

Exhibit No.: 115
Issues: Present Rate Revenues (Sales and Customers), Bad Debt Expense, Insurance Other Than Group, Fuel & Power and Chemical, Contributed Capital
Witness: Donald J. Petry
Exhibit Type: Rebuttal
Sponsoring Party: Missouri-American Water Company
Case No.: WR-2010-0131
SR-2010-0135
Date: April 15, 2010

MISSOURI PUBLIC SERVICE COMMISSION

**CASE NO. WR-2010-0131
CASE NO. SR-2010-0135**

REBUTTAL TESTIMONY

OF

DONALD J. PETRY

ON BEHALF OF

MISSOURI-AMERICAN WATER COMPANY

MAWC Exhibit No. 115
Date 5-17-10 Reporter KF
File No. WR-2010-0131

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

IN THE MATTER OF MISSOURI-AMERICAN) WATER COMPANY FOR AUTHORITY TO) FILE TARIFFS REFLECTING INCREASED) RATES FOR WATER AND SEWER) SERVICE)	CASE NO. WR-2010-0131 CASE NO. SR-2010-0135
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AFFIDAVIT OF DONALD J. PETRY

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

Donald J. Petry

**State of Missouri
County of St. Louis**

**SUBSCRIBED and sworn to
Before me this _____ day of _____ 2010.**

Notary Public

My commission expires:

**REBUTTAL TESTIMONY
DONALD J. PETRY
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WR-2010-0131
SR-2010-0135**

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REBUTTAL TESTIMONY

DONALD J. PETRY

WITNESS INTRODUCTION

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

A. Donald J. Petry, Financial Analyst III for American Water, 727 Craig Road, St. Louis, Missouri 63141.

Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THIS PROCEEDING?

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

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to respond to the Staff Report regarding the following issues on behalf of MAWC:

- 1) Present Rate Revenues (Sales and Customers);
- 2) Bad Debt Expense;
- 3) Insurance Other Than Group;
- 4) Fuel & Power;
- 5) Chemicals; and
- 6) Contributed Capital

(1) PRESENT RATE REVENUES (SALES AND CUSTOMERS)

Q. PLEASE DISCUSS THE ISSUES THAT YOU HAVE WITH REGARD TO THE CALCULATION OF PRESENT RATE REVENUES.

A. I will address two issues involving Staff's calculation of present rate revenues related to sales and customers. They are as follows:

- 1) Staff's approach to annualization and normalization of non-residential and

1 non-commercial customer class sales.

- 2) 2) Staff's approach to residential and commercial customers' sales usage per
3 customer per day.

4 In addition, I will respond to the Missouri Industrial Energy Consumers' (MIEC")
5 objection to the Company's proposal for the St Louis Metro District to provide a
6 revenue contribution to certain districts and two adjustments to revenues.

7
8 **Q. PLEASE DISCUSS THE ISSUE REGARDING ANNUALIZATION AND**
9 **NORMALIZATION OF NON-RESIDENTIAL AND NON-COMMERCIAL**
10 **CUSTOMER CLASS SALES.**

- 11 A. The Staff adjusted the test year sales for the Industrial, Sale for Resale, and
12 other Public Authority customer classes in all districts to reflect actual sales
13 through June 30, 2009. This is consistent with the Staff's approach of updating
14 specific segments of the revenue requirement through June 2009. As part of the
15 Company's proposed true-up, the Company will provide Staff with the required
16 data for the Industrial, Sales for Resale, and Other Public Authority customer
17 classes for the twelve months ended April 2010. Using this data will maintain the
18 matching of revenues, expenses, investments, and capital in the revenue
19 requirement determination.

20
21 **Q. PLEASE DISCUSS THE ISSUE REGARDING RESIDENTIAL AND**
22 **COMMERCIAL CUSTOMER SALES USAGE PER DAY.**

- 23 A. The Company and Staff both calculated present rate revenues for the Residential
24 and Commercial customer classes by applying a sales usage per customer per
25 day ("UCD") to a level of customers for each district. While the Company and
26 Staff have different levels of customers, this difference should be eliminated
27 when the true-up of customers at April 2010 is applied to the appropriate level of
28 UCD.

29 The remaining difference between the Company and Staff for the calculation of
30 the UCD results from differing methodologies I have attached a summary
31 schedule (Rebuttal Schedule DJP-1) that compares each district's UCD and the
32 methodology used for each district for the Residential and Commercial customer
33 classes.

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Q. WHAT METHODOLOGY DID THE STAFF EMPLOY IN DEVELOPING ITS USAGE PER CUSTOMER PER DAY?

A. The Staff Report indicated a six year average (excluding 2003 and 2006) of actual UCD for all districts, with the exception of St. Louis residential monthly and Warren County Water residential and commercial customers. For those exceptions, Staff used actual test year levels. The Company does not oppose Staff's use of actual test year sales level for the St. Louis residential monthly customer class or the Warren County Water residential and commercial customer classes.

Q. DOES THE COMPANY OPPOSE THE STAFF'S POSITION OF USING A SIX YEAR AVERAGE FOR ALL DISTRICTS' RESIDENTIAL AND COMMERCIAL CUSTOMERS?

A. Yes. The Company believes that a thorough review and analysis of residential and commercial customer sales usages needs to be performed when determining the level of present rate revenues which is the basis for the setting of rates. This analysis and review should include appropriate statistical evaluation and testing to determine what is considered to be a normal level of sales when setting rates.

Q. IS THERE SUPPORT FOR THE COMPANY'S POSITION IN THE STAFF REPORT?

A. Yes. In the direct testimony of Staff Witness Ms. Bolin, she identifies at page 52 two major types of revenue adjustments. One of those adjustments is the Normalization Adjustment. Ms. Bolin states "Normalizations deal with test year events that are unusual and are unlikely to be repeated in the years when the new rates from this case are in effect. Test year weather is an example." The purpose of the Company and Staff's adjustments for the test year level of UCD for residential and commercial customers is to set rates at a level that reflects normal ongoing operations. We believe the Company's approach more appropriately accomplishes this goal.

1 **Q. WHAT METHODOLOGY DID THE COMPANY PROPOSE IN DEVELOPING**
2 **ITS USAGE PER CUSTOMER PER DAY?**

3 A. The Company performed a detailed weather normalization study for the St.
4 Louis, St. Joseph, Joplin, St. Charles, and Jefferson City service areas. These
5 five districts represent over 94% of the total revenues of the Company.
6 Professor Edward Spitznagel was hired by the Company to perform the studies.
7 His studies and conclusions are contained in his direct testimony that has been
8 filed in this case. In summary, he found strong statistical significance and
9 correlation between sales and weather using the Palmer Drought Severity Index
10 ("PDSI") in predicting UCD for the following customer classes:

- 11 • St. Louis Residential Quarterly
- 12 • St. Joseph Residential
- 13 • Joplin Commercial
- 14 • St. Charles Residential
- 15 • St Charles Commercial
- 16 • Jefferson City Residential

17
18 When the Company did not rely on a weather normalization analysis, the
19 Company used a six year average.
20

21 **Q. HAS THE COMPANY ASKED PROFESSOR SPITZNAGEL TO DISCUSS THE**
22 **REASONS WHY A STATISTICAL ANALYSIS FOR WEATHER**
23 **NORMALIZATION IS BETTER THAN A SIMPLE SIX YEAR HISTORICAL**
24 **AVERAGE CALCULATION OF UCD?**

25 A. Yes, we have. Professor Spitznagel in his rebuttal testimony will offer detailed
26 support, analysis and reasons for using the weather normalization method over a
27 simple six year average of UCD.
28

29 **Q. DO YOU HAVE ANY COMMENTS THAT WILL SUPPLEMENT PROFESSOR**
30 **SPITZNAGEL'S REBUTTAL TESTIMONY?**

31 A. Yes, I do. As noted by Professor Spitznagel, the UCD for six of the Company's
32 service classes are impacted by weather. The Staff has used a historical six
33 year average to calculate revenues at present rates for those six service classes.

1 The Company believes that the Staff's six year average of UCD overstates the
2 level of sales at present rates because the Staff has ignored the impact of
3 weather on those six years. A review of actual weather for the months of April
4 through October for the years used by the Staff to calculate its UCD, indicates
5 that for all six service areas where the Company has utilized a weather
6 normalized study to calculate UCD, the actual weather conditions were on
7 average both hotter and drier. In other words, because the actual weather was
8 hotter and drier (as measured by temperature, cooling degree days and PDSI)
9 than normal (based on thirty years of data) and because the UCD is impacted by
10 weather, using the Staff's six year average for calculating its UCD overstates
11 sales and revenues at present rates.
12

13 **Q. DID MIEC RAISE ANY ISSUES REGARDING REVENUES?**

14 A. Yes; there were two issues. The first issue was normalization of residential and
15 commercial revenues for weather in the St Louis Metro District and the second
16 issue was the St Louis Metro District providing a revenue contribution to other
17 Districts.
18

19 **Q. HOW DOES MIEC WITNESS COLLINS PROPOSE TO NORMALIZE THE
20 REVENUES FOR THE ST. LOUIS METRO DISTRICT?**

21 A. Mr. Collins used the years 2002 through 2007 to arrive at a six year average for
22 UCD. Mr. Collins' averaging method suffers from the same criticisms Company has
23 with respect to Staff's six year average. Professor Spitznagel will also address this in
24 his rebuttal testimony. In addition, Mr. Collins' average is flawed because it includes
25 two years of inconsistent data. In years 2003 and 2006, the Company changed its
26 accounting system. And, as a result, sales for those years were not recorded on the
27 same basis as all other years. By including those two years in his six year average,
28 Mr. Collins has used two years of revenue that were higher than they should have
29 been but for the accounting change.
30
31

32 **Q. DID THE COMPANY PROPOSE THE ST LOUIS METRO DISTRICT PROVIDE
33 A REVENUE CONTRIBUTION TO OTHER DISTRICTS?**

1 A. Yes, the Company proposed that the St. Louis Metro District provide a revenue
2 contribution to Brunswick, Parkville Water, Warren County Water, Warren County
3 Sewer, and Cedar Hill in the amounts of \$404,851; \$354,195; \$86,022;
4 \$853,790; and \$488,473, respectively. The total amount of the contribution is
5 2,187,330, or 1.1% of the proforma sales for the St. Louis District.

6
7 **Q. DO YOU AGREE WITH MIEC WITNESS COLLINS THAT THE ST LOUIS
8 METRO CONTRIBUTION IS INAPPROPRIATE?**

9 A. No I do not. So that certain of our customers don't experience "rate shock", there
10 needs to be a mechanism to gradually move their rates in line with their cost of
11 service. Without the contribution, the increases for these Districts would be:
12 Warren County Sewer, 474%; Cedar Hill, 190%; Brunswick, 161%; Warren
13 County Water, 63%; and Parkville Water, 34%. Our reasoning was to keep the
14 increase below 30% for all of the districts. St Joseph was the highest increase
15 under 30%, so the contribution was meant to limit the increases in these Districts,
16 whose increases were over 30%, to a level just above that proposed for the St.
17 Joseph District (26.17%).

18
19 **(2) BAD DEBT EXPENSE**

20
21 **Q. WHAT IS THE ISSUE REGARDING BAD DEBT EXPENSE?**

22 A. The issue between Staff and Company regarding bad debt expense is whether or
23 not there should be a bad debt expense attributable to the additional revenues
24 that result from a rate increase in this case.

25
26 **Q. DID STAFF CALCULATE A BAD DEBT EXPENSE ASSOCIATED WITH THE
27 ADDITIONAL REVENUES TO BE RECEIVED AS A RESULT OF A RATE
28 INCREASE IN THIS CASE?**

29 A. No.

30
31 **Q. WHY DOES THE COMPANY APPLY A BAD DEBT RATIO TO THE PROFORMA
32 REVENUES AT PROPOSED RATES?**

33 A. There is a direct relationship between revenues and bad debt expense. In other

1 words, as revenues increase, bad debt expense increases as well. Attached is
2 Rebuttal Schedule DJP-2 which demonstrates this direct relationship in all but one of
3 the past five years. The 2006 to 2007 trend was impacted due to a change in the
4 methodology for calculating the uncollectible reserve and a one time write off of
5 accounts over 180 days. By applying the bad debt ratio to proforma or anticipated
6 revenues resulting from this case, the bad debt expense will be more accurately
7 reflected for the period of time rates set in this case will be in effect.

8 **Q. WHAT IS THE IMPACT OF THE COMPANY'S METHOD OF CALCULATING BAD**
9 **DEBT EXPENSE OVER THAT UTILIZED BY STAFF?**

10 A. Staff's bad debt adjustment of \$(161,763) would increase by \$396,939 to
11 \$235,176 using the Company's method.

12
13 **(3) INSURANCE OTHER THAN GROUP**

14
15 **Q. TO WHAT ASPECT OF THE STAFF REPORT REGARDING INSURANCE**
16 **OTHER THAN GROUP WOULD YOU LIKE TO RESPOND?**

17 A. The Company has two issues with the Staff's calculation of its level of proforma
18 Insurance Other Than Group expense. First, Staff has excluded the allocated
19 cost of the Directors & Officers ("D & O") and the Kidnap & Ransom ("K & R")
20 coverage in the amounts of \$61,296 and \$451 respectively. Second, MAWC
21 disagrees with Staff's allocation of the cost based on Labor Composite.

22
23 **Q. WHAT IS THE ISSUE WITH THE EXCLUSION OF THE COST FOR THE**
24 **DIRECTORS & OFFICERS AND KIDNAP & RANSOM COVERAGES?**

25 A. Staff's Insurance Other Than Group workpaper states that Staff proposed an
26 adjustment to remove the premiums associated with the D & O and K & R coverages.
27 It appears Staff has disallowed D&O and K&R insurance premiums for MAWC
28 directors and officers as well as a portion of the D&O and K&R insurance premiums
29 for its parent company's directors and officers. The Staff Report does not include an
30 explanation of why the expense associated with this coverage was excluded.
31

1 **Q. IS D&O INSURANCE A NECESSARY AND CUSTOMARY BUSINESS**
2 **EXPENSE FOR AMERICAN WATER WORKS COMPANY (AWW) AND ITS**
3 **SUBSIDIARIES?**

4 **A.** Yes. Without a policy of insurance to indemnify and defend its Board of Directors
5 and its corporate officers, it would be extremely difficult to recruit qualified
6 persons to serve on a Board of Directors or in the capacity of executive
7 management. The disallowed amount is primarily related to MAWC's directors
8 and officers in that American Water Works pays one half the premium, and the
9 remainder is allocated to the subsidiaries.

10
11 **Q. WHY IS D & O COVERAGE AN APPROPRIATE AND REASONABLE**
12 **EXPENSE FOR AWW?**

13 **A.** As a publicly traded company, AWW, as well as MAWC's directors and officers
14 are subject to the Securities Exchange Commission Act (SEC), the Sarbanes
15 Oxley Act (SOX), and many other federal and state regulations. The SOX
16 legislation established new or enhanced standards for all U.S. public company
17 boards, management, and public accounting firms. SOX contains 11 titles, or
18 sections, ranging from additional Corporate Board responsibilities to criminal
19 penalties, and requires the SEC to implement rulings on requirements to comply
20 with the new law. SOX also covers issues such as auditor independence,
21 corporate governance, internal control assessment, and enhanced financial
22 disclosure. Prospective internal and external candidates, who are invited to a
23 company, are subject to potential litigation in civil and criminal courts. These
24 many complex and demanding corporate governance obligations are
25 accompanied by potential fines and penalties and possible civil and even criminal
26 liabilities. Any individual taking on such risks will expect and demand insurance
27 coverage for claims that may be lodged in connection with the performance of
28 these and other responsibilities.

29
30 **Q. WHAT ABOUT K&R INSURANCE COVERAGE?**

31 **A.** K & R insurance is also a necessary and customary expense.-. This type of
32 insurance coverage provides protection against kidnapping and extortion threats
33 against senior officials. Additionally, the water industry has been designated as

1 part of the United States critical infrastructure by the Department of Homeland
2 Security. As such, the concerns about risks to senior Company officials are
3 heightened by the possible threat of terrorist acts or extortion against the
4 Company.

5
6 **Q. SHOULD THAT PORTION OF AWW'S D&O AND K&R COVERAGE EXPENSE**
7 **ALLOCATED TO MAWC BE INCLUDED IN MAWC'S COST OF SERVICE?**

8 A. Yes. The allocated D&O and K & R coverage costs in the amounts of \$61,296
9 and \$451, respectively, are prudent business expenditures and should be
10 allowed. This type of expense is crucial to the Company's ability to recruit and
11 maintain qualified individuals to serve on its Board of Directors and in the
12 capacity as senior Company officers. These expenses are considered
13 customary, particularly for large, publicly traded corporations.

14
15 **Q. IS THERE DISAGREEMENT BETWEEN COMPANY AND STAFF REGARDING**
16 **THE CAPITAL AND O & M ALLOCATION FOR OTHER THAN GROUP**
17 **INSURANCE?**

18 A. I do not believe so. Staff's direct filing included an allocation of all insurance
19 between capital and O & M based on a labor composite. The Company agrees with
20 that methodology only for workers compensation and auto liability insurance. The
21 Company believes that other insurance, such as general liability, should be allocated
22 based upon actual experience. In the previous two rate proceedings, the Staff has
23 agreed with that philosophy and a 10% capitalization ratio has been utilized to reflect
24 actual experience. There was no substantial change in actual experience during the
25 test year and the Company believes that the Staff has revised its position regarding
26 this issue in this case.

27
28 **(4 & 5) FUEL & POWER AND CHEMICALS**

29
30 **Q. WHAT IS THE ISSUE REGARDING THESE EXPENSES?**

31 A. The Company and Staff disagree on the proper level of Fuel & Power and Chemical
32 expense as a result of other disagreements they have regarding 1) the proper level of
33 test year sales; 2) Staff's adjustment to limit the amount of non-revenue water

1 (NRW); 3) increased power and chemical costs occurring after October 31, but prior
2 to the true-up (i.e., April 30, 2010). I will also address MIEC's issue regarding
3 disallowance of chemical price increases.
4

5 **Q. PLEASE EXPLAIN EACH OF THE DIFFERENCES AS YOU UNDERSTAND THEM.**

6 A. The Company and Staff disagree on the appropriate level of sales for the test period.
7 Company witnesses Spitznagel and I address this issue. To the extent the
8 Commission agrees that the Company's proposed level of sales is appropriate, then
9 the Company's corresponding fuel & power and chemical expenses would be
10 appropriate as well. Staff has proposed to limit the amount of non-revenue water in
11 each district to a three year average. Company witness Weeks addresses this issue
12 in his rebuttal testimony. To the extent the Commission agrees with the Company on
13 this issue, then the Company's fuel & power and chemical expense would also be
14 appropriate. Finally, the Company is experiencing increased fuel power and
15 chemical costs that have occurred after October 31, 2009, but prior to the true-up
16 date (i.e., April 30, 2010). The Company has chemical contracts in place that
17 occurred after October 31, 2009, but prior to the true-up date of April 30, 2010. We
18 believe Staff will be picking up these increased costs in their true-up and will resolve
19 MIEC's issue on the accuracy of chemical prices. However, to the extent that is not
20 the case, then we would have an issue in that regard as well.
21

22 **(6) CONTRIBUTED CAPITAL**
23

24 **Q. WHAT IS THE CITY OF RIVERSIDE'S ISSUE REGARDING CONTRIBUTED
25 CAPITAL?**

26 A. The City of Riverside's Witness Duffy states the City has approved a capital
27 budget line item of \$500,000 annually for the consecutive five years beginning in
28 2008 to replace water mains and install new water mains in the City. He also
29 states the mains will become the property of MAWC and there is no provision for
30 compensation from MAWC for this contribution and as a result, MAWC is
31 benefiting from these contributions.
32

1 **Q. DO YOU AGREE WITH CITY OF RIVERSIDE'S WITNESS DUFFY THAT THE**
2 **COMPANY IS BENEFITING FROM THESE MAIN INSTALLATIONS AND**
3 **REPLACEMENTS?**

4 **A.** No. While the new and replacement mains become the property of MAWC and
5 are included in rate base, the money paid by the City for these projects is treated
6 as Contributions in Aid of Construction. As such, the Company does not earn a
7 return on this contributed plant, nor does it recover any depreciation expense
8 related to this plant. The customers in the District therefore receive the benefit of
9 this contributed plant, but incur no additional costs in the rates they pay to the
10 Company.

11

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

13 **A.** Yes.

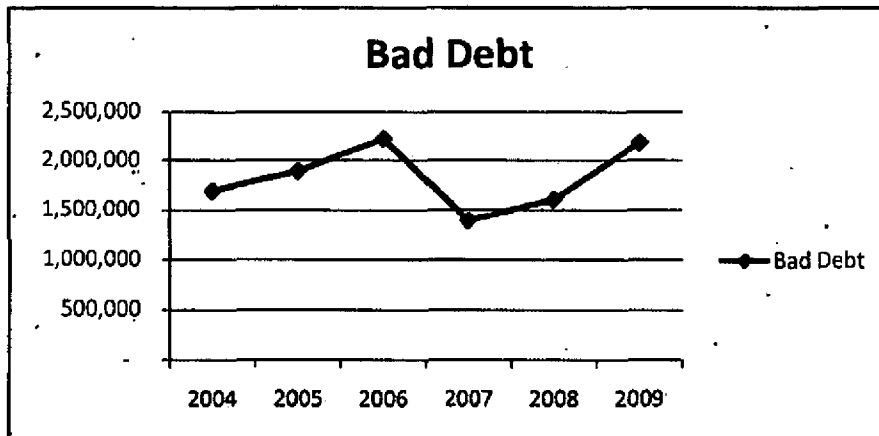
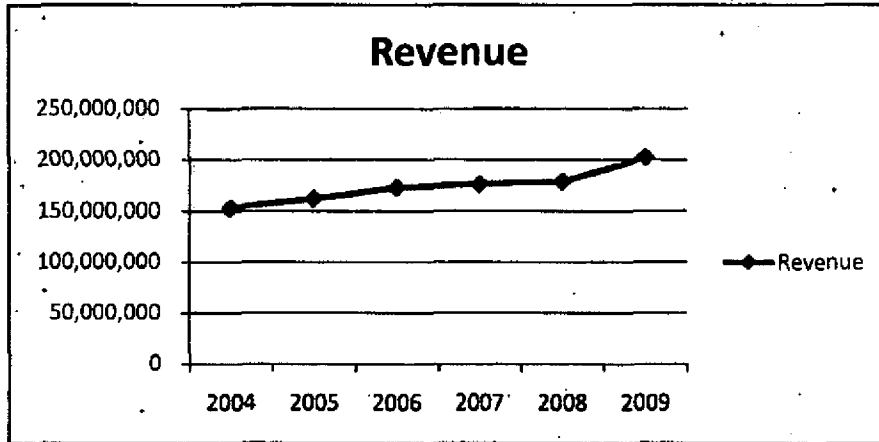
**Missouri-American Water Company
Case No. WR-2010-0131
Usage per Customer per Day - Company Compared to MoPSC Staff**

District	Customer Class	Per Company		Per Staff	
		Usage Per Customer Per Day (1)	Revenue Methodology	Usage Per Customer Per Day (1)	Revenue Methodology
St. Louis	Res Monthly	14230.45*	Actual Test Year	10,560	Actual Test Year
St. Louis	Res Quarterly	246	Weather Norm	330	6 YR AVG
St. Louis	Com Monthly	13,798	6 YR AVG	19,630	6 YR AVG
St. Louis	Com Quarterly	1,054	6 YR AVG	1,440	6 YR AVG
St. Joseph	Residential	159	Weather Norm	163	6 YR AVG
St. Joseph	Commercial	822	6 YR AVG	810	6 YR AVG
Joplin	Residential	185	6 YR TREND	180	6 YR AVG
Joplin	Commercial	1,062	Weather Norm	970	6 YR AVG
St. Charles	Residential	268	Weather Norm	258	6 YR AVG
St. Charles	Commercial	1,275	Weather Norm	1,230	6 YR AVG
Mexico	Residential	145	3 YR AVG	142	6 YR AVG
Mexico	Commercial	579	3 YR AVG	583	6 YR AVG
Jefferson City	Residential	159	Weather Norm	154	6 YR AVG
Jefferson City	Commercial	747	4 YR AVG	760	6 YR AVG
Parkville Water	Residential	262	3 YR AVG	259	6 YR AVG
Parkville Water	Commercial	1,154	3 YR AVG	1,017	6 YR AVG
Warrensburg	Residential	166	3 YR AVG	161	6 YR AVG
Warrensburg	Commercial	709	3 YR AVG	720	6 YR AVG
Brunswick	Residential	114	3 YR AVG	116	6 YR AVG
Brunswick	Commercial	252	3 YR AVG	224	6 YR AVG
Warren County	Residential	173	Actual Test Year	172	Actual Test Year
Warren County	Commercial	689	Actual Test Year	690	Actual Test Year

(1) Gallons per day

*Error - did not get converted from hundred cubic feet to thousand gallons

Missouri-American Water Company



Rate Increases effective 10/22/07 and 11/28/08

	Bad Debt	Revenue
2004	1,688,265	152,517,557
2005	1,889,999	161,480,715
2006	2,219,816	172,584,075
2007	1,386,957	175,799,403
2008	1,600,941	178,588,550
2009	2,179,678	201,808,317