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Witness: Eric W. Thornburg
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Sponsoring Party: Missouri-American Water Company

Case No.: WR-2003-0500
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**MISSOURI PUBLIC SERVICE COMMISSION**

**CASE NO. WR-2003-0500**

FILED

JAN 2 3 2004

Missouri Public Service Commission

**REBUTTAL TESTIMONY**

**OF**

**ERIC W. THORNBURG**

**ON BEHALF OF**

**MISSOURI-AMERICAN WATER COMPANY**

**JEFFERSON CITY, MISSOURI**

Exhibit No. 51
Date ________ Case No. WR-2003-0500
Reporter ________

REBUTTAL TESTIMONY
ERIC W. THORNBURG
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WR-2003-0500

EXHIBIT
MAWC 51

**BEFORE THE PUBLIC SERVICE COMMISSION**

**OF THE STATE OF MISSOURI**

| | | |
|---|---|---|
| In the Matter of the General Rate Increase for Water and Sewer Service provided by Missouri-American Water Company | ) ) ) | Case No. WR-2003-0500 |
| Staff of the Missouri Public Service Commission, Complainant, v. Missouri-American Water Company, Respondent | ) ) ) ) ) ) ) ) | Case No. WC-2004-0168 |

AFFIDAVIT OF ERIC W. THORNBURG

STATE OF MISSOURI )
) SS
COUNTY OF ST. LOUIS )

On this fourth day of November, 2003, before me appeared Eric W. Thornburg, to me personally known, and who being duly sworn upon his oath did state that the Rebuttal Testimony attached hereto consisting of 16 pages and 1 Schedules was prepared by him or under his direction and supervision, and that the answers to the questions posed therein are true to the best of his knowledge, information and belief.

DEBORAH S. HENDRIX
Notary Public-Notary Seal
STATE OF MISSOURI
St. Louis County
My Commission Expires: Aug. 11, 2007

Eric W. Thornburg

Subscribed and sworn to before me on this fourth day of November, 2003.

Deborah S. Hendrix
Notary

My commission expires 8/11/07.

## TABLE OF CONTENTS

## WITNESS INTRODUCTION

**Q. PLEASE STATE YOUR NAME AND ADDRESS, AND, BY WHOM YOU ARE EMPLOYED AND IN WHAT CAPACITY.**

A. My name is Eric W. Thornburg, and I am President of Missouri-American Water Company (Missouri-American or Company). My address is 535 North New Ballas Road, St. Louis, Missouri, 63141. A summary of my work experience, education and background is attached hereto as Schedule EWT-1.

## PURPOSE OF REBUTTAL TESTIMONY

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

A. I am responding to the Missouri Public Service Commission Staff's (Staff) recommendation that Missouri-American reduce its rates and revenues by approximately $20 million dollars annually and to voice the Company's serious and continuing concern over the Staff's positions taken in this proceeding. As I will explain in my testimony, those positions are extreme, and substantial repercussions will be inevitable if the Commission affirms the negative signals that Staff is clearly sending to the Company's leaders, to our employees, to our customers, and to the investment community. I am deeply troubled by the Staff's consistently aggressive posture toward the Company and by the Staff's unwarranted demand that the Company incur at least a $20 million rate reduction. Despite our best efforts regarding customer service improvements, enhanced capital investment, and cost savings initiatives, the Staff is adopting what is tantamount to a punitive stance on nearly every issue before this Commission. Consistent with this testimony, I will cite examples which, in my opinion, demonstrate that an alarming and potentially destabilizing message is being sent.

**Q. HOW WOULD YOU LIKE TO ADDRESS THESE CONCERNS?**

A. I will address the following subject areas:

- A brief discussion of the state of the water utility industry
- My personal experience with Commissions & their Staffs in other states
- How Missouri-American has tried to implement positive changes
- Examples of the Staff's negative response
- The Commission's apparent endorsement of the Staff's objectives and the message that is sent
- The inevitable reaction and the effect on Missouri
- The critical importance of the larger message that will be sent by this case.

## THE STATE OF THE WATER UTILITY INDUSTRY

**Q. FROM AN INFRASTRUCTURE DEVELOPMENT STANDPOINT, HOW DO YOU SEE THE STATE OF THE WATER INDUSTRY TODAY?**

A. This is a critical time for our industry. Water and wastewater utilities are highly capital intensive, particularly when compared with other regulated utilities, such as electric, gas, and telephone companies. While those industries provide essential services and clearly have their share of concerns, water is unique because it is ultimately ingested by our customers. In these times, this responsibility requires an extraordinary measure of caution and long term thinking. Most water utilities across our nation have addressed capital investments driven by the Safe Drinking Water Act and by additional security concerns resulting from the terrorist attacks of September 11, 2001. However, we also face a looming crisis posed by the aging underground infrastructure. In St. Louis County alone, Missouri-American has over 4,000 miles of buried pipelines, with over 1,000 miles installed prior to 1950. At the current rate, we will replace all of our pipe over a 400 year time horizon. That simply will not do. Obviously, that timeframe is unacceptable to Missouri-American, to our customers, and it should be similarly unacceptable to the Commission on a public policy basis. Unfortunately, Staff recommendations that say, in essence, "ignore the needs of the future for false economy today" cripple our ability to meet the challenges of the present. The cycle is lengthy not because the Company is uncommitted to addressing the problem. It is a matter of economics. The pipe we are replacing at $75 - $100 per foot today was likely put into service at a cost less than $5 per foot. And while this Commission has heard much about St. Louis County, the same issue faces all water systems, with few exceptions.

**Q. DO YOU FORESEE ANY OTHER CHALLENGES?**

A. Yes. I have to say that our industry is very fragmented. By that, I mean that we simply do not have the inherent continuity of an electric power grid or natural gas pipeline and distribution system that may take in several companies, so there is no prospect of "leaning" or relying on a larger system. According to the Missouri Department of Natural Resources (MoDNR), there are over 1,400 community water systems and 760 wastewater utilities in the state. Regardless of their size, all face capital attraction pressures in the face of large infrastructure requirements. That is the big picture, the reality if you will, of working in this industry. The ability to attract capital is even more constrained by the present condition of financial markets and the generally negative view of financial analysts with respect to the utility sector. Commercial lenders read utility commission decisions and factor those decisions into deciding who will – and who will not – get capital. Of course, we compete for those capital investment dollars with other utilities just as Missouri competes with other states for business. That is the reality of today's investment climate.

## EXPERIENCE WITH OTHER COMMISSION STAFFS

**Q. CAN YOU TELL US ABOUT YOUR EXPERIENCE WORKING WITH OTHER STATE COMMISSIONS AND THEIR STAFFS?**

A. Yes. For eleven years, I worked in Pennsylvania, and for seven, in Indiana, and I had the opportunity to develop good working relationships with the staffs of Pennsylvania Public Utility Commission, the Indiana Utility Regulatory Commission, and the Indiana Office of Utility Consumer Counselor. In both of these jurisdictions, it was clearly understood that our roles and the public trust did indeed require that we maintain a transparent and open working relationship. We honored and fully complied with each State's *ex parte* requirements, and yet we managed to forge a working relationship that encouraged and ultimately provided a stable and predictable framework for the companies to address the infrastructure needs of the communities we served. We understood that economic development was a public policy goal for both states, so we developed initiatives, acquired troubled utilities, and resolved some seemingly intractable problems in order that those states could achieve that goal. Although we recognize that there are limits as to what one utility can do, Missouri-American serves about 20% of our state's population. Our presence in Missouri would allow us to similarly assist this Commission to achieve the same successes we have experienced in other states. However, this requires that we work together to resolve reasonable differences in order to improve Missouri's standing as a place to invest capital and to relocate businesses. This would, of course, require that the Staff send a different message than the one that has been communicated through the Staff proposal in this case. In Pennsylvania and Indiana, extensive scrutiny and robust review of our company's actions occurred, were welcomed, and, on balance, we were treated fairly. We were not always satisfied with the outcomes of rate cases and promulgated regulations, but we typically could understand how those Commissions arrived at their conclusions and those conclusions were not so punitive that we could not adapt to them. The foundation for economic recovery and growth is found in a strong utility infrastructure.

## <u>HOW MISSOURI-AMERICAN HAS TRIED TO IMPLEMENT POSITIVE CHANGES</u>

**Q. WHAT IS THE COMPANY DOING DIFFERENTLY THAN ITS PREDECESSOR TO MEET PUBLIC POLICY GOALS, AND WHAT IS THE VALUE OF THOSE EFFORTS TO MISSOURI?**

A. It was no secret that the predecessor to the Company's largest district, St. Louis County Water Company (which was owned by Continental Water Company), was constrained in its ability to invest in Missouri. They were candid in testimony before the

Commission about their dissatisfaction with investment returns in Missouri, and they were concerned about the growing need for capital due to infrastructure deterioration. American Water Works Company, which purchased the Continental properties, has a philosophy of growth through acquisitions and economic development, and the implementation of synergies and efficiencies to reduce costs through economies of scale and the application of technology. Despite our predecessor's experience, it has been our goal to try to improve the investment climate so that we can offer customers and communities something in addition to safe, reliable water: i.e., the opportunity to encourage community growth. That was an expectation of utilities in Pennsylvania and Indiana, and we still hope to find that to be a public policy commitment of the Missouri Commission.

**Q. IS IT YOUR PERCEPTION THAT THE MISSOURI PSC STAFF'S POSITION IS COUNTER-PRODUCTIVE TO SUCH A PROGRESSIVE PUBLIC POLICY?**

A. Unfortunately, yes. It does not seem possible to come to any other conclusion given the response of the Staff to our rate case. I cannot reconcile a forward-looking strategic vision that demands an influx of cash and investor confidence with a recommendation that the Company suffer a massive scale-back in rates. Maintaining low rates is a worthy objective, however, this objective must be viewed in the context of balancing the long-term needs of the Company and its customers.

## <u>EXAMPLES OF STAFF'S NEGATIVE RESPONSE</u>

**Q. MR. THORNBURG, WHAT WAS YOUR INITIAL REACTION TO STAFF'S RECOMMENDATION THAT MISSOURI-AMERICAN REDUCE ITS EXISTING RATES AND REVENUES BY APPROXIMATELY $20 MILLION ANNUALLY?**

A. My initial reaction was that there must have been a mistake as such a result clearly made no sense. Everyone acknowledges that the water industry is an increasing cost industry.

As noted earlier, demands placed upon the industry to meet ever increasing quality of water standards, increased security measures and increased rates of infrastructure replacement would lead most people to believe that costs are increasing and not decreasing. Specifically, it has been approximately three years since Missouri-American's last rate case and during that period of time, it has expended over $146 million in order to improve, expand and replace its plant and related facilities. While Missouri-American has aggressively pursued efforts to contain and/or eliminate costs, the fact of the matter is that its cost of doing business has increased over the last three years. Given these facts, it was incomprehensible to me that the Staff could recommend that the Company should reduce its overall rates and revenues by approximately $20 million a year. This is simply not rationally justifiable and the only conclusion that I can reach is that Missouri-American is being punished or that the Staff views this case from the impossibly narrow standpoint of striving for continuous rate reductions. There is a point beyond which we simply cannot go, if we are to meet our obligations to provide safe and reliable water service.

**Q. IS IT YOUR OPINION THAT THE STAFF'S ANALYSIS AND RECOMMENDATION IN THIS CASE ARE UNUSUALLY NEGATIVE?**

A. Yes. On review, whether it be in the areas of rate of return, disallowing customer service improvement investments, laboratory expenses, pension expenses, depreciation expense, or any of thirty other issues, the Staff's extreme position goes beyond what I have witnessed in my twenty-one years in the industry in three states.

**Q. CAN YOU PROVIDE SOME EXAMPLES OF THESE UNWARRANTED STAFF POSITIONS?**

A. Certainly. There are numerous examples, but I will try to limit myself to those that have the most substantial impact upon the Company's revenue requirement. First, Staff's recommended return on equity is conspicuously inadequate by any reasonable standard, including the position of the Office of Public Counsel (Public Counsel). For example, Staff's midpoint recommended return on equity (after taking into account its consolidated capital structure adjustment) is 6.96%. When compared with Public Counsel's recommended midpoint ROE of 9.75%, I can only conclude that Staff is trying to punish this Company, as its recommendation is nearly three full percentage points below Public Counsel's recommendation.

Another example of Staff's extreme position is its recommendations regarding the Company's depreciation expense. Once again Staff has proposed a change in the way depreciation rates are set by eliminating an allowance for cost of removal (net of salvage), lengthening certain service lives and eliminating an existing depreciation reserve amortization. The net effect of Staff's proposed depreciation expense is to reduce Company's annual expense levels by approximately $12 million. Not only is this position untenable as it deviates from standard industry accepted practices, it is unreasonable when considered in light of the Company's need for additional infrastructure improvements and replacements. Staff's position essentially reduces Company's internally generated funds by approximately $12 million. The net result of which will be a reduction in capital spending or an increase in external capital funding (i.e., more debt and/or equity). Yet with a recommended return on equity of 6.96%, what rationale investor will invest equity dollars in this Company when it can invest those dollars elsewhere throughout the American System and earn a substantially greater return on equity.

Another example of Staff's extreme position is its disallowance of approximately $3.6 million in pension expense. The Company has for a number of years followed FAS 87 when computing its pension expense and the Staff and the Commission have followed that methodology in establishing rates in prior cases. Now, Staff recommends that the Commission change prior policy.

Perhaps the most egregious example is the position Staff has taken with respect to the Company's call center costs. Even though Staff was involved in the transition to the call center, and even though Staff concedes that customer service has been improved, the Staff makes a punitive adjustment with respect to operating costs, and it proposes to disallow all the transition costs, in the amount of $5.3 million, which are uncontested as to necessity, but are disallowed solely because they are "non-recurring."

**Q. ARE THE CALL CENTER TRANSITION COSTS IN FACT NONRECURRING?**

A. Only in the most technical sense. They are more appropriately described as transition costs. What is ignored in Staff's analysis are the implications of denying recovery of these costs (after so much Staff involvement) on the Company's willingness or ability to incur future transition costs? If a company knew it would be unable to recover any of these costs, why would any responsible manager <u>ever</u> undertake such a transition? How could a manager, who also has a fiduciary duty to the Company's stakeholders, undertake such a transition knowing that such costs will never be recovered? The irony is that the goal was never improved profits; it was improved customer service and efficiency. If the Staff could demonstrate that our plan was deficient, or the costs unnecessary, then I might reach a different conclusion. But Staff's recommendation is arbitrary: transition costs cannot be recovered. The clear message is that in Missouri, you will be punished for similar efforts, and that such efforts are therefore necessarily inadvisable. In the past, the Staff has always agreed that we have the right to recover transition costs for new water plants, tanks, wells, and meter reading systems, and so on. And now, here, we triple the hours we can interact with our customers, put into service equipment and technology that will allow the Staff to more closely monitor our performance, and while Staff is willing to accept the benefits, it does not allow us to recover the cost. This is a very troubling development.

**Q. ARE THERE OTHER EXAMPLES?**

A. Yes. Staff has proposed similar disallowances of cases incurred in other consolidation efforts involving laboratory costs and other shared services (i.e. accounting, finance). These consolidations were again undertaken by the Company in the pursuit of efficiency. As we transitioned from Jefferson City Water Works, St. Louis County

Water Company, and Missouri-American Water and their separate regimes of support services, we have returned those savings to the customers through our rate filings. In this case, Staff is proposing to disallow approximately $4.4 million of transition costs associated with our National Shared Services Center despite operating expense savings. Again, we have a case where the Staff is willing to accept the savings, but not willing to allow recovery of any of the costs that were reasonably incurred to generate those savings. There are also adjustments with respect to rate base that cannot be interpreted in any other way than discouragement of capital investment.

**Q. PLEASE CITE EXAMPLES.**

A. One example is the disallowance of part of the costs associated with the St. Joseph Treatment Plant under the pretext that it is "excess capacity." There is considerable testimony in this case and the previous case on this issue. We practiced sound engineering decision-making based on experience nationwide with numerous Environmental/Natural Resource Agencies and Public Utility Commissions and their standards. The sizing of the facility was proper, and the Staff's position is clearly arbitrary and not based on generally accepted engineering criterion. The position we are being placed in is untenable. If we are not to operate in accord with accepted engineering principles, how can our Company or any water company properly size a plant in Missouri? There must be a degree of confidence that the engineering and operational decisions we make will be the subject of reasoned review, not an arbitrary exercise in unjustified cost cutting.

**Q. COULD THE STAFF REQUEST BE VIEWED AS AN EFFORT TO PROTECT THE CUSTOMERS FROM HAVING TO PAY A RETURN ON INVESTMENT THAT COULD HAVE BEEN AVOIDED WITH DIFFERENT CONCLUSIONS IN PLANNING?**

A. No, unless you chose to completely disregard the evidence we have submitted. Evidence supports our assertion that the design was appropriate under the circumstances at the time. The evidence was not disbelieved by the Commission in its findings or conclusions. The Staff's adjustment in the last rate case appears to have been accepted out of apparent pragmatism.

**Q. ARE THERE OTHER RATE BASE ADJUSTMENTS THAT DISCOURAGE CAPITAL INVESTMENT?**

A. Yes. The Staff's disallowance of the Company's unrecovered (i.e., undepreciated) investment in its old St. Joseph Water Plant clearly sends a negative signal to investors. In the Company's last rate case, the Commission adopted Public Counsel's recommendation that the Company's undepreciated investment in its old St. Joseph Plant, of approximately $3.2 million, should be written-off as the old plant had been retired and was to be taken out of service. The irony behind this decision is that the reason the Company had undepreciated investment associated with this plant was a direct result of the inadequate depreciation rates the Commission had previously authorized. In fact, in the 1997 rate case for Missouri-American, the Staff specifically brought to the Commission's attention the fact that the old St. Joseph Plant would be coming out of service in approximately three years and that at the present rate of depreciation there would be a substantial amount of unrecovered investment. The Commission, however, in the 1997 rate case, chose to reject Staff's proposal for a special amortization of that anticipated unrecovered investment and continued on with the obviously inadequate depreciation rates. Then in 2000 when the old plant was retired and the unrecovered investment was realized (as predicted by Staff), the Commission decided to reject any recovery of this undepreciated amount and required the Company to write it off. On appeal, the Circuit Court of Cole County reversed the Commission's decision as unlawful and unreasonable. That case is now on remand before this Commission but, to date, no action has been taken. In this case, Staff takes the position that its hands are tied and the decision of the Commission in the Company's 2000 rate case must be followed, ignoring the fact that the Circuit Court has already reversed the Commission's decision. Clearly, this disallowance sends a negative message to investors. In other words, even though the extent the Commission established inadequate depreciation rates it is the investor who bears the financial loss resulting from that decision.

Another rate base adjustment that sends negative signals to the investment community is the Staff's proposal to retroactively adjust the rate on which the Company capitalizes the carrying costs of construction work in progress (i.e., the AFUDC rate). In prior rate cases involving the Company, the Staff and the Commission have allowed the Company to recover the carrying cost of construction work in progress based on a formula which takes into account the cost of all forms of capital, including debt and equity. The only exception to this past practice was the AFUDC rate at which the Company was allowed to capitalize carrying costs on its new St. Joseph Treatment Plant. Now, in this case, the Staff is proposing that the Company change yet again the methodology used and apply that rate retroactively, which has the effect of reducing Company's rate base by approximately $400,000. This will also result in a write-off of capital that has previously been recorded on the Company's books and have a corresponding adverse impact on its financial statements. How can any rationale investor justify an investment in Missouri utility property if the rules of the game are going to be changed after the game has been played?

**Q. CAN YOU CITE ANY EXAMPLES OF WHAT APPEARS TO BE A DISREGARD OF UTILITY PROBLEMS AND CONCERNS?**

A. Yes. The Company (and its predecessor) spent ten years trying to develop some alternative processes to fund infrastructure replacement, only to have them rejected. The Company offered to address the concerns raised by all parties about funding options, including regular audits, reconciliations and prudence reviews. The Staff candidly wanted the Company to suffer the punitive effect of regulatory lag associated with the replacements and refused to endorse anything offered by the Company, even though the Company was willing to accept every reasonable check-and-balance. The Commission rejected the regulatory changes proposed by the Company but was nevertheless compelled by the Company's arguments, signaling to the Company that a Distribution System Improvement Charge (DSIC) might be called for. In place in

Pennsylvania, Delaware, Illinois, Indiana, and recently Ohio, the DSIC program has clearly made an impact. General rate case frequency has been reduced and pipeline replacement cycles have been dramatically improved. In Pennsylvania, Ohio, and Indiana, the Public Utility Commissions or their Staffs of those states took lead roles in getting the enabling Legislation approved

**Q. DO YOU LOOK FOR SIMILAR ADVANTAGES TO ACCRUE TO MISSOURI NOW THAT THE MISSOURI LEGISLATURE HAS APPROVED AN INFRASTRUCTURE SYSTEM REPLACEMENT SURCHARGE (ISRS)?**

A. Unfortunately, no, because Staff seems to be working to undo that advantages that might have been realized from an ISRS. In this case, the Staff proposes a greatly reduced ROE and a massive reduction in depreciation expense, critical components of an asset management - infrastructure replacement program. And just recently, we find that the Staff has chosen to twist the language of the ISRS Legislation to reduce, by half, the recovery of funds expended to replace pipe in St. Louis County. We have worked with members of the Staff to craft the language through compromise. Our good faith efforts at engaging them has been returned with an approach at odds with every notion of fairness and inconsistent with any State's treatment of infrastructure replacement costs. Instead of ramping up our replacement cycle, we must seriously consider the need to reduce it, which will include the loss of jobs. We had planned to add as many as 25 positions and purchase equipment to address the issue. But now, instead, of advancing forward, we could take a giant stride backward.

I realize that those opposed to progress in this area will attempt to characterize this as a threat. I must strongly say that it is not. That is not my approach. My approach is to be candid and honest and note the simple business reality that investment can only be attracted when there is an adequate return. This is just as true for a certificate of deposit, a 401(k) investment decision or a savings account as it is for a multi-million pipeline replacement program. Missouri-American will simply not be in the position to attract significantly higher investments than it has historically made, if the resulting regulatory treatment is a rate reduction and the returns on its investments are not competitive with other market alternatives.

## THE INEVITABLE REACTION AND THE EFFECT ON MISSOURI

**Q. WHAT EFFECT WILL THE COMMISSION'S ACTIONS ULTIMATELY HAVE ON THE ECONOMY IN MISSOURI?**

A. There are at least three public policy concerns that come immediately to mind: First, Missouri has serious economic development concerns. A good example of this is the St. Joseph area that is in desperate need of industry and employment. There are similar problems elsewhere, and the availability of a high quality, well managed and adequate water supply is critical to attracting the necessary relocation of business to these areas. This is evident in the recent attraction of a pork processing center to St. Joseph where available water capacity was essential. Second, there are numerous, relatively small water and sewer operations in Missouri. Most of these have limited management, engineering and operating resources available and even less access to capital. It would make little sense for any Company to attempt to consolidate and improve these operations when the regulatory treatment is going to be so inadequate, or worse, punitive. Third, almost every utility can be more efficiently managed and operated through innovative technology and efficiency. While management responsibility is reason enough to pursue these objectives, it is unrealistic to believe that the necessary investment will be made available for these undertakings when investors are treated so much less favorably.

## THE CRITICALITY OF THE MESSAGE

**Q. DO THESE SAME CONCERNS APPLY TO GAS, ELECTRIC AND TELEPHONE UTILITIES?**

A. Yes, but more so to the water industry. The water industry is the most capital-intensive of all the public utilities. It has significantly more dollars of investment in plant per customer and investment per dollar of revenue than any other utility. It is the only utility service that provides an ingestible product, and that product is critically necessary to human survival. At the same time, water utility piping and other infrastructure is aging and in need of systematic replacement. Replacement costs are many multiples of original installation costs both because of the effect of inflation over time, and the fact that the pipes typically went in the ground when the areas were still unimproved. Those same areas now have trees, roads, driveways and lawns that have to be replaced. While the Staff apparently feels that depreciation should not be a source of funds for rebuilding plant, the amount recovered through depreciation represents a fraction of the cost of replacement. The water industry is an industry nearing crisis, and confronting this reality in a jurisdiction where regulation sacrifices the future to appease the present makes a responsible solution very difficult. What is at stake here is the ability to make capital investment in Missouri, and it is not an overstatement to say that the economic health and the quality of life in the State of Missouri are also on the table.

**Q. DO OTHERS SHARE THIS VIEW?**

A. Yes. The Staff has, in the past, recognized that water is a rising cost industry. The EPA has also expressed serious concerns about the water industry and its revenues. In a speech before the American Society of Civil Engineers on June 23, 2003, Tracy Mehan III, the Assistant Administrator for Water for EPA, said the following:

> Your organization has highlighted infrastructure issues for a number of years with your Report Card. I'm aware of the "D" given our wastewater systems and the "D+" given our drinking water systems in your 2001 Report Card. I understand the reasons for these grades, namely: the need to replace pipes and other facilities that have passed their useful life; the underinvestment and underpricing of water and wastewater; the nationwide tendency to neglect operations and maintenance (O&M) spending, etc. In fact, your report is very similar to our "gap analysis" issued last September. In that analysis, we looked at the dates when most of our water pipes and plants were constructed and estimated the coming wave of financial obligation to replace these facilities in the coming decades. Without significant new investment, we predicted "a gap

> between projected clean water and drinking water investment needs over the twenty-year period from 2000 – 2019 and current levels of spending." Under the flat investment scenario, we estimated a wastewater treatment capital payment gap of $122 billion (the mid-range estimate) over the 20 year time period. Our mid-range estimate for the drinking water capital payment gap is $102 billion for the "no revenue growth" scenario. We pointed out if investment in water and wastewater systems remains flat and does <u>not</u> increase, water quality will likely deteriorate. But if instead, revenue and spending grow at 3%/year over and above inflation, our "gap" estimates drop dramatically and water quality is maintained.

This opinion, by a representative of the EPA underscores the fact that the water industry is facing a period of critical challenges and that we will all have to work together to resolve.

**Q. WHAT IS YOUR RECOMMENDATION TO THE COMMISSION?**

A. The lowest cost solution, while perhaps politically attractive is not the best solution, and it may well inadvertently harm customers over the long term. In cases involving critical utility infrastructure, unwillingness to confront challenges today does not resolve those challenges: it merely postpones and exacerbates them. While we may disagree on the details of regulatory decisions, as a matter of prudent public policy we need to be unified on the issue of capital investment. The Commission Staff needs to embrace the mission of improving the quality of life for the citizens of Missouri. In this we agree that the Commission should seek to balance positions, allowing us to attract capital but challenging us to improve on our efficiency of delivery. None of us want the controversy and angst experienced in the last rate case involving St. Joseph. But today, that community has attracted a large employer requiring a lot of high quality water. Without the new facility, the community would have likely had to turn that new business away. A great deal of the investment that would be beneficial to the State is totally discretionary. The standard of safe and adequate water service cannot be met indefinitely with a relative disregard for striving to make things better. We could read and bill annually, not soften our water, take calls only 8 hours per day, offer no on-line services, only do enough lab testing to meet the bare minimum standards established by DNR, and only replace pipes after a significant disruption of service has already occurred. The acquisition of troubled systems now being considered are discretionary; they need not be undertaken. But I doubt if this is what the Commission wants, and it is certainly not what the consuming public will accept. While the Company is not asking for reward from the Commission, it is unrealistic to expect us to do such things and then subject ourselves to economic sanctions. I am simply asking for the application of sound public policy and rational planning in considering the complete context of this case.

**Q. DOES THAT CONCLUDE YOUR TESTIMONY?**

A. Yes.

# Eric W. Thornburg
# President
# Missouri American Water

**Professional Summary**

Eric W. Thornburg joined the American Water System in 1982 as a Management Trainee. He has held increasingly responsible positions for a variety of subsidiaries of American Water, including Pennsylvania, Indiana, and Missouri American Water Companies. This culminated in 2000, when he was named President of the Missouri Operations. He has participated in a number of significant acquisitions and their ultimate integration, including the Avatar, NEI, and United's Mid-Western companies.

**Employment History**

| | |
|---|---|
| 2000 to Present | **Missouri American Water**<br>**President**<br><br>Responsible for leading the state's largest water utility, employing 650 associates and serving 1.3 million people. The company was successfully merged after the acquisition of St. Louis County Water and Jefferson City Water Works. Since July 2000, the company has made three significant acquisitions, including the City of Florrissant, serving 50,000 people. |
| 1993 – 2000 | **Indiana American Water**<br>**Vice President-Operations & Director**<br><br>Responsible for the operation of statewide water utility, serving approximately 500,000 people. Managed over 260 employees in engineering, water quality, and maintenance services and local water utility staffs in eighteen locations across Indiana. Led the operational integration of the Avatar acquisition in eleven Indiana communities. Headed up the Southern Indiana Regional Water Supply Project. |
| 1989 – 1993 | **Pennsylvania American Water**<br>**Operations Manager**<br><br>Responsible for the operations support team for 377,000 customer water utility with annual revenue of $150 million. Managed $50 million annual capital budget, oversaw engineering, water quality, communications, regulatory relations, loss control, materials management, and maintenance service functions. |

1985 – 1988 **Pennsylvania American Water**
**Butler District**
**Operations Manager**

Responsible for the production, distribution, and commercial functions for 11,000 customer water utility in Western Pennsylvania.

1984 – 1985 **American Water Works Service Company**
**Hershey, Pennsylvania**
**Management Assistant**

Assistant to the Vice President of Operations and Finance. Served as company liaison to the Pennsylvania Public Utility Commission and to Deloitte Haskins and Sells during Company Management Audit.

1982 – 1984 **Keystone Water Company**
**Management Trainee**

Entry level training program designed to expose the individual to production, distribution, commercial, accounting, finance, rates and revenues, and management information systems functions.

## Education

Cornell University – Bachelor of Science (1982)
Indiana Wesleyan University – Masters of Business Administration (1997)

## Professional Affiliations

American Water Works Association
- Management Committee – 1997-1998
- Wetlands Technical Advisory Workgroup – 1993-1994

National Association of Water Companies – Missouri / Illinois Chapter Chairman
Missouri State Chamber of Commerce – Board of Directors
Missouri Homeland Security Task Force – Utility Committee
Arts & Education Council of Greater St. Louis – Board of Directors

## Civic and Community Involvement / Awards

YMCA Board of Managers
Outstanding Professional Award – Indiana Wesleyan University
Boy Scouts of America – Unit Leader and Eagle Scout