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Exhibit No.:
Issues: Hourly Wages Accrued in a Year, Pension Tracker, Billing Services, Allocation of Belleville Lab Costs, MSD Contract, Acquisition Premiums and Discounts, Business Transformation Accounting Treatment
Witness: Dennis R. Williams
Exhibit Type: Rebuttal
Sponsoring Party: Missouri-American Water Company
Case No.: WR-2011-0337
SR-2011-0338
Date: January 19, 2012

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. WR-2011-0337
CASE NO. SR-2011-0338

REBUTTAL TESTIMONY

OF

DENNIS R. WILLIAMS

ON BEHALF OF

MISSOURI-AMERICAN WATER COMPANY

MAWC Exhibit No. 34
Date 2-21-12 Reporter JL
File No WR-2011-0337

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-2011-0337** **CASE NO. SR-2011-0338**

AFFIDAVIT OF DENNIS R. WILLIAMS

Dennis R. Williams, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Rebuttal Testimony of Dennis R. Williams"; 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.

Dennis R. Williams

Dennis R. Williams

State of Missouri
County of St. Louis
SUBSCRIBED and sworn to
Before me this 17th day of January 2012.

Staci A. Olsen

Notary Public

My commission expires:

STACI A. OLSEN
Notary Public – Notary Seal
STATE OF MISSOURI
St. Charles County
Commission Number 09519210
My commission expires March 20, 2013

REBUTTAL TESTIMONY
DENNIS R. WILLIAMS
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WR-2011-0337
SR-2011-0338

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REBUTTAL TESTIMONY

DENNIS R. WILLIAMS

WITNESS INTRODUCTION AND PURPOSE

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

A. My name is Dennis R. Williams, and my title is Senior Manager - Rates and Regulation for the Western District of American Water Works. My business address is 727 Craig Road, St. Louis, Missouri 63141.

Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THIS PROCEEDING?

A. Yes, I have submitted direct testimony in this proceeding on behalf of Missouri American Water Company ("Missouri-American"," 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 and/or the direct testimony of OPC and Intervenors as to the following issues:

1) Hourly Wages Accrued in a Year;
2) Pension Tracker;
3) Billing Services;
4) Allocation of Belleville Lab Costs;
5) MSD Contract;
6) Acquisition Premiums and Discounts; and
7) Business Transformation Accounting Treatment

1) HOURLY WAGES ACCRUED IN A YEAR

Q. PLEASE EXPLAIN THIS ISSUE.

A. In preparing pro forma levels of wages for hourly employees, both Staff and the Company identify all hourly employees and their respective hourly wage level. This wage level is multiplied times the number of work hours in a year to determine pro forma hourly wages before overtime. The only difference between

Staff and Company methods is that Staff assumes there are 2080 base work hours in a year and the Company utilizes 2088 hours. This results in a reduction in the Staff calculation of revenue requirement of about $102,242.

Q. ISN'T DETERMINATION OF THE NUMBER OF HOURS IN A YEAR AS SIMPLE AS LOOKING AT A CALENDAR?

A. Yes. It seems that such a determination should be that simple and straight-forward but this has been an ongoing issue for numerous rate cases.

Q. CAN THE NUMBER OF ANNUAL WORK HOURS IN A YEAR VARY?

A. Yes. The number of base work hours in any twelve month period can vary from a low of 2080 hours to as high as 2096 work hours. Any twelve month period that begins on a Saturday or Sunday will have 2080 work hours, except in a leap year, which will have 2088 hours. Any twelve month period that begins on a Monday through Friday will have 2088 work hours, except in a leap year, which will have 2096.

Q. IF THE HOURS VARY FROM PERIOD TO PERIOD, WHY DO YOU BELIEVE THAT 2088 IS THE CORRECT NUMBER TO USE?

A. Every four year period has the same number of work hours because leap years and the limited number of months that begin on Saturdays and Sundays are equalized over a four-year period. As shown on Rebuttal Schedule DRW-1, over any four year period, more than 75% of every consecutive 12 month period will contain either 2088 or 2096 hours. More importantly, the weighted average annual base work hours is 2087.33 or approximately 2088 hours. On Rebuttal Schedule DRW-1 is a listing of the business work days for the calendar years 2010 through 2014 and the derivation of the weighted average annual base work hours discussed earlier. This is the information that was developed in support of utilizing 2088 hours in the Company's direct case.

Q. HAS THE STAFF CALCULATED SIMILAR WEIGHTED AVERAGE ANNUAL BASE HOURS?

A. Yes. Data request 0282 submitted to Staff by Company, asked "Please explain

Staff's rationale for utilizing 2,080 hours in its payroll adjustment as the number of annualized hours for which an hourly worker will be paid on a pro forma basis. Please provide copies of any studies or analysis that address this issue." In response, Staff supplied calendars from January 2006 through December 2011. Staff summarized these calendars to show that most calendar years reflected only 2080 annual base work hours in a year. However, due to errors in the calendars originally provided (exclusion of July 15 and July 29 from the 2008 calendar and exclusion of October 31 from the 2010 and 2011 calendars), Staff provided a revised set of calendars with a new summary of data as reflected on Rebuttal Schedule DRW-2. That schedule now reflects data that is consistent with the Company developed data – that is, on average, twelve month periods contain approximately 2088 base annual work hours.

2) <u>PENSION TRACKER</u>

Q. DOES THE COMPANY HAVE IN PLACE A PENSION EXPENSE TRACKING MECHANISM?

A. Yes. The pension expense tracker was first approved in Case No. WR-2007-0216. It has subsequently been renewed without significant change in Cases WR-2008-0311 and WR-2010-0131.

Q. HOW DOES THE PENSION TRACKER CURRENTLY WORK?

A. There are two parts to the pension tracker. First, a level of pension expense is established in the revenue requirement in setting rate based upon the FAS 87 pension expense that is estimated to be incurred annually while rates are in effect. The calculation of FAS 87 pension expense is governed by generally accepted accounting principles. At the time the next rate case is trued-up, actual FAS 87 pension expense is compared to the amount that has been collected in rates. The difference is recorded as a deferred regulatory asset or liability and amortized over five years. This part of the mechanism reconciles actual expenses accrued to rates paid by customers and insures that the Company receives a <u>return of</u> the exact amount of pension expense incurred. A second part of the pension trackers is a comparison of the FAS 87 expense to cash contributions made to the pension fund. Cash contributions are generally governed by the Employee Retirement Income Security Act ("ERISA") and may differ in a given year from the FAS 87 expense level, although over time they should be equal. Because the actual cash paid by the Company may be more or less than the recorded expense, the difference is tracked and a pension asset or pension liability is included in rate base. This part of the mechanism is similar to the establishment of prepaid assets or deferred tax reserves in rate base. It insures that the Company receives a <u>return on</u> its funds if it has contributed more than the expense level allowed in rates, but gives credit to customers for a return on their funds if the amount they have paid in rates exceeds the contributions made by the Company.

Q. HAS THE STAFF RECOMMENDED THAT THE PENSION TRACKER BE ELIMINATED?

A. No. A tracking mechanism is appropriate for expense items that are volatile and therefore may vary greatly from test year levels to levels during the period that rates are in effect. Staff recommends keeping the tracker, but dramatically changing the mechanism.

Q. WHY HAS THE STAFF RECOMMENDED THIS CHANGE?

A. The Staff's Report on Cost of Service at page 31 states that Staff identified a "flaw" in the operation of the current tracker mechanism. Staff explains this "flaw" through a fairly lengthy passage that I will attempt to break down into its various parts. First, the Staff states that the:

> problem in the operation of the current FAS 87 tracker mechanism is that it is based upon fluctuations in the Company's ongoing FAS 87 expense compared to the amount of FAS 87 included in MAWC's rate levels. However, if the amounts of MAWC's annual trust fund contributions are not based upon a FAS 87 expense measurement (and, as explained, they currently are not), then there is no cash investment required of either MAWC or its ratepayers associated with annual fluctuations in booked FAS 87 pension.

Q. DO YOU AGREE THAT THIS IS A "FLAW" IN THE CURRENT MECHANISM?

A. No. All this says is that the expense recorded on the Company's books under generally accepted accounting principles may be different than the actual cash expended in a specific year. That is nothing unusual as there are often differences between actual cash expenditures and accrual accounting. For example, a company may prepay for services that it has not yet received. An expense would not be recorded until those services are provided even though cash has already been expended. Similarly, taxes may be expensed on a company's books even though cash payments for those taxes may be deferred for several years. Ratemaking typically follows the generally accepted accounting principles of accrual accounting in setting ongoing expense levels, while giving recognition through adjustments to rate base to recognize the time value of money for differences between those expense levels and actual cash expenditures.

Q. PLEASE CONTINUE WITH YOUR REVIEW OF THE STAFF'S DESCRIPTION OF THE "FLAW" IN THE CURRENT MECHANISM.

A. The discussion on page 31 of the Staff Report continues as follows:

> A financial accounting difference that has no impact on a Company's or its customers' cash investment requirements should not be included in utility rate base. The "pension asset/liability" also included in MAWC's rate base, is a more appropriate surrogate calculation of the Company's or customers' cash requirements arising from the difference between the results of a FAS 87 expense calculation on the Company's books and the amount of its minimum ERISA trust fund contributions.

Q. DO YOU AGREE THAT THIS IS A "FLAW" IN THE CURRENT MECHANISM?

A. No. The first sentence in the quote above implies that no rate base treatment should be afforded to the pension asset/liability. As previously explained, the pension asset/liability does have an impact on cash investment requirements. Inclusion of an item in rate base is to correctly compensate for the return on that cash investment. If rate base exclusion was correct, then similarly, rate base treatment should not be given to prepaid assets where the Company has expended cash but not recorded an expense. Nor should rate base be reduced for deferred taxes that have been expensed, but for which no cash has been expended.

The second sentence in the Staff testimony quoted above seems to be contradictory to the first. It states that the pension asset/liability is more appropriate for calculating cash requirements for the difference between FAS 87 recorded expense and actual cash contributions. That is exactly the intent of the second component of the pension tracker mechanism as described earlier in my testimony. This is not a "flaw". It is working correctly and exactly as intended.

Q. HOW DID THE STAFF REPORT CONCLUDE ITS DESCRIPTION OF THE CURRENT MECHANISM'S - "FLAW"?

A. The paragraph concluded that "Given American Water's current funding practices, inclusion of both a FAS 87 rate base difference and a pension asset/liability in rate base will most likely result in either an overstatement or an understatement of MAWC's actual pension's rate base investment."

Q. DO YOU AGREE THAT THIS IS A "FLAW" IN THE CURRENT MECHANISM?

A. No. I believe that it may demonstrate a lack of understanding that when the tracker mechanism was designed several rate cases ago that there were two distinct factors in the calculation – one for tracking the estimated expense level to the actual expense level, and the other for tracking the time value of money related to differences in the recorded expense level and actual cash contributions. The two factors work together to compute correctly the <u>return of</u> and <u>return on</u> components as designed.

Q. STAFF HAS HAD THE OPPORTUNITY TO REVIEW THIS MECHANISM IN PRIOR CASES. DO YOU HAVE ANY KNOWLEDGE AS TO WHY IT HAS SUGGESTED A CHANGE ONLY AT THIS POINT IN TIME?

A. No. I am aware that in the previous rate cases, the pension asset/liability was in a negative position. In other words, cash contributions were less than the actual recorded pension expense so rate base was reduced to give credit to customers for the time value of money for the excess. It is apparent that at the time of true-up this factor, which Staff has decided in this case is a "flaw", will be added to rate base because the Company contributions are in excess of recorded expense. Eliminating this factor would reduce total revenue requirement in this case, which would not have been the result in prior cases.

Q. HOW DOES STAFF INTEND TO "CORRECT" THE PENSION TRACKER?

A. Staff recommends that in the future the tracker should look at only the pension cash investment. In other words, for ratemaking purposes, pension costs would be put on a cash basis rather than an accrual basis.

Q. DO YOU AGREE WITH THIS RECOMMENDATION?

A. No. There is no good reason to set rates based upon cash accounting for one item when rates are based on accrual accounting for other accounts. Accrual accounting more accurately reflects cost causation and more fairly associates revenue requirements with the parties who have created those costs. Moreover, prior to the establishment of FAS 87, there were no clarified accounting rules governing the accounting treatment of pension costs. At times there were valid reasons for companies to make cash contributions to their pension funds in excess of the ERISA minimum. On the other hand, companies could influence earnings to some extent by making larger contributions than might otherwise be necessary. This resulted in a number of contentious regulatory disagreements as to the proper level of pension cost to be included in rates. There is no reason to risk re-introducing these potential disputes that can arise under the vagaries of cash accounting, when a generally accepted, standardized method for recording pension expense levels has been established.

3) <u>BILLING SERVICES</u>

Q. DOES MAWC PROVIDE BILLING SERVICES TO MUNICIPALITIES IN THE DISTRICTS IN WHICH IT OPERATES?

A. By law, the Company is required to provide water billing information to municipalities and special sewer districts that rely upon water consumption to charge their customers for wastewater services. For over twenty-five years, MAWC or its predecessor companies, as a service to the communities it serves, has also provided billing services for city operated services such as sewer and trash collection. However, MAWC has notified all its municipal customers that it will no longer provide these billing services.

Q. DO YOU AGREE WITH THE STAFF'S RECOMMENDATION THAT ALL BILLING SERVICE REVENUE DURING THE TEST YEAR SHOULD BE REFLECTED AS OPERATING INCOME?

A. No. First, this revenue is generated at little or no incremental cost. Customers are paying their actual cost of service and are not disadvantaged by the service provided to municipalities.

More importantly, it is a known and measureable certainty that the Company is exiting this business and that no billing services revenue will be generated after that exit is complete in 2012. Revenue from the provision of billing services to municipalities will be negligible during the time that new rates are in effect. The only other revenue generation will be the minimal amount associated with the provision of meter reading information to municipalities and sewer districts as required by law.

Q. IS THE AMOUNT OF OTHER REVENUE FROM PROVISION OF METER READING INFORMATION KNOWN AND MEASUREABLE?

A. No. The revenue generated is expected to be relatively minor. There is no definition of what constitutes a reasonable cost so each contract must be individually negotiated. Municipalities and sewer districts are free to refuse to enter into any contract and, in some cases, may have no need to contract for this data. To date, the Company has successfully negotiated only one new contract. That is with the City of Jefferson and should generate $3,000 in revenue annually. Whether the Company will be able to reach agreement with other entities is unknown at this time.

4) ALLOCATION OF BELLEVILLE LAB COSTS

Q. STAFF PROPOSES A REDUCTION OF MAWC'S EXPENSE TO REALLOCATE THE INDIRECT PORTION OF THE BELLEVILLE LAB SERVICE COMPANY COSTS BASED ON AN AVERAGE OF THE NUMBER OF TEST ANALYSES PERFORMED AS OPPOSED TO AN ALLOCATION OF COSTS BASED ON THE NUMBER OF CUSTOMERS. WHAT IS THE BELLEVILLE LAB SERVICE COMPANY?

A. The Belleville Lab is a water quality testing facility located in Belleville, Illinois that is operated by American Water Works Service Company. This facility performs sample testing for the American Water operating companies including MAWC.

Q. DOES THE USE OF THE BELLEVILLE LAB PROVIDE SAVINGS FOR MAWC AND ITS CUSTOMERS?

A. Yes. The Belleville Lab conducts a survey to compare its testing costs to those of outside testing laboratories. Outside labs have been found to be from 6% to 52% more expensive. Also, outside testing labs will charge higher fees for evaluation of "rush" samples. The Belleville Lab does not.

Q. HOW DOES THE BELLEVILLE LAB ALLOCATE COSTS TO MAWC?

A. Those costs directly attributable to MAWC are charged accordingly. The indirect costs are allocated to each of the operating companies based on the number of customers they serve.

Q. HOW DOES STAFF PROPOSE TO ALLOCATE THE INDIRECT COSTS FOR RATEMAKING PURPOSES?

A. The Staff Report proposes an adjustment that would represent an allocation of the indirect costs based on an average of the number of test analyses performed on all samples that were submitted to the Belleville Lab over the last five calendar years.

Q. WHY DOES STAFF ALLEGE THAT NUMBERS OF TESTS IS A MORE APPROPRIATE METHOD FOR THE ALLOCATION OF THESE INDIRECT COSTS?

A. Staff is concerned that MAWC is receiving an allocation of indirect costs of approximately 14.24% (based on customer count), while MAWC's portion of test analyses represents about 5.29% of the total tests performed.

Q. ARE THESE PERCENTAGES LIKELY TO BE THE SAME EVERY YEAR?

A. No. An operating company's total samples can vary from one year to the next because of source water conditions, contamination events and regulations.

Thus, an operating company's portion of Belleville Lab costs could vary widely from one year to the next. I will discuss this later in my rebuttal testimony.

Q. IS THE USE OF CUSTOMER COUNTS MORE STABLE?

A. Yes. Customer counts are much less variable and do not change dramatically from year to year on a system-wide basis.

Q. DOES AWW ALLOCATE COSTS DIFFERENTLY FROM STATE TO STATE?

A. No. It is system-wide policy to allocate Service Company expenses that cannot be direct charged to operating companies on the basis of the number of customers. Doing so makes practical sense, as it is easy to manage and administer and it provides for system-wide consistency over multiple jurisdictions. Customer numbers are currently used to allocate service company costs related to accounting, administration, communications, corporate secretarial and legal, customer services, engineering, financial human resources, information systems, operations, rate and revenues and risk management. If each of these services is examined on a Missouri-only basis for an alternative allocation methodology, I suspect that some alternatives would increase costs currently allocated to MAWC.

Q. WHY IS CONSISTENCY FROM STATE TO STATE IMPORTANT?

A. Applying different allocation methods from one jurisdiction to another will undoubtedly lead to a situation where American Water is unable to recover all of its Belleville Lab costs. Such a loss would either drive up the cost of service to operating companies or, in the alternative, encourage the use of outside labs whose costs, while higher, would likely be recovered in total.

Q. ARE THERE SIGNIFICANT SWINGS IN THE LEVEL OF TEST ANALYSES PERFORMED BY THE VARIOUS STATES THAT HIGHLIGHT THE NEED FOR CONSISTENCY?

A. Yes. Attached is Rebuttal Schedule DRW–3, which shows the percentage of test analyses for each state as compared to the total AW system by year since 2003. The minimum and maximum percentage values for each state over the five year period are identified and a percentage variance is calculated. As shown, the percentage variances are extremely significant. For example, MAWC's minimum and maximum percentages vary by 38.14%. For the state of New Mexico, the percentage variance in the minimum and maximum is over 1,800%. In fact, there are eight out of the total of 17 states that have a percentage variance calculated that exceeded 80%.

Q. DOES THE USE OF TEST SAMPLES INCENT ANY OTHER BEHAVIOR?

A. Focusing on the number of samples could create a situation where an operating company would have the opportunity to directly reduce its costs by reducing the number of sample tests it asks to be performed. Such an operating incentive is not in the best interests of public safety and one that is discouraged by allocating costs based on customer counts.

Q. WHAT IS THE CONSEQUENCE OF STAFF'S BELLEVILLE LAB REALLOCATION?

A. Staff's reallocation would reduce MAWC's expense by about $448,000.

Q. WHAT IS YOUR RECOMMENDATION?

A. The current allocation method for Belleville Lab costs is functioning effectively and is widely accepted by regulators. Any perceived benefits from changing to multiple allocation methods would be offset by the overall impact on a service company system that is providing benefits for MAWC's customers. The Commission should not accept Staff's proposal to reallocate Belleville Lab costs based on test analyses performed.

5) METROPOLITAN SEWER DISTRICT ("MSD") CONTRACT

Q. PLEASE EXPLAIN THE CONTRACT BETWEEN MSD AND MAWC?

A. Missouri-American Water provides billing data services to MSD at a flat fee. Revenue received is recorded above the line and therefore as long as it exceeds the marginal cost of providing the services benefits other customers in the St. Louis district.

Q. HAS THE COMPANY PREPARED AN INCREMENTAL COST STUDY PERTAINING TO THE MSD CONTRACT?

A. Yes. The only incremental cost study prepared by the Company was in connection with Case No. WR-2008-0311, as ordered by the Commission.

Q. WHAT WAS THE TREATMENT OF THE MSD CONTRACT IN THE LAST RATE CASE?

A. No party objected to a settlement between MSD and MAWC leaving the contract rate constant.

Q. WHAT IS MAWC'S PROPOSAL IN THIS CASE?

A. MAWC is proposing no change in the existing amount it charges to MSD for the provision of water usage and customer billing data. For purposes of this case, MAWC has included the full contract price in annualized revenues.

Q. HAVE PARTIES IN THIS CASE TAKEN ISSUE WITH THE MSD CONTRACT?

A. OPC believes the annual amount should be based on an allocation of fully distributed cost, not incremental or negotiated costs to produce the information. They would have the rate increased from $350,000 per year to $545,535.

Q. WHAT IF THE COMMISSION DETERMINES THAT MSD SHOULD BE CHARGED SOMETHING DIFFERENT THAN IT IS CURRENTLY BEING CHARGED FOR THESE SERVICES?

A. If the Commission believes that the MSD contract rate is inappropriate, it should indicate that to be the case, but should make no adjustment to revenue requirement in this case. The contractual amount established and currently being paid is appropriately included in the revenue requirement request in this case. The rate can be changed only after a filing seeking to amend the contract in conjunction with the Company's next rate case. Of course, MSD would also have the option not to renew the contract.

Q. WHY DO YOU BELIEVE THAT ADDITIONAL REVENUE SHOULD NOT BE

IMPUTED TO MAWC IF THE COMMISSION BELIEVES THE CONTRACT SHOULD BE AMENDED AND THE RATE INCREASED?

A. The Company entered into this contract only after receiving authority to do so from the Commission. It cannot be amended except through application to the Commission. Currently, the contract provides for revenue greater than the cost of providing billing services to MSD, thereby providing benefit to all other St. Louis County customers. Finally, I believe that MSD has alternatives to the contract that is in place with MAWC and if it chooses not to renew the contract, MAWC customers would bear additional cost currently being covered by the MSD revenues.

6) ACQUISITION PREMIUMS AND DISCOUNTS

Q. WHAT ARE ACQUISITION PREMIUMS AND DISCOUNTS?

A. Simply stated, premiums occur when the purchase price of an acquired property is more than the net book value of the assets acquired and discounts occur when the purchase price is less than the net book value of assets acquired.

Q. HAS THE MISSOURI COMMISSION PREVIOUSLY INDICATED HOW ACQUISITION DISCOUNTS AND PREMIUMS SHOULD BE TREATED FOR RATEMAKING PURPOSES?

A. Yes. The clearest statement of past Commission treatment of this issue is found in the Second Report and Order in Case No. EM-2000-292, related to the acquisition of St. Joseph Light & Power Co. by UtiliCorp United Inc. That Order stated:

> As a general rule, only the original cost of utility plant to the first owner devoting the property to public service, adjusted for depreciation, should be included in the utility's rate base. That principle is known as the net original cost rule.
>
> The net original cost rule was developed in order to protect ratepayers from having to pay higher rates simply because ownership of utility plant has changed, without any actual change in the usefulness of the plant. If a utility were allowed to revalue its assets each time they changed hands, it could artificially inflate its rate base by selling and repurchasing assets at a higher cost, while recovering those costs from its ratepayers. Thus, ratepayers would be required to pay for the same utility

> plant over and over again. The sale of assets to artificially inflate rate base was an abuse that was prevalent in the 1920s and 1930s and such abuses could still occur.
>
> An acquisition adjustment can be either positive or negative. In other words, when a utility purchases an asset, it may pay more or less than the net original cost of the asset. When the utility pays more than net original cost, it is said to have paid an acquisition premium. But, in some circumstances, a utility may be able to purchase assets at less than net original cost. In that situation, the utility has a negative acquisition adjustment.
>
> Missouri has traditionally applied the net original cost standard when considering the ratemaking treatment of acquisition adjustments. That means that the purchasing utility has not been allowed to recover an acquisition premium from its ratepayers. But it also means that ratepayers do not receive lower rates through a decreased rate base when the utility receives a negative acquisition adjustment. Even if a company acquires an asset at a bargain price, it is allowed to put the asset into its rate base at its net original cost. Similarly, ratepayers do not share in the gains a utility may realize from selling assets at prices above their net original cost. Those gains flow only to the utility's shareholders.

In other words, if recovery of an acquisition premium is not allowed, then conversely, an acquisition discount or negative acquisition adjustment should not be used to reduce the net book value for rate base and rate making purposes.

This principle was cited more recently by the Commission in a certificate case (Case No. GA-2007-0168, concerning Southern Missouri Natural Gas "SMNG"). In that case, Staff proposed a condition that stated that if before SMNG had cost based rates, it disposed of its assets at a fair value less than net original cost, that the new owner would be expected to reflect those assets on its books at its purchase price or the fair value of the assets rather than net original cost. The Commission declined to impose this condition, stating in part:

> The Commission also observes that there are strong precedents against allowing acquisition premiums to be reflected in rates when the assets are purchased at more than book value. For example, the Commission has stated that it will not require a company to write down its rate base when the assets are sold at less than book value. In addition, Mr. Oligschlaeger testified that the Uniform System of Accounts requires that the use of "net original cost" for ratemaking, and that it would require a waiver if a public utility requested the accounting treatment now being advocated by Staff.

Q. DO YOU AGREE WITH THIS POLICY?

A. Yes. Retaining rate base at net original cost as the result of an acquisition protects the customers and provides the Company an incentive to achieve as low a purchase price as possible. It is further equitable in that it balances the interest of the acquiring utility and its customers by applying the same fair treatment whether the acquisition is made at a premium or discount.

Q. WHAT POSITION HAS THE OFFICE OF PUBLIC COUNSEL ("OPC") TAKEN IN REGARD TO ACQUISITION PREMIUMS AND DISCOUNTS?

A. OPC indicates that MAWC should not be allowed to earn a return on a valuation of purchased assets that exceeds the amount of net original cost. At the same time, it states that MAWC should not benefit by a purchase of assets that is below net original cost. In other words, the utility should not benefit whether a purchase is made at a premium or a discount.

Q. DOES OPC PROVIDE RATIONALE FOR ITS OPINION?

A. No. OPC simply appears to take a "heads the customer wins, tails the Company loses" approach to rate regulation.

<u>7) BUSINESS TRANSFORMATION ACCOUNTING TREATMENT</u>

Q. IN YOUR DIRECT TESTIMONY, YOU DISCUSSED THE PROPER ACCOUNTING TREATMENT FOR ANNUAL ("SAP") LICENSE FEES. HAS ANY OTHER PARTY TAKEN AN OPPOSING VIEW TO YOUR RECOMMENDATION?

A. Yes. My recommendation was to expense these annual license fees, even during the period that the new system was being developed, because they are recurring in nature and under generally accepted accounting principles should be reflected as a system maintenance expense. The direct testimony of Staff witness Kimberly K. Bolin, at page 12, states the Staff position that according to the Stipulation and Agreement filed in Case No. WR-2010-0131, all costs associated with the Comprehensive Planning Study and the Business Transformation Project were to be included in construction work in progress and then transferred to Utility Plant when the assets were placed into service.

Q. DO YOU HAVE AN ISSUE WITH ACCEPTING THE STAFF RECOMMENDATION IN THIS REGARD?

A. No. So long as the Commission orders this treatment, the Company, applying FAS 71, can accept this variance from what would otherwise constitute generally accepted accounting principles. However, the Company does not believe that it would be fair or reasonable in the future for any party to argue that these costs should not be recoverable because they should have been expensed previously.

Q. HAS THE STAFF MADE ANY OTHER RECOMMENDATIONS REGARDING THE TREATMENT OF BUSINESS TRANSFORMATION AND COMPREHENSIVE PLANNING STUDY COSTS?

A. Yes. Beginning at page 15 of her direct testimony, Ms. Bolin indicates that the Company's recommendation for special ratemaking treatment of these costs was under review. She stated, "In order for Staff to agree to or accept such special ratemaking treatment for these costs, MAWC should be required to help establish and follow parameters and conditions to allow Staff, and other parties in this case, adequate review of the management of the project, the costs associated with it, and the budget expended for such costs."

Q. IS THE COMPANY WILLING TO ALLOW STAFF AND OTHER PARTIES TO REVIEW MANAGEMENT OF THE PROJECT, ITS BUDGET AND COSTS?

A. Yes. In fact, both Staff and the OPC have met with senior management responsible for documenting not only the associated budget and costs, but also the support for the business decisions to establish the scope, the selection of vendors, contract developments and all other facets of these projects. A dedicated computer-based source library containing all of the cost information and support for the Comprehensive Planning Study and Business Transformation Project has been created. Both Staff and the OPC have been given unrestricted access to this information and can drill down from monthly cost summaries to detailed support for each cost item, including the capitalization of internal costs. The Company understands the desire on the part of Staff and the OPC to be able to access this information on an ongoing basis, outside the pendency of this rate case. If MAWC is granted the recommended accounting treatment outlined in the Company's direct case, the Company is certainly willing to grant continued access to all support for the costs and conduct of these system implementations after this rate case is completed, and to grant reasonable access to management to discuss and explain all decisions surrounding the projects' strategy, design and implementation.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, it does.

Missouri American Water Company

	Normal Work Days	12 Month Cumulative	Cumulative Hours
January-10	21		
February-10	20		
March-10	23		
April-10	22		
May-10	21		
June-10	22		
July-10	22		
August-10	22		
September-10	22		
October-10	21		
November-10	22		
December-10	23	261	
January-11	21	261	2088
February-11	20	261	2088
March-11	23	261	2088
April-11	21	260	2080
May-11	22	261	2088
June-11	22	261	2088
July-11	21	260	2080
August-11	23	261	2088
September-11	22	261	2088
October-11	21	261	2088
November-11	22	261	2088
December-11	22	260	2080
January-12	22	261	2088
February-12	21	262	2096
March-12	22	261	2088
April-12	21	261	2088
May-12	23	262	2096
June-12	21	261	2088
July-12	22	262	2096
August-12	23	262	2096
September-12	20	260	2080
October-12	23	262	2096
November-12	22	262	2096
December-12	21	261	2088
January-13	23	262	2096
February-13	20	261	2088
March-13	21	260	2080
April-13	22	261	2088
May-13	23	261	2088
June-13	20	260	2080
July-13	23	261	2088
August-13	22	260	2080
September-13	21	261	2088
October-13	23	261	2088
November-13	21	260	2080
December-13	22	261	2088
January-14	23	261	2088
February-14	20	261	2088
March-14	21	261	2088
April-14	22	261	2088
May-14	22	260	2080
June-14	21	261	2088
July-14	23	261	2088
August-14	21	260	2080
September-14	22	261	2088
October-14	23	261	2088
November-14	20	260	2080
December-14	23	261	2088
Sum of 48 12-month Periods			100,192
# of Years in average			48
Weighted Average Hours			2087.33

Schedule DRW-2

Month	Work days			Hours
Jan-06	22	X	8	176
Feb-06	20	X	8	160
Mar-06	23	X	8	184
Apr-06	20	X	8	160
May-06	23	X	8	184
Jun-06	22	X	8	176
Jul-06	21	X	8	168
Aug-06	23	X	8	184
Sep-06	21	X	8	168
Oct-06	22	X	8	176
Nov-06	22	X	8	176
Dec-06	21	X	8	168

Total Regular Hours Worked 2006 2,080

Month	Work days			Hours
Jan-07	23	X	8	184
Feb-07	20	X	8	160
Mar-07	22	X	8	176
Apr-07	21	X	8	168
May-07	23	X	8	184
Jun-07	21	X	8	168
Jul-07	22	X	8	176
Aug-07	23	X	8	184
Sep-07	20	X	8	160
Oct-07	23	X	8	184
Nov-07	22	X	8	176
Dec-07	21	X	8	168

Total Regular Hours Worked 2007 2,088

Month	Work days			Hours
Jan-08	23	X	8	184
Feb-08	21	X	8	168
Mar-08	21	X	8	168
Apr-08	22	X	8	176
May-08	22	X	8	176
Jun-08	21	X	8	168
Jul-08	23	X	8	184
Aug-08	21	X	8	168
Sep-08	22	X	8	176
Oct-08	23	X	8	184
Nov-08	20	X	8	160
Dec-08	23	X	8	184

Total Regular Hours Worked 2008 2,096

Month	Work days			Hours
Jan-09	22	X	8	176
Feb-09	20	X	8	160
Mar-09	22	X	8	176
Apr-09	22	X	8	176
May-09	21	X	8	168
Jun-09	22	X	8	176
Jul-09	23	X	8	184
Aug-09	21	X	8	168
Sep-09	22	X	8	176
Oct-09	22	X	8	176
Nov-09	21	X	8	168
Dec-09	23	X	8	184

Total Regular Hours Worked 2009 2,088

Month	Work days			Hours
Jan-10	21	X	8	168
Feb-10	20	X	8	160
Mar-10	23	X	8	184
Apr-10	22	X	8	176
May-10	21	X	8	168
Jun-10	22	X	8	176
Jul-10	22	X	8	176
Aug-10	22	X	8	176
Sep-10	22	X	8	176
Oct-10	21	X	8	168
Nov-10	22	X	8	176
Dec-10	23	X	8	184

Total Regular Hours Worked 2010 2,088

Month	Work days			Hours
Jan-11	21	X	8	168
Feb-11	20	X	8	160
Mar-11	23	X	8	184
Apr-11	21	X	8	168
May-11	22	X	8	176
Jun-11	22	X	8	176
Jul-11	21	X	8	168
Aug-11	23	X	8	184
Sep-11	22	X	8	176
Oct-11	21	X	8	168
Nov-11	22	X	8	176
Dec-11	22	X	8	176

Total Regular Hours Worked 2011 2,080

Missouri American Water Company **Schedule DRW-3**
Belleville Labs - Five Year Review
Summary of Test Analyses by Operating Company
Showing % Minimum and Maximum of Test Analyses

State	2006	2007	2008	2009	2010	Min.	Max.	% Var
Arizona	6.06%	4.29%	5.59%	6.88%	7.95%	4.29%	7.95%	85.36%
California	17.86%	11.48%	14.46%	19.13%	16.27%	11.48%	19.13%	66.64%
Iowa	0.88%	0.69%	0.52%	0.66%	0.38%	0.38%	0.88%	131.81%
Illinois	6.31%	5.87%	7.37%	5.73%	7.74%	5.73%	7.74%	35.12%
Indiana	3.78%	7.33%	6.85%	7.52%	5.70%	3.78%	7.52%	98.94%
Kentucky	1.64%	1.65%	4.07%	1.89%	3.75%	1.64%	4.07%	148.17%
Maryland	0.32%	0.31%	0.29%	0.21%	0.30%	0.21%	0.32%	52.38%
Michigan	0.07%	0.05%	0.21%	0.10%	0.06%	0.05%	0.21%	320.00%
Missouri	6.04%	6.02%	5.51%	4.63%	4.72%	4.63%	6.04%	30.45%
New Jersey	34.89%	33.06%	34.13%	33.48%	24.21%	24.21%	34.89%	44.14%
New Mexico	0.42%	0.25%	0.60%	0.23%	0.79%	0.23%	0.79%	244.25%
New York	2.21%	2.04%	1.82%	1.56%	1.68%	1.56%	2.21%	41.67%
Ohio	1.93%	4.15%	3.53%	2.93%	2.68%	1.93%	4.15%	115.03%
Pennsylvania	11.70%	15.06%	9.44%	11.21%	16.36%	9.44%	16.36%	73.35%
Puerto Rico	0.93%	0.00%	0.00%	0.00%	0.00%	0.00%	0.93%	
Tennessee	1.05%	1.50%	1.12%	1.99%	1.23%	1.05%	1.99%	89.52%
Texas	0.03%	0.08%	0.00%	0.01%	0.01%	0.00%	0.08%	
Virginia	1.18%	3.35%	1.84%	1.84%	4.58%	1.18%	4.58%	288.50%
West Virginia	2.70%	2.82%	2.65%	0.00%	1.57%	0.00%	2.82%	
	100.00%	100.00%	100.00%	100.00%	100.00%			