Exhibit No.: _____
Issue(s): Acquisition/
Rate Base Valuation/
North Jefferson City Assets
Witness/Type of Exhibit: Robertson/Rebuttal
Sponsoring Party: Public Counsel
Case No.: WR-2011-0337

REBUTTAL TESTIMONY

OF

TED ROBERTSON

Submitted on Behalf of the Office of the Public Counsel

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2011-0337

****** ******

Denotes Highly Confidential information that has been redacted

January 19, 2012

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BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri-American Water Company's Request for Authority to Implement a General Rate Increase for Water and Sewer Service Provided in Missouri Service Areas.	)))))	Case Nos. WR-2011-0337 SR-2011-0338

AFFIDAVIT OF TED ROBERTSON

STATE OF MISSOURI)
) **ss**
COUNTY OF COLE)

Ted Robertson, of lawful age and being first duly sworn, deposes and states:

1. My name is Ted Robertson. 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 rebuttal 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.

Ted Robertson, C.P.A.
Chief Public Utility Accountant

Subscribed and sworn to me this 19th day of January 2012.

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

JERENE A. BUCKMAN
My Commission Expires
August 23, 2013
Cole County
Commission #09754037

Jerene A. Buckman
Notary Public

My Commission expires August 23, 2013.

TABLE OF CONTENTS

Testimony	Page
Introduction	1
Purpose of Testimony	1
Acquisition/Rate Base Valuation	1
North Jefferson City Assets	25

REBUTTAL TESTIMONY
OF
TED ROBERTSON

MISSOURI AMERICAN WATER COMPANY
CASE NO. WR-2011-0337

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Ted Robertson, P. O. Box 2230, Jefferson City, Missouri 65102.

Q. ARE YOU THE SAME TED ROBERTSON THAT HAS PREVIOUSLY FILED DIRECT TESTIMONY IN THIS CASE?

A. Yes.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of this rebuttal testimony is to address, in more detail, the Public Counsel's position regarding the rate base valuation and ratemaking treatment of the acquisitions of the Loma Linda Water Company (Loma Linda) in Case No. WO-2011-0015, Aqua Missouri, Inc./Aqua Development, Inc. & Aqua/RU Inc. (Aqua) in WO-2011-0168 and Roark Water and Sewer , Inc. (Roark) in Case No. WO-2011-0213.

III. ACQUISITION/RATE BASE VALUATION

Q. WHAT IS THE ISSUE?

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A. The issue concerns what is the amount of rate base that should be included in the development of rates, in the instant case, for each of the aforementioned acquisitions. In my Direct Testimony I identified for the Commission that each acquisition resulted in an acquisition adjustment which should be properly reflected in the valuation of the individual acquisition's assets for ratemaking purposes.

Q. PLEASE EXPLAIN WHAT IS MEANT BY THE ACCOUNTING TERM "ACQUISITION ADJUSTMENT."

A. In traditional accounting, fixed assets, such as plant, are usually recorded at "original cost." Original cost, as applied to utility plant, means the cost of property to the utility first devoting it to public service; thus, an acquisition adjustment refers to an amount paid for an entity, in excess of or below net book value, by the acquiring company. Net book value is the original cost of the property when the property is first placed in public service minus depreciation, contributions in aid of construction, etc. If the buyer pays more than net book value for the acquired entity, the acquisition adjustment is recognized as an acquisition premium. If it pays less than net book value for the acquired entity, the acquisition adjustment is recognized as an acquisition discount. An acquisition adjustment does not represent a contribution of capital (i.e., neither cash or new investment) to the public service. It merely represents a purchase of the legal interests in the properties that were possessed by the seller.

Q. IN YOUR DIRECT TESTIMONY YOU STATED THAT THERE APPEARED TO BE SOME INCONSISTENCY CONCERNING THE BOOK VALUE OF THE AQUA ASSETS ACQUIRED. HAS COMPANY PROVIDED ADDITIONAL INFORMATION THAT SHOULD HELP TO RESOLVE THIS ISSUE?

A. Yes. Company provided a response to OPC Data Request No. 1132 which it later revised on or about December 12, 2011. The revised response provided a detailed reconciliation of the acquisition's rate base and the Company's purchase price.

Q. DID THE AQUA PURCASE RESULT IN AN ACQUISITION ADJUSTMENT?

A. Yes. Based on my review of the information provided by MAWC, I believe that Aqua's net book value was ** ** at the closing date of the transaction. This amount does not include costs associated with ** ** identified in the response which I believe are not rate base items. Thus, the transaction resulted not in an acquisition discount, which I discussed as possible in Direct Testimony, but instead in an acquisition premium of ** **.

Q. IS THE COMPANY REQUESTING A "RETURN ON" AND "RETURN OF" THE PURCHASE PRICE OF THE LOMA LINDA AND AQUA ACQUISITIONS?

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A. Yes. Both acquisitions resulted in an acquisition premium (i.e., the purchase price was higher than the net book value of the assets acquired). Company seeks to include the higher purchase price in the development of rates in the instant case.

Q. IS THE COMPANY REQUESTING A "RETURN ON" AND "RETURN OF" THE PURCHASE PRICE OF THE ROARK ACQUISITION?

A. No. This acquisition resulted in an acquisition discount (i.e., the purchase price was lower than the net book value of the assets acquired). Company seeks to include the higher net book value in the development of rates.

Q. DOES PUBLIC COUNSEL BELIEVE THAT RECOVERY OF AN ACQUISITION PREMIUM IS APPROPRIATE?

A. No. The rate base of these acquisitions should be derived from the original cost of the property when it was first dedicated to public use. The purchase of the assets at a price higher than book value does not affect the property's original cost. That is, a substitution of owners does not establish a new utility company, nor does the acquisition premium represent the addition of new investment within the operation. The transfer between the sellers and buyers is simply a financial transaction wherein ownership changed. Most, if not all, of the assets transferred will continue to be used to provide the same services to the same ratepayers and those assets will remain subject to the same ratemaking

jurisdiction of the same regulators. This continuity makes a recalculation of rate base unnecessary and inappropriate.

Q. WHAT IS THE HISTORICAL BACKGROUND FOR THE POSITION THAT ACQUISITION PREMIUMS SHOULD NOT BE UTILIZED IN THE SETTING OF RATES?

A. It is my understanding that abuses occurred in the 1920's and 1930's that created the need to adopt the original cost method for valuing rate base and setting rates. Utilities were acquiring other utility properties for amounts in excess of net book value. The valuation and transfer of properties in excess of their book value created inflated rate bases which resulted in higher rates to existing customers. The customers were paying higher rates based on services provided by the exact same property that had been providing them utility service prior to the acquisition, when, in fact, nothing had changed except for the valuation of the properties transferred. Regulators and legislators determined it was unreasonable to charge customers higher rates for the utilization of same utility property simply because the utility providing the service was acquired by another company. Thus, the concept of using the original cost of the property when first devoted to public service came to be widely accepted. This principle has served to protect ratepayers from utilities who would buy properties at inflated prices and then seek revaluation of the properties at higher levels in order to produce greater profits. Absent this protection, the potential for

abuse through acquisitions and mergers is the same today as it was prior to implementation of the original cost concept.

Q. DOES AN ACQUISITION PREMIUM PROVIDE ANY ADDITIONAL BENEFITS TO MISSOURI RATEPAYERS?

A. No. The acquisition premium consists of nothing more than a financial transaction that values the excess purchase cost over and above the net original cost of the acquired properties. In and of itself, the acquisition premium provides no additional benefit to Missouri ratepayers; therefore, to allow the Company recovery through a rate base return or cost of service treatment unjustly penalizes consumers.

Q. HAS THE MISSOURI PUBLIC SERVICE COMMISSION PREVIOUSLY DENIED COMPANY RECOVERY OF AN ACQUISITION PREMIUM?

A. Yes, it has. In Missouri American Water Company, Case No. WR-95-205, the Commission stated the following:

> Missouri-American is proposing recovery of this acquisition adjustment in its revenue requirement. Missouri-American is requesting that it be authorized to amortize the acquisition adjustment over a 40-year period as well as include the unamortized acquisition adjustment in its rate base. This has the effect of increasing the Company's revenue requirement by $692,513. Missouri-American has stated four primary arguments in support of its request. First, the Company has demonstrated that the acquisition has already resulted in actual cost savings which more than offset the associated revenue requirement of including the acquisition adjustment in cost of

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> service. Second, these (aforementioned) cost savings to ratepayers will continue to increase over time. Third, ratepayers of Missouri-American (including former ratepayers of MCWC) are receiving improved service as a result of the acquisition. Fourth, public policy is best served by encouraging mergers and acquisitions where cost savings or other benefits can be demonstrated to accrue to ratepayers.
>
> The commission finds in this case that the Company has failed to justify an allowance for the acquisition adjustment.....Therefore, the Commission finds that the original cost principle is sound for the purposes of this case. The Commission finds that the original cost principle is sound for the purposes of this case. The Commission finds it is appropriate that the excess purchase costs over and above the net original cost of the Missouri Citifies Water company properties be booked to USOA Account 114 (Utility Plant Acquisition Adjustment) and amortized below the line over 40 years to USOA Account 425 (Miscellaneous Amortization).

Q. IS THE COMMISSION'S FINDING IN CASE NO. WR-95-205 CONSISTENT WITH ITS PAST DECISIONS?

A. Yes. I am not aware of the Missouri Public Service Commission ever granting rate recovery of any acquisition adjustment. This policy has been consistent as far back as the Commission ruling in Case No. 17,873:

> Pursuant to orders of the Commission, Laclede Gas Company acquired St. Charles Gas Corp. and Midwest Missouri Gas Company. As a result of those acquisitions, Applicant suffered acquisition adjustments in the amounts respectively of $976,291 and $12,229 for a total acquisition adjustment of $988,520.
>
> Applicant is presently carrying this total acquisition adjustment in Account No. 186, entitled Miscellaneous Deferred Debits, maintained in accordance with the Uniform System of Accounts prescribed by this Commission. Both Applicant and Staff agree that the amount should be

transferred to Account No. 114 of the Uniform System of Accounts, entitled Gas Plant Acquisition Adjustment. The Commission finds this to be a proper transfer.

Applicant proposes the Staff has recommended a forty-year period of amortization of the Plant Acquisition Adjustment. The Commission finds that forty years is a proper period for amortization of this Account.

The only contested request of Applicant is that the amortization be charged against operating expenses by utilizing Account 406 of the Uniform System of Accounts, entitled Amortization of Gas Plant Acquisition Adjustments. It is Staff's recommendation that the amortization of this acquisition adjustment not be treated as an operating expense and that it should therefore be charged against Account No. 425 of the Uniform System of Accounts which is entitled, Miscellaneous Amortization. The Commission finds that no showing has been made which would justify the inclusion of the acquisition adjustment in question in the operating expenses of the Company.

Conclusions

The Missouri Public Service Commission has arrived at the following conclusions:

It is not adverse to the public interest to permit Applicant to transfer the acquisition adjustments in question from Account 186 of the Uniform System of Accounts to Account 114 of the Uniform System of Accounts and to amortize over a forty-year period the amount of this adjustment.

It is adverse to the public to include the acquisition adjustment in question in the operating expenses of the Company, thus requiring the ratepayer to bear the cost of the adjustment over the period of amortization, therefore, the acquisition adjustment in question should be charged against Account 425 of the Uniform System of Accounts, entitled Miscellaneous Amortization.

Q. HAVE THERE BEEN UTILITIES THAT COMMITTED TO NOT SEEK RECOVERY OF ACQUISITION PREMIUMS IN RATES FOR PROPERTY ACQUIRED IN MISSOURI?

A. Yes, in a recent case involving the purchase of the Missouri operations of Associated Natural Gas Company, Atmos Energy Corporation, agreed to forgo any recovery of the acquisition premium it was to pay for the properties. On page eight of the Unanimous Stipulation and Agreement in Case No. GM-2000-312, it states:

> The amount of any asserted acquisition premium (i.e., the amount of the total purchase price above net book value), including transaction costs, paid by Atmos for ANG properties incurred as a result of the acquisition shall be treated below the line for ratemaking purposes in Missouri and not recovered in rates. Atmos shall not seek either direct or indirect rate recovery or recognition of the acquisition premium, including any and all transaction costs (e.g., legal fees, consulting fees and accounting fees), in any future ratemaking proceeding in Missouri.

And,

> In addition, Atmos shall not seek to recover in Missouri the amount of any asserted acquisition premium in this transaction as being a "stranded cost" regardless of the terms of any legislation permitting the recovery of stranded costs from Missouri ratepayers.

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The Commission issued its Order Approving Stipulation and Agreement, Case No. GM-2000-312, approving as a resolution all issues in the case on April 20, 2000, effective on May 1, 2000.

Also, in the purchase of various GTE properties, Case No. TM-2000-182, the witness for Spectra Communications Group LLC, Mr. Kenneth Matzdorf, stated that his Company would not seek ratemaking recovery of the acquisition premium it expects to pay for the GTE exchanges. On page 14 of his Direct Testimony, lines 10-17, he stated:

> Q. How will any acquisition premium be handled in future rate filing? (sic)
>
> A. Spectra understands some parties' concerns that the purchase premium should not be recognized in any rate filing. Spectra also understands that the Commission has traditionally recognized original historical costs in determining the rate base for the calculation of revenue requirement. As a result, Spectra is willing to commit that it will not seek recovery of any portion of the acquisition premium in future rate filings.

Q. PLEASE CONTINUE.

A. A couple of electric utilities that have also agreed to forgo recovery of an acquisition premium include Union Electric Company (UE) in its purchase of the Illinois utility Central Illinois Power Company, Case No. EM-96-149 and in its purchase of the Arkansas Power & Light Company's (APL) Missouri properties, Case No. EM-91-29,

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and Western Resources Inc. in its proposed purchase of Kansas City Power & Light, Case No. EM-97-515.

In Union Electric Company, Case No. EM-96-149, UE agreed not to seek recovery of the acquisition premium in rates. On page two of the Stipulation and Agreement signed in Case No. EM-96-149 it states:

> 2. Merger Premium
>
> UE shall not seek to recover the amount of any asserted merger premium in rates in any Missouri proceeding. UE has identified this amount as $232 million.

In its application to acquire Arkansas Power & Light Company's Missouri properties, Union Electric Company also agreed to not seek recovery of the acquisition premium in any rate case in the future. The Stipulation and Agreement for Case No. EM-91-29 stated:

> The amount of any acquisition premium (i.e., the amount of the purchase price above net book value) paid by UE to APL for the electric properties of APL shall be treated below the line for ratemaking purposes in Missouri and shall not be sought to be recovered by UE in rates in any Missouri proceeding, and the Joint Application should be considered as amended in this regard.

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While in Western Resources Inc., Case No. EM-97-515, the Company essentially agreed to the same conditions and terms that UE had in the two cases discussed above. Beginning on page one of the Stipulation and Agreement of Case No. EM-97-515 it states:

> 2. Merger Premium
>
> The amount of any asserted merger premium (i.e., the amount of the purchase price above net book value) paid by Western Resources for KCPL shall be treated below the line for ratemaking purposes in Missouri and not recovered in rates. The Joint Applicants, including Westar, shall not seek to recover the amount of any asserted acquisition premium resulting from this transaction in rates in any Missouri proceeding and the Joint Application shall be considered as amended in this regard. The Joint Applicants have currently estimated this amount as approximately $870 million. In addition, Westar shall not seek to recover in Missouri the amount of any asserted acquisition premium in this transaction as being a "stranded cost" regardless of the terms of any legislation permitting the recovery of stranded costs from ratepayers.

The most important factor recognized by all the utilities discussed above is that they all agreed that the acquisition premium paid to achieve the transactions that they negotiated is not a cost that should be borne by ratepayers, it is a cost that rightfully belongs to the shareholders. Ratepayers do not receive added value to their utility service or an increase in service just because the utility's ownership changes. The fact that new owners were willing to pay a purchase price that exceeds the net original cost of the property does not affect the utility service provided or the majority of the assets dedicated to the provision

of utility service. Ratepayers should not be required to pay more in rates simply because the ownership of the utility has changed hands.

Q. ARE YOU AWARE OF ANY ORDERS IN OTHER JURISDICTIONS WHERE RECOVERY OF ACQUISITION ADJUSTMENTS HAVE BEEN DENIED?

A. Yes, I am. In the proposed merger of an energy-based holding company, SCANA Corporation, and a natural gas local distribution company, Public Service Company of North Carolina, Docket No. G-5, Sub 400 Docket No. G-43, the North Carolina Utilities Commission Order, dated December 7, 1999, stated:

> In addition, Regulatory Condition 27 prohibits any acquisition premium from being flowed through into PSNC's rates. While a number of other states did not resolve the issue in the merger proceeding of the whether an acquisition premium is recoverable or allowed it to be recovered to the extent merger savings or other benefits could shown in later proceedings, Regulatory Condition 27 resolves this issue in PSNC's ratepayers' favor by excluding the acquisition adjustment from rates in any subsequent proceeding.

Based on the foregoing, the Commission concluded that PSNC's ratepayers are protected from all direct and indirect merger costs. (Public Utilities Reports - 198 PUR4th, page 171)

And,

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> (26) All costs of the merger and all direct and indirect corporate cost increases (including those that may be assigned to SCANA, a service company or any affiliate), if any, attributable to the merger, will be excluded from PSNC's utility accounts, and shall be treated for accounting and ratemaking purposes so that they do not, affect PSNC's natural gas rates and charges. For purposes of this condition, the term "corporate costs increases" is defined as costs in excess of the level that the PSNC would have incurred using prudent business judgment had the merger not occurred.
>
> (27) Any acquisition adjustment that results from the business combination of SCANA and PSNC will be excluded from PSNC's utility accounts and treated for accounting and ratemaking purposes so that it does not affect PSNC's natural gas rates and charges. (Public Utilities Reports - 198 PUR4th, pages 182-183)

Also, in Docket No. E, G-001/PA-96-184, the Minnesota Public Utilities Commission in an Order approving the merger of Interstate Power Company with WPL Holdings, Inc., and IES Industries Inc., stated:

> While requiring that the Company use the pooling method would preclude recovery of an acquisition premium, the Commission notes that the accounting method is governed by accounting standards and is not elective.
>
> The Commission will therefore modify the Department's recommendation as follows. The Commission will approve the merger upon the condition that Interstate not seek recovery of any acquisition price over book value. This preclude rate recovery of any acquisition premium, whether considered as good will or as an acquisition adjustment. (Public Utilities Reports, 177 PUR4th, pages 414-415)

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And,

e. Interstate will not seek recovery of any acquisition price over book value. This will preclude rate recovery of any acquisition premium, whether considered as goodwill or as an acquisition adjustment.

Q. DOES PUBLIC COUNSEL BELIEVE THAT RECOVERY OF AN ACQUISITION DISCOUNT IS APPROPRIATE?

A. No. Except for possibly an extreme case such as a stronger utility acquiring a failing utility (i.e., a utility lacking competent management and resources) Public Counsel believes that a utility should not be allowed to recover the costs associated with an acquisition based on the acquired utility's net book value when the purchase price is less. My position is based on the belief that allowing the acquiring utility to recover the cost of the assets based on their net book value would unfairly enrich shareholders because they would earn a return on and return of an amount greater than that which they have actually invested.

Q. WAS THE ROARK ACQUISITION CONSIDERED AS A TAKEOVER OF A FAILING UTILITY?

A. No. The previous owner of Roark was the White River Valley Electric Cooperative (White River), Inc., which according to its 2009 consolidated financial statements

included a balance sheet which identified its total assets as ** **, and an income statement which identified its operating revenues as ** ** with a net margin of ** ** (the financial documents were provided in the acquisition Application for Case No. WO-2011-0213/SO-2011-0214). In addition, I believe, and no one has yet provided any evidence to dispute the fact, that the management of White River was competent enough to operate the entities with which they were entrusted. Furthermore, it is my understanding that the sole purpose for MAWC entering into the acquisition was so that it could endeavor to increase its earnings capabilities.

Q. IS IT PROBABLE THAT WHITE RIVER VALLEY ELECTRIC COOPERATIVE, INC., WILL EVENTIALLY RECOVER A SIGNIFICANT PORTION OF THE LOSS IT INCURRED FROM THE PURCHASE PRICE BEING LESS THAT THE NET BOOK VALUE OF THE ASSETS IT SOLD?

A. Yes. Depending on its financial situation, it is probable that the loss White River incurred from the sale of the assets at a price less than net book value will result in a tax benefit which will allow it to recoup a portion of the assets value which MAWC now seeks to earn a return on and a return of. Since it is likely White River will be allowed to write-off the loss on the sale for tax purposes, the associated tax benefit will allow it to recover an additional amount of the net book value of the assets it sold thereby reducing its actual loss. However, it is MAWC's position that ratepayers be forced to pay for those assets again even though they will have been fully recovered by White River.

Furthermore, in the Roark acquisition case, File No. WO-2011-0213, et al., the Commission's Order Granting Applications To Transfer Assets, Approving Stipulation And Agreement, And Granting Waiver, Dated April 27, 2011, approved a Unanimous Stipulation And Agreement (attached as Appendix A to the Order). On page two of the Unanimous Stipulation And Agreement it states:

> 3. MAWC shall be authorized to file revised tariff sheets in the current Roark water and sewer tariffs containing new CIAC fees totaling $2,450 per customer applicable to the next 300 new customers in Forest Lake subdivision, to expire twenty (20) years after the effective date of the revised tariff sheets

Those CIAC fees per the Asset Purchase Agreement, ** **, provided in the Company's Application, File No. WO-2011-0213, will be ** **. Thus, White River could potentially collect an additional $735,000 (i.e., 300 multiplied by $2,450) to compensate it for any loss incurred in the sale of the water and sewer assets to MAWC.

Recovery of the combination of tax benefits and CIAC fees have the potential to significantly reduce the loss (i.e., acquisition discount) incurred from the sale by White River. For example, assuming a combined Federal and State tax rate of 38%, the tax benefit to White River would approximate ** ** (acquisition discount **

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** multiplied by 38%). When summed with the potential CIAC fees to be recovered, White River's incurred loss could be reduced by as much as ** ** (tax benefit ** ** plus $735,000). White River's recovery of the** ** would reduce its total loss on the sale of the assets by approximately 84%. Yet, MAWC still wants the Commission to authorize it to earn a return on and a return of the plant represented by the White River loss even though it has absolutely no investment cost in the plant associated with the acquisition discount and White River will likely receive reimbursement for most of these same plant costs via future tax benefits and CIAC fees.

Q. DID MAWC INCUR ANY INVESTMENT COST FOR THE DIFFERENCE BETWEEN THE NET BOOK VALUE OF THE ASSETS AND THE ACTUAL (LOWER) PURCHASE PRICE?

A. No. The portion of the net book value associated with the acquisition discount was acquired without cost (i.e., free) by MAWC.

Q. SHOULD MISSOURI RATEPAYERS BE REQUIRED TO PAY MAWC A RETURN ON AND A RETURN OF AN INVESTMENT FOR WHICH IT HAS INCURRED ZERO COST?

A. No.

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Q. ARE YOU AWARE OF ANY CASE IN MISSOURI WHERE AN ACQUISITION DISCOUNT WAS AFFORDED "ORIGINAL COST" RATE TREATMENT?

A. Yes, I am. In the U.S. Water/Lexington, Missouri ("U. S. Water") general rate case, Case No. WR-88-255, the Commission rejected an acquisition discount adjustment which was proposed by the Office of the Public Counsel. The acquisition discount adjustment was not used by the Commission to reduce U. S. Water's rate base, or to reflect a negative amortization to the cost of service.

Q. WHY DID THE COMMISSION REJECT THE PUBLIC COUNSEL'S POSITION IN THE U. S. WATER CASE?

A. Public Counsel's position was that an acquisition discount existed and should be reflected in the valuation of the assets acquired. The OPC position was premised on the fact that the Company executed a noninterest bearing note as part of the purchase price. Since the note was interest free, OPC believed that it should have been discounted to reflect the time value of money thus, actually lowering the alleged purchase price of the utility. **However, the Commission determined that the acquisition discount did not exist because the principle of the loan would have been the same whether or not the purchaser had financed the transaction with the noninterest bearing note or an interest bearing note.** On page five of the Report And Order, Case No. WR-88-255, the Commission stated:

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> The Commission determines that Public Counsel's recommendation is unreasonable and should be rejected. There is no evidence that Company could have bought the assets for less. The evidence supports a finding that the principal of the loan would have been the same had Company been unable to obtain an interest-free loan.

The Commission did not recognize the acquisition discount associated with the purchase, nor did it "write down" the value of the assets transferred, but it did not do so because it determined that the acquisition discount did not exist. Whereas, in the instant case, the acquisition discount is very much a reality that is not in dispute as to existence.

Q. HOW IS MAWC REQUIRED TO BOOK THE PURCHASE ACCORDING TO GENERALLY ACCEPTED ACCOUNTING PRINCIPALS?

A. According to Generally Accepted Accounting Principals (GAAP), the Company made a 'bargain purchase" so it will report a gain in the amount of the acquisition discount. Accounting Standards Codification (ASC) 805 Business Combinations, formerly Financial Accounting Standard (FAS) 141-R, states:

> Gain from Bargain Purchase
>
> 25-2 Occasionally, an acquirer will make a bargain purchase, which is a business combination in which the amount in paragraph 805-30-30-1 (b) exceeds the aggregate of the amounts specified in (a) in that paragraph. If that excess remains after applying the requirements in paragraph 805-30-

> 25-4, the acquirer shall recognize the resulting gain in earnings on the acquisition date. The gain shall be attributed to the acquirer.

Note: Paragraph 805-30-30-1 (b) is a reference to the net book value of the assets acquired while item "(a)" is a reference to identification of the consideration transferred. Paragraph 805-30-25-4 is a reference that the acquirer shall reassess whether it has correctly identified all the assets and liabilities acquired.

Q. SINCE MAWC WILL BE TAXED ON THE GAIN (ACQUISITION DISCOUNT), SHOULDN'T RATEPAYERS BE REQUIRED TO PROVIDE IT WITH A REFUND EQUAL TO THE TAX PAID?

A. No. Any tax on the gain paid by MAWC should be viewed as a prepayment of tax in the event Company were to sell the associated assets sometime in the future. If such a sale were to occur, the Company might incur more tax or less tax depending on the sale and the basis in the assets at the time of the sale neither of which should be recognized for regulatory purposes in the state of Missouri. Even if no future sale were to occur Company will still have use of the assets as a cost-free producer of revenue until the end of their useful operating lives.

Q. HOW HAVE GAINS AND LOSSES ON SALE OF UTILITY PROPERTY NORMALLY BEEN TREATED FOR RATEMAKING PURPOSES?

A. To my knowledge, the Commission has never allowed ratepayers to share in any gains or losses resulting from the sale of a utility's property. The selling utility's shareholders have always realized the entire benefit of any gains received or losses incurred.

The Commission's position on this issue is illustrated by its decision in Kansas City Power & Light, Case No. ER-77-1 18. On page 42 of its Report and Order, the Commission stated:

> It is the Commission's position that ratepayers do not acquire any right, title and interest to Company's property simply by paying their electric bills. It should be pointed out that Company investors finance Company while Company's ratepayers pay the cost of financing and do not thereby acquire an ownership position. Therefore, the Commission finds that the disposal of Company property at a gain does not entitle its ratepayers to benefit from that gain, nor does the disposal of Company property at a loss require that Company's ratepayers absorb that loss.
>
> (Emphasis added by OPC)

Furthermore, in decisions reached by the Commission in rate cases involving Missouri Cities Water Company, Case No. WR-83-14, and Kansas City Power & Light, Case No. EO-85-185, the Commission found that gains of utility property sold by those utilities would be treated "below-the-line."

Q. WOULD THE COMPANY BE HARMED IN ANY WAY IF THE COMMISSION REQUIRES IT TO BOOK THE VALUE OF THE ROARK ASSETS ACQUIRED AT THE ACTUAL PURCHASE PRICE?

A. No. **The Company would suffer no detriment at all from a Commission ruling no recovery of costs associated with the acquisition discount.** Company would still be authorized to earn a return on its actual investment cost (i.e., purchase price and subsequent investment) along with recovery of prudent and reasonable operating expenses, depreciation and taxes. However, if the Commission authorizes Company to earn a return on and return of the difference between the purchase price and acquired assets net book values, Company would receive recovery from ratepayers for costs which its shareholders have not and will not ever incur.

Q. WOULD DISALLOWANCE OF THE RECOVERY OF ANY ACQUISITION ADJUSTMENT IN RATES CREATE A DISINCENTIVE FOR UTILITIES TO ACQUIRE OTHER UTILITIES?

A. No. If the utility considering an acquisition believes that it is in its economic as well as its business interest, it would still acquire the other utility regardless of any recovery of an acquisition adjustment from ratepayers. The prudent thing to do would be for the utility to pursue the acquisition if it is considered to be in the utility's best interest. Whereas, all other things being equal, if the acquired utility is purchased for less than its

net book value, the acquiring utility would still be allowed to earn a return on and return of its actual investment.

Q DO THE ACQUISITIONS REPRESENT AN ESSENTIAL INTEGRATION OF FACILITIES PROGRAM DEVOTED TO SERVING THE PUBLIC BETTER?

A. Not necessarily. The primary reason that these sales occurred is because MAWC was seeking a way to increase shareholder value. It was not implemented in order to simply integrate the acquired entities into a larger and more efficient system. The premium or discount purchase prices paid, in and of themselves, does not represent or forebode an improvement of service to be provided or rates to be charged customers. The transactions did not occur in order to make the acquired operations more efficient, it transpired because the management of MAWC was searching for ways to increase the value of shareholder's common stock holdings.

However, I would argue that one of the major reasons for a utility acquiring another utility would be to take advantage of the economies of scale (or synergies) that would be created by the combination on the entire entity (purchaser and seller), not just the cost reductions that may or may not occur in the operations of the utility being sold. Whether the economies of scale are represented by employee costs saved, reduced operation & maintenance expenses, lower fuel costs, lower plant costs or whatever savings

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management can squeeze from the operations, the combined companies should have an overall lower cost structure than that of the individual companies on a stand-alone basis.

IV. NORTH JEFFERSON CITY ASSETS

Q. WHAT IS THE ISSUE?

A. This issue is a subset of the acquisition/rate base valuation issue in that it recently came to the Public Counsel's attention that these assets were purchased without Commission authorization and at a purchase price that is less than the book value Company has recorded in its financial records.

Q. WAS THE ACQUISITION SUBJECT TO AUTHORIZATION BY THE COMMISSION?

A. That is an issue I will not be addressing, but will instead leave to determination by legal counsel. However, Company's response to OPC Data Request No. 1135 states:

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I would only add that if the regulatory parties had not become aware of this issue in the current case, it is probable that the Company would not have made it known to the Commission that it is requesting to earn a return of and return of on the assets book value even though the purchase price it paid for the assets acquired is significantly less.

Q. WHAT WAS THE BOOK VALUE OF THE ASSETS ACQUIRED?

A. Company's response to OPC Data Request No. 1135 provided a Bill of Sale 1135-R2 which identifies the original cost of the assets as ** **; whereas, Schedule 1135-R4 provided in the same response identifies the Accumulated Cost as ** ** with the difference being ** **

Q. WHAT WAS THE PURCHASE PRICE PAID BY COMPANY FOR THE ASSETS?

A. On page one, Article 2.1, of the Asset Purchase Agreement, provided in response to OPC Data Request No. 1135, the purchase price is identified as being ** **.

Q. IS IT PUBLIC COUNSEL'S POSITION THAT COMPANY SHOULD NOT BE ALLOWED TO EARN A RETURN ON AND A RETURN OF THE BOOK VALUE OF THE ASSETS ACQUIRED THAT EXCEEDS THE PURCHASE PRICE?

A. Yes. The Company purchased the assets at a discount nearly equal to their original cost and as such, for the same reasons I discussed earlier in relation to the other similar

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acquisitions, should not be authorized a return on or a return of costs that exceed the actual purchase price.

Q. IS PUBLIC COUNSEL AWARE OF ANY OTHER SIMILAR ACQUISITIONS CONSUMMATED BY COMPANY WHEREIN IT DID NOT OBTAIN COMMISSION AUTHORIZATION?

A. Public Counsel sent Company OPC Data Request No. 1135 which sought to obtain this information for the period that MAWC has owned the utility, but none was identified. Company's response to the request stated, in part:

> MAWC suspects that other such acquisitions of assets within the Company's service territory (such as the acquisition from developers of systems associated with new subdivisions) are likely to have occurred since 1879. However, the Company records are not constructed in such a way as to either confirm or dispute this supposition.

Q. IS PUBLIC COUNSEL CONCERNED THAT SIMILAR ACQUISITIONS MAY HAVE OCCURRED IN THE PAST?

A. Public Counsel does not have the information that would verify or disapprove such acquisitions exist; however, the aforementioned data request response only sought information on acquisitions that may have occurred since MAWC has owned the utility, not those that may have occurred from 1879 through to when MAWC acquired the utility. Company's admission that it has not kept records that would isolate the costs of

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such acquisitions leaves open the possibility that it has included in this case additional, but unidentified, costs which it should not be allowed a return on or a return of. Thus, Public Counsel is concerned that the Company's failure to identify and record the costs associated with such acquisitions so that they can be audited by regulators does not provide the Commission with the clarity I believe it needs to determine appropriate rates.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, it does.