BEFORE THE PUBLIC SERVICE COMMISSION

STATE OF MISSOURI

TRANSCRIPT OF PROCEEDINGS

HEARING

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Jefferson City, Missouri

Volume 17

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

BEFORE:

KEVIN A. THOMPSON, Presiding
DEPUTY CHIEF REGULATORY LAW JUDGE.
CONNIE MURRAY,
BRYAN FORBIS,
ROBERT CLAYTON,
COMMISSIONERS.

REPORTED BY:
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JUDGE THOMPSON: Okay. Let's go on the record. State your name, spell your last name for the record, please.

THE WITNESS: My name is Deborah Ann Bernsen, B-e-r-n-s-e-n.

(Witness sworn.)

JUDGE THOMPSON: Thank you.

Mr. Snodgrass.

MR. SNODGRASS: Thank you, Judge.

DEBORAH BERNSEN testified as follows:

DIRECT EXAMINATION BY MR. SNODGRASS:

Q. Good morning, Ms. Bernsen.

A. Good morning.

Q. Did you have occasion to prepare the pre-filed testimony in this case which has previously been marked as Exhibit No. 14, Direct Te-- Test-- Testimony of Deborah Ann Bernsen?

A. Yes, I did.

Q. Let me get my lips unstuck here.

Do you have any corrections or additions to make to your testimony at this time?

A. No, I do not.

MR. SNODGRASS: Judge, based on that, I would offer Exhibit 14 into the record and tender this witness for cross-examination at this point in time.

JUDGE THOMPSON: Thank you, Mr. Snodgrass.
Any objections to the receipt of Exhibit 14?
Hearing none, Exhibit 14 is received and made a part of the recording of this proceeding.
(Exhibit No. 14 was received into evidence.)
JUDGE THOMPSON: Ms. O'Neill?
MS. O'NEILL: No questions.
JUDGE THOMPSON: Mr. Ciottone?
MR. CIOTTONE: No questions.
JUDGE THOMPSON: Just in time for questions from the Bench. Commissioner Clayton?
COMMISSIONER CLAYTON: Appreciate that. No, thank you.
JUDGE THOMPSON: No questions from the Bench.
Redirect?
MR. SNODGRASS: Nothing.
JUDGE THOMPSON: All right. You may step down. I'm not going to excuse you because there may be other Commissioners coming in later who do have questions, in which case we'll put you right back up here.
THE WITNESS: Correct. Thank you.
JUDGE THOMPSON: Thank you. Your grueling day of testifying is over.
THE WITNESS: I'm sort of disappointed.
JUDGE THOMPSON: Well, okay.

Mr. Grubb. Okay. Mr. Grubb, I'll remind you you're still under oath. And you're up here on issue 15, Old St. Joseph Plant Retirement; is that right?

THE WITNESS: That's correct.

JUDGE THOMPSON: Okay. And who's going to be doing the direct with this witness?

MR. COOPER: I am, your Honor.

JUDGE THOMPSON: Come on up. Don't hang back.

MR. COOPER: Your Honor, I believe that Mr. Grubb, on his previous trip to the stand, had all of his pre-filed testimony marked and admitted into evidence. That being the case, we would tender him for cross-examination on the Old St. Joseph Treatment Plant issue.

JUDGE THOMPSON: Okay. Let's see. Ms. O'Neill?

MS. O'NEILL: Thank you.

EDWARD J. GRUBB testified as follows:

CROSS-EXAMINATION BY MS. O'NEILL:

Q. Good morning, Mr. Grubb.

A. Morning, Ms. O'Neill.

Q. The old St. Joseph treatment plant is the plant that was taken out of service when the new plant went into service; is that correct?

A. That's correct.

Q. It is not being used to provide any water service to customers?

A. That is correct.

Q. Missouri-American Water Company no longer owns the old treatment plant, does it?

A. The old treatment plant was taken out of service, as you indicated, and the land upon which that -- those buildings and structures resided was sold to a third party, yes.

Q. So Missouri-American no longer owns the land that the plant was on, does it?

A. That's true.

Q. No longer owns any of the structures that are on the land?

A. That is correct.

Q. Sold that land for 115,000 -- the entire piece of property for $115,000; is that correct?

A. That is correct.

Q. And that was done prior to the test year for this case; is that correct?

A. I believe that transaction occurred during the test year.

Q. During the test year?

A. I -- I believe it was --

Q. 2002?

A. I believe it was in the test year.

Q. Could have been 2001 though?
A. I would have to check some of the data requests, yes.
Q. Don't recall specifically?
A. That's correct.
Q. That's okay.
In any event, in December of 2003 and on a going-forward level, company doesn't own the property?
A. That -- that's correct, yes.
Q. The $115,000 purchase price, is that recorded below the line or above the line?
A. It was recorded below the line as a gain on the sale of the land.
Q. And that gain on sale of land is not something that would be recognized in rates one way or another; is that true?
A. That's correct.
Q. So if you would have sold that property for $2 million, it still wouldn't be recognized in rates, would it?
A. That's correct.
Q. If you'd sold it for $50, it wouldn't be recognized in rates?
A. That's correct.
MS. O'NEILL: No further questions.

JUDGE THOMPSON: Mr. Bates?

MR. BATES: Thank you, your Honor.

CROSS-EXAMINATION BY MR. BATES:

Q. Morning, Mr. Grubb.

A. Morning, sir.

Q. I just have a couple of questions for you.

Is the old St. Joseph treatment plant still on the books of the company?

A. The -- the value of the undepreciated amount and the cost of removal is on the books of the company as a regulatory asset.

Q. Do you know what the amount of those factors are?

A. The total amount is 3,177,861.

Q. And what account is that booked to?

A. It's a regulatory asset account, 186 account.

Q. And can you tell me what a 186 account is?

A. It's a miscellaneous deferred debit account on the company's balance sheet.

MR. BATES: Thank you very much.

JUDGE THOMPSON: Questions from the Bench, Commissioner Murray? Moving like a freight train this morning.

COMMISSIONER MURRAY: Obviously. Judge, may I inquire which issue are we on right now?

JUDGE THOMPSON: That's a very good question. We are on the old St. Joseph plant premature retirement. Ms. Bernsen has been on the stand and gone already. If you have questions for her, I told her I'd bring her back.

COMMISSIONER MURRAY: I listened to her on the stand. That was fascinating.

JUDGE THOMPSON: It was. Some of the best testimony I've ever heard.

COMMISSIONER MURRAY: I'm sorry. I'm going to pass right now.

JUDGE THOMPSON: Very well. Commissioner Clayton?

QUESTIONS BY COMMISSIONER CLAYTON:

Q. Good morning.

A. Good morning.

Q. Since we are now out of order, I'm out of order, frankly, and am not as caught up as I should be.

What is the status of this issue in the other -- there's a prior case that involves this issue.

A. I believe the status is now currently today, based upon the circuit court's decision, it was -- the issue was remanded and reversed and sent back to the Commission for further decisions.

Q. In another case?

A. The original Commission decision was in the

2000 rate case and the company appealed the decision. I believe it went to the circuit court and the circuit court then remanded it back and reversed it and back to the Commission.

Q. So an issue in the 2000 rate case hasn't been decided yet through the judicial system?

A. That's correct.

Q. Doesn't say much for judicial efficiency now, does it?

Well, how does this issue before us here in this rate case relate to that prior issue? Can we decide it twice? Tell me how these all merge together since you all are -- this issue's been brought before us by the parties. And I need to be educated because I wasn't here in the other case, so I need to know what I can actually participate in and what I can't participate in.

A. I'll try and help and go back to the 2000 rate case the best I can.

Q. I would appreciate that.

A. Okay.

MR. COOPER: I would like to I guess make a point. It's probably a little less than an objection at this point depending on where things go. But, Commissioner, I believe maybe the issues you're headed towards are going to be really legal questions that may need to be briefed or argued by the attorneys in terms of what legal effect that earlier case may or may not have and whether that earlier case is eventually mooted out by the resulting rates from this case. So it may be difficult for Mr. Grubb to really get into what impact that 2000 rate case would have.

COMMISSIONER CLAYTON: Then I'll just ask you. What can we do in this case since this is an issue involved in another case? We can't decide it twice, can we?

MR. COOPER: I think you can. I think the question here for you, Commissioner, is whether or not these amounts should be taken into account in setting this company's rates.

The company made a proposal in the 2000 case. Obviously the Commission itself determined that at that time it was not going to include those amounts in rates. As Mr. Grubb indicated, it went up to the circuit court. The circuit court found that decision to essentially be a confiscation, sent that decision -- after some other procedural summersaults, sent that proceeding back to this Commission where it has sat for quite some time now.

It's certainly the company's belief that the Commission has the ability, if it chooses to do so, to in this case go ahead and take into consideration these amounts in setting the company's rates at which case if it would do that, parties would be free to go up on appeal again.

COMMISSIONER CLAYTON: So this issue is before us because it hasn't been fully resolved in the prior rate case. Correct?

MR. COOPER: Correct.

COMMISSIONER CLAYTON: If the decision had been affirmed by the circuit court in the prior rate case, then it certainly could not be before us?

MR. COOPER: Well, with the change of circumstances, it probably could be back before you. We're a little different than a civil matter in that time can change things in the rate case process.

COMMISSIONER CLAYTON: Well then, I guess in a rate case you get two bites at the apple then?

MR. COOPER: Sometimes the bites go on and on and on much longer than just two bites in both directions.

COMMISSIONER CLAYTON: Okay. Well then, I'll direct my questions back to Mr. Grubb then.

BY COMMISSIONER CLAYTON:

Q. Can you give me the bottom line figure for the company's position on the dollars that the company is seeking to recognize on the undepreciated investment and the net cost of removal?

A. In the current case, the company is proposing an annual amortization of $158,893.

Q. That's the annual amount. What's the total

amount? Let's start with that.
A. The total amount is $3.177 million. That's the total value of the undepreciated value of the assets, plus the cost of removal associated with those retirements.
Q. So that's the undepreciated amount and the cost of removal. Now, is that netted with the salvage?
A. Those are added together.
Q. Those are -- has the amount that the company received in the sale -- I think there was a figure of 115,000. Is that removed from that $3.1 million?
A. No, it is not.
Q. Okay. Does the company believe it should be removed?
A. No, we do not. Because the -- the sale of the 115,000 was for the land. And the undepreciated value of the assets is totally associated with water treatment equipment and not the land since land is not depreciated.
Q. Okay. So then the land would just be a free 115 then?
A. That -- it was the sales price, yes.
Q. Okay. So 20 million -- excuse me, 20 years would be the amortization. So now what is your annual annualized amount?
A. The annualized amount would be the 158,893 that the company is requesting in this case. It's a return

of the 3.177 million. The company is not requesting a return on in this case.

COMMISSIONER CLAYTON: Judge, can I ask Mr. Cooper another question?

JUDGE THOMPSON: You can ask anyone in the room any question you want.

COMMISSIONER CLAYTON: What would be the relief that the company would seek in the prior rate case considering the issue is still floating around and hasn't been decided, fully adjudicated?

MR. COOPER: If we set aside this rate case for a moment, I think what we would -- and were seeking from the Commission was that the Commission amend its Report and Order on remand and establish rates that would have included, as to this particular issue, the amounts that Mr. Grubb described.

COMMISSIONER CLAYTON: In the prior rate case? I guess tell me mechanically how the company -- if we were to side with the company in the prior rate case, if we were to side in that case, how the company actually gets relief on this issue.

MR. COOPER: Well, the company really doesn't get relief until it gets new tariff sheets. Certainly what the company would have liked the Commission to have done when that case came back from the circuit court was enter a new order say, Okay, we agree with the circuit court, maybe we should have done things differently and then authorized the company to file new rate tariffs that included those amounts associated with the old St. Joseph plant retirement.

Now, I suspect that even had you done that, other parties may have taken that up on appeal and there would have been some other procedural steps.

COMMISSIONER CLAYTON: Well --

MR. COOPER: That's certainly what the company would have liked for the Commission to have done.

COMMISSIONER CLAYTON: I understand. Well, I don't want to go back and know every single issue or party that was involved in the prior rate case. If we are -- considering that there's a subsequent rate case now, this would probably be the best forum to deal with it then?

MR. COOPER: That's certainly what the company believes at this point in time, yes.

COMMISSIONER CLAYTON: So if we deal with it in a current rate case, then it disposes of the prior rate case one way or the other?

MR. COOPER: I would say it would make that issue moot in the prior rate case.

COMMISSIONER CLAYTON: Okay. Thank you.

BY COMMISSIONER CLAYTON:

Q. And, Mr. Grubb, just to your understanding, Staff's position is that you -- that basically the company gets zero on this issue?

A. That is correct.

Q. And it's your understanding that that's the same position of OPC and all the other parties that are in the case?

A. I believe that is correct, yes.

COMMISSIONER CLAYTON: Okay. Thank you very much.

THE WITNESS: You're welcome.

JUDGE THOMPSON: Further questions from the Bench?

COMMISSIONER MURRAY: Yes.

JUDGE THOMPSON: Commissioner Murray.

COMMISSIONER MURRAY: Thank you. Thank you, Commissioner Clayton. Thank you, Judge.

QUESTIONS BY COMMISSIONER MURRAY:

Q. Good morning.

A. Good morning.

Q. As a result of the last rate case, is there any amount that would still go unrecovered if we find for the company in this case, do you know?

A. As a result of the last rate case? I believe there's an issue coming up behind this issue, the new St. Joe treatment plant. I'm not sure -- are you talking about just this one issue, the old St. Joe treatment plant?

Q. Yes.

A. I think if the Commission made its decision similar to the last rate case, the company would again be not recovering any undepreciated value of the old plant.

Q. Okay. And you said that the company is just asking for a return of and no return on?

A. That's correct.

Q. And if the Commission had found in the company's favor in the last rate case, then at the time the company would have gotten the return of or -- in a more timely fashion, let's put it that way, would have gotten the return of the undepreciated value of the assets; is that right?

A. In the last case the company proposed just the normal retirement of the asset. And I think as our discussions in the ISRS case, when you retire a utility asset, you remove the asset from plant and you remove it from the reserve so there's no rate base impact.

I think Staff in the last case recommended that treatment and then going ahead and addressing it in the next depreciation study, which would have addressed it and then recovered it possibly through future depreciation rates.

Q. And I'm trying to jog my memory here, but

Staff was recommending that it not be -- Staff was not recommending that we just disallow it; is that correct?

A. That's correct. If my memory serves, they were asking that it be retired in the normal utility retirement and then address it in the next depreciation study.

Q. Okay. Thank you. That was how I remembered that as well.

But then the Commission made a different determination and decided to declare that it was just not recoverable; is that right?

A. That is correct.

Q. Okay. And was that a treatment of undepreciated value of assets and cost of removal that departed from the traditional treatment of an item such as that?

A. To my memory in dealing with the utility accounting, yes, it was. It was a write-off of that value of those undepreciated assets. The normal utility accounting would have just handled it as a normal retirement and through the depreciation rates in future cases would have handled any kind of issue related to the undepreciated value of those assets.

Q. Because in rate-making policy the company would be entitled to recover the value of the assets; is that correct?

A. That's correct.

Q. And in this instance, with the decision of the majority of the Commission, it was determined that whatever amount you had not yet depreciated you just lost. Is that what the result was?

A. That's correct.

COMMISSIONER MURRAY: All right. I believe that's all on this issue. Thank you.

Pardon me. One more clarification. We're not addressing the issue of capacity of the new plant at this point; is that right?

JUDGE THOMPSON: I don't think we're there yet, but --

MR. COOPER: I believe, your Honor, that's the next issue after --

JUDGE THOMPSON: Right. I don't think Mr. Grubb was the witness for that issue, were you?

THE WITNESS: No, I was not.

COMMISSIONER MURRAY: All right. Thank you.

JUDGE THOMPSON: Further questions from the Bench?

QUESTIONS BY JUDGE THOMPSON:

Q. Morning, Mr. Grubb.

A. Morning.

Q. As always, I just want to make sure I have the numbers right. The rate base, the company's position is nothing; for revenue, company's position is 158,893?

A. That's correct.

Q. Okay. And Staff's position is zero both rate base and revenue?

A. That's correct.

JUDGE THOMPSON: Great. That's all I need. Thank you.

Recross based on questions from the Bench, Ms. O'Neill?

MS. O'NEILL: Thank you.

RECROSS-EXAMINATION BY MS. O'NEILL:

Q. Mr. Grubb, one of the things that was discussed here, I think maybe actually had to do with some discussion between Commissioner Clayton and your attorney, was the issue of changes and when changes in circumstances happen, issues may come before the Commission in subsequent cases. Do you recall that conversation?

A. I think it was --

Q. Sort of?

A. -- in response to Commissioner Clayton, Mr. Cooper made the comment that if the circuit court had affirmed the Commission's decision --

Q. Actually, I'm talking about whether or not you recall the statement that when there are changes in circumstances, issues come back before the Commission in subsequent cases. Do you recall that line of discussion?

A. Well, I was leading up to as what I understood what Mr. Cooper was saying. As I understood what Mr. Cooper was saying, had the circuit court affirmed the Commission's decision and then changes have occurred after that, then it's possible that -- that the issue could arise again in another rate case. That's what I understood.

Q. Then you do recall that there have been changes in circumstances here, because you don't own the property anymore. Correct?

A. I don't know if that's a relevant circumstance to take into consideration. The relevant circumstance is that there's an undepreciated asset that the company was unable to ever recover on.

Q. Company doesn't own the property anymore, does it?

A. That is correct.

Q. Company has removed the property from service at this point; is that correct?

A. It was removed in service at the time of the retirement, yes.

Q. And when we talk about removal from service, the company's not using any of the equipment from the old plant in the new plant right now? It's not being used to provide service to customers?

A. I believe that's correct.

Q. Do you know what the purpose is of including cost of removal when you set depreciation rates?

A. It's -- if you include cost of removal in the depreciation rates, it then goes into the reserve reducing the rate base. And then as the actual cost of removal is incurred, that's taken back against the reserve.

Q. But isn't the reason that cost of removal is included in depreciation so that when you have to take plant out of service, there's funds available to do that?

A. That's correct.

Q. That's the philosophy behind it?

A. Uh-huh.

Q. Okay. And, likewise, the purpose of including net salvage in that calculation is so that you can recognize that there may be some value -- salvage value to what you take out of reserve, out of service even if it doesn't cover the entire cost of removal? That's the philosophy behind that?

A. That's correct.

Q. And when you retire a plant, you remove it from the rate base; is that correct? When you retire any component of the plant, that part of the plant is taken out

of rate base?
A. There's no impact on rate base. You reduce the utility plant by the value of the retirement, then you reduce the reserve by that same value, so there is no rate base impact of an retirement.
Q. So it's gone, you're not getting depreciation on it in rate base anymore, it's gone, it's removed. Right?
A. I'm not sure I understand when you say getting depreciation on rate base.
Q. When you remove a plant from service, you take it off your books?
A. Uh-huh.
Q. The value of the plant is off the books; is that right?
A. That's correct.
Q. Okay. It's removed from the books?
A. That's correct.
Q. The same way it's removed from service?
A. Right.
Q. And the reason that you remove it from the books when you remove it from service is because it's not appropriate to ask your customers to pay for plant that's not being used to provide them service that's not useful in that fashion; is that correct? Again I'm talking about the reason behind why you do it, not just why you do it.

A. Yeah. When you retire an asset, you take it off the books and then at that point the depreciation is stopped.

Q. Now, is it completely unheard of in utility accounting for property which has been removed from service to be written off? That's not unheard of, is it?

A. Could you repeat that?

Q. Is it unheard of for utility plant that's been removed from service to be written off?

A. Utility plant removed from service, it's written off?

Q. Yeah.

A. I -- I think if you follow the normal accounting, it's not written off. It's simply -- you reduce your utility plant and you reduce your reserve.

Q. You've never heard of a write-off?

A. I've heard of a write-off.

Q. So they're not unheard of?

A. The concept of a write-off is not unheard of, I agree with that.

Q. And actual write-offs are not unheard of either?

A. Actual write-offs are not unheard of, yes.

Q. Subtracting depreciation -- if you take away what's factored in to the cost of plant for depreciation, cost of removal, net of salvage, do you know what the original purchase price was of the plant that was first retired and then sold up in St. Joe?

A. I sure don't, Ms. O'Neill.

Q. Do you know whether it was more or less than $3.177 million?

A. I -- I don't know if I can fully answer that because there may have been assets placed into service in the early 1900's that were, you know, replaced in the '50s and '60s. So if you take the whole St. Joe treatment plant -- the old treatment plant and take it in total, I don't know if -- what is the total value of assets placed into service versus the total depreciation taken on all those assets since day one.

Q. You don't know the answer to that. Okay.

Would you agree, however, that ever since any of that plant was placed into service, the company was receiving a return on that investment in the form of return -- in the form of the rates?

A. The net original cost. The original cost less any accumulated depreciation taken to date.

Q. So that things that were placed in service in the early 1900's, every year a return; on things that were placed in service later, every year that they were in service, a return on those as well?

A. Whatever the net original cost was at any point in time during the general rate case.

Q. So this plant that you don't own anymore, you don't need any actual cash to remove it from service at this time; is that true?

A. It's out of service right now. What we're asking for is a return on the assets that we never recovered --

Q. You don't --

A. -- from the ratepayers.

Q. You don't need to incur any further cost to remove that plant from service because it's already been removed from service?

A. That's correct.

Q. And the gain on the sale is recorded in a fashion that has absolutely no effect on rates one way or another; is that correct?

A. It was recorded below the line, that's correct.

Q. So no effect on rates no matter what the price?

A. I'll agree with that.

Q. But, in fact, the company did receive the money. Correct?

A. We received the money from the sale of the land, yes.

MS. O'NEILL: No further questions.

JUDGE THOMPSON: Thank you.

Mr. Bates?

MR. BATES: Thank you, your Honor.

RECROSS-EXAMINATION BY MR. BATES:

Q. Mr. Grubb, I wonder if you could clear up a few things for me. Can you tell me what the book value of the land was when it was sold?

A. $12,173.

Q. Okay. And it was sold for how much?

A. The sales price was $115,000.

Q. Okay. In the last rate case the company wanted a return of -- excuse me, a return on on the unappreciated balance; is that correct?

A. A return of in the last rate case?

Q. A return of and a return on the unappreciated balance; is that correct? I may have asked -- let me ask it again.

In the last rate case the company wanted a return of and a return on the unappreciated balance; is that correct?

A. I think what we wanted was to recognize in rates the treatment that would be applied to any normal -- or any kind of plant retirement. And that is to remove the value of those assets from utility plant and then those same values are removed from the accumulated depreciation. And that in a future depreciation study, depreciation rates would be adjusted to recognize the undepreciated value of that -- that -- of that plant.

Q.   Would it be an accurate statement to say that a reserve deficiency would exist in the depreciation reserve that increased the rate base?

A.   I think when you -- when you would do a depreciation study, you would see that there's a reserve deficiency similar to what was done in the St. Louis County last two depreciation studies.

And this Commission agreed that there is a depreciation reserve and outside the bounds of depreciation rates, reflected a reserve deficiency to be a recovery of that deficiency. And I believe that's what would have been shown in this depreciation study had the normal utility accounting for a retirement been made in the 2000 rate case.

Q.   Would it be true that the company would get a return on that?

A.   A return on?

Q.   Right.

A.   I think there's a -- there's a return on in comparison to what was done by the Commission in the last rate case. You know, versus a -- the rate base impact by doing the normal utility accounting for retirements versus what was ordered by the Commission, there is a rate base impact, yes. So there would have been a return on versus what we realized in the last case when rate base was reduced by the $3.177 million.

Q. Can you be more specific about what that return on would be?

A. Are you looking for a number?

Q. If possible. If you can give it.

A. I -- not offhand, I do not have it.

MR. BATES: Okay. Thank you very much.

JUDGE THOMPSON: Let's see. Redirect, Mr. Cooper?

REDIRECT EXAMINATION BY MR. COOPER:

Q. Mr. Grubb, you talked a fair amount about return on and return of. Within the context of this issue, when you talk in terms of return on, what are you referring to?

A. The return on is a concept in rate-making where you capture in the revenue requirement the capital costs associated with a rate base item.

Q. Is a return on basically a percentage of the company's investment in plant?

A. Yeah. If the overall weighted cost of capital is 8.3 percent, you take that times the investment you're wanting to make a return on.

Q. And when we're talking in terms of investment in plant, what is the purpose of the return of piece?

A. The return of piece for invested plant would be depreciation, and you're recovering the original cost of the asset that was placed into service.

Q. So the company's recovering the original investment in that asset over time?

A. That's correct.

Q. I believe that perhaps it was Commissioner Murray had asked you about unrecovered amounts. Has the company begun or started the amortization that it proposes in this case?

A. No, we have not.

Q. You were asked about the purpose for the inclusion of cost of removal and depreciation rates, I believe by Ms. O'Neill. If this plant had been fully depreciated, would there have been a need to address cost of removal after the retirement of the plant?

A. I believe had it been fully depreciated, the company would have performed the normal basic utility accounting to retire the asset and there would be no issue before us today.

Q. Now, you were asked a question, also I believe by Ms. O'Neill, and perhaps I misheard, but I thought she asked you about the original cost of the old St. Joseph treatment plant and how that compared to the 2.8 million that is still on the books.

If we refer to original cost within the realm of investment in plant rate base, that sort of thing within the rate case structure, what does original cost mean to you?

A. Original cost means the amount the company has invested in a -- in an asset to serve the customer at the time the asset went into service.

Q. Would it only be the amounts -- well, let's back up.

Would it only be the amounts that were invested at the point it first went into service or would it include other amounts invested in that plant over time?

A. It would be any amount invested over the spectrum of time. In the case of the St. Joe plant, investments were made well -- a long time ago, early 1900's. And as time progressed, additional investments were made, items were retired. And then that whole process went through up to the time when the old plant was retired in 2000.

Q. Now, you were asked a question by Mr. Bates in regard to what the book value was of the real estate where the old treatment plant sat. Do you remember that?

A. Yes.

Q. And I think you referred that it was -- or you answered that it was in the $12,000 range. Correct?

A. Yes.

Q. Do you recall how long that plant had been at that location?

A. Not right offhand, but I know it's been there quite a long time.

Q. More than 100 years?

A. I believe it's -- I've referenced the early 1900's, so it's probably about 100 years, yes.

MR. COOPER: That's all the questions I have, your Honor.

JUDGE THOMPSON: Thank you, Mr. Cooper.

Thank you, Mr. Grubb. You may step down.

Is Mr. Rackers the Staff witness on the Old St. Joe Plant issue?

THE WITNESS: Yes.

MR. SNODGRASS: Judge, could we have about a five-minute recess for Mr. Rackers?

JUDGE THOMPSON: All right. We'll take five minutes at this time.

(A recess was taken.)

JUDGE THOMPSON: Mr. Rackers would you spell your last name?

THE WITNESS: R-a-c-k-e-r-s.

JUDGE THOMPSON: Raise your right hand.

(Witness sworn.)

JUDGE THOMPSON: You may inquire.

STEPHEN RACKERS testified as follows:

DIRECT EXAMINATION BY MR. SCHWARZ:

Q. Good morning. Would you state your name and place of employment for the record, please?

A. Stephen M. Rackers, the Missouri Public Service Commission.

Q. And in what capacity are you employed?

A. I'm a regulatory auditor.

Q. And in the course of your employment did you cause to be pre-filed in this case your Direct Testimony, which has been identified for the record as Exhibit 24; and Surrebuttal Testimony, which has been identified as Exhibit 72?

A. Yes.

Q. And if I ask you the same -- well, let me -- strike that, please.

Do you have any corrections --

A. No.

Q. -- to make to your testimony?

If I asked you the same questions today as were asked in your pre-filed testimony, would your answers be the same?

A. Yes.

Q. And are those answers true and correct to the best of your information, knowledge and belief?

A. Yes.

MR. SCHWARZ: I would offer Exhibits 24 and 72 and tender Mr. Rackers for cross-examination on the issue of the old St. Joe plant.

JUDGE THOMPSON: Do I hear any objections to the receipt of Exhibits 24 or 72?

Hearing no objections, those exhibits are received and made a part of the record of this proceeding.

(Exhibit Nos. 24 and 72 were received into evidence.)

JUDGE THOMPSON: Ms. O'Neill?

MS. O'NEILL: No questions.

JUDGE THOMPSON: Mr. Cooper?

MR. COOPER: Yes, your Honor.

CROSS-EXAMINATION BY MR. COOPER:

Q. Mr. Rackers, would you agree with me this issue arises from the fact that when the new -- what we'll refer to as the new St. Joseph treatment plant came on line in I believe the year 2000, the old treatment plant was not fully depreciated when it was taken out of service?

A. That's correct.

Q. Would you agree with me that the regulated utilities in this state must record depreciation expense based on depreciation rates established by this Commission?
A. Yes.
Q. And so, in other words, you'd agree with me that utility companies in Missouri aren't free to set their own depreciation rates, wouldn't you?
A. That's correct.
Q. And when a utility believes that its existing depreciation rates are inadequate, in a normal rate case the burden would be on that utility to come in and try to persuade the Commission to change those rates. Correct?
A. I think that could happen outside of a rate case, but yes.
Q. But the burden in whatever case would be on the party seeking to change those rates. Correct?
A. Yes.
Q. Now, this issue of under-depreciation, specifically as to the old St. Joseph treatment plant, was addressed by the Commission first in the 1997 MAWC rate case. Would you agree with that?
A. Yes.
Q. And that would be Case No. WR-97-237. Correct?
A. Yes.

Q. Are you familiar with a Mr. Woodie C. Smith?
A. Yes, I am.
Q. Okay. Was Mr. Smith an employee of the Commission Staff in the 1997 time frame?
A. Yes. He was a member of the depreciation department.
MR. COOPER: Your Honor, I'd like to mark an exhibit, if we could.
JUDGE THOMPSON: Okay.
MR. COOPER: And this would be the Surrebuttal Testimony of Woodie C. Smith, Case No. 97--
JUDGE THOMPSON: Hang on.
Okay. This will be Exhibit No. 120. And it is the what? Surrebuttal of Woodie Smith?
MR. COOPER: Yes, your Honor. Case No. WR-97-237.
JUDGE THOMPSON: Okay.
(Exhibit No. 120 was marked for identification.)
JUDGE THOMPSON: Okay. Go ahead.
BY MR. COOPER:
Q. Mr. Rackers, do you have in front of you what has now been marked as Exhibit 120?
A. Yes.
Q. Could you turn to page 2 for me?

A. I'm there.
Q. Do you see a question that begins on line 10?
A. Yes.
Q. Could you read for me the question that begins on line 10?
MS. O'NEILL: Your Honor, I'm going to object to this testimony relating to an item that's not in evidence. And if he's going to offer it, I'd probably have another objection.
JUDGE THOMPSON: Well, I think he can ask him anything he wants. I mean, you can offer a witness anything you want the witness to comment on and he doesn't have to put it in evidence. And so I'm going to overrule the objection. Please proceed.
BY MR. COOPER:
Q. Mr. Rackers, again, could you read for us the question that begins on line 10, page 2 of exhibit 120?
A. Mr. Robertson and Mr. Harwig state on page 5 and 2 respectively of their Rebuttal Testimony that to their knowledge the company neither initiated nor proposed the increase in depreciation -- depreciation expense level. Do you agree with this opinion?
Q. Okay. Now, would you read for me the answer that begins on line 13?
MS. O'NEILL: Your Honor, I know where this is

going, but I need to also object. This is hearsay. This is hearsay not within any exception. And this witness, whose testimony Mr. Cooper is attempting to place in the record, is not available for cross.

MR. COOPER: I believe, your Honor, what I will ask for you to do is take official notice of Mr. Smith's testimony from Case WR-97-237 as it is a public document kept by the Commission filed in that case number maintained by the Commission's records. And I think the Commission has the ability to take notice of that in accordance with its own rules.

MS. O'NEILL: May I respond?

JUDGE THOMPSON: You may.

MS. O'NEILL: I don't know and I cannot tell from the item that's been handed to me whether this has ever been entered into evidence in any case. I do not know Mr. Smith. I know he's not a witness in this case.

Whether or not the Commission can take notice of public documents filed, and I know that it can, is one thing. Whether or not the company should be allowed in this proceeding to introduce evidence into the record for the truth of the matter asserted based on an opinion of someone who's not a witness in this case, who's not been offered and made available for cross-examination in this case is a different issue. We believe that this is hearsay not overcome by any exception.

And although if Mr. Cooper wants to ask Mr. Rackers whether -- you know, to read this to himself and not into the record and ask him if he agrees with the characterizations if he knows, if he's got an opinion, that's a different issue. But if he wants to read the evidence in the record and ask this Commission to consider it as the truth, then I object.

MR. COOPER: Your Honor, the point of this testimony really -- and something else I'm going to do here in a minute -- is to really show the position of the Staff in that WR-97-237 case. I want to bring to the Commission's attention that this issue was first brought to its attention in that 1997 case. I don't know that the truth of what Mr. Smith says is that important to me other than the fact that it was said and was a position taken by the Staff in that '97 case.

MS. O'NEILL: I would also then suggest it's not relevant what the Staff thought in 1997 on top -- without withdrawing my other objection.

JUDGE THOMPSON: Well, it's not even ten o'clock in the morning yet.

Okay. Mr. Cooper, if you want the Commission to take notice of this testimony for the truth of whatever's asserted in the testimony, then I would have to sustain

Ms. O'Neill's objection because you have not established that this testimony was received by the Commission in that other case.

If you want to read a portion of the testimony and ask Mr. Rackers if he agrees with it or doesn't agree with it, then please proceed and I would overrule Ms. O'Neill's objection to that. Because I think in Missouri you can ask a witness whether they agree or disagree with anything you might want to tender to them or read to them.

MR. SCHWARZ: If it would help, your Honor, the Staff will stipulate that for purposes of this case -- for Case WR-97-237, that it did, in fact, propose an increase in depreciation expense using a 2001 retirement date for the St. Joseph plant.

JUDGE THOMPSON: Does that do what you need it to do?

MR. COOPER: I believe that does what I need it to do, your Honor.

JUDGE THOMPSON: Cool. Let's move on then. We'll just set Exhibit 120 aside and move forward. Thank you.

MR. SCHWARZ: 120 has been set aside then. It is not admitted into the record?

JUDGE THOMPSON: Hasn't been offered, hasn't been received.

MR. SCHWARZ: Thank you.

BY MR. COOPER:

Q. Now, Mr. Rackers, are you familiar with the Commission's position in WR-97-237 as to the old St. Joseph treatment plant and depreciation related to that old St. Joseph treatment plant?

A. You say the Commission's decision?

Q. Let me back up. What I mean is the Staff's position in WR-97-237.

A. Well, I read Mr. Smith's testimony prior to the last case, I haven't read it since. But that's my understanding, whatever I read in his testimony.

Q. Is it your understanding that in that case the Staff looking ahead forced -- could see that as of the retirement of the old St. Joseph treatment plant, there was going to be an undepreciated amount on MAWC's books?

A. That's my understanding. If the retirement proceeded as it was proposed at that time, I think Staff recognized that the plant would not be fully depreciated.

Q. And "as it was proposed at that time" refers to the year 2001. Correct?

A. I'm going to have to refer to his testimony because I really don't know.

Okay. Please ask me your question again.

Q. You would agree with me that as of that WR-97-237 case, it was proposed that the old plant would be retired in the year 2001, wouldn't you?
A. My answer is yes, as I read that on page 2 of this testimony, line 6.
Q. And the Commission did not in WR-97-237 grant MAWC any sort of accelerated recovery of depreciation related to the old St. Joseph treatment plant, did it?
A. That's my recollection.
Q. And at that time is it your recollection that the Commission said that it would be speculative and premature to address those amounts?
A. I don't know.
Q. Now, if we turn for a moment to your Surrebuttal Testimony, on page 7 of your Surrebuttal Testimony on line 16 -- and I think actually this may be the theme of your testimony both in your Direct and your Surrebuttal. But on line 16 you say that, Considering that the company is providing no new evidence, that there is no change in the circumstances regarding the retirement of the old St. Joseph treatment plant.
Would you agree with me that that's essentially the substance of both your Direct and Surrebuttal Testimony?
A. In the fact that the Commission has made a

previous ruling and has at least at some point indicated that it intends to -- that it still supports that ruling and intends to appeal the circuit court decision.

Q. And I suppose that based upon your response then, you would not view the circuit court's finding that that earlier Commission ruling was a confiscation to be a change in circumstances or any new evidence. Correct?

MR. SCHWARZ: I'll object to a legal conclusion from the witness.

MR. COOPER: Well --

JUDGE THOMPSON: Wait a minute. I have to rule on the objection, unless you're going to withdraw the question.

MR. COOPER: No, your Honor. I would like to respond to the objection, I guess.

JUDGE THOMPSON: Go ahead.

MR. COOPER: I think Mr. Rackers has stated in his testimony that he doesn't believe there's any new evidence or that there's a change of circumstances. I just want to confirm with him that apparently this circuit court decision ruling that the Commission's order was a confiscation doesn't fit into his category of new evidence or change of circumstances.

JUDGE THOMPSON: I'll allow that question. Objection's overruled.

BY MR. COOPER:

Q. Mr. Rackers, I take it you do not view the circuit court decision reversing and remanding the Commission as to the old St. Joseph treatment plant issue to be new evidence or a change in circumstances; is that correct?

A. That's correct.

MR. COOPER: That's all the questions I have, your Honor.

JUDGE THOMPSON: Thank you, Mr. Cooper.

Let's see. Questions from the Bench for Mr. Rackers. Commissioner Forbis?

QUESTIONS BY COMMISSIONER FORBIS:

Q. Oh, just a couple maybe.

Do you have other examples where depreciation didn't cover plant and the PSC allowed it?

A. I don't have any specific examples where it was an issue in a case --

Q. Okay.

A. -- and the Commission actually had to make a decision. I do have an example -- I can't give you the case cite, but I do have an example where a situation just like this case existed.

Q. All right. Yes.

A. I can recall in a -- I believe it was a United

Telephone case the company retired a switch in the Columbia area prematurely. And there was an issue in that case where the company wanted to recover that premature retirement and the Commission ruled against that. It's -- I think it's very similar to what went on in this case. I mean, with regard to this issue in the last case.

COMMISSIONER FORBIS: I'm going to stop. Thank you.

JUDGE THOMPSON: Commissioner Murray?

COMMISSIONER MURRAY: Thank you.

QUESTIONS BY COMMISSIONER MURRAY:

Q. Good morning, Mr. Rackers.

A. Good morning.

Q. I want to go back to WR-97-237 for a moment.

A. Okay.

Q. I believe Mr. Cooper was asking you some questions about that rate case. And I believe Mr. Schwarz said that Staff stipulated that they and -- Staff had advised the -- and I'm not sure exactly what the wording was that he stipulated to, but that basically what had happened in that case was that Staff had had the position that the depreciation rates in effect at the time would under-recover the assets. Is that your understanding?

A. That's my understanding with regard to Mr. Smith's testimony.

Q. Okay. And then in WR-2000-281 -- well, first of all, before I go to that case, in WR-97-237 the Commission itself declined Staff's recommendation to adjust the depreciation rates at that time; is that right?
A. That's my recollection.
Q. Okay. And the result of that was a continuation of the under-depreciation?
A. Well, the result of that was a continuation of the depreciation rates that were currently in effect.
Q. Which Staff had taken the position were under-re-- under-depreciating; is that right?
A. Based on a retirement that would occur in 2001.
Q. Okay. And then in 2000 -- the WR-2000-281 case -- and I'm reading from the order here on page 51 of that order when the Commission in its -- I believe this must have been the Findings of Fact section on premature retirement.
The Commission stated that -- and I'm on page 51 of that order -- MAWC and Staff agreed that the original cost of the plant should be deducted from both plant in service and accumulated depreciation in order to preserve the old plant's remaining undepreciated value of $2,832,906 until a proper depreciation study can be performed. Were you involved in that case?

A. Yes, I was.

Q. And is that your understanding, that that was both the company and Staff's position at that time?

A. Well, that wasn't the company's original position, but I think it went along with Staff's position by the time the case went to hearing.

Q. Okay. And then the order goes on to say, Additionally, the retirement cost for the plant estimated at $500,000 for -- I'm sorry. Let me read that again. I didn't read it correctly.

Additionally, the retirement cost for the plant estimated at $500,000 should also be deducted from accumulated depreciation, thereby preserving 3,332,906 at the time when the retirement actually occurs.

Is that also your understanding of the Staff and the company's position in that case?

A. Yes.

Q. Okay. And then the Commission went on to discuss Office of Public Counsel's position. And on page 52 -- I'm reading from the order again -- It follows that the treatment proposed by Public Counsel is correct. Utility plant in service will be reduced by the original cost of the old St. Joseph plant while the depreciation reserve will be reduced only by the amount of depreciation accumulated with respect to the plant.

The difference: The plant's net original cost of $2,832,906 will be written off. Likewise, any amount expended by MAWC to retire the old plant is also not recoverable in rates.

And is that your understanding of the position that the majority of the Commission took on that retirement?

A. Yes.

Q. But that was not Staff's recommendation?

A. That's correct.

Q. And the Staff's position at that time that recovery, I think -- and correct me if I'm characterizing Staff's position incorrectly, but I believe Staff was saying that there needed to be more depreciation study before those amounts were fully known; is that correct?

A. I think I'd characterize Staff's position as before we believed that it was appropriate to make a recommendation as to recovery or nonrecovery or how that should proceed with regard to the old St. Joe plant, that it was appropriate to have done a study of all the plant in service with regard to depreciation and how that original cost should be recovered rather than just look at this one item in isolation.

Q. All right. And the company at the time was in agreement with that; is that correct?

A. I think the company was willing to accept that as a resolution of the issue for that case.

Q. Okay. And that was what, before the Report and Order came out I guess, that you thought probably would occur; is that accurate?

A. I'm sorry. I don't understand the question.

Q. Well, before the Report and Order was issued rejecting Staff's and company's position, I assume that both you and the company were thinking that the Commission would agree with that. Did you have any reason to think the Commission would not?

A. Certainly. I mean, other people in the case took differing positions. I mean, there was -- I mean, the Commission had other evidence and other positions to consider. We didn't just automatically expect them to take ours.

Q. Okay. Is the position that you and the company took consistent with traditional rate-making treatment when an asset is retired?

A. I would say with regard to a unit of property like the St. Joe plant, that it probably wasn't.

Q. I'm sorry. You're going to have to clarify that answer a bit.

A. Well, I think that normally Staff would have proposed some disposition of that asset in that case. I think because we didn't have a complete depreciation study of all the assets, I think Staff viewed this as a way to preserve the issue so that it could be decided later when we had -- when we had done a complete depreciation study.

Q. And is that because for rate-making purposes a utility is allowed to recover the full cost of the asset?

A. Well, I think depreciation rates are designed with that in mind. I mean, I think it's pretty rare that what you design the depreciation rate to accomplish comes out to be perfect recovery of exactly the asset value. But obviously the Commission ruled that that wasn't appropriate in the last case.

Q. And do they generally get closer than 3-point-some million dollars?

A. I'd have to answer I don't know.

Q. Okay. And when there is a discrepancy -- you said they don't come out perfect, but when there is a difference between the rate base that is being removed and the accumulated depreciation, is there ordinarily an adjustment made?

A. I'm not sure I understand your question, but when you say is there ordinarily some method proposed to recover that difference --

Q. Yes. Thank you.

A. -- is that what you're asking?

No.

Q. You mean that there is normally a write-off of an accumulated depreciation?

A. Well, the majority of assets that get retired are mass assets like mains, for instance. And whatever -- the normal way you retire a main is whatever the original cost of the plant is, you reduce plant by that amount and you reduce the reserve by the same amount. And as I said earlier, the chance that those would be exactly equal with regard to that piece of plant are -- would be, you know, rare.

Q. Okay. But they would be still in the calculations of what the company would be getting a return of over time, is that correct, looking at the assets as a whole or a group of assets as a whole?

A. Would you ask me that question again, please?

Q. Okay. By reducing the plant by an amount that is equal to the amount you're reducing the accumulated depreciation by, the company is not having to write off any unrecovered assets at that time, is it? Isn't it going into a calculation of at least a class of assets and allowing the company to still earn a return of all of the assets?

A. There wouldn't be a specific write-off.

Q. Okay. And that is, in fact, as I understand it, what Staff was recommending, that not that that 3 million plus be written off, but that it be calculated in terms of depreciation consideration of all of the assets and calculated in that manner rather than being written off; is that accurate?

A. Staff wasn't proposing a write-off.

Q. And is the reason that Staff is proposing a write-off here based on this Commission's decision in WR-2000-281 that is currently on appeal?

A. Well, it -- that decision and at least what I perceive as your continued support of that decision and the fact that I don't see any new circumstances that exist with regard to this retirement.

Q. All right. And when you say "your continued support," you're only talking about the fact that the Commission was not willing to accept the decision of the circuit court and go forward and address it at that time, is that right, but rather appealed the circuit court's decision?

A. That's correct.

Q. Okay.

COMMISSIONER MURRAY: All right. I hope that's all the questions I have. I'm not real organized this morning. Thank you.

JUDGE THOMPSON: Thank you, Commissioner.

Other questions from the Bench?

QUESTIONS BY JUDGE THOMPSON:

Q. Good morning, Mr. Rackers.
A. Good morning.
Q. This issue turns all about depreciation. Right? I mean, how depreciation didn't work in the case of the old St. Joseph plant?
A. Well, I think that's more the company's position than Staff's.
Q. Okay. So an asset is put in service and is put in service at its original cost basis. Right?
A. Yes.
Q. Okay. And the Commission Staff develops a depreciation schedule for that asset. Correct?
A. Yes.
Q. And the company has to use the depreciation schedule that the Commission Staff develops. Correct?
A. Well, if it's ordered by the Commission.
Q. Okay. Let's assume that it is. And this is an approximation of the useful life of the asset. Correct?
A. Yes.
Q. And so every year the asset is considered to lose a portion of its value. Correct?
A. Yes.
Q. It's used up in the public service. Correct?
A. Correct.
Q. And so the value of the asset over time is

essentially reduced by accumulated depreciation. Right?
A.   Yes.
Q.   And the company receives in revenue as an expense the annual amount of that depreciation. Correct?
A.   That's correct.
Q.   Okay. Now, you've testified I believe that it's, in fact, rare that the real useful life of the asset and its useful life for depreciation purposes coincide?
A.   Well, that they would match exactly.
Q.   Right.
A.   Yes.
Q.   Okay. And isn't the residual value of an asset when it's taken out of service, isn't that termed salvage value?
A.   Yes.
Q.   Okay. So the undepreciated portion of the St. Joseph plant -- the old St. Joseph plant, is it accurate to term that salvage value or not?
A.   Well, I'm sorry. When I agreed with your question before, I might have been using the word "residual" differently than you were. I think what you just described was the undepreciated value.
How I would describe salvage is that when I retire the plant, whatever I could sell it for, scrap or otherwise, that's what I call salvage.

Q. Okay. So salvage value is, let's say, the scrap value.
A. Okay.
Q. Right?
A. Yes.
Q. Okay. So it's not its value being used in its original purpose, but being used in some other purpose, some other way?
A. Well, that's the example I used. There's other ways to get this salvage value out of -- out of an asset.
Q. Okay. Well, do you know if Missouri-American recovered any salvage value on the old plant?
A. To the best of my knowledge, no.
Q. Okay. Plant was turned off and torn down. Right?
A. I don't know that it's been turned off. I think it was capped so that it's no longer connected to the distribution system in St. Joseph.
Q. So as far as you know, it may still exist then?
A. Yes.
Q. Okay.
JUDGE THOMPSON: That's all the questions I have. Thank you.

Further questions from the Bench?
Recross, Ms. O'Neill?
MS. O'NEILL: Thank you.
RECROSS-EXAMINATION BY MS. O'NEILL:
Q. Okay. Mr. Rackers, kind of at the risk of prematurely exposing my rudimentary knowledge of depreciation here, when we talk about the return on an asset that the company recovers, that's original cost plus whatever's in the depreciation schedule; is that right? The depreciation rates for that asset; is that accurate?
A. When you say "return on" --
Q. Well, what we put into rates that they -- that -- okay. Let me rephrase.
What we put into rates is the original cost plus whatever number comes up of depreciation which gets approved. Right?
A. Well, what we put into rates is a return on the original -- the undepreciated original cost.
Q. And then --
A. And then plus the annual depreciation expense.
Q. And I'm not being very clear with my question. Let me try this. If you have a plant -- item of plant costs $100, okay, and the depreciation schedule suggests that the cost of removal net of salvage -- and we're using that method of depreciation for the example -- is also $100, then

what goes into rates, is it $200? Not all in the same place, but the original cost and the $200 at the beginning, is that -- and the other $100 for cost of removal net of salvage, you've got $200 there?

A. When you say in the beginning --

Q. When the plant's first placed into service.

A. Okay. When the plant is first placed into service, you would collect $100 into plant in service.

Q. Right. And $100 into --

A. There would be nothing in the reserve.

Q. Nothing in the reserve. The reserve builds up?

A. Correct.

Q. Right.

A. And this $100 -- well, I don't want to get ahead of your question.

Q. That's okay. So the $100 that's in the depreciation schedule builds up from 0 to $100 over the life of the asset; is that correct?

A. That's the intent of the rate.

Q. And as that builds up, the company receives cash flow in the revenues to recognize that; is that right?

A. Yes.

Q. Okay. And also as the $100 reduces the original cost, that reduces down; is that right?

A. That reduces the net plant that's included in rate base.

Q. Okay. So at the time that that plant is fully depreciated, the company will have collected $200; is that right?

A. Yes.

Q. The $100 original cost and the $100 of depreciation?

A. Of cost removal net salvage.

Q. Cost of removal, net of salvage. So if you go all the way to the end of useful life, the company has $200 and a fully depreciated piece of plant?

A. That's correct. Assuming --

Q. Assuming --

A. -- the depreciation rate, you know, worked and the plant lived exactly as long as you --

Q. Wanted it to.

A. -- estimated it would, yes.

Q. And assume that miraculously when the $200 is collected, they take the plant out of service and it costs the company $120 to remove it net of salvage. They just lose that $20; is that right?

A. Well, no. The -- the $20 would get credited.

Q. Into the plant account?

A. I'm sorry. Debited to the depreciation reserve. So the reserve would be reduced by that additional $20.

Q. If it only cost them $30 to remove it, what happens to the $70?

A. The $70 stays in the depreciation reserve. You'd only debit the reserve for the $30.

Q. So they keep the $70, in effect? I mean, in most simplistic terms they keep the $70, they use it for something else, either to remove something else or buy something else, pay dividends, whatever?

A. Well, the cash associated with that.

Q. And that's because depreciation rate setting is not an exact science? It may have some scientific aspects, but it's, would you say, more of an art than a science because you really don't know what's going to happen?

A. I -- I don't know what I'd agree with your characterization, but as I said before, it would be rare that they would match exactly.

Q. Now, in response to some questions from Commissioner Murray, you indicated that the order that came out of the 1997 rate case was an order that the Commission entered after hearing about testimony that depreciation rates were not going to exactly match with the old plant; is that right?

A. That's my recollection.

Q. Heard evidence of that, they made a decision regarding depreciation based on all of the evidence in the case?

A. Yes.

Q. In the 2000 case, 2000-281, Commission heard evidence from different parties, made a decision -- considering all relevant factors, made a decision in that case?

A. That's correct.

Q. And in this case the Commission will make a decision based on all the relevant factors --

A. Yes.

Q. -- correct?

A. Yes.

Q. And we expect them to do that.

And to get back out of depreciation into a ground I feel more comfortable with, the company doesn't own this plant anymore; is that correct?

A. That's my understanding.

MS. O'NEILL: No further questions.

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

COMMISSIONER MURRAY: Judge?

JUDGE THOMPSON: Yes, ma'am.

COMMISSIONER MURRAY: I'm sorry. I need to ask something else.

JUDGE THOMPSON: Absolutely. I had some more too. Please proceed, Commissioner Murray.

FURTHER QUESTIONS BY COMMISSIONER MURRAY:

Q. Mr. Rackers, if you had a piece of property the original cost of which was $1 million and the net salvage value was $200, at the time that plant went into service, you would enter upon a depreciation schedule to depreciate $1,000,200 over the useful life of that plant; is that correct?

A. Yes.

Q. And assuming the plant was taken out of service when there was only $800,000 of accumulated depreciation, how much would rate base be reduced at that time?

A. Rate base would stay the same because you would reduce plant by 1 million and you would reduce the reserve by 1 million, assuming you did the retirement that day.

Q. Let's take it one step at a time. You had 1,200,000 being depreciated. Correct?

A. Yes.

Q. At the time the plant is retired, what do you do to rate base alone? Just look at the rate base.

A. You reduce plant by 1 million and reduce the reserve by 1 million, so the rate base doesn't change. I didn't assume anything with regard to how much it cost to actually make the retirement.

Q. Let's assume it cost 200,000.

A. Rate base would increase by 200,000.

Q. So you would reduce rate base by 800,000 instead of 1 million basically is what the result would be; is that right?

A. No.

Q. You --

A. If we look at rate base as just having --

Q. I'm sorry. I'm sorry.

A. It would go down by 200,000 -- excuse me, rate base would increase by 200,000.

Q. Okay. But you'd also be reducing it by 1 million?

A. No. You'd be reducing it by -- with regard to the original cost of 1 million, there would be no change in rate base because you've taken a million out of plant, a million out of the reserve. And then if you actually incurred 200,000 of removal cost, that would be a -- an increase to rate base.

Q. Okay. The result of removing something from plant is reducing rate base, is it not?

A. Right. But if you remove it from the reserve also, those two net against each other in rate base so there would be no change.

Q. Okay. And why does the 200,000 result in an increase in rate base?

A. Well, the 200,000 would reduce the depreciation reserve. And since it is a reduction to rate base, rate base would actually go up by 200,000.

Q. But it's an equivalent treatment for the amount in plant and the amount in accumulated depreciation, is it not?

A. Not with regard to cost removal. There's no -- cost removal is not carried in the balance associated with plant in service. Just the original cost is carried in the plant balance.

Q. Now, assume that same asset, that $1 million asset with $200,000 cost of removal had been fully depreciated at the time it was removed and it did, in fact, cost $200,000 to remove it. There is 0 effect on rate base; is that correct?

A. No. Rate -- rate base would increase by 200,000.

Q. What would the amount of the accumulated depreciation be?

A. Well, assuming it all worked out right, there would be $1,200,000 in the reserve.

Q. And the reserve would be reduced by that amount; is that correct?
A. That's correct.
Q. And the plant in service would be reduced by $1 million or 1,200,000?
A. One million dollars.
Q. So at the time that the plant goes into service, what is the amount that is placed into rate base?
A. At the date it goes into service in this example, $1 million.
Q. Okay. So there's never an opportunity to earn a return on that cost of removal by including it in rate base; is that right?
A. If you retired the plant before it was fully depreciated, you would eliminate the plant balance. And then the difference between what you had accumulated in depreciation plus whatever you spent on cost of removal, that -- the difference between that number and the 1 million would actually reduce the depreciation reserve.
So there would be a -- that's the undepreciated balance we're talking about. And since it reduces the reserve, it would sit in the reserve as a increase to rate base. So you actually would be earning a return on it until it is either amortized away or depreciated or something.

Q. And I believe you said it sits in the reserve as an increase to rate base. Is that what you just said?
A. Yes.
Q. So -- I'm sorry. I'm struggling with this.
I want to go back to my -- I want to go back to the original assumption except I want to alter it a little bit. Assume you just had $1 million -- $1 million plant going into service being placed into rate base and being a depreciated over time without -- and for simplicity here, I'm just going to leave out the cost of retirement.
Assume at the time it's retired it has only accumulated $800,000 of depreciation. At that time what happens to rate base and what happens to the accumulated reserve?
A. At the time of retirement, assuming we made the retirement the way we've been discussing, plant would go down by 1 million and the reserve would decrease by 1 million. So there would be no -- no change in rate base.
Q. Okay. And then the recovery of that difference, that $200,000, how would that be treated? How would that be recovered, assuming it was allowed to be recovered?
A. It -- it could either remain in the reserve and influence future depreciation studies or a specific amortization of that amount could be calculated and ordered.

Q. And would that amount be included in rate base to amortize it?
A. Unless it was specifically removed, it would sit in the depreciation reserve.
Q. Okay. But I thought your analysis showed that it was removed. Maybe I'm getting confused here.
If you reduce the plant by $1 million and the accumulated depreciation by 1 million, somehow that $200,000 difference has not yet been accounted for. Correct?
A. It -- the effect of that would remain in the reserve.
Q. And that's where I'm struggling. Because you said you took 1 million out of the reserve?
A. Yes.
Q. So why does the effect of that 200,000 remain in the reserve, or how does it?
A. Well, I guess I'm saying the -- you have $200,000 that -- this differential of $200,000. The difference between the 1 million that you debited the reserve and the 800,000 that had actually been accumulated on this asset would remain in the depreciation reserve unless you specifically amortized it away.
Q. So you really wouldn't debit the reserve by 1 million?
A. At the time of retirement, yes.

Q. Okay. I'm not understanding what you're saying about it would remain in the reserve, the 200,000.

A. Well, the difference between what you had accumulated and what you -- what you debited the reserve at the time of retirement would exist in the reserve unless you specifically designed some amortization to remove it.

Q. You would have accumulated $800,000 in the reserve at the time of retirement; is that right?

A. Yes.

Q. So if you debit the reserve by 1 million at the time of retirement, there's a $200,000 difference, but the reserve is smaller by $200,000, is it not?

A. That's correct.

COMMISSIONER MURRAY: Okay. I think I just need to think about this on my own for a while. Thank you.

JUDGE THOMPSON: Further questions from the Bench? You don't want any part of it?

COMMISSIONER FORBIS: I'm not getting into it. You go for it.

JUDGE THOMPSON: Okay.

QUESTIONS BY COMMISSIONER CLAYTON:

Q. Okay. I thought I knew all that could be known and now I realize that I don't.

May I use the same example, the same figures that Commissioner Murray used and I think I'm using the same figures. And if I change the assumptions, then tell me and I'll try to rework everything.

Basically start off with a purchase of $1 million plant, $1 million in plant. Now, starting off with that assumption, you testified that at the start or at -- upon the purchase of that $1 million plant, you immediately add in a net salvage figure; is that correct?

A. No.

Q. Okay. Good. That's fine.

Now, so you start off with a value of plant or value of asset in determining rate base of $1 million. If you assume, just to make it easy, a 5 percent depreciation rate, in the year 2005 you'd have $1 million of plant in service minus 5 percent times 5 years.

So your accumulated depreciation would be $250,000, you have plant in service be a million, accumulated depreciation would be 250,000 and your rate base is $750,000 in five years out; is that correct?

A. I hope I'm doing the math right here, but a 5 percent depreciation rate on $1 million worth of plant, $250,000 worth of depreciation -- worth of accumulated depreciation, that's what you said, then we'd still have a net rate base of 750,000, correct.

Q. That's what I said. So just that basic math in five years out, that's what -- you'd take your plant and service of 1 million, less your accumulated depreciation of 250,000, you got your rate base five years out of $750,000. Correct?

A. Correct.

Q. Okay. Now, when you get out to the year 2020, theoretically you'd have $1 million of plant in service and $1 million worth of depreciation --

A. Correct.

Q. -- correct?

So your rate base would be 0?

A. Correct.

Q. Now, let's say you retire in the year 2020 while your rate base is 0 and you sell the plant for scrap for $50,000, sell it for salvage -- salvage or scrap, I'm not sure if I'm using interchangeable terms -- $50,000. Now, is that $50,000 treated anywhere in either rate base or is it used to calculate anything relating to rates?

A. The $50,000 would increase the amount of the depreciation reserve. So rate base would decrease by $50,000.

Q. So rate base would be a negative $50,000?

A. Right. I'm assuming you hadn't accumulated anything for salvage or cost removal during --

Q. Well, that's what I'm asking. Are you testifying that -- with regard to this issue, that a salvage value was carried forward from the start? Maybe I'm misstating this.

A. Well, maybe this is what you're after. If we assume that the rate throughout this 20 years included something for cost removal and salvage --

Q. Well, let me ask you that. In your opinion, in this issue did it assume a value for scrap at the end?

A. I don't know. I assume the depreciation rate included something for cost of removal net of salvage.

Q. Okay. Help me with this. Using the same fact pattern, let's say you have a 0 salvage value after the 20 years. Plant in service was $1 million, accumulated depreciation is $1 million, your rate base is 0, the property has no value, there's no scrap metal, it can't be recycled, has no use and it costs you $50,000 to remove that plant. How do you treat that $50,000?

A. That $50,000 would decrease the depreciation reserve.

Q. So what would your rate base be?

A. Rate base would increase by $50,000.

Q. Positive 50?

A. Yes.

Q. Now, theoretically if you had cost of removal of 50 and you sold it for scrap for 50, then you'd be back to a rate base of 0?

A. Yes. You said cost of removal of 50 and scrap of 50? Yes.

Q. Those would offset.

Now, in this instance the issue that we're talking about here, we've got a situation of where you have plant in service and the accumulated depreciation did not rise, did not increase enough to reduce your rate base to zero at the time of retirement. Correct?

A. Correct.

Q. So your rate base still has roughly $3.1 million -- $3.177 million. Correct? Do you know? I thought this would be readily available. I'm sorry. I don't --

A. I don't think that's true. I think Mr. Grubb testified this morning that that balance is actually held in a regulatory account.

Q. Well, how about if I were to ask it this way. Maybe the undepreciated amount is roughly, what, $2.8 million and there was a cost of removal of some equipment. Does that sound familiar?

A. Yes. I think the balance we're talking about is 3,177,861. And Mr. Grubb testified this morning that that is in Account 186.

Q. My understanding of depreciation at the time of retirement would be that you would remove the original value of the plant from your plant in service figure and you would remove your accumulated depreciation on that plant from the accum-- the overall accumulated reserve at the time of retirement and it wouldn't change the rate base. Now, is that an accurate statement?

A.   Are you going to remove the same amount from reserve that you did from the plant?

Q.   Well, in this instance they're not the same. Correct?

A.   Correct.

Q.   So is it your testimony -- I think what I'm trying to get at is this undepreciated value is already in rates or is already built into the plant in service or the accumulated depreciation?

A.   The undepreciated balance -- do you mean today? Well, the undepreciated balance at the time of the last rate case counting cost of removal was approximately that $3 million number.

And Staff's position was that plant in reserve would be both reduced by the same amount, whatever the original cost of the St. Joe plant was. So rate base wouldn't change. Plant goes down, reserve goes down by that same number, those two are netted against each other so rate base doesn't change. So whatever that undepreciated balance was, it would remain in the reserve.

COMMISSIONER CLAYTON: Okay. Okay. Thank you.

JUDGE THOMPSON: Commissioner Murray?

FURTHER QUESTIONS BY COMMISSIONER MURRAY:

Q. Mr. Rackers, how did that undepreciated balance get into the reserve in the first place?

A. Well, the reserve was accumula-- if we use the example that we were talking about before, the reserve was accumulated over time, so that was $800,000. At the time of retirement, you reduced the reserve by $1 million so you had an undepreciated amount of $200,000 that is still reflected in the reserve.

Q. When you accumulate depreciation, you add to the reserve, do you not?

A. That's correct.

Q. So if you have an amount that has been under-depreciated, that has not yet been added to the reserve; is that right?

A. In our example the $200,000 had not yet been added to the reserve.

Q. So you're the reducing reserve by 200,000 more than you had ever added to the reserve; is that right?

A. Yes.

Q. But I thought you said that 200,000 remains in the reserve.

A. Well, the differential remains in the reserve. Ideally we would -- a million dollars would have been accumulated in the reserve. At the time of retirement, you would wipe out that $1 million and there would be nothing -- there would be no differential in the reserve. In this case, we still have that 200,000 because you, in fact, reduced the reserve more than you had accumulated.

Q. Now, what is the effect of that differential in the reserve?

A. At the time of retirement there would be no change in the rate base. Well, in other words, we have 1 million in rate base and we only have $800,000 in the reserve. So you've got a net rate base of $200,000 that the company's earning a return on. Now, at the time --

Q. I'm sorry. Stop there and say that last sentence again.

A. Okay. At -- right before we make the retirement, you'd have $1 million in plant and $800,000 in the reserve.

Q. Okay.

A. You net those two and you have $200,000 of net rate base that the company would earn a return on.

Q. So you don't reduce the rate base by the million?

A. Okay. This is right before retirement.

Q. Oh, just before retirement. Okay.
A. Now, after retirement, we reduce plant by 1 million and you reduce reserve by 1 million. But since there was only 800,000 in the reserve and the reserve is a reduction to rate base, net rate base is still $200,000. So the company would continue to earn a return on this $200,000.
Q. So when you say you "reduce plant by 1 million," you're not talking about reducing rate base 1 million?
A. No. No. Since I reduce plant by 1 million, I'll also reduce the reserve by 1 million in our example. So there's no change in rate base. Whatever -- whatever was in net rate base before, in our example $200,000, after that retirement, taking 1 million from both, there's still net 200,000. And the net is 0 plant and negative reserve.
Q. So if you have only 800,000 in reserve at the time the property is retired, how does that affect rate base?
A. There would be no effect on rate base.
Q. So whether the property was fully retired or only -- I mean fully depreciated or only partially depreciated at the time it's retired, there's no effect on rate base?
A. That's correct.

Q. And where ordinarily would the recovery take place of the amount that had not yet been depreciated?

A. I think there's two ways that you could deal with that. One would be that you could approve, design a specific amortization of that $200,000 over some period. And it would be like additional depreciation expense, if you will.

Q. Okay.

A. And what that would do would be it would -- you'd have -- let's say in this example you designed a specific recovery, there's $200,000, you wanted to do it over 10 years.

You'd amortize 20,000 a year. The other side of that 20,000 would go into the reserve, so it would take the reserve to 0. And you'd have $200,000 more of expense over 10 years.

The other way is that you could leave it in the reserve and it would have some influence on your next depreciation rate study.

Q. And is that latter scenario what Staff was looking toward in the last rate case when Staff said that there should be a proper depreciation study performed before any treatment was given to that 3-point-whatever million dollars?

A. I think what Staff was saying was that you need to do both pieces before you determine whether you leave it in the reserve and somehow design rates with that in consideration or whether you would design rates and specifically deal with this item as an amortization. I don't -- Staff didn't really offer a position in the last case that that's -- that's where we were.

Q. Okay. But there are at least two methods of recovery of under-depreciated assets after the assets are retired, the two that you gave here, plus -- are there any more?

A. Well, assuming that that's -- assuming you want to provide recovery.

Q. I'm just saying there are at least that many methods to do so; is that right?

A. Yes.

Q. Another question will pop up, but it's lost right now.

COMMISSIONER MURRAY: Okay. I'll stop there. Thank you.

JUDGE THOMPSON: Further questions from the Bench? Commissioner Forbis, diving in.

FURTHER QUESTIONS BY COMMISSIONER FORBIS:

Q. At some risk. No, no. I'm not -- different type of questioning. I've left my calculator at home.

I thought the Staff had recommended a 10-year amortization last time for the unrecovered depreciation.

A. Staff didn't make a recommendation --

Q. Did not?

A. -- for recovery in the last rate case. I'd have to look through Mr. Smith's testimony to tell you what the recommendation was or what he said in the '97 case.

Q. Okay. And what you were telling Commissioner Murray, in your opinion then, is it standard accounting practice to allow this unrecovered depreciation to be recovered through one of those two methods?

A. I'm going to have to answer I don't know. The method of recovery and how you do design depreciation rates, that's beyond my expertise.

Q. Since you said "I don't know," this is prob-- this next question probably won't work, but let me go ahead and just ask it. So do you feel then there's been a change because the property was sold in what would normal-- do you think the fact that it was sold should make a difference?

A. I -- I think it makes a difference in terms of you can see that the company actually recovered some salvage above the original cost of the land. And at least my understanding of how that was booked or how that was handled, that wasn't offset against what the company's trying to recover here. They kept that gain on sale for themselves.

Q. So --

A. But in terms of -- well, and you can look at it that the plant is no longer even an asset that's owned by the company. I suppose that has some influence.

Q. Would one reasonable approach be to offset whatever that gain was from the sale of the land and so forth to that remaining depreciation expense?

A. I don't know that that would be proper rate-making or accounting. I just -- I think it goes to show that outside of what the company's attempting to recover here, it was able to sell the land and keep a gain for itself.

Q. So -- okay.

COMMISSIONER FORBIS: Well not being a proper accountant, maybe that wouldn't -- thank you very much. I appreciate it. Me not being a proper accountant.

FURTHER QUESTIONS BY COMMISSIONER CLAYTON:

Q. I just want to ask you a question about -- if you can explain to me how the purchase and development of land -- considering land cannot be depreciated plays into rate-making.

A. Well, since the land's not depreciated, the original cost stays in rate base. The company continues to earn a return on it until it's sold and whatever -- whatever -- I think generally whatever it's sold for, gain or loss, that flows to the shareholders.

Q. And I know these figures aren't going to be accurate. This is more for informational purposes. But the land in this case or in this issue was sold for $115,000. Is that your understanding?

A. Yes.

Q. And that no part of that investment in that ground from 1908 or whatever the year that the plant came into service or was purchased, there's no figure included in the plant in service for real estate. Is that a correct statement?

A. No. I think the real estate carried in the balance of plant in service would have been the 12,000.

Q. Would have been 12,000.

COMMISSIONER CLAYTON: Okay. Okay. Thank you.

JUDGE THOMPSON: Commissioner Murray?

COMMISSIONER MURRAY: Thank you.

FURTHER QUESTIONS BY COMMISSIONER MURRAY:

Q. Commissioner Clayton was going where I wanted to go here. And that is the consideration of the value of the land. And you answered to one of his questions that generally a gain or a loss would flow to the shareholders. Correct?

A. Correct.

Q. And that is, in fact, what happened here; is that right?
A. That's my understanding.
Q. And there's nothing improper about that; is that right?
A. That's not improper accounting.
Q. Okay. And that would normally be the case even if you allowed full recovery of the undepreciated portion of the assets; is that right? Because we're talking about apples and oranges here, one depreciated and one not capable of depreciation.
A. I think that's the normal accounting practice with regard to real estate.
Q. So really is there any reason to bring that into the equation when you're looking at taking a position on whether the company should be able to recover the undepreciated amounts of the original assets that were being depreciated?
A. Well, I --
Q. In other words, is the fact that the company was allowed -- that the company realized some gain on the sale of the land, is that fact even relevant in whether the company should also be allowed to recover the full value of the depreciated assets that were under-depreciated?
A. I'm not suggesting that Staff wants to take a

piece of that gain and offset it against the value of the unrecovered plant. But what I'm saying is it has some influence in that you can see that with regard to sale of real estate and gains and losses, those are always retained by the shareholder. Whereas, there was undepreciated value for this plant and the company wants to recover that fully from ratepayers while keeping the gain.

Q. But that would normally be the case, would it not, under normal rate-making, that the company would be allowed to do exactly that?

A. I think that's correct, yes.

Q. So --

A. Well, not necessarily recover the undepreciated portion. In the last case the Commission disallowed that.

Q. Well, aside from the Commission's aberrant decision in the last rate case, would that normally be the case?

A. Well, as I mentioned to Commissioner Forbis, I can think of at least one other case where the Commission did exactly that.

Q. I wasn't listening when you said that. What were you referring to then?

A. I think it was a United Telephone case in which the company replaced a switch in the Columbia service terr-- service area and there was an unrecovered balance associated with that.

Q. Do you know what that amount was?

A. I don't. I'm sorry.

Q. Was it as much as $3 million?

A. I don't recall.

Q. And I --

A. It was a significant amount because I think it was an issue in that case.

Q. Okay. Other than that and the last rate case here, are you aware of any decision in which a company -- a regulated company in Missouri was not allowed to recover the full original cost of the asset?

A. Well, they're not examples that fall specifically with the way we're talking about this situation here, but any time the Commission accepts a disallowance of the value of plant, which that occurred in a couple of cases -- I'm sorry, in a couple of situations in the last rate case, then the company would not recover the total original cost.

Q. And is a part of the reasoning there that it's some decision on prudence?

A. That could be a decision.

Q. So it's really -- that decision would determine how much of the plant was a prudent investment for the company to earn a return on and return of; is that right?

A. Well, prudence could be one reason why you would disallow a portion. Another reason, we had an issue regarding AFUDC, which Staff's position was the company incorrectly calculated the AFUDC rate. And we proposed a disallowance and the Commission approved it.

Q. Okay. And the amount that was being depreciated over time for the plant at issue here, the old St. Joseph plant, that amount wasn't disputed, was it?

A. That there was any imprudence or incorrect calculation of the original cost, I don't believe that's -- that's the case.

Q. And the amount that had been depreciated on, that total was not in dispute, was it?

A. No.

COMMISSIONER MURRAY: All right. Thank you.

JUDGE THOMPSON: We're long since past the time for a break for the court reporter, so let's take 10 minutes now and return with questions from the Bench. We're in recess.

(A recess was taken.)

JUDGE THOMPSON: Okay. Mr. Rackers, I believe we have some more questions from the Bench for you. Commissioner Murray?

COMMISSIONER MURRAY: Thank you. Just probably one more.
BY COMMISSIONER MURRAY:
Q. You mentioned the fact that the plant is no longer owned by the company; is that right?
A. That's my understanding, yes.
Q. The old St. Joseph plant. And you mentioned that as if it had some relevance to whether the company should be able to recover any undepreciated amounts from that plant; is that right?
A. Yes.
Q. When Staff took the position in the last rate case that there should be a depreciation study and a consideration of all of the factors in the next rate case to determine the treatment of those undepreciated amounts, was it Staff's position that the company would have to hold onto that plant until that was determined or lose any recovery?
A. That wasn't Staff's position in the last case.
Q. Did Staff expect that the company would just hold onto the plant and keep it in its possession?
A. I don't think Staff had any expectations one way or the other.
Q. So that's really not relevant, is it?
A. I don't -- my last answer, what I was trying to state, I don't think Staff thought about that. I don't

think that was a consideration that Staff thought about, what if the company sells the plant, how would that influence our position. I don't think that really came to mind.

Q. Well, do you think it would have been reasonable for the company just to leave that asset in its possession and do nothing with it until this issue were finally determined?

A. If -- if the company found a -- someone who wished to buy the land and they believed that they were offering them a good price, I would think it would be reasonable for them to sell.

Q. And do you think that should put them at risk for losing any recovery of the undepreciated assets?

A. I think it bears on the decision that the company is here before you asking for recovery of an asset it doesn't even own.

Q. And how does it bear on the decision? That's what I'm trying to get at. If they sell the asset, should that put them at risk for recovery?

A. It -- in and of itself, that one aspect, I would say no. But I -- I think it has some bearing on the decision.

Q. Okay. How?

A. Well, it -- as I said, normally the company is here for recovery and inclusion in rates associated with assets that it owns that are providing service to its customers.

And here you're -- the company is before you asking for recovery of an asset it doesn't even own. So I -- again, I said I don't know that that aspect in and of itself would necessarily make the Commission rule against it, but I think it has some influence.

Q. The company retired the asset at the time of the last rate case; is that right?

A. Yes.

Q. And then following the rate case, it sold the asset?

A. Yes.

Q. And so for the company to be able to still claim that it should have recovery of the undepreciated assets, is it Staff's position that the company should not have sold it?

A. No.

Q. What should the company have done from a reasonable man's perspective, reasonable woman's perspective?

A. I think I already answered the question. That I said I think it's reasonable that if a purchaser came to the company, made them a reasonable offer for the property, that they would sell it.

Q. And would that be reasonable if they might lose any claim to the over $3 million undepreciated assets?

A. I think that's a consideration the company would have to make, how -- what influence will that have on their ability to recover some undepreciated balance in a full case -- in a future case, excuse me.

Q. And why should that have an influence?

A. Why should the fact that they no longer own the property have an influence?

Q. Yes.

A. Okay. Well, as I said before -- I hope I respond the same way -- if -- I think it has some influence that the company is before the Commission asking for recovery of associated with an asset that it doesn't even own anymore.

Q. Okay. So it sounds to me like it wouldn't have been a reasonable decision to sell that asset if the company, in fact, is putting at risk its ability to recover over $3 million --

A. I --

Q. -- to get --

A. Sorry.

Q. -- to get a difference of approximately $100,000 on the land value, for example.

A. I think that's probably a consideration that should have entered into their decision to sell.

Q. And do you think if they had realized that there was any relevance or assumed that anyone would consider that to be relevant, that they would have made that decision and risked that over $3 million?

A. I don't know the answer to that.

Q. Do you think it would have been reasonable to have risked it?

A. If -- if the company believed that that in and of itself would be the sole decision or sole reason the Commission would not grant recovery and it deemed this item of such importance, then it probably wasn't a good decision.

COMMISSIONER MURRAY: Okay. I think that's all.

FURTHER QUESTIONS BY JUDGE THOMPSON:

Q. You're an accountant. Right?

A. Yes.

Q. Just the man I want to talk to. What's the relationship of Staff's accounting schedules to company's accounting schedules?

A. Can you be a little bit more specific when you say "relationship"?

Q. Well, are they unrelated in that they're two different attempts to set out what the value of the company's assets are, what its costs were, what its revenues were, what its -- you know, or are Staff's accounting schedules essentially a commentary on company's accounting schedules?

A. Staff and company start from the same place. We both have the same test year.

Q. Okay.

A. We make different adjustments to those test year amounts in our determination of revenue requirement.

Q. Okay.

A. Many of the same numbers -- well, by the time Staff does its true-up, many of the same numbers will be used in both sets of accounting schedules.

JUDGE THOMPSON: Fine. Thank you.

Okay. Ms. O'Neill?

FURTHER RECROSS-EXAMINATION BY MS. O'NEILL:

Q. Mr. Rackers, there are two issues in this case regarding St. Joseph water treatment plants; is that right?

A. Yes.

Q. The one we're talking about today is the water treatment plant that's not being used to provide any service to customers?

A. Correct.

Q. And the issue that we're talking about right now is whether those customers in St. Joseph should have to continue paying for the old treatment plant that's not providing them with any service; is that correct?

A. Yes.

Q. Whatever decision regarding rates is ultimately made -- and I know this isn't your issue and I don't want to get into the new treatment plant issue specifically with you, but is that new treatment plant currently included in the rates that the St. Joseph customers are paying?

A. Yes.

Q. And it is providing them with service?

A. Yes, it is.

Q. And presumably there will be some amount of money authorized by this Commission for inclusion in rates going forward that customers will have to pay for the use of the new St. Joseph water treatment plant; is that correct?

A. Yes.

MS. O'NEILL: No further questions.

JUDGE THOMPSON: Mr. Schwarz?

MR. SCHWARZ: Doesn't the company get recross before I --

JUDGE THOMPSON: I'm sorry. Well, yes, we'll let Mr. Cooper do some recross.

FURTHER RECROSS-EXAMINATION BY MR. COOPER:

Q. I think I have a few directions I can go with this. Several maybe.

Let's start with this. In response to a question from Commissioner Forbis, you mentioned a telephone case where you believe that the Commission did not provide for un-- recovery of undepreciated amounts, didn't you?

A. That was my recollection of that case, yes.

Q. Now, I think that the name you mentioned in your response was United Telephone. Would you agree with me that the United Telephone case that's been cited in the various arguments on this issue in the past was one where the Commission did not allow the company a return on those undepreciated amounts but did, in fact, allow the company a return of those undepreciated amounts?

A. My recollection was the Commission didn't allow either, but -- you've raised a question in my mind, but --

Q. Okay. So you're not absolutely certain what the Commission did in regard to return of. Correct?

A. Correct.

Q. And presumably if we take a look at those cases, we'd be able to determine what the Commission did as to return of. Correct?

A. Yes.

Q. Now, in response to, I believe it was, some of Commissioner Murray's early questions, you started to describe I think an example of what would happen with a mass property account. Do you recall that?

A. Yes.

Q. Okay. And in your example of a mass property account, you used mains. Would that be an example of a mass property account?

A. Yes.

Q. What we're dealing with in regard to the old St. Joseph treatment plant is not a mass property account, is it?

A. No.

Q. It is an account where the individual asset has been identified. Correct?

A. Yes.

Q. Now, there was some discussion in response to Commission questions about the $115,000 that the company received from its sale of the real estate at the site of the old St. Joseph treatment plant. Correct?

A. Yes.

Q. The company has also incurred cost of removal associated with the old St. Joseph treatment plant, hasn't it?

A. Yes, it has.

Q. Which if you were to compare -- this may be a comparison of apples to oranges, I think certainly we may argue that even. But if you were to compare that $115,000 that the company received for the sale of the real property to the actual cost of removal at the old St. Joseph treatment plant, which would be greater?

A. The actual cost of removal.

Q. And how much was that actual cost of removal?

A. I think it's been identified as approximately $300,000.

Q. You were asked some questions in regard to, I think, where these dollars are on the company's books today. Correct?

A. Yes.

Q. And I think you referred to Account 186. Correct?

A. Yes.

Q. It's not your testimony, is it, that somehow these dollars are currently in rate base and the company is currently receiving a return on those dollars, is it?

A. No. I don't believe they are.

Q. By being in Account 186, it kind of sets them apart from the numbers that we used to calculate the rate base. Correct?

A. Correct.

Q. The old St. Joseph treatment plant was owned by the company for more than 100 years, wasn't it?

A. I don't know the year of installation, but quite some time.

Q. Okay. Would you be surprised if that year of installation was the year 1881?

A. No.

Q. And if it was installed in the year 1881, you'd agree with me that it provided service to customers for over 100 years. Correct?

A. Yes.

Q. Any time plant is retired -- utility plant is retired, would you agree with me that there is an assumption that it's no longer used and useful for providing -- for the provision of utility service?

A. I'd agree with that statement. It -- it may still be capable of providing service, but the company made the decision that it wants to replace it with something else, so certainly once it's retired, it's no longer in service.

Q. And if it were deemed to be still used and useful for the utility's provision of utility service, it, in fact, would not be retired, would it? It would remain in rate base and the company would earn a return on it. Correct?

A. Assuming that it wasn't replaced by another asset or it wasn't determined to be unnecessary for providing service.

Q. Well, but the question of whether it might have some capability somewhere is different from the question, isn't it, whether that property is used and useful for service for, in this case, Missouri-American Water Company?

A. Yes.

Q. Now, again, we talked about -- or you talked about several times the sale of the real property. Does the actual clean-up and sale of utility property provide the actual numbers as to cost of removal and salvage?

A. Yes.

Q. So prior to the actual clean-up of that property and the sale of that property, we're really dealing with estimates, hypotheticals, that sort of thing. Correct?

A. Yes.

Q. In terms of salvage and cost of removal. Correct?

A. That's correct.

Q. Okay. So, in fact, the actual clean-up and sale of the property brings into focus from a regulatory standpoint or an accounting standpoint what the real numbers are in terms of how the company may have been affected by cost of removal or have been benefited by salvage. Correct?

A. Yes.

Q. Now, Ms. O'Neill I think in her last recross had asked you about whether the customers on a going-forward basis would be paying for the old St. Joseph treatment plant if the company's proposal were adopted. Do you remember that?

A. Yes.

Q. Did the customers of Missouri-American Water Company ever finish providing a return of the company's investment in that old St. Joseph treatment plant?

A. With regard to that specific asset, no.

Q. And that's why we're here today. Right? That's the issue that has arisen, that's why there is an undepreciated amount. Correct?

A. Yes.

Q. If Staff sees that situation developing as to a piece of property, let's say a water plant, that in advance of the retirement of that plant through reasonable assumptions it can see that there are going to be undepreciated amounts at the time of retirement, are there ways to deal with that situation?

A. Yes.

Q. What opportunities -- or what possibilities are there for dealing with that situation?

A. As -- as depreciation studies are performed, if that identification is made, amortizations or changes in

depreciation rates can occur to deal with that situation.
Q. So it's possible along the way to pick up the pace on the depreciation. Correct?
A. Yes.
Q. But at least in this situation in 1997 when that proposal was made to the Commission, the Commission decided not to pick up the pace on the depreciation. Correct?
A. That's correct.
Q. Now, I think you went through a lot of examples to describe what the Staff's proposal was in the last case, that 2000 rate case. Correct?
A. Yes.
Q. The Staff's proposal in the 2000 rate case was not accepted by the Commission. Correct?
A. Correct.
Q. At the risk of further confusing a confusing set of testimony, I think in response to Commissioner Clayton's questions you started with an example that had an original cost of $1 million in a plant. Correct --
A. Yes.
Q. -- you remember that?
And in Commissioner Clayton's example I believe there was a 5 percent depreciation rate. Correct?
A. Yes.

Q. Such that in the assumptions that were made over a 5-year period, there was an accumulated depreciation of $250,000. Correct?

A. Yes.

Q. To get from step one to step two to step three in that example, you have to ignore completely the question of salvage -- cost of removal net of salvage. Correct?

A. You'd have to ignore that it was a component of depreciation rates.

Q. Right. Because if you did make it a component of depreciation, the amount that your depreciation rate was based upon would either be some amount greater than $1 million or some amount less than $1 million depending on whether you determined net salvage was positive or negative. Correct?

A. Correct.

Q. When I refer to the term "return of" in regard to this issue, would you agree with me -- and in regard to this example, would you agree with me that the return of piece is that $250,000 that is built in for depreciation?

A. Yes.

Q. Just out of curiosity, are you familiar with a book called Accounting for Public Utilities?

A. Yes.

Q. Is that something that you find useful in performing your job?

A. With regard to certain items.

Q. And do you make reference to it from time to time in performing your current job?

A. Yes. From a training point of view.

Q. Would you agree with this statement as to depreciation accounting: It should be remembered that book depreciation is provided for the purpose of recovering the original investment in the assets concerned and not for providing for their replacement?

A. Yes.

Q. Now, let's step away from depreciation for a moment. When we speak of return on in regard to these issues of investment in plant, would you agree with me that the return on is the reasonable return that the company gets based on its investment in plant?

A. Yes.

Q. And so in our example that we just talked about that came from Commissioner Clayton's questions, $1 million of initial investment in the treatment plant, after 5 years we have $250,000 of accumulated depreciation.

Let's say at that point the company is in for a rate case. The company receives a return on which is computed by multiplying its weighted cost of capital -- let me back up.

The company would receive a return on that's equal to that $750,000 difference between the initial investment and the accumulated depreciation times its weighted cost of capital. Correct?

A. Yes.

Q. Okay.

MR. COOPER: That's all the questions I have, your Honor.

JUDGE THOMPSON: Thank you, Mr. Cooper.

Now it's your turn, Mr. Schwarz.

MR. SCHWARZ: Thank you.

REDIRECT EXAMINATION BY MR. SCHWARZ:

Q. I would first like to go over Commissioner Murray's questions about the company's decision-making in selling the land. I think Mr. Cooper touched on it a little bit, but I'd like to make sure that we're clear on that.

I think that -- well, would you agree that the -- it is the retirement of an asset that has not been fully depreciated that puts at issue recovery of the undepreciated value?

A. Yes.

Q. So it's not the subsequent sale of that item that puts it at issue. Correct?

A. Correct.

Q. And my recollection is that you agreed with

Mr. Cooper that the actual sale helps put in focus the actual cost of removal and the final undepreciated value of the asset; is that correct?
A. I'm not sure that was really Mr. Cooper's question. If it was, I misunderstood it.
Q. Well, I think he asked you, does the sale and clean-up of the real estate -- well, let me start over.
The real estate includes both the land which is not depreciable and whatever improvements are on it. Would you agree with that?
A. Yes.
Q. And so the sale of the real estate would help provide actual numbers for the subsequent -- or for the prior cost of cleaning the place up and getting it ready for sale?
A. Yes.
Q. Okay. I believe that Judge Thompson asked you about the relationship between the Staff and company's accounting schedules. Do you recall that?
A. Yes.
Q. Is that relationship or the differences reflected in the case reconciliation?
A. Yes.
Q. So it's the case reconciliation that brings into focus the dollar value dispute or issues between the

company's accounting schedules and Staff's accounting schedules?

A. Correct.

Q. And the testimony of the various witnesses provides the basis for the different treatment of the adjustments to test year that each witness makes?

A. That's right.

Q. Are you aware that there's a dispute in this case or disagreement between Staff and the company on the calculation of depreciation?

A. Yes.

Q. And as to methods, the company is proposing, is it not, to use what it terms a traditional depreciation calculation?

A. That's correct.

Q. And if you know, does that approach entail a formula to determine a depreciation rate to accomplish the return of the initial investment, the original cost of the property?

A. Yes.

Q. And there's another factor in the traditional approach that also purports to estimate the eventual cost of removal and allocate that to the same amortization period as the return on; is that correct?

A. Return of.

Q. Yes, the return of. I'm sorry.
A. Yes.
Q. And Staff's approach is based on calculating only the return of the original cost and treating the cost of recovery -- or the cost of removal net of salvage separately as an expense item; is that correct?
A. That's correct.
Q. All right. I'd like to go back to Commissioner Clayton's example, if we might. You have property whose original cost is $1 million to be -- have a depreciation rate of 5 percent over 20 years. And in the example -- or the way that he laid out the example, that 5 percent did not include a factor for cost of removal, did it?
A. That's correct.
Q. So basically that's the approach that Staff would take; is that correct?
A. Yes.
Q. So at the end of that 20-year period when the -- and the property is retired, you would have a credit -- the retirement would be recognized on the books of the company by a credit to the plant account and a debit to the accrual for -- or the reserve for depreciation?
A. That's right.
Q. And the net effect on rate base is zero?

A. That's correct.

Q. All right. Let's assume for a moment that we have used the company's method and that -- and I'm going to hold my nose and close my eyes and make an assumption that the actual cost of removal after 20 years is precisely what was predicted.

Say that in addition to the 5 percent, we have added a 1 percent factor for cost of removal net of salvage for each year that it's in place. At the end of 20 years, what would be the accrual for depreciation?

A. $450,000.

Q. If you have a total of 6 percent -- no, no, no. You annual -- the annual accrual for depreciation is 6 percent a year on $1 million for 20 years. I hope it comes out to 1 million 2.

A. That's correct.

Q. And just closing our eyes and by lightning striking and luck of the Ouija board it turns out net of removal is actually $200,000 for purposes of this example. Are you with me?

A. Yes.

Q. Okay. When the plant is retired, you have the original plant in service at $1 million, the reserve for depreciation at 1,200,000; is that correct?

A. Yes.

Q. Okay. When the plant is retired and the property is removed, you will credit the plant account for $1 million and debit the reserve $1 million to recognize the retirement; is that correct?

A. Of original cost, yes.

Q. Yes. Okay. It costs the company $200,000 net of salvage to remove the plant, so you would credit cash for 200,000, would you not, and debit the accrual for depreciation 200,000. Correct?

A. That's correct.

Q. Now, what does that do to rate base?

A. It increases rate base $200,000.

Q. And would you agree with me that the reason that rate base increases by $200,000 is that the money that the company has essentially been borrowing from the ratepayers over the years which now accumulates $200,000, now must be repaid and that -- the company is now replacing ratepayer money with customer money in the actual payment of the expense?

A. That's correct.

Q. And during the interim, the accrual to depreciation each year or each month has served to reduce rate base which provides the ratepayer in the interim with the return on -- the return to the ratepayers in recognition of their providing their money in advance. Would you agree with that?

A. I'm sorry. You're going to have to ask me that again.

Q. Because the accrual for depreciation, the reserve for depreciation is an offset to rate base, the customer advances through that extra 1 percent is used as an offset to rate base which provides the ratepayer in the meanwhile with an allowance for providing it early?

A. That's correct.

Q. Except, of course, if there's regulatory lag as we learned in the ISRS cases. Right?

A. That's right.

Q. I'm trying to -- I think in response to a question from Commissioner Murray about the recommendation to amortize the $3 million alleged under-accrual in this case, that Staff would recommend doing a study of all plant in service before recommending amortization of the under-accrual. Do you recall that?

A. Yes.

Q. Did Missouri-American, to your knowledge, do a separate study of the St. Joseph plant depreciation for this case?

A. No.

Q. So that to the extent that was a consideration in Staff's recommendation in the past two cases, that's not

a condition that we have in this case. Would you agree?
A. Yes
MR. SCHWARZ: I think that's all I have.
JUDGE THOMPSON: Thank you, Mr. Schwarz.
You may step down, Mr. Rackers.
I think we'll take the lunch recess now. We'll be back at 1:15.
(A recess was taken.)
JUDGE THOMPSON: We'll go back on the record. Please spell your last name for the reporter.
THE WITNESS: Bolin, B-o-l-i-n.
(Witness sworn.)
JUDGE THOMPSON: Thank you. You may inquire.
KIMBERLY BOLIN testified as follows:
DIRECT EXAMINATION BY MS. O'NEILL:
Q. Good afternoon, Ms. Bolin.
A. Good afternoon.
Q. Ms. Bolin, in this case did you prepare for filing and have filed Direct Testimony which has been marked for identification as Exhibit 12, Rebuttal Testimony which has been marked for identification as Exhibit 52, and Surrebuttal Testimony which has been marked as 61?
A. Yes, I did.
Q. And do you have any corrections or changes to any of those pieces of pre-filed testimony?

A. No, I do not.

MS. O'NEILL: Your Honor, in keeping with the stipulation from last week, I would offer Exhibits 12, 52 and 61 at this time.

JUDGE THOMPSON: Okay. Do I hear any objections to the receipt of Exhibits 12, 52 and 61?

MR. COOPER: Yes, your Honor.

JUDGE THOMPSON: Yes. What is your objection?

MR. COOPER: Yes. I would object to and only to Exhibit 61, Surrebuttal Testimony.

JUDGE THOMPSON: Okay. Hang on just a minute. So Exhibits 12 and 52 are received and made a part of the record of this proceeding.

(Exhibit Nos. 12 and 52 were received into evidence.)

JUDGE THOMPSON: What is your problem with 61 exactly?

MR. COOPER: Well -- and, in fact, your Honor, I object to a portion of 61. That would be Appendix A which purports to be an assortment of letters and e-mails, as well as I would object to the description of those that begins on page 10 of Ms. Bolin's testimony on line 6 and continues through line 11 of page 10.

JUDGE THOMPSON: Okay.

MR. COOPER: And the nature of my objection is essentially a hearsay objection. And --

JUDGE THOMPSON: What were the lines you objected to again? I'm sorry.

MR. COOPER: Yes. I'm sorry, your Honor. It would be lines 6 through 11 on page 10.

JUDGE THOMPSON: Okay. Your objection is this is hearsay?

MR. COOPER: It is. And to further explain, I think the Commission as well as the parties went to great effort, if not expense, to hold public hearings in each of MAWC's nine operating districts.

I think the Commission's provided ample opportunity for customer comments to come in under oath as live testimony, and therefore, would object to the portion of this testimony that instead attempts to merely put into evidence copies of, as I say, what purports to be letters and e-mails from customers.

JUDGE THOMPSON: Ms. O'Neill?

MS. O'NEILL: Yes, your Honor. First of all, as far as lines 6 through 13 on page 10 on Surrebuttal Testimony, it's not hearsay. It's a question and answer asking whether or not the Office of Public Counsel has received phone calls and letters in opposition to the rate increase. And the answer is, yes, we've received those. Supporting documentation of that answer is Appendix A.

I would just make a couple of comments regarding the objection to Appendix A. And if the question is whether or not this is the type of information that members of my office rely on, including Ms. Bolin who's a member of my office, in representing the interests of the public and you would like some further foundation, I can ask a couple of questions to that effect, but that wasn't the objection.

I think we heard testimony at the local public hearings -- at several of them at any rate, that the -- remarking on the times that the local public hearings were set and how difficult it was for some people to make an appearance at those local public hearings.

Letters which were solicited, in fact, by the customer notice that went out in this case are letters that are attached as Appendix A. When a rate case is filed and customer notices go out, one of the things that is generally contained in those customer notices is an invitation for customers to contact the Commission Staff or the Office of the Public Counsel to set forth their reaction, opinions and concerns regarding the proposed rate increase.

We accept those in the general course of business. These are those letters that were sent in response to that solicitation in the notice to customers sent by the company under Commission rules.

We believe that while technically these people are not available and so under the technical definition of hearsay as a statement made by someone who's not currently present, that part of the definition as contained may be accurate; however, these are the types of letters that are typically presented into the record in a rate case. I know that I've done it several times and believe it would be appropriate.

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

Objection is overruled. Exhibit 61 is received into the record in its entirety. Please proceed.

(Exhibit No. 61 was received into evidence.)

MS. O'NEILL: I would tender the witness for cross-examination.

JUDGE THOMPSON: You have tendered her. Very well. Let's see. I thought I saw Mr. Zobrist at one time, but he's now gone, so Mr. Schwarz I believe you're up.

MR. SCHWARZ: I have no questions of this witness.

JUDGE THOMPSON: Mr. Cooper?

MR. COOPER: Yes, your Honor.

CROSS-EXAMINATION BY MR. COOPER:

Q. Ms. Bolin, I want to direct you to a couple of spots in your testimony. And let's start with your Direct Testimony, if you have that with you.

A. I do.

Q. On page 11 of your Direct Testimony, lines 12 through 13 do you see a sentence there that says, The company is entitled to the opportunity to earn a fair return on prudent investments that are used and useful in rendering utility service?

A. Yes, I see that.

Q. Now, let's turn to your Rebuttal Testimony for a moment, if you also have that with you. Do you have that with you?

A. Yes, I do.

Q. If you could turn to page 2, on lines 7 through 10 I think you have two sentences that start, To require the current ratepayers to pay for an abandoned water treatment plant and -- the "and" probably doesn't belong in there -- but violates the used and useful standard for inclusion in rate base. The standard holds that property must be used in the current provision of service to customers in order to be included in rate base.

Do you see that?

A. Yes, I do.

Q. Is it your understanding that the company's proposal in this case does not ask for a return on investment associated with the old St. Joseph treatment plant?

A. That's correct, no return on.

Q. Okay. And is it also your understanding that the company's proposal in this case does not include rate base treatment of the undepreciated amounts associated with the old St. Joseph water treatment plant?

A. That is correct.

Q. Now, would you agree with Mr. Rackers' statement this morning that this issue of the possible undepreciated portion of the old St. Joseph treatment plant was first specifically addressed by this Commission in MAWC's 1997 case, Case No. WR-97-237?

A. I don't know if that's the first time, but it was addressed in that case.

Q. Okay. But you're familiar that it was addressed in that 1997 rate case?

A. The setting of the depreciation rates of the old St. Joseph plant.

MR. COOPER: Your Honor, I'd like to have a document marked for identification.

JUDGE THOMPSON: All right. Looks like we're up to 121.

MR. COOPER: And the document that I'm seeking to mark would be the Rebuttal Testimony of Barry Hall from Case WR-97-237.

(Exhibit No. 121 was marked for

identification.)

BY MR. COOPER:

Q. Ms. Bolin, do you have in front of you what has now been marked as Exhibit 121?

A. Yes, I do.

Q. Did you work for the Office of the Public Counsel in 1997?

A. Yes, I did.

Q. Do you know a Mr. Barry F. Hall?

A. Yes, I do.

Q. Did he work for the Office of the Public Counsel in 1997?

A. Yes, he did.

Q. In your preparation for your testimony today, did you -- do you remember whether Mr. Hall testified in WR-97-237?

A. I did not go back and read his testimony in that case.

Q. Okay. If you would for me, would you turn over to page 5 of Exhibit 121??

A. Okay.

Q. Now, let's see. Line 1 there, do you see that a question begins?

A. Uh-huh. Yes, I do.

Q. And would you agree with me that that question says, If you were asked to associate a probability with the future outcome that MAWC actually constructs a groundwater treatment plant substantially similar to the one proposed at the proposed plant site by the date planned or some other date, could you do that?

Would you agree with me that that's what that question says?

A. That is what that question says.

Q. Okay. And then on line 5 there's an answer, isn't there?

A. Yes, there is.

Q. Okay. And would you agree with me that that answer reflects --

MS. O'NEILL: Your Honor, I'm going to object to the reading of this. It's not relevant, it's hearsay. I'll start there.

JUDGE THOMPSON: Well, as I think I told you this morning, I believe that he can present a witness with something and ask the witness to read it and then express agreement or disagreement or comment on it or anything of the sort. And so I'm going to overrule the hearsay objection.

And as to the relevance, I'm going to let Mr. Cooper show us the relevance. Please proceed.

MR. COOPER: Fair enough.

BY MR. COOPER:

Q. I think where we were, we were looking at an answer now that starts on line 5. Correct?

A. Yes. I see it.

Q. And would you agree with me that that answer states as follows: I have no way of doing so. There are too many factors that could affect the future decision-making processes of the company.

The bottom line is, it is not necessary for the Public Service Commission to ascertain such a probability in order to set just and reasonable rates; nor is it advisable to continuously readjust the expected retirement date of facilities as MAWC considers new plans or its plans are changed from time to time.

If and when any plant is retired early, the Commission will be able to consider specifically what plant has been retired and how any undepreciated amount should be recovered.

Is that a statement -- is that a correct reading of that answer as it shows on Exhibit 121?

A. Yes, it is.

Q. Is that consistent with your understanding of the Office of the Public Counsel's position in WR-97-237?

MS. O'NEILL: I'm still going to object on relevance, Judge. I don't know what the 1997 case has to do with what's going on here today. This is 2003.

JUDGE THOMPSON: Objection's overruled. You may answer the question.

THE WITNESS: That is what Mr. Hall has in his testimony.

BY MR. COOPER:

Q. Is that consistent -- you have no reason to believe that --

A. I've not done any other research on any other testimonies filed in this case.

Q. So do you just not have any idea what the OPC's recommendation might have been in WR-97-237 in regard to the old St. Joseph treatment plant depreciation?

A. Mr. Hall's testimony says that it should be considered what to do with the undepreciated amounts when the rate -- when the old plant is retired, the current plant at that time.

MR. COOPER: Now, at this time, your Honor, I'd like to mark another exhibit, if I could.

JUDGE THOMPSON: All right. This will be 122.

MR. COOPER: And this would be the Rebuttal Testimony of Ted Robertson, also from WR-97-237.

(Exhibit No. 122 was marked for identification.)

BY MR. COOPER:

Q. Ms. Bolin, do you have in front of you the document that's been marked as Exhibit 122?

A. Yes, I do.

Q. Could you turn to page 11 of that testimony for me?

A. Okay.

Q. Are you there?

A. Yes, I am.

Q. Do you see a question that starts on line No. 2 on page 11?

A. Yes, I do.

Q. Okay. And would you agree with me that it states, Isn't it also possible that when the retirement of the current St. Joseph water plant actually occurs, if it occurs as proposed by the company, all costs associated with its retirement could be included in the determination of the total cost of the new St. Joseph water plant?

A. That's what it reads.

Q. And then if we move down to line 8, would you agree with me that there's an answer that says, Yes, that is a possibility. Knowledgeable parties may disagree as to the final disposition of the water plant retirement costs; however, the existing plant is currently providing water service, and to my knowledge, it is not obsolete or projected to fail.

Therefore, the costs of its early retirement or premature retirement may be appropriately added to the total cost of the new project if the decision to build the new water plant is deemed prudent by the Commission. If that happens, no intergenerational customer inequity will occur because it is expected that future ratepayers will compensate the company for the capital recovery of the new water plant.

Is that a correct reading of that answer?

A. That's a correct reading.

Q. Okay. And now also in Exhibit 122, if you could turn over to page 16. Are you there?

A. Yes, I am.

Q. Now, starting on line 8 there's a question. Do you see that question?

A. Yes, I do.

Q. Would you agree with me that that question says, Do you have an alternate recommendation regarding the capital recovery for the company's projected retirement of the current St. Joseph water plant?

A. That's what it read.

Q. Okay. And then starting on line 11 also of page 16 and continuing on to 17 there's an answer, isn't there?

A. Yes, there is.

Q. Okay. Would you agree with me that it states as follows, Yes, I do. Since Missouri-American is in the habit of filing a general rate increase case approximately every two or three years, the Public Counsel proposes that the Commission postpone implementation of Mr. Smith's recommendation to add an accelerated amount of depreciation expense to the accrued depreciation reserve until such time as the company files its next general rate case.

Postponement of the Staff's recommendation would provide the company with time to finalize its construction program and possibly begin the actual construction of the proposed water plant. This alternative would also allow the Commission to base any future decisions on solid facts rather than mere promises.

If for some reason the company's projected construction plans are modified, delayed, phased in or even eliminated, it would provide the Commission with the opportunity to act accordingly based on the most recent knowledge available, which certainly should be more definitive than currently available information.

If the construction of the water plant does occur on the time line projected by the company, the shareholders will not be harmed because they are currently receiving in rates a reasonable level of depreciation expense.

Mr. Smith agrees that the current depreciation rates utilized by the company are reasonable; therefore, if the shareholder is not harmed because he or she is receiving just compensation from the ratepayer in current rates, the only party that is subject to any risk of possible deprivation must be the ratepayer.

Public Counsel recommends the Commission weigh carefully all the possible outcomes of the Staff's recommendation. When it does, we believe that the postponement of the inclusion of accelerated depreciation expense in rates until such time that accurate plant construction and retirement information becomes available is the best and safest possible course of action to take.

Is that an accurate reading of that action?

A. That is accurate.

Q. Now, do you know Mr. Ted Robertson?

A. Yes, I do.

Q. He's an employee of the Office of the Public Counsel, isn't he?

A. Yes, he is.

Q. And has been so for some time period to include the year 1997. Correct?

A. Yes. That's correct.

Q. Now, did you have an opportunity to review the Commission's order in WR-97-237?

A. I did not review it in preparation for this case.

Q. Okay. So if I were to tell you that in that order the Commission denied any sort of accelerated depreciation associated with that plant based upon the statement that the Commission agrees with the opposing parties that the 2001 retirement date is somewhat speculative and institution of the amortization would be premature --

MS. O'NEILL: Your Honor, I'm going to object to this. Ms. Bolin has testified she's not familiar with this so any question he could ask after reading this into the record she wouldn't be able to answer.

JUDGE THOMPSON: She can tell us if she can answer. Your objection is overruled.

THE WITNESS: Could you repeat the question?

BY MR. COOPER:

Q. Sure. If I were to tell you that -- well, let me back up.

Do you believe that the Commission provided Missouri-American Water Company with any accelerated depreciation associated with the old St. Joseph water treatment plant in its WR-97-237 case?

A. I do not believe they gave them any accelerated from what I've read.

Q. Would it surprise you if I suggested that they did so based upon the statement that they agreed with the opposing parties that the 2001 retirement date is somewhat speculative and institution of this amortization would be premature?

A. Would I agree with you?

Q. Would that surprise you? Do you have any idea why the Commission --

A. I did not read the order, so I do not know why the Commission --

Q. Okay.

A. -- did not give them accelerated depreciation rates.

Q. So you would agree with me that the St. Joseph treatment plant depreciation was specifically addressed in WR-97-237. Correct?

A. If it was in the order, it was addressed.

Q. Okay. But in preparation for your testimony and the Direct and Rebuttal and Surrebuttal that you've filed in this case, you didn't do anything to examine what position the Office of the Public Counsel might have taken in that case or what the Commission might have ordered in that case?

A. I did not.

Q. Okay. As I understand your recommendation in that case, I believe that -- would you agree with me that you recommend that the undepreciated amounts associated with the St. Joseph treatment plant -- the old St. Joseph treatment plant be given no rate-making effect because that plant is no longer used and useful for service to MAWC's customers?

A. That is correct.

Q. Okay. Now, assume with me for a moment that in WR-97-237 that the Office of Public Counsel took the position that at that time the Commission couldn't deal with this undepreciated amount because it was not known and measurable. Can you do that?

A. That what was not known and measurable?

Q. That the exact amount of under-recovery was not known and measurable.

A. Okay.

Q. That it was speculative and premature prior to the old plant being retired. Can you make that assumption with me?

A. I can try.

Q. Okay. Well, let's -- and I think it's certainly where the company believes it is today. If, on one hand, before the old plant is retired, the Commission's going to take the viewpoint that it can't deal with that projected under-recovery because it's not known and measurable, they don't know the exact dollar amount that's going to be there for under-depreciation, and then on the back side of the retirement Public Counsel or some other party comes in and says, Oh, now that plant's been retired so it's no longer used and useful so we can't deal with the under-recovery, when is the appropriate time to deal with the under-recovery?

A. I do not think rates are set to guarantee the company return on every penny through depreciation. I think they're giving the company an opportunity to earn a return.

Q. But wouldn't you agree with me that depreciation itself gives the party -- or the utility a return of its investment in plant?

A. Depreciation rates are set to deliver reasonable depreciation scheduling, give the company an opportunity to earn a return.

Q. Does the company earn a return on its investment through depreciation or through the amount that's in rate base?

A. It earns a return of and a return on in rate base.

Q. Now, you were here earlier this morning when we were talking to Mr. Rackers, weren't you?

A. Yes, I was.

Q. Okay. And Mr. Rackers was familiar with the publication entitled Accounting for Public Utilities. Are you also familiar with that publication?

A. Yes, I believe.

Q. Okay. Now, Mr. Rackers, I believe, agreed with this statement in terms of what depreciation is: It should be remembered that book depreciation is provided for the purpose of recovering the original investment in the assets concerned and not for providing further replacement.

Do you agree with that statement?

A. Yes, I do.

Q. And I think you told me that depreciation wouldn't necessarily get the company its entire investment down to the penny. Correct?

A. It's like any other expense that we set on an annual level. You're not guaranteed a return of every --

Q. Okay. But in this case -- or in this issue we're not talking about just a few pennies, are we? We're talking about $2.8 million?

A. I believe that's the amount.

Q. Okay. Now, the company is required to utilize depreciation rates that are set by this Commission. Correct?

A. That's correct.

Q. Okay. And similar to what I asked Mr. Rackers this morning, the utility companies in Missouri are not free to set their own depreciation rates. Correct?

A. They have to follow what the Commission orders.

Q. Okay. So let's go back to my hypothetical again. The company's depreciation is driven by the Commission's depreciation rates. Correct?

A. That is correct.

Q. Okay. And through time we may find that those depreciation rates are going to adequately cover the company's investment or we may find that they do not adequately cover the company's investment in plant. Correct?

A. That's correct.

Q. Okay. Let's assume for a hypothetical that the Commission's depreciation rates do not cover the company's -- recover the entire company investment in a piece of plant. The result is going to be what we have here in regard to the old St. Joseph treatment plant. Correct? We're going to have the situation where we have an under-recovery of depreciation?

A. That is true.

Q. Okay. So, again, let me ask you my earlier question. Let's assume that the Commission will not address that projected under-recovery prior to the retirement of the old treatment plant. And after the old retirement of the old treatment plant, they decide that they're not going to address it because it's not used and useful any longer. Is there any way for the company to be made whole by that situation? There's not, is there?

A. The company was given an opportunity to earn on the treatment plant when it was in rate base and they've recovered depreciation from it. They will be re-- receiving depreciation on a new plant and receiving the return on a new plant. It's like any other expense where the annual level does not meet up to what the company has incurred.

Q. But it's not really like any other expense, is it? Because this is an expense in terms of depreciation that -- and in regard to this particular piece of plant, the old St. Joseph treatment plant, the company's accounting records are actually tracking the depreciation in relation to the original cost. Correct?

A. The company's depreciation is tracked back to the plant.

Q. And so unlike, say, chemical costs, which we may hit or miss in any given year, this is a situation where from the moment that that piece -- that that treatment plant is put into service until it's retired, the investment -- the depreciation is tracked very closely. Correct?

A. That is correct. To determine rate base.

Q. Well, to determine rate base, also to determine whether the company has received a return of its original investment. Correct?

A. To track that they have received -- that it has been depreciated and the level of depreciation the company has received.

Q. Well, I think you'd agreed with me a moment ago and with the statement from Accounting for Public Utilities that stated depreciation is provided for the purpose of recovering the original investment in the assets. Correct?

A. That is correct.

Q. Okay. So, once again, go back, we've got the situation the Commission has set depreciation rates, the company is at the mercy of those depreciation rates. In 1997 everyone sees -- everyone, Staff, OPC, company at least suspect that there's going to be a new plant that goes into service in 2001. That at the time that plant goes into service, the old plant will not be fully depreciated.

In spite of that, no adjustment is made for that projected under-recovery of depreciation. Actually the plant goes in in 2000, not 2001. Lo and behold, there really is under-recovery of the depreciation. And now it's your position that, whoops, it's too late, correct, that old plant is no longer used and useful?

A. It's my position the plant is no longer used and useful.

MR. COOPER: That's all the questions I have, your Honor.

JUDGE THOMPSON: Thank you, your Honor.

MR. COOPER: However, I'm going to make another round at something we talked about this morning, if I could, which is I would like to again ask you to take notice of three pieces of testimony that are from Case WR-97-237.

I believe that the Commission has that power within its rules. I believe -- I'm not sure that whether they were ever admitted into evidence or not makes a difference, because I think they're public documents filed and kept in the Commission's records, but beyond that, I think if you'll additionally take notice of Volume 7 of the transcript in that case, you'll be satisfied that those pieces of testimony did make it into evidence in WR-97-237.

JUDGE THOMPSON: Any objection, Ms. O'Neill?

MS. O'NEILL: Your Honor, if Mr. Cooper's merely asking that the Commission take notice of the fact that testimony was filed in a case as opposed to wanting to basically have the Commission read this testimony like they're reading the reams and reams of testimony we've already got in this case, that's one thing. But I think it's the second thing that he wants and we would object.

Now, of the three pieces of testimony he's talked about from this ancient case, Mr. Robertson I think might be around if he wants -- he could be available for cross-examination. The other two, I don't know where they are. I don't have any idea. I've never met them. So I would object to any kind of making their testimony part of the record.

I would also note that I think for every piece of testimony he's referred to, the issues in those pre-filed pieces of testimony go beyond the issue that we're talking about today and we'd have to go through a process of redacting in order to show relevance and that would be real time consuming. So I think in the interest of judicial economy, that would be a bad idea.

JUDGE THOMPSON: Mr. Cooper, are you offering these in order to simply establish that Public Counsel took a different position with respect to the, at that time, possible retirement of the St. Joseph plant?

MR. COOPER: That's correct, your Honor. It's testimony that was offered under oath in that prior case and that's the point.

JUDGE THOMPSON: And, Mr. Schwarz?

MR. SCHWARZ: Just by way of clarification, is the company endorsing the positions espoused in these three pieces of testimony that they have read into the record?

JUDGE THOMPSON: I don't know.

MR. COOPER: Your Honor, I think -- and I hope someone other than me has followed this. I think what the company wants to show is that through the operation of Case 97-237, Case WR-2000-281 and then into the positions that have been taken in this case, the company's been put into an impossible position in order to correct and deal with this under-recovery of depreciation.

And I think that the Office of the Public Counsel's testimony, which was the basis for the Commission's decision in WR-97-237 is important to understand how we've gotten to this point today.

MR. SCHWARZ: I would --

JUDGE THOMPSON: Mr. Schwarz?

MR. SCHWARZ: Does that mean that the company is endorsing the positions that are set out in this testimony that they have read into the record? The purpose for which the testimony is being used I think is something that I'd like to clear up now.

JUDGE THOMPSON: Ask him.

MR. SCHWARZ: Well --

MR. COOPER: In order to try to clear that up, I would tell you, Mr. Schwarz and your Honor, that certainly the purpose for us is to show what the Office of the Public Counsel's position was in that rate case. Not that necessarily the company agrees with that position, but instead that that's what the Office of Public Counsel's position was.

JUDGE THOMPSON: Okay. I will take notice of the testimony for the purpose of showing what the position of the Office of the Public Counsel was in that case. Thank you.

MR. COOPER: And if -- well, let me back up. I think we just spoke in terms of the Office of the Public Counsel, but if you'll remember back to the piece of testimony we talked about this morning, that was a Staff piece of testimony.

And certainly our position would be the same as to that Staff testimony, that we are offering it for the purpose of showing what the Staff's position was in that same case.

JUDGE THOMPSON: Mr. Schwarz?

Okay. I will receive Exhibits 120, 121 and 122 over the objection of Ms. O'Neill for the purpose of showing the positions taken respectively by Staff and by Office of the Public Counsel in WR-97-237.

(Exhibit Nos. 120, 121 and 122 were received into evidence.)

JUDGE THOMPSON: Additionally, I will take notice of Volume 7 of the transcript of that case, although

I would urge you, Mr. Cooper, to please give me a page reference so I don't have to read the entire thing.

MS. O'NEILL: Your Honor, I'll concede that that testimony was entered into evidence if that's why he wants you to refer to the transcript.

MR. SCHWARZ: As will Staff.

JUDGE THOMPSON: Thank you. Can I cross off Volume 7 then of the transcript?

MR. COOPER: I believe you can, your Honor.

JUDGE THOMPSON: Thank you.

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

COMMISSIONER MURRAY: No questions.

QUESTIONS BY COMMISSIONER CLAYTON:

Q. Just to make sure that I understand your responses on cross-examination, in presenting your testimony in this case, you did not perform a review of the prior rate cases involving this company on the issue of retiring the St. Joe plant?

A. I reviewed Case No. WR-2000-281, the prior rate case. I did not examine the '97 rate case though.

Q. Okay. So you're familiar with the 2000 rate case --

A. Yes, I am.

Q. -- and the position of the Office of Public

Counsel?

Would you restate that position from the 2000 case for me?

A. It was -- well, in the 2000 case we were also dealing with a value to put on the new water plant. And our position with -- our Office's position was the new water plant wasn't needed, they could have rehabbed it and we would have included the undepreciated amount on the plant value. But if the Commission would not -- would -- if the Commission determined that it was prudent to have a new plant, that this amount should not be recovered.

Q. So the position of the Office of Public Counsel was simply that the plant was not needed at all?

A. We -- yeah, that's what our position was in that case.

Q. Were you involved in that case personally?

A. Yes, I was.

Q. Do you recall the facts surrounding whether or not a new plant was necessary?

A. I don't remember the exact facts, but I did deal with this issue of the premature retirement of the old plant.

Q. So you didn't work on --

A. The prudence of the new plant.

Q. You didn't assess the prudency of the --

A. No, I did not.
Q. Okay. Is the position taken in this case by OPC on the St. Joe plant retirement consistent with the position in the 2000 rate case of OPC?
A. I believe it is.
Q. Does OPC agree with the figures of accumulated depreciation and -- does OPC dispute the numbers that have been put forward by the company on the amounts?
A. No. I reviewed them and I agree with them.
Q. You agree with those?
A. Yes.
COMMISSIONER CLAYTON: All right. Thank you, Judge.
JUDGE THOMPSON: Thank you, Commissioner.
Mr. Schwarz?
MR. SCHWARZ: No questions.
JUDGE THOMPSON: Mr. Cooper?
MR. COOPER: Very briefly. And I may do it from here, if that's all right.
JUDGE THOMPSON: Please.
CROSS-EXAMINATION BY MR. COOPER:
Q. Ms. Bolin, in that WR-2000-281 case this Commission found that the construction of the new plant was a reasonable alternative. Correct?
A. The Commission found that it was prudent.

MR. COOPER: That's all I have, your Honor.
JUDGE THOMPSON: Ms. O'Neill?
MS. O'NEILL: Thank you.
REDIRECT EXAMINATION BY MS. O'NEILL:
Q. Ms. Bolin, as far as you know, did Public Counsel ever support the idea of completely building a new water treatment plant in St. Joseph prior to the decision in 2000-281?
A. As far as I know, I don't -- I do not believe that.
Q. And I understand that you didn't go back and review all the 1997 case information, but what type of -- do you recall whether or not the issue of how to deal with treatment plant issues in St. Joe was a part of that case as well as the 2000 case?
MR. COOPER: I object, your Honor, to the WR-97-237 question because I believe Ms. Bolin told me she had not examined any of that case for purposes of her testimony.
JUDGE THOMPSON: Could you read back the question, please?
THE COURT REPORTER: "Question: And I understand that you didn't go back and review all the 1997 case information, but what type of -- do you recall whether or not the issue of how to deal with treatment plant issues

in St. Joe was a part of that case as well as the 2000 case?"

JUDGE THOMPSON: I think it's okay for her to ask her what she does recall or whether she recalls a particular point even if she didn't recall it, so I'm going to overrule that objection.

THE WITNESS: I didn't review that.

BY MS. O'NEILL:

Q. Okay. Regardless of what Public Counsel's position was regarding prudency, Missouri-American built a new treatment plant at a different location than the old treatment plant. Correct?

A. That is correct.

Q. And one of the issues in the 2000-281 rate case that you did review was how do we make sure that customers are not paying for two plants when only one plant's being used?

A. That was the issue in this case.

Q. And that's why in the last rate case we asked that this be disallowed and it's the same reason why we still think it should be disallowed in this case?

A. That is true.

MS. O'NEILL: No further questions.

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

And thank you, Ms. Bolin.

THE WITNESS: Thank you.

JUDGE THOMPSON: I understand we'll be seeing you again with some other issues; is that correct?

THE WITNESS: Yes, you will. That's correct.

JUDGE THOMPSON: Now, if I'm not completely off track, I believe our next witness is Mr. Spanos; is that correct?

MR. COOPER: I believe that's correct, your Honor.

JUDGE THOMPSON: Mr. Schwarz, do you need something?

MR. SCHWARZ: I need to go get my depreciation materials from upstairs.

JUDGE THOMPSON: Why don't we take 5 minutes, 10 minutes, you can get your materials on depreciation. We are in recess.

(A recess was taken.)

JUDGE THOMPSON: State your name and spell your last name for the reporter, please.

THE WITNESS: John J. Spanos, S-p-a-n-o-s.

(Witness sworn.).

JUDGE THOMPSON: You may inquire, Mr. England.

MR. ENGLAND: Thank you.

JOHN J. SPANOS testified as follows:

DIRECT EXAMINATION BY MR. ENGLAND:

Q. Mr. Spanos, let me turn your attention to your prepared Direct Testimony, which I believe has been marked as Exhibit 8 in this proceeding, and attached to that is your own exhibit entitled JJS-1. Do you have those in front of you?

A. Yes, I do.

Q. Are there any corrections that you need to make to that testimony or that schedule at this time?

A. Yes. I have one minor change to my Exhibit JJS-1, page 1-4. The middle of the page under the subheading of Calculation of Depreciation there's a phrase that says "equal life group." That needs to be stricken and "average service life" needs to be put in there.

JUDGE THOMPSON: So take out the three words "equal life group" and put in the words "average service life"?

THE WITNESS: That is correct.

MR. ENGLAND: Everybody get that?

BY MR. ENGLAND:

Q. Any other corrections to your Direct Testimony or schedule?

A. No, there isn't.

Q. And then your Rebuttal Testimony I believe has been marked for purposes of identification as Exhibit 50. Any corrections to that document?

A. No.
Q. And then, finally, your Surrebuttal Testimony is marked as Exhibit No. 81. Any corrections that need to be made to that testimony at this time?
A. No.
Q. Thank you, sir.
MR. ENGLAND: I have no other questions. Would offer Mr. Spanos for cross-examination and offer 8, 50 and 81.
JUDGE THOMPSON: Okay. Do I hear any objections to the receipt of Exhibit 8? How about Exhibit 50? How about Exhibit 81?
Hearing no objections, Exhibits 8, 50 and 81 will be received and made a part of the record of this proceeding.
(Exhibit Nos. 8, 50 and 81 were received into evidence.)
MR. ENGLAND: Thank you, your Honor.
JUDGE THOMPSON: You're quite welcome.
Let's see. Cross-examination, Ms. O'Neill?
MS. O'NEILL: No questions, your Honor.
JUDGE THOMPSON: Very well.
Mr. Schwarz?
CROSS-EXAMINATION BY MR. SCHWARZ:
Q. Good afternoon, sir.

A. Good afternoon.
Q. I've got some general background questions that I'd like to start off with first. It's my understanding that your testimony and appearance here today is the result of a contract between Missouri-American Water and Gannett Fleming; is that correct?
A. An agreement to do a depreciation study, yes.
Q. Right. But it's between Gannett Fleming and Missouri-American Water and Gannett Fleming proposed you to do the work and that was agreeable to the company?
A. Yes.
Q. But it's a contract between Gannett Fleming and Missouri-American?
A. I don't think there's any legal document, but yes, that is a -- there's an agreement with a signed letter, if that's what you're asking, yes.
Q. A letter --
A. Okay.
Q. A letter agreement can constitute --
A. Okay. Then, yes.
Q. Okay. And does that letter agreement set out the performance, the work that was expected of Gannett Fleming?
A. Yes. It describes the scope of services that we will conduct for doing a depreciation study.

Q. And does that specify that there will be a single depreciation study for all of the -- a combined study for all of the districts of Missouri-American with the exception of Jefferson City and St. Louis?
A. My understanding is that's what that says. I don't have it here right in front of me to confirm that, but I'm sure it had to do with the seven Missouri-American original districts, yes.
Q. And who would have negotiated that with Missouri-American?
A. I would have.
Q. So you negotiated this contract with Missouri-American?
A. Well, as I said, there wasn't a true negotiation. I wrote a letter explaining my scope of services, the work that I would do, sent it to Missouri-American, they agreed upon what I was going to do and we began going forward.
Q. Do you recall who proposed combining the -- or doing a combined study for the various districts and excluding Jefferson City and St. Louis County from that study?
A. As one of our calls after the letter was agreed upon, that was the discussion we had and how we were going to do the work. And each of the aspects, I don't know

who actually came up with the first thought. I believe it was my discussion based -- my thoughts based on the data that I knew that they had in place.

Q. And that's kind of where I want to go. How did you know what data they had in place before you entered into the performance of the agreement?

A. In asking them the type of data they had and what was available so that I would be able to budget an assignment, I was able to see the last study that was performed.

Q. The last study performed?

A. For Missouri-American districts. I had in my hand already the last St. Louis County study that was performed because my firm had conducted that one.

Q. So did the company, for instance, suggest that you should do -- or that they needed a separate study for the St. Joseph operating district?

A. That was not a suggestion. As I mentioned, when I looked at the data, we had a discussion as to the overall package that needed to be submitted. And as I said, I believe it was me that said given the fact of the -- some of the smaller districts, it would make more sense to have a one combined study for all districts so you get a better service life analysis.

MR. SCHWARZ: May I approach the witness, please?

JUDGE THOMPSON: You may.

BY MR. SCHWARZ:

Q. I've just handed you a document. Would you take a look at it briefly? I'd suggest to you it's copies of various attachments to your testimony and ask you, was that provided to you before you took the stand, a copy of that?

A. A copy of these pages?

Q. Yes.

A. I have seen these pages before, yes.

Q. And do you recognize them as being copies from schedules to your testimony with the exception of the little numbers down in the right-hand corner which --

A. Yes.

JUDGE THOMPSON: Were you going to be marking this?

MR. SCHWARZ: Yes. I would like to mark this.

(Exhibit No. 123 was marked for identification.)

BY MR. SCHWARZ:

Q. You have in front of you what's now been marked as Exhibit 123?

A. Yes, I do.

Q. And they are, in fact, copies of schedules to your testimony?

A. That is correct.

MR. SCHWARZ: I would offer this just --

JUDGE THOMPSON: First, tell me how to describe it.

MR. SCHWARZ: Schedules from Mr. Spanos' testimony.

JUDGE THOMPSON: So they're already in the record once?

MR. SCHWARZ: They're already in the record. I just think it would be easier to work from here than flip through mounds of paper.

MR. ENGLAND: If I may, if I understand, it's an excerpt from selected schedules from Mr. Spanos' study. We were fortunate enough to get a copy just before Mr. Spanos --

JUDGE THOMPSON: I appreciate you pulling out the highlights.

MR. ENGLAND: We can confirm it. We have no objection to its admission if that's what Tim wants to do with it.

JUDGE THOMPSON: Very well. Exhibit 123 is received.

(Exhibit No. 123 was received into evidence.)

MR. SCHWARZ: Thank you.

BY MR. SCHWARZ:

Q. Again, I want to work on some general items, if I might, first of all. Can you identify on Exhibit 123 the first page, what that is?

A. Yes. That is a plot of the original and smooth survivor curves for Account 331, mains, transmission distribution.

Q. And the original plots are the X's and O's that appear at the top of the graph?

A. The -- there are two original curves plotted on this page. One is represented by X's. That represents the surviving percents of assets that were reviewed during the experience span 1956 to 2002. And the circles with the slight little dash at the top are the same assets during the experience band 1978 to 2002.

Q. And there's a legend, if you will, that identifies those in that box on the right; is that correct?

A. That's correct.

Q. And it also refers to 1880 to 2002 placements; is that correct?

A. That's correct.

Q. Would you explain for the Commission what that means?

A. Placements are -- during the experience band, so during the years 1956 to 2002, there were assets that were in service or had been placed in service during the period 1880 through 2002 so they were exposed to retirement during that time period. So we know that we have assets that have been in place since 1880.

Q. So is it safe to say then that at the end of December in 2002, which is the date of this study, that there remained in Accounts 331, mains, property that had been placed at various times from 1880 through 2002?

A. I'll have to confirm that from my study. If I was to look in this particular account back to page 3-160 of JJS-1, that supplies the surviving balances. And, yes, there was dollars that were -- are still in service as of December 31, 2002 that were put into service in 1880.

But this particular schedule doesn't guarantee that because of the fact it is possible that all of the 1880 assets could have been retired during that time period. That's why I had to check to make sure that your full statement was correct.

Q. And you have -- the smooth curve is labeled Iowa 90-R2.5. Correct?

A. That is correct.

Q. And what does that -- break those references down for the Commission, if you would.

A. Sure. The Iowa 90, 90 represents the average service life that we have recommended in this particular case for mains. That means 90 years, on average, the mains were staying in service all the way up until approximately 130 years.

The R2.5 is the dispersion rate that we anticipate for these assets with a 90-year service life. An R-type curve represents that a greater percentage of the assets will be retired to the right of mode, 90 years in this case.

Q. Okay. And the Iowa is a reference to the Iowa curves; is that correct?

A. That's correct.

MR. SCHWARZ: May I approach?

JUDGE THOMPSON: Yes, you may.

BY MR. SCHWARZ:

Q. And I've handed you a booklet that I will refer to as Bulletin 125 and ask you, is that a study that established the Iowa curves?

A. Yes, it is.

Q. And that study sets forth the mathematical and theoretical equations for the graphs of what is known as the Iowa curves; is that correct?

A. The dispersion rates, yes.

Q. The dispersion rates. And it also indicates the empirical study of industrial and utility property that was undertaken to confirm those equations and curves?

A. Yes.

Q. So it's my understanding, and tell me if I'm wrong, that the curves that are used to estimate the average service life and the dispersion pattern of the retirements is based on the known historical original cost of the property that's in the account by year that it was placed; is that correct? That's one of them. I'm going to go through a series.

A. That is one of the factors. The assets that were in -- that were exposed to retirement. It would also include the day that had been retired, but yes, that is a true statement.

Q. And it also includes data as to the retirement of those original placements that have occurred so far, again, by year of retirement?

A. That is correct.

Q. And the object or purpose of the calculations is to estimate the retirement pattern of the property that remains in service that has not yet retired; is that correct?

A. There are other factors that you may or may not be ready to bring up, but there are other factors that require you to bring in additional information other than just the statistical data, but there -- that is true.

Q. But as far as the calculation of these curves --

A. That's correct.

Q. There is additional information and experience that informs, for instance, prescription of depreciation rates; is that --

A. That's correct.

Q. All right. But as far as the Iowa curves are concerned, the data that it analyzes is the original cost of the property that remains in service, the retirements by vintage and year of retirement?

A. There are other activity, but the retirements and the surviving balances are the key elements of shaping these curves and how they're developed, yes.

Q. What other activity? I'll bite.

A. Well, there could be transfers that would affect the exposures, acquisitions could affect exposures. So these are all elements of data that are a subset of developing a surviving balance.

Q. Does Bulletin 125 prescribe a formula or provide a study of the cost of removal of any of these assets or any assets?

A. As part of a life analysis?

Q. Yes.

A. No.

Q. So the statistical basis behind the Iowa curves does not provide any substantiation for estimating a net salvage less cost of removal?

A. That particular document does not.

Q. Okay. And the formula -- let me start again. What is the formula that you used to establish depreciation rates for the accounts that you did?

A. It would be the original cost minus the net salvage component over the life -- over the remaining life is the appropriate way of developing a remaining life basis.

Q. Okay. And you used the average service life in that computation?

A. That is a component, yes.

Q. Can you tell me what the net salvage cost for the mains account will be in, say, the year 2050?

A. The net salvage cost?

Q. Yes.

A. No.

Q. Can you do it for the year 2020?

A. With certainty, no. I won't know that until I know what the retirements are and how much it costs to remove those assets and any salvage value that they received from those assets.

Q. So in your formula, the value for net salvage is not from historical records; is that correct?

A. I disagree. I mean, one of the factors that is a -- similar to my developing of an average service life, you're looking at historical information. For a net salvage estimate, just like life estimation, you come up -- you use historical information to help you lead -- or lead you into what you feel the estimate will be in the future.

So I don't for sure that a life estimation is the exact expectation of that life until history actually occurs. The same thing with the net salvage percents. You don't know what the actual cost is until the retirement occurs.

So I can't give you an actual number. I can give you what my estimation of those numbers are in the years that you present and based on historical information that I have in my report and what my expectations are based on other utilities and what the company has told me they think is going to happen in the near future.

Q. So the estimate of the future cost of net salvage in your calculation is based upon the relationship of a particular year's -- the original cost of a particular year's retirements and the cost of removal experienced in that year; is that correct?

A. That's an example. I can -- the statistical information for Account 331, since that was one of the ones we're talking about, we have in my report, page 3-129, similarly I have years of retirement -- the last 15 years of retirement, how much has actually occurred, the cost of removal for each of those years, the gross salvage for each of those years and then a net salvage percent.

From there, I use similar type judgments as to whether I anticipate net salvage percents to be -- and historical indications would be indicative of the future. So in that particular sense, I'm using the same concepts that I'm doing for life estimation, but I won't know a guarantee for 2020 until the actual retirements occur.

Q. Have you ever taken or undertaken a study of the amount of revenue provided to the company by application of the formula to each year's vintage and then summing that over time to see if when that vintage is retired, that the amount collected actually matches the cost of removal?

A. You mean the amount accrued is equal to the amount incurred?

Q. Yes.

A. I've done some analysis on short periods of times. And, yes, those amounts -- if the estimation was not revised due to situations with environmental issues that came into play, I've done short periods of time, and yes, they have come out -- in most cases I am lower than the expectation cost of removal.

MR. SCHWARZ: Permission to approach the witness.

JUDGE THOMPSON: You may.

MR. SCHWARZ: And I would like this marked as an exhibit.

(Exhibit No. 124 was marked for identification.)

MR. SCHWARZ: I would ask the Commission to take official notice of the transcript in its case EC-2002-1, Volume 3, the excerpt as provided in Exhibit 124, which includes the last page, page 300, that indicates who's talking.

JUDGE THOMPSON: All right.

MR. ENGLAND: Your Honor --

JUDGE THOMPSON: Yes.

MR. ENGLAND: -- may I inquire? It appears this is an excerpt from cross-examination of William M. Stout --

MR. SCHWARZ: That's correct.

MR. ENGLAND: -- in the AmerenUE electric complaint case. May I ask the purpose of the official notice?

MR. SCHWARZ: Well, I propose to inquire of the witness as to differences between his recent testimony and that of Mr. Stout.

MR. ENGLAND: Okay. Thank you.

JUDGE THOMPSON: So you're asking us to take notice of it?

MR. SCHWARZ: Correct.

JUDGE THOMPSON: Okay. So I've marked it as Exhibit 124. Do I hear any objections to receipt of Exhibit 124?

MR. ENGLAND: No, your Honor.

JUDGE THOMPSON: Hearing no objections, the same will be received and made a part of the record of this proceeding. Please proceed.

(Exhibit No. 124 was received into evidence.)

BY MR. SCHWARZ:

Q. Now, in your pre-filed testimony you indicate that you know Mr. Stout?

A. Yes, I do.

Q. And you have worked with him and for him; is that correct?

A. That is correct.

Q. And is that the same gentleman whose paper you appended as Schedule JJS-2 I think to your Rebuttal Testimony?

A. Yes, it is.

Q. Would you take a look at page 171 and beginning at line 4 and continuing through the next page on line 22, if you would? Let me know when you've read that.

JUDGE THOMPSON: Where are we?

MR. SCHWARZ: Page 171 of the excerpt, line 4 through line 22 on the following page, 172.
JUDGE THOMPSON: Thank you.
THE WITNESS: I've read through that.
BY MR. SCHWARZ:
Q.   Thank you. And let me ask you, you agree with his discussion of Bulletin 125, don't you?
A.   Yes, I do.
Q.   Let me ask a parallel question. Have you ever done a study of Missouri-American Water depreciation history to confirm that the actual cost to remove a vintage of a particular plant account actually matches amounts collected in rates from customers for that purpose?
A.   Not for Missouri-American company, no.
Q.   Have you done it for any company?
A.   I've done it for -- let me phrase what I have done and maybe -- I believe it's what you're asking me.
Q.   I'm entitled to a yes or no answer, I think.
JUDGE THOMPSON: Have you done it for any company? Yes, you need to give a yes or no answer, sir.
THE WITNESS: Under my understanding of your question, I've done it for one asset in a company, yes.
BY MR. SCHWARZ:
Q.   And what company was that?
A.   It was a gas company.

Q. What company was that?
A. It was Columbia Gas of Kentucky.
Q. Okay. And what account was it?
A. It was 391, which is an office furniture and equipment account, which has a short life.
Q. Yes, it does, doesn't it?
A. That's why I tried to clause my response.
Q. Have you ever undertaken such a study for an account that would have an average service life of more than 20 years?
A. No.
Q. Let me ask you this. How did you compute the revenue that they received for the cost of removal of office furniture?
A. Well, my response -- and maybe it was in my error, but my response was trying to match the depreciation expense to the actual cost of removal and matching that to what the net salvage accrual was and whether rate base tied into that. So that might not have been exactly what you were asking me or trying to get at and that's why I was trying to reference your question.
Q. Okay. What's the cost of removal of office furniture?
A. For -- for most, it's very little. And that's why I was able to -- the cost of removal and the gross

salvage for such equipment comes out in most cases near zero. And that's why we were able to record that and monitor a short-lived asset and determine how much it was accrued versus how much was incurred.

Q. And you simply -- and you used the per book accruals as the amount of revenue received from the customers --

A. Well, as I did --

Q. -- for the cost of removal?

A. I was dealing more with rate base than actual true revenues incurred. So that's why I was trying to preface my answer to your question.

Q. Well, I'm not entirely clear yet as to what you actually did. Let me ask you this. What was the -- was the cost of removal built into the depreciation rate for office furniture --

A. Yes, it was.

Q. -- in that account?

And what was that factor in the depreciation rate for office furniture?

A. It was 1 percent. Positive 1 percent. So that means gross salvage exceeded cost of removal.

Q. And is that a similar situation to the plant of Missouri-American Water?

A. No. Most of the accounts in Missouri-American

Water cost of removal exceeds gross salvage, so you have negative net salvage.

Q. So I take it that you wouldn't stipulate or agree to use the cost of removal percentage for office furniture from Columbia Gas of Kentucky for the plant accounts for Missouri-American Water; is that correct?

A. Not the office furniture and equipment account. For other assets other than office furniture and equipment.

Q. To your knowledge, is there an empirical study that shows for a particular vintage of, say, mains that were installed in the 1950's that the accrual for net salvage for that vintage matched what was actually collected from the customers?

A. Not that I know of.

Q. So is it safe to say that one of the things to be measured, the things to be estimated in the cost of removal formula is the actual cost of removal itself; that is, the unknown, the parameter that you're seeking is the actual dollar value of the cost of removal, in this case for an average of 90 years, but some of it not for 120 years; is that correct?

A. That's true. There are many estimations in developing depreciation rate, but that is an estimation, that's correct.

Q. Do you have your Rebuttal Testimony with you?
A. Yes, I do.
Q. Would you turn to page 15, lines 27 to 234?
A. I'm sorry. What lines are those?
Q. Page 15, lines 27 through 34. Are you --
A. I believe mine's numbered slightly different, so could you give me the first words?
MR. SCHWARZ: Excuse me. Can I approach the witness?
JUDGE THOMPSON: Yes, you may.
MR. ENGLAND: Tim, his questions are numbered if he doesn't have the same line as yours.
THE WITNESS: Mine's slightly different.
Okay.
BY MR. SCHWARZ:
Q. It's question 26 and question 27. I'm sorry.
A. I see those questions and I've read them.
Q. How does the need for cash flow figure into your computations for depreciation?
A. Your expectation of future additions show that there's a need for cash flow. And depreciation is a non-cash item, but a way to recover that investment.
Q. How does the need for cash flow figure into the computations of depreciation? Where does it fit into the formula?

A. It's not part of the formula.
Q. Is it, in fact, a proper consideration for depreciation?
A. As -- in my mind, it's part of the overall decision-making process that you need to do when doing a depreciation study.
Q. So before you exercise your judgment as to the appropriate curves and the appropriate factors other than strict mathematical fit, one of the things that informs your judgment is the company's need for cash flow?
A. It's a factor in the overall decisions. Obviously in some cases it's a small factor and in some cases it's a bigger factor, but it's usually known as to me as to what's going on.
Q. Can you point out to me any depreciation treatises or texts that provide that a particular company's need for cash flow is an appropriate factor to consider in the depreciation process?
A. I wouldn't say that there's anything that in writing states that is a necessity. They do say that management's outlook, plans and policies are a factor in determining life. So in that particular case, that's an issue in my mind.
Q. I'm sorry. I don't quite follow the connection between a company's plans and your computation of

depreciation. Could you explain that a little further, please?

A. Again, the computation of depreciation, okay, the actual calculation does not bring in cash flow. But the parameters that are included that develop the depreciation rate take into consideration -- when you come up an average service life and a type curve, you take into consideration not only historical indications, but future indications such as what things are going to be retired, what things are going to be built, what plans the company has, are there any other environmental issues that might be coming in that cause you to do things differently than you are doing today.

Those are all factors that come in that help you make a judgment. And in that case, it is part of your depreciation calculation.

Q. So do I understand to say that your depreciation -- the depreciation rate that you've prescribed for Missouri-American Water, one of the factors that you consider is the particular -- this particular company's need for free cash flow?

A. As -- as part of the answer, I know whether they need cash flow to construct new facilities or things of that nature. But do I make that my dominant factor? No. But it is -- it is known to me when I make a decision.

Q. I don't think I've heard an answer. The question is, do you take into account -- when you're prescribing a depreciation rate, do you take into account the particular company's need for free cash flow?

A. I know what it is, so I'll say yes to your question.

Q. Turning back to Exhibit 123 for a moment, if we might, it's my understanding that the actual experience points that are shown on that graph are not the entirety of the points that appear in the following pages which have been numbered 2 through 7; is that correct?

A. That is correct.

Q. And if I read your surrebuttal correctly, you said that someone looking at the graph could easily discover that by looking at those pages; is that correct?

A. That's correct.

Q. Did you actually expect the Commissioners to look at the graph and compare it to those tables?

A. The graph represents my -- the factors that were in place during -- statistically as to what I used. So my understanding was that they can see what was involved in my 90-R2.5 for this particular account and if they wanted to see the exposures, they're all listed there, pages 2 through 7.

Q. I have to translate what I have as page numbers and what he has as question numbers. I'm sorry.

Question 15 of your Direct Testimony, in the last sentence you indicate that the company, in accordance with your directions, classified the data by depreciable type of transaction and the year of the transaction and vintage. Is that my understanding there?

A. That's correct.

Q. Did the company also, at your direction, combine the data from all of the operating districts other than Jefferson City and St. Louis County?

A. Well, in the years 2000 to 2002 the data was -- on their fixed asset system was in a combined fashion. And that was sent to me in that regard based on the earlier discussions we had when we were starting the assignment.

So I received data from '99 and prior that was on a district level and then the 2000 to 2002 data was given to me in a combined basis because that's where they had kept it in under their new fixed asset system.

Q. So let me ask the question again because I don't think I got an answer. Did the company combine the data from the operating districts, other than Jefferson City and St. Louis County, and send it to you at your direction?

A. Maybe I'm a little confused at the phrase at my direction, but I'll say yes, they sent me the data of the seven districts through 2002.

Q. And it was in accordance with your directions or your instructions?
A. Yes.
Q. And so you had directed -- you directed them to combine the data from the other operating districts and you did not then examine that data district by district before you ordered it combined; is that correct?
A. For the last three years, it -- they only maintained it combined. For the prior -- '99 and prior, they sent me the data all as one with district designation, but I did not study it district by district, that is correct.
Q. So then you combined the district data?
A. It came in one file, so that's why I'm not sure what you mean by "combined." It came as one file. All the districts together in one file, '99 and prior. The 2000 through 2002 data came in a separate file. That was all as, again, one database.
Q. Well, and I don't exactly understand what you mean when you say "came as one file." So we'll have to work at that a bit.
When you got the data, could you tell if a specific placement was made in Joplin in 1902?
A. For assets that were put in place '99 and prior -- transactional year '99 and prior, yes, I could see

whether there was a district designation.
Q. Could you tell if a particular placement in the year 1902 was in the Joplin district or the St. Joseph district or the Brunswick district or the St. Charles district?
A. The raw data that came to me had those designations, yes.
Q. Okay. And before you combined the data, did you review the data to make sure that there were no anomalies or mis-entries, things of that nature?
A. I made sure that the database tied into the totals that were to be there through '99. I did not look at every single entry to see whether every entry was in line with the specific district, just in total to make sure that all the data was there.
Q. Do you have your Rebuttal Testimony?
A. Yes, I do.
Q. Do I have your Rebuttal Testimony?
Question 39, which in my version is page 23, line 3.
A. Does the question start with, Do you agree?
Q. Yes. Are you there?
A. Yes, I am.
Q. I guess the second and third sentence indicate, I reviewed this combined database for accuracy and

completeness. I found the data to be accurate.

So is it my understanding from your prior answers and from this answer that you did not review the data prior to combining it?

A. I reviewed the data prior to combining it, making sure that there was total data in the sense that we had the original cost that was in place as of 12/31/99, okay, I had balances -- or surviving age distributions and activity that would have walked us back in time to have been able to run an audit, which is a program that we use to make sure that the data is representative to combine.

Q. And did you run the audit program in your software on the data on an individual district basis or just on the combined basis?

A. We ran it to make sure that the --

Q. Did you run it on --

A. Yes.

Q. -- on the individual district basis?

A. We ran the audit on the individual basis to make sure that the balances were in line and all debits. And then we made sure that -- we combined it at that point and ran the audit to make sure that all the other data was in place.

So on a combined basis, we ran the data to make sure that all of the entries that were there, activity -- and activity is retirements, the additions that we had and the transfers were all in -- in order. On the district by district basis, we just made sure that the balances were in order and the activity back to as far as back in dates that they had.

Q. And I'm not quite clear. So did you run the audit program on each district's data before you combined them?

A. I ran the audit program on each district. There are versions of the audit that are -- might be confusing --

Q. Yeah.

A. -- in this issue, but I ran the audit program for each district to make sure that the balances were in line and the data that was available to me was in line.

Q. Okay. Would you agree that the cost of removal is not known during a property's -- or during an account's life? It's only -- excuse me. Strike all of that.

Would you agree that the cost of removal is not known during a property's life, it's only known after the asset has been retired?

A. That is correct.

Q. Are you aware that in the last St. Louis County Water case, which is now the St. Louis district of

Missouri-American, that there was -- the Commission prescribed an amortization of a reserve deficiency?

A. Yes. There was -- there was actually two in that case.

Q. Do you -- well, why don't you explain what the two were?

A. There was a reserve -- well, there was two reserve variances, one as of the '95 case and one as of the -- in the 2000 case that were part of the whole life method of depreciation that was in place for that particular case.

Q. It seems to me from reading your testimony that you agree with Mr. Macias that if the Commission does not include the cost of removal in the depreciation formula but instead treats it as an expense, that there's no need for a reserve amortization; is that correct?

A. Using the whole life method, I don't agree with that because there's no catch to whether there's full recovery of the assets.

So in my mind, you need -- using the whole life method, whether you have a -- excuse me, using the whole life method, whether you have net salvage part of your estimate or not, you need to have some type of true-up to make sure that the actual costs hitting the reserve are the same as those theoretically being tied in so that you make sure you have full recovery of all your assets.

So in that sense, if you use the whole life method, you need a reserve variance whether you have an expense or an accrual on your net salvage.

Q. Do you have your Rebuttal Testimony there?

A. Yes, I do.

Q. Would you take a look at question 50? Are you with me?

A. Yes. I was assuming I should read it.

Q. Well, I assume you're familiar with it.

A. Well, always like to make sure. Okay.

Q. The second sentence reads, Mr. Macies' recommendation is based on the recovery of only original cost rather than the service value, paren, original cost less net salvage, closed, and is unreasonable survivor curve estimates; is that correct?

A. Yes.

Q. Now, it's my understanding that your most recent answer indicated that there were two reserved amortizations, one of which refers to the net salvage and the other to the unreasonable survivor curve estimates. Is that a misunderstanding on my part?

A. Yes. There were -- there are two -- in the St. Louis County case there was two reserve amortizations, one based on the '95 case and one on the '99 case.

Q. Okay.
A. Sorry.
Q. Okay. Well, I take it from your testimony that you don't agree with what Mr. Macias did, but I don't see any dispute of the mathematics of his calculations. Is that a fair statement?
A. I was in disagreement with what he did because of the fact he's doing life estimation on something very different than what I'm doing. So it's very hard to rebut what he was doing mathematically because we didn't have the same data to be working with.
Q. You didn't have the same data to be working with?
A. He was working on -- his estimates are all based on the St. Louis County data. My estimates are under Missouri-American district data.
Q. So you didn't check to see -- his mathematics to check if they were correct or not?
A. Not theoretically because he wasn't doing the same work that I was doing.
Q. So you have no reason to question then the mechanics of his calculations then; is that correct?
A. No. Not for the Missouri-American district assets.
Q. I want to go back to Exhibit 123 now, if I

might, the very last page, page 15. Are you with me?

A. Yes, I am.

Q. And the smooth curve there is labeled Iowa 80-R1; is that correct?

A. That is correct.

Q. And the representation there, is that what you would call a truncated Iowa curve?

A. Yes.

Q. And what caused the truncation?

A. A point in time when you feel that there will be a concurrent retirement date of assets.

Q. So the entire account is going to disappear at once; is that correct?

A. Well, this represents all the assets in 304.30 so in my mind, when assets reach 75 years, which is consistent with the life span of the assets I have in that account, then there will be a concurrent retirement.

Q. And what are these assets, for instance?

A. These are water treatment plant structures.

Q. Which is?

A. Buildings -- is that what you're looking for?

Q. Yes.

A. Very large buildings that house filters and clarifiers and flocculaters and things of that nature. Usually brick structures.

Q. And what would be the effect if instead of that or -- or that vertical line being drawn at 75 years -- let me ask you first, it is drawn at 75 years, is it not?
A. At age 75, yes.
Q. Right. What would happen if that moved over to 95?
A. The interim survivor curve, which is the 80-R1, would move further down the percent surviving. And then at age 95, you would have a concurrent expectation that retirements would go out of service.
Q. Let me ask you this. Typically this Iowa 80-R1 curve might have a tail that would extend out to 120 or something like that?
A. This particular one would go out beyond 120, yes.
Q. Yeah. What would be the effect on intergenerational equity if, five years from now, that vertical line moves over to 95 instead of 75?
A. Depreciation expense would go down if you lengthen the retirement data. As far as intergenerational equity, the ratepayers and the company has been anticipating depreciation at a certain level up through age 75. At a certain point if you move it out, that gets smoothed out to reduce depreciation over the extent of the remaining life.
Q. So if I understand your answer correctly,

would you agree that if that vertical line shifts to the right, that it's an indication that ratepayers up to the time of the shift have paid relatively too much and that ratepayers after the shift will pay proportionately too little; is that correct?

A. Well, I would have to ask you why you moved it 20 years to the right. Obviously there was a reason for that and -- but if you -- if there's no factor that was built in and you put in -- and you moved that number to 95 years, the ratepayers earlier in time would have paid more depreciation than if you make the move.

I wouldn't say that they paid in excess. I mean, they -- they paid -- at that particular time that was the decision that was considered a fair judgment of the estimate of those assets.

Q. Well, they paid the rates that were prescribed by the Commission, but they paid more than was required to recover the cost of service provided them by those particular assets; isn't that correct?

A. That's correct.

Q. But, likewise, if for some reason that line shifted to the left, it would flip, would it not?

A. That's correct.

Q. And isn't that true -- I mean, it's easy to see with a truncated curve, but it's true also, is it not, with any of the depreciation curves? If the curve shifts one way or the other during the life of the account, then you have some kind of intergenerational inequity; is that correct?

A. If there is a shift, you will -- obviously any time you change the estimate, you will see some type of change. I don't consider those to be intergenerational inequities, but there has to be a reason why you changed it. That's why I don't agree with being intergenerational equities.

There has to be some type of judgment or reason for that change. More retirements occurred, that's why you shorten the life; less retirements occur or higher maintenance expense and that is why you would lengthen the life.

Q. Or perhaps it's hard to predict costs of removal 50 years into the future?

A. Well, cost of removal wouldn't be part of this particular schedule.

Q. But it would have -- the shifts in cost of removal are based on average service lives. And if you change those average service lives, if you change the amount of cost of removal, all of those changes imply intergenerational inequities, don't they?

A. And that's why you do a study every three to five years.

Q. But not an empirical study to match whether the cost of removal actually paid by the ratepayers matches the accrual in the accounts of the company?

A. No. But you always are guaranteed 100 percent and no more of your full service value of the asset.

Q. That's true on the -- I'll call it the depreciation side, but on the cost of removal side, that's not true, is it? There's no guarantee, for instance, looking at your Schedule JJS-4 that begins on page 12 of Exhibit 123 that any of those amounts that conveniently add on your schedule will actually be paid by the ratepayers or incurred by the company; isn't that correct?

A. That's true. But you always make revisions. And the reason why those numbers are there is because we have indications that say that they -- they're sound.

Q. And in the year 2150 it turns out that these computations don't add up. How do you make amends to 100 years of -- 150 years worth of customers in the meantime?

A. I'm sorry. I didn't -- sure what the question was.

Q. Well, in the example that you give for Account 331, everything tidies up in the year 2169.

A. Based on that -- on the particular curve that's in place today, that's -- that is true. That -- the estimated net salvage cost and net salvage accruals are the same.

Q. But, for instance, if you look at the estimated -- at the column Estimated Net Salvage and the column headed Estimated and the column Net Salvage Accrual for the year 2005, there's nothing that -- I mean, those aren't known, are they?

A. They're not known.

Q. So what numbers in those columns are known?

A. There's -- there's nothing in this page that's known because it's all in the future.

Q. So what comfort should a customer in the year 2004 have that the figures may or may not eventually add up in the year 2169?

A. I think a customer is assured that the company will only receive, as I said, full service value of their assets. Whether that be -- you know, as of today, if they incur more today, they will incur less tomorrow because they still will only get full recovery or full service value of their assets.

Q. I agree with that on the assets, but we're looking at a schedule that talks about cost of removal. And your representation is that in the estimated net salvage cost and the net salvage accrual, there's not a known number in any of those columns on almost three pages. And they are projected out for another 165 years from today's date.

And I'm still -- and there's no guarantee -- I mean, there's no guarantee that any one of these estimated net salvage costs nor the net salvage accrual will actually take place and there is no empirical study, is there, to establish that what the company collects for the cost of removal through the formula that's used in your calculations will actually match the cost of removal that the company incurs; is that correct?

A. There's no empirical study, that's a correct statement. Obviously by doing depreciation studies, you come up with estimates that in your best judgment are representative of what's going to happen both on a service life basis and a net salvage basis.

So -- and both of these areas -- the only known thing in a depreciation study is the original cost. The service life is not a known thing. You're -- again, you're estimating what you anticipate being the -- the life of the -- the average service life of those assets and the rate of dispersion just like you're doing the same thing for your estimation of net salvage. It's an estimation based on historical indications and future thoughts.

Q. Well, now, the original cost is not the only known item in the life estimate, is it? Don't you know the pattern of retirements that has occurred to date?

A. Yeah. And I know the pattern of the net salvage that's occurred to date.

Q. But you have an empirical study that says when you have a known historical cost put in place at a given date and you know -- you have a history of retirements, you can then estimate a survival pattern.

But there is no similar empirical study to say I'm now in the year 2003 and I can simply -- there's no empirical study to support your estimate of the actual cost that's going to be collected in 2036 or the cost that's going to be expended in 2036; isn't that correct?

A. In the way that you're describing it, there is no difference between the known facts of the life and the known fact of the net salvage percent. They're both based on historical information.

And the estimates that I have in place there, yes, there is an empirical estimation of the rate of retirement that will occur in the future based on a 90-R2.5, but there's no guarantee that that is the representation of the actual retirements that occur in 2003 or 2004 or 2005.

Q. That's correct. But I believe one of your earlier answers indicated the company's not going to recover more than they actually incurred in original cost, are they, under the asset recovery portion of the depreciation formula?

A. Under the depreciation formula, they recover full service value and that includes the net salvage percent.

Q. No. I'm just talking about -- I'm talking about the formula that's composed of two factors, one factor estimates service life, one factor estimating cost of removal.

On the first factor, the company is not going to recover more than the original -- the original cost of the asset that's booked; is that correct?

A. If you are saying that there is no net salvage component in the -- in the estimate, that is a true statement.

Q. Okay. And the same cannot be said for the calculation of the net salvage; is that correct?

A. That -- that is a correct statement.

Q. Thank you.

JUDGE THOMPSON: This might be a good moment to take a break for the reporter. We'll recess for five minutes.

(A recess was taken.)

JUDGE THOMPSON: We're back on the record. You may inquire.

BY MR. SCHWARZ:

Q. Do you have your Rebuttal Testimony there, sir?
A. Yes, I do.
Q. Question 43 --
A. Does it begin with, Why did you not?
Q. Yes.
A. Okay.
Q. Okay. Now -- well, a little further along you say, Further, the same management team operates these districts. As a result, consistent practice and policies have been in place for a number of years and will continue.
A. I see that.
Q. Right. Can you tell me when the company acquired the Joplin district?
A. I don't know that offhand.
Q. Can you tell me when they acquired the St. Joseph district?
A. I don't know each of the exact years for each of those districts.
Q. Well, let me rephrase it. Do you know the dates the company acquired any of the districts?
A. Of the original Missouri-American district, I don't have those in front of me, no.
Q. Okay. And it's --
MR. SCHWARZ: I think that's all I have.

JUDGE THOMPSON: Thank you, Mr. Schwarz.

I think we are now ready for questions from the bench, if I'm not completely confused. I could be. Commissioner Murray?

COMMISSIONER MURRAY: Thank you.

QUESTIONS BY COMMISSIONER MURRAY:

Q. Mr. Spanos, the Judge made reference to the fact that we now know all we need to know about depreciation or all there is to know about depreciation. I would just like to say for the record I think I could be here 20 years and still not know what there is to know about depreciation.

Could you please enumerate all of the issues that are in dispute concerning depreciation and tell me the amount that are involved in each?

A. Well, there are a handful of issues. I'll try to categorize them as best I can. Some are going to be in groups because it's difficult to break a component down based on the way that the two groups did it.

But there are life estimation issues that Staff has proposed certain lives that are different than mine. And that also incorporates the use of the life span procedure, which in the non-mass accounts, which would be buildings, treatment plants, things of that nature, I've used a life span procedure. I've included that in my life estimation differences. And there's approximately $800,000 difference in annual expense related to life estimation issues.

The comparison of remaining life versus whole life procedures, which is a depreciation procedure that I incorporate the remaining life depreciation method which adjusts over the remaining life for the assets the difference between the theoretical reserve and the actual book reserve.

That difference -- versus Staff's side that uses only the whole life, which has no ability to correct the reserve variance. That's not built into the whole life estimation. That difference is $179,000 approximately.

And the third --

Q. May I stop you there and ask you --

A. Sure.

Q. -- is that a change -- is the company recommending a change in that -- is the company recommending that the Commission adopt a change in methodology on the remaining life versus the whole life issue?

A. In the last case, the company had a whole life methodology with a reserve variance true-up. The remaining life concept does that all in one step. And it -- the true-up has a set period of time, which is normally a lot shorter than the remaining life of the assets.

So the remaining life concept develops one rate for each account, does not have a whole life rate and a reserve variance true-up, which is over usually a 5- or 10-year period of time. So, yes, that's a slight change from where they were for the Missouri districts seven years ago.

Q. Okay. Now go ahead.

A. Okay. The net salvage difference or methodology is the other major issue. This incorporates my philosophy of a net salvage accrual as part of the depreciation rate. The company expenses those issues as they're incurred. That's about a $725,000 difference.

Q. I think you said the company expenses.

A. I'm sorry.

Q. You mean the Staff; is that right?

A. Staff's proposal is to expense that.

Q. And what was the difference, the dollar difference?

A. About 725,000.

Q. All right.

A. And based on my study and Staff's study, that is the overall difference between the two cases. Total of about 1.7 million annually.

Q. For all of the depreciation issues?

A. Yes.

Q. Well, the largest of that is the life estimation and pretty close to that is the net salvage methodology?

A. That's correct.

Q. The life estimation issues, as I read your testimony, you disagree with not only the methodology that Mister -- I never can pronounce the same -- Macias?

JUDGE THOMPSON: Macias.

BY COMMISSIONER MURRAY:

Q. -- Macias used as well as his interpretation of his results; is that right?

A. Yes. I had a different view of things.

Q. Okay. And on the remaining life versus the whole life issue, if the Commission were to adopt the company's methodology going forward and use the remaining life, what effect would that have -- never mind. I can't figure out how to phrase that.

With the net salvage methodology that Staff is recommending that we change to, the company has been accruing the cost of salvage -- the cost of removal net of salvage over the years; is that correct?

A. That is correct.

Q. And if we change methodologies at this point, what effect does that have going forward?

A. Well, one of the issues that's built into have been accruing these net salvage percents is rate base is at a different level than it would have been if we were not accruing those dollars. So --

Q. Meaning it's lower than if you were not?

A. Rate base is lower if -- if we had not been accruing, that's correct. And the other -- the other factor would be that we wouldn't have any guarantee as to the -- at what stage of each of the assets we have recovered true depreciation and what -- and how much of that depreciation rate was part of the net salvage component.

So we couldn't guarantee 100 percent of full investment of your assets if in midstream you switch from the accrual method to the -- the expense method. So there's a -- that level of inabilities to measure how much was recovered through true depreciation and how much is recovered through the net salvage accrual would not be able to be monitored.

And obviously there would be some intergenerational issues as to how much ratepayers had paid to date versus how much they'll pay in the future.

Q. Okay. And is it reasonable to assume that it will cost -- it would cost less today to retire a specific type of asset or specific type of plant than it will cost to retire that same type of plant 20 to 50 years from now?

A. In my mind, it will cost considerably more to retire that asset assuming all things are equal. Obviously there are potential changes in ways that you would remove assets or recover assets, but given all things staying equal, the cost to remove something today -- given the fact that labor is the main factor in cost of removal, the cost to remove an asset today is less than it would be 20 years down the road for that same asset given the cost of labor. And the net -- the gross salvage amount will be very -- the difference will be a lot less.

Q. I'm going to try to go through this without getting too mired in detail here, but if you had $100 million of plant currently that had been in service 25 years and the estimated cost of removal of that plant at the end of its life span was $2 million and at year 2-- and we've been accruing depreciation on that $100 million plant based on the net salvage figure being included in the depreciation accruals.

At year 25 the Commission changes the methodology and says to the company, Now rather than accrue $2 million estimated cost of removal net of salvage each year over the rest of the life of that plant, you've already accrued -- at that point you would have accrued -- let's see -- $2 million -- you would have accrued half of it, 50 million?

A. Assuming a 50-year life?

Q. Yes.

A. Okay.
Q. And assuming you also would have accrued half of the cost of the removal, correct, of the estimated --
A. Given that estimate, yes.
Q. I gave you a wrong figure a minute ago. That $2 million was not to be the cost of -- estimated cost of removal accrual, but I was thinking in terms of -- I guess I was thinking in terms of the estimated cost of removal at the end of the life span of that property being $2 million depreciated over 50 years would be $400,000 a year, I believe?
A. I think it would be 40,000, right.
Q. I don't know. I have trouble with my decimals without a calculator. Do you have a calculator?
A. Did you punch in the number on the -- I have 40,000 by -- for 50 years would get me to 2 million.
Q. Okay. I'll take your calculation then.
A. Thank you.
MR. SCHWARZ: Do you want to hang on it?
THE WITNESS: Maybe I'll hang onto it. Thank you.
MR. SCHWARZ: Yeah.
BY COMMISSIONER MURRAY:
Q. The company might rather take my numbers.
All right. So you've accumulated half of that

cost of removal at year 25. And then the Commission changes to an expensing method. And assuming in year 26 the actual expense to retire plant that is in -- that is being retired that year, in year 26, is $20,000 -- so for year 26 the company expenses 20,000, it no longer puts 40,000 in the accumulated depreciation account; is that right?

A. That's right. In the example that you gave, the assets -- or the recovery rate would be assuming that you're going to be able to recover 102 million over the life of the -- you have 100 of the assets and the 2 million cost of removal.

If you go 25 years down the road with that assumption and then state at the end of year 25 now you're only going to be able to recover 100 million because you will not have that cost of removal component in your estimate, then your rate base will have been reduced by that $2 million and your overall recovery forward would not be 50 percent left to be recovered. It will be 48 percent for the same amount of period of time. So -- or a certain percentage because you're not recovering at the same rate.

So the depreciation expense will go down, but your rate base is lower than it would have been if you had been recovering the accrual for net salvage all along.

Q. Your rate base is lower --

A. Rate base is determined by original cost times one minus the net salvage component. So if you were anticipating recovering 102 million out of 100 million dollar assets to uncover the full service value of the assets and you go halfway towards that goal and then you reduce the ultimate end point so instead of going to 102 million for recovery you're going to 100 million, what happens is your reserve -- depreciation reserve or accumulated depreciation is overstated for the final level as -- because you're not going to the same point.

So now you've reduced your -- artificially reduced your rate base number, it's -- each year it had been overstated for the first 25 years and you're now reducing the recovery rate for where you should be. At 50 percent of life you should have recovered 50 percent of your investment given the example that you have. And you're no longer in that position because you're taking away the final component of the service value of that asset.

Q.   And then is there any place -- any point in time in which that will be trued up, that difference would be rectified?

A.   Well, given the -- the estimates that you have in place, for those assets there's -- there's not a point in time -- well, for that particular asset that -- the point -- the true-up time will occur when you actually make the cost of removal entry.

The problem is the ratepayers that were in place during the time that you made that cost removal entry pay the burden of that $2 million, not the ratepayers that were in place for the 50 years that gained value of those assets. So you will be trued up for the asset when it's finally retired; however, the ratepayers that gained benefit of those assets paid that inproportionate amount.

Q. And what happens to the 1 million that had already been accrued for within the calculation of accrued depreciation for cost of removal net of salvage?

A. At this stage if you -- if there's a transfer to the different component, it would stay in the reserve or you would have to extract that and put that in as a regulatory liability.

So I think that would be a major taxing issue for the utility to do that. Once you're able to determine the amount that was in place, you have to break that down for each of the past studies that have occurred since, you know, the '95 study, the studies prior to that and go through and figure out the amount that was accrued. Because that million dollars might have changed based on the assets that were in place as to the estimate that you've been accruing.

Q. That sounds like a major problem to try to identify what has actually been accrued for which assets and when any cost of removal that applies to those assets would be recovered; is that right?

A. That is a major task and a very difficult task to be sure that you've accrued all the appropriate amounts.

Q. Okay. And as to the intergenerational inequities, it's my understanding that the purpose of depreciation is to allow the company to recover the costs associated with the asset including any cost to remove the asset and to do so over the length of the service period of the asset; is that right?

A. That's absolutely correct.

Q. And the reason for doing it over the length of the period during which the asset is in service is to have the ratepayers who are using the asset pay the full cost of that asset; is that correct?

A. They should pay the full service value of the asset, which includes the last component of that asset, which is the removal of it, yes.

Q. And if the removal is not included in the depreciation accruals over the life of the asset but is rather expensed at the time the asset is retired, then you have a number or a cost of retirement that rather than have been divided by, say, a 50-year asset -- rather than having been spread over 50 years, you've suddenly got the cost of that retirement occurring in one year; is that correct?

A. That's absolutely true. And it might not necessarily be paid by the ratepayers that were in effect for all 50 of those years. Just whoever was in service the year that it was retired are the ones that have to pay that -- that big lump of money.

Q. And even if it is amortized over the next several years to avoid rate shock, it's still a different set of ratepayers than the ratepayers who used the asset that would have been retired?

A. That's correct. Especially with a lot of these long-lived assets that are in the ground 40, 50 years. You're going to have a -- quite a difference in the ratepayers that are -- were in service during the time these assets were put in the ground versus those that are paying taxes today.

Q. And I think you said earlier that it's reasonable to assume that the cost of removal for the same asset -- or the same type of asset would be greater in future years than it would be today?

A. Yes. And one of the -- one of the reasons, statistically average -- the average age of the retirements so far have -- are less than the average -- average service life estimate that we have in place. So that means we have been retiring assets that are younger than the average age.

In the example of mains, the average age of the retirements over the last 20 years have been for assets that were 25 years old where we're estimating a 90-year average for those accounts.

So when -- eventually you'll get to that 90-year average. The difference in time from when the asset went into service and the time it goes out of service is going to be a lot greater than what we've seen to date. So you incorporate more years of inflation for labor. Now you're getting a much bigger estimation of the cost of removal as a percentage of the dollars retired.

And -- and one of the ways that I look at it is if I put in $100 asset in 1970 and retire it today, that's $100, the asset gets retired, say it costs $50 to remove that asset. So we would have -- and you get no salvage value for it, you would have a net salvage estimate of minus 50, the $50 cost to remove that $100 asset.

Well, if we had that same $100 asset and didn't retire it until 2020, which is 20 years later, that's a -- it's now lived 50 years, the cost to remove that $100 asset might now be $75. So the net salvage component would be minus 75 for that asset.

So -- and the reason why I use that example is the fact that the retirements that have occurred over the last 20 years or so have averaged 24 years for mains. And we're going to expect that the retirements that occur are going to be over a longer period of time so there will be a higher rate of cost removal for those assets in place.

Q. And why have the assets been being retired earlier than they were originally --

A. Than the average?

Q. -- thought?

A. One of the reasons that have happened so far is there are other forces of retirement other than wear and tear. Some highway relocations or needs to improve the diameter of a main because there's another facility, you know, acquiring a new system or extending to -- growth in other areas.

And we have a line that would -- would have been a four-inch line that we now need to make an eight-inch line to make sure we serve all those customers, so we're retiring those 20- or 30-year mains prematurely and putting in a bigger main and the cost to remove those mains are less. So those are some of the reasons why you have a 24-year life.

Eventually you're going to also -- wear and tear is going to become a much bigger factor in your cause of retirement and that's when the average age will get closer and closer to 90.

Q. All right. And if the company were to expense those items that it actually retired on an annual basis as the Staff is suggesting here and began to ignore, I guess, for the time being the future costs of removal of the assets that are currently in place, the likely result of that would that be that the ratepayers today, because they would not be sharing in the cost of -- the full cost of the retirement of the assets that they're using, would pay less proportionately than the ratepayers of tomorrow will be asked to pay?

A. That's true. The ratepayers tomorrow will pay more than the ratepayers today for the same asset and the same service value of that asset.

Q. And I always have trouble seeing the value of cutting rates for today to pass them off on somebody else tomorrow. That doesn't seem like a fair rate-making procedure to me.

A. It doesn't to me, and that's why I performed studies in this manner. And that -- the idea is that everybody should pay their fair share of that asset.

And the only way to determine what that is is to put in place all the costs of that asset, which includes the installation of it as well as the removal of that asset. And then estimate the removal asset on a smooth process over the life of that asset and then everybody pays a fair amount from beginning to end. And that's the concept of my depreciation study.

Q. Now, I've heard expressed in the past that if the company never retires an asset but simply lets it sit in the ground, that the accrual method results in a windfall to the company. Can you tell me if that is true; or if not, why not?

A. Well, in the situation where there is no removal for a particular asset, if you let it just sit in the ground, yes, the company would gain from that. However, at a -- at some point you need to remove the main because you need to put a new main in there.

You can no longer -- with all the utilities in the same areas, at some point you must remove that. And there's always a cost to -- even to abandon a main. For instance, you'll have to go in and cut that main and send it off -- you know, send the water to another area or build another main in place. So there's always going to be some associated cost.

And at some point there will be too much in the ground for you to be able to put -- to serve all the people with the water that is necessary and you'll have to eventually pull that main out. And if you wait an extra 20 or 30 years, as we discussed, the cost to remove that main is going to be even greater than it would be if you do it at the time it's necessary and that main is being taken out of service.

Q. Okay. Let's suppose that we've done the accrual method through the whole life span of the piece of certain plant and the cost of retirement turns out to be substantially less than was accrued for the cost of retirement. Is there any kind of a true-up at that period in time?

A. Well, my first statement would be that we do these studies every three to five years to make sure that our estimates are sound. So we would make sure that as -- you know, a 50- or 60-year asset where we've monitored that the cost of removal of those assets seven or eight times over, you know, a 40-period of time. So we're going to make sure by doing that that we have a reasonable estimate.

In the situation where we have -- we might have gotten one asset incorrect, what happens is using the remaining life concept, the asset that was over-recovered, they'll have other assets that are under-recovered and so forth, still making sure you only recover the full amount of the assets. And that's -- that's what the accumulated depreciation shows us is to make sure that we only recover full -- full amount.

And we -- asset by asset gets corrected in that fashion. But a lot of it's being assured by the fact that you do a study every five years or so.

Q. And they are adjusted -- the rates are adjusted for -- the amount that is being depreciated for a particular asset is adjusted as a result of those studies if it's found to be inaccurate?

A. Yes. Not only the net salvage component, which is built into the accrual rate, but also the service life. So if -- each time you do a study, you will adjust those to better represent the assets that are in the ground historically as well as company plans. And then that will, you know, adjust your rate accordingly.

Q. Okay. I want to go back and pursue this because I know it's a problem where there is some concern over this area so I'd like to focus a little bit longer on this plant that is not removed when it's retired.

Do you know -- do you have any way of knowing whether we're talking about an occasional piece of plant that is left in the ground after retirement, or do you know if we're talking about that being a frequent occurrence? Do you know?

A. For a water utility I would say that it's frequent enough that there are assets that are left in the ground. Eventually they are taken out of the ground, but there are assets probably today that are in the ground that have been retired that down the road will be eventually removed because they will need that space to put new mains in depending on the growth or the reconfiguration of the system.

But, yes, you will find a time that those eventually get removed. But right now there probably is some in the ground that have been abandoned.

Q. So would it be your testimony that where the company does not remove an asset at the time of retirement, that it will eventually cost the company more to remove it than the company recovered during the depreciation of that asset?

A. If -- if the company abandons an asset today and doesn't remove it, it will cost them more when they eventually remove that asset.

However, my estimates take into consideration the fact that if they make their retirement, then that obviously -- and do not remove it, then my net salvage component is lower because of the fact they have these retirements that haven't occurred. So they would not be accruing a high percentage of those dollars until they actually make the removal. And then that will adjust their actual net salvage component.

Q. Okay. This stuff is so complicated and I'm getting confused now.

How do you adjust your net salvages if we're talking about a piece of plant that has been in place for a full service life? Under the current methodology, wouldn't the cost -- wouldn't the net salvage figure be included -- have been included in that accrued depreciation over those years?

A. Well, my estimation would have -- taking my historical analysis of dollars retired, if something's abandoned, they usually retire it in place. So those dollars of retirement have occurred.

The cost of removal has not occurred, so I have -- in building my net salvage component, I might estimate a net salvage component that is less negative than what would be in place of the assets that were physically retired and physically removed.

So that's how that accrual is more conservative than compared to the assets that actually come out of service and come out of the ground. So that's how -- and every three to five years when we do a study, we review that same scenario to see the percentage of the dollars retired versus the actual cost to remove those assets.

Q. So it would factor in your calculation of cost of removal of plant going forward? In other words, it would reduce your calculation of cost of removal?

A. With the example that you gave where there are assets that are abandoned, the net salvage percent on the level of cost removal that I'm anticipating is based on the degree of assets that have been retired and abandoned. So, yes, that net salvage is a conservative number as we go forward.

And if the trend continues at the way it is, we would keep the same net salvage component. If -- if the trend changes, then we would make an adjustment to our net salvage component and recover those amounts in depreciation expense.

Q. Okay. And if the company at some point removes the property 10 years after retirement, for example, the company doesn't recover anything for any additional costs of removal, does it?

A. No. It just -- it's continually built into the estimate that they had in place. Now, if there was a lot of that, then the net salvage component would change and you would have more cost of removal as a basis of the retirements.

Q. Okay.

A. And that judgment would be made every five years if you had a common occurrence of that.

Q. So that would be included in the study to show that costs of removal were higher?

A. Yes.

Q. Okay. I think I'm understanding. Let's see. I believe I have a couple of more questions.

COMMISSIONER MURRAY: Since I can't locate any specific questions right at the moment, I will pass this along to Commissioner Forbis or Commissioner Clayton.

JUDGE THOMPSON: Commissioner Forbis?

COMMISSIONER FORBIS: Just a couple.

QUESTIONS BY COMMISSIONER FORBIS:

Q. I wanted to make sure I understood something about -- on this issue of retiring assets before the life expectation has run its course. And you said that was -- they'd been retired because of a variety of reasons, growth, need larger mains, government makes you move because of roads or whatever. Okay. So when that happens, have those assets been fully depreciated or perhaps not?

A. In many cases if an asset is prematurely retired prior to the average, they would come out -- the retirement amounts would be the original cost. The amount that hits the reserve would be equal to the original cost so the rate base effect would be zero. However, they probably did not recover their full amount, that's correct.

So if you have $100 asset that you were expecting to live 50 years, in 20 years it gets retired, you would have -- for better ease, you would have recovered 40 percent of that investment. So in that particular case, other assets would compensate for that loss or under-recovery of that asset.

Q. Okay. Could you explain that last sentence?

Because that was going to be my next question, what does the company do to account for that loss in value because it didn't get the full -- other assets help cover that?

A. Other --

Q. How do you mean that?

A. For instance, we have $100 asset that's recovered. After 20 years, we've recovered $40 --

Q. Okay.

A. -- per se. But our retirement would be $100 to the reserve. So that means there is $60 that goes to the other $100 million of that investment in that account and that gets absorbed in the other asset so that you will have other assets that go beyond the average. Okay?

Because if you have an average of 50 and something goes out 20, there's got to be something that goes out beyond 50. And those assets are the ones that -- that would offset that under-recovery of that particular asset you have in place.

Q. Let me ask you a question. Since you state in your -- what am I reading here -- Rebuttal that it's a fairly dramatic -- so that average approach, that would normally work. But is the company in this case, since they are retiring some of these assets fairly quickly, actually losing money because of that? I mean, is it still working out on balance or is there, in fact, a net loss over this period where they've been -- the company has been retiring assets before they're expected to?

A. Under the remaining life concept, which is what I'm proposing, it guarantees you get full recovery. At certain points in time you -- you might be ahead or behind where you theoretically should be, assuming that you've used that same curve in net salvage component from day one. That's what that theoretical number is in place.

So at any point in time you might be ahead or behind the game and your rate incorporates whether you need to catch up or slow down based on that. And that's the concept of remaining life.

Q. That's why then you want to use that because the retirement time line, if you will, has been shorter than normal -- than was projected?

A. That's correct.

Q. Okay. I'll finish up my note in a minute.

The other question I wanted to ask you just quickly is on the life estimation issue, it seems to me -- is the debate there over choices of database? Is that the main question, what you use to calculate it? Can you help me understand?

A. There's a big -- in the amount that I differ from Staff there are --

Q. The $800,000 issue?

A. Yeah. Right.

Q. Okay.

A. The difference is two-fold. One, I incorporate different service lives that I have determined based on the seven Missouri-American districts that are part of this study. Staff has looked at the St. Louis County assets, developed lives for those assets and applied them to the Missouri-American districts.

Q. Okay.

A. Okay. So there's a difference there.

The second aspect is for non-mass accounts, which I view to be structures, a treatment plant, I view it as though you'll have some dispersion of retirement, the roof will go, windows will go, maybe some of the foundation and then at some point you will say we can no longer function at that particular facility, we're retiring that facility and that's a concurrent retirement. So everything that's left goes at one point.

That's called a life span procedure and that's what I've included in my rate. That includes an estimation of a retirement date in the future that I anticipate will happen and is built into my rate.

Without that, you're anticipating a retirement of that facility more so on an item-by-item basis and each year you'll have equal retirements or a certain percentage of retirement until there's nothing left. So there won't be a concurrent retirement date of the -- of a treatment plant. And that's -- those two components are what builds in the $800,000 difference between my estimates and Staff's.

Q.   Can you attribute the bulk of it to either part one or part two or is it --

A.   Well, for the mass accounts, which I think are big dollar mains, services and things of that nature, it is a service life issue. So I would say since those are the bigger dollars, you're probably seeing a higher percentage of that 800,000 related to the difference in estimating life of the assets.

Q.   Okay. Your sense is using the seven districts to calculate the estimate would be more accurate because --

A.   Yes.

Q.   -- it better reflects the specific assets you're talking about?

A.   That's correct.

Q.   I want to go back to the other question just for a second -- the other other question about this early retirement of assets and you want to use the remaining life concept. Using that then, whether -- sort of addresses the either over- or under-recovery?

A.   That's correct.

Q.   So your sense is that would be equally fair to the company and the ratepayers to go that way?

A. That's right. Because it smooths things out over the remaining life of those assets. So you're not continually making reserve variance true-ups or amortization true-ups that are occurring every time you do a study. You're spreading this difference over the remaining life of those assets, which could be 40 or 50 years it or could be 6 or 7 years depending on the remaining life of the assets.

Obviously the majority of these assets are long-lived assets so it's going to be smoothed out over a much longer period of time. And that's the -- in my mind, the reasonable and fair way to recover the overall assets of all these assets.

COMMISSIONER FORBIS: Okay. Thanks.

COMMISSIONER MURRAY: Judge, may I ask a follow-up?

JUDGE THOMPSON: Please.

FURTHER QUESTIONS BY COMMISSIONER MURRAY:

Q. I just wanted to clarify something on the difference in -- the value of the difference between company's position and Staff's position on the net salvage issue.

A. Okay.

Q. Would you look at page 10 of your Rebuttal Testimony? And maybe I'm not understanding what it is you're saying there, because it appears to me that there's a much greater difference than what you told me earlier.

A. Okay.

Q. The question at the top of the page, By what amount does the net salvage accrual exceed the net salvage cost currently? Wouldn't that be the difference?

MR. SCHWARZ: Question 16.

THE WITNESS: Yes. The -- I guess the first thing is my response is to the differences only related to the Missouri-American districts. And it related to the annual expense for those districts.

So in the case of my study, I'm proposing 6.2 million of annual depreciation expense. Staff is proposing 4.3 I believe is the -- is the number. So those differences are 1.7. And of that annual expense difference, that's where you get the components that I'm dealing with.

The number that you see there relates to St. Louis County and Jefferson City, which I'm not bringing into play.

COMMISSIONER MURRAY: Okay. All right. Thank you.

JUDGE THOMPSON: I think at this time we're going to recess for the day and we'll bring you back, put you on the stand at 8:30 tomorrow morning. You were planning to be here tomorrow anyway. Correct?

THE WITNESS: Yes.

JUDGE THOMPSON: We are recessed.

WHEREUPON, the hearing was adjourned until December 23, 2003 at 8:30 a.m.

I N D E X

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