

Exhibit No.:

*Issues: Tank Painting; Capitalized Software;
Insurance other than Group; Rate
Case Expense; Amortization of OPEB
and Pension Assets; Pension and
OPEBs; Main Breaks; Vehicle
Leases; Franchise Tax*

Witness: Jeremy K. Hagemeyer

Sponsoring Party: MoPSC Staff

Type of Exhibit: Surrebuttal Testimony

Case No.: WR-2007-0216

Date Testimony Prepared: July 31, 2007

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

JEREMY K. HAGEMEYER

MISSOURI-AMERICAN WATER COMPANY


CASE NO. WR-2007-0216

Jefferson City, Missouri

July 2007

In the Matter of Missouri-American Water)
Company's request for Authority to) Case No. WR-2007-0216
Implement a General Rate Increase for)
Water Service provided in Missouri)
Service Areas)

STATE OF MISSOURI)
)
COUNTY OF COLE) ss.


Jeremy K. Hagemeyer

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
County of Cole
My Commission Exp. 07/01/2008


Notary Public

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JEREMY K. HAGEMEYER
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WR-2007-0216

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1 **Tank Painting Expense**

2 Q. Does Staff agree with the criticism presented by Mr. Petry regarding Staff's
3 level of tank painting?

4 A. No. Staff believes that Mr. Petry has ignored the reality of the tank painting
5 costs actually being incurred by MAWC. He states on page 3, that "[t]he Staff's method
6 ignores the current condition of the tanks and the work that must be performed to keep those
7 tanks in working order." However, the past five years of actual experience indicates that less
8 tank painting expense is required to "be performed to keep those tanks in working order."

9 Q. Why does the Staff believe this?

10 A. In its review of the issue, the Staff examined the Company's work paper and
11 found that, even by their own measurements, the Company had only maintained its schedule
12 of internal tank painting 48% of the time and external tank painting 35% of the time. Such
13 performance does not indicate that the Company requires an increased expense level and in
14 fact, shows that the Staff's method is the appropriate level. Increasing the cost of service for
15 additional tank painting expense is contrary to the costs actually being incurred.

16 **Capitalized Software Expense**

17 Q. Has the Staff reassessed its position on capitalized software?

18 A. Yes. After discussing the matter with the Company, Staff feels that the
19 portion of software maintenance fees related to customer billing software should not have
20 been capitalized. This represents \$18,002, of the \$30, 887 identified by Mr. Grubb in his
21 rebuttal testimony. The remaining software supports all of the functions of the Company:
22 operations and capital projects. Therefore, the Staff continues to support capitalization of the
23 remaining software maintenance fees in the amount of \$12,885.

Insurance Other than Group Expense

Q. Have there been any modifications to the Staff's position on Insurance other than Group?

A. Yes. After discussions with the Company, and reading its rebuttal testimony, the Staff has changed the capitalization rate for the general liability related insurance to 10% from the 43.7% proposed in its direct filing. This change also impacts the brokerage fee capitalization rate.

Q. Does the Staff still oppose including any expenses relating to Kidnap and Ransom insurance?

A. Yes. As stated in direct testimony, Staff continues to believe that the operations of MAWC would most likely not be materially affected in the unlikely event that a Company employee were ever kidnapped and held for ransom. Due to this lack of benefit to MAWC's consumers, the Staff disputes Mr. Grubb's claim that this insurance is a prudent cost.

Q. In his rebuttal testimony, Company witness Edward J. Grubb states that the current cost of the directors' and officers' insurance policy will be borne by MAWC in the amount of \$241,744. Has the Staff received any indication that this amount is accurate or that it represents an expense currently being incurred by MAWC?

A. No. To the contrary, the Company is currently covered under a global policy procured by RWE and this coverage will remain in place well beyond the true up period. American Water Company has procured additional coverage and the Staff has received invoices from the Company that would indicate that the amount related to this insurance is approximately \$7,000. This amount has been added to the Staff's cost of service.

1 **Rate Case Expense**

2 Q. What is the Staff's position on rate case expense?

3 A. The Staff's position has not changed. Barring evidence to the contrary, Staff's
4 normal position on rate case expense is to normalize the actual amount over three years.
5 Keeping this in mind, the Staff's normalized level of expense proposed in the direct filing,
6 \$147,256, represents only a third of a total of \$441,768 in rate case expense. The Company
7 has not provided detailed invoices that exceed this amount; therefore the Staff feels that there
8 is no need to change from its direct filed position on this issue. The Staff is open to
9 considering changing its annual expense amount based on prudent, supported increases in the
10 costs of the current rate case.

11 **Amortization of OPEB and Pension Assets**

12 Q. Has the Staff reviewed Company witness Edward J. Grubb's testimony
13 regarding the amortization of OPEB and Pension Assets?

14 A. Yes. The Staff has reviewed this testimony and has made a change in the
15 OPEB expense to include \$31,901 for the amortization of the MAWC Financial Accounting
16 Standard (FAS) 106 deferred costs. The Staff is able to justify this amount based on the
17 Commission's Order in Case No. WR-95-205.

18 Q. Does the Staff agree that there should be an increase in this amount to the
19 level proposed by Missouri-American?

20 A. No. Staff has not found support for the remainder of the Company-proposed
21 amortization expense in past Commission orders or approved Stipulation and Agreements.

Pension and OPEB Expenses

Q. Are Staff's calculations of pension and OPEB expenses consistent with the Financial Accounting Standards Board Statements 87 and 106, respectively?

A. Yes. Although Mr. Grubb opposes Staff's approach, as stated in my direct testimony, the "corridor" defined in these statements specifies the minimum amortization of unrecognized gains and losses. Paragraphs 33 and 60 from FAS 87 and 106, respectively, allow for different approaches for amortizing unrecognized gains and losses. Due to this allowance, the Staff's approach for dealing with pensions and OPEBs is consistent with Statements 87 and 106.

Q. If the approach utilized by the Company is to utilize the minimum amortization for unrecognized gains and losses, isn't it possible that the amortization period could be longer than what the Staff is currently proposing?

A. Yes, and in fact the amortization periods for unrecognized gains and losses are longer than the ten years proposed by the Staff. As stated in the Staff's direct testimony, it is important to recognize costs and benefits in rates in a timely manner. The delayed recognition resulting from the corridor approach and an amortization longer than 10 years does not accomplish this goal.

Q. Does the tracker proposed by the Staff add a significant burden in monitoring pension and OPEB expenses?

A. No. The information utilized in the calculation of Staff's tracker proposal already should be collected. The tracker only monitors the ongoing difference between the actuarially calculated FAS 87 and 106 levels and the amount included in rates from this case.

1 **Main Break Expense**

2 Q. Has the Staff made any changes to its main breaks expense?

3 A. Yes. The Staff recently received information regarding the main break cost
4 through May 31, 2007. After reviewing this information the Staff believes that the
5 Company's proposed annual cost of \$2,100,046 is appropriate.

6 **Vehicle Lease Expense**

7 Q. Has the Staff revised its direct testimony position regarding the adjustment to
8 vehicle leases?

9 A. Yes. The Staff has changed its position to reflect the correction suggested by
10 Mr. Thakadiyil related to vehicle leases. There is now no difference between the Company
11 and the Staff on this issue.

12 **Franchise Tax**

13 Q Do you agree with Company witness Peter J. Thakadiyil's testimony
14 proposing \$41,958 adjustment to increase franchise tax expense.

15 A. Staff has reviewed and accepts the Company's proposed \$41,958 increase in
16 Franchise tax expense.

17 Q. Does this conclude your surrebuttal testimony?

18 A. Yes, it does.