

Exhibit No.:
Issues: *EU Operation & Maintenance Agreement; Use of Projected Expenses to Determine Cost of Service for Ratemaking; Utility Plant-Rate Base; and Depreciation Expense and Depreciation Reserve*

Witness: *Janis E. Fischer*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Rebuttal Testimony*
Case Nos.: *ST-2003-0562 and WT-2003-0563 (Consolidated)*

Date Testimony Prepared: *January 9, 2004*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

JANIS E. FISCHER

OSAGE WATER COMPANY

**CASE NOS. ST-2003-0562 and WT-2003-0563
(CONSOLIDATED)**

*Jefferson City, Missouri
January 2004*

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JANIS E. FISCHER
OSAGE WATER COMPANY
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(Consolidated)**

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REBUTTAL TESTIMONY

OF

JANIS E. FISCHER

OSAGE WATER COMPANY

CASE NOS. ST-2003-0562 and WT-2003-0563

(Consolidated)

Q. Please state your name and business address.

A. Janis E. Fischer, Governor Office Building, PO Box 360, Jefferson City, Missouri 65102.

Q. Are you the same Janis E. Fischer who has previously filed direct testimony in this case?

A. Yes, I am.

Purpose of Testimony

Q. What is the purpose of your rebuttal testimony?

A. I will address certain aspects of Osage Water Company's (OWC or Company) direct filing, including the operations agreement between OWC and Environmental Utilities, LLC (EU), use of projected expenses to determine cost of service for ratemaking, utility plant - rate base, depreciation reserve and depreciation expense. Please refer to Staff witness Dale W. Johansen of the Utility Operations Division, Water and Sewer Department for additional rebuttal to OWC's direct filing related to certain aspects of some of these issues and other issues.

EU Operation and Maintenance Agreement

Q. Has the Staff reviewed the Operation and Maintenance Agreement (Agreement) between EU and OWC?

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1 A. Yes.

2 Q. How does the Agreement impact this consolidated case?

3 A. Effective with the date of the Agreement between EU and OWC,
4 September 1, 2002, OWC has no checking account or general ledger of its own.
5 Employees of EU are required to manage, operate and maintain OWC. These same
6 employees also manage, operate and maintain EU. There are no detailed records to
7 document employee time directly assigned to OWC or EU. All revenues from OWC are
8 paid to EU as a provision of the Agreement. The Agreement appears to obligate EU to
9 adequately manage, operate and maintain OWC.

10 Q. Does OWC witness, William P. Mitchell differentiate between EU's
11 inability to adequately manage, operate and maintain OWC and his inability as President
12 of OWC to enforce the Agreement entered into with EU?

13 A. No, he does not. Mr. Mitchell, on page 7, lines 15-16 of his direct
14 testimony states, "EU needs to hire one more full time operations person to adequately
15 operate and maintain the systems..." Again on page 8, lines 15-16 Mr. Mitchell states,
16 "EU has not been able to provide detailed book keeping for OWC as a result of a
17 shortage in revenues during the winter months."

18 Q. Does the Staff believe that a shortage of revenues during the winter
19 months created a problem in maintaining OWC records?

20 A. No. Water and sewer customer charges are adequate to cover employee
21 costs. Neither of the employees responsible for managing or operating OWC went
22 without a paycheck or had regular work hours restricted. The lack of detailed book
23 keeping is a result of inadequate management of OWC by EU.

24 Q. What other consequences of the Agreement have effected this case?

1 A. The Agreement provides no incentive for EU employees to properly
2 manage, operate or maintain OWC. The Agreement provides a vehicle for EU owners to
3 pay themselves first and only repair and maintain OWC water and sewer systems with the
4 remainder of any revenues.

5 Q. Please explain.

6 A. The three most obvious examples are the following:

7 1) Mr. Mitchell on page 9 discusses the need for additional cash flow
8 because of water being purchased for OWC Eagle Woods customers from
9 EU. What he neglects to mention is that the water being used by Eagle
10 Woods customers is not currently being metered. During July 2003 EU
11 billed OWC \$1,233 in excess of what it billed to Eagle Woods customers.

12 A prudently managed water system would require metering so that
13 customer billings would support water purchased.

14 2) During the test year, payments to Greg Williams for legal fees recorded in
15 the EU check register exceeded \$33,000. Debra Williams received a
16 salary of \$36,000 for managing EU/OWC. OWC is paying monthly
17 payments of \$246 to Ford Motor Company for a Ford Ranger titled to
18 Gregory Williams. OWC is paying over \$2,000 annually in insurance
19 premiums for the vehicle and equipment owned by Gregory Williams.

20 3) Mr. Mitchell estimates \$37,1000 in rate case expenses. Small water and
21 sewer companies typically file informal rate cases that require minimal
22 expenditures for legal services. The rate case estimate includes \$21,600 in
23 legal expenses. Owners do not typically bill the utility their time in
24 preparing an informal rate case because it is minimal. Mr. Mitchell has

1 included an estimate of the value of his time to file a formal rate case at
2 \$12,800. A prudent business person would not incur these types of
3 expenses considering as Mr. Mitchell states on page 10, lines 9-10, “It will
4 take 12 months increased revenue, until summer of 2005 just to repay the
5 costs of this case.”

6 **Use of Projected Expenses to Determine Cost of Service for Ratemaking**

7 Q. What is OWC’s proposed method to determine cost of service in this case?

8 A. Mr. Mitchell, beginning on page 7 of his direct testimony and throughout
9 the remainder of his testimony, provides a list of additional costs that OWC would like
10 included in the water and sewer rates. Mr. Mitchell quantifies these additional costs in
11 WPM Schedule 8 Budget attached to his direct testimony. OWC proposes using a
12 budgeted cost of service for 2004 and 2005 to set water and sewer rates.

13 Q. Does the Missouri Public Service Commission (Commission) set rates
14 based upon a budgeted cost of service?

15 A. No. To the best of my knowledge the Commission has only once set rates
16 based upon a budgeted cost of service. However, the Staff does use budget data when
17 initially establishing rates in certificate cases for small water/sewer companies. The use
18 of a budgeted cost of service would be similar in concept to applying a future test year for
19 the determination of cost of service. While some states do use various versions of a
20 future test year in establishing cost of service, this is not the case in Missouri.

21 Q. What test year period was used to determine OWC cost of service in this
22 case?

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1 A. The test year in this case is the twelve-month period from July 1, 2002,
2 through June 30, 2003. The Staff's Accounting Schedules reflect the cost of service of
3 OWC water and sewer systems for the test year period.

4 Q. Please identify some of the budgeted costs that Mr. Mitchell attempts to
5 support.

6 A. Mr. Mitchell supports hiring additional employees to operate and maintain
7 OWC water and sewer systems. Beginning on page 7, line 13 through page 9, line 5,
8 Mr. Mitchell describes the deficiencies that have occurred in both the management and
9 operation of OWC. Additional costs projected related to employees include health
10 insurance, taxes and salaries for officers, directors and shareholders. Mr. Mitchell also
11 includes budgeted money for an additional vehicle under the assumption that an
12 additional employee is hired.

13 Mr. Mitchell also projects interest, accounting, miscellaneous tax and licenses
14 expenses well in excess of actual expenditures for the test year. In fact, Mr. Mitchell's
15 projected budgeted expense amounts exceed test year actuals in every expense category.

16 Q. Does the first amount column on WPM Schedule 8 represent the test year
17 expenses of OWC?

18 A. No. The Staff was provided an income statement from OWC that it used
19 as a starting point for the test year. The expense amounts included in the first column of
20 WPM Schedule 8 do not match OWC's income statement for the test year period. It
21 would not be appropriate to compare the columns on WPM Schedule 8 to determine the
22 variances between test year expense levels and Mr. Mitchell's budgeted cost of service.

1 **Utility Plant - Rate Base**

2 Q. Does the Staff agree with Mr. Mitchell's determination of the value of
3 OWC's utility plant assets to be included in calculating rate base?

4 A. No. The Staff has reviewed documentation to support the utility plant
5 assets of OWC in each rate case proceeding filed before the Commission and has
6 developed a rate base appropriate for the Company. Additions to the water and sewer
7 systems of OWC since the last rate cases, Case Nos. SR-2000-556 and WR-2000-557
8 have been included to the plant assets in this case. The Staff's determination of utility
9 plant for rate base purposes is based upon the original cost of the assets when they first
10 became used and useful by the water and sewer systems. The original cost of each asset
11 must be supported by invoices, work orders of labor costs, equipment logs, etc.
12 demonstrating the costs associated with placing the asset into service.

13 Q. Does the Commission allow utility plant asset values to be determined by
14 the fair value or replacement cost of the assets when determining rate base?

15 A. No. The Commission requires that utility plant asset values used in
16 determining rate base be set at the original cost of the assets. A rate of return is applied
17 to net original cost, which is the original cost of the system assets less depreciation
18 reserve. When a utility is sold, the difference between the original cost of the utility plant
19 assets less the depreciation reserve and the purchase price of the utility is typically
20 recorded as an acquisition premium or discount. The purchase price of the utility would
21 be considered a fair market value price at the time of the sale transaction.

22 Q. Does the Staff believe that Mr. Mitchell includes contributed utility plant,
23 and even plant that the Company does not own, in his calculation of the "fair value" of
24 utility plant on pages 14-15 of his direct testimony?

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1 A. Yes. The Staff has reviewed the utility plant asset records of OWC and is
2 aware that a substantial amount of utility plant was contributed rather than purchased, and
3 is also aware that some of the facilities for which Mr. Mitchell estimates a “fair value”
4 are not owned by OWC.

5 Q. Does the Commission allow the inclusion of a return on and a return of
6 contributed utility plant in customer rates?

7 A. No.

8 Q. What is the difference in dollar amounts between the Staff’s original cost
9 determination and Mr. Mitchell’s “fair value” calculation of OWC’s utility plant assets?

10 A. The difference is more than \$1.5 million. The Staff’s cumulative analysis
11 of OWC utility plant assets from this case and prior cases results in approximately
12 \$162,000 and \$289,000 of sewer and water utility plant assets respectively. Contributed
13 plant in aid of construction (CIAC) is a component of rate base that is subtracted from the
14 total original cost of the assets to calculate the net rate base.

15 Q. Does the Commission allow the use of asset “fair value” in the
16 determination of customer rates in Missouri?

17 A. No. There is no regulated small water or sewer company in the state of
18 Missouri that has its customer rates established using fair value to determine rate base.

19 **Depreciation Expense and Depreciation Reserve**

20 Q. Does the Staff include an allowance for utility plant depreciation expense
21 and a utility plant depreciation reserve in its calculation of rate base and cost of service in
22 determining appropriate utility rates?

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1 A. Yes. The Staff's Accounting Schedules include both a depreciation
2 expense of approximately \$15,000 per year and a cumulative utility plant depreciation
3 reserve of approximately \$80,000 for OWC sewer and water systems combined.

4 Q. How would the Staff then respond to Mr. Mitchell's requests on
5 pages 10-12 of his direct testimony for a cash reserve for emergencies and funds for
6 depreciation expense?

7 A. OWC's current sewer and water rates include recovery of depreciation
8 expenses and allow for these funds to be set-aside in a reserve account for emergencies or
9 scheduled plant replacements. The inclusion of depreciation expense and utility plant
10 reserve is a common component in the Staff's determination of rate base and cost of
11 service in every rate case. Mr. Mitchell presumably is requesting depreciation expense
12 associated with CIAC that, as in the case of determining net rate base, should be
13 subtracted out of the calculation of depreciation expense. Staff witness Dale Johansen
14 also discusses certain aspects of Mr. Mitchell's direct testimony regarding depreciation
15 expense in his rebuttal testimony.

16 Q. Does this conclude your rebuttal testimony?

17 A. Yes it does.