

Exhibit No.:
Issues: Belleville Lab Cost
Witness: Patrick L. Baryenbruch
Exhibit Type: Rebuttal
Sponsoring Party: Missouri-American Water Company

Case No.: WR-2003-0500
Date Filed: November 10, 2003

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. WR-2003-0500

FILED

JAN 23 2004

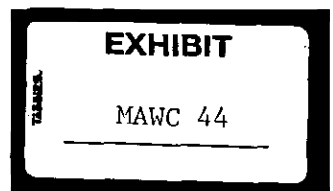
**REBUTTAL TESTIMONY
OF
PATRICK L. BARYENBRUCH**

**Missouri Public
Service Commission**

**ON BEHALF OF
MISSOURI-AMERICAN WATER COMPANY**

JEFFERSON CITY, MISSOURI

Exhibit No. 44
Case No(s). WR-2003-0500
Date 12/16/03 Rptr SLM



BEFORE THE PUBLIC SERVICE COMMISSION

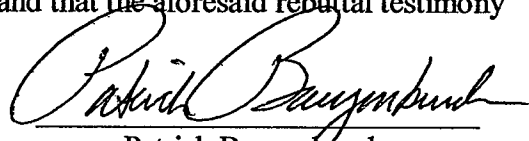
OF THE STATE OF MISSOURI

IN THE MATTER OF MISSOURI-AMERICAN
WATER COMPANY FOR AUTHORITY TO FILE
TARIFFS REFLECTING INCREASED RATES
FOR WATER SERVICE

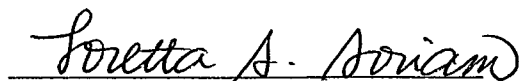
CASE NO. WR-2003-0500

AFFIDAVIT OF PATRICK BARYENBRUCH

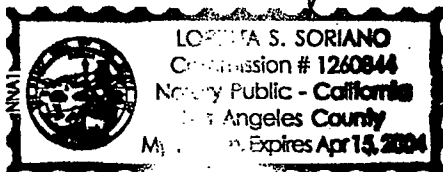
Patrick Baryenbruch, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying rebuttal testimony entitled "Rebuttal Testimony of Patrick Baryenbruch"; that said rebuttal testimony was prepared by him and/or under his direction and supervision; that if inquires were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


Patrick Baryenbruch

State of California
County of Los Angeles
SUBSCRIBED and sworn to
before me this 4th day of Nov. 2003.


Notary Public

My commission expires: April 15, 2004



REBUTTAL TESTIMONY
PATYRICK L. BARYENBRUCH
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WR-2003-0500

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WITNESS INTRODUCTION

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. Patrick L. Baryenbruch, 302 East Park Drive, Raleigh, North Carolina 27605.

3

4 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL**
5 **BACKGROUND.**

6 A. I received a Bachelors degree in accounting from the University of Wisconsin-
7 Oshkosh in 1974 and a Masters in Business Administration degree from the University
8 of Michigan in 1979.

9

10 I am a certified public accountant and am a member of the American Institute of
11 Certified Public Accountants and the North Carolina Association of Certified Public
12 Accountants.

13 I began my career as a staff accountant with Arthur Andersen & Company where I
14 performed financial audits of utilities, banks and finance companies. After three years
15 I left to pursue an M.B.A. degree. Upon graduation from business school, I worked
16 with the consulting firms of Theodore Barry & Associates and Scott, Madden &
17 Associates.

18

19 **Q. WHAT ARE YOUR DUTIES AND RESPONSIBILITIES IN YOUR CURRENT**
20 **POSITION?**

21 A. I am the President of my own consulting practice, Baryenbruch & Company, which
22 was established in 1985. In that capacity, I provide consulting services to utilities and
23 their regulators.

24

25 **Q. WHAT EXPERIENCE DO YOU HAVE IN EVALUATING UTILITY-AFFILIATE**
26 **TRANSACTIONS?**

1 A. During my consulting career, I have performed consulting assignments for
2 approximately 50 utilities and 10 public service commissions. I have participated as
3 project manager, lead or staff consultant for 24 commission-ordered management and
4 prudence audits of public utilities. Of these, I have been responsible for evaluating
5 the area of affiliate charges and allocation of corporate expenses in the Commission-
6 ordered audits of Connecticut Light and Power, Connecticut Natural Gas, General
7 Waterworks Corporation (Pennsylvania Operations), Philadelphia Suburban Water
8 Company, Pacific Gas & Electric Company and Southern California Edison.

9
10 Most recently, my firm performed the commission-ordered audit of Southern California
11 Edison's 2002 transactions with its non-regulated affiliate companies. That audit was
12 successfully completed in May 2003 and I have again been selected to perform the
13 2003 transactions audit.

14
15 I designed and implemented the cost recovery process for Duke Energy's central IT
16 group. This 1,000-person organization provides a wide range of applications and
17 infrastructure services to Duke's regulated and unregulated business units. This
18 project involved the development of products and services and unit prices that
19 business units pay for actual usage. This chargeback arrangement was audited by
20 Duke's regulators who found to be fair for the regulated utility.

21
22 I have acted as an expert witness on the issue of Service Company charges in rate
23 case proceedings for several American Water operating companies. In addition, I
24 helped prepare the Cost Allocation Manual that Missouri American filed in this rate
25 case proceeding.

26
27 **Belleville Water Quality Testing Cost Allocation**
28

1 **Q. PLEASE DESCRIBE THE REASON FOR YOUR TESTIMONY IN THIS CASE.**

2 A. I am responding to the recommendation of MPSC staff witness Mr. John P. Cassidy
3 that Belleville Lab expenses not directly charged to operating companies be allocated
4 on the basis of number of samples tested. American Water now allocates these
5 expenses on the basis of number of customers.
6

7 **Q. IN THE PREPARATION OF THIS TESTIMONY, DID YOU PERFORM ANY**
8 **ANALYSES OF AMERICAN WATER'S HISTORICAL INFORMATION OR OTHER**
9 **DATA?**

10 A. I interviewed by phone Ms. Cheryl Norton, the director of Belleville Lab to understand
11 the nature and pattern of work performed at Belleville. I analyzed the number of
12 samples tested for every American Water operating company for the years 2000
13 through 2003. I also analyzed the number of customers by operating company for the
14 years 2000 through 2003. Finally, I reviewed the 2000, 2001 and 2002 surveys
15 comparing Belleville Lab's cost of testing compared to outside testing laboratories.
16

17 **Q. DO YOU AGREE WITH MR. CASSIDY'S RECOMMENDATION?**

18 A. No. There are several reasons why this recommendation is wrong. First, the
19 Belleville Lab performs not only testing of samples but also water quality research and
20 the development of standards for American companies. These research and
21 standards development services benefit every operating company and are completely
22 distinct from testing services.
23

24 **Q. ARE THERE OTHER REASONS THAT NUMBER OF SAMPLES IS THE WRONG**
25 **METHOD FOR ALLOCATING BELLEVILLE LAB EXPENSES?**

26 A. Yes. An operating company's total samples can vary from one year to the next
27 because of source water conditions, contamination events and regulations. For
28 instance, 2002 samples tested for New Jersey American represented almost 24% of

Belleville Lab's total. At the same time, New Jersey American represents less than 13% of total American Water customers. In 2002, industrial contaminants TCE and PCE were detected in New Jersey American's source water. This required more frequent sampling to ensure that the equipment (carbon contractors) that removes these substance was working effectively.

Allocation on the basis of samples tested could cause an operating company's portion of Belleville Lab costs to vary widely from one year to the next. This is illustrated by the analysis of New Jersey American's 1999 through 2003 sample tests is shown in the table below.

Period	Percent of Total Belleville Lab Sample Tests
1999	23.2%
2000	22.6%
2001	15.9%
2002	23.9%
2003 (6/30 YTD annualized)	11.5%

On the other hand, allocating based on number of customers is much less variable because system-wide customer counts generally do not change dramatically from year to year.

Q. ARE THERE OTHER REASONS THAT NUMBER OF SAMPLES IS NOT THE RIGHT ALLOCATION METHOD FOR BELLEVILLE LAB EXPENSES?

A. Yes. It is a system-wide American Water policy to allocate any Service Company expenses that cannot be direct charged to operating companies on the basis of number of customers. This is an entirely appropriate approach for the following reasons:

1. Straightforward and Understandable – Before 1989, non-direct charge costs

1 were allocated to operating companies based on a multitude of factors (e.g., number
2 of employees, dollar amount of net plant in service). The Company sometimes found
3 this approach difficult and time-consuming to explain to regulators. As a result, a
4 decision was made in 1989 to rely solely on number of customers as the basis for
5 allocation.

6 Since 1989, AWW's customer allocation approach has been examined closely by the
7 regulators of American Water operating companies. In a few instances, it has been
8 subjected to detailed audits by outside consultants hired by regulators. Because of
9 the straightforward nature of the allocation process, regulators have achieved a high a
10 level of understanding and trust that might not have been possible with a more
11 complicated multi-factor allocation approach.

12 **2. System-Wide Consistency** – Every American Water operating company uses
13 the same allocation method for non-direct charge expenses. It is imperative that this
14 consistency be maintained in order to keep the Service Company cost recovery
15 process manageable. If different allocation factors were used in different states, the
16 process would undoubtedly cost more to administer. The Service Company billing
17 system would have to be reprogrammed. It would take a greater effort to calculate
18 and verify the bills. Furthermore, it would be more difficult to ensure that all Service
19 Company expenses would be fully recovered. As a result, American Water would
20 lose some economies of scale and it would drive up the cost of service to operating
21 companies.

22 **3. Consistent Customer Impacts** – By using number of customers as its
23 allocation methodology, American Water ensures that activities cost the same from
24 one customer to another and from one state to the next. For instance, when Belleville
25 Lab's research on cryptosporidium is allocated on the basis of customers, the cost per
26 customer is the same in Missouri as it is in New Jersey. If another allocation method
27 were used, such as number of samples tested, the cost per customer could be
28 different in the two states. This would be unfair because customers benefit equally
29 from the research and system improvements that may result.

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Q. DO YOU BELIEVE MR. CASSIDY'S WORK CONSTITUTES A COMPREHENSIVE ASSESSMENT OF THE SERVICE COMPANY COST RECOVERY METHODOLOGY?

A. Absolutely not. Mr. Cassidy has chosen to narrowly focus his attention on the cost recovery methodology for one Service Company service. Water quality services from Belleville Lab represent only a fraction of services provided by the Service Company. Others include:

- Accounting
- Administration
- Communications
- Corporate Secretarial and Legal
- Customer Services
- Engineering
- Financial
- Human Resources
- Information Systems
- Operations
- Rates and Revenue
- Risk Management

Q. WHAT WOULD YOU EXPECT TO FIND IF YOU EXAMINED ALTERNATIVE COST RECOVERY METHODS FOR THESE OTHER TYPES OF SERVICES?

A. I would expect to find some alternative allocation methods would increase Service Company expenses allocated to Missouri American.

Q. DO YOU THINK IT IS FAIR FOR MR. CASSIDY TO SIMPLY PICK THE ALLOCATION METHODOLOGY FOR ONE SERVICE COMPANY ACTIVITY TO CONTEST?

A. No. Mr. Cassidy's evaluation should have been comprehensive. He should have evaluated the impact of alternative allocation methods for every Service Company service. Only then could he fairly determine the net dollar effect on Missouri American.

1 ratepayers.

2
3 **Q. DO YOU BELIEVE MR. CASSIDY'S RECOMMENDATION WOULD GREATLY**
4 **BENEFIT MISSOURI-AMERICAN RATEPAYERS?**

5 A. No. I do not believe the cost of changing the allocation basis for Belleville Lab
6 services from number customers to number of samples tested is worthwhile. Mr.
7 Cassidy recommends an adjustment of \$346,337 to Missouri American's revenue
8 requirements in connection with this change. This amounts to \$0.07 per customer per
9 month (\$346,337 / 442,904 customers/ 12 months). In return, a considerable effort
10 would be required to inform and secure approvals from regulators in many states it
11 does business.

12
13 As someone who has designed and supported a cost recovery process for a major
14 corporate service organization, I can say that Mr. Cassidy's recommendation is not
15 practical. American Water's policy of using number of customers to allocate Service
16 Company expenses is functioning effectively and widely accepted by regulators. Any
17 perceived benefits from changing to multiple allocation methods are not worth the
18 effort required to transition and maintain a more complex allocation arrangement.

19
20 **Q. DO YOU BELIEVE BELLEVILLE LAB'S COST OF TESTING IS REASONABLE?**

21 A. Yes. Every year, the Belleville Lab conducts a survey comparing its testing costs to
22 those of outside testing labs. During the last three years, these comparisons show
23 that Belleville Lab is the lowest cost provider. A brief description of these studies is
24 provided below.

25 **2001** A comparison of 26 major tests found that the outside labs were 15% more
26 expensive than the Belleville Lab.

27 **2001** 25 major tests found that the outside labs were 20% more expensive than the
28 Belleville Lab.

1 **2002** A comparison of 25 major tests found that the outside labs were 10% more
2 expensive than the Belleville Lab.

3
4 **Q. DID THE MPSC STAFF RECOMMEND THIS ALLOCATION METHOD FOR**
5 **BELLEVILLE LAB COSTS IN PREVIOUS MISSOURI AMERICAN RATE CASE?**

6 **A. No.** It is my understanding that this is the first time Missouri American has been faced
7 with such a recommendation.

8
9 **Q. DOES THIS COMPLETE YOUR REBUTTAL TESTIMONY?**

10 **A. Yes.**

11
12 **Q. IS IT TRUE TO BE BEST OF YOUR KNOWLEDGE AND BELIEF?**

13 **A. Yes.**