

Exhibit No.:
Issues: *Corporate Allocations and
Expenses, Payroll and Payroll
Taxes, External Affairs, and
Incentive Compensation*
Witness: *Lisa K. Hanneken*
Sponsoring Party: *MoPSC Staff*
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Case No: *WR-2007-0216*
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

LISA K. HANNEKEN

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2007-0216

Jefferson City, Missouri
July 2007

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

AFFIDAVIT OF LISA K. HANNEKEN

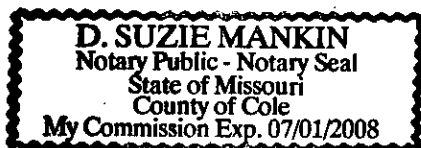
STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Lisa K. Hanneken, of lawful age, on her oath states: that she has participated in the preparation of the following Surrebuttal Testimony in question and answer form, consisting of 10 pages to be presented in the above case; that the answers in the foregoing Surrebuttal Testimony were given by her; that she has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of her knowledge and belief.



Lisa K. Hanneken

Subscribed and sworn to before me this 30th day of July 2007.





Notary Public

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OF
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OF
LISA K. HANNEKEN
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WR-2007-0216

A. Lisa K. Hanneken, 9900 Page Avenue, Ste. 103, Overland, Missouri 63132.

A. Yes.

A. My surrebuttal testimony addresses the City of Joplin witness Ms. Leslie Jones' rebuttal testimony regarding the annualization of payroll taxes. In addition it addresses the rebuttal testimonies of Missouri-American Water Company (MAWC or Company) witnesses Donald J Petry regarding:

- Overtime
- External Affairs
- Incentive Compensation (MAWC specific and allocated)

➤ Allocated Management Fees which includes:

- External Affairs
- Dues and Donations, and Advertising
- PriceWaterhouse Coopers (PWC) Audit Fees,
- Capitalization of Costs
- Transition Costs
- Cash Working Capital Associated with Management Fees

1 **PAYROLL TAX ANNUALIZATION**

2 Q. On page 2 of her rebuttal testimony, the City of Joplin's Witness
3 Ms. Leslie Jones states that the Staff's payroll tax normalization does not flow or follow the
4 payroll normalization. Do you agree with this assertion?

5 A. No. First, Staff did not normalize payroll or payroll taxes, Staff annualized
6 them. Secondly, the way in which Staff annualized payroll taxes was based on each individual
7 employee's annualized payroll. This method of annualization was used for both direct
8 operating district employees and corporate employees. The same allocation factor was used
9 to distribute corporate payroll and payroll taxes. Therefore, contrary to Ms. Jones assertions,
10 payroll taxes do, in fact, follow payroll.

11 **OVERTIME**

12 Q. What is the issue regarding overtime expense?

13 A. The Company's approach in this case simply used the overtime experienced
14 during the test year to reflect its ongoing level of expense, while Staff analyzed each district's
15 hours and employees to determine the ongoing level it presented in its direct testimony. Staff
16 utilized a 4-year average for districts with significant fluctuation, while it used the calendar
17 year level for other districts that exhibited a steady upward trend. The exception to this
18 methodology is in the Jefferson City district where Staff utilized a historic 2-year average
19 based on information from the Company explaining that the dramatic increases over the past
20 2 years were due to abnormal circumstances and should be normalized.

21 Q. How has the Company characterized the Staff's approach to normalizing
22 overtime?

1 A. On page 4 of Mr. Petry's rebuttal testimony he indicates that the Company
2 finds Staff's method unreasonable and that use of Staff's method of analyzing and addressing
3 each district's unique situations had the effect of "finding the lowest revenue requirement".
4 However, this statement is inaccurate. Staff's method seeks to examine the causes underlying
5 the level of overtime in each district and normalize as appropriate. In fact, Staff's adjustment
6 actually increased the test year level of expense in five districts where an upward trend was
7 exhibited in the level of overtime.

8 Q. Why does the Company feel that the method of historical averaging for the
9 Jefferson City district is not indicative of the actual level being experienced?

10 A. The Company has indicated in Mr. Donald Petry's rebuttal testimony that two
11 workers previously ineligible begin incurring overtime in 2005.

12 Q. Does Staff feel this should account for the district's 239% increase in overtime
13 between 2004 and 2006?

14 A. No. The Company's explanation does not appear to justify the amount of
15 increase in overtime hours from 1,291 hours in 2004 to 4,381 in 2006 (a difference of over
16 3,000 hours). The entire district's 17 employees only incurred 1,291 hours of overtime in
17 2004. It does not seem reasonable that two employees incurred an additional 3,000 hours or
18 that this is an appropriate level to include in ongoing rates.

19 Q. Is Staff aware of other factors causing this level of excessive overtime for
20 Jefferson City?

21 A. Yes, in the Company's response to Staff's Data Request No. 249, the
22 Company stated that "...the high level of O&M overtime in 2005 and 2006 in comparison to
23 more normal levels seen in 2003 and 2004 was driven by... the levels of vacancies and sick

1 leave in the operator ranks as well as the two job shifts”. This information corroborates the
2 Staff’s utilization of a historical average to adjust the test year overtime level to the more
3 normal levels seen in 2003 and 2004.

4 **EXTERNAL AFFAIRS EMPLOYEE**

5 Q. Please briefly explain this issue.

6 A. Staff removed the labor and related expenses for Missouri American’s external
7 affairs director. The Company contends in its rebuttal testimony from Mr. Donald Petry that,
8 according to this employee’s job description, he is not involved in lobbying in his day-to-day
9 duties, and further contends that only 5% of his time is spent on such activities.

10 Q. Does Staff agree with this assessment?

11 A. No. Based on the employee’s job description, his primary role is to:

12 Improve business climate for the Company through positive
13 interactions with legislators and regulators and external opinion
14 formers. Influence at state level to promote initiatives that support
15 Company and other stakeholder goals and objectives.

16 This job description indicates that this employee spends significant time on lobbying
17 functions.

18 Mr. Petry’s rebuttal testimony states that this employee spends much of his time on
19 customer issues and complaints, trade group cooperation and training for emergencies.
20 However, Mr. Petry’s statements are totally contrary to the employee’s title of ‘Manager of
21 Government and Regulatory Affairs’ and his job description which indicates significant
22 lobbying duties.

INCENTIVE COMPENSATION

Q. What issue was raised in the Company's Witness Mr. Donald Petry's rebuttal testimony concerning Staff's adjustments to AIP?

A. Mr. Petry indicated that the Staff should have included that portion of AIP and SMIP incentive plans related to the individual goals. He asserts that these incentives assist the Company to provide better service to the customers.

Q. Why did Staff disallow this portion of the plan?

A. As stated in Staff's direct testimony, Staff removed the individual component due to the fact that Staff did not have adequate time prior to filing its direct testimony to determine if this component provided any ratepayer benefit.

Q. Has Staff been able to determine whether there is any ratepayer benefit?

A. Yes. The Staff reviewed the individual goals and found that a portion of the goals provided an acceptable basis for incentive awards. However, Staff also found a portion of the individual goals to be unacceptable. For purposes of this case, the Staff believes that 50% of the awards associated with individual goals should be included in the cost of service.

ALLOCATIONS

Allocated External Affairs (Central Region)

Q. Does the Company feel that 50% of this employee's time is spent on lobbying activities?

A. No. In Mr. Grubb's rebuttal testimony he states that Staff's adjustment is arbitrary and that the job description does not indicate that the employee spends that much time devoted to lobbying activities. Mr. Grubb is correct in that the job description does not show the amount time spent on lobbying. In fact it does not show the amount of time spent

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1 on any of the duties that are listed. However, Staff analyzed the job description based on the
2 verbiage provided, and determined the amount of time spent given the duties listed.

3 Q. Has the Company provided the amount of time that this employee spends on
4 lobbying?

5 A. In response to Staff's Data Request No. 286, Staff requested the job
6 descriptions and time spent on each duty for any employees at the Central Region and
7 Missouri levels, who are listed as registered lobbyists with the State of Missouri. Out of the
8 28 job descriptions requested, this individual was the only one that did not list the amount of
9 time spent on each duty. Staff requested an update of the data request to include this
10 information. While finalizing this surrebuttal testimony an update was provided. Out of the
11 29 duties listed as being a part of this employee's job description, percentages of time were
12 only distributed to 9 duties. The Staff does not find this update to be complete or persuasive
13 regarding the duties of this employee. Therefore the Staff maintains its original
14 recommendation of only allowing 50% of this individual's salary.

15 **Allocated Dues and Donations**

16 Q. In his rebuttal testimony, Mr. Petry identifies \$37,603 of allocated dues and
17 donations that the Company feels should be included in the cost of service. Does Staff agree?

18 A. No. The Company has indicated to Staff that only a portion of this total is
19 recognized by the Company as being appropriate. MAWC agrees with some of the items that
20 Staff disallowed based on the fact they were related to other states' operations. While the
21 Company has not shown the Staff which specific items it agrees with, a significant portion of
22 Staff disallowance was due to the fact that sufficient documentation was not provided to
23 determination whether the items should be allowed.

1 Q. Has Company provided Staff with the information necessary to make a
2 determination on the items it feels should be allowed?

3 A. Yes. Of the total \$281,985 that Staff disallowed in its direct testimony for dues
4 and donations Staff believes an additional \$9,936 should be allowed.

5 **Allocated Advertising**

6 Q. Has the Company provided the documentation it discussed in Mr. Petry's
7 rebuttal testimony regarding advertising expense?

8 A. Yes, Staff received some documentation near the deadline for its
9 Surrebuttal Testimony filing. Staff has performed an analysis of the quite voluminous
10 (approximately 200 pages) response and correlated it to the data already provided. Staff was
11 able to determine that \$2,260 was allowable advertising. However, Staff was also able to
12 determine that \$24,408 should be eliminated since it was related to items typically disallowed
13 as being Promotional, Institutional, or Political advertising; or items such as donations or non-
14 regulated activities. In addition, there remains \$37,471 of items which the Company has failed
15 to clearly identify in order for Staff to make a determination. It should be noted that this
16 response only provided information for \$64,138 of the \$72,693 of allocated advertising
17 disallowed by the Staff. Staff is still waiting for data on the remaining items, as well as
18 clarification related to the \$37,471.

19 **Allocated PWC Audit Fees**

20 Q. What is the issue related to these fees?

21 A. These fees are expected to be incurred in addition to the Company's annual
22 audit fees from its outside auditor, Price Waterhouse Coopers (PWC). The fees relate to

1 Sarbanes-Oxley Act of 2002 (SOX) compliance required for publicly traded companies.
2 However, at present American Water is not publicly traded.

3 Q. Did the Company provide any support for their adjustment prior to
4 Staff's Direct Testimony filing in this case?

5 A. No. At the time of the Staff's Direct testimony filing, the Company had not
6 provided any documentation on this adjustment, although Staff requested such information.
7 MAWC's Direct filing indicates that their adjustment was based on an arbitrary \$1,000,000
8 increase prior to allocations to subsidiary companies.

9 Q. Has the Company provided any documentation subsequent to Staff's Direct
10 Testimony filing?

11 A. Yes, the Company provided internal emails in which the Company attempted
12 to estimate the amount of fees it would incur. This most recent estimate was slightly higher
13 than originally indicated and is based on assumptions made by the Company and PWC.

14 Q. Is it reasonable to increase the Company's expense level based on estimated
15 costs not yet incurred?

16 A. No, it is not. Staff did not include the Company's estimate in its true-up filing
17 because the Company had not incurred any charges related to these fees through the true-up
18 period. In addition, the amount of the increase is not known and measurable. The Company's
19 estimate is not based on any contracts with PWC and is not an established amount.

20 **Allocated National Shared Service and Call Center Transition Costs**

21 Q. Do you agree with Mr. Grubb's rebuttal testimony that MAWC's transition
22 costs should be capitalized?

1 A. No. Staff has never allowed rate base treatment or a “return on” un-recovered
2 transition costs. It is inappropriate for MAWC to capitalize expenses that were incurred by
3 MAWC in order to transition to these affiliate services. While MAWC may have participated
4 in the planning and development of the CSC and SSC, the assets of these affiliates are not on
5 the books of MAWC. Staff contends it is inappropriate for MAWC to capitalize these one-
6 time transition expenses related to assets that it does not own and business processes that are
7 not under its control.

8 Q. How does Staff view Mr. Grubb’s alternative proposal?

9 A. If the Commission does not accept the Staff’s position, the Staff definitely
10 believes that no return on and only a return of these costs would be appropriate. However, the
11 Staff feels that an amortization period of at least fifty (50) years would be more appropriate.

12 **Allocated National Shared Services Charges Capitalized**

13 Q. Do you agree with Mr. Grubb’s assertion in his rebuttal testimony that the
14 management fees associated with the Fixed Asset group should not be capitalized?

15 A. No. Staff believes that a portion of the costs, which are directly associated with
16 the accounting for and placement of fixed assets (capital items), are appropriately capitalized
17 as a cost of the associated assets.

18 **CASH WORKING CAPITAL - MANAGEMENT FEES**

19 Q. Does Staff agree with the statement that Company witness Edward J. Grubb
20 made in his rebuttal testimony that the expense lag for management fees supplied by an
21 affiliated service company should be negative 8.99 days versus the positive 21.41 days
22 utilized in Staff’s Accounting Schedule 8- Cash Working Capital?

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1 A. No. Contrary to the statements of Mr. Grubb, the Staff does not agree that
2 ratepayers should provide the cash working capital requirements of an affiliated company
3 who provides services to the utility. This situation results from requiring the utility to prepay
4 management fees to the affiliated service company, while the affiliate pays its disbursements
5 to vendors in arrears. Affiliated companies should not receive preferential treatment. Rather,
6 the affiliate should be treated like other third-party vendors who supply services to the utility.
7 Therefore, the Staff has assigned the same expense lag to the disbursements for management
8 fees from an affiliated service company that it has utilized for general cash vouchers for goods
9 and services from third-party vendors (i.e. positive 21.41 days.)

10 Q. Does this conclude your testimony in this case?

11 A. Yes, it does.