

EXHIBIT

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Sponsoring Party: Public Counsel
Case No.: WR-2011-0337

REBUTTAL TESTIMONY

OF

TED ROBERTSON

Submitted on Behalf of the Office of the Public Counsel

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2011-0337

**

**

Denotes Highly Confidential information that has been redacted

January 19, 2012

NP

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**REBUTTAL TESTIMONY
OF
TED ROBERTSON**

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

9 I. INTRODUCTION

10 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

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

12
13 Q. ARE YOU THE SAME TED ROBERTSON THAT HAS PREVIOUSLY FILED
14 DIRECT TESTIMONY IN THIS CASE?

15 A. Yes.

16
17 II. PURPOSE OF TESTIMONY

18 Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

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

24
25 III. ACQUISITION/RATE BASE VALUATION

26 Q. WHAT IS THE ISSUE?

NP

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

6
7 Q. PLEASE EXPLAIN WHAT IS MEANT BY THE ACCOUNTING TERM
8 "ACQUISITION ADJUSTMENT."

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

21

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

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

8
9 Q. DID THE AQUA PURCHASE RESULT IN AN ACQUISITION ADJUSTMENT?

10 A. Yes. Based on my review of the information provided by MAWC, I believe that Aqua's
11 net book value was ** ** at the closing date of the transaction. This amount
12 does not include costs associated with **

13 ** identified in the response which I believe are not rate base items. Thus,
14 the transaction resulted not in an acquisition discount, which I discussed as possible in
15 Direct Testimony, but instead in an acquisition premium of **

16 **

17
18 Q. IS THE COMPANY REQUESTING A "RETURN ON" AND "RETURN OF" THE
19 PURCHASE PRICE OF THE LOMA LINDA AND AQUA ACQUISITIONS?

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

4
5 Q. IS THE COMPANY REQUESTING A "RETURN ON" AND "RETURN OF" THE
6 PURCHASE PRICE OF THE ROARK ACQUISITION?

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

10
11 Q. DOES PUBLIC COUNSEL BELIEVE THAT RECOVERY OF AN ACQUISITION
12 PREMIUM IS APPROPRIATE?

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

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

3
4 Q. WHAT IS THE HISTORICAL BACKGROUND FOR THE POSITION THAT
5 ACQUISITION PREMIUMS SHOULD NOT BE UTILIZED IN THE SETTING OF
6 RATES?

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

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

3
4 Q. DOES AN ACQUISITION PREMIUM PROVIDE ANY ADDITIONAL BENEFITS TO
5 MISSOURI RATEPAYERS?

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

11
12 Q. HAS THE MISSOURI PUBLIC SERVICE COMMISSION PREVIOUSLY DENIED
13 COMPANY RECOVERY OF AN ACQUISITION PREMIUM?

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

16
17 Missouri-American is proposing recovery of this acquisition adjustment in its
18 revenue requirement. Missouri-American is requesting that it be authorized
19 to amortize the acquisition adjustment over a 40-year period as well as
20 include the unamortized acquisition adjustment in its rate base. This has the
21 effect of increasing the Company's revenue requirement by \$692,513.
22 Missouri-American has stated four primary arguments in support of its
23 request. First, the Company has demonstrated that the acquisition has
24 already resulted in actual cost savings which more than offset the associated
25 revenue requirement of including the acquisition adjustment in cost of

1 service. Second, these (aforementioned) cost savings to ratepayers will
2 continue to increase over time. Third, ratepayers of Missouri-American
3 (including former ratepayers of MCWC) are receiving improved service as a
4 result of the acquisition. Fourth, public policy is best served by encouraging
5 mergers and acquisitions where cost savings or other benefits can be
6 demonstrated to accrue to ratepayers.
7

8 The commission finds in this case that the Company has failed to justify an
9 allowance for the acquisition adjustment.....Therefore, the Commission finds
10 that the original cost principle is sound for the purposes of this case. The
11 Commission finds that the original cost principle is sound for the purposes of
12 this case. The Commission finds it is appropriate that the excess purchase
13 costs over and above the net original cost of the Missouri Cities Water
14 company properties be booked to USOA Account 114 (Utility Plant
15 Acquisition Adjustment) and amortized below the line over 40 years to
16 USOA Account 425 (Miscellaneous Amortization).
17
18

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

21 A. Yes. I am not aware of the Missouri Public Service Commission ever granting rate recovery
22 of any acquisition adjustment. This policy has been consistent as far back as the
23 Commission ruling in Case No. 17,873:
24

25 Pursuant to orders of the Commission, Laclede Gas Company acquired St.
26 Charles Gas Corp. and Midwest Missouri Gas Company. As a result of
27 those acquisitions, Applicant suffered acquisition adjustments in the
28 amounts respectively of \$976,291 and \$12,229 for a total acquisition
29 adjustment of \$988,520.
30

31 Applicant is presently carrying this total acquisition adjustment in
32 Account No. 186, entitled Miscellaneous Deferred Debits, maintained in
33 accordance with the Uniform System of Accounts prescribed by this
34 Commission. Both Applicant and Staff agree that the amount should be

2 transferred to Account No. 114 of the Uniform System of Accounts,
3 entitled Gas Plant Acquisition Adjustment. The Commission finds this to
4 be a proper transfer.
5

6 Applicant proposes the Staff has recommended a forty-year period of
7 amortization of the Plant Acquisition Adjustment. The Commission finds
8 that forty years is a proper period for amortization of this Account.
9

10 The only contested request of Applicant is that the amortization be
11 charged against operating expenses by utilizing Account 406 of the
12 Uniform System of Accounts, entitled Amortization of Gas Plant
13 Acquisition Adjustments. It is Staff's recommendation that the
14 amortization of this acquisition adjustment not be treated as an operating
15 expense and that it should therefore be charged against Account No. 425
16 of the Uniform System of Accounts which is entitled, Miscellaneous
17 Amortization. The Commission finds that no showing has been made
18 which would justify the inclusion of the acquisition adjustment in question
19 in the operating expenses of the Company.
20

21 Conclusions

22 The Missouri Public Service Commission has arrived at the following
23 conclusions:
24

25 It is not adverse to the public interest to permit Applicant to transfer the
26 acquisition adjustments in question from Account 186 of the Uniform
27 System of Accounts to Account 114 of the Uniform System of Accounts
28 and to amortize over a forty-year period the amount of this adjustment.
29

30 It is adverse to the public to include the acquisition adjustment in question
31 in the operating expenses of the Company, thus requiring the ratepayer to
32 bear the cost of the adjustment over the period of amortization, therefore,
33 the acquisition adjustment in question should be charged against Account
34 425 of the Uniform System of Accounts, entitled Miscellaneous
35 Amortization.
36
37

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

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

8
9 The amount of any asserted acquisition premium (i.e., the amount of the
10 total purchase price above net book value), including transaction costs,
11 paid by Atmos for ANG properties incurred as a result of the acquisition
12 shall be treated below the line for ratemaking purposes in Missouri and
13 not recovered in rates. Atmos shall not seek either direct or indirect rate
14 recovery or recognition of the acquisition premium, including any and all
15 transaction costs (e.g., legal fees, consulting fees and accounting fees), in
16 any future ratemaking proceeding in Missouri.
17
18

19 And,

20
21 In addition, Atmos shall not seek to recover in Missouri the amount of any
22 asserted acquisition premium in this transaction as being a "stranded cost"
23 regardless of the terms of any legislation permitting the recovery of
24 stranded costs from Missouri ratepayers.
25
26

1 The Commission issued its Order Approving Stipulation and Agreement, Case No. GM-
2 2000-312, approving as a resolution all issues in the case on April 20, 2000, effective on
3 May 1, 2000.

4
5 Also, in the purchase of various GTE properties, Case No. TM-2000-182, the witness for
6 Spectra Communications Group LLC, Mr. Kenneth Matzdorf, stated that his Company
7 would not seek ratemaking recovery of the acquisition premium it expects to pay for the
8 GTE exchanges. On page 14 of his Direct Testimony, lines 10-17, he stated:

9
10 Q. How will any acquisition premium be handled in future rate filing?
11 (sic)

12
13 A. Spectra understands some parties' concerns that the purchase
14 premium should not be recognized in any rate filing. Spectra also
15 understands that the Commission has traditionally recognized
16 original historical costs in determining the rate base for the
17 calculation of revenue requirement. As a result, Spectra is willing
18 to commit that it will not seek recovery of any portion of the
19 acquisition premium in future rate filings.

20
21
22 Q. PLEASE CONTINUE.

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

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

3
4 In Union Electric Company, Case No. EM-96-149, UE agreed not to seek recovery of the
5 acquisition premium in rates. On page two of the Stipulation and Agreement signed in
6 Case No. EM-96-149 it states:

7
8 2. Merger Premium

9
10 UE shall not seek to recover the amount of any asserted merger premium
11 in rates in any Missouri proceeding. UE has identified this amount as
12 \$232 million.

13
14
15 In its application to acquire Arkansas Power & Light Company's Missouri properties,
16 Union Electric Company also agreed to not seek recovery of the acquisition premium in
17 any rate case in the future. The Stipulation and Agreement for Case No. EM-91-29
18 stated:

19
20 The amount of any acquisition premium (i.e., the amount of the purchase
21 price above net book value) paid by UE to APL for the electric properties
22 of APL shall be treated below the line for ratemaking purposes in
23 Missouri and shall not be sought to be recovered by UE in rates in any
24 Missouri proceeding, and the Joint Application should be considered as
25 amended in this regard.
26
27

1 While in Western Resources Inc., Case No. EM-97-515, the Company essentially agreed
2 to the same conditions and terms that UE had in the two cases discussed above:

3 Beginning on page one of the Stipulation and Agreement of Case No. EM-97-515 it
4 states:

5
6 2. Merger Premium
7

8 The amount of any asserted merger premium (i.e., the amount of the
9 purchase price above net book value) paid by Western Resources for
10 KCPL shall be treated below the line for ratemaking purposes in Missouri
11 and not recovered in rates. The Joint Applicants, including Westar, shall
12 not seek to recover the amount of any asserted acquisition premium
13 resulting from this transaction in rates in any Missouri proceeding and the
14 Joint Application shall be considered as amended in this regard. The Joint
15 Applicants have currently estimated this amount as approximately \$870
16 million. In addition, Westar shall not seek to recover in Missouri the
17 amount of any asserted acquisition premium in this transaction as being a
18 "stranded cost" regardless of the terms of any legislation permitting the
19 recovery of stranded costs from ratepayers.
20
21

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

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

3
4 Q. ARE YOU AWARE OF ANY ORDERS IN OTHER JURISDICTIONS WHERE
5 RECOVERY OF ACQUISITION ADJUSTMENTS HAVE BEEN DENIED?

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

10
11 In addition, Regulatory Condition 27 prohibits any acquisition premium
12 from being flowed through into PSNC's rates. While a number of other
13 states did not resolve the issue in the merger proceeding of the whether an
14 acquisition premium is recoverable or allowed it to be recovered to the
15 extent merger savings or other benefits could shown in later proceedings,
16 Regulatory Condition 27 resolves this issue in PSNC's ratepayers' favor by
17 excluding the acquisition adjustment from rates in any subsequent
18 proceeding.
19
20

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

24
25 And,

1
2 (26) All costs of the merger and all direct and indirect corporate cost
3 increases (including those that may be assigned to SCANA, a service
4 company or any affiliate), if any, attributable to the merger, will be
5 excluded from PSNC's utility accounts, and shall be treated for accounting
6 and ratemaking purposes so that they do not, affect PSNC's natural gas
7 rates and charges. For purposes of this condition, the term "corporate
8 costs increases" is defined as costs in excess of the level that the PSNC
9 would have incurred using prudent business judgment had the merger not
10 occurred.

11
12 (27) Any acquisition adjustment that results from the business
13 combination of SCANA and PSNC will be excluded from PSNC's utility
14 accounts and treated for accounting and ratemaking purposes so that it
15 does not affect PSNC's natural gas rates and charges. (Public Utilities
16 Reports - 198 PUR4th, pages 182-183)
17
18

19 Also, in Docket No. E, G-001/PA-96-184, the Minnesota Public Utilities Commission in
20 an Order approving the merger of Interstate Power Company with WPL Holdings, Inc.,
21 and IES Industries Inc., stated:
22

23 While requiring that the Company use the pooling method would preclude
24 recovery of an acquisition premium, the Commission notes that the
25 accounting method is governed by accounting standards and is not elective.
26

27 The Commission will therefore modify the Department's recommendation
28 as follows. The Commission will approve the merger upon the condition
29 that Interstate not seek recovery of any acquisition price over book value.
30 This preclude rate recovery of any acquisition premium, whether
31 considered as good will or as an acquisition adjustment. (Public Utilities
32 Reports, 177 PUR4th, pages 414-415)
33
34

1 And,

2
3 e. Interstate will not seek recovery of any acquisition price over
4 book value. This will preclude rate recovery of any acquisition
5 premium, whether considered as goodwill or as an acquisition
6 adjustment.
7

8
9 Q. DOES PUBLIC COUNSEL BELIEVE THAT RECOVERY OF AN ACQUISITION
10 DISCOUNT IS APPROPRIATE?

11 A. No. Except for possibly an extreme case such as a stronger utility acquiring a failing
12 utility (i.e., a utility lacking competent management and resources) Public Counsel
13 believes that a utility should not be allowed to recover the costs associated with an
14 acquisition based on the acquired utility's net book value when the purchase price is less.
15 My position is based on the belief that allowing the acquiring utility to recover the cost of
16 the assets based on their net book value would unfairly enrich shareholders because they
17 would earn a return on and return of an amount greater than that which they have actually
18 invested.
19

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

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

1 included a balance sheet which identified its total assets as ** **, and an
2 income statement which identified its operating revenues as ** ** with a net
3 margin of ** ** (the financial documents were provided in the acquisition
4 Application for Case No. WO-2011-0213/SO-2011-0214). In addition, I believe, and no
5 one has yet provided any evidence to dispute the fact, that the management of White
6 River was competent enough to operate the entities with which they were entrusted.
7 Furthermore, it is my understanding that the sole purpose for MAWC entering into the
8 acquisition was so that it could endeavor to increase its earnings capabilities.
9

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

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

1
2 Furthermore, in the Roark acquisition case, File No. WO-2011-0213, et al., the
3 Commission's Order Granting Applications To Transfer Assets, Approving Stipulation
4 And Agreement, And Granting Waiver, Dated April 27, 2011, approved a Unanimous
5 Stipulation And Agreement (attached as Appendix A to the Order). On page two of the
6 Unanimous Stipulation And Agreement it states:

- 7
8 3. MAWC shall be authorized to file revised tariff sheets in the
9 current Roark water and sewer tariffs containing new CIAC fees
10 totaling \$2,450 per customer applicable to the next 300 new
11 customers in Forest Lake subdivision, to expire twenty (20) years
12 after the effective date of the revised tariff sheets
13
14

15 Those CIAC fees per the Asset Purchase Agreement, **, provided in the
16 Company's Application, File No. WO-2011-0213, will be **

17 **. Thus, White River could
18 potentially collect an additional \$735,000 (i.e., 300 multiplied by \$2,450) to compensate
19 it for any loss incurred in the sale of the water and sewer assets to MAWC.

20
21 Recovery of the combination of tax benefits and CIAC fees have the potential to
22 significantly reduce the loss (i.e., acquisition discount) incurred from the sale by White
23 River. For example, assuming a combined Federal and State tax rate of 38%, the tax
24 benefit to White River would approximate ** ** (acquisition discount **

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

10
11 Q. DID MAWC INCUR ANY INVESTMENT COST FOR THE DIFFERENCE
12 BETWEEN THE NET BOOK VALUE OF THE ASSETS AND THE ACTUAL
13 (LOWER) PURCHASE PRICE?

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

16
17 Q. SHOULD MISSOURI RATEPAYERS BE REQUIRED TO PAY MAWC A RETURN
18 ON AND A RETURN OF AN INVESTMENT FOR WHICH IT HAS INCURRED
19 ZERO COST?

20 A. No.

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

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

8
9 Q. WHY DID THE COMMISSION REJECT THE PUBLIC COUNSEL'S POSITION IN
10 THE U. S. WATER CASE?

11 A. Public Counsel's position was that an acquisition discount existed and should be reflected
12 in the valuation of the assets acquired. The OPC position was premised on the fact that
13 the Company executed a noninterest bearing note as part of the purchase price. Since the
14 note was interest free, OPC believed that it should have been discounted to reflect the
15 time value of money thus, actually lowering the alleged purchase price of the utility.
16 **However, the Commission determined that the acquisition discount did not exist**
17 **because the principle of the loan would have been the same whether or not the**
18 **purchaser had financed the transaction with the noninterest bearing note or an**
19 **interest bearing note.** On page five of the Report And Order, Case No. WR-88-255, the
20 Commission stated:
21

1 The Commission determines that Public Counsel's recommendation is
2 unreasonable and should be rejected. There is no evidence that Company
3 could have bought the assets for less. The evidence supports a finding that
4 the principal of the loan would have been the same had Company been
5 unable to obtain an interest-free loan.
6
7

8 **The Commission did not recognize the acquisition discount associated with the**
9 **purchase, nor did it "write down" the value of the assets transferred, but it did not**
10 **do so because it determined that the acquisition discount did not exist. Whereas, in**
11 **the instant case, the acquisition discount is very much a reality that is not in dispute**
12 **as to existence.**
13

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

16 A. According to Generally Accepted Accounting Principals (GAAP), the Company made a
17 'bargain purchase' so it will report a gain in the amount of the acquisition discount.
18 Accounting Standards Codification (ASC) 805 Business Combinations, formerly
19 Financial Accounting Standard (FAS) 141-R, states:
20

21 Gain from Bargain Purchase

22
23 25-2 Occasionally, an acquirer will make a bargain purchase, which is a
24 business combination in which the amount in paragraph 805-30-30-1 (b)
25 exceeds the aggregate of the amounts specified in (a) in that paragraph. If
26 that excess remains after applying the requirements in paragraph 805-30-

1 25-4, the acquirer shall recognize the resulting gain in earnings on the
2 acquisition date. The gain shall be attributed to the acquirer.
3
4

5 Note: Paragraph 805-30-30-1 (b) is a reference to the net book value of the assets
6 acquired while item "(a)" is a reference to identification of the consideration transferred.
7 Paragraph 805-30-25-4 is a reference that the acquirer shall reassess whether it has
8 correctly identified all the assets and liabilities acquired.
9

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

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

20
21 Q. HOW HAVE GAINS AND LOSSES ON SALE OF UTILITY PROPERTY
22 NORMALLY BEEN TREATED FOR RATEMAKING PURPOSES?

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

4
5 The Commission's position on this issue is illustrated by its decision in Kansas City
6 Power & Light, Case No. ER-77-1 18. On page 42 of its Report and Order, the
7 Commission stated:

8
9 It is the Commission's position that ratepayers do not acquire any
10 right, title and interest to Company's property simply by paying
11 their electric bills. It should be pointed out that Company investors
12 finance Company while Company's ratepayers pay the cost of
13 financing and do not thereby acquire an ownership position.
14 Therefore, the Commission finds that the disposal of Company
15 property at a gain does not entitle its ratepayers to benefit from that
16 gain, nor does the disposal of Company property at a loss require
17 that Company's ratepayers absorb that loss.

18
19 (Emphasis added by OPC)

20
21
22 Furthermore, in decisions reached by the Commission in rate cases involving Missouri
23 Cities Water Company, Case No. WR-83-14, and Kansas City Power & Light, Case No.
24 EO-85-185, the Commission found that gains of utility property sold by those utilities
25 would be treated "below-the-line."

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

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

12
13 Q. WOULD DISALLOWANCE OF THE RECOVERY OF ANY ACQUISITION
14 ADJUSTMENT IN RATES CREATE A DISINCENTIVE FOR UTILITIES TO
15 ACQUIRE OTHER UTILITIES?

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

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

3
4 Q DO THE ACQUISITIONS REPRESENT AN ESSENTIAL INTEGRATION OF
5 FACILITIES PROGRAM DEVOTED TO SERVING THE PUBLIC BETTER?

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

14
15 However, I would argue that one of the major reasons for a utility acquiring another
16 utility would be to take advantage of the economies of scale (or synergies) that would be
17 created by the combination on the entire entity (purchaser and seller), not just the cost
18 reductions that may or may not occur in the operations of the utility being sold. Whether
19 the economies of scale are represented by employee costs saved, reduced operation &
20 maintenance expenses, lower fuel costs, lower plant costs or whatever savings

1 management can squeeze from the operations, the combined companies should have an
2 overall lower cost structure than that of the individual companies on a stand-alone basis.
3
4

5 IV. NORTH JEFFERSON CITY ASSETS

6 Q. WHAT IS THE ISSUE?

7 A. This issue is a subset of the acquisition/rate base valuation issue in that it recently came
8 to the Public Counsel's attention that these assets were purchased without Commission
9 authorization and at a purchase price that is less than the book value Company has
10 recorded in its financial records.
11

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

14 A. That is an issue I will not be addressing, but will instead leave to determination by legal
15 counsel. However, Company's response to OPC Data Request No. 1135 states:
16

17 **

21 **
22
23

1 I would only add that if the regulatory parties had not become aware of this issue in the
2 current case, it is probable that the Company would not have made it known to the
3 Commission that it is requesting to earn a return of and return of on the assets book value
4 even though the purchase price it paid for the assets acquired is significantly less.
5

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

7 A. Company's response to OPC Data Request No. 1135 provided a Bill of Sale 1135-R2
8 which identifies the original cost of the assets as ** **; whereas, Schedule
9 1135-R4 provided in the same response identifies the Accumulated Cost as **

10 ** with the difference being **

11 **

12
13 Q. WHAT WAS THE PURCHASE PRICE PAID BY COMPANY FOR THE ASSETS?

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

16
17 Q. IS IT PUBLIC COUNSEL'S POSITION THAT COMPANY SHOULD NOT BE
18 ALLOWED TO EARN A RETURN ON AND A RETURN OF THE BOOK VALUE OF
19 THE ASSETS ACQUIRED THAT EXCEEDS THE PURCHASE PRICE?

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

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

3
4 Q. IS PUBLIC COUNSEL AWARE OF ANY OTHER SIMILAR ACQUISITIONS
5 CONSUMMATED BY COMPANY WHEREIN IT DID NOT OBTAIN COMMISSION
6 AUTHORIZATION?

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

10
11 MAWC suspects that other such acquisitions of assets within the
12 Company's service territory (such as the acquisition from developers of
13 systems associated with new subdivisions) are likely to have occurred
14 since 1879. However, the Company records are not constructed in such a
15 way as to either confirm or dispute this supposition.
16
17

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

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

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

6
7 Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

8 A. Yes, it does.
9