

Exhibit No.:
Issues: *Acquisitions and
Development of Cost
of Service*
Witness: *Paul R. Harrison*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Surrebuttal Testimony*
Case No.: *WA-2012-0066*
Date Testimony Prepared: *June 5, 2012*

MISSOURI PUBLIC SERVICE COMMISSION

REGULATORY REVIEW DIVISION

UTILITY SERVICES

SURREBUTTAL TESTIMONY

OF

PAUL R. HARRISON

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WA-2012-0066

Jefferson City, Missouri
June 2012

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PAUL R. HARRISON
MISSOURI-AMERICAN WATER COMPANY
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1 **SURREBUTTAL TESTIMONY**

2 **OF**

3 **PAUL R. HARRISON**

4 **MISSOURI-AMERICAN WATER COMPANY**

5 **CASE NO. WA-2012-0066**

6 Q. Please state your name and business address.

7 A. Paul R. Harrison, P. O. Box 360, Jefferson City, Missouri 65102.

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

9 A. I am a Regulatory Auditor with the Missouri Public Service Commission
10 (Commission).

11 Q. Are you the same Paul R. Harrison who contributed to the Commission Staff's
12 (Staff) Recommendation and Rebuttal Testimony for this case?

13 A. Yes, I am. I participated in the preparation of Staff's Recommendation that
14 was filed on January 6, 2012. I also filed Rebuttal Testimony in this case on May 11, 2012.

15 Q. What is the purpose of your Surrebuttal Testimony?

16 A. The purpose of this testimony is to respond to the Office of the Public
17 Counsel's (Public Counsel or OPC) witness Ted Robertson's Rebuttal Testimony concerning
18 Missouri-American Water Company's (MAWC or Company) acquisition of Saddlebrooke
19 Water and Sewer Infrastructure, LLC or Saddlebrooke West, Inc. properties (Saddlebrooke).
20 In addition, I will provide Staff's recommendation concerning the development of cost based
21 rates for Saddlebrooke's water and sewer customers, and respond to the Rebuttal Testimony
22 of MAWC's witness Dennis R. Williams concerning this issue.

1 **EXECUTIVE SUMMARY**

2 Q. In summary, what does your Surrebuttal Testimony cover?

3 A. This testimony will address the issues raised by Public Counsel and Company
4 witnesses in their Rebuttal Testimony.

5 The first issue concerns Public Counsel's witness Ted Robertson's proposal on page 8,
6 lines 4 through 6 that "When assets are acquired (or sold) at a discount, OPC contends the
7 purchase price should be used to established the rate base, rather than the net book value of
8 the acquired assets." Staff's recommendation, as explained in my Rebuttal Testimony, is that
9 the net book value of the acquired properties should be used in determining cost based rates in
10 this situation generally, and for this case, specifically. I will respond to Public Counsel's
11 additional concerns in this testimony as well.

12 I will also respond to MAWC's witness Dennis R. Williams' Rebuttal Testimony
13 concerning the development of cost of service for this case. MAWC has proposed that the
14 cost of service for Saddlebrooke should be determined or based upon the same cost of service
15 that is applicable to the subdivision of Stonebridge Village (formerly known as Roark Water
16 and Sewer Company). In other words, the Company wants the rates for Saddlebrooke to be
17 consolidated with the Stonebridge Village and to use the Stonebridge Village's Cost of
18 Service to determine water and sewer rates for this case. Staff disagrees with this position and
19 recommends stand-alone rates for Saddlebrooke based on its cost of service.

20 **MAWC'S ACQUISITIONS**

21 Q. What is an "acquisition adjustment"?

22 A. In traditional accounting, fixed assets, such as utility plant, are usually
23 recorded at original cost. Original cost as applied to utility plant means the cost of the

1 property to the utility when it first devotes the property to public service. An “acquisition
2 adjustment” results when utility property is purchased for an amount either in excess of or
3 below original cost. If the utility assets are purchased by another utility, the purchaser must
4 record the acquisition in the appropriate plant accounts at the selling utility’s original cost.
5 An “acquisition premium” results when a utility pays more than the net original cost for
6 another utility’s assets. An “acquisition discount” results when a utility pays less than the
7 net original cost for another utility’s assets. Any difference between the original cost and
8 the purchase price paid by the new owner is recorded as an acquisition adjustment in
9 Account 114, Utility Plant Acquisition Adjustments.

10 However, just because utilities record an acquisition adjustment on their books and
11 records does not mean that they should be allowed to recover this adjustment in their cost of
12 service. For ratemaking purposes, it is the sole discretion of this Commission in determining
13 just and reasonable rates to reflect or not reflect an acquisition adjustment in utility rates.

14 Q. Did Staff include an acquisition adjustment in Saddlebrooke’s Cost of Service?

15 A. No. Staff did not include an acquisition adjustment in Saddlebrooke’s Cost of
16 Service. In this particular case, MAWC paid less than the net original cost for Saddlebrooke’s
17 assets, resulting in an acquisition discount.

18 Q. Is Staff opposed to Public Counsel’s proposal to recognize an acquisition
19 discount for this case?

20 A. Yes. Staff has taken a consistent position over a very long period of time to
21 value acquired assets in rate base at net original cost to the initial owner of the assets, and has
22 consistently opposed efforts to recognize either acquisition premiums or acquisition discounts
23 in utility rate base.

1 Q. On Page 10, Lines 4 through 21 of his Rebuttal Testimony, Public Counsel
2 witness Robertson quotes the Second Report and Order from Case No. EM-2000-0292
3 in which the Commission denied ratemaking treatment for an acquisition adjustment. Does
4 Staff agree with the Commission's decision in this case for the traditional treatment of net
5 original cost standard when considering the ratemaking treatment of acquisition adjustments?

6 A. Yes. Staff asserts that it is appropriate to use net original cost for valuation of
7 plant in service in rate base and using net book value provides the most objective value for
8 cost based regulation and does not penalize or benefit the purchasing company or the
9 ratepayer in any single case. Public Counsel contends the purchase price should be used to
10 establish the rate base in an acquisition discount situation, rather than the net book value of
11 the acquired assets. The use of either acquisition premiums or discounts leads to assets being
12 either over-valued or under-valued in rate base when determining a utilities cost of service to
13 provide service to ratepayers.

14 Q. At pages 11-12 of his Rebuttal Testimony, Public Counsel witness Robertson
15 argues that the Commission should change its policies toward rate recovery of acquisition
16 discounts as expressed in the Second Report and Order in Case No. EM-2000-0292. Does
17 Staff agree with Mr. Robertson's argument?

18 A. No, not at all. Mr. Robertson appears to be arguing that, by maintaining a rate
19 base valuation based upon net original cost in an acquisition discount situation, the
20 Commission's traditional policy against inclusion of acquisition adjustments in rates would
21 force utility ratepayers to absorb a "loss" when properties are sold for a price below their net
22 original cost. Staff disagrees. By maintaining net original cost ratemaking, the rate base
23 valuation of utility properties from a customer perspective will never change as a result of an

1 acquisition of assets by a new owner. Seen from that perspective, under the traditional
2 ratemaking approach used in this jurisdiction, utility customers will never have to pay higher
3 rates to cover the additional amount paid for utility assets by a new owner in an acquisition
4 premium situation, but also would not receive any benefit when a utility sells its assets to a
5 new owner at a loss. New owners should be responsible for both paying the “gains”
6 associated with purchase prices greater than the original cost of the assets and, conversely,
7 receive the benefits associated with “losses” when purchasing assets at less than their net
8 original cost. In this manner, utility customers are effectively shielded from the risk that new
9 utility owners will choose to purchase assets at a different value from what has been
10 previously reflected in rates. The acquisition adjustment policy described in the Second
11 Report and Order in Case No. EM-2000-0292 is fair, equitable and symmetrical to both
12 utility shareholders and ratepayers, and should be maintained by this Commission.

13 Q. In future cases, if the Commission should decide that acquisition adjustments
14 are to be included in ratemaking, is it possible that that there may be a need for the
15 Commission to determine if the price paid by the acquiring utility is appropriate?

16 A. Yes, if the Commission were to adopt a position of including acquisition
17 adjustments in rates this may place the burden of determining the appropriate purchase
18 price on the Commission. Such a determination would be inherently very subjective. By
19 maintaining the current position of not allowing acquisition adjustments in rates, the
20 Commission can avoid making a determination that the utility property was acquired at the
21 lowest possible or otherwise appropriate price.

22 Q. At pages 14-15 of his Rebuttal Testimony, Public Counsel witness Robertson
23 alleges that valuation of Saddlebrooke’s rate base using MAWC’s purchase price would be

1 more accurate (“known and measurable”) than the Staff’s recommendation to use estimated
2 net original cost of assets for purposes of valuing rate base. Do you agree with this
3 allegation?

4 A. No, as previously discussed in my Rebuttal Testimony and the Rebuttal
5 Testimony of Staff witness James Merciel, it is not at all uncommon for the Commission to
6 accept use of estimated rate base and expense values for utility properties for ratemaking
7 purposes when they first are placed under cost of service regulation. In this instance, if the
8 Commission maintains its traditional practice of valuing utility rate base at net original cost,
9 Staff asserts its recommended rate base valuation, even using some estimated data, is a much
10 more accurate determination of the net original cost of Saddlebrooke’s assets than the
11 purchase price of those assets by MAWC, which has no relationship at all to the net original
12 cost of Saddlebrooke assets.

13 **DEVELOPMENT OF COST OF SERVICE FOR SADDLEBROOKE**

14 Q. What is Staff’s position for the development of its Cost of Service for the
15 Saddlebrooke water and sewer systems?

16 A. Staff developed the Cost of Service for Saddlebrooke water and sewer system
17 based upon it being a stand-alone-company operation. Staff has reviewed MAWC’s
18 Application, supporting documents, and other available information during its investigation.
19 Staff was unable to obtain complete records for the original construction of the utility systems
20 and recent operations expenses from the Developer’s Companies because the records do not
21 exist. Despite the unavailability of these records, Staff was able to determine a reasonable
22 approximation of plant in service and expenses by using information that was available,
23 documentation of the developer’s activities, and estimates of the cost of existing plant.

1 Staff witness James Merciel of the Water and Sewer Unit provided supporting Rebuttal
2 Testimony on the Staff's calculation of estimated net plant values, as well as calculation of
3 some estimated expense values for this case.

4 Q. On Page 3, Lines 1 through 26 and Page 10, Lines 1 through 5, Company
5 witness, Mr. Williams states the following Question and Answer:

6 **Q. WHY DID THE COMPANY PROPOSE USE OF**
7 **EXISTING TARIFFED RATES RATHER THAN**
8 **DEVELOPING NEW RATES SPECIFIC TO**
9 **SADDLEBROOKE?**

10 A. The objective in establishing rates should be that they
11 are just and reasonable. In support of this objective, there
12 are a number of reasons why the Company made this
13 proposal:

14 1. As stated above, Saddlebrooke currently has no rates
15 in place that have been approved by this Commission, so
16 initial rates must be set. The location of the Saddlebrooke
17 subdivision is in the general proximity of Stonebridge. The
18 very same operating personnel that service Stonebridge
19 will also service Saddlebrooke. The same administrative
20 personnel will manage and service both subdivisions.
21 There are close similarities in the types of residences and
22 consumption patterns in the two subdivisions.

23 2. Saddlebrooke is a subdivision that currently has 79
24 residences and two Home Owner Association facilities
25 that receive both water and sewer service. It is not
26 appropriate to introduce the additional cost and confusion
27 of a new set of tariffs for 81 customers, when utilization of
28 existing tariffs would result in just and reasonable rates.

29 3. During the Company's most recent rate case, Case No.
30 WR-2011-0337, there was considerable effort that went
31 into the negotiation of a small system water tariff, which
32 has been dubbed by some as the "District 8" tariff.
33 Moreover, sewer rates were established so that the vast
34 majority of all residential sewer customers throughout the
35 state pay the same rate. Because Saddlebrooke has
36 similar characteristics, these rates should be a good
37 estimate for Saddlebrooke.

1 Do you agree with Mr. Williams that Saddlebrooke's water and sewer Cost of Service for this
2 case should be consolidated or determined by the Stonebridge service area Cost of Service?

3 A. No. Saddlebrooke's Cost of Service should be developed on a stand-alone-
4 basis. Saddlebrooke has its own rate structure and, as such, should have its own rates based
5 upon a cost of providing service to its ratepayers. Once this Saddlebrooke case is approved
6 by the Commission and the system has been operational under a regulated environment for at
7 least a year, then a Cost of Service based entirely on actual financial data can be performed to
8 determine rates in the next MAWC rate case. At that point, a discussion could occur
9 regarding whether the system should be consolidated with other districts.

10 Furthermore, financial data for Saddlebrooke was not taken into account in the last
11 MAWC rate case, Case No. WR-2011-0337. If it had been taken into account,
12 Saddlebrooke's inclusion in the rate calculation would have affected the amount of costs
13 spread to the other districts and its customers. Furthermore, Saddlebrooke's customers did
14 not have a voice nor were they represented in that MAWC rate case. It would be more
15 appropriate to deal with Saddlebrooke's Class Cost of Service issues in a rate case where the
16 entire Company's books and records are analyzed to determine the appropriate cost of service
17 that would be borne by its customers.

18 In a rate case, the process used to determine certain expense amounts, whether it be by
19 "district specific Cost of Service" or on a "consolidated basis Cost of Service," would affect
20 the amount of the expense that would be included in the Cost of Service. These types of
21 expenses would include corporate allocations for plant, revenues and expenses, bad debt,
22 regulatory expense, electricity costs, property taxes for different counties and depreciation
23 expense. Additionally, there would be an accounting mismatch for ratemaking purposes in

1 attempting to develop a cost of service for Saddlebrooke for one period (the twelve months
2 ended December 31, 2010) and Stonebridge Village from another period (the twelve months
3 ended December 31, 2011).

4 Maintaining this stand-alone system is important at least until MAWC files a
5 Company-wide rate increase to where all books and records can be audited. For all of these
6 reasons, Staff supports a stand-alone rate in this case.

7 Q. What is the revenue requirement impact difference between the Company's
8 and Staff's development of the Cost of Service for this case?

9 A. Staff's revenue requirement for this case is \$109,841 and MAWC's revenue
10 requirement as determined by adopting the Stonebridge service area is approximately
11 \$120,000, for a difference of \$10,159.

12 Q. Are there other issues that you would like to address?

13 A. Yes. On Page 5, Lines 26 through 31 and Page 6, Lines 1 and 2 Company
14 witness Mr. Williams states the following Question and Answer:

15 **Q. MR. JOHNSTONE STATES THAT AGP AND MOST**
16 **OTHER CUSTOMERS ARE SUBSIDIZING SMALL**
17 **UTILITY PROPERTIES THAT HAVE BEEN ACQUIRED**
18 **BY MAWC BY A TOTAL OF ROUGHLY" \$2.4**
19 **MILLION. DO YOU AGREE?**

20
21 A. No. In the Company's last rate case, there were various
22 positions regarding subsidization. Mr. Johnstone has selected
23 one position and stated that as fact, even though the rate case
24 was settled and no determination of subsidization was made.

25 Q. Do you agree that the customers of MAWC in the larger districts are
26 subsidizing the small utility properties that have been acquired by MAWC?

27 A. No. There has been no independent analysis performed that would
28 demonstrate that the small utilities are being subsidized by MAWC customers in the larger

1 districts. For that conclusion to be reached, an in-depth analysis needs to be performed to
2 determine the amount of corporate allocations that the small water and sewer districts are
3 receiving in relation to any perceived subsidization. Staff asserts that there is a benefit to
4 MAWC customers in the larger districts as a result of MAWC's corporate allocations being
5 spread over the small water and sewer districts. The small water and sewer portions of
6 allocations directly decrease the amount of corporate allocations that is being paid for by the
7 larger districts.

8 Q. Does this conclude your Surrebuttal Testimony?

9 A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri-American Water)
Company for a Certificate of Convenience and) Case No. WA-2012-0066
Necessity Authorizing it to Install, Own,)
Acquire, Construct, Operate, Control, Manage) Case No. SA-2012-0067
and Maintain Water and Sewer Systems in)
Christian and Taney Counties, Missouri)

AFFIDAVIT OF PAUL R. HARRISON

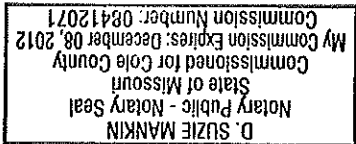
STATE OF MISSOURI)
)
COUNTY OF COLE) ss.

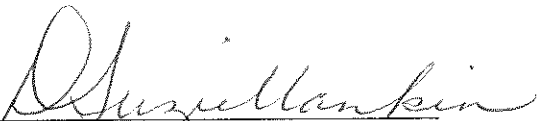
Paul R. Harrison, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Surrebuttal Testimony in question and answer form, consisting of 10 pages to be presented in the above case; that the answers in the foregoing Surrebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.



Paul R. Harrison

Subscribed and sworn to before me this 4th day of June, 2012.





Notary Public