Exhibit No. 42

MAWC – Exhibit 42
John M. Watkins
Direct Testimony
File No. WR-2022-0303

Exhibit No.:	
Issues:	Pension and OPEB Expense, Service Company, Insurance Other Than Group, Revenue Stabilization Mechanism
Witness:	John M. Watkins
Exhibit Type:	Direct
Sponsoring Party:	Missouri-American Water Company
Case No.:	WR-2022-0303 SR-2022-0304
Date:	July 1, 2022

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. WR-2022-0303
CASE NO. SR-2022-0304

DIRECT TESTIMONY

OF

JOHN M. WATKINS

ON BEHALF OF

MISSOURI-AMERICAN WATER COMPANY

AFFIDAVIT

I, John M. Watkins, under penalty of perjury, and pursuant to Section 509.030, RSMo, state that I am Senior Director Regulatory Services for American Water Works Service Company, that the accompanying testimony has been prepared by me or under my direction and supervision; that if inquiries were made as to the facts in said testimony, I would respond as therein set forth; and that the aforesaid testimony is true and correct to the best of my knowledge and belief.

John M. Watkins

July 1, 2022
Dated

DIRECT TESTIMONY
JOHN M. WATKINS
MISSOURI AMERICAN WATER COMPANY
CASE NO.: WR-2022-0303
CASE NO.: SR-2022-0304

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DIRECT TESTIMONY

JOHN M. WATKINS

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is John M. Watkins. My business address is 1 Water Street, Camden, NJ 08102.

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

A. I am employed by American Water Works Service Company (the "Service Company") as Senior Director Regulatory Services.

Q. Please summarize your educational background and business experience.

A. I am a graduate of Trenton State College with a Bachelor of Science Degree in Finance and minors in Mathematics and Economics. I received a Masters in Business Administration, with a concentration in Accounting, from Drexel University.

Q. What are your current employment responsibilities?

A. In my current position my duties consist of reviewing, preparing and assisting in regulatory filings and related activities for all of the regulated subsidiaries of American Water Works Company, Inc. ("American Water"). My responsibilities include the preparation of written testimony, exhibits and work papers in support of rate applications and other regulatory filings as well as responses to data requests for Missouri-American Water Company ("Missouri-American" or "the Company") and its regulated utility affiliates.

Q. Are you generally familiar with the operations, books and records of Missouri-American?

A. Yes.

Q. Have you previously testified before the Missouri Public Service Commission?

A. Yes. I have testified before the Missouri Public Service Commission (the "Commission") in Cases Nos. WR-2000-281, WR-2015-0301, WR-2017-0285 and WR-2020-0344. I have also testified before regulatory commissions in Connecticut (Case 99-08-32), Massachusetts (DTE 00-105), New Jersey (WR03070511, WR06030257, WR08010020, WR10020149, WR10040260 and WR-19121516), New York (Case 04-W-0577, Case 07-W-0508 and Case 11-W-0200), Illinois (Docket No 16-0093), Iowa (RPU-2016-002), Indiana (Cause No. 45032) and Virginia (PUR-2021-00255).

Q. What is the purpose of your direct testimony in this proceeding?

A. The purpose of my Direct Testimony is to support and explain the Company expense levels in several areas. I will discuss the level of expenses associated with pension, OPEBs, the Company's existing Pension and OPEB Tracker, Service Company, and Insurance Other than Group (IOTG). I will also discuss the mechanics of the proposed Revenue Stabilization Mechanism (RSM).

II. PENSION AND OPEB EXPENSE

Q. Please describe the adjustment to operating expenses related to pension expense.

A. Missouri-American provides a defined pension benefit to non-union employees hired before January 1, 2006, and to union employees hired before January 1, 2001. Pro forma pension expense for Missouri-American is comprised of two components. First, consistent with the Company's calculation of pension expense in its last base rate case, the Company calculated its pension expense claim in accordance with Financial Account Standards Board Accounting Standards Codification Topic 715 or "ASC 715" (formerly Statement of Financial Accounting Standards 87). The Company started with the report furnished by its actuary, Willis Tower Watson, that furnished pension costs for 2023 determined in accordance with ASC 715. From that report, the Company identified $2,604,655 of service costs and $582,699 of non-service costs. The service cost portion was reduced by the capitalization rate of 44.79% to determine the portion of service costs recorded as an expense. The non-service costs are all expensed. The net Pension expense is $2,020,818.

The second component of Missouri-American's pro forma pension expense is the amortization of the pension portion of the Company's Pension and OPEB Tracker (discussed further below). The total forecasted balance of the pension tracker at May 31, 2023 is a credit of $11,154,911. The Company is proposing a five-year amortization of the credit balance, which would reduce expense by $2,230,982 annually. Total pro forma pension expense is the sum of these components. For the forecasted twelve months ended May 31, 2023, the sum is a credit of $210,164 ($2,020,818 + ($2,230,982)). Please refer to Schedule CAS-13 for a summary of this adjustment.

Q. What is OPEB expense?

A. OPEB expenses are costs incurred to provide Other Post Employment Benefits.

Q. Please describe the adjustment to operating expenses related to OPEB expense.

A. Missouri-American provides OPEBs to non-union employees hired before January 1, 2002, and to union employees hired before January 1, 2006. Like Pension expense, pro forma OPEB expense for Missouri-American is comprised of two components. The first component of OPEB expense is based on the accrual cost recognized under ASC 715 (formerly Statement of Financial Accounting Standards 106), as projected by Willis Towers Watson for 2023. From that schedule, the Company identified $215,706 of service costs and ($3,324,771) of non-service costs. The service cost portion was reduced by the capitalization rate of 44.79% to determine the portion of service costs recorded as an expense. The non-service costs are all expensed. The net OPEB expense is ($3,205,672).

The second component of Missouri-American's pro forma OPEB expense is the amortization of the OPEB portion of the Company's Pension and OPEB Tracker. The total forecasted balance of the OPEB tracker at May 31, 2023 is a credit of $6,959,657. The Company is proposing a five-year amortization of the credit balance, which would reduce expense by $1,391,931 annually. Total pro forma OPEB expense is the sum of these two components, or a negative $4,597,604 (($3,205,672) + ($1,391,931)) for the twelve months ended May 31, 2023. Please refer to Schedule CAS-13 for a summary of this adjustment.

III. PENSION AND OPEB TRACKER

Q. Please explain the purpose of the Pension and OPEB Tracker and the method for calculating it?

A. As part of the Stipulation and Agreement in Case No. WR-2020-0344, the Company agreed to track actual pension and OPEB costs in comparison to the levels included in rates in the same manner as agreed by the parties in Case No WR-2011-0337. The purpose of the tracking mechanisms for pension and OPEB costs is to protect customers and the Company from the wide variations that can exist in expected costs. Pension and OPEB costs are largely dependent upon market conditions, which can, and have, experienced great volatility. Therefore, a base level of pension and OPEB expense has been established in the Company's rate proceeding and actual costs above or below that base level are recorded monthly as deferrals on the Company's books. Both excess recoveries and shortages can and have occurred. At the time of the next rate case, the cumulative excess or shortage is included in rate base and amortized. The current amortization period is five years.

The Pension and OPEB Tracker pro forma included in rate base in this case is based on a projected balance at May 31, 2023. The projected balance includes the amortization of the vintage deferrals, which were based on balances at December 31, 2020, and authorized to be amortized in the Company's last rate case (WR-2020-0344). The pro forma also includes the deferral of actual cost excesses or shortages from January 1, 2021 to December 31, 2022 as well as the projected deferral of cost excesses or shortages from January 1, 2023 to May 31, 2023. The projected cost deferrals for January 1, 2023 to May 31, 2023 are based on actuarial studies conducted annually by Willis Towers Watson and reduced by the amounts anticipated to be capitalized.

IV. SERVICE COMPANY

Q. What services does MAWC obtain from the Service Company?

A. The services provided by the Service Company include customer service, water quality testing, innovation and environmental stewardship, human resources, communications, information technology, finance, accounting, payroll, tax, legal, engineering, accounts payable, supply chain, and risk management services. The Service Company operates customer service centers that handle customer calls, billing, and collection activities for the Company and its regulated utility affiliates. The customer service centers respond to customer inquiries and correspondence, and process service order requests. In addition, the Service Company operates two Field Resource Coordination Centers responsible for tracking and dispatching service orders for our field representatives and distribution crews. The Service Company also operates the Central Laboratory, located in Belleville, Illinois—one of the most advanced water quality laboratories in the United States.

Q. How do Missouri-American's customers benefit from the services you described from Service Company?

A. The Service Company provides Missouri-American with access to highly trained professionals who possess expertise in various specialized areas, whose background, experience and training are focused on water utility operations and who work exclusively for American Water's subsidiaries. Furthermore, the size of the Service Company and the scope of its operations have enabled it to assemble a uniquely qualified group of professionals who, through the Service Company, have a platform for sharing their extensive knowledge, expertise, experience and best practices across the American Water system to the benefit of all of American Water's state-regulated utilities and their customers. The Company benefits from these services and expertise of the Service Company's personnel at cost. The Company also benefits from the size and breadth of American Water, which affords the Company increased purchasing power that it could not obtain on its own, and provides access to discounts on equipment and supplies needed for utility operations, including, for example, pipe, fittings, and water treatment chemicals. In this way, Missouri-American achieves costs savings that it could not obtain otherwise.

Q. How are Service Company expenses charged to Missouri-American?

A. The Service Company provides its services to MAWC at cost and issues monthly invoices. Service Company expenses are charged to the Company in two ways: 1) directly to the Company at 100% of the cost; or 2) a percentage allocation based on factors such as a per customer allocation across the American Water regulated subsidiaries. The Direct Testimony of Company witness Patrick Baryenbruch demonstrates the reasonableness of Service Company costs that are charged to the Company. The summary of this adjustment can be found on Schedule **CAS-13**.

Q. How were the Service Company expenses calculated?

A. The Company's proposed Service Company expense is reflected in CAS-13 which incorporates the annualization of Historical Test Year expenses as well as known and measurable changes through the May 31, 2023. For example, the Alton, Illinois service center is planned to close in July of 2022 when the building lease expires, and the savings associated with closing that facility are incorporated in the Service Company expense in this case.[1] Another example includes adjustments to the compensation and related expense portion of the Service Company expense. The Company made an adjustment to annualize the base pay increase effective March 7, 2022 at 3.15%, then the three-year average merit increase (based on 2020, 2021 and 2022) of 2.99% was applied to non-union employees for the discrete adjustment period through May 31, 2023. For union employees, the actual contract rate increases were applied to derive the pro forma compensation and related expense levels. Additionally, adjustments were made to eliminate severance expense, to normalize pension and OPEB costs to reflect the forecast for 2023, and to reflect the movement of employees between the Company and the Service Company. Additional adjustments were made for depreciation, interest associated with capital leases and travel expense. Lastly, the Company removed certain expenses or one-time costs from its requested pro forma expense, including but not limited to charitable contributions, donations, injuries and damages, and penalties.

[1] All employees that operate from the Alton facility will continue to work remotely or at another Company location while performing the same functions as they do today.

V. INSURANCE OTHER THAN GROUP (IOTG)

Q. Please describe how the Company's insurance other than group costs are determined.

A. Missouri-American incurs costs related to several types of insurance, including Auto Liability, General Liability, Worker's Compensation, and Property. These insurance costs are referred to as insurance other than group ("IOTG"). The Company's General Liability, Auto Liability and Workers Compensation premiums are based upon a combination of loss experience (50%) and exposure (50% estimated annual revenue and payroll). Exposure for Auto Liability uses estimated annual revenue, payroll and number of vehicles. The loss experience is based upon a 5-year average of historical loss experience. The 5-year average is used to smooth out losses to the extent that MAWC suffers an anomalous year of claims experience. This is consistent with the commercial insurance market underwriting practice.

Q. Please describe the IOTG pro forma adjustments to operating expenses.

A. The majority of the Company's IOTG premiums renew on January 1 of each year (Directors & Officers Liability insurance renews in May of each year, Crime, Employment, Fiduciary, Lawyers and Travel insurance renews in April each year). Development of the pro forma expense begins with adjustments to the 2022 base year, which remove certain credits and remove capitalized credits for certain insurance premiums not capitalized by other Company affiliates. The Company then leverages the annual premiums owed as of early 2022. The 2022 level of IOTG expense is adjusted to arrive at the annualized expense level for 2023. The 2023 expense is then adjusted to arrive at a forecast expense for the twelve months ending May 31, 2023. The pro forma capitalized labor percentage was multiplied by the new Worker's Compensation premium, to reduce the expense. Please also see Schedule **CAS-13** for the detailed calculation.

VI. REVENUE STABILIZATION MECHANISM (RSM)

Q. Please explain the Company's proposal to establish a Revenue Stabilization Mechanism ("RSM").

A. As explained in greater detail in the Direct Testimony of Company witness Charles Rea, the RSM is an accounting and ratemaking tool that is designed to align the Company's revenues going forward (i.e., beyond the conclusion of this proceeding) with the level of authorized revenue ultimately approved by the Commission.

Q. Please describe how the Company proposes to implement the RSM.

A. The Company is seeking Commission approval of Authorized Revenues and production costs in this proceeding. Once approved, the RSM would then compare the Authorized Revenues to actual billed revenues for the residential, commercial, other public authorities (OPA) customer classes and Sale for Resale, and defer/accrue the difference, less the applicable change in production costs, on a monthly basis. Industrial customers would be excluded from the RSM. Production costs would include power, chemicals, purchased water, and water waste disposal (a percentage of usage for Industrial customers would be removed). The annual amount of metered revenues and the annual amount of expenses for all production costs would be prorated to monthly amounts. The Company proposes that the proration be set using the Company's last two years of system delivery to obtain a reasonable monthly amount of Authorized Revenues and production costs. These monthly amounts would be reset in the next base rate case proceeding.

Q. Why does the RSM consider revenues net of production costs?

A. Production costs should be taken into account because they vary with sales volumes. Delivering more water costs more and delivering less water costs less. Netting production costs will ensure that both the Company and its customers are made whole; paying only those production costs associated with the actual amount of water delivered.

Q. Please describe the specific accounting treatment for the RSM.

A. Each month the Company would compare the actual metered revenues for the applicable customer classes to the Authorized Revenues for the applicable classes. The Company would also compare the actual production costs to the amount included in authorized rates for production costs associated with the applicable customer classes. If the actual revenues are less than the authorized revenues, the difference in the revenues less the production costs would be temporarily deferred to a regulatory asset. If the actual revenues are more than the authorized revenues, the difference in the revenues less the production costs would be temporarily deferred to a regulatory liability. The ending balance for each month would accrue interest at the Company's short-term borrowing rate.

Q. Please explain the RSM's reconciliation component.

A. Missouri-American proposes an annual reconciliation to occur at the end of each calendar year. The Company proposes to file the first reconciliation by January 30, subject to a 60-day review and approval period. The first filing will reconcile the revenues net of production costs, plus interest for the period when rates become effective through December 31, 2023. Each subsequent filing will be filed as described above but will reconcile the revenues for the entire preceding calendar year.

The Company proposes that any credit be issued as soon as administratively possible; the credit would be determined based on the number of customers at the time the credit is issued. A one-time credit that is equal to all customers would benefit the lower-usage customers at a greater percentage, rewarding customers who conserve water at a higher percentage than those that use more water. For example, in the 2012 RSM calculation (see Schedule JMW-1), the credit for 2012 would have been $11.2 million. Assuming the customer count for RSM customers is 464,979, then the one-time credit per customer would be $24.17 ($11,239,647/464,979). The Company is proposing that any surcharge be based on a volumetric amount and should be targeted to recover the shortfall within the current calendar year or from April 1 through December 31. An example of the surcharge would be the $4 million shortfall in 2019. Assuming the usage for the applicable customer classes from the rates effective date of June 1, 2021, was 462,045,772 hundred gallons. Prorating this amount to 9 months (April-December), results in an estimated usage of 370,529,292 hundred gallons. The surcharge would have been $0.0107 ($3,981,056/370,529,292) per hundred gallons for nine months.[2] Again, a volumetric surcharge would ensure that the lower-usage customers would continue to benefit from their conservation because the volumetric rate would be equal for the entire Company. Therefore, if a customer conserves water, he or she will save more money not only on the current bill, but also on any adjustment applied the following year. No matter what happens with sales, customers who use less water will pay less.

Q. How does the Company propose to treat customer growth through acquisitions?

A. In the event the Company experiences growth through acquisition, the Company proposes to exclude the acquisition revenue and production costs from the RSM until they can be recognized in the Company's next base rate case. The Company will track the revenues specific to the acquisition and exclude the revenues in any subsequent RSM filings until the acquisition is included in the Company's next base rate case and rolled into the RSM.

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[2] For an average residential customer using 6,000 gallons per month (60 hundred gallons), the monthly surcharge would be $0.64 (60 x $0.0107) per month or $5.76 ($0.64 x 9 months) per year in this example.

The Company will make adjustments to production costs by tracking the actual costs or estimating the costs in relation to any tuck-in acquisitions.

Q. Does the RSM eliminate the need to perform an accurate sales forecast?

A. No. The most accurate forecasts achievable should minimize, to the extent possible, the surcharge or credit under the RSM.

Q. How would declining use affect the calculation?

A. Declining usage lowers the actual water sales volume and therefore actual revenues. The RSM would account for any sales declines not reflected in the pro forma revenue forecast. If the Commission approves both the RSM and the declining usage adjustment, and the Company projects too great a decline in usage, the Company will credit the over-collection of the revenues to customers through the RSM.

Q. Could the RSM potentially result in both credits and surcharges to customers from year to year?

A. Yes, the RSM is symmetrical. Actual revenues can deviate from Authorized Revenues, because of inaccurate sales forecasts and weather. Other causes include improved water and energy efficiency, customer conservation, customer growth or attrition, and changing economic conditions.

Q. Have you provided additional information concerning the operation of the RSM?

A. Yes, the proposed water RSM Tariff is attached for convenience to my Direct Testimony as **<u>Schedule JMW-2</u>**.

Q. Does the proposed tariff include provisions for an annual true-up (Section 386.266.5(2))?

A. Yes. Please refer to the tariff page for RSM (or Schedule JMW-2), which describes the annual true-up.

Q. Does the RSM remedy any over- or under-collections (including interest at the utility's short-term borrowing rate) through subsequent rate adjustments or refunds?

A. Yes.

Q. How?

A. Please refer to the testimony above and to the tariff page for RSM (or Schedule JMW-2), which describes the calculation for the RSM including interest at the Company's short-term interest rate.

Q. Does this conclude your Direct Testimony?

A. Yes.

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Authorized Revenues (1)	$232,142,413	$237,054,075	$237,054,075	$237,054,075	$247,349,919	$258,553,015	$274,074,840	$281,650,968	$281,650,968	$299,556,421
Actual Revenues	243,652,841	229,023,141	227,138,052	218,000,520	233,128,505	259,688,901	286,326,807	276,050,243	284,651,761	296,546,416
Variance - Surcharge (Credit)	($11,510,428)	$8,030,934	$9,916,023	$19,053,555	$14,221,414	($1,135,886)	($12,251,967)	$5,600,725	($3,000,793)	$3,010,005

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Authorized Production Costs (1)	$20,004,431	$20,288,740	$20,288,740	$20,288,740	$20,018,222	$19,723,865	$19,800,483	$19,837,880	$19,837,880	$20,137,561
Actual Production Costs	20,275,212	19,050,403	19,792,061	20,132,948	20,542,707	20,418,118	21,558,886	18,218,210	19,941,615	20,918,189
Variance - Surcharge (Credit)	$270,781	($1,238,337)	($496,679)	($155,792)	$524,485	$694,253	$1,758,403	($1,619,669)	$103,736	$780,628

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenues net of Expenses Variance - Surcharge (Credit)	($11,239,647)	$6,792,597	$9,419,344	$18,897,763	$14,745,899	($441,634)	($10,493,563)	$3,981,056	($2,897,057)	$3,790,633

Note (1): Classes of customers include Residential, Commercial, OPA and Sale for Resale

FORM NO. 13 P.S.C MO NO. 13 Original Sheet No. RT 30.1

Missouri-American Water Company For All Missouri Service Areas
Name of Issuing Corporation Community, Town or City

Revenue Stabilization Mechanism (RSM)

AVAILABILITY – All residential (“domestic”), commercial, other public authority and sale for resale metered water customers.

SECTION A - DEFINITIONS

Actual Revenue (AR) shall mean the actual dollar amount of revenues billed to customers for the identified Service Classifications, excluding revenues arising from adjustments under this tariff and any other tariff, which were billed for the applicable Fiscal Year, excluding revenues from acquisitions approved by the Commission that have not yet been approved in a general rate case and any revenues collected under Rate I (Sheet RT 10) or Rate W (Sheets RT 11.1 and RT 11.2).

Actual Production Costs (APC) shall mean the actual dollar amount of power, chemicals, purchased water and waste disposal incurred by the Company in the Fiscal Year, excluding production costs from acquisitions approved by the Commission that have not yet been approved in a general rate case.

Effective Period shall mean the period for which the adjustments in Section B are to be billed to customers, and shall be the nine-month period April through December after the Filing Month.

Effective Period Usage (G) shall mean the number of 100 gallon units delivered to customers by the Company, including the number of 100 gallon units for the applicable Effective Period.

Filing Month shall mean the month in which an adjustment is determined by the Company and submitted to the Commission, on or before January 31.

Fiscal Year shall mean the Fiscal Year of the Company that ended as of the most recent December 31.

Interest (i) shall mean the Company short-term interest borrowing rate.

Previous Amortization Period shall mean the nine-month reconciliation amortization period that ended as of the most recent Fiscal Year.

Rate Case Revenue (RCR) shall mean the dollar amount of revenues reflected in the revenue requirements approved by the Commission for the applicable Service Classifications in the Company’s most recent general rate case. In a month or year in which new rates come into effect, the RCR shall be prorated based upon the number of days in the month or year under the old rates and the number of days in the month or year under the new rates.

* *Indicates new rate or text*
\+ *Indicates change*

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Issued By: Rich C. Svindland, President
727 Craig Road, St. Louis, MO 63141

FORM NO. 13 | P.S.C MO NO. 13 | Original Sheet No. RT 30.2

Missouri-American Water Company — For — All Missouri Service Areas
Name of Issuing Corporation — Community, Town or City

Revenue Stabilization Mechanism (RSM)

Rate Case Production Costs (RPC) shall mean the dollar amount of power, chemicals, purchased water and waste disposal expenses reflected in revenue requirements approved by the Commission in the Company's most recent general rate case. In a month or year in which new rates come into effect, the RPC shall be prorated based upon the number of days in the month or year under the old rates and the number of days in the month or year under the new rates.

Upcoming Amortization Period shall mean the nine-month reconciliation amortization period commencing on April 1 following the Fiscal Year.

SECTION B – DETERMINATION OF ADJUSTMENT

$$\frac{\big((\mathbf{RCR}-\mathbf{RPC})-(\mathbf{AR}-\mathbf{APC})\big)\mathbf{i}+\mathbf{RA}}{\mathbf{G}}$$

Where:

RCR represents the Rate Case Revenue for the Fiscal Year.
RPC represents the Rate Case Production Costs for the Fiscal Year.
AR represents the Actual Revenue for the Fiscal Year.
APC represents the Actual Production Costs for the Fiscal Year.
i represents the interest rate
G represents the Factor G for the Effective Period.
RA represents the dollar amount due the Company (+RA) or the customers (-RA) arising from adjustments under this tariff that were under-billed or over-billed in the prior Fiscal Year.

The adjustment components above shall be summed together for billing purposes. If either component of the adjustments computes to $0.0001 per 100 gallons or more, any fraction of $0.0001 in the computed per 100 Gallons adjustment amount shall be dropped if less than $0.00005 or, if $0.00005 or more, shall be rounded up to the next full $0.0001.

SECTION C – REPORTS AND RECONCILIATIONS

The Company shall file with the Commission on or before January 30 of each year, the RSM calculation and support for any annual adjustments to be effective under this tariff. The Commission Staff will have 60 days to review. The reconciliation amount will be surcharged from April1 through December 31 of each calendar year. Any credit will be issued as soon as administratively possible.

* *Indicates new rate or text*
\+ *Indicates change*

Date of Issue: July 1, 2022 — Effective Date: July 31, 2022

Issued By: Rich C. Svindland, President
727 Craig Road, St. Louis, MO 63141