

Exhibit No.:  
Issues: Rate Case Test Year, Accounting  
Authority Orders Related to the Tax Cuts  
and Jobs Act, Ratemaking Treatment  
for MAWC's LSRL Program, Rate  
Case Expense, Affiliate Transactions  
Witness: James M. Jenkins  
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Sponsoring Party: Missouri-American Water Company  
Case No.: WR-2017-0285  
SR-2017-0286  
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**MISSOURI PUBLIC SERVICE COMMISSION**

**CASE NO. WR-2017-0285  
CASE NO. SR-2017-0286**

**REBUTTAL TESTIMONY  
REVENUE REQUIREMENT**

**OF**

**JAMES M. JENKINS**

**ON BEHALF OF**

**MISSOURI-AMERICAN WATER COMPANY**

Exhibit No. 19  
Date 3/8/18 Reporter MM  
File No. WR-2017-0285

Exhibit 19  
WR-2017-0285  
Rebuttal Testimony – Revenue  
Requirement of James M. Jenkins

**REBUTTAL TESTIMONY  
REVENUE REQUIREMENT  
JAMES M. JENKINS  
MISSOURI-AMERICAN WATER COMPANY  
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**REBUTTAL TESTIMONY  
REVENUE REQUIREMENT**

**JAMES M. JENKINS**

**I. INTRODUCTION**

1  
2 **Q. Please state your name and business address.**

3 A. My name is James M. Jenkins and my business address is 727 Craig Road, St. Louis,  
4 Missouri 63141

5 **Q. Are you the same James M. Jenkins who previously submitted direct testimony**  
6 **in this proceeding?**

7 A. Yes.

**II. OVERVIEW**

9 **Q. What is the purpose of your revenue requirement rebuttal testimony in this**  
10 **proceeding?**

11 A. The purpose of my revenue requirement rebuttal testimony is several fold: first, I will  
12 address the appropriate test year to be used in setting rates in this proceeding; second,  
13 I will respond to the lead service line replacement (“LSLR”) cost recovery and  
14 accounting issues; third, I will explain why it is appropriate for MAWC to recover the  
15 full amount of its just and reasonable rate case expense; and, fourth, I will describe  
16 why MAWC’s transactions with its affiliates are just and reasonable and in the best  
17 interest of the Company’s customers.

**III. RATE CASE TEST YEAR**

18  
19 **Q. Do witnesses from Staff and interveners address MAWC’s proposed use of a**  
20 **future test year in this proceeding?**

1 A. Yes. Office of Public Counsel (OPC) witness Geoff Marke, Missouri Industrial  
2 Energy Consumers (MIEC) witness Greg Meyer, and Commission (Staff) witness  
3 Mark L. Oligschlaeger, all address and object to the Company's use of a future test  
4 year based on various criticisms. Those criticisms are misplaced and, in many cases,  
5 actually serve to demonstrate why the future test year is a particularly appropriate  
6 ratemaking mechanism for a water company, as opposed to an historic test year.

7 **Q. Mr. Jenkins, are you familiar with the criticisms that OPC witness Geoff Marke**  
8 **has directed at the Company's use of a future test year?**

9 A. Yes, I am. As a result of those criticisms, Mr. Marke alleges that the Commission  
10 should reject the use of the future test period and rely, instead on a historical test  
11 period.

12 **Q. In your opinion, are those criticisms valid?**

13 A. In my opinion, they are not valid reasons to reject the future test year. As I explained  
14 in my Direct Testimony, a future test year is particularly appropriate to use to set rates  
15 in this proceeding for MAWC, which faces unique challenges as a water utility.

16 **Q. OPC witness Geoff Marke levels several criticisms in his direct testimony against**  
17 **the use of a future test year, concluding that (p. 10): "the historic test year and**  
18 **adherence to the matching principle and the known and measurable standard**  
19 **are not only entirely consistent, but the historic test year is entirely needed to**  
20 **maintain this basis of Commission ratemaking in Missouri." Before beginning**  
21 **your response to witness Mr. Marke's specific arguments about a future test**  
22 **year, do you have a general comment about his claim that the future test year is**  
23 **contrary to proper regulation?**

1 A. Yes, I do. OPC witness Marke appears to approach the matter of the future test year  
2 as if it were some sort of experiment or novel ratemaking scheme. It is neither.  
3 Utility regulators have successfully been using the future test year approach to rate  
4 making since 1977, and it has only gained traction over the past forty years. As of  
5 September 30, 2013, the Brattle Group published a study on Alternative Regulation in  
6 the water sector that identified 17 states with provisions for future test years.  
7 Similarly, in October 2013, the National Regulatory Research Institute (NRRI)  
8 reported that” 23 states allow or require commissions to use an FTY for ratemaking,  
9 at least for electric utilities. Over half of the states now allow the use of a test year  
10 other than historical, and this number has grown over time.” *Future Test Years:  
11 Evidence from State Utility Commissions, Ken Costello, Principal Researcher  
12 National Regulatory Research Institute, October 2013.* More important, the NRRI  
13 report went on to note that “[m]ost reported commissions expressed confidence in  
14 using an FTY to set rates.” Consequently, rather than being an untried novelty, it  
15 should be abundantly clear that the future test year is a time-tested regulatory  
16 mechanism that has been used successfully by state utility regulatory commissions for  
17 decades.

18 **Q. OPC witness Marke claims in his direct testimony (at p. 7) that the Future Test**  
19 **Year equates to single issue ratemaking because “it would cause the Commission**  
20 **to set rates based on certain isolated adjustments and forecasts of expenses to the**  
21 **exclusion of all others.” Is he correct?**

22 A. No, Mr. Marke is not correct in this regard. As I explained in my Direct Testimony,  
23 and other MAWC witnesses have demonstrated, the future test year that MAWC  
24 developed examined all elements of revenue, expenses and rate base and took into

1 account the most relevant information as to each of those cost elements, including  
2 increases and decreases in cost per unit, numbers of units, changes in revenue and  
3 changes in plant in service. It is, in fact, exactly the opposite of single issue  
4 ratemaking and matches all elements of the Company's cost of service to be  
5 encountered in the relevant test period.

6 **Q. OPC witness Marke also contends in his direct testimony (at p. 7) that “[a]**  
7 **regulators [sic] credibility is inevitably challenged by the inherent asymmetric**  
8 **information hurdles innate to the ratemaking process” because “MAWC owns**  
9 **and control all information about its current and future costs.” Is this a fair**  
10 **criticism?**

11 **A.** No, it isn't. Mr. Marke alludes to the discovery process, but he appears to brush it  
12 aside as a mere exercise. The Company, in contrast, takes its discovery obligations  
13 very seriously. In this case alone, to date MAWC has responded to over 500 discovery  
14 requests, many of them multi-part requests which, if requested individually, would  
15 approximately double the number of requests in this case. That, alone, is significant,  
16 but Mr. Marke pointedly ignores an even more important regulatory factor. The  
17 Company carries the burden of proof in a rate case. Although it is true that the  
18 information comes from the Company, that is hardly the end of the story. Especially  
19 in the case of a future test year, unless the utility makes a compelling case for why a  
20 forecasted number should be accepted over a historical one, it will not carry the day.

21 **Q. How did MAWC prepare its future test year proposal?**

22 **A.** As the Company's direct case demonstrates, it was carefully constructed starting from  
23 actual cost amounts that were tested and normalized for ratemaking veracity. Then

1 those known, measured and validated numbers were carefully analyzed for the cost  
2 influences from the end of the historical test year to the end of the future test year.

3 **Q. Is the information situation described by OPC witness Marke unique to the**  
4 **future test year issue?**

5 A. No. OPC witness Marke forgets that the charge of information asymmetry is equally  
6 true for the historical test period as it is for a forecasted period. Historical information  
7 could be developed that is unrepresentative of the rate year and produce inflated  
8 expenses that will never materialize. Indeed, I would argue that when projections for  
9 the future are used, the utility actually faces higher hurdles to prove its case than it  
10 does when submitting historical numbers; especially when historical expenses, for  
11 example, have the appearance to be representative of ongoing conditions but are  
12 known to be overstated.

13 **Q. Does OPC witness Marke address the “matching principle?”**

14 A. Yes, he does, but, while he claims that the future test year violates the matching  
15 principle, Mr. Marke doesn’t explain why this is the case beyond claiming historic  
16 information can be better matched. The reality is that the future test period is  
17 composed of the exact elements that composed the historic period, just validated,  
18 normalized and projected into the rate year. In fact, as I explained above, the future  
19 test year ensures that the matching principle will be respected.

20 **Q. Why do you believe that the use of a future test year will ensure the integrity of**  
21 **the matching principle?**

22 A. As I explained previously, all cost elements of the future test year are in  
23 synchronization and match up with each other. This is so because the forecasted test  
24 year is developed from normalized, actual amounts in the base year. It is a fiction,

1           however, to claim that the relationships that existed in the historical test year will  
2           exactly match those that exist in the future test year. That, for example, is why we  
3           normalize even historical test year results for capital, revenue and expenses so that the  
4           future test year is the best, most accurate, representation of the cost of service that will  
5           exist in the first year of the new rates.

6   **Q. Do you have concrete examples to support your claim?**

7   A. Yes, one need only look at the Tax Cuts and Jobs Act of 2017. The historical test  
8   year reflects a Federal Income Tax rate of 35%. The new law sets it at 21%. It would  
9   be indefensible to set rates on the fiction that the tax rate was the 35% rate that existed  
10   in the historical test year. This fact, alone, demonstrates conclusively that a historical  
11   test year is not the essential condition of regulatory purity. In fact, to set rates on the  
12   fiction of the abandoned 35% statutory federal income tax rate extant in the historical  
13   test year would do nothing but bestow a windfall on the Company. Similarly, it  
14   would be improper to set rates based on the revenue collected in the stale historical  
15   test year without normalizing it and recognizing the conservation trend that results in  
16   less water sold to customers, year over year. This is equally true for setting debt costs  
17   on historic debt rates when they are known to be changing or chemical or electric  
18   expense that was inflated due to an abnormally hot and dry summer. Such future test  
19   year adjustments are not “single issue” ratemaking in any way, nor do they violate the  
20   “matching principle.” As I pointed out above, the use of a carefully constructed,  
21   properly forecasted test year properly maintains the matching principle among all  
22   elements of a utility’s cost of service, while a slavish adherence to unrepresentative,  
23   stale numbers makes a mockery of this regulatory requirement.



1 Q. OPC Witness Marke concludes his criticism about the future test year with a  
2 charge that MAWC has not justified using it. He contends:

3 In addition, the resultant abandonment of the matching  
4 principle and known and measurable standard, as well as the  
5 acceptance of another form of single-issue ratemaking, would  
6 be a “major” change in the Commission’s approach to utility  
7 ratemaking. To justify such a departure, there must be a  
8 serious need. There is not. Or at least, MAWC has not  
9 demonstrated such a need.

10 Is OPC witness Marke correct in this regard?

11 A. No, he ignores the realities facing the water industry, in general, and MAWC, in  
12 particular. Mr. Marke particularly ignores the fact, as noted in my Direct Testimony,  
13 that in 2005, NARUC recognized the enormous financial challenges facing the water  
14 industry require the use of innovative ratemaking, including but not limited to, the  
15 future test year:

16 WHEREAS, To meet the challenges of the water and wastewater  
17 industry which may face a combined capital investment  
18 requirement nearing one trillion dollars over a 20-year period, the  
19 following policies and mechanisms were identified to help ensure  
20 sustainable practices in promoting needed capital investment and  
21 cost-effective rates: a) the use of prospectively relevant test years;  
22 b) the distribution system improvement charge; c) construction  
23 work in progress; d) pass through adjustments; e) staff-assisted rate  
24 cases; f) consolidation to achieve economies of scale; g) acquisition  
25 adjustment policies to promote consolidation and elimination of  
26 non-viable systems; h) a streamlined rate case process; i) mediation  
27 and settlement procedures; j) defined timeframes for rate cases; k)  
28 integrated water resource management; l) a fair return on capital  
29 investment; and m) improved communications with ratepayers and  
30 stakeholders; . . .

31  
32 RESOLVED, That the National Association of Regulatory Utility  
33 Commissioners (NARUC), convened in its July 2005 Summer  
34 Meetings in Austin, Texas, conceptually supports review and

1 consideration of the innovative regulatory policies and practices  
2 identified herein as “best practices;” *and be it further*

3  
4 RESOLVED, That NARUC recommends that economic regulators  
5 consider and adopt as many as appropriate of the regulatory  
6 mechanisms identified herein as best practices; *and be it further*

7  
8 RESOLVED, That the Committee on Water stands ready to assist  
9 economic regulators with implementation of any of the best  
10 practices set forth within this Resolution.

11  
12 *Sponsored by the Committee on Water*  
13 *Adopted by the NARUC Board of Directors July 27, 2005*

14  
15 **Q. Has NARUC indicated any hesitation with respect to its 2005 Resolution?**

16 A. No, quite the contrary. In fact, as I explained in my direct testimony, in 2013, NARUC  
17 reiterated its concerns that water companies were facing unique challenges that set  
18 them apart from other utilities and it re-emphasized its support for more forward  
19 looking regulation, including the use of future test years, because, among other things:

20 WHEREAS, Recent analysis shows that as compared to other  
21 regulated utility sectors, significant and widespread discrepancies  
22 continue to be observed between commission authorized returns on  
23 equity and observed actual returns on equity among regulated water  
24 and wastewater utilities; and

25  
26 WHEREAS, The extent of such discrepancies suggests the  
27 existence of challenges unique to the regulation of water and  
28 wastewater utilities; and

29  
30 WHEREAS, Ratemaking that has worked reasonably well in the  
31 past for water and wastewater utilities no longer addresses the  
32 challenges of today and tomorrow. Revenue, driven by declining  
33 use per customer, is flat to decreasing while the nature of  
34 investment (rate base) has shifted largely from plant needed to  
35 serve new customers to non-revenue producing infrastructure  
36 replacement; and

37

1 WHEREAS, Deficient returns present a clear challenge to the  
2 ability of the water and wastewater industry to attract the capital  
3 necessary to address future infrastructure investment requirements  
4 necessary to provide safe and reliable service, which could exceed  
5 one trillion dollars over a 20-year period; and . . .  
6

7 WHEREAS, A number of issues have been identified that if  
8 addressed may assist in lessening the discrepancy between  
9 authorized and actual returns, including: a) reducing, where  
10 appropriate, the length of time between rate cases and/or the length  
11 of time to process rate cases for regulated water and wastewater  
12 utilities; b) reducing rate case expense relative to requested revenue  
13 increases through the encouragement of mediation and settlement  
14 as appropriate; and c) examining the rate of infrastructure  
15 replacement and system improvements among regulated water and  
16 wastewater utilities; *now, therefore be it:*  
17

18 RESOLVED, That the Board of Directors of the National  
19 Association of Regulatory Utility Commissioners, convened at its  
20 2013 Summer Meeting in Denver, Colorado, identifies the  
21 implementation and effective use of sound regulatory practice and  
22 the innovative regulatory policies identified in the *Resolution*  
23 *Supporting Consideration of Regulatory Policies Deemed as "Best*  
24 *Practices"* (2005) as a critical component of a water and/or  
25 wastewater utility's reasonable ability to earn its authorized  
26 return...  
27

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28 *Sponsored by the Committee on Water*

29 *Adopted by the NARUC Board of Directors, July 24, 2013*

30 **Q. Did OPC witness Marke address the NARUC resolutions?**

31 A. No.

32 **Q. What is the implication of OPC witness Marke not recognizing NARUC's**  
33 **recommendations?**

34 A. Mr. Marke undercuts his position by arguing in the abstract, rather than addressing the  
35 specifics of MAWC's proposal. Mr. Marke contends that "no Missouri utility to my

1 knowledge has proposed a future test year in a rate case.” (Marke Dir., p. 5) Given  
2 the unique challenges faced by the water industry, the argument that no other utility  
3 has sought a future test year is out of place. The NARUC material shows NARUC’s  
4 deep concern that water utilities face unique challenges that differentiate MAWC from  
5 gas and electric utilities in Missouri. In my direct testimony, I explained that the use  
6 of future test year was warranted because the evidence shows that MAWC’s costs and  
7 revenue are not differing in the same proportion experienced in the historical test year.  
8 This is especially true where the conservation trend identified by Mr. Roach  
9 demonstrates that the decline in usage is unrelenting. At the same time, water utilities  
10 are the most capital intensive of all utilities, and MAWC is no exception. Our  
11 construction costs and requirements continue to increase. The future test period is  
12 designed to address the mismatch of revenue, expenses and rate base that arise from  
13 the use of fully historical rate periods. Contrary to OPC witness Marke’s assertion  
14 that the Company has not demonstrated the need to employ a future test year (Marke  
15 Dir., p. 11), the evidence is plentiful that a future test year is not only warranted; it is  
16 the superior ratemaking approach for a water utility.

17 **Q. Do other witnesses address the matter of the appropriate test year to use in this**  
18 **matter?**

19 A. Yes, MIEC witness Greg R. Meyer also objects to the use of the future test year.

20 **Q. MIEC witness Meyer contends that MAWC’s proposed future test year does not**  
21 **comply with the Commission’s directive for the true up period (Meyer Dir., p. 5).**  
22 **Is he correct?**

23 A. No, he is not correct. The Company is fully complying with the Commission’s August  
24 9, 2017 Order Regarding Test Year in this case. That Order stated in relevant part:

1 THE COMMISSION ORDERS THAT:

- 2 1. The parties shall use a test year of the 12 months ending  
3 December 2016, with an update period of the six months ending  
4 June 2017, and a true-up period of the six months ending  
5 December 2017.  
6 2. All parties shall use actual historic financial data for Missouri-  
7 American Water Company to present their positions based upon  
8 the periods set in Ordered Paragraph 1.  
9 3. Parties may present further adjustments for the Commission's  
10 consideration based upon projected or forecasted data past  
11 December 2017. No party shall be precluded from opposing such  
12 adjustments.

13 The Company filed its direct case on June 30, 2017. That case included the use of an  
14 historical test year of the 12 months ending December 2016, later provided updated  
15 information for the six months ending June 2017, and by January 31, 2018, in  
16 accordance with the procedural schedule in this case, will have provided updated  
17 information for the a true-up period for the six months ending December 2017. The  
18 Company's presentation of evidence supporting a future test year is in addition to, and  
19 not inconsistent with, the Commission's order in this case. As the Commission  
20 explained:

21 Presently, only MAWC has submitted testimony. Without a  
22 complete record provided through an evidentiary hearing, there is  
23 insufficient evidence to establish whether a future test year or a  
24 historic test year should be utilized, or what that future test year  
25 would encompass. After reviewing the filings and arguments made  
26 by the various parties, the Commission concludes that Staff's  
27 suggestions will allow the parties to thoroughly present their  
28 positions, while not adversely impacting the case procedurally.

29 *Order Regarding Test Year*, p.2 (August 9, 2017).

30 As I explained previously, our future test year was carefully constructed from  
31 historical information that was then projected into the rate year based on known trends

1 and assumptions. The historical test year is the baseline that, along with the updates,  
2 provide a verifiable link or bridge between an historical and a future test year as a  
3 point of reference. The base year (historical test year) update and true up periods  
4 (6/30/17 and 12/31/17) are, therefore, “Calibration points” that can be used to gauge  
5 the fairness and reasonableness of the forecast. This is the extent of their usefulness.

6 **Q. MIEC witness Meyer contends in his direct testimony that “[t]he known and**  
7 **measurable standard requires that an event must have occurred or be known.”**  
8 **(p. 6) He goes on to aver that “[i]n addition, that known event must be**  
9 **measurable with certainty.” (p. 6) Are Mr. Meyer’s statements correct?**

10 **A.** No, they are not. Ratemaking is not simply accounting. The courts have stated that  
11 "the Commission must make an intelligent forecast with respect to the future period  
12 for which it is setting the rate; rate making is by necessity a predictive science." *State*  
13 *ex rel. Missouri Public Service Commission v. Fraas*, 627 S.W.2d 882, 886 (Mo.App.  
14 W.D. 1981). Mr. Meyer seeks to ignore this aspect of the Commission’s job with strict  
15 adherence to historical data – something that ignores the revenues, expenses, and  
16 investment that will be experienced by the Company during the time rates will be in  
17 effect.

18 **Q. MIEC witness Meyer offers an example of a post-historical test year wage**  
19 **increase that is known with certainty but which he contends should not be**  
20 **recognized in ratemaking because the numbers of employees to which the**  
21 **increase is to be applied might change in the year. He argues (p. 6):**

22 **In this case, the true-up period ends December 31, 2017. If the**  
23 **next management wage increase was set to occur at June 30,**  
24 **2018, that wage increase may be considered known with regard**  
25 **to the increase percentage and the date of occurrence. However,**  
26 **it is not measurable for purposes of this rate case because one**

1 would not know, with certainty, the number of employees to  
2 apply the wage increase to, nor the salary levels to apply the  
3 increase to due to employee churn.

4 Please explain the flaw in Mr. Meyer's argument from a ratemaking perspective.

5 A. Mr. Meyer's argument is circular and self-defeating; this is not how rates are set.  
6 Even when using an historical test year, Mr. Meyer cannot say with certainty that the  
7 test year employee levels won't be higher or lower. Taken to its logical conclusion,  
8 we would not put much faith in historical numbers, either, because they could be  
9 affected by numerous factors that render them unsound. The "churn" argument is self-  
10 defeating and would counsel that the test year level is also unrepresentative because  
11 churn might change the employee numbers or salary levels. Using such reasoning, a  
12 regulator would never be able to set rates with any confidence. The fact is that even  
13 using an historical test year, a utility's employee levels are scrutinized for necessary  
14 additions or places where efficiencies might lower such levels. That is precisely what  
15 we do when constructing a future test year. We take the existing employee levels;  
16 determine if they are reasonable and then project them forward based on reasonably  
17 projected increases in numbers and costs.

18 Q. Mr. Meyer also claims in his direct testimony (p. 6) that because MAWC's future  
19 test year contains adjustments to include a 13-month average rate base ending  
20 May 31, 2019 (for rates that will go into effect sometime around May 31, 2018),  
21 customers will be paying rates for investment that is not used and useful. Is that  
22 a valid criticism?

23 A. No. An October 2013 Report by the National Regulatory Research Institute (NRRI)  
24 finds that most future test year states subject to a "used and useful" standard include  
25 future, major capital projects as part of the revenue requirement as long as: (a) the

1 commission found the costs prudent; and, (b) a project is scheduled for in-service  
2 during the test year. Such charges represent “capital actually expended” and are “used  
3 and useful” in the utility business. Further, the Commission need not merely trust the  
4 Company’s statements that capital will be invested. Investment is something that can  
5 be reviewed, compared, and adjusted in the future, if investment does not meet levels  
6 used to establish rates.

7 Further, this claim ignores several important facts. First, in the context of the future  
8 test year, it is entirely proper to set rates based on a 13-month average. As the Illinois  
9 Commerce Commission noted in a case involving The Peoples Gas, Light and Coke  
10 Company:

11 The average rate base proposed by Staff more accurately reflects the cost of service  
12 for the test year because it better matches the level of rate base during the test year  
13 with the revenues and expenses during the test year. The Commission finds that the  
14 average rate base proposed by Staff is more appropriate than the year-end rate base  
15 proposed by the Company, given the future test year selected by the Company. *N.*  
16 *Shore Gas Co. the Peoples Gas Light and Coke Co.*, 2013 WL 1932740, at \*28 (Apr.  
17 26, 2013).

18  
19 In other words, using a 13-month average rate base with a future test year is not only  
20 entirely proper but also consistent with the matching principle, which requires the  
21 synchronization of rate base, revenue and expenses. Second, MIEC witness Meyer  
22 patently ignores the corollary of his argument, namely that failure to recognize any  
23 rate base in the first year that rates will be in effect will bestow upon customers the  
24 right to use rate base that is used and useful in providing service to them without  
25 paying for it. The use of a 13-month average rate base ensures that customers will



1 pay the amounts to support the rate base that has been dedicated to their use. MAWC's  
2 direct filing provided the Commission and all of the parties with a carefully set forth  
3 and fully explained capital plan. All that is required is that rates be based on "capital  
4 expended." Consistent with Section 393.270.4, RSMo, MAWC's future test year  
5 proposal is designed to base rates on capital that will be expended through the first  
6 year in which new rates set in this case will be in effect. Given the Company's past  
7 spending and the detailed capital forecast presented in our case, there can be little  
8 doubt that MAWC will expend on the order of an additional \$250M in plant from  
9 January 1, 2018 through the future test year ending May 31,2019.

10 **Q. You stated that the use of the 13 month forecasted average rate base is more**  
11 **consistent with the matching principle. Is that also true of the future test year**  
12 **generally?**

13 A. Yes, it is and this is what MIEC witness Meyer fails to recognize. The ratemaking  
14 formula consists essentially of three elements – revenue, expenses and rate base, with,  
15 of course, taxes thrown into the mix. In the historical test year, all elements are in  
16 synchronization because, of necessity, they represent the costs actually incurred,  
17 revenue actually received, and capital actually expended in the historical period. But  
18 rates are not set for a historical period – they're being set for a future period. In this  
19 case, the historical test year is the twelve months ended December 31, 2016, and the  
20 first year new rates will be in effect are the 12 months ending approximately May 31,  
21 2019. Thus the question is whether the historical test year costs will be a reasonable  
22 proxy for the first year that rates will be in effect. We know with certainty that the  
23 answer to that question is "no" and the historical costs elements will no longer match  
24 in future periods. Even if the expenses in the historical test year were a reasonable

1 proxy for the future test year (they aren't), it is indisputable that the historical rate base  
2 in the test year will ignore all additions in the future test year. Moreover, MAWC  
3 witness Greg Roach has demonstrated that revenue, too, will be mismatched in any  
4 comparison between the historical test year and the future test year due to the  
5 conservation effect. And one doesn't have to take Mr. Roach's word for this because,  
6 as I noted above, NARUC has recognized this phenomenon. It is clear, therefore, that  
7 two of the three essential ratemaking elements – revenue and rate base – see a breaking  
8 of symmetry when we attempt to use the historical test year as a proxy for the first  
9 year that rates will be in effect. And, this says nothing of taxes, where the recent  
10 major federal tax law changes addressed previously in my testimony render taxes  
11 calculated in the historical test year, less than useless in estimating federal income tax  
12 rates and their associated rate effects for the future.

13 **Q. On pages 7 through 9 of his direct testimony, MIEC witness Meyer offers a**  
14 **comparison of MAWC's O&M costs over the period 2010 to 2016, and claims**  
15 **that the historical results are considerably lower than the amount MAWC has**  
16 **requested in the future test year. Do you have an opinion on the comparisons**  
17 **offered?**

18 **A.** Yes, Mr. Meyer's comments focus on unadjusted numbers that if viewed in isolation,  
19 are not particularly useful to the ratemaking process, especially where he offers for  
20 consideration, amounts relating to periods that exclude certain acquisitions, as well as  
21 estimated results adjusted for acquisitions that have since occurred. Tellingly, Mr.  
22 Meyer then refutes his entire presentation by referring to pending federal tax law  
23 changes that he avers will lower corporate tax rates and result in a decline in customer  
24 rates. Mr. Meyer thus seems confused as to whether future events are to be considered

1 or ignored in setting rates. Mr. Meyer even states (p. 10) “I could foresee a situation  
2 wherein MAWC would argue that reflecting tax reform before the end of the future  
3 test year period would be inappropriate because the Commission had already  
4 established just and reasonable rates through May 31, 2019.” Mr. Meyer’s concerns,  
5 however, are unwarranted because MAWC’s rebuttal testimony includes the very  
6 impacts of the reduction of the corporate tax rate that he claimed MAWC would try to  
7 keep for itself. For further discussion of the Tax Cuts and Jobs Act (“TCJA”) of 2017,  
8 and its impact on proposed Missouri-American rates, please see the rebuttal testimony  
9 of John Wilde, as well as my own testimony below on two proposed Accounting  
10 Authority Orders (“AAO’s) related to income tax rates changes.

11 **Q. MIEC witness Meyer also attempts to show that MAWC’s sales forecasted for**  
12 **the future test year are refuted by increases in sales in the period immediately**  
13 **following the end of the historical test year. Is this presentation relevant to the**  
14 **issue of declining sales?**

15 A. No, and Mr. Meyer immediately refutes his own argument by conceding that one  
16 explanation for the apparent sales increase is the concept of normalization. What I  
17 find particularly troubling about Mr. Meyer’s comments regarding sales forecasting is  
18 his failure to even address the well known and demonstrated national trend of  
19 declining use of water per customer.

20 **Q. MIEC witness Meyer claims in his direct testimony (p. 12) that the lag produced**  
21 **by the use of a historical test year is not a concern because MAWC “is free to file**  
22 **a rate case at any time.” Is his point valid?**

23 A. No. Filing more frequent rate cases based on historical test years doesn’t address the  
24 problem of earnings erosion caused by regulatory lag, at all, when the rate base is

1 being increased significantly and sales are declining at approximately two percent per  
2 year. As the NRRI report of October 2013 noted at FN 18, found:

3 Both utilities and commissions would more likely favor an FTY when  
4 average cost increases. This condition occurs when the combined  
5 growth in input prices and levels exceeds the growth in sales. For  
6 example, with moderate to high inflation, large investments in new  
7 facilities, and slow sales growth, average cost would likely rise. Failure  
8 to account for the higher average cost in setting rates would likely lead  
9 to more frequent rate cases and revenue deficiencies.

10  
11 “Frequent rate cases and revenue deficiencies” are not in the interest of the  
12 Commission, its Staff, the Company or the Company’s customers. The use of the  
13 future test year is the clear answer to this dilemma.

14 **Q. MIEC witness Meyer dismisses the cost of a rate case as “miniscule” in his direct  
15 testimony (p. 12). Is he correct?**

16 **A.** If, as he claims, the cost is miniscule, then Mr. Meyer should have no problem with  
17 the Company’s request to recover all of its rate case expense. What Mr. Meyer  
18 pointedly ignores, however, is the effect of a rate case, including the strain on both  
19 Company and Staff resources produced by frequent rate cases, as well as the disruptive  
20 and troubling impact upon our customers.

21 **Q. Finally, Staff witness Oligschlaeger, as reflected in the Staff Report- Cost of  
22 Service, has presented an analysis and critique of the use of a future test year  
23 from Staff’s prospective. Do you have a response to the concerns raised by Mr.  
24 Oligschlaeger?**

25 **A.** Yes. First, the Company appreciates Staff’s willingness to consider the future test year  
26 and its statements of concern with its use. I will attempt to allay those concerns and  
27 explain why MAWC believes they are exaggerated and of less concern than Staff  
28 believes.

1 Q. What is the essential basis of Staff’s concern?

2 A. It appears to be based on a belief that ratemaking must adhere to a standard of  
3 recognizing changes in cost elements only if they have actually occurred. Staff states  
4 (Staff Rep. COS, p. 5):

5 use of a historic test year approach in Missouri has  
6 included a number of features intended to reasonably  
7 ensure that utility rates are set to reflect the most current  
8 trends in the company’s revenue, expense and capital  
9 results. However, in almost all cases, ratemaking  
10 allowances have been restricted to those qualifying  
11 under the “known and measurable” cost standard. The  
12 “known and measurable” standard requires that only the  
13 costs associated with events have actually occurred, and  
14 for which the financial impact can be accurately  
15 quantified, should be reflected in utility rates. If adhered  
16 to, the known and measurable standard precludes the  
17 use of budgeted, projected or forecasted information in  
18 setting utility rates.

19 Q. What is your response to this concern?

20 A. First, I take issue with Staff’s claim that “[i]f adhered to, the known and measurable  
21 standard precludes the use of budgeted, projected or forecasted information in setting  
22 utility rates.” If this were accurate, we would never normalize actual data to make it  
23 more representative of expected or normal conditions. Indeed, the very act of  
24 normalization is to reject “known” data in place of substitute constructs, which the  
25 analyst “projects” will be more accurate. Whether this is based on a multi-year  
26 average or by substituting recent information, the result is still the same – actual data  
27 is being replaced by forecasts or projections. Second, the Company appreciates Staff’s  
28 (and the Commission’s) past willingness to consider cost changes that occur after the  
29 historical test year when setting rates. We would point out, however, that even  
30 considering updates through December 2017, ignores the fact that an additional five  
31 months of actual information will be known before new rates take effect on June 1,

1 2018. Furthermore, the fact that Staff realizes that more recent information must be  
2 used to adjust the historical test year numbers is, in itself, an acknowledgement that a  
3 trend of deteriorating earnings is occurring that must be recognized due to plant  
4 additions and, in MAWC's case, relentlessly declining use per customer.

5 **Q. Staff claims that the "known and measurable" standard is "jettisoned" when the  
6 future test year is used. (Staff Rep. COS, p. 5) Is that a fair criticism?**

7 A. I think it's an exaggerated criticism. The cost elements that MAWC has used are  
8 solidly grounded in actual, normalized cost, revenue and plant levels and are then  
9 trended forward through the future test year based on very careful projections using  
10 sound forecasting techniques based on known changes. The plant levels are  
11 forecasted based on approved projects or reasonable levels of blanket project work  
12 and the revenue is forecasted based on normalized past usage and a trend of declining  
13 use per customer that is irrefutable and based on a nationally recognized and measured  
14 trend. As is the case with an historical test year, in addition to known and measurable  
15 adjustments, forecast adjustments also include normalizing and annualizing  
16 adjustments. In addition, the future test year permits the inclusion of trend adjustments  
17 (declining revenues and inflation) that are reasonably predictable. Our projections are  
18 factual, not speculative.

19 **Q. Staff contends (Staff Rep. COS, p. 5-6) that "[f]or historic test year ratemaking,  
20 the revenues/expense/rate base relationship is based upon actual past financial  
21 results. For future test year ratemaking, this relationship is constructed using  
22 forecasted amounts." Does Staff have a point?**

23 A. No, this statement is not entirely accurate. Staff cannot be contending that it would  
24 ever base rates on "actual past financial results" that were unadjusted and that were

1 not normalized. All the future test year does is take adjusted, normalized historical  
2 results and trend them forward based on reasonably predictable assumptions. The  
3 claim that actual results are some “holy grail” of ratemaking is simply not accurate.  
4 Again, Staff would never base rates on actual, unadjusted, non-normalized results  
5 merely because they were booked.

6 **Q. In addressing the challenges that Staff perceives in adopting a regime of using a**  
7 **future test year, Staff avers (Staff Rep. COS, p. 7):**

8 use of future test years will require greater expertise on Staff’s  
9 part regarding analysis and critiques of utility budgeting  
10 practices and forecasting techniques than it currently possesses.  
11 For this reason, additional Staff training will be necessary if use  
12 of future test years is implemented in this jurisdiction. However,  
13 even with enhanced training, Staff cautions that it will take time  
14 and effort to gain expertise in future test year ratemaking  
15 commensurate with its current experience with historic test year  
16 ratemaking.

17 **Do you have a response to Staff’s concerns?**

18 **A.** Yes, I do. Again, I respect Staff’s concerns and appreciate their willingness to  
19 consider the use of the future test year. I do believe, however, that Staff’s concerns  
20 are exaggerated and that the use of a future test year will not require the devotion of  
21 the level of resources and training that Staff believes are necessary. As we noted in  
22 a discovery response, only 4 of 14 American Water jurisdictions do not currently  
23 authorize the use of a future test year and one of these is Missouri. I would, moreover,  
24 point to the fact that two of our jurisdictions have used the future test year for many  
25 decades without any problems. I would also point to the fact (also provided in  
26 discovery) that several of our jurisdictions that have more recently adopted the future  
27 test year such as Indiana Indian American Water Company, Inc., Cause No. 44450

1 (Order January 28, 2015)); and Pennsylvania (Pennsylvania-American Water  
2 Company Case No. R-2013-2355276 (Order December 19, 2013)); *see also* West  
3 Virginia (West Virginia-American Water Company, Case No. 15-0675-8-42T (Order  
4 February 24,2016)). Staff has referenced two NRRI reports, one of which I mentioned  
5 previously. Tellingly, both reports demonstrate that regulatory commissions that have  
6 adopted the future test year have not experienced significant problems and are satisfied  
7 with it. I and my colleagues stand ready to assist Staff in overcoming the barriers that  
8 they perceive to the adoption of this forward-looking regulatory regime.

9 **Q. You mentioned that the future test year concept is not new. Do you have**  
10 **evidence of its acceptance ?**

11 **A.** Yes, I do. In this regard I would point to the Rate Case and Audit Manual Prepared  
12 by NARUC Staff, under the sponsorship of the Subcommittee on Accounting and  
13 Finance and note that it is dated from the summer of 2003 – more than fourteen years  
14 ago. There are a number of interesting observations in that report that indicate that  
15 the use of a future test year is not a particularly daunting exercise. For example, the  
16 report notes (p. 4) that the processes followed for using a historical or a future test year  
17 do not fundamentally differ:

18 An example of a common difference among the jurisdictions is the test year used.  
19 Some states use an average historic test year, others use a year-end historic test year,  
20 and others use projected, future test periods. Yet, this difference does not generally  
21 change the nature or importance of the test year, nor does it change the basic list of  
22 elements that are included in the rate base or the operating income statement.

23 **Q. Are there other significant portions of that report that indicate that the**  
24 **difficulties alleged to be associated with the future test year might be overstated?**



1 A. Yes. Here, again, the report indicates (p. 10) that the differences between the use of  
2 historical and future test periods do not differ fundamentally:

3 The test year is a period of measurement for a recent, consecutive  
4 twelve-month period consisting of a full year of operations where  
5 data is readily available. While many jurisdictions have traditionally  
6 used, and continue to use, historical test year data, some  
7 commissions either allow or mandate the use of a projected or future  
8 test year. In either case, the test year is used to examine earned  
9 returns compared to either previously authorized earnings levels  
10 (based on approved rates of return) or compared to requested  
11 earnings levels (based on requested or recommended rates of  
12 return). Whether using a future or historic test year, the auditor  
13 should judge the appropriateness of the test year that has been  
14 proposed. Is it representative, after adjustments, of the period in  
15 which rates take effect?  
16

17 When looking at an historic test year, one of the first questions asked  
18 is whether the test year is too stale to make it a reasonable basis upon  
19 which to establish rates for a future period. In looking at the  
20 appropriateness of the test year (and whether it might be too old),  
21 one should look at what has happened since the end of the test year  
22 and the current time. Are the historic costs and revenues normal or  
23 recurring? Has extraordinary growth occurred during the  
24 intervening time (e.g., has a new industrial customer come on line)?  
25 Or, has there been a negative impact on revenues through shift  
26 reductions at the local foundry? In looking at the months beyond the  
27 end of the test year, have the growth rates for rate base, expenses,  
28 and revenues all remained fairly close and constant, maintaining the  
29 test year relationship among these three elements, or has one  
30 element changed dramatically, making the test year out of kilter with  
31 current operations? If so, can this situation be resolved through  
32 adjustments to the test year?  
33

34 When looking at a future test year, one will want to examine the test  
35 year selected for reasonableness. Is this period mandated by rules,  
36 statute, or Commission directive? Is the test year founded on a  
37 historical base or documented figures, such that its projections are  
38 readily understandable and traceable?  
39

1 As I have explained, our future test year was carefully constructed based on  
2 normalized historical data and was offered because there are significant differences  
3 between historical and more current operations (most notably rate base additions and  
4 revenue declines) that mandate its use.

5 Q. Staff contends (Staff Rep. COS, p.7) that there are two arguments discouraging  
6 the use of a future test year:

7 The first is that use of speculative data is inherently a less  
8 reliable foundation for ratemaking than reliance on known and  
9 measurable information. This concern is increased by the  
10 incentive by the utility to, consciously or unconsciously,  
11 overstate its cost of service estimations, in order to achieve  
12 higher rates and earnings levels. The second major  
13 disadvantage of future test years compared to historic test  
14 years is that the incentives for a utility to minimize increases in  
15 its cost of service over time will inherently be less when  
16 forecasts of an increasing cost of service are used to set rates in  
17 comparison to the situation in which the historical known and  
18 measurable standard is adhered.

19  
20 Please respond to Staff's concerns.

21 A. I fundamentally disagree with the claim that our data is "speculative." Our future test  
22 year is no more "speculative" than stale historical information that we know to be  
23 unrepresentative of trends that occur immediately after the conclusion of the historic  
24 test year. Here, again, the NRRI October 2013 Report is instructive when it states:

25 "6. How do commissions determine the accuracy of forecasts, which  
26 after all is the most important and difficult challenge they face with  
27 an FTY? Are the forecasts, for example, reasonably accurate and  
28 compatible with prudent utility management?"

29 \* \* \* \* \*

30 As part of standard reporting in rate cases, commissions may require  
31 a utility to provide a verifiable link or bridge between an historical  
32 and a future test year as a point of reference. Without this  
33 benchmark, parties reviewing a utility's filing would find it more  
34 difficult to review the forecasts. As an example, the historical test  
35 year can represent the baseline. (p.2 and FN 6)

1 Again, the historical test year is the baseline that, along with the updates, provide a  
2 verifiable link or bridge between an historical and a future test year as a point of  
3 reference. The base year (historical test year 12/31/16)) update and true up periods  
4 (6/30/17 and 12/31/17) are “Calibration points” that can be used to gauge the accuracy  
5 and reasonableness of the forecast.

6 As I testified, we carefully projected the adjusted, normalized test year data based on  
7 either known increases or demonstrable cost trends that are fully explained by MAWC  
8 witness Nikole Bowen and other MAWC witnesses. In the case of revenue, we have  
9 years of data, informed by national trends and local conditions, all of which are fully  
10 explained by MAWC witness Roach. For rate base, our plant in service projections  
11 are, as I explained, fully demonstrated by individual projects and known levels of  
12 blanket activity, all of which are explained by MAWC witnesses Aiton and LaGrand.  
13 The Company has no incentive to overstate these cost elements, and they are laid out  
14 with full transparency. Moreover, if this were a problem it would have long been  
15 manifested in the jurisdictions that employ future test periods. To the best of my  
16 knowledge, it has not been so proven.

17 **Q. Staff also contended that the use of a future test year would have a mitigating**  
18 **effect on the Company’s pursuit of efficiency. Do you agree?**

19 **A.** No, I don’t. As far as the tendency of the future test year to minimize the Company’s  
20 incentive to control costs, I would point out that cost control is a company-wide  
21 endeavor at American Water and is not limited to MAWC. Given that many of our  
22 utilities operate in jurisdictions using a future test year, this claim that we would ignore  
23 cost control under a future test year regime is incorrect. Staff’s claim that “the  
24 Commission’s directive to set just and reasonable rates must be “fair to both the utility

1 and its customers” (Staff Rep. COS, p.8) appears to ignore the fact that the historical  
2 test year regime followed to date has not been fair to the Company because it has  
3 produced consistently lower earnings for MAWC than were anticipated in the  
4 Commission’s orders. This is especially vexing when one considers the  
5 acknowledged fact that the Company has carefully and successfully controlled its  
6 O&M expenses. Given the Company’s demonstrated efficiency, the fault lies with  
7 the ratemaking method, not the Company’s management.

8 **Q. Staff contends (Staff Rep. COS, p. 8) that “[a] properly adjusted set of historical**  
9 **test year process financial data should provide utilities with a reasonable**  
10 **opportunity to earn their authorized return.” Do you agree?**

11 **A.** For new rates to be fully compensatory to the utility and fair to customers using an  
12 historical test year, investment, expenses and revenue must differ from their historical  
13 test year levels in the same proportion. If they do not, then the imbalance will cause  
14 rates to be set that are not reflective of the investment, costs, and revenue that will  
15 exist in the rate year, rendering those rates unreflective of the utility’s actual cost of  
16 service. We know with certainty that the Company will be making significant  
17 additions to its rate base. We also know with certainty that there is a national trend of  
18 declining use per customer that MAWC witness Roach has identified with specificity  
19 for MAWC. Therefore, it is highly unlikely that the historical relationship between  
20 rate base, revenue and expenses will hold true in the first year of the new rates’  
21 effectiveness. We also know with absolute certainty that the ratemaking *status quo*  
22 with respect to MAWC has not produced a reasonable opportunity for the Company  
23 to earn its authorized rate of return. Clearly, then, something is amiss, especially when  
24 the Company has so successfully constrained the growth of its O&M expenses.

1           Consequently, we propose the use of a future test year in order to remedy this  
2           ratemaking anomaly.

3   **Q.   Staff claims that there are certain things that should be considered in the event**  
4           **the Commission were to consider the use of the future test period; among them**  
5           **are: the avoidance of using inflation factors, the imputation of productivity**  
6           **adjustments, a reconciliation of rate base for projects that are used and useful,**  
7           **and a quarterly rate variance analysis. Please address these recommendations,**  
8           **starting with the use of inflation factors.**

9   **A.   Staff contends that “if future test years are used, proposed increases to historical**  
10           **expense levels should be justified by a specific and detailed analysis on an individual**  
11           **expense level. Use of inflation/escalation factors for this purpose should not be**  
12           **accepted.” I find this proposed exclusion to be unreasonable. Inflation is a**  
13           **longstanding and well-accepted economic indicator that is often used to estimate**  
14           **changes in the cost of goods and services. Inflationary adjustments are embedded in**  
15           **cost of service. For example, the interest rate at which the Company compensates its**  
16           **bondholders for debt, has inflation as one of the core assumptions of cost. Likewise**  
17           **actuarial reports used to develop postretirement benefit costs utilize inflation trends to**  
18           **measure health care costs. Inflationary adjustments represent a small fraction of the**  
19           **Company’s expense forecast. The Company’s expense projections have, for the most**  
20           **part, been based on factors other than inflation, and inflation was only used when an**  
21           **alternate method of forecasting was not deemed preferable. For example, if the**  
22           **company had a specified contract cost for an item (such as union labor), or could**  
23           **reasonably forecast the change in cost based on recent experience (such as rate**  
24           **increases for purchased water), then the contracts and experience were used. Likewise**

1 if a cost was based on detailed engineering plans (such as tank painting) or on actuarial  
2 evaluations (pension), then these forecasting tools were used. In all, only 10 of the 35  
3 expense and general tax line items listed on CAS 13 include any sort of inflationary  
4 adjustment. The direct testimony of Company witness, Nikole Bowen, outlines the  
5 forecasting methodologies used by the Company, and provides detail around use of  
6 known and measureable changes, adjustments based on Company experience, and use  
7 of inflationary factors. In most cases, our expenses have been forecasted individually,  
8 based on normalized, historical information that is then trended based on known  
9 changes in activity and cost levels, informed by things such as vendor contracts and  
10 pricing information and other verifiable data. Our inflation adjustments to O&M and  
11 general tax for the 12 months ended May 31, 2018 totaled \$1.34 million which is 0.8%  
12 of the total expenses (\$1.34/\$161.96). Inflation adjustments to O&M and general tax  
13 for the 12 months ended May 31, 2019 totaled \$0.47 million which is 0.3% of the total  
14 expenses (\$.47/\$163.53). In the aggregate, using inflation for such pools of expenses  
15 is fair to both the Company and its customers.

16 **Q. Staff also (Staff Rep. COS, p. 9-10) “recommends that the Commission require**  
17 **utilities seeking future test years to demonstrate how their projected adjustments**  
18 **in total reasonably impute a level of increasing productivity and efficiency in**  
19 **their operations for the ongoing benefit of customers and to offset projected cost**  
20 **of service increases.” What is your reaction to that proposal?**

21 **A.** I agree that the Commission must assure itself that a utility is operating in a prudent  
22 and efficient manner. I disagree that the proper way to achieve this would be by  
23 means of an artificial productivity imputation. MAWC has demonstrated an  
24 extraordinary level of productivity in the past that have kept its O&M cost increases

1 at minimum levels. So an imputation of some artificial productivity target would not  
2 seem warranted. As I have demonstrated, there is not a fundamental difference  
3 between historical and future test periods and this lack of a process difference should  
4 not require a change in how the Commission views productivity.

5 **Q. Staff also recommends (p.10) that there be a reconciliation mechanism for plant  
6 projections if a future test year were to be employed. Do you agree?**

7 A. I generally do not support this type of true up, “cost of service” type regulation. I  
8 recognize, however, that both Staff and the Commission are struggling with the future  
9 test year concept. Consequently, the Company would be willing to reconcile its plant  
10 projections with its actual plant placed into service for the first year that rates are in  
11 effect if those rates are set on a future test year basis. The rate consequence of any  
12 shortfall between projected and actual plant could be deferred for our customers’  
13 benefit, if it occurs, and preserved to be returned in the next rate case.

14 **Q. Staff also seeks a quarterly rate variance if the future test year is employed. Do  
15 you agree?**

16 A. No. The Company already files monthly surveillance reports with the Commission  
17 that should be sufficient to show whether the Company’s earnings are exceeding  
18 authorized levels. Quarterly reporting is unnecessary and will consume far too many  
19 resources of the Company and Staff to provide and review such quarterly data.

20 **Q. Does this conclude your response to Staff with respect to the use of the future test  
21 year?**

22 A. Yes. Again, we believe that we have presented a cogent and transparent construction  
23 of the future test year in this case. We stand willing to work with Staff to allay their  
24 concerns and develop a consensus approach, that will permit Staff to feel comfortable

1 enough to adopt the future test year o. As I have explained previously, and as NARUC  
2 has recognized, water companies face unique challenges not faced by other utilities  
3 that merit the use of a future test year.

4 **IV. ACCOUNTING AUTHORITY ORDERS (“AAO”s) RELATED TO THE TAX**  
5 **CUTS AND JOBS ACT (“TCJA”)**

6 **Q. Is the Company proposing AAOs related to the TCJA?**

7 A. Yes. The Company is proposing two AAOs related to the TCJA. The first proposed  
8 AAO is related to the remeasurement of the Company’s accumulated deferred income  
9 taxes (“ADIT”). I’ll refer to this as the “ADIT Remeasurement AAO.” The second  
10 AAO proposal deals with the tax expense changes the Company is experiencing while  
11 it awaits the authorization of new rates. I’ll refer to this as the “Stub Period AAO”  
12 and it is intended to combine the effects of the Property Tax Expense AAO proposed  
13 in WU-2017-0351 and the federal income tax expense savings experienced by MAWC  
14 between January 1, 2018 and the time when new rates would go into effect.  
15 I’ll discuss these AAO’s and the Company’s other proposals for implementing the  
16 TCJA in rates below. For more detailed information on the impacts of these tax  
17 changes, please see the rebuttal testimony of John Wilde.

18 **Q. Can you explain how the ADIT Remeasurement AAO would work?**

19 A. The ADIT Remeasurement AAO would authorize the Company to (1) record on its  
20 books regulatory assets and liabilities, which represent the change in MAWC’s  
21 deferred taxes as a result of the TCJA that are subject to the normalization provisions  
22 in the TCJA; and (2) maintain these regulatory assets and liabilities on its books until  
23 the effective date of the Report and Order in Missouri-American’s next general rate  
24 proceeding and, thereafter, until all eligible costs are amortized and recovered in rates.



1 It is anticipated that the remeasurement of MAWC's net deferred taxes would be  
2 expected to result in a net regulatory liability that would be returned to utility  
3 customers over the remaining life of the related assets and liabilities, although the  
4 precise amount of that benefit is, as Mr. Wilde has explained, not possible to determine  
5 today. Furthermore, the Internal Revenue Service (and other regulatory bodies) might  
6 yet issue regulations and regulatory guidance regarding the interpretation of the new  
7 tax law that will affect our revenue requirement in the future. Because those changes  
8 are as yet unknown and unimplemented, an AAO appears to be the appropriate  
9 mechanism to address them.

10 **Q. Can you explain how the Stub Period AAO would work?**

11 **A.** The Stub Period AAO would combine the two material tax changes the Company has  
12 experienced into a single regulatory deferral. This would include the property tax  
13 expense increases addressed in WU-2017-0351 and also the income tax expense  
14 savings the Company records between January 1, 2018 and the time when new rates  
15 go into effect that incorporate the rate effect of the federal corporate income tax  
16 reduction.. The total net liability or asset would be amortized over three years and  
17 would be included in the rates authorized in this proceeding.

18 **Q. Is there anything required to make the Stub Period AAO appropriate and**  
19 **reasonable?**

20 **A.** Yes. If the Commission were to act favorably on the Company's Application for  
21 Rehearing In the Matter of the Application of Missouri-American Water Company  
22 for an Accounting Authority Order related to Property Taxes in St. Louis County and  
23 Platte County in File No. WU-2017-0351, filed December 29, 2017. In that

1 application, MAWC sought a reconsideration of the Commission's denial of an AAO  
2 to recover over \$6.9 million of property tax expenses in St. Louis County from January  
3 2017, to May, 2018 that were unforeseen and otherwise unrecoverable and \$560,000  
4 of property taxes in Platte County that were similarly unforeseen and which, together  
5 were unforeseen, extraordinary and material. If the Commission were to act favorably  
6 on the application for rehearing on the property tax AAO, it would become reasonable  
7 for MAWC to use its tax savings in the first few months of 2018 to apply against the  
8 unforeseen, extraordinary and material property tax expense that the Commission  
9 denied and for which rehearing has been sought

10 **Q. If the federal income tax savings were sought to be captured for the period**  
11 **prior to the effectiveness of new rates without using those tax savings to offset**  
12 **the property taxes as just described, would this be appropriate ratemaking?**

13 A. No, I do not believe it would be. Rates have previously been set so any attempt to  
14 change them based on changed circumstances and recapture the differences would be  
15 retroactive ratemaking. Furthermore, looking just at the tax law change for that five  
16 month stub period without investigating all of the other changes in the cost of service  
17 and without looking at whether the Company was actually earning its allowed rate of  
18 return would be an impermissible single issue ratemaking.

19 **Q. Why does the Company believe that a change in an expense that typically is**  
20 **considered an ordinary one appropriate for an AAO?**

21 A. The fact that an expense is typically an ordinary one does not preclude the *level* of the  
22 expense associated with it from being extraordinary under specific circumstances.  
23 Expenses related to vegetation management, compliance with the Cold Weather Rule,

1 and changes to post-retirement benefits all reflect ordinary cost categories of utility  
2 service for which the Commission has granted AAOs when the anticipated level  
3 becomes extraordinary. Income tax expense is no different. In each case, there is an  
4 extraordinary cost change, unforeseeable for purposes of traditional ratemaking, and  
5 beyond the utility's control. While income tax expense is an ordinary cost, it is the  
6 sheer magnitude of the change that makes it extraordinary. This reduction in income  
7 tax expense has a considerable effect on the Company's revenue requirement and the  
8 difference between the 35% rate and the 21% rate would have a material effect  
9 MAWC's annual income. While the precise amount of the tax expense savings won't  
10 be known until these first few months of the year transpire, it is estimated that the  
11 impact would reach the threshold of materiality. This significant cost change was  
12 unforeseeable from a ratemaking perspective, was also outside of MAWC's control,  
13 and could not be addressed under traditional ratemaking.

14 **Q. Was MAWC and the other parties in this case “put on notice” that there could**  
15 **foreseeably be a change in the federal income tax rate?**

16 A. Yes, federal tax reform has been at the top of this Administration's agenda and was  
17 being negotiated in Congress throughout 2017. It was unknown, however, whether the  
18 law would pass, and, if it did, what rates and tax law changes would be a part of it.

19 **Q. Should that preclude the approval of AAOs?**

20 A. No, it shouldn't. For ratemaking purposes, MAWC could only seek cost recovery of  
21 federal income tax expenses based on the tax law that ultimately emerged.  
22 Furthermore, the Company was not on notice of the actual change in federal income  
23 tax expense rate until the approval on TCJA in December 2017. Even up to the

1           eleventh hour, there was talk of a 20% rate, a 25% rate or no agreement, at all. Thus,  
2           MAWC had no notice of the actual change in federal income tax expense rate until the  
3           Act was signed into law on December 22, 2017. MAWC's federal income tax expense  
4           rate is extraordinary and material regardless of whether the possibility of such a  
5           change at some point in the future existed. The mere possibility of future changes is  
6           simply not notice of an actual change. Moreover, there is no requirement that all  
7           involved expenses be unforeseeable for an AAO to be granted.

8   **Q.    If the ADIT Remeasurement AAO is not granted what will happen?**

9    A.    What will happen is that the preliminary calculations that we can make now are likely  
10       to be wrong and our rates will be either too high or too low. This situation is not fair  
11       to either the Company or our customers. It is far better to estimate those tax effects  
12       now and true them up later when they are known with certainty.

13 **Q.    Are any other proposals being recommended in regards to the TCJA?**

14  A.    The rebuttal testimony of witnesses Brian LaGrand and John Wilde recommend a  
15       revenue requirement reduction to the fully forecasted future test year of more than  
16       \$20 million related to the impacts of the Tax Cuts and Jobs Act.

17 **Q.    If all three of these proposals were adopted, including the future test year and  
18       the two AAOs, what would happen?**

19  A.    If the Company's future test year is adopted, as revised by witnesses Wilde and  
20       LaGrand, and the two AAOs are approved, then the full quantifiable benefit of the  
21       2017 Tax Cuts and Jobs Act would promptly flow back to our customers. The future  
22       test year, as revised, will give back to customers all of the tax reduction benefits  
23       beginning when rates go into effect. The Stub Period AAO would give back to

1 customers all of the tax reduction benefits experienced before rates go into effect. And  
2 the ADIT Remeasurement AAO would give back to customers all of the net tax  
3 reduction benefits to future ADIT, after the Company is able to properly quantify  
4 them. In addition to the benefits passed back to customers in this case, the ADIT  
5 Remeasurement AAO provides further benefits to customers following the next rate  
6 case, without any diminishment from premature amortization. These three pieces, in  
7 sum, allow Missouri-American customers to reap the full benefit of the 2017 Tax Cuts  
8 and Jobs Act and to enjoy more affordable water service.

9 **V. RATEMAKING TREATMENT FOR MAWC’S LSLR PROGRAM**

10 **Q. Are you familiar with the Company’s Accounting Authority Order (“AAO”)**  
11 **proceeding regarding lead service line replacement (LSLR) costs (Case No. WU-**  
12 **2017-0296)**

13 **A.** Yes, I am. The Commission approved the Company’s application for an AAO in that  
14 case permitting MAWC to defer costs of its LSLR Program<sup>1</sup> from January 1, 2017  
15 through May 31, 2018. The Commission also found that the ratemaking treatment for  
16 the Company’s LSLR Program should be addressed in MAWC’s pending general rate  
17 case, which will likely result in new rates being established in May, 2018. (Report and  
18 Order, ¶18, p. 8).

19 **Q. What is the purpose of your revenue requirement rebuttal testimony regarding**  
20 **MAWC’s LSLR program in this proceeding?**

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<sup>1</sup> (Report and Order, Case No. WU-2017-0296, ¶16, pp. 8 - 9 (Issued November 30, 2017, Effective December 10, 2017).

1 A. I will address the ultimate cost recovery and accounting treatment for the Company's  
2 LSLR Program.<sup>2</sup> I will also address OPC's concerns about whether the Company is  
3 authorized to replace customer-owned service lines and whether the Company is  
4 otherwise violating its Commission approved tariff.

5 **Q. How should MAWC account for replacing customer-owned lead service lines?**

6 A. MAWC recommends recording these costs consistent with the guidance found within  
7 the Uniform System of Accounts ("USOA") to account 345 – Services. In accordance  
8 with the USOA account 345, capitalized mains include the installation cost of pipes  
9 and accessories. This account includes other restoration cost items such as disturbed  
10 pavement, cutting and replacing pavement, pavement base, sidewalks, curbing, etc.  
11 Restoration costs also generally include costs related to damages to the property of  
12 others, and other general costs relating to restoring areas to a safe or prior condition.  
13 The replacement of customer-owned lead service lines is similar to the restoration of  
14 other customer property. These restoration expenditures would normally be  
15 capitalized to plant as part of overall project costs.

16 **Q. Why is the Company proposing to include customer-owned lead service line  
17 replacements as restoration costs as part of its main replacement program?**

18 A. As Company witnesses Naumick and Aiton have explained in the LSLR AAO  
19 proceeding, the customer-owned line is restored (replaced with new material) for  
20 safety reasons - to mitigate the potential increased risk of lead contamination  
21 following physical disturbances related to infrastructure work in the area. In that  
22 proceeding, the Commission made the following findings of fact:

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<sup>2</sup> MAWC to defer costs from January 1, 2017 through May 31, 2018 of its LSLR Program

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5. In most cases, the water utility owns the portion of the water service line between the water main and a point at or near the property line. At this location, there is often a utility-owned water meter. The remaining portion of the water service line is owned by the customer. However, in St. Louis County, customers own the entire water service line between the water main and the premise.

6. MAWC proposes to replace the entire lead portion of service lines in St. Louis County from the newly installed water main to the customer's home when service lines containing lead are discovered.

7. The advantage of full lead service line replacement ("LSLR") is that it does not cause the increased risk of lead contamination exposure that would be caused by partial LSLR. The Environmental Protection Agency recommends full LSLR.

8. MAWC is embarking upon the LSLR program because lead is a naturally occurring metal that is harmful if inhaled or swallowed, particularly to children and pregnant women. Lead exposure can cause a variety of adverse health effects. For example, lead exposure can cause developmental delays in babies and toddlers and deficits in the attention span, hearing and learning abilities of children. It can also cause hypertension, cardiovascular disease and decreased kidney function in adults. The most common sources of lead exposure are paint and dust, but lead can also be found in drinking water. Recent events, including those in Flint, Michigan, have heightened concern about the presence of lead in drinking water.

9. MAWC has a program to replace water mains throughout its service areas. The main replacement is prioritized by considering a variety of factors, including the condition of the main, gauged by a combination of leaks or breaks in the line, pressure and flow conditions, and pipe age and material. MAWC also coordinates with local municipalities to replace mains in conjunction with road projects. It is during this regular main replacement process that MAWC anticipates replacing the lead service lines. Under the LSLR Program, when the Company encounters lead service lines during a main replacement project, it will replace the lead portion of the service line.<sup>3</sup>

36 **Q. Who will own the replaced lead service line if MAWC bears the cost?**

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<sup>3</sup> *In the Matter of the Application of Missouri-American Water Company*, Report and Order, p. 5-7, Case No. WU-2017-0296 (November 30, 2017).

1 A. The resulting replaced portions of the service line owned by the Company will belong  
2 to the Company, and the portions owned by the customer will still belong to the  
3 customer. Ongoing responsibility for repairs and maintenance of the customer owned  
4 portion of the line remains with the customer. Similar to repaving roads or restoring  
5 sidewalks, MAWC would not own the asset when the work is done, but the investment  
6 is part of a prudent expenditure incurred on behalf of MAWC'S customers for the  
7 purpose of maintaining safety and public health.

8 **Q. Why is it appropriate for MAWC to capitalize the costs to replace customer  
9 owned lead service lines if MAWC will not own them?**

10 A. Replacing aging infrastructure often can disrupt and damage the assets of others,  
11 including customers, private entities and municipalities. Utilities routinely incur costs  
12 to restore those assets. This includes pavement, sidewalks, mailboxes, curbing and  
13 driveways. MAWC (and other utility companies) routinely capitalize and recover  
14 infrastructure costs associated with restoring other entities' assets that it disturbs or  
15 damages as part of its aging infrastructure replacement programs. While water utilities  
16 do not own the roads, sidewalks, curbing and driveways, water infrastructure  
17 replacement projects can disturb or damage these nearby assets, and the cost to restore  
18 these assets is properly included in the utility's rate base.

19 **Q. Why isn't MAWC proposing to assume ownership of the customer-owned lead  
20 service lines that it replaces?**

21 A. First, it would be inconsistent with the long-standing approach to how restoration costs  
22 have been addressed for decades in the water industry. Utilities do not assume  
23 ownership for assets that customers or other third parties own simply because it makes  
24 expenditures to restore customer assets. So MAWC is not proposing to own the



1 restored service lines, just as it doesn't propose to own the roads, sidewalks, curbing,  
2 or driveways that it replaces.

3 Moreover, even if MAWC could take ownership of the customer-owned lead service  
4 lines that it replaces, it would result in one group of customers being treated differently  
5 than other groups of customers. This would require MAWC to manage a relatively  
6 small proportion of service line assets and handle them differently for all customers  
7 within tariff groups.

8 **Q. Does MAWC recommend that the costs to replace customer-owned lead service  
9 lines be amortized or depreciated?**

10 A. Yes. Consistent with plant investment, the cost incurred to restore customer owned  
11 lead service lines should be depreciated. The depreciation period should align with  
12 the established depreciation rate approved by the Commission. The depreciation rate  
13 should be the combined rate which includes service life and net salvage rate. The  
14 Commission approved depreciation rate for account 345 – Services is 2.92%  
15 (approved in WR-2015-0301). This same rate should be applied to the LSLR AAO  
16 approved in Case No. WU-2017-029 and the unamortized balance should be included  
17 in rate base.

18 **Q. If negative net salvage is included in the depreciation rate, will this lead to  
19 different recovery rates?**

20 A. No, only one rate should be applied, and if net negative salvage is included in the  
21 depreciation rate, then the combined depreciation rate should be applied including  
22 both the service life and net salvage value (cost of removal) rate. This is the normal  
23 practice and in Missouri this translates into these expenditures collected in rates over  
24 approximately 34 years on a levelized basis.

1 **Q. How does MAWC propose to record any additional sources of funding to replace**  
2 **customer owned lead service lines?**

3 A. To the extent that the Company receives any grant funding, the restoration costs should  
4 still be recorded into plant in service but a liability should be recorded as a contribution  
5 in aid of construction to offset applicable plant amounts to ensure our rate base only  
6 includes investor supplied funds. Whether the Company provides the funds or  
7 receives grants to restore customer owned lead service lines, all of this activity should  
8 be recorded on a utility's books. This is a decade old process, aligns with the Uniform  
9 System of Accounts and allows us to track these important activities.

10 **VI. RATE CASE EXPENSE**

11 **Q. How did MAWC calculate its rate case expense?**

12 A. We calculated rate case expense by developing a reasonable and prudent level of rate  
13 case expense and then amortizing it over a period of three years to approximate the  
14 period between rate cases (LaGrand Dir., p. 30, lines 9-15).

15 **Q. Does Staff challenge the reasonableness of the Company's rate case expense costs**  
16 **themselves or identify which particular costs should be disallowed?**

17 A. No. Staff simply proposes to limit the Company's recovery of its rate case expense  
18 using a formulaic approach that would disregard our reasonable and prudent level of  
19 rate case expenses. Staff's recommendation is as follows (Staff Rep. COS, p. 72):

20 Staff recommends that rate case expense be shared between MAWC  
21 ratepayers and shareholders using the option which was ordered by  
22 the Commission in the KCPL rate case, Case No. ER-2014-0370.  
23 Staff is proposing that rate case expense be shared between  
24 ratepayers and shareholders. Staff recommends that ratepayers pay  
25 the same percentage of regulatory expense as the percent of the total  
26 rate case increase that is ultimately determined to be just and  
27 reasonable by the Commission.

28 **Q. Do you agree with Staff's recommendation?**

1 A. No, I do not. The Company should not be penalized for needing to seek a rate increase.  
2 There are a large variety of factors that go into setting rates. A significant deviation in  
3 any one could necessitate the Company to seek rates to recover its actual cost of  
4 service. Declining consumption levels is a good example of such a deviation and is  
5 one that is out of the Company's control.

6 **Q. Has Staff offered evidence of any correlation between the cost of a rate case and**  
7 **the amount of the rate increase requested?**

8 A. No, and the Company asserts that no such correlation exists. This approach could  
9 actually "incentivize" parties in a rate case to propose as many adjustments to the  
10 revenue requirement as they can, knowing that such adjustments will lower the  
11 authorized rate increase down as low as possible. Should this happen, it is possible for  
12 a utility to incur substantial rate case expense, yet only recover a small fraction of the  
13 amount it requested. This result is neither fair nor reasonable given that the Company  
14 does not have control of the recommendations of parties in a rate case.

15 **Q. Staff claims that "[t]his sharing mechanism only includes in the cost of service**  
16 **those costs that are reasonable and from which ratepayers receive a benefit." Do**  
17 **you agree with Staff's claim?**

18 A. No, Staff provides no basis for this claim except the bare assertion that it is true.  
19 Customers are protected from utilities seeking excessive levels of rate case expense  
20 by Staff's review of the level of expenses to determine if they are just and reasonable.  
21 Using an arbitrary mechanism to disallow prudently incurred costs benefits no party.  
22 In fact, Staff even concedes that its proposal is imprecise: "It is understood that some  
23 of the issues litigated in this case do not directly affect the overall revenue requirement  
24 granted by the Commission....." Report p. 71, fn. 75. There are many issues such as

1 rate design issues, conservation matters, allocation matters, and the like that have little  
2 or nothing to do with the ultimate revenue requirement. Yet these issues must be as  
3 carefully and fully presented as any other issues in the case.

4 **Q. Staff further claims that its sharing proposal “reduces the Company’s significant  
5 financial advantage over other participants in the rate case process.” Does Staff  
6 provide support for this claim?**

7 A. No, it is a bare assertion and ignores the fact that other parties are quite well funded.  
8 Furthermore, such parties do not carry the ultimate burden of proof that utilities do;  
9 nor do they have to respond to a large amount of discovery requests or intervenor  
10 testimony addressing a myriad of issues.

11 **Q. Staff further claims that this arbitrary disallowance “provides an incentive for  
12 the Company to control its costs.” Do you agree?**

13 A. No, it does nothing of the sort. We are quite cautious and careful when we submit  
14 our rate case expense. All the Staff proposal does is to disallow expenses that we’ve  
15 proven to be prudently and reasonably incurred in order to present our rate case  
16 claims.

17 **Q. Staff avers that its “sharing mechanism” will “incentivize a utility to file a case  
18 that is easier to process.” Is Staff correct?**

19 A. No, quite the opposite is true. Carefully presented and fully documented cases are  
20 the most easy to process. Sloppily prepared and poorly documented cases might be  
21 cheap to prepare but they certainly do not provide for easily processed rate cases. They  
22 are, moreover, unfair to Staff and the Commission and do a disservice to our  
23 customers. Well prepared and presented cases require considerable effort and

1 expenditure. When those expenditures are prudently and reasonably incurred, all  
2 parties benefit.

3 **Q. Has Staff or any other party demonstrated that any element of MAWC' rate case**  
4 **expense is overstated or unreasonable?**

5 A. No, they have not. There is no evidence questioning the reasonableness of the  
6 Company's costs to litigate this rate case. Staff's recommendations are nothing more  
7 than an approach to reduce the Company's recovery of legitimate and prudently  
8 incurred costs.

9 **Q. How should the Commission seek to minimize rate case expense?**

10 A, To the extent the Commission is looking for ways to minimize rate case expense, the  
11 Company points the Commission to the ratemaking proposals in this case. Not only  
12 do the Company's proposed rate case test year and revenue stabilization mechanism  
13 provide examples of the critical issues the Company had to adequately support and  
14 defend in this case, but they also give the Company the opportunity to increase the  
15 time between rate cases and potentially limit litigation over controversial issues in the  
16 future.

17 **Q. Assuming for sake of argument that a portion of the Company's rate case**  
18 **expense should be shared among customers and shareholders, are there certain**  
19 **expenses that should not be shared under any circumstances?**

20 A. Yes. Rate case expenses incurred by the Company as a result of Commission  
21 mandates should not be shared. For example, to the extent the Company is required  
22 to prepare and submit a Depreciation Study, a Class Cost of Service Study, Minimum  
23 Filing Requirements, or other study or report, the costs associated with those mandates  
24 should not be shared and should be fully recoverable from the customer. Similarly,

1 costs associated with customer/public notices should not be shared. In addition,  
2 unamortized rate case expenses from prior rate cases should not be shared and should  
3 be fully recovered from customers. For example, in the last case, the Company, as  
4 part of a global settlement, agreed to share rate case expense between customers and  
5 shareholders on a 50/50 basis to be amortized over 30 months. At the very least, the  
6 Company should be allowed to fully recover in its rates that portion of its rate case  
7 expense that was agreed to and approved by the Commission. Finally, the Company  
8 utilizes the services of its Service Company to prepare, submit and process its rate  
9 case. As I explained in my direct testimony, MAWC does not retain in-house  
10 resources necessary to fully support a rate case. MAWC uses the Service Company  
11 to support the preparation and presentation of many aspects of its rate case, including  
12 everything from testimony, schedules and workpapers to discovery and hearings and  
13 all the way through briefing until a final order is issued by the Commission. Because  
14 rate cases are somewhat cyclical, the Service Company employs several persons that  
15 work on rate cases in multiple states. By doing this, individual operating companies  
16 like MAWC avoid the need to hire full-time employees to process rate filings, which  
17 would be a more costly alternative and would increase the level of O&M expense  
18 embedded into the Company's revenue requirement in this case. Service Company is  
19 providing quality service to MAWC at a cost that is less than it would be if MAWC  
20 had to hire full-time employees to perform that work. Service Company costs have  
21 been demonstrated through the analysis and report of Company witness Baryenbruch  
22 to be less than what they would otherwise be if MAWC had to hire and staff a full-  
23 time Rate Department. Consequently, MAWC should not be penalized for rate case

1 related services being charged to rate case expense by the Service Company and those  
2 costs should be fully recovered in rates.

3 **Q. Mr. Jenkins, has OPC also taken a position in support of sharing rate case**  
4 **expense?**

5 A. Yes. OPC witness Connor at pages 2 through 4 of her direct testimony supports a  
6 sharing of rate case expense. (Connor Dir., p. 3) OPC's justification for sharing rate  
7 case expenses is similar to that of Staff and my previous testimony regarding why a  
8 sharing of rate case expense is neither reasonable nor appropriate applies to Ms.  
9 Connor's testimony as well.

10 **Q. Did OPC witness Connor propose a different formula for sharing rate case**  
11 **expense?**

12 A. Yes. OPC witness Connor analyzed the five most recent large utility general rate cases  
13 and calculated an average ratio of Commission-ordered revenue requirement increases  
14 to utility-requested revenue requirement increases of 41%. Accordingly, OPC witness  
15 Connor proposes to recover 41% of the Company's rate case expense in rates and  
16 require shareholders to absorb 59% of the Company's rate case expense.

17 **Q. Is this approach, in your opinion, appropriate?**

18 A. No. Ms. Connor's approach to use electric rate cases as a proxy for MAWC is neither  
19 appropriate nor accurate. Electric utilities have different filing requirements,  
20 regulatory challenges, customer bases, service areas, infrastructure requirements, data  
21 systems and rate designs that do not lend themselves, in any way, to a comparison  
22 with MAWC. Tellingly, Ms. Connor offered no explanation or analysis that would  
23 suggest comparability. Ms. Connor's sharing proposal is, therefore, arbitrary and

1 unfairly denies the Company an opportunity to recover its reasonable and prudent rate  
2 case expenses.

3 **VII. AFFILIATE TRANSACTIONS**

4 **Q. What recommendations does OPC witness Marke make about affiliate  
5 transactions?**

6 A. OPC witness Marke recommends that the Commission consider opening a rulemaking  
7 to establish affiliate transaction rules for water utilities similar to the rules the  
8 Commission has created for electric and gas utilities in Missouri. In addition, OPC  
9 witness Marke recommends that the Commission order MAWC to create a cost  
10 allocation manual (“CAM”) for Commission approval within six months of the date  
11 of its Report and Order in this rate case.

12 **Q. Is there a need for MAWC to be subject to the affiliate transaction rules similar  
13 to the rules the Commission has created for electric and gas utilities in Missouri?**

14 A. No, I do not believe such rules are necessary. In many cases, the gas and electric  
15 companies have transactions with affiliates that compete with other, unregulated  
16 entities in the marketplace. These transactions may consist of natural gas and power  
17 purchases and sales, including electric power supply agreements, capacity supply  
18 agreements, energy swaps and energy products, and transmission services.

19 We have no such similar situation. If one is speaking of the Service Company charges,  
20 they are fully audited and auditable by the Commission Staff and OPC. If there is a  
21 cogent reason why such rules should be applied to MAWC, I am unaware of it, and it  
22 has not been presented here.

23 **Q. Is there a need for MAWC to create a new cost allocation manual?**



1 A. No, there is no need. Service Company's Billing and Accounting Manual ("BAM") is  
2 a set of criteria, guidelines and procedures for the Service Company cost allocations  
3 to MAWC and its affiliates.<sup>4</sup> The costs of support services, including wages, employee  
4 benefits, professional services, and other expenses, are based on, or are an allocation  
5 of, actual costs incurred. MAWC affiliates transactions have been scrutinized in all  
6 of its rate cases, including this one. OPC witnesses Marke, however, has not proposed  
7 any rate case adjustments for improper affiliate transactions or cost allocations to  
8 MAWC. I urge the Commission to reject OPC witness Marke's recommendations.

9 **Q. Does this conclude your revenue requirement rebuttal testimony?**

10 A. Yes, it does.

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<sup>4</sup> See BAM attached as Schedule JMJ-1 CONFIDENTIAL.