IN THE CITY OF ST. LOUIS

STATE OF MISSOURI

MSD TECHNICAL CONFERENCE FOR REBUTTAL TESTIMONY

MAY 9, 2019

Metropolitan Saint Louis Sewer District

2350 Market Street

Saint Louis, MO 63103

INDEX OF EXAMINATION

A P P E A R A N C E S

COMMISSIONERS:

Mr. Leonard Toenjes, Chairman
Mr. Russell Hawes
Mr. Don Bresnan
Ms. Mickey Croyle
Mr. Mark Schoedel
Mr. John Stein
Mr. Lloyd Palans
Mr. Gerald Beckmann
Mr. Paul Ziegler (via telephone)

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A P P E A R A N C E S
(CONTINUED)

ALSO PRESENT:

Ms. Pamela Lemonie, Consultant to the Rate Commission
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Ms. Nicole Young
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MSD Director of Finance:
Mr. Marion Gee

MSD Director of Engineering:
Mr. Rich Unverferth

MSD Executive Director and CEO:
Mr. Brian Hoelscher

WITNESSES:

Mr. Michael Gorman
Ms. Pamela Lemoine
Ms. Prabha Kumar
Ms. Nicole Young

Court Reporter:
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CHAIRMAN TOENJES: We will call to order the May 9, 2019, meeting of the Rate Commission of the Metropolitan St. Louis Sewer District.

Our technical conference will begin. My name is Leonard Toenjes. I am the Chair of the Rate Commission Metropolitan St. Louis Sewer District, and will serve as Chair of this proceeding. Let's start with a role call. We will ask Mr. Schoedel to take the role call.

MR. SCHOEDEL: Thank you. Jerry Beckmann.

MR. BECKMANN: Present.

MR. SCHOEDEL: Brandy Bowdry. Paul Brockmann. Don Bresnan.

MR. BRESNAN: Present.

MR. SCHOEDEL: Mickey Croyle.

MS. CROYLE: Present.

MR. SCHOEDEL: Brad Goss.

MR. GOSS: Present.

MR. SCHOEDEL: Russell Hawes. Chan Mahanta. Steven Mahfood. Lloyd Palans.

MR. PALANS: Present.

MR. SCHOEDEL: Tom Ratzki. Mark Schoedel, present. John Stein.

MR. STEIN: Present.

MR. SCHOEDEL: Leonard Toenjes.

CHAIRMAN TOENJES: Present.

MR. SCHOEDEL: Paul Ziegler. Paul, are you online? Mr. Chairman, we have eight. We have a quorum.

CHAIRMAN TOENJES: Thank you, Mr. Schoedel. The charter plan for the District was approved by the voters of St. Louis and St. Louis County at a special election of February 9, 1954, and amended at a general election on November 7, 2000.

The amendment to the charter plan established the Rate Commission to review and make recommendations to the District regarding changes in wastewater rates, stormwater rates, and tax rates proposed by the District.

The charter plan requires the Board of Trustees of the District to select organizations to name delegates to the Rate Commission to ensure a fair representation of all users of the district's services.

The Rate Commission representative organizations are to represent commercial/industrial users, residential uses, and other organizations interested in the operation of the District; including organizations focusing environmental issues, labor issues, socioeconomic issues, community neighborhood organizations, and other nonprofit organizations.

The Rate Commission currently consists of representatives of Associated General Contractors of

Missouri, St. Louis County Municipal League, Lutheran Senior Services, St. Louis Counsel of Construction Consumers, Greater St. Louis Labor Counsel, Missouri Botanical Garden, Mound City Bar Association, League of Women Voters of Metro St. Louis, Home Builders Association, Farm County Incorporated, Missouri Coalition for the Environment, City of Ladue, Engineers Club of St. Louis, Missouri Industrial Energy Consumers, and Education Plus.

Upon receipt of a rate change notice from the District, the Rate Commission is to recommend to the Board of Trustees changes in the wastewater, stormwater, or tax rate necessary to pay, number one, interest and principal falling due on bonds issued to finance assets of the District; number two, the cost of operation and maintenance; and number three, such amounts as may be required to cover emergencies and anticipated delinquencies.

Further, any changes in a rate recommended to the Board of Trustees by the Rate Commission is to be accompanied by a statement that the proposed rate change:

Number one, is consistent with constitutional statutory or common law as amended from time to time.

Number two, enhances the district's ability to provide adequate sewer and drainage systems and facilities, or related services.

Number three, is consistent with and not in violation of any covenant or provision relating to any outstanding bonds or indebtedness of the District.

Number four, does not impair the ability of the District to comply with applicable federal or state laws or regulations as amended from time to time.

And number five, imposes a fair and reasonable burden on all classes of ratepayers.

The Rate Commission received a rate change notice from the District on March 4, 2019.

Under the District's charter plan, the Rate Commission must, on or before July 2, 2019, issue its report on the proposed rate change notice to the Board of Trustees and the District, unless the Board of Trustees, upon application of the Rate Commission, extends the period of time for the issuance of the Rate Commission report for an additional 45-day period.

At its meeting on March 14, 2019 the Board of Trustees approved the Rate Commission's request for an extension.

The rate commission's report on a proposed rate change must now be issued on or before August 16, 2019.

Under procedural rules adopted by the Rate

Commission on March 8, 2019, any person affected by the rate change proposal had an opportunity to submit an application to intervene in these proceedings no later than March 25, 2019.

An application to intervene was filed by Missouri Industrial Energy Consumers, which was deemed granted.

On March 4, 2019 the District submitted to the Rate Commission prepared direct testimony of Brian L. Hoelsher, Susan M. Myers, Richard L. Unverferth, Brett A. Berthold, Marion M. Gee, Tim R. Snoke, Bethany Pugh, William Stannard, and Thomas A. Beckley.

On March 8, 2019, the Rate Commission submitted its first discovery request to the District. On March 13, 2019, the District filed its responses.

On March 11, 2019, the Rate Commission submitted its second discovery request to the District, which the District responded to on March 20, 2019.

On March 25, 2019, the Rate Commission submitted its third discovery request to the District, which the District responded to on April 2, 2019.

On April 8, 2019, a technical conference was held on the record regarding the rate setting documents and the direct testimony filed with the Rate Commission by the District.

The purpose of the technical conference was to provide the District an opportunity to answer questions propounded by members of the Rate Commission, then by any intervenor, and finally by Lashly and Baer, legal counsel to the Rate Commission.

On April 8, 2019, intervenor Missouri Industrial Energy Consumers submitted its first discovery request to the District, which the District responded to on April 18, 2019.

On April 11, 2019, the Rate Commission submitted its fourth discovery request to the District, which the District responded to on April 22, 2019.

On April 11, 2019, intervenor Missouri Industrial Energy Consumers submitted its second discovery request to the District, which the District responded to on April 22, 2019.

On April 26, 2019, the District submitted its first discovery request to intervenor Missouri Industrial Energy Consumers; to which Missouri Industrial Energy Consumers responded to on May 7, 2019.

On April 23, the Rate Commission consultants and intervenor Missouri Industrial Energy Consumers submitted rebuttal testimony.

This technical conference will be held on the record, regarding the rebuttal testimony.

Each person submitting rebuttal testimony shall answer questions propounded by members of the Rate Commission, the District, then the intervenor, and finally by our legal counsel.

Following the technical conference, the District, the intervenor, and the Rate Commission consultant may submit prepared surrebuttal testimony and schedules.

A technical conference will be held on the record regarding the surrebuttal testimony on June 20, 2019.

Ratepayers who do not wish to intervene will be permitted to participate in a series of on-the-record public hearing sessions, which will begin on May 14, 2019.

Who is here on behalf of St. Louis Metropolitan Sewer District?

MS. MYERS: Susan Myers.

CHAIRMAN TOENJES: Who is here on the behalf of Missouri Industrial Energy Consumers?

MR. NEUSCHAFER: Brandon Neuschafer.

CHAIRMAN TOENJES: Also present are Pam Lemoine and Prabha Kumar of Black and Veatch, Nicole Young of Lion CSG, consultant to the Rate Commission.

And Lisa Stump and Brian Malone on Lashly and Baer, legal counsel to the Rate Commission.

Under the Rate Commission's operational rules, no person shall be required to answer questions for a total period of more than three hours.

And the time shall be evenly divided among all of the participants desiring to ask questions.

Following questions by members of the Rate Commission, I will attempt to allocate the time equally among the participants and our legal counsel.

To the extent that the District, the intervener, or legal counsel has not completed the questions at the expiration of that person's allotted time; and to the extent that time remains, such persons will be permitted to propound additional questions until the three hours has expired.

Does anyone have any procedural matters?

MS. STUMP: Mr. Chair?

CHAIRMAN TOENJES: Yes, Ms. Stump.

MS. STUMP: Would you like to approve the minutes while you have a quorum?

CHAIRMAN TOENJES: I would love to.

MS. STUMP: I think they should -- everyone should have them. They're the minutes from April 9 -- April 8 and 9.

MR. SCHOEDEL: Mr. Chairman, I note that Mr. Goss has arrived as well. Paul Ziegler, are you online.

MR. ZIEGLER: I am online.

MR. SCHOEDEL: Thank you. Noted in attendance.

CHAIRMAN TOENJES: Would anyone care to review the minutes and/or make a motion in regard to the minutes?

MR. BROCKMANN: I'll make a motion.

MR. BRESNAN: Second.

CHAIRMAN TOENJES: A motion made and seconded to adopt the minutes as presented. All in favor, signify by saying aye.

(THOSE VOTING IN FAVOR ANNOUNCED AYE)

CHAIRMAN TOENJES: Opposed? Hearing none, the minutes approved. Thank you, Ms. Stump. Any other procedural matters?

MR. GOSS: Mr. Chairman, I need some technical assistance to get on MSD's network. If someone can help me from MSD. I had the same problem had last time I'm having again. Thank you.

CHAIRMAN TOENJES: There being no further procedural matters, Mr. Neuschafer, are you ready to present those persons for whom you've filed testimony on behalf of Missouri Industrial Energy Consumers?

MR. NEUSCHAFER: I am.

CHAIRMAN TOENJES: Plead proceed.

MR. NEUSCHAFER: Brandon Neuschafer.

CHAIRMAN TOENJES: Would you introduce your witness, please.

MR. NEUSCHAFER: Yes. On behalf of Missouri Industrial Energy Consumers, Mr. Michael Gorman of Brubaker and Associates is here to answer questions about the written testimony that was submitted.

CHAIRMAN TOENJES: Thank you. Mr. Gorman, is the testimony you're about to give the truth, the whole truth, and nothing but the truth?

MR. GORMAN: Yes.

CHAIRMAN TOENJES: Thank you. Does any member of the Rate Commission have questions of Mr. Gorman at this time?

Hearing none, Ms. Myers do you have any questions for Mr. Gorman?

MS. MYERS: Yes, we do.

CHAIRMAN TOENJES: Please come forward.

MS. MYERS: Good morning.

CHAIRMAN TOENJES: Ms. Myers, will you please introduce your team.

MS. MYERS: I will. The district's first line of questioning is going to have to do with our finance plan so Tim Snoke, MSD secretary/treasurer, and Bethany Pugh from PFM are going to ask that line of questions.

CHAIRMAN TOENJES: Thank you. Please proceed.

MS. MYERS: Thank you.

EXAMINATION

BY MR. SNOKE:

Q. Good morning again.

A. Good morning.

Q. Okay. I want to start by talking about interest rates. So throughout your rebuttal testimony, which is on Exhibit MIEC73, you broadly use the term interest rate.

But there are different kinds of interest rates, correct? For example, coupon rate and yield?

A. Yeah. I was using the term to describe the cost of the funds to the MSD for issuing additional --

Q. Okay. So cost can be interpreted in a different way. So coupon rate is the rate of interest paid on the bond's face value; is that correct?

A. Yes.

Q. And then a yield is the actual return an investor receives, based on the coupon rate, but also the price paid for the bond, right?

A. Correct.

Q. So those can be different?

A. They can.

Q. In your model, you assume that they are the same?

A. I was attempting to price the actual cost to the MSD of issuing additional debt.

I will acknowledge that I did not notice a line in your model, where you were projecting to issue debt at a premium to face value.

So the 3 percent interest costs that I included in my model, I will acknowledge is probably too low.

Q. Okay. So that will actually let me skip a little bit of questions, which I think will please everybody.

So if we go to your model. So in the -- your response to our first discovery request, you did provide a table, table 2 to question five, I believe. That will be on page 3 of Exhibit 75.

A. I did. Yes.

Q. I don't want to belabor this point; but you are showing premium, correct?

A. I did.

Q. And that's the line that should --

A. I used the same assumption that was already built into the model, and that assumed that the bond would be sold at a premium.

(INTERRUPTION BY COURT REPORTER)

A. I did not change the model. The model had built in an assumption that the bonds would be sold at a premium.

Q. Is it fair to say that the construction fund cash for financing plan in your model right now is not correct?

A. I do believe the interest costs are probably too low. But the model still projected the level of the funds available.

Q. Well --

A. Including the premiums. I can review that, but it's my understanding that the model automatically estimated the amount of bonds to be issued, and then made the assumption about the bonds face value being sold at a premium.

Q. In your models, since you're assuming the lower cost of debt, it should be assuming lower premiums than what's in our model.

And in fact, this shows higher premiums than in our model.

I know you don't have our model in front of you. But do you recall if that's correct?

A. I will review that. But the interest costs probably understates what the costs of funds would be to MSD.

But the actual cash proceeds from bond sales is a function of additional debt that needs to be sold in order to have the cash available to fund the program.

And using the model, with an assumption of selling an amount of bonds stated in the face value, and then the model having the stated amount of assumptions for premiums, would accumulate the amount of cash available to MSD by selling more bonds.

Q. Okay. So it sounds like it's fair to say that you're not aware of an error in your version of the model that is calculating premium, when it should not be calculating premium.

A. Well, I don't agree with the assertion you're making.

I will say that I think I've understated the funds -- the cost of funds available to MSD.

Q. Okay. So going back to our discussion -- brief discussion about coupons and yields.

We've already agreed that coupon can be different than yield.

Do you understand that a premium is generated only when the coupon rate is higher than the yield?

A. That's right. Yes.

Q. Okay. And in your model, you stated in -- this was in discovery response, Exhibit 75 again. This was on page 1 in response one.

The face value of the bonds would be equal to the proceeds received from market; which by definition, means no premium, correct?

A. Where did I say that?

Q. That is in Exhibit 75 on page 1 in response one.

The second sentence says: Hence, it assumes that the face value of the bonds would be equal to the bond proceeds received from the market.

A. Yeah. That is the understanding I had at the model, because I missed the line that showed that the bond would be sold at a premium.

Q. Okay. So --

A. I acknowledged that when I first sat down.

Q. Right. But that statement then, by definition, means there's no premium.

A. It does. Yes.

Q. Okay. So the amount of premium, which totals 95 million in table two then, should not be in your financing plan.

That's line 3 of table two at the bottom of page 3 in Exhibit 75.

A. That may be. Yes.

Q. And so given that that -- and it's a total of 95 million, should not be there, isn't it likely that increasing the funding of CIRP by that amount to cover the shortfall is going to increase the proposed wastewater service charges that you've proposed?

A. It would increase the revenue department. Yes.

Q. Okay. Thank you. I want to move on to some of the underlying assumptions in your plan.

So we've already established that in your model, the bond -- the coupon rate equals the yield rate.

In our first discovery request, which is Exhibit 74, we asked if you were aware of any recent transactions that used similar assumptions to what you used; including coupons and yields that match.

And you provided three examples. Do you want me to go through those examples or --

A. No. I recall them. Two of them were MSD recent bond issues.

Another one was in Indianapolis, a citizens wastewater report.

Q. Right. One of them was an MSD bond issuance. It's series 17A. I have the official bond statement here.

So I'm going to open it up to the inside page, where it lists the interest or coupon rates and the yields.

A. I'm familiar.

Q. Okay. So the yields and the coupons on that page are not the same, are they?

A. They are not.

Q. Okay. And in fact, can you tell by looking at that, that the majority of the coupons -- I'm sorry, yes.

The coupon rates, or interest rate, in that model are 5 percent, consistent with MSD's model?

A. I think I said that in the data response that you're referring to. Yes.

Q. All right. So this is not an example of a bond being issued for a coupon rate equals yield.

A. I wasn't disputing that the bonds can be sold. I'm agreeing to the face value.

I'm simply stating the assumption I believed was accurately reflected in the model, where I was attempting to estimate the cost to MSD. Not issuing additional debt financing.

Q. Okay. Then the next two examples you gave are from Citizens Energy Group, CWA Wastewater Authority.

And on page 2 of your discovery response, which again is Exhibit 75, you reference a page in Citizen's 2018 financial report that lists bond issuances.

It is page 22 that you reference -- can you confirm; is that -- that is the page that you referenced?

A. Yes.

Q. Okay. Thank you. And so I'll start with the second issuance listed there, which is a 2017A fund.

There's a description in the far left of that bond. I won't ask you to read it. But there's a

parenthetical in that description that says SRF; is that correct?

A. Yes.

Q. Are you aware that's State Resolving Fund?

A. That is correct. Yes.

Q. So this is a State Revolving Fund loan. It's actually issued at a subsidized rate, so it's not a comparable bond transaction. But MSD has proposed senior issuances; is that correct?

A. That's what SRF mean, and that would be a correct description.

Q. Okay. And then the 2016A bonds, it's noted -- and you note that the coupons there range from 2 to 5 percent.

And so I can show you a page from that official statement, if you like. But again, that's going to be a bond where the coupons and the yields do not match. So a premium would be generated, correct?

A. That's any understanding. Yeah.

Q. Yeah. Okay. So I talked just a little bit about the wastewater market in general.

Do you understand that the benchmark yield -- are you aware that the benchmark yield in the municipal bond market is the MMD rate?

A. Benchmark yield on an AA-rated water/wastewater?

Q. Within the tax exempt municipal bond market, MMD is the benchmark at which bonds are priced. And so they're in a spread to MMD?

A. If you're -- yes. If you're acquiring a bond, that's true.

Q. Okay. And so while MMD is reported as a yield, it assumes 5 percent coupons; are you aware of that?

A. Well, that's what you modelled so --

Q. So it assumes --

A. That's what you sold your 2017 bond issuances.

Q. And so if MSD is projecting bond issuances at mostly 5 percent coupon rate, the MMD benchmark rate assumes a 5 percent coupon rate, and the examples you provided use mostly a 5 percent coupon rate, isn't it reasonable that our financial model should use those same assumptions?

A. It would. But the combination of those assumptions would result in bonds that are too expensive in your model.

With a 5 percent coupon rate, then the premium you used was too low. The premium should have been higher or be more in line with what your 2017 net cost of your bond was, which is around -- what did I say? Three and a half?

Q. It was about three and a half on the new money.

Three quarter roughly overall. So future bonds --

A. -- assumptions you had in your model at a 5 percent coupon rate, you're net cost of those bonds would've been in excess of 4 percent.

Q. Okay. So -- and this is another assumption in your model; that future rates should reflect current rates and not make an allowance for rate increases for the uncertainty of future projections?

A. It's my recommendation to the commission that the model be developed as closely as possible to what the actual cost will be to MSD.

I've been looking at projected interest rates for 20 years now. And in the data response I provided you, I showed that over the last 10 years, in particular, there have been projections of very large increases, the interest rates, which have always turned out to be wrong in the last 10 years.

There continues to be an outlook for an increase in interest rates. The change in market conditions still seems to leave us with a lot of uncertainty about whether or not interest rates really will change.

So your question and the data response to me was whether or not I accommodated an expectation of an increased in interest rates.

And my response was, is I recognize interest rates can increase. But there's no clear known fact that they will increase.

So in order to accommodate the uncertainty about where interest rates will be, I thought it would be more appropriate to be more conservative in estimating what the interest rate is in the model, relative to currently interest rates.

And that's what I attempted to do. But as I stated at the outset, I did make an error in the model. Because I did not recognize the line item, which assumed those bonds would be sold at a premium.

Q. So in your rebuttal testimony, and then as revised a little bit in your discovery request, you did report that economist's estimates over a shorter period, two years, have proven to be incorrect.

And given that you just stated that there is uncertainty in the marketplace, and that even economists are not able to accurately predict rates, isn't it reasonable to, over a longer forecast period, five years, in the case of our rate proposal, to make some allowances for the possibility of increasing rates?

A. As I said, I think it's appropriate to have a conservative estimate of what the interest rate will be.

But I don't think there needs to be too much of a risk factor added.

Because interest rates, as I've said, over the last 10 years, there's been projections of very large increases in interest rates. They have not been realized.

Interest rates have stayed low over the last 10 years. Market data and the federal reserve are projecting interest rates to be relatively stable, largely because inflation is relatively stable.

The federal reserves' interaction in the marketplace has been normalized. So the impact to -- the federal reserve impact on both short-term and long-term interest rates is no longer received this as a factor that may drive up interest rates.

So with all of that, I would agree that there needs to be some consideration that interest rates can increase.

But I would recommend to the Rate Commission that an interest rate projection that is much higher than what current interest rates not be used in the model.

Because I think that it unjustifiably inflates the revenue requirement, and unnecessarily increases wastewater rates to MSD customers.

Q. Okay. And as you noted earlier, the rates that are currently in your model, you acknowledge, are too low?

A. I will correct those in rebuttal if you believe they are incorrect. And I would agree.

Q. Okay.

A. Based on a more detailed review of that model with more time to look at it.

And quite frankly, in responding to your data request, I was wondering why you were asking those questions.

It caused me to dig into it a little deeper and see that I did make a mistake.

MR. SNOKE: Okay. Thank you. I don't have any place questions.

MS. MYERS: Okay. I have a few questions. We're going to switch gears and talk about the CIRP for a little bit.

CHAIRMAN TOENJES: Ms. Myers, for the court reporter, we now have Rich Unverferth.

MS. MYERS: Rich Unverferth, our Director of Engineering, is sitting at the table with me.

CHAIRMAN TOENJES: Thank you.

EXAMINATION

BY MS. MYERS:

Q. Okay. Like I said, this set of questions is going to be around our CIRP program --

A. Okay.

Q. -- and your rebuttal testimony to that. So on page 16 and 17 of your rebuttal testimony, you identified three examples of projects that you believe are discretionary and could be deferred for a few years.

Is that an accurate characterization of your testimony? 16 and 17.

A. Yeah. I was trying to give examples of certain projects that were included in the forecast for Fiscal Year 23 and 24 that could be deferred for a couple of years.

I wasn't trying to identify the specific projects that should be deferred; but simply there should be -- I believe there is flexibility in order to levelize the level of annual CIRP annual spend.

So this was an attempt to identify projects that may give MSD more flexibility and levelizing that level.

Q. Okay. Did you characterize those three examples as, one, the wastewater solids combustion boiler; two, the wastewater plant repair; and three, capacity expansion?

A. I did. Yes.

Q. Okay. And also on page 2 of your schedule MPG3, in your testimony, you further identified seven specific project numbers that you believe are discretionary during the FY23-24 period; is that correct?

A. It was my attempt at identifying whether or not there is some discretion in MSD.

It was not my recommendation to defer those specific projects.

Rather, it's my recommendation to levelize the annual CIRP spend. And to the extent that flexibility exists I'm encouraging you to do it.

Because levelizing the CIRP will levelize the regular ^ product? and mitigate unnecessary increases in wastewater rates.

Q. Okay. So I want to talk about those three examples, project types that you've used.

First, we'll talking about the wastewater solids combustion boiler.

If you look at page 17 of your testimony, you list a wastewater solids combustion boiler as a project that could be deferred, as we've just spoken, correct?

A. It's my understanding it can be. Yes.

Q. Okay. So you've also said that you were not identifying specific projects.

But that wastewater solids combustion boiler that you're referring to, is that actually Project 12565 from page 2 of your schedule MPG3?

A. I believe it is. Yes.

Q. You understand the incinerators at the Bissell

and Lemay wastewater treatment plants are required for proper handling of biosolids; is that correct?

A. I understand that they're not in service right now. But they will be placed in service for this purpose. Yes.

Q. You also understand that the incinerators at the Bissell and Lemay treatment plants were constructed in the early 1970s?

A. I did confirm that. But I do understand that has MSD found it appropriate to replace them.

Q. Okay. Do you also understand that the operation of the incinerators are regulated by the United States EPA and MDNR?

A. That's my understanding.

Q. Are you familiar with the regulations and subsequent operating permits for the Bissell and Lemay treatment plant incinerators?

A. I did not review that specifically.

Q. So you are not familiar with those regulations?

A. The regulations on the need for the -- the boilers?

Q. The regulations that relate to the operation of the incinerators.

A. I have not reviewed that specifically.

Q. Okay. What is your understanding of the

District's Second Material Amendment to the Consent Decree?
A. That there's certain levels of retrofits and improvements to the system that have to be made to satisfy the consent decree with the EPA.
Q. Okay. I'm going to hand to you MSD Exhibit 37A. Would you please identify the title of that document.
A. United States District Court, Eastern District of Missouri, Eastern Division. Second Material Amendment to Consent Decree.
Q. Okay. And as you just confirmed, that was issued by the U.S. District Court of the Eastern District of Missouri, correct?
A. That's the title of the document. Yes.
Q. Okay. Would you please turn to page 3 of that document.
A. I'm there.
Q. And read the highlighted portion.
A. Whereas the parties agree that the proposed amendment is necessary because MSD currently incinerates 68,000 tons of sewage/sludge annually, utilizing multiple-earth incinerators, the federal plan requirements for sewage/sludge incineration units constructed on or before October 14, 2010, set forth in 40CFR Part 62, Subpart LLL, paren, SSI rule, close

paren, issued by EPA in 2016 required MSD to replace its multiple-earth incinerators. The replacement of the incinerators will occur in fiscal years 21 through 26. The timeframe is estimated to cost approximately 360 million in 2017 dollars.

Q. So based upon the District's Second Material Amendment to the Consent Decree, the District really doesn't really have a discretion to delay this project, does it?

A. Well, not beyond 2026. That's true.

Q. Okay. Thank you. I want to move on to the second example. Actually, it was your third example.

Capacity expansion. Regarding the capacity expansion that you referred to in your testimony, are you referring to the projects related to the capacity expansion of the lower Meramec wastewater treatment facility, which was Project 12255 on page 2 of your schedule MPG3?

A. Yes.

Q. Okay. And are you also referring to Project 12170 of that same table as the decommissioning of the Fenton treatment plant facility?

A. Well, I understand those two are interrelated together. Yes.

Q. Okay. So those are the two specific projects

that you are referring to in your testimony.

A. That was a project that was identified as potentially allowing MSD some flexibility on managing this annual CIRP spending.

Q. Are you aware that all of these projects are listed in consent decree?

A. No, I am not.

Q. Do you understand that the Fenton treatment plant facility, to be eliminated by these projects, is located in the Meramec River flood plain?

A. I haven't confirmed that. But that does sound correct.

Q. Okay. And did you know that that treatment plant has flooded twice in the last four years?

A. It's my understanding that there are issues with that plant. Yes.

CHAIRMAN TOENJES: I couldn't -- could you please.

MR. GORMAN: Pardon me.

CHAIRMAN TOENJES: -- speak in the microphone.

MR. GORMAN: Pardon me.

MS. MYERS: Do you hear that, or do we need to back up.

(THE COURT REPORTER READ BACK THE LAST ANSWER)

Q. MS. MYERS: So the District does not really have

the discretion to delay consent decree projects associated with the Meramec treatment plant or the decommissioning on the Fenton treatment plant, do we?

A. Well, you don't have complete discretion. But my recommendation wasn't to not do the project.

But simply manage the annual spend, such that you can do it in a reasonable amount of time, and do it in such a way that you don't have unnecessary increases in wastewater rates.

Q. But you also indicated that you were not familiar with the projects being listed in the consent decree.

So you're not familiar with the schedule of those projects in the consent decree?

A. Not specifically on a project basis. But I did look at your consent decree timeline projections.

And the period over which you are given in order to make retrofits in the system to comply with the consent decree.

And I believe, moving some of these capital programs that you budgeted to '23 and '24 out to '25 and '26, it's my understanding would not conflict your obligations of the consent decree.

Q. But you testified you did not look at the specific schedule for the specific projects, correct?

A. Yeah. There's only so much time to look at all of these projections.

And in looking at the revenue requirements, you've included in support of your proposal to increase wastewater rates, I did look at the eye-level budgeting information.

And based on that, it did appear as though there was some time available to comply with the consent decree and accommodate all of these projects.

But do it over a period that stretched out two years, relative to what MSD was projecting.

Q. Okay. So just to summarize, I understand you did not look at these specific project schedules in the consent decree --

A. Correct.

Q. -- correct?

A. Correct.

Q. Okay. So moving on to your second example, which is the wastewater plant repair.

In your testimony, you provided a listing of various wastewater treatment plant repair projects you feel could be delayed at the district's discretion; is that correct?

A. I feel could possibly be delayed, as some items that would support the levelization of the annual CIRP spending.

Q. Okay. So what environmental impacts or MPDS permit violations would result from the District's failure to complete the listed rehabilitation repair and replacement projects? Are you aware of any?

A. I have not reviewed that.

Q. Okay. The District is obligated to operate and maintain its facility to stay in compliance with its regulatory obligations and wastewater treatment plant permits; is that correct?

A. That's my understanding. Yes.

Q. Have you reviewed the district's asset management approach and prioritization process in planning these types of projects?

A. Well, I have reviewed that before. But in this case, I was simply look at their budgeted level of capital expenditures and noted that there was a very significant increase in FY23 and 24.

That seemed ripe for replanning and spreading it out up through FY26. And that can be done.

The level of wastewater rate increase needed in this case would be considerably lower.

Q. So based upon your review, the District really does not have any discretion to delay these types of projects due to regulatory risk, do we?

A. I can't specifically say that there's a requirement to do it by fiscal year 2024.

But based on my review, the EPA consent decree does extend beyond that date.

But I can't point to any specific commitment MSD has made to the EPA.

Q. Okay. Thank you. So moving on to the extra strength surcharge topic.

A. All right.

Q. So on page -- on page 29 of your rebuttal testimony, starting on line 11.

You state MSD's capital expenditures related to BOD and TSS are primarily associated with the improvement of operating efficiency of wastewater treatment plants, because these improvements are expected to reduce the costs of waste disposal.

Is that an accurate characterization of your statement?

A. It is.

Q. Okay. So is it true that MSD allocated these capital costs to all of our customer classes?

A. It is. But the capital costs associated specifically with the extra strengths are assumed to be a basic level for all customers.

And then customers that have extra strength are paying extra charges for those.

So the effect of modernizing and improving the wastewater treatment plant, as I understand your cost of service study supports a proposal to increase BOD and TSS extra strength surcharge.

Q. Okay. But it is your testimony that are all of our customers pay the -- that is allocated across all of our customers, correct?

A. It is a cost of wastewater treatment, so yes. It is a certain assumption with a level of BOD and TSS that's made by all customers.

MS. MYERS: Okay. Thank you. We don't have any further questions.

CHAIRMAN TOENJES: Thank you, Ms. Myers. Ms. Stump, do you have questions for Mr. Gorman on behalf of the Rate Commission.

MS. STUMP: I do, Mr. Chairman.

CHAIRMAN TOENJES: Please come forward.

EXAMINATION

BY MS. STUMP:

Q. Good morning, Mr. Gorman.

A. Good morning.

Q. Forgive me if it takes a minute. I just want to not be repetitive.

As you know from having done this before, my role is a little bit different. I kind of want to make sure

we're clarifying things for the record and the Rate Commission has what it needs on the various factors and criteria under the charter, which I think you're familiar with, correct?

A. I am. Thank you.

Q. Let's start on page 2 and 3 of your testimony. On the finance policy for the CIRP, you talk about how the District in the past has had 75 percent debt and 25 percent PAYGO.

And this rate change proposal as 60 percent debt and 40 percent PAYGO.

But then you conclude that you believe that 70 percent debt and 30 percent PAYGO is correct for this rate change proposal. Can you explain why you got to the 70/30?

A. Yes. A financial policy is both the PAYGO debt financing and the PAYGO financing. But it also includes a debt service coverage minimum.

Under the policy that this board approved in the last three rate cycles, it was 75/25 as a targeted debt and equity funding. It also has a minimum debt service coverage funding of 1.6 times.

As the level of imbedded debt grows for the utility, as they continue to make work-related and EPA capital expenditures, the percentage of rate revenue funding needed to maintain a minimum debt service coverage ratio of 1.6 times is growing in relationship to the annual grip spend.

So in order to maintain that minimum debt service coverage requirement at around 1.6 times, in this case, I think the 75/25 can't be met it, because it will push the debt service coverage ration below 1.6 times.

So I've recommended 70/30, which actually sets it a little above 1.6 times.

And I think that's significant, because the combination of these two financial metrics under the old policy ensure that there's adequate debt service coverage, because that's an important factor in the credit standing of the utility.

It also helps establish just how much equity funding is needed on an annual basis in order to maintain that level of debt service coverage.

So in this case, it's grown from 75/25 in the last couple cases to what I think is appropriate in this case of 70/30.

I expect in the next case, because the capital expenditures appear to be levelling off, that the level of PAYGO funding will be much higher than 70 percent.

And the reason I would expect that is because in order to maintain the minimum debt service coverage ratio, the level of PAYGO funding is going to increase from this point, because we have moved so far into the major capital expenditure program.

Q. Thank you. While we're on page 3, you've got -- page 2 actually. You're proposing to reduce amount of revenue the rate change proposal would bring into the District over the four-year period.

I'm looking at that little chart that you have. The District proposes to generate 69 million in increased revenue, and then you've got 45 million?

A. I do, yeah. That's about a $24 billion reduction by the end of the fourth year.

Q. And why do you believe that that's appropriate?

A. Well, there's three adjustments I made to the cost of service.

One, I will reverse. That is the level of interest rates. They were overstating their cost in these bonding issues.

I still believe that they're probably overstated there, but I think I understated it in the way I adjusted the model. I will correct that.

The second issue is their proposal to increase the debt service coverage minimum from 1.6 times, as it's been in the last three rate proceedings, up to 1.8 times in this case unnecessarily shifts the level of rate revenue funding to equity versus debt.

And that unnecessarily increases the revenue requirement in each of the four years over the next -- in this rate cycle.

And second, the level of annual CIRP spending has been increasing in each of the rate cycles.

In this year, this cycle again has increased. But particularly, in the last two years of the four-year rate cycle, it increased by about $70 million a year.

If that can be spread out over a six-year appeared instead of -- well, let me go back.

The CIRP annual spend over this cycle increased relative to the last cycled, but significantly the last two years of this cycle increased by about $70 million, relative to the first two years.

But the year immediately following, fiscal year 2024, which is in this rate cycle, the annual CIRP drops significantly and stays lower through 2030.

So if that $70 million increase in CIRP funding in '23 and '24 can be spread out over '25 or '26, then you can reduce the revenue increase and rate increase you need in this case to pay for the level of CIRP funding that will be done over the next four years.

And significantly, if that can be accomplished, then you not only reduce the wastewater rates needed over the next four years; but by spreading the level of CIRP spending out, you actually reduce the amount of the bonds that have to be sold to fund those programs when they're actually funded.

So I think there's benefits to customers by reducing rate increases in this case. I think there will be -- in this rate cycle, I think there will be benefits to customers and subsequent rate cycles, because more of the CIRP funding will be -- revenue funding, as opposed the issuing additional debt.

Q. As Ms. Myers pointed out, though, I believe that one of the things that the District and the Rate Commission also have to consider is whether the rate change proposal will allow it to comply with all laws, including the consent decree.

So my question would be, given what you know now, do you believe the rate change proposal, as you've got it here with 45 million, do you believe that that would be -- impair the District's ability to comply with the laws and regulations, including the consent decree?

A. Well, not sure. But I will look at that. Ms. Myers showed me a document that showed that certain incinerator projects have to be done by 2026.

That's two years beyond 2024. And in my modelling, I deferred a couple of projects out through

2026.

So I don't think that change would necessarily conflict with that timeline obligation of MSD.

She also commented on some wastewater capacity expansions and suggested there's some timeline limits on those. I'll review that to see whether or not this proposal conflicts with that.

If it doesn't, then I think that -- what's very significant about this is to the extent there is any flexibility in MSD's ability to time when they actually make this capital investment that they have some control over the pace.

And then they also have some control over the rate increases that's needed in this case.

And Ms. Myers has raised some important issues that I don't dispute. You have to comply with the EPA regulations.

But considering whether or not the MSD has timed the capital investments in a way that doesn't result in the most attractive rate structure for its customers, I think it has merit and should be explored by the Rate Commission to ensure customers don't have to pay rate increases that could be avoided by more prudent management of CIRP spending by MSD.

Q. One of the other factors that the Rate Commission

has to determine is whether the rate change proposal generates funds necessary for emergencies and delinquencies.

Do you think that your -- is it your opinion that the proposal that you're making will generate funds necessary for emergencies and delinquencies with the smaller proposed revenue increase?

A. Yes. With the corrections, it may be necessary for the interest rate, and I will review the CIRP funding issues. That will change the revenue position that I take with modifications.

But with those adjustments, the rate model I used was essentially the same as the MSD's rate model.

It accommodates the need for cash for the MSD. It reflects uncollectible bills by MSD, and need to pass those costs on to customers who do pay their bills.

It reflects the liquidity needs of the MSD to fund their operating expenses, their cash reserves to ensure that they're in compliance with the bonds, or issuing additional bonds.

It ensures that the debt service coverage ratio is adequate to not only meet the initial requirements for minimum debt service coverage, but also is strong enough to maintain a AA bond rating, which is MSD's current bond rating, and is what I targeted -- or I accepted as a reasonable target for these financial forecasts.

So I believe the actual objectives -- financial objectives the MSD included in their model were not contested.

And with very limited changes in that model, I think there's opportunities for much lower rate increases in this case, while still providing MSD the funding needed to accommodate all the capital investment that has to be made to comply with EPA regulations.

But there are some soft spots that I do need to look at, based on what the MSD pointed out today --

Q. So even though it will result in less revenue, it is still your opinion that it would be sufficient to cover all emergencies and delinquencies.

A. The revenue is adequate under the forecast included the model.

The adjustments to revenue was an opportunity to reduce the debt service coverage ratio down to what has been previously approved by this board, which changes the mix of funding from debt and equity percentages that the MSD had to 40 percent.

Equity funding is 60 percent debt, I changed it to 30 percent equity funding and 70 percent debt. That lower the revenue requirement.

The increase in capital spending in the last two years for those projects, which I believe were discretionary and could be deferred for a couple of years, also reduced the revenue increase in those two years.

All other financial metrics in the MSD were met in this financial model.

Q. You had a lot of discussions about the interest rates, so I don't want to -- you're going to go back and look at that again, it's my understanding.

But you believe the 5 percent is too high; is that the sum of where you are right now?

A. Yeah. The 5 percent interest rate was accompanied by an assumed premium, selling the bond in the model.

And that premium was about 13 percent. And the net effect of that would price a bond out a little more than 4 percent.

That's about a percentage point more than what MSD paid for 2017 bond issue.

So the real question is, will interest rates increase over the next four years.

I've been in rate cases for many, many years, including the last four rate cycles for the MSD.

We've always been looking at increases in interest rates, and we haven't seen them.

There's projections for increases in interest rates now. There have been every year for the last 12 years.

More often, those projected interest rate increases have not materialized. Interest rates have stayed relatively flat.

But nevertheless, the MSD has to recover its actual interest costs, and that will be based on market conditions when the bonds are sold.

But at the same time, the overstating what those interest costs will likely be will have the effect of unnecessarily increasing wastewater rates to customers in this utility.

And I think that the cost to customers should be considered in formulating what an appropriate assumption is for what the interest rate will be over this four-year rate cycle.

Q. And Mr. Gorman, what do you -- you obviously think it's going to less than what they're proposing.

What do you think the effect to MSD is, if in fact the interest rates will increase?

You already said we don't have any clear indicators. But what if instead, interest rates -- something happens in this country where interest rates

are above 5 percent, or at 5 percent?
What's going to going to happen to the CIRP or MSD in general, based on that assumption in this model for this rate change proposal?
A. Well, I'm not aware of anything that would prevent the MSD from coming in and saying, look, there's been a material change in our cost. And we need to adjust the wastewater rates approved for this docket.
To the extent that interest rates do increase well beyond what's reflected in the forecast, and MSD's rates are not adjusted, that would mean that their debt service coverage would be a little lower.
Probably not below the minimum level of 1.6 times used in the forecast; certainly well above the 1.25 minimum, that would put them in default and the bond in danger.
So there is some flexibility in the debt service coverage level in the event that interest rates are higher than what's included in the forecast here.
But there's also the natural hedge for the MSD here. If their costs increase considerably, relative to what is assumed when we make these rate forecasts that threatens their financial strength, financial viability, I think -- I presume they would have the right to come in and ask the Rate Commission to consider an emergency

rate increase, because something beyond their control happened, which threatens the financial strength of the MSD.

Q. So if interest rates in fact go up, your answer is that MSD would need to come back to the Rate Commission to do a new rate change proposal, essentially.

A. No. I think I explained that if interest rates go up, but not significantly, then that would simply mean a lower debt service coverage would be earned relative to the forecast period.

But that would not harm MSD's financial integrity because rates are being set -- even at 1.6 times debt service coverage ratio, at a relatively strong financial coverage of debt obligations.

So that would erode the actual earned ESC relative to the target ESC. But there's a lot of breathing room in that factor.

My second point was, is that there's a material change in the MSD's costs relative to what's included in the rates.

And that material change increases their financial integrity, or financial viability; then it would seem prudent for them to seek an increase in rates to accommodate that change in costs.

Q. Thank you. Let's switch to I&I for a minute. I think it's on page 6 of your testimony.

You note that I&I costs are more accurately reflected as 50/50 as opposed to MSD's proposal of 40 percent customer and 60 percent throughout.

Could you please explain what supports your 50/50 breakdown as supplied to MSD?

A. Well, I believe Black and Veatch's studies would support it; your on witness's studies support --

Q. Correct. I'm asking you your opinion right now.

A. Well, that's part of my opinion; is the studies done by Black and Veatch supports -- reflect an I&I at a much higher ratio for customers than reflected in MSD's studies here.

For other wastewater utilities, I believe it is common to have a customer component of I&I at 50 percent or even higher.

And another aspect of I&I cost is, you know -- the reason I&I's infiltration, the inflow of ground water and sewer water into the wastewater system so that the amount of that water collected is a direct function of the length of pipe you have to connect all your customers to the wastewater system, the number of lift stations that can get water infiltrated, the number of manhole covers that can get water infiltrate.

So that the number of customers on the system, the geographical distance that the utility has to install pipe in order to connect all those customers, has a big impact on the amount of the amount I&I, water -- I&I infiltration into the wastewater system.

It's not simply the volume of the wastewater that those customers put into the system. It's more largely driven by the length of the pipe and the number of that infrastructure I just described.

That's typically recognized by companies like Black and Veatch when they do studies on I&I.

And because of the causation of I&I, the length of pipe and those other factors, the classification of those costs is generally weighted more heavily toward a customer component and not as heavily weighted towards actual wastewater contributions to the system.

Because the wastewater contributions to the system really don't drive the I&I. They're just an additional cost the wastewater utility has to incur because it exists in some I&I in meeting their primary objective. And that's to treat the wastewater fluid that's put into the system.

Q. Thank you. As we talked about, the Rate Commission has certain factors and criteria that they have -- that they look at and they have to determine

under the charter in looking the rate change proposal.
And certainly, from your testimony, there's parts about the district's proposal that you disagree with.
But I'm going to ask you some questions, just because I'm trying to get exactly what -- you don't mention the factors and criteria in your testimony. So I just want to ask you about them.
A. Thank you.
Q. And right now, I'm asking about the District's rate change proposal.
So do you believe that -- do you have an opinion on whether the rate change proposal is necessary to pay interest and principal falling due on bonds issued to finance the assets with the District?
A. Not the rate increase proposed by MSD staff. But a rate increase is necessary, particularly in fiscal year 23 and 24.
Q. Do you have an opinion on whether the rate change proposal is necessary to pay for the cost of operation and maintenance?
A. The rate increase that I've outlined in my testimony is necessary for that. Yes.
Q. What about the district's rate change proposal?
A. I think they're -- the proposed District rate increase produces revenues that are in excess of the

amount of revenue needed to cover those costs.
Q. And do you have an opinion on whether the rate change proposal provides for funds in such amounts to cover emergencies and anticipated delinquencies?
A. Under my proposal, I believe it does. Under the District's it would also.
But again, I believe the District's rate change proposal creates more revenue than the District needs.
Q. Okay. And is the District's rate -- well, let's talk about both.
The rate change proposal; do you have an opinion as to whether it's consistent with constitutional, statutory, or common law, as amended from time to time? And you don't have to have an opinion on those.
A. As my non-lawyer opinion, I think the rates need to be adequate to maintain the financial integrity of the utility.
Which is what I sought to estimate in my testimony, and I believe MSD staff's level of revenue is in excess of an amount needed to maintain the financial integrity of the utility.
Q. Do you have an opinion as to whether the District's rate change proposal enhances the District's ability to provide adequate sewer and drainage systems and facilities and related services?

A. Again, I believe my revenue increase is adequate to cover that in a conservative manner.

And I believe MSD staff's revenue increase is in excess of the amount needed to cover those costs.

Q. Do you have an opinion as to whether the District's rate change proposal is consistent with and not in violation of any covenant or provision, relating to any outstanding bonds or indebtedness of the District?

A. Sorry. Can you repeat that?

Q. Sure. Whether the District's rate change proposal is consistent with and not in violation of any covenant or provision relating to any outstanding bonds or indebtedness of the District?

A. I don't believe that they're inconsistent with their debt obligations, no.

I believe they're inconsistent with their obligations for reasonable pricing to the customer.

Q. And the next factor we've talked about a little bit, but I would also like to ask again.

Do you have an opinion as to whether the rate change proposal does not impair the ability of the District to comply with applicable federal or state laws or regulations?

A. Same answer. I believe the district's revenues are in excess of what they need to comply with the state laws and regulations, with the caveats that we've walked through already.

And I believe that the lower revenue requirement would be adequate to accommodate those obligations.

Q. And then finally, do you have an opinion as to whether the District's rate change proposal, as they propose it, imposes a fair and reasonable burden on all classes of ratepayers?

A. I do not. I believe the MSD's proposal produces an excessive rate burden on all customers.

And I don't believe that they're cost of service study accurately allocates costs to the various classification of functional components of wastewater service.

So I propose to reduce the revenue collections from the MSD that is necessary to maintain the financial integrity, and meet their capital expenditure obligations to state and federal regulatory agencies.

And do so in a way that will maintain their financial integrity and earn their very strong AA-rated bond rating, but do so at more reasonable prices to customers.

I also believe that the MSD has proposed a rate structure, which shifts too much costs to the volume charge, which can create instability in the revenue collections, which I think is a bad policy for a utility that keeps taking on more debt.

You want stable revenue collections. So reducing the -- increasing the level of revenue collected from the volume charge and reducing the relative level from customers and fixed charges that are imposed on customers each month may have -- may create more instability and revenue collections.

So I think from a financial and integrity standpoint, the MSD proposed rate structure should be modified to at least have the same increase in the monthly customer charges as they do in the volume metric charges.

MS. STUMP: Okay. Excuse me just a minute, Mr. Chair. Prabha Kumar is one of the rate change consultants. She's got at least one question, I believe.

EXAMINATION

BY MS. KUMAR:

Q. Mr. Gorman, I think to the counsel's question on what happened if the interest rate potentially goes higher.

One of the things that you mentioned was that if interest rates happen to go higher, then the one thing

that could happen is the debt service coverage could be lower than the 1.6, but were it -- would it still be higher than the 1.25, was your statement. Was that correct? Did I capture that correctly?

A. Well, I don't know if I got that specific. But if you look at my schedule MPG1, page 2, I'm actually setting rates at the minimum DSC of 1.7 times, which increases over the forecast period, up to almost 1.9 times.

So what I said was is that if interest rates are higher than what is reflected in my forecast, that will increase interest expense on new bonds; not the old bonds, because there will be contractural obligations.

But that increase in interest expense on the new bonds will increase operating expenses and reduce the revenue available to -- that goes -- essentially reduces operating income to the utility.

And that will shrink the actual earned debt service coverage ratio. And it will shrink it below what was assumed for ratemaking purposes.

But it would be below the 1.6 times, if rates were set based on 1.6 times. But my projection shows something a little higher than 1.7 and 1.8.

Q. Correct. So in the situation when if interest rates go higher than projected, then you are

acknowledging that it could reduce the debt service coverage, relative to what you have projected.

So the question, then, is if the debt service coverage get reduced to what you have projected, that could also have an impact on the amount of money available for cash financing of capital for the program; would you agree to that?

A. Yes.

MS. STUMP: Thank you. I believe that's it. Thank you very much.

CHAIRMAN TOENJES: Thank you, Ms. Stump. Before we proceed with your questions, Mr. Neuschafer, we'll take a 10-minute break and resume at 10:25.

(WHEREUPON, A BRIEF RECESS WAS TAKEN)

CHAIRMAN TOENJES: We will continue with our questioning. Next step in the process is to allow Mr. Neuschafer to ask Mr. Gorman any questions.

Mr. Neuschafer, do you have questions for Mr. Gorman?

MR. NEUSCHAFER: I do not.

CHAIRMAN TOENJES: You do not. Thank you. Any of the rate commissioners have questions for Mr. Gorman.

MR. SCHOEDEL: Yes, Mr. Chairman.

CHAIRMAN TOENJES: Mr. Schoedel, then Mr. Stein.

EXAMINATION

BY MR. SCHOEDEL:
Q. Mr. Gorman, you stated that the interest rates -- and I know it's a complicated issue with projecting interest rates. And I'm certainly not a finance person.
But with your experience and reviewing over the years, you mentioned that MSD's may be too high based on past experience and hard to interpret what might -- I shouldn't say interpret, but guess what the future interest rates are.
In your opinion, what do you think would be a more appropriate interest rate to include in their model?
A. Well, I need to look at that more carefully, because their model actually assumes that the coupon rate and -- it is not necessarily the cost of the bonds, because the bonds are expected to be sold at a premium.
But I would think that the net effect; that is the actual cost to MSD of the proceeds from the bond, which would be a combination of what the coupon cost is, and the net proceeds to MSD should produce a net cost of around 3 and a half to 4 percent.
Their cost right now is closer to 4 and a half percent. So I think there is some interest rate -- there is an overstatement in the interest cost to the MSD in their model.

But it's not as large as I reflected in my direct testimony.

Q. So roughly speaking, about a percentage less than what their model currently shows?

A. Yeah. I need to confirm those numbers. But it's something, 1 half to 1 -- 1 half of 1 percent to 1 percent. Yes.

MR. SCHOEDEL: Okay. Thank you.

CHAIRMAN TOENJES: Mr. Stein.

EXAMINATION

BY MR. STEIN:

Q. Mr. Gorman, there's been a lot of discussion around debt service coverage ratios.

I think it's been stated that in the past, the District's financial guidelines have said that they wanted to maintain a minimum of 1.6 in order to maintain their AA bond rating; is that correct?

A. That is.

Q. Currently, in this case, they're looking at a minimum of 1.8.

In an era of very steady interest rates and nothing on the horizon to indicate that's going to change in the foreseeable future, why would we want to increase the debt service coverage from 1.6 to 1.8?

A. Well, the debt service coverage is a different issue than the interest rate issue. That really helps establish the equity in debt funding of the capital program.

We have a rough target of 75 percent debt, 25 percent equity initially. But that percentage really is ultimately going to be controlled by maintaining a minimum the debt service coverage ratio.

So there's two things. The debt service coverage ratio gives an idea of the financial stability of the utility, and the credit rating agencies will review.

So 1.6 coverage, 1.6 times debt service coverage is very, very strong coverage for a utility company of MSD's size and the stability of their revenue collections.

You know, other utility companies, like the one in Indiana that we talked about a little bit, they actually set rates at a 1.45 debt service coverage target on the total debt service.

So 1.6 has already got a lot of cushion built into it. So the need to push it up to 1.8 would be necessary if there's any threat to their bond rating, for the bond rating to express any concern on the financial strength of the utility.

They're not. And for that reason, I don't believe there's a need to change the financial policy from a minimum of 1.6 coverage up to a 1.8 coverage, as proposed by MSD in this case.

Q. If the debt service coverage were to shrink below 1.6 and -- what level do you think the District's bond rating would be reduced?

A. The bond rating analyst would look at the actual -- our debt service coverage ratio, look at the utility's ability to correct it.

So if it dipped down to a low level, as long as it's not in default range at 1.25 or less, they can issue additional bonds.

Then there's a remedy available to the utility to adjust their rates to increase their level of debt service coverage.

I would expect, based on the events that have taken place at my other utilities, that they can weather a short period where they have a much weaker debt service coverage ratio than 1.6; possibly down to 1.4 or even 1.3.

As long as there's the expectation from credit analysts that the utility can correct that by seeking a rate change that will ultimately strengthen that debt service coverage ratio, in a reasonably short period of time.

Q. If their bond rating went below AA, what would be

the financial implications of that?

A. Their new bond issues would be sold at a higher interest cost to the utility.

Q. Do you have any sense of what percentage rate that might result in, what delta in the percentage rates there might be?

A. Depends on the market that it occurs in. And on average, it probably would be 10 to 20 basis points.

But in a period of financial distress, the difference between a AA and a single A bond rating could be 50 to 70 basis points.

That would be a market where there's overall distress in the marketplace, and the market participants are looking for securities of higher protection, lower risk, and paying a premium for them.

MR. SCHOEDEL: Thank you.

CHAIRMAN TOENJES: Mr. Palans.

MR. PALANS: Thank you.

EXAMINATION

BY MR. PALANS:

Q. Mr. Gorman, were you present during the proceedings, where testimony was educed on April 8 and April 9 earlier?

A. I was not at that those proceedings.

CHAIRMAN TOENJES: Mr. Palans, could you get a little closer to the microphone?

Q. MR. PALANS: Have you had an opportunity to review the transcript of the proceedings and testimony that was educed on April 8 and April 9?

A. No, I did not. I primarily focused on the testimony, discovery responses, and all the exhibits included in the MSD original filing.

Q. So you've not reviewed that transcript nor the evidence that was educed?

A. I think the evidence was included in their filing, but I have not reviewed the transcript.

Q. Have you had an opportunity to review the declaration of our consultant, the Rate Commission's consultant, Ms. Lemoine?

A. Yes.

Q. I'm going to start with basics to just understand. And the basics, I'm going to the beginning of your declaration, pages 2 and 3, where you summarize your findings and conclusions.

I want to just make this as simple as possible. You propose to reduce the revenues available to the District during the this cycle by $24 million; am I reading that correctly?

A. At the end of the fourth year, that is correct.

Q. Then you begin to describe adjustments that you

made to MSD's forecasted wastewater revenue requirements.

And you say that you made only three adjustments. Then you go on to list a paragraph with four subparts.

Identify those three adjustments that you made for us.

A. The three adjustments include the following: I revised their model to reflect that the financial policy that's been approved by this Rate Commission, at least over the last three rate cycles, that included a funding mix of 75 percent bonds, 25 percent equity, and a minimum debt service coverage ratio of 1.6 times.

MSD's filing was based on a 60 percent debt, 40 percent equity funding mix, and a minimum debt service coverage of 1.8 times.

Q. Let me just interrupt. So that's number one.

A. That's number one.

Q. Okay. Number two.

A. Number two is: I adjusted the interest rate on new bonds projected to be issued over the four-year rate cycle.

Q. Okay. That's number two.

A. Number three is: I adjusted the annual CIRP spend in fiscal year 23 and 24, and moved some of those capital projects out to FY25 and 26.

So that levelized the annual CIRP spending over the period FY21 through FY26.

Q. I would like to just focus on two of the three that you mentioned; the two being interest rate and the CIRP scheduling.

A. Okay.

Q. You indicated that, with respect to interest rates, that you may be wrong on your estimate of the interest rate pricing. Did I understand your testimony correctly?

A. Yeah. I may have understated the interest costs because of other components of the model, which I overlooked. Correct.

Q. So if you were wrong on the interest rate reduction, your assumption would similarly be incorrect, correct?

A. The revenue requirement adjustment would be overstated. Yes.

Q. And with regard to CIRP, which was number three, you deferred projects that are identified CIRP projects during the this period; is that my understanding?

A. Yeah. I deferred projects that were scheduled in the MSD projections for FY23 and 24 to FY25 and 26.

Q. And I believe in response to Mr. Myers' question, you identified an amendment to the consent decree that

was filed with the Court, and which the EPA has agreed upon; is that correct?

A. Yes.

Q. Have you ever seen that amendment to the consent decree before today?

A. I did not. But I would note that that amendment doesn't conflict with what I did.

Q. It does not conflict with what you did; that's your opinion?

A. Well, that's what it said.

Q. Well --

A. It said that the capital requirements for the wastewater treatment plants must be completed by 2026.

And that's consistent with the change in the MSD's forecast that I made.

Q. Are you aware of the fact that consent decree is mandated requirement under law?

A. I am.

Q. And that you are proposing that CIRP projects be spread in fiscal year fiscal 24 -- beyond that period to a future period, correct?

A. For the -- yes. And doing that would levelize the annual CIRP spending.

Q. Doesn't deferrals make those project costs increase with increased risks?

A. Well, if you push them out into a future period, there may be some inflationary impacts on the costs.

Q. Inflationary impacts could be higher interest rates applicable, correct?

A. Could be lower interest rates. So I don't see interest rate as a risk that, particularly, by pushing them out, would allow for more of these projects to be funded by equity because there wouldn't be such a significant need for more debt capital in FY23 and 24.

Q. Are you aware of the fact that the testimony is that the District must spend $600 billion in present-day costs to satisfy its obligations under the consent decree during the next 20 years?

A. Yes. That consent decree, -- I haven't checked that number but, yes.

There is a present value cost in the consent decree that was estimated by MSD at the outset of the program that was designed to comply with the EPA consent decree.

Q. And are you aware of fact -- I believe you testified, that interest rates have been consistently low for the past 10 years?

A. Yes.

Q. And --

A. Well, yes. Around 2008, you know, there was a period where municipal interest rates were higher.

But they've been relatively low, certainly -- interest rates from a treasury and a corporate bond perspective have been low for the last 10 years.

There was a period where municipal rates were high, relative to corporate bonds.

But certainly for the last five to eight years, all interest rates, including municipals, have been relatively allow.

Q. If you've reviewed the transcript from the proceedings on April 8 and April 9, there was a term used that interest rates are at historical lows. Do you remember that?

A. I wouldn't be -- that's certainly true with respect to treasury securities.

Q. Do you agree with my statement; that interest rates are at historical lows?

A. They have been. Right now, they're -- I don't know if that's necessarily true.

I think treasury bond -- 30-year treasury bond has dipped back below 3 percent. But 3 percent is so. It's not historically low, but not --

Q. It's low?

A. Yeah. Well, it's low. But the reason it's low is because inflation is under control.

A 3 percent treasury bond implies a 1 percent real return and a 2 percent inflation outlook, and that type of real return and treasury bond is really not low.

It just indicates that we're in an environment of low interest rates.

Q. And you also aware, if you read the transcript, that the pricing for projects, CIRP projects, are also at historical lows?

A. Well, I didn't read the transcripts. But I didn't contest the CIRP projected costs.

I'm simply observing that if you can manage the pace in such a way that you levelize the annual CIRP spend, you can accomplish all the projects without much more of an increase in rates to MSD customers.

Q. And you're also aware, and I think you referred to the fact, that the District enjoys a AA rating from one of the credit agencies. I think it's Standard and Poor's; do you recall that?

A. I do.

Q. And that liquidity of the District is strong at present?

A. It is.

Q. So based upon low interest rates, favorable pricing on CIRP, and a strong liquidity position, it's your position that CIRP projects should be deferred into

future periods as opposed to done at the present?

A. Yes. And I would point out that all of those positive financial metrics that you just walked through, where that accomplished into financial policy that's been approved by this Commission for the last three rate cycles, there's no need to change it as MSD is proposing in this case.

And deferring CIRP program will not impair the financial strength of the utility.

It will simply spread out the cost over more years and mitigate the increased wastewater rates needed to maintain this strong financial standing of this utility and still fund all of those programs within a time period that meets their EPA and state and federal regulatory mandates.

But it will lower the cost to wastewater customers.

Q. Doesn't these deferrals that you propose of CIRP projects expose to District to contingencies such as may be encountered with its aging infrastructure?

A. There could be outages of the existing infrastructure. That's true.

Q. And it would expose the District to funding or financing that may be highly competitive and cost more in future years?

A. I don't think that's a real risk. I think that's an exaggeration of the system planning.

Q. And do you believe that regulatory compliance, or changes in regulatory compliance might affect the contingent exposure risks of the District?

A. Regulatory compliances and obligation of the utility they must comply with. Yes.

Q. And are you aware of the fact that District has advised us that there is a declining consumption and a reduction of water demand and revenues, while costs for water services are increasing?

A. I do. And that's why I propose to reject the wastewater rate design of MSD and focus instead on fixed monthly fees to the customers to reflect this fixed cost nature of MSD and stabilize that revenue collection.

Q. And would you also consider inflationary risks to be a potential additional cost for the District?

A. Inflation is a risk to the extent it increases the level of spend necessary to maintain service operations and reliability.

MR. PALANS: Thank you. I have no further questions.

CHAIRMAN TOENJES: Thank you, Mr. Palans. Any questions by any other rate commissioner at this time? Mr. Gorman, I have one question.

EXAMINATION

BY CHAIRMAN TOENJES:

Q. You talked about the -- well, I have a couple of questions.

The first one: You talked about the volume metric charge and how that created some uncertainty in your reallocation comments. Could you sort of elaborate on that a little bit?

A. Sure. The MSD rate design doesn't increase the fixed monthly fees to all customers by the same percent increase.

It's increasing the volume metric charge. The volume metric charge is based on the billable water, billing units that are measured by the water utility.

They are applied to the volume metric charge as they're approved by the MSD wastewater rate structure.

To the extent customers' volume metric use of water varies during the relevant time period, that can have an impact on the amount of revenue collected by MSD, because the rates are applied to those volume metric billing charges.

To the extent customers reduce consumption, volume consumption, that can reduce revenues to MSD.

To the extent customers install more efficient water appliances, that can reduce revenue collections to

MSD.

In contrast, of those revenue collections through the volume metric charge, it will depend on what the actual volume metric billing is collected by MSD, by water utilities within the service territory.

In contrast to that, the fixed monthly fees, the meter charges, and the other fixed fees in the MSD are stated on the customer bill.

So they're stable. The revenue collections is far more predictable.

And because of MSD's largely-fixed cost nature -- there are some volume metric charges that vary with usage on the system.

But most of their capital -- most of their cost-related capital investments are in the fixed costs.

So stabilizing revenue collections by pricing the structure, pricing the MSD service in a way that provides more stable revenue collection will benefit the MSD and the bond orders in the MSD, because it makes their ability to meet debt service targets, it makes the ability to predict whether or not they can achieve the debt service charges in a more highly probablistic fashion.

Conversely, you know, when you have revenue that's dependent on volume metric billing units, which can be impacted by a lot of factors, it's much less ceratin how much revenue the MSD will actually collect.

Q. So your recommendation will be to change that percentage -- change that balance --

A. Well, just --

Q. -- more related towards a fixed rate?

A. Relative to what the MSD has proposed here, yes. Their cost of service studies supports -- with it just from an I&I allocation -- supports pricing that wastewater service in a way that it imposes higher fixed charges on customers and lower volume metric charges.

So that's supported by both cost of service study. I think it's fair to all customers.

And I think it's also more prudent, given the significant debt load that the MSD has taken on, because it stabilizes revenue collection.

CHAIRMAN TOENJES: Any other questions by any other of the Commissioners? Thank you, Mr. Neuschafer. Thank you, Mr. Gorman.

Ms. Stump, are you ready to present those persons for who you filed testimony on behalf of the Rate Commission.

MS. STUMP: I am.

CHAIRMAN TOENJES: Please come forward.

MS. STUMP: We will start with Ms. Pam Lemoine.

CHAIRMAN TOENJES: Thank you. Ms. Lemoine, is the testimony you're about to give the truth, the whole truth, and nothing but the truth?
MS. LEMOINE: Yes.
CHAIRMAN TOENJES: Thank you. Ms. Myers, do you have questions for Ms. Lemoine.
MS. MYERS: Yes, we do. With me, I have Marion Gee and Tim Snoke, our secretary/treasurer.
EXAMINATION
BY MS. MYERS:
Q. Good morning.
A. Good morning.
Q. The questions we have for you are around your rebuttal testimony.
So I'm certain you have that with you. I'm just going to kind of walk through that.
On page 6 of your rebuttal testimony, you agree with and support MSD's rate proposal, seeking authorization to issue additional bonds during the period of FY21 through 24; is that correct?
A. Yes.
Q. And you also state that issuing additional bonds provides multiple benefits. Can you explain some of those benefits?
A. Certainly. When utilities are undertaking large

capital programs, there are a number of different factors to take into consideration in developing a long-term financial plan to provide the maximum benefit and the lowest cost for customers.

So by issuing debt, you have the ability spread costs out over the users, who will benefit from those facilities.

So for instance, with treatment plant expansion or something like that, if you were to cash finance it, your current customers pay that entire burden.

Whereas if you debt finance a portion of that, or all of that, you spread that cost over the users who benefit from that facility.

Q. Okay. You also agree that MSD's proposed capital financing plan provides a reasonable mix of cash and debt financing; is that correct?

A. Yes.

Q. Okay. Is this a reasonable and cost-effective approach?

A. Is the funding mix that you're speaking to?

Q. Correct.

A. Yes. When I reviewed the MSD proposal, I looked at the policies that were taken into consideration in developing that financial plan, in light of the commentary provided by the rating agencies in your 2017 rating, and the considerations they gave for affirming your ratings, as well as their comments with regard to items that could cause a decline in your rating in the future.

And as has been stated previously, at this point in time for the District, debt service coverage really is driving the financial plan, not the cash debt mix.

The cash debt mix is an outcome of achieving the debt service coverage that's required in light of the currently CIRP funding level.

Q. Okay. On page 13 of your testimony, you noted -- I'll wait until you get there -- that MSD's capital financing plan to finance the CIRP is a sound capital financing approach. What do you mean by that?

A. The capital financing approach in the financial plan is showing stability in the utility's financial metrics over time.

So while the financial plan is showing a decline in debt service coverage, for instance, over the study period to the minimum of the 1.8 times in 2024, that rate of decline has been managed over that time period.

It's not jumping around, for instance. The rate increases over that time period are fairly levelized.

And so the overall mix shows stability over that study period.

Q. Okay. And in your professional opinion in assuming voter authorization for additional bonds, does MSD proposed financing plan help minimize the impact of the CIRP on the wastewater rates during the FY21 through FY24 period?

A. It appears to do so. Yes. Obviously, there are multiple ways to put together financial plans that could shift costs here or there over time.

But in total, the based on a 1.8 debt service coverage target, the capital program that you're facing, the financial plan seems reasonable to me.

Q. Okay. And also on page 6 of lines 20 through 22, do you concur with the District's approach to establish a financial plan that allows for the debt service coverage of two and a half times or greater for senior lien bonds, and 1.8 times or greater for total debt coverage?

A. Yes, I do. As I indicated, I reviewed the rating agency reports with regard to the 2017 rating and the commentary that they provided.

Each of the rating agencies have slightly different ways they go about conducting their methodology for rating debt.

And certainly, debt service coverage is just one of many factors that have to be looked at.

So it's important to look at everything in total. But in reviewing the rating agency's criteria and their commentary, 1.8 times seems reasonable to me.

It's higher than Standard and Poor's rating threshold of 1.6 times. But when you look at Moody's and Fitch, they are more conservative with their expectations for debt service coverage. And one of the them even indicated that they would look closely at a downgrade or a negative rating action if the debt service coverage dropped below what they were expecting to see, which they quoted as being 1.9 or so, if I recall correctly.

Q. Okay. Do you agree that the escalation factors in debt financing assumptions MSD used to project operating and maintenance expenditures and debt service are reasonable?

A. Yes.

Q. Did you also conclude that MSD CIRP is reasonable?

A. I will defer the review of the CIRP to Ms. Nicole Young, as far as the details are concerned.

As a rate consultant, I'm not versed in all of the details that would be necessary to evaluate each of the projects specifically.

I'd really defer to MSD experts in developing that plan. But in my review of the consent decree and the schedules, in my review of how the costs were estimated, and my review of how the costs were either incorporated into the financial plan, as indicated in the rate proposal, adjusting for inflation, adjusting for liquidations and so forth, it appears reasonable to me.

Q. Okay. Just as a follow up to that, can I draw your attention to page 12, line 10 through 12 of your testimony. That's where this question came from.

Could you just read line 10 through 12 at the beginning of --

A. Based on your experience with other large wastewater utilities, do you have an opinion regarding the reasonableness of the District's CIRP.

Q. And you answered that yes --

A. Yes.

Q. -- correct? Okay. Thank you. You agree with MSD that the proposed rates outlined in the rate proposal will achieve adequate fund balances to provide for any unanticipated expenditures or emergencies during the proposed rate cycle?

A. Based on my review of the rate proposal, and more specifically, the rate model, the details therein, the rate projections appear to project sufficient fund balances over the study period.

Q. Okay. On page 7 -- back on page 7 of your rebuttal testimony, starting with line 6, you recommend that MSD increase its rates during the FY21 through FY24 to avoid a potential spike in rates in FY25; is that correct?

A. That's correct.

Q. Okay. The rate increases shown for FY25 are for illustrative purposes only.

A. That's correct.

Q. And you also understand that these rates are not the proposed rates on which the Rate Commission is issuing anything in this rate proposal.

A. That is correct. The rate study period is through 2024.

But it's always important to look at a longer term -- longer period, particularly the year or two subsequent, to be knowledgeable about what the potential implications might be down the road of decisions that are be being made for this rate proposal period.

Q. So given your knowledge of the district's history of the projected rate increases beyond the proposed four-year rate cycle being less than expected, would you agree that it would be fair and reasonable to increase rates in the current four-year cycle to mitigate a

potential spike in 2025?

A. I do. I think that, in the past, it is true that costs have been lower than anticipated, which have allowed the rates for this current rate period to be lower than what had previously been projected in the prior rate period.

However, at this point in time, we are looking at low interest rates. There's been testimony that the bids are come in lower than even budgeted. So we're in a very favorable time period.

So I think there is a risk of assuming that that trend will continue to become even more apparent in the future.

In fact, I think there's probably a risk -- more of a risk at this point in time the other way; that three or four years from now, interest rates could be -- or inflation rates could be higher, the construction industry could be in a different position, where bids are coming in higher.

So I really don't agree that you can extrapolate the fact that we came in lower this time, that that would happen again in the future. It's a risk.

MS. MYERS: That complete our questions. Thank you.

CHAIRMAN TOENJES: Thank you, Ms. Myers. Mr.

Neuschafer, do you have questions for Ms. Lemoine?

MR. NEUSCHAFER: I do.

EXAMINATION

BY MR. NEUSCHAFER:

Q. Good morning.

A. Good morning.

Q. Looking at your testimony I want to talk about the ratio of debt to cash financing, question 23.

Actually, to begin, you indicate that 25 to 30 percent is -- of the ratio of a debt to dash financing is an industry-accepted best practice, and is in practice with other utilities.

A. That is correct.

Q. Okay. Yet this proposal, you identify that MSD is calling for cash financing of 37 percent.

A. On average for this rate period, that's correct.

Q. Okay. And your testimony is that 37 percent is consistent with the industry accepted-best practice and practice of other utilities of 25 to 30 percent?

A. That is a target and an industry practice, correct.

But again, as I mention earlier, the debt cash mix that is targeted is not a standalone policy that can be achieved in a vacuum.

It's a function of a utility's outstanding debt, and the impact that debt service coverage has on revenue that's generated to meet that debt service coverage level, as well as the size of the capital program.

So if the capital program changes, all things being equal, that cash generated will result in a different percentage, just from the basic math.

Q. Okay. I guess I'm having trouble understanding -- using your testimony, using the numbers provided in your testimony, how 37 percent is consistent with 25.

I understand that can change. But I don't understand how a number that is anywhere from 25 to 50 percent higher than the range that is best practice is consistent with that range?

A. Because based on the District's outstanding debt and debt service coverage requirement of 1. -- or the target goal of 1.8 times, that generates revenue sufficient to, in this rate period, cash finance 37 percent on average.

Over time again, it's your -- the debt service coverage provides cash for cash finance capital; that's your numerator.

Your CIRP is your denominator. So as those two -- as that changes, that percentage will change.

Because the District is heavily debt burdened right now due to the consent decree and the requirements thereunder, that debt service coverage does provide for additional cash financing that is, right now, on a percentage basis, more than what we see on average for the industry.

Q. Okay. I believe you just spoke a bit about establishing a series of revenue increases in '21 through '24 that are slightly higher than those proposed.

Is that your testimony; that you think MSD should consider that approach?

A. Correct. In order to mitigate what could potentially be a spike of two times that level that we're looking at now in 2025.

Q. Did you consider any alternatives, like spreading out the projects to the extent possible under, you know, applicable law or consent orders, over a greater period of time?

A. I did not look at moving out capital projects, because the capital projects are predominantly consent decree-related and regulatory-driven.

And again, not being an engineer that's focused on that, would not be in my position to be making decisions on projects building out.

Q. Okay. So just to be clear, I'm not talking about not doing the projects. I'm talking about timing of

projects.

A. Correct.

Q. Okay. And you don't have an opinion on that; or you haven't looked at that issue.

A. No. I think that there are a lot of risks -- or a lot of things that need to be taken into consideration in developing a schedule for capital projects.

Certainly, costs and trying to levelize costs is one of them. Meeting schedule projects in the consent decree is obviously critical. And then the regulatory requirement for the incinerator project that's required a date certain.

And you don't want to postpone those projects out to the deadline, because then you run a great risk if thing that happens, as far as weather, or ability to obtain contractors, or whatever the case may be, you don't want to run the risk in missing those deadlines. So you need to have a cushion there as well.

There are also considerations that capital project managers take into consideration is the sequencing of certain projects.

So on the asset management side, oftentimes projects need to sequenced in a certain way.

And so you can't move one out without moving another. And so there are a lot of different considerations that are really beyond the scope of my expertise.

Q. Okay. So did you -- you didn't, if I'm understanding, you didn't really look at the timing of projects.

Did you look at any other methods to address rate increases, other than just higher revenues?

A. Again, in an addressing this question, that was the point of the question; was that with slightly higher revenue increases in this study period, that spike in 2025 could be mitigated.

MR. NEUSCHAFER: Okay. That's all I've got. Thank you.

CHAIRMAN TOENJES: Thank you, Mr. Neuschafer. Ms. Stump, do you have further questions for Ms. Lemoine.

MS. STUMP: Just going to ask her a real quick question.

EXAMINATION

BY MS. STUMP:

Q. So Ms. Lemoine, in your interchange with Mr. Neuschafer about the CIRP, is it correct, though, that Ms. Young did look at the -- in more detail, the CIRP and the timing of the projects?

A. Yes.

Q. So if he has additional questions, he could ask those of her --
A. Correct.
Q. -- when she testifies? Thank you. I think that we -- I mean, I will have an opportunity in surrebuttal to discuss what your thoughts are and what your opinions are on Mr. Gorman's testimony.
We can do that in the surrebuttal phase. But I guess I just want to give you an opportunity, since he brought it up.
When I was asking him about the I&I percentage, and he referred to -- he was relying on Black and Veatch. And would you like to comment on that at all?
A. The report that he referenced is not a report that I personally developed myself, but I am familiar with it.
And it evaluated different methodologies for determining an estimate for how to allocate I&I between customer and volume.
And I would refer to Ms. Prabha Kumar, who will be testifying soon, related to her testimony with regards to I&I as well from her perspective.
But there is there's no specific hard engineered way to determine an allocation of I&I. That's why we see a range in the industry.

Q. Okay. Like I said, we'll have an opportunity in surrebuttal to address the issues raised by Mr. Gorman more.
A. Yes.
MS. STUMP: That's all I have.
CHAIRMAN TOENJES: Thank you, Ms. Stump. Questions from our rate commissions? Mr. Palans.
MR. PALANS: Thank.
EXAMINATION
BY MR. PALANS:
Q. Ms. Lemoine, on your declaration page 6, paragraph 1. Your testimony is that you support the District's rate proposal to seek authorization for the District to issue additional bonds to finance a portion of the CIRP during the fiscal year 21 through 24, correct?
A. Correct.
Q. And this financing provides multiple benefits, including it mitigates the impact on users rates, correct?
A. That's correct.
Q. And it aligns repayment of debt with the long-term useful life of the assets correct?
A. Correct.
Q. And it enables future ratepayers of the system to

contribute to the cost of the debt service, correct?

A. That's correct.

Q. And you state that this proposed capital financing, which is 37 percent cash funding of CIRP, is consistent with similar financial best practices used by other peer wastewater facilities, and it provides a reasonable mix of cash and debt financing, correct?

A. Correct.

Q. And the proposal allows the debt service coverage of 2.5 times or greater for senior lien bonds, and 1.8 or greater for total debt coverage, right?

A. That's correct.

Q. You go on to say on page 7, paragraph 6, that while there are gradual annual revenue adjustments presented through fiscal 24, the District's long-term projection is outlined in MSD number 57 and the District's rate model, which is MSD 52, indicate a much higher revenue increase in fiscal 25. Is that your testimony?

A. Yes.

Q. And on pages 11 and 12, question 20. You indicate that during the current rate cycle of fiscal 21 through 24, there are almost 1.6 billion in total CIRP needs, and almost 30 million in routine cap ex, right?

A. Yes.

Q. In fact, the District projects that its CIRP needs for fiscal 25 to 28 are expected to be $873 million, and substantial capital spending remains after fiscal 28 to comply with the consent decree, right?
A. Correct.
Q. And that consent decree is not going to expire for another 20 years, through 2039; is that correct?
A. I believe that's the date. Yes.
Q. And how much capital spending is required after fiscal 28, if you know?
A. I could not state off the top of my head accurately.
Q. But we know that the cost of compliance through the duration of the consent decree, 20 years from now, is roughly 600 billion -- I'm sorry, $6 billion in today's dollars?
A. It's substantial. Yes.
Q. At the beginning of fiscal 25, as I understand your testimony, the District is projecting a potential rate increase of 7.2 percent to maintain its minimum policy level; is that right?
A. Correct.
Q. And this is nearly double the indicated rate increases for the current rate cycle, correct?
A. Correct.

Q. And is this projected rate increase projected to continue in later fiscal years after fiscal 25?

A. No. As I recall, it drops back down.

Q. And it's your testimony that this type and magnitude of higher rate increase right at the beginning of the next cycle may cause -- and I'm quoting, bill impact volatility, correct?

A. Correct.

Q. What do you mean when you say, it may cause bill impact volatility?

A. It would result in customers seeing a much larger percentage increase in their bills in that year than would be necessary if the rates were adjusted to eliminate that spike.

Q. And this is going to impact both mom-and-pop consumer ratepayers, as well as high-volume user ratepayers, correct?

A. That's correct. Particularly being in the first year. With MSD's rate proposal, they conduct the cost of service analysis and establish rates based on cost of service in year one.

With that larger revenue increase required, in addition to any potential adjustments to cost of service in that year, could even further impact certain customers, depending on how that cost of service study turns out.

Q. You were present during the testimony that was educed on April 8 and April 9 last month; were you not?

A. Yes.

Q. And you heard the testimony of the witnesses, recognizing that the District faces mandatory compliance with the consent decree?

A. Yes.

Q. And the District has an aging sewer system infrastructure?

A. Yes.

Q. And the District currently experiences a favorable financial position and favorable liquidity position?

A. Yes.

Q. That these are times of historically low interest rates?

A. Yes.

Q. And that the District confirms that it has experienced historically favorable competitive bid pricing on certain CIRP projects, correct?

A. Yes.

Q. Given all these factors and current conditions, what can the District do to avoid or mitigate this bill impact volatility, or smooth the bill volatility, which

is projected to occur at the beginning of fiscal 25?
A. The primary action would be -- as I stated in my testimony, would be to slightly adjust the revenue increases in this rate proposal period to allow for a levelization of those increases over time.
Q. And this would be an increase, which would be slightly higher than those proposed?
A. It would require slightly higher rate increases in one or more of these -- the years of this rate proposal. Yes.
Q. And you believe that these can be increased within a range of reasonableness?
A. Yes.
Q. Do you have an opinion as to what would be a reasonable amount for that increase?
A. I do not have the specific numbers here today. But I can provide that in surrebuttal testimony.
Q. Given the favorable conditions that we now have -- by favorable conditions, I'm including low interest rates, low CIRP pricing and so forth.
Should the District take advantage of this additional debt financing as well during the this cycle, and thereby perform more CIRP projects than those which are currently scheduled?
A. I don't know that I would recommend that. There

are a lot of additional factors that one has to take into consideration, including, you know, contractor capacity, the capacity of MSD's staff to manage a large program and more projects.

I will say also that the District has experienced significant double-digit rate increases for many years. I think that there is rate fatigue in the community.

And so the ability to continue to move forward in a meaningful way with the consent decree, based on the outcome of the second material amendment to the consent decree, while moderating rate increases as much as possible is recommended.

Q. So is it your testimony that the District has an opportunity to adopt a pragmatic approach to establish a series of revenue increases during this rate cycle, which are moderate and reasonable in amount?

A. Correct.

Q. Will such an approach help to moderate or smooth the level the annual rate increases are projected through fiscal 24, as well as mitigate the anticipated spike in the revenue increase in fiscal 25 and thereafter?

A. Yes.

Q. In this suggested revenue increase, during the current rate cycle, is this consistent with Ms. Kumar's

testimony of her declaration where she states, quote, to mitigate any potential rate shock on surcharge customers, the District should consider phasing in to cost of service over at least a two-year time period.

The District should also consider increasing all rates, including surcharge rates, during fiscal 22 through 24, based on an across-the-board increase approach, close quote. Do you agree with that statement?

A. That is correct.

Q. You were present today and had the opportunity to hear Mr. Gorman's testimony?

A. Yes.

Q. Can you tell me if you agree with his testimony? I'm not holding you to specifics at all.

We don't need to embellish there. What strikes you as being good or bad?

A. I was going to say, there were a number of different topics that were addressed in his testimony.

Again, as we've spoken about, the debt cash financing mix and debt service coverage.

One of the comments I would make with regard to adhering to historic -- past policy for the current rate cycle, I would suggest that it's always important to look at current conditions and current rating agency expectations.

That rating agency expectations in the past may not be the rating agency expectations of today.

And as you review the rating agency reports, it's clear that there is an expectation that, given the high level of debt that MSD holds now and is anticipated to increase in the future, that there is an expectation collectively among the three rating agencies for debt service coverage that is higher than the 1.6 times.

In addition, the Moody's median report -- which is an exhibit, I don't recall the number -- the current median debt service coverage for water and wastewater utilities right now is closer to 1.9 times as well.

So the policy of 1.8 is in line with stated objectives at the rating agencies, as well as current medians.

Q. Mr. Gorman's testimony is that he would extract $24 million of revenue from the District during this rate cycle, this next rate cycle.

Do you agree with the concept of extracting $24 million in revenue from the District during this cycle?

A. So what he's proposing were a series of adjustments that would reduce the revenue requirement, which reduces the increase in revenue to MSD.

So I would pose it in a little bit of a different manner. He's stated that he acknowledges that his assumed interest rate for future debt is too low. That is the biggest driver of that $24 million.

In looking at the rate model that he provided in response to the discovery request, it appears to me -- it's difficult because of the nature and the way adjustments were made to that model. It's a little difficult for me to say with all certainty.

But in looking at the -- pardon me while I find it real quick.

In looking at his testimony, MPG1, comparing the revenue requirement for the MSD proposal in the MIEC adjusted proposal, at the bottom shows that the projected debt service coverage -- his projected debt service coverage is also not reaching 1.6 times. It's not substantially different than the MSD proposal.

Q. Mr. Gorman is incorrect on the cost of funds -- interest rates increase, his premise is flawed; is it not?

A. Correct.

Q. And if Mr. Gorman is incorrect on the ability to extend the CIRP projects, defer CIRP projects which are required under the consent decree, his proposal is flawed; is it not?

A. Correct.

MR. PALANS: Thank you. I have no further questions.

CHAIRMAN TOENJES: Thank you Mr. Palans. Any further questions for Ms. Lemoine?

Hearing none. Thank you, Ms. Lemoine. Ms. Stump, do you have any additional witnesses?

MS. STUMP: I do. Ms. Prabha Kumar.

CHAIRMAN TOENJES: Ms. Kumar, is the testimony you're about to give the truth, the whole truth, and nothing butt the truth?

MS. KUMAR: It is.

CHAIRMAN TOENJES: Does any member of the Rate Commission have questions for Ms. Kumar at this time?

Hearing none, Ms. Myers do you have questions for Ms. Kumar on behalf of the District?

MS. MYERS: Yes we do.

EXAMINATION

BY MS. MYERS:

Q. Okay. The questions that we have are around your rebuttal testimony.

So starting off on page 6, line 11, you state that MSD's rate proposal is fair and reasonable on all classes of ratepayers; is that correct?

A. That is correct.

Q. In your rebuttal testimony, you recommend phasing

in the cost of service over at least a two-year period, correct?

A. That is correct. For the surcharge customers.

Q. So if MSD were to phase in the cost of service, is it your opinion that other MSD customers not subject to the extra surcharge rate should subsidize the revenue lost from phasing in the surcharge rate?

A. That would be the eventual impact of your subsidized -- if you are phasing in for a class of customer, all things being equal, then that class of customers temporarily would take on that impact.

Q. So do you believe that that is fair and reasonable for those customers?

A. From the point of view of practical ratemaking, creating an impact on a class of customers, while from a cost of service perspective may be necessary, it does pose a practical problem in terms of the level of increase somebody can absorb.

But in that context of practical ratemaking, it is a common practice in the industry to have a phase-in approach.

Q. Okay. Are you aware that the existing extra strength surcharge rates charged over the period of FY18 through FY20 do not cover the actual cost of service?

A. Yes.

Q. Okay. So page 7 on your rebuttal testimony, starting with line 14.

You indicate that it is not clear to you which specific section of the CDM report the District used to attribute the allocation factors for infiltration and inflow of 40 percent to customers and 60 percent volume components.

Are you aware that this information was provided in Exhibit MSD65C?

A. Yes. The report was referenced. But what I'm really saying there is that when you look at the CDM report, there are lots of numbers and lots of tables, and there are about eight or nine scenarios that the CDM report has.

And if you look at just the tables in the report, every scenario has an assumption already built into the table. But those assumptions are not explained at all.

And also in the CDM report, it doesn't draw a specific conclusion to say after all the analysis, this should be the percentage for I&I.

And the second thing I want to point out in the CDM report that we got, there are pages missing in the report.

And that also, for example, section 4.3; while it's listed in table of the contents, that was not there as the last section in that report. They're both not there, and in-between pages are missing.

Q. So is that what you meant by it wasn't clear how we came to our conclusion?

A. Yeah. What I'm saying is that the specific section, the specific recommendation in the report is not really clearly cited in the -- in saying that the 60/40 use that that was really referring to the testimony from Mr. Bill Stannard when I was making it.

Q. On page 7 of your testimony, and page 8 -- so it's page 7, lines 22, 23; and page 8, lines 1 and 2.

You indicate that the 40 percent customer and 60 percent volume allocation factors used in this proposal to allocate I&I tends to allocate more I&I costs to the volume component than the example guidelines provided in the WEF manual of practice, number 27.

Isn't it true that this manual provides for illustrative purposes only and is not intended to reflect a standard that can be applied to just any entity?

A. That is correct. We are not saying that it is a standard, and that's why we clearly use the words that this is as an example guideline.

However, it is an industry guideline and an industry-accepted practice manual.

Q. Okay. So what do you mean by it's an industry standard guideline?

A. The standard -- again, I'm not an attorney, so I'm going to say the standard is really like a stipulation.

Saying that, okay -- these are for example. If you want to convert gallons to a number, to another measure that are standards, you can use a conversion factor to specifically stimulate the standards.

Here, what the manual says is that it's qualitatively explains what infiltrates and in-flow is there, and the impact of infiltration and in-flow.

And then it gives guidelines to say that these are the guidelines -- in an illustrative example, it gives the guidelines of 66 percent for customer and the 37 percent for volume.

And so that's really what we mean. But in the absence of any detailed engineering study, these guidelines are used in practical ratemaking, because ratemaking is not always a precise science.

But in the absence of actual data, there are guidelines that are used as a basis.

Q. So it was used for illustrative purposes.

A. In the manual, it's used for illustrative purposes. But in the industry, in the absence of very detailed and reliable data, these guidelines are used as a basis.

Q. Okay. I'm going to hand you MIEC Exhibit 73. I'm assume you don't have that with you.

A. I have -- actually, I do have it.

Q. I'm sorry. I shouldn't have made that assumption. Will you please identify that document?

A. This is the rebuttal testimony of Mr. Michael Gorman.

Q. Okay. And would you turn to page 26 of that document. Have you reviewed table 5 on page 26?

A. Yes. I've seen this.

Q. So is table 5 titled, I&I Allocation Basis Used By Other Utilities?

A. That is correct.

Q. Is it correct that line 2 of that table states that Kansas City, Missouri I&I allocation is 40 percent to customers and 60 percent to volume?

A. That is correct.

Q. Would you agree that Kansas City, Missouri is more similar to St. Louis in terms of geographic proximity, having both a combined and separate sewer system climatic conditions, and geographic size than the other cities shown in that table?

A. I can't attest to that level of specificity. But

I can say, yes, Kansas City has the geographic proximity and does have combined sewer systems.

And obviously, Kansas City is different from -- in terms of geographic location, is different from some of the other utilities listed in table 5.

MS. MYERS: Okay. That concludes our questions. Thank you.

CHAIRMAN TOENJES: Thank you, Ms. Myers. Mr. Neuschafer do you have questions for Ms. Kumar.

MR. NEUSCHAFER: I do.

CHAIRMAN TOENJES: Please come forward.

EXAMINATION

BY MR. NEUSCHAFER:

Q. Good morning.

A. Good morning.

Q. I would like to go to your testimony. Let's go to question 9, in which you opine about the fairness and reasonableness of the District rate proposal.

If you recall, Ms. Myers asked you about one sentence in this answer, where you said that the District's rate proposal can be considered to be fair and reasonable; is that correct?

A. That is correct.

Q. In fact, it appears that your conclusion was that, first, overall it can be considered fair and

reasonable; is that correct?

A. Yes. I'm saying that it is fair and reasonable, but there are practical considerations that the District can also use in setting rates.

Q. And then you identified a number of these practical considerations in your answer to this question, including long-term resiliency, mitigation of future rate volatility, fair allocation of cost to classes that not only align with the industry-accepted practices, but also doesn't impose undue burden on customers classes, and a fair levels of revenue increases from customer classes during the rate period; is that correct?

A. Correct.

Q. And then you end with, the District's proposal could better reflect these other considerations; is that correct?

A. Correct.

Q. Thank you. I would like to then move over to the infiltration and in-flow discussion that I believe was at question 11.

I'm trying not to ask the same questions we've already got here. So please bear with me just a bit.

So just to be clear, your testimony is that the 40 percent customer/60 percent volume tends to allocate

more I&I cost to volume component than more commonly seen in other utilities, many other utilities, and in the example guidelines that were discussed.

A. Correct.

Q. Do you have a recommended I&I allocation, based on your knowledge of the MSD system?

A. It's not a specific number that I'm specifically recommending here.

But what I'm saying is, again, when you look at the number of utilities, and even when you look at -- again, the overall guidelines, but really if you look at the utilities, generally you find that there's allocation more leaning towards the number of customers a because the numbers of customers has an influencing role in the I&I.

And so it's not only just volume. And that was the point we were trying to make here.

Q. Sure. And I believe you referenced the CDM report --

A. Correct.

Q. -- in your responses to Ms. Myer's questions. And I'm not -- are you familiar with the statement in the original rate proposal, MSD Exhibit 1, that says, there are no known changes in the system that would significantly change the assumptions in that report --

A. Yes.
Q. -- leading to a 60/40 split?
A. I remember that statement.
Q. Do you agree with that statement; that there have been no changes between 2005 and 2019 that would necessitate a change to the I&I allocation?
A. That was actually one of our concerns; that the passage of time is significant between 2005 and the CDM report was prepared in 2019.
And during that passage of time, things do change. The number of -- the service could be changed, and the service area, in terms of number of connections that could have come into the system.
And of course, on the flipside, the controls that are being done in terms of capture.
So all we are saying is that, yes, that is a big passage of time. And therefore, to just cite a report that was done in 2005 -- and especially when that report also has some of the issues, where there are a lot of assumptions that went into the report, which are not clearly stated, whether the assumptions are not from numbers that we see plugged in.
And again, as I said before, the pages were missing. So it was a concern that the 60/40 is being used, because it was cited in a CDM report from 2005.

Q. Okay. One final question. Again, at the end of page 7 of your testimony and the beginning of page 8, we've talked about this a couple times already.

You reference what is commonly seen in many other utilities. Can you provide some examples of what other utilities, and perhaps also their I&I rates that they use?

A. From my experience and judgment -- and again, we did municipalities, because not many municipalities really have a significant study done, and it is a costly study to do.

Generally, the guidelines are that 66 percent/37 percent. Or for example, in Citizens Energy, where they had a similar kind of study done, but more recent -- it was not as old as the 2005 CDM study -- where they looked at multiple types of allocation parameters.

We analyzed six different types. And the -- there, we did get an average from those analysis, and it turned out to be 75 percent for customer and 25 percent for volume. And that is also a midwestern utility.

So those are some of the examples. So oftentimes, even in the exhibit that was referenced before in my testimony and questions, there are more that are leaning towards a little more towards volume than leaning more towards number of customers in I&I

allocation.
Q. And that was Citizens Energy you said?
A. Citizens Energy.
Q. And that is in?
A. Indianapolis.
MR. NEUSCHAFER: Indianapolis. Okay. Thank you.
CHAIRMAN TOENJES: Thank you, Mr. Neuschafer. Ms. Stump, do you have questions for Ms. Kumar.

EXAMINATION

BY MS. STUMP:
Q. I would ask for Ms. Kumar to just restate what she just what said on the percentages.
A. In the context of the Citizens Energy Group, where we did do a study, and part of the study there, we evaluated six different approaches to determining what the I&I application would be.
And sort of what showed was that in that study, 75 percent of the allocation was to customers, and 25 percent of the allocation was to volume. So it was a 75/25 kind of an issue.
CHAIRMAN TOENJES: Thank you. Is there a --
MS. STUMP: I think we're good.
CHAIRMAN TOENJES: Thank you, Ms. Stump. Do any of the rate commissioners have questions for Ms. Kumar? Mr. Stein.

MR. STEIN: Thank you, Mr. Chairman.

EXAMINATION

BY MR. STEIN:

Q. Ms. Kumar, I would like to talk about two things. First of all, the I&I issue.

In the cross-examination, it was pointed out that Kansas City has a 40/60 split.

In that same table, on page 26 of Mr. Gorman's testimony, does it not show that St. Joseph, Missouri, has a 60/40 split?

A. Correct.

Q. And is St. Joseph not in the same geographical area as St. Louis?

A. It is.

Q. And is it not maybe 80 miles from Kansas City?

A. I would -- subject to tests, I would --

Q. Okay.

A. -- indicate that.

Q. So it would appear that there is a reasonable spread of potentially reasonable splits on I&I?

A. Correct. It really -- there's a very reasonable difference.

Q. In past testimony and past rate cases, I believe MSD has stated over and over that it has the fourth largest collection system in the country.

A. I'm aware.
Q. More miles of sewer than all but three other sewer systems in the country.
And would you agree that the length or the extent of collection systems has an a direct impact on potential I&I?
A. Correct. I mean, the spread of the collection system, the number of connections, the number of manholes, all of those do have an influential role in the I&I.
Q. So that would argue for a higher emphasis on customer versus volume?
A. That could be a potential opportunity for the I&I leaning more towards customers than just volume.
Q. I would like to switch now and talk about the issue of extra strength surcharges, that I think you addressed.
And if I may paraphrase what you said, your opinion is that it would be more appropriate to phase those charges in rather than increase them all in one year?
A. Correct. That's a consideration that could play a role here.
Q. Would you agree that the typical extra strength wastewater discharger has options to reduce those

charges?

Such as, number one, instituting projects or process changes to reduce those discharges of BOD and suspended solids?

A. They do.

Q. Could they also reduce production at that site to do the same thing?

A. Subject to what their business is and the nature of their business.

Q. Could they close their facility to eliminate those charges?

A. Again, not knowing what the facilities are and what the specific circumstances are, I would not be able to say whether they could close the facility.

But there may be things that are under their control.

Q. If they instituted any of those options, would that not result in stranded investment on the part of the District for handling those extra strength components?

A. Again, depending on the level of what they do, yes. The District always has fixed costs in what they design the facility for.

But again, this is not just one consideration. There are multiple considerations, including environmental considerations of being a good steward when you're operating a business in that environment.

Q. But for sake of argument, if those -- if a discharger reduced or eliminated its discharges, and there were stranded investment in terms of equipment or facilities that the District no longer needed, who would bear the fixed costs for that stranded investment?

A. It would be the entire system users.

MR. STEIN: Thank you.

CHAIRMAN TOENJES: Thank you, Mr. Stein. Do any other rate commissioners have questions for Ms. Kumar? Mr. Goss.

MR. GOSS: I just have one question about the I&I assumptions.

EXAMINATION

BY MR. GOSS:

Q. If you use Mr. Gorman's assumptions as opposed to MSD's assumptions on I&I allocations, what does that do to MSD's rate? How does it change? Do you know?

A. We haven't run the analysis. We can certainly run it and have it in the rebuttal -- surrebuttal testimony.

But what it would do is when you allocate a little more cost to the customer, meaning doing 40 to customer and 60 to volume, or 50 to customer and 50 to volume, including the fixed charges portion of the rate structure, and then it would reduce the volume rate and rate structure, all else being equal.

Q. Okay. But I would like to see that run, because what I try -- what I'm trying to do is understand with all the technical testimony, do I care?

Because if it's not going to affect in a material way the rate that's being proposed, I don't.

If it does, then that's a different story. So that would be helpful to me.

A. Sure.

CHAIRMAN TOENJES: Do any other rate commissioners have questions for Ms. Kumar? Hearing none Ms. Kumar, thank you. I suggest with take a break until 11:55, at which time we will resume.

(WHEREUPON, A BRIEF RECESS WAS TAKEN)

CHAIRMAN TOENJES: All right. Being 11:55, Ms. Stump, do you have any additional witnesses?

MS. STUMP: I do. Ms. Nicole young.

CHAIRMAN TOENJES: Ms. Young is the testimony you're about to give the truth, the whole truth, and nothing butt the truth?

MS. YOUNG: It is.

CHAIRMAN TOENJES: Do any of the rate commissioners have any questions for Ms. Young?

Hearing none, Ms Myers, do you have any questions for Ms. Young on behalf of the District?

MS. MYERS: I do.

CHAIRMAN TOENJES: Please come forward.

EXAMINATION

BY MS. MYERS:

Q. Couple real quick ones. Is it your opinion that -- you identified in your rebuttal testimony that the projects that the District has identified in the CIRP for FY21 through FY24 are appropriate?

A. Yes.

Q. And how did you come to that conclusion?

A. The majority of the projects -- about 1.1 billion -- are consent decree related.

Another -- my estimation is 340 million are regulatory based. It leaves very little room for adjustment within the CIRP.

Q. Okay. And do you also agree that the cost estimates for the projects identified for that same period are sufficient?

A. I do.

Q. And how did you come to that conclusion?

A. Overall basis, looking at the scope of work and general estimation of knowledge of the projects, they seemed reasonable.

MS. MYERS: That concludes my questions. Thank you.

CHAIRMAN TOENJES: Thank you, Ms. Myers. Mr. Neuschafer, do you have questions for Ms. Young.

MR. NEUSCHAFER: I do.

EXAMINATION

BY MR. NEUSCHAFER:

Q. How are you?

A. Good. You?

Q. Good. So your testimony, I believe you just summarized it with Ms. Myers.

Basically on two point; the projects identified are appropriate, right?

A. Yes.

Q. Okay. And that the cost estimates were completed in accordance with common practice; is that correct?

A. Yes.

Q. Did you -- anywhere in your testimony, analyze or provide any opinion on the timing of projects? Whether the timing selected by MSD is appropriate.

A. I did review the consent decree. And my understanding of the MAC regulations for the incinerator, they do seem appropriate. Yes.

Q. Okay. Is that in your written testimony?

A. No.

Q. Okay. You that actually just related to the fluidized bed?

A. Sure.

Q. What about -- you said that it's accurate. Is there an obligation to complete it during or prior to 2024?

A. Based on the consent decree, yes.

Q. Okay. Do you recall the testimony earlier where the second amendment was referenced that said it needed to be completed by 2026?

A. If -- okay.

Q. Okay. What about the timing of the other consent decree required projects?

Did you analyze whether MSD has the appropriate timing schedule, based on the consent decree requirements?

A. I did look at the critical milestones in the consent decree, you know, some of them have specific bid years.

All of them have dates for achievement for full operation. We did evaluate those. I did evaluate those.

Q. Did you provide any analysis of that in your testimony?

A. Not in my written testimony. No.

Q. Did you prepare a memorandum or any other notes relating to the timing of projects?
A. I did not.
Q. Okay. Let's talk about cost estimates. You said they were completed in accordance with common practice.
And I believe you explained to Ms. Myers that you looked at the scope of work and general estimates; is that correct?
A. Yes.
Q. Can you explain more as to what you considered to determine that the cost estimates are in accordance with common practice?
A. Looking at the scope of work for the projects and the size and magnitude of them, looking at the costs, they seem appropriate to me.
Q. Did you look at individual projects?
A. I did.
Q. And did you look at the cost documentation for individual projects?
A. I looked at what was provided by the District.
Q. In the record?
A. Yes.
Q. Where in the record did you find this information?
A. In the CIRP.

Q. And that included backup cost documentation, or did that include MSD's conclusions as what the estimated costs were?

A. Based on the conclusions.

Q. Okay. So you didn't review any of the underlying documentation --

A. That's correct.

Q. -- you just reviewed MSD's conclusion of the estimated costs.

A. I reviewed what was submitted by the District. That is correct.

Q. So then how do we know that the cost estimates were completed in accordance with common practice if all you saw with the number associated with the proposed projects?

A. We have not dug into the underlying cost.

Q. Okay. So then how do you know -- or how can you testify that the cost estimates were completed in accordance with common practice?

A. It's based on my knowledge of the District and the way that they do cost estimate.

Q. So you're taking the District's word for it?

A. Not taking the District's word for it. But it's my understanding, based on my experience.

Q. What experience is that?

A. 20 years working with the District.
Q. Okay. You work with a company called Lion CSG?
A. I do.
Q. Are they a current contractor of MSD?
A. We are.
Q. Do you intend to -- does Lion CSG intend to bid on projects that might be completed pursuant to the CIRP?
A. We do.
Q. Have you -- well, you talked about your 20 years of experience.
Have you analyzed a capital spend program of this size and duration in the past?
A. I have.
Q. And who was that for?
A. MSD.
Q. MSD. Okay. Any program other than MSD's -- an MSD program?
A. Yes. I've done rate work for American Bottoms. I've done analysis for a number of clients.
I would have to go back and honestly look at my résumé over the 20 years to give you a full list.
Q. And those -- I guess I want to be clear, those are capital spend programs that involve spending billions of dollars on system upgrades?

A. For St. Louis MSD, I worked on the Skimi [phonetic] project, which was a precursor to a lot of the work that's being done now.

We did a full analysis of the entire District. I was responsible for the Wood River/Des Peres watershed, which is the largest watershed in MSD.

MR. NEUSCHAFER: That's all I got. Thank you.

CHAIRMAN TOENJES: Thank you, Mr. Neuschafer. Ms. Stump, do you have further questions for Ms. Young?

MS. STUMP: I do.

EXAMINATION

BY MS. STUMP:

Q. Nicole, does the fact that Lion CSG may or may not bid on any future projects with MSD affect your opinion at all in your testimony you submitted?

A. Not for this rate case. No.

Q. Thank you. Also, trying to summarize I think where Mr. Neuschafer was headed.

So as we now -- and as you heard, the MIEC testimony was certain major capital projects in 2023 and '24 are not needed at that level; you remember that discussion earlier today?

A. I do.

Q. Can you just give your overall opinion on that testimony and that idea?

A. Sure. We did look at the projects that were identified by -- to be identified as potentially moving farther out.

And looking at that, 92 percent of those are either consent decree or regulatory driven.

So there's -- as I stated earlier, there's really very little opportunity for movement of those projects.

Q. So it would arguably make it difficult for the District to comply with the consent decree if it was?

A. That's correct.

MS. STUMP: Thank you. I have no further questions.

CHAIRMAN TOENJES: Thank you, Ms. Stump. Do any of the rate commissioners have any -- yes, Mr. Bresnan.

EXAMINATION

BY MR. BRESNAN:

Q. I, too, have like, 39 years in the construction industry.

And I think a point we're overlooking here is, also from a consumer standpoint, we're talking about spreading the cost out over the consumer.

Isn't one of the ultimate goals to finish the project?

Because if you're a person with flooding in your yard -- I'm backing up and putting on a very basic

premise.

Don't you want that project finished, rather than having your bill reduced, as Mr. Goss might say, where it only makes two dollars a month difference?

So my question to you would be, isn't is it a best practice to finish these project, either ahead of schedule or on time, rather than just spread them out, in your opinion?

A. I think given the deadlines in the consent decree, it is a risk to defer them until the year that they're required by the consent decree.

Because there are always issues in construction. And so starting those earlier is generally better.

I will also say that the dates in the consent decree for the achievement of full operation is not just for construction, but for full startup.

And oftentimes, some of these projects have startup issues that need to be worked out before full achievement can be made.

MR. BRESNAN: Thank you. No further questions.

CHAIRMAN TOENJES: Thank you, Mr. Bresnan. Mr. Stein.

MR. STEIN: Thank you, Mr. Chairman.

EXAMINATION

BY MR. STEIN:

Q. Ms. Young, a few questions about the CIRP. May I presume that you have read and familiarized yourself with this extensive list of projects?

A. I have.

Q. Can you tell me what percentage, by dollar, is driven by the consent decree versus other needs?

A. Yes. Sorry. I do have this in one of my spreadsheets somewhere. It appears to be about 77 percent.

Q. Is consent decree?

A. Consent-decree driven.

Q. So if my math is still good, that says 23 percent is non-consent decree, and there is some leeway, potentially, in the timing of those projects; is that correct?

A. In the remainder?

Q. Yes.

A. There are two other buckets of projects -- well, actually three.

But another portion of that is the incinerator projects and sludge transfer, which is an additional 19 percent.

Those are driven by regulations that have target dates. And then there are another 3 percent that are driven by BDS permit requirements.

Q. If my math is correct, that says that 99 percent of what's in the CIRP, you have to do?

A. That's correct.

Q. Okay. Just a couple questions here, just picking some things out here at random.

On page 4 of the CIRP project list, Bissell Point treatment plant. Prepare sluice gates and components of concrete: 2.4 million.

Is that required by the consent decree or any other MPDS gas obligations?

A. Sorry. Could you state that again?

Q. Project 12548.

A. That project is about -- what I can say about that is the sluice gates and concrete structures are critical to providing treatment at Bissell.

And if that treatment isn't provided, MPDS permits cannot be met.

Q. Let's go down to the next project, 12566, Bissell Point trickling filter media replacement: $23.2 million.

Are you aware that aeration facilities have been mothballed that could potentially take those trickling filters offline with no problems in meeting the MPDS permit?

A. I am aware of that. And an evaluation had been done previously by the District to look at the electrical costs of running those aeration systems.

And it was determined that the trickling filters were more efficient from an energy standpoint.

Q. No question as to the energy efficiency. But the capital project could be postponed with a hit to the energy cost, and a potential benefit resulting from postponing that capital expenditure.

It's no different than my car. If I have a 10-year-old car, and I would like to replace it with a new one, but I'm looking at $30,000 to do that.

But maybe I can get by with a $500 tune-up and a couple new tires for $400.

So if I don't have the cash on hand right now, and the financing doesn't look appropriate, I can get a couple -- a little more time out of that car.

I'm saying here, if we looked farther at this CIRP list, could we not identify projects that could be pushed back?

I'm not saying five or 10 years, or eliminate it; but pushed back further in time that we could spread the cost out and reduce some of the rate shock?

A. I will say specific to the Bissell plant, the aeration systems that you're mentioning, unfortunately, have been out of service and have deteriorated to the point that they are no longer able to be put back in service.

Q. Are you certain of that?

A. Yes. I would be happy to visit the Bissell plant with you sometime.

MR. STEIN: Thank you very much.

CHAIRMAN TOENJES: Thank you, Mr. Stein. Further questions for Ms. Young? Thank you, Ms. Young.

Are there any other matters before the Rate Commission this morning?

I would like to thank Mr. Neuschafer and MIEC for all their hard work and helping the Rate Commission understand various aspects of the proposal.

I would like to thank Ms. Lemoine and the team, and Ms. Young and Ms. Kumar for their hard work in helping the rate commissioners understand aspects of the proposal.

And hearing no other matters, we will adjourn until 9:00 a.m. on June the 20th, 2019. Mr. Stein.

MR. STEIN: Do we not have public hearings coming up?

CHAIRMAN TOENJES: Mr. Brockmann, would you care to talk about the public hearing?

MR. BROCKMANN: We have one next Tuesday. I don't know the location, but I will be there.

CHAIRMAN TOENJES: So there will be a public hearing at the county library on Music Road on May 14th.

MR. BROCKMANN: Another one on May 22, another one on June 4. And then we'll be here, and then following that, June 27, July 10, July 24.

CHAIRMAN TOENJES: As any good public relations chair would be. Do we have a motion to adjourn?

MS. CROYLE: I have a question.

CHAIRMAN TOENJES: Ms. Croyle.

MS. CROYLE: Will the MSD information be on the website before the meeting? So those of us that are attending can see it ahead of time.

MR. HOELSCHER: The information that is being presented? Sean, is that a plan or not? We'll make sure it gets up by late in the day Monday.

MS. CROYLE: Monday or Tuesday would be fine.

MR. HOELSCHER: We'll make sure it goes up before we have.

MS. CROYLE: It's nice to see ahead of time and download it and have it be able to look at it. Thank you.

CHAIRMAN TOENJES: Any other matters? I think I heard a motion to adjourn somewhere down here.

MR. STEIN: Motion to adjourn.

CHAIRMAN TOENJES: Is there a second?

MR. BROCKMANN: Second.

CHAIRMAN TOENJES: All in favor.

(THOSE VOTING IN FAVOR ANNOUNCED AYE)

CHAIRMAN TOENJES: Opposed? Thank you.

CERTIFICATE OF REPORTER

STATE OF MISSOURI)
) ss.
CITY OF ST. LOUIS)

I, Georgia Beth Long, a Certified Shorthand Reporter, Certified Court Reporter, do hereby certify that the meeting aforementioned was held on the time and in the place previously described.

IN WITNESS WHEREOF, I have hereunto set my hand and seal.

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