STAFF - 4

Exhibit No.:	
Issues:	*Corporate Allocations and Expenses, Payroll and Payroll Taxes, External Affairs, and Incentive Compensation*
Witness:	*Lisa K. Hanneken*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Surrebuttal Testimony*
Case No:	*WR-2007-0216*
Date Testimony Prepared:	*July 31, 2007*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

LISA K. HANNEKEN

MSSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2007-0216

Jefferson City, Missouri
July 2007

Staff Exhibit No. 4
Case No(s). WR-2007-0216
Date 8-14-07 Rptr DF

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

AFFIDAVIT OF LISA K. HANNEKEN

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

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

Lisa K Hanneken
Lisa K. Hanneken

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

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

D Suzie Mankin
Notary Public

TABLE OF CONTENTS

SURREBUTTAL TESTIMONY

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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. Have you previously filed direct testimony in this case?

A. Yes.

Q. What is the purpose of your surrebuttal testimony?

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

- MAWC Payroll and Related Expenses which includes:
  - Overtime
  - External Affairs
  - Incentive Compensation (MAWC specific and allocated)

and Edward J Grubb, regarding:

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

PAYROLL TAX ANNUALIZATION

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

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

OVERTIME

Q. What is the issue regarding overtime expense?

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

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

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

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

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

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

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

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

A. Yes, in the Company's response to Staff's Data Request No. 249, the Company stated that "...the high level of O&M overtime in 2005 and 2006 in comparison to more normal levels seen in 2003 and 2004 was driven by... the levels of vacancies and sick leave in the operator ranks as well as the two job shifts". This information corroborates the Staff's utilization of a historical average to adjust the test year overtime level to the more normal levels seen in 2003 and 2004.

EXTERNAL AFFAIRS EMPLOYEE

Q. Please briefly explain this issue.

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

Q. Does Staff agree with this assessment?

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

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

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

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

INCENTIVE COMPENSATION

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

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

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

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

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

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

ALLOCATIONS

Allocated External Affairs (Central Region)

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

A. No. In Mr. Grubb's rebuttal testimony he states that Staff's adjustment is arbitrary and that the job description does not indicate that the employee spends that much time devoted to lobbying activities. Mr. Grubb is correct in that the job description does not show the amount time spent on lobbying. In fact it does not show the amount of time spent on any of the duties that are listed. However, Staff analyzed the job description based on the verbiage provided, and determined the amount of time spent given the duties listed.

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

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

Allocated Dues and Donations

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

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

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

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

Allocated Advertising

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

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

Allocated PWC Audit Fees

Q. What is the issue related to these fees?

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

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

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

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

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

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

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

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

Allocated National Shared Service and Call Center Transition Costs

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

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

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

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

<u>Allocated National Shared Services Charges Capitalized</u>

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

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

<u>CASH WORKING CAPITAL - MANAGEMENT FEES</u>

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

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

Q. Does this conclude your testimony in this case?

A. Yes, it does.