Exhibit No.:	
Issue(s):	St. Joseph Accelerated Depreciation
Witness/Type of Exhibit:	Robertson/Rebuttal
Sponsoring Party:	Public Counsel
Case No.:	WR-97-237 et al

REBUTTAL TESTIMONY

OF

TED ROBERTSON

Submitted on Behalf of
the Office of the Public Counsel

FILED[3]
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Missouri Public
Service Commission

MISSOURI-AMERICAN WATER COMPANY

Case No. WR-97-237 et al

July 18, 1997

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Case No(s). WR-2003-0500
Date 12-22-03 Rptr TC

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 No. WR-97-237 et al

AFFIDAVIT OF TED ROBERTSON

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

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

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

2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony consisting of pages 1 through 17.

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

Ted Robertson

Subscribed and sworn to me this 18th day of July, 1997.

Bonnie S. Howard
Notary Public

My commission expires May 3, 2001.

REBUTTAL TESTIMONY

OF

TED ROBERTSON

MISSOURI-AMERICAN WATER COMPANY

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

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Ted Robertson, P. O. Box 7800, Jefferson City, Missouri 65102.

Q. ARE YOU THE SAME TED ROBERTSON THAT HAS PREVIOUSLY TESTIFIED IN THIS CASE?

A. Yes, I am.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. I will present testimony explaining the Public Counsel's opposition to the recommendation of the MPSC Staff's depreciation witness, Mr. Woodie C. Smith, that Missouri-American should begin collecting from current ratepayers accelerated depreciation expense associated with the projected future retirement of its St. Joseph, Mo. water treatment plant.

ST. JOSEPH ACCELERATED DEPRECIATION

Q. WHAT IS THE ISSUE?

A. In the Direct Testimony, pp. 5-6, of MPSC Staff's depreciation witness, Mr. Woodie C. Smith, he recommends an adjustment to increase the Company's accrued depreciation reserve balance. According to Mr. Smith, the projected retirement date of the Company's St. Joseph, Mo. water treatment plant is 2001. He states that if the Commission accepts the depreciation rates he has recommended for the six accounts containing the St. Joseph water treatment plant investment, $3,964,372 of unrecovered investment will remain at the approximate operation of law date of the instant case, November 12, 1997, and $3,133,075 of unrecovered investment will remain at the end of the year 2001. Mr. Smith recommends that the Company's normal depreciation expense level should be increased in the instant case to begin compensating the Company's shareholders because in his words, "...under-recovery of the current plant investment is fully anticipated." It is his recommendation that an additional level of depreciation expense recovery begin immediately, but a pace to fully recover the plant's remaining $3,964,372 investment in ten years instead of four.

Q. WHAT IS DEPRECIATION?

A. As applied to depreciable utility plant, depreciation means the loss in service value not restored by current maintenance, incurred in connection with the consumption or prospective retirement of utility plant in the course of service from causes which are known to be in current operation and against which the utility is not protected by insurance. Among the causes to given consideration are wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in the art, changes in demand and requirements of public authorities, etc.

Q. WHAT IS DEPRECIATION ACCOUNTING?

A. The most widely recognized definition of depreciation accounting is that of the American Institute of Certified Public Accountants (AICPA), which states:

> Depreciation accounting is a system of accounting which aims to distribute the cost or other basic value of tangible capital assets, less salvage value (if any), over the estimated useful life of the unit in a systematic and rational manner. It is a process of allocation, not of valuation. American Institute of Certified Public Accountants, *Accounting Terminology Bulletin* No. 1 (New York: AICPA, Committee on Terminology, August 1953), p. 25.

Q WHAT DO YOU MEAN WHEN YOU STATE "NORMAL DEPRECIATION EXPENSE"?

A. Normal depreciation expense, as used in the context of this testimony, is the level of depreciation expense that results from multiplying the water plant's original cost investment by the Company's Commission authorized depreciation rates. Any amount included in rates above this normal level would be a recovery of investment cost unrelated to the Company's current approved depreciation rates. This is the accelerated depreciation expense which the Public Counsel opposes.

Q. DOES MR. SMITH RECOMMEND THAT THE COMMISSION ORDER A CHANGE IN THE COMPANY'S CURRENT DEPRECIATION RATES FOR THE ST. JOSEPH WATER PLANT?

A. No, he does not. Mr. Smith states on page 5 of his Direct Testimony that it is his opinion that the Company's current depreciation rates are reasonable, and he has recommended that there be no change in those depreciation rates.

Q. BY WHAT AMOUNT WOULD THE ANNUAL DEPRECIATION EXPENSE LEVEL HAVE TO BE INCREASED IN ORDER TO SATISFY MR. SMITH'S RECOMMENDATION TO FULLY RECOVER THE PLANT'S INVESTMENT OVER THE NEXT TEN YEARS?

A. In order to recover the plant investment of $3,964,372 over ten years the required annual depreciation expense level would need to be $396,437. The annualized normal depreciation expense recommended by Mr. Smith is $203,583 (i.e., plant original cost multiplied by Commission ordered depreciation rates). The difference, $192,854, is the accelerated (non-depreciation rate related) annual depreciation expense Mr. Smith would have this Commission include in the instant case rates (i.e., (($203,583 + $192,854) = $396,437) x 10 = $3,964,372).

Q. DID MISSOURI-AMERICAN SPECIFICALLY REQUEST RECOVERY OF THIS ACCELERATED DEPRECIATION EXPENSE IN ITS RATE FILING? 81

A. No, it did not. To my knowledge, the Company neither initiated nor proposed this 82 increase in depreciation expense level (i.e., revenue requirement). The recommendation apparently originated solely with Mr. Smith, and the MPSC Staff.

Q. DOES THE COMPANY SUPPORT MR. SMITH'S RECOMMENDATION?

A. It's my understanding that the Company fully supports Mr. Smith's recommendation of including an <u>additional $192,854 of accelerated depreciation expense unrelated to its current cost of service</u> in the determination of the instant case revenue requirement.

Q. WHAT REASONS DOES MR. SMITH GIVE FOR SUPPORTING SUCH AN ADJUSTMENT?

A. Mr. Smith's rationale is twofold: (1) he believes that the under-recovery of the plant investment is fully anticipated because the Company has stated that it is scheduled for retirement in the year 2001. He tempers this statement with the caveat that while it is possible that construction of the replacement St. Joseph plant may be delayed, thereby delaying the retirement of the current plant, his recommendation eases this concern because he is recommending recovery over ten years rather than the four years left until the scheduled retirement date, and (2) intergenerational equity demands that future ratepayers who would not be receiving service from the current plant should not be required to fully compensate the Company for its retirement.

Q. DOES THE PUBLIC COUNSEL AGREE WITH MR. SMITH'S RATIONALE?

A. No, we do not.

Q. IS THE ASSERTION THAT UNDER-RECOVERY OF THE CURRENT PLANT INVESTMENT IS FULLY ANTICIPATED REALISTIC?

A. No, it is not. Mr. Smith has stated that under-recovery of the current plant investment is fully anticipated, but in fact, the retirement date of the water plant is not all that certain.

It appears to me that Staff has based its recommendation almost solely, if not completely, on filings and testimony in Company's Case Nos. WA-97-46 and WF-97-241. Case No. WA-97-46 is the Company's Certificate Of Convenience And Necessity request, and Case No. WF-97-241 is the Company's Project Financing request. These two cases were consolidated as Case No. WA-97-46 et al because both are associated with the Company's proposal of new water plant construction in its St. Joseph, Mo., service area. Mr. Smith's recommendation appears to be founded on the Company's project financing plans whereby it has proposed to completely replace the current St. Joseph water plant, but those plans are not yet finalized nor approved. No construction has actually begun to replace the water plant nor has any construction firm committed to a construction schedule. The only plans to date are Company's proposed financing options and alternatives. There are no guarantees that the "new plant" will be on-line in the year 2001 or that the "old plant" will be replaced in the same year.

Furthermore, the Company has not received Commission authorization approving the requested certificate of convenience and necessity. However, Staff is recommending that this Commission authorize in the determination of the instant case rates the inclusion of accelerated depreciation expense that is totally unrelated to the Company's actual current cost of service, but directly interrelated with the certificate of convenience and necessity request.

The Staff's recommendation surreptitiously requests that this Commission rule on the prudence of the proposed new St. Joseph water plant construction, and the current water plant's retirement as identified in Case No. WA-97-46 *et al.* If the Commission rules that an accelerated depreciation expense amount related to the projected retirement of St. Joseph's current water plant is reasonable now, before financing has occurred, construction bids have been taken, before construction has begun, or even before the Missouri Department of Natural Resources has approved the Company's plans, this Commission would be effectively prejudging the prudence of the Company's financing and construction proposals in its entirety. The Public Counsel opposed the preapproval of the prudence of the Company's selected proposal for project financing and plant construction in Case No. WA-97-46 et al, and it continues to do so in the instant case.

For further discussion relating to the inherent uncertainty of the Company's proposals for project financing and plant construction in Case No. WA-97-46 et al see the instant case Rebuttal Testimony of OPC witness, Mr. Barry Hall.

Q. WHAT IS INTERGENERATIONAL CUSTOMER EQUITY?

A. The regulatory concept of intergenerational customer equity is based fundamentally on the accounting implementation principle of "matching." One of the earliest concepts of accounting, the matching principle attempts to relate costs to the period in which they occur and against revenues generated for which those costs were incurred. The matching principle states that for a reporting period revenues should be recognized in conformity with the revenue principle (i.e., basically means that revenue is recognized on an accrual basis rather than a cash basis); then the expenses incurred in earning that revenue should be recognized during the same period.

Intergenerational customer equity merely means that current customers should be charged for all costs related to providing them with the services they utilized. If revenue is carried over from a prior period or deferred to a future period in conformity with the revenue principle, all identifiable elements of expense related to earning the revenue likewise should be carried over from the prior period or deferred to a future period. Many expenditures are recognized as assets because they aid in the earning of future revenues, In this case, the matching principle requires that as the revenues are earned, those assets sold or consumed must be recognized and reported as expenses of the period in which the related revenue is recognized.

Q. WILL STAFF'S FEAR OF INTERGENERATIONAL INEQUITY MATERIALLY IMPACT THE COMPANY'S CUSTOMERS IF ITS ACCELERATED DEPRECIATION EXPENSE RECOMMENDATION IS NOT APPROVED BY THE COMMISSION?

A. No, I do not think so. In my opinion, if the Commission does not authorize the Company to collect the accelerated depreciation expense recommended by Staff any intergenerational inequity that may occur would be relatively insignificant. That is because any inequities that might occur from matching the revenues of one period with the expenses of a different period would be mitigated by the passage of time until the current water plant is actually retired, and the fact that the Company will enjoy the capital recovery inherent in the implementation of the depreciation rates authorized by the Commission.

However, if the Commission authorizes the Company to collect the accelerated depreciation expense recommended by Staff, the Public Counsel believes that significant intergenerational customer inequities will occur. The inequity would occur because the Company would be allowed to charge ratepayers for the cost related to the consumption of assets which have not been expended. Mr. Smith's depreciation rate recommendations are not intended for the purpose of achieving any objectives other than the recovery of capital invested in a manner properly related to the useful life of the Company's water plant nor should they be. However, his recommendation of including in the revenue requirement an amount for accelerated depreciation expense is based on nothing more than the proposed plans of the Missouri-American Water Company.

Q. ISN'T IT ALSO POSSIBLE THAT WHEN THE RETIREMENT OF THE CURRENT ST. JOSEPH WATER PLANT ACTUALLY OCCURS, IF IT OCCURS AS PROPOSED BY THE COMPANY, ALL COSTS ASSOCIATED WITH ITS RETIREMENT COULD BE INCLUDED IN THE DETERMINATION OF THE TOTAL COST OF THE NEW ST. JOSEPH WATER PLANT?

A. Yes, that is a possibility. Knowledgeable parties may disagree as to the final disposition of the water plant retirement costs; however, the existing plant is currently providing water service, and to my knowledge, it is not obsolete or projected to fail. Therefore, the costs of its early retirement or premature retirement may be appropriately added to the total costs of the new project if the decision to build the new water plant is deemed prudent by the Commission. If that happens no intergenerational customer inequity will occur because it is expected that future ratepayers will compensate the Company for the capital recovery of the new water plant.

Q. ISN'T THE STAFF'S RECOMMENDATION OF INCLUDING THE ACCELERATED DEPRECIATION EXPENSE IN RATES OVER THE NEXT TEN YEARS RATHER THAN FOUR YEARS RATHER SUBJECTIVE?

A. It is completely subjective, and it is based on an illogical rationale. Too often observers stress systems and forget that generally accepted accounting principles (GAAP) require that depreciation be both systematic and rational. To be rational, depreciation generally should match the consumption of the assets. Matching expense recognition with consumption ensures that financial statements accurately reflect the results of operations. The matching concept of accounting renders utility depreciation accounting a twofold process involving both measurement of consumption and recovery through service rates.

Staff's recommendation appears on the surface to match the consumption of the current St. Joseph water plant with its retirement date, but in actuality it does not. Mr. Smith's testimony suggests that a ten year amortization of the remaining investment is more reasonable than a four year amortization to the projected retirement date. His recommendation implicitly admits that he does not know when the plant will actually be retired. How can he? To my knowledge, the only evidence that the St. Joseph water plant retirement will occur is based on information presented in Case No. WA-97-46 et al. This case is currently awaiting a decision from the Commission, and it has not been consolidated with the instant case. His recommendation is illogical because the proposal of a ten year amortization is merely a guess of the water plant's eventual retirement date rather than an allocation of the capital recovery over the estimated useful life of the current water plant.

Remember, depreciation means the loss in service value not restored by current maintenance, incurred in connection with the consumption or prospective retirement of utility plant in the course of service from causes which are known to be in current operation. No evidence has been presented in the instant case that would reliably substantiate the future retirement date of the current St. Joseph water plant. The Company's project financing plans are just that--plans. They alone should not be taken as sufficient evidence to meet this Commission's "Known And Measurable" standard.

Q. DOES THE STAFF'S ADJUSTMENT MEET THE "KNOWN AND MEASURABLE" STANDARD?

A. In my opinion, it does not. In St. Louis County Water Co., Case No. WR-91-361, Order Establishing Test Year, pp. 2-3, (September 6, 1991), the Commission states:

> An additional period may be tacked onto the test year to include an update of significant items from the test year. Recognition of "known and measurable" changes in significant items comprise the update of the test year. An update period concludes after the test year, but prior to the date the Staff files its revenue requirement determination. By the time the Staff files its revenue requirement determination, there will be actual data for the update period for the Staff to use in its case.

The Order goes on to state:

> "Isolated adjustments," or changes to isolated items, such as items imposed by government, e.g., increases in the cost of postage, are presented to the Commission for a determination as to whether they are "known and measurable". If the isolated items are know and measurable, it may be contended that the test year numbers should be adjusted for the changes.

The Company has not presented Staff or OPC with any data regarding the actual final total costs of the planned new construction in the St. Joseph service area nor has it provided Staff or OPC with any data regarding the actual final total costs of the planned retirement of the current St. Joseph water plant. Without this information, Staff's recommendation does not satisfy the "known and measurable" standard for updated or isolated adjustments. Since data regarding the actual costs does not exist to allow an updated or isolated adjustment, there is no basis for allowing the Staff's accelerated depreciation expense adjustment in the instant case revenue requirement.

Mr. Smith has recommended that the Company's current depreciation rates are reasonable for determining the annual level of depreciation expense in rates. No other depreciation adjustment should be allowed in the instant case revenue requirement if the Commission accepts his depreciation rates recommendation because authorization of those rates implies that the Company is being fairly compensated for recovery of its used and useful capital investment.

Q. MR. SMITH STATES ON PAGE 6 OF HIS DIRECT TESTIMONY THAT IT IS ENTIRELY POSSIBLE THAT CONSTRUCTION OF THE REPLACEMENT ST. JOSEPH PLANT MAY BE DELAYED. DO YOU AGREE WITH HIM THAT THE CONSTRUCTION OF THE PROPOSED NEW WATER PLANT MAY BE DELAYED, AND IF SO, WHAT ARE THE RAMIFICATIONS CONCERNING HIS RECOMMENDATION OF ACCELERATING DEPRECIATION EXPENSE?

A. Yes, I do agree with Mr. Smith that it is entirely possible that the projected construction of the new St. Joseph water plant, as envisioned by the Company, may be delayed. If events occur that prohibit or delay the Company from constructing the new water plant as planned, the ratepayer would be forced to continue compensating the shareholder for service costs which the Company would not be incurring. This would all occur simply because Staff has accepted the Company's statements that the water plant is "scheduled" for retirement. The Public Counsel asserts that scheduling is not construction, budgets can and are changed on a regular basis. Missouri-American's own recent history of modifying and eliminating construction plans in its Joplin service area is an illustration of the dynamic nature of this Company's budgeting and construction processes. Until this Commission is able to actually verify that a new St. Joseph water plant will replace the current St. Joseph water plant, and that the retirement date of the current St. Joseph water plant is know with modicum level of reliability, the Public Counsel requests that the Commission oppose any attempts to have ratepayers compensate the Company for costs unrelated to and above its actual cost of service.

Q. DO YOU HAVE AN ALTERNATE RECOMMENDATION REGARDING THE CAPITAL RECOVERY FOR THE COMPANY'S PROJECTED RETIREMENT OF THE CURRENT ST. JOSEPH WATER PLANT?

A. Yes, I do. Since Missouri-American is in the habit of filing a general rate increase case approximately every 2 or 3 years, the Public Counsel proposes that the Commission postpone implementation of Mr. Smith's recommendation to add an accelerated amount of depreciation expense to the accrued depreciation reserve until such time as the Company files its next general rate case. Postponement of the Staff's recommendation would provide the Company with time to finalize its construction program, and possibly begin the actual construction of the proposed water plant. This alternative would also allow the Commission to base any future decisions on solid facts rather than mere promises. If for some reason the Company's projected construction plans are modified, delayed, phased-in, or even eliminated, it would provide the Commission with the opportunity to act accordingly based on the most recent knowledge available, which certainly should be more definitive than currently available information. If the construction of the water plant does occur on the timeline projected by the Company, the shareholders will not be harmed because they are currently receiving in rates a reasonable level of depreciation expense.

Mr. Smith agrees that the current depreciation rates utilized by the Company are reasonable; therefore, if the shareholder is not harmed, because he or she is receiving just compensation from the ratepayer in current rates, the only party that is subject to any risk of possible deprivation must be the ratepayer. The Public Counsel recommends that the Commission weigh carefully all the possible outcomes of the Staff's recommendation. When it does, we believe that the postponement of the inclusion of accelerated depreciation expense in rates until such time that accurate plant construction and retirement information becomes available is the best and safest possible course of action to take.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, it does.