

*Exhibit No.:*

*Issue:* Algonquin's Proposed  
"Unrecorded Plant"

*Witness:* Cary G. Featherstone

*Sponsoring Party:* MoPSC Staff

*Type of Exhibit:* Surrebuttal Testimony

*Case Nos.:* WR-2006-0425 and  
SR-2006-0426 (consolidated)

*Date Testimony Prepared:* January 12, 2007

**MISSOURI PUBLIC SERVICE COMMISSION**

**UTILITY SERVICES DIVISION**

**SURREBUTTAL TESTIMONY**

**OF**

**CARY G. FEATHERSTONE**

**FILED<sup>2</sup>**

FEB 08 2007

Missouri Public  
Service Commission

**ALGONQUIN WATER RESOURCES OF MISSOURI, LLC**

**CASE NOS. WR-2006-0425 and SR-2006-0426**

**(Consolidated)**

*Jefferson City, Missouri  
January 2007*

STAFF Exhibit No. 26  
Case No(s) WR-2006-0425  
Date 1-22-07 Rptr KF

**BEFORE THE PUBLIC SERVICE COMMISSION**  
**OF THE STATE OF MISSOURI**

In the Matter of the Tariff Filing Algonquin Water )  
Resources of Missouri, LLC to Implement a )  
General Rate Increase for Water and Sewer Service )  
Provided to Customers in Its Missouri Service )  
Areas. )

Case No. WR-2006-0425

AFFIDAVIT OF CARY G. FEATHERSTONE

STATE OF MISSOURI       )  
                                      )     ss.  
COUNTY OF COLE        )

Cary G. Featherstone, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Surrebuttal Testimony in question and answer form, consisting of 12 pages to be presented in the above case; that the answers in the foregoing Surrebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

  
Cary G. Featherstone

Subscribed and sworn to before me this 10th day of January 20 07.

  
Notary Public



ASHLEY M. HARRISON  
My Commission Expires  
August 31, 2010  
Cole County  
Commission #06898978

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**CARY G. FEATHERSTONE**

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1 adjustments as “unrecorded plant.” Specifically, I will respond to Mr. Loos’ Rebuttal  
2 Testimony appearing at pages 14 through 19 on the subject of “unrecorded plant.”

3 **EXECUTIVE SUMMARY**

4 Q. Please summarize your testimony.

5 A. Algonquin is proposing a unique adjustment to its books and records, in order  
6 to reflect plant investment it claims should have been included on the books and records of  
7 Silverleaf, the previous owner of the three Missouri utility properties. This “unrecorded  
8 plant” adjustment is a new concept that is novel in the realm of utility regulation. It is a term  
9 that Algonquin has coined for purposes of this case.

10 Algonquin believes this was an oversight of Silverleaf, which resulted from sloppy  
11 accounting for plant investments that were made before Silverleaf received its certificate to  
12 operate as a public utility in this state. Silverleaf never recognized this investment on its  
13 books, and never requested ratemaking treatment for this property, but Algonquin claims that  
14 it discovered this accounting error long after it took ownership of the Silverleaf utility  
15 operations.

16 Staff does not agree with Algonquin’s position regarding “unrecorded plant.” Staff  
17 believes that Silverleaf kept its records correctly and accounted for its investment in the  
18 “unrecorded plant” as part of its resort operations. Silverleaf identified the plant investments  
19 relating to pre-1994 costs as resort property and recovered them as part of the sale of the  
20 resort operations through time shares, condominiums and private residential lots.

21 Algonquin’s proposed adjustment for “unrecorded plant” is nothing more than  
22 estimates that are completely unsubstantiated and unsupported by any documented evidence.  
23 This plant estimate process has no relationship to actual costs, which are substantiated by the

1 typical documentation of construction projects, such as the contracts, invoices and purchase  
2 orders that would constitute evidence of the actual dollar amount that it took to design,  
3 construct and install this property. The Company's estimation process to determine the  
4 "unrecorded plant," for which it desires rate base treatment, completely ignores the reality of  
5 how water and sewer systems are typically constructed. Customarily, a substantial portion of  
6 the costs to design, construct and install these systems is contributed by the developers who  
7 create the need for the utility plant investment.

8 **ALGONQUIN'S PROPOSED "UNRECORDED PLANT"**

9 Q. At page 14 of his Rebuttal Testimony, Mr. Loos identifies two areas that he  
10 terms as "fundamental issues" with regard to plant. Does Algonquin's Rebuttal Testimony  
11 change the Staff position regarding the Company's proposed "unrecorded" adjustments to  
12 plant?

13 A. No. As indicated in my Rebuttal Testimony, these adjustments are  
14 inappropriate and should not be included in Algonquin's rate base to establish rates in this  
15 case.

16 At page 14 of his Rebuttal Testimony, Mr. Loos states that the two fundamental issues  
17 regarding plant are:

- 18 1. What criteria should be used to determine plant in service and  
19 rate base value?
- 20 2. Should the Company's books and rate base reflect plant  
21 installed prior to 1993 but not recorded on Silverleaf's books?

22 The issue surrounding Algonquin's proposal to adjust its plant investment to include  
23 property that it claims Silverleaf should have included in plant-in-service accounts for pre-  
24 1994 investments relates to how Silverleaf treated that property for its resort operations.

1       The fundamental issue between Algonquin and Staff regarding the proper treatment of  
2 plant investment is that Algonquin believes it is entitled to account for plant that Silverleaf  
3 never recognized as utility property, either on Silverleaf's books or for ratemaking purposes.  
4 Staff, on the other hand, believes that Silverleaf viewed the plant investments in question as  
5 resort property for land and infrastructure improvement, and that it therefore determined that  
6 the costs relating to this plant investment were part of its resort operations.

7       Q.     How did Algonquin develop its proposed "unrecorded" adjustments to plant?

8       A.     The Company estimated the costs relating to this "unrecorded plant" using a  
9 technique that could best be described as a process of estimation. Algonquin identified the  
10 approximate amount of material needed to construct a water and sewer system and then  
11 estimated what the costs for the material and installation might have been -- many years ago --  
12 in order to determine these estimated costs. From these estimates, the Company proposed its  
13 "unrecorded plant" adjustment for pre-1994 property. It made a retrospective guess about  
14 what it might have cost to construct a hypothetical plant many years ago.

15       Q.     Has the Commission had experience with this type of an approach in  
16 developing estimated plant costs?

17       A.     Yes. The process Algonquin used to make its "unrecorded plant" adjustment is  
18 really nothing more than the feasibility studies that companies use to present information to  
19 the Commission for certification cases. Utility companies develop estimates to construct and  
20 operate utility systems and present those findings to the Commission in the certificate  
21 applications. These feasibility studies are only projections of what the utility systems are  
22 expected or projected to cost at completion. Typically, the company makes projections of  
23 what its operating costs and revenues will be, to show that the new operating system will be

1 profitable. At some point after the operations are established, an audit is performed to  
2 determine what costs were actually incurred to construct and maintain the utility operations,  
3 and to see what revenues were actually received for the new service.

4 Algonquin has taken the same approach to identify its proposed "unrecorded plant"  
5 adjustments that is used for developing feasibility studies. The key difference in how these  
6 feasibility studies are used is that Algonquin does not propose to ever update its estimate of  
7 the costs relating to its proposed "unrecorded plant" adjustment. The proposed "unrecorded  
8 plant" adjustment is a permanent adjustment that the Company wants reflected on its books  
9 and used for rate determination in this case, as well as in future rate cases.

10 Q. Can Algonquin update its proposed "unrecorded plant" adjustment?

11 A. No. Unlike the feasibility studies that use projections and estimates for the  
12 certificate applications that ultimately get updated with actual costs and revenues, it is not  
13 possible to ever update Algonquin's proposed "unrecorded plant" adjustment with actual  
14 costs. The actual costs to construct this plant that Silverleaf treated as resort property were  
15 incurred over twenty years ago. It is not possible to track these costs to actuals because  
16 Silverleaf long ago made the decision not to treat these costs as utility property.

17 Q. Why does Algonquin believe it is necessary to make an adjustment to reflect  
18 "unrecorded plant" on its books?

19 A. Mr. Loos indicates at page 14 of his Rebuttal Testimony that the problem was  
20 that "the books and records that were maintained by Silverleaf leave a lot to be desired."  
21 While Mr. Loos did not elaborate on the exact problem with Silverleaf's books, it can be  
22 assumed that he was criticizing the previous owner's ability to maintain sufficient plant  
23 records for the utility to fully identify all of the plant investment. However, Algonquin

1 presents no evidence and has absolutely no support of any kind that this plant was anything  
2 other than resort property that Silverleaf installed as part of its development costs. Silverleaf  
3 also did not present any evidence in the previous sale case, Case No. WO-2005-0206, that this  
4 property should be treated as utility plant investment. Algonquin could not have provided any  
5 evidence in the sale case because Algonquin was not even aware of this "unrecorded plant" at  
6 the time the Company acquired the three Missouri utility properties.

7 In fact, Silverleaf itself never presented evidence that its plant investment was ever  
8 understated, and made no proposed adjustments to reflect this understatement in its books and  
9 records. Indeed, Silverleaf never asserted that its utility property was understated and never  
10 asked Staff to consider such in any of its previous rate cases.

11 Q. Could Algonquin have known that the Silverleaf plant records were  
12 understated?

13 A. No. The Company did not "discover" that the Silverleaf books did not reflect  
14 the need for the "unrecorded plant" adjustments until December 2005, several months after it  
15 acquired the property from Silverleaf. Staff submitted Data Request No. 7 to the Company,  
16 asking when it first had the opinion that "the Missouri utilities contained plant not recorded on  
17 the utility books of Silverleaf." Algonquin's response to this data request stated that  
18 "Mr. Loos initially informed Algonquin of the fact that available accounting information did  
19 not reflect consideration of the "unrecorded plant" in December 2005."

20 In fact, the purchase agreement between Silverleaf and Algonquin was dated  
21 August 29, 2004, 16 months before the Company became aware of the alleged "unrecorded  
22 plant" issue. In other words, Algonquin could not have known at the time it was making its

1 | proposal to acquire the Silverleaf property in the summer of 2004 that the property balances  
2 | were understated on Silverleaf's books.

3 | Q. What is the main difference between Algonquin's approach to determine its  
4 | proposed "unrecorded plant" adjustment and the approach Staff took in developing its plant  
5 | adjustments?

6 | A. As described above, Algonquin estimated an amount that it believes should  
7 | have been reflected on Silverleaf's books, but wasn't. On the other hand, Staff examined the  
8 | actual records of Silverleaf and relied on documented evidence of what plant amount  
9 | Silverleaf maintained on its books as actual and legitimate utility operations. To the extent  
10 | that Silverleaf, which operated the utility for over 20 years before Algonquin purchased that  
11 | property in August 2005, did not assert that this plant investment was legitimate utility assets,  
12 | it is extremely difficult to comprehend that Algonquin can make such a claim 20 years after  
13 | such plant was supposed to have been installed by the previous owner, Silverleaf.

14 | Q. Why did Silverleaf not reflect the plant investment on its books?

15 | A. To the extent that Silverleaf did not identify this property as utility operations,  
16 | Silverleaf treated this property as resort operations property. Silverleaf did not reflect the  
17 | plant investment in question on Silverleaf's books because Silverleaf viewed the plant as  
18 | resort property and not utility property. If Silverleaf considered it to be utility property, then  
19 | it would have booked it as such. One must remember that Silverleaf was not an  
20 | unsophisticated business entity. It was then, and continues to be today, a large business with  
21 | an impressive resort community located in three locations in Missouri and many other states.  
22 | As an on-going business concern, Silverleaf was used to dealing with construction projects  
23 | and having systems in place to track construction costs. Silverleaf used these costs to

1 determine the proper amount to charge its resort customers for private residential lots, time  
2 shares and condominiums.

3 Q. Does Algonquin agree with this explanation?

4 A. No. Algonquin seems to imply in its testimony about the need for its proposed  
5 "unrecorded plant" adjustment that if the plant investment was not included on Silverleaf's  
6 books and records, then this was due to poor accounting records or an oversight on  
7 Silverleaf's part. From this, Algonquin appears to also believe that, to the extent that the plant  
8 investment was not included on Silverleaf's books, this plant investment was somehow  
9 understated. Further, to complete Algonquin's logic on this subject, if Silverleaf did not  
10 reflect amounts on its books and, therefore, the plant was understated then Algonquin's books  
11 must also be understated; thus, there was a need for the proposed "unrecorded plant"  
12 adjustment. However, the flaw in this approach is that, to the extent that Silverleaf's books  
13 were actually understated (which Staff does not agree with), Algonquin would have only  
14 paid for the actual assets on the Silverleaf books at the time of Algonquin's review of the  
15 transaction.

16 Q. Did Silverleaf recover the costs to construct the infrastructure at its resorts?

17 A. One must assume that, as a sophisticated resort operator, Silverleaf was able to  
18 properly identify its costs, including the land improvements and infrastructure costs such as  
19 the construction of utility services, and to determine the price it needed to charge its resort  
20 customers to properly recover its necessary costs. In order to stay in business over the long  
21 term, Silverleaf would have to not only recover the cost of doing resort business but these  
22 operations would also have to show a profit for Silverleaf's owners.

23 Q. What are the costs for which Algonquin now requests rate recovery?

1           A.     Staff believes the costs relating to unrecorded plant are developer costs that  
2 Silverleaf incurred during the build-out of the Silverleaf resort in the 1980s. A developer of  
3 resort property, like Silverleaf, incurs various costs to develop land for either sale for  
4 residential use or for the sale of time shares and condominiums. The actual cost of the land  
5 itself is a major cost. But there are other costs for land improvements, such as site preparation  
6 for excavation, curbing, streets, and all utility services, including piping of water and sewer  
7 systems. Since Silverleaf was not certificated as a public utility prior to 1994, the only place  
8 it could recover its substantial investment in the water and sewer systems was through the sale  
9 of resort property, through time shares, condominiums, and the private residences.

10           Silverleaf, just like any other developer, had to have a means to recover the investment  
11 it made to develop these resort properties. Businesses will not stay in business long if they  
12 cannot pass their actual costs on to their customers, in this case, the resort and time share  
13 customers. The very costs that Mr. Loos and Algonquin are trying to include in this case as  
14 rate base investment were never treated as utility property by Silverleaf Resorts. Silverleaf,  
15 many years ago, during the development of these resorts recovered its investment through the  
16 sale of the time shares and other resort property. Silverleaf, many years ago, recovered these  
17 costs from the owners who purchased the time shares and private residences. If Algonquin's  
18 "unrecorded plant" proposal is adopted in this case, Algonquin would recover these  
19 development costs again, from customers paying utility rates. Clearly, the plant investment  
20 that Silverleaf made prior to certification as a public utility was treated as development costs  
21 and was correctly not excluded from its utility property records. Algonquin did not pay for  
22 this contributed plant and should not now include any of those amounts in its utility property

1 records. This contributed plant should certainly not be allowed in rate base and included in  
2 the determination of rates in this case.

3 Q. Mr. Loos identifies what he believes to be "a more definitive method to  
4 determine the original cost balance" in his Rebuttal Testimony, at page 18. Do you any  
5 comments regarding this method?

6 A. Yes. Mr. Loos describes a method that he thinks may be the definitive way to  
7 determine plant in service, by developing "a complete inventory of all facilities owned by  
8 Algonquin that are used to provide service" to its utility customers. He further explains that  
9 "once this inventory is developed, its cost can be developed at current levels and then restated  
10 to reflect cost levels at the time the property was originally installed." However, the method  
11 Mr. Loos described in his Rebuttal Testimony is not unlike what Algonquin attempted to do  
12 in developing its proposed "unrecorded plant" adjustment. While a physical inventory of  
13 plant was not taken, Algonquin restated the costs of the estimated plant investment Mr. Loos  
14 determined from maps of the resort property supplied by Silverleaf. Once the estimate of  
15 plant investment was determined, Mr. Loos "restated" the costs to what he purports to be the  
16 time the plant was originally installed. However, Algonquin has no actual knowledge or idea  
17 when this so-called utility plant was installed, or about how it was treated on Silverleaf's  
18 books and records, much less what the original costs of this alleged plant were.

19 Q. Algonquin concludes that the definitive method to identify plant is  
20 unnecessary. Do you agree?

21 A. Yes. Mr. Loos concludes that it is not necessary to use the definitive approach  
22 as he does "not believe the benefits of such a study are sufficient to justify its cost." Staff  
23 agrees that such a study is unnecessary. Staff believes that this definitive study identified in

1 Mr. Loos' Rebuttal Testimony would not prove any more than the analysis Algonquin is  
2 relying on in this case. As noted above, the two analyses are very similar and would still be  
3 nothing more than estimates of the plant investment the Company alleges should be  
4 recognized as utility property. Staff believes the definitive study described at pages 18 and 19  
5 of Mr. Loos' Rebuttal Testimony would have the exact same flaws as the analysis he  
6 performed for this case. This so-called definitive study would not be supported by  
7 documented evidence of plant costs, but would have to rely on estimates and projections, both  
8 in material and material costs. It would also have to rely on projections of what labor costs  
9 would have been incurred to construct this plant. Whomever performs such a study would  
10 also have to guess when this so called plant investment was installed. Staff agrees with  
11 Algonquin that performing this analysis would not be a worthwhile exercise of time and  
12 money. Even after the analysis would be complete, it still would not address the fundamental  
13 issue between the Company and Staff, which is that Silverleaf constructed this property as  
14 part of its resort operations and included the construction costs in the prices of the time shares,  
15 condominiums and private residences.

16 Q. At page 19 of his Rebuttal Testimony, Mr. Loos describes the contribution in  
17 aid of construction adjustment as "phantom CIAC." What does this mean?

18 A. The dictionary defines the word "phantom" as 1. "something apparently seen,  
19 heard, or sensed, but having no physical reality; ghost; specter. 2. An image that appears only  
20 in the mind. -- adj. Unreal; ghostlike" It is ironic that Algonquin refers to CIAC as  
21 "phantom," even though there is explicit and real language about CIAC in the Silverleaf  
22 tariffs that Algonquin adopted when the Commission approved the acquisition of the three  
23 Missouri utility properties. It is even more ironic that Algonquin uses the word "phantom" to

1 describe CIAC, when "phantom" could more aptly describe the Company's alleged  
2 "unrecorded plant" proposal. Indeed, there is "no physical reality" to the "unrecorded plant"  
3 adjustment Algonquin is proposing rate base treatment. Silverleaf did not physically  
4 recognize on its books and records any amount for "unrecorded plant"; yet Algonquin refuses  
5 to accept this fact and "imputes" a substantial amount in its rate base, as though it was an  
6 oversight on the part of the previous owner. One could refer to Algonquin's "unrecorded  
7 plant" as the "phantom unrecorded plant adjustment."

8 Further, Mr. Loos states at page 19 of his Rebuttal Testimony that "Staff's imputation  
9 is based on no definitive data." That is precisely the criticism relating to Algonquin's  
10 "phantom unrecorded plant adjustment"-- there is absolutely "no definitive data" to support in  
11 any manner this plant adjustment.

12 Q. Does this conclude your Surrebuttal Testimony?

13 A. Yes.  
14