

Exhibit No.:
Issues: Inclusion of Acquisition
Adjustments in the Rate
Structure, Interruptible Tariff
Witness: James M. Jenkins
Exhibit Type: Surrebuttal Testimony
Sponsoring Party: Missouri-American Water Company

Case No.: WR-2003-0500
Date Filed: December 5, 2003

MISSOURI-AMERICAN WATER COMPANY

SURREBUTTAL TESTIMONY

OF

JAMES M. JENKINS

MISSOURI-AMERICAN WATER COMPANY

CASE NOS. WR-2003-0500

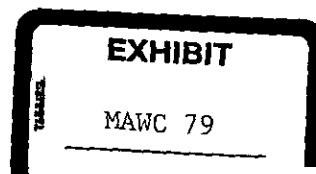
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**Missouri Public
Service Commission**

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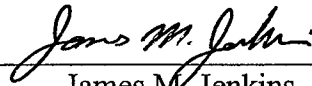


BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

IN THE MATTER OF MISSOURI-AMERICAN	)	CASE NO. WR-2003-0500
WATER COMPANY FOR AUTHORITY TO FILE	)	
TARIFFS REFLECTING INCREASED RATES	)	
FOR WATER SERVICE	)	

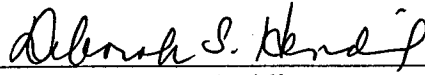
AFFIDAVIT OF JAMES M. JENKINS

James M. Jenkins, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying surrebuttal testimony entitled "Surrebuttal Testimony of James M. Jenkins"; that said surrebuttal testimony was prepared by him and/or under his direction and supervision; that if inquires were made as to the facts in said surrebuttal testimony, he would respond as therein set forth; and that the aforesaid surrebuttal testimony is true and correct to the best of his knowledge.



James M. Jenkins

State of Missouri
County of St. Louis
SUBSCRIBED and sworn to
before me this 1st day of December 2003.



Notary Public

My commission expires: 8/11/07

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

SURREBUTTAL TESTIMONY
JAMES M. JENKINS
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WR-2003-0500

TABLE OF CONTENTS

I.	Witness Introduction.....	1
II.	Inclusion Of Acquisition Adjustments In The Rate Structure	1
III.	Interruptible Tariff	4

WITNESS INTRODUCTION

Q. PLEASE STATE YOUR NAME, TITLE AND BUSINESS ADDRESS.

A. James M. Jenkins, Vice President and Treasurer for Missouri-American Water Company, 535 N. New Ballas Road, St. Louis, Missouri 63141.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. The purpose of my testimony is to address the comments filed in the rebuttal testimonies of Kimberly Bolin of the Office of the Public Counsel (the OPC) and Stephen D. Wurtzler of the St. Joseph Water Rate Coalition (St. Joseph Coalition) concerning the treatment of the acquisition adjustments related to the acquisitions of the water systems of United Water Missouri, Inc. (United Water) and the Cities of Webster Grove, Valley Park and Florissant.

INCLUSION OF ACQUISITION ADJUSTMENTS IN THE RATE STRUCTURE

Q: THE OPC AND ST. JOSEPH COALITION ARE BOTH OPPOSED TO THE INCLUSION OF ACQUISITION ADJUSTMENTS IN RATES. DO YOU BELIEVE THIS IS IN THE BEST INTEREST OF THE CUSTOMER?

A: No. Wholesale exclusion of acquisition adjustments from rates would create a business environment which would preclude mergers and acquisitions that can bring significant benefits to the customer by creating a barrier to recovery of the investments required to deliver those benefits. These benefits are evident in transactions like the MAWC acquisitions of United Water, Webster Grove, Valley Park and Florissant, where significant costs savings, improved customer service and improved financial capability to address current and future capital expenditure requirements were created for the customer.

Q: OPC WITNESS BOLIN CONTENDS THAT THE INCLUSION OF ACQUISITION ADJUSTMENTS IN RATES WOULD CREATE AN ENVIRONMENT IN WHICH

1 **THERE IS NO CAP TO THE PREMIUMS THAT COULD BE PAID, AND THAT**
2 **CONSUMERS WOULD BE FORCED TO PAY EVER ESCALATING RATES TO**
3 **THE STOCKHOLDERS OF BOTH BUYER AND SELLER AS A RESULT OF**
4 **THESE PREMIUMS. DO YOU AGREE WITH THIS PREDICTION?**

5
6 A: No. The argument that there would be no cap on acquisition premiums if they were to be
7 included in rates is erroneous.

8
9 **Q: HOW IS THE ARGUMENT ERRONEOUS?**

10
11 A: There is a no detriment standard which applies to transaction approvals. This standard
12 requires the applicants to show evidence that the customer would not be harmed by a
13 proposed transaction. The Company believes that this effectively caps acquisition premium
14 recovery by ensuring that any premium paid and the recovery thereof would not cause rates to
15 be higher than they would have been in absence of the transaction. In other words, the no
16 detriment standard effectively caps acquisition premiums at the amount of cost savings and
17 service enhancements which the acquiring party is able to deliver. Therefore, the inclusion of
18 an acquisition adjustment cannot lead to the “blank check” that Ms. Bolin predicts in her
19 Rebuttal Testimony.

20
21 **Q: ON PAGE 8 OF HIS REBUTTAL TESTIMONY, MR. WURTZLER STATES THAT**
22 **ACQUISITION ADJUSTMENTS SHOULD NOT BE INCLUDED IN THE RATE**
23 **STRUCTURE BECAUSE INVESTORS WOULD NOT EXPECT AN**
24 **IMPROVEMENT IN THEIR REVENUE STREAM. IS THIS CORRECT?**

25
26 A: Mr. Wurtzler’s statement is misleading in that he characterizes the inclusion of an acquisition
27 adjustment in the rate structure as a revenue increase. MAWC has shown that the cost
28 savings associated with these transactions more than offset the proposed cost associated with
29 the inclusion of the acquisition adjustment in the rate structure. Further, it is important to
30 point out that the acquisition adjustment is temporary, and will drop from the rate structure
31 after the amortization period but the savings will continue.

1
2 **Q: ST. JOSEPH COALITION WITNESS WURTZLER FURTHER SUGGESTS ON**
3 **PAGE 8 OF HIS REBUTTAL TESTIMONY THAT INVESTORS IN MAWC FACE**
4 **THE SAME CONSIDERATION IN REGARD TO ACQUISITIONS AS INVESTORS**
5 **IN AN UNREGULATED COMPANY. IS MR. WURTZLER'S COMPARISON OF**
6 **THE DECISION MAKING PROCESS OF INVESTORS IN UNREGULATED**
7 **COMPANIES WITH THAT OF INVESTORS IN REGULATED COMPANIES**
8 **VALID?**

9
10 **A:** No. Mr. Wurtzler's reference to the unregulated business model is significantly different
11 from the regulated business model. There are numerous differences between the regulated
12 and unregulated business models. First, there is no governing agency that precludes a non-
13 regulated entity from maintaining prices so that a premium may be recovered over time,
14 raising prices to increase revenue or adjusting to cost increases over time. In a regulated
15 model, any and all rate changes must be approved by a regulatory authority and be based on
16 increases in actual and prudently incurred costs. Cost savings created by a transaction in the
17 unregulated environment can be captured permanently for the shareholder. In the regulated
18 environment, all of these savings are passed along to the consumer unless recovered
19 temporarily through the inclusion of the acquisition premium in rates.

20
21 Unregulated businesses also have the flexibility to adjust prices over time as the market
22 changes to capture the full value of the services provided, and not just the cost of providing
23 that service. Finally, unregulated businesses have the ability to choose which customers to
24 serve, to include when and how, while regulated utilities have the obligation to serve all
25 customers in their service territories.

26
27 **Q: GIVEN THESE DIFFERENCES, WHAT CONSIDERATIONS WOULD AN**
28 **INVESTOR IN A REGULATED UTILITY HAVE THAT AN INVESTOR IN AN**
29 **UNREGULATED UTILITY WOULD NOT HAVE.**

30
31 **A:** Among others, an investor in regulated utilities would evaluate the regulatory environment.

1 As part of that evaluation, an investor would consider whether acquisition premium recovery
2 will be available through rates given that the acquisition premium portion of the rates would
3 have to be less than the cost savings generated by the transaction. Investors will seek
4 territories and businesses where the regulatory environment provides an opportunity for a fair
5 return on capital.
6

7 **Q: IN HIS REBUTTAL TESTIMONY, MR. WURTZLER STATES THAT THE ST.**
8 **JOSEPH COALITION IS OPPOSED TO THE INCLUSION OF AN ACQUISITION**
9 **PREMIUM BECAUSE THERE ARE “NO APPARENT BENEFITS TO THE ST.**
10 **JOSEPH DISTRICT RATEPAYERS”. DO YOU AGREE?**
11

12 **A:** No. As stated in earlier testimony, all of the MAWC ratepayers have benefited from the
13 addition of the acquired customers. The addition of the acquired customers lowers costs to all
14 of the MAWC customers through allocation of costs across a larger customer pool. The new
15 customers were acquired without a pro-rata increase in costs at the corporate office and field
16 levels. This means that the previous cost structure is now allocated across a greater pool of
17 customers thereby reducing the per customer cost to the previous rate base. The proposed
18 inclusion of the acquisition premium would not negate these savings, and the existing
19 customers will still receive lower rates than they otherwise would have without these
20 transactions.
21

22 **INTERRUPTIBLE TARIFF**

23

24 **Q. HAVE YOU PREPARED SURREBUTTAL TESTIMONY WITH RESPECT TO THE**
25 **COMPANY’S CONTRACT WITH EMPIRE DISTRICT ELECTRIC COMPANY?**
26

27 **A.** Yes. Mr. Hubbs of the Staff has filed Rebuttal Testimony recommending that the
28 Commission not approve an interruptible tariff for Empire District as suggested by Mr.
29 Kalbarczyk in his Direct Testimony filed on October 10, on behalf of the intervenor Empire
30 District Electric Company. Mr. Hubbs also recommends that the Commission not approve an

1 interruptible rate or the special contract between Empire and the Company, until such time
2 that the two file for approval of the special contract service and the resulting proposed rates
3 that should be charged for such service.” (Hubbs Rebuttal at page 31)

4
5 **Q. DO YOU THINK MR. HUBBS’ RECOMMENDATIONS ARE APROPRIATE?**

6
7 **A.** No. On the contrary, a rate case is the most appropriate and ideal time to address rate issues,
8 and especially those issues such as this one which will affect rate design and cost of service.
9 In this situation, the Contract itself specifies that whatever rate is on file with and approved by
10 the Commission will dictate charges for service to Empire for the present, and it specifies that
11 if Empire wants a different rate treatment than that which is applicable to all of the
12 Company’s retail industrial customers, that, “Empire may propose and Water Company will
13 support an alternate ‘interruptible’ tariff during any applicable subsequent Water Company
14 Missouri Rate Proceeding that allows or cost savings for both Empire and Water Company
15 which rates may supersede those in the paragraph above.” In other words, this is not only the
16 ideal opportunity for the Commission to address the concerns raised by Mr. Hubbs, it is when
17 both regulated utilities believe is the most appropriate time to do so. It seems short sighted
18 and unnecessary to put it off.

19
20 **Q. WAS THE CONTRACT BETWEEN THE COMPANY AND EMPIRE DRIVEN BY**
21 **EMPIRE’S DESIRE FOR SPECIAL RATE TREATMENT?**

22
23 **A.** No. It was driven by Empire’s urgent need for water to continue the reliability of its public
24 utility operations, and the Company’s inability to guarantee that the amounts needed could
25 always be available. Due to the Company’s supply problems in the Joplin system, which are
26 addressed in detail in this case, the Company had to either decline to assist Empire with its
27 urgent needs until additional capacity could be constructed, or insist that Empire contractually
28 accept the realities of limited supply in the area. In addition, significant investment in

1 transmission piping was necessary, so the Company needed some contractual assurances that
2 Empire would remain as a customer long enough for the Company to assure that its
3 investment would continue to be used and useful into the future.

4
5 **Q. DOES THE CONTRACT AFFORD EMPIRE ANY SPECIAL PRIVILEGES?**

6
7 A. No. To the contrary, Empire has voluntarily accepted restrictions and limitations that are more
8 restrictive than those that are applicable to other industrial customers. All of this was driven
9 by the realities of urgency of need and supply limitations at the time.

10
11 **Q. IS THE COMPANY CIRCUMVENTING OR IGNORING THE COMMISSION'S**
12 **JURISDICTION OVER RATES AND CONDITIONS OF SERVICE?**

13
14 A. No. Not only does the Contract specify that there is no special rate treatment for the
15 interruptible contract without Commission approval, but the entire agreement is subject to the
16 Commission's jurisdiction. ARTICLE V states in pertinent part:

17
18 ...this Agreement may be subject to the approval of the Missouri Public Service
19 Commission and/or may require the obtaining of a Certificate of Convenience
20 and Necessity to serve the area. Water Company agrees that it will use its best
21 efforts to obtain such regulatory approval should it become necessary and
22 further agrees that Empire may take steps on its own behalf to assist in
23 obtaining regulatory approval. In the event, that it is determined that Water
24 Company has not satisfied all PSC approval and/or Certificate of Convenience
25 and Necessity requirements, and Water Company is eventually unable to
26 obtain either or both after exhausting all regulatory remedies, and therefore
27 cannot continue to provide water service to Empire, this Agreement will be
28 determined to be null and void and Empire will reimburse Water Company for
29 one-half the un-depreciated balance of the constructed additional water
30 facilities and any related costs at that time at a total cost not to exceed One
31 Million Dollars.

32
33 **Q. WHY DIDN'T THE PARTIES SUBMIT THIS MATTER TO THE COMMISSION**
34 **EARLIER?**

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A. Empire’s needs were urgent, and the parties, both being regulated utilities, agreed that the matter of any special rate treatment for the “necessarily” interruptible service, would be best addressed and resolved in the next rate case, which is this proceeding.

Q. PLEASE ADDRESS THE TESTIMONY OF MR. DONALD JOHNSTONE CONCERNING THE AVAILABILITY OF INTERRUPTIBLE SERVICE IN ALL DISTRICTS.

A. The Company does not believe that the demand for interruptible service is widespread. Therefore, the Company would prefer to negotiate such interruptible service contracts on an individual basis.

Q. WHAT WOULD THE PARAMETERS OF SUCH A CONTRACT INCLUDE?

A. The parameters for an interruptible service contract would include, but not necessarily limited to the following:

- Contract period of at least fifteen years.
- A minimum quantity of water purchased each month with a take-or-pay minimum charge.
- Proof that the customer has a viable alternative supply or a combination of supply and storage sufficient to cover an interruption.
- Items covering point of delivery, pressure, metering, and interruption, etc.
- Rate per thousand gallons would be determined for each district. Initially the rate would be the lesser of a tail-block rate or the production delivery of water under average load conditions determined in the Company’s cost of service study.
- Require the customer to pay for any local facilities in order to provide service.

Q. SHOULD AN INTERRUPTIBLE RATE FOR AN EXISTING CUSTOMER BE

1 **APPROVED OUTSIDE THE CONTEXT OF A RATE FILING?**

2

3 A. No, unless the existing customer can demonstrate the ability to return an equivalent revenue

4 stream that is currently included in rates. Interruptible rates that lower the equivalent revenue

5 stream from a prior proceeding should be evaluated in the context of a current rate filing to

6 ensure fairness among all customer classes.

7

8 **Q: DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

9

10 A: Yes, it does.