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EXHIBIT NO.

Issues: Corporate Allocations and  
Expenses, Payroll and Payroll  
Taxes, Employee Benefits  
including Incentive Compensation

Witness: Lisa K. Hanneken

Sponsoring Party: MoPSC Staff

Type of Exhibit: Direct Testimony

Case No: WR-2007-0216

Date Testimony Prepared: June 5, 2007

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

LISA K. HANNEKEN

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2007-0216

~~STAFF~~ Exhibit No. 3-NP  
Case No(s) WR-2007-0216  
Date 8-14-07 Rptr PF

Jefferson City, Missouri  
June 2007

**\*\* Denotes Highly Confidential Information \*\***

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**DIRECT TESTIMONY**

**OF**

**LISA K. HANNEKEN**

**MISSOURI-AMERICAN WATER COMPANY**

**CASE NO. WR-2007-0216**

Q. Please state your name and business address.

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

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

A. I am a Utility Regulatory Auditor IV for the Missouri Public Service Commission (Commission).

Q. Please describe your educational background.

A. In July of 2001, I earned a Bachelors degree in Accounting from Webster University in St. Louis. In December 2006, I completed my Masters of Business Administration with an emphasis in Accounting at Maryville University, St. Louis.

Q. Please describe your work background.

A. In August 1989, I began employment with Rinderer's Union Drug as a pharmacy technician and bookkeeper. Beginning in June of 1997, I was employed by Bucklick Creek, Inc., as the head of accounting and office manager. During 2000, I completed an internship at the Internal Revenue Service (IRS) as an auditor of small corporations and businesses. In September 2001, I commenced employment with the Commission's Staff (Staff).

Q. What is the nature of your duties at the Commission?

1           A.     I am responsible for providing supervision and assistance in the audits and  
2 examinations of the books and records of utility companies operating within the state of  
3 Missouri.

4           Q.     Have you previously filed testimony before this Commission?

5           A.     Yes, please refer to Schedule 1, attached to this direct testimony, for a  
6 complete listing of testimony I have filed, including the related case numbers and issues  
7 involved.

8           Q.     Did you make an examination and analysis of the books and records of  
9 Missouri-American Water Company (MAWC or Company) in regards to matters raised in  
10 this case?

11          A.     Yes, in conjunction with other members of the Staff. I specifically examined  
12 the Company's workpapers and testimony, the Company's response to Staff data requests,  
13 minutes of the Board of Directors, portions of the Company's general ledger and trial  
14 balances, as well as the Company's Cost Allocation Manual (CAM). I also examined  
15 testimony, workpapers and Commission Report and Orders from recent rate proceedings  
16 involving the Company.

17       **EXECUTIVE SUMMARY**

18          Q.     What matters will you address in your direct testimony?

19          A.     I will explain and sponsor adjustments related to MAWC's payroll, payroll  
20 taxes, employee benefits, and incentive compensation. I annualized the amount of expense  
21 reflected in the Company's cost of service to include current employees and wage rates,  
22 related payroll tax and benefits. In regards to incentive compensation, I made an adjustment to  
23 remove amounts related to portions of the plans. I will explain the relationship between

1 MAWC, American Water Works Company, Inc., and the American Water Works Service  
2 Company (Service Company). In addition, I am sponsoring adjustments regarding the  
3 amount of allocated expense that MAWC receives from its service company.

4 **TRAINING AND EXPERIENCE**

5 Q. What knowledge, skill, experience, training and education do you have in these  
6 matters?

7 A. Through the accounting classes, training and internships required for my  
8 educational degrees, as well as my previous work experience, I have obtained a broad  
9 working knowledge of accounting. In addition, I regularly attend continuing professional  
10 education seminars and classes. From the review of workpapers and other information from  
11 this and previous rate cases, as well as researching the Commission's orders, I have acquired  
12 knowledge of my assigned issues related to MAWC and other companies. Since joining the  
13 Commission Staff, I have assisted with and directed audits and examinations of the books and  
14 records of various utility companies operating within the state of Missouri. I have also  
15 conducted audits of small water and sewer companies in conjunction with the Commission's  
16 small company rate increase procedure. Furthermore, I have received and continue to receive  
17 training and guidance from the experienced senior auditors at the Commission.

18 **ALLOCATIONS**

19 Q. Please discuss MAWC's relationship with American Water Works Company,  
20 Inc. (AW), and RWE AG (RWE).

21 MAWC is a subsidiary of AW, which in turn, is owned by RWE. RWE is a global,  
22 multi-utility company that does business through its subsidiaries and affiliates in over

1 120 countries. RWE is headquartered in Germany and its core businesses include electricity,  
2 gas, water, waste, and recycling. A subsidiary of RWE, Thames Water, completed its  
3 acquisition of AW during January 2003. At the end of 2005, RWE decided to withdraw from  
4 the water sector in the UK and North America. As a result, at the end of 2006, RWE sold  
5 Thames Water and currently plans to sell the majority of AW by the end of 2007. RWE  
6 intends to focus on Europe's gas and electricity markets.

7 AW is headquartered in Voorhees, New Jersey, and serves approximately 17 million  
8 customers in 29 states and three Canadian provinces. AW performs many functions and  
9 activities on a consolidated or centralized basis for many of its regulated and unregulated  
10 subsidiaries. These consolidated or centralized functions are carried out for the AW-owned  
11 subsidiaries by the AW wholly-owned Service Company. Through a process of direct  
12 assignment and allocation, Service Company employees' time and all other related costs are  
13 ultimately charged to the AW-owned utility subsidiaries receiving service. In addition to the  
14 Service Company, in 2000, American Water Capital Corporation (AWCC) was created to  
15 provide a single source of long and short term debt capital for AW and its utility subsidiaries.  
16 A service agreement exists between MAWC and both the Service Company and AWCC.

17 Q. What regulated subsidiaries and non-regulated affiliated entities receive direct  
18 assignment or allocation of Service Company costs?

19 A. The following subsidiaries or affiliated entities currently receive direct or  
20 allocated charges from the Service Company:

**Regulated Entities**

Arizona American Water  
California American Water  
Elizabethtown Water Company Inc.  
Hawaii American Water  
Illinois American Water  
Indiana American Water  
Iowa American Water  
Kentucky American Water  
Long Island Water Corporation  
Maryland American Water  
Michigan American Water  
Missouri American Water  
Mount Holly Water Company  
New Jersey American Water  
New Mexico American Water  
Ohio American Water  
Pennsylvania American Water  
Tennessee American Water  
Texas American Water  
Virginia American Water  
Virginia American Eastern District (formerly United Water)  
West Virginia American Water

**Unregulated Entities**

American Water Enterprises (AWE)  
American Water Capital Corporation (AWCC)  
American Water Resources, Inc. (AWR)  
American Water Works (AWK)  
Edison Water Company  
Elizabethtown Services LLC  
Liberty Water Company

Q. How does the Service Company classify its costs?

A. Services performed by the Service Company can be grouped into the following  
cost centers, each with their own list of services provided:

Corporate: provides executive management, finance, human resources,  
engineering, water quality and operations support and is located in Voorhees,  
NJ.

1           Shared Services Center: provides financial, accounting, procurement, cash  
2 management and human resource benefits coordination and is located in  
3 Cherry Hill, NJ.

4  
5           Call Center: national call centers which handle customer service calls; located  
6 in Alton, IL, and Pensacola, FL.

7  
8           Belleville Lab: national trace substance laboratory located in Belleville, IL.

9  
10          ITS: two ITS centers which provide information technology support and  
11 customer billing for operating companies, located in Haddon Heights, NJ, and  
12 Hershey, PA.

13  
14          Region Offices: handle management, rates and revenues, external affairs, loss  
15 control, maintenance, legal, human resources, engineering and construction  
16 management, water quality and other operations support services for operating  
17 companies in their region as listed below:

18  
19               Northeast Region (located in NJ): serves New Jersey and New York.

20  
21               Southeast Region (located in WV): serves Kentucky, Maryland,  
22 Pennsylvania, Tennessee, Virginia, and West Virginia.

23  
24               Western Region (located in CA): serves Arizona, California, Hawaii,  
25 and New Mexico.

26  
27               Central Region (located in MO): serves Illinois, Indiana, Iowa,  
28 Michigan, Missouri, and Ohio.

29           Q.     How do the above cost centers differ from what was presented in MAWC's  
30 last rate case, Case No. WR-2003-0500?

31           A.     Since the last case, the Shared Services Center relocated to Cherry Hill from  
32 Voorhees; and one of the three ITS centers was eliminated and its work absorbed by the  
33 Hershey and Haddon Heights ITS centers. Also, an additional call center was added in  
34 Pensacola. Finally, in the last case there were 5 regional offices, two of these, the Illinois  
35 regional office and the Indiana regional office, were combined into the Central Region during  
36 the Company's reorganization process in 2005.

37           Q.     Please explain the reorganization that took place.



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Lisa K. Hanneken

A. The Company consolidated its offices and moved employees from its operating companies to its regional offices.

Q. Does each AW subsidiary take all of the services listed above?

A. Not all AW subsidiaries require all of the services listed. Several of the subsidiaries are capable of performing many of these activities and functions, in part or in total, at the local company level.

Q. What types of expenses are allocated from the Service Company?

A. Based on the Company's CAM, Service Company expenses can be categorized as follows:

Expense Category	Description	Direct Charged	Allocated	Comments
Labor	Base pay (salaries) of managerial, professional and technical employees	Yes	Yes	Professional personnel working for one or several operating companies
Support	Wages and salaries of office support personnel, including secretaries, clerical personnel, telephone operators and mail clerks		Yes	Administrative personnel support the professional staff, thus support costs are allocated on the basis of professional labor
Labor Related Overhead	Employee benefit costs (payroll taxes, medical coverage, pensions, disability insurance) and other general expenses	Yes	Yes	These are primarily employee benefit costs that relate directly to labor
Office Expense	Office rent, equipment leases, telephone, electric, office supplies, property taxes, office maintenance		Yes	Are all allocated on the basis of professional labor
Vouchers/ Journals	Travel expenses incurred by Service Company personnel; other items submitted for reimbursement by employees, including professional association dues; outside service contracts for such things as actuarial services; and various other expenditures, including data center expenses for software licenses and hardware maintenance	Yes	Yes	May be either directly in support of one operating company (e.g. an engineer traveling from the Corporate Office to the operating company) or allocated to several operating companies

Q. Please describe how the Service Company charges time and expenses to affiliate companies.

1           A.     According to the Company's Cost Allocation Manual (CAM), Service  
2 Company transactions are assigned with information so that proper accounting for the service  
3 can take place. This information includes the affiliate company number (if a direct charge) or  
4 a formula number if a transaction is allocated, the number of hours the employee worked, and  
5 the appropriate account number for non-labor items. This method allows for direct charges to  
6 both regulated and non-regulated entities when the employee can clearly identify the hours  
7 spent providing service to a specific affiliate.

8           Q.     What methodology does AW utilize to allocate costs to both its regulated and  
9 non-regulated companies?

10          A.     Using the time reporting system, each employee has the ability to charge hours  
11 on their time sheet to billing formula numbers that allocate those hours (or portions of hours)  
12 among the group of companies (including regulated and non-regulated) receiving those  
13 services when it is not practicable to determine the actual time spent performing that task for  
14 each of the companies.

15          Q.     What types of formulas are used to allocate these costs?

16          A.     When a Service Company employee provides services that benefit both  
17 regulated and non-regulated entities, they choose one of the Tier-One allocation factors to use.  
18 An employee who only performs services for regulated companies will utilize a Regulated  
19 Formula based on customer counts, and while providing services to non-regulated companies  
20 will use a Non-Regulated Formula based on a combination of revenues, amount of plant and  
21 number of employees.

22          Q.     How are the Tier-One formulas derived?

1           A.     Tier-One Formulas are based on different criteria, such as revenues,  
2 employees, plant investment, and others. Some of the formulas are a composite of these  
3 criteria, while others are based on only one criterion such as employee numbers. The  
4 employee will choose the formula that matches with the service provided. For example, an  
5 employee in payroll will most likely choose a formula based on employee numbers.

6           Q.     Do the formulas differ for services provided by regional cost centers?

7           A.     Yes, regional offices have formulas for the regulated entities they serve based  
8 on customer numbers.

9           Q.     Can the regional cost centers charge to other companies outside of their given  
10 service area?

11          A.     Yes, if a particular regional office has the expertise in a certain area, such as  
12 engineering, that is lacking in another region, they may perform tasks for a specific operating  
13 company outside of their given service area. For example, if a certain type of plant project is  
14 under construction by California-American, but the only engineer that is familiar with the  
15 specifics of that type of plant is located in the Southeast region office, he will provide services  
16 to California-American and can charge his time directly.

17          Q.     Are there a large number of charges to areas outside the region?

18          A.     No, only a minimal amount of these charges appear in the Company's CAM.

19          Q.     What type of adjustments did the Staff make to the allocated expenses in their  
20 filing?

21          A.     The Staff made several adjustments, which I will describe in detail below.

22          **Allocated External Affairs Expense Adjustment (Central Region)**

23          Q.     What adjustment was made for External Affairs?

1           A.     Following the test year, two employees, who were employed at the Central  
2     Region office which supports Missouri American, were transferred to MAWC. These  
3     employees were transferred because they were spending 100% of their time providing  
4     services for MAWC. Therefore Staff removed this amount from the Company's allocated  
5     expense levels and included these individuals in its annualization of payroll.

6           Q.     Did Staff make any other adjustments related to External Affairs?

7           A.     Yes, Staff removed a portion of the amount of wages and the associated  
8     payroll tax, employee benefits, and incentive compensation associated with the Regional Vice  
9     President of External Affairs given that his job description indicates that he performs some  
10    lobbying related duties, as well as directs employees that perform lobbying duties.

11          Q.     Has the Commission previously indicated lobbying expenses were not to be  
12    borne by a company's ratepayers?

13          A.     Yes, in several past cases the Commission has disallowed the costs associated  
14    with lobbying. Specifically in Case No. 18,180 In the matter of Missouri Public  
15    Service Company, Kansas City, Missouri, 20 Mo.P.S.C. (N.S.) 68, 105 (1975) and Case  
16    No. ER-83-49, In the matter of Kansas City Power & Light Company, 26 Mo.P.S.C.  
17    (N.S.) 104, 116 (1983), the Commission stated that the beneficiaries of lobbying activities are  
18    usually the stockholders of the company involved in lobbying. The Commission has also  
19    stated that the stockholders of a company involved in lobbying should be the ones to assume  
20    responsibility for these expenses unless the company offers substantial evidence for their  
21    inclusion in rates.

1 **Allocated Labor and FICA Expense Adjustments**

2 Q. Please describe the adjustments made related to all allocated labor and FICA  
3 taxes.

4 A. The Staff increased the amount of the allocations MAWC receives to include  
5 changes for wage increases, discontinued labor and the related FICA taxes. The Staff  
6 adjustment recognized a wage increase that took effect on 4/1/2006. Another wage increase  
7 effective on 4/1/2007 will be considered as part of its true-up process.

8 **Allocated Other Expenses Adjustment**

9 Q. Please explain the Staff's adjustment for 'Other' items.

10 A. MAWC removed an allocated total of \$84,252 related to membership dues,  
11 donations, lobbying, and other miscellaneous items it felt should not be considered as part of  
12 the rate case. Since the Staff was not provided with the detail for these items to make its own  
13 determination, Staff has disallowed these amounts.

14 Q. Did Staff discover other items such as these that it feels should be removed  
15 from the Company's level of allocation expense?

16 A. Yes. Staff disallowed \$37,603 of other dues and miscellaneous items expensed  
17 by the Company during the test year. In the past it has been the Commission's position to  
18 disallow dues and donations that: (1) provided no direct, quantifiable benefit to the ratepayer,  
19 (2) were not necessary in providing safe and adequate service to the ratepayer, and  
20 (3) represented an involuntary contribution on the part of the ratepayer to an organization. The  
21 Staff contends that although the Company's management may choose to make these types of  
22 expenditures, the cost should be borne by the shareholder, not the ratepayer. While Staff tried  
23 to identify each item and make a determination, some items were not identified by the

1 Company through the data requests submitted by Staff. Therefore, Staff has removed these  
2 allocated items until such time as the Company provides an explanation.

3 Staff removed various items, including dues to the Leadership Missouri program,  
4 which is related to Missouri's Chamber of Commerce. The Staff has traditionally allowed  
5 dues to chambers of commerce on the local level. However, expenses related to similar  
6 organizations at the state or national level have been disallowed on the basis that such costs  
7 are duplicative.

8 Additionally, Staff removed expenses related to organizations that are known for their  
9 lobbying activities on the same basis as previously discussed.

10 Q. Were there other items that Staff removed?

11 A. Yes, Staff removed a total of \$72,693 related to advertising. The Company  
12 provided a listing of the payee and amounts that were allocated; however Staff could not  
13 determine what these items were. Staff requested from the Company a more detailed  
14 description in order to determine what these expenses were, but to date Staff has not received  
15 that data. The Company did provide copies of 3 advertisements; however, these were just the  
16 ad copies without any reference to the listing of expenses, so Staff did not know how they  
17 related to the list. However, the Staff was able to identify what it believes to be expenses  
18 related to help wanted advertising, which it allowed. All the other items were disallowed.

19 Staff is willing to reconsider any allocated items that were removed at such time an  
20 adequate description and details are provided.

21 **Allocated One-Time Expense Adjustment**

22 Q. Please explain the Staff's adjustment related to one-time costs.

1           A.     The Company identified costs that were passed through the Service Company  
2 that were considered to be one-time costs. Included in this amount were costs related to  
3 RWE's divestiture of AW and costs related to complying with the Sarbanes-Oxley Act of  
4 2002 (SOX). Staff has eliminated these non-recurring costs from MAWC's expenses.

5     **Allocated Service Company Additions Adjustment**

6           Q.     Please explain the adjustment Staff made to its allocation expense level.

7           A.     This adjustment includes amounts related to increases at the Service Company  
8 for an increase in employees and increased expenses such as depreciation and interest related  
9 to increases in plant assets.

10          Q.     Please discuss the increase in employee levels.

11          A.     Staff included amounts for employees that were shown in the Company's  
12 workpapers as being filled positions. Staff requested data for an update of hires through  
13 December 31, 2006, but to date has not received such information. At such time this  
14 information is provided, Staff will consider it as part of its analysis. Staff will also consider  
15 the information it requested regarding any employees hired by May 31, 2007, as part of the  
16 true-up process.

17          Q.     Please describe the increase costs related to assets.

18          A.     These costs related to items such as software, hardware and building upgrades.  
19 Staff received a revised listing from the Company on May 14, 2007, which gave amounts for  
20 the items completed as of December 31, 2006, the update period in this case. Staff utilized  
21 these amounts in its cost of service level. The Company is to update Staff as to the amount  
22 completed by the end of the true-up period in this case (May 31, 2007) so that Staff may make  
23 a determination as to the amount to include its in true-up calculations.

**Allocated National Shared Services Charges Capitalized**

Q. Please explain Staff's adjustment related to capitalization of allocated costs.

A. Staff's adjustment represents the capitalization of the costs that were expensed during the test year associated with various accounting and financial services provided by National Shared Services. Based on discussions with the Company, some portion of the accounting services being provided to MAWC pertain to fixed assets and would, therefore, appropriately be a capitalized cost. Staff has calculated its adjustment based on amounts provided in the last case and a partial data request response in the current case. Staff will update its calculations when it receives a complete response to its request in the current case.

**Allocated Transition Costs Related to Call Center and National Shared Services Center**

Q. Please explain Staff's adjustments related to transition costs.

A. Staff removed one-time, transition costs that the Company capitalized as plant in service related to its decision to begin taking service from the Alton Call Center. Staff also removed a similar one-time, non-recurring transition cost from the Company's plant in service that was related to the Company's decision to begin taking service from the Service Company National Shared Services Center.

Q. How was the implementation of the Call Center and the Shared Services Center handled?

A. The implementation of the Call Center and the Shared Services Center was directed at the Service Company level. Most of the costs associated with the planning, development and implementation were incurred and recorded at the Service Company level and, therefore, allocated to each of the Companies which would be transitioning to the Call Center and to the Shared Services Center.



1 Q. What did these transition costs relate to?

2 A. During the last case, the Company indicated to the Staff that it had capitalized  
3 \$5,263,822 of expenditures that were made to plan, design and implement the concept of the  
4 customer call center. Similarly, the Company indicated that it has capitalized \$4,488,826 of  
5 expenditures that were made to plan, design and implement the concept of the shared services  
6 center.

7 These expenditures were for labor, travel expenses, consulting fees and other related  
8 expenses such as employee recruiting and training for the design and implementation of the  
9 Call Center and Shared Service Center.

10 Q. What is the basis of the Staff's proposed disallowance of these transition costs?

11 A. Staff contends that all of these costs are one-time, non-recurring expenses and  
12 as a result, these costs should not be reflected in MAWC's ongoing cost of service. The key  
13 point is that MAWC owns none of the assets at either the National Call Center or at the  
14 Shared Services Center. The Service Company owns all of these assets and controls all of the  
15 business processes related to these assets. Therefore, the Company's attempt to recover these  
16 costs through rate base has no basis. No tangible asset was created for MAWC. The Staff  
17 contends it is inappropriate for MAWC to capitalize these one-time transition expenses  
18 related to assets that it does not own and business processes that are not under its control.

19 Q. Has the Commission disallowed transition costs in any other rate proceedings?

20 A. Yes. In its Report and Order from Case No. WR-2000-844, involving St. Louis  
21 County Water Company, the Commission disallowed transition costs related to the  
22 Company's use of the name "MAWC Water Company." In this case, the Commission's ruling  
23 stated the following:

1           The Commission finds that these costs are a direct result of Company's  
2           management's decision to operate under a new name. Furthermore,  
3           there is no evidence that these costs will be incurred in the future when  
4           the rates set in this case are in effect, and the Commission finds them to  
5           be non-recurring.

6           Q.     Historically, what has been the Staff's position with regards to transition costs  
7           like those proposed for inclusion by MAWC in the current case?

8           A.     The Staff's position with regard to transition costs has been to allow recovery  
9           for any un-recovered transition costs that generate actual cost savings to the ratepayers of a  
10          Company. The Staff has allowed recovery of transition costs over periods covering 10 or  
11          20 years. The Staff has never allowed rate base treatment or a "return on" un-recovered  
12          transition costs. The Staff has historically disallowed one-time transition costs that do not  
13          generate measurable cost savings.

14          Q.     Please explain why the Staff believes the Company's proposal for a recovery  
15          of transition costs related to the move to the Call Center is inappropriate.

16          A.     Traditionally, the Staff has proposed "return of" un-recovered transition costs  
17          that relate to activities that result in achieved cost savings to ratepayers. For example, in Case  
18          No. EM-96-14 involving the merger of Union Electric and Central Illinois Public Service  
19          Company, Union Electric was able to demonstrate to the Staff that the resulting merger was  
20          likely to lead to sufficient efficiencies and cost savings to cover the amount of merger  
21          transition costs. The Staff ultimately agreed to an amortization over ten years, with no rate  
22          base treatment, for certain Union Electric un-recovered transition costs.

23                 MAWC has proposed to receive both a "return of" and a "return on" Call Center  
24          transition costs. The Staff believes that neither of these proposed treatments are justified  
25          because the Call Center has not resulted in any achieved cost savings for MAWC. Instead the

1 Company proposes to significantly increase the total amount of Call Center costs and related  
2 customer service activities. Therefore, since these costs represent nothing more than one-time,  
3 non-recurring expenses that relate to business assets that MAWC does not own and does not  
4 control, they should not be included in rates. Even Company witness Thornburg in MAWC's  
5 last rate case admitted the costs are nonrecurring (See Thornburg rebuttal WR-2003-0500,  
6 page 8, line 7). Furthermore, the 2001 AW SEC 10K also characterizes these costs  
7 as "one-time."

8 Q. Why is it inappropriate for the Company to capitalize the transition costs  
9 related to National Shared Services Center?

10 A. The transition costs relate to assets that MAWC does not own and to business  
11 processes that they do not control. Seeking to recover a "return on" and a "return of" these  
12 costs is totally inappropriate. In the response to Staff Data Request No. 181 from the last rate  
13 case, the Company indicated through a cost benefit analysis that it expects to generate annual  
14 savings of \$2,575,688. Taking the Company's prediction at face value, the Company has  
15 already recovered the entire cost of the transition through the savings thereby generated.  
16 MAWC transitioned to the Shared Services center on November 7, 2001, which occurred after  
17 the date that rates were established in Case No. WR-2000-281 for MAWC (September 14,  
18 2000) and Case No. WR-2000-844 for St. Louis County Water Company (May 13, 2001).  
19 The following chart reflects the amount of savings the Company has and will continue to  
20 recapture to offset the Shared Services transition costs through the operation of law date in the  
21 current case:

		SAVINGS GENERATED AND RETAINED BY MAWC
	<u>PERIOD</u>	
1		
2		
3		
4		
5	11/7/01-12/31/01	\$ 388,117
6	1/1/02 – 12/31/02	\$2,575,688
7	1/1/03-12/31/03	\$2,575,688
8	1/1/04-12/31/04	\$2,575,688
9	1/1/05-12/31/05	\$2,575,688
10	1/1/06-12/31/06	\$2,575,688
11	1/1/07-11/14/07	<u>\$2,253,727</u>
12	Total Savings Realized	\$15,520,284

13        This chart reflects that by the end of the operation of law date, by its own  
14 calculations, the Company will have already recovered approximately \$11,031,457  
15 (\$15,520,284 - \$4,488,827) more in cost savings from its participation in the National Shared  
16 Services Center than it actually incurred for transition costs. Allowing MAWC to include the  
17 transition costs in the cost of service for this case will afford the Company double recovery of  
18 these costs. In fact, the Company has not only enjoyed more savings than the Shared Services  
19 Center transition costs, but also the Alton Call Center transition costs. The Staff recommends  
20 that the Commission disallow these transition costs.

21        **Additional Allocation Recommendations**

22        Q.     Does Staff have any additional recommendations regarding allocations?

23        A.     Yes. During MAWC's last rate case, Case No. WR-2003-0500, Staff learned  
24 that MAWC is required to pay management fees in advance for services provided by the  
25 Service Company.

26        The Staff believes that this is inappropriate given the affiliated relationship between  
27 these two entities. The Company, on average, is not required to prepay for the goods and  
28 services from the various vendors that were included in the cash vouchers expense lag in its  
29 cash working capital analysis. The Staff also contends that while the affiliate Service

1 Company is requiring MAWC to prepay for services provided, the Service Company actually  
2 pays its invoices for goods and services in arrears. Therefore, under the current prepayment  
3 situation, the ratepayers of MAWC are being required to provide an unnecessary cash  
4 working capital allowance to the affiliate Service Company.

5 As was done in the last case, Staff has applied the cash vouchers expense lag to  
6 management fees. Please refer to Staff witness Edward F. Began's direct testimony for an  
7 explanation of the Staff's calculation of the cash vouchers expense lag. The Staff recommends  
8 that the Commission only include the cash working capital requirement associated with  
9 paying for services that it receives from its affiliated Service Company in a manner similar to  
10 the payments MAWC makes to other vendors as is represented by the cash vouchers expense  
11 lag.

12 **PAYROLL**

13 Q. Please explain the adjustments to payroll.

14 A. Staff's payroll adjustments represent the Staff's individual payroll  
15 annualizations to the various operating rate divisions in Missouri.

16 Q. What are the different components of Staff's payroll annualization?

17 A. The payroll annualization takes into account the wage increases for both union  
18 and non-union Company employees and differences in the on-going level of employees not  
19 reflected in the test year.

20 Q. Please explain the methodology you employed to determine annualized  
21 payroll.

22 A. Staff based its annualization on the Company's actual labor dollars for the test  
23 year ending June 30, 2006. Staff then made adjustments to increase the payroll levels to

1 reflect the current union labor rates, the April 2006 non-union labor increase, and the number  
2 of employees at year end December 31, 2006, in an effort to bring the Company's labor  
3 expense current through the update period. Staff also took into consideration the amount of  
4 labor related to summer interns.

5 Q. Why did Staff not include the April 2007 non-union labor increase?

6 A. As this increase was outside of the update period, it would not be appropriate  
7 to include it in Staff's annualization. However, the Staff intends to re-examine the Company's  
8 labor expense for inclusion in its true-up estimate. Staff's true-up recommendation is further  
9 discussed in the direct testimony of Staff witness Stephen M. Rackers.

10 Q. Were there any union labor increases that took place subsequent to the update  
11 period, but prior to the true-up date?

12 A. No. The labor contracts indicate that the increases are scheduled to occur on  
13 dates subsequent to the true-up period; therefore, Staff will not include them in its true-up  
14 examination.

15 Q. Were there any other adjustments made to the Company's labor expense?

16 A. Yes, Staff removed the cost related to an employee who, according to the job  
17 description, participates in lobbying activities. The reasons for excluding lobbying expense  
18 were previously explained on page 10 of this testimony.

19 Q. Did Staff examine the level of overtime incurred by the Company?

20 A. Yes. Staff examined overtime from January 2003 – December 2006 and found  
21 that in several districts, there was an upward trend. In these districts, Staff adjusted the  
22 amount of test year overtime to the amount known for the 2006 calendar year as an ongoing  
23 level. However, in other districts, Staff saw fluctuation in the amount of overtime during this

1 time period. Therefore, Staff calculated a 4-year average amount of overtime and adjusted the  
2 test year level to this 4-year average.

3 Q. Why did Staff not use a 5-year average?

4 A. Staff has not yet been provided with the data for 2002 in order to calculate the  
5 5-year average; however Staff will review this data when it is provided.

6 Q. Please discuss which treatment was applied to each district.

7 A. The 4-year average was used for the Brunswick, Joplin, Parkville Water,  
8 St. Charles, St. Joseph, and St. Louis districts. Staff utilized the 2006 year totals as the current  
9 ongoing levels for all other MAWC districts, except the Jefferson City district, which  
10 displayed abnormal levels.

11 Q. What abnormal data did the Jefferson City district show?

12 A. In the Jefferson City District, Staff found that in 2004 and 2005 the district  
13 experienced an increase in its overtime hours related to O&M payroll of 155% and 33%,  
14 respectively. While most other districts increased their amount of overtime during these time  
15 periods, this extreme jump in 2005, which continued in 2006, was exceptional as compared to  
16 the other districts. In response to Staff Data Request No. 55, the Company responded that  
17 much of the increase in its overtime was due to vacancies, increased shut-offs and  
18 maintenance. In subsequent Data Request No. 249, Staff asked for the Company, in particular,  
19 to explain the situation in Jefferson City. In response to this data request the Company  
20 indicated that the hours experienced in 2005 and 2006 were higher than the more normal  
21 levels experienced in 2003. Based on this response Staff utilized a 2-year average of the  
22 normal level of overtime hours experienced in 2003 and 2004 to determine its adjustment.

1 Q. Did Staff notice any other district specific abnormalities?

2 A. Yes, the Cedar Hill district seemed to have a discrepancy in the amount of  
3 overtime hours incurred detailed in Staff Data Requests Nos. 55 and 55.1. Staff inquired about  
4 this discrepancy and to date has not received an explanation. Staff used the most current data  
5 request in its calculations; however, if that data request is incorrect Staff will need to revise its  
6 calculation based on the correct data when it is received.

7 Q. Are there any other items Staff noticed as part of its overtime analysis?

8 A. Yes, Staff became aware of the fact that the Company has employees who  
9 work an excessive amount of overtime. For example, one construction truck driver worked  
10 2,514 hours of overtime during the test year, according to the data provided, which is more  
11 than working a double shift every single work day. Staff did not make an adjustment related  
12 to these workers, since most of the cost is capitalized and the specific adjustment would be  
13 immaterial to the revenue requirement at the St. Louis District. While Staff realizes that some  
14 positions require overtime and specific experience levels, hiring another truck driver seems  
15 warranted. Even with the added amount of labor overhead resulting from another employee,  
16 there should be cost savings, as well, there may be a safety issue related to employees who  
17 drive large trucks for 16 hours, 5 days a week.

18 **PAYROLL TAXES**

19 Q. Please explain the Staff's payroll tax adjustment.

20 A. This adjustment represents the Staff's annualization of Federal Insurance  
21 Contributions Act taxes (FICA), Federal Unemployment Tax (FUTA), and State  
22 Unemployment Tax (SUTA).



1 Q. Describe the Staff's annualization of payroll tax.

2 A. Staff calculated the amount for each individual employee included in its  
3 payroll annualization through the update period. Staff also recognized any other adjustments it  
4 made to payroll-related items, including incentive compensation as discussed later in this  
5 testimony, in its calculations.

6 Staff also annualized the amount of FUTA and SUTA associated with the Company's  
7 labor level. The annualization was based on the most current Company specific  
8 unemployment rate percentages available.

9 **EMPLOYEE BENEFITS**

10 Q. What types of benefits are provided by the Company?

11 A. The Company provides various benefits to the employee, including 401K  
12 matching, health insurance, a post-retirement medical cost saving account, accidental death  
13 and dismemberment, short-term disability, long-term disability, life insurance and incentive  
14 compensation. Staff will discuss incentive compensation in the section following this  
15 employee benefits section.

16 Q. Please describe Staff's adjustment for the Company's group insurance.

17 A. Staff considered the Company's health insurance, accidental death and  
18 dismemberment, short-term disability, long-term disability, and life insurance as the group  
19 insurance category. Staff was able to perform an analysis by employee with current rates.  
20 Therefore, Staff is making an adjustment to bring the level of group insurance up to the  
21 amount related to the employee level at year end December 31, 2006. Staff's adjustment  
22 represents a sizable increase in these costs over test year, which is due to the rise in health  
23 care costs.

1 Q. Please describe Staff's adjustment related to Voluntary Employees'  
2 Beneficiary Association (VEBA).

3 A. \*\* \_\_\_\_\_  
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7 \_\_\_\_\_ \*\*

8 Q. Please describe Staff's adjustment related to MAWC's 401K matching  
9 program.

10 A. As part of its employee benefits the Company contributes to the employees'  
11 401K fund. Staff was able to analyze these contributions on a per employee basis as of  
12 December 31, 2006, and made an adjustment to reflect the changes in the employee levels and  
13 contribution elections.

14 **INCENTIVE COMPENSATION**

15 Q. Please discuss the Company's incentive compensation plans.

16 A. \*\* \_\_\_\_\_  
17 \_\_\_\_\_  
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21 Q. What criterion is set for eligibility?

22 A. \*\* \_\_\_\_\_  
23 \_\_\_\_\_

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4 Q. How many MAWC employees are eligible for the AIP?  
5 A. \*\* \_\_\_\_\_  
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7 Q. \*\* \_\_\_\_\_ \*\*  
8 A. \*\* \_\_\_\_\_  
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12 Q. How does the plan work?  
13 A. \*\* \_\_\_\_\_  
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Q. \*\* \*\*

1 A. \*\* \_\_\_\_\_

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4 Q. Please explain how the funding for this plan works.

5 A. \*\* \_\_\_\_\_

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21 \_\_\_\_\_ \*\*

22 Q. Did Staff make an adjustment regarding \*\* \_\_\_\_ \*\*

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11           Q.    Why did Staff make an adjustment related to the \*\* \_\_\_\_\_  
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13           A.    \*\* \_\_\_\_\_  
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15 \_\_\_\_\_  
16 \_\_\_\_\_  
17 \_\_\_\_\_ \*\*  
18           Q.    Did Staff make any other adjustments to \*\* \_\_\_\_\_ \*\*  
19           A.    \*\* \_\_\_\_\_  
20 \_\_\_\_\_  
21 \_\_\_\_\_  
22           \*\*



1 Q. \*\*

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3 A. \*\*

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9 In the Southwestern Bell Telephone (SWB) Case No. TC-89-14, the Commission  
10 agreed with Staff that incentives based on goals related to non-regulated subsidiaries and non-  
11 Missouri portions of SWB should not be included in the Staff's amounts stating that:

12 "achieving the goals of SBC and unregulated subsidiaries is too remote  
13 to be a justifiable cost of service for Missouri ratepayers".  
14 29 Mo.P.S.C. (N.S.) 607, 627 (June 20, 1989).

15 These principles remain reasonable to consider in the current utility environment. In  
16 the 2004 Missouri Gas Energy case, GR-2004-0209, the Commission stated:

17 Those financial incentives seek to reward the company's employees for  
18 making their best efforts to improve the company's bottom line.  
19 Improvements to the company's bottom line chiefly benefit the  
20 company's shareholders, not its ratepayers. Indeed, some actions that  
21 might benefit a company's bottom line, such as a large rate increase, or  
22 the elimination of customer service personnel, might have an adverse  
23 effect on ratepayers....the shareholders that benefit from that plan  
24 should pay the costs of that plan. 12 Mo.P.S.C.3d 581, 606-07.

25 \*\*

28 \*\*

NP

1 Q. Did Staff take into consideration the incentive compensation received through  
2 allocations to MAWC?

3 A. \*\* \_\_\_\_\_  
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12 Q. Did Staff make adjustments related to the \*\* \_\_\_\_\_  
13 \_\_\_\_\_ \*\*

14 A. \*\* \_\_\_\_\_  
15 \_\_\_\_\_ \*\*

16 Q. What adjustments did Staff make to the Company's allocated \*\* \_\_\_\_\_ \*\*

17 A. \*\* \_\_\_\_\_  
18 \_\_\_\_\_  
19 \_\_\_\_\_ \*\*

20 Q. Did Staff make any additional adjustments to the \*\* \_\_\_\_\_ \*\*

21 A. \*\* \_\_\_\_\_  
22 \_\_\_\_\_ \*\*

NP

Direct Testimony of  
Lisa K. Hanneken

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

2           A.     Yes, it does.

**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 Service provided )  
in Missouri Service Areas )

Case No. WR-2007-0216, *et al*

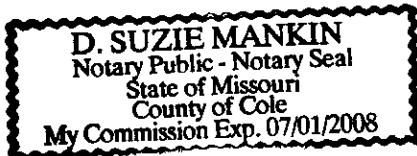
**AFFIDAVIT OF LISA K. HANNEKEN**

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 foregoing Direct Testimony in question and answer form, consisting of 33 pages to be presented in the above case; that the answers in the foregoing Direct 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 4th day of June 2007.



  
\_\_\_\_\_  
Notary Public

# CASE PROCEEDING PARTICIPATION

LISA K. HANNEKEN

PARTICIPATION		TESTIMONY
COMPANY	CASE NO.	ISSUES
Laclede Gas Company	GR-2002-356	<u>Direct</u> - Cash Working Capital, Rate Case Exp./PSC Assessment, Advertising, Misc. Expense
Missouri-American Water Company	WR-2003-0500	<u>Direct</u> - Rate Base and Related Expenses, AFUDC, Dues and Donations, Waste Disposal Expense, Storage Tank Lease Expense, Deferred Maintenance Expense, Transportation Expense, Insurance Other Than Group, Cost of Depreciation Study Expense
Missouri-American Water Company	WR-2003-0500	<u>Surrebuttal</u> - AFUDC, Dues and Donations, St. Joseph Waste Disposal Expense, Transportation Expense, Property Taxes
Fidelity Telephone Company	IR-2004-0272	<u>Direct</u> - Rate Base and Related Expenses; Insurance Other Than Group; Miscellaneous Other Taxes
Atmos Energy Corporation	GR-2006-0387	<u>Direct</u> - Corporate Allocations and Expenses, Payroll and Payroll Taxes, PSC Assessment, Taxes Other, Legal Fees
AmerenUE Electric Company	ER-2007-0002 and GR-2007-0003	<u>Direct</u> - Corporate Allocations and Expenses, Payroll and Payroll Taxes, Employee Benefits, Incentive Compensation, Miscellaneous Expenses