

Exhibit No.:
Issues: *Unamortized Balance of Security*
 AAO, Cedar Hill Waste Water
 Plant, Tank Painting Expense,
 Fire Hydrant Painting Expense
Witness: *Kimberly K. Bolin*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Surrebuttal Testimony*
Case No.: *WR-2008-0311*
Date Testimony Prepared: *October 16, 2008*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

KIMBERLY K. BOLIN

MISSOURI-AMERICAN WATER COMPANY

CASE NOS. WR-2008-0311 & SR-2008-0312

Jefferson City, Missouri
October 2008

TABLE OF CONTENTS
SURREBUTTAL TESTIMONY
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| | |
|---|---|
| UNAMORTIZED BALANCE OF THE SECURITY AAO | 2 |
| CEDAR HILL WASTE WATER TREATMENT PLANT | 3 |
| TANK PAINTING EXPENSE | 5 |
| FIRE HYDRANT PAINTING EXPENSE | 7 |

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Q. Please state your name and business address.

A. Kimberly K. Bolin, 200 Madison Street, Suite 440, Jefferson City, MO 65102.

Q. By whom are you employed and in what capacity?

A. I am employed by the Missouri Public Service Commission (Commission) as a Utility Regulatory Auditor V.

Q. Are you the same Kimberly K. Bolin who has filed direct and rebuttal testimony in this case?

A. Yes.

Q. What is the purpose of your surrebuttal testimony?

A. The purpose of my surrebuttal testimony is to address the rebuttal testimony of Missouri-American Water Company (Missouri-American or Company) witness Tyler T. Bernsen regarding the inclusion of the Accumulated Deferred Income Taxes associated with the Security Accounting Authority Order as an offset to rate base. My surrebuttal testimony also addresses Company witness Dennis R. William's Rebuttal Testimony concerning the accounting treatment of the Missouri Public Service Commission Staff's (Staff) proposed Cedar Hill Treatment Plant disallowance. Finally, I will address the rebuttal testimony of Company witness Frank L. Kartmann in regards to the Company's

1 | proposal annual level for its Tank Painting Tracker and Company's proposal for rate
2 | treatment of Fire Hydrant Painting Expense.

3 | **UNAMORTIZED BALANCE OF THE SECURITY AAO**

4 | Q. Does the Staff agree with the rebuttal testimony of Office of the Public
5 | Counsel witness Ted Robertson that the accumulated deferred income taxes (ADIT)
6 | associated with the amortization of the Security AAO be treated as an offset to rate base?

7 | A. Yes. In fact, the Staff has included the accumulated deferred income taxes
8 | associated with the amortization of the Security AAO in its deferred tax calculation.

9 | Q. Does the Staff agree with Missouri-American that the accumulated deferred
10 | income taxes associated with the Security AAO should only be included as an offset to rate
11 | base if the unamortized balance of the AAO is included in rate base?

12 | A. No. Accumulated deferred income taxes associated with the Security AAO
13 | should be included as an offset to rate base regardless of the rate base treatment given the
14 | unamortized balance of the AAO. Deferred taxes are simply the result of timing differences
15 | between when a company deducts certain expenses on its tax return and when it deducts the
16 | expense for ratemaking purposes. The deferred tax reserve represents, in effect, a prepayment
17 | of income tax by Missouri-American customers.

18 | Q. Has the Commission previously ruled that accumulated deferred income taxes
19 | associated with an AAO be included as an offset to rate base?

20 | A. Yes. In Case No. GR-98-140, which I previously mentioned in my rebuttal
21 | testimony, the Commission found that accumulated deferred income taxes associated with the
22 | Missouri Gas Energy's service line replacement deferrals should be included as an offset to
23 | rate base. The Commission stated the following in its Report and Order on Rehearing:

1 Deferred income taxes, including MGE's accumulated deferred
2 income taxes for SLRP deferrals, result from the timing difference
3 between when a company currently deducts an expense on its income
4 tax return and when it later deducts the expense on its financial
5 statement records. This is also known as a book-tax timing difference.
6 MGE's accumulated deferred income taxes for SLRP deferrals are
7 created by a book-tax timing difference.

8 The purpose of including an offset to rate base for accumulated
9 deferred income taxes is to recognize that ratepayers have provided
10 money through rates for the payment of taxes that the utility has
11 deferred paying until a later period. The utility may use the ratepayers'
12 money until the payment of the deferred income taxes is made.

13 MGE's witness, June Dively, testified to the fact that MGE was
14 "enjoying" the benefits of those deferred taxes. Therefore, MGE's
15 deferred income tax reserve represents a prepayment of income taxes
16 by the ratepayers from which MGE "enjoys" a financial benefit.

17 MGE's witness Dively further admitted that MGE's taxes
18 would not be affected by whether or not the item was included or
19 excluded from rate base. Because it is the book-tax timing difference
20 which gives rise to the benefit that MGE receives, and not the SLRP
21 deferrals that have been excluded from rate base, the Commission finds
22 that the SLRP accumulated deferred income taxes are not related to the
23 actual SLRP expense deferrals for purposes of inclusion in rate base.
24 Therefore, the SLRP accumulated deferred income taxes should
25 continue to be included as an offset to MGE's rate base.

26 **CEDAR HILL WASTE WATER TREATMENT PLANT**

27 Q. On page 3 of Company witness William's Rebuttal Testimony in this case he
28 cites Financial Accounting Standards Board (FASB) Statement of Financial Accounting
29 Standards (FAS) No. 90, entitled "Regulated Enterprises – Accounting for Abandonments and
30 Disallowances of Plant Costs" paragraph no. 59. Mr. Williams then states the following
31 paragraph no. 60 of Statement No. 90 confirms that if the Commission accepts the Staff's
32 proposed disallowance of the most of the Cedar Hill Treatment Plant that the Company would
33 have to write the asset off its books for financial reporting purposes. Does the Staff agree
34 with Mr. Williams's interpretation of paragraph no. 60 of FAS 90?

1 A. No. The Staff believes this statement would not require the Company to write
2 the asset off in light of an ordered disallowance. Paragraph No. 60 of FASB Statement of
3 Financial Accounting Standards No. 90 states the following:

4 60. Some respondents to the Exposure Draft requested that
5 the Board address “excess capacity” disallowances. Those
6 disallowances relate to part of the cost of service of a recently
7 completed plant and are based on a finding that the utility’s reserve
8 capacity exceeds an amount deemed to be reasonable. If an “excess
9 capacity” disallowance is ordered by a regulator without a specific
10 finding that the enterprise should not have constructed that capacity or
11 should have delayed the construction of that capacity, the rate order
12 raises question about whether the enterprise meets the criteria for
13 application of Statement 71, in that it is not being regulated based on its
14 own cost of service. However, because such a rate order itself is neither
15 a direct disallowance nor an explicit, but indirect, disallowance of part
16 of the cost of the plant, this Statement does not specify the accounting
17 for it. If an “excess capacity” disallowance if ordered by a regulator
18 with a specific finding that the enterprise should not have constructed
19 that capacity or should have delayed the construction of that capacity,
20 the rate order may be an explicit, but indirect, disallowance of part of
21 the cost of the plant, and the enterprise should account for the substance
22 of that order as set forth in paragraph 7 of this Statement.

23 Q. Therefore, if the Commission were to accept Staff’s disallowance of a portion
24 of the Cedar Hills treatment plant, would the Company have to write the assets of the books?

25 A. No. According to paragraph no. 60 of FASB Financial Accounting Standards
26 No. 90, if the Commission orders the disallowance without a finding that the construction
27 should not have been completed or delayed, then Statement No. 90 would not apply and the
28 Company would not be required to write the assets off its books.

29 Q. Does the Staff believe the construction of the Cedar Hills plant in question was
30 unreasonable or imprudent or should have not been completed or the construction delayed?

1 A. No. The Staff is not contesting the prudence or timing of the construction of
2 the plant. Staff witness Jim Merciel's Surrebuttal filed in this rate proceeding states the
3 reasons for Staff's proposed disallowance.

4 Q. Has the Staff removed Contributions in Aid of Construction (CIAC) that were
5 given to MAWC for the purposes of constructing the Cedar Hills plant from its cost of
6 service?

7 A. After discussions with the Company during the settlement conference and
8 review of Company witness Dunn's Rebuttal Testimony, the Staff will remove \$538,069 from
9 Contributions in Aid of Construction. This amount was received by the Company from a
10 developer and Northwest High School for the construction of the addition to the Cedar Hill
11 treatment plant and should be removed from CIAC under Staff's proposed disallowance.

12 Q. What is the amount is the Staff proposing to disallow?

13 A. The Staff is recommending that \$2,179,907 be disallowed from plant in service
14 in this rate proceeding with possible recovery of this amount in the future.

15 **TANK PAINTING EXPENSE**

16 Q. On page 5 of Company witness Kartmann's Rebuttal Testimony he implies
17 that the Staff used the costs of current tank painting contracts to base its recommendation of
18 setting the tracker at an annual level of \$1,000,000. Is this a correct assessment of how the
19 Staff arrived at its recommendation?

20 A. No. The \$1,000,000 level was established in the Stipulation and Agreement in
21 Missouri American's last rate proceeding, Case No. WR-2007-0216. As the Staff stated in its
22 Cost of Service Recommendation filed in this rate proceeding, the tank painting tracker was
23 only in effect for two months of the test year, thus Staff felt revising the annual level would be

1 inappropriate at this time. The Staff's comment in the Cost of Service Report in regard to the
2 four tanking painting contracts that were in place for 2008 was only made to suggest that the
3 Company was making an effort to utilize the tracker at the current annual level, thus
4 continuation of the tracker at the current annual level would be reasonable. The Staff does
5 not believe the tracker should be used to predict future costs of tank painting, but should be
6 used to ensure the Company completes the tank painting at the level that is built into the cost
7 of service.

8 Q. Has the Staff reviewed the Company's prior years experience for tank painting
9 expense incurred?

10 A. Yes. The Staff reviewed the past five years of tank painting expense and
11 found a huge variance from year to year in the amount of tank painting expense that was
12 incurred by the Company. The Company incurred the following tank painting expense for the
13 last five years:

| <u>Year</u> | <u>Tank Painting Expense</u> |
|-------------|------------------------------|
| 2003 | \$0 |
| 2004 | \$0 |
| 2005 | \$ 140,793 |
| 2006 | \$1,724,575 |
| 2007 | \$ 75,884 |

20 Q. Is the Company's proposed annual level of tank painting funding of
21 \$1,700,000 based upon projected costs?

22 A. Yes, it appears the Company is using 2009 contracts that the Company
23 finalized as of September 29, 2008 to bolster its recommended tracker annual level. In the

1 Company's direct filing the Company proposed an annual level of \$1,600,000 for tank
2 painting, which was based upon estimated amounts.

3 Q. Does the fact that the Company has contracts signed for work to be performed
4 in 2009 change the Staff's recommendation of an annual level of \$1,000,000 for the tank
5 painting tracker?

6 A. No. The Staff still believes that with the tank painting tracker only going into
7 effect two months prior to the end of the test year in this rate proceeding that there is not
8 enough historical information to base an increase or decrease to the annual tracker level of
9 \$1,000,000. The Staff believes the annual tracker expense level should be determined by
10 examining historical expenses rather than projected or future costs.

11 **FIRE HYDRANT PAINTING EXPENSE**

12 Q. Attached to Company witness Kartmann's Rebuttal Testimony are Schedules
13 FLK-5 and FLK-6 which are price quotes and contracts for the Company's proposed fire
14 hydrant painting project. In regards to these items, has the Staff changed its position on this
15 proposed project?

16 A. No. The Staff is still opposed to including in the cost of service costs which
17 have not been incurred during the test year or beyond. To include costs that have not been
18 incurred during the test year would violate the matching principle.

19 Q. Please describe the concept of the matching principle.

20 A. The matching principle is an accounting/regulatory concept, which compares
21 the level of revenue received from the sale of goods or services with the expenses incurred
22 and investment necessary to provide that level of goods or services during a specific period.

1 This concept is reflected in the revenue requirement formula (Revenue Required = Operating
2 Costs + Return Allowed on Net Property Investment).

3 Q. On page 8 of witness Kartmann's Rebuttal Testimony he proposes as an
4 alternative to his original proposal a tracker for this expense. Is Staff opposed to a fire
5 hydrant painting tracker?

6 A. Yes. Staff is opposed to a tracker that would track the costs of fire hydrant
7 painting. Based upon the Company's description of its fire hydrant painting initiative, fire
8 hydrant painting is planned as an on-going maintenance cost that will take place over a
9 number of years. This type of maintenance activity does not require special ratemaking
10 treatment that would allow the Company a guaranteed dollar for dollar recovery of the
11 expense.

12 Q. Why is the Staff proposing the continuation of the tank painting tracker, but
13 opposing Company's proposed tracker for fire hydrant painting?

14 A. The tank painting tracker was established in Missouri-American's last rate
15 proceeding, Case No. WR-2007-0216 through a Stipulation and Agreement. As a previously
16 stated, the tank painting tracker was only in effect for the last two months of the test year,
17 November and December, 2007 in this case; thus, the Staff did not believe the tracker had
18 been given a fair test and should be continued until the effectiveness of use of this tracker can
19 be evaluated. Missouri-American cannot point to any prior historical experience as it relates
20 to the Company's proposed fire hydrant painting program as to why traditional ratemaking
21 approaches would not work for fire hydrant painting expenses.

22 Q. Does this conclude your surrebuttal testimony?

23 A. Yes.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

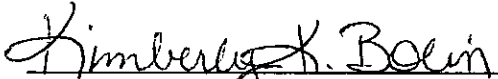
In the Matter of Missouri-American Water)
Company's request for authority to)
implement a general rate increase for water)
and sewer service provided in Missouri)
Service Areas)

Case No. WR-2008-0311

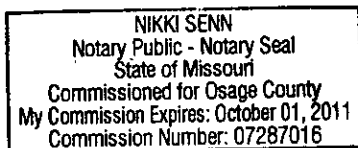
AFFIDAVIT OF KIMBERLY K. BOLIN

STATE OF MISSOURI)
)
COUNTY OF COLE) ss.

Kimberly K. Bolin, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Surrebuttal Testimony in question and answer form, consisting of 8 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.


Kimberly K. Bolin

Subscribed and sworn to before me this 15th day of October, 2008.




Notary Public