Exhibit No.:	________
Issue:	**Depreciation of Plant**
Witness:	**Woodie C. Smith**
Type of Exhibit:	**Surrebuttal Testimony**
Sponsoring Party:	**MO PSC Staff**
Case No.:	**WR-97-237** **SR-97-238**

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY OPERATIONS DIVISION

MISSOURI AMERICAN WATER COMPANY

CASE NOS. WR-97-237 & SR-97-238

FILED[3]

JAN 2 3 2004

Missouri Public Service Commission

SURREBUTTAL TESTIMONY

OF

WOODIE C. SMITH

Exhibit No. 120

Case No(s). WC-2003-0500

Date 12-22-03 Rptr RT

Jefferson City, Missouri
August 1997

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of Missouri-American Water Company's Tariff Designed to Increase Rates for Water Service Provided To Customers in the Missouri Service Area of the Company.	)))))	Case Nos. WR-97-237 SR-97-238

AFFIDAVIT OF WOODIE C. SMITH

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Woodie C. Smith, of lawful age, on his oath states: that he has participated in the preparation of the foregoing written testimony in question and answer form; consisting of 8 pages to be presented in this case; that the answers in the foregoing 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.

Woodie C. Smith

Woodie C. Smith

Subscribed and sworn to before me this 4th day of AUGUST, 1997.

Beverly S. Lehmen

Notary Public

My commission expires

BEVERLY S LEHMEN
NOTARY PUBLIC STATE OF MISSOURI
CALLAWAY COUNTY
MY COMMISSION EXP. MAR. 9,1998

SURREBUTTAL TESTIMONY

OF

WOODIE C. SMITH

MISSOURI- AMERICAN WATER COMPANY

CASE NOS. WR-97-237 & SR-97-238

Q. Please state your name and business address.

A. Woodie C. Smith, P.O.Box 360, Jefferson City, Missouri 65102.

Q. Are you the same Woodie C. Smith who caused to be filed direct testimony in these proceedings on behalf of the Staff of the Missouri Public Service Commission (Staff)?

A. Yes.

Q. What is the purpose of your present surrebuttal testimony?

A. I am filing this testimony in response to the rebuttal testimony of the Office of the Public Counsel (OPC) witnesses Mr. Ted Robertson and Mr. Barry Hall, Missouri American Water Company (MAWC) witness Mr. Thomas McKitrick, and Industrial Intervenors' witness Mr. Ernest Harwig regarding the Staff's recommendation for an amortization of the Company's unrecovered St. Joseph water plant investment.

Q. Please respond to the characterizations of the plant retirement dates used in your direct testimony as "tentative" and "speculative" by the rebuttal testimony of Mr. Hall and Mr. Harwig, and specifically their contention that the present water treatment facilities may not be retired in the year 2001.

A. Planning may be described as "speculative or tentative" because the projected event has not occurred. My direct testimony acknowledged this fact and stated the potential for delays in the Company's plans.

Q. How do you respond to the rebuttal testimony of Mr. Robertson and Mr. Harwig that no evidence was submitted in this docket to indicate that the present water treatment facilities will be retired in the year 2001?

A. I believe Staff witness Mr. Johansen addresses this in his surrebuttal testimony in detail, but I would like to note that this information was provided to Staff openly by the Company, and was clearly stated in my direct testimony.

Q. Mr. Robertson and Mr. Harwig state on page 5 and 2 respectively of their rebuttal testimony that to their knowledge the Company neither initiated nor proposed the increase in depreciation expense level. Do you agree with this opinion?

A. No. The direct testimony and depreciation study filed by the Company witness Mr. McKitrick specifically indicated the lifespan of Company Account No. 313, Lake, River & Other Intakes, as terminating in the year 2001 (Table 2, Average Service Life and Iowa Curve, TGM-Depreciation Study, pg.12). Additionally, the retirement date was further documented by a Depreciation Reserve and Accrual Summary schedule sheet for Account 313, Intake Structures, which specifies "Year of Final Retirement: 2001"(TGM-Depreciation Study, pg.18). Further evidence of the short remaining life was readily visible because the Company had proposed that the rate for Account 313, Lake, River & Other Intakes be increased from 3.11% to 14.08 %, generating an increase in the annual accrual of $142,396

(Table 3, Depreciation Accrual Rate Comparisons, TGM-Depreciation Study, pg.13). This information was apparently overlooked by both Mr. Robertson and Mr. Harwig.

Therefore, while the approaches are different, both Staff and MAWC proposed increases in depreciation expense using a 2001 retirement date for the St. Joseph plant.

DEPRECIATION RESERVE AMORTIZATION

Q. Why is the statement of Mr. Hall in his rebuttal testimony (page 5, lines 10-12) that "if and when any plant is retired "early" the Commission will be able to consider specifically what plant has been retired and how any undepreciated amount should be recovered" erroneous in your opinion?

A. My direct testimony attempted to identify the potential unrecovered investment for the Commission <u>before</u> the planned retirement date. The Commission will have an opportunity to evaluate this potential. If the amortization I proposed is approved, then collection of a portion of the unrecovered depreciation reserve will be from existing customers. A "wait and see" recovery of these costs will shift the burden to a generation of customers who receive <u>no benefits or service</u> from the retired plant. Mr. McKitrick also points out in his rebuttal testimony that "customers will be bearing the full costs of the new water treatment plant at the same time". Postponing this issue until the plant is actually retired will necessarily cause a generational inequity situation. Now is the time to begin recovery, not later.

Q. Do you agree with Mr. Hall's assertion in his rebuttal testimony (page 5, lines 7-10) that "it is not necessary for the Public Service Commission to ascertain such a probability to set just and reasonable rates, nor is it advisable to continuously readjust the expected retirement date as MAWC considers new plans or its plans are changed from time to time"?

A. No. Depreciation rates are reviewed and changes approved by the Commission from case to case. Considering the magnitude of the proposed project, I think the suggested wait and see process advocated by Mr. Hall to be wrong. While having 20-20 hindsight is a safe position from the witness' perspective, I believe the Commission should be provided the information to assess potential rate impacts when these can be identified.

Q. Do you agree with Mr. McKitrick's rebuttal testimony that over-recovery would not occur until the year 2007 if amortization is started and the St. Joseph treatment plant was not retired?

A. Yes.

Q. What reasons support your position that over-recovery will not occur when the St. Joseph plant is retired?

A. Staff's proposed amortization does not include cost of removal or salvage of the facilities in question. The future impact of these parameters will be better determined closer to the actual project construction and retirement dates. I also anticipate that several rate proceedings will take place between the year 2000 and 2007, at which time adjustments to the amortization could be made as necessary.

Q. Mr. Robertson quotes an American Institute of Certified Public Accountants (AICPA) definition of depreciation accounting, which includes the desire to distribute costs over the estimated useful life of the unit (rebuttal, page 3, lines 10-16). Do you agree with his subsequent statements that Staff's position results in "accelerated depreciation costs" (rebuttal, page 3, lines 20-page 4, line 2)?

A. Definitely not. Staff's position can only be considered accelerated if complete recovery comes before the end of the plant's useful life. Staff's position is recognition that under-recovery will occur at the projected plant retirement date and to recommend a method to fully recover the investment <u>six years after scheduled retirement</u>. This can hardly be construed as "accelerated depreciation expense" and demonstrates OPC's misunderstanding of the issue.

Q. What is the error of Mr. Robertson's statement in his rebuttal testimony that "$192,854 is the accelerated (non-depreciation rate related) annual depreciation expense" (rebuttal, page 4, line 19)?

A. Staff seeks full recovery of the original investment, which is a goal of depreciation accounting. For OPC to claim Staff's position is "non-depreciation related " further demonstrates his misunderstanding of the issue.

Q. What is the error of Mr. Robertson's comment in his rebuttal testimony that the Staff proposal is <u>accelerated depreciation expense unrelated to its current cost of service</u> (rebuttal, page 5, lines 12-13 and page 7, lines 15-17)?

A. Again, Mr. Robertson obviously does not understand that the depreciation expense proposed by the Staff is <u>not accelerated</u> and, because it is related directly to the recovery of existing plant investment, <u>is</u> related to the cost of service.

Q. Is Mr. Robertson's opinion erroneous when he responds that under-recovery of the current plant investment is not realistic (rebuttal, page 6, lines 13-15)?

A. Yes. At current rates of recovery, if the St. Joseph plant remains on the books, it will not become fully recovered until the year 2028. If the plant retires any time prior to this date, under-recovery is certain. Staff's position addresses this.

Q. Why is Mr. Robertson's assertion that if the Commission approves Staff's position it effectively is prejudging the prudence of MAWC's financing and construction proposals in its entirety (rebuttal, page 7, lines 19-page 8, line 10) misleading?

A. This argument skews the issue of recovery of the St. Joseph plant investment to something it is not. In setting depreciation rates on large structures, such as buildings, water plants, telephone switches, electric power plants and nuclear power plants, depreciation professionals and the Commission rely on forecasted retirement dates to determine average service lives. The same thing has been done here, but in a discreet fashion, so as to fully recover one plant over a reasonable period of time.

Taking OPC's argument to the extreme, if the depreciation professional can not use estimated retirement dates to set lives and depreciation rates for large items, such as water plants, using the lifespan method, then the tool for setting depreciation rates for such investments has been stripped away. And the recovery of such investments will not begin until the plant is actually retired and no longer used and useful. For depreciation to commence only when plant retirement is imminent or in progress defies OPC's own definition of depreciation.

Staff witness Mr. Dale Johansen has filed further surrebuttal testimony on the issue of the St. Joseph water treatment plant retirement.

Q. What is wrong with Mr. Robertson's statement that "the costs of its early retirement or premature retirement may be appropriately added to the total costs of the new project"(rebuttal, page 11, lines 11-13)?

A. This accounting treatment is not only inappropriate, it would be irresponsible. The St. Joseph plant investment has already been made by MAWC and Staff's recommendation reflects recovery of the difference between the original investment and recovery which has already taken place.

It would be extremely inappropriate for embedded investment costs to be added into new project costs. Not only would this be double booking of assets, such treatment will guarantee generational inequity if the Commission allowed this to occur, a point the OPC witness speaks in opposition to several times.

Q. Why is Mr. Robertson's assertion (rebuttal, page 14, lines 10-13) that Staff has not received data regarding planned retirement costs of the St. Joseph plant incorrect?

A. Staff <u>has</u> received that data by plant account and Staff relied upon that very data to calculate the amortization amounts OPC now contests.

Q. Mr. Smith, in your opinion does OPC understand your position on the continuance of existing depreciation rates coupled with the amortization for unrecovered St. Joseph plant investment?

A. No. Implicit in my recommendation to maintain existing depreciation rates is my recommendation to begin a 10 year amortization for the St. Joseph plant. I never intended for depreciation rates to remain frozen absent the proposed amortization and my testimony does not support Mr. Robertson's contentions (rebuttal, page 14, lines 20-page 15, line 2 and page 17, lines 3-11).

Q. Does this conclude your surrebuttal testimony?

A. Yes, it does.