mr. Snodgrass.

RECROSS-EXAMINATION

QUESTIONS BY MR. SNODGRASS:

Q. Mr. Burdette, you indicated, I believe, in some of your answers here that if American Water Capital Corporation issued a large amount of debt to Missouri-American, that you were not sure that you would classify that debt as Missouri-American Water Company debt. Is that a fair characterization of what you said?

A. I'm not sure what I said. My meaning is if -- if American Water becomes, or their financing arrangement, becomes that an entity within the company, like American Capital Corporation or American Water Capital Corporation, is doing all of the borrowing, and then the corporation is allocating the money out, then I think that's much less -- it's much less stand alone companies as subsidiaries than has been in the past.

Q. All right. Now, going to Mr. England's exhibit that we just talked about where he does some calculations, it goes without saying that the calculations contained in that exhibit provided to you presumes that Missouri-American Water Company's capital structure is the appropriate one to use, does it not?

A. Yes, it's definitely using Missouri-American's capital structure.

MR. SNODGRASS: I don't think I have anything else, thanks.

JUDGE THOMPSON: Mr. England.

MR. ENGLAND: No questions, your Honor.

JUDGE THOMPSON: Bless you, Mr. England.

Ms. O'Neill.

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

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REDIRECT EXAMINATION

QUESTIONS BY MS. O'NEILL:

Q. Mr. Burdette, why do you rely so heavily on your DCF calculations and your DCF analysis when you analyze situations different from your opinion in a case like this?

A. I think it's rooted in very solid fundamental financial theory. It's well-respected in the financial community and this Commission has shown respect for the model.

Q. And you had indicated in one of your answers to a question from the Bench that you would expect your CAPM analysis to be higher than your DCF analysis. Do you recall that?

A. I performed two different CAPMs and I said that I would expect the second CAPM to be higher because it specifically had a higher market premium.

Q. Okay. And how does that -- how does that relate to your comparing back to your DCF analysis to see whether or not you would want to make any changes as far as the recommendation?

A. I did the two CAPMs because just about every component that goes into the CAPM, we end up arguing about in one way or another, so I just kind of decided to shunt some of that from the beginning and used two analysis with two different market premiums, knowing, obviously, that if you choose a larger market premium, you're going to get a larger result, but at least I know what the number was that I calculated going in.

Q. And the fact that that later CAPM analysis was 11.15 --

A. One nine, I believe.

Q. -- didn't affect your recommendation regarding -- your final recommendation regarding ROE is what you've testified to. Can you explain that a little bit more?

A. The first methodology for the CAPM that I used I think is much more traditional and much more -- well, traditional and usual and it was 9.69 and fell right in the middle of my original range, so it provided corroboration, I thought.

Q. And you thought that that original CAPM that you did adequately looked at business risk and what the expected return would be that investors would want in a company like this one?

A. Correct.

Q. Now, can you explain why you chose not to use or perform a risk premium analysis?

A. In general, I think risk premium

analyses can be manipulated. You can choose -- you can very carefully choose the time that you measure the risk premium and pretty much come up with any number you want.

There have also been historically been times when the risk premium between bonds and stocks has actually been negative, so it just seemed -- and I've seen it done, analysts will come in and they will choose a very long historical period to measure the risk premium; they'll choose a very short period; they'll choose a very select set of years or skip a couple years. It's just -- I've written good rebuttal against it, so it's not something that I choose to set myself up for.

Q. You find that DCF is a more objective analysis than risk premium?

A. In general.

Q. And why was it that you chose not to do a CMM -- CEM analysis?

A. Comparable Earnings Model?

Q. Yes.

A. Again, it has been tried before, what it means is you try to go out and find companies of the same risk but in different industries, and so then it comes down to what is it you're trying to use. Is it just beta, is it some other measure of risk, and any comparable earnings analysis that I've seen, I've greatly disagreed with companies that were selected, and I've never come to the conclusion of how to appropriately select the companies to imitate the risk of utility.

Q. And in fact, in the comparable earnings analysis that Ms. Ahern did, she chooses competitive companies, and that's typical in those types of tests; is that correct?

A. That's exactly what they would be.

Q. There are companies that are not regulated by a Public Service Commission or a Public Utilities Commission?

A. Correct.

Q. Things like grocery store chains?

A. Or whatever you would choose that you think is the same risk.

Q. Pretty much any kind of company that you wanted to put in that list if you could come up with a rationale for saying the risk was similar?

A. Correct.

Q. And so it's very subjective?

A. In my opinion.

Q. And is it also somewhat result-driven?

If you want a high number, you put companies in there --

A. I think you could do that pretty easily.

Q. I want to talk just real briefly with you about the new ISRS statute, and that's a law that just recently went into effect; is that correct?

A. July, I believe.

Q. And although Mr. England suggested that the regulatory lag reduction was a difference between eleven months and four months, it's a little more complicated than that, would you agree?

A. I would think so. I mean, a rate case, I believe, takes eleven months.

Q. And in fact, a company could apply for more than one ISRS between rate cases; is that correct?

A. I believe they can apply twice a year.

Q. And so if rate cases were every two or three years, but suddenly these single-issue rate cases came in every six months, that would be much less regulatory lag. Is that fair to say?

A. Correct.

Q. And are you aware of specific customer numbers related to the St. Louis County district?

A. Not specifically.

Q. Are you aware of whether the St. Louis County area is a large or a small portion of the company's total customer base in Missouri?

A. I believe it's relatively good size, but I don't know the specific numbers offhand.

Q. In fact, do you believe that it's, in fact, the largest district that they have in the state?

A. I do.

Q. And we're glad you do. And for all of those reasons, it's appropriate for the Commission to consider these -- this reduced regulatory lag in considering whether or not the ISRS lowers business risk?

A. Yeah, I think it's a pretty fundamental change in Missouri regulation. I don't think it's something that can just come into play without the Commission considering it.

Q. And St. Louis County Water has -- are you aware of other cases where they've come in and requested some sort of special treatment to deal with their infrastructure replacement problems?

A. I've been involved with several cases with St. Louis County Water going back eight and a half years.

Q. So it's a fairly substantial investment that they're looking to do under the ISRS?

A. I believe so.

Q. Okay.

MS. O'NEILL: No further questions.

JUDGE THOMPSON: Thank you. You may step down, Mr. Burdette. Thank you very much for your testimony.

MS. O'NEILL: Your Honor, may Mr. Burdette be excused? I know he has a daughter who's sick that he needs to go take care of.

JUDGE THOMPSON: Absolutely, and I hope your daughter recovers quick.

Is Mr. Gibbs in the house?

MR. SNODGRASS: Judge, I have that cite you were looking for and you asked me about.

JUDGE THOMPSON: Absolutely.

MR. SNODGRASS: On that prior Commission decision, it's 706 S.W. 2nd 87, Missouri Appellate, 1985.

JUDGE THOMPSON: Thank you very much.

MR. SNODGRASS: You're welcome.

MR. ENGLAND: Your Honor.

JUDGE THOMPSON: Yes, sir.

MR. ENGLAND: Can we go off-the-record for a second?

JUDGE THOMPSON: Well, that's more complicated than you might think, but sure, why not.

(AN OFF-THE-RECORD DISCUSSION WAS HAD.)

JUDGE THOMPSON: Mr. Gibbs, I will remind you that you are still under oath.

THE WITNESS: Yes.

JUDGE THOMPSON: And we are ready for questions from the Bench for Mr. Gibbs on the pension issue. Commissioner Murray. And Commissioner, if you prefer, we can take a recess if you need to find your notes or anything of that sort. I apologize.

COMMISSIONER MURRAY: Well, Judge, I would -- oh, I think I may have found my notes. Thank you.

QUESTIONS BY COMMISSIONER MURRAY:

Q. Good afternoon, Mr. Gibbs.

A. Good afternoon.

Q. It's hard to change gears and get back into pensions, but let's see if I can think that way for a moment. Has the -- did the company propose not using the FAS 87 methodology, to your knowledge, in any rate cases where ERISA would have provided more revenue requirements?

A. Since the Staff adopted the use of FAS 87, since 1994, I don't believe the company has proposed anything other than FAS 87.

Q. Okay. And when you were being cross-examined, I believe, you stated that or agreed that the FAS 87 is an accrual method that does not match actual payments; is that right?

A. On the current basis, yes, that is correct.

Q. And if, for rate-making purposes, the FAS 87 methodology were employed some years and the ERISA methodology were employed other years, would the end result over time be that the company did not recover all of the expenses associated with pension?

A. I seem to recall in the pension testimony that was given, particularly by Mr. Williamson, in terms of measurement from beginning to end, that FAS 87 and ERISA would wind up, you know, at the same point, the problem is that, you know, that's impossible to determine because ERISA, FAS 87 and -- these all began in different points.

ERISA was, what, 1974, I believe. FAS 87 came into being in 1987. We started using FAS 87 for rate-making in '94, so there's no way that, you know, that given any kind of measurement of time that these things would ever equal.

Q. But if you change to Staff's recommendation in this case, is there an amount that would not be recovered?

A. I think the Staff's position is they would recover pension expense, it would just be on a different basis than FAS 87. As I've stated in my testimony that under the FAS 87 basis, the company has already collected in excess of 9 million dollars more than what they've had to contribute to the pension fund since we've switched over to the FAS 87 method, so.

Q. And while that has been the case, while the market situation has been positive to the extent that the fund was building up, excessing fund was, or whatever, I guess you wouldn't call it excess, but the fund was building more rapidly because of the market situations, right?

A. The market has a great deal to do with the -- how the fund -- the position of the fund.

Q. Okay. And when the position of the fund was building more rapidly, for rate-making purposes, Staff wanted the company to use FAS 87 because that required recognition of those -- those -- I wish I had the terminology before me.

A. Down recognized gains and losses?

Q. Yes, thank you, the unrecognized gains had to be considered for rate-making purposes, right?

A. Yes, I mean, when we adopted FAS 87 for rate-making purposes, FAS 87 for all intensive purpose for almost all utilities operating in the state was already in excess of what ERISA pension expense would be if we had been on an ERISA basis.

The situation with the unrecognized gains and losses was that under FAS 87, there is a minimum amortization that takes place, and the original adoption of FAS 87 for rate-making, there was tremendous unrecognized gains in a lot of pension plans, and we thought it would just be more appropriate that those gains be recognized in a more expedient manner rather than waiting 20, 30 years down the road for those gains to flow back into the calculation of pension expense.

Q. And what rate-making period are you talking about now?

A. We adopted, in 1994, for rate-making, the FAS 87, and during that time frame, and particularly during the early-90's and mid-90's, there was tremendous amount of unrecognized gains, and like I've indicated in my testimony, that Staff's methodology has changed with regards to FAS 87, over this time frame, not change for change sake, which seems to be what's been implied, but the changes in our methodology in the amortization has been as a result of rate cases where company's, during the rate case procedure, have come to us, you know, with concerns about the volatility in the various methods that was trying to be explored in the amortization of these gains and losses.

And what has happened over a period of time, particularly with the way the stock market just -- the bottom fell out of it, we were seeing that -- that even the amortization methodology that we had changed to try to address the volatility issue was still creating a volatility in the development of pension expense for rate-making, and so beginning with the AmerenUE complaint case, the 2002-1, Staff's methodology, since that case, the Staff has consistently requested the use of ERISA as a basis for setting pension expense.

Q. And am I understanding you to say that that's because that would produce less volatility for rate-making purposes?

A. Yes, most of these utilities during this time frame when we initiated this was still a situation where regardless of what FAS 87 was doing, the ERISA minimum contribution was still at zero.

Q. Okay. But, now, when you go forward, and with the projected ERISA minimums looking forward, I'm looking at your Schedule No. 1 attached to your surrebuttal.

A. There's quite a lot of change projected going forward, correct, under the ERISA calculation?

A. And I think that when you use the word projection, I think that's a correct term to use. These numbers are, in fact, projections based on assumptions that -- that I have.

Q. Okay. That's a given, they're projections, is that an accurate statement?

A. Yes. Yes, it is.

Q. Thank you. So is there volatility with the numbers under ERISA?

A. Based on the numbers that's in here, I don't know that volatility can be completely eliminated; however, at least under ERISA, the funding would be taking place based on federal guidelines and be in compliance with the federal guidelines for funding the pension plan.

Q. Okay. And the fact that they're currently in the pending rate case, as I understand it, are there unrecognized losses?

A. In the current rate case, based on the latest actuarial, the 2003 actuarial for American Water, there is an unrecognized loss of 128 million dollars.

Q. And it's the Staff's position that the company should not -- not consider that unrecognized loss in rate-making, but that it was appropriate that it considered every unrecognized gain in the past; is that right, for rate-making purposes?

A. I think it was -- it was more a --

Q. Is that accurate?

A. In two of the prior cases, the calculation of FAS 87 expense for rate-making did include a reduction in the FAS 87 expense to reflect an amortization of the gain balances.

Q. Okay. Was there ever a time in which it caused a reflection of unrecognized loss?

A. No, there was the -- the one case that the unamortized gain or loss balance, which was the '97 case, I believe. In that particular case, I revisited the data from that particular case, and although there's nothing in the record, nothing in the work papers to support this, but my review of the data that was available that the test year in that particular case, which was the 1996 calendar year for the company, the company went from a -- and when I'm saying company here, I'm referring to American Water total.

Missouri-American is just a piece -- a piece of this. American Water went from a half a million dollar gain balance to almost a 16 million dollar loss balance at the same time those assets earned thirty-three and a half percent. There was just something in the calculations that the Staff felt was abnormal, and looking at the unrecognized gain loss balance subsequent to that, I think that -- I think that holds true because the 15 -- the 16 million dollar loss, the very next year turned into a 21 million dollar gain.

Q. So at the time that it was considered in rate-making, there was a net gain; is that right?

A. There was a net gain during the '95 case, and there was also a net gain that was reflected in the calculation of pension expense in the 2000 case. In the '97 case, the Staff did not use the amortization but just with the straight FAS 87 calculation.

Q. So if you had used the amortization, it would have required recognizing a loss; is that right?

A. If we had recognized, it would have been a loss; however, it was on the basis that we felt that the loss balance that was there was not a normal situation. There was something in the calculation that created that loss.

Q. Okay. And that's why you didn't think it was inappropriate at the time to not allow the company to offset any gains if it had to recognize in the past with the current unrecognized loss because it was an aberration; is that right?

A. That's correct.

Q. Okay. Now, this particular case, you're taking that same position, but even though the company in the past has had to include its unrecognized gains in rate-making treatment, it must now not include any unrecognized losses because now you want to go to a different methodology. Is this an aberration also or is this your policy going forward?

A. I don't want to call it an aberration because the gains and loss balances comes into play under the FAS 87 methodology, and because of what we have seen, and like I said, the Staff's -- the audit Staff's policy with regards to addressing pension expense to rate-making, that policy was redirected to the ERISA methodology in the Union Electric or the AmerenUE complaint case, and it's been consistent with that -- that policy since.

Q. And is that because now, for rate-making treatment, it would be -- it would give a higher revenue requirement to companies when they are given the same treatment under FAS 87 that they had been given in the past rate case? Is that the reason for the change in policy?

A. No.

Q. If not, can you give me a reason?

A. As I indicated, the policy change was initiated with the AmerenUE complaint case, and if I'm not mistaken, even in that complaint case, I think under the FAS 87 methodology using an amortization, we were creating a negative pension expense, and it was our concern that even though the FAS 87 created a negative pension expense, that wasn't appropriate for rate-making either, so going to an ERISA basis, which in the AmerenUE case was zero, zero was all actually greater than what FAS 87 expense created, so that is a carry forward, and it's just unfortunate in this proceeding that, you know, it seems like the pages are reversed.

Q. Okay. And in this proceeding, since there's -- seems like quite a discrepancy between what has been recognized in the past when it worked to the company's detriment and what Staff is saying should be recognized now, which would also work to the company's detriment, can you tell me how that will ever balance itself out or will it or is this just going to be a loss for the company?

A. Well, I can't say that it's a loss, I mean, No. 1, under the FAS 87 methodology that the Staff has used with the company since '94, the company has collected from the rate payers in excess of 9 million dollars. That's 9 million dollars greater than what they've actually had to contribute, so there's a balance sitting on their books of 9 million dollars that represents cash that they have collected.

Q. And that's because we have been using the FAS 87 method, which you have admitted in the past, is an accrual method rather than the actual payment method, right?

A. FAS 87 is the accrual, but if you have FAS 87 for rate-making, that is a cash flow benefit to the company, particularly when they don't have to make a contribution.

Q. Okay. And then when there are unrecognized gains in that, they have to take a -- tell me how that affects the rate base.

A. Well, the expense itself is part of operating expenses. How this affects rate base is when through FAS -- through recognition of FAS 87 for rate-making, that there is a positive expense in the books, but they have no contribution that's required, then the accounting entries from that -- from those transactions creates a liability on the books and because the rate payer has provided those funds to the company, that liability is used in rate base to reduce rate base thereby giving at least a return equal to what the company is able to earn on its assets back to the rate payers.

Q. Okay. So it is -- as a liability on the books?

A. Yes.

Q. It is calculated rate base?

A. The liability, I mean, the liability that's there is no different from accumulated depreciation on plant contributions in aide of construction, it represents dollars that have been provided by the rate payer that the company and the company itself uses as a reduction to its rate base.

Q. Okay. And with ERISA, with the change to the ERISA accounting method for rate-making purposes at this point in time, tell me what happens to -- okay. Tell me at this point in time, is there a liability on the books in pension?

A. At the moment, there is over a 9 million dollar liability on the books of Missouri-American. Now, that's Missouri-American's piece of the total American Water.

Q. Okay. And what happens to that if Staff's recommendation is followed here?

A. Well, I believe what was recommended in another case, which I think was accepted by the company, I think it was the last Laclede Gas Company rate case that the company accepted Staff's methodology of using ERISA for rate-making, but would still adopt FAS 87 for purposes of financial statement purposes, so what happens --

Q. Excuse me, but do they have to use FAS 87 for financial purposes?

A. I don't think it would be an absolute requirement. There is a -- and it escapes me again, it escaped me the other day when I was up on the stand, but there is a FAS that allows for deviations for regulatory purposes.

Q. Okay. Go ahead.
A. I mean, that's -- I guess they can account for their books on ERISA or a FAS 87 basis depending on what the Commission decides.
Q. What happens to the liability in terms of rate-making?
A. If they continue to report on a FAS 87 basis, then when the contributions begin to exceed what the FAS 87 expense is, that difference gets credited against the liability and that liability is then reduced. I think it was Mr. Grubb's testimony that based on the size of that liability as it currently exists, and what they these projected contributions to be in the future, that it would take until sometime in 2007 for that liability to be erased from the books.
Q. And that's based on -- that's based on FAS 87, correct?
A. Yes.
Q. And with ERISA calculations?
A. ERISA is strictly a cash basis, what they have to contribute to their pension fund to make sure that it's adequately funded.
Q. And what is considered adequately funded? I mean, what does that relate to, adequately

funded in terms of what?

A. That's established in ERISA, that when they calculate the minimum contribution, that minimum contribution is supposed to provide enough funds that if that -- at any given time, if that pension plan was to expire, that they would have sufficient funds to pay their retirees.

Q. And that's supposed to be taken care of by whatever the minimum ERISA requirement is?

A. That is the purpose of the minimum ERISA, to make sure that the pension fund is adequately funded.

Q. And with your Schedule 1 looking at what ERISA would require between now and 2008, it's going from zero up to 76 million at 2005, and anywhere between 12 and 76 million per year, right, would be the minimum required payments?

A. Yes, and as indicated earlier, I mean, these are based on the projections, the assumptions that Mr. Williamson built into his calculations, and I think it's obvious if you take a look at that next to last column what those unrecognized gains and loss balances have been over a period of time, that quite often those assumptions are considerably different from the actual results that take place throughout use of those assumptions is.

Q. And that's not because of any flaw in the calculations here, but just on the fact that nobody has a crystal ball and can tell exactly what's going to happen in the future, right?

A. I think that's correct.

Q. Okay. Okay. I wish I had been able to question you when we were in the subject because I'm not remembering it well enough, but thank you.

A. And I would have been done, so.

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

QUESTIONS BY COMMISSIONER FORBIS:

Q. Having questioned you while we were there wouldn't have helped me at all, sir, but just one or two quick questions. So either the ERISA number, if you go that route, or the FAS 87 accounting cost numbers was used in rate base, right?

A. The FAS 87 or the ERISA, at one time or another, had been used in the determination of the cost of service. Those amounts are usually included in their operating expenses. The rate base is -- generally reflects the investment side of the equation either liability or an asset that they need to earn a return on.

Q. Okay. So how does -- how does this fit in, again, then, make sure I understand that. Whether we choose ERISA or FAS 87, it affects the company how?

A. Whatever level of expense is determined, either whether it be through the FAS 87 methodology or whether it be through ERISA, that is what would be incorporated into the company's rate structure, and that's what they would collect from the rate payers.

Q. Okay. I'm -- I am confused, then, as to ERISA using these numbers from your Schedule 1 -- or Mr. Williamson's -- Mr. Grubb's EJG-4. These ERISA numbers move all over the place whereas the FAS 87 numbers tend to be somewhat consistent.

They range from, you know, 12.4 in the EJG-4 but nonetheless, is it true with FAS 87 that your numbers aren't as volatile, do you have a certain stability from year to year, and would that not be a good thing to take the volatility out as opposed to using the ERISA pay as you go method?

A. Well, I think if on my Schedule 1 --

Q. Right?

A. -- I'm not so sure -- I mean, in terms of absolute dollars, if you take a look at that --

those percentage changes --

Q. Uh-huh.

A. -- there is still volatility within the FAS 87.

Q. Yeah, but much less -- I'm sorry, I won't interrupt you, keep going.

A. The thing with FAS 87, when they do calculate an expense, even though they calculate it -- calculate a funded percent of how the pension plan is funded under FAS 87, that funded percentage doesn't -- doesn't relate to the calculation of the FAS 87 expense.

At least under the ERISA methodology, when they calculate the current liability, the expense under ERISA for that year, then under ERISA, they look at that funded percentage to see whether or not the fund has been adequately funded, so you're giving credit for what you have already provided.

Under FAS 87, you do not get that, and that is one of the reasons why you have the unrecognized gains and losses that you do within FAS 87, and that was -- those gains and losses have -- was the subject of debate between the Staff and utilities who have filed rate cases before the Commission, and that's the reason why our methodologies that had changed over a period of time with FAS 87 to address the company's concern on the volatility issue.

Q. Say that again. Okay. Not the whole thing.

A. Our methodologies changed because initially when we went to FAS 87, and the companies had substantial unrecognized gains --

Q. Uh-huh.

A. -- it was the Staff's belief that these things need to be treated in a more expeditious manner than what FAS 87 treats them. FAS 87 normally has a minimum amortization, which is called a corridor approach, where a very small amount, as Mr. Williamson indicated, there's a threshold that that has to get to, and then only a piece of that above that threshold winds of getting amortized.

Q. Okay.

A. And so when you had a build up of these gains, it was the Staff's position that these ought to be recognized sooner than later.

Q. By going to an ERISA approach?

A. No, by going to a different amortization process.

Q. All right.

A. And so in the rate -- in the -- when as rate cases came along, companies was bringing to our attention that that particular methodology caused more volatility, and so we changed our methodology in the amortization area of the calculation to try to alleviate the volatility, and what we've found is no matter what we did, that volatility issue still existed, and it exists because there's too many things within the FAS 87, and for that matter, the ERISA calculation, particularly how the market operates, that's totally out of the control of the company.
Q. Uh-huh.
A. And that's one reason why, after approximately nine to ten years, the Staff has finally determined that, you know, maybe ERISA was -- is really the proper way to go.
Q. Over the next couple years, though, the estimated minimal required contribution would be more than what you would show under FAS 87 in the short-term, right?
A. Yes, based on Mr. Williamson's projections, and they are projections.
Q. Okay. So it's your position that using ERISA -- well, your position is that regardless of

Mr. Williamson's projections that ERISA would, in fact, result in a lower required amount that would show up in rate base over the next three to four years?

A. I wouldn't want to put it that way. I mean, the final result, we didn't go to minimum ERISA in an attempt to pick up the -- the lower of the two. It's not -- it's not like an ERISA calculation where you have to use the higher of these two calculations and the lower of these. It's a matter of what we think is more appropriate going forward for rate-making.

Q. So the actual amount in question, if I understood that correctly, wasn't a factor in which approach to take?

A. No, it was not.

Q. Okay. Let me absorb that for awhile. Thank you.

A. You're welcome.

JUDGE THOMPSON: Commissioner Clayton.

COURT REPORTER: Can we take a short break?

JUDGE THOMPSON: We'll take a ten-minute break for the reporter.

(A BREAK WAS HAD.)

JUDGE THOMPSON: Okay. We're back on the record.

COMMISSIONER CLAYTON: Can we talk some real numbers here, just for to start off? It is my understanding in my notes, I have reflected that the company is seeking to claim as a pension expense roughly 4.1 million dollars. Is that accurate?

A. Based on their original filing, I believe that is correct.

Q. Okay. And Staff is stating that the amount that should be used for pension expense is roughly 180,000?

A. No, that's not correct.

Q. Okay. Then what is the Staff amount?

A. The Staff pension expense in comparison to the 4.1 million is actually $466,177.

Q. All right. I don't know where I got that other figure, but that's what I wanted to make sure that I was using accurate numbers.

So basically, that makes the difference between the parties what I thought was about 3.8 million is now about, what, 3.5 million?

A. In terms of absolutes, I think that's correct.

Q. I mean, roughly. A million here, a

million there, right? Okay. Staff has not been very consistent over the last several rate cases; the methodologies have changed, have they not?

A. As I've indicated, the methodologies has changed, but it was changed as in response to --

Q. Well, regardless of the reasons, the methodologies have changed. I mean, I didn't ask the reasons, but they have changed over the last three to four rate cases?

A. Yes, they have.

Q. Okay. And the '95 case was the first case to use the FAS 87 figures. Is that accurate?

A. Yes, for this company, yes.

Q. For this company, and how long have you been with the Commission, so I want to make sure how far back do you go with --

A. A little over 27 years.

Q. So you were here in '95?

A. Yes, I was.

Q. Okay. So did you participate in the '95, '97 and 2000 rate cases?

A. I participated in the -- the '97 and the 2000 cases, I was not a participant in the earlier case.

Q. Okay. In the '95 case, you used the

FAS 87 cost less an amortization of unrecognized gains, correct?

A. That is correct.

Q. In the '97 case, used FAS 87 costs straight up without any reductions.

A. That is correct.

Q. In 2000, you used FAS 87 less also an amortization for some unrecognized gains.

A. That also is correct.

Q. Okay. And those reductions would be to the detriment, those amortized -- amortized unrecognized gains would reduce the amount of the pension allowance expense for the company, correct?

A. It reduced the amount that was included in rates for expense, but it still exceeded what the company had to contribute under the ERISA methodology for funding their pension.

Q. Okay. Despite those reductions and the inconsistencies, the company was still able to collect 9 million dollars more than it actually spent on pension expense during the same time?

A. On a cash basis, that is correct.

Q. And that's since 1995?

A. Yes.

Q. Now, FAS 87 is an accrual method of

determining expense for rate-making purposes, correct, it's not a cash basis?

A. It's not a cash basis, it's a financial -- it's a method of accounting for an accrued expense for financial statement purposes.

Q. So the theory in using this type of expense is that over time, there are going to be cash outlays that are going to be greater than the amount that they can actually claim for rate base, correct?

A. Yes, I think the theory that over a period of time, ERISA and FAS 87 should equal

Q. You would agree that with current estimates into the future that with the rate of return considerations being lowered in terms of interest rate, that the projections in the future that the cash outlays by the company are going to be significantly higher than they have been in the past with today's calculations?

A. Based on the assumptions that Mr. Williamson has in his calculations, yes.

Q. Well, are there any part of his assumptions that are not correct in terms of citing what the law is under ERISA?

A. No, not in terms of the calculation, but I think what happens is when you assume a certain rate of return, and then you're going to calculate the expense for the subsequent year, the value of those assets in his calculation assumes that whatever he used as his rate of return is what happens, so -- so if you happen to actually earn a greater rate of return, that following year, your asset base on which to earn a return is going to be greater, and over a period of time, we don't know what the values that's going to be, but it's certainly going to create a difference in what the funded percentage is of that pension fund, and that's going to have a direct impact on what the necessary contribution is going to be.

Q. Did you or anyone with Staff prepare any similar chart that -- that the company prepared in making projections for pension contributions in future years in light of the discount rate that is required to be used under ERISA?

A. No, we have not.

Q. Okay. Do you know what rate of return the company will see on the pension assets in the years to come?

A. No, I do not.

Q. Okay. Is there any way that anyone would know what rate of return the company will get on the pension assets in the future?

A. I don't believe so.

Q. The two figures that are at issue here, the 4.1 million dollars and the 466,000 dollars that Staff is using are pretty far apart. Would you agree with that?

A. Yes, I would.

Q. Would you agree that there is the potential, or at least possibility, that the company would face significant contributions into the pension system in the coming years?

A. There is that possibility; however, as I've already indicated, the company already has, if you want to call it a reserve, they've collected 9 million dollars in excess of what's already been provided through rates under the FAS 87 method since that '95 case.

Q. Did you take into consideration the reduced ERISA percentages for mandatory pension contributions into your calculations?

A. I did not actually do a calculation. The amount that the Staff has proposed is the actual ERISA calculation for the company.

Q. Help me with understanding this process. I'd like to say that as the newest member of the Commission. If we choose, or when we choose, one figure over the other, and let's say -- let's just assume that we were to choose the Staff figure 466,000, and in the next three years, the contributions -- actual cash contributions that have to be made by the company and are made exceed the 9 million dollar accumulated amount that they've paid in.

Does the company ever have an opportunity to come back and recoup the monies that they've paid into the system or is that money that they've lost and they cannot recoup from rate payers?

A. Rates aren't set retroactively; however, you can't look at pensions, this particular issue in a vacuum. You have to look at what the other aspects of the company, you know, what's happened to their rate base, what's happened to their other levels of expense. Where you may have an increase here, you may have a decrease somewhere else. As a matter of fact, they may have larger decreases somewhere else.

What they have to take into account and it is their responsibility that when they see that their bottom line -- and they're not earning the rate of return that's been authorized, it would behoove them to come before the Commission and request a rate increase, at which time that that can be evaluated.

Q. Okay. But it would never be based on just a single issue, unless it's another issue, but not this single issue, correct?

A. That is correct.

Q. Okay. In essence, that's what Staff is doing now. Basically, Staff -- the Staff position now is that the company has overcollected in the past on this issue, and now there has to be a reconciliation in the current rate case. Would you agree with that?

A. Not entirely. I mean, that's what it may appear. But like I said, the Staff policy as to the methodology that we are employing is a Staff policy that was initiated during a -- a case with AmerenUE, and subsequent to that, has been employed in a Laclede case, an AmerenUE gas case, as well as a recent Aquila Electric filing.

Q. Okay. Let's talk about comparable utility cases in Missouri. In '95, did -- and since you've been here for a few years, in '95, did all companies go to using FAS 87, and did Staff propose to use FAS 87 in all rate cases as of 1995, like in this case?

A. Yes, all major utilities that came before the Commission since the adoption of FAS 106 for rate-making purposes, the Staff has adopted the use of FAS 87 in the determination of pension expense.

Q. When did that -- when did it change that FAS 87 was no longer used in these other cases that you've mentioned; Ameren, Aquila, Laclede, when did the change occur?

A. The first case was the AmerenUE complaint case, which was EC-2002 --

Q. That's all right. Well, you can give the number, I'm not interested in the number, but I'm more interested in the year. If you want to give the number for the record, that's fine.

A. Well, the case number kind of signifies the year in which it was filed or applicable, so 2002 is when we was switched over to the ERISA methodology, at least in the UE -- AmerenUE case.

Of course, that switch does not take place to other utilities until they actually come before the Commission for a rate case.

Q. Okay.

MR. SCHWARZ: May I interject at this stage?

JUDGE THOMPSON: You may.

MR. SCHWARZ: EC-2002-1, I think the Commission records will reflect, was filed in early July of 2001.

COMMISSIONER CLAYTON: Okay. Anything else?

MR. SCHWARZ: No.

Q. (By Commissioner Clayton) Okay. That was in a complaint case?

A. Yes, it was.

Q. Okay. And did Ameren take a position -- well, I assume that they agreed to the ERISA calculation as opposed to pushing for FAS 87?

A. The case was eventually stipulated. I don't think there's any language one way or the other with regards to treatment of pensions.

Q. Okay. How about other cases in which there's been a switch from FAS 87 to ERISA, and just to keep it simple, I'm just looking for a company name and a year.

A. Okay. In the Laclede Gas Company, their last rate case, which was GR-2002-356, that was also a settled case, but I think the language actually exists in the stipulation that the company would use ERISA for rate-making purposes, but continue, I think, I believe it's in the language that they would continue to use FAS 87 for financial statement purposes.

Q. Okay. What else do you got?

A. Subsequent to the Laclede Gas case, there was an AmerenUE Gas case, GR-2003-0517. That case was actually filed subsequent to the filing of this case, but has already been stipulated and settled to.

I don't believe there's any language associated with pensions in that, and the final case is an Aquila Electric case, ER-2004-0034, which has just recently been filed and is still, I assume, at issue.

Q. Now, to be clear, these are cases in which Staff has changed its methodologies, not cases in which either the company has agreed to the change in methodology or the Commission has adopted the methodology, is that correct?

A. This is the first instance where the issue has actually been presented before the Commission for their decision with regards to the pension issue.

Q. Okay. Staff changed its policy, then, roughly 2001?

A. That is correct.
Q. Would that be a fair statement? Okay. But the Commission has never adopted that position in any case except for maybe the Laclede where the stipulation may include it?
A. That is correct.
Q. Okay. All the other ones were settled without agreeing to a specific figure or methodology in dealing with pension expense?
A. That is correct.
COMMISSIONER CLAYTON: I don't believe I have any further questions. Thank you.
THE WITNESS: You're welcome.
JUDGE THOMPSON: Thank you, Commissioner.
QUESTIONS BY JUDGE THOMPSON:
Q. Mr. Gibbs, remind me, if you would, what was the actual cash contribution that the company made during the test year?
A. During the historic test year --
Q. Yes.
A. -- which was the twelve months ending December, 2002, the actual contribution that the company made with regards to their minimum ERISA contribution was approximately 180,000 dollars.

Q. Okay. So where does Staff get the 466,177?

A. That 466,177 dollars is a combination of the minimum ERISA as established by their actuarial, their final actuarial for the -- for American Water, which was allocated down to Missouri-American, they contributed 180,000 during the test year, which is the second -- during the last six months of our test year.

In the first six months following the test year, which incorporated our known and measurable period for this case, they paid an additional 197,000 dollars into their pension fund for the total of 377,000. That was their minimum contribution associated with the American Water minimum contribution calculated by their actuarial.

In addition to that amount, there was approximately 51,000 dollars with regards to supplemental pensions that are not within their ERISA or FAS 87 calculation. These are just supplemental pensions that they make monthly payments to former employees who have retired.

It also included a -- an allocated portion of the service company's pension cost, which was approximately 51,000, and what makes up the final

37,000 dollars of the Staff's four hundred sixty-six represents an amortization of -- a pension amortization that was established in the WR-95-205 case.

Q. And is all that in testimony anywhere?

A. The components are not. All those various components, they are a component of my work paper that supports that number that is in the filing.

Q. So your work paper shows how you arrived at the 466,177?

A. Yes, it does.

JUDGE THOMPSON: You guys planning to put that in evidence?

MR. SCHWARZ: We were not planning on doing so.

JUDGE THOMPSON: What if you were invited to do so?

MR. SCHWARZ: If we were invited to do so, and none of the other parties objected, we could certainly -- actually, he's going to be back up on the stand later, and for the purposes of introducing it, an additional exhibit on this issue, we can certainly provide it at that time.

JUDGE THOMPSON: All right. Would you

make a note of that?

MR. SCHWARZ: Would you remind me.

JUDGE THOMPSON: Sure, I'll remind to you make a note.

MR. SCHWARZ: You can send me an e-mail now, can you not?

JUDGE THOMPSON: Let's move on. Yes, sir.

QUESTIONS BY COMMISSIONER CLAYTON:

Q. I'm sorry, this is a -- the way the timing is working out, I prepared for pensions a long time ago, and we heard part of it on Monday, and we skip a day, and we come back, so my notes are quite jumbled.

Are there any issues in dispute relating to other post-employment benefits? We haven't talked about that and I don't remember it ever coming up.

A. No, the real -- the only real issue in this is the difference between FAS 87 and minimum ERISA. The supplemental pensions, the amortization are not at issue.

Q. The FAS 106 is controlling. I mean, that's state law, so there's no --

A. The FAS 87, not 106; 106 is for OPEBs.

Q. That's what I'm talking about, the other post-employment benefits, the OPEBs, that's FAS 106, and that's mandatory state law, and there's no dispute on that issue, correct?
A. That is correct.
Q. Okay. So we're just dealing with the FAS 87 pension issue?
A. That is correct.
Q. Okay.
COMMISSIONER CLAYTON: Thank you very much.
JUDGE THOMPSON: Commissioner Murray would like me to ask you whether you were citing the settled cases you've referred to as support for the policy that you are advocating here?
THE WITNESS: When this testimony was filed, that was the only thing that I had to base the policy on, so yes, it was based on those settled cases.
QUESTIONS BY JUDGE THOMPSON:
Q. Okay. Now, you've told me where Staff got the 466,177. Can you tell me where the company got the 4,139,534?
A. Yes, the FAS 87 expense for the American Water system was approximately 32.6 million

dollars of which the Missouri-American portion of that was three point -- roughly 3.3 million dollars. That's where they got their FAS 87 amount.

The additional amount of pension expense that come up to the 4.1 million was the additional supplemental opinions and the amortization of the pension as established in the 95-206 case.

Q. So some of the same sorts of things you added in?

A. Yes. Outside of the FAS 87 calculation versus the ERISA, that is the real only true issue in the pensions. There is no debate on the supplemental pensions and the amortization.

Q. I understand. Nonetheless, we need to know where all the parts of the number come from in order to understand this stuff. So the -- Mr. Williamson, the actuary, testified, did he not, that it is his present prediction that the required minimum contribution is going to go steeply up in years to come; is that correct?

A. Yes, based on his assumptions, yes, that is correct.

Q. Okay. And Staff, as far as I know, and please correct me if I'm wrong, Staff has not presented anything to suggest that he is wrong in that conclusion, has it?

A. No, we have not; however, I would also suggest even though the possibility does exist, we have -- I think if you go beyond what's known and measurable, you create a test year issue.

We have, when developing a revenue requirement, we try to keep the relationship between the rate base revenue and expense -- a relationship needs to be -- to exist there, and if you go another year down the road to pick up an individual expense, we don't know what's going to happen to those other components and whether or not that relationship would still exist?

Q. So in other words, if the Commission tried to build in an expected increase and increase, in fact, did not occur, then that would mean that rate payers were paying for something that, in fact, they didn't need to; is that correct?

A. That would be correct.

Q. Okay.

JUDGE THOMPSON: Absolutely, Commissioner Clayton.

COMMISSIONER CLAYTON: I'm sorry. Since we're the only ones down here, take advantage of this.

JUDGE THOMPSON: Absolutely.

COMMISSIONER CLAYTON: Although I know they're listening in upstairs.

QUESTIONS BY COMMISSIONER CLAYTON:

Q. The chart -- I'm looking at a chart that relates to past FAS 87 costs -- pension costs that have been allocated in prior rate cases, specifically for people who were paying attention, if anyone's paying attention, EJG exhibit or schedule EJG-3. I want to make sure that these are accurate. In the '95 rate case, the FAS 87 cost allocated were 279,334, does that sound -- and that's adjusted for the unrecognized gains. Is that accurate?

A. Could you repeat the amount again?

Q. Well, first of all, I guess I'll ask, do you have, I believe this is Mr. Grubb's testimony, his rebuttal testimony, do you have that with you?

A. Yes, I believe I have that.

Q. You have the schedule?

A. I have the schedule you're referring to, yes.

Q. I'm looking at the bottom of the first column in the '95 rate case, you have total cost before operation of maintenance ratio, 279,334. Was that the pension expense under FAS 87 used in the '95 rate case?

A. Yes, it was.

Q. Okay. In the '97 rate case, the figure was 191,815 dollars?

A. That is correct.

Q. In the 2000 rate case, the figure was 168,567; is that correct?

A. Yes, that is correct.

Q. And you are proposing the next figure there, which is 466,177 being used?

A. Yes.

Q. So the figure that is proposed by the company of 4.1 million dollars is, I don't even know how many times that is, from the last rate case. Is that accurate?

A. Yes, that's correct.

Q. So your figure is more than twice of what it was last time, and the company's proposing, gosh, some 400 percent increase or something like that; 4,000 percent increase?

A. Yes.

Q. Okay.

COMMISSIONER CLAYTON: Thank you.

JUDGE THOMPSON: So there -- the plan year is not a calendar year, it's July 1 through June

30th; is that right?

THE WITNESS: For ERISA, the actuarial report actually has a calculation that develops of FAS 87 expense for a calendar year basis but the minimum ERISA is based on a June 30 calendar year, yeah.

JUDGE THOMPSON: Commissioner Murray.

COMMISSIONER MURRAY: Just in time. Oh, I forget where I'm sitting.

QUESTIONS BY COMMISSIONER MURRAY:

Q. Mr. Gibbs, I was listening upstairs and I wanted to be sure and ask you because you had some exchange with Commissioner Clayton about some of the recent cases in which Staff had recommended the use of this methodology, the same methodology you're recommending now, right, do you remember that exchange with Commissioner Clayton?

A. Yeah, you're referring to the -- the AmerenUE complaint case, the Laclede case, yes.

Q. Yes, those cases you discussed then. And I believe you said that they were all settled, is that right?

A. Three of the four cases have been settled, the Aquila is still --

Q. Okay.

A. -- in process.

Q. The ones that are completed were all settled?

A. Yes.

Q. And I just want to make sure you're not trying to cite those to indicate any policy of the Commission in regard to that issue.

A. Oh, no, I'm not trying to cite a Commission policy. It's the -- the audit Staff policy with regards to the issue.

Q. Okay. And you're not citing them to indicate that the companies had accepted that policy outside of any other issue that they may have considered in a stipulation and agreement, are you?

A. All I -- there is language in the Laclede case if they accepted the minimum ERISA methodology.

Q. Okay.

A. How that is incorporated in the give and take in the stipulation, I'm not aware of.

Q. Okay. And that's my point. You understand that when a party stipulates to settlement of many issues, that you can't make a determination that they've agreed that any one of those issues as being appropriately treated; is that correct, by itself?

A. Well, I would say what we used to refer to as the black box settlement, you know, where nothing was stated, but in the -- in the text of the stipulation when a company agrees to account for something a certain way, I would assume that that's an agreement with the Staff's methodology.

Q. When taken in consideration in conjunction with consideration of all of the other issues that were settled at that time, right?

A. I'm sure it wasn't settled in a vacuum, that there were other issues that may not -- how those issues were disposed was not written into the -- into the stipulation, so, yes.

Q. Okay.

COMMISSIONER MURRAY: I think that's all I have. Thank you.

THE WITNESS: You're welcome.

JUDGE THOMPSON: Commissioner Clayton.

COMMISSIONER CLAYTON: Last -- no, I'm done.

JUDGE THOMPSON: I'm done, too. Any further questions from the Bench? Okay.

Mr. Zobrist, he's gotten away.

Ms. O'Neill.

MS. O'NEILL: No questions.

JUDGE THOMPSON: Mr. Cooper.

MR. COOPER: Yes, your Honor.

RECROSS-EXAMINATION

QUESTIONS BY MR. COOPER:

Q. Mr. Gibbs, just a few moments ago, you were pointed to Schedule EJG-3. Do you remember that?

A. Yes.

Q. And I believe there was a discussion of the pension cost numbers that are reflected on EJG-3; is that correct?

A. That's correct.

Q. Okay. Are those numbers reflective of Missouri-American as it existed before it purchased St. Louis County Water Company?

A. I think the first three cases; '95, '97, and the 2000 case was prior to the purchase of Jefferson City and County Water. The 466,000 dollar figure there represents the minimum ERISA after the incorporation, if you will, or the merger, of Missouri-American and St. Louis and Jefferson City, and -- but would I add that the pension plan for the St. Louis County at this time had a zero contribution level.

Q. But the first three case numbers that you -- that are cited there, the '95, '97, 2000 case, Missouri-American only, correct?
A. That is correct.
Q. And the 467 is after we add in Jefferson City and St. Louis, correct?
A. Yes, that is correct.
Q. And would you agree with me that St. Louis County Water is approximately three times as large as the old Missouri-American Water Company properties in terms of number of customers?
A. In terms of number of customers, but the addition of St. Louis and Jefferson City really doesn't have an impact, at least not the County Water, has an impact on this number because County Water had its own pension plan that has not yet been rolled into the American Water plan, and for this similar time frame, the County Water plant had a zero contribution.
Q. So for purposes of ERISA calculation, that number was zero, correct, for St. Louis?
A. That is correct.
Q. But for purposes of FAS 87, it might have an impact different from that zero number, correct?

A. Yes, it would.

Q. Okay. Now, I believe in some questions from Commissioner Forbis, you described kind of a corridor approach, do you remember that?

A. Yes, that's described within ERISA, I believe --

Q. Okay.

A. -- or FAS 87, I'm sorry.

Q. Within FAS 87, and that is a way to kind of reduce volatility on unrecognized gains and losses, correct?

A. It's a method to amortize gains and losses once they get to a certain level. I seem to recall there was something in the FAS 87 language, when it was originally established, that I think that the corridor approach was, like, compromise. I don't think that there was a -- a total agreement in the accounting community as to the proper way to amortize that, so I mean it was kind of a settlement, so to speak. It wasn't something that the total accounting community was happy with, but.

Q. Would you agree with me that in terms of the Missouri Commission's application of FAS 87, that the corridor approach has been heavily litigated over the years?

A. It's certainly probably been a debate between the Staff and the -- between the Staff and the company. I don't know to what degree it's actually be litigated.

Q. Okay. Now, you were describing some of the changes that Commission Staff has made in its calculation of FAS 87 over the years. Would you agree with me that in addition to the ones you mentioned, the Commission Staff also had made changes over the years in regard to how many -- how many years would be used to average the unrecognized gains and losses?

A. I think that's the reference to the changes that has taken place. I think when we initially started using FAS 87, particularly in this '95 case that's referenced here, it was not -- it just took the balance as of the end of the particular test year and did a five-year amortization.

Subsequent to that, I mean, other than the '97 case, in the 2000 case it was a five-year amortization of the five-year average of the gains and losses, so yeah, the methodologies, and that's what I was referring to the changes in the methodologies that we were trying to address that was brought to us in rate case proceedings by the various utilities.

Q. Now, you talked a lot about Mr. Williamson's projections. I think we established the other day that Mr. Williamson's the only actuary that's testifying in this proceeding, correct?

A. That is correct.

Q. And you're not an actuary, correct?

A. No, I'm not.

Q. Now, there was several mentions of the 9 million dollar pension liability that Missouri-American Water Company has on its books, correct?

A. That is correct.

Q. The creation of that pension liability was a function of the operation of FAS 87, correct?

A. And its -- and the difference between that and ERISA.

Q. Let's look at EJG-3 for a second, if you still have that in front of you.

A. Yes, I do.

Q. Now, I think you told us that that pension liability comes from the difference between what the company receives in rates versus what it pays on its ERISA minimum cash contribution, correct?

A. I don't think that's totally accurate.

I think what it is is the difference between FAS 87 and ERISA.

Q. Okay. So it really doesn't have anything to do with what is built into the company's rates, correct?

A. At any given time, what's collected through the rates is going to be different from what might have -- what the company would collect. You've got, in determining the rates, a total revenue requirement is developed and a rate schedule is established.

Now, anything can affect the actual flow of collection of revenue. It could be weather, weather could be wetter, hotter than normal, that's going to increase or decrease the amount of revenues, so to try to -- to try to account for the dollars that's been collected through rates with the actual revenues, I don't think that that's possible.

Q. Well, let's do it -- let's get at it a little differently. I think you said you still have EJG-3 in front of you. If what you're telling me about where that pension liability amount comes from is true, then for the years, approximately, 1995 to 1997, the company would have built into its rates and into its revenue requirement 279,000 dollars, correct?

A. Based on this, that is correct.

Q. Okay. And I think if we look back at your Schedule 1, we'll find there actually was some cash contributions in those years, but for purposes of this line of questioning, let's just assume that the ERISA cash contribution was zero, so for '95, '96, maybe '97, you've got, what, 280,000 approximately three times, what do we end up with at the end of that 8.4 million, or I mean, 840,000, correct, the difference between the amount built into rates and the ERISA cash payment?

A. Mathematically, that would appear to be so.

Q. Okay. So then in '97, we build in 191,000 into rates, and from '97 to 2000, and we'll still assume zero for the cash contribution, maybe there's a little less than 600,000 that the company gets which gets us to 1.4 million in round numbers, correct?

A. I'll accept that.

Q. And then in 2000, we've got 168,000 built into rates, we've got another three years, maybe, we'll assume still zero cash contribution, we've got another 450,000. I think we're no more farther along than, what, 1.6 million something, certainly we haven't gotten to 2 million dollars, have we, in terms of the cash contribution and amount the company has received in rates?

A. Certainly there seems to be a -- quite a variance in that number versus the 9 million, but again, in terms of revenue, even though you say 179,000 was built into rates in '95, I don't know that you can literally go back and say that that's how much we collected or did not collect --

Q. Well, let me suggest --

A. -- but strictly based on the mathematics, I see that, you know, that what you're trying to say is that there's no way, based on what at least what was built in the rates, that you're going to get to that 9 million dollar balance.

Q. And nowhere close in terms of the dollars the company actually received versus the dollars it paid out, correct? Let me -- would you agree with that?

A. Mathematically, yes, that would appear to be so.

Q. Let me suggest another alternative to you in terms of where that 9 million dollar pension liability comes from. What if that 9 million dollar pension liability actually comes from the difference between the FAS 87 number in any given year, irrepresentative of what's built into rates, versus the cash contribution. Can you get a lot closer to 9 million that way?

A. That could be. Now, again, what we're looking at here in terms of the -- what's built into the rates, we're looking strictly at Missouri-American. That 9 million dollars that's in the books, it also incorporates what has been built into rates and what's collected and the amount of FAS 87 in excess of the contribution associated with County Water, so what we're looking at here in terms of these numbers, we're strictly looking at a Missouri-American, and when you add St. Louis in here, which I don't actually have the figures on that right with me.

St. Louis, as you've already recognized, is considerably larger, it's much larger than the total Missouri-American, so that 9 million dollar is not attributable to these numbers, but it also includes what is attributable to County Water, which is what is incorporated into the Missouri-American system.

Q. Do you have any knowledge of the actual

FAS numbers that were used for pension expense for St. Louis County Water Company?

A. No, I do not.

Q. Okay. So you don't have any knowledge as to whether you could agree with me that St. Louis County Water has actually had negative pension expense from time to time?

A. I don't have any knowledge of that, no.

Q. I believe Commissioner Clayton took you through some questions to ask you about the real numbers that we're talking about in terms of revenue requirement in this case. Do you remember those questions, generally?

A. Yeah, I mean, you say revenue requirement and I'll say expense, but.

Q. Okay. But -- and I can work off that.

A. Okay.

Q. So the real numbers associated with the pension expense number that's being proposed by Staff versus the pension expense number that's being proposed by the company, correct?

A. That is correct.

Q. Okay. And as to the Staff's recommendation as to pension expense, I think you told us that it was 466,177 dollars, correct?

A. That's correct.

Q. And of that, I believe it's 377,000 dollars that's really associated with the ERISA minimum cash contribution piece of this thing, correct?

A. That's correct.

Q. Okay. Now, you also told us that the company was recommending in terms of pension expense 4.1 million, correct?

A. Yes, that includes the FAS 87 as well as the supplemental pensions. It also includes the amortization I referred to that was authorized by the Commission in the 95-205 case, and it also includes based on, I assume, the stipulated methodology, it also includes, I think, 299,000 associated with the amortization of the unrecognized loss balance.

Q. So back up for me. If I'm trying to just put my hands on the piece of that 4.1 million that's associated with the FAS 87 adjustment, what would that number be, approximately?

A. That number would be 3,266,000.

Q. Back to the pension liability, just for a moment, the 9 million dollar pension liability. Now, again, that comes about as a result of the workings of FAS 87, correct?

A. And ERISA contributions.

Q. And kind of the mix between the two, correct?

A. Well, it's the difference between the two.

Q. Now, if the Commission continues along the FAS 87 path as a result of its decision in this case, we know how to treat that 9 million dollar pension liability, don't we?

A. It's -- I mean, it would be treated the same way as it was prior. I mean, based on the projections, which I don't know that we necessarily agree with, but I mean, assume those projections come to where the ERISA contribution actually exceeds FAS 87, that difference, then, reduces that balance of liability.

Q. If instead we go with the ERISA method, would you agree with me we don't today know what to do with that 9 million dollar pension liability? I'm sure you would have some suggestions, but we -- all of a sudden, we're out of the FAS 87 realm, aren't we?

A. We're out of FAS 87, and personally, I would probably recommend the methodology that was recommended in the Laclede case, that for financial statement purposes, you continue to report on FAS 87 and until such time, I guess, really, as we can eliminate the liability and go forward from there.

Q. Now, as long as that pension liability exists, it serves to reduce rate base, the company's rate base, correct?

A. That is correct.

Q. Okay. And as a function of reducing the company's rate base, it also reduces the overall revenue requirement for the company, correct?

A. Yes, because that liability does reduce rate base, which the rate of return was applied.

Q. Could you turn to Page 11 in Mr. Grubb's rebuttal testimony? Are you there?

A. I'm here.

Q. Okay. On Lines 10 through 15, do you see a table?

A. Yes.

Q. Now, when you and I were speaking, I think, yesterday, on this issue, we talked a lot about Schedule 1. Do you remember that, to your testimony?

A. Yes.

Q. Okay. And Schedule 1, as you pointed out, and I agree, deals with FAS 87 and ERISA contributions for American Water as a whole, doesn't it?

A. Yes.

Q. Would you agree with me that -- that what Mr. Grubb has done on Page 11 on that table is take those projected numbers for 2004 to 2007 for American Water as a whole, as to both FAS 87 and ERISA, and then converted them into MAWC specific numbers? Let me back up, to MAWC's portion of those overall American Water numbers?

A. That's what it purports.

Q. Okay. So if we look towards the right of that table, there's an -- over the last two columns, there is Missouri-American, correct, do you see that?

A. Yes, I do.

Q. Okay. And the column to the left under Missouri-American says FAS 87, correct?

A. That is correct.

Q. And the column to the right under Missouri-American says ERISA?

A. That is correct.

Q. And those two columns are the columns that represent the MAWC portion of the overall American Water FAS 87 or ERISA minimum contribution, correct?

A. Based on the calculations as provided by Mr. Williamson using his assumptions.

Q. And as we've talked about before, they're the only assumptions we have, right?

A. That is correct.

Q. Okay. Now, when we started this Recross, I think you told me that the portion of the Staff pension expense number associated with the ERISA cash contribution was 377,000, correct?

A. Yes, that is correct.

Q. If we compare 377,000 to the numbers in that right -- far right column, 5.7 million, 10.1 million, 9.6 million, 6.3 million, do we get anywhere close?

A. No, you're not getting close in terms of absolute dollars; however, when you take a look at the FAS 87 versus the ERISA, it's that difference that winds up reducing the liability.

Q. Well, let's set the liability aside for a minute, okay? Let's just talk about what we're building into the revenue requirement ultimately associated with pension expense.

Now, I believe you told me that under Staff's recommendation, well, as to the ERISA cash

contribution, 377,000 dollars, correct?
A. That's correct.
Q. Okay. And you'd agree with me, wouldn't you, that's a long way from the numbers that are represented in the far right column for the next four years?
A. For the next four years, but the company does have the opportunity to refile.
Q. Okay. And I'd like to follow-up on that as well, because Commissioner Clayton asked you what kind of happened if we miss in the meantime. Let's assume that we put 377,000 dollars into the revenue requirement and that the rate design people know what they're talking and we actually receive 377,000 dollars as you intend for us to receive for the ERISA cash contribution. And in 2004, company's responsible for a cash payment of 5.7 million, can they get back in quick enough to get any of that 5.7 million?
A. With regards to single-issue, maybe not, but we have to look, you know, at operations as a whole. I mean, this is, I mean, you're talking about a cash contribution for -- for ERISA here in 2004, but what happened to your other operations during that time frame in terms of your revenue flow,

your operating expenses.

Again, you can't look at it in a vacuum, and if the overall effect of the company's earnings are down, the company has a responsibility to come and file a rate case.

Q. But we're missing by a lot, aren't we, from 377,000 to 5.7 million?

A. On a single-issue, yes.

Q. So we have to make up a whole lot somewhere else, right?

A. It's substantial compared to --

Q. And let's say it has to go -- we have to wait another year for whatever reason. We don't get back in immediately, we don't file a rate case the day after this case is decided, and some time period passes and we roll into that 10.1. Now the company is really behind, isn't it?

A. Based on these estimates, hopefully maybe something will turn around and help reduce that.

Q. Yeah, maybe.

A. Well, that's what I'm saying. These are unknown. They're based on the assumptions as we now know them, and there's nothing wrong with mathematically with Mr. Williamson's calculations.

We don't know if this is actually going to happen or not.

Q. Let's turn our attention, then, to the company's proposed pension expense number, and I think you told me that that portion of the company's pension number associated with the FAS 87 piece was 3.266 million, correct?

A. That's correct.

Q. Okay. Now, to the left under that Missouri-American heading is the FAS 87 numbers, correct?

A. That is correct.

Q. If we compare the company's 3.266 million to those numbers, the company is still coming out behind, isn't it?

A. Based on the mathematics, yes.

Q. Okay. And based upon the projections?

A. Yes.

Q. If we compare that to the company's cash contributions, the 3.26 million to the company's cash contributions that are projected in the right-hand column, the company is still coming out behind, aren't they?

A. Yes.

Q. But they're a little closer with 3.266

million than they would be with 377,000, wouldn't they?

A. If we're accepting these figures as actual figures.

Q. And now, if we turn our attention back to the 9 million dollar pension liability that you've been telling us about quite a bit, let's say that the Commission orders the company to continue under FAS 87, provides the 3.266 million in the revenue requirement, isn't it under that situation that Mr. Grubb says that the 9 million dollar pension liability will still be gone by 2007?

A. Yes, he's comparing the difference between FAS 87 and ERISA in this table that's included in his testimony, and that difference is the reduction in that pension liability that's on the books of the company.

MR. COOPER: That's all I have, your Honor.

JUDGE THOMPSON: Thank you, Mr. Cooper.

Mr. Schwarz.

REDIRECT EXAMINATION

QUESTIONS BY MR. SCHWARZ:

Q. Mr. Cooper, and I think some of the Commissioners, asked you about the pension positions in this case and described them as a snapshot. Do you recall that?

A. Yeah, I believe that expression was used.

Q. And the snapshot represents the latest known and measurable costs that we have to use for pensions, would that be correct?

A. Last known and measurable, that is correct.

Q. And do you have a copy of Schedule EJG-4 there?

A. Yes, I do.

Q. And on the first page of that, there is a table of the ERISA required contributions, correct?

A. That is correct.

Q. And the first figure in millions is 12.4, and that claims to be an actual?

A. Yes, and that's the number that the 377,000 dollars relates to.

Q. So if you look at the year 2004, that claims to be a snapshot of what something's going to look like in 2004. Is that your understanding?

A. Yes.

Q. So that's like someone showing you something printed on photographic paper saying oh, by the way, Mr. Gibbs, this is what you're going to look like in 2004, and unfortunately, you're now five times bigger than you were there then. Is that an analogy?

A. Unfortunately, that's pretty close to being true sometimes.

Q. But that's -- that's what we are talking about, is it not?

A. Yes.

Q. It's a snapshot in the sense that it's a frozen point in time, but it doesn't, like a photograph, depict an actual known spatial or other relationship; is that correct?

A. Yes, that would be correct.

Q. Well, not to worry, because the photograph shows that by 2007, you have returned to approximately your current girth. There were some questions about Staff's adoption of FAS 87. Do you recall those questions?

A. Which one?

Q. And is it safe to say that Staff's adoption of FAS 87 was to reflect the FASB position, which had been adopted Legislatively for FAS 106 and OPEBs?

A. Yes.

Q. And there were questions about unrecognized gains on -- in some of the questions. If those unrecognized gains in prior cases had not been recognized, wouldn't the 9 million dollar pension liability be even greater than it is now?
A. I think that would depend on how it's actually being accounted for on the books. If they are carrying for pension expense is calculated using an amortization as proposed in those cases --
Q. Let me rephrase the question.
A. Please.
Q. If the unrecognized gains in previous cases had not been recognized, at least partially, wouldn't the FAS 87 pension expense in those cases have been higher?
A. Yes, they would have.
Q. And as a result of ERISA being -- contributions being zero, wouldn't this have resulted in an even greater pension liability?
A. The difference between the two would be greater, yes.
Q. So the 9 million dollar you would expect to increase?
A. Yes.
MR. SCHWARZ: I think that's all that I

have. Thank you.

JUDGE THOMPSON: Thank you, Mr. Schwarz. I believe there's additional questions from the bench. Commissioner Clayton -- do you have any commissioner Murray?

QUESTIONS BY COMMISSIONER CLAYTON:

Q. Mr. Gibbs, after our last conversation prior to all the other questions that have been posed, I feel kind of silly because I was not comparing apples to apples and oranges to oranges, but was comparing them to, like, grapes to oranges or something like that.

Do you know anything about the size of St. Louis County Water when it was -- when it was purchased by Missouri-American?

A. I don't have the actual numbers, but County Water was bigger than the rest of Missouri-American combined.

Q. Was -- is St. Louis Water, was it public or private?

A. I believe it was privately held by NEI.

Q. And I believe there were other districts or water companies within St. Louis County that were not part of St. Louis Water that Missouri-American has also acquired in that time; is

that correct, do you know?
A. Geographically, St. Louis County is on one side of the river, and the St. Charles division of the Missouri-American system was on the other side of the river. Now, St. Charles, I think, may be somewhere in the vicinity of twenty-five to thirty thousand customers compared to a thousand.
Q. But Florissant Water -- wasn't Florissant separate from St. Louis County water?
A. There was several, I want to call municipalities or customers, that were, like, sales for resale type customers that purchased, I want to call it in bulk, from the company, and then resold the water to their constituents, and the Missouri-American has purchased those -- those systems and are now -- those customers within those systems are each individual customers.
Q. I believe a question was posed to you regarding the last rate case being in 2000 whether or not all of these acquisitions were included in the calculations in that 2000 rate case, and I believe your answer was no; is that correct?
A. That's correct, I believe the County -- the St. Louis County and Jefferson City operations was purchased subsequent to that.

Q. Well, would it be a fair statement that Missouri-American has grown three and a half times, as the question was posed to you by Mr. Cooper?
A. I believe that would be correct, yes.
Q. Three and a half, four times, something like that?
A. Yes.
Q. So comparing on EJG-3, it's not a fair comparison from the first three figures to the fourth figure, is it?
A. No, and I mean, in terms of those figures, we're not even comparing the same thing. The first three columns, which are the -- the three rate cases of the company prior to the acquisition of St. Louis and Jefferson City, those were dollars associated with ERISA -- with FAS 87, not ERISA.
The 466,000 dollars that's associated in that last column is an ERISA figure. If you wanted to put each one of those on ERISA that -- I'm not quite sure, it depends on what the test year was in the '95 case, but in the '97 and 2000 case under ERISA, those amounts would be zero.
Q. Is it your testimony that the 9 million dollar pension liability, is how I think you referred to it, is it your testimony that that 9 million

dollars came from St. Louis County Water?

A. The bulk of that probably was, yes.

Q. Okay. But we're not for sure?

A. I couldn't tell you the exact amount.

Q. So we don't know where that 9 million dollar figure comes from?

A. I think we -- we know it comes in total from their operations; as to how much came from the St. Louis operations, I couldn't say.

Q. Otherwise, we'd have to go back and look at St. Louis County water and -- I'm sorry, we can't see each other because of the Court Reporter, we'd have to go back and look at St. Louis County water to make that determination, wouldn't we, otherwise we simply don't know?

A. Yes, we would.

Q. Is the 9 million dollars part of the complaint case filed by Staff?

A. Yes, it is. As a matter of fact, I mean, the original rate case that was filed, I mean, is essentially identical to the complaint filing.

Q. I don't understand that.

A. Well, the revenue requirement that was filed in the original rate case was the negative 20 million or whatever it was, and the complaint case is the 20 million. Basically, the filing in the complaint case was just a duplication of what we filed for the rate case.

Q. So your -- just so I understand this, the 9 million dollars in pension liability is part of the 20 million dollars that you believe that the company has overearned in the complaint case?

A. It's a 9 million dollar liability that's used in the determination of rate base in both the rate case and the complaint proceeding, yes.

Q. Okay. So in determining the complaint, the Staff complaint portion of this case, 9 million out of the overall 20 million dollars is an accumulated pension liability? I want to make sure that I understand this correctly because I may not understand it, so that would mean that there's 11 million dollars elsewhere that the company overearned according to Staff?

A. The 20 million dollars is a combination of return on their investment, their revenue stream, and their level of expenses. Now, what's -- what the company is wanting to include in expense is the 4.1 million, the Staff is saying no, it should be 466,000. That's on the expense side.

Q. Looking forward, not looking backward.

I'm talking about the Staff complaint looking backward.

A. Okay. The 9 million dollar difference between what they have collected in rates theoretically through FAS 87 and what they have actually made in the way of contributions is a 9 million dollar liability. That 9 million dollar liability is used to reduce rate base.

Now, the revenue requirement associated with that 9 million dollar rate base would essentially be 9 million dollars times the rate of return grossed up for whatever the tax factor would be, so it's -- it's not a dollar for dollar, it's probably closer to maybe a million dollar impact on, you know, in rates as opposed to 9 million dollars, which is the liability side of the issue.

Q. Okay. My last question, and I may have touched on this before, you do not challenge the actuarial projections by Mr. Williamson; is that correct?

A. I am not challenging his calculations, no.

Q. And Staff will put on no evidence challenging those figures?

A. The Staff doesn't have an actuarial

that can do that.

Q. Okay.

COMMISSIONER CLAYTON: I have no other questions. Thank you very much.

THE WITNESS: You're welcome.

JUDGE THOMPSON: Thank you, Commissioner.

Additional recross, Ms. O'Neill.

MS. O'NEILL: No, your Honor.

JUDGE THOMPSON: Mr. Cooper?

MR. COOPER: Yes, your Honor.

FURTHER RECROSS-EXAMINATION

QUESTIONS BY MR. COOPER:

Q. Mr. Gibbs, you had a question about the complaint looking backward, I think. Let's see if we can go through this. There is no complaint looking backward, is there, that's been filed by the Staff?

A. There's no complaint looking backward nor is there a revenue requirement looking backward. We use -- we use a test year that develops a cost of service that will be applied on a forward-looking basis.

Q. So there's no allegation, there's no request in the Staff's complaint for a refund of past amounts, correct?

A. That is correct.
Q. And the rates that are being charged by the company today are rates that are in accordance with current Commission Orders, correct?
A. That is correct.
Q. And to get to the 20 million dollar reduction that's referenced in the Staff's complaint, you have to adopt the Staff proposals that are built into its direct case, correct?
A. That is correct.
Q. And you have to move forward in time, the Staff complaint actually is saying that if you adopt the Staff's proposals, rates needs to be reduced going forward by 20 million, correct?
A. That's correct, the current tariffs would stay in effect until ordered to be changed by the Commission.
Q. And there's nothing about the complaint that looks backwards at those current tariffs, correct?
A. That is correct.
Q. Okay.
MR. COOPER: Thank you, your Honor.
JUDGE THOMPSON: Thank you, Mr. Cooper.
Mr. Schwarz, additional redirect?

FURTHER REDIRECT EXAMINATION

QUESTIONS BY MR. SCHWARZ:

Q. Mr. Gibbs, is it safe to say that the 9 million dollar pension liability is a balance sheet item?

A. It is a balance sheet item; yes, it is.

Q. And the company's 4 million dollar pension expense and the Staff's 466,000 dollar pension expense are income statement items?

A. That is correct.

Q. Okay. And as to projections, has Staff projected any other expense item in this rate case as far as chemicals; for instance, does Staff project chemical costs?

A. No, all revenue streams cost and rate base reflect what is known and measurable as of the time of our known and measurable period into this proceeding.

Q. And that's the purpose of the test year?

A. That is correct, the test year concept to keep those things in alignment.

Q. And has the company proposed any projected expenses?

A. I think they have to the extent that

they've -- their filing included out to November, which would be addressed in our true-up procedure.

MR. SCHWARZ: Thank you.

JUDGE THOMPSON: Thank you, Mr. Schwarz.

You may step down Mr. Gibbs?

THE WITNESS: Thank you.

JUDGE THOMPSON: Who's the next witness? We're going to hear from, what, Mr. Van Den Berg.

MR. CIOTTONE: Well, your Honor, we're trying to figure out how to do this, and if you read the order of witnesses exactly, you will be starting on the laboratory expense issue first, and the company's witness is Mr. Baryenbruch, and he's not available until January 8th, so does that mean, then, we go to the Staff's witness on that issue or do you want to do all of the Staff's issues, all Mr. Cassidy's issues at once putting Mr. Baryenbruch first? That's the thing we don't understand. I am not sure we have a serious preference about it, we just don't understand what is in order.

JUDGE THOMPSON: Okay. All I have is the order provided to me by Staff, which kind of clumps all the witnesses for issues 5 through 8 together, so.

MR. CIOTTONE: Well, the first issue is laboratory expense, and that's not Mr. Van Den Berg's issue.

JUDGE THOMPSON: Let me put it this way. Who are we going to hear from next? I don't care who it is, but let's get somebody up here.

MR. BATES: I would suggest the first company witness who's available. I think that in agreeing to Mr. Baryenbruch's later appearance, the Staff did not necessarily indicate that it was going to put its witnesses, and I don't know if the -- it's not my issue.

JUDGE THOMPSON: Okay. Let me repeat. I don't care who it is, but let's have someone in the witness stand.

MR. CIOTTONE: We'll be happy to tender Mr. Van Den Berg, but are you saying that I can't cross Cassidy on labs?

JUDGE THOMPSON: Let's go off the record and take a five-minute recess.

(A BREAK WAS HAD.)

JUDGE THOMPSON: Okay. Would you raise your right hand, sir?

(THE WITNESS WAS SWORN)

JUDGE THOMPSON: Thank you. Please proceed.

DIRECT EXAMINATION

QUESTIONS BY MR. CIOTTONE:

Q. Mr. Van Den Berg, you've prepared rebuttal testimony in this case, did you not, that has been designated Exhibit No. 42?

A. Yes, I did.

Q. And that exhibit has been previously presented to the Commission. I tender -- do you have any errata, any changes that are necessary to that?

A. I do not.

MR. CIOTTONE: I offer Exhibit 42 and tender Mr. Van Den Berg.

JUDGE THOMPSON: That's exactly right. The only one you have is 42? Okay. Do I hear any objections to the receipt of Exhibit 42?

MR. BATES: No objection.

MS. O'NEILL: No objection.

JUDGE THOMPSON: Hearing no objections, Exhibit 42 is received and made a part of the record in this proceeding. This is a company witness. I believe Ms. O'Neill, you are the first cross-examiner.

MS. O'NEILL: No questions.

JUDGE THOMPSON: Okay.

Mr. Bates.

MR. BATES: Thank you, your Honor.

CROSS-EXAMINATION

QUESTIONS BY MR. BATES:

Q. Good afternoon, Mr. Van Den Berg. I'd like to refer you to your testimony, which has been marked and received in this case, and also to Schedule 6 of your testimony.

I believe you reference a number of industry benchmarks in your testimony and also on that schedule; is that correct?

A. That's correct.

Q. Would it be fair to say that these benchmarks are limited to four categories; specifically, first Deloitte International Research, secondly, Comparable Municipal Water Utility, thirdly, the produced study, which is based on competitive industries, such as airlines, credit cards and banks, and forth, American Water in total. Is that correct?

A. That is correct.

Q. Now, do you see studies to support your criteria for industry standards that you compare Missouri-American Water with; is that correct?

A. Yes. The metrics that you use for Call Centers can vary, but normally, what you want to do is get it to the lowest common denominator, which in this case would be dollars cost per call because if you do other than dollar cost per call, you have a tendency to mix apples and oranges in the way in which you're doing your comparisons.

Q. Is it correct that your Deloitte International Research represents a summation of nine electric and gas utilities?

A. In that case, that is correct.

Q. And is it correct that you've used that research to compare Missouri-American's number of calls per customer and costs per customer?

A. We have used it to track where they fit into the continuum.

Q. Okay. Can you identify the nine electric and gas companies that you examined?

A. I can. I don't have that off the top of my head. I have it in my back-up material.

Q. Can you tell us how many are engaged in the business of selling electricity?

A. I believe that, again, I don't have the actual numbers, I would have to look, but I would say seven of the nine.

Q. Okay. Are you familiar with FPL Energy?
A. Absolutely.
Q. And who are they?
A. Florida Power and Light. It's a utility and -- headquartered in Juneau Beach, Florida.
Q. And is that one of the companies that you examined?
A. I believe it was.
Q. Do you know if that company is regulated or unregulated?
A. It is a regulated entity.
Q. I'm sorry, it is?
A. It is.
Q. It is regulated?
A. Yes, it is.
Q. Okay.
A. The distribution electric utility is a regulated entity.
Q. Are any of the other companies that you examined regulated?
A. All of the companies in the study were regulated.
Q. Okay. Thank you. Now, I believe you

based -- based on your comparison, I believe you show that nine electric and gas companies in your Deloitte studies showed that each customer in those utilities called the electric utility an average of 2.2 times each year; is that correct?

A. I believe that is correct.

Q. Okay. And I believe you also identified that the average cost per customer was $10.80 per year; is that correct?

A. That is correct.

Q. Okay. And I believe that you identified that based on your projected of Missouri-American Water calling volumes, that each Missouri-American Water customer will call the Call Center 1.18 times per year; is that correct?

A. That is correct.

Q. And I believe you identified that a cost per customer for each one of those -- for Missouri-American Water would be $9.28 per year; is that correct?

A. That's correct.

Q. Now, based on this comparison of 2.2 calls to the electric gas utilities and 1.18 for Missouri-American Water, is it safe to say that those nine electric or gas utilities handle nearly twice

the number of calls as Missouri-American Water?
A. Per customer?
Q. Yes.
A. They do handle, on an average, a significantly larger number, 2.2 versus 1.2.
Q. Okay. Now, based on your comparison of $10.80 versus $9.28, would you also agree that the average cost for handling the -- twice the level of calls on a cost per customer basis is very similar or at least substantially similar?
A. Would you do me a favor and rephrase?
Q. Yeah. You made a comparison between two figures, $10.80 and $9.28. Now, would you agree that the average cost, then, for handling twice the number of calls on a cost per customer basis is very similar as far as a cost is concerned?
A. Not really. You have to look at the spectrum that you're looking at. You're taking the average, and you have to look from the small to the large as you go up to $15. If you look at the size of the companies, you have to go ahead and take a look at where they are on the spectrum.
There are some economies of scale and that's the reason why American Water has decided to go to the Alton Call Centers, because there are

economies of scale which can be achieved when you have a larger volume of calls coming into a Call Center than you do when you have a smaller.

When you only have 400,000 customers going into a Call Center or multiple Call Centers, the efficiencies in that operation is not going to be as good efficiency-wise as the Alton Call Center. As you're looking at what we're comparing here, we need to be looking at what the comparison is of what Missouri-American was on an efficiency basis versus what the efficiency of Missouri-American activity within the new Call Center is.

If you compare that, you will see the efficiency improvement. It fits within the overall spectrum. The purpose was not to say that the Alton Call Center or the previous Missouri-American was first quartertile, second quartertile or not. It is in the range of benchmarks that we see in the industry to see that it is in that character, and then it was to compare Missouri-American prior to the Alton Call Center with Missouri-American's cost on a per call basis after the Alton Call Center. That was the purpose of that information.

Q. Okay. And what information did you utilize in making that comparison and projection?

A. The projection that we used in terms of looking at where the current state is; i.e., we're looking at the volume for the Alton Call Center from May through the end of November, which was the data that has the -- all of the customers in the Call Center that would be part of Missouri-American, and then projected that based on the characteristics of the call basis for the previous year in terms of the amount of self-service and total call volume, and that got us to what our total call volume is today versus what the total call volume was in the as-was previous case, what it was before we went to the Call Center.

Kind of like if you were going to do a comparison, we were trying to get to what is the miles per gallon of the old Call Center to what is the new miles per gallon of the new Call Center. So that as we look at it, if we have an increased number of miles we have to drive, we have an increased number of calls, we will be able to compare our apples to apples on an appropriate basis.

Q. Okay. Have you done this sort of projection before?

A. Projections of what the call volumes will be?

Q. Yes.
A. Absolutely.
Q. Okay. Ever for Missouri-American?
A. Not for Missouri-American.
Q. Ever for a company of this sort, a utility, a water utility?
A. Yes, I have.
Q. I believe also in your testimony, you identify that the average American Water customer calls the Call Center 1.34 times per year; is that correct?
A. If that is what was in the testimony, that is what we are projecting the number to be.
Q. If you have that before you, can you check that for me on Schedule 6 of your testimony just to confirm?
A. I think it's one point -- the 1.18.
Q. And I think there's a 1.34 figure; is that correct?
A. Oh, for the overall American Water system?
Q. Yeah.
A. That is correct.
Q. And I think you've already confirmed that based on your estimation the average

Missouri-American Water customer calls the Call Center 1.18 times per year; is that correct?

A. That is correct.

Q. That's what you were saying. Okay. Based on your own calculations, do you think it would be fair to say that other water operating companies in other states that are part of the American Water system, on the whole, have customers who call the Alton, Illinois, Call Center more often than Missouri-American customers call the Call Center?

A. By the difference of 1.34 to 1.17.

Q. Okay. Would it also be fair to say that given that these other state's customers call the Call Center more often than MAWC customers, that they also require more of the Call Center's resources than the Missouri-American Water customers would?

A. There are multiple elements of what the costs are when you look at them. You have both the call volume and call handling aspects, so you have to look at whether or not the call handling aspects are the same for those other customers. In other words, does it take the same amount of time to answer a call, does it take as much time to respond to whatever the inquiry was and to do follow-up on that to determine what the total cost is because it's really -- the cost is the number calls times the call handling costs that is associated with it, and that is not something which I know about for the other jurisdictions.

Q. Okay. Thank you. Are you aware of your own knowledge that in Missouri, electric utilities routinely experience greater levels of calls per customer when compared to Missouri-American Water Company?

A. Yes.

Q. Okay. Do you know whether or not Missouri consumers pay more per year for electricity or for water service?

A. I do not know the answer to that.

Q. Would you have any reason to dispute that electric utilities experience greater calls per customer than AWC?

A. That appears to be the case.

Q. Okay. And would it be your opinion that by virtue of handling more calls than an electric utility with half a million customers, say, would incur more costs in handling calls than a water utility with the same number of customers because the electric utility customers are generating more calls per customer?

A. Again, you have to look at what the call volume is and the call handling time. Many of the electric utility calls may be very short and the cost per call then may go down in comparison to what it is.

We have not done a comparison to what that total cost is versus the total cost except on a per customer basis, and it appears that the total cost per customer is the same, which means there's probably call handling aspects that's getting it even-steven.

Q. Thank you. Are you aware that over 75 percent of Missouri-American Water's customers are also served by AmerenUE?

A. I accept your number.

Q. Okay. Thank you. Do you know of your own knowledge how many calls per one thousand customers that AmerenUE receives in comparison with Missouri-American Water?

A. I do not. You're comparing an electric service versus a water service. You're talking about something that may be billed once every quarter versus once a month, very different aspects.

Q. Would you accept that a typical residential AmerenUE bill is much higher than the typical residential Missouri-American Water bill?

A. I wouldn't -- without no specific knowledge, would not be surprised if the Ameren bill on a monthly basis was higher than the water bill was.

Q. If that was the case, would it be your opinion that that fact might impact the number of calls that a customer might potentially have with regard to his bill?

A. Actually, not necessarily. There is some corelation between the price and number of calls per customer, but not directly. There are entities across the country who have relatively low prices and have higher volumes. It depends on the delivery of the electricity or water, and it has to do with the increases in prices rather than necessarily the stable price, so there are a lot of different factors that come in. You can't just say it's one to the other.

Q. Okay. What are some of the other factors?

A. Well, I just gave you which is outages, you've got billing errors or billing issues, you've got increases in pricing, decrease in prices, storms, there are a lot of different things. There are more things that probably affect the load characteristics of the calls in the electric than if you're talking about Ameren than there are, potentially, for the water.

Q. Okay. Would you agree that a -- or would you accept my representation that a residential AmerenUE bill was sent out monthly to the customer?

A. Yes, I would.

Q. And do you know -- would you accept that a residential Missouri-American Water bill is sent out quarterly?

A. For most of the customers, that is correct.

Q. All right. In your opinion, might that impact the number of calls that a customer might have with regard to his bill?

A. It might impact the number of calls, yes.

Q. Okay. I believe you made a comparison with a comparable water utility in your testimony. Is that true?

A. That's correct.

Q. What utility is that?

A. That's -- I have not had clearance from that company to provide that.

Q. Okay. Can you tell me this, is it a municipal water utility?
A. Yes, it is.
Q. Okay. Would you agree with me that municipal water utilities are not regulated by this Commission or any Commission that you're aware of?
A. This Commission? It is regulated by its City Counsel.
Q. But not by a state Public Service Commission? Was that a yes?
A. Yes, I believe that is correct.
Q. Okay.
A. I don't have a hundred percent of the 50 states to be able to state that, but I believe that to be the case.
Q. Now, would you agree with me that the produced study that you cite in your testimony references the travel industry, the financial industry, banks in particular, the credit card industry, the insurance industry, and the catalog industry; is that correct?
A. That's correct.
Q. Okay. Now, these are industries where customers have choice in selecting providers, would you agree with that?

A. The customers would like to believe that yes, that's right.
Q. Okay. Do you dispute that?
A. No, I'm just --
Q. Okay.
A. There are times when all of us wonder sometimes, yes.
Q. I understand. Missouri-American's Water customers do not have the choice of another utility supplier in Missouri and their areas of operation; is that correct?
A. That is correct.
Q. Okay. In the produced study, which you use as an industry standard, can you identify for me any regulated utilities involved in that study?
A. I can go through it, and off the top of my head, I don't have the answer to that. Again, the purpose was not to use that as a direct comparison, that was, again, to put it into the range to make sure that when we were looking, we were not getting information that was so out of whack that it didn't make sense for our, then, being able to project how that was going to be for the total year.
Q. I understand.
A. The produced study does have utilities

included, and that the utilities are included in its exhibits within this study.

Q. Okay. Are any of those regulated utilities?

A. By definition, they would be regulated utilities.

Q. Okay. Regulated by State Commissioners?

A. That is correct.

Q. Okay.

MR. BATES: That's all for right now. Thank you very much.

JUDGE THOMPSON: Thank you, Mr. Bates. Questions from the Bench, Commissioner Murray.

COMMISSIONER MURRAY: Thank you.

QUESTIONS BY COMMISSIONER MURRAY:

Q. Good afternoon. On Page 9 of your testimony, you indicate that there has been a growth of approximately 28,000 customers to the customer base that Staff was using; is that right?

A. From the original DR-110, which took a static picture of the number of customers and the calls that were coming in for those number of customers that gave a as-was dollar cost per call, and that did not take into account the increase of customers that occur.

Q. So would it be reasonable to assume that the costs were the as-was center would have been increased even over what Staff is estimating in its -- in Staff's testimony that the costs would have been?

A. Staff in its -- has basically said that if you were buying gasoline and you were going to go 10,000 miles and you paid X dollars for the gasoline, that would be your cost, even if you ended up driving 15,000 miles because they're saying it was -- we have this number of calls and that's what your costs were, and therefore, that's what we believe you should get is just those costs that were associated with those calls that were in the as-was case.

If we were in a situation where we were comparing apples to apples, it would be appropriate, but what we're finding is that from the old Call Center to the new Call Center, we've seen a significant increase in the volume of calls that have come in from the -- from Missouri-American, and we've now got new data that shows that both the St. Louis properties, as well as the non-St. Louis properties, are having the same percentage increase in calls per customer that would tie to that -- to the expected number of calls we are projecting for an annual year.

Q. And you would attribute that increase in calls primarily to the longer hours and more efficient handling of the calls or what?

A. Well, there is -- during the mid-to-late 1990s, there was a set of best practices put out for Call Centers, and part of that best practice was there were a lot of people in the same situation, in the old green screen system, where you really couldn't do transfers of calls between agents and have skill based answering of questions, so people would necessarily not get the answer the first time, they'd hold and transfer and transfer, and one of the best practices was rather than put people in a cue and have them hold for 20 to 25 minutes, you gave them a busy signal, and so you would end up actually not getting in.

So what we're seeing is that now the technology is available to actually bring the rest of the customers in, the call volume is coming up because it's what's measured. The call volume is measured by a switch that measures whether or not the call actually is brought into the system, and in the old technology, the only thing you got were those that actually got past getting a busy signal and were answered.

The new system is able to, because of the size of the switch and capability, take a significant larger number calls without going to such a kind of old best practice system, so we're now seeing that that is the increase, and we're also noticing across the country, whether it's because of cell phones or two lines and DSL, overall call volumes in general are increasing.

Q. Thank you. Would you assume under the old system that some people just gave up before they actually reached anyone?

A. One of the things that a previous questioner asked was is there more in the electric and water. Because of the timing of the water maybe in a quarterly bill, they would call, they didn't get -- they'd put it down for a day, they wouldn't get it back up. And they wouldn't think about it because they wouldn't get another bill for another three months, so that may be part of it, but all we know is that we haven't gone onto a customer survey to determine what it is, but we are seeing the resulting increased number of calls coming in.

Q. Does Staff disagree with your calculation that the cost of remaining on the Legacy

Call Center would have been $4,401,704? Do you know if they disagree with that number?

A. Their approach was that they believed that the original submission talked about an as-was that was a smaller number and they have not, I don't want to characterize Staff on this, have not specifically stated that that is the wrong number.

They have just not accepted that the call volume is a higher call volume. They're still focused that we still should be looking at a cost for all of the Call Centers to be the same regardless of if we have 380,000 calls or 568,000 calls.

Q. Okay. So they would have used the old volumes as well as the old number of customers?

A. They would have used the old cost regardless of volume or number of customers.

Q. And getting there, basically, they would be assuming it was the same number of customers with the same volume, would they not?

A. Right, theirs is at -- this is a fixed cost part of the business, and my belief, in my knowledge of the industry, is it is primarily a variable cost business.

Q. And your calculation of the ongoing costs using the National Call Center, you indicate there are savings of close to $300,000 per year, and your calculation of that cost was based on the new number of customers plus based on the volume of calls that are going through per customer now?

A. That is correct.

Q. And that was at -- that would be at what point in time that you're measuring customers and call volumes?

A. We made that at the end of November, using the data that we had at the time. We have, since that time, gotten additional data, which in this case, because all of the system -- all the Missouri-American system didn't come on until the first of May, it provides us with a much better picture of what the total volume is going to look like and what the costs and call volume is going to be, and it is now actually demonstrating that the call volume is a little higher than what we had projected it to be in my testimony. The call volume is now looking to be close to 560,000 calls a year.

Q. And how would that equate to calls per customer?

A. It would probably put it at about 1.2, approximately.

Q. Still below the calls per customer for

American Water overall?
A. That is correct.
Q. And how many of American Water's customers on a percentage basis call into the Alton Center?
A. I don't have the total now. There's about two point -- let me see if I can tell you. There's about 2.9 million customers that, right now, are in the Alton Call Center.
Q. And how many customers are Missouri-American Water customers?
A. About 442 to 443,000.
Q. Let me see if we -- I'm trying to remember which issues you're actually covering besides the Call Center, the transition costs, and the shared services transition costs. They all relate to the Call Center; is that right?
A. They relate to the fact that when the decision was made to go to a single entity for American Water for those activities, that there are efficiencies, Call Center, and shared services. The decision was made to do that and they were made in a decision that such that they all kind of go together, yes.
Q. And the -- all right.

COMMISSIONER MURRAY: I think that's all. Thank you.

JUDGE THOMPSON: Thank you, Commissioner Murray.

Commissioner Forbis.

COMMISSIONER FORBIS: No.

JUDGE THOMPSON: Commissioner Clayton.

COMMISSIONER CLAYTON: No questions.

QUESTIONS BY JUDGE THOMPSON:

Q. Mr. Van Den Berg, what is the amount that the company's asking for in revenue requirement for the annual operating expenses of the Call Center?

A. The purpose of my testimony was to show the differences between the two. I believe that it is, and this is subject to the response from the company themselves, is the 4.102145.

Q. Okay. And if you know, what is the amount that Staff is suggesting to be included in revenue?

A. They are requesting it to be, and I believe this is after an errata from Mr. Cassidy, theirs is approximately $800,000 less, which would be 3.261.

Q. Okay. Now, with respect to the transition costs for the Call Center alone, it's my understanding the company proposed to capitalize them and amortize them at a rate of 20 years, so 1/20th of the total to be in revenue each year; is that correct?

A. I believe that is their proposal.

Q. Okay.

A. Correct.

Q. Do you know -- the two figures that I want, then, are the total amount of the transition costs and the amount that company proposes to be included in revenues annually, if you have that information.

A. I don't have the specifics on the amount of the transition costs. I believe that it was approximately -- it was in a DR, I believe it was approximately 5.5 million for Call Center and four million for the --

Q. Shared service?

A. -- shared services.

Q. That was going to be my next set of questions. So can you tell me is there an individual witness that you can name that is going to be better able to answer these questions than you are?

A. In terms of the actual costs that they are asking for in the rate case, I believe that Jim

Jenkins will be able to answer that, or Ed Grubb.
Q. Okay.
JUDGE THOMPSON: Mr. Ciottone, are either of those individuals going to be on the stand on this issue?
MR. CIOTTONE: They're both available, they're both here, we can put them on.
JUDGE THOMPSON: Okay. Very well.
Q. (By Judge Thompson) Now, I'll just make a note here. With respect to the transition costs, I know you don't have the precise numbers, but it is your position that Staff is recommending zero; is that correct?
A. That is correct.
Q. And with respect to the shared services center, is that the same?
A. That was their original proposal, that is correct.
Q. The Staff is recommending zero?
A. Right.
Q. As far as you know, have they changed from that position?
A. In Mr. Cassidy's surrebuttal, I believe he did have a potential where he would be willing to accept some cost recovery. I would not say

necessarily the capitalization.

Q. Okay. I should ask Mr. Cassidy about that, probably?

A. That's correct.

Q. Very well.

JUDGE THOMPSON: That's all the questions that I have for you. Any further questions from the Bench? There appear to be none.

Recross based on questions from the Bench, Ms. O'Neill.

MS. O'NEILL: No questions.

JUDGE THOMPSON: Mr. Bates.

MR. BATES: Very briefly, your Honor.

JUDGE THOMPSON: Very briefly would be great.

RECROSS-EXAMINATION

QUESTIONS BY MR. BATES:

Q. Mr. Van Den Berg, do you know whether or not the as-was cost total of $3,261,840 is calculated by Mr. Grubb for the company was calculated to include all known increases in cost to reflect 2003 current costs?

A. It only included increases in those FTEs that were in the current system and a labor escalator associated with that. It did not take into account what the cost would be for the additional FTEs, technology, and space required to handle the increase of close to 50 percent in call volume.

Q. Okay.

MR. BATES: Thank you.

JUDGE THOMPSON: Thank you, Mr. Bates. Before we get to you Mr. Ciottone, I have a question that Commissioner Gaw has sent in.

QUESTIONS BY JUDGE THOMPSON:

Q. How long does it take, sir, if you know, on average, for an actual person to answer a call coming in to the Call Center?

A. There are metrics that have been established for that. I think it's 95 percent in --

Q. Ninety-five percent of what?

A. Of the calls coming in are answered in -- hold on.

Q. Are these metrics in your testimony?

A. No, these metrics are actually in Ms. Bernsen's --

Q. Okay.

A. -- testimony.

Q. So that might be a better person to ask these questions?

A. Well, they -- the goal was to meet the customer service standards that were in the merger agreement, which they have been achieving, and if we look at that, it's probably just -- on the stipulation agreement, it was targeting 80 percent of the customer calls answered in 30 seconds, that's the metric that is being used.

Q. Okay. And are they achieving that, as far as you know?

A. For most months, yes, there are times when they're still working, but yes, general basis, yes, they are.

Q. Okay.

A. One of the things that's useful, when you asked that question about the average speed of answer, the technology historically that was in place couldn't provide any of those kind of metrics to you. The way in which the system was in the technology, it couldn't tell you anything about any of the metrics that the industry would be using. So without the new technology that the Call Center is providing, you wouldn't be able to get any of those answers.

Q. Okay.

JUDGE THOMPSON: Additional Recross based on Commissioner Gaw's question?

MS. O'NEILL: Actually, I do, your

Honor.

JUDGE THOMPSON: Sure.

RECROSS-EXAMINATION

QUESTIONS BY MS. O'NEILL:

Q. Sir, would you -- you said that the goal was 80 percent calls answered in 30 seconds, was that answered by a living person or just answered by the system?

A. Answered so that if you go into self-service, that you made the decision to go self-service through the route, or gotten through the IBR to your rep.

Q. How long, on average, then, is it from getting some kind of response to real life person talking to customer on average?

A. It depends. I don't have the numbers for Missouri-American on that.

Q. Were you asked to determine those numbers when you became a witness in this case?

A. No.

Q. So no one knows how long it takes for an actual person to talk to an actual person calling in?

A. No. The thing to remember is that society's changing and we're seeing an awful lot more people going down the self-service route and never talking to a representative, and we're seeing, particularly, I can show you a chart on the American Water system, the number people that are going to the self-service has -- is steadily increasing to the point where by the end of the year, we're going to be close to about 22 percent of the people who come in are just going through the self-service route.

Q. Twenty-two percent of customers who call never talk to a living, breathing person?

A. They make the determination that they would rather do it that way.

Q. And when you say they make the determination, is that because at some point, they fall out of the decision tree or is that because their problems are solved?

A. The way it works is to have it resolved, 95 percent firsthand resolution, which is the other one of the metrics that they're using, they have to be resolved. If they drop out, it's considered an abandoned call, which again, that is tracked and it's about five percent.

Q. How do you track that?

A. The technology can tell when you go in and the amount that you didn't go through and get resolved and say I'm okay, I'm done, you just basically jump out.

Q. So if a customer calls with an issue that requires actual interaction with a human being, you don't have the data to tell us how long that takes?

A. I don't have the data. The way the prompts works is if it's related to a leak or emergency, it goes very quickly into that group. There's a specific skill set within the Call Center who handle those calls.

One of the things that the Alton Call Center has been able it to do is to accelerate the process of going through the technology to a customer is rather than you going in and getting anybody, the pathway that you've done will put you specifically to -- it's called a skill-based representative for Missouri who will know about the Missouri market and will understand it and will be able to do it. It's not like you're going to be talking to somebody whose last call was Pennsylvania.

Q. And what is the success rate of routing those callers to a person knowledgeable about Missouri issues, do you know?

A. I don't know -- I'm not sure. Do, you know -- do you mean are they successful in getting those people to go to the Missouri skill base?

Q. I guess that's the first part of that question. Is it successfully routing people to the Missouri skill base?

A. Yes, that's correct.

Q. And once they get to the Missouri skill based, do those people have the appropriate answers to the questions that are being asked?

A. Yes. Again, the objective is to have first call effective, which is measured so that when you get in, you get your answer, and if you talk to someone, you're satisfied, at least 85 percent of the time.

Q. And do you know whether or not 85 percent satisfaction has been achieved?

A. It has.

Q. And what measures have you looked at to determine that?

A. That is one of the measures that was in the stipulation, the merger stipulation, that is tracked.

Q. And did you personally measure that?

A. No, that is provided by the company both to -- by all the Call Centers to

Missouri-American, as well as to the Commission.

Q. That's not part of the analysis that you did?

A. No.

Q. Okay.

A. That's correct.

Q. And you haven't spoken to any customers who have used the call in to see whether or not they were personally satisfied with any results?

A. No, I have called it and members of the Staff have called, and I'm sure that many people in the room today have probably called to see how they went through.

Q. Well, yes, as a matter of fact I have called, and that's one of the reasons I wanted to know, because I'm pretty sure that I've never gotten through to any person in 30 seconds, but I don't have any further questions.

MS. O'NEILL: Thank you.

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

Mr. Bates.

MR. BATES: Thank you, your Honor.

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FURTHER RECROSS-EXAMINATION

QUESTIONS BY MR. BATES:

Q. Mr. Van Den Berg, are you aware that the company developed and agreed to specific goals for performance indicators that were agreed to in a stipulation and agreement in Commission Case No. WM-2001-309?

A. I'm looking at that, yes.

Q. Okay. And would you agree that one of those goals was that the average abandon call rate was not to exceed an average of 5.5 percent annually plus a 100 basis point variance, which would mean a maximum allowable level of 6.5 percent?

A. Yes.

Q. And that another goal was that the average speed of answer target was to be at least 80 percent of customer calls answered within 30 seconds?

A. That is correct.

Q. And are you aware that the company's abandoned call rates of the last three quarters of 2002 were significantly worse, by which I mean higher, than the target of 6.5 percent?

A. The Alton Call Center, the --

JUDGE THOMPSON: Pardon me, Mr. Van Den Berg, is that a yes or a no?

THE WITNESS: That is a yes.

Q. (By Mr. Bates) Okay. And what is the -- what was the performance rate, actually?

A. By quarter, it ranged anywhere from two percent to, I believe it was one quarter they were at ten percent, and they are now steadily in the last two quarters averaging below that 6.6 in the four percent range.

Q. But you do agree that for one quarter it was about ten percent?

A. That is correct.

Q. And were you aware, too, that the ASA percentages did not meet the company's objective and were below the target for 2002?

A. I don't have the data on that.

Q. Okay.

MR. BATES: Thank you very much.

JUDGE THOMPSON: Mr. Ciottone, redirect.

MR. CIOTTONE: Thank you, your Honor.

REDIRECT EXAMINATION

QUESTIONS BY MR. CIOTTONE:

Q. Mr. Van Den Berg, with respect to Judge Thompson's questions about what the Staff's recommendations is, how have they characterized their allowance for O&M costs for operating the Call Center? Did they base it on legacy costs or what have they done?

A. They based it on that whatever the cost was to serve the customers in that previous year is what should be the cost going forward, regardless of what the level of service is, the number of customers, the number of calls.

Q. So it's just the cost of the old Call Center plus wage increases?

A. That's correct.

Q. And they just allowed everything associated with the Call Center?

A. That's correct, they've disallowed or they're proposing to disallow anything relating to increasing volume or increasing calls that have gone to the Call Center.

Q. Right. Now, Commissioner Murray seized on the issue here of the cost per call and that it is the difference between the as-was cost and as-is cost, which is the very complicated disagreement we have with Staff?

A. That's correct.

Q. In going to the new as-is cost, two things have changed. What are those two things?

A. The number of customers and the call volume.

Q. And is Staff disputing those changes?

A. Staff has disputed the call volume.

Q. And that's because in your testimony, at the time you drafted rebuttal testimony, you were making estimates?

A. They have used that I was doing it as an estimate, and also that there were potentially some increase in my calculation of call volume as a result of AWR's water line protection program.

Q. Have you, since that time, had the opportunity to develop actual data?

A. We have expanded so that we have more actual data to measure the call volume than we did before because we didn't have all the data out of the switch for Missouri 800 number, which we now have.

Q. Have you prepared an exhibit to demonstrate the updated actual data that you have with respect to numbers of calls?

A. Yes, we do.

MR. CIOTTONE: Your Honor, may I approach?

JUDGE THOMPSON: You may.

MR. CIOTTONE: This will be Exhibit

107.

(EXHIBIT NO. 107 WAS MARKED BY THE COURT REPORTER.)

THE WITNESS: This is the updated data on call volume, actual information, which is coming out of the VDM switch for the 800 number that Missouri-American Water customers call, and as you can see from this, the actual call volumes, as of December 6th, were actually 521,918. The number that I included in my testimony for the whole year was 521,529.

This volume here is -- does not include the increase in volume for the addition of the rest of the Missouri-American of this year, so there's four months that only had the previous St. Louis property, so as we, then, take and say what would the annual be when we have the blue line to be straight across; i.e., we would have 442,000 customers for the year, the number would be annualized over 600,000.

If we used the similar pattern of calls from the previous year, because we've looked at it and the pattern of calls is matching, it's just that a magnitude higher for 2003, we would come in at about 568 to 570,000 calls.

Q. And with respect to Commissioner

Murray's observation that this comparison of as-is to as-was cost is going to be critical, Staff raises another objection that you just mentioned about the number of calls that you just mentioned, which is what?

A. Related to the water line protection program that is available to a small portion of the Missouri-American customers.

Q. And what is the Staff's contention with respect to that?

A. That the calculation of calls, which I had developed, was inflated as a result of not subtracting out the number calls for the water line protection program that may have come in through that 800 number.

Q. And in response to that contention, have you developed more accurate data with respect to those calls, the quantification of those calls?

A. We have, as a result of that statement, we have gone and looked at the water line protection program and the call volumes associated with them. The water line protection program, the only customers who get a mailing are those that are determined to be eligible. In Missouri-American, that amounts to about 83,000 customers; for the American Water, it's about 1.5 million customers.

Those customers all have a separate 800 number that they get to call in on, so that the volume of calls related to the water line protection, the vast, vast majority is going to go in through a separate 800 number, not through the Missouri-American customer service line.

So to determine what that might be, we went and looked at the total calls that have come in on the switch for the water line protection program, which is an 800 number that is available for all of the 1.5 million eligible customers across American Water, and then looked at the number of calls that have been given to the skill set.

As I talked earlier about how there is a group that is available just for Missouri, there's a group in the Call Center whose skill set is just related to the water line protection program, and those water line protection skill sets, CSRs have done right, up to now, about 36,000 calls, so we annualized it out to about 39,000.

When you, then, take a reasonable number of self-service calls that people might make on the water line protection program and take those out saying that that was what has come through the

800 switch for the water line protection program, it leaves a remainder of about 5,000 calls across the 1.5 million customers that have potentially come in through the wrong 800 number; i.e., either the New Jersey American or the Pennsylvania American customer service line or the Missouri-American, and then you take the portion of the 83,000 of the 1.5 million customers that Missouri-American customers are eligible, you end up with 290 customers who may have called in versus the 521,000 for the regular Call Center, so it's basically a non-event in the Call Center calculation.

MR. CIOTTONE: I think's all I have. Thank you.

JUDGE THOMPSON: Thank you, Mr. Ciottone. Thank you, Mr. --

MR. CIOTTONE: Oh, and your Honor, I offer 107.

JUDGE THOMPSON: All right. Did we ever get a description of it?

MR. CIOTTONE: Its title is customer growth leads to increased call volume, so its a graph of volume versus customers.

JUDGE THOMPSON: Very well. Do I hear any objections to the receipt of exhibit 107?

MR. BATES: Your Honor, could I voir dire the witness on this exhibit or at least have some opportunity to cross?

JUDGE THOMPSON: Absolutely, go ahead.

VOIR DIRE EXAMINATION

QUESTIONS BY MR. BATES:

Q. Mr. Van Den Berg, do I understand that you prepared this yourself?

A. I prepared this with the information provided to me by the Alton Call Center.

Q. Okay. And when did you prepare it?

A. I got this information about a week and a half ago.

Q. Okay. From whom did you receive it?

A. Steve Harkins.

Q. Okay. And who is he?

A. He is a Manager within the Administration Functions at the Alton Call Center.

Q. And did you do any independent research to -- to check these numbers?

A. The technology spits out, I'll call it a report, the VDM switch spits out a report and it comes in and it gets dumped into an Excel spreadsheet. There's very little anybody can do to dispute the switch taking the numbers and then giving them back out. It's very accurate.

Q. Can you explain how, in a space of a little over a month, there were an increase of looks like almost 140,000 calls?

A. We added all of the rest of the customers in and it wasn't -- it amounts to -- you got to look at the ones on the left side.

Q. Okay.

A. That's the call volume, and so you've seen an increase in about 6,000 calls, 7,000 calls. I don't have the absolute numbers sitting here, but that's your call -- your weekly call volume is on the left, so we've seen probably a 24,000 -- 20 to 24,000 increase in call volume when we added the rest of the customers.

Q. Okay.

MR. BATES: Thank you.

JUDGE THOMPSON: Does that conclude your voir dire?

MR. BATES: Yes, thank you.

JUDGE THOMPSON: And after having that voir dire, do you have an objection to receipt of Exhibit 107?

MR. BATES: No, your Honor.

JUDGE THOMPSON: Exhibit 107 is

received and made a part of the record. Commissioner Murray.

COMMISSIONER MURRAY: Yes. Mr. Ciottone, is there any document or exhibit that the company is going to file regarding the study that the witness testified to about the calls relating to the water line protection program?

MR. CIOTTONE: We have these exhibits, I can -- I didn't want to be guilty of overkill, but since you asked, we will certainly provide these -- this analysis to you right now.

Could I have these marked as Exhibit --

JUDGE THOMPSON: Next one would be 108.

MR. CIOTTONE: It would be 108, 109, and 110 then, please.

JUDGE THOMPSON: Okay.

COMMISSIONER MURRAY: Thank you.

(EXHIBIT NOS. 108, 109 AND 110 WERE MARKED BY THE COURT REPORTER.)

FURTHER REDIRECT EXAMINATION

QUESTIONS BY MR. CIOTTONE:

Q. Mr. Van Den Berg, with the permission of your Honor, would you like to explain exhibits 108, 109, and 110, please?

A. If counsel will provide me a copy.

Okay. The first is -- this is the call volume to the specific VDN switch. It has a different telephone number than the Missouri-American customer service call number is, so if you're going to do -- if you got a mailing on the water line protection program, you would be given a separate 800 number to call, and this is the number of calls coming in there, and you'll see that on a regular basis, it's a pretty small volume of calls that come in through it. And the total volume of that up to this point have been 39,000, and we just projected, then, for the rest of this year to about 43,000 calls into the switch, so that is what the AWR-related call volume is.

The next one, the pie chart, this goes into what I went through, and that the pie on the left shows the percentage of eligible customers for the water line protection program and the American Water system versus the 83,000 for the Missouri-American represents about 5.6 percent of the total enterprise that is getting the water line protection program in Missouri, and then the right pie just talks about taking the call volume that has come into the switch, and what I did was take a more aggressive slash conservative from this perspective IVR, a self-service take the rate on the switch saying that 20 percent of them are currently.

The calculation for the rest of the Missouri-American is, right now, averaging 15.8 percent. I did that and that resulted in 34,000 calls that are going to the skill -- the AWR skill call rep from the switch, and their total that they measure, because those people still keep track of all of the calls, they get projected to be 39,900, which results in 52,011 AWR calls coming in through a root other than the 800 number that has been given to people for the water line protection program. And then based on the percentage that Missouri-American is, you get 292 calls.

What the last one is is then just taking and making sure that we've incorporated that in to the various scenarios -- to have -- to look at where it is. The 787 was the updated as-is that we submitted in my testimony.

If you look at where we are today with the AWR and the new call volume, you basically are in scenario four. If you're taking the most extreme, which is taking the total volume of the switch and saying all those calls are extended out through the year in the same pattern, you would get 621, when this is to show that almost any scenario that we develop, the efficiency that I have represented at 787 is conservative in comparison to the ongoing state of affairs.

JUDGE THOMPSON: Commissioner, is that adequate?

COMMISSIONER MURRAY: Thank you. I appreciate it.

JUDGE THOMPSON: Okay. Are you going to offer those exhibits?

Q. Please, I'd like to offer Exhibit 108, 109, and 110.

JUDGE THOMPSON: Any objections?

MR. BATES: Your Honor, I would like the opportunity to voir dire the witness again.

JUDGE THOMPSON: Go ahead.

VOIR DIRE EXAMINATION

QUESTIONS BY MR. BATES:

Q. Did you prepare all three of these exhibits yourself?

A. Me or -- myself.

Q. Okay. From where did you get the information?

A. The information came from American Water.

Q. And do you know who at American Water provided you with the information?

A. Yes.

Q. Who was that?

A. Steve Harkins.

Q. Okay. And do you know what methodology he used to provide this?

A. Yes, he has, again, getting the switch information, he has a report that comes out of the VDN switch that gives that volume of calls, and then they track the calls that go to the desks of the skill-based people, that gets totaled and he gets a report of that total, and that's the information he provided.

Q. Okay. Are you aware that starting in June, Staff asked for this information in discovery requests?

A. I have looked at the discovery requests and I have seen things related to costs, I've seen things related to number of customers signed up, I have not seen any requests to call volumes going to the switch or skill set requirements.

Q. Okay. Would you accept that in number, excuse me, DR-173, that information was asked for requested of Ed Grubb?

A. I don't have that in front of me to

comment.

Q. Okay. When did you prepare these exhibits?

A. This information was received just this week.

Q. Okay. Are you aware that Mr. Grubb, in response to that DR, stated that company doesn't have any categorical breakdown for the call volume?

A. I'm not sure what you mean by --

Q. For AWR.

A. First, I haven't given you any breakdown, all I've told you is the number of skill people who have gotten the calls who are AWR skill based.

MR. CIOTTONE: Your Honor, could Mr. Bates provide the witness a copy of the DR that he is questioning him about?

JUDGE THOMPSON: I don't know, can he?

MR. BATES: May I approach the witness?

JUDGE THOMPSON: You may.

Please proceed.

MR. BATES: I'd like him to study it and then answer the question.

THE WITNESS: Okay. Again, there is nothing in this DR that would provide the information

I provided. The questions in this DR are related to the number of breakdown of the calls on the 800 number coming in from Missouri-American. There isn't anything that provides that in the American Water system.

I have done a calculation based on the logic of the customers eligible for the Missouri-American versus the total population that American Water customers have, and have applied that to the total number of calls that are not being handled by the 800 number for the AWR, the water line protection program, so you only have a small number of -- no matter whether we take a -- if I'm not right by 100 percent on the 5.6 percent, it's only 500 calls a year.

Q. Okay. Are you aware that, and I'm going to approach, if I may, and show you DR-174, that the company was asked to provide by month for the period covering January 1st, 2002, through December 31st, 2003, and asked that that information be updated, the total number calls for the Alton Call Center and some related information.

MR. BATES: May I approach?

JUDGE THOMPSON: You may.

THE WITNESS: Okay.

Q. (By Mr. Bates) Okay. Is the information that you have included in these proffered exhibits responsive to that DR?

A. The exhibits that I've had would only be related to the -- this call volume probably matches, I would assume, although I can't read it, I have to admit.

Q. Are AWR calls identified on that?

A. Okay. This is offered to the state, this is offered to the skill set, this is what this information is. This is not the call volume by the switch. This is the call volume offered to the representative that has the skill set for Missouri or Pennsylvania or West Virginia, okay, that so that's a portion of the calls that's coming in on the 800.

That's not 100 percent of them. I can't tell whether or not this includes the skill set related to AWR, but given that the AWR is not part of the regulated aspect of the Alton Call Center, they may not have felt it needed to provide for this because I don't see across the top that name.

Q. Okay.

MR. BATES: That's all, thanks. We don't have any objection to the admission of these exhibits.

JUDGE THOMPSON: Thank you, Mr. Bates. Exhibits 108, 109 and 110 will be received and made a part of the record in this proceeding. Are we done with Mr. Van Den Berg?

MR. CIOTTONE: As far as I'm concerned.

JUDGE THOMPSON: Speak now or forever hold your peace. You are excused, sir, thank you. Now, Mr. Ciottone, are we going to have anybody from the company who can talk in more detail about these metrics and the performance of the Call Center and whether or not those metrics are being achieved or not?

THE WITNESS: The -- in reality, the report that is submitted, I apologize for interrupting on that.

JUDGE THOMPSON: That's okay. I don't care who answers the question just so we get an answer.

THE WITNESS: The -- I go to --

MR. CIOTTONE: My recollection is that Ms. Bernsen spoke to all that -- the Staff witness went into detail about the metrics and which ones were being met, and in fact, even requested more metrics.

JUDGE THOMPSON: Okay. So is she going

to be the only live witness that we can see?
MR. CIOTTONE: About metrics, I suspect?
THE WITNESS: Yeah, that was not --
JUDGE THOMPSON: Okay.
THE WITNESS: I felt that she had done a pretty good job of outlining it.
JUDGE THOMPSON: Very well. I just wanted to know who to ask because I know at least Chairman Gaw has a great deal of interest in those items and --
THE WITNESS: The one thing, if you haven't had chance, the Call Center is a very efficient operation, new set up.
MR. CIOTTONE: Your Honor, do you want someone to talk about dollars?
JUDGE THOMPSON: Exactly.
MR. CIOTTONE: I have that human here if you wanted to speak with him now.
JUDGE THOMPSON: You have who?
MR. CIOTTONE: That human being.
JUDGE THOMPSON: Well, do you think he will be here tomorrow?
MR. CIOTTONE: I'm sure he will.
JUDGE THOMPSON: Good. Now, before we

leave, tomorrow, I anticipate starting at 8:30. Is that acceptable to everyone? Okay.

And now I want to get at least a projected outline of what we're going to do tomorrow. Who's going to be our first witness tomorrow?

MR. CIOTTONE: Well, about costs?

JUDGE THOMPSON: Mr. Jenkins will talk to us about costs, and any other company witness that the other parties want to question who had brief testimony with respect to the issues that Mr. Cassidy testifies on?

MR. BATES: I believe Mr. Grubb is scheduled to testify and we would definitely have questions for him.

JUDGE THOMPSON: Okay. So Mr. Jenkins and then Mr. Grubb. Okay.

MR. CIOTTONE: Do you know what issues you'll be talking to Mr. Grubb about, just out of curiosity, if I may ask?

JUDGE THOMPSON: It's going to have to be issues 5 through 8.

MR. BATES: The entirety of his testimony, I think, I mean, I've already -- I do already have a number of questions at this point. It covers much of his testimony.

JUDGE THOMPSON: Well, Mr. Grubb gave testimony on many, many, many issues, and the issues that he's going to be on for tomorrow morning at least include and are limited to the Belleville Laboratory, if he has anything to say about that, the National Call Center, the continued reports to Staff, other transition costs, and American Water resources.

If you want to have at him for other issues than those, you're going to have to wait for another occasion.

MR. BATES: I'm sorry, I meant based on what's on that schedule.

JUDGE THOMPSON: Okay. Fine.

MR. BATES: I'm sorry, I didn't say that well.

JUDGE THOMPSON: Fine, so we'll do Mr. Grubb.

MS. O'NEILL: Actually, Ms. Bolin is listed under these issues, but the reason she's listed is the -- in one of her Q and A's and her prefiled testimony regarding affiliate transactions, she references American Water resources.

If you want, I can put her up.

JUDGE THOMPSON: Do we need her?

MS. O'NEILL: But we don't necessarily

need her for this. She'll be testifying later in the case anyway.

JUDGE THOMPSON: Okay. Does anyone have any questions on this stuff for Ms. Bolin?

MR. BATES: No, your Honor.

JUDGE THOMPSON: So Ms. Cassidy and Ms. Bernsen; is that correct?

MR. BATES: That's correct.

JUDGE THOMPSON: All right. And assuming that we actually get through those persons and there's some time left in the day, we would then be starting with Mr. Jenkins; is that correct, on acquisition premiums and transaction cost adjustment?

MR. SNODGRASS: On Friday, we'll be putting some input in on the metrics and reporting requirements on this Call Center issue.

JUDGE THOMPSON: Right, I understand that.

MR. SNODGRASS: Sorry if I misunderstood you.

JUDGE THOMPSON: In other words, we're going to talk to Jenkins, Grubb, Cassidy and Bernsen on the issues that are numbered 5 through 8. Then we're going to go to Issue No. 9 and start with Mr. Jenkins or Mr. Grubb as we begin a new issue; isn't that right?

MR. CIOTTONE: Yes.

JUDGE THOMPSON: Okay. And from there, we'll proceed through Mr. Rackers, correct? Ms. Bolin, now, she will actually be testifying in this?

MS. O'NEILL: Yes.

JUDGE THOMPSON: Okay. We're done with Wurtzler, so we're not going to hear from him again. LaConte won't be here. What about Gorman, does anyone know?

MS. O'NEILL: It's my understanding he will be available during rate design.

JUDGE THOMPSON: Okay. So we won't here from him tomorrow either. That's sufficient people to line up for tomorrow. And if we do get through all that and we need to go further, then I'm sure we can find someone to put on the stand.

Is that everything? Thank you very much. We are recessed.

WHEREUPON, the hearing of this case was recessed until December 18, 2003.

I N D E X

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