

*Exhibit No.:*  
*Issues:* Capitalized O&M Depreciation;  
Emerald Pointe Rate Base  
Treatment; Arnold Amortization  
*Witness:* Lisa M. Ferguson  
*Sponsoring Party:* MoPSC Staff  
*Type of Exhibit:* Rebuttal Testimony  
*Case No.:* WR-2015-0301  
*Date Testimony Prepared:* February 11, 2016

**MISSOURI PUBLIC SERVICE COMMISSION**

**COMMISSION STAFF DIVISION**

**AUDITING DEPARTMENT**

**REBUTTAL TESTIMONY**

**OF**

**LISA M. FERGUSON**

**MISSOURI-AMERICAN WATER COMPANY**

**CASE NO. WR-2015-0301**

*Jefferson City, Missouri*  
*February 2016*

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OF  
LISA M. FERGUSON  
MISSOURI-AMERICAN WATER COMPANY  
CASE NO. WR-2015-0301**

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1 fund in order to continue to receive wastewater treatment service from the Metropolitan  
2 St. Louis Sewer District (MSD). These projects were paid for by MSD and then a portion of  
3 the total costs were collected from the City of Arnold. MAWC assumed the responsibility  
4 for quarterly payments to MSD in order to pay for these projects upon acquiring the City of  
5 Arnold operations.

6 **CAPITALIZED O&M DEPRECIATION**

7 Q. What is capitalized O&M depreciation and why does Staff make an adjustment  
8 for this item?

9 A. Depreciation expense is calculated yearly on all MAWC-owned plant in  
10 service. For certain plant accounts, such as power-operated equipment, Staff recommends  
11 that a portion of depreciation expense should be capitalized during the year when those  
12 assets are partly used for capitalized construction projects. For projects in which the same  
13 power-operated equipment is used for maintenance work, the depreciation should be recorded  
14 as an expense. Staff's position is that the portion of depreciation expense for these assets that  
15 is applicable to the time that those assets were used for construction projects should be  
16 capitalized by MAWC on a going forward basis.

17 Q. Please indicate all MAWC Uniform System of Accounts (USOA) plant in  
18 service accounts that Staff proposes to adjust to exclude from the depreciation expense  
19 annualization an appropriate portion of ongoing capitalized depreciation.

20 A. Staff proposes to remove a capitalized portion from the annualization of  
21 depreciation expense from the following USOA plant in service accounts: 392, 392.1, 392.2,  
22 392.3, 392.4 for transportation equipment; account 394 for tools, shop, and garage equipment;  
23 and account 396 for power-operated equipment. Again, Staff will perform this adjustment to

1 address the fact that for a portion of time during any given year, MAWC uses these assets for  
2 capital projects rather than entirely for operations and maintenance expense projects.

3 Q. Does Staff calculate this adjustment for all regulated utilities or just water  
4 utilities?

5 A. It has been Staff's practice to calculate this adjustment for all utility types.  
6 For instance, at a minimum Staff has reflected this adjustment in its cost of service calculation  
7 in recent rate cases involving Union Electric Company d/b/a Ameren Missouri,  
8 Liberty Utilities (Midstates Natural Gas), Laclede Gas Company and their Missouri Gas  
9 Energy operating unit, Kansas City Power & Light Company, KCP&L-Greater Missouri  
10 Operations Company and Raytown Water Company.

11 Q. In general, how does Staff determine the ongoing amount of capitalized  
12 depreciation that should be removed from the annualization of depreciation expense?

13 A. In other rate cases, Staff submits a data request to the utility that it is  
14 auditing seeking the amount of depreciation expense that has been booked to each account  
15 and will ask for that amount to be divided amongst the amount of time those assets were spent  
16 being used for construction, expense, and non-utility for a specified time period. In general,  
17 this division is determined by an assignment of labor costs to capital and expense items.  
18 Once the Staff receives the response to this data request, Staff will adopt this assignment if  
19 appropriate or develop a ratio of how much of the depreciation expense should be designated  
20 for construction purposes. Staff will then apply that ratio to each account mentioned above  
21 and that ratio will reflect the amount of the adjustment that will be removed from annualized  
22 depreciation expense. That portion which is removed from annualized depreciation expense

1 is the amount that is expected to be capitalized based on Staff's evaluation of the actual  
2 historical usage of the investment being examined.

3 Q. Did Staff seek the capitalized depreciation information from MAWC through a  
4 data request in this proceeding?

5 A. Yes. Staff submitted Data Request No. 0363 seeking this information for the  
6 twelve months ending September 30, 2015. MAWC's response did not provide the  
7 information regarding the depreciation dollars broken out amongst construction, expense and  
8 non-utility for which the assets were used during that 12-month period. After meeting with  
9 MAWC on February 10, 2016, Staff was informed that MAWC does not currently capitalize  
10 any depreciation expense. Staff has explained to MAWC the rationale for capitalizing some  
11 of the depreciation expense and MAWC has committed to providing the Staff with necessary  
12 information in a supplement response to this request in order to make this determination.

13 Q. When will Staff calculate how much capitalized O&M depreciation should be  
14 removed in this case?

15 A. Staff will calculate the amount needed to be removed based on updated plant in  
16 service and depreciation expense amounts as of January 31, 2016, that will be provided by the  
17 Company as part of true-up in this case. At that time, Staff should have received the  
18 requested information from MAWC regarding the amount of time the above assets are  
19 used for construction, expense, and non-utility.

20 **EMERALD POINTE CONTRIBUTED PIPELINE RATE BASE TREATMENT**

21 Q. Please explain how the Emerald Pointe pipeline was treated in an  
22 Emerald Pointe informal rate proceeding prior to MAWC's acquisition of Emerald Pointe.

1           A.     Prior to MAWC's acquisition, Emerald Pointe provided water and sewer  
2 service to approximately 389 customers located in Taney County, Missouri. Emerald Pointe  
3 constructed a new sewer main to connect its system to the City of Hollister, Missouri, in order  
4 to have its wastewater treated by Hollister. The project was completed and placed in service  
5 on January 7, 2013. At that time, Staff examined the project costs and included their analysis  
6 of the costs as part of the small company rate increase request in Case Nos. SR-2013-0016  
7 and WR-2013-0017. In that case, Staff included the portion of the pipeline which was owned  
8 by and located on Emerald Pointe property as well as installed lift stations that were  
9 required to pump sewage through the pipeline, as well as other required items for the pipeline  
10 such as easements and engineering costs, in Emerald Pointe's plant in service. However,  
11 there was a portion of the pipeline from the flow meter to the City of Hollister treatment plant,  
12 which Emerald Pointe was required to pay for that is actually owned and maintained by the  
13 City of Hollister. The amount of the piece of the pipeline project that was paid for by  
14 Emerald Pointe but is owned and maintained by the City of Hollister is \$323,321. In Case  
15 Nos. SR-2013-0016 and WR-2013-0017, Staff included an amortization of this amount in  
16 Emerald Pointe's cost of service to allow that entity recovery of its costs for the part of the  
17 project that Emerald Pointe paid for. Staff also included the unamortized balance of \$323,321  
18 in its accounting schedules as an addition to rate base in that rate case. However, it is  
19 important to note that this rate base treatment was never discussed in the *Notice Of*  
20 *Company/Staff Partial Agreement Regarding Disposition Of Revenue Increase Request And*  
21 *Request For Hearing* that was filed in that case, nor is there any discussion found in the  
22 Auditing Unit Recommendation Memo. In addition, the treatment is not discussed in any  
23 filed testimony in that case nor was it a litigated issue in that rate case. In hindsight, the Staff

1 maintains today that the inclusion in rate base for the unamortized balance related to the  
2 contributed pipeline that was donated to the City of Hollister was a mistake on Staff's part.  
3 That rate case was finalized and tariffed rates were ordered by the Commission on July 31,  
4 2013. MAWC later acquired the assets of the Emerald Pointe Water and Sewer systems as  
5 part of Case Nos. WO-2014-0113 and SO-2014-0116. The Commission issued an order  
6 approving the acquisition effective April 24, 2014, and MAWC assumed all aspects of  
7 revenue, expense, and investment that were previously the responsibility of Emerald Pointe.

8 Q. Does Staff and MAWC disagree with the rate base treatment of this  
9 unamortized balance for the pipeline project in this rate case?

10 A. Yes. MAWC contends that when they acquired Emerald Pointe that the rate  
11 base treatment would continue under MAWC ownership as was reflected in the accounting  
12 schedules in the prior Emerald Pointe rate case. Staff maintains that it is inappropriate to  
13 include the unamortized balance in rate base for a project that is not owned by the utility and  
14 which the utility is not responsible for maintaining. Simply put, the Staff made an error when  
15 it included the unamortized balance of this non-utility property in rate base in the accounting  
16 schedules in the Emerald Pointe rate case (Case No. SR-2013-0016). Now, since this error  
17 has now come to light, it is appropriate to correct this mistake at this time in the context of the  
18 current MAWC rate case.

19 Q. Why does Staff maintain that the regulatory treatment recommended in Case  
20 No. SR-2013-0016 is incorrect?

21 A. In that rate case, Staff included an amortization that addressed all of the costs  
22 payable by Emerald Pointe that were associated with the pipeline that was located within the  
23 city limits of Hollister and donated to the city. That amortization was sufficient to address all



1 of the financial impact of this pipeline on Emerald Pointe. It is Staff's position that any rate  
2 base treatment of the unamortized balance of the contributed portion of pipeline costs is  
3 inappropriate. Emerald Pointe at that time did not retain ownership of that portion of the  
4 pipeline because it was contributed to the City of Hollister. It was not appropriate for  
5 Emerald Pointe to earn a return on an item that they did not own, that was contributed to  
6 another entity, is not an asset on the utility's books and records and for which it made no  
7 upfront investment. Staff maintains that MAWC should continue to earn a return on and of  
8 the plant assets that were actually owned by Emerald Pointe and acquired by MAWC through  
9 its purchase of Emerald Pointe. However, the piece of pipeline investment that was  
10 contributed to the City of Hollister is not owned by Emerald Pointe and was not distinguished  
11 as a regulatory liability in Case No. SR-2013-0016. As such, it is inappropriate to include this  
12 unamortized balance in rate base as MAWC does not have any ownership of that property,  
13 nor is MAWC responsible for maintaining that property.

14 **CITY OF ARNOLD/MSD AMORTIZATION AND RATE BASE TREATMENT**

15 Q. As part of this proceeding, has Staff reviewed MAWC's application for a  
16 certificate of convenience and necessity in Case No. SA-2015-0150, Staff's recommendation  
17 in that case and the Commission's *Order Approving Application of Convenience and*  
18 *Necessity* related to MAWC's acquisition of sewer assets from the City of Arnold?

19 A. Yes.

20 Q. Does Staff have anything that it would like to point out with regard to the  
21 information presented in that case?

22 A. Yes. It has come to Staff's attention in this case that the amount of the  
23 obligation MAWC indicated it would assume from the acquisition of the City of Arnold assets

1 was misstated. In the application that was filed by MAWC, it was stated that MAWC would  
2 assume \$8 million of debt as a result of acquiring the Arnold system. This amount was also  
3 reflected in Staff's recommendation in that case and referred to in the Commission's Order.  
4 However, based on discussions with MAWC, they have indicated to Staff that they didn't  
5 assume any actual loans with regard to the \$8 million of debt as a part of that transaction.  
6 The City of Arnold extinguished that debt with the proceeds that they received from MAWC.  
7 However, Staff would point out that MAWC has assumed responsibility for a Sewerage  
8 System Agreement and a subsequent addendum which is attached to this rebuttal testimony as  
9 Schedule LMF – r1 and LMF – r2. As part of that agreement MAWC must now pay for  
10 capital projects that were previously required by MSD. Staff learned the actual amount of  
11 "obligation" the MAWC assumed under the Sewerage System Agreement as part of its  
12 acquisition of the City of Arnold was actually approximately \$15.97 million.

13 Q. Please explain MAWC witness Wright's proposal to include an amortization of  
14 the cost of four capital projects over the depreciable life of the assets and to include in rates  
15 the unamortized portion of the project costs in rate base that will be actually paid for by  
16 MAWC prior to the proposed amortization tied to the depreciable life of the projects that are a  
17 result of capital improvements that the MSD required the City of Arnold to fund prior to  
18 MAWC's acquisition of that system.

19 A. The Commission granted MAWC a certificate of convenience and necessity  
20 for the City of Arnold sewer system on April 24, 2015. The actual transfer of this property  
21 occurred on May 22, 2015. As part of that acquisition, MAWC entered into an asset  
22 purchase agreement for approximately \$13 million and the assumption of an approximately  
23 \$15.97 million obligation by the City of Arnold to MSD under the aforementioned

1 Sewerage System Agreement. MAWC owns and maintains Arnold's sewer collection  
2 facilities but MSD treats the wastewater under that agreement assumed by MAWC.  
3 The original agreement between MSD and City of Arnold was established in 1982; however,  
4 this contract has been updated for the project described below and superseded by a new  
5 agreement that replaced the original in 2008. Then an addendum was written in 2015  
6 delineating that MAWC assumed all contract obligations that were once the responsibility of  
7 the City of Arnold. \*\* \_\_\_\_\_  
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15 This \$15.97 million obligation relates to a wastewater treatment plant and pipeline that was  
16 necessary for MSD to install in order to treat the wastewater capacity from the City of Arnold.  
17 When MAWC acquired the City of Arnold Sewer, it assumed the obligation owed to MSD  
18 related to this item.

19 Q. What does the \$15.97 million obligation relate to?

20 A. There are three parts to the project mentioned above, where each part has a set  
21 interest rate; I will refer to the parts as "Phase 1", "Additional Phase 1", and "Disinfection".

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. \*\* The City of Arnold began payments on the obligation and when MAWC acquired the sewer assets, the balance of that obligation was approximately \$15.97 million.

Q. How does MAWC propose to treat the assets, payments, and interest expense associated with the MSD assets for regulatory purposes?

A. The Company has not capitalized the assets of MSD as the Company contributed 9% of the cost of the wastewater treatment/pipeline facilities and does not own those assets. The Company recorded the principal payments and interest for these sewer plant assets as a Regulatory Asset to be amortized over 42 years (i.e. the depreciable life of the assets). MAWC also proposes to include the unamortized balance of this obligation and interest as a rate base item that would earn a return until fully amortized. This proposed treatment of the unamortized balance is similar to the Emerald Pointe treatment discussed above.

Q. Does Staff agree with the regulatory treatment proposed by MAWC for the assets, principal and interest payments?

A. Staff agrees that the sewer treatment assets are not plant assets of MAWC and as such would not be included in Company rate base because they are assets contributed to MSD. However, Staff does not agree with the rate base treatment of the principal and interest that will not be recovered in rates subsequent to when the actual obligation would be paid in full as proposed by Company. First, Staff maintains that the life of the principal obligation and the amount of interest payments should be based on the contract terms that MAWC

1 assumed as part of the acquisition of the City of Arnold. Those contract terms specifically  
2 state that:

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17 MAWC calculates the life of the principal and interest payments based on the depreciable life  
18 of the assets, rather than the contract terms. Second, Staff also maintains that it is  
19 inappropriate to include the unamortized balance in rate base as MAWC does not own any of  
20 the assets; it will fully recover all costs of the obligation and interest in the amortization costs  
21 Staff plans to include in its cost of service; and MAWC has not made any upfront investment  
22 in these items. MAWC is drawing out the principal obligation longer than the terms of the  
23 contract claiming that this will lower the cost to customers in rates; however, MAWC also  
24 wants to include an unamortized balance in rate base that would receive a return over the life  
25 of the obligation, essentially recovering more costs than what the actual principal and interest  
26 payments would be at regular contract terms.

27           Q.     Why does MAWC assert it is appropriate to include the unamortized balance  
28 in rate base?

29           A.     MAWC maintains that the treatment afforded them in the Emerald Pointe Case  
30 applies here. Staff maintains it is clear in both the Emerald Pointe and Arnold cases that

Rebuttal Testimony of  
Lisa M. Ferguson

1 MAWC may have paid or is paying for the systems, but did not put forth any initial capital  
2 investments for these projects nor does MAWC own the assets. Staff maintains that the rate  
3 base treatment afforded Emerald Pointe in that previous informal rate case was made in error  
4 and Staff reserves the right to correct that error going forward. Certainly, in any event, an  
5 error made by Staff in one proceeding should not be considered as somehow “binding” in  
6 subsequent and different proceedings.

7 Q. Does this conclude your rebuttal testimony?

8 A. Yes, it does.

**BEFORE THE PUBLIC SERVICE COMMISSION**

**OF THE STATE OF MISSOURI**


In the Matter of Missouri-American Water )  
Company's Request for Authority to Implement ) Case No. WR-2015-0301  
a General Rate Increase for Water and Sewer )  
Service Provided in Missouri Service Areas )

**AFFIDAVIT OF LISA M. FERGUSON**

STATE OF MISSOURI )  
 ) ss.  
COUNTY OF COLE )

**COMES NOW LISA M. FERGUSON** and on her oath declares that she is of sound mind and lawful age; that she contributed to the foregoing REBUTTAL TESTIMONY; and that the same is true and correct according to her best knowledge and belief.

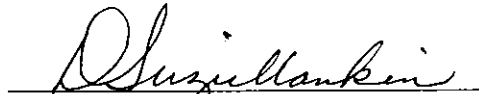
Further the Affiant sayeth not.

  
**LISA M. FERGUSON**

**JURAT**

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 10<sup>th</sup> day of February, 2016.

D. SUZIE MANKIN  
Notary Public - Notary Seal  
State of Missouri  
Commissioned for Cole County  
My Commission Expires: December 12, 2016  
Commission Number: 12412070

  
Notary Public

**SCHEDULE LMF-r1 AND**

**SCHEDULE LMF-r2**

**HAVE BEEN DEEMED**

**HIGHLY CONFIDENTIAL**

**IN THEIR ENTIRETY**