

STATE OF MISSOURI  
PUBLIC SERVICE COMMISSION

TRANSCRIPT OF PROCEEDINGS

Evidentiary Hearing  
October 30, 2008  
Jefferson City, Missouri

Volume 9

In the Matter of )  
Missouri-American Water )  
Company's Request For )  
Authority To Implement A )  
General Rate Increase For ) Case No. WR-2008-0311  
Water and Sewer Service )  
Provided In Missouri )  
Service Areas )

KENNARD L. JONES, Presiding,  
SENIOR REGULATORY LAW JUDGE.

JEFF DAVIS, Chairman,  
CONNIE MURRAY,  
ROBERT M. CLAYTON III,  
TERRY JARRETT,  
KEVIN GUNN,  
COMMISSIONERS.

REPORTED BY:

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1 P R O C E E D I N G S

2 (ALL EXHIBITS, UNLESS OTHERWISE NOTED,  
3 WERE PREMARKED FOR IDENTIFICATION PRIOR TO THE  
4 HEARING.)

5 JUDGE JONES: Let's go ahead and go on  
6 the record. This is Case No. WR-2008-0311 consolidated  
7 with SR-2008-0312, In the Matter of Missouri-American  
8 Water Company's Request for Authority to Implement a  
9 General Rate Case for Water and Sewer Service  
10 Provided in Missouri Service Areas. My name is  
11 Kennard Jones. I'm the presiding judge over this  
12 matter.

13 At this time let's take entries of  
14 appearances. And I'm taken to believe that you-all  
15 have turned in entries of appearance to the court  
16 reporter, so you don't need to repeat your address  
17 and all of that. Just say your name and who you  
18 represent for purposes of brevity, of course.

19 Let's start with Missouri-American  
20 Water.

21 MR. ENGLAND: Thank you, your Honor.  
22 Let the record reflect the appearance of W.R. England  
23 on behalf of Missouri-American Water Company. Also  
24 appearing on behalf of the company are my partners  
25 Dean Cooper and Paul Boudreau as well as John

1 Reichert who is an attorney with the company. Thank  
2 you.

3 JUDGE JONES: And Office of Public  
4 Counsel.

5 MS. BAKER: Thank you, your Honor.  
6 Christina Baker appearing for the Office of the  
7 Public Counsel.

8 JUDGE JONES: Staff of the Commission.

9 MS. BRUEGGEMANN: Your Honor, Shelley  
10 Brueggemann representing Staff of the Commission  
11 along with the General Counsel Kevin Thompson, and  
12 Steve Reed will also be participating in this  
13 evidentiary hearing.

14 JUDGE JONES: Missouri Energy Group.

15 MS. LANGENECKERT: Lisa Langeneckert  
16 appearing on behalf of Missouri Energy Group. Good  
17 morning.

18 JUDGE JONES: Good morning. City of  
19 Riverside and Missouri Gaming Company.

20 MR. BEDNAR: Joseph Bednar and Matt  
21 Turner with City of Riverside, Missouri Gaming  
22 Company, as well as John McClelland.

23 JUDGE JONES: Ag Processing.

24 MR. CONRAD: Stu Conrad and also David  
25 Woodsmall for Ag Processing.

1 JUDGE JONES: City of Jefferson.

2 MR. COMLEY: Good morning, Judge Jones.

3 Let the record reflect the entry of Mark W. Comley  
4 with Newman, Comley & Ruth, P.C. on behalf of the  
5 City of Jefferson.

6 JUDGE JONES: Missouri Industrial Energy  
7 Consumers.

8 MS. VUYLSTEKE: Diana Vuylsteke of the  
9 law firm of Bryan Cave.

10 JUDGE JONES: Utility Workers Union of  
11 America Local 335.

12 (NO RESPONSE.)

13 JUDGE JONES: Not here? City of Joplin.

14 MR. ELLINGER: Good morning, Judge. Let  
15 the record reflect Marc Ellinger with the law firm of  
16 Blitz, Bardgett & Deutsch on behalf of the City of  
17 Joplin. Also appearing may be Mr. Tim Schwarz.

18 JUDGE JONES: Public Water Supply  
19 District Nos. 1 and 2 of Andrew County and Public  
20 Water Supply District No. 1 of DeKalb County.

21 MR. DORITY: Thank you, your Honor.  
22 Larry W. Dority and James M. Fischer, Fischer &  
23 Dority, PC, appearing on behalf of Intervenor Public  
24 Water Supply District Nos. 1 and 2 of Andrew County  
25 and Public Water Supply District No. 1 of DeKalb

1 County. Thank you.

2 JUDGE JONES: Thank you. Metropolitan  
3 Sewer -- St. Louis Sewer District.

4 MR. FRANCIS: Thank you, your Honor.  
5 Byron Francis and Jacqueline Ulin Levey from Armstrong  
6 Teasdale on behalf of Metropolitan St. Louis Sewer  
7 District.

8 JUDGE JONES: Is there anyone I've  
9 missed?

10 (NO RESPONSE.)

11 JUDGE JONES: Doesn't look like it.  
12 Okay. First we're going to deal with some  
13 outstanding motions. There have been motions to file  
14 statements of positions out of time. Those motions  
15 are granted.

16 Also there was a motion filed to -- by  
17 the union filed to reclassify documents, but because  
18 that union isn't here today, that motion still  
19 stands. They haven't moved, so to speak.

20 Also a couple of housekeeping notes.  
21 There is a holiday during the process of this  
22 hearing. We don't intend to have the hearing on that  
23 day unless we're behind. If we're behind then we  
24 will meet on the holiday.

25 Also November 5th, the day after the



1 election, I think people will probably be up late  
2 that night, so if we're not behind at that point,  
3 then we might be able to start late the following  
4 day.

5                   And let's see. And on November 4th, I  
6 don't know, if anyone's unable to vote before or  
7 after, we may take a two-hour lunch that day so  
8 people are able to eat and vote.

9                   And also today we have a 12 o'clock  
10 agenda. We'll break at a quarter till 12 and take a  
11 two-hour lunch. And in that lunch, of course, will  
12 be agenda and the time to eat.

13                   Is there anything else anyone has on  
14 their mind they think needs to be discussed before we  
15 get started with opening statements?

16                   MS. BRUEGGEMANN: Your Honor, I would  
17 make a motion to allow the parties, if they so wish,  
18 to make mini openings or openings before each issue  
19 if they feel they want to explain it a little bit.

20                   JUDGE JONES: Well, if we're going to do  
21 that, then it has to start today. In other words,  
22 the opening that you give today should be relevant  
23 only to the issues that we're dealing with today. In  
24 other words, you know, we'd have to hear your whole  
25 opening over the whole case and then hear other

1 openings throughout the hearing.

2 Does anyone have any opinion on that?

3 Mr. England? I see your forehead wrinkling.

4 MR. ENGLAND: It's in a perpetual  
5 wrinkle, your Honor. Ms. Brueggemann articulated  
6 kind of a concern that I had last night. I had  
7 worked on an opening for revenue requirement issues,  
8 but as you probably see, there are a number of them  
9 from the joint issue list, so I was only going to  
10 highlight those that I thought were of particular  
11 significance or noteworthy.

12 I don't know that I've got an objection  
13 to individual openings before each -- each issue.  
14 The problem is in some cases we have out of town  
15 witnesses who we'd like to get on and off the witness  
16 stand that may address more than one issue, and I'm  
17 not sure how we handle an opening at that time.

18 So with that, as I said, I don't know  
19 that I've got an objection, but it could get a little  
20 confusing where we have one issue addressed -- or one  
21 issue addressing multiple issues.

22 JUDGE JONES: Okay. Mr. Conrad.

23 MR. CONRAD: We certainly don't have any  
24 objection to Staff counsel's suggestion. Indeed, in  
25 my experience sometimes doing it that way is helpful

1 to the bench because it helps to orient to what the  
2 particular issue of the day or the hour or the minute  
3 may be. I'm sensitive to Water Company counsel's  
4 comment, though, and perhaps, you know, there's a way  
5 around that. I won't have an objection, Mr. England,  
6 if -- or, Judge, if Mr. England wants to do a broader  
7 statement at this point and then just -- and then  
8 just lift up the high points.

9 JUDGE JONES: Mr. Dority.

10 MR. DORITY: Your Honor, I really don't  
11 have a position on that particular point, but I would  
12 note that the parties did indicate that we would be  
13 able to reserve our openings on the rate design/cost  
14 of service issues until that portion of the hearing,  
15 and I certainly intended to take advantage of that  
16 opportunity. Thank you.

17 JUDGE JONES: Well, I tell you what  
18 we'll do then. I'm going to think about it, but in  
19 the meantime I'll give you this guidance. If you're  
20 compelled to give an opening as if there were a jury  
21 sitting up here, then I'll allow you that freedom.  
22 But keep in mind that we do have time constraints.  
23 This is a long hearing and openings can be quite  
24 verbose, and if it looks like your opening is going  
25 to go on and on and on, I'll be rude and interrupt

1     you and ask you to be quiet and have a seat.

2                     So if that's okay with you-all, then  
3     perhaps we'll proceed that way. Is there anything  
4     else?

5                     (NO RESPONSE.)

6                     JUDGE JONES: Okay. Take a pause and  
7     I'll go gather the other three Commissioners and  
8     we'll get started with opening statements today.

9                     (A RECESS WAS TAKEN.)

10                    JUDGE JONES: Okay. Let's go ahead and  
11    get started with opening statements starting with  
12    Missouri-American.

13                    MR. ENGLAND: Good morning. May it  
14    please the Commission. I'm Trip England. I  
15    represent the water company in this case that will  
16    from time to time be referred to as Missouri-American  
17    Company, MAWC, and hopefully nothing worse than that.

18                    As you know, the Missouri-American Water  
19    Company has filed a rate case with the Commission  
20    seeking to increase water revenues by approximately  
21    \$49 million on an annualized basis, or approximately  
22    26.4 percent, and sewer revenues by approximately  
23    133,000 or 28.7 percent.

24                    As a result of prehearing conference,  
25    the parties, believe it or not, were able to narrow

1 some of their differences, unfortunately not all.  
2 And as you will see from the joint list of issues,  
3 there are, depending on how you count them,  
4 approximately 28 issues involving revenue requirement  
5 which basically amount to issues regarding revenues,  
6 expenses, return on equity, capital structure.

7                   And then there are approximately 15  
8 issues or subissues relating to rate design which is,  
9 once you determine the revenue requirement, how are  
10 you going to parse it among the various districts,  
11 and from there, how are you going to parse among the  
12 various customer classes and the rates that they will  
13 ultimately pay?

14                   I had intended to make an opening  
15 statement on the revenue requirement issues today,  
16 but in light of Staff counsel's suggestion or request  
17 that we make individual opening statements before  
18 various issues, I will limit myself to just the  
19 issues that will be tried today and possibly carried  
20 over tomorrow, that being the appropriate return on  
21 equity and the appropriate capital structure to be  
22 utilized for purposes of setting rates in this case.

23                   On the issue of return on equity, the  
24 company has retained the services of Ms. Pauline  
25 Ahern. She's a principal with the consulting firm of

1 AUS, and she has done this work before, for  
2 Missouri-American at least, in its most recent two  
3 rate cases prior to this case.

4 Ms. Ahern has performed a detailed  
5 analysis and used four different models: The  
6 discounted cash flow model or DCF, the risk premium  
7 model, the capital asset pricing model, sometimes  
8 called CAPM, and a comparable earnings analysis, all  
9 of which led her to an ultimate conclusion or  
10 recommendation of 11.25 percent as an appropriate  
11 return on equity for the Missouri-American Water  
12 Company.

13 Now, this 11.25 percent compares to  
14 Staff's recommended midpoint range on equity of 10.10  
15 percent and Intervenor MIEC's recommended return on  
16 equity of 10.03 percent. The difference in these  
17 numbers, however, is not nearly as wide as it might  
18 first appear. Although Staff relied almost  
19 exclusively on a DCF analysis to arrive at a  
20 recommended range on returns of equity from 9.59 on  
21 the low side to 10.59 on the high side, it did  
22 perform a check of its DCF results utilizing two  
23 versions of the CAPM approach, one of which indicated  
24 an appropriate return on equity of 11.27 percent, a  
25 figure that compares very favorably with that of

1 company witnesses -- company witness Ahern.

2 MIEC witness Janous undertook three  
3 different versions of the DCF, a CAPM analysis and a  
4 risk premium analysis, using both water and natural  
5 gas proxy groups. His constant growth DCF model  
6 resulted in a 10.51 percent return on equity for the  
7 gas proxy group and a 12.96 return on equity for the  
8 water proxy group with the midpoint of those two  
9 groups at 11.74 percent.

10 Similarly, his CAPM analysis generated a  
11 10.76 midpoint for the gas proxy groups and an 11.28  
12 percent midpoint for the water proxy group. Although  
13 Mr. Janous has either fully or partially discarded  
14 these results in arriving at his ultimate  
15 recommendation, it is clear that Ms. Ahern's  
16 recommendation is well within the range of reasonable  
17 outcomes, and this has become even more evident in  
18 light of current market conditions.

19 The issue of capital structure is also  
20 an important one and one that you will hear in the  
21 next two days. It is addressed primarily by company  
22 witness Scott Rungren. Mr. Rungren recommends that  
23 the Commission use the actual standalone capital  
24 structure of Missouri-American Water Company at the  
25 end of the true-up period which is September 30th,

1 2008.

2                   Staff witness Barnes, on the other hand,  
3 recommends that the consolidated capital structure of  
4 Missouri-American's parent company, that is, American  
5 Water Works, be used for purposes of determining an  
6 overall rate of return.

7                   It is appropriate to use  
8 Missouri-American's capital structure to establish an  
9 authorized rate of return in this case for several  
10 reasons. First, Missouri-American is a separate  
11 corporate entity. It is not a division of its parent  
12 company. Missouri-American issues its own debt and  
13 equity, and when it issues debt, it is the primary --  
14 excuse me -- the sole obligor on that debt. It  
15 maintains a separate capital structure that is  
16 independently determined by its management, not by  
17 American Water Works.

18                   This is significant because this  
19 independent or standalone capital structure  
20 represents the actual capital that finances the  
21 company's jurisdictional rate base to which the  
22 overall rate of return established in this case will  
23 be applied.

24                   Moreover, Missouri-American's capital  
25 structure, that is its balance between debt and



1 equity, is a reasonable one for ratemaking purposes.  
2 This is demonstrated by the fact that its debt equity  
3 ratios are consistent with those maintained on  
4 average by the water proxy group that is utilized  
5 both by company and Staff in this case.

6                   It is also worth noting that MIEC  
7 witness Mr. Janous applied his recommended return on  
8 equity to Missouri-American's standalone capital  
9 structure in calculating an overall rate of return.

10                   Now, Staff attempts to justify the use  
11 of its parent company consolidated capital structure  
12 based on prior Commission decisions involving MGE and  
13 Aquila prior to Aquila's acquisition by Great Plains.  
14 But Staff's analogy or comparison is flawed as these  
15 utilities, MGE and Aquila, are not separate corporate  
16 entities distinct and apart from the -- a parent  
17 company. They were operating divisions of a larger  
18 company.

19                   The utility operating divisions of  
20 Missouri Gas Energy and Aquila did not issue their  
21 own debt and equity, and therefore, the Commission  
22 was left with either using the parent company capital  
23 structure in those cases or creating a hypothetical  
24 or allocated capital structure in those cases. So  
25 there's a very big distinction between what was done

1 for Missouri Gas Energy and Aquila in past cases and  
2 what you have before you here today.

3 Most significantly is that Staff  
4 presents no evidence that Missouri-American's  
5 standalone capital structure is unreasonable. In  
6 fact, it can't do that because Missouri-American's  
7 capital structure is four square in line with the  
8 average capital structure of Staff's own water proxy  
9 group. There is simply no justifiable reason for  
10 deviating from Missouri-American's standalone capital  
11 structure for purposes of setting rates in this case.

12 That's all I have. Thank you for the  
13 opportunity for this opening.

14 JUDGE JONES: Thank you. Next we'll  
15 have opening from Staff.

16 MR. THOMPSON: Good morning.

17 JUDGE JONES: Good morning.

18 MR. THOMPSON: May it please the  
19 Commission. I'm going to, like Mr. England, address  
20 only the cost of capital issues that we're going hear  
21 today and tomorrow, and you'll hear additional  
22 opening statements from Staff prior to each of the  
23 topics that we take up during this hearing.

24 Cost of capital is one of the single  
25 most important issues and one of the most troubling

1 issues that you have to address in a rate case. It  
2 is a matter with respect to return on common equity  
3 of expert estimation.

4               You will hear three experts in the  
5 course of this proceeding telling you what the  
6 appropriate cost of common equity for this company  
7 is. For Staff, you will hear from Matt Barnes; for  
8 the company, you will hear from Pauline Ahern; and  
9 from the Missouri Industrial Energy Consumers Group,  
10 you will hear from Brian Janous.

11              First, the issue of capital structure.  
12 In many respects, that issue has become less  
13 troublesome over the passage of time because Staff  
14 has moved closer to the company's view with respect  
15 to the quantity or ratio of common equity in the  
16 capital structure.

17              Staff originally took the position that  
18 the company's capital structure included 42.85  
19 percent equity, but in rebuttal, Staff moved to  
20 46.53, closer to the company's position of 47.65.  
21 And I'm told by my expert, Mr. Barnes, that on  
22 true-up, Staff expects to move even closer to the  
23 company figure. So for all practical purposes, that  
24 issue has become much less important.

25              I will say, however, with respect to the

1     theoretical basis of which capital structure to use,  
2     this Commission has, to my knowledge, always used the  
3     consolidated capital structure of the parent that is  
4     publicly traded, rather than the purported capital  
5     structure of the subsidiary, the operating company,  
6     which is a captive of that parent. I urge you to  
7     continue to adhere to this Commission's traditional  
8     approach with respect to capital structure.

9                 In the area of cost of common equity,  
10    the company witness has recommended a range 11.075 to  
11    11.425, midpoint 11.25. Mr. Janous, the expert for  
12    the Missouri Industrial Energy Consumers, has  
13    recommended a range from 9.96 to 10.09 with a  
14    midpoint of 10.03. Mr. Barnes for Staff has  
15    calculated a range from 9.6 to 10.6 with a midpoint  
16    at 10.10.

17                The figures recommended by Mr. Barnes  
18    and Mr. Janous are clustered slightly above  
19    10 percent. The figure recommended by Ms. Ahern, on  
20    the other hand, is quite a bit higher, 11.25. And I  
21    should point out that that includes an adder of two  
22    and a half basis points that she applied because  
23    Missouri-American is smaller in terms of total  
24    capitalization than the average of her proxy group of  
25    water companies.

1                   Staff's recommendation and the  
2   recommendation of Mr. Janous are only seven basis  
3   points apart. Ms. Ahern's recommendation is 115  
4   basis points higher than that of Mr. Barnes, 122  
5   basis points higher than that of Janous. In fact,  
6   the low end of Ms. Ahern's recommendation even  
7   without the adder is higher than the high end of  
8   either of the other two recommendations. The highest  
9   figure recommended by Janous and Barnes is below the  
10   low end of the company witness recommendation, even  
11   removing the adder.

12                   Over the past several years, you've seen  
13   many witnesses for utilities of different sorts  
14   recommending high common equity values. You know as  
15   well as I do that the company prefers a high number.  
16   That means higher rates. That means higher profits.  
17   And their witnesses have always delivered high  
18   numbers. It's clear that financial analysis is an  
19   art, not a science. Therefore, you need to take into  
20   account the motivations of the parties that are  
21   offering each of these recommendations.

22                   Missouri-American is a good company. It  
23   deserves a fair and reasonable return on common  
24   equity. Your duty under the law is to award it a  
25   fair and reasonable return on common equity. The

1 Constitution requires that the company has an  
2 opportunity to earn a reasonable return on the net  
3 value of the property that has been committed to the  
4 public service.

5 That value, however, should not be such  
6 as to provide a windfall. It should be commensurate  
7 to the returns earned by similar companies of similar  
8 risk. Thank you.

9 JUDGE JONES: Thank you. Now we'll have  
10 opening from Missouri Energy Group.

11 MS. LANGENECKERT: The Missouri Energy  
12 Group has no opening statement at this time.

13 JUDGE JONES: Thank you. City of  
14 Riverside?

15 MR. BEDNAR: No opening statement.  
16 We'll reserve for rate design and cost of service.

17 JUDGE JONES: Ag Processing?

18 MR. CONRAD: Your Honor, we have no  
19 opening on this issue.

20 JUDGE JONES: City of Jefferson?

21 MR. COMLEY: Likewise, we have no  
22 opening. Thank you.

23 JUDGE JONES: Missouri Industrial Energy  
24 Consumers?

25 MS. VUYLSTEKE: MIEC has no opening

1 statement.

2 JUDGE JONES: City of Joplin?

3 MR. ELLINGER: City of Joplin has no  
4 opening at this time.

5 JUDGE JONES: Public Districts?

6 MR. DORITY: Your Honor, the Public  
7 Water Supply Districts have not taken a position on  
8 most of the revenue requirement issues. Our  
9 participation will focus on the rate design cost of  
10 service and we will reserve any opening until those  
11 issues are taken up at that portion of the hearing.  
12 Thank you.

13 JUDGE JONES: Thank you. Metropolitan  
14 St. Louis Sewer District?

15 MR. FRANCIS: Metropolitan St. Louis  
16 Sewer District has no opening at this time. We'll  
17 reserve our opening for the rate design issues.

18 JUDGE JONES: Okay. Missouri-American,  
19 you can call your first witness. Oh, I'm sorry,  
20 Public Counsel.

21 MS. BAKER: You know I do. But it's  
22 short. The Office of the Public Counsel has no  
23 testimony that's been filed on the issues of return  
24 on equity capital structure, but Public Counsel would  
25 like to take this opportunity to speak in front of

1 the Commission to state that the customers do need to  
2 be protected in -- in these issues.

3 The economy is suffering, returns are  
4 falling and the customers depend on this Commission  
5 to approve rates that are fair and reasonable.  
6 Public Counsel asks that the Commission take this  
7 into account and look very carefully at the proposals  
8 before it to ensure that the return on equity and  
9 capital structure that is approved be fair and  
10 reasonable for the customers who are affected by it.  
11 Thank you very much.

12 JUDGE JONES: Thank you. And now we'll  
13 have Missouri-American's first witness.

14 MR. ENGLAND: Your Honor, our first  
15 witness is Ms. Pauline Ahern, and my partner  
16 Mr. Boudreau will be conducting the examination. We  
17 also have premarked Ms. Ahern's testimony, and we'll  
18 await your instructions as to how to handle that.

19 JUDGE JONES: Ms. Ahern, will you please  
20 raise your right hand?

21 (The witness was sworn.)

22 JUDGE JONES: Thank you, ma'am. You may  
23 be seated. Mr. Boudreau, you may proceed.

24 MR. BOUDREAU: May it please the  
25 Commission.



1 JUDGE JONES: Please.

2 DIRECT EXAMINATION BY MR. BOUDREAU:

3 Q. Would you state your name for the  
4 record, please.

5 A. My name is Pauline N. Ahern, A-h-e-r-n.

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

8 A. I am a principal with AUS, which is A --  
9 capital A, capital U, capital S, Consultants in Mount  
10 Laurel, New Jersey.

11 Q. And are you here to testify on behalf of  
12 Missouri-American Water Company?

13 A. Yes, I am.

14 Q. And on the issue of return on equity?

15 A. Yes.

16 Q. Are you the same Ms. Ahern who has  
17 caused to be filed prepared direct, rebuttal and  
18 surrebuttal testimony which has been marked for  
19 identification as Exhibits MAWC 1, 2 and 3?

20 A. Yes, I am.

21 Q. Was that testimony prepared by you or  
22 under your direct supervision?

23 A. Yes.

24 Q. Do you have any corrections that you  
25 need to make to any of your prefiled testimony at

1 this time?

2 A. I have two corrections to make to the  
3 rebuttal testimony which I believe is MAWC 2.

4 Q. Would you direct us to the changes that  
5 you would like to make?

6 A. The first is on page 10, line 10 before  
7 the phrase "security market line," the word "the,"  
8 t-h-e, should be inserted. And on page 21, line 1,  
9 it should be "Mr. Janous" instead of "Mr. Barnes."  
10 And that's the extent of my corrections.

11 Q. Okay. Thank you. Normally these  
12 questions are somewhat routine. You filed your  
13 direct testimony in the spring of this year; is that  
14 correct?

15 A. Yes.

16 Q. And since the time of the filing of your  
17 direct testimony which contains your ultimate  
18 recommendation of this Commission, we've had some  
19 changes in the financial markets, haven't we?

20 A. Yes, we have.

21 Q. And would you characterize them as  
22 being -- or would you agree with my characterization  
23 that they've been unprecedented?

24 A. Yes, I would.

25 Q. And they're fairly recent -- they're

1 fairly recent events, at least in the -- in the  
2 popular news as we know them, right?

3 A. Yes.

4 Q. And so the question -- the reason I  
5 premise this is that given these current  
6 developments, if I were to ask you the same questions  
7 as are contained in your testimony that was prefiled,  
8 would your answers be substantially the same?

9 A. Substantially. The -- to qualify that,  
10 my recommendation has not changed nor is the company  
11 changing its requested ROE of 11.25 percent. But my  
12 opinion, the recent events in the capital markets  
13 have just shown that the 11.25 percent is imminently  
14 more reasonable now than it was at the time.

15 MR. BOUDREAU: Okay. With that, I will  
16 tender the witness for cross-examination and offer  
17 Exhibits MAWC 1, 2 and 3 into the record.

18 JUDGE JONES: Are there any objections  
19 to Exhibits -- Exhibits MAWC 1, 2 or 3?

20 (NO RESPONSE.)

21 JUDGE JONES: Seeing none, they are  
22 admitted into the record.

23 (MAWC EXHIBIT NOS. 1, 2 AND 3 WERE  
24 RECEIVED INTO EVIDENCE AND MADE A PART OF THE  
25 RECORD.)

1 JUDGE JONES: And we will start with  
2 cross-examination from Jefferson City.

3 MR. COMLEY: Your Honor, Jefferson City  
4 will have no cross-examination for Ms. Ahern on this  
5 issue. It does not have any cross-examination for  
6 Mr. Rungren, Mr. Barnes or Mr. Janous. The court may  
7 skip Jefferson City in sequence of cross-examination  
8 of these witnesses.

9 JUDGE JONES: The City of Riverside have  
10 any cross?

11 MR. BEDNAR: No cross, your Honor.

12 JUDGE JONES: Parkville?

13 (NO RESPONSE.)

14 JUDGE JONES: The Water Districts?

15 MR. DORITY: Your Honor, I would echo  
16 Mr. Comley's remarks. Thank you.

17 JUDGE JONES: City of Joplin?

18 MR. ELLINGER: Your Honor, I would also  
19 join in Mr. Comley's remarks with respect to the City  
20 of Joplin.

21 JUDGE JONES: MSD?

22 MR. FRANCIS: Likewise, your Honor. We  
23 would -- Mr. Comley's remarks are appropriate for us  
24 as well.

25 JUDGE JONES: MEG?

1 MS. LANGENECKERT: MEG will have no  
2 cross-examination for any of these witnesses on this  
3 issue.

4 JUDGE JONES: MIEC?

5 MS. VUYLSTEKE: MIEC has no  
6 cross-examination for this witness.

7 JUDGE JONES: AGP?

8 MR. CONRAD: No questions, your Honor.

9 JUDGE JONES: And Public Counsel?

10 MS. BAKER: Public Counsel has no cross  
11 for this witness, but we do reserve the right for  
12 cross of the other witnesses if necessary.

13 JUDGE JONES: Staff of the Commission?

14 MR. THOMPSON: I have some cross, your  
15 Honor. I don't see why that's funny.

16 CROSS-EXAMINATION BY MR. THOMPSON:

17 Q. Good morning -- good morning, Ms. Ahern.

18 A. Good morning.

19 Q. Now, in your analysis that your  
20 recommendation is based upon, you used certain  
21 mathematical methods; is that correct?

22 A. Yes.

23 Q. And in using mathematical formulas, it's  
24 true, is it not, that the result is dependent upon  
25 the input?

1           A.       Yes, to a certain extent. It's also  
2 dependent upon the form of those mathematical models.  
3 There are many forms of the DCF, the CAPM risk  
4 premium. It also depends on the particular version  
5 you're using.

6           Q.       Yes, ma'am. But with respect to the  
7 versions that you used, the result that you obtained  
8 is dependent upon the inputs that you used in working  
9 each of those formulas; is that not correct?

10          A.       Yes, it's dependent upon the inputs, but  
11 it's also dependent upon my judgment as to the value  
12 of those inputs and the reasonableness of those  
13 inputs given certain market conditions and given the  
14 standards of Hope and Bluefield.

15          Q.       Yes, ma'am. I understand that your  
16 selection of inputs was a matter of professional  
17 judgment, but nonetheless, in a purely mathematical  
18 sense, it is true that the results obtained through  
19 working any mathematical formula is dependent upon  
20 the inputs?

21          A.       The -- yes, the results obtained from  
22 the mathematical models are results of the inputs.  
23 My recommendation is a result of my application of  
24 informed judgment to those results.

25          Q.       So it's true, is it not, that the

1 results you obtained in your analysis was driven by  
2 the inputs that you selected?

3 A. No. It is driven by my judgment, it is  
4 driven by the form of the models I used as well as  
5 the inputs.

6 Q. Now, Ms. Ahern, you will agree with me,  
7 will you not, that the company benefits from a higher  
8 ROE rather than a lower ROE?

9 A. I would agree, all else equal. The  
10 outcome of this rate case depends on many, many  
11 factors other than the ROE.

12 Q. Yes, ma'am. But the company still  
13 prefers a higher cost of common equity rather than a  
14 lower one; isn't that true?

15 A. They've not told me that, no. They rely  
16 on me to look -- to apply the models, to look at  
17 them, apply my informed expert judgment and to come  
18 up with a rate of return. They have never indicated  
19 to me what they wish that rate of return to be, high  
20 or low, point estimate or missing.

21 Q. Now, you've been compensated for your  
22 work in this case, haven't you?

23 A. My company has been compensated.

24 Q. How much, do you know?

25 A. Personally I only receive a salary from

1 my company.

2 Q. How much has your company been  
3 compensated, ma'am?

4 A. I do not know off the top of my head.

5 Q. What is the rate that your company  
6 charges for your services?

7 A. The -- my services are charged -- here  
8 it is ready to file, a fixed fee for the direct  
9 testimony. And off the top of my head, I don't know.  
10 I'm sure it's in the rate case expense reports. My  
11 typical hourly rate is 210, my -- I mean, \$210 per  
12 hour.

13 The supporting staff is anywhere from  
14 100 to \$125 an hour. Clerical help is 60 to \$65 an  
15 hour. Since I utilize my staff, there's usually a  
16 composite rate which is less than the 210. What it  
17 is, I don't know without looking back at specific  
18 invoices.

19 Q. So do you keep track of your hours?

20 A. Post filing, yes.

21 Q. So how many hours have you expended in  
22 this case?

23 A. Without checking invoices, I do not  
24 know.

25 Q. You have no idea?



1           A.       No.

2           Q.       Who would know?

3           A.       As I said, it would probably be in the  
4       invoices and in the rate case expense reports.

5           Q.       Now, you were asked some questions by  
6       Mr. Boudreau having to do with recent changes in the  
7       national economy. Do you recall those questions?

8           A.       Yes -- yes, I do.

9           Q.       And are you aware that the Federal  
10       Reserve Board has recently reduced the prime rate?

11          A.       I'm aware the Federal Reserve Board has  
12       recently reduced the Fed Funds rate, banks reduced  
13       the fine.

14          Q.       That's all, Ms. Ahern. Very good. And  
15       what is the Fed Funds rate today?

16          A.       It is one percent, and I'm also aware  
17       that as the Fed Fund --

18                   MR. THOMPSON: Thank you for your  
19       answer, ma'am. I have no further questions of this  
20       witness.

21                   JUDGE JONES: We'll have questions from  
22       the Commission beginning with Commissioner Murray.

23       QUESTIONS BY COMMISSIONER MURRAY:

24          Q.       Good morning.

25          A.       Good morning.

1           Q.       I would like to know if you could  
2     characterize your position as to the effects of the  
3     recent happenings in the market and those effects on  
4     ROE. You made the statement that recent events have  
5     shown that the 11.25 percent was even more reasonable  
6     than it was at the time you filed your testimony,  
7     your direct testimony, I assume.

8           A.       Yes.

9           Q.       And I'd just like you to explain why it  
10    is you say that.

11          A.       The reason I say that is right now it's  
12    multifaceted. Right now we're in an unprecedented  
13    credit and stock market environment. It is extremely  
14    risky. Money is extremely tight. The investment  
15    banks aren't lending, the investors aren't investing.  
16    The market went up significantly two days ago, much  
17    of which had to do with hedge funds and short  
18    selling. It also has to do with people coming in  
19    wanting to buy low. It doesn't mean that money is  
20    flowing back into equities.

21                 And basic principle of risk and return,  
22    as the investment markets are riskier, the return  
23    acquired by investors, be it in debt instruments or  
24    in equity instruments, rises. The cost of capital  
25    has increased even though the models may not -- may

1 not show it.

2 As I was trying to explain with the last  
3 question, although the Fed Funds rate has fallen, the  
4 relationship of the Fed Funds rate to public utility  
5 bond yields has increased, the spread has increased  
6 tremendously. And I have a little chart -- I only  
7 have one copy -- that shows the Fed Funds rate has  
8 been declining. This is October '08. And these are  
9 A-rated public utility bond yields.

10 As of October 28th, Moody's was  
11 reporting an A-rated public utility bond yield of  
12 7.94 percent. The last A-rated public utility bond  
13 yield, which I had in my direct exhibit on page 2 of  
14 Schedule PMA-11, was an average for January '02, it  
15 was 6.02 percent. So since the time of the  
16 preparation of my testimony, A-rated public utility  
17 bond yields have risen nearly 200 basis points.

18 BBBs, BAA in January '08 were 6.35  
19 percent. And as of October 28, they were 9.18. My  
20 recommendation of 11.25 represents a risk premium  
21 over the 6.02 A-rated public utility bond yield from  
22 January of about 523 basis points. As of the 28th  
23 and relative to the 7.94 A-rated public utility bond  
24 yield, it represents that risk premium has fallen to  
25 330 basis points.

1                   So -- and as -- and we know, as interest  
2 rates rise, the cost of equity rises. It does not  
3 rise in tandem, but it will rise as well. So that's  
4 why I say the 11.25 is even more reasonable relative  
5 to these capital markets because it provides for a  
6 lower risk premium over the cost of debt.

7           Q.       Can -- can you explain why investors  
8 today are unable to receive either the bond yields or  
9 the high rate of return on equities that has -- you  
10 know, you're -- you're saying, and I've heard other  
11 people say, that the cost of equity and the cost of  
12 debt have risen, however, investors don't seem to be  
13 recognizing that.

14          A.       In my opinion, I think what you're  
15 asking, why are they not investing, I think? I think  
16 there's a fear on the part of both lenders and equity  
17 investors about investing in the current turbulent  
18 market. And I think the reasons are also multifold.  
19 Part of it is -- is the election. In any election  
20 year, you have uncertainty in the markets until the  
21 election is decided and we know who the players are  
22 going to be in the new administration.

23                   We also have a -- everybody is --  
24 there's a flight to quality, and I think the  
25 investment bankers right now are putting -- they're

1 not lending. There's very little lending going on.  
2 And they're putting their money under their  
3 proverbial mattress as well.

4           The White House came out, I think it was  
5 on Monday, and actually admonished them and said, you  
6 know, please, start -- start releasing your money.  
7 And it really has nothing to do with the Fed Funds  
8 rate, even though the Federal Reserve is lowering  
9 that rate so that the banks will lend to each other  
10 and there will be some liquidity in the credit  
11 market. But the banks just aren't lending.

12       Q.       So in other words, for an investor to  
13 have the incentive to either invest in equities or in  
14 debt, they're going to have to receive a higher  
15 percentage than they would have before to encourage  
16 them to invest?

17       A.       Correct. And -- and -- and there's  
18 another side to that coin as well. If people -- if  
19 lenders aren't lending and the equity investors  
20 aren't investing, then utilities -- where are  
21 utilities going to get their financing for the  
22 capital expenditures that they need to expend,  
23 whether it be a water utility, electric utility for a  
24 power plant or gas for their pipes? It's going to  
25 have to come from somewhere. It's going to have to

4                   And there are three ways to finance your  
5   capital expenditures; one is the debt, the equity  
6   or -- or -- or cash flow. And until the investors  
7   start flocking back -- I believe they will.

9                               We'll have a better idea of where we're  
10   going over the next few months, but that it's going  
11   to take several quarters, year and a half to two  
12   years I believe is what Paulson and Bernanke are  
13   saying, for us to really kind of get out of the  
14   recession, the low -- the fear.

21 COMMISSIONER MURRAY: Okay. Thank you.

22 I appreciate that explanation.

24 JUDGE JONES: Commissioner Clayton?

1 minutes?

2 JUDGE JONES: Sure. Commissioner  
3 Jarrett?

4 QUESTIONS BY COMMISSIONER JARRETT:

5 Q. Good morning.

6 A. Good morning.

7 Q. I had just a few questions. You know,  
8 one of the issues that was discussed in the opening  
9 statements was the capital structure, which is the  
10 appropriate capital structure to use, whether it's  
11 Missouri-American Water standalone or whether it's  
12 the consolidated American Water's capital structure.

13 And I believe you used the  
14 Missouri-American capital structure in determining  
15 your -- when using your calculations; is that  
16 correct?

17 A. Correct. I used what the company was  
18 proposing through Mr. Rungren.

19 Q. Right. Do you know if -- if you were to  
20 use the consolidated, the American Water capital  
21 structure, what would that do to your numbers?  
22 Would -- would that increase the -- the rate, the  
23 final rate of return or the return on equity or would  
24 it lower it?

25 A. It would not alter my return on equity

1 recommendation necessarily. It might, to the extent  
2 that the common equity ratio on a consolidated basis  
3 is significantly different from Mr. Rungren's common  
4 equity ratio. That 11.25 relative to that common  
5 equity ratio. Off the top of my head I don't know  
6 the differences between the two without checking.

7                   If there were, say, ten percentage  
8 points between them, that would reflect -- the  
9 consolidated would reflect a different level of  
10 financial risk and that would impact the 11.25. I  
11 believe the equity ratios are significantly close  
12 enough that my recommendation would not change.

13           Q.       Okay. I also had a question about your  
14 adder. If you could just describe, first of all, why  
15 an adder is needed and then how you came up with the  
16 number.

17           A.       Okay. The -- you're talking about the  
18 two -- 2.5 percent --

19           Q.       Yes.

20           A.       -- you know, the small size? Well, as I  
21 just said, risk equals return, and size is a risk  
22 factor that must be considered in any common equity  
23 cost rate calculation. The proxy companies that I  
24 used are on average significantly larger than  
25 Missouri-American in total. I believe one proxy



1 group is not and the other one is significantly  
2 larger, but on average they are larger than  
3 Missouri-American.

4 Ibbotson & Associates has done a study  
5 of the companies on the New York Stock Exchange, the  
6 NYSE and the NASDAQ, broken them into deciles by size,  
7 and they have determined that -- they've used a  
8 capital asset pricing model -- and determined that  
9 over time, from '26 to 2007, that size matters, that  
10 the smaller the size of the decile, the greater the  
11 actual return earned on the stock market return, it  
12 was greater than what was predicted by the capital  
13 asset pricing model. And the conclusion is that the  
14 models are not picking up size as a factor.

15 So they have a series of premiums  
16 according to each decile, and my analysis estimated  
17 market capitalization for Missouri-American, compared  
18 it to the market capitalization of the proxy  
19 companies, determined where in those deciles the  
20 groups would fall and where Missouri-American would  
21 fall, what the appropriate premiums were for each of  
22 the deciles relative to the groups and  
23 Missouri-American, and took the difference between  
24 them.

25 And if my recollection is correct, I

1 think for the one proxy group it was zero, for the  
2 other -- they were in the same decile as the first  
3 proxy group -- for the second proxy group, it was 78  
4 basis points or .78 percent.

5                   And then I used my judgment and  
6 determined that I thought, you know, 78 percent,  
7 while that is appropriate, I mean, that would have,  
8 you know, increased my -- my ROE to 12 percent or  
9 more, and recognizing that what is likely to -- to  
10 flow out of any regulatory proceeding, I determined  
11 that, you know, to -- to be more conservative and  
12 recommended 2.5 percent.

13           Q.       All right. I assume that you read or  
14 reviewed Mr. Barnes' rebuttal testimony?

15           A.       Yes.

16           Q.       Okay. I guess a bone of contention in  
17 that is the use of -- your use of arithmetic means.  
18 And I think he discussed in his -- why that was not  
19 appropriate, and I wanted to give you a chance to  
20 tell us why you believe it is appropriate.

21           A.       Okay. Again, it goes back to the basic  
22 financial principle of risk and return. Investors  
23 base their required returns, make their investment  
24 decisions based on the perceived risk of the  
25 investment in which they're going to invest. The

1 geometric mean does not consider that risk. The  
2 arithmetic mean does.

3           If you look in my rebuttal exhibit  
4 which, I guess, it's MAWC 2, Schedule PMA-16, page 1,  
5 that plots all the returns on the broad market, the  
6 S&P 500 large company stock returns from 1926 to  
7 2007, and you can see that they're -- they're all  
8 over the place. The -- there's a great deal of  
9 volatility in the returns.

10           The arithmetic mean when calculated,  
11 would -- is the arithmetic mean of every single one  
12 of those returns. The geometric mean is calculated  
13 from the first point and the last point only, and  
14 doesn't take into account all of the intervening --  
15 the intervening volatility, and therefore, it doesn't  
16 really reflect the risk.

17           And I think in my surrebuttal, I likened  
18 it to, you know, reading a book on the Civil War,  
19 reading the first page and last page and presuming to  
20 know what happened in the Civil War. And I think  
21 we've seen now with the way the markets are behaving  
22 that it's even more important to reflect that  
23 volatility.

24           People will say, well, you know, we  
25 don't necessarily need to because, you know, we don't

1 have another Great Depression or another World War,  
2 but the effects of those events, it's clear that can  
3 happen again because they are happening now, and the  
4 arithmetic mean will reflect that volatility.

5 Q. Now, I'm looking on Mr. Barnes' rebuttal  
6 testimony, page 7.

7 A. Okay. Just give me a minute, please.

8 Q. Starting down on line 18.

9 A. Yes.

10 Q. And first of all, he indicates that the  
11 reason why it is not a good tool is because it  
12 assumes that investors don't sell -- it -- I guess it  
13 assumes that investors don't hold on to utility  
14 stocks for the long term. Do you believe that -- do  
15 you -- first of all, do you agree with that? Do you  
16 think people that buy utility stocks, buy and sell,  
17 speculate with utility stocks?

18 A. Well, I think because there's trading in  
19 utility stocks every single day that -- that the  
20 typical utility investor is not buying it with the  
21 intention of holding it for the long term. They're  
22 buying it, they -- they're going to hold it as long  
23 as they think they're receiving a return, then  
24 they're hoping to sell it for a -- you know, for  
25 capital appreciation at a higher price. And in doing

1 that, they are interested in the year-to-year  
2 fluctuations, and what -- what can they expect?

3 I think every investor buys a stock and  
4 assumes they're going to hold it until they can get  
5 the return that they -- they require. So I -- they  
6 use -- they are -- because they are traded on a daily  
7 basis, I think it is important to -- to capture those  
8 variations by using the arithmetic mean.

9 Q. So you no longer, I guess, agree with  
10 the old conventional wisdom that, you know, widows  
11 and orphans buy utility stocks for the -- for the  
12 dividends and hold on to them for that purpose?

13 A. No, no. Let me -- let me find  
14 something. Utility stocks are no longer viewed as  
15 the -- the safe income investment that they -- they  
16 have been in the past. If I can find it.

17 Q. What have utility stocks done in regards  
18 to the broader market? I mean, are they -- are they  
19 as volatile as, say, GM or the banks or...

20 A. They have been -- the times I have  
21 checked them, they have been following the broader  
22 market. Maybe not to the extent. I know I checked  
23 them a couple of weeks ago, the day the market went  
24 down about 8 percent, and most of the water stocks  
25 went down about 5, 6 percent. So they are following

1 as well.

2 Q. Right. And what did the broader Dow  
3 Jones drop, 40 percent?

4 A. I -- well, I was just looking one day.

5 Q. Oh.

6 A. No. Actually, I -- I did see recently  
7 that the utility sector has fallen about 30 percent  
8 over that same time period. I believe S&P published  
9 that. But they're not -- you -- you're seeing an  
10 increasing number of institutional holders of utility  
11 stocks. There was a time when individual investors  
12 were up in the -- 70 percent of the stocks were held  
13 by individual investors. Now it's -- it's down  
14 closer to 50 to 55.

15 Q. I have just one more question. I was  
16 looking at your table 4 in your direct on page 64. I  
17 believe it's a summary of all of your calculations on  
18 ROE.

19 A. Okay.

20 Q. And I notice that if you use the  
21 discounted cash flow model, it has a range for 9.86  
22 to 10.23.

23 A. Uh-huh.

24 Q. Your risk premium model, 11 to 11.31;  
25 your capital asset pricing model, 10.8 to 11.42 and

1    then your comparable earnings model, 14.13 to 14.0.  
2    Did you -- in coming up with your range of 11.05 --  
3    11.075 to 11.425, did you -- did you average all four  
4    of those?

5           A.       No, I did not. I -- again, I used  
6    informed judgment. I looked at all four of them, the  
7    results of all four models for both groups, and  
8    really looked at the preponderance of -- of the  
9    returns. And if you look at the risk premium capital  
10   asset pricing model, they all cluster around  
11   11 percent.

12                    They actually -- there was premium and  
13   CAPMs for the one group for the sixth, averages 10.9,  
14   and for the four is 11.37. And I -- you know, giving  
15   some weight or some judgment to both comparable  
16   earnings, very little to comparable earnings because  
17   I do believe that that is -- while it may be an  
18   investor-required return, again, looking back at what  
19   regulators are likely to do, investors will temper  
20   that requirement knowing the outcomes of rate cases.  
21   I determined that the 11.05 to 11.04 was a reasonable  
22   range given the eight results shown there.

23           Q.       So correct me if I'm wrong, but if I  
24   heard you correctly, you weighted the risk premium  
25   model and capital asset pricing model a little bit

1 more than the discounted cash flow and comparable  
2 earnings model?

3 A. Correct, given that they appeared to  
4 be -- be outliers. But I can't give you a  
5 mathematical weighting again. It is a judgment.

6 Q. Judgment. Okay. Thank you. That's all  
7 I have.

8 JUDGE JONES: Commissioner Gunn?

9 COMMISSIONER GUNN: Yeah, I just have  
10 a -- I have a couple questions.

11 QUESTIONS BY COMMISSIONER GUNN:

12 Q. I -- I just want to clarify some of the  
13 things, and some of my questions have -- have already  
14 been asked, and I apologize for that. But in between  
15 the time you did your initial analysis and today --

16 A. Uh-huh.

17 Q. -- you -- you testified that there's  
18 been an unprecedented change in the financial markets  
19 including -- and I -- and I -- you didn't say this,  
20 but I'll paraphrase it -- including really basically  
21 the collapse of all pure investment banking in the  
22 United States where we don't have any pure investment  
23 banks anymore. The -- the two that were left were  
24 converted to holding companies so they can accept  
25 commercial deposits.



1                   Fed rate's been cut, you've had  
2   government infusion into -- into this, and the  
3   markets really don't look any -- credit markets have  
4   deferred essentially. As you've testified, access to  
5   money -- people are not lending money. I'm just  
6   curious that -- that we've had -- we've had that kind  
7   of unprecedented change in the markets and yet your  
8   recommendation is exactly the same for what the ROE  
9   should be?

10           A.       I have not updated. If I were to update  
11   based on the -- the models and the market data at  
12   that time, that would be my recommendation based on  
13   those results. I can say that for current cases I'm  
14   involved in, my recommendations are higher. They  
15   would be -- be tempered.

16                   But I believe the question is, if, you  
17   know, asked those same questions based on that same  
18   data, I would rather stick with the 11 -- 11.25. The  
19   data are now showing a trend towards higher -- higher  
20   results, and the company has chosen not to -- for  
21   whatever reason, a reason I don't know, they have  
22   chosen to stick with their original 11.25.

23           Q.       Which is a separate issue. When they  
24   choose not to go higher, that's a separate issue from  
25   what your testimony is, because what you've said was,

1 is -- is that taking into account all of those  
2 factors, your ROE recommendation is even more  
3 reasonable today.

4                   And it seems to me that we've had -- had  
5 such a change in the way that the market looks  
6 that -- that it seems -- it seems to imply that if  
7 you had done this -- that -- that when you did the  
8 analysis originally, that it was unreasonable because  
9 of the unprecedented market forces they have going.

10                   Now, if the company has -- decides that  
11 for whatever reason they don't want to ask for a  
12 higher ROE than 11.25, that's perfectly  
13 understandable. But -- but in my mind, and maybe I  
14 want to give you the opportunity to explain it, there  
15 seems to be a huge disconnect --

16           A.       I understand.

17           Q.       -- between -- between your initial  
18 analysis, the unprecedented -- as you said,  
19 unprecedented market conditions that have occurred  
20 and the fact that when you run it through that same  
21 analysis, that you said that you believe that this  
22 number is exactly the same, as a matter of fact, it's  
23 even more reasonable?

24           A.       Okay. I mean, let me -- that -- that  
25 was maybe poorly phrased. Let me -- let me explain.

1 Based on the market data at the time, the 11.25 was  
2 reasonable. Based upon current market data, if I  
3 were to -- to do the analysis today, a recommendation  
4 flowing out of today's market data would be -- be  
5 close to 12 percent.

6 But what I'm saying is, I am --  
7 nevertheless, I have not changed my recommendation  
8 based on that market data, so the 11.25 stands. And  
9 I was not -- not part of my -- the scope of my  
10 assignment to provide an update at this time.

11 But yes, I do believe that the cost of  
12 equity has -- has increased. Looking at current  
13 market data for a water company, it's -- it's upwards  
14 of 12 percent. And what I meant when it was more  
15 reasonable, as -- as I explained with Commissioner  
16 Murray, reasonable in terms relative to the bond  
17 yields at each -- each time. I think a risk premium  
18 of 330 basis points can be considered more  
19 reasonable, more conservative than one of over 400.  
20 That's what I meant by -- by more reasonable.

21 Q. Well, let me -- I -- and I'm -- I  
22 planned on asking the same question to -- to  
23 Mr. Barnes and some of the other -- other witnesses.

24 Given the market conditions and given  
25 the change in the market conditions, are any of your

1 assumptions valid or should they all be redone based  
2 on what we've seen in -- in literally the last three  
3 weeks?

4 A. They probably should be redone almost on  
5 a daily basis because it's such a fluid market right  
6 now.

7 Q. Well -- and obviously --

8 A. Yeah.

9 Q. -- we can't do that.

10 A. Right.

11 Q. But -- but in terms of -- in terms of  
12 the snapshot -- market conditions fluctuate, but  
13 we've had such a dramatic change in where we are and,  
14 quite frankly, I don't know what the effect is on the  
15 credit markets and -- and access to -- to -- to money  
16 and credit as it exists today.

17 A. Uh-huh.

18 Q. And you're saying that -- that people  
19 aren't lending and I agree with that, but I don't  
20 know if we've taken into account those sorts of -- of  
21 impacts on -- on what an ROE should -- and whether --  
22 and there may -- it may be perfectly acceptable to  
23 say that since the cost of money has become cheaper  
24 because rates are going down, and -- and we -- we may  
25 see a translation in -- in -- in -- with the Fed rate

1 going down and some of the other -- other costs of  
2 capital becoming cheaper, that -- that the -- the  
3 risk or that the -- the credit freeze and the  
4 difficulty with access to capital may balance each  
5 other out --

6 A. Uh-huh.

7 Q. -- and we may come out in exactly the  
8 same place. But I want to follow up on -- on what  
9 Commissioner Jarrett asked. And you said that the  
10 utility stocks have basically tracked what the market  
11 has done, or that's your belief, that the utility  
12 stocks have basically tracked what the market's done?

13 A. Based on my sampling, yes.

14 Q. So they've been no more -- no more  
15 volatile or less volatile than -- and I think your  
16 probably using bank stocks and GM are probably not  
17 the two best --

18 A. Right.

19 Q. -- because of -- of where those ended  
20 up. But the utility stocks have probably been less  
21 volatile than bank stocks or automaker stocks?

22 A. I would say yes, though everybody's  
23 tracking down, but yes.

24 Q. Right, anecdotally?

25 A. Right.

1           Q.       And -- and they're probably -- and you  
2   said that -- that these institutional investors and  
3   other people are not going into the utility stocks.  
4   Where are they going if they're not --

5           A.       I'm sorry. They are. We have seen  
6   over -- more institutional investors over the years.

7           Q.       Let me -- you're absolutely right. You  
8   did say that. Let me -- let me track back. You said  
9   that people are not using the utility stocks as the  
10  income investment that they had been previously.

11          A.       Correct.

12          Q.       As Commissioner Jarrett said, the widows  
13  and orphans that -- that buy this as the most stable  
14  stocks. If they're not going to utility stocks,  
15  where are they going?

16          A.       I don't know. I believe we've seen this  
17  increase in investor -- institutional investors  
18  because they're viewed more now as growth stocks. I  
19  don't know where they're going -- well, they may be  
20  going into treasury bonds. I -- I don't know where,  
21  you know, they've flown from utility stocks.

22          Q.       How do -- how do water company stocks  
23  compare to the other stocks in the utility sector?  
24  Are they more or less volatile?

25          A.       Well, based on the betas, they're more

1 volatile. The betas of utility stocks, I think I  
2 have in my rebuttal testimony, have increased  
3 significantly over the last six or seven years  
4 relative to energy, the electric and the gas.

5 Electric and gas stock volatility has  
6 increased as well, but the water utility stock  
7 volatility is approaching that of the other sectors  
8 of the utility industry.

9 Q. Has increased, but it's not at the same  
10 level yet?

11 A. Actually, the betas for the water  
12 companies are higher than for the electric and for  
13 the gas companies.

14 Q. Okay. Because I thought you just said  
15 that they're approaching, that the water --

16 A. Well, they have approached and  
17 surpassed.

18 Q. All right.

19 A. You know, it's surpassed.

20 Q. All right.

21 A. There was a bigger gap earlier, and  
22 they're closed up and gone past them.

23 Q. I'm still learning this stuff, so we've  
24 got to be specific.

25 A. Okay. I'm sorry, I'm sorry.

1           Q.       You can't -- you can't assume that  
2 I'm -- that I understand what you're saying --

3           A.       I'm sorry.

4           Q.       -- on the first part. So -- so the  
5 water -- water stocks in the utility sector are as  
6 volatile or more volatile than the electricity stock?

7           A.       On average.

8           Q.       On average?

9           A.       Yes.

10          Q.       All right. What about Missouri-American  
11 Water compared to those?

12          A.       Well, because it's not publicly traded,  
13 I -- it does not have a beta. And American Water --

14          Q.       American Water.

15          A.       Amer -- I say American Water, the  
16 parent, has too short a track record in terms of --  
17 since the IPO to calculate a beta that would be -- be  
18 comparable. But I've also looked at them and they  
19 have been moving in the last couple of months in  
20 similar fashion to the rest of the water utility  
21 stocks. You know, if their -- water stocks have been  
22 moving down on average 5, 6 percent in one day, they  
23 would move similarly.

24          Q.       And are you -- I'll switch subjects  
25 here. Are you saying that the institutional



1 investors are trying to time the market here now with  
2 utility stocks and they're trying to essentially buy  
3 low and sell high rather than holding and -- and --  
4 and believing that the -- the utility stocks will pay  
5 dividends and will eventually increase in value?

6 A. I can't get in the mind of what -- what  
7 they're doing with utility stocks. I just know that  
8 we're seeing more institutional investors in utility  
9 stocks.

10 But I do think in the general broader  
11 market, we're seeing a lot of the -- the volatility  
12 for the buying low, selling high people coming in  
13 thinking we've hit the bottom, they're going to buy,  
14 and then, oh, gee, we go up really well and then they  
15 sell very quickly. I think this -- I haven't checked  
16 it, but I believe there's a significant amount of  
17 turnover.

18 We're also seeing hedge funds having to  
19 cover their short positions and there's a lot of  
20 movement there.

21 Q. Right. And hedge funds are a different  
22 story. But I'm talking about the institutional  
23 investors --

24 A. Right.

25 Q. -- that are holding -- holding funds

1     for, you know, pensions and things like that.

2             A.       Right.

3             Q.       Are they -- are they churning these  
4     stocks, are they buying and selling utility stocks,  
5     are they -- are they trying to buy low and sell high  
6     or are they -- are you talking about the rest of the  
7     market?

8             A.       Talking about both. I can't speak from  
9     having spoken with any institutional investors and  
10    whether or not that's what they're doing with utility  
11    stocks, but it appears that as utility stocks are,  
12    you know, tracking the market that this is what's  
13    happening in the market, that -- and I'm just making  
14    that -- I'm surmising that from looking at the rest  
15    of the market.

16                    I don't know what the turnover is for  
17    the institutional holders. I do know that they were  
18    holding, you know, large cash positions for a while  
19    because of the market, and now they are switching  
20    their positions to -- you know, to maintain their  
21    returns. So there's an awful lot of buying and  
22    selling going on. In which particular sector I'm not  
23    sure, and how long they're holding utility stocks  
24    before they sell them.

25             Q.       So we don't really know whether the

1 investors are -- are -- are flocking away from  
2 utility stocks as a sound -- as a -- as a solid  
3 income investment because we don't know whether --

4 A. Well --

5 Q. -- I mean, the large institutional folks  
6 are -- are -- are -- are different -- have a  
7 different mindset than the hedge funds --

8 A. Right.

9 Q. -- and have a different mindset than the  
10 individual folks and have a different mindset than --  
11 than day traders.

12 A. Right.

13 Q. And they -- and you said they hold maybe  
14 50 percent of the -- of the stuff that's being --

15 A. Well, now they're -- they're holding  
16 more. They're up to, you know, 60 or 70. It used to  
17 be the other way around. Institutional -- the  
18 proportion of institutional investors has increased,  
19 and typically, institutional investors are  
20 growth-oriented, not income-oriented. It's the  
21 individual investors that are income-oriented.

22 And we've seen greater positions by  
23 institutional investors in water utility stocks which  
24 shows a shift in their thinking that the water stocks  
25 are becoming growth stocks or all utility stocks are

1 becoming growth stocks rather than the safe income  
2 investment that they had been in the past.

3 Q. Even under the current market condition?

4 A. Even -- yes, the numbers are showing  
5 that. The numbers that we're using in all of our  
6 models are -- are going to take some time to catch up  
7 with the current market conditions, you know.

8 COMMISSIONER GUNN: Okay. Thank you. I  
9 appreciate it. That's all the questions I have.

10 JUDGE JONES: Commissioner Clayton?

11 QUESTIONS BY COMMISSIONER CLAYTON:

12 Q. Ms. Ahern, thank you. I have a number  
13 of questions here, and I apologize for duplication if  
14 I repeat some other questions.

15 First of all, can you give me a little  
16 history of -- of your relationship with American  
17 Water? Have you testified in prior cases in other  
18 states?

19 A. Yes, I have. I've testified here a  
20 couple of times, I've testified -- whether it was  
21 settled or not, I was the cost of capital witness  
22 in -- for Iowa American, Illinois American, Ohio  
23 American, New Jersey American, California American.  
24 I was also the cost of capital witness during the  
25 merger process when RWE acquired them.

1           Q.       Okay. Okay. So a number of different  
2 states. Do you recall the conclusion of your  
3 analysis on return on equity for those prior cases?

4           A.       No, other than I believe one of the  
5 witnesses has a tabulation of authorized returns for  
6 some of the other jurisdictions, and it -- it -- it  
7 would be in there.

8           Q.       It has -- it has the position that you  
9 advocated in comparison to what a commission  
10 eventually authorized, or it just has what was  
11 authorized by --

12          A.       Just what was authorized.

13          Q.       What was authorized. Is there a  
14 document anywhere that would set out a little bit  
15 of -- a little bit of history of -- of your advocacy  
16 on behalf of ROEs for the company?

17          A.       I maintain one back at the office.

18          Q.       Is that something that you could supply  
19 to us --

20          A.       Yes.

21          Q.       -- with just a general idea of  
22 comparisons of what other subsidiaries of American  
23 Water Works should be earning from your point of  
24 view?

25          A.       In other words, you're -- you're looking

1 for what I recommended and what was authorized, then?

2 Q. How does Missouri compare to other  
3 states in terms of advocacy? There's a lot of  
4 discussion here about capital structure and the  
5 comparison between the parent and the subsidiary.  
6 And what I'm trying to get is a perspective of the  
7 difference of the -- of the various subsidiaries in  
8 terms of your analysis.

9 A. Okay. I can do that.

10 Q. Okay. Great. Also, I wanted to see --  
11 I wanted to follow up on a question by Mr. Thompson.  
12 I just want a general idea of -- of the compensation  
13 that firm has received. I don't need a detailed  
14 bill, and I --

15 A. Okay.

16 Q. -- you stated that you don't know the  
17 answer to that. Is that something that you could  
18 provide --

19 A. Yes.

20 Q. -- in terms of number of hours that are  
21 either estimated and a general hourly rate, an idea  
22 of how much is going to be paid to your firm?

23 A. Would my -- if, I guess, the company  
24 agrees, would my invoices suffice?

25 Q. Certainly. Certainly. And I don't want

1 a whole package of --

2 A. I think there --

3 Q. -- I'm just asking for just a summary.

4 A. Okay.

5 Q. And if it's part of testimony somewhere,

6 then someone could identify that. But generally on

7 rate case expense, we're talking about normalization

8 and averaging and things like that. We don't

9 generally get into specifics of it, but if it's

10 somewhere else, let me know and I can look there.

11 A. Okay. I'll find out or we'll find out.

12 But you're primarily interested in hours and rates

13 and...

14 Q. Yeah, compensation, basically, is what

15 I'm --

16 A. But you just don't want the total

17 compensation, you want a breakdown, a little bit of

18 detail?

19 Q. Okay. I think the -- the general number

20 of hours and the compensation rate for a total would

21 be great.

22 A. Okay.

23 Q. I don't want to get into different staff

24 and everything else.

25 A. Like hours on a composite rate. Okay.

1           Q.       There's been some discussion about what  
2   is going on in the market today, the credit markets  
3   as well as the stock market.

4           A.       Uh-huh.

5           Q.       Have you been given any specific  
6   examples of American Water or Missouri-American Water  
7   trying to access capital in either market?

8           A.       No.

9           Q.       Okay. So you're not aware of any  
10  examples of where either the parent or the subsidiary  
11  or the financing subsidiary have had difficulty  
12  accessing capital or --

13          A.       No. The only reason I hesitated was, to  
14  the best of my knowledge, the equity market was the  
15  only access of the IPO last spring. I do not know  
16  what Cap Corp has -- has done subsequently,  
17  especially in the last several weeks. I think  
18  Mr. Rungren may be aware of that.

19          Q.       Okay. So -- so a lot of this discussion  
20  about what is going on in both the credit markets and  
21  the stock market is -- it's fairly speculative and  
22  it's looking at the markets as a whole rather than  
23  looking at what is going on with this particular  
24  company at this particular time?

25          A.       Yes and no. I've spoken with some



1 bankers who do loan to water utilities, and it's also  
2 based on that and specific to the utility industry.  
3 Missouri-American, American Water Capital  
4 specifically, I -- I have no direct knowledge.

5 Q. Okay. Relative to the market as a  
6 whole, are utilities having more difficulty or less  
7 difficulty in accessing capital in comparing to the  
8 market as a whole?

9 A. They -- I was informed by this banker  
10 that they're actually having more difficulty because  
11 of -- some of the spreads are greater, they can make  
12 more money by loaning to, you know, GE, GM and make  
13 some of the larger deals.

14 Q. So there's -- so there's less risk  
15 associated with GE or a retailer going into a  
16 recession or some other firms that -- that are based  
17 more on the economy as a whole than -- than there  
18 would be for a utility that has --

19 A. No, there's --

20 Q. -- fairly stable revenues?

21 A. No, there's actually more risk, but they  
22 make their money on the spread that's built into the  
23 loan covenant. And right now all the bankers want --  
24 you know, want to make money because they want  
25 liquidity. They're -- you know, they're scared.

1           Q.       So bankers are -- bankers are looking  
2   for more risk, is that what you're telling me right  
3   now?

4           A.       There's -- well --

5           Q.       I'm not sure if I buy that.

6           A.       Yeah, that's what it sounds like, but  
7   that's -- yes, that's what it sounds like. But I've  
8   also been told that the opportunity for -- for  
9   getting a loan, that's -- that's very short. You go  
10  in and you want to issue debt. And you know, usually  
11  these are the terms, you hash them out over several  
12  days, and now you're told if you get something, you  
13  know, close it in two hours because two hours from  
14  now, it may not be there, somebody else may have it.

15          Q.       Okay. But that would be -- that would  
16  be the case across the board, not just on utility?

17          A.       I heard that directed to utility.

18          Q.       Directed to utilities?

19          A.       To -- to -- directed to water utilities  
20  by bankers, yes.

21          Q.       Okay. So someone like GE would have an  
22  easier time than a utility? And I just use GE as an  
23  example because you mentioned it.

24          A.       Well, I think --

25          Q.       I'm having a hard time believing that.

1           A.       I know. Well, right now risk doesn't  
2     matter to them. There's a spread built in -- into  
3     some of these -- these -- these covenants. There's a  
4     spread over LIBOR relative to spread over prime.  
5     It's -- that's a bigger spread for some of the larger  
6     corporations. And they're -- they're placing bets,  
7     they're placing bets that they're going to be able to  
8     get that spread, and it really is not risk-driven.

9           Q.       I don't want to belabor this.

10          A.       Yeah.

11          Q.       It just seems that that -- that you  
12     tend -- it seems to me that you're contradicting  
13     yourself --

14          A.       Uh-huh.

15          Q.       -- saying that the markets are too  
16     scared to lend right now because there's so much  
17     risk, yet they're looking for the riskier stock to  
18     lend to and that's why the safer or less risky stock  
19     or -- or company can't access the credit markets, and  
20     that seems like it contradicts.

21          A.       Uh-huh. Yeah, I agree.

22          Q.       All right. Are you aware of any future  
23     plans for accessing capital, specific plans that are  
24     affected by the ongoing issues in both the credit  
25     markets and the stock market?

1           A.       You mean specifically for  
2   Missouri-American?

3           Q.       Yes.

4           A.       I'm not aware of them.

5           Q.       Okay. Are you aware of what the stock  
6   price of -- of American Water has done over the last,  
7   say, three to six months? You may have answered this  
8   for Commissioner Jarrett.

9           A.       No.

10          Q.       But you're not aware --

11          A.       Not over three to six months. I just  
12   know that one day I looked at it, that it was falling  
13   in the market.

14          Q.       Okay. So in preparation for today, you  
15   haven't reviewed to see what American Water's stock  
16   price has done in the course of -- of these difficult  
17   financial times?

18          A.       Correct, because they weren't part of my  
19   analysis.

20          Q.       Okay. Okay. Can you tell me whether or  
21   not Missouri-American's revenues should be expected  
22   to be volatile or subject to significant change  
23   during times of a recession or would they continue to  
24   remain relatively stable?

25          A.       I think that really depends on -- it

1 really depends on water usage both from, you know,  
2 industrial customers, commercial customers and from  
3 residential customers. If their service territory is  
4 severely impacted by the recession, and, you know,  
5 you have companies closing or a company -- you know,  
6 large companies closing for a week or two, and if  
7 water usage is impacted, then I do believe the  
8 revenues will be impacted.

9 But we always need water, so I think  
10 it -- they be -- they may be -- water utilities in  
11 general may be more insulated in terms of volatility  
12 of revenues than some other sectors of the economy.

13 Q. Can you explain to me whether the change  
14 in American Water's ownership structure, its IPO and  
15 its going from being a subsidiary of RWE and going to  
16 be partially, I guess, public now, and -- and -- and  
17 RWE was going to, I suppose, sell more shares, has  
18 that changed the cost of equity for Missouri-American  
19 Water?

20 A. No, it doesn't, because it's the use of  
21 the funds, not the source of the funds that give rise  
22 to the risk. Missouri-American's operations haven't  
23 changed in any way.

24 Q. Okay. Regarding capital structure,  
25 Mr. Barnes spent time discussing a concept known as

1 double leverage in the way Missouri-American is. Do  
2 you agree or disagree that Missouri-American Water is  
3 double-leveraged?

4 A. I would have to defer to Mr. Rungren. I  
5 can --

6 Q. You're the wrong witness?

7 A. I'm the wrong witness.

8 Q. Okay. I apologize. Can you explain to  
9 me again the difference between arithmetic and  
10 geometric averages that are used? Because I'm  
11 struggling with that.

12 A. Okay.

13 Q. And I suppose the way I was looking at  
14 it is that one looks at short-term volatility and one  
15 looks at long-term volatility or changes. And is  
16 that a correct way of looking at it?

17 A. Not really.

18 Q. Okay.

19 A. Not really. They both look at the  
20 long term. They look at the same set of data. The  
21 arithmetic mean is an average of every single data  
22 point. Therefore, it takes account of every single  
23 data point, whether it's high or it's low. It takes  
24 account of the variability. There's a standard  
25 deviation of volatility associated with the

1 arithmetic mean.

2                   The geometric mean will look at the same  
3 set of data, takes the beginning point, takes the  
4 ending point, calculate a difference, raise it to a  
5 certain power to annualize it and come up with  
6 another mean. It doesn't -- there's no standard  
7 deviation associated with the geometric mean;  
8 therefore, there's no reflection of volatility.

9                   The geometric mean is appropriate for  
10 measuring wealth over a period of time, much like  
11 your mutual fund, 401(k) or your pension fund, what  
12 the ending wealth might be. You cannot achieve that  
13 without actually earning the arithmetic mean over a  
14 period of time.

15                  And since risk is measured by the  
16 standard deviation of volatility, risk is very  
17 important to investors when they make their  
18 investment decisions. The arithmetic mean is the  
19 appropriate one to use for cost of capital purposes.  
20 Is that cleared up a little bit?

21           Q.       I think that's -- that's helpful --

22           A.       Okay.

23           Q.       -- helpful to understand your position.

24 I also want to ask you just a couple of questions in  
25 your analysis of Mr. Barnes' CAPM analysis --

1           A.       Okay.

2           Q.       -- or it may have been -- it wasn't --  
3     it may have been risk premium. I'm not sure which  
4     analysis it was.

5                   Specifically, you went in and -- and had  
6     a problem with the -- you had a problem with how he  
7     used, I believe it was the risk-free performance over  
8     time when subtracted from the overall market  
9     performance, and it should only include income rather  
10    than a total value. I think this was the first point  
11    that you made in your testimony.

12          A.       Right.

13          Q.       And I was wondering if you could  
14    elaborate on that.

15          A.       Okay.

16          Q.       Do you remember it?

17          A.       Uh-huh. I think it may be helpful to go  
18    to page 7 of my rebuttal testimony, and I think  
19    Ibbotson says it much better than I can paraphrase  
20    it.

21          Q.       I tried to find the Ibbotson book, and  
22    the only one...

23          A.       And I didn't bring mine this time.

24          Q.       The only one we have is the -- the 2008  
25    classic yearbook, the old classic --



1           A.       It --

2           Q.       -- which is a real page-turner, I'd add.

3           A.       May I look at it? Because it might be

4   in there.

5           Q.       I don't know if it's necessary, but I --

6           A.       Okay.

7           Q.       -- was trying to find the Ibbotson, so

8   please go ahead and I'll try to find your testimony.

9           A.       Okay. All right. Ibbotson says -- and

10   this is to paraphrase -- that the total return has

11   three components: Capital appreciation --

12          Q.       Yeah.

13          A.       -- the income or the yield and the

14   reinvestment return. The income return is what they

15   receive interest payments --

16          Q.       Sure, sure.

17          A.       -- the periodic interest payments. The

18   appreciation return, as Ibbotson says, results from

19   the price change of a bond over a specific period.

20   Prices change in reaction to unexpected fluctuations

21   in yields. Well, those unexpected fluctuations are

22   risky. There's a risk associated.

23                    The reinvestment return is when you

24   reinvest the income just like a dividend reinvestment

25   on a stock. Therefore, the component, the only

1 component of the three -- well -- well, not  
2 reinvestment. The only component of those three,  
3 especially in relation to capital appreciation that  
4 is risk-free, is the income return.

5               There's some risk involved in the -- the  
6 capital appreciation. There's some volatility in  
7 your capital appreciation. Your total return will  
8 go -- you know, will go up and down from period to  
9 period. That's why the income return should be used.

10              It is analogous to when we go forward,  
11 we put a -- if you put a perspective yield in or you  
12 use a current yield as a risk-free rate. You  
13 don't -- you don't use an estimate of the total  
14 return on the bonds, you use an estimate of the  
15 yield.

16              But the income return is the riskless  
17 portion. And the -- the -- that becomes more  
18 important the longer the term bond you're using. And  
19 he has used, as I've used, like a 30-year long bond  
20 in the capital asset pricing model rather than a  
21 short-term T-bill or a short -- shorter term T-note.  
22 And the reason we do that is because the assets are  
23 long-lived and stocks are long-lived. But you really  
24 need to remove that risk portion.

25              Q.       What I was trying to find -- I

1 understand that angle of it. I think what I was  
2 trying to find when I was searching in the library  
3 for Ibbotson is, does the market return simply just  
4 an income analysis, or does the -- that first figure  
5 where you'd subtract off the risk-free performance --

6 A. Oh, okay.

7 Q. -- shouldn't it also just include income  
8 rather than include the appreciation and reinvestment  
9 also?

10 A. No. That -- that -- what -- that total  
11 return is appreciation plus dividends, and that would  
12 also include any reinvestment. That should not  
13 include just the income return which would be the  
14 dividend yield only.

15 Q. So doesn't it -- doesn't the logic seem  
16 that if you use one set of analysis on -- on -- for  
17 one number, that you'd use the same data on the  
18 second?

19 A. No, because the capital -- capital asset  
20 pricing theory says that a -- the cost of equity is a  
21 risk-free rate plus a risk premium derived from a  
22 risk-free rate subtracted from a total return times  
23 beta.

24 And what I'm saying is, that when you  
25 look at a long bond, you need to look at the riskless

1 portion of the long bond as a proxy for the true  
2 risk-free rate, and that would be the income portion.  
3 It appears inconsistent because you're using --  
4 you're not using two total returns.

5 Q. Well, if you --

6 A. But point to capital asset pricing  
7 theory, it calls for risk-free rate. And typically,  
8 at a point in time, it can be -- originally it was  
9 the T-bills, but they tend to be too volatile.

10 Q. If a -- if a bond appreciates in value,  
11 it's still risk-free, correct? I mean, you can have  
12 an appreciation in the value of the investment which  
13 would be realized, and it's still risk-free. So why  
14 shouldn't that appreciation be included in the  
15 analysis?

16 A. Not if you hold it to maturity. And the  
17 presumption is just like the common stocks. If  
18 they're outstanding in perpetuity, and the --

19 Q. So we should make -- we should make a  
20 presumption that someone will hold a treasury bond  
21 for 30 years?

22 A. Capital asset pricing theory would --  
23 would -- would hold that, yeah.

24 Q. Would. Okay. Do you know what  
25 percentage of revenues Missouri-American contributes

1 to American Water Works' overall revenues?

2 A. No, I don't.

3 Q. You don't. Do you know how  
4 Missouri-American compares in size with all the other  
5 subsidiaries in the American Water family, so to  
6 speak?

7 A. Based on -- on the work I have done,  
8 it's among one of the -- I believe one of the larger  
9 ones, and again, maybe Mr. Rungren could -- could  
10 clarify that.

11 COMMISSIONER CLAYTON: Okay. I don't  
12 think I have any other questions. Thank you.

13 THE WITNESS: Thank you.

14 JUDGE JONES: Mr. Chairman?

15 QUESTIONS BY CHAIRMAN DAVIS:

16 Q. Going back to Mr. Thompson's  
17 cross-examination, did you have cause to look at the  
18 recommendations filed by Mr. Barnes in this case?

19 A. Yes, I did.

20 Q. Did you look at any of the variables  
21 that -- that Mr. Barnes used to -- to plug into his  
22 formulas for ROE, and did you -- did you think any of  
23 those variables might be low?

24 A. I looked at the various components that  
25 he plugged in, but I didn't analyze them or conclude

1     that they were low. I criticized some of them for  
2     being inappropriate from a conceptual point of view,  
3     one of them being the total return, the risk-free  
4     rate, and also, I believe, his use of a current or  
5     historical bond yield rather than a prospective bond  
6     yield.

7             Q.       Okay.

8             A.       But I didn't -- I don't believe I  
9     characterized any -- well, I characterized his  
10    results as -- as low compared with authorized returns  
11    in other jurisdictions, but not that any of the  
12    components were in any way particularly low or  
13    particularly high.

14            Q.       Okay. Just -- it was your opinion that  
15    some of them were inappropriate?

16            A.       Correct.

17            Q.       Okay. And any further thoughts on the  
18    testimony by MIEC's return on equity witness?

19            A.       No further thoughts than I put in both  
20    my rebuttal and surrebuttal.

21                   CHAIRMAN DAVIS: Okay. Thank you,  
22    Judge. No further questions.

23                   COMMISSIONER MURRAY: Judge?

24                   JUDGE JONES: Commissioner Murray.

25    QUESTIONS BY COMMISSIONER MURRAY:

1           Q.       I got a little confused in some of your  
2   question-and-answer period with Commissioner Clayton,  
3   and I just wanted to clarify something.  You -- you  
4   were talking at one point about the income portion of  
5   the long bond, correct?

6           A.       Right.

7           Q.       And is that income portion equivalent to  
8   the yield?

9           A.       Yes, it is.

10          Q.       And did I hear you call that risk-free?

11          A.       That is on a treasury bond that is the  
12   risk-free portion, yes.

13                   COMMISSIONER MURRAY:  Treasury.  Okay.  
14   Thank you.

15                   THE WITNESS:  You're welcome.

16                   JUDGE JONES:  And let's move on to  
17   recross.  Questions?

18                   MR. THOMPSON:  No questions, Judge.  
19   Thank you.

20                   JUDGE JONES:  Redirect?

21                   MR. BOUDREAU:  Yes, thank you, just a  
22   few.  Is it all right if I present my questions from  
23   here?

24                   JUDGE JONES:  That's fine.

25   REDIRECT EXAMINATION BY MR. BOUDREAU:

1           Q.       Ms. Ahern, I want to go back through and  
2       just follow up on some points that were discussed  
3       with a number of the commissioners.

4           A.       Okay.

5           Q.       Let me just go backward in time simply  
6       because that's the most current, I guess.

7                    I believe it was in connection with some  
8       of the questions that you got from -- from  
9       Commissioner Gunn, and you made a reference to betas  
10      I think in the context of talking about volatility.

11          A.       Yes.

12          Q.       And just so the record is clear, beta is  
13      a measure of volatility?

14          A.       Yes, it is. It's a measure of a -- the  
15      volatility of a particular security or stock market  
16      price relative to the volatility of the market as a  
17      whole.

18          Q.       Okay. And also, as concerns his  
19      questions about whether or not any of the assumptions  
20      or models are -- are reliable in current financial  
21      circumstances, from just a mechanical perspective,  
22      we're dealing with a true-up date of September 30th,  
23      2008 in this case; isn't that correct?

24          A.       Yes.

25          Q.       Okay. And I think you also said that --



1     that -- I don't know if it was a deficiency in the  
2     models, but you said the numbers -- the numbers that  
3     are out there to be plugged in are kind of lagging  
4     behind? I mean, I just kind of wanted to follow up.  
5     If you were to redo your models now --

6             A.       Uh-huh.

7             Q.       -- I mean, do you have a sufficient  
8     degree of -- of confidence that -- that the results  
9     that you get reflect current circumstances? And by  
10    "current," I'm talking about the end of October as we  
11    sit here.

12            A.       Yes. They would reflect current  
13    circumstances, and -- and -- because the -- both  
14    ratemaking and the cost of capital are prospective  
15    that the -- you know, the prices that investors are  
16    paying now, the analysts' earnings forecasts, the  
17    yields we're looking at, especially the -- the two  
18    that I just -- I've cited, the -- you know, that are  
19    high right now, the 793 for A-rates, that would be  
20    reflected in the analysis.

21                    It's -- what I meant when I said they  
22    lag is thinking of betas particularly, betas are  
23    calculated using five years' worth of data. Two --  
24    the Value Line ones are -- used 260 observations.

25                    And we've only seen this market

1 volatility for two months, eight, ten weeks. You  
2 take ten weeks off the front and add ten weeks on --  
3 on -- on the back, it's not going to have that much  
4 of an impact on beta at this point in time.

5 Q. Thank you for that. And you mentioned  
6 the bond yield. I'm glad you did that. And I think  
7 your testimony, you said "as of the 28th." And when  
8 you said "as of the 28th," you're referring to  
9 October the 28th?

10 A. October 28th, right.

11 Q. And what was the source of the  
12 information?

13 A. It was from Moody's web site.

14 Q. Okay. I believe in your discussion with  
15 Commissioner Murray, you referred to a chart that  
16 showed the Fed -- Fed Fund rates --

17 A. Yes.

18 Q. -- Fed Funds rate drop in the recent --  
19 well, let me go about it this way. Let me rephrase  
20 it. The Federal Reserve recently lowered the Fed  
21 Funds rate and you referred to a chart that you had  
22 to illustrate a point.

23 A. Yes.

24 Q. And the -- and the chart compared Fed  
25 Funds rate to what?

1           A.       Moody's A-rated public utility bond  
2 yields.

3           Q.       May I see the chart? Just as a  
4 mechanical matter, is this the only copy of this --  
5 this chart that you have?

6           A.       Yes, it is. You may have it.

7           Q.       Okay.

8           A.       And -- and --

9           Q.       So the -- so the document you just  
10 handed me was the chart that you were referring to in  
11 your conversation with Commissioner Murray?

12          A.       Yes. And it does not reflect either the  
13 A-rated bond yield from the 28th or yesterday's Fed  
14 Funds cut.

15                   MR. BOUDREAU: I think what I'd like to  
16 do is have this document marked as an exhibit. I  
17 don't have any other -- any copies beyond this. What  
18 I'd like to do is mark it as an exhibit, offer it  
19 into the record and I can have copies of it made for  
20 counsel.

21                   JUDGE JONES: Okay. Any objections?

22                   MR. THOMPSON: Well, I'm going to object  
23 because I haven't seen it. If I could have a moment,  
24 your Honor?

25                   JUDGE JONES: Sure.

1                   MR. THOMPSON: Could I voir dire just  
2 for a moment?

3                   JUDGE JONES: Yes, you may.

4 VOIR DIRE BY MR. THOMPSON:

5           Q.       This chart shows the Federal Funds rate  
6 compared to A-rated public utility bonds; isn't that  
7 correct?

8           A.       Correct.

9           Q.       Is Missouri-American A-rated?

10          A.       Missouri-American is not rated.

11          Q.       Is American Water Works A-rated?

12          A.       No.

13                  MR. THOMPSON: Thank you. I have no  
14 objections.

15                  JUDGE JONES: Okay. We'll mark that as  
16 MAWC 31.

17                  MR. BOUDREAU: Would you like me to go  
18 ahead and make copies and bring it back at a later  
19 time or have it marked now? Mechanically, how would  
20 you like this done?

21                  JUDGE JONES: We'll -- we'll take care  
22 of it at the break that we'll be having after you're  
23 finished questioning.

24                  MR. BOUDREAU: Okay. Very good. Thank  
25 you. Excuse me. I don't think I have any further

1 questions for this witness.

2 JUDGE JONES: Okay. Let's take a short  
3 five-minute break. We'll come back with Rungren.

4 (MAWC EXHIBIT NO. 31 WAS MARKED FOR  
5 IDENTIFICATION BY THE COURT REPORTER.)

6 (A RECESS WAS TAKEN.)

7 JUDGE JONES: Back on the record. I  
8 neglected to excuse Ms. Ahern. Ms. Ahern, you are  
9 excused.

10 THE WITNESS: Thank you.

11 JUDGE JONES: And Missouri-American, you  
12 can call your next witness.

13 MR. BOUDREAU: I'd like to call  
14 Mr. Scott Rungren to the stand, please.

15 JUDGE JONES: And Mr. Rungren, will you  
16 please raise your right hand?

17 (The witness was sworn.)

18 MR. BOUDREAU: May I proceed?

19 JUDGE JONES: Yes, you may.

20 DIRECT EXAMINATION BY MR. BOUDREAU:

21 Q. Mr. Rungren, will you say your name for  
22 the record, please.

23 A. My name is Scott Rungren.

24 Q. By whom are you employed and in what  
25 capacity, sir?

1           A.       I'm employed by American Water Service  
2 Company as a financial analyst III.

3           Q.       And you are here to testify on behalf of  
4 Missouri-American Water Company today?

5           A.       That's correct.

6           Q.       Are you the same Mr. Rungren who has  
7 caused to be filed prepared direct, rebuttal and  
8 surrebuttal testimony that have been marked as  
9 Exhibits -- or premarked as Exhibits MAWC 20, 21 and  
10 22, respectively?

11          A.       Yes.

12          Q.       Was that testimony prepared by you or  
13 under your direct supervision?

14          A.       Yes, it was.

15          Q.       Do you have any corrections you need to  
16 make in any of your items of testimony?

17          A.       Not at this time.

18          Q.       If I were to ask you the same questions  
19 as are contained in that prepared testimony, would  
20 your answers today be substantially the same?

21          A.       Yes, they would.

22          Q.       And would they be true and correct to  
23 the best of your information, knowledge and belief?

24          A.       Yes, they would.

25                 MR. BOUDREAU: With that, I will offer

1 Exhibits MAWC 20, 21 and 22 into the record and  
2 tender Mr. Rungren for cross-examination.

3 JUDGE JONES: Any objections?

4 MR. THOMPSON: No objections.

5 MR. BEDNAR: None.

6 JUDGE JONES: Exhibits MAWC 20, 21, 22  
7 are admitted into the record.

8 (MAWC EXHIBIT NOS. 20, 21 AND 22 WERE  
9 RECEIVED INTO EVIDENCE AND MADE A PART OF THE  
10 RECORD.)

11 JUDGE JONES: Cross-examination by  
12 Staff?

13 MR. THOMPSON: No questions.

14 JUDGE JONES: Cross-examination by the  
15 Office of Public Counsel?

16 MS. BAKER: No cross, thank you.

17 JUDGE JONES: Cross-examination from  
18 anyone else present?

19 (NO RESPONSE.)

20 JUDGE JONES: Okay. No  
21 cross-examination. Questions from the bench,  
22 Commissioner Murray?

23 COMMISSIONER MURRAY: No questions.

24 JUDGE JONES: Commissioner Clayton?

25 COMMISSIONER CLAYTON: Not from me

1     either, Judge.

2                   JUDGE JONES:  Commissioner Jarrett?

3                   COMMISSIONER JARRETT:  I will join in

4     the no-questions position.

5                   JUDGE JONES:  Commissioner Gunn?

6                   MR. THOMPSON:  No questions.

7                   JUDGE JONES:  You may step down,

8     Mr. Rungren, but I can't excuse you until I check

9     with the Chairman to see if he has questions for you.

10                  THE WITNESS:  Okay.

11                  JUDGE JONES:  Thank you.

12                  THE WITNESS:  Okay.

13                  JUDGE JONES:  We move on to Staff's

14     witnesses.

15                  MR. THOMPSON:  Your Honor, I would call

16     Matt Barnes at this time.

17                  JUDGE JONES:  Thank you.  Mr. Barnes,

18     will you please raise your right hand?

19                  (The witness was sworn.)

20                  JUDGE JONES:  Thank you, sir.  You may

21     be seated.

22     DIRECT EXAMINATION BY MR. THOMPSON:

23                  Q.     State your name, please.

24                  A.     Matthew J. Barnes.

25                  Q.     How are you employed?



1           A.       I'm employed as a utility regulatory  
2 auditor IV with the Missouri Public Service  
3 Commission.

4           Q.       And are you the same Matt Barnes that  
5 prepared and caused to be filed certain testimony in  
6 this case?

7           A.       Yes, I am.

8           Q.       And you contributed, did you not, to  
9 what's known as Staff's cost of service report which  
10 has been marked as Staff Exhibit No. 1?

11          A.       Yes.

12          Q.       And you also prepared and caused to be  
13 filed testimony marked as Staff Exhibit 3, Matt  
14 Barnes' -- excuse me -- Staff Exhibit 2, Matt Barnes'  
15 rebuttal testimony?

16          A.       Yes.

17          Q.       And that particular testimony you filed  
18 in two versions, NP and HC; is that correct?

19          A.       Yes.

20          Q.       And you also caused to be prepared and  
21 filed Staff Exhibit No. 3 which has been marked -- or  
22 excuse me -- which is Matt Barnes' surrebuttal  
23 testimony?

24          A.       Yes.

25          Q.       Okay. Do you have any corrections to

1 any of that testimony at this time?

2 A. No, I do not.

3 Q. And if I were to ask you the same  
4 questions today, would you give the same answers?

5 A. Yes, I would.

6 Q. And are the answers that you did give in  
7 the prepared testimony true and correct to the best  
8 of your knowledge and belief?

9 A. Yes, they are.

10 MR. THOMPSON: At this time I would move  
11 the admission of Exhibits -- Staff Exhibits 2 and 3.

12 MR. BOUDREAU: Just as a matter of  
13 clarification, Staff Exhibit 2 is?

14 MR. THOMPSON: Staff Exhibit 2 is  
15 Mr. Barnes' rebuttal testimony.

16 MR. BOUDREAU: So it's his rebuttal and  
17 surrebuttal?

18 MR. THOMPSON: Yes.

19 MR. BOUDREAU: Okay.

20 JUDGE JONES: Any objection to the  
21 admission of Staff's 2 and Staff 3 Exhibits?

22 (NO RESPONSE.)

23 JUDGE JONES: Seeing none, Exhibits  
24 Staff 2 and 3 are admitted into the record.

25 (STAFF EXHIBIT NOS. 2 AND 3 WERE RECEIVED

1 INTO EVIDENCE AND MADE A PART OF THE RECORD.)

2 BY MR. THOMPSON:

3 Q. Now, Mr. Barnes, has the status of the  
4 United States economy changed at all since you  
5 prepared the testimony that we've referred to?

6 A. Yes, it has.

7 Q. And were you here during the testimony  
8 of Ms. Ahern for the company?

9 A. Yes, I was.

10 Q. And you heard Ms. Ahern testify as to  
11 her understanding of the changes in the economy?

12 A. Yes.

13 Q. Do you have any comments to make with  
14 respect to the testimony Ms. Ahern gave live today as  
15 to how the economy has changed?

16 MR. BOUDREAU: Well, I'm going to object  
17 to this line of questions on -- and -- on -- on the  
18 grounds that basically it's surrebuttal testimony  
19 that was given by the other witness. I mean, I don't  
20 think I have a problem if he wants to direct some  
21 questions to Mr. Barnes along the lines that I did  
22 about whether his recommendations would be the same  
23 given current market circumstances, but to have him  
24 comment now on testimony that was given by another  
25 witness I think is inappropriate.

1 JUDGE JONES: I would consider it to be  
2 live direct, and your objection is because it should  
3 be surrebuttal? I --

4 MR. BOUDREAU: Well, I don't think -- I  
5 don't think live direct...

6 JUDGE JONES: You can cross-examine him  
7 on whatever he says.

8 MR. BOUDREAU: Well, I'm going to renew  
9 my objection. I think we have prepared direct,  
10 rebuttal and surrebuttal testimony. To offer  
11 additional direct testimony live I think is  
12 inconsistent with the rules that we've all agreed to  
13 in terms of how testimony is presented.

14 JUDGE JONES: Well, that may or may not  
15 be true, but it's not even relevant to the rules of  
16 evidence, so I have to overrule your objection.

17 MR. BOUDREAU: So just so I understand  
18 the ruling of the bench, the parties are allowed  
19 additional live direct testimony in this -- in  
20 this --

21 JUDGE JONES: Well, if you have direct  
22 testimony that you want to present and it can be  
23 subject to cross-examination, my understanding of  
24 prefiled testimony is that it helps the parties  
25 generally understand what their positions are and to

1     assert further a complicated case along. But there  
2     has been discussion today about current market  
3     conditions which weren't current when the testimony  
4     was initially filed.

5                   MR. BOUDREAU: Well, I guess -- I guess  
6     my point is that I thought at this point it was  
7     cross-examination. To the extent that there's  
8     additional direct, it's in response to the questions  
9     that are presented on cross. And I think this takes  
10    the company by surprise that there's to be additional  
11    commentary from one of the witnesses, which basically  
12    is, like I said, surrebuttal of testimony that she's  
13    given on the stand.

14                  JUDGE JONES: I understand what you're  
15    saying, but your objection isn't a legal objection.  
16    I -- I didn't study that at all in school. I  
17    don't -- I didn't even know what prefiled testimony  
18    was. So you can cross-examine him on whatever  
19    testimony he gives today.

20                  MR. BOUDREAU: Well, I think the  
21    establishment of a procedural schedule does follow  
22    the Commission's rules on how these things are  
23    supposed to be handled; that direct is prefiled along  
24    with whatever rounds of rebuttal testimony are  
25    permitted or agreed to, and this is basically outside

1 the scope of the procedural schedule that this  
2 Commission's already approved.

3 JUDGE JONES: Mr. Thompson?

4 MR. THOMPSON: Well, your Honor, it  
5 seems to me that Ms. Ahern was permitted to respond  
6 to questions from the company with respect to changes  
7 in economic conditions and whether or not she would  
8 change her recommendation, and I think that  
9 consequently, Staff has to be given the same leeway.

10 MR. BOUDREAU: And I have no objection  
11 to him asking his witness if his witness is changing  
12 his recommendation given current market  
13 circumstances. That was the line of questions that  
14 I -- or the question, the single question that I  
15 asked Ms. Ahern when she took the stand. And I don't  
16 have any objection to offering the same sort of  
17 latitude to counsel with his witness.

18 But to have his witness start commenting  
19 on what my witness said in -- in response to  
20 questions primarily from the bench, I think it's  
21 inappropriate, and I think it's outside the scope of  
22 what's contemplated in the procedural schedule.

23 MR. THOMPSON: Well, your Honor, I think  
24 the company is attempting to impede this Commission's  
25 understanding of a difficult question in tumultuous

1 financial and economic times, and I believe that  
2 Mr. Barnes should be given the opportunity to provide  
3 comments and response to Ms. Ahern's unexpected  
4 direct testimony today.

5 JUDGE JONES: I don't -- I don't recall,  
6 Mr. Thompson, if you had recross for Ms. Ahern. Did  
7 you?

8 MR. THOMPSON: I had no recross  
9 questions for her, no.

10 JUDGE JONES: Okay. Well, upon  
11 reflection, that may have been a proper time for you  
12 to ask her questions regarding these times, and  
13 perhaps Mr. -- Mr. Boudreau is correct in that  
14 Mr. Barnes should respond to what his direct  
15 testimony is and how it's modified by our current  
16 economic situation.

17 MR. THOMPSON: Well, if I could, Judge,  
18 if this were a trial in Circuit Court --

19 JUDGE JONES: Which it isn't.

20 MR. THOMPSON: Which it is not, but  
21 nonetheless, if this were, I would have the  
22 opportunity to present direct evidence and I would  
23 also have the opportunity to present rebuttal  
24 witnesses. What I want to elicit from Mr. Barnes is  
25 live rebuttal as opposed to live direct, and I

1 suggest to you that it's entirely correct -- proper.

2 JUDGE JONES: I disagree with you. I  
3 think your opportunity to get the information would  
4 have been for you to be talking to Mr. Barnes when  
5 Ms. Ahern was on the bench during questions from  
6 this -- from the -- or not on the bench, on the stand  
7 during questions from the bench and then ask her  
8 questions that he would otherwise contest in her  
9 position during recross, but you didn't ask her any  
10 recross.

11 MR. THOMPSON: That's true.

12 JUDGE JONES: I think that was your  
13 opportunity to address those issues. So I'm going to  
14 sustain the objection.

15 MR. THOMPSON: Very well, then.

16 BY MR. THOMPSON:

17 Q. Mr. Barnes, in light of the changes in  
18 the economic situation, do you have any change to  
19 your recommendation?

20 A. Not as -- as of this moment. I'd have  
21 to do another analysis to make that determination.

22 MR. THOMPSON: Thank you. I'll tender  
23 the witness for cross-examination.

24 JUDGE JONES: Cross-examination from --  
25 does AGP have any cross?



1                   MR. CONRAD: Well, just to ask a  
2 question or two here.

3 CROSS-EXAMINATION BY MR. CONRAD:

4           Q.       Mr. Barnes, has there been a -- at some  
5 point momentous change in the economy in the last  
6 couple of weeks?

7           A.       Yes, there has.

8           Q.       Could you comment on how that might  
9 affect your recommendation?

10          A.       It could affect the stock prices that  
11 are in my DCF model, but I don't know without doing  
12 another analysis.

13          Q.       So another analysis would be necessary?

14          A.       If the Commission were to order me to do  
15 another analysis, I would do it, but as of right now,  
16 I don't think it's necessary.

17          Q.       Okay. Would you agree with me that --  
18 that one of the problems with -- with doing that  
19 is -- right at this moment, it would be kind of  
20 difficult to say, everybody stop what you're doing so  
21 I can analyze it?

22          A.       Yes, I'd agree with that.

23          Q.       That -- that the markets are moving  
24 somewhat more rapidly than we have -- have seen?

25          A.       Yes.

1           Q.       Am I correct in recalling that the day  
2 before yesterday, it went up like 900 points?

3           A.       Yes, I believe that's correct.

4           Q.       And the following day it went down like  
5 200 or something?

6           A.       Yes.

7           Q.       Have you seen what it's doing today?

8           A.       Not as of this morning, no. I haven't  
9 seen it.

10          Q.       Do you realize that the GDP was down  
11 about 2 percent -- or two -- two-tenths of a percent  
12 or was it a half a percent?

13          A.       I don't know right now.

14          Q.       You didn't follow that?

15          A.       No.

16          Q.       You are aware of what the Federal  
17 Reserve Board did yesterday, are you not?

18          A.       Yes. They lowered the Fed Funds rate to  
19 1 percent.

20          Q.       From one and a half, right?

21          A.       Yes.

22          Q.       It was a half a percent drop?

23          A.       That's right.

24          Q.       Where do they go from here, Mr. Barnes?

25          A.       That I don't know.

1 MR. CONRAD: All right. Thank you.

2 Thank you, your Honor.

3 JUDGE JONES: Are there any -- is there  
4 any cross from MIEC?

5 MS. VUYLSTEKE: No cross, thank you.

6 JUDGE JONES: Public Counsel?

7 MS. BAKER: No cross, thank you.

8 JUDGE JONES: Missouri American Water?

9 MR. BOUDREAU: Yes, please.

10 CROSS-EXAMINATION BY MR. BOUDREAU:

11 Q. Good morning, Mr. Barnes.

12 A. Good morning.

13 Q. Now, I want to follow up on -- on just  
14 the -- some of the foundation -- or at least one of  
15 the foundation questions you got from your counsel  
16 which was your participation in the preparation of  
17 the Staff report. And is it fair for me to conclude  
18 that you authored the cost of capital sections of  
19 that report?

20 A. Yes.

21 Q. Okay. Was there anybody else that --  
22 that co-authored it or is it primarily your work  
23 product?

24 A. It's primarily mine.

25 Q. Okay. Thank you for that. And just so

1 we're all kind of starting from the same -- the same  
2 point for our discussion, as I understand it, Staff  
3 has relied -- or you -- well, let me -- let me just  
4 phrase it this way: You've relied for your  
5 recommendation to this Commission on return on equity  
6 on -- on using the DCF model and you've used the CAPM  
7 to -- as kind of a sanity check or a test?

8 A. Check of reasonableness.

9 Q. Check of reasonableness. Thank you for  
10 that. And as I understand it from your -- from your  
11 testimony or from the Staff report which I guess is  
12 where this data comes from, is the range -- the  
13 unadjusted range from your DCF model was 9.22 to  
14 10.22 with a midpoint of 9.72?

15 A. Yes, that's correct.

16 Q. Okay. And like I said, that range is  
17 unadjusted --

18 A. Correct.

19 Q. -- is that correct? And would it be  
20 fair to say that -- that it's your testimony that any  
21 number that the Commission chooses within that range  
22 is reasonable?

23 A. Yes.

24 Q. And again, that's unadjusted, you've  
25 also recommended a .37 or a -- a 3.7 -- let me get

1     this right -- .37 basis point adjustment; is that  
2     right?

3             A.       That's correct.

4             Q.       Which -- which ups that range, and we'll  
5     get to that. So let me circle back around to that in  
6     just a moment. Now, you used the -- in your DCF, you  
7     used three projected earnings per share growth rates;  
8     is that correct, for inputs?

9             A.       Actually, I used two projected.

10            Q.       Oh, I'm sorry. Two projected --

11            A.       We used to use three, but Standard &  
12     Poor's doesn't publish those anymore.

13            Q.       And just so I have my numbers right,  
14     those -- the average of those growth rates was 8.59?

15            A.       Correct.

16            Q.       Okay. And then you averaged that data  
17     with historical growth rates; is that correct?

18            A.       That's correct.

19            Q.       And that came -- and that generated the  
20     6.45 percent?

21            A.       Yes, it did.

22            Q.       Okay. Have you read Mr. Janous's  
23     testimony?

24            A.       Yes, I have.

25            Q.       Do you happen to agree with Mr. Janous's

1 statement in his direct testimony that security  
2 analyst estimates of earnings per share growth have  
3 been shown to be more -- a more accurate predictor of  
4 future growth rates than historical data?

5 A. I don't entirely agree with that, which  
6 is one reason I used both historical and projected.

7 Q. Okay. You said earlier you used the  
8 CAPM test as a test of reasonableness on your DCF  
9 model?

10 A. Yes, I did.

11 Q. And you ended up with two data points  
12 there. We ended up with -- using a long-term  
13 arithmetic average, you ended up with an 11.27 --

14 A. Yes.

15 Q. -- CAPM? And using the long-term  
16 geometric average, you ended up with a 9.65; is that  
17 correct?

18 A. That's correct.

19 Q. But just so the record's clear, you  
20 didn't actually include either of those data points  
21 in terms of establishing a range, it was just -- it  
22 was just kind a -- like I said, a reasonableness  
23 check?

24 A. Just a check of reasonableness, yes.

25 Q. Okay. And you did not do a risk premium

1 analysis as -- as did witnesses Janous and Ahern?

2 A. No, I did not.

3 Q. And you did not do a comparable earnings  
4 model as did Ms. Ahern?

5 A. No, I did not.

6 Q. Okay. I want to go back to your 37  
7 basis point adjustment, and -- and correct me or help  
8 me if I'm mischaracterizing this or if I characterize  
9 it in a way that you're uncomfortable with, but I  
10 look at that as a creditworthiness adjustment. Does  
11 that make sense?

12 A. Yes, that -- that's right.

13 Q. Okay. And that -- that -- so what you  
14 ended up doing is you added that 37 basis points to  
15 your original range, established a new range which I  
16 understand is 9.59 to 10.59; is that correct?

17 A. That's correct. I did round it to 9.6  
18 to 10.6.

19 Q. Okay. Fair enough. Thank you for that.  
20 And again, using the rounding approach, your  
21 recommendation is 10.10?

22 A. That's correct.

23 Q. Okay. And again, I -- now I want to  
24 kind of circle back to the question I asked you  
25 earlier. Anything within that range in your view, if

1 the Commission were to choose it, would be a  
2 reasonable result. Would that -- would that be your  
3 testimony?

4 A. Within the range of 9.6 to 10.6?

5 Q. Yes.

6 A. Yes.

7 Q. Okay. So if the Commission were to  
8 think that the higher end of the range of 10.6 was a  
9 reasonable outcome, you'd be okay with that?

10 A. I would be, yes.

11 Q. Okay. Now, in terms of using the CAPM  
12 results as a test of reasonableness on your DCF  
13 results, I didn't see in your testimony how you  
14 actually applied that. So -- so let me -- let me  
15 take -- take this approach and see if you agree or  
16 disagree with this. Is it fair to say that you gave  
17 principle weight to -- to the CAPM test using  
18 long-term geometric average in terms of testing the  
19 reason -- or in terms of ascertaining the  
20 reasonableness of your DCF result?

21 A. I didn't give any weight at all. I just  
22 used it as a check of reasonableness, and my results  
23 fall within the geometric and the arithmetic range,  
24 so that would be 9.65 to 11.27.

25 Q. Okay. All right. Thank you for that.



1 Did you take a look at the two proxy groups that  
2 Mr. Janous used?

3 A. I briefly remember them. I haven't  
4 looked at his testimony, though.

5 Q. Well, let's -- let's see how far we go  
6 with your recollection. I think he used two proxy  
7 groups, one was a water proxy group, right?

8 A. Yes.

9 Q. And the other was a natural gas proxy  
10 group?

11 A. Yes.

12 Q. Okay. Do you recall whether his  
13 testimony is that the water proxy group has a -- had  
14 a rating range of A-plus to A-2 depending on the  
15 rating agency that you use?

16 A. I don't remember that off the top of my  
17 head.

18 Q. Okay. And -- well, let me just go --

19 A. That --

20 Q. -- to the gas proxy group, and I believe  
21 his testimony was that he used an A-minus to BAA-1  
22 range, do you recall that?

23 A. I'd have to go back and check. I'm not  
24 for sure.

25 Q. And -- and that's fair. Let's assume

1 that's right. Are those rate -- are those rating  
2 ranges comparable to the rating range of your proxy  
3 group?

4 A. Mine are -- my proxy group is an average  
5 of an A rating, so it would be, I guess, towards the  
6 higher end of his range.

7 Q. Okay. So A -- so if -- if -- if his  
8 water proxy group is A-plus for I guess it's  
9 Standard & Poor's and A-2 for Moody's, is that  
10 comparable to your group or not quite as high rated  
11 as your group? I guess that's what I'm trying to...

12 A. The A-plus would be a little bit higher.

13 Q. Okay.

14 A. I don't recall what A-2 is equivalent  
15 to -- to the Standard & Poor's, but I think those are  
16 the same.

17 Q. Okay.

18 A. I'd have to go back and check. But it  
19 would be -- that would be comparable to my average  
20 credit rating for my group.

21 Q. Okay. Thank you for that. Let's turn  
22 to A-minus to B -- BAA-1. And A-minus would be an  
23 S&P rating and BAA-1 would be a Moody's rating. Are  
24 those comparable or is it a somewhat different range  
25 of risk there -- or ratings, I should say?

1           A.       There is a little bit of difference.

2   Again, mine's an A -- average credit rating of an A  
3   for my company, and A-minus is a little bit lower  
4   than -- than mine, so --

5           Q.       Okay. Thank you for that. Do you know  
6   whether Mr. Janous made an investment risk adjustment  
7   in his ROE recommendation?

8           A.       I don't recall if he did or not.

9           Q.       Bear with me a moment. I want to turn  
10   your attention, if I might, to page 10 of the Staff  
11   report.

12          A.       My pages aren't numbered, so hopefully  
13   I'm on the right page.

14          Q.       Well, let's see if I can help you.  
15   Under the -- it's under the top -- well, actually,  
16   it's the beginning of the section that talks about  
17   "Capital Structure and Embedded Costs." Are you  
18   there? Hopefully I'm working from the same document  
19   you are.

20          A.       I have the title "Capital Structure and  
21   Embedded Costs," yes.

22          Q.       Okay. Very good. The final line of the  
23   first paragraph --

24          A.       Yes.

25          Q.       And I believe your testimony is

1 talking -- you know, this is the rationalization that  
2 you're -- that's being provided for using the  
3 consolidated parent rather than the standalone  
4 company.

5 A. Yes.

6 Q. And the final statement is -- well, the  
7 final statement in this paragraph says, "First, MAWC  
8 is not a publicly traded company and does not issue  
9 its own common stock." Do you see that?

10 A. Yes.

11 Q. Now, Missouri-American does issue its  
12 own common stock, doesn't it?

13 A. Not that I'm aware of on the market.

14 Q. Okay. So that's the distinction you're  
15 making?

16 A. Yes.

17 Q. Is that they -- that they -- they don't  
18 issue common stock on -- on a publicly traded market?

19 A. That's correct.

20 Q. Would you agree with me that they do  
21 issue common stock, but the stock is held by its  
22 parent company, American Water Works?

23 A. I don't know. As far as I know,  
24 American Water is the only one that issues common  
25 stock to the public.

1           Q.       Okay. So you don't know whether or not  
2 Missouri-American Water Company issues stock at all;  
3 is that correct? Is that your testimony?

4           A.       Yes.

5           Q.       Okay. Let me -- let me ask this, then.  
6 If you were to assume with me that Missouri-American  
7 Water Company does, in fact, issue the common stock,  
8 not on a publicly traded market, but it does have  
9 common stock that it issues -- issues to its parent,  
10 would that change your view of this topic?

11          A.       No, it would not.

12          Q.       Okay. I guess I want to test these  
13 waters just a little bit with you. Let's assume that  
14 Missouri-American Water Company, in fact, did -- that  
15 its -- that its common stock did trade in a public  
16 market. If it had -- and with that assumption, if it  
17 had a number of public investors, let's say 300  
18 public investors, would that change your view at this  
19 time?

20          A.       If it was publicly traded on the market,  
21 it's possible that I would look at the subsidiary  
22 capital structure in more detail than I have today,  
23 so --

24          Q.       Does it -- does it matter how many  
25 people hold the -- or how many investors hold the

1 stock? Is that -- is that --

2 A. That's not a criteria for me, no.

3 Q. Is it Staff's position that

4 Missouri-American Water Company would have a  
5 different equity ratio if it were publicly traded?

6 A. It's possible. I don't have a yes or no  
7 answer because they're not publicly traded, so I  
8 couldn't tell you definitely.

9 Q. But -- but it's in a -- in a -- okay.  
10 And I -- and I -- and I appreciate that answer, but  
11 I -- just to kind of circle back around. So your --  
12 your testimony is not that there would necessarily be  
13 a different capital structure or equity level just  
14 because it's publicly traded?

15 A. It would depend on how much common stock  
16 is issued, and that would be another analysis I'd  
17 have to do. But I can't answer yes or no.

18 Q. But the fact that -- the fact that it's  
19 publicly traded isn't the thing that would  
20 necessarily change that, it would be --

21 A. It's one of the factors that -- that  
22 could change that, yes.

23 Q. If Missouri-American Water Company were  
24 publicly traded, would it be Staff's recommendation  
25 that the use of that market value or book value of

1 common equity would be appropriate in the -- in the  
2 capital structure for purposes of determining rates  
3 in this case?

4 A. If they were publicly traded --

5 Q. Yes.

6 A. -- would that capital structure be  
7 appropriate to use?

8 Q. Would that be Staff's view?

9 A. We would look at it, sure, yes.

10 Q. Okay. But that's not necessarily  
11 determinative?

12 A. No, that's only one of them.

13 Q. Okay. Let's talk about the  
14 recommendation that you've actually made in this  
15 case. If American Water Works, the parent company's,  
16 equity ratio were 55 percent instead of roughly  
17 42 percent, would your recommendation to use the  
18 consolidated capital structure in this case be the  
19 same?

20 A. Based on the -- my reasons I did for  
21 using the consolidated capital structure, more than  
22 likely, yes.

23 Q. Are you aware of any case in which Staff  
24 has recommended a parent -- a consolidated parent  
25 capital structure where the equity ratio was higher

1     than the -- than that of the operating company?

2             A.       I don't know off the top of my head.

3             Q.       Okay. The report also makes some  
4     reference to the equity infusions from the parent  
5     company to the operating company, Missouri-American.  
6     Do you recall that?

7             A.       Yes.

8             Q.       And those equity infusions can be made  
9     in the form of either the purchase of common stock or  
10    paid in capital; would you agree with me?

11            A.       Or could possibly be some debt what was  
12    issued at the parent company, but it's assumed that  
13    it is common stock. But it's hard for -- for me to  
14    trace that.

15            Q.       Okay. Well, let's limit it just to  
16    equity. Okay. So the sources of equity infusions  
17    from the parent would be paid in capital or  
18    purchase -- or acquisition, purchase of common stock  
19    from the subsidiary, would you agree with that?

20            A.       Yes.

21            Q.       And in terms of another source of  
22    capital for the operating company, would you agree  
23    with me that Missouri-American Water Company has  
24    retained earnings as a source of equity capital?

25            A.       Yes, they do.



1           Q.       And just so that we're clear on the  
2 record -- and it's kind of self-defined -- what are  
3 retained earnings?

4           A.       Retained earnings is just income that  
5 the company keeps instead of paying out dividends.

6           Q.       I want to turn now to some -- your  
7 rebuttal testimony, if you can make that handy to  
8 yourself. And I think you make reference near the  
9 bottom of page 2 of that testimony. And it's on  
10 line 18, I believe, where you talk about  
11 Mr. Rungren's recommendation of an allocated capital  
12 structure?

13          A.       Yes.

14          Q.       Do you see that? And I want to talk  
15 with you a little bit about the term "allocated." Do  
16 you agree with me that Missouri-American Water  
17 Company has its own actual capital structure?

18          A.       No. I believe it's allocated.

19          Q.       Okay. Maybe I want to explore that a  
20 little bit with you. In what sense are you using the  
21 term "allocated"? Are you -- are you --

22          A.       Essentially, it's an assigned capital  
23 structure.

24          Q.       Okay.

25          A.       The company decides how much debt and

1 equity it's going to need and it's assigned from  
2 the -- from my understanding, it's assigned from the  
3 parent.

4 Q. Okay. Does that come -- does that  
5 circle back to your testimony about that -- that it's  
6 your understanding that the company doesn't issue,  
7 for instance, common stock?

8 A. Yes.

9 Q. Okay. If, in fact, the evidence were to  
10 show in this case that it does issue its own common  
11 stock, does that change your view of the  
12 appropriateness of the use of the term "allocated"?

13 A. It might change that view if they are  
14 publicly traded.

15 Q. But -- okay.

16 A. That's --

17 Q. So that's -- that's the --

18 A. Yeah.

19 Q. So even if they -- even if they have  
20 common stock that they've issued, if it's not  
21 publicly traded, you still view it as an allocated  
22 capital -- capital structure; is that correct?

23 A. Yes.

24 Q. All right. The term "allocated," I  
25 think has been -- let me just -- let me rephrase

1     that.  Would you agree with me that the term  
2     "allocated capital structure" is a more appropriate  
3     term in the context of a divisional type of  
4     structure?

5             A.       It could be.

6             Q.       Okay.  But -- and I -- and I take it  
7     from your answer, you view that it has a little bit  
8     more flexibility than just that limited use?

9             A.       Yes.

10            Q.       Okay.  Thank you for that.  You also --  
11    I think there was a critique in your testimony on  
12    page 5 about Mr. Rungren's recommendation of the use  
13    of pro forma capital structure.  Do you recall that?

14            A.       Could you point me to --

15            Q.       Sure.

16            A.       -- what line?

17            Q.       It's -- it's -- the first question and  
18    answer -- actually, it's -- there's a question that's  
19    asked at line 3 and then just the first sentence of  
20    the answer, I think, addresses that topic.  Are you  
21    there?

22            A.       Yes.

23            Q.       Okay.  And I -- and I believe the gist  
24    of that testimony is that you think it's  
25    inappropriate to use a pro forma capital structure

1 because it's not known and measurable?

2 A. That's correct.

3 Q. Okay. Now, as of September 30th, 2008,  
4 which is the true-up date in this case, the actual  
5 structure of the operating company is now known,  
6 isn't it?

7 A. Yes, it is. In fact, I have my  
8 consolidated capital structure -- I mean, I know what  
9 the numbers are going to be and --

10 Q. Okay.

11 A. -- it's going to be pretty close to what  
12 the company's pro forma is.

13 Q. Thank -- thank you for that. That was  
14 going to be my -- my follow-up question. So in terms  
15 of the -- the conceptual issues using pro forma,  
16 that's not really much of a consideration now at this  
17 point; is that --

18 A. Since it's known and measurable now.

19 Q. Okay. Thank you. Actually, why don't  
20 we just do a -- do a sanity check on some of the --  
21 not a sanity check, just a -- an assessment of what  
22 that actual capital structure is and compare it to my  
23 numbers. Why don't you go ahead and tell me what  
24 your understanding of the actual capital structure of  
25 the -- of Missouri-American was as of September 30th,

1 2008.

2 A. I don't have that data in front of me.

3 Q. Oh, you do not?

4 A. No.

5 Q. Okay. Well, then we won't go there,  
6 then. Do you know whether or not the Commission used  
7 a standalone capital structure for Missouri-American  
8 Water Company in its 1995 rate case?

9 A. I wasn't assigned to that case, but I am  
10 aware that Staff did use a subsidiary capital  
11 structure previously to when AW -- American Water  
12 Capital Corp. was created.

13 Q. Okay. Now -- and I'll -- and we'll  
14 circle back around because I want to explore that  
15 topic with you at some point.

16 Actually, let's do it now. As I  
17 understand it, the reason for Staff's shift in its  
18 recommendation where capital structure is concerned  
19 from Missouri-American actual to American Water Works  
20 consolidated is driven by the creation of and the use  
21 of a financing affiliate for -- for financing certain  
22 long-term debt by Missouri-American Water Company; is  
23 that -- is that correct?

24 A. Since I've been in -- in that position,  
25 yes, that's my understanding.

1           Q.       Okay. And when -- do you have a -- can  
2     you give us kind of a time frame of your  
3     understanding about when American Capital -- well,  
4     let me ask you this, just a premise -- premise  
5     question. The financing affiliate is American Water  
6     Capital Corp., right?

7           A.       That's correct.

8           Q.       And would it be okay with you if I  
9     sometimes shorthand that to Capital Corp. just for  
10    discussion purposes?

11          A.       That's fine.

12          Q.       Okay. What is your understanding of  
13    when Capital Corp. came into -- into being?

14          A.       My understanding, I believe, was in -- I  
15    want to say at the -- at the end of 2002.

16          Q.       Okay. And in fact, there was a  
17    financing case that Missouri-American filed for  
18    approval to undertake certain financing trans -- debt  
19    financing transactions --

20          A.       Yes.

21          Q.       -- through Capital Corp.; is that  
22    correct?

23          A.       Yes.

24          Q.       Do you recall whether that was Case  
25    No. WF-2002-1096?

1           A.       I believe it was. I wasn't assigned to  
2       that case, but I believe it was.

3           Q.       Okay. Thank you. Okay. Let's go back  
4       on page 3 of your rebuttal testimony. I asked you  
5       about the first sentence in that answer to the -- to  
6       the question that appears on lines 3 and 4, and I  
7       want to move to the second sentence.

8           A.       Of my rebuttal, page 3?

9           Q.       Of your rebuttal. Excuse me, I'm sorry.

10          A.       I think I'm on the right page. Is the  
11       question, Why is it inappropriate to use MAWC's --  
12       MAWC -- capital structure for ratemaking --  
13       ratemaking purposes in this case?

14          Q.       That's correct.

15          A.       Okay.

16          Q.       And your answer -- we talked about the  
17       first sentence. Then you say, "Second, MAWC no  
18       longer issues all of its own debt." And I wanted to  
19       visit with you about that. You are aware that I  
20       think in 2000 -- well, just -- just recently,  
21       Missouri-American -- Missouri-American issued  
22       long-term debt through the EIERA state mechanism --

23          A.       Yes, sir.

24          Q.       That's a tax advantage financing?

25          A.       Yes.

1           Q.       So they still go to third -- and EIERA  
2 isn't in any way affiliated with American Water Works  
3 or Missouri-American Water Company, is it?

4           A.       No, it's not. It's a -- I believe it's  
5 a quasi-judicial agency with the State.

6           Q.       Okay. So it's -- so they do -- they  
7 do -- can and do, in fact, still pay some long-term  
8 debt with what I call third-party independent  
9 lenders. Do you agree with that?

10          A.       They -- they could, yes.

11          Q.       Okay. And in fact, as evidenced --

12          A.       Through --

13          Q.       -- by this recent bond issuance, they  
14 do?

15          A.       Through EIERA --

16          Q.       Right.

17          A.       -- but they have not issued any other  
18 bonds or any other debt except through AWCC.

19          Q.       Okay. But in order to back those EIERA  
20 bonds, they -- they issue their own general mortgage  
21 bonds as kind of a security mechanism to secure the  
22 funding through the State; is that correct, or do you  
23 know?

24          A.       I don't know right -- right now.

25          Q.       Okay. So you don't know whether or not



1 the company issues what I call a mirrored set of  
2 general mortgage bonds that bear the same designation  
3 as the EIERA bonds?

4 A. I don't know.

5 Q. Okay. Okay. I want to direct your  
6 attention to page 5 -- page 5 of your rebuttal  
7 testimony.

8 A. Okay.

9 Q. And again, there's a question that --  
10 that appears on lines 4 and 5 and then a rather  
11 lengthy answer that goes from lines 6 through 18, and  
12 I want to explore some -- at least one of the  
13 statements in that answer. Are you there in that  
14 general area?

15 A. Could you read the question to make sure  
16 I'm on the right page?

17 Q. Sure. The question is, "Does the  
18 consolidation of financing needs through AWCC" --  
19 which I understand is the shorthand for the Capital  
20 Corp. --

21 A. Yes.

22 Q. -- "make MAWC's allocated capital  
23 structure inappropriate for purposes of arriving at a  
24 recommended ROR?"

25 A. Yes.

1           Q.       Okay. That's the question. And as part  
2 of your explanation of why that -- that does have an  
3 effect in your view, you talk -- and it's down -- it  
4 begins on -- near the end of line 8. You said, "By  
5 carrying most of this debt at the parent company  
6 level rather than at the subsidiaries, American Water  
7 is able to produce subsidiary capital structures that  
8 are more heavily weighted in capital [sic] which  
9 would not be the case otherwise." Do you see that?

10           MR. THOMPSON: Excuse me. I object. He  
11 misread that sentence.

12           MR. BOUDREAU: Well --

13           MR. THOMPSON: He said, "more heavily  
14 weighted in capital," and it actually reads "more  
15 heavily weighted in equity."

16           MR. BOUDREAU: And I -- and I appreciate  
17 that being -- the correction.

18 BY MR. BOUDREAU:

19           Q.       "More heavily weighted in equity which  
20 would not be the case otherwise"?

21           A.       Yes.

22           Q.       Are you there?

23           A.       Yes.

24           Q.       Okay. And what I want to ask you is,  
25 that's kind of a general statement. Is that -- is

1 that critique or observation, is that directed  
2 specifically at Missouri-American Water Company?

3 A. It's just a general observation assuming  
4 AWCC or Capital Corp., as you're calling it, didn't  
5 exist --

6 Q. Okay.

7 A. -- the situation would be different than  
8 at that time, but they do exist, so --

9 Q. Okay.

10 A. -- it's my understanding they use AWCC  
11 as a financing source to -- to hopefully get a lower  
12 interest rate on -- on their debt. But this is just  
13 a general observation.

14 Q. Okay. And I guess -- and I guess  
15 just -- just to not put too fine a point on it,  
16 you're not trying to suggest that a common -- common  
17 equity in the range of 48 percent is excessively  
18 equity-rich in terms of a capital structure?

19 A. No, I'm not saying that at all.

20 Q. Okay. I want to take a look at your  
21 list of comparable companies, and I think it's  
22 Schedule 12 on the Staff report. And I want to ask  
23 you if you would turn to that, please.

24 A. Yes.

25 Q. Actually, I probably have misdirected

1     you.  It's actually Schedule 18.  I'm sorry.  And I  
2     believe on this schedule -- and this is your -- it's  
3     your group of four comparable companies and you've  
4     got common equity ratios for those companies and then  
5     long-term debt ratios.  Do you see that?

6             A.       Yes, uh-huh.

7             Q.       Now, I believe from looking at your --  
8     and I think I'll have to go to your rebuttal  
9     testimony because we haven't updated.

10            A.       Okay.

11            Q.       We haven't updated to the actuals, but I  
12     think in your rebuttal testimony you identify  
13     Missouri-American Water Company's common equity ratio  
14     at about 47.65 percent?

15            A.       In my rebuttal?

16            Q.       I think it was in your rebuttal  
17     testimony.

18            A.       I show 44.28 percent.

19            Q.       Let me -- let me get to that -- on the  
20     same page here.

21            A.       I may have the former rebuttal schedule  
22     because it shows -- well, I think I have less  
23     short-term debt, so this is -- this should be  
24     correct.

25            Q.       Yeah, because I think -- I think in your

1     rebuttal you kind of -- you corrected your original  
2     numbers.

3             A.       That's correct.

4             Q.       That's why I was pointing to your  
5     rebuttal.

6             A.       Yes.

7             Q.       So just -- just so we're on the same  
8     page here, I had from your rebuttal testimony that  
9     the capital structure that you were looking at,  
10    taking into account that short -- short-term debt  
11    correction, is 47.65 percent for common equity?

12            A.       I don't show that on mine. I show  
13    44.28.

14            Q.       Okay. I see. I was looking at the  
15    wrong set of numbers. Okay. Let's take your  
16    numbers, 44.28 percent for common equity?

17            A.       That's correct.

18            Q.       55.01 percent for -- for long-term debt?

19            A.       That's correct.

20            Q.       .34 for preferred?

21            A.       Yes.

22            Q.       Okay. And what I want to do is with  
23    those numbers, turn back to your schedule on Staff's  
24    Schedule 18 in the report. And I want to ask you if  
25    you would agree with me that Missouri-American Water

1 Company's capital structure using your numbers is  
2 within the range reflected in your chart of  
3 comparables?

4 A. The equity ratios, at least as of  
5 March 31st, which will be updated through true-up, is  
6 lower than what the average is. But it is in line  
7 with one of my comparable companies.

8 Q. You use --

9 A. But using the average, it is below the  
10 average.

11 Q. Okay. So the equity ratio is a little  
12 bit below the average of your comparables?

13 A. That's right.

14 Q. And it's kind of in line with Aqua  
15 America, to identify a company?

16 A. That's correct.

17 Q. Okay. Now, you were the cost of capital  
18 witness in the Algonquin case, weren't you?

19 A. Yes, I was.

20 Q. Would you agree with me that Staff  
21 recommended a hypothetical capital structure for  
22 Algonquin of 52 percent -- 52.12 percent debt to  
23 47.88 percent common equity in that 2006 rate case?

24 A. It sounds right, but I'd need -- I'd  
25 need to go back and check that. But yes, it is a --

1 it was a hypothetical capital structure.

2 Q. Okay. And do you remember whether or  
3 not it was Staff's testimony that that was  
4 appropriate because it was in line with capital  
5 structures of other regulated water companies?

6 A. Yes. That was one of the reasons we  
7 used hypothetical, yes.

8 Q. I want to go back to your rebuttal  
9 testimony, page 5. Near the top there's a sentence  
10 that starts on line 2 and ends on line 3, and I'll  
11 try to quote it correctly this time. "Consequently,  
12 the cost of capital provided to MAWC is driven by the  
13 consolidated operations of American Water." Do you  
14 see that statement?

15 A. What line was that again?

16 Q. It begins on line 2, starts with the  
17 word "Consequently."

18 A. In my rebuttal testimony?

19 Q. Yes, I believe so.

20 A. I have different line numbers than you  
21 do.

22 Q. All right. Well, let's see if we can  
23 pin it down differently, then. It's in partial --  
24 it's a partial part of your response to the question,  
25 "How does Standard & Poor's evaluate the

1 creditworthiness of American Water and its  
2 subsidiaries?" Do you happen to see that question?

3 A. Yes.

4 Q. Okay. Go to the end of your answer.

5 A. Okay. Yes.

6 Q. Okay. And did I correctly read that or  
7 would you like me to read it again? I have,  
8 "Consequently, the cost of capital provided to MAWC  
9 is driven by the consolidated operations of American  
10 Water."

11 A. Yes.

12 Q. Okay. And I guess my question to you  
13 with respect to that statement is, what capital costs  
14 are you talking about?

15 A. The cost of debt that AWCC issues.

16 Q. Okay. With respect to long-term debt, I  
17 wonder if you could explain how the cost to MAWC or  
18 Missouri-American Water Company is impacted by  
19 American Water Works' consolidated capital structure.

20 A. It's based on the company's credit  
21 rating. Missouri-American does not have a credit  
22 rating, therefore, its debt costs are affected by its  
23 parent, American Water, who does have a credit  
24 rating.

25 Q. Okay. Thank you. I want to ask you



1 about another statement in your rebuttal testimony.  
2 We're getting a little fouled up here on pages. I  
3 want to go back to the question where we're  
4 talking -- I've asked you a number of questions about  
5 a couple of selected portions of your answer, one of  
6 which was -- well, actually, I mean -- I am in a  
7 different section.

8 Let's go to the next question in your  
9 testimony. The next question is, "Does the  
10 consolidation of financing needs through AWCC make  
11 MAWC's allocated capital structure inappropriate for  
12 purposes of arriving at a recommended ROR?" Are you  
13 there?

14 A. Yes.

15 Q. Okay. Part of your answer below that,  
16 and I'm not sure how to direct you to it because I  
17 think we're -- we're a little bit off on page numbers  
18 and line numbers, but near the end, I think it's the  
19 second-to-the-last sentence, your answer says,  
20 "Because American Water's capital structure directly  
21 affects the cost of capital that is available to its  
22 subsidiaries, it is unlikely that American Water  
23 would manage this capital structure in an imprudent  
24 manner." Do you see that?

25 A. Yes.

1           Q.       Now, are you suggesting that  
2       Missouri-American Water Company has managed its  
3       capital structure in an imprudent manner?

4           A.       No, I am not.

5           Q.       Do you believe that American Water Works  
6       manages its capital structure in a more prudent  
7       manner than does Missouri-American Water Company?

8           A.       Using the consolidated capital  
9       structure, yes, I think they do, but  
10       Missouri-American is -- they are still prudent as  
11       well in their decision-making.

12          Q.       Okay. Well, let me ask you this: Would  
13       you agree with me that using Missouri-American Water  
14       Company's actual capital structure for ratemaking  
15       purposes is actually an incentive for the company to  
16       maintain a prudent capital structure?

17          A.       Could you rephrase that question again?

18          Q.       Well, let me ask it this way: If --  
19       would you agree with me that if we -- if the  
20       Commission were to use the operating company,  
21       Missouri-American Water Company's actual capital  
22       structure for ratemaking purposes, that that's  
23       actually an incentive to maintain a prudent capital  
24       structure in the sense that it would be perhaps less  
25       inclined to use a more highly leveraged capital

1 structure?

2 A. I would hope the company would, but yes,  
3 assuming that's part of their job is to manage their  
4 finances prudently.

5 Q. Now, the other -- other than the -- the  
6 other witness or the other party that has submitted  
7 testimony on cost of capital is MIEC; is that  
8 correct?

9 A. That's correct.

10 Q. And their witness, Mr. Janous, has not  
11 made any suggestion that the parent company  
12 consolidated capital structure would be appropriate  
13 capital structure for ratemaking purposes. Would you  
14 agree with that?

15 A. Not that I've read in his testimony,  
16 yes.

17 Q. And -- and, in fact, isn't -- isn't it  
18 your -- well, would you agree with me that if you --  
19 if you review the testimony of Mr. Janous, he's  
20 applied his ROE recommendation to the company's  
21 actual capital structure which it's recommending that  
22 the Commission use in this case?

23 A. He -- he does use the company's actual  
24 capital structure, but doesn't explain anything else  
25 other than that, so --

1           Q.       I agree with that. I mean, it's just --  
2   it's kind of a footnote to one of his schedules --

3           A.       Right.

4           Q.       -- that he used the company's capital  
5   structure?

6           A.       That's correct.

7           Q.       Okay. Would you agree with me that  
8   drawing down debt capital through the Capital Corp.  
9   actually can be a cost effective way of -- of  
10   obtaining long-term debt capital for the company's  
11   operations?

12          A.       Yes.

13          Q.       And is it Staff's belief that the use of  
14   American Water Capital Corp. as a financing vehicle  
15   is a prudent cost management policy on -- on the part  
16   of the company?

17          A.       I believe that it is. That's why it was  
18   created.

19          Q.       And that to the extent that  
20   Missouri-American Water Company can obtain low-cost  
21   debt through -- by financing through the affiliate,  
22   that policy ultimately benefits ratepayers in the  
23   sense that the overall cost of capital of the company  
24   is lower than it otherwise would be, all other things  
25   remaining equal; is that -- is that fair?

1           A.       Yes, that's fair.

2           Q.       How long have you been employed by the  
3 Commission?

4           A.       Five -- over five years. Since 2002.

5           Q.       Have you ever been involved in any  
6 telephone company rate cases? I know that's almost a  
7 thing of the ancient past now, but I didn't know if  
8 you'd ever had occasion to --

9           A.       My very first case was BPS Telephone,  
10 and I was at the tail end of -- of that case, but  
11 other than that, no, I've not.

12          Q.       Were you the cost of capital witness in  
13 that case?

14          A.       Yes.

15          Q.       Okay. Was BPS publicly traded, do you  
16 recall?

17          A.       I don't recall.

18          Q.       I want to talk generally. There's --  
19 there's a number of places, I think maybe in the  
20 report -- I know you've referenced it in your  
21 surrebuttal -- you talk about the topic of double  
22 leverage.

23          A.       Yes.

24          Q.       Which is -- is -- is a term that has --  
25 is used in different ways. Would you agree with

1     that?

2             A.       It could be, yes.

3             Q.       Yeah. I mean, it has -- well, let --  
4     let me clarify the -- the -- the genesis of my  
5     question. It has kind of a ratemaking implication,  
6     you know, double -- double leverage for ratemaking  
7     purposes in the context of establishing a return on  
8     equity, right?

9             A.       Yes.

10            Q.       But it also issues in just a pure  
11    finance concept about the idea of a parent company  
12    relationship with a subsidiary.

13            A.       That's correct.

14            Q.       Now, when you use that term in your  
15    testimony, is it fair to say that you're using it in  
16    the latter category, kind of a finance aspect of  
17    things? I mean, the Staff isn't recommending that  
18    the Commission make a double leverage adjustment on  
19    return on equity in this case, right?

20            A.       That's correct.

21            Q.       So as I understand your testimony,  
22    you're just talking about the general concept of a  
23    parent/subsidiary relationship and sources of capital  
24    or equity?

25            A.       More or less, yes.

1 Q. For the operating company?

2 A. Right.

3 Q. We talked a little bit about when the  
4 Capital Corp. was created and when Missouri-American  
5 started using it as a financing vehicle for obtaining  
6 long-term debt capital. Do you recall that?

7 A. Yes.

8 Q. And that was roughly a 2002 time frame?

9 A. Yes.

10 Q. And I think my -- and it's my  
11 understanding that in the 2003 rate case,  
12 Missouri-American Company rate case, Staff really  
13 first recommended the use of a consolidated capital  
14 structure for Missouri-American, right?

15 A. That's correct.

16 Q. And so that dovetails with your earlier  
17 testimony that it was the creation and use of  
18 American Water Capital Corp. that -- that caused that  
19 change in position; is that correct?

20 A. That's my understanding of it, yes.

21 Q. Yes.

22 A. I was not assigned on those cases, but  
23 yes.

24 Q. Now, to the extent that the issue of  
25 double -- and to the extent that the issue of double

1 leverage justifies, or you say that it justifies your  
2 recommendation of a consolidated capital structure,  
3 would you agree with me that that circumstance  
4 existed without regard to the creation of American  
5 Water -- American Water Capital Corp.?

6 I mean, let me come at it from a  
7 different angle. Missouri-American Water Company has  
8 been a subsidiary of American Water Works for some  
9 number of years prior to 2002?

10 A. That's correct.

11 Q. And I think that the testimony was that  
12 even in the 1995 rate case, Staff's recommendation  
13 was -- to the Commission was use the -- the operating  
14 company's actual capital structure?

15 A. That's my understanding. I haven't read  
16 that case.

17 Q. Okay. Well, that case will say what it  
18 says, and I can brief that to the Commission. Excuse  
19 me. I guess my question to you is, the concept of  
20 double leverage as you're using it in your testimony,  
21 that existed in 1995 because there was still a  
22 parent/subsidiary relationship?

23 A. Yes, it could be, yes.

24 Q. Right. Okay. So really, there's  
25 nothing that's changed in terms of -- I mean, I -- I



1     guess that -- that American Water Capital Corp.  
2     really doesn't change that concept?

3                   THE COURT REPORTER:   It doesn't change  
4     what?

5                   MR. BOUDREAU:   Doesn't change that  
6     concept.

7                   THE COURT REPORTER:   Okay.

8                   THE WITNESS:   Of double leverage.

9     BY MR. BOUDREAU:

10           Q.     Of double leverage the way that you're  
11     using it in your testimony?

12           A.     I would agree with that, yes, along with  
13     that the company, as far as decision-making with  
14     Staff, that the company's not publicly traded along  
15     with double leverage and it doesn't have its own  
16     credit rating.

17           Q.     Okay.   Well, we --

18           A.     Double leverage is not the only reason  
19     that --

20           Q.     Okay.   Well, let's talk about not --  
21     not -- not publicly traded.   That hasn't changed.

22           A.     That's correct.

23           Q.     It doesn't have its own debt rating.  
24     That hasn't changed.

25           A.     That's correct.

1           Q.       We just talked about three things. Are  
2   there any other factors that -- that you're looking  
3   to in terms of a recommendation for -- to this  
4   Commission that they use the parent company  
5   consolidated capital structure?

6           A.       Those are the main three.

7           Q.       Okay. You also have a statement in your  
8   testimony -- let me see if I can locate it for you.  
9   Your rebuttal testimony. I think maybe your  
10   surrebuttal -- excuse me. Okay. It's your  
11   surrebuttal testimony. If you would turn that,  
12   please, and we'll try this page and line number  
13   again, see if it works out.

14                   I want to direct you to page 2, starting  
15   on what I have as line 15, and I'll read you the  
16   statement that I want to ask you about. I believe  
17   you have a statement there. It says, "The existence  
18   of double leverage as one of the criteria is often  
19   considered when determining if the subsidiary or  
20   parent company capital structure is appropriate for  
21   ratemaking purposes." Are we -- have you found that?

22          A.       Yes.

23          Q.       And I want to ask you, what is the basis  
24   for your statement that this is often -- that this is  
25   a concept that's often considered? You know, you

1 didn't have any references or authorities that you  
2 cited, and I just wanted to know the source of the  
3 basis for this statement.

4 A. Although I didn't list the source here,  
5 I used David Parcell's Cost Of Capital, I believe  
6 it's Practitioner's Guide, and he lists some  
7 reasons --

8 Q. Okay.

9 A. -- why a parent company or a subsidiary  
10 capital structure should be used.

11 Q. Okay. You don't happen to have that  
12 handy, do you?

13 A. Not with me, no, I do not.

14 Q. We'll move on, then. Let's talk a  
15 little bit more about Missouri-American Capital Corp.  
16 Would you agree with me that when a subsidiary,  
17 Missouri-American Water Company, places debt through  
18 the Capital Corp., that the subsidiary,  
19 Missouri-American Water Company, is the primary  
20 obligor on that debt?

21 A. I believe American Water is, and that  
22 that -- proceeds are just given to Missouri-American  
23 to pay back to American Water.

24 Q. When you say that, is -- so are -- are  
25 you suggesting that American Water Works issues a

1 promissory note evidencing that obligation?

2 A. I -- I don't know. I believe there's an  
3 internal loan agreement with AWCC and American Water.

4 Q. Okay. Now, let's talk about the  
5 promise -- we talked about that financing case that  
6 was 2002. Did you have some involvement in that?

7 A. No, I did not.

8 Q. Do you recall the details of the  
9 documentation that he filed?

10 A. I briefly looked at what was filed, but  
11 I haven't analyzed it or anything.

12 Q. Okay. So you don't know as you sit here  
13 today whether -- what party issues the promissory  
14 note for the indebtedness?

15 A. Not off the top of my head. I'd have to  
16 go back and look at that.

17 Q. Okay. Those documents, though, those  
18 loan documents were filed as exhibits to that  
19 application in that case. Do you know --

20 A. In the financing case?

21 Q. In the financing case.

22 A. I haven't seen them but that -- but I'll  
23 take your word that they were.

24 Q. We may have covered this somewhat  
25 indirectly, but I also want to make -- just kind of

1 circle back around and make sure that it's -- it's --  
2 it's clear. Would you agree with me that  
3 Missouri-American Water Company is free to pursue  
4 long-term debt borrowings from independent  
5 third-party lenders without regard to the existence  
6 of American Water Capital Corp.?

7 A. It's my understanding they can if it's  
8 economical for them to do that.

9 Q. And that's their stated policy, is that  
10 correct, that they use Capital Corp. unless a --

11 A. I believe so, yes.

12 Q. -- there's a more cost-effective debt  
13 available through some other source?

14 A. Yes.

15 Q. And would you agree with me that  
16 issuances, the -- the placement of long-term  
17 indebtedness through American Water Capital Corp.  
18 doesn't influence Missouri-American Water Company's  
19 debt ratio?

20 A. I guess it would depend on if the  
21 proceeds are given down to Missouri-American, unless  
22 I'm misunderstanding your question.

23 Q. Well, let me come at it from a different  
24 angle. American Water Capital Corp. is a -- is a  
25 financing affiliate through which the operating

1 companies can and, in fact, do place long-term debt  
2 for operations; isn't that correct?

3 A. That's correct.

4 Q. And so Missouri-American has gone to  
5 American Water Capital Corp. a number of times?

6 A. That's correct.

7 Q. And so I guess with respect to those  
8 particular transactions, my question is, that those  
9 long-term debt issuances by the operating company  
10 through the Capital Corp. doesn't really -- doesn't  
11 impact Missouri-American Water Company's debt ratio.  
12 Would you agree with that statement?

13 A. I'm not for sure if I still understand  
14 your question.

15 Q. Sure. I think I'm getting pretty close  
16 to getting wrapped up here. Bear with me a second.  
17 I'll direct your attention to your surrebuttal  
18 testimony. And you have in there on what I have is  
19 pages 5 and 6. It starts near the bottom of page 5,  
20 overlaps onto page 6.

21 You made -- you have some observations  
22 about how the topic of capital structure's been  
23 handled with respect to other regulated utilities in  
24 this state. Do you see that?

25 A. Yes.

1           Q.       You open by talking about the Missouri  
2 Gas Energy two thousand -- 2004 Missouri Gas Energy  
3 or MGE rate case. Do you see that?

4           A.       Yes.

5           Q.       Now, would you agree with me that MGE is  
6 not a subsidiary of Southern Union, but -- but in  
7 contrast, it's just a divisional operation of  
8 Southern Union Company?

9           A.       Yes, I'd agree with that.

10          Q.       And it does not issue equity or debt in  
11 its own name, MGE, that is?

12          A.       I don't think so. I'd have to -- I  
13 wasn't involved with that case either, but I don't  
14 think so.

15          Q.       Okay. Would you agree with me that the  
16 question in that case was whether to use a  
17 hypothetical capital structure because MGE did not  
18 have a standalone capital structure?

19          A.       That's correct, I believe, yes.

20          Q.       Would you also agree with me that the  
21 capitalization of Southern Union is not decided or  
22 determined by MGE?

23          A.       I don't know. I think it would just  
24 depend on the sources of capital that MGE needs.

25          Q.       Okay. And I guess my -- just to make

1     sure that -- that I understand your answer, I'm  
2     talking in terms of MGE's management making decisions  
3     about how Southern Union finances its various  
4     operations. And my question to you is, do you know  
5     whether or not MGE makes the determinations about how  
6     Southern Union finances its various operations?

7             A.       I don't know if they -- they do or not.

8             Q.       Okay. You have some other examples you  
9     make reference to, and I won't take these necessarily  
10    in order. You make reference to Aquila, and, of  
11    course, we're talking about Aquila prior to the time  
12    it was acquired by GPE, so I want to kind of --

13            A.       Okay.

14            Q.       -- frame my questions in that context.  
15    So that's the 2007 rate case for Aquila. Do you see  
16    that reference?

17            A.       Yes.

18            Q.       Would you agree with me that Aquila was  
19    like MGE in that Aquila was a divisional operation  
20    and not itself a standalone subsidiary?

21            A.       Yes, I -- I believe so.

22            Q.       You also have a reference that --  
23    that -- that I must confess I'm curious about. You  
24    reference an Empire -- you reference Empire, and in  
25    particular a series of cases, but I'm not sure that I



1 need to identify a particular case for you. I'm just  
2 kind of curious. Empire is not a subsidiary of --  
3 of -- of another company, is it?

4 A. No. They're a standalone company.

5 Q. Okay. Well, that being the case, why --  
6 I always hate to ask a why question in these  
7 contexts -- but being that it is a standalone company  
8 and not a subsidiary, not a -- in a holding company  
9 structure, why do you point to the Empire case as --  
10 as indicative of some policy on the part of the  
11 Commission?

12 A. Because we used a consolidated capital  
13 structure because at the time, Empire had quite a bit  
14 of nonregulated operations. They don't anymore. So  
15 that was one of the reasons that Staff used  
16 consolidated capital structure in those cases.

17 Q. Okay. Okay. Thank you for that. You  
18 also mentioned KCP&L, but I guess conspicuous by its  
19 absence is any reference to AmerenUE. How does the  
20 Commission handle the AmerenUE situation?

21 A. I wasn't assigned to those cases. I  
22 don't know what our consultant recommended for the  
23 current case.

24 Q. Okay.

25 A. And I don't recall if -- if that was an

1 issue in the last case.

2 Q. Okay. So you don't know whether or not  
3 this -- this Commission has established cost of  
4 service based on AmerenUE's or, I guess, Union  
5 Electric's standalone capital structure?

6 A. Not that I know of.

7 Q. Okay. I want to just ask you one final  
8 question or maybe a short series of questions,  
9 depending on how this plays out, on the topic of the  
10 true-up. What is your understanding -- I take it  
11 from your earlier testimony that one of the items of  
12 true-up that will be taken into account before this  
13 is all over is the issue of capital structure and  
14 cost of capital?

15 A. Yes.

16 Q. Okay. So that's -- that's -- that is a  
17 true-up item as you understand it in this case?

18 A. Yes, it -- I guess it depends on how the  
19 parties agree to the capital structure because it  
20 will be very close. I assume that's going to be an  
21 issue still.

22 MR. BOUDREAU: Okay. Fair enough. I'll  
23 just have a moment and I think I'll be done here.

24 Thank you for that allowance of time. I  
25 don't have any further questions for this witness at

1 this time.

2 JUDGE JONES: We will try to get through  
3 questions from the bench. Commissioner Murray is not  
4 here. Commissioner Clayton?

5 COMMISSIONER CLAYTON: Thank you, Judge.

6 QUESTIONS BY COMMISSIONER CLAYTON:

7 Q. Mr. Barnes, welcome back.

8 A. Thank you.

9 Q. I do have some questions that I want to  
10 ask you from the rebuttal and surrebuttal testimony  
11 of Ms. Ahern. She criticizes some of your -- some  
12 points of your analysis, and I wanted to get your  
13 response in person here today.

14 First of all, I had a conversation with  
15 her regarding the appropriate method or the  
16 appropriate data that should be included in the CAPM  
17 analysis that you performed.

18 A. Yes.

19 Q. And that I believe in the -- in the  
20 equation is the capital  $R_f$  cap which I think is the  
21 risk-free rate and the performance of a risk-free  
22 investment over a certain period of time; is that  
23 correct?

24 A. That's correct.

25 Q. Okay. And she criticizes your analysis

1 because you include the -- the total amount of gains  
2 associated with that risk-free investment including  
3 appreciation, reinvested dividends and income. She  
4 criticizes you and says, no, you shouldn't do that,  
5 you should only use income.

6 And that's when I went and looked for  
7 the Ibbotson book to find out if it really said that.  
8 I just -- I wanted to get a full context of what it  
9 said. Can you give me a response? Tell me why she  
10 isn't right. Isn't just using income the most  
11 appropriate risk-free measure?

12 A. I believe that it is. The total return  
13 is not income. The total return is the appropriate  
14 way to do this because it's assumed that investors  
15 reinvest that dividend up to the maturity of the  
16 bond, and most of the time when you invest in a bond,  
17 it's for long term.

18 Q. The reference that she uses to Ibbotson  
19 quotes a section out of the book that says the most  
20 appropriate method of running this type of analysis  
21 is to only use income. Do you dispute that is the  
22 recommendation of Ibbotson or do you know?

23 A. I don't know. I'd have to go back and  
24 look at that myself.

25 Q. Well, we didn't have the book in our

1 library, so if you didn't see it, I'm not going to  
2 hold that against you. But is this a point of  
3 contention in the regulatory field or in the  
4 financial world or is it -- is it pretty clear that  
5 only the income component should be used in that  
6 calculation?

7 A. I wouldn't agree that it is totally  
8 clear the income should be used in that situation,  
9 but for -- for regulation, I believe the total return  
10 is -- is the appropriate measurement there.

11 Q. Is that what you've used in your career  
12 when doing a CAPM analysis here at the Commission?

13 A. Yes, yes.

14 Q. Okay. So you've never used the  
15 income-based --

16 A. No, no, I --

17 Q. -- investment?

18 A. -- have not.

19 Q. Okay. Are you aware -- I mean, is  
20 Ibbotson just out on a limb here or -- I mean,  
21 tell -- tell me why there seems to be this dispute on  
22 this component in the analysis.

23 A. I don't know if I have a real good,  
24 clear answer for you, but Staff and myself just  
25 assumed that the investor holds -- reinvests their

1 dividends in appreciation. We don't try to take into  
2 account, well, if I keep my dividend, what's my  
3 return going to be. We just assume that the  
4 investors are investing for the long term, and we  
5 assumed that all of their dividend return and  
6 appreciation is -- is included in the CAPM.

7 Q. Okay. She also criticizes your analysis  
8 in setting up the risk-free rate in how you compute  
9 that, and I think her -- her specific concern is that  
10 you use only historical data and you don't use any  
11 forward-looking data. Can you respond to that?

12 A. Sure. A lot of times, the prospective  
13 yield on -- or anything pro forma is not certain,  
14 it's not known and measurable. I believe that the  
15 historical rates are a good indicator of what could  
16 be going forward.

17 I'll give you an example with KCP&L.  
18 They -- in one of their cases, they tried to issue  
19 some hybrids at a certain return that they wanted and  
20 it didn't end up that way. So there's -- there's  
21 just a risk there that if you rely on prospective  
22 yields, that they're not going to happen. So that's  
23 why I used the historical rate.

24 Q. Okay. The last question is this  
25 arithmetic versus geometric measures or averages.

1 And I was corrected by Ms. Ahern because she -- I  
2 thought the arithmetic looked at short-term  
3 volatility and perhaps the geometric looked at  
4 long-term volatility. But explain to me why you  
5 think using geometric is the most appropriate measure  
6 here.

7 A. Again, you're -- you're -- she's correct  
8 when you measure -- you invest from point A, and at  
9 point B when I -- when that bond matures or that -- I  
10 want to sell my stock, that that's -- it's compounded  
11 throughout the term of the bond. And I believe that  
12 the -- using the geometric approach smooths out all  
13 the volatility that's involved with their arithmetic  
14 version of it.

15 And again, I believe that when you  
16 invest, you invest for the long term, and you're  
17 not -- you are concerned somewhat about what goes on  
18 in between, but trying to figure that out if you know  
19 you're going to keep your investment for a while, the  
20 result's going to be different than using the  
21 geometric approach.

22 Q. Okay. I want to just ask you some basic  
23 questions about the current climate in the credit  
24 markets and in the stock market, like I asked  
25 Ms. Ahern. Are you aware of any specific examples,

1 past or future, of problems that either American  
2 Water or Missouri-American Water will face in  
3 accessing the credit market that should require  
4 additional scrutiny on our part?

5 A. I don't right now, no. I don't know of  
6 anything in the past either -- even -- even after  
7 September 11th the market took a dip for a little bit  
8 just like it is now, and it's expected to hopefully  
9 come back. And -- but I don't know of any specific  
10 situation where American Water or Missouri-American  
11 has had problems issuing debt.

12 In fact, Missouri-American just  
13 issued -- or AWCC issued some debt earlier this year  
14 even back in May, but it was before all of this  
15 really took place.

16 Q. Well, your analysis -- your analysis  
17 concludes the recommended return on equity value of,  
18 what, between 9.6 and 10.6; is that correct?

19 A. That's correct.

20 Q. Do you believe any changes should occur  
21 to that recommendation based on what has occurred in  
22 credit stock markets in the last 30 or 60 days?

23 A. No, I don't, because this is a  
24 measurement for the long term, the return on equity  
25 is. I know the market's been down quite a bit, but I



1 don't think for American Water or Missouri-American  
2 an adjustment should be made for that.

3 Q. Do you believe they'll have difficulty  
4 accessing the credit markets based on what your  
5 recommendation is or do you know?

6 A. I -- I don't know, but based on their  
7 credit rating, they're at a BBB-plus now. I assume  
8 that they will not have a problem, but I don't know  
9 for sure.

10 COMMISSIONER CLAYTON: Okay. I'm going  
11 to go ahead and conclude right there. Thank you.

12 JUDGE JONES: Commissioner Jarrett, do  
13 you have questions?

14 QUESTIONS BY COMMISSIONER JARRETT:

15 Q. Yeah, I just had a -- a quick question  
16 going back to the arithmetic mean. And you were here  
17 during Ms. Ahern's testimony?

18 A. Yes, I was.

19 Q. And when she was talking about -- and  
20 we -- we had to sort of go back and forth on sort of  
21 the volatility and buying and selling of stocks. Do  
22 you recall that?

23 A. Briefly, yes.

24 Q. Do you agree with her assessment on sort  
25 of the volatility and buying and selling of utility

1 stocks?

2           A.       I would agree that there probably are  
3 some investors that do buy and sell frequently, but I  
4 believe a majority of the investors that invest in  
5 American Water invest for the long term. And to me,  
6 that is one of the reasons to use the geometric  
7 approach. I don't -- I don't know what investor she  
8 was talking or referring to.

9                   I did hear you say the -- the widower  
10 and the kids, and I still believe that those --  
11 you're still going to get those type of investors  
12 that expect that dividend for the long term and  
13 expect appreciation and -- and an investment in the  
14 water company.

15          Q.       Right. And I believe -- she'd indicated  
16 in her testimony, she talked a lot about  
17 institutional investors more and more in the market  
18 rather than just individual. I -- I assume you have  
19 an understanding of the market and how people invest.  
20 I mean, institutional investors, would you agree that  
21 they diversify their portfolio?

22          A.       Yes, definitely.

23          Q.       That's one of their goals. And so they  
24 would buy some risky stocks speculating on return --  
25 on price going up and that they might buy utility

1 stocks to balance that out because it's less risky?

2 A. That's very possible, yes.

3 Q. Get -- get a -- you'd return dividends  
4 and that helps balance out?

5 A. Yes, in their portfolio, yes.

6 Q. And so that investors aren't necessarily  
7 speculating on utility stocks, they're buying them  
8 for the long term because of the dividend yields?

9 A. I would agree with that, yes.

10 COMMISSIONER JARRETT: Thanks. That's  
11 all I have.

12 JUDGE JONES: Commissioner?

13 COMMISSIONER GUNN: My questions were  
14 covered. I don't have anything. Thanks for your  
15 testimony.

16 THE WITNESS: Thank you.

17 JUDGE JONES: Chairman?

18 CHAIRMAN DAVIS: Mr. Barnes, it's a  
19 pleasure to see you this afternoon.

20 THE WITNESS: Thank you, Mr. Chairman.

21 CHAIRMAN DAVIS: It is now afternoon.

22 JUDGE JONES: Okay. Commissioner Murray  
23 isn't here, so you're not excused. She may have  
24 questions for you. But at this time we will recess  
25 for two hours. Two o'clock we'll be back here.

1                   And Mr. Rungren, you are excused. Now  
2 we're off the record.

3                   (THE LUNCH RECESS WAS TAKEN.)

4                   JUDGE JONES: We are back on the record  
5 with Case No. WR-2008-0311. On the stand is Matt  
6 Barnes. We have had questions from the bench. At  
7 this time we will move to recross from  
8 Missouri-American.

9                   MR. BOUDREAU: Okay. Thanks.

10                  RECROSS-EXAMINATION BY MR. BOUDREAU:

11                 Q.       I just have a few questions for you,  
12 Mr. Barnes, related to, I think, an exchange you had  
13 with Commissioner Clayton where he inquired about the  
14 concept of forecasted interest rates. Do you recall  
15 that?

16                 A.       Yes.

17                 Q.       And I think you said that you -- that  
18 you thought it more appropriate to look at current  
19 interest rates?

20                 A.       That's correct.

21                 Q.       Was that your testimony?

22                 A.       (Nodded head.)

23                 Q.       With respect to that topic, if we'd go  
24 to Staff report, Schedule 5-1. Tell me when you get  
25 there.

1           A.       Okay.

2           Q.       This is a tabulation of average yields  
3 on corporate bonds?

4           A.       Public utility bonds.

5           Q.       Public utility bonds?

6           A.       Yes.

7           Q.       Over, well, actually quite some period  
8 of time?

9           A.       Yes.

10          Q.       And that -- and the source of this is  
11 Mergent Public Utility bonds?

12          A.       That's correct.

13          Q.       And the most current information you  
14 have, and this was the most current information as of  
15 the time I take it this report was filed, was June of  
16 2008?

17          A.       That's correct.

18          Q.       And it was -- the rate at that time was  
19 6.50 percent; is that correct?

20          A.       That's correct, as of June.

21          Q.       Okay. Your unadjusted midpoint  
22 recommendation to the Commission is 9.72 percent; is  
23 that correct?

24          A.       Yes.

25          Q.       Okay. And so if we take that 6.50 --

1 and I -- I -- what I -- actually, maybe I should back  
2 up here for a second. I assume that this -- the rate  
3 that you've got in Schedule -- or that is contained  
4 in Schedule 5.1 is a composite rate?

5 A. I believe it's just an average for --  
6 for each month.

7 MR. BOUDREAU: Okay. Let me -- I'm  
8 going to -- actually, I think what I'd like to do is  
9 get an exhibit marked.

10 (MAWC EXHIBIT NO. 32 WAS MARKED FOR  
11 IDENTIFICATION BY THE COURT REPORTER.)  
12 BY MR. BOUDREAU:

13 Q. I think you've been handed -- I believe  
14 you've had handed to you what's been marked for  
15 identification as Exhibit MAWC 32; is that correct?

16 A. Yes, that's correct.

17 Q. And ask you if you'd take a look at that  
18 and familiarize yourself with it, and I just want to  
19 ask you a few questions about it.

20 A. Okay.

21 Q. Just so I understand, I've used the term  
22 composite use, you've used the average, and I know  
23 this doesn't cover the same time frame of -- the same  
24 period of time that your Exhibit 5.1 covers, but my  
25 question is, if you look at the center column, it

1 talks about public utility bonds -- let me back up.  
2 The -- the -- the source of this document is Mergent  
3 Bond Record, right?

4 A. Correct.

5 Q. And that would be what you're looking to  
6 in terms of assembling your exhibit -- or  
7 Schedule 5.1, right?

8 A. That's correct.

9 Q. So if we look at the center column of  
10 Exhibit 32, we've got a public utility bond column,  
11 and then we'll have -- then -- then there are for any  
12 period of time, if you go from left to right, three  
13 entries depending on the bond rating. Do you see  
14 that?

15 A. That's correct, yes.

16 Q. So if I were to go to, for instance,  
17 January of 2007 and add those three together and take  
18 an average, would I come up with your January of  
19 2007 -- I think you called it an average, I call it a  
20 composite, but is that the source of this number?

21 A. Yes. And I believe that would be  
22 reflected in the columns where it says "Corporate by  
23 Groups," which it should average to 5.96 as of  
24 January 2007, so the average of those three bond  
25 ratings.

1           Q.       Oh, I see. I'm with you. So let me see  
2 here. My golly, it does match. Okay. Good. Thank  
3 you for that.

4                   Now, with respect to the -- let's stick  
5 with the most current number on your schedule or  
6 Staff's Schedule 5.1, and we've got 6.50, right?

7           A.       Yes.

8           Q.       So if we were to subtract that 6.50 from  
9 your midpoint recommendation -- well, let me go at  
10 this from a different angle here.

11                   MR. THOMPSON: Your Honor, I'm going to  
12 object because I don't see that this has any  
13 particular relation to the exchange between this  
14 witness and Commissioner Clayton that counsel  
15 referenced when he began this line of questioning.

16                   MR. BOUDREAU: The pertinence will  
17 become obvious here in a second because I want to  
18 move into -- we're talking about -- his testimony was  
19 that you'd need to look at current interest rates.  
20 He's looking at historical, so I want to try to tie  
21 the historical into the current. That's the  
22 relevance of it.

23                   JUDGE JONES: Relevant to questions from  
24 the bench or relevant to --

25                   MR. BOUDREAU: Yes. Yes, because I



1 believe he had a question from Commissioner Clayton,  
2 and I believe his answer was, as my opening, a couple  
3 of questions established that he -- he -- that this  
4 witness is maintaining that you should look at  
5 current interest rates and not, you know, for  
6 purposes of determination of cost of capital.

7 JUDGE JONES: Okay. Objection  
8 overruled.

9 BY MR. BOUDREAU:

10 Q. Were you here this morning for  
11 Ms. Ahern's discussion about recent yields on public  
12 utility bonds?

13 A. Yes, I was.

14 Q. Have you seen any information or looked  
15 into any information that would cause you to be --  
16 well, let me ask you this: Are you familiar with  
17 current -- with what the current yields on public  
18 utility bonds are?

19 A. I don't have that information available  
20 to me, but just based on September data, I could tell  
21 you what the actuals were based on this exhibit.

22 Q. What were the actuals as of September?

23 A. If you use the average of BAAA and AA,  
24 public utility bonds would be 6.59 percent.

25 MR. BOUDREAU: I don't think I'm going

1 to have this marked as an exhibit. May I approach  
2 the witness?

3 JUDGE JONES: Yes.

4 BY MR. BOUDREAU:

5 Q. Mr. Barnes, I'm going to ask you to take  
6 a look at that document and see if you can -- well,  
7 first of all, familiarize yourself with it.

8 A. Okay.

9 Q. Do you recognize that document?

10 A. They're daily bond yields and key  
11 indicators.

12 Q. Okay. And the source -- the source of  
13 the information is?

14 A. It looks like Moody's Investor Service.

15 Q. Okay. And if you look under the title  
16 for it, it says, "As of October 28th, 2008"; is that  
17 correct?

18 A. That's correct.

19 Q. Okay. And that would have been a couple  
20 of days ago --

21 A. Yes.

22 Q. -- right? And what this -- what this --  
23 well, would you agree with me that looking under the  
24 "Utilities" column, it gives an average of daily bond  
25 yields for public utilities that are --

1                   MR. BEDNAR: Your Honor, if we're  
2     reading from something that's marked as an -- can we  
3     at least get it marked as an exhibit and distribute  
4     it to counsel? I mean, not to be too technical here,  
5     but it appears there's going to be a line of  
6     testimony in regards to a piece of paper that none of  
7     the other counsel have been able to see.

8                   JUDGE JONES: I agree.

9                   MR. BOUDREAU: Well, I can have it  
10    marked as an exhibit. I'm not sure --

11                  MR. BEDNAR: I appreciate it.

12                  MR. BOUDREAU: -- I don't know if I have  
13    enough copies to go around to all the counsel.

14                  MR. THOMPSON: Well, I certainly would  
15    like a copy.

16                  MS. VUYLSTEKE: We'd also like a copy.

17                  MR. BOUDREAU: We'll see how long this  
18    lasts.

19                  MR. BEDNAR: If it's read into the  
20    record, it should be marked, I guess.

21                  MR. BOUDREAU: Well, let me have that  
22    one marked. Can you two share?

23                  THE WITNESS: I scribbled on that.

24                  MR. BOUDREAU: And mine's highlighted,  
25    so I'm not sure -- let's go ahead and have this

1 marked for identification.

2 (MAWC EXHIBIT NO. 33 WAS MARKED FOR  
3 IDENTIFICATION BY THE COURT REPORTER.)  
4 BY MR. BOUDREAU:

5 Q. Okay. To follow up on where I was  
6 before marking that as an exhibit, there's a -- the  
7 left-hand column shows utility -- "Yields on Utility  
8 Bonds For" -- well, it has entries for four, but it's  
9 only got three entries. AAA is not available.  
10 They've got AA at 7.19, A-rated as 7.94, BAA as 9.18  
11 with an average of 8.10; is that correct?

12 A. That's what it says, but it doesn't say  
13 how many days that that average is for.

14 Q. Yeah, it says "Data as of October 28th,  
15 2008," right?

16 A. Yes, but I don't know --

17 Q. Okay.

18 A. -- how far back it goes or if it's 30  
19 days or if it's a year.

20 Q. Okay. Well, let's -- if we take your  
21 midpoint, your recommended return on equity midpoint  
22 of 9.72 percent and we subtract the 6.50 percent that  
23 shows up in your Schedule 5.1 -- or Staff's Schedule  
24 5.1, we end up with 3.22 as the remainder. Would you  
25 agree with that?

1           A.       I would agree with that, yes.

2           Q.       Okay.  Would it be fair to look at that  
3   3.22 percent as the risk premium?

4           A.       One person could, but, again, based on  
5   the 9.18 percent, I don't know how far back that data  
6   goes, what the average is, is it 30 days, 60 days,  
7   but --

8           Q.       I'm sorry.  You lost me.  The 9.18  
9   you're referring to?

10          A.       Yes, that's what this says, the  
11   "Utilities for BA" --

12          Q.       Well, I'm --

13          A.       -- "long-term corporate bond yields."

14          Q.       Okay.  Maybe -- maybe we've passed in  
15   the night here.  I want to ask you with respect to  
16   your recommended midpoint unadjusted of 9.72, if we  
17   were to subtract the 6.50 which is the most current  
18   data available in Staff's Schedule 5.1, we'd end up  
19   with 3.22?  I mean, that's just the math, right?

20          A.       Yes, you would take --

21          Q.       And then my question, would it be fair  
22   to characterize that 3.22 as a risk premium?

23          A.       You could, yes.

24          Q.       Okay.  All right.  So let's take that  
25   risk premium of 3.22 and add it to the 8.10 on

1 Schedule MAWC 33, I believe the Moody's schedule?

2 JUDGE JONES: Yeah.

3 BY MR. BOUDREAU:

4 Q. If we were to do that math, we'd come up  
5 with 11.32 percent?

6 A. That's correct.

7 MR. BOUDREAU: Now, the -- I think at  
8 this point I'd like to offer into the record Exhibits  
9 MAWC 32 and 33.

10 JUDGE JONES: What is 33 again?  
11 Describe it.

12 MR. BOUDREAU: 33 -- oh, I'm sorry. 33  
13 is the Moody's Daily Bond Yields and Key Indicators  
14 tab -- table.

15 MR. BEDNAR: You can have my copy,  
16 Judge.

17 MR. BOUDREAU: I'll get more -- more  
18 copies made, but I apologize for that.

19 JUDGE JONES: Is there any objection to  
20 MAWC 32?

21 MR. CONRAD: Not -- not if we get a  
22 copy, and I'm assured by counsel we will.

23 JUDGE JONES: Hearing none, MAWC 32 is  
24 admitted into the record.

25 (MAWC EXHIBIT NO. 32 WAS RECEIVED INTO

1 EVIDENCE AND MADE A PART OF THE RECORD.)

2 JUDGE JONES: Is there any objection to  
3 MAWC 33?

4 (NO RESPONSE.)

5 JUDGE JONES: Seeing none, it is also  
6 admitted into the record.

7 (MAWC EXHIBIT NO. 33 WAS RECEIVED INTO  
8 EVIDENCE AND MADE A PART OF THE RECORD.)

9 BY MR. BOUDREAU:

10 Q. Now, again, working with the idea of  
11 current interest rates as the place to look, you did  
12 adjust your range and therefore your midpoint by 37  
13 basis points for a -- what I characterize as a  
14 credit -- creditworthiness adjustment?

15 A. That's correct.

16 Q. And you got to that adjustment by  
17 looking at the spread between BAA and A public  
18 utility bonds; is that right?

19 A. Yes, as of the time that I wrote this  
20 testimony.

21 Q. Okay. As of the time you wrote the  
22 testimony. And then I think you -- you adjusted,  
23 it's like two-thirds of the -- of that figure; is  
24 that correct?

25 A. Essentially, yes. So there's per notch

1 with -- with the company's credit rating and then my  
2 couple of groups' credit rating.

3 Q. Okay. Fair enough. Now, if we were to  
4 use the current spread between BAA as shown on MAWC  
5 Exhibit 33 and A-rated bonds, I get 1.24. Does that  
6 look right to you or sound right to you?

7 A. Yes, that sounds right.

8 Q. All right. And if we were to make a  
9 similar adjustment to that spread, we'd end up with  
10 basically 83 basis points. Would you agree with  
11 that?

12 A. If you were to use that approach, yes.

13 Q. Okay. I just want to wrap up at this  
14 point. Given -- given the increase in public utility  
15 bonds yields as shown in that schedule, No. 33, would  
16 it be reasonable now for the Commission to look more  
17 at the higher end of your range of recommended  
18 returns rather than the midpoint?

19 A. I can't say what the Commission may or  
20 may not do, but if it's --

21 Q. I'm asking you if you think it would be  
22 appropriate.

23 A. If they want to move to the high end of  
24 my range, I wouldn't disagree with that.

25 MR. BOUDREAU: Okay. I don't think I



1 have any more questions for this witness. Thank you.

2 JUDGE JONES: Okay. Any redirect?

3 REDIRECT EXAMINATION BY MR. THOMPSON:

4 Q. Mr. Barnes, in response to a question  
5 asked by Mr. Boudreau during cross-examination, he  
6 asked you if you knew that certain loan documents  
7 were included in a financing case that you had  
8 indicated you were not part of. Do you recall that  
9 question?

10 A. Yes.

11 Q. And -- and you answered by saying that  
12 you would take his word for it. Do you recall that?

13 A. Yes.

14 Q. And in fact, you have no idea whether  
15 those loan documents are in that case, do you?

16 A. I know there's a loan agreement, but as  
17 far as specifics from third-party investors, I don't  
18 know. I know there's internal documents available.

19 Q. And do you recall that Commissioner  
20 Clayton asked you whether you thought the company  
21 would have difficulty accessing the capital market if  
22 they were to adopt your recommendation with respect  
23 to return on equity, do you recall that?

24 A. Yes, I do.

25 MR. THOMPSON: May I approach, your

1 Honor?

2 JUDGE JONES: Yes, you may.

3 BY MR. THOMPSON:

4 Q. I've handed you a document. I wonder if  
5 you could tell me if you recognize it.

6 A. Yes, I do.

7 Q. What is it?

8 A. This is American Water's Value Line  
9 investment survey tariff sheet, and Value Line's a  
10 very popular source for investors to use.

11 Q. Is it for any particular date?

12 A. This is as of October 24th.

13 Q. I wonder if you see a starred portion?

14 A. Yes, I do.

15 Q. Could you read the portion that's been  
16 starred?

17 A. "This stock seems to be a good place for  
18 investors looking to take shelter from the tumultuous  
19 economic environment."

20 Q. Thank you. I'm going to hand you  
21 another document. I'd like you to take a look at it.  
22 Do you recognize that?

23 A. Yes. This is from MarketWatch and it  
24 compares American Water's price of the stock compared  
25 to the S&P 500.

1           Q.       In fact, it does that comparison through  
2 a graph, does it not?

3           A.       Yes, it does.

4           Q.       And it shows how American Water's stock,  
5 how the price has changed over a period of time  
6 compared to the S&P 500; isn't that correct?

7           A.       That's correct.

8           Q.       And what -- what is that change? In  
9 other words, compared to the change that it depicts  
10 in the value of the S&P 500, what is the change of  
11 American Water's price, share price?

12          A.       The change is -- as of, it looks like  
13 October 30th, minus 10 percent compared to the S&P  
14 500's at minus 30. So there's a spread there. But  
15 the stock's not as volatile as the S&P 500.

16          Q.       So based on that graph and on this  
17 tariff sheet that I showed you previously, are you  
18 able to draw any conclusion based on your  
19 professional knowledge and experience with respect to  
20 whether or not the company would be able to access  
21 capital markets at your recommended return on equity?

22          A.       Just by looking at that, it would just  
23 point to me that it's not as volatile as the market  
24 as a whole. And plus, the credit rating, that  
25 BBB-plus and the recent issuance earlier this year,

1 it doesn't appear that they would have a problem  
2 issuing any debt, but I don't know the specifics of  
3 if it would or not so...

4 MR. THOMPSON: Thank you. No further  
5 questions.

6 JUDGE JONES: Okay, thank you,  
7 Mr. Barnes. You may step down. I want to be clear  
8 on the exhibits that Staff offered for this witness.  
9 Those are Exhibits 2 -- Staff 2 and Staff 3 rebuttal  
10 and surrebuttal?

11 MR. THOMPSON: That is correct, your  
12 Honor.

13 JUDGE JONES: No Exhibit 1 for Staff?

14 MR. THOMPSON: Well, Exhibit 1 is the  
15 Staff cost of service report, and Mr. Barnes is one  
16 of a number of Staff witnesses who contributed to  
17 that report. And it's my view that it would be  
18 appropriate to offer the report after all of those  
19 witnesses have been up.

20 JUDGE JONES: Okay. All right. Let's  
21 move on to MIEC's witness, Mr. Brian Janous. Is he  
22 here?

23 MS. VUYLSTEKE: Yes, he is.

24 JUDGE JONES: Good afternoon, sir.  
25 Would you please raise your right hand after you get

1     situated?

2                     (The witness was sworn.)

3                     JUDGE JONES:   Thank you.   You may be  
4     seated.

5                     (MIEC EXHIBIT NOS. 1, 2 AND 3 WERE  
6     MARKED FOR IDENTIFICATION BY THE COURT REPORTER.)  
7     DIRECT EXAMINATION BY MS. VUYLSTEKE:

8             Q.       Can you state your name and business  
9     address for the record.

10            A.       Brian Janous.   And forgive me a second  
11     for my business address.   We just moved last week,  
12     and so the date -- the address that's on there, the  
13     direct testimony, is not correct anymore, but the  
14     surrebuttal should be.   16690 Swingley Ridge Road,  
15     Suite 140, Chesterfield, Missouri 63017.

16            Q.       Are you the same Brian Janous that filed  
17     MIEC Exhibits 1 through 3, direct, rebuttal and  
18     surrebuttal testimony of Brian Janous?

19            A.       Yes, I am.

20            Q.       Are the answers in that prefiled  
21     testimony true to the best of your knowledge and  
22     belief?

23            A.       Yes, they are.

24            Q.       Are those the same answers that you  
25     would give today if you were asked those questions?

1           A.       Yes, they are.

2           Q.       Do you have any corrections to that  
3 testimony?

4           A.       I do not.

5                   MS. VUYLSTEKE:   Okay.   I would tender  
6 the witness, then, for cross -- or excuse me -- I  
7 need to move for the admission of MIEC 1, 2 and 3.

8                   JUDGE JONES:   Are there any objections  
9 to either of those exhibits?

10                  MR. THOMPSON:   No objections.

11                  JUDGE JONES:   Seeing none, Exhibits MIEC  
12 1, 2 and 3 are admitted into the record.

13                   (MIEC EXHIBIT NOS. 1, 2 AND 3 WERE  
14 RECEIVED INTO EVIDENCE AND MADE A PART OF THE  
15 RECORD.)

16                  MS. VUYLSTEKE:   At this time I would  
17 offer Mr. Janous for cross-examination.

18                  JUDGE JONES:   Does Ag Processing have  
19 any cross-examination?

20                  MR. CONRAD:   We do not.   Thank you, your  
21 Honor.

22                  JUDGE JONES:   Public Counsel, do you  
23 have cross-examination?

24                  MS. BAKER:   No, your Honor.   Thank you.

25                  JUDGE JONES:   Staff of the Commission?

1 MR. THOMPSON: No, your Honor.

2 JUDGE JONES: Missouri-American Water  
3 Company?

4 MR. BOUDREAU: Yes, thank you.

5 CROSS-EXAMINATION BY MR. BOUDREAU:

6 Q. Good afternoon, Mr. Janous. My name is  
7 Paul Boudreau. I don't believe we've met.

8 A. I don't believe we have.

9 Q. I'm the attorney for Missouri-American  
10 Water Company in this case. I was going to say I  
11 have just a few questions, maybe more than just a  
12 few. I'll try to move through fairly quickly.

13 I want to ask you a few questions about  
14 the prefiled prepared testimony --

15 A. Okay.

16 Q. -- that you have filed in this case, and  
17 I want to start with your direct testimony. And I'd  
18 direct you to page 2 specifically. Are you there?

19 A. I am.

20 Q. Down near the bottom there's a Q&A. The  
21 question is, "Please describe how Missouri-American  
22 attracts external debt and equity capital."

23 Your answer goes to the end of that  
24 page, but the first -- your first sentence there is  
25 the one I'm interested in is, "Missouri-American does

1 not access external capital markets on its own;  
2 rather, it gets all of its external capital through  
3 its parent company or affiliate companies." Do you  
4 see that?

5 A. I do.

6 Q. Did I read that correctly?

7 A. Yes, you did.

8 Q. You are aware, are you not, that  
9 Missouri-American Water Company, in fact, does access  
10 the capital markets or at least for long-term debt  
11 through -- well, by placements of long-term debt in  
12 the capital markets to third-party lenders. Are you  
13 aware of that?

14 A. It was my understanding that the access  
15 to capital was through American Water Works, the  
16 parent company.

17 Q. Okay. So you're not -- you're not  
18 familiar with whether or not Missouri-American Water  
19 Company, in fact, does -- can and does place  
20 long-term debt in the -- in the capital markets?

21 A. As I said, it was my understanding it  
22 was through American Water Works.

23 Q. And are you aware of whether or not  
24 about \$213 million of long-term debt to third-party  
25 unaffiliated lenders is currently on the company's



1 books?

2 A. I don't have that number in front of me,  
3 no.

4 Q. I'll jump around here a little bit. I  
5 want to refer you to your -- let's see here. Well,  
6 let me do this. Let's -- refer you to your rebuttal  
7 testimony, page 5. Tell me when you're there.

8 A. I'm there.

9 Q. Okay. Bottom of the page again, there's  
10 a Q&A, and I'm not sure if I want to necessarily  
11 reread it, but your answer contains the statement  
12 that a BBB -- or at least I'll characterize it -- a  
13 BBB-plus bond rating is a strong investment grade  
14 bond rating. Do you see that?

15 A. I do.

16 Q. Okay. And that's your testimony still  
17 today?

18 A. It is.

19 Q. Okay. Would you agree -- and this is a  
20 Standard -- I take it we're talking about the  
21 Standard & Poor's rating?

22 A. Yes.

23 Q. Would you agree with me that the BBB  
24 rating is the bottom tier of investment bonds under  
25 the S&P rating system?

1           A.       The BBB as a whole, yes. BBB-minus  
2 would actually be the bottom tier, bottom of the --

3           Q.       Yes. You anticipated my -- well, I was  
4 going to use different jargon, but you anticipated my  
5 next question. So BBB-minus under the S&P rating  
6 system is the lowest investment-grade-rated bond that  
7 they -- that they will rate; is that correct?

8           A.       Correct.

9           Q.       What's the significance of investment  
10 grade rating? I mean, what -- what happens -- what's  
11 the difference? I mean, what advantage is there to  
12 being an investment grade rating?

13          A.       Well, it's somewhat of a subjective  
14 measure, obviously, of where that line is drawn, but  
15 S&P has drawn it at BBB-minus. There's no obvious  
16 implication. Sometimes contractual arrangements may  
17 be tied to that, but there's nothing to say that a  
18 BBB-minus versus a, you know, noninvestment-  
19 grade-rated entity is substantially different, other  
20 than S&P is obviously assessing their risk.

21          Q.       Okay. Are there certain investors or  
22 even the, you know, government standards that  
23 restrict the -- restrict the investment of funds in  
24 anything less than investment grade funds?

25          A.       There -- there are.

1           Q.       Okay. So that can be a consequence as  
2 well?

3           A.       Yes.

4           Q.       Okay. Page 8 of your direct testimony,  
5 you talk a little bit about your proxy groups. And  
6 as I understand, what you've done is you've used two  
7 proxy groups, one of which is a proxy group of water  
8 utilities and the other is a proxy group of natural  
9 gas utilities; is that correct?

10          A.       That is correct.

11          Q.       And with respect to the water proxy  
12 group, you've got a spread of bond ratings of from  
13 A-plus to A-2, and A-plus -- well, yeah, A-plus being  
14 those S&P rating and A-2 being the Moody's rating; is  
15 that correct?

16          A.       I'm sorry. Were you referring to the  
17 water group or the gas group?

18          Q.       The water proxy.

19          A.       The water group. Yes, that is correct.

20          Q.       So is it your testimony that an A-plus  
21 rating is comparable to a BBB-plus investment grade  
22 rating?

23          A.       Yes, I think it's reasonably close  
24 enough. The issue dealing with water proxy groups is  
25 having sufficient access to data on water groups.

1 You'll notice that nearly half of my water proxy  
2 groups are not actually rated entities by S&P, so  
3 there's a limitation --

4 Q. Okay.

5 A. -- in using a water proxy group because  
6 of limited access to the data which is why I also  
7 used a gas proxy group.

8 Q. Okay. Let's talk about the A-plus S&P  
9 rating. Is that the highest rating for -- for an  
10 S&P-rated utility?

11 A. No, it's not.

12 Q. What's the highest rating for S&P?

13 A. It's AAA-plus.

14 Q. So I mean -- so I want to go to the  
15 Moody's rating which is the A-2, and I'm going to ask  
16 you a similar sort of question that I did with  
17 respect to the S&P rating. Is the A-2 out of the  
18 Moody's comparable to a BAA-1?

19 A. It's reasonably comparable. But once  
20 again, unfortunately, the water companies in my proxy  
21 group, only one of eight actually had a credit rating  
22 from Moody's. So the A-2 is actually comparing only  
23 one entity within my proxy group.

24 Q. I want to move on to your gas proxy  
25 group, then, while we're on the topic. And though --

1 that group had a range of ratings for S&P of being  
2 from A at S&P ratings to A-3 for Moody's; is that --  
3 is that correct?

4 A. That is correct.

5 Q. And I want to ask you similar sort of  
6 questions. Is it your testimony here today that an  
7 A rating at -- on S -- or by S&P is comparable to a  
8 BBB-plus rating?

9 A. It's within two notches, so I'd say it's  
10 reasonably comparable.

11 Q. And it probably anticipates the next  
12 question. Is it your testimony that an A-3 rating  
13 under the Moody's system is comparable to a BAA-1  
14 rating?

15 A. It's -- it's reasonably comparable.

16 Q. Did you take a look at Staff witness  
17 Barnes' testimony in this -- in this case?

18 A. I -- I did, somewhat.

19 Q. Are you familiar with the proxy group  
20 that he used for his analysis?

21 A. Not -- not that I could speak to it, no.

22 Q. Okay. Are you aware of the fact that he  
23 made a 37 basis point creditworthiness adjustment  
24 based on the fact that his comparables under the S&P  
25 system were A-rated versus American Water Works'

1 BBB-plus rating?

2 A. I can't verify that, no.

3 Q. Okay. Do you have his testimony handy?

4 A. I do not, actually.

5 Q. I want to talk -- you did three  
6 different versions of the DCF for your -- for your  
7 testimony, and I want to talk first -- you talk, I  
8 think, starting on page 9 or thereabouts about the  
9 constant growth DCF.

10 And as I read your testimony, what you  
11 ended up with is you established your range as  
12 between what the DCF would generate for the water  
13 proxy group and the -- the gas proxy group?

14 A. That's correct.

15 Q. Okay. But other than that, you did kind  
16 of a similar sort of thing, you established a range  
17 and then you picked a midpoint?

18 A. Correct.

19 Q. Okay. As I understand -- yet the results of  
20 your constant growth DCF model showed that if you  
21 used the water proxy group, you ended up with a  
22 12.96 percent?

23 A. That's correct.

24 Q. Okay. And as for the gas proxy group came  
25 in at 10.51 percent; is that correct?

1           A.       That's correct.

2           Q.       With a midpoint of 11.74 percent?

3           A.       That's correct.

4           Q.       Okay. And this model used security  
5 analyst growth estimates, didn't it?

6           A.       I did.

7           Q.       Okay. I believe you also stated on  
8 page 10 of your direct testimony that the security  
9 analyst's estimates have been shown to be more  
10 accurate predictors of future growth than historical  
11 data; is that correct?

12          A.       That is correct.

13          Q.       What you've done is -- as I understand  
14 your testimony, that you've rejected the results of  
15 the constant growth DCF, and I believe the gist of  
16 your testimony is that the -- the earnings -- or the  
17 earnings projections for the next three to five years  
18 aren't sustainable for a longer period of time. Is  
19 that kind of the bottom line of your discarding of  
20 those results?

21          A.       Yes, that is.

22          Q.       Okay. So you've -- is it fair to say  
23 that you believe that the earnings projections for  
24 the next three to five years are at least reasonable?

25          A.       The -- the projections of analyst growth

1 rates for the next three to five years are reasonable  
2 projections for the next three to five years.

3 Q. Do you not have any opinion over what  
4 time -- period of time the rates set in this  
5 proceeding will be in effect?

6 A. I would -- I don't have any knowledge of  
7 exactly how long they'll be in effect, no.

8 Q. Do you think that they would be in  
9 effect indefinitely?

10 A. I would highly doubt it.

11 Q. You also did a two-stage DCF, but as I  
12 understand it, you did not consider those results in  
13 making your recommendation to the Commission; is that  
14 correct?

15 A. That is correct.

16 Q. And you also did a three-stage DCF, and  
17 I believe that analysis starts up around page 16 of  
18 your direct testimony -- or not -- excuse me, 19 --  
19 well, that may be right. Yeah, page 16.

20 Just so we're on the same page in terms  
21 of what the results of that study indicated, is you  
22 came up with a -- or the -- you came up with a water  
23 proxy, and I'll call it a data point of 9.02 percent;  
24 is that correct?

25 A. That is correct.



1           Q.       For the gas proxy, 9.3 with a midpoint  
2 of 9.16?

3           A.       That's correct.

4           Q.       You also did a risk -- risk premium  
5 model for your analysis; is that correct?

6           A.       I did.

7           Q.       And it came up with a range, but the  
8 midpoint of that range was 10.02 percent; is that  
9 right?

10          A.       That is.

11          Q.       And you also did a CAPM analysis; is  
12 that correct?

13          A.       That's correct.

14          Q.       And came up with a range there --  
15 correct me if I'm wrong on those figures -- for your  
16 water proxy group, 11.82 percent?

17          A.       For the -- yes, that is correct.

18          Q.       And for your gas proxy group, 10.76  
19 percent?

20          A.       That also is correct.

21          Q.       Okay. Thank you. I want to now direct  
22 you to page 25 of your direct testimony and  
23 specifically the table 2 that shows up on that page.  
24 Are you there?

25          A.       I am there, yes.

1           Q.       This is kind of where the rubber meets  
2   the road in terms of your recommendation, isn't it?  
3   It's kind of where you summarize how you put it  
4   together and how you make a recommendation?

5           A.       Yes, it is.

6           Q.       So your recommend -- recommendation to  
7   this Commission is that you've come up -- you've  
8   generated a range of 9.16 percent on the low end to  
9   10.76 percent on the high end; is that correct?

10          A.       I'm sorry. What was the high end?

11          Q.       I think it was 10.76.

12          A.       I believe my -- my high end number in  
13   the table was 11.02 percent.

14          Q.       Well, I'm talking about your ultimate  
15   recommendation to the Commission.

16          A.       The ultimate recommendation, actually,  
17   to some degree does incorporate the 11.02 as -- as  
18   providing partial weight.

19          Q.       Okay. Let me -- let me circle back  
20   around and make sure we're on the same page here.  
21   Your gas proxy group is 10.76, correct, on the --  
22   under the CAPM?

23          A.       Under the CAPM, correct.

24          Q.       Under the CAPM. Well, let me -- let me  
25   just -- let me just ask it this way: What is the

1 recommended range, the -- the high and low end of the  
2 range that you're recommending to this Commission?

3 A. The midpoint of the range that I  
4 developed was 10.03, and just to be clear about how  
5 the 11.02 fit into there --

6 Q. Uh-huh.

7 A. -- what I did is I took the -- the  
8 entire range of my results, the high and low, the  
9 9.16 to the 11.02, to come up with a 10.09 percent.  
10 However, taking into account my concerns regarding  
11 the beta estimates for the water group, I also ran  
12 the analysis excluding the water group CAPM results  
13 and came up with a average of 9.96. The midpoint of  
14 those two numbers was 10.03. So the 11.022 was  
15 considered, it was -- just provided less weight than  
16 the overall result than the other results.

17 Q. Well, let me try this again. What's the  
18 you upper end that you're looking at for purposes of  
19 establishing a range of reasonable ROE for  
20 Missouri-American Water Company?

21 A. If we're considering the total -- I  
22 mean, I would not establish the upper end as any one  
23 single analysis. For instance, I would not say that  
24 it is reasonable to take my CAPM analysis results and  
25 establish that as the upper end.

1                   What establishes the upper end would be  
2   the average that incorporates the water group CAPM  
3   results, and that upper end is 10.09 percent and the  
4   low end is 9.96 which excludes the water group CAPM  
5   results.

6           Q.       Well, the highest CAPM that I'm seeing  
7   in table 2 is 11.02 and the lowest is 10.76.

8           A.       That's correct.

9           Q.       And so what's the CAPM that you're --  
10   what's the CAPM data point that you're using for  
11   making your recommendation in this case?

12          A.       I'm incorporating both.

13          Q.       Okay. So it's not just -- but it's not  
14   a -- it's not a midpoint between 11.02 and 10.76?

15          A.       It is -- it is not. I'm --

16          Q.       And it's an average of those two?

17          A.       It is not.

18          Q.       Okay. So what is --

19          A.       What I'm doing is taking the DCF, the  
20   risk premium --

21          Q.       Okay.

22          A.       -- and the high end of the CAPM, the  
23   11.02 --

24          Q.       Okay.

25          A.       -- and come up with an average of 10.09.

1 I am also taking, as -- as that would be my high end,  
2 the low end would be the 9.16 DCF, the risk premium,  
3 and just the gas group CAPM. That would establish my  
4 low end of 9.96.

5 To provide some weight to the water  
6 group CAPM, I took the midpoint of those two results.  
7 I could argue for either one, but I thought it was  
8 fair to take the midpoint of those. So that's where  
9 I get my -- my two results. If you look on line 7 of  
10 that, you can see that the midpoint of 10.09 and 9.96  
11 is 10.03 which is my recommendation.

12 Q. And the source of the 10.09 number is  
13 again?

14 A. That is the --

15 Q. That's the average of 9. --

16 A. Yes. If you look on lines 1 and 2, you  
17 can see where the 10.09 came from.

18 Q. Okay. Did you think the 10.09 percent  
19 result was unreasonable?

20 A. I was concerned, as I state in my direct  
21 testimony, about the betas used in the water group  
22 CAPM which is why I only divided partial --

23 Q. Let's go back to your constant growth  
24 DCF. I mean, you -- you -- you -- you discarded that  
25 result, presumably, because you didn't think that

1 the -- that the result of the test was reasonable?

2 A. Actually, I discarded that result  
3 because I didn't think the inputs into the test -- or  
4 I didn't think the model itself was appropriate  
5 given --

6 Q. Okay.

7 A. -- the level of the inputs into the  
8 model.

9 Q. So I want to come back down to this  
10 10.09 percent which is the average of the -- of the  
11 range of 9.16 to 11.02. Your recommendation to the  
12 Commission in this case is 10.03, right?

13 A. Correct.

14 Q. And I guess my -- my question to you is  
15 did you think that the 10.09 was unreasonable? I'm  
16 trying to figure out why that number was, you know,  
17 essentially not used by you for your recommendation.

18 A. By -- it was, again, not the result that  
19 I found reasonable, it was the input that derived  
20 that result which I found somewhat problematic. Not  
21 so much that I would disregard it entirely, but I  
22 didn't want to give as -- as great a weight to that.

23 Q. So it's your testimony, I take it, today  
24 since you didn't make a creditworthiness adjustment,  
25 that you don't think a creditworthiness adjustment is

1 appropriate?

2 A. I don't believe it's necessary in this  
3 case.

4 Q. What do you mean by "necessary"?

5 A. Well, I wouldn't have changed my proxy  
6 group. The proxy group is developed according to the  
7 standards that I had established in my testimony and  
8 I wouldn't have changed those -- those standards.

9 Q. All right. Bear with me here for a  
10 second while I gather my bearings. I believe you  
11 made some reference in your rebuttal testimony to the  
12 Illinois American Water Company rate case. Do you  
13 recall that?

14 A. I do.

15 Q. What was the allowed ROE in that rate  
16 case?

17 A. Actually, I can't recall off the top of  
18 my head what the allowed ROE was in that case.

19 Q. Do you know whether or not it was 10.35  
20 percent?

21 A. I can't say with certainty.

22 Q. Okay. Were you a party in that -- or  
23 were you a witness in that case?

24 A. I was.

25 Q. Okay. And what was your responsibility

1 in that case?

2 A. It's testifying with respect to the  
3 return on equity.

4 Q. Okay. When -- when was your testimony  
5 given?

6 A. It was earlier this year.

7 Q. Okay. And you did, in fact, testify?

8 A. I did.

9 Q. Okay. And so you're not familiar with  
10 what the results of that case were?

11 A. I'm familiar with the results. I don't  
12 recall the results off the top of my head.

13 Q. Okay.

14 CHAIRMAN DAVIS: Wait a minute, Judge.  
15 Can I interject? So you -- you testified you don't  
16 know whether on your portion of the case you won or  
17 lost?

18 THE WITNESS: I -- no, I'm not -- I'm  
19 not testifying to that. I'm testifying to the fact  
20 that I don't know the exact number that that case  
21 ended up with.

22 CHAIRMAN DAVIS: Okay. So did you win  
23 or lose?

24 THE WITNESS: I know that we ended up  
25 with a number that was somewhat close to my



1 recommended range, but I don't remember exactly what  
2 my recommendation was.

3 CHAIRMAN DAVIS: Okay. Thank you.

4 Excuse me.

5 BY MR. BOUDREAU:

6 Q. Let me go back momentarily to invest --  
7 investment grade bond ratings. Would you agree with  
8 me that a BBB-plus rating is viewed as marginally  
9 riskier than an investment in an A-minus rated bond?

10 A. I would agree with that.

11 Q. And I take it your testimony would be  
12 the same if the bond rating were A or A-plus, that  
13 BBB-plus would be considered riskier than those two  
14 ratings?

15 A. I would agree with that.

16 Q. S&P recently downgraded -- this is for  
17 American Water Company -- from A-minus to BBB; isn't  
18 that correct?

19 A. That's correct.

20 Q. And that took place in June of this  
21 year?

22 A. That sounds about right.

23 Q. I want to turn now to a discussion on  
24 page -- well, I want to look at your testimony on  
25 page 14 of your rebuttal on the topic of the measure

1 of beta. Are you there?

2 A. I am, yes.

3 Q. Second paragraph of your answers has --  
4 this is what I'm -- I'm going to read from it. It  
5 says, "First, the beta is a measure of a company's  
6 specific risk premium from the market risk premium  
7 relative to a risk-free security." Do you see that?

8 A. I do.

9 Q. Is that still your testimony today?

10 A. It is.

11 Q. This is not how Value Line measures  
12 beta, is it?

13 A. I -- I don't know specifically what  
14 you're referring to.

15 Q. Well, I'm just asking you if you know  
16 how Value Line measures beta.

17 A. I'm -- I'm familiar with Value Line's  
18 ratings and their adjusted beta, if that's your  
19 question, yes.

20 Q. The reason I ask you this is that you  
21 use Value Line data --

22 A. Correct.

23 Q. -- isn't that correct? Yeah. Now,  
24 Value Line looks at price change and not price change  
25 less risk-free; isn't that correct? It just looks at

1 change in price?

2 A. That's correct.

3 Q. I'm going to turn now to page 15, the  
4 following page, your answer to that question. You  
5 have a reference at the end of your first paragraph  
6 of your answer where you refer to "water utility  
7 business risk." Do you see that?

8 A. Yes.

9 Q. I want to go further up in your answer  
10 to another reference. You talk about other risk  
11 factors. You see that reference, it's on line 6?

12 A. I do.

13 Q. What do you mean by "other risk  
14 factors"?

15 A. Give me just a second. I want to read  
16 through the paragraph.

17 Q. Yes.

18 A. What I'm referring to there is that  
19 business risk factors facing water utilities at this  
20 time from everything that S&P is saying are still  
21 relatively stable. If I could -- could point you to  
22 page 5 of my testimony where S&P specifically  
23 discusses American Water Works and their supported  
24 competitive and regulatory environment.

25 Q. Good. And we'll come back to that --

1           A.       Okay.

2           Q.       -- because that's where I'm headed.

3       Would you agree with me, sir, that beta is a measure  
4       of systemic or undiversifiable risk?

5           A.       I would.

6           Q.       Okay. And diversifiable risks are those  
7       that are specific to a company and in general not  
8       reflected in beta, would you agree with that?

9           A.       I would.

10          Q.       Okay. I want to refer you now to your  
11       direct testimony, page 8 to begin with. Are you  
12       there?

13          A.       I am, yeah.

14          Q.       In the middle of the page, there's a  
15       question, you know, "How did you select your gas LDC  
16       group?" Do you see that? And you looked at a number  
17       of criteria, I see five criteria --

18          A.       Yes.

19          Q.       -- listed there. Now, are those  
20       criteria, are those company-specific risks?

21          A.       They primarily appear to be.

22          Q.       Okay. And that means that they are  
23       diversifiable?

24          A.       Largely, yes, they would be.

25          Q.       I want to turn now -- I think it's a --

1 let me get there and I'll -- I'll misguide everybody.

2 I want to turn to your rebuttal testimony, Schedule

3 BAJ-3. Are you there?

4 A. BAJ-3?

5 Q. BAJ-3.

6 A. Yes.

7 Q. And so that -- this appears to be a

8 document that was generated by American Water?

9 A. Yes.

10 Q. And you -- and you've referred to this

11 in part in your -- in your -- in addressing the topic

12 of beta in your rebuttal testimony, correct?

13 A. I'm trying to find exactly the page

14 number of the reference to that, so pause with me for

15 a moment.

16 Q. That would be the same page 15 that we

17 were talking about.

18 A. Okay. All right. Yes.

19 Q. And I guess my question to you is, are

20 the items listed on Schedule BAJ-3 items of the same

21 nature as the ones that we just talked about, and

22 that is industry-specific or diversifiable?

23 A. Yes, I believe they are.

24 MR. BOUDREAU: I think I want to just do

25 a quick wrap-up here.

1 BY MR. BOUDREAU:

2 Q. So as I understand your testimony, you  
3 did a constant growth DCF, but you discarded the  
4 results; is that correct?

5 A. That is correct.

6 Q. Okay. And the result -- the midpoint  
7 result of that was an 11.74 rate of -- rate of return  
8 on equity capital; is that correct?

9 A. That's correct.

10 Q. Okay. And you also did a CAPM for the  
11 water proxy group and that gave you an 11.28  
12 percent --

13 A. That's correct.

14 Q. -- return on equity capital; is that  
15 correct?

16 A. That is correct.

17 MR. BOUDREAU: Give me a moment, please.

18 Thank you, Mr. Janous. I have no further questions  
19 for this witness.

20 JUDGE JONES: Okay. We'll move to  
21 questions from the bench. Commissioner Murray?

22 COMMISSIONER MURRAY: No questions.

23 JUDGE JONES: Commissioner Jarrett?

24 QUESTIONS BY COMMISSIONER JARRETT:

25 Q. Good afternoon, Mr. Janous.

1           A.       Good afternoon.

2           Q.       I just have maybe one or two quick  
3 questions. I was having a little trouble following  
4 back and forth between you and Mr. Boudreau on how  
5 you arrived at your final number of 10.03. And I'm  
6 referring specifically to page 25, I believe, of your  
7 direct in your table 2.

8           A.       Sure.

9           Q.       Could you -- could you -- I apologize  
10 for making you go through this again, but would you  
11 walk through how you used all those numbers and  
12 arrived at 10.03?

13          A.       Absolutely. And I apologize for it not  
14 being as clear maybe as it ought to have been. What  
15 I did is considered -- in the first case, you can see  
16 on lines 1 and 2 of page 25 the range of 9.16, which  
17 was my three-stage DCF, and 11.02, which is the --  
18 the midpoint of the water and gas CAPM analysis that  
19 I performed. And that ended up with a result of  
20 nine -- 10.09. So that was my -- my first result.

21                 Secondly, given the concerns that I had  
22 with the beta estimates that we were discussing,  
23 while I didn't want to discard them entirely because  
24 I felt it appropriate to include the current beta  
25 estimates for those -- that water proxy group in my

1 final result, I didn't want to provide them the full  
2 weight of the gas group.

3           So I did it a separate calculation that  
4 was replacing the 11.02 percent CAPM result with the  
5 10.76 which is a CAPM result solely for the gas  
6 group. And so the average of the 9.16 and 10.76 in  
7 that range became 9.96. And so that established a  
8 high and a low of which I -- my recommendation is the  
9 midpoint of those two as you can see on line 7.

10           Q.       Okay. And then what were your  
11 concerns -- specific concerns about the beta  
12 estimates that you mentioned?

13           A.       My concerns about the beta estimates had  
14 to do with the level of betas relative to the recent  
15 historical level of betas. The -- for the water  
16 proxy group, the present betas were .95 percent. The  
17 highest beta that we have recorded for the previous  
18 five years was .83 percent with a low of .59 percent.

19           So I was concerned that the present  
20 betas were somewhat of an outlier relative to the  
21 recent historical period. So I didn't want to  
22 provide as much of a weight to those numbers as I did  
23 to the betas that were derived in a calculation in my  
24 gas proxy group CAPM, though I didn't discard them  
25 entirely.



1           Q.       And what do you think is the reason why  
2     the beta, say, jumped up to .95 from those -- those  
3     earlier ones, .83 and .59?

4           A.       As -- as we discussed, the betas are a  
5     measure of the volatility of a stock price relative  
6     to the market as a whole. And apparently, the stock  
7     prices for this proxy group of water companies have  
8     as of late been more volatile in terms of -- of  
9     moving in conjunction with the market. It seems to  
10    imply a higher degree of risk associated with those  
11    companies.

12                   In fact, the .95 percent would imply  
13    that the risk is similar to that as the market as a  
14    whole. And my point in my testimony was I don't  
15    think it's appropriate to say that -- that water  
16    companies that are regulated utilities share the same  
17    sort of risk as the market as a whole.

18                   COMMISSIONER JARRETT: Thank you. I  
19    have no further questions.

20                   JUDGE JONES: Mr. Chairman?

21                   CHAIRMAN DAVIS: No questions.

22                   JUDGE JONES: You may step down,  
23    Mr. Janous. Thank you.

24                   Okay. It looks like we are way ahead of  
25    schedule, I think, unless I'm mistaken. Am I? It

1 doesn't look like it. What I propose we do, then, is  
2 to stop for today because I anticipate no one's  
3 actually prepared for Monday's issues, and we can  
4 pick up with Monday's issues tomorrow. Does anyone  
5 have any objection to that?

6 MS. BAKER: Let me ask.

7 MR. CONRAD: Your Honor, could we have  
8 maybe about five minutes off the record?

9 JUDGE JONES: Sure. We can go off the  
10 record.

11 (DISCUSSION HELD OFF THE RECORD.)

12 (WHEREUPON, the hearing of this case was  
13 recessed until 1:00 p.m. on November 3, 2008.)

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1	I N D E X	
2	Opening Statement by Mr. England	23
	Opening Statement by Mr. Thompson	29
3	Opening Statement by Ms. Baker	34
4	ISSUE: RETURN ON EQUITY AND CAPITAL STRUCTURE	
5	(RATE OF RETURN ISSUES)	
6	MISSOURI-AMERICAN'S EVIDENCE	
7	PAULINE AHERN	
	Direct Examination by Mr. Boudreau	36
8	Cross-Examination by Mr. Thompson	40
	Questions by Commissioner Murray	44
9	Questions by Commissioner Jarrett	50
	Questions by Commissioner Gunn	59
10	Questions by Commissioner Clayton	71
	Questions by Chairman Davis	88
11	Questions by Commissioner Murray	89
	Redirect Examination by Mr. Boudreau	90
12	Voir Dire by Mr. Thompson	95
13	SCOTT RUNGREN	
	Direct Examination by Mr. Boudreau	96
14		
15	STAFF'S EVIDENCE	
	MATTHEW BARNES	
16	Direct Examination by Mr. Thompson	99
	Cross-Examination by Mr. Conrad	108
17	Cross-Examination by Mr. Boudreau	110
	Questions by Commissioner Clayton	158
18	Questions by Commissioner Jarrett	164
	Recross-Examination by Mr. Boudreau	167
19	Redirect Examination by Mr. Thompson	180
20		
21	MIEC'S EVIDENCE	
22	BRIAN JANOUS	
	Direct Examination by Ms. Vuylsteke	184
23	Cross-Examination by Mr. Boudreau	186
	Questions by Commissioner Jarrett	209
24		
25		

1	EXHIBITS INDEX		
2		MARKED	RECEIVED
3	MAWC Exhibit No. 1		
4	Direct testimony of Pauline Ahern	16	38
5	MAWC Exhibit No. 2		
6	Rebuttal testimony of Pauline Ahern	16	38
7	MAWC Exhibit No. 3		
8	Surrebuttal testimony of Pauline Ahern	16	38
9	MAWC Exhibit No. 20		
10	Direct testimony of Scott Rungren	16	98
11	MAWC Exhibit No. 21		
12	Rebuttal testimony of Scott Rungren	16	98
13	MAWC Exhibit No. 22		
14	Surrebuttal testimony of Scott Rungren	16	98
15	MAWC Exhibit No. 31		
16	Chart showing the Federal Funds rate compared to A-rated public utility		
17	bonds	96	98
18	MAWC Exhibit No. 32		
19	Mergent Bond Record	169	177
20	MAWC Exhibit No. 33		
21	Table of Moody's Daily Bond Yields and Key Indicators	175	178
22	Staff Exhibit No. 1		
23	Staff's cost of service report	16	*
24	Staff Exhibit No. 2 NP and HC		
25	Rebuttal testimony of Matthew J. Barnes	16	101

1	EXHIBITS INDEX		
2		MARKED	RECEIVED
3	Staff Exhibit No. 3		
4	Surrebuttal testimony		
4	of Matthew J. Barnes	16	101
5	MIEC Exhibit No. 1		
6	Direct testimony of		
6	Brian Janouos	184	185
7	MIEC Exhibit No. 2		
8	Rebuttal testimony		
8	of Brian Janous	184	185
9	MIEC Exhibit No. 3		
10	Surrebuttal testimony		
10	of Brian Janous	184	185
11			
12			
13			
14			
15			
16			
17			
18			
19			
20			
21			
22			
23			
24			
25			