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Issues: Relief Requested and Summary of
Witnesses, Reasons for Rate Request.
Test Year and the Company's Request
for a True-Up, Labor and Labor Related
Expenses, Pensions, Pension/OPEB
Tracker, Tank Painting Costs, AWW
Support Services, Comprehensive
Planning Study, Income Taxes,
Depreciation Study, Net Negative
Salvage. Rate Design
Witness: Dennis R. Williams
Exhibit Type: Direct
Sponsoring Party: Missouri-American Water Company
Case No.: WR-2010-XXXX
SR-2010-XXX
Date: October 30, 2009

MISSOURI PUBLIC SERVICE COMMISSION

**CASE NO. WR-2010-XXXX
CASE NO. SR-2010-XXXX**

DIRECT TESTIMONY

OF

DENNIS R. WILLIAMS

ON BEHALF OF

MISSOURI-AMERICAN WATER COMPANY

MAWC Exhibit No. 130
Date 5-17-10 Reporter KF
File No. WR-2010-0131

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 AND SEWER) SERVICE)	CASE NO. WR-2010-XXXX CASE NO. SR-2010-XXXX
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AFFIDAVIT OF DENNIS R. WILLIAMS

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

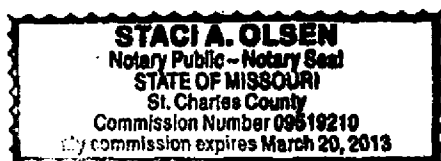

Dennis R. Williams

State of Missouri
County of St. Louis

SUBSCRIBED and sworn to
Before me this 28th day of October 2009.


Notary Public

My commission expires:



**DIRECT TESTIMONY
DENNIS R. WILLIAMS
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WR-2010-XXXX
SR-2010-XXXX**

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DIRECT TESTIMONY

DENNIS R. WILLIAMS

I. WITNESS INTRODUCTION

1

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

3 A. My name is Dennis R. Williams. I am employed by American Water Works
4 Service Company, Inc. ("AWWS"), 727 Craig Road, St. Louis, Missouri
5 63141.

6

7 **Q. WHAT IS YOUR POSITION WITH MISSOURI-AMERICAN WATER**
8 **COMPANY ("MISSOURI-AMERICAN" OR "MAWC" OR THE**
9 **"COMPANY")?**

10 A. I am employed as Senior Manager – Rates and Regulation for the Western
11 Region of AWWS, which includes Missouri-American.

12

13 **Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND**
14 **PROFESSIONAL EXPERIENCE.**

15 A. I received a Bachelor of Science in Business Administration, summa cum
16 laude, in 1974 from the University of Central Missouri, with majors in
17 accounting and finance. After graduation, I was licensed in Missouri as a
18 Certified Public Accountant and employed as an auditor in the Regulated
19 Industries division of Arthur Andersen & Company. After leaving Arthur
20 Andersen, I was employed for five years with a regulatory consulting firm. In
21 1986, I joined the Regulatory Services department of Aquila, Inc., formerly an

1 electric and gas utility, headquartered in Kansas City. I served in a number of
2 roles at Aquila, progressing to the position of Vice President – Regulatory
3 Services. I joined AWWWS in my current capacity in May 2008. Over the
4 years I have participated in regulatory proceedings in 19 jurisdictions and
5 provided testimony in ten states, Canada and Australia.

6
7 **II. PURPOSE OF TESTIMONY**

8 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

9 **A.** The purpose of my testimony is to discuss on behalf of MAWC:

- 10 1) Relief Requested and Summary of Witnesses;
- 11 2) Reasons for Rate Request;
- 12 3) The Test Year and the Company's Request for a True-up;
- 13 4) Labor and Labor Related Expenses;
- 14 5) Pensions;
- 15 6) Pension/OPEB Tracker;
- 16 7) Tank Painting Costs;
- 17 8) AWWWS Support Services;
- 18 9) Comprehensive Planning Study;
- 19 10) Income Taxes;
- 20 11) Depreciation Study;
- 21 12) Net Negative Salvage; and,
- 22 13) Rate Design.

23
24 **Q. WILL YOU BE TESTIFYING IN SUPPORT OF ANY SCHEDULES?**

1 A. Yes. Mr. Don Petry is sponsoring all of the Company's Accounting Schedules
2 (CAS). These schedules consist of a Rate Increase Summary, Rate Base,
3 Income Statement, Summary of Adjustments, and a Bill Analysis at Present
4 and Proposed Rates. I will be testifying in support of specific schedules
5 within the CAS, which will be identified later in my testimony.

6

7

III. RELIEF REQUESTED AND SUMMARY OF WITNESSES

8 **Q. WHAT RELIEF IS MAWC SEEKING IN THIS CASE?**

9 A. MAWC is seeking a rate increase to produce additional annual water
10 revenues of \$48.56million, or an overall 22.47% increase, and additional
11 annual sewer revenues of \$144,000, or an overall 25.96% increase.

12

13 **Q. WHAT WITNESSES WILL BE FILING DIRECT TESTIMONY IN SUPPORT**
14 **OF MAWC'S PROPOSED RATE INCREASE AND TARIFF SHEETS AND**
15 **WHAT SUBJECTS WILL THEY BE ADDRESSING?**

16 A. The following persons will be filing testimony in support of MAWC's proposed
17 tariffs:

18 1) Greg Weeks, Vice President Operations, will testify regarding the
19 operations of the Company, the consolidation of proposed tariffs, and
20 changes to service fees;

21 2) Kevin Dunn, Director, Engineering, will testify concerning capital additions
22 since the last rate case;

23 3) Donald Petry, Financial Analyst III, will testify concerning Revenues at
24 Present Rates, Customer Usage in smaller districts, Production Costs,

1 Insurance Other Than Group, Property Taxes and other selected proforma
2 operating expense adjustments;

3 4) Gina Tierney, Financial Analyst II, will testify to rate base, depreciation
4 expense and other selected pro forma operating expense adjustments;

5 5) Professor Edward Spitznagel, Consultant, will testify on the usage trend
6 and weather normalization for the larger districts;

7 6) John Spanos, Consultant with Gannett Fleming, will testify to the results of
8 a Depreciation Study he prepared;

9 7) Michi Chao, Financial Director, will testify to the capital structure, including
10 pro forma rates for debt and preferred stock. She has incorporated a
11 proposed 11.6% return on equity which will be supported by another witness;

12 8) Pauline Ahern, Consultant with AUS, will testify concerning cost of equity;
13 and,

14 9) Paul Herbert, Consultant with Gannett Fleming, will testify to a Class Cost
15 of Service Study and Tariff Design.

16
17 **IV. REASONS FOR RATE REQUEST**

18 **Q. WHEN WERE MAWC'S BASE RATES LAST ADDRESSED IN A GENERAL**
19 **RATE CASE?**

20 **A.** On November 14, 2008, the Commission addressed the Company's base
21 rates by its Order Approving Stipulations and Agreements in Case No. WR-
22 2008-0311. The Commission's Order approved an increase in base rates of
23 \$34,471,091 for MAWC. As a result of the change in the base rates, the
24 Infrastructure System Replacement Surcharge ("ISRS") was reset to zero.

1 Thus, the Company's net increase in revenues was approximately \$31.8
2 million or 16.6%.

3

4 **Q. SINCE BASE RATES WERE ADDRESSED IN CASE NO. WR-2008-0311,**
5 **HAVE THERE BEEN ADJUSTMENTS TO MAWC'S RATES?**

6 A. Yes. On July 8, 2009, the MPSC issued an Order authorizing the Company
7 to establish an ISRS to recover annual pre-tax revenues of \$2,652,705 or
8 1.2%, effective July 18, 2009. The ISRS was authorized by the Missouri
9 General Assembly in 2003 for St. Louis County only.

10

11 **Q. PLEASE DESCRIBE THE RATE INCREASE REQUESTED BY MAWC IN**
12 **THIS PROCEEDING.**

13 A. MAWC seeks a rate increase that would produce additional permanent
14 annual water and waste water revenues of approximately \$48.7 million, or
15 approximately 22.47%. As a result of the existing ISRS surcharge being
16 rolled into permanent rates and reset to zero, the net percentage increase to
17 customers would be 21.25%. It should be noted that this is the overall
18 recommended increase and that individual district increases in terms of both
19 dollar amounts and percentage will vary.

20

21 **Q. WHY DOES THE COMPANY SEEK A RATE INCREASE?**

22 A. For the twelve months ended June 30, 2009, the Company's pro forma
23 earned rate of return is 5.16%. This overall return is well below the current
24 cost of capital recommended by Ms. Chao in this case. We have filed this

1 case to provide the Company with an opportunity to earn better and more
2 appropriate returns. The Company's ability to provide water service is
3 dependent on a consistent level of adequate earnings. Adequate earnings
4 are those which justify the investment of capital in the Company. Revenues
5 must be sufficient to cover operating expenses, such as employee payroll and
6 benefits, insurance, taxes, depreciation, and costs associated with
7 maintenance and operation, and, thereafter, provide for the payment of
8 capital costs which include interest and dividends. Revenues generated by
9 the current rates the Company is authorized to charge for water and sewer
10 service will not adequately accomplish this task.

11

12 **Q. WHAT ARE THE PRIMARY REASONS DRIVING THE NEED FOR THE**
13 **INCREASE IN RATES?**

14 **A.** The water rate increase is primarily due to the following factors:

- 15 • **Infrastructure investments** - Across the state, the Company will have
16 invested, net of retirements, over \$96 million in the communities it serves
17 from the true-up date in the last case to the true-up date proposed in this
18 case -- including replacing and installing water lines, meters, hydrants and
19 improvements at water treatment, pumping and storage facilities, all of
20 which enhance customer service and support local economic
21 development. Mr. Kevin Dunn will provide some more specific detail
22 regarding these investments.
- 23 • **Property Taxes and Depreciation** – Increases in utility plant also result
24 in higher property tax and depreciation expenses.

- 1 • **Depreciation Study** – Mr. John Spanos testifies in this case regarding the
2 need to modify existing depreciation accrual rates. Depreciation refers to
3 the loss in service value, as a result of obsolescence, wear and other
4 causes, as utility plant is utilized in the course of service. Depreciation
5 accrual rates should be sufficient to match in rates the cost of assets over
6 their service lives.
- 7 • **Pensions and Other Post Employment Benefits (OPEBs)** – Pension
8 and OPEB costs are largely attributable to the return on investments of
9 their underlying investment portfolios. Due to the vagaries of the market,
10 these costs are subject to wide fluctuations and volatility. Therefore,
11 MAWC rates have been designed to track costs so that the customer pays
12 only for the actual pension and OPEB cost incurred. Since the time of our
13 last rate proceeding, these costs have increased considerably and it is
14 necessary to adjust the tracker calculations.
- 15 • **Increases in Operating Costs** - MAWC has experienced continued
16 increases in costs for labor and labor related costs, fuel and power,
17 property insurance and other operating costs since the last rate order.
- 18 • **Rate of Return** - Like all water utilities, MAWC must continually invest in
19 the water plants, towers and pipelines that serve our communities. In
20 order to attract the capital needed to fund these improvements, the
21 Company must earn a fair rate of return. This rate increase will allow
22 MAWC to earn a fair rate of return which will allow us to continue with
23 infrastructure investment needs across the state.

- 1 • **Reduced Sales** - The Company continues to see a decline in overall
2 sales of the Company, both in terms of number of customers and in usage
3 per customer.
4

5 **V. TEST YEAR AND COMPANY'S REQUEST FOR A TRUE-UP**

6 **Q. WHAT TEST YEAR HAS MAWC USED IN THIS RATE CASE?**

7 **A. MAWC has used a historical test year of the twelve months ending June 30,**
8 **2009, adjusted for changes that are known and measurable at this time and**
9 **that will be effective by the time new rates are anticipated to go into effect.**
10

11 **Q. IS THE COMPANY PROPOSING A TRUE-UP IN THIS CASE?**

12 **A. Yes. If prospective rates are to be set that properly reflect the cost of**
13 **providing service, a true-up of rate base and related operating revenues and**
14 **costs at a point in time as close as possible to the operation of law date**
15 **should be permitted. Otherwise, the new rates will not be sufficient to cover**
16 **all of MAWC's expenses and investments which have been incurred to**
17 **provide safe and adequate service. In this case, the Company is proposing a**
18 **true-up at April 30, 2010, for the following components of its revenue**
19 **requirement: rate base, capital structure, and revenues (using customers at**
20 **April 30, 2010). Expenses MAWC proposes to true-up are labor and labor**
21 **related, fuel and power, chemical, purchased water, waste disposal, hydrant**
22 **painting, tank painting, rate case expense, property taxes, depreciation, PSC**
23 **Assessment Fees, pension and OPEB trackers, and income taxes. The**

1 specific items MAWC proposes to true-up will be set forth in its Motion for
2 True-Up.

3
4 **VI. LABOR AND LABOR-RELATED EXPENSES**

5 **Q. PLEASE EXPLAIN THE COMPANY'S PRO FORMA ADJUSTMENT TO**
6 **LABOR AND LABOR-RELATED EXPENSES.**

7 A. The Company has proposed adjustments to its Labor Expense (including
8 Incentive Plan), Group Insurance Expense, Pension Expense, 401K, and
9 Payroll Tax Expense.

10
11 **Q. PLEASE EXPLAIN THE COMPANY'S PRO FORMA ADJUSTMENT TO**
12 **LABOR.**

13 A. The expenses associated with the labor adjustment include salary,
14 overtime, incentive pay, and shift premium pay. Base salary is calculated
15 by the number of work hours in a normal year multiplied by the appropriate
16 wage rate. The Company used 2,088 hours to calculate an hourly
17 employee's annual salary. The wage rate for a union employee is
18 determined by the contract rate that will be in effect by April 2010. Non-
19 union employees' wage rates were increased by the annual wage
20 adjustment. The Company is using 3.00% for this adjustment. The
21 Operating and Maintenance expense percentage used to allocate each
22 employee's salary was based on the three year average of capital charged
23 by district and total labor. The Company's adjustment for overtime was
24 calculated by taking the three year average of overtime in relation to total

1 payroll. Incentive pay was calculated based on the employee's pro forma
2 salary level incentive payout percentage. The labor adjustment is
3 summarized on CAS – 15, page 1.
4

5 **Q. PLEASE EXPLAIN THE COMPANY'S ADJUSTMENT TO GROUP**
6 **INSURANCE.**

7 A. The purpose of this adjustment is to annualize the Company's expense
8 associated with Group Insurance. Except for OPEBs, these expenses
9 were adjusted by applying historical group insurance expense as a
10 percentage of payroll to current payroll expense.
11

12 **Q. HOW WERE OPEBS ANNUALIZED?**

13 A. The Company used the most recent actuarial report prepared for
14 American Water Works Company ("AWWC") by Towers Perrin to calculate
15 the pro forma cost. The capitalization rate from the labor adjustment was
16 applied to arrive at the pro forma expense. As a result of union
17 negotiations, union employees who are not eligible for post-retirement
18 benefits are provided an annual \$500 contribution that is to be paid into a
19 VEBA account for the employee to pay for medical costs after retirement.
20 The current OPEB funding levels were added to existing amortization
21 levels for prior OPEB deferrals. Finally, the level of amortization of the
22 current OPEB tracker was estimated based upon the deferred balance at
23 June 30, 2009. This balance could increase or decrease based upon
24 market conditions and should be updated at the time of true-up in this

1 case. The pro forma OPEB expense is included on Schedule CAS -15,
2 page 2 as a part of the Group Insurance expense adjustment.

3

4 **Q. PLEASE EXPLAIN THE COMPANY'S ADJUSTMENT TO 401K**
5 **EXPENSE.**

6 A. The purpose of this adjustment is to annualize the Company's expense
7 associated with 401K. This expense was adjusted on a district by district
8 basis by applying historical 401k contributions as a percentage of payroll
9 to pro forma payroll costs and applying an appropriate capitalization rate.
10 This adjustment is summarized on CAS - 15, page 4.

11

12 **Q. PLEASE EXPLAIN THE COMPANY'S ADJUSTMENT TO PAYROLL**
13 **TAX.**

14 A. The purpose of this adjustment is to annualize the Company's expense
15 associated with Payroll Tax. The employer portion of the tax rate for state
16 unemployment tax, Federal unemployment tax, FICA, and Medicare,
17 respectively, was applied to the lower of each individual's total pro forma
18 payroll or the maximum individual taxable wage. An appropriate
19 capitalization rate was applied to the result to determine pro forma payroll
20 tax expense. A summary of this adjustment is shown on page 5 of CAS -
21 15.

22

23

24

1 **VII. PENSION**

2 **Q. PLEASE DESCRIBE THE ADJUSTMENT TO OPERATING EXPENSES**
3 **RELATED TO PENSION.**

4 A. Missouri-American has included in its pro forma pension expense the actual
5 cost related to the FAS 87 accrual which is supported by AWWC's latest
6 actuarial report. Starting in 2006, nonunion employees hired before January
7 1, 2006, and union employees hired before January 1, 2001, are included as
8 participants in the Company's defined benefit pension plan. The FAS 87
9 Pension cost is based on actuarial studies conducted annually by Towers
10 Perrin for the defined benefit participants. For employees in the defined
11 contribution plan, a rate of 5.25% of base salary is used to calculate the
12 expense. The total costs for pension were reduced by the amounts
13 anticipated to be capitalized based on the payroll adjustment. The current
14 pension funding levels were added to existing amortization levels for prior
15 pension deferrals. Finally, the level of amortization of the current pension
16 tracker was estimated based upon the deferred balance at June 30, 2009.
17 This balance could increase or decrease based upon market conditions and
18 should be updated at the time of true-up in this case. A summary of this
19 adjustment is found on Schedule CAS-15, page 3.

20
21 **VIII. PENSION/OPEB TRACKERS**

22 **Q. YOU MENTIONED PENSION/OPEB TRACKERS EARLIER IN YOUR**
23 **TESTIMONY. ALSO, IN THE STIPULATION IN THE LAST RATE CASE,**
24 **THE COMPANY AGREED TO TRACK PENSION AND OPEB COSTS FOR**

1 THE DIFFERENCE BETWEEN THE LEVEL OF COST RECOVERY IN
2 RATES AND THE LEVEL INDICATED BY THE COMPANY'S ACTUARIAL
3 REPORTS. CAN YOU DESCRIBE IN MORE DETAIL HOW THESE
4 TRACKERS WORK?

5 A. Yes. As the result of a stipulation in Commission Case No. WR-2007-0216,
6 the Company agreed to track actual pension and OPEB cost in comparison to
7 the levels included in rates. The concept behind the establishment of tracking
8 mechanisms for pension and OPEBs is to protect customers and the
9 Company from the wide variations that can exist in expected costs at the time
10 rates are set from what actually occurs beyond that point in time. Pension
11 and OPEB costs are largely dependent upon market conditions and,
12 especially in recent years, the market has experienced great volatility.
13 Therefore, a base level of pension and OPEB expense has been established
14 in the Company's rate proceeding. Actual costs above or below that base
15 level are recorded monthly on the Company's books. Both excess recoveries
16 and shortages can and have occurred. At the time of the next rate case, the
17 cumulative excess or shortage is included in rate base and amortized over a
18 period of five years.

19
20 Q. ARE YOU PROPOSING ANY CHANGE TO THE TRACKER MECHANISM
21 IN THIS PROCEEDING?

22 A. Yes. When the pension and OPEB trackers were first established, it was the
23 Company's understanding that the mechanisms applied only to Missouri
24 direct employees. Pension and OPEB costs that are incurred for AWWWS

1 employees and billed through the MAWC management service agreement
2 are subject to the same volatility as MAWC direct employees. Inclusion of the
3 service Company pension and OPEB costs in the tracker mechanism would
4 provide the same level of protection to customers and the Company from
5 volatile market conditions.

6
7 **Q. HAVE YOU PROPOSED AN ADJUSTMENT IN THIS CASE TO INCLUDE**
8 **SERVICE COMPANY PENSION AND OPEB IN THE TRACKER**
9 **MECHANISM?**

10 A. No. The Company's proposal is to include the pro forma AWWS pension
11 expense and OPEB expense as part of the baseline in the tracker
12 establishment in this case. We have not proposed that an adjustment be
13 made to reflect inclusion of the AWWS in past tracker calculations.

14
15 **IX. TANK PAINTING COSTS**

16 **Q. PLEASE DESCRIBE THE ADJUSTMENT TO OPERATING EXPENSES**
17 **RELATED TO TANK PAINTING COSTS.**

18 A. The Company is proposing a pro forma level of tank painting costs in the
19 amount of approximately \$1,600,000. As reflected on CAS – 15, page 19,
20 this is the level of tank painting that is projected to take place on an annual
21 basis. Contracts are in the process of being developed and awarded for
22 2010 tank painting and should approximate this pro forma amount.
23 Moreover, contracts currently in place will result in tank painting expenses
24 of about \$1.6 million for the calendar year 2009. Mr. Greg Weeks is

1 presenting testimony in this proceeding that provides greater detail
2 regarding tank painting costs. The Company's request to increase the
3 baseline of tank painting costs in rates to \$1,600,000 represents a
4 \$600,000 increase in the current level and is commensurate with the
5 ongoing level of tank painting expense. The Company is currently
6 recording a Tank Painting Deferral to reflect an annual level of expense in
7 the amount of \$1,000,000. The Company proposes to begin recording
8 this increased tracker effective with the issuance of a Commission Order
9 in this proceeding which would include \$1,600,000 of expense in the
10 revenue requirement. The Tank Painting Deferral is a form of accounting
11 treatment that allows direct auditing of tank painting expense in
12 comparison to what is embedded in rates. Amounts actually incurred
13 above or below the level of what exists in rates can be easily identified for
14 possible special treatment in the Company's next rate case.

15
16 **X. AWWWS SUPPORT SERVICES**

17 **Q. WHAT ADJUSTMENT WAS MADE TO THE COMPANY'S TEST YEAR**
18 **LEVEL OF SUPPORT SERVICES?**

19 **A.** Test year Support Services from AWWWS were adjusted to reflect current
20 ongoing levels of labor and labor related expenses, plus anticipated cost
21 increases of four percent. In addition, two employees were transferred
22 during the year from AWWWS Support Services positions to direct MAWC
23 positions. Their payroll and related benefits were included in the
24 adjustment of MAWC direct labor and were therefore eliminated from the

1 Support Services adjustment. Details of this adjustment can be found at
2 Schedule CAS-15, page 12.
3

4 **XI. COMPREHENSIVE PLANNING STUDY**

5 **Q. WHAT IS MEANT BY THE TERM COMPREHENSIVE PLANNING STUDY?**

6 A. In late 2008, AWWWS began a process to review its business systems and
7 processes because the systems at AWWWS, which support many of our
8 processes, are at the end of their useful life cycle. The existing business
9 systems and processes were designed to accommodate a much smaller
10 customer base than the Company now serves and are increasingly costly and
11 more difficult to maintain and support since the vendors have issued newer
12 versions that are not compatible with ours. In addition, customer expectations
13 for service are far greater today than existed when our existing systems were
14 acquired. The lack of sufficient automation limits opportunities for a customer
15 to conduct basic self-service tasks or an employee to effectively service a
16 customer by obtaining appropriate information quickly and consistently from
17 across multiple non-integrated systems. The demand for information to
18 satisfy stakeholder needs is beyond the capability of our existing systems and
19 requires a high degree of manual involvement. The initial phase of
20 addressing these needs is being referred to as the Comprehensive Planning
21 Study ("CPS") and is related to identifying the investments needed to replace
22 aged business systems and improve business processes. The purpose of the
23 CPS is to assess the needs of our business to satisfy customer and other
24 stakeholder expectations and review different technology options to support

1 the implementation of automated processes that provide improved service to
2 our customers. AWWC began the CPS in the first quarter of 2009. The cost
3 of the CPS is being allocated to all the regulated entities of AWWC based on
4 customer count.

5
6 **Q. HAS MAWC INCLUDED IN ITS FILING ANY OF THE COSTS**
7 **ASSOCIATED WITH THE CPS?**

8 A. Yes. Missouri American's allocation is \$938,062 and this is the amount the
9 Company is proposing to include in rate base in this proceeding. The study
10 will be completed and placed into service by the end of 2009. MAWC is
11 recording these costs in account 339 – miscellaneous intangible plant. The
12 proposed depreciation rate associated with these assets is addressed by Mr.
13 Spanos.

14
15 **Q. WILL THERE BE ADDITIONAL COSTS INCURRED TO IMPROVE**
16 **BUSINESS PROCESSES AND REPLACE AGED BUSINESS SYSTEMS?**

17 A. Yes, it is anticipated that there will be. Details, including scope, cost and
18 implementation of solutions to replace, upgrade, enhance and/or redesign
19 specific business processes and specific business system components will
20 not be known until the CPS has been completed.

21 As part of the CPS, AWWC conducted an internal evaluation of processes,
22 along with the information systems associated with those processes. The
23 scope of this part of the study incorporated a range of functional areas,
24 including: human resources; finance and accounting; purchasing and
25 inventory management; capital planning; cash management; and customer

1 and field services. The results thus far show that the internal and external
2 demand for information (data, trends etc.) has surpassed the ability of existing
3 processes and systems. Existing business systems rely on independent
4 databases, which often require manual intervention to relate information from
5 one to the other. Current state of the art business system technology relies
6 on relational databases, which offer opportunities to improve efficiency and
7 effectiveness in executing tasks by eliminating multiple, unrelated data
8 storage sites and eliminating redundancy of the same data on multiple sites.
9 In order to take advantage of those opportunities, business process
10 consistency, common definitions, and data conformity are important.
11 As a result, AWWC is pursuing a multi-year program to streamline and
12 automate processes, as well as remove inefficient manual tasks, controls and
13 processes to allow our business to build efficiencies and provide the best
14 service to our customers. The program aims to optimize workflow throughout
15 our field operations, improve our back-office operations and enhance our
16 customer service capabilities, which the Company believes is necessary and
17 appropriate. In summary, the Company is committed to investing in its key
18 business processes and the information systems that support them, so it can
19 continue to deliver high-quality water and wastewater service to our
20 customers in an efficient and effective manner.

21
22 **Q. HOW DOES MAWC INTEND TO RECOVER THESE FUTURE COSTS?**

23 A. The regulatory accounting alternatives are deferral of the costs associated
24 with these projects and amortization over a period of time, expensing of some

1 portion or all of these costs, inclusion of the costs as construction work in
2 progress until complete and then placing them in-service with appropriate
3 depreciation rates, or some combination of all three. The Company is
4 proposing that all the expenditures associated with the multi-year business
5 transformation program be treated as construction work in progress until they
6 become used and useful and then they would be placed into plant in service
7 for subsequent consideration as appropriate components of rate base. This
8 means that MAWC would capitalize in construction work in progress accounts
9 all facets of this program, including planning, software development,
10 hardware, IT costs, training, etc. and seek recovery in rates at some future
11 date when the projects are complete and in-service.

12 **XII. INCOME TAXES**

13
14 **Q. PLEASE EXPLAIN THE COMPANY'S CALCULATION OF ITS PRO**
15 **FORMA LEVEL OF INCOME TAXES.**

16 **A.** The Company's pro forma level of current income taxes at present rates is
17 based on deducting from revenues all operating expenses and interest
18 expense. Additional add-backs and deductions are reflected for tax-over-
19 book depreciation, non-deductible meals and preferred stock expense. The
20 resulting taxable income is then multiplied by the state and federal statutory
21 rates of 6.25% and 35%, respectively.

22 Deferred income taxes for the temporary timing difference related to tax-over-
23 book depreciation were calculated at the statutory rates. The per books level
24 of the amortization of the Deferred Investment Tax Credits ("ITC") and the

1 Deferred Taxes associated with the amortization of the regulatory assets and
2 liabilities was also included in the calculation of income taxes.

3 Income taxes at proposed rates reflect the impact of the Company's request
4 for additional revenues.

5
6 **XIII. DEPRECIATION STUDY**

7 **Q. DO YOU HAVE ANY COMMENTS REGARDING DEPRECIATION RATES?**

8 A. Yes. MAWC, in a 2006 rate filing, proposed new depreciation rates based on
9 a study using 2005 plant data. Rather than implement the full impact of the
10 depreciation rate study at that time, the Company proposed transitioning to
11 those new depreciation rates over time. John Spanos of Gannet Fleming
12 performed the original depreciation study and for this filing he has updated his
13 original study utilizing 2008 plant data.

14 **Q. IS THE COMPANY PROPOSING TO IMPLEMENT THE DEPRECIATION
15 RATES AS RECOMMENDED BY MR. SPANOS?**

16 A. Yes, it is.
17

18 **XIV. NET NEGATIVE SALVAGE**

19 **Q. DO THE DEPRECIATION RATES YOU DESCRIBE ABOVE INCLUDE A
20 COMPONENT FOR NET NEGATIVE SALVAGE (COST OF REMOVAL AND
21 SALVAGE)?**

22 A. Yes, they do. We have calculated pro forma depreciation expense utilizing
23 these depreciation rates including net negative salvage, and have adjusted

1 maintenance expense accordingly. This adjustment is summarized on CAS –
2 15, page 16.

3
4 **XV. RATE DESIGN**

5 **Q. HAS MAWC PREPARED A CLASS COST OF SERVICE STUDY FOR THIS**
6 **RATE CASE?**

7 A. Yes. MAWC has contracted the services of Paul Herbert of Gannett Fleming
8 to prepare a class cost of service and rate design analysis. Mr. Herbert has
9 prepared and is filing direct testimony and schedules to support the class cost
10 of service study and rate design. Mr. Herbert prepared his study based on
11 the Base-Extra Capacity Method of cost allocation. The Company provided
12 Mr. Herbert the following guidelines regarding rate design: (1) Maintain
13 district specific pricing for each district's rate structure and taking into account
14 a revenue contribution for several small districts as discussed below; (2)
15 determine the unit cost per public fire hydrant in the St. Louis Metro Area so
16 that public fire protection costs can be recovered from each customer in a
17 similar manner as the current practice in St. Louis County; (3) for districts
18 other than St. Louis Metro, use a one-block structure for the residential class
19 and two- to four-block structures for non-residential classes; (4) incorporate
20 new fee schedules as reflected in the testimony of Greg Weeks; and, (5)
21 design the customer charges and volumetric rates so that proposed revenues
22 by customer classification move toward or approximate the indicated cost of
23 service in each district.

24

1 Q. **BASED ON THE COMPANY'S CLASS COST OF SERVICE STUDY AND**
2 **PROPOSED RATE DESIGN, WHAT ARE THE OVERALL INCREASES IN**
3 **REVENUES BY DISTRICT AND CUSTOMER CLASSES WITHIN EACH**
4 **DISTRICT THAT ARE BEING PROPOSED.**

5 A. Please refer to the Company's minimum filing requirements that are attached
6 to the direct testimony of Mr. Petry.

7

8 Q. **IS THE COMPANY PROPOSING A REVENUE CONTRIBUTION AMONG**
9 **DISTRICTS AS A PART OF ITS RATE DESIGN?**

10 A. Yes, it is. The Company has included a revenue contribution for the
11 Brunswick District, Parkville Water District, Cedar Hill Sewer District and
12 Warren County Water and Sewer Districts in the amounts of \$404,851,
13 \$354,195, \$488,473, \$86,022 and \$853,790, respectively. The revenue
14 contribution is being provided by the St. Louis Metro Area District. The rates
15 being proposed for the Jefferson City, Joplin, Mexico, St. Joseph,
16 Warrensburg and Parkville Sewer Districts are based on each district's
17 revenue requirement. The Company's proposal for the revenue contribution
18 was based on the belief that the smaller districts should receive a revenue
19 contribution if their rate increase, on a district specific basis, was significantly
20 above the overall increase for the Company.

21

22 Q. **HOW WERE THE PROPOSED RATES DEVELOPED FOR THE THREE**
23 **SEWER DISTRICTS?**

1 A. The Company did not perform a class cost of service study for the three
2 sewer districts because the three operations are comprised mainly of
3 residential and commercial customers. The Company is proposing an across
4 the board increase for all customers within each sewer district based on the
5 proposed revenue increase, after revenue contribution, if any, for the district.

6

7 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

8 A. Yes, it does.