Exhibit No.:	______________
Issue(s):	AAO Request/ Proposed Pilot Program/ Proposed Cost Treatment
Witness/Type of Exhibit:	Hyneman/Direct
Sponsoring Party:	Public Counsel
Case No.:	WU-2017-0296

DIRECT TESTIMONY

OF

CHARLES R. HYNEMAN

Submitted on Behalf of the Office of the Public Counsel

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WU-2017-0296

August 1, 2017

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of Missouri-American Water Company for an Accounting Order Concerning MAWC's Lead Service Line Replacement Program	)))))	File No. WU-2017-0296

AFFIDAVIT OF CHARLES R. HYNEMAN

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Charles R. Hyneman, of lawful age and being first duly sworn, deposes and states:

1. My name is Charles R. Hyneman. I am the Chief Public Utility Accountant for the Office of the Public Counsel.

2. Attached hereto and made a part hereof for all purposes is my direct testimony.

3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.

Charles R. Hyneman, C.P.A.
Chief Public Utility Accountant

Subscribed and sworn to me this 1st day of August 2017.

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

JERENE A. BUCKMAN
My Commission Expires
August 23, 2017
Cole County
Commission #13754037

Jerene A. Buckman
Notary Public

My Commission expires August 23, 2017.

TABLE OF CONTENTS

Testimony	Page
Introduction	1
Education and Experience	1
Executive Summary	2
MAWC's AAO Request	3
OPC'S Proposed Pilot Program	6
OPC'S Proposed Cost Treatment	6

DIRECT TESTIMONY

OF

CHARLES R. HYNEMAN
MISSOURI-AMERICAN WATER COMPANY

CASE NO. WU-2017-0296

Introduction

Q. Please state your name, title and business address.

A. Charles R. Hyneman, Chief Accountant, Office of the Public Counsel (OPC or Public Counsel), P.O. Box 2230, Jefferson City, Missouri 65102.

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

A. I am employed by the OPC as the Chief Accountant.

Q. What is the role of the Public Counsel?

A. The Public Counsel represents and protects the interests of the public in any proceeding before or on appeal from the Missouri Public Service Commission ("Commission").

Education and Experience

Q. Please describe your educational background.

A. I earned Associates in Applied Science (AAS) degree in Contracts Management from the Community College of the Air Force ("CCAF") at Wright-Patterson Air Force Base. I also earned Bachelor of Science degrees in Accounting and in Business Administration (dual major) from Indiana State University at Terre Haute. Finally, I earned an MBA from the University of Missouri at Columbia.

Q. Did you perform post-graduate work in the field of Finance for the University of Missouri?

A. Yes, I did.

Q. Are you a Certified Public Accountant ("CPA") licensed in the state of Missouri?

A. Yes.

Q. Are you a member of any professional Accounting organizations?

A. Yes. I am a member of the American Institute of Certified Public Accountants ("AICPA"). The AICPA represents CPAs and the accounting profession nationally regarding rule-making and standard-setting. The AICPA established accountancy as a profession and developed its educational requirements, professional standards, code of professional ethics, licensing status, and its commitment to serve the public interest.

Q. Please summarize your professional experience in the field of utility regulation.

A. My professional experience in accounting and auditing began in April 1993 when I began my employment with the Staff of the Missouri Public Service Commission ("Staff"). As a Staff regulatory auditor and auditing manager of the Commission's Kansas City satellite Auditing office from 1993 to 2015, I participated in many different types of regulatory proceedings involving all major electric, gas, and water utilities operating in the state of Missouri. I left the Staff in November 2015 when I joined the OPC.

<u>Executive Summary</u>

Q. Summarize OPC's position.

A. OPC opposes the company's requested relief, but proposes an alternative pilot program related to the replacement of customer-owned lead service lines. OPC witness Dr. Geoff Marke includes in his direct testimony a recommendation to reject the company's requested AAO and instead consider a pilot program within the context of MAWC's pending rate case to study the feasibility, implementation and policy implications of a program to replace customer-owned lead service lines. My direct testimony outlines OPC's proposed accounting treatment for expenses related to OPC's proposed pilot program if it is considered in the rate case.

<u>MAWC's AAO Request</u>

Q. Please summarize MAWC's AAO request in this case.

A. On May 12, 2017, MAWC filed its *Application and Motion for Waiver* "concerning the accounting for MAWC's lead service line replacement program".[1] Specifically, MAWC seeks an accounting authority order ("AAO") containing the following language:

> a) That Missouri-American Water Company is granted an Accounting Authority Order whereby the Company is authorized to record and defer on its books a regulatory asset that represents the cost of all customer-owned lead service line replacements made beginning in 2017 and to calculate a monthly carrying charge on the balance in that regulatory asset account equal to the weighted average cost of capital from the Company's last general rate case for use with the Infrastructure Replacement Surcharge, whether established by agreement or in accordance with Section 393.1006.4, RSMo; and,
>
> b) That MAWC may defer and maintain this regulatory asset on its books until the effective date of the Report and Order in MAWC's next general rate proceeding.
>
> c) This regulatory asset will remain in place until all eligible costs are amortized and recovered in rates.[2]

Q. What is an AAO?

A. An AAO is simply an order by the Commission that allows a utility to deviate from the Commission's normal accounting requirements and also deviate from the accounting requirements of generally accepted accounting principles ("GAAP"). Typically an AAO allows a utility to defer expenses as a deferred debit or a regulatory asset and allows the utility an opportunity to address these deferred expenses in a future rate case, if necessary.

[1] MAWC's Application, Doc. No. 1, p. 1.
[2] MAWC's Application, Doc. No. 1, p. 5.

For water utilities, the Commission's normal accounting requirements are found in 4 CSR 240-50.030(1) where the Commission prescribed and ordered the adoption of the uniform system of accounts ("USOA") for Class A water companies, issued by the National Association of Regulatory Utility Commissioners in 1973, as revised July 1976 ("NARUC USOA") for all Missouri water companies.

Q. As opposed to an electric or natural gas distribution company, can a water utility in Missouri create a regulatory asset based on the actions of the Commission in an AAO case?

A. No. I am not aware of any provision in the NARUC USOA for a water company to record a regulatory asset. There is a provision, however, for a water utility to record deferred expenses in Account 186, Miscellaneous Deferred Debits. In contrast, the Federal Energy Regulatory Commission ("FERC") USOA for electric and natural gas utilities includes an account 182.3, which allows for the creation of a regulatory asset.

If the electric or natural gas utility management (and not the Commission) makes an independent determination that the expenses deferred under an AAO are probable of rate recovery, they can record the deferral as a regulatory asset. Otherwise, the deferred costs are included along with other miscellaneous deferred debits on the utility balance sheet.

Q. Is the essence of the difference between a regulatory asset and a deferred debit the "probability" or rate recovery?

A. Yes.

Q. Has the Commission restricted AAOs to costs that have certain characteristics?

A. Yes. Traditionally, the Commission, by granting an AAO, recognizes that certain costs incurred by a utility were extraordinary (unusual in nature and infrequent in occurrence). Materiality of the costs to annual reported earnings is also a factor considered by the

Commission in AAO cases. The "rule of thumb" used by the Commission in past AAO cases was that the extraordinary costs must be at least 5 percent of net income of the period. Otherwise the cost was not considered material. The Commission has said when evaluating AAO applications, the "initial inquiry is whether the costs sought to be deferred are indeed extraordinary. If they are not, the inquiry is at an end, and the other questions are moot."[3]

In orders regarding AAO's the Commission permits a company to defer costs but does not grant ratemaking treatment. The Missouri Court of Appeals has summarized the purpose of an AAO: "The whole idea of AAOs is to defer a final decision on current extraordinary costs until a rate case is in order."(*Missouri Gas Energy v. PSC*, 978 S.W.2d 434, 438 (Mo. App. W.D. 1998).

Q. Does MAWC's request for an AAO seek ratemaking treatment for the costs at issue in this case?

A. Yes, and this is not appropriate. MAWC is not only asking for an accounting order, but is also seeking ratemaking treatment by asking that the regulatory asset "remain in place until all eligible costs are amortized and recovered in rates." The request by the company runs counter to longstanding Commission practice and the guidance from Missouri Courts by seeking a ratemaking decision outside of a general rate case.

Furthermore, the company has not demonstrated that the costs it seeks to defer (and recover) are extraordinary and eligible for an AAO. Based on those factors, OPC does not support MAWC's proposed AAO.

Q. Based on your experience with AAO cases, is it typical or even appropriate for a utility to seek an AAO from the Commission when that utility has an existing rate case?

---

[3] *In the Matter of the Joint Application of Missouri-American Water Company, St. Louis County Water Company, d/b/a Missouri-American Water Company, and Jefferson City Water Works Company, d/b/a Missouri-American Water Company, for an Accounting Authority Order Relating to Security Costs*, Case No. WO-2002-273, Report and Order on Remand, p. 39.

A. No. It is highly unusual and potentially even unprecedented. I believe the reason it is highly unusual is that it just makes no sense to file for an AAO in the middle of a rate case.

Q. Please explain why it makes no sense for a utility to seek an AAO while it has a pending rate case?

A. The only possible actions the Commission can take in an AAO case is to deny the request or grant the utility the requested accounting order. The accounting order will only allow for the deferral of certain extraordinary expenses incurred outside of a rate case test year for potential consideration in a future rate case. Importantly, there is no assurance of future rate recovery. In a rate case, however, the Commission can not only grant accounting authority, but it can also order specific ratemaking treatment. If the company's ultimate goal is to recover costs the request should be made in a rate case.

<u>OPC'S Proposed Pilot Program</u>

Q. What is OPC's proposed pilot program?

A. Essentially, OPC's proposal is for MAWC and other regulatory stakeholders to study the feasibility, implementation and policy implications of a program to replace customer-owned lead service lines. The proposal is detailed in OPC witness Geoff Marke direct testimony.

<u>OPC'S Proposed Cost Treatment</u>

Q. How does OPC propose the costs associated with the pilot program be treated?

A. First, the company would withdraw its AAO request and pursue the pilot program within the pending rate case. Then, if approved by the Commission, MAWC would conduct the pilot program proposed by OPC. During the pilot program, for a maximum period of 2 years (beginning with the date of a Commission order approving the pilot program), MAWC may defer prudent and reasonable construction costs spent replacing customer-owned lead service lines as well as prudent and reasonable third-party administrative costs of the pilot program to NARUC Class A USOA Account 186 Miscellaneous Deferred Debits. The amounts booked shall not exceed four (4) million dollars per year. In MAWC's current and future rate cases MAWC may seek recovery of these Account 186 deferred program costs.

The financing cost component of the program costs to be charged to Account 186 will be at American Water Works Company's ("AWWC") current short term debt rate. When seeking recovery in rate cases, MAWC will propose the balance of Account 186 be amortized over an accelerated period of 10 years with no rate base treatment of the deferred program costs.

Amortization of the deferred program costs begins immediately upon a Commission order approving the pilot program in this rate case. Upon the conclusion of the pilot program or 2 years after a Commission order authorizing the pilot program, MAWC shall immediately cease booking costs into Account 186 for this purpose. Any outside funding received (federal grants, etc.) shall be used to offset the Account 186 balance.

Q. Does this cost treatment provide greater certainty of cost recovery for MAWC than an AAO?

A. Yes. An AAO merely permits the company to defer costs from one period to another. No ratemaking treatment is given to those costs and whenever the utility may seek to recover the deferred costs in a rate case, recovery is often challenged by various parties.

OPC's proposal would have the company withdraw its AAO request and give cost treatment for a pilot program within MAWC's pending rate case. Doing so would assure that MAWC is able to include the cost of the pilot program in rates – a significant benefit to the utility.

Q. Explain why the financing cost should be at AWWC's short term debt rate.

A. First, it is my understanding that MAWC does not issue its own debt. Therefore, it is appropriate to use the debt rate of its parent company, AWWC. Second, the short term debt rate is appropriate because this is a pilot program lasting only two years. Using the short term debt rate will permit the company to recover its capital costs to replace the customer-owned service lines. This rate is further appropriate because OPC proposes to give MAWC rapid recovery over a 10 year period when the life of these service lines is likely much longer.

In proposing the foregoing treatment, OPC looked at similar treatment ordered by the Commission in Kansas City Power & Light Company ("KCPL") rate case No. ER-2007-0291. The issue faced by the Commission was to determine the appropriate financing rate on the level of excess off-system sales revenues KCPL received under its Experimental Regulatory Plan. The Commission selected a short-term debt interest rate and no rate base treatment as the appropriate financing cost and ratemaking treatment for this utility experimental regulatory plan.

Q. Is the short-term debt financing OPC is recommending for this MAWC project the same type of project financing KCPL proposed to the Commission for its Experimental Regulatory Plan off-system sales issue in its 2007 rate case?

A. Yes. It was recommended by KCPL and adopted and ordered by the Commission. The Commission specifically adopted the KCPL proposed short-term debt financing rate as its preferred method to balance the interests of utility shareholders and utility ratepayers.

> **In short, in balancing the interests of shareholders and ratepayers,** straying from KCPL's recommended 25th percentile might benefit ratepayers some, but might also damage KCPL much, much more than any benefit that might accrue to ratepayers. The Commission will adopt KCPL's position…. (emphasis added)

> KCPL shall pay a short-term interest rate of LIBOR plus 32 basis points on all margin amounts exceeding the 25% level, with the interest paid not charged to ratepayers in cost of service.
>
> [ER-2007-0291 Commission Report and Order page 39].

Q. Summarize the reasons OPC is recommending a short-term interest rate as the rate to compensate MAWC's financing costs in this lead service line replacement pilot program.

A. The reasons are listed below:

> 1) This is an experimental or pilot program for MAWC. The Commission determined this method was appropriate under an experimental type program for KCPL
>
> 2) The Commission determined that this method was fair to both KCPL's shareholders and KCPL's ratepayers. Therefore, this treatment would be fair to apply in MAWC's case.
>
> 3) This method allows for recovery of debt cost financing only and does not allow MAWC's shareholders to profit on a safety-only pilot project.

Q. Does this conclude your direct testimony?

A. Yes, it does.