BEFORE THE PUBLIC SERVICE COMMISSION

STATE OF MISSOURI

TRANSCRIPT OF PROCEEDINGS

HEARING

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In the Matter of the Application of) Case No.
Missouri-American Water Company for) WO-2004-0116
Approval to Establish an Infrastructure) Tariff No.
System Replacement Surcharge (ISRS)) YW-2004-0274

BEFORE:
MORRIS L. WOODRUFF, Presiding
SENIOR REGULATORY LAW JUDGE.
STEVE GAW, Chair
CONNIE MURRAY,
BRYAN FORBIS,
ROBERT CLAYTON,
COMMISSIONERS.

REPORTED BY:
TRACY L. THORPE, CSR, CCR
ASSOCIATED COURT REPORTERS

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JUDGE WOODRUFF: We're on the record. This is Case No. WO-2004-0116. And the caption is in the matter of the application of Missouri-American Water Company for approval to establish an Infrastructure System Replacement Surcharge.

And we'll begin today by taking entries of appearance. Let's begin with Staff.

MR. KRUEGER: Keith R. Krueger and Thomas R. Schwarz for the Staff of the Missouri Public Service Commission. Our address is PO Box 360, Jefferson City, Missouri 65102.

JUDGE WOODRUFF: And for Missouri-American Water Company?

MR. ENGLAND: Thank you, your Honor. Let the record reflect the appearance of W.R. England of the law firm of Brydon, Swearengen and England, PC, Post Office Box 456, Jefferson City, Missouri 65102 appearing on behalf of the applicant, Missouri-American Water Company.

JUDGE WOODRUFF: And for Public Counsel?

MS. O'NEILL: Good morning, your Honor. My name is Ruth O'Neill. I'm with the Office of the Public Counsel and representing that office. Our address is PO Box 2230, Jefferson City, Missouri 65102.

JUDGE WOODRUFF: And for the Missouri Industrial Energy Consumers?

MS. VUYLSTEKE: Diana Vuylsteke of the firm Bryan Cave, LLC, 211 North Broadway, Suite 3600, St. Louis, Missouri 63102.

JUDGE WOODRUFF: And for Missouri Energy Group?

MS. LANGENECKERT: Lisa C. Langeneckert of the law office of Robert Johnson, 720 Olive, 24th Floor, St. Louis, Missouri 63102.

JUDGE WOODRUFF: I believe that's all the parties.

The way we're going to work this today is we're going to start out by taking opening statements from the parties. The Commissioners have requested an opportunity to then question counsel either as part of the process like a court of appeals type process where the questions are at the end of your presentations.

After that then, we're going to go ahead and take whatever testimony we need to take to fill up the factual issues and the witnesses will be subject to cross-examination as they would be in an ordinary hearing, of course, questions from the Bench and the usual process.

Before we do that, are there any other matters anybody wants to bring up while we're on the record?

MR. ENGLAND: I don't know if it needs to be brought up on the record, but I was going to request that we premark exhibits, one I plan on using.

JUDGE WOODRUFF: Yes. We'll do that as soon as we get off the record and we'll take a short break. And I'll go upstairs and get the Commissioners and bring them back down and get started.

All right. Anything else while we're on the record? Mr. Krueger, did you have something?

MR. KRUEGER: No, your Honor.

JUDGE WOODRUFF: I thought I saw your hand going up.

Okay. With that, we're off the record.

(A recess was taken.)

(Exhibits Nos. 1 through 7 were marked for identification.)

JUDGE WOODRUFF: We're ready to go ahead and get started with opening statements and we'll begin with Missouri-American.

MR. ENGLAND: Thank you, your Honor. Good morning. May it please the Commission. I'm Trip England. I represent the applicant, Missouri-American Water Company.

And I believe you have a case of first impression before you today. To my knowledge, this is the first and only application for an Infrastructure System Replacement Surcharge, I-S-R-S, or as I sometimes refer to it and probably will throughout this proceeding, ISRS.

It was filed pursuant to new legislation, passed this last session, Section 393.1000 through 1006. We believe the purpose of that legislation was to allow the recovery of specified costs or revenue requirements directly associated with particular plant that's placed in service subsequent to our last rate case before you all.

There are three specific types of plant that are eligible for this recovery. There are mains, valves and hydrants installed as replacements for facilities that have been worn out or in a deteriorated condition; there are facilities that represent main cleaning and relining projects; and finally, there are facility relocations, which have come about as a result of governmental entities such as the Highway Department requiring the company to move its lines when it moves or reconstructs highways.

The other significant feature of the legislation is it applies only to the St. Louis County district of the company. As you know, the company serves approximately eight other districts throughout the state. This is only applicable in the St. Louis County area.

I'd like to refer to an exhibit that has been marked for purposes of identification as Exhibit No. 6. It is a one-page exhibit and it has Revised Appendix B up in the right-hand corner. And essentially this is a revised revenue requirement calculation that the company has performed after Staff's review of its initial application and with adjustments that we have agreed to.

Despite our efforts to try to reach agreement, both through discussions with Staff in the prehearing conference earlier this week, we still have three areas of disagreement between us and the Staff and various other parties regarding the way in which you calculate the revenue requirement associated with this infrastructure replacement plan. From time to time, we'll refer to it as revenue requirement or the revenues that we're trying to generate with the surcharge.

The three areas where we disagree are accumulated depreciation, accumulated depreciation as it relates to the net cost of removal, and property taxes. And if you're following on Exhibit 6, the accumulated depreciation amounts that are in controversy are on lines 6 and 24. The accumulated depreciation related to net cost of removal is located on line 29. And the property tax figure is on line 48.

With those three exceptions in mind, generally speaking, everything else on this schedule, the other numbers that are being used, the calculations that are being made, are not in disagreement. Essentially Staff either uses the same numbers or performs the same calculations. So we're really just focusing on these three areas highlighted by these four lines on this exhibit.

We also have agreed for purposes of this case to the appropriate rate design. And that is the way in which these revenues get allocated to the various customer classes and the way in which the rates get spread -- or the surcharge, if you will, gets spread to those customer classes.

The only thing we need for you to tell us is what is the revenue requirement. We know the billing determinants, we know the cost allocations. The last plug, if you will, in the calculation is for you to tell us the revenue requirement, which our exhibit will show as of today is roughly $3.8 million. It's the last number on the far right column in Exhibit 6.

Now, there is no disagreement between Staff and company with respect to the total plant or gross plant that has been spent since the last rate case. And that number is roughly 29 million. It is the sum of lines 3 and 20, I believe.

As I mentioned to you, the issue -- the first big issue and really the major issue between the parties is the amount of accumulated depreciation that you deduct from that gross plant figure to arrive at a net plant figure.

Our proposed accumulated depreciation is roughly $790,000. And that, as I pointed out, was line 6 and 24. Staff, by way of comparison, is $15.5 million of accumulated depreciation.

Now, to put that in perspective, Staff is assuming an amount of accumulated depreciation associated with this replacement plant that is over 50 percent of the total amount invested in just the last two and a half years. Stated another way, Staff's calculation assumes that this plant is 53 percent depreciated. Stated another way, that assumes an effective depreciation rate on an annualized basis of approximately 21 percent.

The authorized depreciation rates for this plant on average is about 2 percent. So that ought to tell you something about that figure. It's way out of line with what our authorized depreciation rates are. It's way out of line with common sense.

We also disagree with the way in which cost of removal, I guess, is not being handled by Staff. We have proposed a further adjustment -- excuse me, the cost of removal associated with net salvage. We have proposed a further adjustment to the accumulated depreciation to reflect the fact that as we retire plant and replace it, we incur an actual expense to remove it from service.

That expense, on average, exceeds the salvage value. That is an out-of-pocket expense we incur. When we incur it, it is booked to the accumulated depreciation account and reduces the amount of accumulated depreciation. We, therefore, believe it is appropriate to further reduce accumulated depreciation for these costs of removal net of salvage.

Finally, we disagree with Staff with respect to the property tax calculation. Now, there is no disagreement between Staff and company on the appropriate rate -- tax rate to be applied to the property. And I don't believe there's a dispute with the notion that the company is going to have to pay property taxes on this property.

The dispute centers upon, at least in Staff's mind, whether or not all of the property tax is due within the first 12 months of the filing of this ISRS application. Staff contends that property placed in service after January 1, 2003 will not become due until December 2004 or roughly 16 months after the filing of the application.

We disagree. First, we believe that is a strained and overly narrow reading of the statute regarding the way in which property taxes are to be calculated. And second, more importantly, those taxes on plant placed in service after 2003 will become due on January 1, 2004 because the company begins accruing property tax on that plant on that date and does so throughout the year.

So there you have it, the three issues that we have with Staff. The bottom line is we believe the revenue requirement associated with this roughly $30 million in new plant we put in the ground is $3.8 million. Staff would have you believe that it's 1.8 million. And it's attributable to those three issues that we've just discussed. Thank you very much.

JUDGE WOODRUFF: Thank you. Please stay here for questions, Mr. England.

MR. ENGLAND: I'm sorry.

CHAIR GAW: I'm going to defer until they're all finished.

JUDGE WOODRUFF: Commissioner Murray?

COMMISSIONER MURRAY: I just have one. Most of that difference, is that in the net cost of removal?

MR. ENGLAND: No. It's in the -- what I call the accumulated -- the first issue, the accumulated depreciation generally. The net cost of removal is about a million dollar figure on line 29. The first difference is the difference between the roughly $800,000 that we have for accumulated depreciation and the 15.5 million that Staff has, roughly $14.5 million difference.

COMMISSIONER MURRAY: All right. Thank you.

JUDGE WOODRUFF: Commissioner Forbis? Commissioner Clayton? Chair Gaw, are you ready?

CHAIR GAW: No. I'm going to wait until all of them have finished, see if I have any questions. But thank you for asking, Judge.

JUDGE WOODRUFF: Okay. That's fine. I do have a question and it's following up on what Commissioner Murray indicated --

MR. ENGLAND: Certainly.

JUDGE WOODRUFF: -- about the cost of the accumulated depreciation, I believe. Do you know how much difference that actually makes in the revenue requirement?

MR. ENGLAND: Roughly what you're talking about -- the difference between the two accumulated depreciation amounts are 14.5 million. It's the difference between the rate of return applied to that, if you will. In other words, if you buy Staff's approach, you've just reduced your gross plant by that much more. So you've got a smaller number against which you multiply your rate of return.

Conversely, if you buy our accumulated depreciation, you have a higher net original cost against which you apply the rate of return.

JUDGE WOODRUFF: Okay. I think I understand that. If the Commission were to agree with Missouri-American on that first issue and with Staff on the other two issues, have you done any calculations to indicate what --

MR. ENGLAND: Yes.

JUDGE WOODRUFF: -- what the results would be?

MR. ENGLAND: I'm sorry. I haven't, but I believe the Missouri Energy Group has. And I believe it's in their response to -- or their reply to our response to Staff.

JUDGE WOODRUFF: All right. I think I remember seeing that.

MR. ENGLAND: It's roughly a $3.6 million figure.

JUDGE WOODRUFF: So the first issue is making the biggest swing on the rate requirement?

MR. ENGLAND: Absolutely.

COMMISSIONER MURRAY: Judge, may I ask another one?

JUDGE WOODRUFF: Yes.

COMMISSIONER MURRAY: Thank you.

Mr. England, the issues that are -- that there's disagreement on here, is the Staff taking the position that there should be a different methodology applied then has been applied in your previous rate cases for these items?

MR. ENGLAND: That would be my contention, your Honor.

COMMISSIONER MURRAY: And the language of the legislation itself where it says in 393.1006.1 -- or rather .2, subsection 2 that no other revenue requirement or rate-making issue shall be examined in consideration of the petition or proposed rate schedules, isn't that a rate-making issue if there is a difference in methodology from what has been applied in the past being proposed here?

MR. ENGLAND: That would be my belief. I believe that what you just read indicates that in general or in essence what the legislature is saying, you will engage in single-issue rate-making and this is the single issue that you will examine. By bringing in what we believe accumulated depreciation that's not associated with the new plant, you've gone beyond the concept or the narrow single-issue rate-making issue, if you will.

COMMISSIONER MURRAY: By changing the methodology that has previously been applied to accumulated depreciation; is that right?

MR. ENGLAND: Correct. That and it's a mismatch. I mean, you're basically attributing accumulated depreciation from other plant to this plant, yet you're not giving us the benefit in your gross plant figure of all that other plant.

COMMISSIONER MURRAY: So would it be the company's position then that this should not be an issue that we are considering?

MR. ENGLAND: I don't know what -- I guess parties can raise whatever issue they want to raise and I can't tell you it's irrelevant. I just -- I'm just telling you it's wrong.

COMMISSIONER MURRAY: Well, is it in compliance with the statute to raise that issue though -- for Staff to raise it?

MR. ENGLAND: No. Our argument is they're going beyond the dictates of the statute. But obviously -- and they'll speak for themselves -- they're going to tell you they're not. So, I mean, I think that's the issue you have to resolve.

COMMISSIONER MURRAY: Thank you.

MR. ENGLAND: You bet. Thank you.

JUDGE WOODRUFF: Any further questions for Mr. England?

Then we'll move to Staff.

MR. KRUEGER: Thank you, your Honor. Good morning. May it please the Commission. My name's Keith R. Krueger. And Tim Schwarz and I will be representing the Staff of the Missouri Public Service Commission in this proceeding.

This is the first case in which an Infrastructure System Replacement Surcharge, or ISRS, will have to be determined. The parties to this case and the Commission will be breaking new ground in a decision that's rendered in this case. There are no rules to guide us, no forms have been prescribed for us to use in deciding how to determine the amount of the ISRS.

The statute that established the ISRS, House Bill 208, was passed in the 2003 legislative session and has not been construed by an appellate court nor by any other court nor by this Commission. Not surprisingly, there are differences of opinion as to how the statute should be construed.

Probably as a result of this uncertainty, there's a wide discrepancy between the level where Missouri-American Water Company thinks the ISRS ought to be established and the level that the Staff thinks is appropriate.

The company thinks that the ISRS should be based on ann-- should result in an annual revenue requirement of a little under $4 million and the Staff believes it ought to be a little under $2 million.

The procedure that the company followed in reaching its conclusion is set forth in a revenue requirement calculation that it filed with its application in this case. The Staff has filed a similar document with the Commission in its recommendation to the Commission.

Fortunately, these two calculations are very similar in form. In fact, the Staff's calculation followed the same form as the company's calculation did. This Exhibit 6 that has been referred to in the opening statement, rearranges numbers a little bit, but essentially does the same thing.

These two calculations do have different inputs and they come to different conclusions, but since the forms are similar, it's relatively easy to identify the half dozen or so issues on which the company and the Staff initially disagreed.

The parties have now resolved some of these disagreements, so there are only three significant disputes remaining. Once the Commission resolves these disputes, it can simply plug in the numbers that it chooses into the revenue requirement calculation form and calculate the company's annual revenue requirement and from that determine what the amount of the surcharge will be.

One of these unresolved issues is property taxes. The issue is whether the property tax the company will have to pay in December 2004 on infrastructure replacement plant that was placed in service during 2003 can be included in determining -- in determining the amount of this ISRS.

The resolution of that question turns almost exclusively on legal question. By far the biggest issue is the amount of the accumulated depreciation that should be offset against the infrastructure replacement plant to determine the net original cost of eligible plant.

I wouldn't agree with Mr. England's statement of the depreciation rates that he says that the Staff has applied to infrastructure replacement plant and we'll present evidence regarding the way that we determined the appropriate accumulated depreciation. Our approach is completely different and the Staff will explain the way that it derived its number.

The Staff will present evidence, examples and illustrations to show that in order to determine the amount of the net original cost of the infrastructure replacement plant and to prevent the company from recovering more than the General Assembly has authorized, it's necessary to determine the net change and the amount of the company's invested plant since its last rate case and to determine the net change and the amount of the company's depreciation reserve since its last rate case.

The Staff's evidence will show that when these factors are accounted for, the depreciation reserve that is applicable to the company's infrastructure replacement plant is $11,897,494. I believe that may be only for the valves, mains and hydrants.

The other disputed issue is the question of how the cost of removal net of salvage should be treated.

The Staff will present evidence to show that the company has been receiving cost of removal net of salvage through its depreciation rates and accumulating these funds to pay for the cost when it's incurred and that it would be improper for the company's ratepayers to pay these costs again by including them as an addition to the ISRS revenues.

Other issues, including offsets for reimbursements that the company has received for facilities relocation, the proper recognition of deferred income taxes, the proper rate of return to apply to the infrastructure replacement plant and the appropriate rate design have all been resolved by agreement of the parties so there are just these three issues that remain.

Steve Rackers will be testifying in support of the Staff's position on these matters and he'll be pleased to answer your questions. Thank you.

JUDGE WOODRUFF: Chair Gaw, do you have any questions at this time? Commissioner Murray?

COMMISSIONER MURRAY: Just one, I believe.

Mr. Krueger, are the calculations that the Staff has made based on the company's total plant since the last rate case and the company's total accumulated depreciation on all of the assets since the last rate case?

MR. KRUEGER: That's a factor. The Staff's calculation is shown in its initial filing in this case, the case file memorandum. And Attachment B to that memorandum, page 2 of 4, that's Exhibit 1, shows the way that the calculation is done.

We first showed the change in plant in service since the last rate case, that's on the first line there, 107,748,771, changes in advances, changes in CIAC are also shown and those numbers are listed there. And that results in a change in invested plant since the last rate case of $93,315,598.

The infrastructure replacement is 20,723,376 and that represents approximately 22 percent of the $93 million figure. And that 22 percent is applied to the depreciation reserve, which is on the bottom line there. The depreciation reserve shows 53,573,609 and applying 22 percent to that results in 11,897,494. And then a similar calculation is done with regard to the facilities relocations.

COMMISSIONER MURRAY: And I said I just had one question, but I have another one. Is the methodology that Staff is applying a different methodology for determining accumulated depreciation than was applied in the last rate case?

MR. KRUEGER: Well, the last rate case didn't address the Infrastructure System Replacement Surcharge, so I think the issue in this case is what is the appropriate revenue requirement for the infrastructure replacement plant that's been installed.

COMMISSIONER MURRAY: I understand that. But you have to -- you had to have a methodology for accumulated depreciation in your previous rate cases.

MR. KRUEGER: I think, you know, the statute refers to the -- I have it here -- the net original cost of eligible Infrastructure System Replacements. The methodology that we used was an attempt to determine what is, in fact, the net original cost of eligible infrastructure replacements, which of course, was not -- not an issue in a previous case.

I might be able to illustrate the point a little bit by saying that if the company's plant in service is determined in a rate case and if there are no additions to the plant in service and if there are no retirements, the plant in service declines over time as depreciation accrues. That reduces the rate base.

Then if there's infrastructure system or an infrastructure replacement plant is installed, that would increase it. But if, for example, the net plant were determined in a prior rate case to be $100 million and if depreciation reduced the value of that plant, like as I say -- assuming no additions and no retirements, if that reduced, as a result of depreciation, the $95 million, but if there was $5 million of infrastructure replacement plant added, the company's net plant in service would then be $100 million, the same as in the prior rate case.

Under the company's calculation, it would be entitled to the rev-- the rates and the revenues that are established in the prior rate case, plus an additional return on the $5 million of infrastructure system replacement, even though the net plant in service doesn't change.

This results in a kind of double collection or double dipping that we don't think the legislature intended. That's why it's necessary to offset this and to determine the depreciation in the way that the Staff has done so. The --

COMMISSIONER MURRAY: May I ask you, in determining the accumulated depreciation, are you applying the same methodology that -- is Staff applying the same methodology that it has applied in the past in rate cases?

MR. KRUEGER: Yes.

COMMISSIONER MURRAY: No change in methodology?

MR. KRUEGER: Correct.

COMMISSIONER MURRAY: How about the cost of net salvage removal, cost of removal?

MR. KRUEGER: The Staff used the depreciation rates that were prescribed in the prior case in the St. Louis County Water case, the last rate case. In that case the rate base against which the depreciation is applied includes the original plant plus cost of removal net of salvage based upon estimates of what that will be at some -- at some point in the future.

So those rates are designed to collect a cost of removal that has not been incurred and will not be incurred for quite some time until the plant is retired. The numbers that the company has included here are the cost of removal of the items that have been replaced. These are historical replacements. So that's a difference.

COMMISSIONER MURRAY: Okay. That's all my questions right now. Thank you.

JUDGE WOODRUFF: Commissioner Forbis? Commissioner Clayton?

All right. I have a couple questions. And the first one concerns accumulated depreciation. And as I understand it, the whole idea of the statute is that the company is to be allowed to recover the cost of infrastructure replacement. Would you agree on that?

MR. KRUEGER: Yeah. It's to --

JUDGE WOODRUFF: That's probably oversimplifying.

MR. KRUEGER: -- eliminate or reduce the

effects of regulatory lag.

JUDGE WOODRUFF: So, in effect, they get to recover it sooner?

MR. KRUEGER: Correct.

JUDGE WOODRUFF: And this will all be examined in the upcoming rate case so that if --

MR. KRUEGER: Correct.

JUDGE WOODRUFF: -- they recover too much now --

MR. KRUEGER: No. The amount that is recovered pursuant to the order that the Commission will enter in this case will be collected from January 1 of 2004 until the effective date of the rates in the pending rate case, which is April 16th. That will eventuall-- of 2004.

That will eventually have to be reconciled, but since the collection will continue until the effective date of the order in the rate case, it can't be reconciled as part of that rate case. It will be reconciled I believe at the time of the next ISRS application or within 12 months. I'm not -- I'm not certain about that, but it will be some time subsequent to that. It will not be determined in this --

JUDGE WOODRUFF: It will be reconciled based on what the Commission orders in the upcoming rate case?

MR. KRUEGER: No. What will be reconciled is in this case -- in this ISRS case, the Commission will have to determine a bottom line number on how much the company ought to recover on an annual basis from the Infrastructure System Replacement Surcharge. And then they're entitled to recover that over a period of approximately three and a half months.

So taking that annual requirement and prorating it over the three and a half months, you can come up with a dollar amount that the company should recover during this period of time under the ISRS. Then that will simply be compared with the amount that the company actually does recover under the ISRS. And so that number will be determined and it will be subtracted and either an over-recovery or under-recovery will be built into the next ISRS.

JUDGE WOODRUFF: So, in effect, is the legislature saying that the company gets to recover these costs sooner than they would otherwise?

MR. KRUEGER: Yes.

JUDGE WOODRUFF: Okay. Would they eventually recover the costs anyway?

MR. KRUEGER: Well, not necessarily. I don't think they'd recover all of it, because a major issue in the last St. Louis County Water rate case was the fact that providing water utility service is a rising cost industry and they're continually making replacements of their infrastructure system and they're not able to recover these until the next rate case; that is, they're not able to recover them at all until the next rate case.

Then in the next rate case, their rate base is determined anew and new rates are set. But during that period of time between the rate cases, they're not able to recover it.

One method of dealing with that sort of problem that has been proposed is an AAO. An AAO merely allows the company to book expenditures and then the question of whether -- of how much of them they're able to recover is determined in the next subsequent rate case.

In this proceeding, they will actually be authorized to start recovering revenues based on these investments from now until the effective date of the order in the rate case.

JUDGE WOODRUFF: Okay. Another thing I don't understand, again, concerning the accumulated depreciation on the affected plant. I believe the company's position is they've got this amount of plant over here, these mains and whatever pumps or whatever they're replacing, they're taking depreciation on that; is that correct?

MR. KRUEGER: Yes.

JUDGE WOODRUFF: And the Staff's position is that, no, we're not going to look at just what's over here, we have to look at -- can you explain to me what Staff wants to look at?

MR. KRUEGER: The Staff wants to look at the change in the company's invested plant and the change in --

JUDGE WOODRUFF: What is the reason? Why is that more appropriate than looking at the plant itself?

MR. KRUEGER: Well, because of the reason that I tried to explain a little bit earlier. The company's invested plant declines as a result of depreciation all the time. And to allow them to not recognize that in the ISRS would be to allow them to recover on a change in plant that results from depreciation and to also recover on the ISRS. So they would be double recovering to the extent of the depreciation that occurs between the last rate case and the present time.

JUDGE WOODRUFF: Okay. That's all the questions I have.

Anybody else have any questions for Staff at this time?

Step down then.

And for Public Counsel then?

MS. O'NEILL: Good morning. As you know, I'm Ruth O'Neill. I represent the Office of the Public Counsel.

My office continues to be concerned that this

Infrastructure System Replacement Surcharge could result in a utility collecting surcharges related to the single issue even in situations when it may be in an over-earning situation.

But we recognize that the statute allows a company to apply for an ISRS as long as that company, like Missouri-American, meets the statutory investment thresholds for applying for that ISRS. And that's why we're here today. We're not here to rehash whether or not the status was something we supported.

The parties come before you today in this first ISRS proceeding before the Commission's rules governing how these proceedings should happen have been fully implemented. So the parties and the Commission can't be guided by the rules. Therefore, the Commission has to review this application solely on the issue of whether the application meets the statutory requirements.

That doesn't necessarily mean that all the issues are completely cut and dried. This statute, which is now at Section 393.1000 through 1006, reduces this Commission's inquiry into whether the amount being sought can be justified under the ISRS mathematical formula.

In order for the Commission to ensure that it only authorizes an ISRS that is lawful and reasonable, it's important that the component numbers in that formula be reasonable and accurate.

This is not the same as a prudence review. A prudence review of the infrastructure replacement comes up during the true-up phrase and that's not here in this proceeding. However, especially with this first ISRS in Missouri, it's vital to the interest of the company's customers that the numbers be right and that the numbers be no higher than necessary to comply with the statute.

Determining the right numbers to place in the calculation for the surcharge is important for consistency and to avoid surcharge shock to the customers. After the limited review my office has been able to conduct in this case, Public Counsel believes that the Staff has done the most accurate job of designating the appropriate numbers, which should be the component of the ISRS calculation.

Staff's correctly identified infrastructure replacements for which the company received reimbursement for exclusion from the ISRS and the company has agreed to that exclusion. That's no longer an issue.

Staff also correctly identified and the company has agreed and I think all parties are in agreement now about how this surcharge should be applied to customer bills. My office also believes that Staff has correctly identified the method for calculating how property taxes should be included in the ISRS. Staff has correctly identified the way in which accumulated depreciation reserve related to the cost of removal and salvage should be calculated.

Public Counsel believes the statutory language regarding the treatment of accumulated depreciation is not perfectly clear. My office does not have sufficient resources at this time to fully review the ramifications of the different methods of determining this number that have been proposed by the Staff or the company or to come up with any alternative proposals at this time.

However, based on what we've been able to review, we believe that Staff's approach would result in a lower surcharge and we would be comfortable, therefore, with the adoption of Staff's approach. We merely ask the Commission be mindful of the effect of the surcharge on the company's customers in determining which components are the best to use in calculating this ISRS. Thank you.

JUDGE WOODRUFF: Commissioner Gaw? Commissioner Murray?

COMMISSIONER MURRAY: Yes. Ms. O'Neill, something you said there. Is it accurate to say that the Office of Public Counsel did not review the calculations and the methodology, but simply supports Staff's recommendations because it results in a lower surcharge?

MS. O'NEILL: On the accumulated depreciation issue? We have not been able to thoroughly analyze that. Our staff has been -- as you're aware, we've got several rate cases going on and our staff is very small and stretched. We weren't able to do very much analysis regarding that issue. And that one we believe requires more analysis than we were able to put in.

So when we're looking at it, I think at the time that we filed the list of issues, my office officially does not take a position, however, we recognize that that calculation would be a lower number and we think that's better for the customers, so we're very comfortable saying that the Commission should consider a lower surcharge.

COMMISSIONER MURRAY: All right. Thank you.

JUDGE WOODRUFF: Commissioner Forbis? Commissioner Clayton?

You may step down. Thank you.

And for the Missouri Industrial Energy Consumers?

MS. VUYLSTEKE: Good morning. My name is Diane Vuylsteke. I represent the Missouri Industrial Energy Consumers.

We support Staff's position in this case. And we have settled on the issue of rate design, but we do support the Staff's position on the amount of the ISRS rate. And we have reviewed the Staff's calculations and we have today our witness, Mike Gorman, who's available to answer any questions that the Commission has about that. That's all. Thank you.

JUDGE WOODRUFF: Any questions for Ms. Vuylsteke?

MS. VUYLSTEKE: I apologize.

JUDGE WOODRUFF: All right. I don't see any questions, so you can step down.

For Missouri Energy Group?

MS. LANGENECKERT: May it please the Commission. I have a cold so excuse me if I start coughing.

I am Lisa Langeneckert and I represent the Missouri Energy Group. And we do not agree with the concept of the Infrastructure System Replacement Surcharge. And we were clear with that with the legislature but they passed it anyway. And so we are here to make -- or to indicate that we feel the reading of the statute goes along with what the company is saying should be the infrastructure depreciated amount.

We believe it's single-issue rate-making and I think that those problems have come to the forefront now because we're seeing a part of the case where it's believed that the company is over-earning, yet under the statute, they're allowed to come in and say that they need to recover this surcharge. But by reading of the statute, we believe that they are allowed to do that.

Our witness, Billie LaConte, is here and she can answer any questions you have relating to our positions we've stated.

JUDGE WOODRUFF: Any questions for Ms. Langeneckert?

COMMISSIONER MURRAY: I do, Judge.

JUDGE WOODRUFF: Go ahead.

COMMISSIONER MURRAY: Let me make sure that I understood what you said. I know you said you didn't agree with the concept of the surcharge, but that you believed that the company's calculations comply with the statute; is that correct?

MS. LANGENECKERT: That's our reading of the statute, yes, the plain language.

COMMISSIONER MURRAY: Thank you.

MS. LANGENECKERT: We understand why Staff believes what it believes.

COMMISSIONER MURRAY: Thank you.

JUDGE WOODRUFF: All right. Thank you then.

I believe that's all. Every party has had an opportunity to give an opening statement now.

Let's go ahead and take any evidence. And we'll begin with Missouri-American Water Company.

MR. ENGLAND: Thank you, your Honor. I'd like to call to the witness stand Mr. Ed Grubb.

JUDGE WOODRUFF: Good morning, Mr. Grubb.

(Witness sworn.)

JUDGE WOODRUFF: You may be seated.

You may inquire.

MR. ENGLAND: Thank you, your Honor.

EDWARD GRUBB testified as follows:

DIRECT EXAMINATION BY MR. ENGLAND:

Q. Would you please state your name and address for the record, please?

A. My name is Edward J. Grubb. My address is 535 North New Ballas Road, St. Louis, Missouri 63141.

Q. Mr. Grubb, by whom are you employed and in what capacity?

A. I'm employed by Missouri-American Water Company in the capacity of director of rates and revenues.

Q. And would you please briefly identify your duties and responsibilities as director of rates and revenues for the Missouri-American Water Company?

A. My primary responsibilities as director of rates and revenues is to file rate petitions before this Commission.

Q. Let me turn your attention to an exhibit that has been marked for purposes of identification as No. 5. It's titled Application and Petition for Establishment of an

Infrastructure System Replacement Surcharge. Do you have that in front of you, sir?

A. Yes, I do.

Q. In your capacity as the director of rates and revenues, were you involved in the preparation of this application and the appendices attached thereto?

A. Yes, I was.

Q. And with specific reference to those appendices, were they prepared by you or under your direct supervision?

A. They're either prepared by me or under my supervision, yes.

Q. Turning your attention to the appendices and beginning with Appendices A, would you briefly describe -- I believe there are two schedules there?

A. Yeah. There are two schedules under Appendix A. The first schedule under Appendix A is identified at the top and it consists of five pages and it's titled ISRS Eligible Facility Relocations.

The second schedule under Appendix A is a 20-page schedule and at the top of that -- those schedules are ISRS Eligible Mains, Hydrants and Valve Replacements.

Q. With respect to those schedules, is the format essentially the same?

A. Yes, they are.

Q. And would you briefly describe what it is you're trying to show with the various columns, please?
A. The schedule contains seven columns. The first column on the schedules is the Task Order Number. The task order number represents something similar to a work order where costs are accumulated for the projects.
The second column is a Short Project Description. The third column labeled Investment is the original cost of that project. The next column is the Depreciation Rate. That's the depreciation rate the company is using to depreciate the asset.
The third -- the next column is the In Service Date. That's the date that the asset was placed into service to serve our customers. The next column, Accumulated Depreciation, that is the actual -- actual accumulated depreciation on that asset that has been recorded to date through the filing of our ISRS surcharge.
And the last column is the Depreciation column. That is a function of multiplying the investment of original cost times the actual depreciation rate. And these -- these columns are the same for both Schedule 1 and Schedule 2 of the Appendix A.
Q. With respect to that last column, Depreciation Expense, is that an annualized expense figure?
A. Yes, it is.

Q. Turning your attention now to Appendix B, would you please describe that exhibit and the various schedules that comprise it?

A. Appendix B contains three schedules. The first schedule is a sample tariff sheet that we filed in our original application. It lists the short description of the availability of the tariff and the rate components contained within the tariff.

As a result of negotiations between the parties, the original tariff that was filed, the rate component was based on a percentage adder on top of the customer's bill as a result of the ISRS surcharge. We have had discussions and has been agreed upon that the company will use a volumetric rate or a commodity rate based on the actual customer's water usage within a billing period rather than a percentage adder.

Q. Are you saying then that the rate component language and percentages there will have to change as a result of our agreement regarding rate design?

A. Yes. That's correct.

Q. And will that be a difficult thing to do?

A. No. Once the Commission rules upon the final revenues to be determined in the surcharge, it's just a matter of going back and looking at the actual billing determinants from the last rate case, doing a quick calculation, coming up with a rate for each of the rate customers listed on the tariff now.

Q. Can you explain the second schedule that's part of Appendix B, please?

A. The second schedule under Appendix B is a four-page document. Page 1 will actually calculate the revenue requirement and simply identifies the actual ISRS replacement original costs, identifies the deferred taxes and the actual accumulated depreciation associated only with those assets, creates a revenue requirement based on the rate of return from the last St. Louis County rate case and then adds in the depreciation expense, the annualized depreciation expense on those assets and the property taxes on those assets also to come up with a total revenue requirement.

Q. Staying with page 1 of that second schedule in Appendix B and the top half, it appears that you've done the similar calculation for the various types of eligible replacement plant. Would you briefly describe those three categories, please?

A. Yeah. There are three categories that are contained within the legislation. The first category is a replacement of mains and associated valves and hydrants. That is at the top of the -- of the schedule.

There's another provision in the legislation concerning main cleanings and relinings. The company has not undertaken any of those projects in the last two and a half years. And the last one is facility relocations as a result of relocating our mains at the request of various governmental entities.

Q. With respect to the plant figure and the accumulated depreciation figure for the two categories of plant that you have there, and let's take water mains and associated valves, etc., first, do those numbers tie into your schedule -- your second schedule, page 20 of 20 of Appendix A?

A. Yes, they do.

Q. And similarly, under the facilities relocation, those numbers for plant and accumulated depreciation tie into your earlier schedule -- four- or five-page schedule, I believe, in Appendix A?

A. That's correct, yes.

Q. Would you please then describe the -- go on to describe the second and remaining pages of this schedule?

A. Page 2 of 4 of the second schedule of Appendix B is the calculation of the property tax associated with the investment in the ISRS replacements. Page 3 is the calculation of the deferred income taxes. And the fourth page is the -- the laying out the rate design that was used to allocate the costs to the various rate classifications.

Q. As a result of discussions with Staff and other parties, would the calculation of deferred taxes and the rate design portion of this schedule now be subject to revision or update?

A. The -- the calculation of deferred income taxes has been adjusted slightly by Staff. And the company does not disagree with their -- their adjustment.

Q. And the percentage calculations on the fourth page of this schedule, those would obviously no longer be appropriate since we've agreed to a volumetric rate. Correct?

A. The fourth page will actually just take the costs and develop the revenue requirement by class. The methodology will stay the same, but the allocation of that revenue requirement will cha-- the allocation won't change, but what will change is whether it's a volumetric rate charge or a percentage adder. That's -- basically this schedule will stay the same.

Q. I thought this tariff created the percentage adder.

A. It does at the bottom, but we can -- that last couple lines on there, tariff design will only change in that you will insert billing determinants to determine what a rate is. So the last column, proposed tariff rate of 4.29 percent for the rate A and K customers, instead of being

4.29 percent, it may be 10 cents per thousand gallons.
That's the only difference.
Q. So it changes from a percent to a per gallon or volumetric --
A. That's correct.
Q. Thank you.
Turn your attention please to the third schedule, which I believe is 39 pages of Appendix B. And would you briefly describe that?
A. As a result of making the ISRS eligible plant investments, the company had to obviously retire the old, worn-out facilities. And this schedule, Schedule 3 of Appendix B, is 39 pages of the actual plant retirements that the company made.
There are six columns here. There's a task order number which identifies the project, a short description, the out of service date that the asset was taken out of service, the original cost that was retired by the company, the cost of removal net of salvage, and the depreciation expense on the original cost.
And I included the depreciation expense here because as you take the asset out of service, you're actually going to reduce your depreciation expense within the ISRS calculation because you're taking these assets out of service. So the company reduced the depreciation expense

by the depreciation on the retired assets.

Q. On page 39 of 39 of that exhibit in the next to last column you have a grand total of cost of removal net of salvage of a little over a million dollars. Do you see that?

A. Yes, I do.

Q. And does that number flow through to your revenue requirement calculation in Appendix B?

A. Yes, it does.

Q. Or excuse me, I guess it's the second schedule of Appendix B.

And that's one of the issues we have with Staff. Correct?

A. That's correct.

Q. With respect to the application, the statements contained therein and then the information contained in Appendices A and B and their various schedules, is the information contained therein true and correct to the best of your knowledge and belief at the time they were prepared?

A. That's correct.

Q. Okay. Let me turn now to your -- or turn your attention rather now to an exhibit that has been marked for purposes of identification as Exhibit 6, which has a revised Appendix B denomination, if you will, up in the right-hand corner. Do you have that?

A. Yes, I do.

Q. Would you please explain that schedule?

A. Yes. Upon -- after filing the original ISRS on September 2nd, the company realized that it inadvertently did not reduce the net cost of the -- of the investments by the reimbursements that we received from the various governmental entities in relation to our relocation projects.

The company during audit by the Staff talked about this issue and alerted the Staff of the issue. They have appropriately, you know, reflected that reduction in the net cost for reimbursements. The Staff also made an adjustment to the company's calculation of the deferred income taxes as a reduction in the net cost of the investments, and the company does not disagree with that adjustment.

So taking those two issues and incorporating them into our original schedule, the -- the company's proposed ISRS revenue is now 3.813 million rather than 4.038 million in its original filing.

Q. Was this Exhibit No. 6 prepared by you or under your direct supervision?

A. Yes, it was.

Q. And is it true and correct to the best of your information, knowledge and belief?

A. Yes, it is.

Q. You've indicated changes that were made as a result of agreements with Staff and other parties in the case. What areas of disagreement remain between the company, the Staff and perhaps other parties here in the case?

A. There are basically three, as has been noted earlier. The accumulated reserve -- the proper level of accumulated reserve to include in the net cost of investments, the treatment of cost of removal net of salvage and property taxes.

Q. Let's start with the accumulated depreciation. Would you please describe how you calculated that for purposes of your overall revenue requirement calculation?

A. What we did is to look at each of the individual projects that the company performed that are included in the ISRS. And we've identified the actual accumulated depreciation that has been accrued on those projects through the ISRS filing.

Q. Turning your attention to, say, Schedule 1, the five-page schedule attached as Appendix A to the application, can you just take us through that exercise with respect to one line item?

A. Yeah. I'm looking at Appendix A, Schedule 2, page 1 of 20. There there's various project descriptions going down the column. And in the fifth column over is the actual accumulated depreciation for that project that has been accrued and relates to those projects for that specific project.

So for each project on here, we have identified the actual accumulated depreciation accrued to date and that's in the reserve account for those projects.

Q. Now, having determined then the total amount of accumulated depreciation associated with all of these projects, did you further adjust accumulated depreciation for the net cost of removal?

A. Yes, we did. As shown on Appendix B, Schedule 3, the company has incurred expenditures of about 1.3-- $1.036 million associated with the plant investments in the ISRS to retire the old assets.

What happens when these expenditures are made, the company makes the expenditures, the cash goes out the door and the resulting other side of the entry is a reduction to the accumulated reserve account on the company's books.

And company believes it is appropriate to reflect the fact that these expenditures and this cash was invested and that the reserve should be reduced, thus increasing the accu-- or increasing the net investment or net cost of the ISRS investment.

Q. Let me turn your attention now to the property tax calculation. Would you please describe how you did that?

A. The company used the actual current property tax rate and multiplied it times the total of the eligible ISRS investment.

Q. And is that shown on your second schedule of Appendix B, page 2 of 4?

A. Yes, it does.

Q. For purposes of calculating the revenue requirement associated with the eligible infrastructure replacement plant, what rate of return did you use?

A. We used the rate of return from the last St. Louis County district's rate -- rate case, Case No. 2000-844.

Q. And why did you use that rate of return, Mr. Grubb?

A. First, it's the most recent actual regulatory capital structure that was used for the company in that case. And it's the most recent one. And second, that we believe it's appropriate because that rate of return was developed for St. Louis, the St. Louis district and it is the St. Louis district that we filed the ISRS filing for. So we're trying to match the rate of return with the actual district that's applying for the ISRS.

Q. In your opinion, would it be appropriate to use the rate of return authorized in the most recent case involving Missouri-American Water Company for purposes of this calculation?

A. No, I do not.

Q. And why not?

A. That rate of return in the last Missouri-American case, Case No. 2000 I believe 280, applied to all the other districts of Missouri-American, excluding St. Louis County.

Q. If you don't use the St. Louis County-specific rate of return from its most recent rate case, what would be an appropriate alternative then, in your opinion?

A. I guess since we have -- we had two legal entities and then at the end of 2001, it became one legal entity. A weighted blending charge of the two capital structures could be deemed appropriate.

Q. And is that what you've attempted to show on the exhibit that's been marked for purposes of identification as Exhibit 7?

A. Yes, I have.

Q. Was that exhibit prepared by you or under your direct supervision?

A. Yes, it was.

Q. And would you briefly describe what you've done there?

A. In looking at Exhibit 7 --

Q. Correct.

A. -- Mr. England?

What we did was we -- we identified the dollar amount of long-term debt preferred stock and common equity that were utilized in the Commission's orders in Case 2000-844 and 2000-280, calculated the ratio of the -- those capital components to the total and used the cost rates from those two Commission orders to come up with a weighting of the overall cost of capital with a result of 8.43 for the overall and total weighted cost of debt of 3.57 percent.

Q. Mr. Grubb, what was your goal in calculating the revenue requirement to be recovered from the IR-- excuse me, ISRS?

A. My primary goal was to basically take a snapshot view of the revenue requirement associated with the ISRS replacement investments. So we identified the actual investments that we've -- that were placed into service, we've identified the actual accumulated depreciation on those investments since they've been placed into service, we've identified the actual deferred taxes on those investments, calculated the depreciation expense and the property taxes on those investments and also took into account the actual cost of removal and its impact on the accumulated reserve for those investments and came up with a revenue requirement.

Q. Do you believe you've achieved your goal?

A. Yes, I do.

Q. Conversely, do you believe that Staff's calculation of the revenue requirement associated with the ISRS plant reasonably reflects the revenue requirement attributable to that plant?

A. No, I do not.

Q. And why not?

A. First, the Staff grossly or substantially overstates the accumulated depreciation and the calculation of the net cost. They have taken depreciation on non-ISRS eligible plant and applied it to the ISRS eligible plant. They've overstated the accumulated depreciation by not reflecting the impact of the cost of removal net of salvage and they understated the level of property taxes.

Q. Describe briefly, if you would, how Staff calculated the accumulated depreciation for purposes of this calculation.

A. Staff has performed a calculation that incorporates accumulated -- accumulated depreciation associated with non-ISRS eligible infrastructure. Staff's calculation assumed a ratable proration of the increase in the accumulated depreciation based upon the ratio of the ISRS investment divided by the total increase in the net company assets since the last rate case. And by doing that, they've assigned accumulated depreciation on all assets to the ISRS assets.

Q. What percent of eligible infrastructure replacement plant does Staff's accumulated depreciation amount represent?

A. It's over 53 percent.

Q. What would be the effective depreciation rate associated with this accumulated depreciation?

A. Using the 53 percent and an average service life of two and a half years from the time of the last rate case to ISRS filing, it creates an approximate depreciation rate of about 20 percent, 21 percent.

Q. And what is the company's presently authorized depreciation rates for these items of property?

A. It's approximately 2 percent.

Q. How has Staff treated the net cost of removal for purposes of its calculation?

A. Staff has not shown the impact at all in the calculation. They've ignored it from the calculation.

Q. And what effect does that have on the calculation?

A. It overstates the level of accumulated depreciation on the ISRS investments.

Q. And is that appropriate, in your opinion?

A. No, it is not.

Q. Why not?

A. It's not appropriate because you have to take all impacts on the accumulated reserve in the determination of the net cost. And one of those impacts of accumulated depreciation is the expenditures made by the company to retire assets to place into service the new assets related to the ISRS.

Q. And how has Staff treated the property tax expense for purposes of its calculation?

A. Staff has eliminated the property tax expense on the 2003 investments made by the company that were placed into service this year.

Q. And is that appropriate, in your opinion?

A. No. We do not believe that's appropriate.

Q. And why not?

A. All property taxes on eligible infrastructure placed into service in 2003 will become due beginning in January of 2004, which is within 12 months of the filing of the ISRS. The recording of the liability, in effect, becomes -- recording of the expense on the accrued liability, in effect, becomes due on the company's books for financial reporting purposes at that time.

And I think that the -- the inclusion of those property taxes is appropriate because the ISRS will go into effect December 31st of this year and that ISRS revenues should include the property taxes on investment that we will begin actually incurring the expense on January 1st of next year.

MR. ENGLAND: Your Honor, I have no other questions of the witness, but would offer at this time Exhibits 5, 6 and 7.

JUDGE WOODRUFF: Exhibits 5, 6 and 7 have been offered into evidence. Are there any objections to their receipt?

Hearing none, they will be received into evidence.

(Exhibit Nos. 5, 6 and 7 were received into evidence.)

MR. ENGLAND: Thank you, your Honor. And I'll tender the witness for cross-examination.

JUDGE WOODRUFF: Okay. For cross-examination then we'll begin with Staff.

CROSS-EXAMINATION BY MR. SCHWARZ:

Q. Morning, Mr. Grubb.

A. Morning, Mr. Schwarz.

Q. I'd like to discuss first, if we might, the process for setting rates in a general rate case. Okay?

Would you agree that a major part of a general rate case is to determine the utility's revenue requirement?

A. I think that's one of the outcomes of a rate case. In my opinion, the final determination of a rate -- general rate case is set, just and reasonable rates for its customers.

Q. But you would agree that determining the revenue requirement is a significant piece of that?

A. That leads -- if the revenue requirement is set appropriately, that leads to a level of just and reasonable rates.

Q. Do you then agree that determination of the revenue requirement is a significant part of a general rate case?

A. I'll agree with that.

Q. Is one part of the revenue requirement in a rate case determination of the company's cost of capital?

A. That -- that is correct, yes.

Q. Would you agree that you obtain that revenue requirement by multiplying the utility's rate base for the test year by its weighted cost of capital?

A. Adjusted for true-up items that may occur, yes.

Q. Would you agree that another element of revenue requirement is depreciation expense?

A. That's correct.

Q. Would you agree that depreciation expense in the rate case is calculated by multiplying the test year plant account balances by the depreciation rate as prescribed by the Commission for each account?

A. That's correct.

Q. Would you agree that the rates the company -- the company's rates that are charged to its customers that are set in a general rate case reflect these levels of cost until the rates from the next general rate case take effect?

A. I would agree with that.

Q. Okay. I'd like to shift gears a little bit now and talk about the term "regulatory lag." Are you familiar with that term?

A. Yes, I am.

Q. Would you agree that regulatory lag is the delay in recognizing in rates changes in costs and expenses from the levels that were used to set those rates in the last general rate case?

A. That would be correct. Any change in revenues, expenses, investment, that's right, yes.

Q. Would additions to plant possibly result in regulatory lag?

A. Additions to plant creates costs that are not reflected in the current rates. Assuming that investment is made after the cut-off of when rates are set, that's correct.

Q. Mr. Krueger in his opening mentioned Accounting Authority Orders. Are you familiar with the concept of an Accounting Authority Order?

A. Yes, I am.

Q. And would you agree that -- well, let me ask you this. What's your understanding of an Accounting Authority Order?

A. An Accounting Authority Order is a -- it's a request made by a company to request the Commission to defer certain costs into a regulatory asset account to allow it to recover it in a future rate increase.

Q. So instead of, for instance, booking property tax expense that might be associated with a particular item as an expense in the year it's incurred, that will be booked to the deferral account for consideration later?

A. If --

Q. Assume --

A. -- an AAO is granted on that request.

Q. Right.

A. That -- that would be the process, yes.

Q. Okay. So Accounting Authority Orders are a method of addressing regulatory lag. Would you agree with that?

A. They -- they can be, yes, if approved.
Q. And whether they actually do or not won't be known until the Commission acts on the rate-setting principles or the rate-making in the next rate case; is that correct?
A. That's correct.
Q. Does the ISRS also address the problem of regulatory lag?
A. It allows the company to make the investments necessary to provide the service to the customers and allow us to recover those costs prior to the next general rate increase.
So, you know, it -- it would cut down or reduce the regulatory lag on those costs associated with the infrastructure system replacements specific to those infrastructure system replacements.
Q. Right. It addresses the regulatory lag associated with the eligible property for an ISRS?
A. And all the costs associated with those -- that eligible, yes.
Q. I want to talk now about plant retirements just generally. Would you agree that when plant is retired, the plant balance on the company's books is reduced by the original cost of the retired property and the reserve for depreciation is reduced by the same amount?

A. That -- that's the correct utility accounting, yes.

Q. And given the net plant and what we talk about as rate base, a plant retirement doesn't affect rate base?

A. Well, if we want to bring in the St. Joe treatment plant, I can't say that's a correct statement.

Q. I don't want to --

A. On --

Q. Just in general principles, if you will.

A. Okay. That's fine. In general, for the retirements that we've included in our schedule -- or Appendix B, Schedule 3, the accounting would be to reduce the utility plant, reduce the reserve, yes.

Q. Let's talk about depreciation expense, if we might. Would you agree that each month depreciation expense increases the reserve for depreciation?

A. Recording depreciation would, yes, increase the reserve.

Q. Would you agree that without considering any plant additions to a particular account, that the increase in depreciation reserve would act to reduce rate base?

A. If one assume the utilities stop making -- stop making any investments, that's correct.

Q. So, again, excluding any thought of plant additions, the rate base at any point in time will be less than it was when rates were last set in a rate case due to the effect of the interim accumulation of depreciation expense; is that correct?

A. Can you repeat that, please, sir?

Q. Without considering any additions to plant, rate base at any point in time is less than it was when rates were last set in a rate case?

A. Ma-- yeah, making the assumption that no additional investments are being made, that's correct.

Q. And are the rates to customers reduced to reflect this reduction in rate base?

A. As earlier you stated that you would not change the rates until you went through another -- another rate case and -- and rates are reset looking at the impact on the reserve, the plant, as you're saying, would also in the level of revenues and expenses. And we look at everything in the context of a general rate case.

Q. So your answer is no? Are rates to customers reduced to reflect the reduction in rate base?

A. I don't know if that would happen. Because you're just looking at one piece of regulatory lag, whereas, you know, you can also be having rising costs of your labor.

I mean, if you exclude everything else and make the assumption that everything else stays the same, then if you went into a general rate increase situation and your net investment goes down and all your costs that were there in the prior rate case are exactly the same, then the Commission would probably authorize lower rates. The problem I'm having is you're just pointing at one little piece of --

Q. Understood. I don't mean to be suggesting --

A. -- the rate case.

Q. -- that that's the only thing that changes between rate cases. But between rate cases, the rates that are charged to customers don't reflect, for instance, the reduction in rate base net of any plant additions. That's just one item? I'll read it again.

A. Read that again, please.

Q. Sure.

A. Thank you.

Q. Are rates to customers reduced to reflect the reduction in rate base, you know, excluding any plant additions between rate cases?

A. No. No. Because --

Q. Right.

A. -- there's no mechanism to do that.

Q. Would you also agree that retirements -- plant retirements without -- again, without considering any additions to plant since the last rate case, that plant retirements would reduce the plant account balances used to calculate the monthly depreciation expense?

A. That -- that is correct, yes.

Q. And, again, rates don't change in between rate cases to reflect that reduction, do they?

A. Not until you go to the next general rate increase.

Q. I want to talk about property taxes for a moment, if I might. And the American Heritage College Dictionary defines the word "due," d-u-e as payable immediately or upon demand. That's the first definition in that particular dictionary for the word "due."

Is it your contention that the property taxes for the year 2004 will be payable immediately or due upon demand in January of 2004?

A. In reading and applying to our interpretation of due, we interpret it as being due in terms of financial reporting --

Q. Well --

A. -- and recording the expense. We record the expense starting in January on the '03 additions.

Q. Is it your position that the county collector or school district or any other political subdivision could demand that you pay a portion of your property -- of your 2004 property taxes in January 2004?

A. I'll agree that the company will pay the property taxes. I'm not going to dispute that. The company will pay the property taxes associated with the 2003 additions some time in November or December of 2004. I'll -- I agree with that. Okay?

The company's interpretation of due -- when it was due, is when it incurs the liability. And I think this whole discussion will just be a determination of how the legislation is interpreted.

Q. So that, for instance, is that the same position that you take with respect to other invoices or purchases that you might make; that is, you take delivery of chemicals on March the 1st with -- and the terms are net 60, is that invoice due on March the2nd?

A. When we receive the materials, we immediately recognize a liability.

Q. I understand.

A. And that's similar to what we're saying on the property. We incur the liability and those liabilities are due. They may be paid subsequent to that.

Q. Okay. I think we've -- I think we've got that. At least we understand the difference.

A. Yes, sir.

Q. I want to talk about cost of removal in net salvage. Are you familiar with the depreciation rates prescribed by the Commission for the St. Louis County operations in the last St. Louis County Water case?

A. I'm familiar with them, yes.

Q. Do those depreciation rates include a factor for net salvage cost of removal?

A. Yes, they do.

Q. To your knowledge, how long have the rates prescribed for St. Louis County included those items?

A. To the best of my knowledge, going back and discussing the issue with company officers, I think it's been that way for an extremely long time.

Q. And is that factor of the depreciation rates applied to account balances every month to determine depreciation expense?

A. That is correct.

Q. In response to a question by Mr. England on this subject, you said that when retirement costs are incurred, the cash goes out the door. Do you remember --

A. That -- that is correct.

Q. But isn't it true that through the depreciation rate, you have been collecting those costs for decades through the depreciation rates?

A. Key point here that we have to understand is that the current rates of the company, being St. Louis district, includes a level of accumulated depreciation that was recorded on the books of the company that included the amounts for cost of removal net of salvage.

So that means that has -- through the years has increased the reserve and that reserve has been used to lower rate base. So the customers have been receiving a benefit of the lower rate base on the reserve piece associated with the cost of removal.

Now, the company has taken that cash and taken it, paid it out and that -- recording of that entry or that transaction increases or decreases the reserve, thus, increasing the net investment.

Q. But the ratepayers have provided the actual cash over many, many years through the depreciation rates to reflect the additions to accumulated depreciation. Is that not correct?

A. Yes. And they are receiving the benefit of the lower rates because of their providing those funds. Those funds come in and the reserve is higher than it would have been without those funds -- or the reserve would have been lower without those funds and the water rates would have been higher.

Q. But you concede that the ratepayers have already provided cash to the company to the extent that the company has reflected the cost of removal in the depreciation rates?

A. That is correct. And the -- and that cash goes into the company and that recording of that accumulated depreciation lowers their rates. So they're getting the benefit by paying into the depreciation reserve.

Q. Well, they get the benefit of the use of that money; that is, it reduces the cost of capital, if you will. But we're talking about now the principal that the ratepayers have provided to the accumulated -- or the reserve for depreciation. So that the customers have received the benefit of providing this money in advance by reduction in the cost of capital, but now it's time for them to get back the principal amount as well?

A. I disagree with your statement that cost of capital is reduced. I -- I don't know what you're referring to. I don't know how the cost of capital is reduced by the customer paying in.

Q. The cost -- well --

A. Cost of capital is a percentage, like 8 percent on the cost of capital. I'm not following you.

Q. But the company's revenue requirement, as we discussed earlier, is based -- the cost of capital component is based on multiplying the weighted cost of capital times the rate base, is it not?

A. The rate of return times the rate base produces a level of utility operating income.

Q. So to the extent that the customers are given credit through the reserve for depreciation for their cost -- the cost of removal factor in the depreciation expense, that increases the reserve for depreciation, does it not?

A. Increases the reserve for depreciation.

Q. Which reduces the rate base. And that reduction of rate base is, during the time that it remains in the reserve for depreciation, used to reduce the company's revenue requirement for cost of capital?

A. And that -- I fully agree with that.

Q. Okay.

A. And so the customers are getting a benefit of reduced rates for --

Q. For the use of their money in advance?

A. That's right.

Q. And when the company actually expends costs to remove the property, it's time to give the customers back the principal amount of the reserve for depreciation that they have already provided in cash to the company. Is that not correct?

A. And that is done by decreasing the reserve, which then pushes up the rate base. And when you multiply it by your cost of capital, the rates are higher.

Q. Well --

A. That's --

Q. -- except that at the same time the retired property also comes out of the rate base; isn't that correct?

A. But it also comes out of the reserve also, so there's no rate base impact there.

Q. Right.

A. There is a rate base impact to the -- to the customer when the company makes a cost of removal expenditure. It increases rate base and increases the net investment. That's what we tried to do in this ISRS.

Q. Does the depreciation factor the company applied to the ISRS balances and the Staff applied to the ISRS balances reflect the factor for net salvage cost of removal?

A. The current depreciation rates include a recognition of the cost of removal and salvage, yes.

Q. What's the period over which this ISRS rate will be collected?

A. The effective date, I believe, is December 31st. And then it will -- and whatever the rate is that we agree on in the tariff will be set back to zero April 16th, I believe --

Q. At the --

A. -- when the new rates -- operation of law date, when new rates in this case go into effect.

Q. And I think you agreed earlier that the 2004 property taxes will likely be paid in November, December of 2004?

A. The property taxes on the '03 additions will be.

Q. On all the company's property for 2004 will be paid in November or December of 2--

A. Well, the property additions made -- the company will be paying property taxes on the '02 additions in December of this year.

Q. And --

A. And, again --

Q. Yes.

A. -- and again and again. That's right, yes.

Q. So the company's requesting inclusion of property taxes in its ISRS that will expire more than eight months before the taxes must be paid or will be paid?

A. The company will recover the property taxes as it incurs the expense. And that expense will be -- that liability will be paid at the end of '04.

MR. SCHWARZ: Thank you. I think that's all I have.

JUDGE WOODRUFF: All right. We've been going for about an hour and a half, so we're due for a break. Take a break now and we'll come back at 10:45.

(A recess was taken.)

JUDGE WOODRUFF: Before we took our break, Staff had concluded its cross-examination of this witness and we'll now move to Public Counsel.

MS. O'NEILL: No questions, your Honor.

JUDGE WOODRUFF: And the Missouri Industrial Energy Consumers?

MS. VUYLSTEKE: No questions, thank you.

JUDGE WOODRUFF: And Missouri Energy Group?

MS. LANGENECKERT: No questions.

JUDGE WOODRUFF: We'll come up to the Bench for questions. And, Chair Gaw, do you have any questions?

CHAIR GAW: Not right now.

JUDGE WOODRUFF: Commissioner Murray?

COMMISSIONER MURRAY: Yes, I do. Thank you.

QUESTIONS BY COMMISSIONER MURRAY:

Q. Good morning.

A. Good morning.

Q. When Mr. Schwarz was questioning you earlier, he was asking you about plant retirements. And he said, and I believe you agreed, that retirement of plant does not affect the rate base?

A. That is correct.

Q. What is the effect on rate base of the retirement of the ISRS property, if any, in the way that the company has calculated it?

A. There will be no -- no impact. It reduces -- a retirement would reduce the cost of the old plant out of the utility plant and also reduce the accumulated reserve by the same amount, the original cost of the plant out of the reserve. So it's a net of zero.

Q. Is your mic on? It's doesn't --

A. I'm just probably not close enough.

JUDGE WOODRUFF: I think you need to be a little bit closer.

THE WITNESS: Okay.

BY COMMISSIONER MURRAY:

Q. And then what is the effect on rate base of retirement of the ISRS property as Staff has made its calculations, if any?

A. In looking at their schedule and comparing it to our schedule, they've basically -- on the retirement side have reflected it in the same fashion. They've -- there's no impact on rate base of retirements of just the physical retirement of the asset.

Q. Okay. Would you explain, as you understand it, the reconciliation process? For example, how much of the 3.8 million, if that is the amount that is put into the ISRS here, how much do you expect of that amount would be recovered at the effective date of the next rate case?

A. Once we know what the -- assuming the Commission authorizes the $3.8 million, we will develop a rate and that rate will be applied to all customers' bills from December 31st through April 16th. Depending on the -- the actual sales that the company has, there will be a difference between what we actually collect and what the Commission authorizes.

Q. When will that be trued up?

A. The physical reconciliation I believe can be done fairly quickly, within a month or two after the April 16th date. The -- if -- should the company under-collect, that under-collection would be -- our plans are to roll it into the next ISRS filing. If it's -- if it's an over-collection, we would reduce the next ISRS filing by that over-collection.

Q. So will there be a true-up prior to the next ISRS filing or will that occur at the next ISRS filing?

A. Because of the rate case setting ISRS rate back to zero, the ISRS -- I believe there should be a reconciliation and that reconciliation, whether it's an under-collection or over-collection, will be trued up and included in the next ISRS filing.

Q. And it will be trued up at the time of the rate case? I'm trying to figure out when the true-up actually occurs.

A. No. I -- as I understand it, the rate case -- the results of the rate case will take effect April 16th. And at that point the ISRS will cease, it will just be set back to zero so there will be no surcharge on the customers' bills.

The company then will obviously go back in and look at all the revenues collected. And then within a short time period determine whether there's an under-collection or an over-collection. And if it's an under-collection of, say -- I'll just throw out a number here -- of $15,000, that $15,000 will be incorporated into the next ISRS filing of the company. So I don't think it will be part of the rate case.

Q. But it probably will be part of the next ISRS case?

A. Yes. That's correct.

Q. Okay. In terms of the property tax issue, I believe I heard you confirm that the actual payments of the amounts owed for 2003 will not be made until some time in November or December of 2004; is that correct?

A. That's correct.

Q. And you're interpreting due to mean not due to be paid, but -- how are you interpreting it?

A. There's a liability on the books of the company. As soon as January 1st begins, the company has a liability to pay those taxes when we receive invoices or tax bills from the -- from the governing authorities.

Q. I'd like to talk about the net salvage issue a little bit to get a little more clarification on that. The company isn't taking the position that the cost of removal should be both amortized and expensed, is it?

A. In the context of the ISRS filing?

Q. Yes.

A. In the context of the ISRS filing, the company is treating it as an expenditure which reduces the accumulated reserve account. And by reducing the accumulated reserve account, it recognizes an increase in the company's net investment cost of the ISRS infrastructure.

Q. Okay. And as net salvage has been -- or cost of removal has been treated in the past, the cost of removal has been amortized throughout the life of the plant; is that correct?

A. That's correct. That's included as part of the depreciation expense.

Q. With the idea that it is a cost of that plant and it is being caused by the ratepayers that are using that plant?

A. That's correct.

Q. So it matches the cost causer to the cost payer?

A. That's correct.

Q. And does your treatment, in terms of recognizing the expenditure when it is made and then reducing the accumulated depreciation by that same amount, is that any different than cost of removal would be treated at retirement time absent the ISRS?

A. There would be no difference. We would still, just like we are proposing in the ISRS, go ahead and reduce the reserve for the actual cost of removal. In the context of a rate case, if any plant is retired and has associated cost of removal, the reserve is also reduced.

Q. And your calculations have -- in looking at the net cost of plant that is being replaced, you are taking your calculations of accumulated depreciation based on that specific plant; is that correct?

A. That is correct.

Q. And Staff is somehow incorporating accumulated depreciation on the company's entire plant?

A. That's correct, yes.

Q. And trying in some way to tie that to the net cost of plant that is being replaced?

A. That's right. That is correct. They are reducing the total investment made by the company for a prorata portion of all depreciation -- all accumulated depreciation recorded on the books of the company.

Q. And I believe that your calculations have shown that if you then took that prorated cal-- prorated amount of accumulated depreciation and applied it just to the plant that is being retired, you would come up with an effective rate of between 20 and 21 percent per year for depreciation?

A. That's correct. The Staff is showing approximately $29 million and we agree upon the total cost of the plant invested $29 million. They're assigning approximately or -- assigning $15.5 million of accumulated depreciation to that investment, recognizing basically that that plant is 53 percent depreciated. And that -- translating that into over two and a half years of depreciation since the last rate case, it's about 20 percent depreciation rate.

Q. And why is the accumulated depreciation -- why does the last rate case determine the length of time in which you're calculating that or Staff is calculating it?

A. Because you can only incorporate into the ISRS investment made by the company that has not been included in the last rate case. Obviously we've made investments in infrastructure system that are currently in rates. We do not want to incorporate into the ISRS any of those investments or any depreciation on those investments.

Q. And so Staff's position would effectively say that 53 percent of the investment that the company has not yet recovered in rates since the last rate case has already been depreciated?

A. In essence, that's what they're doing, yes.

Q. Are you aware of any other time in the history of your company's regulation that an effective depreciation rate of 20 to 21 percent was applied to -- well, let's say any asset?

A. I can recall in my history with American Water that there may have been some accounts that may have had a depreciation rate that high such as vehicles, which has a four- or five-, six-year life versus mains upwards of 50, 70, 80 years. But nothing to the extent of 20 percent on a main or hydrant or a valve.

Q. And the Appendix A -- Appendix A that you attached shows the plant that is being replaced. Correct?

A. Appendix A shows the -- shows the new plant that we've placed into service.

Q. Okay. That's what I meant but I didn't say it that way. The replacement plant?

A. Right.

Q. And the plant that is being retired, I'm sure that every piece of that plant did not have the same depreciation applied to it; is that correct? There was some variance in what you were allowed to -- well, you weren't allowed to because it wasn't in the last rate case.

Similar plant, what rate does it have applied to it now for depreciation rate?

A. If the plant is recorded to the same account, it would be using the same depreciation rate.

Q. Which would be what?

A. For the retirements or for the additions?

Q. Well, let me think a minute which I'm trying to get at. Since I'm wanting to reference accumulated depreciation, it would be for the retirements.

A. The retired assets did have a depreciation rate attached to it where they were depreciated using the current depreciation rates, but on this schedule it doesn't show what those rates are. But they would be very similar to the ones under Appendix A.

Q. In your column Depreciation Rate, which varies somewhere between it looks like 1.5 something up to --

A. Up to 2.6 or 2.8.

Q. And where did you get those rates that you put in this schedule?

A. They're authorized by the Commission in the company's last rate case, Case 2000-844.

Q. And the plant that is replacing that retired plant would be ordinarily treated similarly, if not the same, for depreciation; is that correct?

A. Yes, it would be exactly the same. It would use the same depreciation rates as the retired plant.

Q. And, once again, the depreciation rates on your Appendix A, are those the rates that were assigned to the retired plant?

A. If we can locate retired asset and then show the new asset, you know, obviously put a main in and you take it out and you replace it, the depreciation rates would most likely be the same, assuming it's the same size main and the same type of main.

For example, we may put in a ductile iron main whose depreciation rates may be a little bit differently than the main that was replaced. It could be cast iron. So there's a -- there's going to be a depreciation rate for the new main and there was a depreciation rate on the old main.

The depreciation rates can vary amongst different assets because of the rate applied for ductile iron, cast iron, the age -- the age of the assets may -- may come into play. And that was all determined in the last Missouri -- last St. Louis County rate case.

COMMISSIONER MURRAY: I think that's all I have for you right now anyway. Thank you.

THE WITNESS: Thank you.

JUDGE WOODRUFF: Commissioner Forbis?

Commissioner Clayton?

COMMISSIONER CLAYTON: No.

JUDGE WOODRUFF: All right then. We'll go back to questions -- to recross based on questions from the Bench beginning with Staff again.

RECROSS-EXAMINATION BY MR. SCHWARZ:

Q. Mr. Grubb, do you understand -- is it your understanding that Staff is recommending a depreciation rate of 20 percent per year on the ISRS replacement property?

A. The 20 percent rate is a rate based upon the impact of what the Staff is recommending. By applying an excessive amount of accumulated reserve from all non-ISRS plant, applying it to this investment, they've made an assumption that the rate is 20 percent over the last two and a half years.

Q. Are you suggesting that Staff's position is that an appropriate depreciation rate for the plant that's been placed in service since the last rate case is 20 percent per year?

A. No.

Q. Okay. Isn't it -- or would you agree that the difference in accumulated depreciation reflects a difference in the starting point of the calculation between the company and the Staff?

A. I just believe the difference between the company and the Staff is the Staff has taken depreciation on non-ISRS property and applied it to the ISRS property. To me, that's the difference.

Q. And by "non-ISRS property," you mean property that was in place at the close of the company's last rate case?

A. Yes. And possibly additional non-ISRS property that has been placed in the service beyond that last rate case, such as if we replaced a booster station, there's depreciation on that. We believe a part of that may have worked itself's way into the -- into the Staff's calculation. By just doing a prorata amount --

Q. Okay.

A. Okay.

Q. So their method of estimation of the change in the reserve for depreciation may not be an accurate estimation, but what it's estimating is the change in the reserve for depreciation for the ISRS accounts. Is that fair to say? And whether or not it's accurate or not, I know -- I understand you dispute.

A. Is that Staff's determination? I --

Q. Yes.

A. Sort of -- can you repeat that one more time?

Q. I don't know if I can or not.

A. I'm sorry. It got kind of long on me.

Q. Yeah. The Staff's 11 million and 2, whatever, that number that's in dispute, reflects Staff's estimate of the change in the reserve for depreciation for the I-- the ISRS account since the last rate case?

A. I don't know what Staff is -- I mean, they just do a mathematical calculation and --

Q. And you don't understand what it's gauged to do?

A. Well, I could tell you what I think it's gauged to do.

Q. Well, that --

A. Is to overstate the accumulated reserve.

Q. So -- I'm sorry. Go ahead.

A. To overstate the accumulated reserve and to produce a revenue requirement far below what really should be reflected for the ISRS assets.

Q. And that's what Staff intended to do?

A. That's what Staff did. And I assume they -- Staff knew the end result of what they were doing.

Q. Okay.

JUDGE WOODRUFF: Anything else, Mr. Schwarz?

MR. SCHWARZ: No. I'm sorry.

JUDGE WOODRUFF: Then for Missouri Industrial Energy Consumers?

MS. VUYLSTEKE: No questions. Thank you.

JUDGE WOODRUFF: Missouri Energy Group?

MS. LANGENECKERT: No.

JUDGE WOODRUFF: I'm sorry. I passed you.

MS. O'NEILL: No questions, your Honor.

JUDGE WOODRUFF: Then redirect?

MR. ENGLAND: Thank you, your Honor.

REDIRECT EXAMINATION BY MR. ENGLAND:

Q. Mr. Grubb, let me go back to some questions I think you had -- or received both from Mr. Schwarz and from the Bench regarding the accounting treatment for a retirement. Do you recall those questions?

A. Yes, I do.

Q. Now, just looking at the accounting treatment, what happens when you retire a piece of property?

A. When you retire a piece of property, you determine what the original cost is. Say we have a main that was -- the original cost that was put into service 40 or 50 years ago, $1,000. You would reduce the $1,000 from the utility plant in service account and then you would reduce that same $1,000 from the accumulated reserve account.

Q. Okay. Now, holding you right there, does that have any effect on the net plant or the rate base on which the Commission sets a rate of return?

A. There is no impact, zero.

Q. Okay. Now, assuming when you retire that piece of property that had an original cost of $1,000, it costs $500 to take it out of service and there's no salvage, what would be its net cost of removal?

A. $500.

Q. And what would the accounting treatment for that be?

A. You would reduce company cash and then reduce the accumulated reserve account by the same $500.

Q. And would that have an impact on the net plant or the rate base on which the Commission applies a rate of return?

A. Yes, it would increase rate base by $500.

Q. Okay. Thank you, sir.

The way in which you have handled accumulated depreciation for this net cost of removal for purposes of your ISRS calculation, is that in any way different than the way you would do it in a general rate case?

A. I think the -- in taking a look at a general rate increase versus taking a look at the revenue requirement in the ISRS, in the general rate increase, you're looking at everything. So you're looking at a piece of an asset, plant, mains, everything and you're deducting from rate base the accumulated reserve on all those assets. So you're encompassing everything.

When you get to the ISRS, the -- the intent was to take the ISRS investment and reduce it by the accumulated reserve on those assets and the deferred taxes on those assets and include it in the depreciation of property taxes.

So I think the -- the intent was to take a general rate increase, basically run through all the calculations of the utility plant and the reserve. And then when you get to the ISRS, do the same exact thing but you only take the reserve deferred taxes and other components associated with that ISRS plant and those ISRS assets.

Q. So other than the fact that you're dealing with a bigger basket of money, if you will, in the rate case, is your approach any different in this exercise for this proceeding?

A. No.

Q. I believe there was also some questions perhaps more in the nature of a hypothetical in a situation where the company since its last rate case may not have invested enough in new plant to offset the increase in depreciation -- or accumulated depreciation. Do you recall that line of questioning?

A. Yes, I do.

Q. In practice, in actuality, has the company ever, in your experience, invested less in new plant than the growth in the accumulated reserve?

A. In my time with Missouri-American and looking back at some prior numbers, the -- the level of investment has always exceeded the level of depreciation.

Q. So from a purely rate base perspective, holding all things equal, rate base has been increasing for the company over time; is that right?

A. That -- that's correct.

MR. ENGLAND: Thank you. No other questions.

JUDGE WOODRUFF: Thank you. You may step down.

THE WITNESS: Thank you.

JUDGE WOODRUFF: Missouri-American, have any other witnesses?

MR. ENGLAND: No, your Honor.

JUDGE WOODRUFF: All right. Then we'll move to Staff. If you'd call your witness.

MR. KRUEGER: Steve Rackers.

JUDGE WOODRUFF: Good morning, Mr. Rackers.

(Witness sworn.)

JUDGE WOODRUFF: You may inquire.

STEPHEN RACKERS testified as follows:

DIRECT EXAMINATION BY MR. KRUEGER:

Q. State your name and address for the record, please.

A. Stephen M. Rackers, 1845 Gorman Court, St. Louis, Missouri 63136.

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

A. I'm employed by the Missouri Public Service Commission, and I'm a regulatory auditor five.

Q. What is your educational background?

A. I graduated from the University of Missouri at Columbia in 1978. I also hold a license -- a CPA license in the state of Missouri.

Q. Please briefly describe your employment history.

A. For the last 25 years approximately I've been employed by the Missouri Public Service Commission.

Q. Did you participate in the Staff's investigation of Missouri-American's request to establish an Infrastructure System Replacement Surcharge?

A. Yes, I did.

Q. What was your role in that investigation?

A. I examined the company's filing. I also examined additional information that I requested and received from the company. I spoke with company personnel regarding the various data in their filing. And I also examined Commission orders from the last Missouri-American rate case and the last St. Louis County Water rate case.

Q. And did you participate in the preparation of documents filed with the Commission?

A. Yes, I did.

Q. Do you have the Exhibits 1 to 4 that have been marked?

A. Yes. I think I so.

Q. Okay.

A. If you'll go through with me which ones those are. I've got copies of them.

Q. The one that's marked as Exhibit 1 is the Case File Memorandum which is dated October 31, 2003.

A. Yes, I have that.

Q. Exhibit 2 is the Staff's reply to Missouri-American's response.

A. I have that.

Q. Exhibit 3 is the portions of House Bill 208 that pertain to water corporations.

A. I have that.

Q. And Exhibit 4 is the illustration of calculations of accumulated depreciation.

A. Yes, I have that.

Q. Okay. Referring now to the document that's been marked as Exhibit 1, can you identify that document, please?

A. That's Staff's recommendation in this case.

Q. Did you prepare that document?

A. Yes, I did.

Q. And does that include as Attachment A an accurate copy of a section of House Bill 208 as passed by the General Assembly in 2003?

A. Yes, it does.

Q. Does that document also summarize the results of your investigation of the company's request?

A. Yes, it does.

Q. And does it include the Staff's conclusions and recommendations?

A. Yes, it does.

MR. KRUEGER: Your Honor, I'd offer Exhibit 1.

JUDGE WOODRUFF: Exhibit 1 has been offered into evidence. Are there any objections to its receipt?

MR. ENGLAND: No objections.

JUDGE WOODRUFF: It will be received into evidence.

(Exhibit No. 1 was received into evidence.)

BY MR. KRUEGER:

Q. I'd like to call your attention next to Exhibit 2. Can you identify that document, please?

A. That's Staff's reply to Missouri-American's response to Staff's recommendation.

Q. Did you participate in the preparation of that document?

A. Yes, I did.

Q. And did you review the contents of that document before it was filed with the Commission?

A. Yes, I did.

Q. Does that accurately state the Staff's position with regard to the issues in this case?

A. Yes, it does.

MR. KRUEGER: Your Honor, I would offer Exhibit 2.

JUDGE WOODRUFF: All right. Exhibit 2 has been offered into evidence. Are there any objections to its receipt?

MR. ENGLAND: Your Honor, I'm not sure I have an objection, but perhaps clarification and further request. To the extent that it contains legal argument, I'm assuming this witness is not supporting that as his testimony. Would that be an accurate statement?

MR. KRUEGER: That's accurate.

MR. ENGLAND: And then since it purports to respond to a document that the company prepared and filed, would Staff have any objection then to taking official notice of our document that this document purports to respond to?

MR. KRUEGER: I would not.

JUDGE WOODRUFF: All right. That document is in the file.

MR. ENGLAND: Correct. With that clarification and the request for notice, as I understand, un-objected to, then I have no problem with this going into the record.

JUDGE WOODRUFF: All right. Exhibit 2 then will be received into evidence.

(Exhibit No. 2 was received into evidence.)

BY MR. KRUEGER:

Q. Okay. Now, I'm going to call your attention to Exhibit 1, the case file memorandum, and specifically to Attachment B to that memorandum, which is the last few pages of Exhibit 1. Do you have that?

A. I think I do. Yes.

Q. Okay. Can you tell me what that Attachment B is?

A. Attachment B shows Staff's calculation of the appropriate revenue requirement for the ISRS.

Q. Did you perform the calculations that are summarized on that sheet?

A. Yes, I did.

Q. What did you attempt to show when you prepared this?

A. I attempted to show the amount of revenue requirement associated with infrastructure system replacements that the company was entitled to.

Q. The last entry on that page reads Total ISRS Revenues, $1,887,301. What is the significance of that entry?

A. That's Staff's recommendation for the amount of revenue -- annual revenue requirement associated with its ISRS calculation.

Q. Now, did the company also prepare a similar revenue requirement calculation?

A. Yes.

Q. And file it in this case?

A. Yes, it did.

Q. And that was attached to its application as Appendix B, I believe; is that correct?

A. Yes.

Q. How does the company's form differ from the one that you prepared?

A. Well, the form is the same. Some of the numbers in the calculation are different.

Q. Have any of those numbers that are different been resolved?

A. Yes.

Q. Which ones have been resolved?

A. Staff's calculation of accumulated depreciation -- I'm sorry -- accumulated deferred income taxes is different from the company's. And that item has been resolved. The company's filing did not remove the reimbursement for relocations. Staff's did. That item has been resolved.

Q. On which inputs to that form does the Staff still disagree with the company?

A. The calculation of accumulated depreciation that is the appropriate offset is still a dispute. The amount of property taxes to be included in the calculation is still a dispute. And whether it's appropriate to include cost of removal net of salvage is still a dispute.

Q. Except for those three inputs, would the bottom line on your revenue requirement calculation be the same as the bottom line on the company's revenue requirement calculation?

A. Yes. I believe it would.

Q. And are those the issues that have been identified in the list of issues that the parties filed as issues A, B and C?

A. Yes.

Q. Near the top of -- at page 1 of 4 of Attachment B, the revenue requirements calculation, under water utility plant projects, replacement mains and associated valves and hydrants, there's a line that reads accumulated depreciation, in parenthesis, 11,897,494. Do you see that?

A. Yes.

Q. Can you tell what that means?

A. That is Staff's calculation of the appropriate accumulated depreciation to be used as an offset to the ISRS investment.

Q. For replacement mains and associated valves and hydrants?

A. That's correct.

Q. And a little further down near the middle of page under water utility projects, facilities relocations there's another line that reads accumulated depreciation, in parenthesis, 3,652,677. Do you also see that?

A. Yes.

Q. Can you tell what that means?

A. That is Staff's calculation of the appropriate accumulated depreciation that should be used as an offset to facilities relocations.

Q. Can you tell me just in general terms how those numbers were determined?

A. The amount of ISRS investment was compared to the total change in invested plant since the last rate case. And that ratio was applied to the change in the accumulated depreciation reserve.

Q. Did you include in your case file memorandum a more detailed calculation showing specifically how you arrived at those numbers?

A. Yes.

Q. And where is that found?

A. I believe it's on the bottom of page 2 --

Q. Okay.

A. -- in Appendix B.

Q. I'm sorry?

A. In Appendix B.

Q. Could you just walk us through this form to explain how you calculated the amount of accumulated depreciation?

A. I referenced the final run that determined the revenue requirement from the St. Louis County Water Company's last rate case, WR-2000-844, and compared the balances -- the appropriate rate base balances from that case to the balances that occur as of July 2003 for the St. Louis district of Missouri-American Water Company.

And there is investment that is specifically allocated to the district and then there is some investment that is allocated to a corporate entity. So I had to perform a calculation to allocate a portion of that corporate amount to the district amount. And the corporate plus the district amount is what's used at the top of the page as the July 2003 balance.

Q. Okay. So the numbers from Case No. WR-2000-844 are shown where?

A. Excuse me?

Q. The numbers from Case No. WR-2000-844 are shown where on this form?

A. They appear at both the top of the schedule and then they're also shown at the bottom of the schedule too.

Q. Okay. And the numbers that you just mentioned inputting the corporate allocations, where do those appear?

A. Well, the amount that was located in the corporate section is at the bottom of the page. And then the portion allocated to the St. Louis district is combined with the St. Louis district. That's shown at the top of the page under the July 2003 column.

Q. And that's the column that's headed Final July 2003?

A. Yes.

Q. Okay. And continue with how you -- with your explanation of how you calculated the accumulated depreciation.

A. Once I determined the change in the balance for plant advances, CIAC and that -- those three numbers, I was -- that allowed me to determine the change in the invested amount of plant since the last St. Louis County

Water Company rate case.

Q. And where do you find that -- the change in the invested plant since the last St. Louis Water County rate case in this form?

A. That's at the top of the schedule.

Q. In which column and which line?

A. It's the fourth line and the third column of numbers.

Q. Do you need to see the form?

A. Yes.

MR. KRUEGER: May I approach, your Honor?

JUDGE WOODRUFF: Yes, you may.

THE WITNESS: As I said, the fourth line, the third column of numbers.

BY MR. KRUEGER:

Q. Okay. What's the next step then in your determination of the accumulated depreciation?

A. I compared that amount, 93,315,958, I compared that amount to the amount of infrastructure replacements investment. And based on that ratio, I applied it to the depreciation reserve, the accumulated depreciation reserve and determined the appropriate amount of the reserve to apply to the ISRS investment.

Q. Can you tell us the mathematical calculations, using the numbers from this form, so that the Commission can clearly understand how these numbers were determined?

A. I divided 20 million, which appears -- 20,723,378, which appears as the fourth amount in the fourth column of numbers at the top of the page, by the 93,315,958, which is the fourth number in the third column of numbers. That resulted in an approximate percentage of 22, 22 percent. And I applied that 22 percent to the fourth number -- I'm sorry, fifth number in the third column, which is 53,573,609. That times 22 percent is 11,897,494.

Q. Okay. Do you believe that that's an accurate determination of the depreciation reserve for infrastructure replacement?

A. I think it is the appropriate amount to use as an offset for accumulated depreciation.

Q. Why?

A. The -- the company has available to it in its revenue requirement depreciation expense that, as this document shows, has accumulated to 53 million since the last rate case. Those funds are available to support its construction, its total construction.

Those funds -- a portion of that is certainly infrastructure plant, but that 53 million is available to support their construction budget. So I have allocated 22 percent of that amount as being available or as an appropriate offset to the infrastructure plant.

Q. Now, turning to the figures that are shown in the facilities relocations column, which is the far right column on that form, can you tell how the numbers in the fourth and fifth lines of that column were determined?

A. The amount appearing in the fourth line, 6,362,331, is the amount of facility's relocations plant that has been added since the last St. Louis County Water rate case. The 1,962,266 is the amount of reimbursements associated with that plant.

Subtracting the reimbursements from the invested plant -- excuse me, from the plant gives you the invested amount of 6,362,331. That amount divided by the total change in invested plant, the 93,315,958, provides a percentage which I apply to the total change in the accumulated depreciation reserve, the 53 million amount, to determine the appropriate accumulated depreciation offset for facilities relocations.

Q. And why do you believe that that's the appropriate accumulated depreciation offset for the facilities relocations?

A. Well, again, it's the same thought process. The company is generated -- or has generated $53 million worth of depreciation accrual that is currently in rates. And that -- that amount is available to support its entire construction budget. So I have allocated a portion of that to facilities relocations.

Q. Thank you.

Do you have in front of you the document that's been marked as Exhibit 4?

A. Which one is that?

Q. That's the illustration -- I gave you my copy, but here's another copy. I'm not sure how we titled it.

A. Yes, I have that.

Q. Okay. Can you tell me what that document is?

A. Yes. That is an illustration of the company's and the Staff's method for determining the accumulated depreciation reserve offset to the ISRS plant.

Q. Did you prepare that document?

A. Yes, I did.

Q. What did you attempt to show by this document?

A. I attempted to show that the difference between Staff and the company and how under alternative situations the -- the Staff's approach to determining the depreciation offset is more appropriate then what the company has done.

Q. Would you please explain these two examples that are shown on this Exhibit 4?

A. Yes. The -- the item that I have entitled Actual, that is a variation of the schedule that Mr. Krueger and I just went through. It's -- it's similar to the calculation that's on page 2 of Appendix B. And it shows the determination of the change in total plant since the last case.

Q. And where is that shown?

A. That's shown in column 3, line 4.

Q. Okay. Continue.

JUDGE WOODRUFF: If I can clarify, you described that as showing actual. There's nothing on the chart that says actual. Is that the first set of columns?

MR. KRUEGER: It shows up on my copy, but apparently not on the one that was copied.

JUDGE WOODRUFF: Not on the official exhibit.

THE WITNESS: Okay. On the first example, the first six lines on the top of the page --

JUDGE WOODRUFF: That is actual?

THE WITNESS: Yes. That's what I'm calling the actual example.

JUDGE WOODRUFF: Thank you.

THE WITNESS: That shows the change in invested plant on line 4, column 3, since the last case and the change in the depreciation -- the accumulated depreciation reserve since the last case for a net change in invested plant of 39 million -- approximately $39 million.

Now, the next column, column 4, shows Staff's determination of the appropriate depreciation reserve that should be allocated to the ISRS investment. And as this schedule shows, I calculated a percentage. 22 percent is the ratio of the ISRS investments to the total plant. That same 22 percent has been applied to the change in the depreciation reserve to determine the appropriate amount to subtract from the ISRS investments, resulting in a net investment that Staff believes is appropriate to determine the ISRS rate of the approximately 8.8 million.

Now, in the sixth column, that's the company's calculation which shows the same amount of ISRS investment, but yet they have only allocated approximately 1 percent of the change in the accumulated depreciation reserve to the ISRS investment using their calculation. So that -- that is a depiction of the current situation.

Now, what I'm trying to show in the next six lines at the bottom of the page is -- it's the same effect as what's going on in the top, but what I'm trying to show is if the company actually invested less plant and the only number that's changed from the top -- only two numbers is the amount of plant in service as of July 2003, that number is approximately 45 million less than what's shown at the top, and I've also reduced the depreciation reserve to reflect that there would be 45 million less investment.

If that were the actual situation, as you can see in column 3, the net change in plant would actually be -- I'm sorry, the net change in -- that's right, the net change in plant would actually be negative. Approximately 5 million negative.

And under the Staff's calculation, an allocation of that de-- that change in the depreciation reserve would be applied to the same ISRS investment that's shown at the top. And what would result is that you would have a negative amount calculated for net plant of the ISRS. And as a result, Staff would -- barring additional costs that would offset that in the calculation, Staff would not be recommending establishing an ISRS.

But yet, what you can see in column 6 is that under the company's methodology, nothing would change. They would still have the same ISRS investment, they would still allocate -- excuse me, still apply the same amount of accumulated depreciation expense and establish an ISRS to recover the same amount that they have in this case.

And I think the bottom example shows that if you had a situation where the plant -- the net plant would actually show up as negative, that this would be an indication that perhaps the company's over-earning in the second situation. It would certainly indicate that they're generating enough depreciation accruals to support all of their construction budget.

And Staff just thinks that it is illogical that what this statute would allow the company to do, if interpreted by using the company's interpretation, is that when a company's in a situation of over-earning or if it's generating so much cash that it's able to support its entire construction budget, that it's just illogical for the Staff to believe that this statute would be designed to allow the company to establish a surcharge if that was the situation going on. But if you use the company's methodology, that's exactly what could happen.

MR. ENGLAND: Your Honor, I have an objection. Since this is live, I didn't know where he was going until he got there, but I think his immediate past testimony as to what the legislature intended is beyond the scope of this witness's ability to testify.

JUDGE WOODRUFF: Response?

MR. KRUEGER: I think the Commission is going to have to determine how to interpret this statute and how it will be applied in this case and in other similar cases that come up in the future.

And in order to determine that, I think the Commission needs to understand what the possible ramifications of its determination will be. And I think this serves to support the Staff's position that this -- concerning the interpretation of the word "net" which appears in 393.1000(1)(a), I believe.

JUDGE WOODRUFF: Further response, Mr. England?

MR. ENGLAND: Despite Staff's obvious dislike for the legislation, that aside, the fact that the witness is testifying as to what the legislature may or may not have intended is completely beyond his ability to testify in this proceeding. He has no foundation, no background, no expertise to do that.

JUDGE WOODRUFF: Clearly this witness doesn't have any expertise to explain what the legislature meant what it passed the statute. I don't know if anyone can explain that. And that's not a reflection on the legislature, simply that there are many members of the legislature who all intend different results when they pass legislation.

However, I'm going to overrule the objection. He's offering his opinion as to what Staff believes. I'm not going to prevent him from doing that, certainly with the understanding that he cannot speak for -- explain, give a definite opinion or definite answer as to what the legislature meant. The objection is overruled.

MR. KRUEGER: Thank you, your Honor.

BY MR. KRUEGER:

Q. Mr. Rackers, did you hear Mr. Grubb testify a little bit ago?

A. Yes.

Q. And did you hear him say that according to Staff, the ISRS plant is already more than 50 percent depreciated?

A. Yes.

Q. Do you agree that that is the Staff's position?

A. No, I do not.

Q. Why not?

A. The Staff did not attempt to determine the age of the ISRS replacements. It did not try to calculate and -- any implicit depreciation rate to apply to those investments. It took a ratable share of the revenue requirement and the cash available to the company through its depreciation accrual since the last case and applied that to the ISRS investments.

Q. And did the Staff do any depreciation calculations at all?

A. It -- it did, but that was with regard to determining depreciation expense.

Q. Okay. I'm referring now to the -- in connection with the accumulated depreciation.

A. No.

Q. And does the Staff have any recommendation regarding the depreciation rate for purposes of the

accumulated depreciation?
A. No.
Q. Is there a disagreement between the Staff and the company over the amount of accumulated depreciation that is accrued to the ISRS property since its placement?
A. Would you ask me that again, please?
Q. Does the Staff disagree with the company over the amount of accumulated depreciation that has been accrued to the ISRS property since its placement?
A. If -- if you're asking me does the Staff dispute or is there a disagreement between the Staff and the company with regard to what the accumulated depreciation expense is on this specific $20 million of ISRS property that's been added --
Q. That is my question.
A. -- I don't believe there is.
Q. Okay. Has the company benefited from regulatory lag since its last rate case?
A. I would say yes. Specifically with regard to the net plant calculation that I've shown. At least with regard to the -- certainly with regard to ISRS replacements.
Q. Is that benefit measured by reference to a change in depreciation reserve multiplied by the company's weighted cost of capital?
A. Yes.

Q. Turning next to the issue of the cost of removal net of salvage, how did you address the issue of -- that issue in your revenue requirement calculation, which is part of Exhibit 1?

A. I -- my examination of the statute showed no reference whatsoever to that term, cost removal or salvage.

Q. So --

A. So I did not include a separate line item for that amount. Now, whatever cost removal and salvage has been experienced and charged to the depreciation reserve since the last case, that will be a component of that total change in the depreciation reserve.

Q. How does this compare with the company's calculation in its revenue requirement calculation?

A. The company has identified the cost removal and salvage that it incurred with regard to the old plant, presumably plant that was included in the last rate case, and has added it to the investment -- the ISRS investment in the determination of the annual revenue requirement.

Q. Why do you believe it's incorrect to include an entry for cost of removal net of salvage in your revenue requirement calculation?

A. Well, the initial reason is because I find absolutely no reference to it in the statute, so I don't know that I think the statute contemplates cost removal and salvage in any way. In addition, ratepayers have been paying cost removal and salvage associated with this plant in rates probably for many years. So I -- in theory, those dollars have already been paid by the ratepayer. Why they should be included in an ISRS calculation going forward, that -- that's illogical to me.

Q. Under the company's methodology, would these cost of removal be passed along again to the ratepayers?

A. I believe they would be.

Q. In your analysis of the revenue requirement, did you also investigate the property tax issue?

A. Yes, I did.

Q. What did you attempt to determine when you investigated the property tax?

A. I attempted to determine the amount of property taxes associated with the ISRS property that would be due within 12 months of the company's filing.

Q. And is that number shown on your revenue requirement calculation?

A. Yes, it is.

Q. How does your -- tell me what that number is.

A. Staff believes that number is 240,765.

Q. Does your approach differ from the approach that the company used in determining the amount for property taxes?

A. Yes, it does.

Q. In what way does it differ?

A. The company applies a property tax rate to all of the investment -- all of the ISRS investment that it's including in this filing. Staff only applies the property tax rate to the plant that was in service prior to January 1 of 2003.

Q. So the difference then is you did not apply it to plant placed in service since January 1 of 2003?

A. That's correct.

Q. Otherwise, your calculation is the same as the company's?

A. That's correct.

Q. Why did you not include plant placed in service since January 1 of 2003 in your calculation of property tax?

A. Because property taxes will not be due on that plant until December of 1984 -- I'm sorry, 2004.

Q. Mr. Rackers, is one of the fundamental differences between the Staff and the company in this case that the Staff tried to establish what current ratepayers were paying for these areas in current rates and the company has not attempted to make that determination in the current ISRS case?

A. I believe that's true.

MR. KRUEGER: I believe that's all the questions I have, your Honor.

JUDGE WOODRUFF: All right. It's nearly twelve o'clock so it's time to break for lunch. We'll come back at one o'clock.

(A recess was taken.)

JUDGE WOODRUFF: Okay. We're ready to resume after lunch. And before lunch, we just finished direct examination of Mr. Rackers and so we'll begin with cross-examination beginning with Public Counsel.

MS. O'NEILL: No questions, your Honor.

MR. KRUEGER: Your Honor, I believe I neglected to offer Exhibit 4, which I intended to do.

JUDGE WOODRUFF: And I don't have 3 either.

MR. KRUEGER: I didn't elicit any testimony in regard to that. That's the statutory provisions which were included in Exhibit 1 and so I think it's not necessary to offer that.

JUDGE WOODRUFF: All right. Exhibit 4 has been offered into evidence. Any objection to its receipt?

MR. ENGLAND: No objection.

JUDGE WOODRUFF: Hearing none, it will be received into evidence.

(Exhibit No. 4 was received into evidence.)

MR. ENGLAND: Your Honor, I didn't have an objection if Mr. Krueger wanted to offer 3, although I believe a correct copy of the same portion of the statute or statutes is attached to Staff's memorandum, which was Exhibit 1.

JUDGE WOODRUFF: And, of course, it's in the books upstairs as well.

MR. ENGLAND: Right.

JUDGE WOODRUFF: All right. Thank you.

For cross-examination then, Public Counsel?

MS. O'NEILL: No questions.

JUDGE WOODRUFF: And Missouri Industrial Energy Consumers? Doesn't look like she's back yet.

Then for Missouri Energy Group?

MS. LANGENECKERT: No questions.

JUDGE WOODRUFF: Okay. Then for Missouri-American?

MR. ENGLAND: Yes, your Honor. Thank you.

CROSS-EXAMINATION BY MR. ENGLAND:

Q. Good afternoon, Mr. Rackers.

A. Good afternoon.

Q. I think we've pretty well established that we've only got three areas of disagreement between the Staff and the company insofar as the revenue requirement for the ISRS plant is concerned. Correct?

A. Yes.

Q. And I think maybe you said this, but I just want to make sure that with setting those three issues aside, all of the other numbers in the company's calculation or the Staff's calculation for that matter are the same or essentially the same?

A. Yes.

Q. Okay. I want to go one step further with you. If the Commission accepts the company's position with respect to all three of these contested issues, would you agree with me that the company's calculations, as shown on its Exhibit 6, which is that revised revenue requirement calculation, is accurate or are accurate?

A. I haven't had an opportunity to run through that calculation, but just the overview that I've given it so far, I think that if not the number, it's very close.

Q. Okay. Fair enough. Thank you.

Let me ask you a few questions about property tax, if I can. I don't believe you've disagreed with the company over the actual tax rate that's utilized for purposes of developing the expense; is that right?

A. That's correct. I compared it to the tax rates that we're experiencing in the rate case and it looked reasonable to me.

Q. So both you and the company are using the same tax rate, it's the property to which you apply that rate that differs between the two?

A. That's correct.

Q. Okay. And you only applied the tax rate to the ISRS property that was placed in service in calendar years 2001 and 2002. Right?

A. Yes.

Q. So you excluded any property that was placed in service in 2003, and if I'm correctly paraphrasing your reason, because the tax that would be due on that property would not be due, in your opinion, until December of 2004 or approximately 16 months after the filing of the application?

A. That's correct. That's beyond 12 months from when the filing occurred.

Q. Okay. And that 12 months you take from the statute. Correct?

A. Yes.

Q. Would you agree with me that under your approach, the company will never recover property tax on any ISRS property placed in service in the same year that the ISRS filing is made unless that filing is made in December?

A. I think that's true with regard to an ISRS.

Q. Now, you don't --

A. Let me --

Q. Go ahead.

A. It wouldn't be recovered -- I think that's correct, it wouldn't be recovered within the calculation of an ISRS.

Q. And you don't contend that the company will never have to pay property taxes on this plant, you're just saying it's more than 12 months down the road. Right?

A. That's correct. And at this point it's unknown what -- what that property tax is.

Q. But we know what the rate is or at least we have agreement on that?

A. We have agreement on the rate.

Q. Okay. And we know the amount of the property that's been placed in service for all three years?

A. Yes.

Q. Okay. And the calculation is simply a product of the multiplication of the two. Right?

A. Yes.

Q. Do you have your Exhibit No. 1, which was the Staff memorandum I believe dated 10/31/03 in front of you?

A. Yes.

Q. And I want to turn your attention to Attachment A, which I believe is a copy of the relevant portions of -- what is it -- House Bill 208 regarding the ISRS at least as far as water corporations are concerned?

A. Correct.

Q. Okay. Would you turn to Section 393.1006.4, please, which I believe is at the bottom of -- they're not numbered, but it's the third page of your attachment of the appendix.

A. And which item under 1006?

Q. Item 4 at the bottom. Would you agree that it begins, In determining the appropriate pre-tax revenues, the Commission shall consider only the following factors, colon?

A. Yes.

Q. Okay. Now, turn the page. And I'm interested in sub-item 5 in parenthesis. Are you there?

A. Five in parenthesis?

Q. Yes.

A. Okay.

Q. On the next page. Would you agree with me that it states there in continuation, The current property tax rate or rates applicable to the eligible infrastructure system replacements?

A. That's what the words say.

Q. Okay. Would you agree with me that there is no mention of the word "due" or "payable" or anything of that nature in that provision?

A. Yes.

Q. And would you agree with me then a strict reading of this provision only would lead you to believe that the property tax expense is simply the product of the appropriate tax rate times all of the ISRS eligible plant?

A. What -- do you mean that I'm not supposed to consider anything else I know that's in the statute? I'm just supposed to use these words?

Q. Correct. A strict interpretation of just this provision or this particular provision.

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

Q. Okay. How don't you agree with that or why don't you agree with that?

A. Well, knowing that -- knowing how property taxes are paid and when they become due and what property they're applied to, I think there would be some question as to whether it would be appropriate to include property taxes that won't be payable associated with this property until after this ISRS has completely expired.

Q. Well, you don't agree with me because you don't think it's right to include all of the property in the calculation of the expense because a portion of it won't be due within 12 months, or you don't agree with me that the strict reading of this statute doesn't limit you to just the exercise of multiplying the ISRS plant times the tax rate?

A. I think if this was all the language I had, there would be some question in my mind what the appropriate property tax would be to include.

Q. It certainly is ambiguous without any reference to the 12 months from your perspective. Right? Or excuse me, without reference to the due within 12 months language?

A. Yes.

Q. By the way, that language appears on the first page of your Attachment A under 393.1000(1) -- excuse me, paren 5, end paren. So it's your opinion you have to read the two together, I would assume --

A. Yes.

Q. -- rather than a strict reading of the specific statute dealing with the specific provision dealing with property tax expense?

MR. KRUEGER: Objection, your Honor. That's a misstatement. Could you repeat the question, please?

MR. ENGLAND: I'm going to ask for the reporter to do that.

THE COURT REPORTER: "Question: By the way, that language appears on the first page of your Attachment A under 393.1000(1) -- excuse me, paren 5, end paren. So it's your opinion you have to read the two together, I would assume --

"Answer: Yes.

"Question: -- rather than a strict reading of the specific statute dealing with the specific provision dealing with property tax expense?"

MR. KRUEGER: Mr. Rackers testified that he would -- he would have to look at these two items together and determine the application of the taxes according to that.

JUDGE WOODRUFF: Okay. I'm going to overrule the objection. If Mr. Rackers indicates he does not agree with what -- the question that was just asked, he can say so, but I'll overrule the objection. You can answer the question. If you need to have it repeated again, you can do that.

THE WITNESS: Yeah. Let's have a repeat one more time. Thank you.

THE COURT REPORTER: "Question: By the way, that language appears on the first page of your Attachment A under 393.1000(1) -- excuse me, paren 5, end paren. So it's your opinion you have to read the two together, I would assume --

"Answer: Yes.

"Question: -- rather than a strict reading of the specific statute dealing with the specific provision dealing with property tax expense?"

THE WITNESS: I think you have to use all the statutes to determine the appropriate calculation for the ISRS. There's certain provisions that are intertwined and linked together. They're not always in one specific place.

Sometimes you have to reference certain items here and then go to another portion to find a definition. So you have to read the two together to actually figure out how to calculate property taxes.

BY MR. ENGLAND:

Q. Do you have to apply a little common sense as well?

A. Sure.

Q. Okay. Let's change gears and talk about accumulated depreciation. As I understand, both company and Staff have calculated an amount accumulated depreciation and deducted that from the gross ISRS plant amounts. Correct?

A. Yes.

Q. The argument is over how much accumulated depreciation?

A. Yes.

Q. Okay. And would you agree with me that for purposes of developing the revenue requirement associated with ISRS plant, it is appropriate to make an adjustment to the gross investment to reflect some amount of accumulated depreciation?

A. Yes.

Q. And, in fact, the legislature -- or excuse me, the legislation specifically mentions accumulated depreciation, does it not?

A. The legislation specifically cites accumulated depreciation.

Q. And that specific reference is in 393.1000(1)(a) on the first page of your Attachment A. Correct?

A. It's -- it's listed there. I'm not sure if there might be another reference to accumulated depreciation somewhere else among these statutes.

Q. Are you aware of any at this point in time --

A. No.

Q. -- that you can cite me to?

A. No.

Q. Well, then let's just deal with this one. Would you read for me 393.1000(1)(a) in its entirely, please?

A. The water corporation's weighted cost of capital multiplied by the net original cost of eligible infrastructure system replacements, comma, including recognition of accumulated deferred income taxes and accumulated depreciation associated with eligible infrastructure system replacements which are included in a currently effective ISRS.

Q. Okay. I'm interested in the very last phrase that begins, Accumulated depreciation associated with eligible infrastructure system replacements which are

included in a currently affected ISRS.
Do you see that?
A. Yes.
Q. You would agree with me that there is no currently effective ISRS in place today. Right?
A. Yes, I'd agree with you.
Q. So there can be no eligible infrastructure system replacements which are included in a nonexistent ISRS. Right?
A. Yes.
Q. So a strict reading of this statute would tell you that you don't attribute any accumulated depreciation to ISRS plant because there is no effective ISRS in place today. Right?
A. No, I don't agree with that. It's -- it's telling you -- the way I interpret this section is that it's telling you what to do with accumulated depreciation and accumulated deferred taxes with a currently effective ISRS. It's not providing you much direction what to do or how to calculate the net original cost for an initial ISRS or the ISRS in this case.
Q. But we agree there is no currently effective ISRS?
A. Yes.
Q. And we've agreed that there's no eligible

infrastructure system replacements associated with a currently effective ISRS. Right?

A. That's correct.

Q. So how can there be any accumulated depreciation on nonexistent plant included in a nonexistent ISRS today?

A. There isn't any today.

Q. Okay. That's a rather tortured reading of that statute. Would you agree with me?

A. Whose?

Q. My reading.

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

Q. Okay. You think it's appropriate not to have any accumulated depreciation for purposes of the calculation of the ISRS revenue requirement before the Commission today?

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

Q. Okay. I thought you just agreed with me that there wouldn't be any accumulated depreciation associated with eligible infrastructure system replacements because there are none included in a currently effective ISRS?

A. No. What -- what you -- what I agreed with you on was that there is no accumulated deferred income taxes and accumulated depreciation applicable to a currently effective ISRS because there is no currently effective ISRS. In other words, the way I read this section is everything after the comma applies to a currently effective ISRS of which there isn't any. But the --

Q. So shouldn't we not include then -- we should include zero, excuse me, for accumulated deferred income taxes and zero for accumulated depreciation for purposes of the first ISRS?

A. You could interpret it that way, but I think that's illogical considering the word "net" is in the first part of that sentence.

Q. And that's not the way the company interpreted it, is it? Because they have, in fact, calculated accumulated depreciation and taken that, if you will, as a deduction on the original cost of the ISRS plant?

A. Yes.

Q. Okay. I guess the point I'm getting at is that you agree you don't necessarily follow the strict language of the statute here for purposes of accumulated depreciation, but you don't agree that you follow the strict language of the statute with respect to property taxes where it says take the tax rate times the ISRS plant and no mention of due date?

MR. SCHWARZ: I object. I think that mischaracterizes this witness's testimony as to the application of the last clause of 393.1000(1)(a). I think he's made clear that the reason that he's considers accumulated depreciation applicable is due to the need to figure out what net original cost is. I think that the question mischaracterizes that answer and it goes to the heart of the disagreement between the parties.

JUDGE WOODRUFF: I'm going to overrule the objection. If the witness believes his testimony has been mischaracterized, he can explain that in his answer.

You can answer the question.

THE WITNESS: I think you're mischaracterizing my testimony.

MR. ENGLAND: Your Honor, I was totally surprised by that and I'm going to need a little time to regroup. I'll move on. Thank you.

BY MR. ENGLAND:

Q. Let's talk about the actual calculation of the accumulated depreciation amounts, if you will. Would you agree with me that your total ISRS plant is approximately $29 million --

A. Yes.

Q. -- before the deductions and what have you?

A. Yes.

Q. And I think I'm taking that from your Appendix B -- actually, I think it appears on both page 1 and page 2. Essentially the sum of the two different types of plant that we're talking about here today, the infrastructure replacement as you've identified it and the facility relocations?

A. Yes. That's correct.

Q. And would you also agree with me that your total accumulated depreciation is approximately -- attributable to this plant, excuse me, is approximately $15.5 million?

A. Yes.

Q. And I don't think you disagree that if you looked at $15.5 million as a percent of the 29 million original cost, that that represents approximately 53 percent. Right?

A. Yes, it does.

Q. But I understand earlier from your testimony you're not saying that this plant is 53 percent depreciated. Right?

A. That's correct.

Q. Okay. So I think I can extrapolate that you would agree or at least have no disagreement with the actual depreciation rates for the various categories of property that are shown on Mr. Grubb's appendices to his -- or to the verified application?

A. I would agree that if you applied the depreciation rates to the infrastructure plant since it was placed in service from the last case through approximately

July of 2003, that that would be the accumulated depreciation.

Q. Okay. On that plant. Correct? That ISRS plant?

A. Yes.

Q. Okay. My question actually is a little different than that, so let me back up. I was just asking, you don't have any reason to believe that the individual rates of depreciation that he shows on his appendices for the various property items is anything but what the Commission authorizes?

A. I don't have any reason to believe that that's not the case.

Q. Okay. Now, for purposes of calculating the accumulated depreciation, I think it's obvious that you did not create the same type of schedules that Mr. Grubb did where you looked at each item of plant. Correct?

A. Yes. That's correct.

Q. The way in which you did it, as I understand, is depicted here on page 2 of Appendix -- excuse me, your Attachment B?

A. That's correct.

Q. And for lack of a better description, it's a ratioing factoring approach; is that right?

A. That's -- that's the calculation method, yes.

Q. Okay. I'd like to ask you a few questions with respect to Attachment B, page 2 of 4. And I'll try to be specific so you know what I'm referring to. On line 4, invested plant, and I'll call it column 3, you have a $93 million figure. Do you see that?

A. Yes.

Q. Now, if I understand correctly, that is the growth in plant from 1/1/2001 to July 2003; is that right?

A. Yes.

Q. And maybe I need to clarify for the record. 1/1/2001 being the date or the -- I guess the cut-off date, if you will, for purposes of the last rate case, which you've identified as WR-2000-844?

A. Correct.

Q. And you would agree with me that that $93 million figure does not include any plant placed in service prior to January 1, 2001?

A. Ask me that question again, please.

Q. Sure. You would agree with me that that $93 million figure you have under the change column does not include any plant placed in service prior to 1/1/2001?

A. That's correct.

Q. Now, let's look at the growth -- or change, I'm sorry, in accumulated depreciation of roughly $53.5 million; is that right?

A. Yes.
Q. Or excuse me, growth and depreciation reserve of roughly $53.5 million?
A. Yes.
Q. And, again, that's the growth -- or the change, excuse me, that has taken place since the end of the last case and July of 2003?
A. Correct.
Q. Would you also agree with me though that the accumulated depreciation represented by your 53.5 million figure includes accumulated depreciation on plant placed in service prior to 1/1/2001?
A. Yes.
Q. So the accumulated depreciation amount of 53.5 million against which you apply your factor I believe of 22 percent includes accumulated depreciation on plant placed in service prior to 1/1/2001, non-ISRS plant placed in service after 1/1/2001 and ISRS plant placed in service after 1/1/2001?
A. That's correct.
Q. And, therefore, a portion of the $15.5 million offset that you have calculated for purposes of your accumulated depreciation is, therefore, not necessarily associated with ISRS plant placed in service since January 1 of 2001?

A. There was not an effort to specifically determine the portion of that $53 million specifically generated by the 29 million of ISRS property.

Q. Well, there is in Mr. Grubb's testimony and schedules, isn't there?

A. Yes.

Q. So my point is, by using the $15.5 million figure offset that you have created or calculated in the manner in which you've calculated, you have, by necessity, included accumulated depreciation on non-ISRS plant?

A. Yes.

Q. I believe your rationale for doing so is based on the availability of funds that depreciation expense creates which is then available to the company for investment in plant; is that right?

A. Yes. Well, and also the vast majority of that $53 million is included in rates also.

Q. Right. But when the customer pays his bill -- and correct me if I'm wrong, but I think your position is part of the bill is a depreciation expense as set in the last case and that portion of the bill that the company receives, that money for that depreciation expense is available to the money for construction purposes. Right?

A. The funds are available for -- to support the company's construction budget.

Q. Would you also agree with me those funds are available to pay day-to-day expenses of the company?
A. Yes.
Q. Such as payroll, materials and supplies. Correct?
A. Yes.
Q. Those funds are also available to pay for extraordinary costs that may be created by a one-time event such as a flood or an ice storm or a tornado, correctly -- or correct?
A. Yes.
Q. In fact, these funds could be used to pay down debt or dividends to stockholders, couldn't they?
A. That's correct.
Q. The fact of the matter is, when the money comes in the door, regardless of whether it's for depreciation expense, payroll expense, return on equity, that's the company's money to do with as it sees fit. Right?
A. Yes.
Q. Okay.
A. But I think it's important to recognize its availability --
Q. Correct.
A. -- in this -- in this setting.

Q. You certainly would agree, however, that it can't be earmarked, wouldn't you?
A. I don't think the cash that comes in the door for depreciation expense is earmarked by the company when it pays its bills of any kind.
Q. As a practical matter, it can't be by any company, can it, any utility company?
A. I agree with that.
Q. Okay. Yet your calculation for purposes of the ISRS is earmarking a portion of those funds for construction of ISRS plant?
A. Well, I -- I don't consider that I'm earmarking it. I think that it's important to take into consideration what's in rates today before you establish an additional surcharge, which we're establishing an additional rate in this proceeding. And I think you have to consider what's in rates today, what's the company recovering today before you just blindly establish a new surcharge on top of that.
Q. And I think maybe that gets to the heart of the disagreement between Staff and company. You don't believe that the exercise called for by the statute is a determination of the incremental revenue requirement associated only with ISRS plant. Right?
A. I think the only plant -- in other words,

the -- the new investment that's considered in an ISRS is the $29 million, whatever has been added since the last rate case. But I think in determining the proper revenue requirement associated with that investment, you have to consider what's in rates today.

Q. That's not -- I don't believe that's responsive to my question.

My question is, for purposes of your exercise here, you were not attempting to identify the incremental revenue requirement associated with the ISRS plant, holding everything else equal?

A. I don't think that's true. I don't agree with that.

Q. Well, let me ask you this. You've agreed that the amount of accumulated depreciation you have included as an offset to ISRS plant includes accumulated depreciation associated with non-ISRS plant. Correct?

A. Yes.

Q. Then how can that be a matching of plant to specific accumulated depreciation on that plant?

A. Right now your rates include recovery of depreciation expense. And you've retired certain plant and replaced it with ISRS plant. And your rates include depreciation, which has accumulated, generated, $53 million of available funds that you can use to -- for those infrastructure replacements, you can use it for all of your plant in service.

MR. ENGLAND: I don't believe the witness was responsive. May I have the question read back, please?

THE COURT REPORTER: "Question: Then how can that be a matching of plant to specific accumulated depreciation on that plant?"

MR. ENGLAND: I'm sorry. I didn't hear all of that, please.

THE COURT REPORTER: "Question: Then how can that be a matching of plant to specific accumulated depreciation on that plant?"

MR. ENGLAND: Wasn't there a preface to that? If not, there certainly should have been.

THE COURT REPORTER: "Question: Well, let me ask you this. You've agreed that the amount of accumulated depreciation you have included as an offset to ISRS plant includes accumulated depreciation associated with non-ISRS plant. Correct?

"Answer: Yes.

"Question: Then how can that be a matching of plant to specific accumulated depreciation on that plant?"

BY MR. ENGLAND:

Q. Can I have an answer to that question, please?

A. I have not attempted to match, as the company did, the specific accumulated depreciation on the 29 million. And I don't think -- I don't think the statute defines that that's a requirement.

Q. My next question though is, therefore, you did not create an incremental revenue requirement attributable only or associated only with this ISRS plant, holding all else equal. Correct?

A. If your question is I didn't consider in any way what's currently included in rates, I -- I -- I did consider that.

Q. No. My question is, for purposes of determining the revenue requirement associated with this ISRS plant, you've borrowed, if you will, depreciation -- or accumulated depreciation that has accrued on other items of plant other than this ISRS. Correct?

A. I -- I wouldn't really agree with your term "borrow."

Q. Well, I didn't expect you to, but I thought I'd give it a try.

A. I've considered it.

Q. And, in fact, it is included?

A. In -- in my 15 million, yes.

Q. You seem to be concerned with the fact that if the company is over-earning during a period when it implements an ISRS, the ISRS, as I understand if calculated in the way the company proposed, would only exacerbate the situation. Is that a fair characterization of your concern?

A. I think that would be one way to look at it, yes.

Q. How have you handled the situation where we might be under-earning? Have you done anything for us in that regard?

A. The company has the ability and it probably is their duty to file a rate case.

Q. Just like --

A. Staff can't file a case for you.

Q. No. But just like when we're over-earning, it's your duty and obligation, if you believe it to be the case, to pursue that. Correct?

A. Correct.

Q. Okay. The fact of the matter is, you haven't addressed the situation where the company may be under-earning when it files for an ISRS?

A. Are -- are you asking me have I attempted to somehow alleviate that under-earnings in the ISRS calculation?

Q. Have you even addressed it in your prorata attribution, if you will, of accumulated depreciation?

A. No, I haven't specifically addressed that.

Q. I want to ask you some questions regarding this cost of removal. And I believe you were in the room when I asked on redirect Mr. Grubb a specific example and I want to see if you agree.

Isolating on just one piece of property with an original cost of $1,000 that is retired, would you agree with me that you make an adjustment -- an accounting adjustment to remove that -- remove that $1,000 from plant and a corresponding $1,000 adjustment to remove it from reserve?

A. That's correct.

Q. Okay. Would you also agree with me if associated with the retirement of that plant you incur cost of removal net of salvage of $500, that you remove that from the reserve as well?

A. It -- that would reduce the reserve.

Q. And that would have an impact, all other things being equal, on the rate base, would it not?

A. Yes.

Q. It would increase the rate base by approximately $500, all other things being equal?

A. Yes, it would. But, in theory, there are dollars in the rate base in the depreciation reserve to pay for that cost removal that the ratepayer has already provided.

Q. And the ratepayer, as Mr. Grubb said, gets the benefit of that because it goes to the accumulated depreciation reserve. Correct?

A. You get the time value of money associated with it. He has to pay it up front.

Q. Right. And it goes to the reserve, which goes to offset rate base -- excuse me, offset investment to arrive at your rate base. So the ratepayer gets the benefit of a lower rate base for the depreciation expense he is paid, which includes an element for cost of removal?

A. Well, I -- I guess it depends on how you look at a benefit. The fact the ratepayer's got to pay it up front for potentially 40 years until you finally retire that plant, I'm not sure where the -- who's getting the benefit exactly, but --

Q. Well, let's just approach it then from a pure accounting perspective. That's, in fact, what happens. Correct?

A. Those would be the accounting entries.

Q. Right. And that would happen whether it's a regulated or a non-regulated industry. Correct? As far as the simple accounting entries are concerned?

A. It -- that would occur with regard to mass asset accounts in the regulatory realm. When -- if you're not dealing with a mass asset account when you make a retirement, it's my understanding that you do it at net book value.

Q. And no recognition for cost of removal?

A. Cost removal is recognized.

Q. Let me get back to the rate-making aspect. The way in which cost of removal is handled for rate-making is the way in which we just discussed, isn't it, on that one specific item? You take $1,000 out of plant when it's retired, you take $1,000 out of reserve. Correct?

A. For the original cost of the asset.

Q. And if there's a $500 cost removal associated with it, you take that in addition out of the reserve?

A. That's correct.

Q. And that's what you do for rate-making in a general rate case. Right?

A. That's how the company keeps its books for mass asset accounts.

Q. And that's what you do for rate-making generally. Correct?

A. Well, to the extent that when you pick up the balance for the accumulated depreciation reserve, any retirements, any entries to that reserve associated with cost removal and salvage are in there through a certain point in time.

Q. Get back to our specific example. The way in which it's handled, $1,000 taken out of plant, $1,000 taken out of reserve and an additional 500 taken out of reserve for cost removal, that's the way it's handled for rate-making. Yes or no?

A. That's the way the books are kept for rate-making.

Q. Thank you, sir.

That's not the way, however, it's been handled for purposes of your ISRS calculation, is it?

A. I -- I wouldn't strictly agree with that. I did not include a specific line item increasing investment for cost removal or salvage. But whatever cost removal or salvage has been -- whatever effect it's had on the depreciation reserve since the last case, that's reflected in this change in the depreciation reserve, this $53 million on page 2 of Attachment B.

Q. By not specifically recognizing the cost of removal in your ISRS calculation, you have departed from the way in which it would be handled for purposes of a general rate case. True or false?

A. False.

Q. Explain why, please.

A. Well, in a general rate case what you include in rate base is the accumulated depreciation reserve at a point in time. That accumulated depreciation reserve has -- any cost removal or salvage transactions are embedded in that depreciation reserve. So they'll be reflected in whatever balance is included in the rate base and then subtracted from plant.

Q. And to the extent there's been net cost of removal, that's been removed from that reserve for purposes of rate-making. Correct?

A. That -- the accumulated depreciation reserve is less because of the situations in which cost removal is higher than salvage.

Q. Mr. Rackers, it's a simple question. Yes or no: The reserve is adjusted downward to reflect the net cost of removal for rate-making purposes. Right?

A. Assuming that's a positive number, yes.

Q. Okay. But that is not the adjustment -- you have not made any similar adjustment for purposes of your ISRS calculation. Correct?

A. I haven't made a specific adjustment. I think I explained to you earlier --

Q. Okay. I think you've answered my question.

My final question is, to the extent you haven't, you have departed from traditional rate-making, have you not?

A. No.

MR. ENGLAND: Thank you, sir. I have no further questions of this witness.

JUDGE WOODRUFF: Okay. We'll come up from questions from the Bench. Commissioner Murray?

COMMISSIONER MURRAY: Thank you.

QUESTIONS BY COMMISSIONER MURRAY:

Q. Where to start? Let's go to Exhibit 4. Do you have that, Mr. Rackers?

A. Yes.

Q. In order to come up with the negative net plant that Staff calculated on that exhibit, how --

A. I'm sorry. The negative 4 million, 7?

Q. Let me see. I'm having trouble locating it now. I had it earlier.

JUDGE WOODRUFF: Third column under change.

BY COMMISSIONER MURRAY:

Q. What did you say the amount was? Oh, okay. Yes. Right. Thank you.

What did you do with the treatment of net cost of removal?

A. Whatever net cost of removal transactions or entries actually existed between the last rate case for St. Louis County Water Company and July 2003, they're embedded, if you will, in that $52,196,530 of depreciation reserve.

Q. So in relation to what Mr. England was just asking you, you did not treat it the way you would have treated it in rate case if plant would have been retired?

A. No. That's not correct. Let me try this again. In a rate case, when you construct a rate base, you start out with plant in service. One of the things you subtract from it is accumulated depreciation reserve.

Q. Right.

A. Embedded in there -- well, yeah, embedded in there are all the entries that have occurred for cost removal and salvage. And that's -- that's exactly the way you treat it in a rate case.

Q. But you had an exchange just a few minutes ago in which you said, And when you remove plant, assuming you're removing $1,000 plant, you remove it from plant in service. Correct?

A. Yes.

Q. You remove it from the reserve account?

A. That's true.

Q. And you remove it -- you remove the cost of removal from the reserve account? If the cost is $500, you remove that?

A. That's correct.

Q. But in this instance if you were looking at $1,000 plant, you would have only done the first two steps to equate to your calculations here; is that correct?

A. I would say that's not true, because in that

52 million that appears in column 3, line 11, that's the total change in the depreciation reserve since the last case. And any entries to the depreciation reserve associated with cost removal and salvage since the last case are part of what goes into determining that change in the depreciation reserve.

That's not just the additional depreciation that was generated, although I would tell you that that's the fact for most of it. To the extent that there were cost removal and salvage entries, they would have had an effect on the 52 million, either up or down.

Q. Let's go through this. The $1,000 that Mr. England went over with you, if what you're saying here is accurate, why would you remove $500 from the reserve?

A. Well, the -- the $500 would be -- when you retired a piece of plant, the retirement from both the plant and the reserve, the part that came out of the reserve plus cost removal, whether a positive or a negative, that would be embedded in whatever balance -- that would be embedded in the balance that appears column 2, line 11.

Q. Okay. Let's just keep this real simple. We got the $1,000 and we got the $500 in our example here. Where would that $500 be embedded?

A. In column 2 --

Q. No. I'm talking about our example of $1,000

plant removal with $500 cost of removal.
A. It would be a reduction to the accumulated depreciation reserve.
Q. But it's embedded somewhere. Right? Where is it embedded?
A. Well, embedded, I -- it would be a reduction to the accumulated depreciation reserve that appears in column 2, line 11.
Q. Okay. You're on Exhibit 4?
A. Yes.
Q. Let's put these numbers in here. Put the $1,000 in this exhibit, show me where it would go.
A. To the extent that you made that retirement during the year or during this time frame between July 2003 and the last case, the $1,000 retirement would have reduced plant in service -- that's column 2, line 7.
Q. All right.
A. It would also have reduced the depreciation reserve, column 2, line 11.
Q. All right.
A. And your $500 would have been a further reduction to column 2, line 11, the depreciation reserve.
Q. Okay. Now, show me where that -- in this exhibit, the numbers that you have here, what number equates to the reduction of the $500 in line 11?

A. The $52 million approximately that appears in column 3, line 11 --

Q. Wait a minute. How did we get over to column 3?

A. Well, I would --

JUDGE WOODRUFF: If I could interrupt here, which exhibit are you looking at, Mr. Rackers?

THE WITNESS: I'm looking at Exhibit 4.

JUDGE WOODRUFF: Okay. I don't see any line numbers on here.

THE WITNESS: Okay. Sorry.

COMMISSIONER MURRAY: You have to count.

THE WITNESS: I've got the advanced version over here. The -- the fifth amount in column 3.

JUDGE WOODRUFF: The depreciation reserve?

THE WITNESS: Yes. On the bottom of the sheet.

BY COMMISSIONER MURRAY:

Q. All right. Now, just a second. I'm trying to equate this to our example of retiring $1,000 worth of plant and $500 cost of removal. What would equate to that example? Can you give me something that would equate to our example?

A. Well, I -- I think I can. That 52 million amount, that is because it's been reduced by the $500 of cost removal, it's $500 less than it would be. That -- and when I say embedded, it's in there.

Q. Okay. I'm going to have to move on and I hope somebody can clarify that on recross.

You mentioned earlier that Staff has a belief that the company's over-earning; is that correct?

A. The current rate case that we're involved in Staff believes the company's currently over-earning.

Q. And in order to determine that, make that determination, what revenue requirements in rate-making issues did you have to examine?

A. Well, without going through a long list, we tried to examine all the pertinent items that affected the company's current cost of service.

Q. All right. And you said that you used that belief that the company's over-earning in your interpretation of the ISRS statute and how it should be applied; is that correct?

A. Well, I -- no, I didn't. I used that as an example, a situation in the bottom half of Exhibit 4. And I said this situation where you actually had a declining rate base could be indicative of a company that's in an over-earning situation.

Q. And you also mentioned that because Staff believes that this company is over-earning, you think it's appropriate to consider that in this ISRS under the way the statute is written; is that correct?

A. What I said was using this example that's on Exhibit 4, if the company was in this situation where net plant was actually declining and the company was generating enough cash, enough revenue requirement simply through depreciation accruals that it could fund its entire construction budget, it would seem -- it wouldn't make any sense to Staff that the statute would allow the company and would require the Commission to pile on another surcharge.

Q. Okay. And in order to determine that that were the situation, you would have to look at several rate-making issues, would you not?

A. To know whether the company's over-earning, in fact?

Q. Yes.

A. You'd have to -- you'd have to look at everything. You'd have to perform an entire rate case.

Q. And didn't the legislature mandate that Staff could only examine the proper calculation and that no other revenue requirement or rate-making issues could be examined when a company petitions for an ISRS? Have you read the statute?

A. Yes, I have. I'm -- I was trying to decide whether I was going to agree with you or sort of paraphrase there.

Q. You may look at 393.1006.2.

A. And your question is do I think that I've complied with this section?

Q. Well, my question is, when you're talking about examining this ISRS in terms of whether it should be applied to the company that may be over-earning, don't you have to look at those issues that you were told specifically not to look at to determine that?

A. Well, my answer to your question is no. But what I was trying to do with Exhibit 4 here was to set up a scenario, a situation which would show a company with a declining rate base.

And I said that might be indicative of a company that's over-earning, but in Staff's opinion, it would certainly be indicative of a company that didn't -- that shouldn't get an ISRS. Because if their depreciation reserve, if their depreciation accruals are generating so much cash, so much revenue requirement that they can fund their entire construction process, what -- what's the need for a surcharge to be filed on top of that?

Q. Where do you see the legislation allows you to go into that analysis?

A. Well, I -- I don't see that it doesn't allow me. And I think that the Commission has got to consider --

I mean, we're establishing a rate with the surcharge. And I think --

Q. Which is subject to true-up?

A. That's correct. And I think the Commission has got to consider where rates are today and what's -- what kind of funds that's generating for the company before it just piles on an additional surcharge. That's what I'm trying to say.

Q. And how do you do that in light of no other revenue requirement or rate-making issue shall be examined in consideration of a petition?

A. Well, I guess I don't read this the same way you do. There's numerous items from the last case that have to be taken into consideration in this case. Now, I don't think that Staff is trying to re-try any issues that it lost in the last case through its calculation. It -- anything that's encompassed within the Commission's order, there's numerous items that the statute actually requires me to take into account.

Q. When you give an estimate of accumulated depreciation that you're -- and you're looking at all of the plant, the whole company, as I understand it. Right? Taking a total accumulated depreciation to start with?

A. I'm looking at the change, yes, in the total accumulated depreciation.

Q. And what types of property are in that?

A. All types of property the company uses to provide service.

Q. Does that include vehicles, computer equipment?

A. The depreciation on those items, yes.

Q. It would include all things regardless of the length of service that those items were --

A. That's correct.

Q. -- given?

And this may be painful, but I'm going to have you go through something here. You stated earlier that under the company's analysis the costs of removal would be passed along a second time to the ratepayers; is that correct?

A. I -- I think that's -- that's correct. There's at least a potential for that, yes.

Q. Okay. I want you to go through that step by step and assume that -- well, let's just take our $1,000 example. We've got $1,000 of plant being retired. Now, in determining the depreciation that would be allowed to that plant when it was placed in service, the net cost of removal was calculated and it was spread out over the life of that plant; is that correct?

A. Yes. It would have been included as a component of the rate and accumulated over the life of the plant.

Q. Okay. So let's say that this plant started out at -- just say it started out worth $10,000.

A. Okay.

Q. And at the time it's retired, all but $1,000 had been depreciated.

A. Okay.

Q. And it cost $500 to remove it.

A. Okay.

Q. So where are the ratepayers paying for that $500 interval?

A. As part of the depreciation rate that you would apply to the $10,000 of original cost, a component of that depreciation rate at least for this company -- it's not true for every company, but at least for this company -- would be related to cost of removal and salvage.

So every year as you accumulate depreciation through the application of the depreciation rates times original cost, the ratepayer would pay through its depreciation rates and through rates the cost removal and salvage, that $500.

Q. So $10,500 would have been depreciated over time then?

A. Yes. Well, assuming the plant lived its entire life and that was the amount that you had included in the rate, that's correct. That -- that $500 would be accumulated in the reserve.

Q. And what if you had accumulated 500 and the cost of removal was 700?

A. Well, you would make the same entries that we talked about before, but the -- at least with regard to this specific piece of plant, the ratepayers would not have paid the total cost removal and salvage.

Q. And what makes you think the ratepayers in this case have paid for the total cost of removal and salvage of this plant that's being replaced?

A. I don't necessarily think that. In fact, I don't know that. I don't know of any evidence or any calculations that have been provided that show exactly how much of the -- I think it's about a million three that the company wants to include in the ISRS has, in fact, been paid by ratepayers.

But at least for me, that's not -- that's only -- that's a problem, not knowing how much of that's already been paid by ratepayers, but for me the real determining factor is I don't see any discussion in statute anywhere about cost removal and salvage.

Q. Well, do you see discussion anywhere in the statute about is accumulated depreciation set out specifically in the statute?

A. It is in 393.1000(1)(a). I don't think the place where it's mentioned is pertinent to this ISRS, however.

Q. I'm sorry. 393--

A. 1000(1)(a).

Q. But if you took a definition of accumulated depreciation under the traditional rate-making treatment, accumulated depreciation would include a value for net salvage, would it not?

A. Yes. Amounts collected for net salvage are computed on the original cost of plant for net salvage, would be included in the accumulated depreciation reserve.

Q. So the fact that the statute didn't specifically mention the subcategory of accumulated depreciation does not necessarily mean the statute meant to specifically leave it out, does it?

A. I guess the answer to your question is no, but it would seem like if the statute even contemplated the use of it in any way, especially the way the company's used it, and that is as a specific line item addition to the ISRS investment, it's logical to me that it would have at least been mentioned somewhere in these six statutes.

COMMISSIONER MURRAY: Okay. I think that's all. Thank you, Judge.

JUDGE WOODRUFF: Commissioner Forbis? Commissioner Clayton?

QUESTIONS BY COMMISSIONER CLAYTON:

Q. I want to start off by saying this has got to be one of the most exciting hearings that I've ever participated in and that I'm working on retrieving all the information on depreciation that I learned my sophomore year of college in accounting.

Can I reference Exhibit 4? I think you were working off that before. And I want to be clear on the amount of depreciation reserve that you have listed on there. And I think I'm confused on where that number came from. I want to try to get that clarified. That 53.5 million which is listed there --

A. Yes.

Q. -- includes a number of different things, does it not, in terms of depreciation and assets? I guess I can clarify that answer. That includes -- I think in discussion earlier, it includes assets or depreciation from prior to January 1st of 2001 and assets after January 1st, 2001, does it not? Didn't you testify to that earlier?

A. Would you ask me your question one more time? I'm sorry.

Q. The depreciation reserve line -- and you see where I'm talking about the 53--

A. Yes.
Q. --573,000?
That depreciation reserve includes depreciation accumulated prior to January 1st of 2001 and after January 1st of 2001. Correct? Isn't that what you testified to earlier?
A. No. It would -- it would be -- one component of that number would be only the depreciation accumulated since the company's last rate case -- or since the cut-off in the company's last rate case. So that would be all the depreciation accumulation since 1/1/2001.
Q. So it's just a depreciation since January 1st?
A. Well, that's not all that's in there.
Q. Okay.
A. But the depreciation, that's what's in there.
Q. Okay. But -- well, I may be -- I obviously don't understand this. How's that for an honest answer?
COMMISSIONER CLAYTON: I'll tell you what, it may be better just to remain silent rather than ask the questions. Thank you.
JUDGE WOODRUFF: Commissioner Gaw?
QUESTIONS BY CHAIR GAW:
Q. Reminds me of something that Abe Lincoln once said.
Mr. Rackers, let's back this thing way up for

a moment. Okay? And focus on the first issue in regard to what's included in depreciation and just get for a moment to rate-making theory and how the big picture works as far as what's in depreciation and accumulated depreciation.

Ignore the ISRS entirely for a moment. And give me a 101 on what occurs in a rate-making case and how depreciation is intended to be utilized as an account -- as an account -- accumulated depreciation for investment in new infrastructure or whatever needs to be done for a utility. Can you do that for me?

A. I'll -- I'll give it a shot. In a rate case, one of the components that goes into constructing a rate base and reduces the company's investment in plant is the accumulated depreciation reserve.

What -- what causes it -- the main item that causes it to accumulate as an account is annual depreciation expense that's taking -- taken on the plant that the company has in service. Now, other entries that affect that balance are retirement of plant, cost of removal that's incurred.

Now, the second part of your question --

Q. Before you go into that, let me ask you -- let me ask you this. We're strictly talking about an entry for accounting purposes; is that accurate? We're not talking about cash, we're not talking about property. This entry line on accumulated depreciation represents the paper estimate of depreciation on whatever rate the depreciation is taken. Is that -- is that true or not?

A. Yes.

Q. Okay. Now, move over for a moment for me and translate that into what it means in dollars and cents, if anything, for the company to actually have money available for any particular purpose?

A. The fact that it has cash coming into it for depreciation expense which doesn't have to be paid to anyone in particular makes it available for, as Mr. England and I discussed, a variety of purposes. One most notably, cash to support the company's construction budget.

Q. Now, as far as the -- as rate-making theory and the concept of regulation is concerned, is that philosophy that that money that might be held by the company or accumulated by the company as a result of the fact that it's shown -- or that there is a line item for accumulated depreciation that can result in money that is not -- is not reflected in -- is not taken into -- well, let me start over.

The fact that there is money that the company has access to because of this accounting method, is the thought that -- the general thought for rate-making theory that that will allow the company to invest in plant improvement, new plant construction?

A. I would say that -- that what the depreciation expense is designed to do is the recovery of the original cost and cost of removal for plant that's in service. The practical matter of it is, it's a source of cash that the company can use for new investments and does.

Q. And I understand that that's the practical side of it. I'm asking you, is that your theory -- not your theory, but your analysis of what that might be used for or is it more widespread than just you?

A. I think it's pretty widespread.

Q. Isn't it accepted as far as regulatory analysis is concerned that that is a place where that -- a purpose for that money that might be accumulated, cash that might be accumulated?

A. Yes.

Q. Okay. Now, let's enter into the ISRS surcharge issue for a moment. If you add in this new tool for recovery for money expended on new plant and improvements, that would be on top of -- potentially, according to the company, on top of the ability of the company to have access to cash as a result of this accumulation of cash from accumulated depreciation? Is that your understanding of their theory of what the statute means, if you know?

A. I think that it would provide additional funding for construction and for -- I don't know that that's specifically what the company's theory behind ISRS is.

Q. What's your theory about how this should work, just in very general terms?

A. I think the ISRS should determine the revenue requirement that the company's entitled to associated with these ISRS investments over and above what's being provided in current rates. And I say that because it just seems illogical to the Staff that you're going to establish a surcharge, you're going to increase rates over and above what they are today without knowing what's in those rates today.

Q. Is Staff's theory based upon the premise that rate-making theory is based upon the idea that that accumulated depreciation account generates cash for purposes of new investment?

A. Well, I think it's more than that.

Q. Okay. Go ahead, but tell me how it fits in when you're answering, if you would.

A. Well, I think your statement fits in in that the practical matter -- the -- for practical purposes, it's a source of cash that the company uses for various things. One, in particular, to fund new construction.

Q. And does Staff believe that that's already built into the rates?

A. Well, some amount is already built into the rates. And I think Staff would say that you have to consider what's already being provided before -- in the establishment of this additional surcharge.

Q. Okay. And how does Staff -- and I know you've already done this, but I want you to explain it like -- on this track. How does Staff make the calculation of what's already built into rates with your exhibits and things that you've done?

A. Looking at Exhibit 4, Staff does that by assigning a ratable share, a portion, a ratio of the growth in the depreciation reserve to the ISRS property based on the relationship of the ISRS property to the total change in plant.

Q. And why did you use that? Where did you come up with that?

A. Well, as in our discussion, the initial part, trying to measure the change in plant and the change in the depreciation reserve is a consideration of what are rates, what's in rates today. And then the second step, trying to figure out how should a revenue requirement for the ISRS be constructed based on what's in rates today.

Q. Can you be a little more specific about how you develop -- is this a theory that Staff has come up with or is it a theory consistent with what's done in other areas? This all may be very self-evident, but I need you to go through and help me understand here how that theory came about that this is the right -- this is the way to determine what portion of this is already built into these rates. I'm sorry I'm not being any more clear with my question.

A. Well, I -- I wouldn't characterize it as a new theory. Certainly any time we have a rate case, one of the first things you do is consider what are the current rates. You price out -- you figure out what the new cost of service is, you price out your quantities using the current rates that are in effect. So you determine what are my rates recovering today, what should the rates recover and then you look at the difference.

Q. Okay. But how did you make the determination of what is included in rates today with this analysis? Where did you get that -- where did you get the theory in making the calculation? Where did that come from?

A. Well, examining the change in net plant is -- is something that's taken into consideration during a rate case. I mean, it -- it's a way to measure the change in the cost of service.

Q. And what you've done here is consistent with what you would have done in a rate case; is that true?

A. In my example, yes.

Q. And you did say yes?

A. Yes.

Q. I talked over the top of you.

Is Staff's theory consistent with the concept of bringing up to date accumulated depreciation with the -- corresponding with the time of ISRS as you would in a rate case without anything else being considered besides the depreciation issue?

A. Yes.

Q. Can you explain that just a little bit?

A. Well, with regard to plant that was placed in service and is currently being reflected in rates, as additional depreciation accruals are accumulated, the actual cost related to that plant declines because it's -- it's been depreciated, it has less net book value. So that's something that should be considered before you establish a new rate on -- or a new surcharge on top of the current rates.

Q. So is Staff trying to look at the issue of -- the depreciation issue in order to determine what the appropriate amount of additional net charge there should be based upon the current situation at the time of the ISRS so that there is almost a true-up of sorts in that accumulated depreciation account?

A. Yes.

Q. And does Staff believe that that is a more accurate reflection of what is actually occurring with the company's investment and infrastructure and revenue streams that are available for purposes of that accumulated depreciation account?

A. Yes.

Q. And what is it about the company's position that does not do that?

A. Well, as I show on this Exhibit 4 on the bottom, the company's calculation is the same no matter what the company's revenue stream is currently, what the -- what the company's earnings are currently. It's a strict, very narrow look at what are my ISRS investments and what depreciation have I accumulated on those specific adjustments -- excuse me, investments since they were placed into service.

Q. Well, is Staff taking the position that you should look at other things besides the issue of what should be an accumulated depreciation as you would in a full-blown rate case in dealing with this ISRS calculation?

A. I think you have to consider what depreciation accruals are, what kind of funds the company is accumulating from the rates it's charging its ratepayers currently before you establish a surcharge on top of that.

Q. But are you looking beyond the accumulated depreciation account as you would in a full-blown rate case, look at every issue? You're not proposing to do that here, are you?

A. No.

Q. Are you narrowly just looking at that -- in regard to this issue, the accumulated depreciation numbers?

A. Yes.

CHAIR GAW: Okay. I think that's all I have, judge. Thank you.

QUESTIONS BY JUDGE WOODRUFF:

Q. All right. I'm going to plunge into this briefly also, hopefully briefly. Again, on Exhibit 4 -- let me back up for a minute too.

Not everything that's included in an ISRS charge -- not all investments can go into an ISRS. Correct?

A. That's right.

Q. Only infrastructure replacements, and they specifically cannot include infrastructure that would increase their -- add customers and increase their revenues. Right?

A. That's true.

Q. So, for example, if a company were to come into St. Louis County and build, say, a hog processing plant that's going to take lots of water, that's not going to be an ISRS allowable expense. Right?

A. That's correct.

Q. Now, let's go back to your actual alternative scenarios on Exhibit 4. Now, I understand that the company's ISRS investment in both cases is the 20,723,000. That doesn't change on either scenario; is that right?

A. That's right. I've only included the infrastructure replacement piece and not the facilities relocates on my Exhibit 4.

Q. All right. Well, that will work for this exhibit.

Now, your first one is the actual. And down on your alternative one here you decrease the invested plant while not changing the ISRS. Right? So in this one the hog plant doesn't go in?

A. Correct.

Q. Okay. Now, over here on -- let's take it the other direction. Instead of an alternative where the -- alternative where the other investment has gone down, let's suppose it's gone up, it's an even bigger hog plant that's coming in. So now the change invested in plant is now larger and it's -- so the ISRS portion is a smaller percentage, the total, which would mean then that Staff's revenue -- appropriate pre-tax revenues will go higher. Would that be correct? When you said --

A. Yes. In this example, if you would increase the 93 million rather than decrease it, as I did in my alternative, the ratio of ISRS plant to total plant would be smaller than the 22 percent, so accumulated depreciation offset would be less.

Q. Would that mean then the company would get a larger surcharge?

A. Correct.

Q. And the only variable is the amount of non-ISRS investments; is that correct?

A. Well, the -- well, the variable is what has actually been your change in net invested plant and -- on variables and the depreciation reserve.

Q. Okay. And we said that the ISRS cost didn't change?

A. Correct.

Q. So the only change in that scenario then is the non-ISRS investments?

A. Oh, in your example? I'm sorry.

Q. In my example.

A. Yes. Yes. That's correct.

Q. Okay. Is there anything in the statute that says Staff should be looking at non-ISRS investments?

A. No.

JUDGE WOODRUFF: All right. I have no other questions.

Go ahead.

QUESTIONS BY COMMISSIONER FORBIS:

Q. At some risk I'll try to ask one simple question to make sure I -- on these two dueling Appendices B here, the Staff version does not have line 29, accumulated depreciation, net cost removal; is that right?

A. That's correct.

Q. Okay. And there's been a lot of discussion about that. Just so I'm clear in the -- in our -- historically in traditional rate-making cases, Staff has never included that line 29 in its calculations? You've always taken the approach that that's embedded in depreciation? Do you know?

A. I think the answer to your question is yes, but I just want to clarify my response just a little bit.

Q. Okay.

A. This calculation is -- is somewhat unique in that it specifies it as a line item increase to the ISRS investment the company wants to calculate its revenue requirement on.

Now, in a rate case when Staff would pick up the amount of the accumulated depreciation reserve to reduce rate base by or reduce the company's plant by in rate base, embedded included in that accumulated depreciation reserve would be entries for cost removal and salvage.

Q. So help me just make sure. You're thinking this is a bit of a different example is why you're kind of -- this situation is somewhat different than from a traditional rate-making case so you're kind of hedging your answer a little bit? Did I pick up on that?

A. The format here is different is what I was trying to say.

Q. Okay.

A. The fact that cost removal and salvage is considered in a rate case, that's true, it is.

Q. And it's always included just generally and depreciation is embedded in that, not a separate line item?

A. It's not a separate line item in the rate base.

Q. Okay.

A. But it's -- it's certainly a component.

Q. It is a component and it is considered?

A. Right. Well, and it's certainly a component of the rates that customers pay. They're paying for cost removal and salvage.

Q. Okay. And so in your calculations on Attachment B, you consider that cost to be included in your depreciation?

A. Whatever transaction -- whatever entries regarding cost removal and salvage that affected the change in the accumulated depreciation reserve since the last case, a portion of that, that -- the allocation, the 22 percent, that -- some portion of those would be reflected in Staff's calculation.

Q. And do you know how much that is, or that could be determined?

A. I don't know how much it is. I presume it could be determined probably with some difficulty.

Q. Nobody said it was easy. Right?

COMMISSIONER FORBIS: Okay. Thank you.

JUDGE WOODRUFF: With that, we're going to take a break. Let's come back at three o'clock.

(A recess was taken.)

JUDGE WOODRUFF: Before we took a break, we had just finished questions from the Bench, so we'll now come back for recross based on questions from the Bench and begin with Public Counsel.

MS. O'NEILL: No questions.

JUDGE WOODRUFF: Missouri Industrial Energy Consumers?

MS. VUYLSTEKE: No questions.

JUDGE WOODRUFF: Missouri Energy Group?

MS. LANGENECKERT: No questions, your Honor.

JUDGE WOODRUFF: Missouri American Water?

MR. ENGLAND: Thank you, your Honor.

RECROSS-EXAMINATION BY MR. ENGLAND:

Q. Good afternoon again. Try one or two questions here, if I can. Try to keep it short, Mr. Rackers.

If you accept for purposes of my question that the ISRS legislation only wants you to calculate the accumulated depreciation that is specifically associated with the IR-- excuse me, ISRS plant, would you agree with me that the company has appropriately done that?

A. Yes.

MR. ENGLAND: That's all I have.

JUDGE WOODRUFF: All right. Thank you.

Any redirect?

MR. KRUEGER: Yes, your Honor.

REDIRECT EXAMINATION BY MR. KRUEGER:

Q. Good afternoon, Mr. Rackers.

A. Good afternoon.

Q. Mr. England asked you some questions about Section 393.1006.4(5). Do you remember those questions about property tax?

A. Yes.

Q. That subsection states, In determining the appropriate pre-tax revenues, the Commission shall consider only the following factors. And then No. 5 is, The current property tax rate or rates applicable to the eligible infrastructure system replacements.

Is that how that reads?

A. Yes.

Q. Does that particular subsection tell how the property tax is calculated?

A. I think that subsection just discusses a portion of how the property tax should be calculated.

Q. Does that particular subsection tell what property is to be considered?

A. No.

Q. Do you know when the current property tax rates are determined?

A. I don't know the specific day, but the current property tax rates I think are determined in the October time frame.

Q. And to what property do those current property tax rates apply?

A. The current rates that are in effect today?

Q. The ones that are determined in October.

A. They're applied to the plant in service as of 1/1 of the current year; January 1st of the current year.

Q. So the property -- the plant that was in service as of approximately nine months earlier?

A. Yes.

Q. So would you agree that to the extent that one would know that the current property tax rate -- that the eligible infrastructure that would be subject to that tax rate would be that investment as of the beginning of the year?

A. That's correct.

Q. Mr. England also asked you some questions about Section 393.1000(1)(a). Do you recall those questions?

A. Yes.

Q. And am I correct to say that -- to read that as saying, Appropriate pre-tax revenues is the revenues necessary to produce net operating income equal to what is listed in subparagraph A there?

A. That's correct.

Q. For purposes of this case, did you calculate accumulated depreciation?

A. I calculated the change in accumulated depreciation since the last St. Louis County Water Company rate case.

Q. Did you calculate that because of the language that was found in Section 393.1000 that Mr. England asked you about?

A. No.

Q. Did you rely on Section 393.1000 as the reason for calculating?

A. I didn't rely on the specific language here for calculating it. I relied on the fact that there -- in this language I think there's the contemplation that something will be netted against the original cost.

Q. And by that you're referring to what appears in -- I believe it's the first line there where it refers to the net original cost of eligible infrastructure replacements?

A. Yes.

Q. And that's the reason why you calculated the accumulated depreciation?

A. Yes.

Q. I believe you suggested that accumulated depreciation provides funds to the company -- or testified so; is that correct?

A. Yes.

Q. Is it also true that the accumulated depreciation adjustment is needed to give customers credit for the regulatory lag experienced since the last rate case for depreciation expense and cost of capital?

A. Yes.

Q. And has the Staff attempted in this case to determine incremental revenue requirement for this ISRS investment or what is currently being paid by ratepayers for this area of investment?

A. I think that's reflected in Staff's

calculation.

Q. I tried to copy down the answer you gave to a question from the Bench and I'm not sure whether I got it exactly right, but I'm going to state it as nearly as I got it and ask you whether that's a correct statement of Staff's position.

The ISRS should represent what the company is entitled to for these investments over and above the rates established in a general rate case. Is that an accurate statement of your position?

A. I think what I said, over and above what customers are providing in current rates, but what you said was close.

Q. With that change, that is your position?

A. Yes.

Q. Okay. Does the cost of removal by increasing rate base cause an increase in regulatory lag to the company?

A. No.

Q. Why not?

A. Well, I guess I would say that it's -- the event has already been accrued for or paid for in rates by the customer.

Q. When plant is removed from service, if there is a cost of removal associated with it, the number that's been mentioned in the examples is $500, does that increase or decrease rate base or does it have an effect on rate base?

A. It increases rate base.

Q. Increase in the rate base have a regulatory lag consequence for the company?

A. Yes.

Q. And what is that consequence?

A. Well, it would increase the -- it would increase the revenue requirement associated with the return on rate base.

Q. And does that result in regulatory lag?

A. Yes.

Q. Is that regulatory lag addressed by Staff's treatment of the reserve for depreciation?

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

Q. Is that regulatory lag that we just talked about addressed by Staff's treatment of the reserve for depreciation?

A. Yes.

Q. Even though Staff didn't make a line item adjustment?

A. That's correct.

Q. I'd like to ask you some questions now to maybe try to illustrate some of the concepts that we've been talking about.

Can you all see this? If I turn it to you, the Bench can't see it.

Assuming that in the last rate case the company presented to the Commission a determination was made on these items that are subject to ISRS, hydrants, mains and valves, and that a revenue requirement is associated with that and that the impact on a customer based on the hydrants, mains and valves that existed at the time of that rate case was $20 per year. Ask you to assume that.

Subsequently, the ISRS statute is passed and two years later -- two years after this rate case the company files for an ISRS. And using the company's methodology, they determine the revenue requirement supports an ISRS that amounts to $5 per year for a customer.

Now, if other things are equal, if there's no other changes in revenues and expenses and so forth, would the revenue requirement be equal to -- would the revenue requirement at this time be equal to, greater than or less than the $20 that it was up here?

MR. ENGLAND: Your Honor, I'm going to post an objection because I'm not sure what cross-examination or question from the Bench this responds to.

JUDGE WOODRUFF: Could you clarify that?

MR. KRUEGER: Well, I think there were

numerous questions regarding Exhibit B and I think this is -- I mean Exhibit 4 and this is intended to bring that into sharper focus, make it clearer using small numbers that show the effect that results from circumstances that we now face.

JUDGE WOODRUFF: I'm going to overrule the objection. You can proceed.

BY MR. KRUEGER:

Q. So my question then is, at this time, other factors being equal, no new plant investment, no retirements, no change in revenue and expense and so forth, would the revenue requirement at this time be equal to $20, greater than $20 or less than $20?

A. The revenue requirement associated with the hydrants, mains and valves --

Q. Yes.

A. -- from the last case?

It would be less than $20.

Q. Okay. I don't think the exact number we pick is going to matter, so let's just say that it's 18. Now, under the company's methodology that they've presented in this case when they file the application for an ISRS under their methodology, what would the rate be for that customer?

A. Twenty-five dollars.

Q. And how did you determine that amount?

A. Well, the amount reflected in current rates is $20 and the ISRS surcharge would be an additional 5.

Q. Now, under the Staff's proposal -- I think you said 25 here for the company. Under the Staff's proposal and the Staff's methodology, what would the customer's rates be?

A. Twenty-three.

Q. And how do you determine that amount?

A. Well, the cost of service associated with those assets from the last case has been reduced by 2 and that cost of service should be considered in the determination of the ISRS. So it should reduce the surcharge by $2.

Q. So what numbers have you added and subtracted to come to the conclusion that under the Staff's proposal the customer would pay $23 per year?

A. Well, I've examined what's in rates today and the cost of service today and subtracted that difference and compared it to -- I'm sorry, subtracted it from the surcharge that the company wants to put -- wants to establish.

Q. And I'm asking you, just tell me the math. What numbers did you combine to get to $23?

A. Eighteen and five.

Q. Okay. And the 18 being $20 -- okay, 18 being the amount that you said would -- that we assumed would be the revenue required per customer under this assumption and then the $5 being the amount that would be added for the ISRS surcharge?

A. That's correct.

Q. So in these circumstances that I've assumed and talked about, the difference would be under the company's proposal the customer would pay $25 and under Staff's proposal they'd pay $23; is that correct?

A. That's correct.

Q. Would you agree that whether the company is over- or under-earning has no relevance in this case?

A. Yes.

Q. That the ISRS is determined independent of over-earning or under-earning?

A. Yes.

Q. Do you have an opinion about the input that would occur in the change of rate base when you consider the different depreciation rates that are applied to different categories of plant, about the magnitude of that?

A. Let me hear your question again. I'm not sure I understood that.

Q. Do you have an opinion about the magnitude of the effect that would occur in the change in rate base when you consider the different depreciation rates that are applied to different categories of plant?

A. In my opinion, the variation in the depreciation rate would not have much effect because the company's composite depreciation rate is approximately 2 percent currently. And I think that that appears somewhere in somebody's exhibit, that the depreciation rates for the ISRS property, that that 2 percent would fall in the range of depreciation range for the ISRS property.

Q. And would the variation in these depreciation rates have a significant impact on the difference in depreciation reserve?

A. No.

MR. KRUEGER: That's all the questions I have.

JUDGE WOODRUFF: All right. And you may step down, Mr. Rackers.

Does Public Counsel have any witnesses?

MS. O'NEILL: No, your Honor.

JUDGE WOODRUFF: Missouri Industrial Energy Consumers, do you wish to call your witness?

MS. VUYLSTEKE: Mike Gorman of Brubaker and Associates is available, but I'm not sure if the Commission or the parties have any questions for him. So I would ask at this time if anyone has any questions in which case I would ask that Mr. Gorman would be sworn in. And if there are no questions, we'll just omit smearing him in, if that's acceptable to you, Judge.

JUDGE WOODRUFF: All right. Let me ask the parties. Do they have any questions for Mr. Gorman?

MS. O'NEILL: No, your Honor.

MR. KRUEGER: Staff does not, your Honor.

MR. ENGLAND: No questions from the company.

CHAIR GAW: Oh, yeah.

JUDGE WOODRUFF: All right. Bring him forward.

MS. VUYLSTEKE: MIEC calls its witness, Mr. Mike Gorman.

(Witness sworn.)

MICHAEL GORMAN testified as follows:

DIRECT EXAMINATION BY MS. VUYLSTEKE:

Q. Mr. Gorman, can you state your name and business address for the record, please?

A. My name is Michael Gorman. My business address is 1215 Fernridge Parkway, St. Louis, Missouri.

Q. And on whose behalf are you testifying for today?

A. Missouri Industrial Energy Consumers.

Q. And you have not submitted any pre-filed written testimony; is that correct?

A. Yes.

Q. But in this case your client, the Missouri

Industrial Energy Consumers, has stated it supported the Staff position on the amount of the ISRS rate; is that correct?

A. That is.

Q. And on rate design and cost allocation, at this point we have no dispute with the company or the Staff at this point?

A. Correct.

MS. VUYLSTEKE: Okay. At this point then, I would tender the witness for cross-examination or questions by the Commission.

JUDGE WOODRUFF: Okay. Do any of the parties wish to ask any cross-examination questions?

Hearing none, we'll come up to questions from the Bench and Chair Gaw.

CHAIR GAW: Thank you.

QUESTIONS BY CHAIR GAW:

Q. Good afternoon, Mr. Gorman.

A. Good afternoon.

Q. How thoroughly have you reviewed the paperwork and positions of the parties in this case?

A. Well, I think well enough to answer questions on them. I can't say I've confirmed all the calculations submitted by all parties.

Q. All right. Let's just stick with theory anyway for the moment. Staff's position in regard to accumulated -- treatment of accumulated depreciation, do you agree with that, with their position?

A. Well, I -- as I understand their position to be is that they believe that the surcharge should reflect the revenue requirement which represents the higher investment level the company currently has made in qualifying infrastructure investment above that which is already reflected in base rates.

Q. All right. And you've examined how they made the calculation to come to the conclusion as far as the rationale for that calculation, have you not?

A. I've reviewed their work papers, yes.

Q. All right. Explain to me your understanding of how their theory works and how their calculation works.

A. Well, my understanding is that there is a recognition that once base rates are established, customers pay rates, which allow the company to recover depreciation expense. As the company recovers depreciation expense, rate base would decline except for the company's additional investment in utility property.

If the additional investment in utility property is recognized in a surcharge, then the rate base which is paid for by customers through base rates will decline each year. In the development of the surcharge, Staff increased the amount of accumulated depreciation to attempt to balance what customers are paying for in base rates plus what they will pay for in the infrastructure surcharge.

Q. All right. And how do you determine what they are already paying according to Staff, and I assume you're agreeing with? How do you make that determination?

A. Well, I believe there are certain qualifying investments --

Q. All right. Go ahead.

A. -- which should be the focus of the surcharge. From that, assumptions need to be made concerning how much accumulated depreciations for similar investments that are already reflected in base rates are being accrued by the company and recovered through depreciation expense.

To the extent the company's investments and assets which would otherwise qualify as infrastructure investments but for they're already reflected in base rates, the amount of the surcharge must be adjusted such that as the company recovers the hydrants and fees and that through base rates and the rate base for those specific items decreases on an annual basis, as the company makes investments in the infrastructure surcharge, that's -- if you'll look at it from two separate rate bases, a rate base for base rates and a base for the infrastructure surcharge for just these assets, as the company charges base rates, the rate base for those qualifying investments decreases every year.

The reason it decreases is because they're not adding additional rate -- investments to that rate base because those additional investments will be treated separately in the infrastructure surcharge.

So as the -- so if you don't recognize the decreasing rate base nature of the qualifying investments that is occurring in base rates and you only recognize the incremental investments in the surcharge, then the net effect is the company will earn more than the rate of return the Commission has authorized it to earn for both a combination of qualifying investments built into base rates and qualifying investments recovered through the infrastructure surcharge.

Q. Okay. And I would like for you to take that and expand upon it just a little bit more and go into why that is the case. And I know that you've already given me a succinct answer about it. Tell me how that results in a rate of return that is other than what's authorized. If you want to give me a specific example that you want to throw out, if you want to use something that's already in front of -- some exhibit --

A. Okay. Well, I think maybe a simple example.

Let's assume the surcharge doesn't exist.

Q. All right.

A. And the initial qualifying investments has a rate base of $10. The depreciation expense on those investments is $10 per year. That's built into base rates right now. Every year the company expends, makes capital improvements, for those assets of $10.

So in the first year you start off, develop rates based on a $10 rate base. Rate case is over, the first year those rates are in effect, by the end of that year there's $10 of additional depreciation expense which reduces that rate base, but the company made $10 of capital improvement which increased the rate base. So a $10 decrease and a $10 increase leaves the rate base at $10. So by the end of the second year, the base rates are still providing a return on $100 rate base.

Okay. Now, second example, let's assume the surcharge goes into effect. Got $100 rate base starting in year zero. Over the first year, rates are set to provide a return on that $100 rate base plus $10 of depreciation expense. Capital additions are no longer built in or recovered through base rates. Instead they're recovered through the surcharge.

At the end of the second year, company recovers $10 of depreciation expense. And the base rates are now -- were originally designed to support $100 rate base are now supporting a $90 rate base. So the operating income the company recovers through base rates supports a lower rate base which produces a higher rate of return.

Now, the $10 of incremental investment the company made is now recovered through the instrument -- or infrastructure surcharge. So the $10 of additional investment, assuming there's no accumulated depreciation in the first year, would be -- would -- would be set to provide a revenue requirement equal to that rate base times the rate of return the Commission approved in the last rate proceeding.

So in this instance the company would, in essence, have base rates which are supporting a $100 rate base even though the actual rate base is now only $90, plus we have an infrastructure surcharge supporting a $10 rate base, which is the actual amount of infrastructure rate base. But the sum of the two would be supporting a rate base of $110 when the company's actual rate base is only 100.

Q. Is that the result that you would -- that would occur if the company's position is held to be the correct one?

A. Well, that -- that's one of the drawbacks of single-issue rate-making. So, yes, that is what would happen if the company's position is adopted on the development of revenue requirement.

Q. And I understand part of this issue that's -- part of the issue in front us has to do with the legal question of what the statute means, but aside from that, just dealing with the question of what the result is, the scenario you've just described would result in the potential for additional recovery over and above the rate of return authorized by the last rate case that the Commission would have looked at for the company?

A. For the qualifying infrastructure investments, both incremental reflected in the incremental -- or infrastructure surcharge plus the same types of investments which are currently built into base rates, the company would earn more than the Commission authorized returns on -- on the total of those types of investments.

Q. All right. Does the theory that Staff is supporting here fix that problem; and if so, how?

A. The Staff's method attempts to fix that problem by taking some general ratios factoring analysis to adjust the incremental rate base to reflect that the rate base in base rates has decreased. So it's a simplified method of attempting to fix that.

Q. I see. Can you give me a little explanation of how that method works in coming up with that ratio and how that's -- and whether or not that's reflective -- or a good way of handling that problem that you pointed out?

A. Well, going back to our example, let's assume there's a 30-- third scenario where the $100 rate base decreases the $90 by the end of the second year and there's $10 of incremental infrastructure -- qualifying infrastructure investments.

Under Staff's method, even though there weren't any accumulated depreciation to apply against that infrastructure surcharge in that first year, Staff would take some of the depreciation expense provided from customers to the company and base rates and credit that against the infrastructure surcharge rate base and developing a revenue requirement for the infrastructure surcharge.

The net effect of that would be to reduce the rate base from the $110 implied from base rates plus infrastructure surcharge back down closer to the $100 rate base which is -- really represents the amount of invested capital the company currently has outstanding.

Q. Okay. Are there any problems created by Staff's theory that you can discern?

A. Well, it's a simplified method of factoring the amount of accumulated depreciation. A more precise method may be to actually track the recovery of depreciation expense for qualified investments after the rate case along with instrument surcharges. That might be a more exact way of accomplishing what Staff's attempting to do.

So -- so the danger is it's making simplified assumptions that may work -- may balance customer -- customer interests or it may work to the detriment -- probably more so of the company than of the customers.

Q. And the methodology that you described as being something that may be more accurate, what would be -- what would be the problems with using that kind of a method where you specifically track rather than basing the -- utilizing the Staff's theory?

A. Well, other than -- other than myself right now, nobody proposed that in this proceeding. I guess that would be the only issue. Along with the -- tracking the additional depreciation on these expense -- these qualifying assets or these accounts that would qualify for treatment under the infrastructure surcharge, along with the additional accumulated increases or decreases through accumulated deferred income taxes probably would provide the most accurate assessment of the amount of revenue requirement the company needs to fully support these types of new investments.

Q. You haven't supplied anything for the record, have you, on the methodology that you described that you proffered?

A. I have not.

Q. Okay. Is that a -- is that very difficult -- would that be difficult for the Staff and company and Public Counsel to track, that method?

A. No.

CHAIR GAW: I think that's all I have, Mr. Gorman. Thank you.

JUDGE WOODRUFF: Commissioner Clayton?

QUESTIONS BY JUDGE WOODRUFF:

Q. All right. I'm going to ask you a question also and it's about Exhibit 4, if you have a copy of that there. This will be the same question that I asked of Mr. Rackers.

A. I'm not sure I do have a copy of Exhibit 4.

Q. I'll race your counsel to see who finds it first. Looks like she's going to make it here.

THE WITNESS: Thank you.

BY JUDGE WOODRUFF:

Q. Okay. You were here during that testimony, I guess?

A. Yes.

Q. Okay. Staff's Exhibit 4 talks about an actual scenario which is based on the numbers that they found in this case and an alternative scenario where they have a hypothetical situation where they had less invested plant and I believe we established that that less invested plant would be from non-ISRS investments. Are you following me so far?

A. Yes.

Q. Okay. And they indicated that under that alternative, the percentage of total investment that would be represented by the ISRS investments would increase and, therefore, under Staff's scenario, the surcharge would decrease. Would you agree with that?

A. Well, I think the percentage of the amount of accumulated depreciation would increase and that would reduce the estimate of the -- the surcharge net plant value and that would decrease the revenue requirement.

Q. Okay. And then we went to the opposite scenario where I think I said a major, large hog processing plant came in and the company added a whole bunch of non-ISRS investment so that the percentage of ISRS was now decreased, lower than 22 percent. And I believe Staff's witness indicated that that would increase the amount of the surcharge. Do you agree with that?

A. I would have to check that math to verify how the plant in service would be recorded and whether or not it would be offset by customer contributed capital. And --

Q. Assuming it wasn't offset.

A. Well, I'm -- depending on how it's accounted for, the amount of accumulated depreciation could be adjusted also. And then the -- while the percentage that's applied to that accumulated depreciation could be higher, if a higher percentage is applied to a lower base, then the dollars amount that would be allocated to the surcharge may not be that much different. I would just need time to look at all those numbers and see what the outcome would be.

Q. It would depend on the actual facts --

A. Yes.

Q. -- of the situation?

Okay. That's fair enough.

But in either case the ISRS investment amount didn't change? The amount that qualifies under the statute as an ISRS investment would not change; is that correct?

A. Yes.

Q. Okay.

A. That's my ass-- or that's my understanding of the assumption.

JUDGE WOODRUFF: Okay. That's all the questions I have then.

And do we have any recross based on questions from the Bench? Speak up now if you want to.

MR. ENGLAND: Yes. But I'd prefer to go last.

JUDGE WOODRUFF: Does --

MS. O'NEILL: No questions from Public Counsel.

MR. KRUEGER: Staff has no questions, your Honor.

MS. LANGENECKERT: None from Missouri Energy Group.

RECROSS-EXAMINATION BY MR. ENGLAND:

Q. Good afternoon, Mr. Gorman.

A. Good afternoon.

Q. I want to follow up on one of your answers where you talked about looking at it as two separate rate bases. Do you recall that?

A. Yes.

Q. And I think what you were saying is on the one hand we've got the rate base associated with the ISRS qualifying plant. Right?

A. Yes.

Q. And on the other hand we have the rate base associated with all the other plant?

A. Correct.

Q. That was established we'll say in the company's last rate case. Correct?

A. Well, not exactly. The ISRS type of qualifying investments, on the one hand, that go into the surcharge, those same types of investments that were built into the rate base in the last rate case was the example. So we're talking about the same assets, it's just a point in time of when the investments were reflected by the utility in development of rates.

Q. Maybe we have a difference of opinion on semantics here, but if ISRS-type investments were put into service prior to the last rate case, they were included in the general rate case rate base. Right?

A. Yes.

Q. If ISRS investments were made after that rate case, they haven't been captured in that past rate case. Right?

A. Well, I want to make sure I understand that question. I want -- I don't want to make it more difficult than it is, but are you asking me whether or not the rates that were developed in the last rate case are adequate of supporting the additional investment in ISRS-type assets?

Q. No. That's not the question. It's pretty simple, sir. You're the one that started it by talking about two separate rate bases.

We've got a rate base as of the last rate case that includes all the plant the company has in service as of 1/1/2001. Okay?

A. Okay.

Q. Since 1/1/2001 and through July of 2003, the company has made new investments that aren't included in that rate base utilized in the last case. Right?

A. Okay.

Q. Of the investments that the company has made over the last two and a half years, some of that is ISRS qualifying plant. Correct?

A. Okay.

Q. And that's the one rate base we're talking about. All right?

A. This example that you're constructing, yes.

Q. And isn't that what you were talking about in the way of two rate bases?

A. No, sir.

Q. Then you need to explain --

A. Okay.

Q. -- what two rate bases you're talking about.

A. I'll try to explain this so you'll understand. We're talking about specific assets that were separated from all the other investments and operating costs the company incurs. What happens when those hydrants and transmission mains that were reflected in the company's base rates in the last rate case -- what happens to the portion of rates the customers are paying that supports those investments?

Well, if there's no additions to those specific account investments after the rate case, then the rates the customers are paying for those -- to support those specific asset types will produce an increasing rate of return the longer those rates are in effect.

And the reason that happens is because the company's net investments in those specific types of investments decreases every year as the company recovers depreciation expense. And, in essence, the company recovers from customers their investments in those -- those assets.

Now, if there's --

Q. Let me stop you for just a second. You're also assuming everything else being equal. There's not a commensurate increase in operating expenses or a decrease in revenues due to a loss of customers or something of that nature. You're holding everything else constant for purposes of your hypothetical. Right?

A. Yes.

Q. I'm sorry. Go ahead.

A. Now, if in addition to paying those base rates which support those specific asset types, customers are also asked to pay another rate that supports all incremental investments and additional hydrants and transmission mains and other qualifying investments, then customers will pay the rate of return prescribed by the Commission on the incremental investments, but the base rates will produce an increasing rate of return on the same investments built into base rates.

The net effect to the company over time is that they will earn more then the Commission authorized returns on the total investments in hydrants, transmission mains and other accounts which would represent qualifying infrastructure investments.

Q. Speaking hypothetically however, if the company is actually making more investments than it's accruing in depreciation reserve, all other things being equal, its rate of return will be going down. Correct?

A. No, sir. Not on those specific assets. Not as long as the infrastructure surcharge is in effect.

Q. No. I'm putting the infrastructure surcharge on the side for a second.

A. Well, you're creating a different hypothetical example. So maybe you should explain to me what your hypothetical example is.

Q. Well, let me just take the first rate base, and that's the existing rate base that was set in the last rate case. Okay?

A. Uh-huh.

Q. And I think you were telling me that holding all else equal, if the company's investment since the last rate case doesn't equal or exceed its accumulated depreciation since the last rate case, there's going to be an increasing return on the rate base because of decreasing rate base. Right?

A. If -- if we're looking at -- looking at the utility globally now --

Q. Can I have an answer to my question, sir? I think it can be answered yes or no.

A. I'm sorry. Your question was rather confusing to me. You seem to be mixing the concepts we're talking about here, so I'm just trying to make sure I understand what your question is.

Q. My question is that the rate base from the last rate case is fixed. Correct?

A. Total rate base.

Q. Right. Rates are set based on that rate base. Correct?

A. Yes.

Q. And if, since that last rate case, investments have not matched accumulated depreciation, if I understand your hypothetical correctly, all other things being equal, the company is experiencing an increased rate of return because of the decreasing rate base?

A. If your operating income is staying low and your rate base is decreasing, the rate of return on your rate base will be increasing, yes.

Q. Okay. Now, conversely, if, since the last rate case, the company has invested more in plant than it has accumulated depreciation since that point in time, again, holding all else equal or everything else equal, the company will be experiencing a decreased return. Correct?

A. Yes.

Q. Okay. Now, look at Exhibit No. 4, if you would, please, and the top half of that exhibit. I think that's the exhibit either Commissioner Gaw or Judge Woodruff asked some questions about.

A. Okay.

Q. In the column under Plant In Service Change, do you see the 93 million figure about four lines down?

A. Invested plant, yes.

Q. Correct. Assuming that's the change in plant since the last rate case --

A. Yes.

Q. -- for Missouri-American and assuming the 53 million below it -- in the next line below it is the accumulated depreciation that has occurred since the last rate case, Missouri-American is in an increasing rate base position, all other things being equal. Correct?

A. Well, the rate base is increasing, yes.

Q. Okay. And based on our hypothetical we talked about just a minute ago, all other things being equal, the company is going to be experiencing a lower rate of return.

Correct?

A. Correct.

Q. Okay. Now, look at the column to the immediate right of Invested Plant under Staff ISRS Replacements, the 20 million figure. Do you see that?

A. I do.

Q. Now, that's the infrastructure qualifying plant. Do you understand that?

A. Uh-huh.

Q. Okay. Would you agree with me then that since the last rate case, if these figures are accurate, the company has invested in addition to $20 million in infrastructure replacement plant that they seek recovery for through the surcharge, nearly $70 million in other non-qualifying plant that was not included in the rate base in the last rate case?

A. Out of the total $93 million of additional investment, the company is seeking $20 million reflected in the surcharge.

Q. Correct.

A. Yes.

Q. Yes, to my prior question or --

A. That's my understanding of what the company is seeking in this surcharge proceeding.

Q. And I guess my question then was, there's

70 million out there of new plant that is not being recovered either through the old case or through the ISRS surcharge?

A. Well, now that's a different question because you didn't ask me to hold everything else constant. I mean, is that an ongoing assumption I'm supposed to make?

Q. And holding everything else constant.

A. Holding everything else constant, then there potentially could be $70 million of investment the company's rates may not be adequate to support. However, if you don't hold everything else constant, that may not be the case.

Q. I understand. But if you do hold everything else constant, then the company is experiencing a decreasing rate of return under this scenario and it's implementing a surcharge in that circumstance. Right?

A. If you hold everything else constant, yes.

MR. ENGLAND: Thank you, sir. No other questions.

JUDGE WOODRUFF: All right. Any redirect?

MS. VUYLSTEKE: No, thank you.

JUDGE WOODRUFF: Mr. Gorman, you can step down.

Then for the Missouri Energy Group?

MS. LANGENECKERT: Yes. We have Billie LaConte here who is our constant and who helped in our preparation of our response to the pleadings that were filed. And she is available also to testify. If anyone's interested, we can have her sworn in. Otherwise we won't waste the Court's time.

JUDGE WOODRUFF: Let me ask the parties first. Does anyone wish to cross-examine Ms. LaConte?

MS. O'NEILL: No your Honor.

MR. KRUEGER: Staff does not, your Honor.

MR. ENGLAND: Not based on the record so far.

JUDGE WOODRUFF: All right. Commissioners, do you wish to ask questions of Ms. LaConte? I'm being tempted here.

Bring her forward, I'll ask a few questions.

MS. LANGENECKERT: Instead of her whole day being in vain.

JUDGE WOODRUFF: That's right.

(Witness sworn.)

JUDGE WOODRUFF: You may be seated. You may inquire.

BILLIE LACONTE testified as follows:

DIRECT EXAMINATION BY MS. LANGENECKERT:

Q. Please state your name and address for the record.

A. Billie LaConte, 8000 Maryland Avenue, Suite 1210, Clayton, Missouri 63105.

Q. On whose behalf are you testifying today?
A. The Missouri Energy Group.
Q. By whom are you employed by and in what capacity?
A. I'm employed by Drazen Consulting Group as a consultant.
Q. And could you give some of your educational background, please?
A. I have a bachelors degree in mathematics from Boston University and I also have an MBA from Washington University.
Q. And some of your professional background?
A. I've been working for Drazen Consulting Group for eight years now. And I've participated in rate cases here in Missouri, Iowa and in Canada.
Q. Now, you've reviewed materials in this case and assisted in preparation of the Missouri Energy Group reply to Missouri-American Water's response to Staff's report and recommendations; is that correct?
A. That's correct.
Q. And our current position is that we support the company on its accumulated depreciation issue; is that correct?
A. That's correct.
Q. And we support the Staff on the net salvage

value and property tax issues. Correct?

A. That's correct.

MS. LANGENECKERT: I tender Ms. LaConte for cross-examination.

JUDGE WOODRUFF: Since she's up here, I'll let the Commissioners go first if they want to.

QUESTIONS BY JUDGE WOODRUFF:

Q. I'll go ahead and ask questions then. Let's talk about accumulating depreciation first. And it's my understanding that your position is that the company is correct on that position. Can you explain why?

A. Well, let me first state that -- well, I looked at the legislation. And after reading it, legally I think the way the company calculated accumulated depreciation for this ISRS is correct.

Q. Do you want to go into more detail on that, if you can?

A. I don't know how -- what else to say. I looked at the way you normally calculate accumulated depreciation. They listed all the new ISRS plant, they showed how much depreciation there was, how much was accumulated, they subtracted that and came up with a net plant. That's the way you normally calculate it. That's the way I think it should be calculated in this case also.

Q. All right. I believe your position is that you agree with Staff on the other items?

A. Yes. In terms of the net salvage, I agree with the Staff. I think that the company is trying to collect or include the net salvage for rate base that is not associated with the eligible infrastructure.

I understand -- excuse me -- when plant is retired, you remove the amount of that from the gross plant account, you also remove the same amount from the accumulated depreciation. The effect on net plant is zero. Yet you also have to remove from accumulated depreciation the cost of net salvage which would increase the rate base.

However, the amount that the company is increasing the rate base for is based on the old infrastructure that the new eligible infrastructure is replacing. I don't think that should be included. When this eligible infrastructure is retired, then they should be able to show the increase on the rate base at that time.

Q. So that's the difference, it's the old --

A. Yes.

Q. -- material that's being discarded for which depreciation is based on the rates that are established in 2001?

A. Right. That is for non-eligible infrastructure, in my opinion.

Q. So if there were something that had

depreciated that quickly within this period, then they could recover for that?

A. That's correct.

Q. A computer system or something that went obsolete very quickly?

A. I agree with that, yes.

Q. Okay. About the property tax, again, I believe you agree with Staff. Can you explain your position there?

A. From my reading of the statute, it says that may recover property taxes that are due within 12 months of the filing. Any infrastructure that was in place after January 1st, 2003 is not due until the end of 2004, which does not fall within the 12 months of when the application was filed in September.

Q. Okay. I believe there's some earlier testimony or questions along the line that if that theory is accepted, the company could never recover taxes for the last year of their filing. Would you agree with that?

A. I think that they will recover the taxes for that last year in their next rate case.

Q. Okay. It wouldn't be able to recover it through the surcharge?

A. No.

Q. Okay. When would the company begin

recognizing these taxes on its books?

A. It would recognize it on their books January 1st of 2004 for infrastructure that went into place after January 1st, 2003. However, they are not required to pay it until the end of the year.

Q. I understand. But they're going to be setting aside a certain amount --

A. Yes.

Q. -- for those taxes on their books?

A. Yes. I understand that. I'm trying to stick to the wording --

Q. Okay.

A. -- of the statute.

Q. So just a question of the wording of the statute then?

A. Yes. I -- I don't agree with the statute. I think that it is single-case rate-making or single rate-making issues. I don't agree with it, but we're trying to follow it.

JUDGE WOODRUFF: Okay. Fair enough. I believe that's all the questions I have.

Did that prompt some?

QUESTIONS BY COMMISSIONER CLAYTON:

Q. I'm going to ask a question that I'm more familiar with on a subject that I'm more familiar with here today and that's property taxes.

A. Okay.

Q. Just got my bill the other day. Actually, several bills.

You stated and I think you properly read from the statute that property taxes that are, I suppose, assessed or due or whatever the language is within 12 months of filing are taken into consideration on this ISRS; is that correct --

A. Yes.

Q. -- do you recall that?

And can you tell me how taxes for these -- this new infrastructure is taken into consideration? And let me try to give you an idea of what I'm talking about. Within the next 12 months if you have -- the assets are put into service, when would they be assessed for tax purposes by the county, I suppose? Do you understand my question?

A. Are you talking about within the next 12 months of today -- from today?

Q. Well, would they be? Would there be a new tax amount due for those assets within the next 12 months or would it even take longer?

A. Not within the next 12 months, because they would not be in place on January 1st. That's when they're assessed. That's when -- for example, I bought a car on

January 5th. I will not have to pay taxes on that car until -- January 5th, 2003. The taxes on that car will not be due until December 31st, 2004.

Q. But that's personal property.

A. Right.

Q. This isn't personal property. Correct?

A. Yes.

Q. Does it make any difference whether or not the improvements occur on January 1st or not? Do you know the answer to that?

A. No, I don't. I'm sorry. I don't know the answer to that. I'm assuming that if it's not in place by January 1st, then they are not due until the following year.

COMMISSIONER CLAYTON: Okay. Thank you.

JUDGE WOODRUFF: Anything else?

CHAIR GAW: Thank you, Judge.

QUESTIONS BY CHAIR GAW:

Q. First of all, let me ask you, your position in regard to the accumulated depreciation matter is based upon your analysis of the statute, is that -- and whether or not there is any ability to do what Staff is attempting to do in its methodology?

A. Yes. I think by reading the statute, the way the company calculated the accumulated depreciation for the eligible infrastructure is correct.

Q. And is that based upon your belief of what the statute says?

A. Well, mine and my lawyer's interpretation of the --

Q. Okay.

A. -- statute.

Q. So you started with that assumption after your --

A. Yes.

Q. -- your discussion with --

A. Yes.

Q. -- your attorney?

A. Yes.

Q. Are you an attorney?

A. No.

Q. If you make the assumption that Staff's position in regard to the law is correct for a moment --

A. Okay.

Q. -- what's your assessment of Staff's methodology with that assumption?

A. If I assume that it's correct with the interpretation of the law, I agree with Staff's method.

CHAIR GAW: That's all I have.

Thank you, Judge.

JUDGE WOODRUFF: All right. Then recross

based on questions from the Bench beginning with Staff?

RECROSS-EXAMINATION BY MR. SCHWARZ:

Q. Good afternoon. You've been present all day, you've heard the discussion, for instance, about regulatory lag?

A. Yes.

Q. What's your understanding of regulatory lag?

A. My understanding is that when a company has a rate case, they're determined what their rates are at that time. And until the next rate case, any additional expenditures, capital expenditures that occur -- that occur are not collected until the next rate case when there's a full analysis of their books.

Q. Let me ask you the question I asked Mr. Grubb, since I have it written down. Would you agree that regulatory lag is the delay in recognizing in rates changes in costs and expenses from the level used to set rates in the last general rate case?

A. I agree with that. And I sympathize with your goal and what you're doing. But I have to say that based on my understanding of the law, I think the way the company calculated accumulated depreciation is correct.

Q. Well, let me ask you this. Can regulatory lag cut in favor of the company and cut against the company?

A. Yes.

Q. And assume for me further that the purpose of the statute, which I know you don't agree with, it's hypothetical, but if the purpose of the statute is to address the regulatory lag associated with what the legislature has defined as ISRS eligible property, would Staff's approach appropriately address that construction of the statutes?

A. Can you repeat that again for me?

Q. If the statute is construed that the General Assembly was addressing problems with regulatory lag associated with --

A. Yes.

Q. -- ISRS eligible property, would Staff's approach be an appropriate way to recognize the totality of the regulatory lag involved with ISRS property?

A. Yes, it would.

MR. SCHWARZ: I think that's all I have.

JUDGE WOODRUFF: All right. Public Counsel?

MS. O'NEILL: No questions.

JUDGE WOODRUFF: And the Missouri Industrial Energy Consumers?

MS. VUYLSTEKE: No questions, thank you.

JUDGE WOODRUFF: Missouri-American?

MR. ENGLAND: No, thank you.

JUDGE WOODRUFF: Any redirect?

MS. LANGENECKERT: No, sir.

JUDGE WOODRUFF: Okay. I believe that's all the witnesses. Any other matters anyone -- go ahead.

I'll throw it out here. The Commission just asked me about when Mr. Corman was on the stand -- or Gorman, excuse me, whether there were questions that qualified him as an expert. I don't really remember.

MS. VUYLSTEKE: Actually, you're correct, Judge. I did not ask him to provide his background and qualifications, so maybe I should call Mr. Gorman back to the stand.

JUDGE WOODRUFF: Well, let me ask the parties first. Is there anyone who would object to him being considered as an expert witness?

MR. KRUEGER: Staff does not.

MS. O'NEILL: Public Counsel does not.

MS. LANGENECKERT: MEG's fine with it.

MR. ENGLAND: Reluctantly, we won't object.

JUDGE WOODRUFF: All right. We'll leave it at that then.

MS. VUYLSTEKE: Thank you.

JUDGE WOODRUFF: All right. Then the other remaining matter is -- go ahead.

MR. KRUEGER: Your Honor, I would like to offer as an exhibit the document that's on the easel for the benefit of the Commissioners who weren't able to be here at the time this was presented. I think it would be useful for them in understanding the transcript.

JUDGE WOODRUFF: Would you like to reduce it to a size that can be --

MR. KRUEGER: We will do so.

JUDGE WOODRUFF: Okay. We'll go ahead and call it Exhibit 8, call it Staff's diagram. And Exhibit 8 has been offered into evidence. Does anyone have any objections to its receipt?

MR. ENGLAND: No objection.

MS. O'NEILL: No objection, although we would like to have a copy provided.

(Exhibit No. 8 received into evidence.)

JUDGE WOODRUFF: Certainly. And if Staff would go ahead and make a reduced copy of that however you want to do that. It's not anything highly technical.

MR. KRUEGER: We will do that promptly.

JUDGE WOODRUFF: All right then. The next matter then is briefs and the transcripts. I'm going to ask that the transcript be expedited in this case because we do have a fast-approaching deadline established by the statute. So I'm going to ask that the transcripts be filed on the 26th of November, that's next Wednesday. Thereafter, I'm going to ask that the parties file simultaneous briefs on

December 4th. That would be the following Thursday.

Any other matters anyone wants to bring up while we're still on the record?

All right. With that then, this hearing is adjourned.

WHEREUPON, the hearing was adjourned.

I N D E X

EXHIBITS INDEX

* Late-filed exhibit