

# EXHIBIT

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Case No.: WA-2012-0066

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## SURREBUTTAL TESTIMONY

OF

TED ROBERTSON

Submitted on Behalf of the Office of the Public Counsel

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WA-2012-0066

June 5, 2012

OPC Exhibit No. 2  
Date 6-28-12 Reporter AF  
File No. WA 2012-0066

**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI**

In the Matter of Missouri-American Water Company     )  
 for a Certificate of Convenience and Necessity         )  
 Authorizing it to Install, Own, Acquire, Construct,     ) Case No. WA-2012-0066  
 Operate, Control, Manage, and Maintain Water and     )  
 Sewer Systems in Christian and Taney Counties,         )  
 Missouri.   )

**AFFIDAVIT OF TED ROBERTSON**

STATE OF MISSOURI    )  
                                    ) ss  
 COUNTY OF COLE        )

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


1. My name is Ted Robertson. I am a Public Utility Accountant for the Office of the Public Counsel.
2. Attached hereto and made a part hereof for all purposes is my surrebuttal testimony.
3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.

  
 Ted Robertson, C.P.A.  
 Chief Public Utility Accountant

Subscribed and sworn to me this 5<sup>th</sup> day of June 2012.



JERENE A. BUCKMAN  
 My Commission Expires  
 August 23, 2013  
 Cole County  
 Commission #09754037

  
 Jerene A. Buckman  
 Notary Public

My Commission expires August 23, 2013.

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SURREBUTTAL TESTIMONY  
OF  
TED ROBERTSON

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MISSOURI-AMERICAN WATER COMPANY  
CASE NO. WA-2012-0066

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I. INTRODUCTION

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Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

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A. Ted Robertson, P. O. Box 2230, Jefferson City, Missouri 65102.

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Q. ARE YOU THE SAME TED ROBERTSON THAT HAS PREVIOUSLY FILED  
REBUTTAL TESTIMONY IN THIS CASE?

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A. Yes.

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II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. The purpose of this Surrebuttal Testimony is to address the Rebuttal Testimonies of  
Missouri Public Service Commission (MPSC) Staff witnesses, Mr. Paul R. Harrison, and  
Mr. James A Merciel, Jr. regarding the rate base valuation and ratemaking treatment of  
the Saddlebrooke Water and Sewer assets acquired by Missouri-American Water  
Company (MAWC).

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III. ACQUISITION RATE BASE VALUATION

Q. DOES MR. HARRISON BELIEVE THAT COST RECOVERY FOR THE ACQUISITIONS SHOULD BE BASED ON THE SELLER'S BOOKED COST?

A. Yes. Beginning on page 6, line 8, of his Rebuttal Testimony, he states:

Q. What is Staff's position on inclusion of acquisition premiums or acquisition discounts in utility rate base?

A. Staff has taken a consistent position over a very long period of time to value acquired assets in rate base at net original cost to the initial owner of the assets, and has consistently opposed efforts to recognize either acquisition premiums or acquisition discounts in utility rate base.

Q. Did Staff include an acquisition premium or discount adjustment in rate base for the acquired properties in this case?

A. No.

Q. WHAT IS MR. HARRISON'S RATIONALE FOR OPPOSING INCLUSION OF ACQUISITION ADJUSTMENTS IN RATE BASE?

A. Mr. Harrison does not appear to provide any support for the position other than his personal belief of objectiveness and what dictates an over or under valued rate base.

Continuing on page 6, line 19, he states:

1 Staff's position is appropriate because using the net original cost, (to the  
2 original owner) for valuation of plant in service in rate base provides the  
3 most objective value for cost based regulation and does not penalize or  
4 benefit the purchasing company in any single case. The use of acquisition  
5 premiums or discounts leads to assets being either over-or-under-valued in  
6 rate base when determining a utilities (sic) cost of service to provide  
7 service to ratepayers.  
8  
9

10 Q. IS HIS TESTIMONY ACCURATE WHEN HE STATES THAT THE PURCHASING  
11 COMPANY IS NOT PENALIZED OR DOES NOT BENEFIT BY STAFF'S  
12 POSITION?

13 A. No, it is not. His testimony is somewhat ambiguous as to when a utility may be  
14 penalized or may benefit, but, based on my knowledge of Staff's position, I presume he  
15 means that by not allowing recovery of an acquisition premium the purchaser does not  
16 benefit and vice-versa for an acquisition discount. However, I believe his position to be  
17 extremely limited in identified support or explanation as to why Staff opposes the rate  
18 base inclusion of acquisition adjustments; particularly when it is quite apparent, in the  
19 current case, that if the Staff and MAWC position are authorized, MAWC will benefit by  
20 recovery of a return on and of plant which it acquired at no cost. Yet, if their position is  
21 not authorized, MAWC would not be penalized because it would recover a return on and  
22 of its actual incurred cost (purchase price).  
23

24 Q. WHY HAVE ACQUISITION PREMIUMS HISTORICALLY BEEN DISALLOWED  
25 FROM RATE BASE?

1 A. Events in the earlier part of the 20th century led to the concept of the use of original cost  
2 to the initial owner of the assets in order to protect ratepayers from certain unscrupulous  
3 business practices occurring at that time. Utilities were entering strategic transactions  
4 that raised rate bases by changing nothing in the operation but ownership. Thus, the  
5 rationale for disallowing a purchaser recovery of an acquisition premium is based on the  
6 fact that the only thing that changed in the transaction was ownership. The plant and its  
7 usefulness did not change; therefore, ratepayers are to be protected from higher rates that  
8 would occur if the acquisition premium were incorporated into the development of rates.

9  
10 However, Commissions have not necessarily set the concept of no recovery of acquisition  
11 premiums in stone. There have been cases wherein acquisition premiums have been  
12 authorized for recovery from ratepayers if the benefits of the transaction equaled or  
13 outweighed the costs the utility sought to recover. Occasionally, a Commission may  
14 even recognize that a utility will recover all or a portion of the premium paid in the lag  
15 period between the purchase authorization and the next authorized change in the utility's  
16 rates. These authorized recoveries recognized that the sale transaction actually had a  
17 sound business purpose that benefited both the shareholder and ratepayers. Whereas,  
18 Staff's position that it does not support any acquisition premium recovery, at any time,  
19 does not recognize the facts and events that led to the development and use of the original  
20 cost concept or what it was intended to protect.

1 Q. HAVE ACQUISITION DISCOUNTS ALSO BEEN HISTORICALLY DISALLOWED  
2 RATE BASE TREATMENT?

3 A. Because the original plant concept was developed and implemented primarily to confront  
4 problems with the overvaluing of plant due to a sale transaction when nothing else  
5 actually changed in the operation and acquisition discounts (bargain purchase) are  
6 relatively uncommon and their treatment has normally been adjudicated on a case by case  
7 basis.

8  
9 Q. IS THE ORIGINAL PLANT CONCEPT RELEVANT TO THE RATEMAKING  
10 TREATMENT OF ACQUISITION DISCOUNTS?

11 A. Yes, it is relevant in that the purpose for its implementation was to prevent utilities from  
12 inappropriately benefiting from a transaction at the expense of ratepayers. An acquisition  
13 premium should be disallowed recovery absent convincing evidence of benefits while an  
14 acquisition discount should reduce rate base absent a rational public interest need to  
15 allow the purchaser to earn a return on and of an asset which it obtained free.

16  
17 I have not found anywhere in my research on the issue where a basis of reciprocity, as  
18 described and supported by Staff and Company, exists for the theory of unqualified  
19 disallowance of acquisition premiums and recovery of acquisition discounts. Staff and  
20 Company's reliance on such an argument exists only as their opinion as to the position  
21 the Commission should authorize. Whereas, the OPC's recommendation is that the

1 Commission looks at the facts in the instant case and the actual purpose of the original  
2 plant concept.

3  
4 Q. WHY IS PUBLIC COUNSEL RECOMMENDING THAT THE ACQUISITION  
5 DISCOUNT IN THIS CASE REDUCE THE UTILITY'S RATE BASE?

6 A. As in cases where an acquisition premium occurs, I believe that ratepayers should be  
7 protected from paying higher rates when a utility would inappropriately benefit from a  
8 purchase transaction. The acquisition discount results from the seller's decision to sell  
9 their assets at a loss; thus, since gains do not flow through to ratepayers neither should  
10 losses. It is a long-held ratemaking concept that gains on assets sales do not flow through  
11 to ratepayers since they do not hold any ownership rights. If gains do not flow to  
12 ratepayers neither should losses. However, that is exactly what would occur if rate base  
13 were not reduced by the acquisition discount. The losses of the seller would be  
14 incorporated into the rate base of the buyer and the buyer would recover the losses  
15 incurred by the seller by charging the ratepayer. That is nonsensical. Unless there are  
16 compelling public interest reasons for the larger utility to take over the smaller utility  
17 (which in this case none have been identified since MAWC is simply attempting to grow  
18 its operations through acquisitions), I do not believe it is appropriate for ratepayers to pay  
19 MAWC for plant which it acquired at no cost.

20



1 Q. IS STAFF'S RELIANCE ON ESTIMATES ALSO A REASON FOR PUBLIC  
2 COUNSEL'S TAKING THE POSITION THAT IT HAS?

3 A. Yes. Staff's reliance on estimates and its inability to obtain complete records regarding  
4 original construction costs presents the actual purchase price paid by MAWC as the most  
5 logical and substantiated value of the properties acquired. Apparently, the developer of  
6 the properties failed to maintain adequate documentation and accounting procedures or  
7 processes which have led to Staff's identification in testimony that it has relied heavily on  
8 estimates to value the utilities rate bases. The estimates are a weak link in the  
9 determination of the actual costs incurred by the developer to build the plant; costs which  
10 were not audited, verified for accuracy or substantiated for reasonableness and prudence.  
11 Whereas, the purchase price provides a solid valuation of the properties agreed to by both  
12 the buyer and the seller. Reliance on the estimated costs does not provide the higher  
13 level of substantiation and comfort for the valuing of the rate bases that the actual  
14 purchase price incurred by MAWC does.

15  
16 Q. IS IT PUBLIC COUNSEL'S INTENTION TO PENALIZE THE COMPANY FOR ITS  
17 PURCHASE?

18 A. No. OPC's rationale for the position taken on this issue, succinctly stated, is that  
19 acquisition premiums should not be allowed rate base treatment to avoid charging  
20 ratepayers higher rates when the only thing that changed in an acquisition was ownership  
21 while rate base should be reduced by the amount of acquisition discounts to reflect that

1 the seller of regulated utility assets owns both gains and losses and to prevent the buyer  
2 from unjust recovery of asset costs (investment) which it received free of charge. The  
3 Commission should accept the OPC's position because it is based on the actual facts  
4 surrounding the acquisitions and not some unsubstantiated and oft misconstrued concept  
5 of reciprocity.

6  
7 Q. SHOULD THE COMMISSION BASE ITS DECISION ON THE RATEMAKING OF  
8 AN ACQUISITION DISCOUNT ON THE FACTS ASSOCIATED WITH THE  
9 TRANSACTION ITSELF AND NOT SOME UNSUBSTANTIATED RECIPROCITY  
10 HYPOTHESIS?

11 A. Yes, it should. The facts associated with the acquisition identify that the transaction  
12 resulted in a substantial acquisition discount. That is, the assets were purchased far  
13 below book because the seller willingly chose to take a loss on the sale (a loss which  
14 should be reduced significantly for the seller via future tax benefits and connection fee  
15 recovery). Further, MAWC will not be harmed in any way if it is not authorized  
16 recovery on and of the assets associated with the acquisition discount since it will in all  
17 likelihood be authorized recovery on and of its actual investment cost. The only party  
18 that stands to be harmed, at all, is the seller, but they, of their own accord, made the  
19 decision to take a loss on the sale. A loss which should not be inappropriately converted  
20 into a gain for MAWC at the expense of the ratepayers. Even if MAWC is denied  
21 recovery on and of the assets associated with acquisition discount, it will still benefit

1 from the cost-free use of those revenue producing assets for their entire remaining life.

2 In essence, if the Commission accepts the OPC's recommendation, both MAWC's  
3 shareholders and ratepayers benefit from the seller's decision to sell its property at a loss.

4  
5 Q. DOES THE SELLER'S DECISION TO SELL THE PROPERTIES AT A LOSS  
6 BENEFIT RATEPAYERS IF MAWC IS NOT AUTHORIZED RECOVERY ON OR OF  
7 THE PORTION OF PLANT IT RECEIVED COST FREE IN THE PURCHASE?

8 A. Yes, it would. The rate base values would be lower so the amount of recovery by the  
9 buyer would be lower; however, as I stated previously, MAWC will also benefit because  
10 it gets the use of the properties free of charge so it is a win-win situation for both  
11 Company and ratepayers. In fact, though the seller "eats" the loss that loss will in all  
12 likelihood be mitigated by tax benefits it receives associated with the loss.

13  
14 Q. HAS STAFF INCLUDED IN ITS ESTIMATED RATE BASES THE COST OF PLANT  
15 THAT IS NOT IN SERVICE?

16 A. Yes. On page 4, lines 9-13, Mr. Merciel identifies plant costing approximately \$31,000 that  
17 needs to be installed to correct certain deficiencies. The plant, as identified by Mr. Merciel,  
18 includes security fencing for the water well and tank site and sewage treatment facility site, a  
19 spare well pump and an additional groundwater monitoring well for the sewage effluent land  
20 application area.

1 Q. IS PUBLIC COUNSEL OPPOSED TO THE INCLUSION OF THE COST OF THE  
2 ADDITIONAL PLANT THAT IS NOT YET IN SERVICE?

3 A. Yes. Since the plant is not in-service it is not used and useful. Regulatory ratemaking  
4 concepts and procedures dictate that if plant is not in-service it is not used and useful so its  
5 cost should not be passed on to ratepayers until the plant is actually placed in service and  
6 those costs are thoroughly reviewed in the ratemaking process. Staff's persistent maneuvers  
7 to force ratepayers to pay for plant from which they receive no service is a violation of the  
8 Commission's long standing following of regulatory ratemaking upon which we all rely in  
9 the development of a utility's rates.

10  
11 Q. DOES MR. MERCIEL RECOGNIZE THAT THE PLANT IS NOT IN-SERVICE?

12 A. Yes. Beginning on page 5, line 1, he provides testimony that the plant is not in-service, but  
13 he argues that the current case is a Certificate of Convenience and Necessity (CCN) case and  
14 it is typical to include such proposed plant additions in rate base and the rate calculation in a  
15 CCN case.

16  
17 Q. DO YOU AGREE WITH MR. MERCEIL TESTIMONY ON THE ISSUE OF CCN  
18 ESTIMATES?

19 A. I agree as far as it is typical in a CCN case where the construction has not been finalized and  
20 is nearing completion; however, that is not the case in this instance. As stated on page 3,  
21 lines 16-17, of Mr. Harrison's Rebuttal Testimony, "The initial construction of Saddlebrooke

1 began during calendar year 2004 and ended in calendar year 2006." The utilities at issue are  
2 not a new construction nearing finalization; they are already built and have been in service  
3 for approximately 5 to 6 years. Mr. Merciel presents an inordinate amount of testimony that  
4 does not correlate to the actual operation of the utility. In fact, on page 6, lines 11-12, he  
5 identifies that a CCN case, "is much different than studying existing but changing expenses  
6 of an established utility in a rate case." Never mind that, though not in a regulated capacity,  
7 the purchased utilities have been operating for years and have very likely experienced  
8 changing expenses in each of those years.

9  
10 Q. DOES MR. MERCIEL MAKE ANY OTHER ATTEMPTS TO OBFUSCATE THE  
11 FACTS IN THE CURRENT CASE?

12 A. Yes, he does. Beginning on page 13, line 11, Mr. Merciel states his opinion that, "While this  
13 Saddlebrooke case could be termed an "acquisition" case, it is properly classified as a CCN  
14 case." In actuality, this is as much an acquisition case as it is a CCN case. The testimony he  
15 provides on the topic is clearly directed at supporting his belief that estimated costs,  
16 including those for plant not in-service, can reasonably be included in the development of the  
17 utility's rates after the acquisition by MAWC.

18  
19 Q. DO YOU AGREE WITH MR. MERCIEL'S POSITION ON RECOVERY OF PLANT  
20 NOT IN-SERVICE?

Surrebuttal Testimony of Ted Robertson  
Case No. WA-2012-0066

1 A. No. The facts of this case are MAWC has an agreement to purchase a utility that has been  
2 illegally operating outside the Commission's jurisdiction. As such, rates need to be  
3 developed and implemented, but it is still an acquisition case and regulatory ratemaking  
4 concepts and procedures need to be followed to determine proper rates to be charged  
5 customers.

6

7 Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

8 A. Yes, it does.