

Exhibit No.:
Issues: Tank Painting, Main Break,
Insurance, Pensions and OPEBs,
Leases, Waste Disposal, Rate Case
Expense, STEP Cost and Penalties
Witness: Jeremy K Hagemeyer
Sponsoring Party: MoPSC Staff
Type of Exhibit: Direct Testimony
Case No: WR-2007-0216 et al.
Date Testimony Prepared: June 05, 2007

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

JEREMY K. HAGEMEYER

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2007-0216

Jefferson City, Missouri
June 2007

~~STAFF~~ Exhibit No. 11
Case No(s). WR-2007-0216
Date 8-14-07 Rptr. JF

STAFF-11

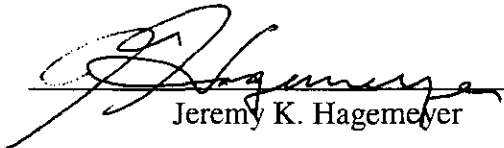
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri-American Water)
Company's request for Authority to) Case No. WR-2007-0216, *et al*
Implement a General Rate Increase for)
Water Service provided in Missouri)
Service Areas)

AFFIDAVIT OF JEREMY K. HAGEMEYER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)


Jeremy K. Hagemeyer, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Direct Testimony in question and answer form, consisting of 10 pages to be presented in the above case; that the answers in the foregoing Direct Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.


Jeremy K. Hagemeyer

Subscribed and sworn to before me this 4th day of June, 2007.



ASHLEY M. HARRISON
My Commission Expires
August 31, 2010
Cole County
Commission #06898978


Notary Public

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DIRECT TESTIMONY
OF
JEREMY K. HAGEMEYER
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WR-2007-0216, *et al.*

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DIRECT TESTIMONY
OF
JEREMY K. HAGEMEYER
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WR-2007-0216, *et al.*

Q. Please state your name and business address.

A. Jeremy K. Hagemeyer, 9900 Page Avenue, Suite 103, Overland, MO, 63132.

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

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

Q. Please describe your educational background.

A. I graduated from Southwest Missouri State University, receiving a Bachelor of Science in Accounting and German in May 2001.

Q. Please describe your duties while employed by the Commission.

A. I have assisted with audits and examinations of the books and records of public utility companies operating within the state of Missouri.

Q. Have you previously filed testimony before this Commission?

A. Yes. Please refer to Schedule 1, attached to this testimony for a listing of the cases and issues for which I have filed testimony.

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

1 A. Yes, in conjunction with other members of the Commission's Staff (Staff). I
2 reviewed Staff data request responses in this case, the general ledger, prior case files,
3 workpapers for this case and Case No. WR-2003-0500, monthly financial reports and past
4 Commission rulings.

5 **EXECUTIVE SUMMARY**

6 Q. What matters will you address in your testimony?

7 A. I will address expenses relating to tank painting, main breaks, insurance, other
8 post employment benefits (OPEBs), pensions, leases, transportation leases, waste (sludge)
9 disposal, rate case, "Standardized Technology Enabled Processes" (STEP) cost, and penalties.

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

12 A. I have reviewed the filed testimony, schedules, workpapers and data request
13 responses regarding these issues in this case. I have also reviewed documents from previous
14 rate cases. In addition, I have relied on the accounting training I have received during college
15 and the training I received through classes and seminars in utility regulation. I have also
16 engaged in discussions with and received guidance and in-house training from my supervisors
17 with regard to these issues and in general for this Company.

18 Q. What adjustments are you sponsoring in this case?

19 A. I am sponsoring the following adjustments in Accounting Schedule 10,
20 Adjustments to Income Statement:

21 Tank Painting	S-14.9
22 Main Breaks	S-12.4 & S-14.13
23 Insurance	S-14.7
24 Other Post Employment Benefits	S-14.8
25 Pensions	S-14.10
26 Leases	S-9.4, S-10.4, S-11.4, S-12.3 & S-14.4

1	Transportation Leases	S-14.11
2	Waste (Sludge) Disposal	S-11.5 & S-14.12
3	Rate Case	S-14.14
4	STEP Cost	S-14.5
5	Penalties	S-14.28

6 In addition, I am sponsoring rate base amounts related to the Other Post Employment
7 Benefit asset and accrued pension liability.

8 **TANK PAINTING EXPENSE**

9 Q. Please explain adjustment S-14.9.

10 A. Adjustment S-14.9 represents the normalized level of interior and exterior tank
11 painting expense.

12 Q. How were the normalized levels for interior and exterior tank painting expense
13 determined?

14 A. Based on the information provided by the Company in its work papers and in
15 the response to Staff Data Request No. 201, Staff averaged the actual tank painting costs
16 incurred by the Company over the past five years. Staff also included an annualized level of
17 inspection costs.

18 Q. Please explain how the annualized level of inspection expense was determined.

19 A. This was determined by accepting the assertion of the Company that a full
20 inspection and wash out with a visual/sanitary inspection were performed for each tank once
21 every four years. MAWC has 89 tanks that need inspection, divided by four, this equals an
22 average of 22.25 tanks inspected annually. The cost of this inspection process is \$2,900/tank.
23 Staff multiplied the average annual inspections by the cost to derive the annualized level of
24 inspection expense. Staff has requested information that would allow it to compare actual
25 inspections with the four-year inspection schedule, but to date has not received a response.

1 Staff reserves the right to update this calculation based on the information provided and file
2 supplemental direct testimony if necessary.

3 Q. Is there a tank painting schedule that is used by MAWC?

4 A. Yes. Tank interiors are normally scheduled to be painted every 12 years and
5 tank exteriors every 8 years. However, Staff's comparison of the scheduled tank paintings
6 and the timing of actual tank painting, shows that the use of 12 and 8 year painting intervals is
7 not a reliable method for determining an annualized expense level as the Company has not
8 kept up with these standards. Therefore the Staff utilized a five-year average of tank painting
9 expense for the interior and exterior surfaces.

10 **MAIN BREAK EXPENSE**

11 Q. Please explain adjustments S-12.4 and S-14.13

12 A. Adjustments S-12.4 and S-14.13 adjusts the test year level of expense for main
13 breaks to the level experienced as of the twelve months ending December 31, 2006. A main
14 break occurs when a water pipe (or main) breaks and/or separates completely or a leak is
15 detected which requires a portion of the main to be repaired or replaced. Staff noted that there
16 has been a generally declining trend in the number of main breaks and that the number of
17 breaks has decreased significantly from the years prior to the implementation of the
18 Infrastructure System Replacement Surcharge (ISRS).

19 Q. What impact does Staff believe that the ISRS implementation has on main
20 breaks?

21 A. Staff believes that ISRS programs will lead to fewer main breaks as older
22 infrastructure that is likely to cause a main break is systematically replaced over time. Given
23 this, and the generally decreasing number of main breaks, Staff feels that the 12-months

1 ending December 31, 2006, is an appropriate level of main breaks to include in expense.
2 Despite this reduction in the number of breaks, there has been an increase in the overall cost.
3 Staff's movement to the 12-months ending December 31, 2006, captures this increased cost
4 per break.

5 **INSURANCE EXPENSE**

6 Q. Please explain Staff's annualization of Insurance Expense.

7 A. Staff has annualized this expense by using the most recent insurance premiums
8 and allocations to MAWC provided by the Company in their work papers. The amount of
9 each allocated insurance premium was multiplied by the applicable operations and
10 maintenance (O&M) expense percentage. For example, the Staff used the payroll O&M
11 percentage to determine the expense portion of the workman's compensation insurance
12 premium.

13 Q. Did the Staff disallow any of the Company's insurance expense premiums?

14 A. Yes, the Staff is recommending disallowance of the cost of the kidnap and
15 ransom premium. The Staff believes that the operations of MAWC would most likely not be
16 materially affected in the unlikely event that a Company employee were ever kidnapped and
17 held for ransom.

18 Q. Has Staff included the cost of Directors and Officers insurance premiums?

19 A. No. The Company has not provided any proof of the existence of such a
20 policy, so Staff has not included it in the cost of service.

21 **PENSIONS AND OTHER POST EMPLOYMENT BENEFITS**

22 Q. Please explain the Staff's adjustments for Pensions and Other Post
23 Employment Benefits (OPEBs) Expense.

1 A. These adjustments reflect Staff's calculations of Pension and OPEBs Expenses
2 associated with the Company's pension plan and OPEB plan. For purposes of calculating the
3 pension and OPEB expenses, Staff relied on the Financial Accounting Standard (FAS) 87 and
4 FAS 106 computations performed by the Company's actuary, Towers Perrin. Staff proposes a
5 modification to these calculations to eliminate the "corridor" approach and amortize
6 unrecognized gains and losses over a ten-year period.

7 Q. Please explain what the "corridor" approach is and why Staff has chosen to
8 eliminate it.

9 A. Part of the calculation of pension and OPEB expense according to FAS 87 and
10 106 is the amortization of unrecognized gains and losses. The "corridor" approach defines the
11 minimum amount of amortization of unrecognized gains and losses required during the year.
12 The "corridor" is equal to ten percent of the greater of the projected benefits that a company is
13 obligated to pay an employee after retirement (PBO for pensions and APBO for OPEBs) or
14 the market-related value of the assets in the pension or OPEB fund. Only the amount of gains
15 and losses that exceed the corridor are required to be amortized during the year. The amount
16 of gains and losses identified by the corridor is then amortized over the remaining life of the
17 plan participants.

18 Since the projected benefits of an entire workforce or the fund balance is a substantial
19 amount, the corridor approach shields a significant amount of gains and losses from even
20 being considered for amortization. Staff believes that an approach that eliminates a
21 significant component from being considered in the calculation of annual benefit cost is
22 inappropriate for ratemaking. Therefore, the Staff proposes that the corridor approach be
23 eliminated for the purpose of establishing rates and that unrecognized gains or losses be
24 amortized over a period of ten years.

1 Q. Please explain why the Staff believes a ten-year amortization is appropriate for
2 ratemaking.

3 A. The Staff believes that it is important to recognize costs and benefits in rates in
4 a timely manner. The delayed recognition resulting from the corridor approach and an
5 amortization longer than 10 years does not accomplish this goal. The Staff believes that a ten-
6 year amortization period is long enough to address any questions of volatility that may arise
7 by using a shorter time period, yet short enough to achieve the goal of recognizing the cost or
8 benefit of gain/loss amortization in a timely fashion. In addition to the elimination of the
9 corridor and the change in amortization period, to address the over and under recovery of
10 pension and OPEB expense, the Staff wishes to establish tracking mechanisms (trackers).

11 Q. Please explain the trackers.

12 A. The trackers will accumulate the difference between the pension and OPEB
13 amounts calculated by the Company's actuary and the amounts calculated using Staff's
14 recommendation to eliminate the corridor and to amortize gains and losses over a ten year
15 period. The amounts accumulated in the trackers, either positive or negative, will be included
16 in rate base in future cases.

17 Q. Does the Staff have any additional items to discuss regarding pensions and
18 OPEBs?

19 A. Yes. Included in the additions to Staff's rate base, there is a line item related to
20 the Deferred OPEB asset. The OPEB asset represents contributions the Company made to an
21 external fund in 1993 and 1994, before the implementation of FAS 106 for ratemaking. The
22 inclusion of this item in rate base was ordered by the Commission in case No. WR-95-205.
23 There is also a reduction to the rate base related to the accrued pension liability. This liability
24 represents the difference between the amount of FAS 87 expense that the company accrues

1 and the amount that it funds. This offset to rate base has been recognized in previous rate
2 cases. The Staff's proposed pension tracker in conjunction with pension liability will
3 accumulate the difference between the pension cost included in rates and the amount actually
4 funded. The inclusion in rate base of these amounts will compensate either the Company or
5 the ratepayer for the additional cash supplied above or below the amount included in rates.
6 Since the Company is funding the amount its actuary has calculated for OPEBs, the inclusion
7 of the amount accumulated in the OPEB tracker in rate base will likewise compensate either
8 the Company or the ratepayer for the additional cash supplied above or below the amount
9 included in rates.

10 **LEASE EXPENSE**

11 Q. Please explain adjustments S-9.4, S-10.4, S-11.4, S-12.3 and S-14.4.

12 A. These adjustments annualize the expense for leases related to buildings,
13 equipment and software licenses. Since the office space in St. Louis is shared between
14 MAWC personnel and American Water Works, Inc., personnel, Staff requested and received
15 a diagram of the building. Taking the measurement of the space allocated to MAWC
16 employees, Staff allocated the common space such as conference rooms, lunch facilities and
17 the atrium between MAWC and American Water Works, Inc. The O&M percentage for the
18 specific employees assigned to this office was used to determine the overall expense
19 associated with this office space. For all other buildings which do not share space with the
20 parent company, Staff applied the district average O&M percentage. A similar approach was
21 used in determining the expense associated with equipment and software leases.

22 **TRANSPORTATION LEASE EXPENSE**

23 Q. Please explain adjustment S-14.11.

1 A. This adjustment annualizes the lease expense associated with vehicles. The
2 O&M percentages were used to determine the amount of the annual vehicle lease that should
3 be charged to expense.

4 Q. Why does the Staff feel that it is appropriate to apply the O&M percentages to
5 this expense?

6 A. It is appropriate because the Company's employees that make use of these
7 vehicles are involved in both operations activities and capital projects.

8 **WASTE (SLUDGE) DISPOSAL EXPENSE**

9 Q. Please explain adjustments S-11.5 and S-14.12.

10 A. These adjustments annualize MAWC's waste disposal expense. Staff analyzed
11 each district individually and determined the appropriate level of expense. For the St. Louis
12 and St. Joseph districts, Staff used a two-year average of waste disposal costs due to the
13 Company being on a two-year cycle. For the Cedar Hill district, the Company informed Staff
14 that the waste disposal expense incurred during the test year expense was only expected to be
15 repeated every 15 to 20 years. Staff normalized the test year level by dividing the cost by
16 17.5 years, the average of 15 and 20. For the Joplin district, Staff was informed that the
17 Company had spent \$21,878 in 2005, but had not incurred any costs for 2003, 2004 and 2006.
18 This pattern indicated a four year interval. Therefore, Staff divided the \$21,878 by four to
19 normalize the expense level. Staff found that the remaining districts had a generally growing
20 amount of waste disposal expense and therefore, included the test year levels as the most
21 indicative of the ongoing cost.

22 **RATE CASE EXPENSE**

23 Q. Please explain Staff's adjustment for rate case expense.

1 A. Staff has adjusted the test year level of rate case expense to reflect the level of
2 cost that the Company has incurred to date and for which invoices have been provided to Staff
3 for the current rate case. Staff has removed any amounts that were not explained and is
4 currently waiting on information from the Company regarding these amounts. Staff believes
5 this is the most representative amount of normalized rate case expense, based on the
6 information available to date. Staff will continue to monitor this expense throughout the rate
7 proceedings and will propose changes to rate case expense levels as warranted.

8 **STEP COSTS**

9 Q. Please explain the adjustment to remove STEP Costs from test year expense.

10 A. These test year costs will not be incurred in the future and have been removed
11 from the ongoing cost of service. STEP costs were incurred by the Company to aid it in
12 utilizing business process software. The program has since been canceled. The Company has
13 also proposed removal of STEP Costs from its case.

14 **PENALTIES EXPENSE**

15 Q. Please explain adjustment S-14.28.

16 A. This adjustment removes unnecessary penalties incurred by the Company in
17 the test year.

18 Q. Does this conclude your testimony?

19 A. Yes, it does.

CASE PROCEEDING PARTICIPATION

JEREMY K. HAGEMEYER

PARTICIPATION		TESTIMONY
COMPANY	CASE NO.	ISSUES
AmerenUE	ER-2007-0002 and GR-2007-0003	Direct – Revenues, Pay Stations, Advertising, Dues and Donations, Insurance, Leases, Uncollectibles
Atmos Energy Corporation	GR-2006-0387	Direct – Employee Benefits including Pensions and OPEBs; Incentive compensation & Katrina; Bonus; Injuries and Damages, Insurance, Lobbying, Advertising, Dues, Donations and Miscellaneous Expenses
Missouri-American Water Company	WR-2003-0500 and WC-2004-0168	Direct – Payroll, Payroll-Related Benefits; Rents, Leases and Software Licenses; Rate Case Expense; PSC Assessment; Governmental Affairs/ Lobbying Rebuttal – Employee Expense; Relocation Expense; Customer Service Bonus Surrebuttal – Employee Expense; Relation Expense; Equipment Leases; Annual Incentive Plan; Customer Service Bonus; Lobbying Expense
Laclede Gas Company	GR-2002-356	Direct – Plant and Reserve; Other Rate Base and Related Expense (Except Cash Working Capital); Depreciation Expense; Dues, Donations, Membership Fees and Miscellaneous Expense