

Exhibit No.: _____
Issue(s): Cedar Hill Waste Water Plant
Capacity Disallowance/
Security AAO Rate Base Treatment/
Fire Hydrant Painting Proposal
Witness/Type of Exhibit: Robertson/Surrebuttal
Sponsoring Party: Public Counsel
Case No.: WR-2008-0311

SURREBUTTAL TESTIMONY
OF
TED ROBERTSON

Submitted on Behalf of the Office of the Public Counsel

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2008-0311

**

**

Denotes Highly Confidential that has been redacted

October 16, 2008

NP

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of Missouri-American)
Water Company's Request for Authority to)
Implement a General Rate Increase for)
Water and Sewer Service Provided in)
Missouri Service Areas.)

Case No. WR-2008-0311

AFFIDAVIT OF TED ROBERTSON

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Ted Robertson, of lawful age and being first duly sworn, deposes and states:

1. My name is Ted Robertson. I am a Public Utility Accountant for the Office of the Public Counsel.
2. Attached hereto and made a part hereof for all purposes is my surrebuttal testimony.
3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.



Ted Robertson, C.P.A.
Public Utility Accountant III

Subscribed and sworn to me this 16th day of October 2008.



JERENE A. BUCKMAN
My Commission Expires
August 10, 2009
Cole County
Commission #05754036



Jerene A. Buckman
Notary Public

My Commission expires August, 2009.

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**SURREBUTTAL TESTIMONY
OF
TED ROBERTSON**

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**MISSOURI AMERICAN WATER COMPANY
CASE NO. WR-2008-0311**

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I. INTRODUCTION

16
17

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

18
19

A. Ted Robertson, PO Box 2230, Jefferson City, Missouri 65102-2230.

20
21

Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THE PROCEEDING?

22
23

A. Yes, I have submitted rebuttal testimony in this proceeding.

24
25
26

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. I intend to respond to the rebuttal testimonies of Company witnesses, Messrs. Dennis R. Williams, Frank L. Kartmann, and Tyler T. Bernsen regarding the issues Cedar Hill Waste Water Plant Capacity Disallowance, Security AAO Rate Base Treatment, and the Company proposal for a Fire Hydrant Painting Project.

III. CEDAR HILL WASTE WATER PLANT CAPACITY DISALLOWANCE

Q. WHAT IS THE ISSUE?

A. Staff has proposed an excess plant capacity adjustment which the Company opposes. To support Company's position, Mr. Kevin H. Dunn and Mr. Dennis R.

1 Williams filed rebuttal testimony explaining why they believe the adjustment is
2 inappropriate. The purpose of my testimony is to correct misrepresentations
3 contained within the rebuttal testimony of Mr. Williams.
4

5 Q. IS IT MR. WILLIAMS' POSITION THAT COMPANY WILL HAVE TO
6 RECOGNIZE A LOSS IF THE COMMISSION ACCEPTS THE STAFF'S
7 PROPOSAL?

8 A. Yes. On page 4, lines 4-9, he states:
9

10 Q. CAN YOU EXPLAIN IN LAYMAN'S TERMS WHAT THAT
11 MEANS IN REGARD TO CEDAR HILL?
12

13 A. Yes. It means that even though the Staff has not directly
14 challenged the prudence of the construction of Cedar Hill, if
15 the Commission accepts the Staff position, the Company
16 would be required to recognize an almost \$2.2 million loss
17 and write the asset off its books.
18
19

20 Q. WHAT IS THE BASIS FOR MR. WILLIAMS STATEMENTS?

21 A. Beginning on page 3, line 5, he states that his conclusion is based on the
22 accounting requirements of the Financial Accounting Standards Board (FASB)
23 Statement of Financial Accounting Standards No. 90 (SFAS No. 90), Regulated
24 Enterprises - Accounting for Abandonments and Disallowances of Plant Costs.
25

1 Q. IS MR. WILLIAMS' CONCLUSION CORRECT?

2 A. No. While Mr. Williams correctly cites Paragraph 59 of SFAS No. 90, his reliance
3 on it as evidence that a loss would have to occur is inappropriate. SFAS No. 90
4 is not the governing accounting pronouncement covering this issue. Mr. Williams
5 failed to explain to the Commission that in the event that the Commission
6 accepts the Staff's proposal, but does not make a specific finding that the
7 enterprise should not have constructed that capacity or should have delayed the
8 construction of that capacity the accounting requirements of Financial Accounting
9 Standards No. 90 do not apply.
10

11 Q. DOES THE STAFF'S PROPOSAL FOR RATEMAKING OF THE EXCESS
12 CAPACITY REQUEST A FINDING THAT THE COMPANY SHOULD NOT HAVE
13 CONSTRUCTED THE EXCESS CAPACITY OR SHOULD HAVE DELAYED THE
14 CONSTRUCTION?

15 A. No.
16

17 Q. WHAT DOES SFAS NO. 90 ACTUALLY SAY REGARDING THE ISSUE AS
18 RECOMMENDED BY THE STAFF?

19 A. In Paragraph 60 of SFAS 90 it states, in clear unambiguous language, that the
20 pronouncement does not apply in this instance:
21

60. Some respondents to the Exposure Draft requested that the Board address "excess capacity" disallowances. Those disallowances relate to part of the cost of service of a recently completed plant and are based on a finding that the utility's reserve capacity exceeds an amount deemed to be reasonable. If an "excess capacity" disallowance is ordered by a regulator without a specific finding that the enterprise should not have constructed that capacity or should have delayed the construction of that capacity, the rate order raises questions about whether the enterprise meets the criteria for application of Statement 71, in that it is not being regulated based on its own cost of service. However, because such a rate order itself is neither a direct disallowance nor an explicit, but indirect, disallowance of part of the cost of the plant, this Statement does not specify the accounting for it. If an "excess capacity" disallowance is ordered by a regulator with a specific finding that the enterprise should not have constructed that capacity or should have delayed the construction of that capacity, the rate order may be an explicit, but indirect, disallowance of part of the cost of the plant, and the enterprise should account for the substance of that order as set forth in paragraph 7 of this Statement.

(Emphasis by OPC)

I cannot say whether or not it was Mr. Williams' intention to purposely mislead the Commission, but his representation that the accounting requirements of Statement of Financial Accounting Standards No. 90 govern this issue is incorrect.

Q. IS THE COMMISSION REQUIRED BY ANY AUTHORITY, ACCOUNTING OR OTHERWISE, TO MAKE A FINDING THAT THE COMPANY SHOULD NOT

1 HAVE CONSTRUCTED THE EXCESS CAPACITY OR SHOULD HAVE
2 DELAYED THE CONSTRUCTION IN THE EVENT IT ACCEPTS THE STAFF'S
3 RECOMMENDATION?

4 A. No.

5
6 Q. SINCE STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 90
7 DOES NOT APPLY TO THE STAFF'S RATEMAKING PROPOSAL FOR THE
8 EXCESS PLANT CAPACITY, WHAT IS THE RELEVANT ACCOUNTING
9 PRONOUNCEMENT THAT COMPANY MUST FOLLOW IN THE EVENT THAT
10 THE COMMISSION AUTHORIZES THE STAFF'S RECOMMENDATIONS?

11 A. Company must follow the accounting requirements of Statement of Financial
12 Accounting Standards No. 71 as referenced in Paragraph 60 of SFAS No. 90.

13
14 Q. WILL THE ACCOUNTING REQUIREMENTS OF STATEMENT OF FINANCIAL
15 ACCOUNTING STANDARDS NO. 71 REQUIRE COMPANY TO RECORD A
16 LOSS, FOR FINANCIAL REPORTING PURPOSES, IF THE COMMISSION
17 AUTHORIZES THE STAFF'S RECOMMENDATIONS?

18 A. No, it does not.

19 **IV. SECURITY AAO RATE BASE TREATMENT**

20 Q. WHAT IS THE ISSUE?

1 A. The issue concerns Company's request for rate base treatment of the
2 unamortized costs associated with the Security AAO. Company wishes to
3 include the unamortized costs in rate base while Public Counsel is opposed to
4 the proposal.

5
6 Q. WHAT EVIDENCE DOES COMPANY PROVIDE TO SUPPORT ITS REQUEST?

7 A. Beginning on page 6, line 1, of Mr. Bernsen's rebuttal testimony he proffers the
8 Company's position for rate base treatment. In essence, he provides his opinion
9 that rate base treatment of the unamortized costs should be allowed because,
10 "The sole result of this investment of capital was the continued provision of safe
11 and adequate service to MAWC's customers as the security expenditures were
12 made to protect our customers and the assets that serve them."

13
14 Q. DID ANY OTHER UNMENTIONED PARTIES BENEFIT FROM THE AAO?

15 A. Yes. Mr. Bernsen neglects to identify that Company's shareholders were the
16 primary beneficiaries of the AAO and the resultant inclusion of the deferred costs
17 in rates. Were it not for authorization of the AAO, and subsequent ongoing
18 amortization of the deferred costs into rates, the shareholders earnings during
19 the period of deferral would have been lower. In addition, costs incurred to
20 protect customers and assets directly benefit shareholders because as the

1 owners of the operations and assets their investment was certainly at risk in the
2 event of a terrorist attack.

3
4 Q. IN THE EVENT THE COMMISSION DOES NOT AUTHORIZE COMPANY'S
5 RATE BASE TREATMENT REQUEST DOES COMPANY SUBMIT AN
6 ALTERNATIVE REQUEST?

7 A. Yes. Beginning on page 6, line 17, Mr. Bernsen states, "If the Company is not
8 allowed to earn a return on the unamortized balance of the Security AAO asset,
9 then the deferred taxes associated with the AAO asset should not be used to
10 reduce rate base."

11
12 Q. WHAT EVIDENCE DOES COMPANY PROVIDE TO SUPPORT THIS
13 ALTERNATIVE REQUEST?

14 A. Continuing on page 6, line 21, Mr. Bernsen again gives his opinion when he
15 states that, "It is neither fair nor reasonable to include a rate base reduction for
16 the deferred taxes associated with the Security AAO asset without recognizing
17 the very same asset as an addition to rate base. This treatment would cause a
18 mismatch in the revenue requirement model in that the customers will receive the
19 benefit of the deferred tax deduction without have to pay for the Security AAO
20 asset in rate base."

1 Q. IS MR. BERNSEN'S ASSESSMENT AN ACCURATE REPRESENTATION OF
2 THE ISSUE?

3 A. His assessment is partially correct and partially incorrect.
4

5 Q. PLEASE EXPLAIN WHERE HE IS CORRECT.

6 A. He is correct that ratepayers will receive the benefit of a deferred income tax
7 deduction in rate base, but that is only appropriate since it is ratepayers that
8 provide the funds that the Company utilizes to pay the income taxes which give
9 rise to the recording of the deferred income tax. As I explained in my rebuttal
10 testimony, tax timing differences give rise to deferred income tax (tax payable at
11 some date in the future) and current income tax payable which summed together
12 represent the Company's total income tax liability for any given year. Since it is
13 ratepayers which provide the funds to Company to match its total income tax
14 liability (per Internal Revenue Service normalization rules and regulations), the
15 deferred income tax balance represents a cost-free loan from ratepayers to the
16 Company. It would be quite inappropriate for ratepayers to provide Company
17 with a return on funds which they previously provided to Company to pay income
18 tax which it has not yet paid. Reducing rate base by the accumulated deferred
19 income tax balance achieves that goal.
20

21 Q. PLEASE EXPLAIN WHERE HE IS INCORRECT.

1 A. He is incorrect in his assessment that the rate base deduction would cause a
2 mismatch in the revenue requirement model. Deferred income taxes are
3 ratepayer supplied funds thus, they are properly included as an offset in the
4 determination of rate base. Deferred income taxes remain ratepayer funds
5 regardless of any subsequent regulatory treatment of the original investment (i.e.,
6 costs) that gave rise to the taxes. A regulator's decision on whether or not a cost
7 warrants ongoing rate base treatment has no relationship to the cash provided to
8 the Company, by the ratepayer, for payment of its currently payable and
9 postponed (i.e., deferred income tax) income tax liability. A decision by the
10 Commission to deny inclusion in rate base of Company's unamortized Security
11 AAO costs does not change the fact that it is ratepayers that have provided
12 monies to the Company, via the regulatory process, for deferred income tax in
13 conformance with the Internal Revenue Service rules and regulations. Public
14 Counsel's position on this issue does not cause a mismatch in the revenue
15 requirement model. Neither does it harm or benefit the Company. It is simply
16 based upon normal regulatory ratemaking concepts and practices

17 Q. IS THERE COMMISSION PRECEDENT THAT SUPPORTS THE PUBLIC
18 COUNSEL'S POSITION THAT ACCUMULATED DEFERRED INCOME TAXES
19 RELATED TO AN AAO SHOULD BE INCLUDED AS AN OFFSET TO RATE
20 BASE?

1 A. Yes. In Missouri Gas Energy, Case No. GR-98-140, the Commission heard this
2 same AAO deferred income tax issue and authorized ratemaking according to
3 the position Public Counsel is supporting in the current case. In the case *Report*
4 *and Order on Rehearing*, beginning on 5, it states:

5
6 MGE is involved in an accelerated program to replace customer
7 service lines as ordered by the Commission. While implementing
8 the SLRP, MGE has been granted a series of accounting authority
9 orders that permit MGE to accumulate expenditures that would
10 normally be expense in the period in which they were incurred.
11 These items are depreciation expense, property tax expense, and
12 carrying costs associated with the installed SLRP plant after the
13 actual SLRP plant was placed in service, but prior to these related
14 expenses being directly reflected in rates.

15
16 In Case No. GR-96-285, the Commission permitted MGE to include
17 these expensed deferrals in rate base as well as to amortize the
18 deferrals over a 20-year period. By including the expense deferrals
19 in rate base, MGE earned a return on the unamortized deferred
20 amounts. In the present case, the Commission excluded those
21 deferrals from rate base, but accelerated MGE's total recovery of
22 the costs from 20 to ten years.

23
24 MGE argues that since the shareholders are financing the
25 investment that gave rise to deferred income taxes, the benefit of
26 those deferred income taxes should flow to the shareholders (in
27 other words, the deferred income taxes should not be an offset to
28 rate base). The Commission was not persuaded by MGE's
29 arguments or the testimony of its witnesses and determines that the
30 use of the SLRP accumulated deferred income taxes, as an offset
31 to rate base, is appropriate as explained below.

32
33 Deferred income taxes, including MGE's accumulated deferred
34 income taxes for SLRP deferrals, result from the timing difference
35 between a company currently deducts an expense on its income
36 tax return and when it later deducts the expense on its financial

statement records. This is also known as a book-tax timing difference. MGE's accumulated deferred income taxes for SLRP deferrals are created by a book-tax timing difference.

The purpose of including an offset to rate base for accumulated deferred income taxes is to recognize that ratepayers have provided money through rates for the payment of taxes that the utility has deferred paying until a later period. The utility may use the ratepayers' money until the payment of the deferred income taxes is made.

MGE's witness, June Dively, testified to the fact that MGE was "enjoying" the benefits of those deferred taxes. Therefore, MGE's deferred income tax reserve represents a prepayment of income taxes by the ratepayers from which MGE "enjoys" a financial benefit.

MGE's witness Dively further admitted that MGE's taxes would not be affected by whether or not the item was included or excluded from rate base. Because it is the book-tax timing difference which gives rise to the benefit that MGE receives, and not the SLRP deferrals that have been excluded from rate base, the Commission finds that the SLRP accumulated deferred income taxes are not related to the actual SLRP expense deferrals for purposes of inclusion in rate base. Therefore, the SLRP accumulated deferred income should continue to be included as an offset to MGE's rate base.

V. FIRE HYDRANT PAINTING PROPOSAL

Q. WHAT IS THE ISSUE?

A. The issue concerns Company's request to include forecasted costs, associated with a proposed fire hydrant painting project that it has not yet implemented, in

1 the current case cost of service. Public Counsel is opposed to the request for the
2 reasons I discussed in my rebuttal testimony.

3
4 Q. HAS COMPANY PROVIDED ANY NEW INFORMATION REGARDING ITS
5 PROPOSAL?

6 A. Yes. In his rebuttal testimony, beginning on page 6, line 31, Mr. Frank L.
7 Kartmann states that Company has recently signed a contract to implement the
8 proposed painting project (attached as HC Schedule FLK-6 to his rebuttal
9 testimony). Further, beginning on page 8, line 17, he suggests that a hydrant
10 painting tracker could be established in order to encourage Company and
11 provide assurance to regulators that the work will be performed (as an alternative
12 he suggests that the current tank painting tracker be increased to include the
13 estimated cost).

14
15 Q. DOES THE FACT THAT COMPANY HAS ENTERED INTO A CONTRACT
16 AFFECT PUBLIC COUNSEL'S RECOMMENDATION THAT COMPANY'S
17 PROPOSAL NOT BE AUTHORIZED?

18 A. No. Irrespective of the reasons for disallowance that I discussed in my rebuttal
19 testimony, Company's proposal lacks significant detail information regarding the
20 proposed project. For example, to my knowledge, the Company has not done a
21 detailed survey that would identify the number of fire hydrants that actually

1 require environmental remediation (he provides on page 28 of his direct
2 testimony an estimate of 17,000). Furthermore, the number of fire hydrants
3 requiring actual remediation is not included within the documents constituting the
4 contract or its attachment.

5
6 Q. DOES THE CONTRACT PROVIDE ANY ASSURANCE THAT THE LEVEL OF
7 COSTS IDENTIFIED BY COMPANY WILL ACTUALLY OCCUR?

8 A. No. I believe that the contract is deficient in that it describes the work to be done
9 as simply, "*** _____

10 _____ ***"

11 The contract does not contain, or identify, any schedules or documents listing the
12 fire hydrants to be remediated, their locations or the workflow wherein the
13 timeframe for the processing of the individual fire hydrants will occur. In my
14 opinion, the contract language is too vague in its scope and intentions and
15 provides no assurance that the level of costs estimated by the Company will be
16 incurred.

17
18 Q. EVEN IF THE COSTS WERE TO BE INCURRED, AS DESCRIBED BY
19 COMPANY, ARE THEY CURRENTLY KNOWN AND MEASURABLE?

20 A. No. As I discussed in my rebuttal testimony, the total cost identified by Mr.
21 Kartmann is a forecasted amount that is based on the contract price and his

1 estimate of fire hydrants to be environmentally remediated. The actual cost is
2 not yet known and measureable because it has not yet been incurred (although
3 incurred O&M costs, normal environmental remediation costs included, are
4 included in the cost of service in every rate case). Further, the Company's "plan"
5 is based on an estimate of fire hydrant numbers that are not specifically identified
6 within the language of the new contract thus, facts dictate that the cost Mr.
7 Kartmann predicts is neither known or measureable.
8

9 Q. IS THERE OTHER LANGUAGE WITHIN THE CONTRACT THAT CAUSES
10 PUBLIC COUNSEL TO BE APPREHENSIVE WITH REGARD TO THE
11 CONTRACT'S SUBJECTIVELY IMPLIED ASSURANCE?

12 A. Yes. In Paragraph 3, the language states that Company may terminate the
13 contract by the term, "*** _____
14 _____
15 _____ ***" This
16 means that if the Commission were to authorize the Company's proposal to
17 include the estimated costs in rates, Company could modify or cancel the
18 proposed project at will and there would be no recourse to recover the monies for
19 ratepayers.
20

1 Q. SHOULD THE CONTRACT BE RELIED UPON BY THE COMMISSION IN
2 RENDERING ITS DECISION ON THIS ISSUE?

3 A. No. I believe that the contract should not be relied upon by the Commission to
4 render its decision on this issue. The contract is deficient with regard to the
5 goals stated in the proposal that the Company requested. The lack of important
6 language and descriptions that would protect ratepayers from improper actions
7 raises more questions and concerns than the contract actually resolves. The
8 contract does not provide this regulator with any assurance that the project will
9 proceed as Mr. Kartmann discusses in his rebuttal testimony.
10

11 Q. WOULD THE TRACKER MECHANISM SUGGESTED BY MR. KARTMANN PUT
12 PUBLIC COUNSEL AT EASE?

13 A. No. The inherent problem with tracker mechanisms is that they effectively
14 guarantee recovery of all costs incurred by a utility thus, eliminating any of the
15 associated risk and management's incentive to perform responsibly and with due
16 diligence in incurring the costs. Essentially, the use of tracker mechanisms
17 "circumvent" the process of regulatory competition all the while allowing the utility
18 to earn a return that has not been adjusted for the reduced risk the tracker
19 creates by its implementation. Mr. Karman's proposition to implement a new
20 tracker mechanism, or modify the existing tank painting tracker, is not, in my
21 opinion, an appropriate resolution for this issue.

1

2

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

3

A. Yes, it does.