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MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. WA-2012-0066

REBUTTAL TESTIMONY

OF

DENNIS R. WILLIAMS

ON BEHALF OF

MISSOURI-AMERICAN WATER COMPANY

MAWC Exhibit No. 3
Date 6-28-12 Reporter KF
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, OPERATE,)
CONTROL, MANAGE AND MAINTAIN)
WATER AND SEWER SYSTEMS IN)
CHRISTIAN AND TANEY COUNTIES,)
MISSOURI)

CASE NO. WA-2012-0066

AFFIDAVIT OF DENNIS R. WILLIAMS

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

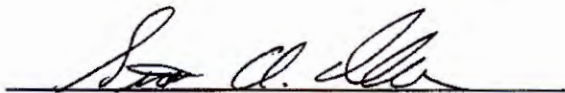

Dennis R. Williams

State of Missouri

County of St. Louis

SUBSCRIBED and sworn to

Before me this 11th day of May 2012.


Notary Public

My commission expires:



REBUTTAL TESTIMONY

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DENNIS R. WILLIAMS

WITNESS INTRODUCTION AND PURPOSE

Q. PLEASE STATE YOUR NAME, TITLE AND BUSINESS ADDRESS.

A. My name is Dennis R. Williams, and my title is Senior Manager - Rates and Regulation for the Central Division of American Water Works. My business address is 727 Craig Road, St. Louis, Missouri 63141.

Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THIS PROCEEDING?

A. Yes, I have submitted direct testimony in this proceeding on behalf of Missouri-American Water Company ("Missouri-American", MAWC", or "Company").

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. I will respond to the direct testimony of Donald E. Johnstone, who is appearing on behalf of AG Processing Inc. ("AGP"). I will address Mr. Johnstone's concerns and recommendations summarized on page 5 of his direct testimony, particularly in regard to the Company's proposal for the establishment of rates in connection with the request for certificates of convenience and necessity to provide water and sewer service to the Saddlebrooke area.

Q. ON PAGES 2 AND 3 OF HIS DIRECT TESTIMONY, MR. JOHNSTONE STATES THAT HE IS NOT AN ATTORNEY. HOWEVER, HE ALSO MAKES ASSERTIONS AS TO MISSOURI LAW, SPONSORS AN AGP BRIEF FROM A PRIOR COMMISSION CASE AND PROVIDES A

1 **MISSOURI SUPREME COURT OPINION. WILL YOU BE**
2 **RESPONDING TO THESE LEGAL ARGUMENTS?**

3 A. No. I am also not an attorney. I will leave these legal arguments to be
4 briefed at the appropriate time.

5

6 **Q. IS IT NECESSARY TO ESTABLISH RATES IN A CERTIFICATE**
7 **CASE?**

8 A. Yes. There must be some authorized rate in place when MAWC begins
9 to provide service to the Saddlebrooke area. This process always
10 requires estimates because there is necessarily no history associated
11 with provision of service by a newly certificated Company. Here, while
12 service has been provided by another entity, it has been unregulated in
13 nature and there are no Commission-approved, just and reasonable rates
14 for Saddlebrooke in place to use as a surrogate.

15

16 **Q. PLEASE SUMMARIZE THE COMPANY'S POSITION REGARDING THE**
17 **ESTABLISHMENT OF RATES IN THIS PROCEEDING.**

18 A. MAWC has proposed that the rates to be charged in the newly certificated
19 area be based on the same rate sheets that are applicable to the
20 subdivision of Stonebridge Village. Those rate sheets for water and
21 sewer are attached as Schedules DRW-1 and DRW-2, respectively.

22

23 **Q. MR. JOHNSTONE SUGGESTS THAT "THE SADDLEBROOKE RATES**
24 **SHOULD BE SET AT THE COST OF SERVICE" (DIRECT TESTIMONY,**
25 **P. 8). DO YOU DISGAREE WITH THIS SUGGESTION?**

26 A. Not necessarily. My point is that we will not know what that cost of
27 service will be until after MAWC has begun to operate the water and
28 sewer systems.

29

1 **Q. WHY DID THE COMPANY PROPOSE USE OF EXISTING TARIFFED**
2 **RATES RATHER THAN DEVELOPING NEW RATES SPECIFIC TO**
3 **SADDLEBROOKE?**

4 **A.** The objective in establishing rates should be that they are just and
5 reasonable. In support of this objective, there are a number of reasons
6 why the Company made this proposal:

7 1. As stated above, Saddlebrooke currently has no rates in place that
8 have been approved by this Commission, so initial rates must be set.
9 The location of the Saddlebrooke subdivision is in the general proximity of
10 Stonebridge. The very same operating personnel that service
11 Stonebridge will also service Saddlebrooke. The same administrative
12 personnel will manage and service both subdivisions. There are close
13 similarities in the types of residences and consumption patterns in the two
14 subdivisions.

15 2. Saddlebrooke is a subdivision that currently has 79 residences and
16 two Home Owner Association facilities that receive both water and sewer
17 service. It is not appropriate to introduce the additional cost and
18 confusion of a new set of tariffs for 81 customers, when utilization of
19 existing tariffs would result in just and reasonable rates.

20 3. During the Company's most recent rate case, Case No. WR-2011-
21 0337, there was considerable effort that went into the negotiation of a
22 small system water tariff, which has been dubbed by some as the "District
23 8" tariff. Moreover, sewer rates were established so that the vast majority
24 of all residential sewer customers throughout the state pay the same rate.
25 Because Saddlebrooke has similar characteristics, these rates should be
26 a good estimate for Saddlebrooke.

27

28 **Q. IS THIS PROCESS SIMILAR TO ANY COMMON COMPANY**
29 **PRACTICE?**

30 **A.** Yes. This approach is similar to what occurs every day when a new
31 customer is added. During 2011, for example, a net of 2,625 new water

1 and 2,885 new sewer connections were added. No individual cost
2 studies were made for each additional customer. Instead, existing rates
3 in place and approved by the Commission were applied to the new
4 accounts. By the same token, it makes little sense to estimate a separate
5 new rate for the 81 customers being added through this Application.
6

7 **Q. WHEN NEW CUSTOMERS ARE ADDED TO A SYSTEM, IS THERE A**
8 **DIRECT BENEFIT TO EXISTING CUSTOMERS?**

9 **A.** Yes, to the extent that the revenues from the new customers are in
10 excess of the marginal cost to serve. Mr. Johnstone focuses his
11 comments on subsidies that he believes exist between various
12 geographical locales. However, he fails to recognize that acquisitions,
13 such as this one, that are made without incurrence of any ongoing
14 additional expenses, benefit existing customers. As long as revenues are
15 sufficient to recover the return on acquired assets, the Company's
16 expenses are spread over a greater number customers, which benefits all
17 existing customers.
18

19 **Q. HAS THE COMPANY INDEPENDENTLY TESTED THE**
20 **REASONABLENESS OF THE PROPOSED RATES?**

21 **A.** Yes. In order to test the reasonableness of the existing rates that it is
22 proposing be applied to Saddlebrooke, the Company looked at the
23 underlying estimated rate base and costs. This review was supported
24 through the direct testimony of Company witness Brian LaGrand. The
25 results of that review indicated that the application of the existing
26 Stonebridge Village small system water and sewer rates to Saddlebrooke
27 would result in just and reasonable rates. In fact, it is entirely possible
28 that application of those existing rates may be more in line with actual
29 costs that will be experienced, than the estimated costs included in Mr.
30 LaGrand's study.
31

1 **Q. WHY DO YOU BELIEVE THAT IT IS POSSIBLE THAT THE COSTS**
2 **USED IN MR. LAGRAND'S STUDY COULD BE LESS THAN**
3 **ACCURATE?**

4 **A.** The books and records of the existing utility are not of the quality that one
5 would expect of a utility regulated by this Commission. Mr. LaGrand
6 made a concerted effort to locate supporting documentation, but in a
7 number of cases, costs are based on incomplete records and estimates
8 based on industry knowledge and discussions with current ownership. In
9 addition, operating costs under MAWC ownership, may vary from existing
10 operations. The Company has done its best to identify these differences,
11 but again those costs are estimates. As Mr. Johnstone points out on
12 page 8 of his direct testimony, "while this is not a general rate case, as a
13 practical matter rates for the Saddlebrooke water and sewer customers
14 are a necessary result." The Company believes that it is more
15 appropriate to apply rates that have previously been approved as being
16 just and reasonable for similar customers, rather than developing a new
17 set of rates based on estimates and incomplete accounting information.

18

19 **Q. HOW WILL MAWC ACCOUNT FOR THE SADDLEBROOKE**
20 **CUSTOMERS GOING FORWARD?**

21 **A.** For accounting purposes the Company will treat Saddlebrooke as a
22 separate district through its next general next rate case so that if there are
23 questions regarding the appropriateness of rates for these customers,
24 they can be addressed at that time.

25

26 **Q. MR. JOHNSTONE STATES THAT AGP AND MOST OTHER**
27 **CUSTOMERS ARE SUBSIDIZING SMALL UTILITY PROPERTIES**
28 **THAT HAVE BEEN ACQUIRED BY MAWC BY A TOTAL OF**
29 **"ROUGHLY" \$2.4 MILLION. DO YOU AGREE?**

30 **A.** No. In the Company's last rate case, there were various positions
31 regarding subsidization. Mr. Johnstone has selected one position and

1 stated that as fact, even though the rate case was settled and no
2 determination of subsidization was made.

3
4 **Q. A 7.58% RATE OF RETURN WAS ASSUMED BY MR. JOHNSTONE IN**
5 **CALCULATING THIS SHORTFALL. WAS A 7.58% RATE OF RETURN**
6 **APPROVED IN THE MOST RECENT RATE CASE?**

7 **A.** No.

8
9 **Q. AT PAGE 5 OF HIS DIRECT TESTIMONY, MR. JOHNSTONE STATES**
10 **THAT “WATER AND SEWER SERVICE SHOULD REFLECT THE**
11 **COST OF SERVICE TO BE PROVIDED, NO MORE AND NO LESS.”**
12 **ARE THERE PROBLEMS WITH THAT STATEMENT?**

13 **A.** Yes. First, as I pointed out previously, neither the Company, nor Mr.
14 Johnstone, nor any other party, can accurately identify all of the existing
15 or pro forma level of costs on which rates should be based for
16 Saddlebrooke. Adequate records simply do not exist to do so.
17 Second is the matter of practicality. The Company's proposal would
18 generate estimated revenues of about \$127,000 annually. Even if this
19 amount were 25% off from actual cost based rates (assuming that cost
20 based rates could be determined), the impact on average to other
21 customers would be about ½ penny, per month. Spending the time and
22 resources to litigate the method of establishment of a rate that may or
23 may not impact customers by ½ cent makes little sense when there is a
24 viable alternative.

25 Third is the question of where to draw the line for establishing costs
26 based rates. Is it necessary to identify the cost to serve each of the
27 individual 81 customers? Are rates based on class cost of service
28 determinations, such as are made in most electric and gas distribution
29 company rate cases sufficient? Or is some middle ground more
30 appropriate? These are questions that were discussed at length in
31 testimony filed in MAWC's last rate case (Case No. WR-2011-0337),

1 have been discussed in a generic docket created by this Commission
2 (Case No. SW-2011-0103) and remain to be fully resolved. The
3 Company does not believe that determination needs to be made in this
4 certificate of convenience and necessity case. The Company's proposal
5 to institute existing rates is a practical solution that results in a fair and
6 equitable result.

7
8 **Q. IN ADDITION TO HIS RECOMMENDATION FOR RATES BASED ON**
9 **COSTS, MR. JOHNSTONE, AT PAGE 5 OF HIS DIRECT TESTIMONY,**
10 **MADE A NUMBER OF ADDITIONAL RECOMMENDATIONS. WOULD**
11 **YOU AGREE WITH HIS RECOMMENDATION THAT POTENTIAL**
12 **COST OF SERVICE ADJUSTMENTS BE CONSIDERED IN THIS**
13 **PROCESS?**

14 **A.** Yes. As noted previously, Mr. LaGrand made certain pro forma cost of
15 service adjustments to reflect the estimated impact of changes in
16 operations under MAWC ownership in order to develop his model. His
17 model incorporated these pro forma adjustments in the reasonableness
18 test of of the rate recommended by the Company.

19
20 **Q. DO YOU AGREE WITH MR. JOHNSTONE'S RECOMMENDATION**
21 **THAT THE RATE BASE VALUATION MUST BE EXPLICITLY**
22 **IDENTIFIED IN THIS PROCEEDING?**

23 **A.** Yes. I believe that it is necessary to identify the amount of rate base in
24 relation to the purchase price in order to determine whether an acquisition
25 premium is being paid. To the extent that an acquisition premium is
26 present, the Commission should take the proposed ratemaking treatment
27 of that premium into consideration in determining whether the acquisition
28 results in a detriment to the public interest. However, since there is no
29 premium being paid for the assets being acquired in connection with this
30 case, the issue is moot.

31

1 **Q. WHAT IS YOUR RESPONSE TO MR. JOHNSTONE'S STATEMENT**
2 **THAT THERE SHOULD BE CONDITIONS PLACED ON THE**
3 **APPROVAL OF A CERTIFICATE OF CONVENIENCE AND**
4 **NECESSITY THAT WOULD PROVIDE PROTECTIONS AGAINST A**
5 **POTENTIAL DETRIMENT TO EXISTING CUSTOMERS?**

6 **A.** Mr. Johnstone has not, at this time, recommended any specific
7 conditions. I will wait to respond those conditions when they are known.

8

9 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

10 **A.** Yes, it does.

11