EXHIBIT

Exhibit No.: OPC 3-NP
Issue(s): Acquisition Rate Base Valuation/ Metropolitan St. Louis Sewer District Agreement
Witness/Type of Exhibit: Robertson/Surrebuttal
Sponsoring Party: Public Counsel
Case No.: WR-2011-0337

SURREBUTTAL 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 and Proprietary information that has been redacted

OPC Exhibit No. 3-NP
Date 2-21-12 Reporter TL
File No. WR-2011-0337

February 2, 2012

NP

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri-American Water Company's Request for Authority to Implement a General Rate Increase for Water and Sewer Service Provided in Missouri Service Areas.	)))))	Case Nos. WR-2011-0337 SR-2011-0338

AFFIDAVIT OF TED ROBERTSON

STATE OF MISSOURI)
) **ss**
COUNTY OF COLE)

Ted Robertson, of lawful age and being first duly sworn, deposes and states:

1. My name is Ted Robertson. I am the Chief Public Utility Accountant for the Office of the Public Counsel.

2. Attached hereto and made a part hereof for all purposes is my surrebuttal testimony.

3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.

Ted Robertson, C.P.A.
Chief Public Utility Accountant

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

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

JERENE A. BUCKMAN
My Commission Expires
August 23, 2013
Cole County
Commission #09754037

Jerene A. Buckman
Notary Public

My Commission expires August 23, 2013.

TABLE OF CONTENTS

Testimony	Page
Introduction	1
Purpose of Testimony	1
Acquisition Rate Base Valuation	2
Metropolitan St. Louis Sewer District Agreement	12

SURREBUTTAL TESTIMONY
OF
TED ROBERTSON

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

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

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

Q. ARE YOU THE SAME TED ROBERTSON THAT HAS PREVIOUSLY FILED DIRECT AND REBUTTAL TESTIMONY IN THIS CASE?

A. Yes.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. The purpose of this Surrebuttal Testimony is to address the Rebuttal Testimonies of Missouri-American Water Company (MAWC or Company) witness, Mr. Dennis R. Williams, and Missouri Public Service Commission (MPSC) Staff witness, Mr. Paul R. Harrison, regarding the rate base valuation and ratemaking treatment of the Loma Linda Water Company (Loma Linda), Aqua Missouri, Inc./Aqua Development, Inc. & Aqua/RU Inc. (Aqua) and Roark Water and Sewer, Inc. (Roark) acquisitions. I will also address the Rebuttal Testimonies of Company witness, Mr. Dennis R. Williams and

Metropolitan St. Louis Sewer District (MSD) witnesses, Ms. Janice M. Zimmerman and Mr. Keith D. Barber regarding the MSD Agreement.

III. ACQUISITION RATE BASE VALUATION

Q. DOES MR. WILLIAMS BELIEVE THAT COST RECOVERY FOR THE ACQUISITIONS SHOULD BE BASED ON THE SELLER'S BOOKED COST?

A. It would appear that he does. Beginning on page 15, line 2, of his Rebuttal Testimony, he states:

> Retaining rate base at net original cost as the result of an acquisition protects the customers and provides the Company an incentive to achieve as low a purchase price as possible. It is further equitable in that it balances the interest of the acquiring utility and its customers by applying the same fair treatment whether the acquisition is made at a premium or discount.

Q. DO YOU AGREE WITH MR. WILLIAMS'S RECIPROCITY POSITION?

A. No. The rationale for disallowing a purchaser recovery of an acquisition premium is based on the fact that the only thing that changed in the transaction was ownership. The plant and its usefulness did not change; therefore, ratepayers are to be protected from higher rates that would occur if the acquisition premium were incorporated into the development of rates. Furthermore, I believe that ratepayers should also be protected from paying higher rates when assets are sold for less than book value. The acquisition

discount results from the seller's decision to sell their assets at a loss; thus, since gains do not flow through to ratepayers neither should losses. Mr. Williams apparently believes that ratepayers should be required to pay MAWC for the seller's loss. That is not reciprocity; it is inappropriate recovery on and of an investment for which no cost was incurred.

Q. DID MR. WILLIAMS PROVIDE ANY SUPPORTING MATERIAL TO SUBSTANTIATE HIS BELIEF THAT RECIPROCITY IS THE "EQUITABLE" METHODOLOGY THAT SHOULD BE FOLLOWED WHEN DETERMINING RATEMAKING FOR ACQUISITION ADJUSTMENTS?

A. Yes. Beginning on page 13, line19, of his Rebuttal Testimony, Mr. Williams cites the Second Report and Order in Case No. EM-2000-292. The Order states, in part, "as a general rule" the net original cost rule was developed in order to protect ratepayers from having to pay higher rates simply because ownership of utility plant has changed, without any actual change in the usefulness of the plant. It also states, "But it also means that ratepayers do not receive lower rates through a decreased rate base when the utility receives a negative acquisition adjustment. Even if a company acquires an asset at a bargain price, it is allowed to put the asset into its rate base at its net original cost. Similarly, ratepayers do not share in the gains a utility may realize from selling assets at prices above their net original cost. Those gains flow only to the utility's shareholders."

Q. DO YOU BELIEVE THAT THE ORDER CITED ABOVE CORRECTLY EXPLAINS THE APPROPRIATE RATEMAKING FOR ACQUISITION DISCOUNTS?

A. No, I do not. The Order states that because the general rule is to disallow recovery of acquisition premiums; rate base should not be lowered to account for acquisition discounts. Yet, in the very last sentence quoted, the Order recognizes the long-held ratemaking concept that gains on assets sales do not flow through to ratepayers since they do not hold any ownership rights. If gains do not flow to ratepayers neither should losses. However, that is exactly what would occur if rate base were not reduced by the acquisition discount. The losses of the seller would be incorporated into the rate base of the buyer and the buyer would recover the losses incurred by the seller. That is nonsensical. The language in the Order has mismatched the appropriate ratemaking that should occur and should be treated as irrelevant with regard to ratemaking treatment of acquisition discounts.

Q. DID MR. WILLIAMS CITE ANY OTHER ORDERS TO SUPPORT HIS POSITION?

A. Yes. Beginning on page 14, line 28, of his Rebuttal Testimony, Mr. Williams cites page 17 of the Report and Order, Case No. GA-2007-0168. Case No. GA-2007-0168 was a request by Southern Missouri Natural Gas (SMNG) for a Certificate of Public Convenience and Necessity. It was not a general rate case. On page 17, the Commission is discussing a Staff condition that if the SMNG assets are sold or disposed at a value less than net original cost prior to the introduction of cost based rates the new owner will

reflect those assets on its books at its purchase price (ironically, Staff's position in the current case is the exact opposite of the Staff's position in the SMNG case).

The Commission did not approve the condition, nor did it make any ratemaking authorization in the case. In fact, on page 17 of the Report and Order, as cited by Mr. Williams, the Commission stated, "the Commission has stated that it will not require a company to write down its rate base when the assets are sold at less than book value." However, this language in the SMNG Report and Order is cited as being from the Commission Second Report and Order, Case No. EM-2000-292, previously discussed.

Q. IS THE ACQUISITION DISCOUNT LANGUAGE REFERENCED IN THE SMNG REPORT AND ORDER AN ACCURATE REPRESENTATION OF THE ACTUAL LANGUAGE IN THE CASE NO. EM-2000-292 SECOND REPORT AND ORDER?

A. No, it is not. Apparently, the Judge in the SMNG case chose to paraphrase the actual language (see my testimony above for the actual language as quoted by Mr. Williams from, page 5, of the Second Report and Order, Case No. EM-2000-292). In Case No. EM-2000-292, the Commission did not state, "the Commission has stated that it will not require a company to write down its rate base when the assets are sold at less than book value." It did discuss the reciprocity concept, but as I explained earlier, I believe that they confused the issue entirely.

Q. DOES MR. WILLIAMS EXPRESS HIS OPINION ON OPC'S RATIONALE FOR ITS POSITION ON THIS ISSUE?

A. Yes. On page 15, lines 17-18, of his Rebuttal Testimony, he states, "OPC simply appears to take a "heads the customer wins, tails the Company loses" approach to rate regulation."

Q. HAS MR. WILLIAMS ACCURATELY REPRESENTED OPC'S RATIONALE FOR THE POSITIONS IT HAS TAKEN?

A. No. Although his heads versus tails statement is somewhat comical, intermixed with a tinge of despair, it is nowhere accurate. OPC's rationale for the positions taken on this issue, succinctly stated, is that acquisition premiums should not be allowed rate base treatment to avoid charging ratepayers higher rates when the only thing that changed in an acquisition was ownership while rate base should be reduced by the amount of acquisition discounts to reflect that the seller of regulated utility assets owns both gains and losses and to prevent the buyer from unjust recovery of asset costs (investment) which it received free of charge. The Commission should accept the OPC's position because it is based on the actual facts surrounding the acquisitions and not some unsubstantiated and oft misconstrued concept of reciprocity which does not exist.

The Commission has often recognized that acquisition premiums should not be recovered from ratepayers while acquisition discounts are a rare occurrence which has not been, to my knowledge, an issue decided in any contested general rate case in the state of

Missouri. However, authoritative literature does exist which describes how acquisition discounts should be treated in the ratemaking process. In the ratemaking reference book, Hahne & Aliff, Accounting for Public Utilities (Matthew Bender), 4.04[2], p. 4-10, 4-11, it states:

> On occasion, a utility may purchase used plant at a price lower than the net book value in the hands of the selling utility, thus creating a negative acquisition adjustment. These transactions are generally accounted for by a debit to plant in service for the net original cost with a credit to the acquisition adjustment account for the deficiency. In these cases, a similar question arises regarding the handling of the credit acquisition adjustments for ratemaking purposes. The regulatory commissions and courts have varied in their opinions as to the appropriate treatment of these balances and have not necessarily followed the same reasoning as followed regarding ratemaking treatment for debit adjustments. In general, credit balances are used to reduce the rate base and are also amortized above-the-line (as a reduction of operating expenses) with what appears to be greater frequency than corresponding treatment for debit adjustments. However, the FERC currently treats a negative acquisition adjustment as a credit to accumulated depreciation.
>
> (Emphasis added by OPC.)

The Federal Energy Regulatory Commission credit methodology increases the accumulated depreciation balance which offsets plant in service and effectively reduces the net plant to the purchase price paid in the acquisition. Thus, OPC's rationale is based on sound ratemaking concepts and not the entertaining, but meritless, colloquialism provided by Mr. Williams.

Q. WHY HAS STAFF TAKEN THE POSITION TO NOT RECOGNIZE ACQUISITION PREMIUMS OR DISCOUNTS IN RATE BASE?

A. On page 4, line 3, of Mr. Harrison's Rebuttal Testimony, he states:

> Staff deems this position to be good practice.

Q. DOES MR. HARRISON PROVIDE ANY AUTHORITATIVE SOURCES, COMMISSION ORDERS OR ANY OTHER DOCUMENTATION TO SUBSTANTIATE THE MEANING OF THE TERM "GOOD PRACTICE" AND WHY IT IS THE BASIS FOR NOT RECOGNIZING ACQUISITION ADJUSTMENTS IN RATE BASE?

A. No authoritative sources, Commission orders or other documentation are included in his testimony; however, he does include testimony which mostly buttresses one of the reasons why acquisition premiums are not included in rate base. On page 4, lines 3-8, he states:

> The net original cost is the most objective and verifiable method to value rate base assets. Differences in the purchase price and net book value of utility assets often relate to expectations of future efficiencies or saving in the utility's operations caused by the new owners of the utility assets, but the existence and the amount of such efficiencies and savings are often very difficult or impossible to "prove up" in rate proceedings.

Q. DOES HIS TESTIMONY FURTHER EXPOUND ON WHY STAFF BELIEVES ACQUISITION DISCOUNTS SHOULD NOT BE RECOGNIZED IN RATE BASE?

A. No. It seems to me that Mr. Harrison believes if acquisition premiums are not recognized in rate base, reciprocity dictates that acquisition discounts should not either.

Q. SHOULD SOUND RATEMAKING BE BASED ON AN ILLOGICAL RECIPROCITY POSITION?

A. No. As I discussed in my Direct Testimony, the rationale for disallowance of acquisition premiums is well documented and supported by Commission decisions in prior cases. As such, the rationale for allowing recovery on and of an acquisition discount should be documented and supported too. Staff's apparent reliance on an ambiguous "best practice" and/or a simple illogical reciprocity belief does not address the actual accounting or ratemaking associated with acquisition discounts.

Q. SHOULD THE COMMISSION BASE ITS DECISION ON THE RATEMAKING OF AN ACQUISITION DISCOUNT ON THE FACTS ASSOCIATED WITH THE TRANSACTION ITSELF AND NOT SOME ILL-ADVISED RECIPROCITY BELIEF OR AMBIGUOUS "BEST PRACTICE?"

A. Yes, it should. The facts associated with the Roark acquisition identify that the transaction resulted in a substantial acquisition discount. That is, the assets were purchased far below book because the seller chose to take a loss on the sale (a loss which

should be reduced significantly via future tax benefits and CIAC fee recovery). Further, MAWC will not be harmed in any way if is it is not authorized recovery on and of the assets associated with the acquisition discount since it will in all likelihood be authorized recovery on and of its actual investment cost. The only party that stands to be harmed, at all, is the seller, but they, of their own accord, made the decision to take a loss on the sale. A loss which should not be inappropriately converted into a gain for MAWC. Even if MAWC is denied recovery on and of the assets associated with acquisition discount, it will benefit from the cost-free use of those revenue producing assets for their entire remaining life. In essence, if the Commission accepts the OPC's recommendation, both MAWC's shareholders and ratepayers benefit from the seller's decision to sell its property at a loss.

Q. ON PAGE 6, LINES 4-8, OF HIS REBUTTAL TESTIMONY, MR. HARRISON STATES THAT IF THE SELLERS OF THE UTILITIES HAD INSTEAD FILED RATE CASES, THE RATE BASE STAFF WOULD HAVE INCLUDED IS THE SAME AS THAT WHICH WAS INCLUDED FOR MAWC. IS THAT AN ACCURATE REPRESENTATION OF WHAT WOULD HAVE HAPPENED HAD THE SELLERS INSTEAD FILED RATE CASES?

A. Yes, most likely it is, but the question and answer are non sequitur as far as the instant case is concerned. The prior owners did not file rate cases; they instead voluntarily sold their assets for prices either higher or lower than their booked cost. On one hand Loma

Linda and Aqua received a gain on the asset sales and on the other Roark incurred a loss. To my knowledge, the Commission does not have the authority to dictate the purchase price associated with the transfers, but it does have the responsibility to determine the proper ratemaking of the associated assets. Thus, the ratemaking associated with the assets at issue should be based on the facts and evidence present in this case and not some hypothetical case which never existed.

Q. ON PAGE 6, LINES 9- 12, OF HIS REBUTTAL TESTIMONY, MR. HARRISON STATES THAT MAWC IS NOT REQUESTING RECOVERY OF THE ACQUISITION PREMIUM ASSOCIATED WITH THE LOMA LINDA ACQUISITION. IS HE CORRECT?

A. Not necessarily. Apparently, Mr. Harrison has not reviewed the Company's response to OPC Data Request No. 1126 and its later update. As I discussed in my Direct Testimony, page 9, the initial purchase price identified was ** **; whereas, Company workpaper Schedule CAS-3-LL shows a December 31, 2010 (just prior to the closing date) rate base of ** **. Based on those MAWC provided amounts the acquisition resulted in an acquisition discount and Company sought recovery on and of the higher booked cost rather than the purchase price.

Whereas, the update to OPC Data Request No. 1126 provided information that the final purchase price was ** ** and the actual rate base, at the closing date, was

NP

** ** which results in an acquisition premium being paid for the assets. To my knowledge, Company has provided no information whether it is continuing to seek recovery on and of the rate base identified in its workpapers, the actual updated rate base or the actual final purchase price. If Company ultimately identifies that it does not wish to seek recovery on and of the acquisition premium it incurred in the transaction, then the Loma Linda (and possibly the Aqua) portion of this issue will have been resolved; otherwise, it remains a contested issue.

IV. METROPOLITAN ST. LOUIS SEWER DISTRICT AGREEMENT

Q. DOES MR. WILLIAMS BELIEVE THAT THE CURRENT COMPENSATION METHODOLOGY BENEFITS RATEPAYERS?

A. Yes. On page 11, lines 30-33, of his Rebuttal Testimony, he states:

> Missouri-American Water provides billing data services to MSD at a flat fee. Revenue received is recorded above the line and therefore as long as it exceeds the marginal cost of providing the services benefits other customers in the St. Louis County district.

Q. WHY DOES PUBLIC COUNSEL DISAGREE WITH MR. WILLIAMS?

A. Public Counsel does not disagree entirely with the essence of Mr. Williams statement. The compensation provided by MSD appears to exceed the incremental cost of MAWC creating a methodology to produce the data to MSD (based on a 2007 analysis, but the

current incremental cost is actually unknown because MAWC has not updated the 2007 analysis even though its cost structure has changed as evidenced by the rate increases that have occurred since). MSD's payments also provide additional funding that goes towards meeting MAWC's total costs to create and provide the data. However, the issue is not whether all MAWC customers in the St. Louis district benefit from the agreement. The issue is whether MAWC customers who are not MSD customers are harmed by being forced to pay above cost rates for the creation and production of the data to MSD customers who are MAWC customers and whether the compensation provided represents a fair allocation of costs. Public Counsel believes that they are.

Q. PLEASE EXPLAIN YOU POSITION.

A. For illustration purposes (actual customer-related numbers and dollar amounts are described in my Direct Testimony), assume that the MAWC St. Louis district has 100 customers, the total cost to create and utilize the billing data is $100 and MSD does not require the information. Using those criteria the 100 MAWC customers would be responsible for compensating the Company for the entire $100 it incurs to create and utilize the billing data.

Now, assume 50 of those 100 customers are also MSD customers and MSD requires the billing data since it has decided not to develop its own systems to capture and create the information. Fairness would seem to dictate that MSD, a totally separate and unaffiliated

utility service, should be required to pay 50% of the $100 total so that MAWC customers would pay $50 and MSD customers would pay $50 (in reality the relevant MSD customers are also MAWC customers and they would end up paying a total of $75 out of the $100 (i.e., MSD specific $50 plus 50% of MAWC's $50)). However, since MAWC also requires the data for billing its customers that are MSD customers some of those costs should flow through MAWC rates.

To account for the fact that both MAWC and MSD require the data for the 50 customers who are MSD customers, 50% of the total $100 should be assigned to MAWC customers who are not MSD customers and the remaining $50 should be split evenly between MAWC and MSD. MAWC customers would be responsible for $75 (i.e., $50 plus ($50 multiplied 50%)). MSD's customers would be responsible for the remaining $25. The end result would be that MAWC customers that are also MSD customers would be responsible for $62.50 of the $100 for the two utility services they receive (i.e., $75 multiplied by 50% plus $25) - not the $75 a full 50%/50% assignment would yield. Whereas, MAWC customers who are not MSD customers would pay the remaining $37.50. If MSD pays anything less MAWC customers who are not MSD customers are harmed.

Q. PER THE AGREEMENT WITH MSD, DOES MAWC RETAIN THE RIGHT TO REQUEST COMPENSATION BASED ON ANY METHODOLOGY OTHER THAN INCREMENTAL COST?

A. ** **. On page 8, of the Water Usage Data Agreement between MAWC and MSD, it states:

**

**

Q. ON PAGE 12, LINES 29-30, OF MR. WILLIAMS'S REBUTTAL TESTIMONY, HE STATES, "THE RATE CAN BE CHANGED ONLY AFTER A FILING SEEKING TO AMEND THE CONTRACT IN CONJUNCTION WITH THE COMPANY'S NEXT RATE CASE." IS HIS TESTIMONY AN ACCURATE INTERPETATION OF THE AGREEMENT?

A. I do not believe that it is. On page 6, of the Water Usage Data Agreement, it states:

**

NP

**

(Emphasis added by OPC.)

Continuing on page 8, it states:

**

**

(Emphasis added by OPC.)

It seems to me, based on the above language, that either MAWC or MSD can void the Agreement if the Tariff is modified. Furthermore, Mr. Williams would have the Commission believe its authority to review and revise rates is limited in the current case; whereas, such limitation is not applicable to either MAWC and MSD. I believe his assessment to be inaccurate due to the fact that the Commission is the regulatory body in the state of Missouri authorized to set rates and tariffs for regulated utilities; a power which neither MAWC or MSD hold. If the Commission determines, in the current case, that the MSD Agreement should be modified, I believe that MAWC and MSD would have the right to either abide by its ruling or exit the Agreement.

NP

Q. REGARDING THE REBUTTAL TESTIMONIES OF THE MSD WITNESSES, MS. ZIMMERMAN AND MR. BARBER, WHAT IS THE PRIMARY BASIS FOR THEIR OPPOSITION TO THE OPC POSITION ON THIS ISSUE?

A. It appears to me that the fundamental concept they propose for opposing the OPC's position is as stated on page 3, lines 10-12, of Ms. Zimmerman's Rebuttal Testimony:

> MAWC would incur the cost of meter reading and other water billing data development costs regardless of whether or not MSD required the information for their separate billing activities.

And, as stated on page 8, lines 9-11, of Mr. Barber's Rebuttal Testimony:

> MSD should not be required to subsidize one-half of MAWC's own data collection efforts, which are necessary for MAWC's own billing purposes.

Q. IS PUBLIC COUNEL'S POSITION BASED ON A FULLY-DISTRIBUTED COST OF ALL MAWC COSTS INCURRED TO READ ST. LOUIS DISTRICT CUSTOMER'S METERS AND PROCESS READ DATA NECESSARY TO PREPARE BILLS?

A. No. it is not. The 2007 analysis Company had prepared identified that the total cost to develop the data was ** ** or ** ** per customer; whereas, the OPC's position is based on amounts identified in the analysis which are stated as excluding

NP

** **. If a fully-distributed cost, based on all costs incurred by MAWC, were calculated, the cost per customer to MSD would increase by more than double from what OPC has proposed.

Q. WHY HAS PUBLIC COUNSEL NOT PROPOSED TO ASSIGN A FULLY-DISTRIBUTED COST BASED ON ALL COSTS INCURRED BY MAWC TO PRODUCE THE DATA?

A. Public Counsel is cognizant that keeping the cost to MSD as low as possible provides an incentive for the entity to continue using the services it is provided. Thus, Public Counsel believes that the costs used in its proposal represent a reasonable middle ground to achieve that goal while ensuring that the pricing signal to MSD customers is not unreasonably understated.

Q. DOES PUBLIC COUNSEL BELIEVE THAT THE MSD AGREEMENT SHOULD BE UPDATED ON A REGULAR BASIS TO ACCOUNT FOR COST OF SERVICE CHANGES WITHIN THE MAWC OPERATIONS?

A. Yes. MAWC does not operate in a static environment. As evidenced by recent rate increases, MAWC's cost of service has increased significantly over the past several years. For several reasons, it is my expectation, that the Company's cost of service will continue to increase in future years (one of which is the high cost soon to be implemented Business

NP

Transformation Project). Yet, the compensation MSD provides MAWC for the services it is provided has not changed.

Q. WILL ANY OTHER PUBLIC COUNSEL WITNESS BE ADDRESSING THIS ISSUE?

A. Yes. Ms. Barbara Meisenheimer, OPC's Chief Economist, will address the specifics of the fully-distributed versus incremental cost pricing models in greater detail in her Surrebuttal Testimony.

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes, it does.