

Exhibit No.:
Issues: Comprehensive Planning and Business Transformation ("BT"), Pension Tracker, AIP Compensation Recovery, Acquisition Premiums and Discounts, Empire Contract and Interruptible Tariff, Rate Design
Witness: Dennis R. Williams
Exhibit Type: Surrebuttal
Sponsoring Party: Missouri-American Water Company
Case No.: WR-2011-0337
SR-2011-0338
Date: February 2, 2012

MISSOURI PUBLIC SERVICE COMMISSION

**CASE NO. WR-2011-0337
CASE NO. SR-2011-0338**

SURREBUTTAL TESTIMONY

OF

DENNIS R. WILLIAMS

ON BEHALF OF

MISSOURI-AMERICAN WATER COMPANY

Staff Exhibit No. 35
Date 2-2-12 Reporter JL
File No. WR-2011-0337

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

IN THE MATTER OF MISSOURI-AMERICAN) WATER COMPANY FOR AUTHORITY TO) FILE TARIFFS REFLECTING INCREASED) RATES FOR WATER AND SEWER) SERVICE)	CASE NO. WR-2011-0337 CASE NO. SR-2011-0338
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AFFIDAVIT OF DENNIS R. WILLIAMS

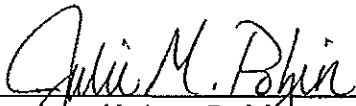
Dennis R. Williams, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Surrebuttal Testimony of Dennis R. Williams"; that said testimony and schedules were prepared by him and/or under his direction and supervision; that if inquires were made as to the facts in said testimony and schedules, he would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his knowledge.



Dennis R. Williams

State of Missouri
County of St. Louis

SUBSCRIBED and sworn to
Before me this 2nd day of February 2012.



Notary Public

My commission expires: 6/11/2012

JULIE M. POLZIN
Notary Public - Notary Seal
STATE OF MISSOURI
St. Louis County
My Commission Expires 6/11/2012
Commission # 08575308

**SURREBUTTAL TESTIMONY
DENNIS R. WILLIAMS
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WR-2011-0337
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1 **SURREBUTTAL TESTIMONY**

2
3 **DENNIS R. WILLIAMS**

4
5 **WITNESS INTRODUCTION AND PURPOSE**

6
7 **Q. PLEASE STATE YOUR NAME, TITLE AND BUSINESS ADDRESS.**

8 A. My name is Dennis R. Williams, and my title is Senior Manager - Rates and
9 Regulation for the Central Division of American Water Works ("AWW"). My
10 business address is 727 Craig Road, St. Louis, Missouri 63141.

11
12 **Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THIS PROCEEDING?**

13 A. Yes, I have submitted direct and rebuttal testimony in this proceeding on behalf
14 of Missouri-American Water Company ("Missouri-American", "MAWC", or
15 "Company").

16
17 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

18 A. The purpose of my rebuttal testimony is to respond to rebuttal testimony of other
19 parties. Specifically I will address the following issues:

20 1) Business Transformation Costs discussed in the rebuttal testimony of the
21 Missouri Public Service Commission Staff ("Staff") witness Kimberly Bolin and
22 Office of the Public Counsel ("OPC") witness Shawn Lafferty;

23 2) Pension Tracker as discussed in the rebuttal testimony of Staff witness
24 Paul Harrison;

25 3) Annual Incentive Plan ("AIP") costs as discussed in the rebuttal testimony
26 of OPC witness Shawn Lafferty;

27 4) Acquisition Premiums and Discounts as discussed in the testimony of
28 OPC witness Ted Robertson;

29 5) Empire Contract and Interruptible Tariff as discussed in the testimony of
30 The Empire District Electric Company ("Empire") witness Blake Mertens; and

31 6) Rate Design issues specific to comments made in the rebuttal testimony
32 of Ag Processing witness Donald Johnstone and OPC witness Barbara
33 Meisenheimer regarding acquisitions and phase-in plans.

1 **1. BUSINESS TRANSFORMATION**

2

3 **Q. WHAT IS BUSINESS TRANSFORMATION?**

4 A. The term "Business Transformation" or "BT" refers to the procurement, development,
5 and deployment of new, integrated information technology systems, and the process
6 of implementing the new systems in a manner that properly aligns the Company's
7 business processes with the increased capabilities of the new systems. Over the life
8 of the BT program, there will be four primary areas of focus:

- 9 • Replace legacy systems near the end of their useful lives;
- 10 • Promote operating excellence, efficiency, and economies of scale;
- 11 • Enhance the customer experience; and
- 12 • Increase employee effectiveness and satisfaction.

13

14 **Q. WHAT ARE THE PROJECTS THAT COMPRISE THE BT PROGRAM?**

15 A. There are three projects that comprise the core of the BT program: Enterprise
16 Resource Planning ("ERP"); Enterprise Asset Management ("EAM"), and Customer
17 Information System ("CIS"). ERP includes human resource, finance and accounting,
18 supply chain, and procurement management functions and operations. EAM
19 includes the management of asset lifecycles including: the design, construction,
20 commissioning, operations, maintenance and decommissioning/ replacement of
21 plant, equipment and facilities; as well as work management for both customer
22 service field work (service turn-ons, leak inspections, etc.) and Transmission &
23 Distribution system work. CIS includes all billing and personal data about our
24 customers, including billing rates, water consumption, associated charges, meter
25 information, and the strategy for managing and nurturing our interactions with our

1 customers. ERP will go into service by August of 2012. CIS and EAM will be placed
2 into service in for MAWC the first quarter of 2013.

3
4 **Q. WHAT IS THE ESTIMATED COST OF THE BUSINESS TRANSFORMATION**
5 **PROGRAM?**

6 A. The costs associated with the BT program are significant because the BT initiative is
7 significant. Missouri-American's allocated share of these costs is almost \$45 million.

8
9 **Q. WHAT ARE COST AREAS FOR THE BUSINESS TRANSFORMATION**
10 **PROGRAM?**

11 A. There are four distinct areas of cost related to the Business Transformation program:
12 (i) the initial comprehensive planning studies, (ii) hardware (e.g., personal computers,
13 servers, storage, and networking equipment), (iii) software licenses, and (iv)
14 capitalized labor costs required to design and modify the base software package as
15 required, cleanse historical data and develop transition routines to transfer historical
16 data from existing systems, modify business processes to optimize implementation of
17 new information technology systems, train and prepare our employees for the new
18 business processes and information technology systems, and implement the go-live
19 use of the new information technology systems.

20
21 **Q. WHAT RATE TREATMENT IS MISSOURI-AMERICAN REQUESTING FOR**
22 **BUSINESS TRANSFORMATION PROGRAM COSTS?**

23 A. The Company requests that the Commission approve an Accounting Authority Order
24 ("AAO") allowing the Company to synchronize the in-service dates and rate relief of
25 its Business Transformation program assets. The Company also requests that the

1 Commission approve a 12 year depreciation period for the Company's depreciable
2 BT assets.

3

4 **Q. STAFF AND OPC OPPOSE THE COMPANY'S REQUEST TO APPROVE AN AAO**
5 **AND A 12 YEAR DEPRECIATION PERIOD FOR THE COMPANY'S**
6 **DEPRECIABLE BT ASSETS. DO YOU HAVE ANY GENERAL COMMENTS ON**
7 **THE STAFF AND OPC RECOMMENDATIONS?**

8 A. Yes, and, as I will explain further below, Staff's and OPC's analysis and
9 recommendations reveal a fundamental misunderstanding of the Company's BT
10 program, are inconsistent with Commission practice, and are not in the best interests
11 of customers or the Company.

12

13 **Q. WHAT IS AN ACCOUNTING AUTHORITY ORDER?**

14 A. An AAO is a Commission order authorizing a specified accounting treatment other
15 than what would otherwise be prescribed by the Uniform System of Accounts
16 ("USOA"). The usual and primary benefit of an AAO to a utility is that utility earnings
17 are improved during the deferral period. The regulatory asset is amortized over a
18 prescribed period. Further, the Commission may permit future recovery in rates of
19 some portion of the amount deferred. Granting of an AAO does not guarantee
20 recovery of the deferral. An AAO in this case would defer a final decision on current
21 extraordinary BT costs until the next rate case, when the utility would be allowed to
22 make a case that the deferred costs were prudently incurred and should be included
23 in rates. AAO's may also have benefit to customers. By deferring costs from one
24 period to another, rates may be more levelized, and the number of rates cases and
25 their associated costs may be lessened. Finally, AAOs can be used by the

1 Commission to better match the timing of expenses and receipts, providing a balance
2 between the interests of the Company and its customers.

3

4 **Q. WHEN IS IT APPROPRIATE FOR THE COMMISSION TO APPROVE AN AAO?**

5 A. The Commission has found AAOs to be appropriate in a wide variety of
6 circumstances. For example, AAOs have been sought to defer expenses where a
7 utility has undertaken a large construction project. This is often referred to as
8 construction accounting. An AAO permits a utility to capture those extraordinary
9 expenses for potential recovery in the forward-looking rates to be established at a
10 future rate case (even though the extraordinary expenses may occur outside the "test
11 year" utilized in that future rate case).

12

13 **Q. MS. BOLIN INDICATED THE BENEFIT OF THE COMPANY'S REQUEST IS
14 SIMPLY TO REDUCE REGULATORY LAG. IS THE MITIGATION OF
15 REGULATORY LAG AN APPROPRIATE USE OF AAOs?**

16 A. Yes. In an Order issued in Case No. WO-2002-273, a case concerning Missouri-
17 American, the Commission stated:

18 In such cases, a primary purpose of the deferral may be to mitigate regulatory
19 lag. The new asset can be added to rate base only through a traditional rate
20 case (an eleven-month-long process in Missouri) and only after the asset has
21 become used and useful in the public service. However, the USOA requires
22 that expenses associated with the asset -- depreciation and the carrying costs
23 of construction financing -- be booked from the moment it is placed in service.
24 In such a case, an AAO is often sought in order to defer those expenses until
25 the asset has been added to rate base and revenues associated with the
26 asset become available.

27

28 *In the Matter of the Joint Application of Missouri-American Water Company, et al.,*

29 237 P.U.R.4th 353 Case No. WO-2002-273 (November 10, 2004).

30

1 The Commission further stated:
2

3 AAOs are not used merely for the mitigation of regulatory lag, although
4 that is a proper purpose for an AAO, as the Missouri Court of Appeals
5 has made clear:
6

7 "The Commission has the regulatory authority to grant a form of relief to
8 the utility in the form of an accounting technique, an Accounting
9 Authority Order, (hereinafter called an "AAO") which allows the utility to
10 defer and capitalize certain expenses until the time it files its next rate
11 case. The AAO technique protects the utility from earnings shortfalls
12 and softens the blow which results from extraordinary construction
13 programs."

14 The AAO is one of the Commission's chief regulatory tools for
15 implementing another aspect of the Matching Principle. As discussed
16 above, one aspect of the Matching Principle is to match revenues and
17 expenses with the period in which they were incurred. However, under
18 another aspect of the Matching Principle, "ratepayers are charged with
19 the costs of producing the service they receive." The purpose is to
20 match costs with benefits so that the ratepayers that enjoy the benefits
21 of utility property also bear the costs thereof.

22 *Id.*
23

24 Moreover, as I demonstrate later in my testimony mitigation of regulatory lag is only
25 one of a number of benefits of the Company's request.
26

27 **Q. ARE THERE OTHER INSTANCES WHERE AAOs HAVE BEEN GRANTED?**

28 A. Yes. As the Commission acknowledges: "AAOs have also been granted ... where
29 utilities have incurred expenses due to "Acts of God," such as ice storms; to facilitate
30 compliance with changing statutes or regulations, such as the Commission's Cold
31 Weather Rule, the Commission's Gas Safety Rules, or a new state statute requiring
32 an accounting change with respect to employee benefits; and where expenses were
33 incurred in preparing company computer equipment for the year 2000 ("Y2K"). *Id.*

34 Ms. Bolin's testimony specifically refers to AAO's associated with "Acts of God", but

1 does not focus on the construction accounting type AAO that the Company has
2 requested in this case.

3

4 **Q. WHAT TEST DOES THE COMMISSION USE FOR DETERMINING WHETHER TO**
5 **GRANT AN AAO?**

6 A. The Commission set out criteria in the above- referenced case:

7 The USOA permits the deferral of "unusual and extraordinary" expenses. It is
8 important to bear in mind that these words are used in an accounting sense
9 and not in the common sense of 'remarkable.' The USOA defines
10 "extraordinary items" as "those items related to the effects of events and
11 transactions which have occurred during the current period and *which are not*
12 *typical or customary business activities of the company.*" This definition,
13 adopted by the Commission as part of its regulation, is controlling here. An
14 'unusual and extraordinary' transaction is one that is not typical or customary.

15

16 *Id.*

17

18 **Q. DOES MS. BOLIN REFER TO A COMMISSION ORDER ADDRESSING**
19 **PURCHASED POWER CONTRACTS FOR WHICH THE COMMISSION DID NOT**
20 **GRANT AN AAO.**

21 A. Yes. Ms. Bolin is referring to a Commission decision on AAO's concerning the Sibley
22 Generating Plant life extension project that involved both a request for construction
23 accounting and the two purchased power contracts to which she refers. Ms. Bolin
24 does not mention that the Commission granted the request for construction
25 accounting. The Missouri-American case quoted above refers to "The Sibley Test"
26 as "the leading decision on AAO's." It sets out the Commission standard as follows:

27

28 In the Sibley decision, the Commission emphasized that it is the extraordinary
29 event that is the "primary focus" in any request for an AAO, considered on a
30 case-by-case basis: "The decision to defer costs associated with an event
31 turns on whether the event is in fact extraordinary and nonrecurring." The
32 Commission emphasized that "[e]xtraordinary means unusual and

1 nonrecurring." Also relevant, but not dispositive, the Commission explained is
2 "whether the event has a material or substantial effect on a utility's earnings."
3 Another relevant factor is the certainty of the event's occurrence.
4

5 *Id.*
6

7 **Q. IS BT AN UNUSUAL AND EXTRAORDINARY EXPENSE?**

8 A. Yes, it is. The Company's BT program is an extraordinary and unusual capital
9 project in scope, complexity, and cost. The Company undertook the BT program in a
10 reasonable manner. The business process analysis and improvement efforts were
11 extensive and comprehensive. The Company's information technology systems are
12 reaching or have reached the end of their useful life. The need for undertaking the
13 BT program is well documented, and the Company has provided Staff and OPC with
14 ample evidence to confirm the need and inefficiencies caused by the Company's
15 aging IT systems. The selections of the new ITS platform and system integrator for
16 the program were performed in an appropriate fashion using exhaustive competitive
17 bidding and evaluation processes. This enterprise-wide project has been termed
18 "Business Transformation" because it is more than a technology implementation
19 project. The scope of the BT program includes all of the Company's core functional
20 areas, including: human resources, finance and accounting, purchasing and
21 inventory management, capital planning, cash management, and customer and field
22 services to design and modify the base software package as required, procure
23 hardware to support the new software applications, cleanse historical data and
24 develop transition routines to transfer historical data from existing systems, modify
25 our core business processes to optimize implementation of new information
26 technology systems, train and prepare our employees for the new business

1 processes and information technology systems, and implement the use of the new
2 business processes and information technology systems.

3 BT is not a typical or customary upgrade of an information technology system.
4 BT is an "unusual and extraordinary" capital program that will have taken five
5 years to develop and implement at a cost of over \$300 million dollars enterprise
6 wide - \$45 million for MAWC. The BT solutions will be implemented for MAWC
7 over a seven month period. It is no exaggeration to state that the Company
8 expects, over time, that the Business Transformation program will enable the
9 Company to transform the way it does business.

10
11 **Q. WHY DO STAFF AND OPC OPPOSE THE COMPANY'S REQUEST FOR AN**
12 **AAO?**

13 A. Staff and OPC note that the Company has undertaken the BT program voluntarily
14 and not to comply with a government mandate or in response to an "Act of God" over
15 which the Company has no control. As discussed above, however, the Commission
16 does not limit the use of AAOs to government mandate or in response to an "Act of
17 God." In fact, the Commission finds AAOs to be appropriate in a wide variety of
18 circumstances, for example, when a utility incurs extraordinary expenses associated
19 with the construction of a new, productive asset.

20
21 **Q. DOES MAWC HAVE CONTROL OVER THE TIMING OF THE BT**
22 **IMPLEMENTATION?**

23 A. No. AWW is coordinating the development and implementation of integrated
24 technology systems that will serve its utility subsidiaries in fifteen states. In order to

1 gain the economies of scale and performance benefits available through a combined
2 project, MAWC is dependent upon the overall AWWWS implementation schedule. The
3 only timing issue that MAWC can control is the timing of the rate case it files in order
4 to recover the costs of the BT assets.

5

6 **Q. IF THE COMPANY CAN ONLY CONTROL THE TIMING OF RATE CASES, WHAT**
7 **WOULD THE LIKELY RESULT BE IF THE COMPANY'S PROPOSAL IS NOT**
8 **APPROVED?**

9 A. The only other obvious solution for the Company, outside of the requested
10 accounting treatment, would be to file another rate increase request as soon as
11 possible. Because of the impact on our customers, the Company desires to avoid
12 this solution.

13

14 **Q. PLEASE EXPLAIN.**

15 A. I have attended numerous local public hearings over the past two months and a
16 consistent theme from many of our customers has been one of rate case fatigue.
17 Many understand the need to replace infrastructure and to recover costs, but they
18 point to recurring rate increases that have strained their financial resources. Absent
19 approval of the Company's special accounting request, it will be difficult to avoid an
20 almost immediate new rate increase application. Application of construction
21 accounting would allow the Company to delay recording depreciation expense until
22 such time as the costs of the BT program are included in rates – a matching between
23 cost recognition and revenue recovery. At the same time, the construction
24 accounting concept would allow the Company time to develop savings that may be

1 available from the BT program and utilize those saving to mitigate future increases. It
2 simply serves no useful purpose to force the Company into an early rate case filing.

3
4 **Q. STAFF AND OPC ARGUE THAT THE COMPANY'S BT ASSETS ARE NOT**
5 **EXTRAORDINARY, UNIQUE, OR NON-RECURRING. DO YOU AGREE WITH**
6 **THIS CHARACTERIZATION?**

7 A. No, I do not. In support of this position, OPC witness Lafferty argues that "Missouri-
8 American experiences significant fluctuations in capital expenditures each year," and
9 the Company's estimated total cost for BT is within "the normal range of annual
10 fluctuations." I do not believe that the Commission should consider whether an event
11 is "extraordinary" by comparing the expenditure to the "range of annual fluctuations"
12 in a company's capital program. The Commission, however, may consider the
13 relative amount of BT expenditures to the Company's other capital expenditures. For
14 example, if we look at the make-up of rate base additions in the current case, we find
15 that the largest single project in this case was for the installation of new intake valves
16 in the Missouri River at Jefferson City. The cost of the intake valves, at slightly over
17 \$11 million, was over five times more than any other single project. MAWC's portion
18 of the cost of the Business Transformation program is almost \$45 million dollars -
19 more than four times the cost of the Jefferson City intakes and twenty times greater
20 than the second largest single project. Moreover, the average depreciation life for
21 most construction projects is about 50 years or 2% per year, whereas the
22 depreciation rate on BT is 20%, 10 times as high. A typical large construction project
23 might be \$1 million. The annual dollar impact in depreciation expense for BT is over
24 \$8 million or more than 400 times the depreciation expense of a typical large rate
25 base addition. Clearly, the BT program is not a typical, normal or usual capital

1 project.

2

3 **Q. OPC WITNESS LAFFERTY ARGUES IN HIS REBUTTAL TESTIMONY THAT THE**
4 **HISTORICAL INTERVALS BETWEEN RATE CASES AND THE PHASED**
5 **IMPLEMENTATION OF THE BT PROGRAM SHOULD MINIMIZE THE**
6 **COMPANY'S CONCERN ABOUT REGULATORY LAG. DO YOU AGREE WITH**
7 **OPC'S ASSESSMENT?**

8 A. I do not agree with Mr. Lafferty's assessment. The phased implementation of BT for
9 MAWC will occur over only a seven month period - from August of 2012 (ERP in
10 service) to March 2013 (EAM and CIS in service). Further Mr. Lafferty's argument
11 assumes that the Company would continue to file rate cases in the future with the
12 same frequency as it has in the recent past. As noted earlier, the annual
13 depreciation expense associated with the BT program is \$8 million. If one were to
14 assume for argument sake that the Company will file its next rate case in two years, it
15 would not recover \$16 million of the cost of its BT investment and would be denied
16 the opportunity to earn a return on that \$16 million of investment.

17

18 **Q. STAFF CONTENDS THAT THE COMPANY SHOULD SUPPORT ITS REQUEST**
19 **FOR AN AAO BY PERFORMING AN ANALYSIS OF THE NET FINANCIAL**
20 **IMPACT OF DEFERRING THE BT PROGRAM COSTS VERSUS NOT DEFERRING**
21 **THESE COSTS, AND SHOULD OFFSET SOME OF THE BT COSTS WITH**
22 **PROJECTED SAVINGS. DO YOU AGREE?**

23 A. No, I do not agree with Staff's argument that the Company should be required to
24 perform "analysis of the net financial impact of deferring these [BT program] costs
25 versus not deferring these costs, taking into account savings related to the Business

1 Transformation Program” as a precondition to the grant of an AAO. Staff argues that:

2 ...the Company should incur some savings due to the implementation of the
3 Business Transformation assets which should offset some of the costs of
4 placing the assets into service. However, MAWC has not supported its request
5 by performing any analysis of the net financial impact of deferring these costs
6 versus not deferring these costs, taking into account savings related to the
7 Business Transformation Program.

8 First, the Company cannot begin to achieve cost savings from the new BT systems
9 that will be deployed until the systems are fully functional and employees have
10 become fully acclimated to them. As Mr. Lafferty points out in his rebuttal testimony,
11 the majority of any savings will occur in or subsequent to 2014, after full BT
12 implementation. To the extent that BT produces productivity savings, they will
13 manifest themselves as the new solutions are fully implemented. All other things
14 being equal, potential BT savings should produce lower operating costs that will be
15 realized in future rate cases. Through rejection of the Company's AAO proposal,
16 Staff and OPC would make it necessary to consider an early and additional rate case
17 filing. There are significant costs associated with conducting rate cases. It seems to
18 be a better idea, especially in these economic times, to delay a new rate increase as
19 long as possible and match the recovery of costs with the recognition of savings.
20 Further, AAOs are not the same as ratemaking decisions. An AAO in this case
21 would defer a final decision on current extraordinary BT costs until the next rate case.
22 At the next rate case, the Company would be allowed to make a case that the
23 deferred costs were prudently incurred and should be included in rates and, all other
24 things being equal, potential BT savings should produce lower operating costs that
25 are being realized at that time.

26
27 **Q. OPC WITNESS LAFFERTY CONTENDS THAT THE COMPANY'S REQUEST FOR**

1 AN AAO VIOLATES AN EXISTING STIPULATION IN CASE NO. WR-2010-0131.

2 CAN YOU PROVIDE THE CONTEXT OF THAT STIPULATION?

3 A. Yes. The Stipulation approved by the Commission in Case No. WR-2010-0131

4 states, in part, that:

5 Costs associated with the CPS and the Business Transformation Project shall
6 be accounted for on the books of the Company as construction work in
7 progress (CWIP)...the Company shall accrue allowance for funds used during
8 construction (AFUDC) on the related CWIP balances at the Company's
9 monthly calculated AFUDC rate. The Company shall transfer the CWIP
10 balances to Utility Plant in Service when in-service in accordance with the
11 NARUC Uniform System of Accounts and, beginning in the month immediately
12 following transfer, shall record depreciation thereon at the appropriate
13 Commission approved depreciation rate.

14
15 Prior to instituting BT, a Comprehensive Planning Study ("CPS") was conducted to
16 assess American-Water's IT needs and the best manner in which to address those
17 needs. The BT program was a result of the CPS. The key question under discussion
18 in the prior rate case was whether, given the fact that the CPS was complete, the
19 cost associated with that Study should be declared in-service and if so, how costs
20 should be treated for recovery in the pending case. Ultimately, an agreement was
21 reached that, in essence, concluded that the BT program was a continuation of the
22 CPS, and therefore, the latter should not be declared to be in-service. It was
23 assumed at that time that normal ratemaking treatment for the BT Program as a
24 whole would be appropriate and in the customers' best interest. The Company's
25 current request for an AAO in this case is in no way inconsistent with the Stipulation
26 and Agreement in Case No. WR-2010-0131 as Mr. Lafferty contends. If, and to the
27 extent an AAO is granted by the Commission, the AAO would modify the Stipulation
28 and Agreement in Case No. WR-2010-0131. But as noted above, the granting of an
29 AAO does not guarantee recovery of the deferral. AAOs are not the same as

1 ratemaking decisions. An AAO in this case would only defer a final decision on
2 current extraordinary BT costs until the next rate case. At the next rate case, the
3 utility is allowed to make a case that the deferred costs were prudently incurred and
4 should be included in rates.

5
6 **Q. WHY IS IT APPROPRIATE FOR THE COMPANY TO CAPITALIZE BT COSTS**
7 **AND DEPRECIATE THEM OVER THEIR ANTICIPATED USEFUL LIVES?**

8 A. By approving the Stipulation discussed earlier, the Commission has already deviated
9 from generally accepted accounting principles ("GAAP"). Without the accounting
10 authority embodied in that agreement, GAAP would likely have required the
11 expensing of about 40% of the BT project – primarily those costs associated with
12 project labor. As the parties are aware, the costs associated with the BT program are
13 significant because the BT initiative is significant. Given the sheer magnitude of the
14 costs, it would be problematic to expense them or depreciate them over five years.
15 For one reason, expensing the costs would require a much greater increase to the
16 revenue requirement in the years the expenditures were made. By using the rate
17 base treatment we proposed, those costs can be spread over the useful life of the
18 project and be recovered on a levelized basis. Because the BT expenditures will
19 provide service to ratepayers over their useful life, recovery of these significant costs
20 on a levelized basis over time is a more responsible ratemaking method than seeking
21 to recover the costs over a short four or five year period. Although it is certainly the
22 case that American Water Service Company fees are usually recorded as expenses,
23 the sheer magnitude of the BT effort justifies their being capitalized for the reasons
24 expressed previously. Quite simply, these are not routine Service Company
25 expenses but, rather, are labor charges devoted to an extensive, unique project. The

1 Company's capitalization proposal is consistent with prior precedent and results in
2 proper intergenerational equity and mitigates the up-front rate increases that would
3 be necessary if we attempted to collect as expenses over four years.
4

5 **Q. WHY IS MISSOURI-AMERICAN REQUESTING A 12 YEAR DEPRECIATION**
6 **PERIOD FOR THE BT ASSETS?**

7 A. The depreciation rates authorized by the Commission and applicable to the
8 investment category that BT falls under are currently based on a five year life. The
9 anticipated life cycle of the BT assets is estimated to be approximately twelve years.
10 Given the sheer magnitude of the BT costs it would be problematic to depreciate or
11 expense them over a five year period. Depreciating or expensing the BT costs over a
12 five year period would require a quite significant increase to the MAWC revenue
13 requirement. By using the depreciation rate MAWC proposes, those BT costs can be
14 spread over the useful life of the assets and be recovered on a levelized basis.
15 Because the BT expenditures will provide service to ratepayers over their useful life,
16 it appears to the Company that recovery of these significant costs on a levelized
17 basis over time is a more responsible ratemaking method than seeking to recover the
18 costs over the shorter, five year period during which they are incurred or to capitalize
19 them over a five year period. When compared to collecting certain BT costs as
20 expenses in rates, or depreciating all of BT costs over a five year life, the Company's
21 request to depreciate the BT assets over a 12 year life will mitigate the up-front rate
22 increase for MAWC's customers. In other words, capitalizing and depreciating BT
23 costs over 12 years will result in significantly lower annual revenue requirements.
24 Capitalizing BT costs over twelve years will result in proper intergenerational equity
25 by more closely aligning BT cost recovery with the anticipated service life of the

1 assets and their use by customers. Finally, if the Company discontinues Allowance
2 for Funds Used During Construction ("AFUDC") and begins depreciation on the
3 anticipated in-service dates, the BT assets could be well over fifty percent
4 depreciated before even being considered for rate recovery in the Company's next
5 rate case, thereby denying the Company the opportunity to recover a significant
6 portion its BT investment. Therein lies the need for the Company to file an early rate
7 case if the requested AAO treatment is not granted.

8

9 **Q. WHAT IS THE APPROPRIATE DEPRECIATION RATE FOR THE DEPRECIABLE**
10 **ASSETS THAT COMPRISE THE BT PROGRAM?**

11 A. Given an estimated service life of twelve years, the appropriate annual depreciation
12 or amortization rate for the BT assets is 8.33 percent.

13

14 **Q. WHAT IS STAFF'S RESPONSE TO THE COMPANY'S PROPOSAL TO**
15 **APPROVE A 12 YEAR AMORTIZATION PERIOD FOR MAWC'S BT ASSETS?**

16 A. Staff witness Rice opposes MAWC's request to approve a 12 year amortization
17 period for MAWC's BT program assets and claims that he "will not have sufficient
18 information to recommend a specific amortization in this case because Staff will not
19 be able to identify what current software and hardware that will be retired until the
20 Business Transformation System is installed and operating."

21

22 **Q. DID THE STAFF ADDRESS THE BT PROGRAM IN ITS DIRECT TESTIMONY?**

23 A. Yes. Ms. Bolin stated: "In order for Staff to agree to or accept such special
24 ratemaking treatment for these costs, MAWC should be required to help establish
25 and follow parameters and conditions to allow Staff, and other parties in this case,

1 adequate review of the management of the project, the costs associated with it, and
2 the budget expended for such costs. Staff is willing to discuss this issue with the
3 Company and other parties to see if a resolution can be reached.”
4

5 **Q. HAS THE COMPANY ALLOWED STAFF TO REVIEW THE MANAGEMENT OF**
6 **THE PROJECT, ITS COSTS AND BUDGET?**

7 **A.** Yes. Both Staff and OPC have been given complete access to budgets and cost
8 information, as well as to a dedicated website that includes all supporting invoices for
9 every cost item comprising the BT program. I have made specific inquiry on several
10 occasions as to whether additional information is necessary for Staff to make what it
11 considers an adequate review so that agreement can be reached that would, I
12 believe, have a beneficial result to our customers. Personnel directly associated with
13 the management of the project at its highest level have met with both Staff and OPC,
14 explained the project and its management in detail, and are available for further
15 discussion on an ongoing basis.
16

17 **2. PENSION TRACKER**

18

19 **Q. HAVE YOU READ THE REBUTTAL TESTIMONY OF STAFF WITNESS PAUL**
20 **HARRISON REGARDING STAFF’S PROPOSAL TO INSTITUTE A REVISED**
21 **PENSION TRACKING MECHANISM?**

22 **A.** Yes. Most of Mr. Harrison’s testimony is a reiteration of the Staff proposal contained
23 in the Staff Report – Cost of Service issued on November 17, 2011. I have
24 previously responded to that proposal in my rebuttal testimony.
25

1 Q. PLEASE SUMMARIZE THE MOST SALIENT ISSUES YOU HAVE WITH THE
2 STAFF PROPOSAL.

3 A. Staff continues to argue that they have suddenly discovered a “flaw” in the existing
4 pension tracker mechanism. Mr. Harrison summarizes this “flaw” in the following
5 words: “inclusion of both a FAS 87 rate base difference and a pension/asset liability
6 in rate base will most likely result in either an overstatement or an understatement of
7 MAWC’s actual pension tracker for rate base.” This “flaw” simply does not exist. The
8 pension tracker is fair, was designed appropriately and is operating as designed. As
9 I explained in my rebuttal testimony, the existing tracker was designed with two
10 components. The first compares the estimated FAS 87 expense included in rates to
11 the actual FAS 87 expensed on the Company’s books. The difference, positive or
12 negative, is included in rate base and amortized over five years. The second
13 component compares the difference in the actual contributions recorded on the
14 books and the actual cash expended by the Company. The difference, positive or
15 negative, is recognized in rate base so that the Company earns a return only on its
16 actual cash investment.

17

18 Q. PLEASE CONTINUE.

19 A. FAS 87 contribution levels are calculated on formulas that differ from ERISA
20 minimum contribution levels. This leads to differences between costs recorded on
21 the Company’s books and actual cash payments – not unlike any number of other
22 items under accrual accounting and the Commission’s prescribed system of
23 accounts. Since the establishment of the MAWC pension tracker, pension cost
24 recorded on the Company’s books was always greater than the actual contribution.
25 Therefore, a pension liability was recorded and rate base reduced to reflect the fact

1 that customers, through rates that were based on FAS 87 levels, had contributed
2 more than the Company had actually expended. The credit (or reduction) to rate
3 base compensated customers for the carrying cost of this difference. That has
4 recently changed, however. As of the true-up period, the level of actual cash
5 contributions made by the Company exceeded the level of FAS 87 levels reimbursed
6 by customers. Therefore, a pension asset has been recorded and rate base
7 increased to recover the Company's carrying cost for this excess contribution. There
8 is no sudden "flaw" in the mechanism design. It is simply that the relationship
9 between actual cash contributions and pension expense has changed.

10
11 **Q. HOW HAS THE STAFF PROPOSED CHANGING THE TRACKING MECHANISM?**

12 **A.** Mr. Harrison explains the proposal as follows:

13 Staff recommends that on a going forward basis the Commission modify
14 MAWC's pension's tracker mechanism so that it is a direct measurement of
15 the Company's ongoing pension cash investment in its trust fund compared to
16 its rate recovery of pension expense. This would require a direct comparison
17 between the amount of MAWC's rate allowance for pension expense (currently
18 calculated on a FAS 87 basis) and the amount of its allocated cash
19 contributions to the pension trust fund (currently calculated on a minimum
20 ERISA basis). This can be accomplished in one of two ways, either MAWC
21 can agree to make cash contribution based upon a FAS 87 calculation and
22 continue to include in rates the FAS 87 pension cost, or the Company's
23 pension costs included in rates can be calculated on a minimum ERISA basis
24 to match the Company's present minimum ERISA funding.
25

26 **Q. WOULD THE STAFF'S PROPOSAL WORK?**

27 **A.** Yes, but only as to the second way proposed. The Company cannot agree to make
28 cash contributions based upon a FAS 87 calculation. MAWC participates in a
29 national pension plan administered by AWWWS. AWWWS determines the level of
30 contributions to be made based on the plan as a whole. The only way that MAWC
31 could dictate the funding level of its pension plan would be to withdraw from the

1 national plan and establish a much smaller independent plan. Such an action would
2 eliminate the existing economies of scale, increasing risk and greatly adding to the
3 administrative costs of the plan, all to the detriment of our customers. However, if I
4 understand the Staff proposal, that tracking mechanism would also provide fair and
5 equitable recovery of costs if implemented appropriately.

6
7 **Q. PLEASE EXPLAIN.**

8 A. My understanding of the Staff proposal is simply that it intends to combine the two
9 components of the existing tracking mechanism into one component, moving from an
10 accrual basis to a cash basis. Over time, the cash basis and the accrual basis
11 should equal (i.e. when the last pensioner receives the last paycheck from the fund,
12 the amount of total cost over the life of the fund will equal the total cash expended
13 from the fund). Therefore, if properly instituted the Staff's new proposal should have
14 the same result as the existing tracking mechanism, as long as the new tracking
15 mechanism is properly instituted and transitioned.

16
17 **Q. WHAT CONCERNS WOULD YOU HAVE IN REGARD TO CHANGING TO**
18 **STAFF'S PROPOSAL?**

19 A. There are two of which I am currently aware. First, Mr. Harrison states that the
20 tracking mechanism should be established comparing pension expense to actual
21 cash contributions to the pension trust fund. If the existing tracking mechanism is to
22 be replaced, I would agree with this approach. However, Mr. Harrison parenthetically
23 states that actual contributions are currently calculated on a current minimum ERISA
24 basis. This is not always the case. At times, plan trustees have determined that, in
25 order to maintain the integrity of plan assets and alleviate significant underfunding

1 situations, contributions in excess of minimum ERISA calculations should be made.
2 Any tracking mechanism based on the cash basis, as recommended by Staff, should
3 clearly be tied to actual cash contributions, not to ERISA minimum calculations.
4 Secondly, in order for the transition to a new method to be equitable, the existing
5 tracker balances that have arisen as a result of the tracking mechanism on which
6 rates are based should be included in rate base and continued to be amortized until
7 the balances are zero. Likewise, the recorded pension asset balance at the true-up
8 date should be allowed in rate base and amortized over some reasonable period of
9 time to reflect the Company cost of capital for contribution to the pension plan in
10 excess of funds received from customers through the current mechanism.

11 12 **3. AIP COMPENSATION RECOVERY**

13
14 **Q. WHAT IS THE OPC ISSUE YOU ARE ADDRESSING IN REGARD TO AIP**
15 **COMPENSATION?**

16 **A.** I will address the ratemaking aspects of AIP compensation. Company witness
17 Maxine Mitch filed rebuttal testimony explaining the Company's AIP program.
18 Unfortunately, OPC witness Lafferty did not have the benefit of that explanation prior
19 to filing his own rebuttal testimony and, as a result, has interpreted the AIP to be
20 based entirely upon financial goals.

21
22 **Q. WHAT IS MR. LAFFERTY'S REBUTTAL POSITION?**

23 **A.** Mr. Lafferty agrees with the Staff position that AIP compensation related to financial
24 goals should be eliminated from recovery in setting rates. However, based upon a
25 reading of the Company's Annual Incentive Plan Highlights, he has drawn an

1 incorrect conclusion that 100% of AIP compensation is dependent upon financial
2 goals.

3

4 **Q. DOES THE COMPANY AGREE THAT AIP ASSOCIATED WITH FINANCIAL**
5 **GOALS SHOULD BE ELIMINATED FROM RECOVERY?**

6 A. No. That issue is addressed in the rebuttal testimony of Company witness William
7 Rogers.

8

9 **Q. DOES THE COMPANY AGREE WITH MR. LAFFERTY'S ASSERTION THAT ALL**
10 **AIP COMPENSATION IS ASSOCIATED WITH FINANCIAL GOALS?**

11 A. No. Company witness Maxine Mitch, in her rebuttal testimony, indicates that about
12 7% of the Company's individual goals are what should be considered financial in
13 nature.

14

15 **Q. DO YOU BELIEVE YOU UNDERSTAND THE SOURCE OF CONFUSION?**

16 A. Yes. As described by Ms. Mitch, there is a level of earnings that must be achieved
17 before any AIP compensation is "unlocked" and available for distribution to
18 employees who have achieved their individual goals, most of which are not financial
19 in nature. Ms. Mitch explains how this mechanism serves to protect both the
20 Company and its customers. Once achieved, 70% of the total AIP is unlocked. The
21 remaining 30% is unlocked based upon customer service, safety and other factors.

22

23 **Q. IS MR. LAFFERTY CORRECT THAT IT IS POSSIBLE THAT INDIVIDUAL**
24 **EMPLOYEES COULD HAVE OUTSTANDING PERFORMANCES YET RECEIVE**
25 **NO AIP AWARD?**

1 A. Yes. As a protection to the overall financial health of the Company and for the
2 benefit of its customers, a minimum earnings level is an appropriate and common
3 hurdle that must be achieved before the opportunity for AIP compensation is
4 unlocked. However, once this hurdle is met, an individual employee's AIP payout is
5 still made based on individual goals. Mr. Lafferty's attempt to broadly characterize all
6 those goals as financial in nature and recommend elimination of the entire plan is, in
7 essence, simply a veiled restatement of his biased opposition to the concept of
8 incentive compensation in general.

9

10 **Q. HAS THE COMMISSION PREVIOUSLY ADDRESSED THE RECOVERABILITY OF**
11 **INCENTIVE COMPENSATION?**

12 A. Yes. The Order issued in The Empire District Electric Company Case No. ER-2001-
13 299 states the following: "Nonetheless, the Commission finds that the incentive
14 payments at issue were made to employees who did in fact achieve goals that were
15 beyond their normal job duties and responsibilities. The Commission also
16 determines that Empire's plan directly benefits the Company's customers given that a
17 portion of employee pay is at risk, causing employees to recognize that superior
18 performance will generate greater compensation."

19

20 **Q. IS THE AMERICAN WATER AIP PLAN DESCRIBED BY COMPANY WITNESS**
21 **MITCH BASED UPON ACHIEVING GOALS BEYOND AN EMPLOYEES NORMAL**
22 **JOB DUTIES AND RESPONSIBILITIES?**

23 A. Yes, it is.

24

25 **Q. DOES THE AMERICAN WATER AIP PLAN DESCRIBED BY COMPANY WITNESS**

1 **MITCH PLACE A PORTION OF EMPLOYEE PAY AT-RISK, CAUSING**
2 **EMPLOYEES TO RECOGNIZE THAT SUPERIOR PERFORMANCE WILL**
3 **GENERATE GREATER COMPENSATION?**

4 A. Yes, it does.

6 **Q. IS MR. LAFFERTY'S STATEMENT CORRECT THAT COMPANY EMPLOYEES**
7 **COULD BE PROVIDING POOR SERVICE, YET STILL RECEIVE AN AIP AWARD?**

8 A. No. This is a mischaracterization of the plan. While achieving Company customer
9 service metrics "unlock" 7.5% of the plan for distribution, payout is still based solely
10 on an individual employee's performance. As I stated previously, if an employee has
11 individual goals that are customer service related, and if that employee has not
12 achieved those goals, there will be no AIP payout awarded for the goals that were
13 not achieved.

15 **Q. DO YOU AGREE WITH MR. LAFFERTY'S STATEMENT THAT STAFF IS**
16 **INCONSISTENT IN DETERMINING THE AMOUNT OF AWARD THAT IS**
17 **RELATED TO FINANCIAL GOALS?**

18 A. Yes. Staff utilized the same method of review of MAWC individual goals that it has
19 used in at least the past four rate cases – that is, the Staff looked at specific
20 individual goals and eliminated the payout associated with those goals that it
21 considered to be financial in nature or had no other benefit. Company witness Mitch
22 in rebuttal testimony noted her agreement with this review process but her
23 disagreement with specific goals that should be excluded. In its review of Service
24 Company AIP, however, Staff applied a standard not utilized in prior cases. Even
25 though both MAWC and Service Company employees are part of the same AIP plan,

1 Staff simply eliminated 70% of all Service Company AIP compensation, ostensibly
2 because of the fact that 70% of the payout was “unlocked” by achieving a threshold
3 of minimum earnings. Ultimately, an AIP payout is made only if an employee has
4 achieved his/her individual goals.

5
6 **Q. MR. LAFFERTY ALSO STATES THAT CERTAIN OTHER AIP RELATED**
7 **EXPENSES SHOULD BE DISALLOWED. DO YOU AGREE?**

8 A. No. Mr. Lafferty indicates that the Company paid its portion of FICA, FUTA, and
9 SUTA taxes on the incentive compensation payments and that these tax payments
10 should also be disallowed. All these taxes are limited to certain maximum earnings
11 levels (e.g. FUTA is paid only on the first \$7,000 of an individual’s base
12 compensation). It should be noted that AIP payments are made in March, prior to the
13 time that most individuals have achieved the maximum earnings levels for
14 withholdings. Much of these taxes would have been incurred during the year,
15 whether or not any AIP payment was made in March.

16
17 **4. ACQUISITION PREMIUMS AND DISCOUNTS**

18
19 **Q. WHAT ISSUES DO YOU WISH TO ADDRESS IN REGARD TO ACQUISITION**
20 **PREMIUMS AND DISCOUNTS?**

21 A. I will address issues contained in the rebuttal testimony of OPC witness Ted
22 Robertson, both as they relate to the calculation of acquisition premiums and
23 discounts, and the appropriate ratemaking treatment after they are properly
24 calculated.

25

1 Q. HAS MR. ROBERTSON CALCULATED ACQUISITION PREMIUMS OR
2 DISCOUNTS FOR THREE PROPERTIES ACQUIRED BY MAWC SUBSEQUENT
3 TO ITS LAST RATE CASE?

4 A. Yes. Mr. Robertson has correctly identified a discount for the acquisition of Roark
5 and a very small premium for the acquisition of Loma Linda. However, he made an
6 error in calculating whether there was a premium or discount on the acquisition of the
7 Aqua properties.

8

9 Q. PLEASE EXPLAIN.

10 A. In calculating net book value, Mr. Robertson subtracted from the purchase price
11 certain non-rate base items such as construction work in progress. What he fails to
12 recognize is that the Company, in developing its rate case filing, did not include the
13 full purchase price in rate base. It only included those items that are typically
14 included in rates. Construction work in progress, for example, was not included in
15 the Company's request for recovery.

16

17 Q. CAN YOU PROVIDE A SIMPLE EXAMPLE?

18 A. Yes. Assume that for a purchase price of \$1,050 the Company acquired plant in
19 service with a net book value of \$1,000 and construction work in progress with a
20 book value of \$100. Thus, the Company would acquire assets with a total book
21 value of \$1,100 for \$1,050 and would recognize that it paid a \$50 discount. In its rate
22 case, the Company would then reflect \$1,000 in rate base, seeking to earn a return
23 on only plant that is in service and used and useful (and therefore excluding the \$100
24 of construction work in progress). The \$100 of construction work in progress would
25 be included in future rate cases after the associated plant has been placed into

1 service.

2

3 **Q. WHAT DID MR. ROBERTSON DO DIFFERENTLY?**

4 A. As indicated in his rebuttal testimony, Mr. Robertson made his calculations of
5 premium or discount by subtracting construction work in progress from the purchase
6 price. In the above example, he would calculate a net book value of \$950 by
7 subtracting the \$100 of construction work in progress from the \$1,050 purchase
8 price. Subtracting his derived net book value from the purchase price results in a
9 \$100 premium. This is clearly in error. If Mr. Robertson chooses to eliminate the
10 value of construction work in progress from the net book value of assets acquired, he
11 must also subtract that same value from the purchase price. The Company did not
12 acquire the plant items that were in the process of construction for free. It acquired
13 \$1,100 of assets for \$1,050, a price that is an obvious discount from recorded book
14 value.

15

16 **Q. WHY IS THE CALCULATION OF WHETHER AN ITEM IS A DISCOUNT OR**
17 **PREMIUM IMPORTANT FOR RATEMAKING PURPOSES?**

18 A. Normally, it would not be. Under traditional ratemaking treatment, assets acquired in
19 a purchase transaction are recorded at their depreciated net original cost. Cash is
20 credited for the amount paid for those assets and the difference is recorded as a
21 discount or premium. OPC, however, is introducing a new ratemaking concept.
22 Instead of simply recording assets at original cost, OPC suggests that ratemaking
23 should vary depending upon whether a premium or discount is calculated.

24

25 **Q. WHAT IS OPC'S PROPOSED TREATMENT FOR ACQUISITION PREMIUMS?**

1 A. OPC believes that recovery of an acquisition premium is inappropriate. Mr.
2 Robertson explains the OPC position stating:

3 The rate base of these acquisitions should be derived from the original
4 cost of the property when it was first dedicated to public use. The
5 purchase of the assets at a price higher than book value does not affect
6 the property's original cost. That is, a substitution of owners does not
7 establish a new utility company, nor does the acquisition premium
8 represent the addition of new investment within the operation. The
9 transfer between the sellers and buyers is simply a financial transaction
10 wherein ownership changed. Most, if not all, of the assets will continue
11 to be used to provide the same services to the same ratepayers and
12 those assets will remain subject to the same ratemaking jurisdiction of
13 the same regulators. This continuity makes a recalculation of rate base
14 unnecessary and inappropriate.
15

16 **Q. ARE THERE SITUATIONS WHERE THE PSC SHOULD APPROVE RECOVERY**
17 **OF ACQUISITION PREMIUMS?**

18 A. Yes, in instances where there is a showing that to do so would be in the public
19 interest.
20

21 **Q. HAS THE COMPANY REQUESTED RECOVERY OF AN ACQUISITION PREMIUM**
22 **IN THIS CASE?**

23 A. No.
24

25 **Q. THEN WHAT IS THE ISSUE IN REGARD TO ACQUISITION PREMIUM**
26 **RECOVERY IN THIS CASE?**

27 A. Aside from Mr. Robertson's calculation error as discussed above, I do not believe
28 there is one.
29

30 **Q. DOES OPC PRESCRIBE THE SAME RATEMAKING TREATMENT FOR**
31 **ACQUISITION DISCOUNTS AS IT DOES FOR ACQUISITION PREMIUMS?**

1 A. No. OPC abandons its position that the rate base of acquisitions should be derived
2 from the original cost of the property when it was first dedicated to public use.
3 Instead, OPC believes that the benefit of any acquisition discount, which occurs with
4 the purchase of assets at a price lower than book value, should be flowed through to
5 the customer.

6

7 **Q. REFERRING BACK TO MR. ROBERTSON'S TESTIMONY, DOES THE**
8 **PURCHASE OF ASSETS AT A PRICE LOWER THAN BOOK VALUE AFFECT**
9 **THE PROPERTY'S ORIGINAL COST?**

10 A. No.

11

12 **Q. DOES THE SUBSTITUTION OF OWNERS, ESTABLISHMENT OF A NEW UTILITY**
13 **COMPANY OR ACQUISITION DISCOUNT REPRESENT A CHANGE IN THE**
14 **INVESTMENT WITHIN THE OPERATION?**

15 A. No. In the same context that an acquisition premium does not, neither does an
16 acquisition discount represent a change in the investment in the assets serving the
17 customers within the operation.

18

19 **Q. IS THE TRANSFER OF ASSETS BETWEEN THE SELLERS AND BUYERS THAT**
20 **INCLUDES AN ACQUISITION DISCOUNT SIMPLY A FINANCIAL TRANSACTION**
21 **WHEREIN OWNERSHIP CHANGED?**

22 A. Yes.

23

24 **Q. IN A TRANSACTION INVOLVING THE SALE OF UTILITY ASSETS AT A**
25 **DISCOUNT, WILL MOST, IF NOT ALL, OF THOSE ASSETS CONTINUE TO BE**

1 **USED TO PROVIDE THE SAME SERVICES TO THE SAME RATEPAYERS?**

2 A. Yes.

3

4 **Q. WOULD THOSE SAME ASSETS REMAIN SUBJECT TO THE SAME**
5 **RATEMAKING JURISDICTION OF THE SAME REGULATORS?**

6 A. Yes.

7

8 **Q. DOES THEN THE CONTINUITY THAT EXISTS IN A TRANSACTION INVOLVING**
9 **AN ACQUISITION PREMIUM SIMILARLY EXIST IN A TRANSACTION INVOLVING**
10 **AN ACQUISITION DISCOUNT?**

11 A. Yes, it does.

12

13 **Q. HAS THE MISSOURI PUBLIC SERVICE COMMISSION PREVIOUSLY TAKEN A**
14 **POSITION ON THE APPROPRIATE RATEMAKING TREATMENT OF**
15 **ACQUISITION DISCOUNTS?**

16 A. Yes. I addressed this matter in my rebuttal testimony. A clear and concise statement
17 of the Commission's past position is found in the Second Report and Order in
18 Commission Case No. EM-2000-292, which reflected the following:

19 Missouri has traditionally applied the net original cost standard when
20 considering the ratemaking treatment of acquisition adjustments. That
21 means that the purchasing utility has not been allowed to recover an
22 acquisition premium from its ratepayers. But it also means that
23 ratepayers do not receive lower rates through a decreased rate base
24 when the utility receives a negative acquisition adjustment. Even if a
25 company acquires an asset at a bargain price, it is allowed to put the
26 asset into its rate base at its net original cost. Similarly, ratepayers do
27 not share in the gains a utility may realize from selling assets at prices
28 above their net original cost. Those gains flow only to the utility's
29 shareholders.

30

1 Q. DID MR. ROBERTSON ADDRESS THE SUBJECT OF GAINS ON PURCHASES
2 BELOW NET BOOK VALUE?

3 A. Yes. He described the appropriate accounting treatment for gains from bargain
4 purchases in his rebuttal testimony, beginning at page 20, and correctly indicates that
5 the discount from the acquisition of utility assets at a price below net book value must
6 be reflected on the Company's books as a gain.

7

8 Q. DOES HE INDICATE THE COMMISSION'S NORMAL TREATMENT FOR GAINS
9 OR LOSSES ON THE SALE OF UTILITY PROPERTY?

10 A. Yes. Mr. Robertson states that, "To my knowledge, the Commission has never
11 allowed ratepayers to share in any gains or losses resulting from the sale of a utility's
12 property."

13

14 Q. YET, OPC PROPOSES THAT THE GAIN THE COMPANY HAS RECORDED IN
15 ASSOCIATION WITH THE ACQUISITION OF PROPERTY BE GIVEN TO
16 RATEPAYERS?

17 A. Yes. Not only does he propose that gain be given to ratepayers, he seems to further
18 suggest that any taxes on that gain should be absorbed by the Company despite the
19 fact that the ratepayers received the benefit of the gain.

20

21 Q. WHAT ACCOUNTING ENTRIES WOULD HAVE TO BE REFLECTED IF THE
22 COMMISSION FOLLOWED MR. ROBERTSON'S SUGGESTION?

23 A. The Company would have to recognize a loss in the year the Commission issued its
24 Order approving Mr. Robertson's suggestion, thereby negatively impacting the
25 opportunity for MAWC to earn its authorized return.

1

2 **Q. MR. ROBERTSON REFERS TO THE WHITE RIVER VALLEY ELECTRIC**
3 **COOPERATIVE, INC. AND INDICATES IT IS PROBABLE THAT ENTITY WILL**
4 **BENEFIT FROM SELLING THEIR ASSETS AT A DISCOUNT. DO YOU AGREE?**

5 A. The owners of White River Valley Electric Cooperative, Inc. (seller of what is
6 commonly referred to as the Roark assets) desired to exit the water and wastewater
7 utility business. Unless Mr. Robertson has special knowledge of the Cooperative's
8 corporate structure and tax situation, I do not believe that electric cooperatives are
9 subject to income taxation and therefore question whether the tax benefit Mr.
10 Robertson asserts could be achieved.

11 Further, I disagree with Mr. Robertson's statement that MAWC wants ratepayers to
12 pay for assets that have been fully recovered by White River. It is MAWC's position
13 that it should include in its rate base only the net book value of the utility assets at the
14 time of the close of the acquisition recorded in accordance with the Commission
15 approved NARUC system of accounts. The fact that those assets were reflected on
16 the books of White River is indicative of the fact that they had not been fully
17 recovered through rates charged to customers. In fact, the recorded net book value
18 of utility assets reflected in the Company's current rate case would have been higher
19 had White River chosen to file its own rate case instead of having sold its utility
20 assets.

21

22 **Q. MR. ROBERTSON SAYS THAT ACQUISITIONS ARE DRIVEN BY A DESIRE TO**
23 **INCREASE SHAREHOLDER VALUE. DO YOU AGREE?**

24 A. That is certainly one reason that utilities pursue acquisition opportunities.
25 Acquisitions also occur to make operations more efficient. That is another way to

1 derive economic value from an acquisition, although admittedly that value is returned
2 to customers through rates. There are other factors that sometimes motivate
3 acquisitions, including fill-in of existing service areas, reputation, economies of scale
4 opportunities, anticipated growth and social responsibility. Still, MAWC is a
5 corporation responsible to its shareholders and accordingly must always be
6 cognizant of a potential acquisition's impact on earnings.

7
8 **Q. FOR THE SAKE OF ARGUMENT, LETS ACCEPT MR. ROBERTSON'S CLAIM**
9 **THAT ACQUISITIONS OCCUR PRIMARILY TO INCREASE SHAREHOLDER**
10 **VALUE. IN LIGHT OF THIS, IS MR. ROBERTSON CORRECT THAT**
11 **DISALLOWANCE OF ACQUISITION DISCOUNTS WOULD NOT IMPACT UTILITY**
12 **ACQUISITION DECISIONS?**

13 A. No. Mr. Robertson's claims are based on faulty logic. To the contrary, the
14 disallowance of acquisition discounts would clearly serve as a disincentive to utility
15 acquisitions. As an example, one can simply look to Mr. Robertson's discussion of
16 the acquisition of the North Jefferson City assets. Those assets were part of an
17 extremely troubled system that the prior owners had unsuccessfully attempted to
18 divest for a long period of time. OPC's proposed treatment for acquisition discounts
19 would have essentially guaranteed that MAWC could achieve no (zero) earnings
20 through its operation of the North Jefferson City assets. From a practical standpoint,
21 why would any company take on the risks of ownership of troubled assets for which it
22 had no opportunity to earn any return? Although part of MAWC's decision to acquire
23 those assets was based on social responsibility and the recognition that the assets
24 were close to existing operations, the inability to earn any return on the operation of
25 those assets certainly would have been a very strong disincentive for the Company to

1 finalize the transaction.

2

3

5. EMPIRE CONTRACT AND INTERRUPTIBLE TARIFF

4

5 **Q. HAVE YOU READ THE REBUTTAL TESTIMONY OF EMPIRE WITNESS BLAKE**
6 **MERTENS?**

7 A. Yes, I have.

8

9 **Q. DO YOU AGREE WITH MR. MERTENS' COMMENTS REGARDING A NEW**
10 **WATER SERVICE AGREEMENT BETWEEN EMPIRE AND MAWC?**

11 A. Yes. Mr. Mertens has correctly described the new water service agreement. The
12 new 25 year agreement replaces the existing water supply agreement that would
13 otherwise expire in 2016. Except for the new contract expiration date, the major
14 terms of the agreement have changed little, if at all, from the original.

15

16 **Q. UNDER WHAT TARIFF IS EMPIRE CURRENTLY SERVED?**

17 A. Empire is served under Original Tariff Rate Sheet Number 53, which is an
18 interruptible rate tariff.

19

20 **Q. DID THE COMPANY PROPOSE AN INTERRUPTIBLE TARIFF IN THE CURRENT**
21 **PROCEEDING?**

22 A. No. MAWC has proposed consolidated tariff pricing in the current proceeding. At the
23 time of filing, the Company believed that Empire would be served under the same
24 tariff that it proposed for other manufacturers and large quantity users of water. Due
25 to the numerous rate design alternatives presented in the current rate proceeding

1 and the Company's original proposal to eliminate the interruptible tariff, it is unclear at
2 this time, however, under what tariff Empire might be served.

3

4 **Q. DO YOU AGREE WITH EMPIRE'S POSITION THAT IF THE NEW AGREEMENT IS**
5 **NOT APPROVED BY THE COMMISSION, THE INTERRUPTIBLE RATE SHOULD**
6 **BE RETAINED?**

7 A. Yes. The new service agreement clarifies that Empire would be served under the
8 same tariff for manufacturers and large quantity users, retains an interruptible feature
9 and clarifies the terms under which Empire will take service at its State Line facility.
10 However, if the new service agreement is not approved, an interruptible rate should
11 be reinstated.

12

13 **Q. DO THE COMPANY AND ITS CUSTOMERS GAIN BENEFIT FROM THE**
14 **INTERRUPTIBLE NATURE OF THE SERVICE TO EMPIRE?**

15 A. Yes. The existing tariff under which Empire is served allows the Company to
16 interrupt service to Empire when water availability is in relatively short supply. The
17 new service agreement maintains this interruptible feature.

18

19 **Q. HAS THE COMPANY EVER INTERRUPTED SERVICE TO EMPIRE'S STATE LINE**
20 **FACILITY?**

21 A. Yes, on a number of occasions.

22

23 **Q. DOES MAWC AGREE THAT THE SETTLEMENT AGREEMENT WITH EMPIRE IS**
24 **IN THE PUBLIC INTEREST?**

25 A. Yes. The Settlement Agreement in this case serves to present to the Commission a

1 new water service agreement for approval. The new water service agreement
2 insures that Empire will continue to take service from MAWC and that water service
3 will be available to the State Line plant for the current expected life of the facility;
4 increases the existing base rate by about 35 percent; and retains the interruptible
5 feature of the existing agreement. The provisions of the new service agreement
6 provide a reasonable balance between the Company and customers and results in
7 just and reasonable rates.

8
9 **6. RATE DESIGN**

10
11 **Q. WHAT ISSUES WILL YOU DISCUSS IN REGARD TO RATE DESIGN?**

12 A. My testimony will be limited to addressing the rate design concepts Ag Processing
13 Inc. ("AGP") witness Johnstone has proposed in regard to rate changes for
14 customers in his recommended hybrid district, particularly his phase-in proposal.

15
16 **Q. BRIEFLY DESCRIBE MR. JOHNSTONE'S HYBRID RATE PROPOSAL.**

17 A. Mr. Johnstone has proposed a hybrid district that would eventually equalize rates for
18 all water customers in the subdivisions of Maplewood, Lake Carmel, Riverside
19 Estates, Lake Taneycomo, Spring Valley, Ozark Mountain, Lakewood Manor, White
20 Branch and Rankin Acres; the villages of Loma Linda and Incline Village; the
21 township of Roark; and the City of Brunswick. Because of existing rate levels and
22 sizable increases he has proposed to recover district specific costs of service, Mr.
23 Johnstone has proposed that this equalization take place over a four year period and
24 has divided these entities into four (4) different zones, proposing to phase-in rates
25 through rates designed specific to each of these four (4) zones.

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Q. HOW DOES MR. JOHNSTONE’S PHASE-IN PLAN WORK?

A. For three (3) of his zones, Mr. Johnstone suggests that the required rate increase be limited in the first year of implementation and that a second rate increase be implemented in year 2 sufficient to recover the year 1 shortfall over the ensuing three years. This approach would theoretically restore to the Company, over a four year period, the revenues that would have been received had there been no phase-in of rates.

Q. WHAT WOULD HAPPEN TO THE PHASE-IN PLAN IF A NEW RATE CASE WERE FILED DURING THE FOUR YEAR INTERIM?

A. Mr. Johnstone does not discuss that possibility.

Q. HOW OFTEN ARE RATE CASES FILED?

A. That depends on investment, customer growth or decline, cost increases and a number of other factors, but generally MAWC rate cases have been filed about every other year over the past decade. In fact, the Company has indicated that it is willing to agree to file a request for a change in rates within three years to alleviate concerns expressed by Staff and OPC. The Company has also indicated that it is likely that it will have to file an earlier rate increase request if its request for accounting treatment of its BT investment is not approved. A rate case during the pendency of Mr. Johnstone’s proposed phase-in would certainly create complications in setting future rates.

Q. YOU INDICATED THAT THE PROPOSED PHASE-IN PLAN WOULD

1 THEORETICALLY RESTORE THE LEVEL OF REVENUES THAT WOULD
2 OTHERWISE HAVE BEEN RECEIVED OVER THE FOUR YEAR PERIOD. DOES
3 THAT MEAN THAT THE COMPANY WOULD BE MADE WHOLE FROM AN
4 EARNINGS PERSPECTIVE?

5 A. No. Mr. Johnstone ignores the time value of money. He proposes no mechanism to
6 fully reimburse the Company for the shortfall in earnings that will occur in the first
7 year of his plan. In essence, he is asking the Company to provide ratepayers with an
8 interest free loan during the term of the phase-in and thereby denies the Company
9 the opportunity to earn its authorized return.

10
11 Q. HAVE ANY OTHER PARTIES TO THIS PROCEEDING DISCUSSED A PHASE-IN
12 PLAN?

13 A. Yes. OPC witness Barbara Meisenheimer suggests that, for districts facing large
14 increases, she would recommend phase-ins of up to three years. She did not,
15 however, describe in detail a concept of how a phase-in approach would operate.
16 Therefore, I have limited my comments to Mr. Johnstone's phase-in proposal.

17
18 Q. DID MS. MEISENHEIMER ADDRESS THE TIME VALUE OF MONEY ISSUE IN
19 PHASE-IN PLANS?

20 A. Yes, it appears she does. She stated that carrying costs should be paid to the
21 Company at a rate equal to the Company's AFUDC rate.

22
23 Q. DO YOU AGREE THAT IF A PHASE-IN PLAN WERE TO BE INSTITUTED THAT
24 THE PHASE-IN PLAN SHOULD REFLECT THE COST OF MONEY USING AN
25 AFUDC RATE?

1 A. Yes, but let me make it clear that the Company does not agree to a phase-in plan as
2 proposed by Ms. Meisenheimer or Mr. Johnstone, even if carrying costs on deferred
3 revenues are included in their plans. First, their phase-in plans cite no authority for
4 the Commission to mandate a phase-in of rates without the concurrence of the
5 Company. Second, and more importantly, their plans lack specificity and adequate
6 assurances that the Company will receive a return on and of money it has expended
7 in providing service to the public. The Company would be willing to discuss the
8 specifics of a phase-in plan, but only if such phase-in plan: 1) resulted in just and
9 reasonable rates to its customers; and, 2) fully compensates the Company for the
10 money it has invested in providing service to the public. Neither Ms.
11 Meisenheimer's nor Mr. Johnstone's plans currently meet these criteria.

12 .
13 **Q. DOES MR. JOHNSTONE HAVE A DIFFERENT RECOMMENDATION FOR HIS**
14 **FOURTH ZONE?**

15 A. Yes. His phase-in plan for the zone containing Brunswick would operate generally
16 the same as for his first three zones, except that Mr. Johnstone did not design rates
17 so that the level of revenue over the four years of the phase-in plan would be
18 equivalent to the same level of revenues that would be generated under traditional
19 ratemaking. Instead, Mr. Johnstone places a cap on the Brunswick increase and
20 expects the Company to absorb a reduction of over \$1.2 million dollars during this
21 four year period. It should be noted that Mr. Johnstone has estimated this permanent
22 taking of income based on Staff's filing in this case and that under the Company's
23 revenue requirement proposal, the amount would be much larger.

24
25 **Q. DOES MR. JOHNSTONE EXPLAIN WHY HE BELIEVES IT IS NECESSARY TO**

1 **CAP THE BRUNSWICK RATE INCREASE?**

2 A. Yes. Mr. Johnstone stated that he limited the increase “in consideration of impact
3 and the relatively high rates in Brunswick.”

4

5 **Q. ARE THERE OTHER MEANS FOR THE COMMISSION TO ADDRESS THE**
6 **IMPACT AND RELATIVELY HIGH RATES IN BRUNSWICK?**

7 A. Yes. Consolidated pricing as proposed by the Company and supported by Company
8 witness McDermott would address this issue.

9

10 **Q. DOES MR. JOHNSTONE PROPOSE ANY ALTERNATIVES TO HIS PHASE-IN**
11 **PLAN?**

12 A. Yes. He suggests that instead of implementing a phase-in plan that Missouri-
13 American could simply absorb the amount that he has suggested be held for phase-
14 in. Over the course of four years, this would amount to over \$3 million based on the
15 Staff filing and substantially more based on the Company’s request.

16

17 **Q. HOW DOES MR. JOHNSTONE SUPPORT THIS PROPOSAL?**

18 A. He indicates that based on a Company response to a data request that the Company
19 never considered whether it would be able to increase rates or recover costs to newly
20 acquired customers in a manner that would provide cost recovery. Although Mr.
21 Johnstone did not identify these data requests by number, I have attached copies of
22 the two data requests and responses to which I believe Mr. Johnstone was referring
23 as Schedule DRW – 1 and Schedule DRW – 2.

24

25 **Q. WHAT DOES MR. JOHNSTONE SAY ABOUT THE COMPANY’S RESPONSE?**

1 A. He states that the Company made a dubious assumption that it should expect to
2 recover costs incurred in consideration of the district-specific pricing that has been
3 the norm. He goes on to state that MAWC should bear the consequences, if it
4 incorrectly assumed that existing customers could be called upon to subsidize its
5 system expansion.

6
7 **Q. DO THE DATA RESPONSES YOU PROVIDED REFER TO BRUNSWICK**
8 **OPERATIONS?**

9 A. No. The data requests were restricted to certain specified wastewater operations.

10
11 **Q. ARE THE COSTS OF SYSTEM EXPANSION A MAJOR DRIVER IN THE**
12 **COMPANY'S CURRENT REQUEST TO INCREASE RATES?**

13 A. No. The Company has included in its current rate filing three acquisitions, Aqua,
14 Loma Linda and Roark. Combined, these three acquisitions are very small in
15 comparison to Missouri-American's existing investment and operations. The rate
16 base for these acquisitions has been reflected in this filing at original cost and is
17 equivalent to or lower than what the previous owners would have reflected in a rate
18 case, in lieu of selling their assets. Economies of scale have been included in the
19 cost of service. For example, the Joplin district manager is now also responsible for
20 the village of Loma Linda and the township of Roark. His costs will be spread over a
21 larger customer base. Likewise, the costs of the call center and other administrative
22 costs will be spread over a larger customer base. While it is true that under a
23 consolidated pricing concept some of the Company's existing districts may
24 experience a very small increase as a result of these acquisitions, overall the total
25 revenue requirement will be less than had these acquisitions not been made and all

1 these properties had filed separate rate requests.

2

3 **Q. DID THE COMMISSION APPROVE THESE ACQUISITIONS?**

4 A. Yes, it did.

5

6 **Q. AND IN APPROVING THESE ACQUISITIONS, DID THE COMMISSION FIND**
7 **THEM TO BE IN THE PUBLIC INTEREST?**

8 A. Yes, it did.

9

10 **Q. WHAT IS YOUR UNDERSTANDING OF CONSIDERATIONS USED TO**
11 **DETERMINE WHETHER AN ACQUISITION IS IN THE PUBLIC INTEREST?**

12 A. My understanding is that the public interest is broadly defined. In determining
13 whether an acquisition is in the public interest, regulators take into account
14 economies of scale, technical expertise, protection of the environment, long-term
15 commitment, financial capacity and other factors. The public interest is certainly
16 broader than the parochial interests of Ag Processing or the City of St. Joseph or any
17 other individual entity. Self-serving arguments against system expansion that are in
18 the public interest seem to be the regulatory equivalent of a water customer saying
19 "not in my back yard".

20

21 **Q. WOULD YOUR ANSWER TO THIS DATA REQUEST HAVE BEEN ANY**
22 **DIFFERENT HAD IT ALSO REFERRED TO UTILITY OPERATIONS IN**
23 **BRUNSWICK?**

24 A. No. The Company believes that in a rate case it is reasonable and lawful that the
25 Commission establish rates at a sufficient level to allow a utility to recover its

1 prudently incurred costs and an opportunity to earn a fair and reasonable return.

2

3 **Q. MR. JOHNSTONE SUGGESTS THAT THE COMPANY'S RESPONSE WAS**
4 **DUBIOUS GIVEN THAT DISTRICT SPECIFIC PRICING IS CURRENTLY**
5 **UTILIZED. DO YOU AGREE?**

6 **A.** No. The Commission-ordered revenue requirement determination in a rate case
7 determines the level of operating and capital cost recovery. Rate design, whether
8 district specific, consolidated, hybrid or any other method, has nothing to do with the
9 total cost recovery a company receives. Different rate design approaches may
10 increase or decrease the revenue from a particular district, but the overall revenue
11 determination remains the same.

12

13 **Q. IS IT YOUR UNDERSTANDING THAT MR. JOHNSTONE BELIEVES THAT THE**
14 **DISTRICT SPECIFIC RATE DESIGN HE ENDORSES WOULD RESULT IN RATES**
15 **SO HIGH FOR BRUNSWICK CUSTOMERS THAT HE BELIEVES THEM TO BE**
16 **UNTENABLE?**

17 **A.** Yes, that is my understanding.

18

19 **Q. AND IS IT YOUR UNDERSTANDING THAT MR. JOHNSTONE SUGGESTS THAT**
20 **THE COMPANY ABSORB ANY SHORTFALL FROM BRUNSWICK BECAUSE IT**
21 **WAS PART OF A SYSTEM EXPANSION, AND THE COMPANY SHOULD HAVE**
22 **BEEN AWARE THAT UNDER DISTRICT SPECIFIC PRICING IT MIGHT NOT BE**
23 **ABLE TO RECOVER ITS FULL COST OF SERVICE?**

24 **A.** Yes, that is also my understanding.

25

1 Q. WHEN DID THE CITY OF BRUNSWICK BECOME A PART OF THE MISSOURI-
2 AMERICAN SYSTEM?

3 A. The City of Brunswick has been a part of the MAWC system for 19 years. It was
4 acquired as part of the Missouri Cities transaction in 1993.

5

6 Q. AT THE TIME OF THE BRUNSWICK ACQUISITION, WAS DISTRICT SPECIFIC
7 PRICING IN PLACE?

8 A. No. The Missouri Public Service Commission at the time of the acquisition and for
9 some time thereafter approved consolidated pricing for some or all of the MAWC
10 properties. While the Commission announced a move toward district specific pricing
11 in the 2000 rate case, rates have never been set based on full district specific pricing
12 in that the Commission has approved inter-district subsidies in all rate cases
13 subsequent to the 2000 rate case.

14

15 Q. IF DISTRICT SPECIFIC PRICING WERE STRICTLY ENFORCED, WOULD IT BE
16 APPROPRIATE FOR THE COMMISSION TO ESTABLISH RATES AT A LEVEL
17 THAT WAS NOT DESIGNED TO FULLY COMPENSATE THE COMPANY FOR ITS
18 COSTS?

19 A. No. A utility company should have the opportunity to recover fully its prudently
20 incurred costs and a fair and reasonable rate of return on its invested capital.

21

22 Q. WHAT WOULD BE THE CONSEQUENCE OF THE COMMISSION ADOPTING AN
23 APPROACH SUCH AS THAT SUGGESTED BY MR. JOHNSTONE?

24 A. Public utilities would have no motivation to serve a community where they could not
25 earn a reasonable return or recover their costs. Communities, such as Brunswick,

1 would either have no water supply, go out of existence or be forced to turn to other
2 sources of supply, such as self-provision, which would likely lead to rates even higher
3 than what Mr. Johnstone already finds to be untenable.
4

5 **Q. YOU EARLIER MADE MENTION OF THE LOMA LINDA ACQUISITION. IN ITS**
6 **ORDER APPROVING THAT ACQUISITION, DID THE COMMISSION APPROVE**
7 **THE INTEGRATION OF LOMA LINDA INTO THE JOPLIN DISTRICT FOR RATE**
8 **DETERMINATION?**

9 A. Yes. Existing rates for Loma Linda were to be maintained until the Company's next
10 rate proceeding and then rates for Loma Linda were to be consolidated with Joplin.
11

12 **Q. DID MR. JOHNSTONE INCLUDE LOMA LINDA IN THE JOPLIN DISTRICT IN HIS**
13 **RATE DESIGN?**

14 A. No. He included Loma Linda as a part of his hybrid district.
15

16 **Q. WHY?**

17 A. I do not know. However, it does demonstrate the arbitrariness of his
18 recommendation. If a new subdivision had been built within the city limits of Joplin,
19 there would be no question that the subdivision would be considered a part of the
20 Joplin district for ratemaking purposes. However, Mr. Johnstone does not include
21 Loma Linda, a small village just outside the city limits and interconnected with the
22 existing Joplin district. Mr. Johnstone apparently assumes that if a new group of
23 customers is added, the possibility that the new cost structure could impact existing
24 customer rates dictates establishment of a separate and distinct district. Simply put,
25 the concept of district specific pricing is all about where one draws an imaginary line.

1 Certainly, there are different cost structures from district to district. There are also
2 different cost structures from customer to customer. Where the Commission draws
3 that line should be based upon all the factors discussed by MAWC witness Dr.
4 McDermott, not on cost alone.
5

6 **Q. WHAT IS THE ULTIMATE RESULT OF MR. JOHNSTONE'S PHASE IN PLAN?**

7 A. As reflected on his Rebuttal Schedule 1, there would be an extremely wide range of
8 rate increases among the various customers served by Missouri-American. Again,
9 utilizing the Staff recommended overall revenue requirement increase, Mr. Johnstone
10 would increase the rates for residential customers in St. Louis County, the district
11 with the lowest current rates, only 19 cents per 1000 gallons over the next two years.
12 During the same two years, he would increase residential rates for the Brunswick
13 district, the district with the highest current rates, by \$6.73 per 1000 gallons over 35
14 times greater than St. Louis County, and still far lower than what Mr. Johnstone
15 suggests should be implemented to reflect appropriate rates
16

17 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

18 A. Yes, it does.

Ag Proc 098

**DATA INFORMATION REQUEST
Missouri-American Water Company
WR-2011-0337 & SR-201-0338**

Requested From: John Reichart
Date Requested: 9/20/11
Date Response Provided: 9/29/11

Information Requested:

Please identify each acquisition of a wastewater system in the state of Missouri in the last decade. Please explain why MAWC has made each such acquisition in consideration of its alleged persistent inability to earn allowed returns.

Requested By: Stuart Conrad - stucon@fcplaw.com, - 816-753-1122
Finnegan, Conrad & Peterson, L.C. - Attorney for Ag Processing, Inc.

Information Provided:

2004 – Warren County
2004 – Cedar Hills
2010 – Lake Tamarack
2011 – Roark
2011 – Aqua American

There are a number of reasons why MAWC may pursue ownership of utility properties or systems including, but not limited to, projected incremental increases in earnings, spreading overhead costs over a larger base, system growth, infilling of existing systems and as a response to requests from regulatory authorities.

Ag Proc 158

**DATA INFORMATION REQUEST
Missouri-American Water Company
WR-2011-0337 & SR-201-0338**

Requested From: John Reichart
Date Requested: 10/5/11
Date Response Provided: 10/25/11

Information Requested:

Please refer to the response to data request AG Proc 098. For each acquisition, please provide each projection of earnings and increased earnings and any documents created or modified in connection with this projection. Did MAWC assume that MAWC's capital costs for the acquired system would be recovered from the customers of the acquired system. Please explain fully why or why not.

Requested By: Stuart Conrad - stucon@fcplaw.com, - 816-753-1122
Finnegan, Conrad & Peterson, L.C. - Attorney for Ag Processing, Inc.

Information Provided:

For earnings information please see the response to Ag Proc 157.

MAWC assumed that its capital costs, including those capital costs associated with each acquired system, would be recovered from its customers in a rate proceeding subsequent to the acquisition to the extent those costs were determined to be prudently incurred.