BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the General Rate Increase	)	
for Water and Sewer Service Provided	)	Case No. WR-2007-0216
by Missouri-American Water Company.	)	SR-2007-0217

PREHEARING BRIEF

OF

MISSOURI-AMERICAN WATER COMPANY

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I. INTRODUCTION

Comes now Missouri-American Water Company (MAWC) and, as its Prehearing Brief, states as follows to the Missouri Public Service Commission (Commission):

II. REVENUE REQUIREMENT

Rate of Return Issues

Return on Common Equity: What return on common equity should be used for determining MAWC's rate of return?

The Company proposes an overall cost of capital or rate of return (ROR) of 8.44 percent. This is based upon the following capital structure and component costs:

	Percent	Cost Rate	Weighted Cost
Short Term Debt	7.26	5.39%	0.39%
Long Term Debt	44.50	5.87%	2.61%
Preferred Stock	0.44	9.17%	0.04%
Common Equity	47.81	11.3%	5.40%
Cost of Capital/Rate of Return:			8.44%

As part of its overall cost of capital, the Company recommends that it be authorized to earn 11.3 percent on its actual equity investment. This cost of equity or return on equity (ROE) recommendation is supported by Company witness Ahern's analysis of market based cost rates of relatively similar risk companies. Ms. Ahern's analysis reflects current capital market conditions and results from the application of four well-established market-based costs of common equity models – the Discounted Cash Flow (DCF) approach, the Risk Premium Model (RPM), the Capital Asset Pricing Model (CAPM), and the Comparable Earnings Model (CEM). (Ahern Dir., pp. 5, 64). General financial principles mandate the use of multiple costs of common equity models, as adjusted for MAWC's greater business risk. (Ahern Dir., pp. 22-24).

The water utility industry's high degree of capital intensity coupled with the need for substantial infrastructure capital spending and increased anti-terrorism and anti-bioterrorism security spending, requires regulatory support in the form of adequate and timely rate relief. This rate relief is necessary in order for water utilities to successfully meet the challenges they face. (Ahern Dir., p. 7-14).

After reviewing the cost rates based upon the four market-based costs of common equity models, as applied to two carefully selected proxy groups, Ms. Ahern concluded that a range of common equity cost rate, before adjustment for MAWC's relative business risk, of 10.95 to 11.5 percent was indicated. (Ahern Dir., pp. 17-19, 66). Ms. Ahern's financial analysis demonstrates that business risk adjustments of 0.55% and 0.88% are indicated for the two proxy groups, but Ms. Ahern makes a conservatively reasonable business risk adjustment recommendation of 0.075%. After applying this business risk adjustment of 7.5 basis points due to MAWC's smaller size vis-à-vis the proxy groups, Ms. Ahern recommends a common equity cost rate range of 11.025 to 11.575 percent, with a midpoint of 11.3 percent. (Ahern Dir., pp. 66-68). This cost rate is reasonable and well supported by the data and evidence which will be presented to the Commission, and such an authorized ROE is necessary to provide MAWC with sufficient earnings to enable it to attract necessary new capital and compete in the market place, while providing safe and adequate service to its customers.

Staff's recommended common equity cost rate range of 8.6 to 9.6 percent is not adequate for a number of reasons. First, Staff witness Murray erroneously relies solely upon a DCF analysis to arrive at his recommended common equity cost rate despite the Commission's recent consideration of the results of other cost of common equity models and the results of recently awarded ROEs to utilities by various regulatory commissions around the country. (Ahern Reb., p. 4). For example, a review of returns on equity (ROEs) authorized by other regulatory commissions and recently litigated cases average approximately 10.5%, relative to an average common equity ratio of approximately 47.9%. Moreover, the average of all litigated, awarded ROEs reported by regulatory research associates during the two and one-half year period ended June 30, 2007, of 10.51% provides further confirmation that Mr. Murray's recommended range of common equity cost rate of 8.6 to 9.6 percent is inadequate. (Ahern Reb., pp. 38-39).

With regard to MIEC witness Gorman, his recommended return rate on common equity of 9.7% is also inadequate when viewed in light of the ROEs authorized by other regulatory commissions around the country. In addition, a properly applied risk premium model (RPM) and capital asset pricing model (CAPM) yield results of approximately 11% and 10.3%, respectively, for Mr. Gorman's two proxy groups. (Ahern Reb., pp. 50, 52). Neither result corroborates his recommended cost rate of common equity of 9.7% for MAWC.

(MAWC testimony on this issue: Ahern Dir., pp.2-68; Ahern Reb., pp. 21-54; Ahern Sur., pp. 5-28; Jenkins Reb., pp. 4-5, 13-14).

<u>Capital Structure:</u> What capital structure should be used for determining MAWC's rate of return?

MAWC believes that its actual capital structure at May 31, 2007 is the most appropriate capital structure to use in this proceeding for determining the overall cost of capital. Use of MAWC's actual capital structure is appropriate, lawful, and reasonable because: (1) MAWC is a separate corporate entity that issues its own debt and equity; therefore, it has an independently determined capital structure; (2) MAWC's stand-alone, actual capital structure represents the actual capital financing of MAWC's jurisdictional rate base to which rates set in this proceeding will be applied; (3) MAWC's stand-alone, actual capital structure is consistent with the capital structure ratios maintained, on average, by other water companies; (4) MAWC's stand-alone, actual capital structure is consistent with Standard & Poor's financial target ratios of total debt to total capital criteria for utilities; and (5) MAWC's stand-alone, actual capital structure is consistent with the capital structures previously allowed or authorized by this Commission. (Ahern Sur., p. 4; Ahern Reb., pp. 6-21).

The capital structure of MAWC's ultimate United States parent company, Thames Water Aqua US Holdings, Inc. (formerly, American Water), should not be used for ratemaking purposes for MAWC in this proceeding. The parent company, an entity not regulated by this Commission, *owns* operations in over 20 states and has regulated subsidiaries serving over 3,000,000 customers, while MAWC *operates* only in Missouri and serves less than 500,000 customers. The parent company's consolidated capital structure ratios do not represent the actual capital which finances MAWC's jurisdictional rate base. (Jenkins Sur., pp. 5, 9-10) The absence of a stand-alone credit rating for MAWC is irrelevant. MAWC's creditworthiness can be judged on a stand-alone basis without having a current, stand-alone credit rating. (Jenkins Sur., pp. 5-6, 11).

Additionally, and quite significantly, MAWC manages its capital structure independently of its parent, as evidenced by the fact that the decision of whether to issue equity or debt, and the type of debt, is made based on MAWC's target capital structure and capital market conditions at the time the security is to be issued. Unlike past cases where this Commission has determined that use of a consolidated capital structure is appropriate, MAWC is a separate legal entity that is responsible for making its own decisions regarding its sources of financings and its overall capital structure. Further, MAWC attempts to obtain the most favorable financing terms possible, so as to produce the lowest overall cost of debt available. (Jenkins Reb., pp. 8-9, 11).

(MAWC testimony of this issue: Jenkins Dir., pp. 8-11; Jenkins Reb., pp. 2-4, 6-12; Jenkins Sur., pp. 2-23; Ahern Reb., pp. 5-21; Ahern Sur., pp. 3-4).

Revenue Issues

<u>Revenue Normalization (Weather):</u> What is the appropriate weather-normalized revenue to be included in MAWC's cost of service?

It is appropriate to adjust test year revenues to reflect the effects of weather (i.e., weather normalization) and sales trend. In order to do that, the Company retained the services of Professor Edward Spitznagel from Washington University. Professor Spitznagel has performed a detailed statistical analysis of the residential and commercial class customers for the St. Louis, St. Charles, St. Joseph and Joplin Districts which represents over 94% of the customer base for the Company. Based on his analysis, Professor Spitznagel has made recommendations to MAWC regarding the appropriate level of usage per day, per customer for the revenue classes noted above. As a result of Professor Spitznagel's analysis, he recommends the following daily water utilization under average weather expressed in gallons per customer per day.

	Residential	**Commercial**
St. Louis County Quarterly	260.681	1214.18
St. Louis County Monthly	N/A	14,448.09
St. Charles	270.755	1215.55
St. Joseph	158.307	833.223
Joplin	185.770	960.654

(Spitznagel Dir., p. 7).

Staff's weather normalized revenues result from recommendations made by Staff witness Patterson. Unfortunately, Mr. Patterson's analysis which includes a complicated multi-step process for estimating customer numbers and a regression model with questionable variables contains serious flaws all as more fully described in the Rebuttal and Surrebuttal testimony of Professor Spitznagel. Accordingly, the Commission should accept the weather normalized revenues proposed by Staff in this case.

(MAWC testimony on this issue: Spitznagel Dir., Reb. and Sur.; Grubb Dir., p. 7, Sur., pp. 14-15).

Revenue Annualization: What is the appropriate level of customers and water usage revenues to be used in determining MAWC's test year annualized revenue?

The appropriate level of customers and water usage to be used in determining MAWC's test year annualized revenue is the actual number of customers as of the date of true-up (i.e., May 31, 2007). Multiplying the actual number of customers at May 31, 2007 times the usage per customer, per day, produces the most appropriate test year annualized revenues. This is also consistent with past rate cases in which MAWC has been involved. In this case, Staff departs from prior rate case methodology and estimates the number of customers for the St. Charles, St. Louis, Joplin and St. Joseph Districts as of May 31, 2007, rather than using actual customers. MAWC believes it is more appropriate to use actual customers at May 31, 2007 simply because this most accurately represents the actual customers being served. This level of customer base then provides for a proper matching of revenues, expenses and investment in the ratemaking formula as of the true-up date. (Grubb Sur., pp. 17-19).

(MAWC testimony on this issue: Grubb Dir., pp. 5-9, Sur., pp. 17-19)

AWR Compensation to MAWC: What amount of revenues, if any, should be included in MAWC's cost of service as compensation for services provided to American Water Resources by MAWC?

The Staff has imputed revenues of $137,449 associated with certain service line protection programs managed by American Water Resources. The imputed revenues are far in excess of what MAWC receives for providing much greater assistance for a similar program operated by St. Louis County.

American Water Resources, Inc. (AWR), an unregulated subsidiary of American Water Works Company, Inc., provides service line protection programs that, for a fee, will reimburse the participant for certain repairs to the water and sewer service lines owned by the customer. Mr. Cassidy takes the total revenue associated with the Missouri customers served by AWR, assumes half of that revenue is profit and then "splits" the profit between MAWC and AWR. The only association MAWC has with the mailings is that AWR uses the mailing list compiled by MAWC. This list does not include St. Louis County, which has its own line protection program administered by the County government. Thus, AWR will not mail information to approximately 312,000 of MAWC's 424,000 residential customers.

If revenues are to be imputed, MAWC believes that a much lower cost would be appropriate. For example, the Company's research shows that customer lists can be purchased for approximately $37 to $75 per 1,000 customers.

In the alternative, guidance could be found by looking to the revenues MAWC receives for assisting with the St. Louis County program. MAWC performs all billing and collection functions associated with the St. Louis County program, to include the provision of its mailing list. As compensation, MAWC receives one percent (1%) of the gross revenues collected. The compensation received by MAWC for administering the St. Louis County (one percent of gross revenue) represents a ceiling for any such adjustment as the services provided to St. Louis County are far greater than anything provided to AWR.

(MAWC testimony on the issue: Grubb Reb., pp. 2-5).

Expense Issues

<u>Depreciation:</u> What are the appropriate depreciation rates to be applied to MAWC's depreciable plant?

With respect to the Company's proposed depreciation rates, the Company has will offer the testimony of John Spanos with the firm of Gannett Fleming, Inc. Mr. Spanos, has extensive experience in the field as a member of the Society of Depreciation Professionals. He has testified extensively on the topic before other regulatory agencies and has prepared and will sponsor a depreciation study of Missouri-American Water Company's operations. Based on that study, Mr. Spanos will recommend new depreciation accrual rates for the Company. Mr. Spanos used the straight line whole life method of depreciation, with the average service life procedure to develop recommended depreciation accrual rates. He also calculated the amount required to amortize the variance between the book depreciation reserve and the calculated accrued depreciation. His total annual depreciation recommendation is based on a system of depreciation accounting which aims to distribute the cost of fixed capital assets over the estimated useful life of the unit, or group of assets, in the systematic and rationale manner. This study will be presented as an exhibit to his testimony (Exhibit JJS-1).

His determination of recommended annual depreciation accrual rates consists of two phases. In the first phase, service life and net salvage characteristics are estimated for each depreciable group, that is, each plant account or subaccount identified as having similar characteristics. In the second phase, the annual depreciation accrual rates were calculated based on the service life and net salvage estimates determined in the first phase. Mr. Spanos' testimony provides substantial detail about each aspect of this approach.

Mr. Spanos ultimately recommends that the Company be authorized to use the composite annual depreciation accrual rate for each account or subaccount. These recommended depreciation accrual rates are set forth for each account in Column 6 of Table 1 on pages iii-4 and iii-5 of Exhibit JJS-1. Based on his professional experience and expertise, Mr. Spanos holds the opinion that these are reasonable and appropriate depreciation accrual rates for the Company. He also believes that they are reasonable for plant added subsequent to December 31, 2005. He states that if the rates can reasonably be applied to the total balance including new plant additions during the next several years.

Mr. Spanos will testify that the recommended rates from the depreciation study will not be implemented as of January 1, 2006 because to do so will result in large increases for many customers due to the consolidation of all the Company's operating districts into one study. Therefore, the Company has decided to transition the rates from their current level to the proposed level over a number of years as a rate mitigation strategy.

The difference between the Staff's proposal as presented by Gregory Macias in Mr. Spanos' depreciation study is approximately $4 million dollars in annual depreciation expense. In light of the Company's decision to mitigate the impact of the proposed increase through appreciation expense over time, the difference between the two proposals before the Commission is only approximately $600,000. Conceptually, however, Mr. Spanos will testify that he believes that it is important that the life span procedure he has utilized is the most appropriate method for matching recovery of plant and service to the life characteristics of assets at major structures. He believes Staff's decision to use the interim survivor curve without the use of the life span approach ignores many retirements associated with final retirement of a facility. Consequently, Staff has proposed life for a number of accounts that is longer than is appropriate. In this regard, it is relevant to note that the life span approach advocated by Mr. Spanos was utilized and approved for some of the facilities for the Company's St. Louis County Division.

(MAWC testimony on this issue: Spanos Dir., pp. 5-14; Spanos Reb., pp. 1-5).

<u>Pension/OPEB Methodology:</u> How should pension and OPEB expense be treated for purposes of the revenue requirement and how should it be accounted for on a going

forward basis?

The Staff is proposing to recognize in rates an amortization of the unrecognized gains and losses over a ten-year period as part of the pension and OPEB costs. The Staff's proposed ten-year amortization period for unrecognized gains and losses eliminates the "corridor" approach to the handling of the unrecognized gains and losses as utilized by SFAS 87 and SFAS 106. The Staff is also recommending that the Company initiate a tracker mechanism for the difference between the Company's actuary costs and the amounts calculated using Staff's recommendation.

The Company does not agree with the Staff's recommendation. The Company believes that this added level of monitoring is unnecessary since the use of the "corridor" approach allows costs to be properly recorded on the books.

The purpose of the "corridor" approach is to recognize in current pension and OPEB cost gains and/or losses that fall outside the corridor. In other words, this approach will smooth out any volatility in the calculations of pension and OPEB costs. One of the factors that drives the level of these costs is the actual return generated by the financial markets which impacts the plan's asset values. There will always be up years and down years in the market. The "corridor" approach will smooth the impacts of the financial markets. No additional adjustment is necessary.

(MAWC testimony on the issue: Grubb Reb., pp. 8-10).

<u>Amortization of Pension/OPEB assets:</u> What is the appropriate level of expense to be included in MAWC's cost of service related to recovery of the regulatory asset created by the transition to accrual accounting for pensions and OPEBs?

MAWC (and at that time St. Louis County Water Company) received authority from the Commission to defer certain transition costs associated with the OPEB and Pension Costs transition to accrual accounting brought about by FAS 106 and FAS 87. These deferrals occurred in the mid-nineties. The Company has been amortizing these costs since that time and, it believes, recovering them in rates. They should continue to be recovered in rates.

(MAWC testimony on this issue: Grubb Reb., p. 7).

<u>Insurance Other than Group:</u> What is the appropriate level of expense to be included in MAWC's cost of service related to insurance other than group?

The Company has three issues with the Staff's calculation of its level of pro forma Insurance Other Than Group.

The first item is the exclusion of the cost of the Kidnap and Ransom policy. The Kidnap and Ransom coverage is a prudent business expenditure and should be allowed in rates.

The second item is the Staff's application of the payroll O&M percentage to insurance costs in order to capitalize a portion of those insurance costs. The effect of this action is to identify a portion of the cost of insurance to be capitalized as construction overhead related to placing assets in Utility Plant in Service.

The Company believes only that portion of the cost of insurance that relates to the cost of placing utility plant assets in service should be capitalized. While MAWC agrees that workers compensation, auto liability, and surety collateral have a link to utility assets, the remaining insurance policies cannot be readily tied to the cost of placing utility assets into service.

The final item is the exclusion of any cost for directors and officers coverage. This insurance coverage has previously been paid for by RWE in its global policy. However, starting in 2007, RWE will no longer pay for this cost and it will be directly borne by MAWC. The Company believes that the current cost should be reflected in rates.

(MAWC testimony on this issue: Grubb Reb., pp. 11-13).

<u>Uncollectible-Present Rates:</u> What amount of uncollectibles/bad debt should be included in MAWC's cost of service?

According to witness Donald Petry, the Company has computed bad debt expense using a two-year average. The Company has chosen a two-year average because its bad debts have steadily increased over the past several years. Petry points out those bad debts have increased by approximately $404,000, $55,000 and $191,000 for the years 2004, 2005, and 2006, respectively. The Company believes a shorter normalization period more accurately tracks this increasing trend.

In contrast, Staff witness Grissum has sponsored an adjustment which calculates a net write-off amount based on a five-year average, excepting St. Louis and St. Joseph in which case Staff has used actual numbers from 2006. Staff's use of, variously, a five-year average and 2006 actuals is out of step with its past practice in Case Nos. WR-2003-0500 and WC-2004-0168 in which Staff used a three-year average to calculate bad debt expense.

(MAWC testimony on this issue: Petry Reb., pp. 1-2).

<u>Uncollectible-Rate Increase:</u> Should the uncollectibles/bad debt expense be adjusted to reflect the total revenues, including any rate increase in Missouri jurisdictional retail revenues awarded in this proceeding?

In addition to its two-year average calculation for bad debt expense, the Company also calculated a two-year average of net charge-offs and water revenue to come up with a percentage of net charge-offs to revenue. The Company applied this percentage to proposed water revenue to more accurately reflect the impact of a rate increase on uncollectibles. The approach used by the Company is consistent with that authorized by the Commission in Case No. ER-2006-0314 (Kansas City Power & Light Company) wherein the Commission found that it is "more probable, and therefore just and reasonable, that an increase in the amount of revenue that KCP&L is allowed to collect from its Missouri retail ratepayers will result in a corresponding increase in bad debt expense". In this case, the Company recommends that the Commission apply a weighted average bad debt write-off factor of 1.09 percent to the actual Missouri jurisdictional revenue that the Commission finds appropriate in this case. This is consistent with the Commission's policy on this topic.

(MAWC testimony on this issue: Petry Reb., 3-4).

Audit Fees: What is the appropriate level of expense to be included in MAWC's cost of service related to audit fees for Sarbanes-Oxley compliance?

The Company has included an amount associated with the expected cost for Price Waterhouse Coopers ("PWC") to perform an annual audit to insure compliance with the Sarbanes Oxley Act of 2002 ("SOX"). The amount included in the Company's original filing was increased because the Company has since been advised by its auditors that it can expect to incur additional annual audit fees associated with being SOX compliant. The PWC Audit Fees are a known and normal-course-of-business expense and should be included in the Company's cost-of-service in determining just and reasonable rates.

(MAWC testimony on this issue: Grubb Reb., pp. 16-17).

Tank Painting Expense: What is the appropriate level of expense to be included in MAWC's cost of service related to tank painting expense?

Staff proposed an adjustment to tank painting expense that included an average of the five prior years' actual tank painting expense and annualization of the level of inspection costs. The Company has utilized costs based on a projected painting schedule and the expected life of the coatings.

The Staff method ignores the current condition of the tanks and the work that must be performed to keep those tanks in good working order. The Company's approach has the advantage of taking into account the impact of all the tanks and not just the ones painted in the last five years. (Petry Reb., p. 3-4).

Capitalized Software: Should any of the costs associated with computer software and/or maintenance agreements be capitalized? If so, what amount?

The Company has included in revenue requirement the cost of software leases, which include maintenance agreements, as an expense item. The Staff has proposed a pro forma adjustment to annualize certain annual leases for expensed software. Staff reduced the amount of software lease for the percent that it proposes should be capitalized. The Company believes that Staff's adjustment is inappropriate and that the software lease should be a 100 percent expense item.

(MAWC testimony on this issue: Grubb Reb., 13).

<u>Incentive Compensation:</u> What is the appropriate amount of costs associated with MAWC's incentive compensation plan that MAWC should recover from its customers?

Staff witness Hanneken has recommended negative adjustments of $432,662 and $126,028 from the incentive compensation payments of the Service Company and Missouri-American Water Company, respectfully. The Company believes that the recommended adjustments are inappropriate because the incentives have been selected to assist the Company to provide better service to the customers and, as such, are an appropriate cost-of-service. The Annual Incentive Plan ("AIP") establishes targets derived from performance in the areas of financial, customer, process and employee metrics. The Company believes the incentives drive its employees to strive for improved process and financial results and to improve customer service. Consequently, the Commission should include in the revenue requirement the disputed amounts associated with the AIP.

(MAWC testimony on this issue: Petry Reb., pp. 6-7).

<u>External Affairs:</u> What is the appropriate level of expense to be included in MAWC's cost of service related to its external affairs department/employees?

The Company has included in cost-of-service the position of Regional Vice-President of

External Affairs. Staff eliminated half the costs for this employee on the grounds that some of the individual's responsibilities included lobbying relating duties. The Company disagrees with this adjustment on the grounds that there is no evidence showing that anywhere near 50% of this individual's time is devoted to lobbying activities.

The Company will offer the testimony of Donald Petry who will show that the Company's Manager of Governmental and Regulatory Affairs spends 65% of his time responding to customer issues and complaints, maintaining relationships with large customers, working with industry trade or consumer groups and local response officials for training. Only about 5% of his activities are legislative efforts in communications regarding Company's goals and objectives. The remaining time is spent communicating with state holders and colleagues regarding issues concerning the Company. Staff's recommendation that 50% of the cost of this employee be disallowed from rates that is not justified in that the overwhelming majority of this employee's time is spent on activities other than lobbying.

(MAWC testimony on this issue: Petry Reb., pp. 5-6; Grubb Reb., p. 17).

<u>Overtime Hours:</u> What is the appropriate level of expense to be included in MAWC's cost of service related to employee overtime?

Staff calculated an adjustment for overtime hours by utilizing a four year average for the Brunswick, Joplin, Parkville Water, St, Charles, St. Joseph, and St. Louis districts. They used a two year average of the years 2003 and 2004 for Jefferson City and based the remaining districts' overtime hours on 2006 totals. The Company used the overtime hours experienced during the test year for all districts.

Staff found that in several districts, there was an upward trend. In these districts, Staff adjusted the amount of test year overtime to the amount known for the 2006 calendar year as an ongoing level. However, in other districts, Staff saw fluctuation in the amount of overtime. In these districts, Staff calculated a 4-year average amount of overtime. In Jefferson City, Staff determined that overtime had extreme fluctuations from year to year and concluded an average of 2003 and 2004 was a more normal level.

Use of different methods from one district to another appears to drive toward finding the lowest revenue requirement. MAWC's overtime hours are trending upward. IN this situation, the test year is more accurate predictor of the expenses to be incurred when the rates will be in effect than the methods proposed by the Staff.

(MAWC testimony on this issue: Petry Reb., pp. 4-5).

<u>Fuel & Power/Chemicals Due to Unaccounted-for Water:</u> What is the appropriate amount of fuel & power/chemical expenses to be included in MAWC's cost of service for weather-normalized sales?

The Staff has disallowed a portion of MAWC's fuel & power and chemical expenses because Staff arbitrarily assigned a 15% loss factor cap in its calculation of system delivery. That is, Staff made a pro rata reduction of fuel & power and chemical expense in any district where billed water made up less than eighty-five percentage of the total water produced in that district.

There is no rule or third party standard that indicates that a loss factor of greater than 15% is unreasonable. In fact, the American Waterworks Association's (AWWA) 'Water Conservation Programs – A Planning Manual' states "Unbilled water can be less than 10% in a relatively new, well-managed system. It is not uncommon to find unbilled water to be over 20 percent in an older system."

Examination of the 5-year average loss factor for MAWC's districts indicates that those loss factors are consistent with the above AWWA reference. For example, the St. Charles District is a relatively new system and has a 5-year average loss factor of 3.8%, while the St.

Louis County District is a relatively old system with a 5-year average loss factor of 19.1%.

MAWC recommends that the 5-year average loss factor be applied to Normalized Sales to arrive at Normalized System Delivery values and expense levels for fuel & power and chemicals.

(MAWC testimony on this issue: Weeks Reb., pp. 4-6).

<u>Belleville Lab:</u> What is the appropriate amount of costs to be included in MAWC's cost of service for its use of the Belleville Laboratory facility?

The Belleville Lab is a testing facility located in Belleville, Illinois that is operated by American Water Works Service Company. This facility performs sample testing for the AWW operating companies, to include MAWC.

The use of the Belleville Lab provides a benefit to MAWC's customers. Every year the laboratory conducts a survey to compare its testing costs to those of outside laboratories. Outside labs have been found to be from 18% to 43% more expensive in each of the last six years. Additionally, outside testing labs charge higher fees for evaluation of "rush" samples. The Belleville lab does not.

To remain a viable option, however, the Belleville lab must recover its costs. It does that by direct charging those costs directly attributable to a specific operating company. Indirect costs are allocated on the basis of customer count. Staff witness John Cassidy suggests that the indirect costs should instead be allocated based on the number of tests analyses performed by the lab for an operating company. Mr. Cassidy is concerned that the percentage of the indirect costs being borne by MAWC (14.5%) exceeds MAWC's percentage of the test analyses performed (7.04%). Utilizing Mr. Cassidy's proposed allocation method would reduce by $336,129, the amount of expense included in MAWC's revenue requirement for the Belleville Lab.

The use of customer counts, to some extent, is driven by the reality of the regulatory world in which MAWC and its sister companies operate. An operating company's total samples can vary from year to year because of source water conditions, contamination events and state-specific regulations. Because utility rates are not automatically adjusted every year, the variation in an operating company's portion of the Bellville Lab costs would constantly create "winners" or "losers" on an annual basis. The alternative would be a situation where Bellville Lab would not recover all of its costs – a situation that would lead to either higher costs for the services performed by the Bellville Lab or encourage the use of higher cost outside labs, whose costs would be more likely to be recovered in total.

Customer counts, on the other hand, are much less variable and do not change dramatically from year to year, when looked at from a system-wide perspective. This consistency makes it much more likely that rates and costs will more closely track one another and that the Belleville Lab will recover its costs, thereby preserving a testing option that provides benefits for MAWC's customers.

(MAWC testimony on this issue: Grubb Reb., pp. 13-16).

<u>Management Fees Capitalized:</u> Should some portion of the management fee paid by MAWC be capitalized? If so, what amount?

Staff is recommending that $168,390 of management fees associated with the Fixed Asset group be capitalized as part of the Company's capital expenditure program.

The cost that Staff is recommending to capitalize relates to the management of the Company's Fixed Asset and Task Order system. These are accounting functions which should properly be recorded as period expenses.

(MAWC testimony on this issue: Grubb Reb., p. 17).

Rate Base Issues

<u>Warren County Sewer Plant and Cedar Hill Sewer Plant:</u> Should the entire cost of

construction of the Warren County and Cedar Hill sewer plants be included in plant in service?

The entire cost of the Warren County and Cedar Hill Sewer Plants should be included in MAWC's plant in service. These districts were acquired by MAWC since its last rate case.

The circumstances surrounding the Warren County system are well documented in Commission Case No. WM-2004-0112. Briefly, MAWC came in and took over a small, troubled water and sewer utility and expended the necessary funds to ensure not only safe and adequate service to existing customers but to future customers as well.

The purchase of the Cedar Hill system was approved by the Commission in its Case No. SM-2004-0275. The old Cedar Hill Plant, while adequately handling existing customers, did not have any capacity for growth, and an expansion of the plant was needed shortly after its acquisition. MAWC was able to invest the dollars necessary to expand the Cedar Hill Plant so that it would continue to have sufficient capacity as well as provide service to a new development in the area.

Staff has proposed a disallowance from rate base of approximately 60% of the Warren County Sewer Plant (which Staff claims is attributable to future growth) and 100% of the Cedar Hill Sewer Plant (which Staff claims is attributable to future growth). This proposed disallowance is a classic example of how traditional ratemaking principles conflict with the economic realities of providing safe and adequate service to customers at small utility systems.

The proposed disallowance presents a very real dilemma for not only MAWC but also this Commission. If a utility is unable or decides not to build needed capacity, it is subject to complaints related to its ability (or inability) to provide safe and adequate service either now, or in the future when growth takes place. On the other hand, if a utility takes advantage of economies of scale and willingly builds sufficient capacity for both present and the future, the utility investment stands a reasonable chance of being disallowed as unnecessary or having created excess capacity.

Capacity cannot be added in small, finite increments. It is much cheaper to add capacity in blocks with a view towards growth. Taking advantage of this economic efficiency necessarily results in situations where there may be excess capacity for periods of time, but the investment is still the most prudent course of action for the Company and the customers.

MAWC should not be penalized for taking actions that are in the long term best interest of the utility customers. This is especially true in an environment where there is limited interest in making the necessary investments in small water and sewer systems. (Jenkins Reb., pp. 19-21).

(MAWC testimony on this issue: Jenkins Reb., pp. 17-21; DeBoy Reb.).

<u>Shared Services and Call Center Transition Costs:</u> What is the appropriate way in which to recognize the costs which MAWC has incurred in transitioning to its National Shared Services Center and Call Center?

MAWC has capitalized $5,263,822 of investment that was made to plan, design and implement the National Call Center. MAWC has capitalized $4,488,826 of investment that was made to plan, design and implement the Shared Services Center. Staff has recommended that the costs relate to the planning, development and implementation of the National Call Center and Shared Services Center be disallowed. Removal of these amounts from rate base and denial of recovery would reduce MAWC’s revenue requirement by approximately $728,930 (the return on and return of associated with the investment). More significantly, denial of recovery would result in a write-off of these amounts for MAWC.

Staff argues that these costs should not be recovered because MAWC does not own the assets. MAC believes this is a distinction without a difference as it relates to possible recovery.

MAWC believes it would have spent much more on a per customer basis than it did to build its own shared services center or call center, or to upgrade an existing call center, to install the same level of customer service found in the Alton Call Center and the Shared Services Center. Because MAWC combined its efforts with other operating companies in order to provide economies of scale, it is being denied recovery of its investment in these projects.

The question is whether the capital assets acquired through the investment are used and useful in providing service to the customers. In this case, they are used and useful given the fact that without the involvement, neither the Call Center nor the Shared Services Center would exist today. The Call Center has provided benefits to the customers while the Shared Services Center has resulted in reduced operation and maintenance costs associated with these services. All costs incurred for the Call Center and Shared Services business initiatives fall within the framework for components of costs for assets to be capitalized to utility plant. MAWC believes that many of the costs associated with the projects should be capitalized and that this is an appropriate approach to recognize for both the financial impact and rate impact in terms of benefits to the customers.

In the alternative, MAWC has proposed that the Commission authorize a thirty (30) year amortization of the subject investments without a return on the investments. Doing so would follow a part of the Staff's recommendation by not requiring customers to provide a return on the investment, provide the Company with a return of the investment that has benefited customers and avoid the necessity of a complete write-off of this investment.

(MAWC testimony on this issue: Grub Reb., pp. 18-23).

<u>Cash Working Capital (Management Fee lag):</u> What is the appropriate amount to be included in MAWC's rate base for cash working capital as it relates to the management fees expense lag?

Both the Company and Staff used a Lead/Lag Study approach in determining the level of working capital in rate base. The determination of the amount of working capital for a specific item in the study is calculated by multiplying the daily expense requirement by the difference between the revenue lag and the expense lag for the category. For the expense category Management Fees, the Company disagrees with the Staff position related to the expense lag. The Company's adjusted expense lag for Management Fees is a negative 8.99 days and the Staff's lag is a positive 21.41 days.

The Staff calculated its lag by assuming that the management fee payments are made in arrears. The management fees are paid in advance and the invoice clearly states this fact. This is very similar to the treatment of MAWC's PSC Fee Assessment. The Commission gives the Company the option of paying the entire yearly amount in one lump sum or quarterly. However, either way the amounts are paid in advance of the applicable quarter.

The Company's expense lag for Management Fees should be used in computing cash working capital.

(MAWC testimony on this issue: Grubb Reb., pp. 23-24).

<u>Rate base for security deferral:</u> Should the unamortaized balance of deferred Security costs be included in rate base?

In Commission Case No. WO-2002-273, the Commission authorized the Company to defer certain costs associated with security measures taken by the Company in the aftermath of the September 11, 2001 terrorist attacks. The Company was authorized to defer the costs for a two-year period ending on September 11, 2003. The Company was also authorized to amortize the costs over a 10-year period. The Company began amortizing the costs in December 2002 upon receipt of the Commission's Report and Order.

The Company believes that the unamortized amount should be afforded rate base treatment because the Company incurred the costs to provide security to its production and distribution systems, its offices, its customers, and its employees. The sole purpose of these efforts was to provide safe and adequate service to its customers and the assets that serve them. Therefore, rate base treatment of the unamortized balance is appropriate.

(MAWC testimony on this issue: Grubb Reb., pp. 5-6; Grubb Sur., pp. 2-4).

III. RATE DESIGN/COST OF SERVICE

Rate Design/Cost-of-Service: How should any revenue increase for MAWC that results from this case be implemented in rates?

MAWC, in its initial filing, proposed that the increased revenue requirement resulting from this case be recovered through an across-the-board increase of approximately twenty-five percent (25%) on water and sewer revenues. While cost is a factor that should be taken into account when determining district and class revenue requirements and designing rates, rate stability, affordability and customer acceptability are other factors that should also be taken into consideration when designing rates. MAWC's proposal for an across-the-board increase places an equal cost responsibility on each customer – that is, every customer's bill will receive approximately the same percentage increase over their existing bill at the same usage level. MAWC's proposal is supported by the concept of gradualism which means that rates should increase on a gradual basis and avoid drastic changes when possible. MAWC believes that an across-the-board increase is affordable and recovers the same level of revenues, but does not adversely affect any specific customer groups. (Jenkins Dir., pp. 19-20) An across the board increase recovers the full cost of service proportionately among all districts and classes of users without any undue hardship to any one class or district and maintains the revenue distribution that was approved in the last case. (Jenkins Reb., p. 14)

Notwithstanding its initial proposal, MAWC is aware that most, if not all, of the other parties to the case appear to support a rate design that more closely matches district specific costs (although it is not clear that within the districts parties are advocating rates that would recover each customer class' specific costs). Accordingly, as an alternative to an across-the-board increase and strict district specific pricing, the Company proposed a rate design in its rebuttal testimony that reduces the total number of districts, mitigates the large impacts on some districts and still maintains to a large degree, the concept of district specific pricing. Specifically, MAWC's alternative proposal would combine the St. Louis County and St. Charles Districts into one district as these districts are contiguous and physically interconnected. A single tariff would be developed for this district that is sufficient to recover the costs of service for those combined districts and also recover the deficits (approximately $1.9 million) projected for Brunswick, Cedar Hills Sewer and Warren County Water & Sewer Operations, after the proposed 25% increase is applied to these districts. This alternative proposal would mitigate the extremely large increases that otherwise would be required under strict district specific pricing for these districts. All other districts under this alternative proposal would receive district-specific pricing. (Jenkins Reb., p. 15).

(MAWC testimony on this issue: Jenkins Dir., pp. 19-20; Jenkins Reb., pp. 14-17).

<u>District Pricing v. Other:</u> What is the appropriate way to allocate costs among MAWC's various operating districts?

As previously indicated, MAWC is not advocating strict district specific pricing, but rather an equal percentage, across-the-board increase to each district and to each customer class within such district. While other parties appear to be advocating district specific pricing to one degree or another, they do not appear to be advocating that rates for each customer class within a district be based upon their identifiable costs. For the reasons stated above, MAWC believes its uniform across-the-board percentage increase to districts and customer classes is an appropriate way to recover increased revenues resulting from this case. Alternatively, MAWC would recommend that if the Commission determines that district specific pricing is appropriate, that it first consolidate the St. Louis County and St. Charles Districts and, further, that it mitigate rate increases to the Brunswick, Warren County and Cedar Hill Districts by increasing their rates to an acceptable level and then recovering any excess revenue requirement from those districts from the combined St. Louis County/St. Charles District. (Jenkins Reb., pp. 16-17).

(MAWC testimony on this issue: Jenkins Dir., pp. 19-20; Jenkins Reb., pp. 14-17).

District Specific Costs: What are the costs of each district?

Allocations: What is the appropriate basis upon which to allocate MAWC Corporate Administrative and General Expenses to the various districts?

The total test year costs (investments and expenses) are either directly assigned or allocated to each operating district. Each District's specific costs are set forth in the Accounting Schedules attached to the Direct Testimony of Don Petry. Generally speaking, expenses and investments that are directly attributable to a district (such as plant, related depreciation expense, etc.) are directly assigned to that district. Corporate expenses, which include MAWC employees that have statewide responsibilities and expenses paid at the state level (e.g., insurance other than group, PSC assessment, franchise tax, etc.) are primarily allocated to the operating districts based on the number of customers in each district. Workers compensation expense is allocated based on payroll percentage. (Petry Dir., pp. 13-14) These cost allocations have been used by MAWC in a number of prior rate cases.

(MAWC testimony on this issue: Petry Dir., pp. 13-14, attached accounting schedules; Grubb Sur., pp. 4-6).

<u>District Specific Revenues:</u> What are the normalized revenues associated with each district?

For purposes of this case, MAWC has normalized and annualized revenues for each operating district. Revenues were normalized for weather and annualized for customers and water usage. See Company's position on Revenue Normalization (Weather) and Revenue Annualization above.

<u>Joplin Overcharge (WR-2000-281 Appeal):</u> Should an adjustment be made related to the appeal of Commission Case No. WR-2000-281? If so, what adjustment should be made?

An adjustment should not be made in this proceeding related to the appeal of Commission Case No. WR-2000-281, as this issue is not properly before the Commission at this time, and any such adjustment would amount to retroactive ratemaking.

On March 29, 2007, Joplin moved to consolidate Commission Case No. WR-2000-0281 (before the Commission on remand from the Court of Appeals) with the instant rate case proceeding. By its Order of May 17, 2007, the Commission denied Joplin's Motion to Consolidate, and, as such, this issue is not before the Commission in this proceeding. As noted by the Commission in its May 17th Order issued herein, the current rate case is unrelated to the alteration of the Commission's Report and Order issued in Case No. WR-2000-0281. The findings of fact and conclusions of law, if any, to be added to that Report and Order must be drawn from the record in that case and the then-applicable laws.

Further, an adjustment at this time, as requested by Joplin, would amount to retroactive ratemaking. As numerous appellate courts have noted, including the court in *State ex rel. City of Joplin v. Public Service Commission*, 186 S.W.3d 290 (Mo.App. W.D. 2005), "the Commission lacks authority to retroactively correct rates," "lacks the authority to refund money," and may not "take into account overpayments when fashioning prospective rates." *City of Joplin*, 186 S.W.3d at 297; *see also State ex rel. The Empire District Electric Co. v. Public Service Commission*, 100 S.W.2d 509, 512 (Mo. 1936). The rate impact of the 2000 Report and Order may not properly be considered in the instant proceeding, and the rate adjustment suggested by Joplin may not lawfully be made.

<u>Class Identification/Cost of Service:</u> What is the appropriate way in which to identify classes and to allocate costs among customer classes within each operating district?

MAWC's tariffs currently classify customers according to the American Water Works Association (AWWA) manual. These customer classifications are defined by AWWA as follows:

- Residential – one and two family dwellings, usually separate.
- Commercial – multi-family apartment buildings and non-residential, non-industrial business enterprises.
- Industrial – manufacturing and processing establishments.
- Public Authority – public schools, hospitals, colleges, municipal or other governmental offices or operations.
- Resale – sales of water to another water utility for resale.
- Fire Protection – private fire lines for businesses and public fire hydrants paid for by municipalities.

Each customer is classified into one of the above categories based on the characteristics of the customer. This is common practice in the water industry. (Herbert Reb., pp. 15-16) MAWC has always recorded revenues using these rate classes and the Uniform System of Accounts for water companies provides for the recording of revenues in this manner. In addition, rate classes are necessary in order to allocate costs to such classes and determine the relative cost responsibility of each class. Then, a single, declining block rate schedule can be designed to recover the allocated costs of service by class. (Herbert Sur., pp. 1-2).

MAWC does not oppose having a single, declining block rate schedule applicable to all classes. A properly structured declining block rate design will include most of the residential usage in the first block, the commercial and public usage in the first and second blocks and some in the third, and the industrial and resale usage predominantly in the third and fourth blocks. (Herbert Sur., pp. 1-2)

The appropriate way to allocate costs among customer classes within a district is to use the Base Extra Capacity method as described in the AWWA Manual. Mr. Paul Herbert, a consultant with the consulting firm of Gannett Fleming Inc., was retained by the Company to perform such a study. Mr. Herbert's class cost of service study is contained in his rebuttal testimony. As he explains, the Base Extra Capacity method is a recognized method for allocating the cost of providing water service to customer classifications in proportion to the classification's use of the commodity, facilities and services. (Herbert Reb., p. 3). Both Staff and Public Counsel use the Base Extra Capacity method of allocation in developing their class cost of service studies, however, there are a number of differences between the studies performed by Mr. Herbert, on the one hand, and Staff and Public Counsel, on the other hand. The primary difference is in the allocation of distribution mains in the St. Louis County, Joplin and St. Joseph Districts. Mr. Herbert used a "small main adjustment" in developing his class cost of service study whereas Staff and Public Counsel did not. Mr. Herbert's small main adjustments reflect the fact that many of the large users in those three districts are served primarily from large transmission mains (generally larger than 10") and do not benefit from the smaller mains in the distribution system. (Herbert Reb., pp. 9-11, 12-13). If the Commission determines that it is appropriate to establish cost based rates for individual customer classes within each district, then the class cost of service study performed by Mr. Herbert is the appropriate way in which to allocate costs among those customer classes.

(MAWC testimony on this issue: Herbert Reb. and attached schedules; Herbert Sur.).

IV. MISCELLANEOUS

Jefferson City Issues: Are MAWC's Jefferson City facilities adequate as related to back-up power generation, storage and small main replacement?

The City of Jefferson has raised three issues though the testimony of Robert F. Rennick. These are the need to install permanent power generation, adequacy of storage and plant capacity, and main sizes in the transmission network. (Rennick Reb.). MAWC is in the process of addressing all three issues.

MAWC is currently in the design phase to provide a permanently installed generator at the Jefferson City plant. This generator will be online by the end of this calendar year. The generator will be designed to meet the average day load to keep the plant in operation in case of a power outage. MAWC previously completed related work to protect its dual power feeds and to limit tripping of plant pumps during brief voltage drops.

MAWC is currently in the process of studying forecasted consumer loads for the Jefferson City operation and plant improvements that may be prudent to provide peak day coverage for those loads. This study includes an assessment of storage volumes and is anticipated to be completed in the third quarter of 2007, with capital being allocated in the budget beginning in 2008 to start work on design and construction of any improvements deemed appropriate.

Lastly, MAWC has had a continuing commitment to the replacement of mains in Jefferson City. The major focus of this process has been the replacement of obsolete mains. However, MAWC ahs also made some upgrades to the size of mains to provide better fire flow in parts of the system. This program to replace mains is being reviewed with Chief Rennick and the City of Jefferson City annually.

MAWC believes there is no need for a Commission order in regard to the Jefferson City issues.

(MAWC testimony on this issue: Weeks Reb., pp. 1-4).

Joplin Surcharge: Should MAWC be allowed to implement its proposed Joplin plant improvement surcharge?

MAWC proposed with the filing of this case a Joplin Plant Improvement Charge (Joplin Surcharge). The Joplin Plant Improvement Charge option will allow the Company to earn a current return on a portion of the construction work in progress ("CWIP") related to the substantial investments to be made in Joplin in lieu of accruing AFUDC on the entire project cost. While MAWC asks that the surcharge process be put in place as a result of this case, the first actual surcharge to customers would begin on January 1, 2008.

MAWC believes such a surcharge is appropriate in Joplin because the Company has initiated the planning and construction of a three-year, $44 million Water Treatment Plant Rehabilitation and Improvement Projects located in the Joplin District. This plant received its last significant improvements in 1959 and some of the structures date back to prior to 1900.

The Company has placed raw water transmission piping, intakes and a pump station into service this year at a cost of approximately $10 million. The remaining $34 million attributable to the Joplin Project is expected to be completed and in-service by December 2008. A detailed explanation of this project is found in the Direct Testimony of MAWC witness Alan DeBoy.

Under traditional rate of return rate ratemaking, once the Project is in service and included in rate base, Joplin District customers would experience a significant rate increase as the construction costs plus accrued financing costs (AFUDC, or Allowance for Funds Used

During Construction) begin to be recovered. In order to mitigate the possible rate shock, the Company is presenting the Commission with an option for Joplin customers to pay for improvements to the Joplin Plant over time instead of all at once upon completion of this project in December 2008.

The Joplin Plant Improvement Charge would be filed quarterly with the Commission to reflect updated CWIP on the Project. This Plant Improvement Charge would continue until the Project is included in rate base and reflected in the Company's base rates.

It would be calculated in a manner that is similar to the Infrastructure System Replacement Surcharge ("ISRS") in its components and application, except there would be no depreciation expense or property tax components in the Plant Improvement Charge.

The initial charge would go into effect on January 1, 2008, based on the applicable CWIP balance for the Project at December 31, 2007. At the beginning of each quarter through 2008, the improvement charge would be increased based on the applicable CWIP balance at the end of the preceding three months. Once construction is completed, and the capital investment for the project is reflected in base rates, the Joplin Plant Improvement Charge would cease.

The Joplin District customers would experience an estimated increase of 64.5% solely attributable to the inclusion of the Project (and its accrued AFUDC) in rate base. At present rates this project alone would require the average residential customer to pay an additional $10.51 per month solely for this project. The use of the Joplin Surcharge would help mitigate the one-time rate spike to customers and allow customers to adjust to rising prices over time as opposed to a one-time 64.5% increase.

(MAWC testimony on this issue: Jenkins Dir, pp. 11-19; Jenkins Sur., pp. 24-34; DeBoy Dir., pp. 5-28).

<u>Consolidated Billing:</u> Should the proposed consolidated billing tariff be approved?

As a result of a stipulation and agreement in MAWC's last rate case (Case WR-2003-0500), the Company agreed to propose such a tariff for the St. Louis district providing for the consolidation of certain customer's bills. Such a process would allow for an aggregation of the customer's usage and, in theory, allow them to take advantage of lower rates associated with that higher usage. Such consolidation is only reasonable where the accounts to be consolidated are located contiguous, owner occupied properties.

MIEC witness Gorman addressed this proposed tariff and suggested a few language changes. [*MAWC does not object to those language changes, with one exception.]* Mr. Gorman recommends that the tariff be made available to qualifying customers at the conclusion of this case. MAWC had proposed that customers be allowed to apply for such treatment at the conclusion of this case, but that the actual consolidation not take place until the conclusion of MAWC's next general rate case.

The difference is in how to handle the assumed revenue short fall that will result from the implementation of consolidated billing. MAWC's approach allows for some level of certainty as qualifying customers seeking this rate will be known and the effect n the Company's revenues associated with consolidated billing can then be taken into account in the ratemaking process in the next rate case.

Because at this time MAWC does not know what customers will qualify and apply, it is difficult to make an appropriate adjustment to the billing determinants.

(MAWC testimony on this issue: Grubb Dir., p. 16-17; Grubb Reb., pp. 24-25; Grubb Sur., pp. 13-14).

<u>Triumph Foods/ St. Joseph Issue:</u> Should an adjustment be made associated with the rate paid by Triumph Foods, LLC in St. Joseph?

Triumph Foods, LLC (then known as Premium Pork, LLC) proposed to construct a pork-processing facility in the Stockyards area of St. Joseph, Missouri. This area was described at that time to be derelict. The Stockyards was formerly the site of an extensive animal slaughtering and processing operation that historically formed the economic core of St. Joseph. The new facility was projected to require significant investment in plant and many employees and, as a result, to have a substantial payroll. The city and community of St. Joseph were said to be eager to attract this entity to locate there, based upon affidavits presented to the Commission.

Triumph Foods had a viable competitive alternative in another geographical area and the availability of a competitive rate was critical to its decision to locate at St. Joseph. The "viable competitive alternative" was the city of Albert Lee, Minnesota, whose applicable water service rate was a fraction of that available in St. Joseph.

In an attempt to assist in the location of this entity in St. Joseph, MAWC entered into a contract with Triumph Foods and presented the contract to the Commission for approval. The Commission approved MAWC's contract with Triumph, to include the rate and an associated tariff (P.S.C. Mo. No. 1, Sheet 61) by its Order Concerning Agreement and Tariffs, Application to Intervene and Motion to Suspend Tariffs issued on November 20, 2003, in Commission Case No. WT-2004-0192.

The approval turned upon application of the terms of MAWC's economic development rider (EDR) (P.S.C. Mo. No. 1, Sheets 49-60) that was previously approved by the Commission in Case No. WT-2004-0156. That tariff offers water service at a discounted rate in specified circumstances "to encourage industrial and commercial development in the State of Missouri." P.S.C. Mo. No. 1, Sheets 49.

AG Processing (AGP) appears to suggest that perhaps the Commission should impute additional revenues associated with Premium Pork as a part of setting MAWC'S rates. (Johnstone Reb., p. 4). Imputing revenues during the rate setting process requires the assumption that MAWC has received revenues that do not really exist, thereby lowering the amount of revenues the rates are designed to produce.

This is inappropriate for several reasons. First, the rate being charged to Triumph is a Commission-approved rate that is presumed to be just and reasonable. This was the rate that was believed to be necessary in order to attract the customer. Without that rate, there would be no revenues associated with Triumph.

Second, the rate being charged to Triumph exceeds the variable cost of providing service to Triumph. The impact of this is that the rate being charged to Triumph benefits the other St. Joseph district customers by reducing the fixed costs that must be obtained from those customers. This is consistent with the Commission's finding in Case No. WT-2004-0192 that, in addition to the economic benefits for the State of Missouri, St. Joseph and the surrounding area, that the rate being charged Triumph constitutes "a benefit to the other customers of the St. Joseph district because it . . . serve[s] to reduce the revenue requirement of the district as a whole."

Lastly, if the Triumph rate were found to no longer benefit the public, the remedy is not to impute revenues, as suggested by AGP, but rather to increase the rate to be paid by Triumph. There is a provision in MAWC's economic development rider tariff, as well as the contract, that provides that in such situations the Commission may "allow the Company to continue providing service under the contract after adjusting rate conditions to restore the interests of the Company's other customers in the service territory, or it may direct the Company to terminate the contract."

(MAWC testimony on this issue: Grubb Sur., pp. 6-13; Herbert Sur., pp. 4-5).

<u>Union Issues:</u> Are MAWC's efforts in regard to asbestos-cement and led jointed piping adequate and appropriate? Confidentiality of Payroll? Proper Allocation of Funds from the Rate Increase to Ensure the Provision of Safe & Adequate Service?

Alan Ratermann on behalf of Utility Workers Union of American Locals 335 and 455 (the "Union") has filed testimony requesting that an unspecified additional amount be included in rates to establish a program for the removal of asbestos cement ("AC") piping from the company's distribution system and for training employees to safely work with AC piping.[1] Mr. Radermann alleges, generally, that the use of AC piping presents a heath risk that justifies the additional funding.

The Company's evidence will show that AC piping is an acceptable material for use in drinking water distribution systems and that it takes precautions to meet all federal and state standards when handling it. The Company's evidence will show that very little AC pipe is used in its operations and, moreover, that the occurrence of repairs to that piping is very low. Contrary to the Union's testimony, the Company does offer training to its employees concerning the safe handling of AC piping. Also, contrary to Mr. Radermann's testimony, the Company always flushes new piping to remove any debris, including asbestos slurry, which may have entered the piping system as a result of any repair activities. Finally, the Missouri Department of Natural Resources has thoroughly tested AC piping as used in drinking water distribution systems and found no problems associated with the use of this material.

(MAWC testimony on this issue: Hebenstreit Sur., pp. 2-6; Weeks Sur., pp. 1-5).

<u>Capacity Charge Revenue:</u> Should there be any adjustment related to the capacity charge MAWC has proposed in Case No. ST-2007-0443?

An adjustment should not be made in this proceeding related to the capacity charge

[1] On July 31, 2007, the Company has filed a motion to strike Mr. Ratermann's testimony as inappropriate rebuttal under Commission rule 4 CSR 240-2.130(7)(B). *See*, EFIS Doc. No. 175. Should it be granted by the Commission, the issue will be moot and this section of the Company's brief may be disregarded.

MAWC has proposed in Case No. ST-2007-0443 (consolidated with the instant proceeding for decision-making purposes, although under a separate procedural schedule). On April 2, 2007, MAWC filed proposed tariff sheets applicable to its Warren County and Jefferson County sewer districts. These tariff sheets have been suspended by the Commission until November 14, 2007, and a hearing regarding the tariff sheets is scheduled to begin on September 5, 2007.

The Capacity Charge proposed by MAWC in Case No. ST-2007-0443 will be a one-time, non-recurring charge payable at the time a new customer connects to the subject sewer systems. It is designed to recover a portion of the capital costs that the Company has incurred in expanding its treatment facilities in these districts. To the extent paid by customers, the Capacity Charge payments will be treated as contribution in aid of construction, serving to reduce the rate base upon which MAWC will earn a return in future rate cases. The amounts to be collected are not associated, in any measure, with the recovery of operating costs or expenses. The payments will represent contributions associated with capital investment.

If the tariffs proposed in Case No. ST-2007-0443 become effective, payments for the Capacity Charge, on a going forward basis, will serve to reduce the Company's rate base and, all else being equal, will thereby reduce future rates. This item, of course, is not relevant to the test year in the instant proceeding and should not be considered by the Commission at this time. Until the tariffs proposed in Case No. ST-2007-0443 become effective, and until payments are made pursuant thereto, the proposed Capacity Charge can have no impact on the amount of capital investment that has been made by MAWC in the subject districts nor on the rates to be established as a result of this proceeding.

WHEREFORE, MAWC respectfully request that the Commission consider this Prehearing Brief and, after hearing, issue such orders as the Commission shall find to be reasonable and just.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been sent by electronic mail this 2nd day of August, 2007, to:

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