

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

<b>In the Matter of Missouri-American Water</b>	)	
<b>Company's Request for Authority to Implement</b>	)	<b>Case No. WR-2008-0311</b>
<b>a General Rate Increase for Water and Sewer</b>	)	<b>SR-2008-0312</b>
<b>Service Provided in Missouri Service Areas.</b>	)	

**STAFF'S STATEMENT OF POSITION**

COMES NOW the Staff of the Missouri Public Service Commission ("Staff"), by and through counsel, submits its Statement of Position on the issues of this case.

**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 appropriate cost of capital or fair rate of return, for MAWC on its jurisdictional water utility rate base is in the range of 7.60 percent to 8.04 percent with a mid-point of 7.82 percent as of March 31, 2008. The proper return on common equity is in the range of 9.60 percent to 9.26 percent with a mid-point of 10.10 percent as of March 31, 2008.

**Capital Structure:** What capital structure, MAWC stand alone or American Water consolidated, should be used for determining MAWC's rate of return?

The appropriate capital structure for MAWC is American Water Works Company, Inc.'s capital structure as of March 31, 2008, on a consolidated basis.

**Rate Base Issues**

**Cedar Hill Sand Creek Sewage Treatment Plant:** Should the capital and depreciation expense costs associated with the capacity expansion project of Cedar Hill Sand Creek sewage treatment facility be disallowed for ratemaking in this proceeding?

Yes, the capital and depreciation expense costs associated with the expansion project of the Cedar Hill Sand Creek sewage treatment facility should be disallowed for ratemaking in this

proceeding. Recovery of these costs may be possible in future rate proceedings if additional customers are connected. The Staff is not contesting the prudence or timing of the construction of the plant, thus the Company will not have to write the asset off its books. Inclusion of the costs of the expansion without the new customers available to pay results in both rate shock and an undesirable impact upon existing customers in that they are being required to pay the entire cost of an expansion project that is necessary to serve future customers.

**Cash Working Capital (Management Fee Lag):** 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?

The appropriate amount to be included in MAWC's rate base for cash working capital is \$2,346,552 which is calculated by using a positive expense lag of 21.41 days. Working capital is included in rate base to compensate investors for the lag between the time service is rendered and revenue is received for that service. In this instance, the management fee is charged by an affiliate in advance. On the other hand, MAWC's non-affiliated vendors provide goods and services on credit. MAWC's affiliate should not get preferential treatment. The appropriate expense lag for management fees is the same as that for other third-party vendors who supply goods and services to the utility on an arm's-length basis - a positive 21.41 days. Utility affiliates should not receive preferential treatment by requesting prepayment of services it provides to its affiliate.

**Rate Base for Security Deferral:** Should the unamortized balance of deferred Security costs be included in rate base?

The unamortized balance should not be included in the rate base. The Staff believes this regulatory treatment, which has been accepted by the Commission for other AAOs, should be adopted in this case as well.

**Accumulated Deferred Income Taxes Associated with the Security AAO:** Should accumulated deferred income taxes associated with the Security AAO be included as an offset to rate base? Does this change if the unamortized balance of the security AAO is not included in rate base?

Accumulated deferred income taxes associated with the Security AAO should be included as an offset to rate base regardless of the rate base treatment given the unamortized balance of the AAO. Deferred taxes are simply the result of timing differences between when a company deducts certain expenses on its tax return and when it deducts the expense for ratemaking purposes. The deferred tax reserve represents, in effect, a prepayment of income tax by Missouri-American customers.

## **Revenue Issues**

**Customer Water Usage Normalization (Usage per Customer per Day):** What is the appropriate method to use to normalize customer water usage?

The appropriate method to normalize customer usage data is using a six (6) year average. Staff used known usage numbers provided by the Company to compute an average usage per customer for the years of 2000 through 2007. Data for the years of 2003 and 2006 were excluded from the calculations because the Company has found the data to be unreliable due to billing method changes that occurred in those years. Averaging the actual usage from the current decade allows for the varying rainfall amounts and temperatures that occurred in that time period, for each service area, and is therefore the most reliable prediction method to use. Further, trends in water usage due to conservation practices or lawn size/irrigation practices may be unique to any given service area, and would also be accounted for in an average of actual usages. This method of averaging the actual usage is the same method the Company utilized to determine usages for nine of the 19 individual customer types.

**Revenue Normalization (Weather):** What is the appropriate weather-normalized revenue?

Staff did not file testimony on this issue and reserves the right to assert a final position based upon the testimony provided at hearing.

**Triumph Foods, LLC:** Should an adjustment to revenues be made associated with the Special Service Contract rate paid by Triumph Foods, LLC, in St. Joseph pursuant to the Economic Development Rider tariff?

No adjustment to revenues should be made because of the special contract. The Commission order in WT-2004-0156 approving the contract found the contract was in the public interest. There is no evidence to indicate a change in circumstances since that time. Per OPC's request under the tariff language, the Commission may open an inquiry to make a determination in the next rate case about whether revenue should be imputed or the special contract should be canceled. The Economic Development Rider, under which the special contract with Triumph was permitted, allows any party to request a Commission review of the appropriateness of the special rate in Triumph's contract. The purpose of the review would be to determine whether the alternative rate in the contract is still in the best interests of all the customers in the St. Joseph district.

**AWR Compensation to MAWC:** Does MAWC provide services to American Water Resources? If so, what amount of revenues for services provided to American Water Resources by MAWC should be used to determine MAWC's revenue requirement?

Yes. The services that MAWC has provided to AWR have allowed it to profit from those MAWC customers who have signed up with AWR for a water-line, sewer-line and in-home plumbing protection plan offering. Staff's compensation proposal results in a more equitable sharing of resulting profits between MAWC, its ratepayers and AWR. The Staff contends that these MAWC marketing activities have created a significant amount of credibility for the services offered by AWR. This establishment of credibility and trust lends tremendous value to AWR's offerings for which MAWC should be fairly compensated. The Staff adjustment to

increase MAWC's revenues by \$67,826 annually is attempting to recover a portion of the profits that AWR will generate annually from offering the water line, sewer line and in-home plumbing protection programs in Missouri.

## **Expense Issues**

**Pension/OPEB Methodology:** 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 proposed to maintain the approach agreed to in the prior case is as follows:

1) Use of the FAS 87 approach to develop pension expense and the FAS 106 approach to determine OPEBs expense; 2) Amortization of pension and OPEB trust fund gains and losses using a ten-year period and elimination of the "corridor approach; and 3) Use of trackers to quantify the differences between the pension and OPEBs expense amounts included in the Company's rates and their actual incurred expense levels, with the difference being amortized to cost of service over a five-year period in subsequent rate proceedings.

**Amortization of Pension/OPEB Assets:** 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?

The Staff has researched and reviewed these two proposed OPEB deferrals. The first deferral mentioned by MAWC witness, Mr. Grubb, was a result of a prior Missouri-American rate case, No. WR-95-205. In that proceeding, the Commission ordered a 20-year amortization of an OPEB deferral relating to the St. Joseph and Joplin districts. Consistent with that Order, the Staff has recognized and included \$31,901 into the Company's OPEB expense level in this case. However, the Staff could not find any similar evidence of Commission ordered rate treatment for the second OPEB deferral in the amount of \$844,643 mentioned by Mr. Grubb, which he states is associated with the St. Louis County District. The only discussion of this deferral that the Staff found was in Case No. WR-94-166 (St. Louis County Water Company) by

Company witness J. Jenkins in his Direct Testimony, pages 44-45. The Staff can find no evidence that his proposal to include this amortization in cost of service was adopted in either the Stipulation and Agreement or the Commission Order for that case. If the Company could provide evidence showing this adoption by the Commission in that or subsequent rate cases, the Staff would consider including this amortization in its OPEB expense calculation.

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

The Staff proposes that matching risk exposure to premiums paid based on the level of activities, which can be measured by dollar, is the most appropriate method of assigning costs for these activities. The Staff's analysis of MAWC's employee activities in this case indicated that 42.54% of their time is associated with capital functions, as opposed to operating functions. Therefore, this matching is best accomplished by applying the overall Staff annualized O&M factor to the general liability insurance premiums when determining an appropriate level of expense.

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

The Staff recommends maintaining the level of expense (\$1 million) which was agreed to in the Nonunanimous Stipulation Agreement in the last rate case, Case No. WR-2007-0216. In that case a tank painting tracker was established in the Nonunanimous Stipulation and Agreement. The tracker was to be maintained through the effective date of rates in the next regulatory proceeding (which is this case), with the continuation of the tracker to be addressed and evaluated in that subsequent period. Staff is of the opinion that since the tank painting tracker was only in effect for two months of the test year revising the annual level (\$1,000,000) would be inappropriate at this time.

**Annual Incentive Program (AIP):** What is the appropriate amount of costs associated with MAWC's incentive compensation plan that MAWC should recover from its customers?

The Staff is proposing an adjustment in the amount of \$207,669 to eliminate the amount associated with the financial component of the 2007 AIP payout. The Staff proposes that if the Company chooses to reward employees an AIP payout based upon financial goals then stockholders, not ratepayers, should be responsible for the costs.

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

The Staff believes \$199,792 should be removed from MAWC's cost of service due to lobbying activities performed by MAWC employees. Staff reviewed job descriptions for MAWC and American Water employees. These job descriptions reveal that two MAWC employees and one American Water service company employee spend significant time on lobbying functions.

**Fuel & Power/Chemicals/Purchased Water Due to Unaccounted-for Water:** What is the appropriate level or percentage for Unaccounted for Water as it relates to fuel & power/chemicals/purchased water expenses?

The appropriate level is 15%. Any amount of water loss beyond 15% is excessive and customers should not have to pay for MAWC's lost water beyond that amount. In MAWC's districts the amount of lost water varies from 5.16% to 24.76%. It is neither just nor reasonable for customers to have to pay an additional 20 or 25% for additional fuel, power, chemicals or purchased water when that amount of water is lost and unaccounted for. The Staff increased its normalized and annualized water sales by the lower of the actual loss or 15%.

**Belleville Lab:** 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 Laboratory costs proposed by the Staff in this case are based upon a 5-year average of actual test analysis performed by the Laboratory. The Staff's test analysis allocation

methodology best represents the true nature of work that is performed at Belleville Lab for MAWC and for all of the other American Water operating companies. The Staff used an average of the test analysis performed on water samples by Belleville Lab over the last five calendar years ending December 31, 2007. The Staff's proposed methodology of allocating non-direct Belleville Lab costs using an average of actual test analysis for all of the operating companies taking service from Belleville Lab results in a more accurate assignment of cost to each operating company because it appropriately reflects the work that is performed at Belleville Lab.

**Fire Hydrant Painting:** What is the appropriate level of expense, if any, to be included in MAWC's cost of service related to fire hydrant painting? Should a tracker be established to track costs incurred for fire hydrant painting?

The Staff is opposed to including in the cost of service costs related to fire hydrant painting. The Company did not incur this expense during the test year or any time in the past. To include costs that have not been incurred during the test year would violate the matching principle. Also, the Staff cannot verify any actual costs incurred for this activity. The Company is requesting special ratemaking for this project. The Company has indicated that if special ratemaking is not considered the Company will not pursue this project.

The Staff does not believe a tracker should be established for the fire hydrant painting. Staff is opposed to a tracker that would track the costs of fire hydrant painting. Based upon the Company's description of its fire hydrant painting initiative, fire hydrant painting is planned as an on-going maintenance cost that will take place over a number of years. This type of maintenance activity does not require special ratemaking treatment that would allow the Company a guaranteed dollar for dollar recovery of the expense.

**Dues, Donations and Contributions:** What dues, donations or contributions should be included in MAWC's cost of service?



Test year expense associated with \$188,728 of dues, donations, and membership expenses, which provide no benefit to ratepayers and are not necessary for the provision of utility service should be eliminated.

**Advertising:** What is the appropriate level of expense to be included in MAWC's cost of service?

The test year cost of service should be reduced by \$49,464 to reflect the disallowance of a portion of MAWC's advertising expenses.

**Rate Case Expense:** Should rate case expense be normalized or amortized and should prior rate case expense be recovered in this rate case? What is the appropriate level of rate case expense to be included in MAWC's cost of service?

The Staff is proposing to normalize current rate case expense over a three-year period. The total amount of rate case expense incurred by MAWC through March 31, 2008 associated with the consolidated Case No. WR-2008-0311 is being allowed at this time. Any additional costs that are reasonably incurred rate case expense will be considered for inclusion later during the true-up period. The Staff opposes the inclusion of any prior rate case expense be included for recovery based upon any type of amortization.

**Property Tax:** What is the appropriate level of property tax to be included in MAWC's cost of service?

The appropriate amount of expense to be included in MAWC's cost of service for property taxes is the estimated amount due in December 2008 for plant in service as of January 1, 2008.

**Waste Disposal:** What is the appropriate level of waste disposal expense to be included in MAWC's cost of service?

Waste removal is an expense that is likely to vary from year to year. Traditionally, the Staff has used a multi-year average to smooth out (normalize) these variances as it has done with the other districts in this case. The Company did not provide the correct level of waste disposal

to the Staff in Data Request No. 129, but has since provided corrected amounts. The Staff is proposing a disallowance of \$13,980 to the newly reported waste disposal expense amount for this case.

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

In the last several MAWC rate cases, the Staff has proposed that the corporate costs should be based upon different allocation factors depending upon the causes that required the costs to be incurred. For example, the Staff proposes that allocated costs, between the districts, for payroll and payroll related benefits should be based upon a labor allocation factor. Most, if not all, of the Corporate Administration and General Expenses are labor related expenses.

**Management Fee – SOX Compliance:** What is the appropriate level to be included in MAWC's cost of service for SOX compliance costs allocated to MAWC from the Service Company through management fees?

The Staff and the Company eliminated the Sarbanes-Oxley Act (SOX) non-recurring costs from MAWC's expenses for the 2007 test year. However, the Company included an adjustment of \$93,282 to account for the difference between a budgeted one time cost to Business Unit 032037 of \$145,000 for calendar year 2008 and actual 2007 test year amount of \$51,718. The Staff did not include this adjustment in its cost of service.

**Management Fee – Labor Costs:** What is the appropriate level to be included in MAWC's cost of service for labor costs allocated to MAWC from the Service Company through management fees?

The Staff included in its cost of service a wage increase for American Water Service Company (AWSC) employees of 3% for March 2008. However, the Company included a 3.75% wage increase for its AWSC employees. The Staff has requested additional information concerning the wage increase for the AWSC employees and will analyze this data when received.

**Joplin True-up Issue:** What items should be examined for the true-up audit? What is the appropriate true-up date? Instead of a true-up should a fully adjusted test year be utilized?

The following items should be examined in the true-up audit: Plant in service and other rate base items (such as depreciation reserve, deferred income taxes, customer advances, contributions, working capital and other deferred regulatory assets and liabilities), Revenues (customers, production costs and uncollectible expense), Fuel and Power Expenses, Chemical Expense, Purchased Water Expense, Rate Case Expense, Labor and Labor related expenses (Employee Levels and Wage Rates and related benefits), Uncollectible Expense, Depreciation Expense, Leases and Income Taxes. Staff proposes using a true-up audit ending date of September 30, 2008. Staff believes a true-up audit is warranted in this proceeding based upon the amount of plant the Company placed in service after the test year update period. A fully adjusted test year through June 30, 2008 should not be utilized because it would not consider this large amount of plant added through September 30, 2008, significantly impacting the Company's cost of service.

**Jefferson City Issue on Joint Task Force Case No. WO-2008-0167:** What rate impacts, if any, are being evaluated within the Task Force created by stipulation in Case No. WR-2007-0126?

Staff has no position on this issue. Staff notes that a Joint Task Force Report was submitted on October 20, 2008, in WO-2008-0167 addressing the status of those issues.

## **RATE DESIGN/COST OF SERVICE**

**Inter-District Support or Revenue Contribution:** Should or may any district provide a support so that another district may be provided service that is priced below that district's cost of service? If so, which district(s) should receive support and which district should be required to provide that support?

Yes. The St. Louis district should subsidize the Brunswick water district and Warren County sewer district. The cost of service in these districts is excessively high based on the

results of the Staff's CCOS study resulting in increases 138% for Brunswick and almost 400% for Warren County. The St. Louis district is the logical district to provide any subsidy because of its large size and the overall impact being minimal on customers.

Parkville should receive no support because the results of Staff's CCOS indicate the highest increase to any customer class of this district at slightly more than 50%. And an overall increase to the district of approximately 10%.

**St. Louis Metro District:** Should the St. Louis County, St. Charles, and/or Warren County water districts be combined?

No. The districts are separate with distinct district costs. This is especially true in the case of Warren County district that is not contiguous with either of the other two districts and only shares some of the personnel from the St. Charles district.

**Allocations:** What is the appropriate basis upon which to allocate costs to each customer class?

**(A) Should there be a small mains adjustment?**

No. The distinction between transmission mains and distribution mains is based on function and not on size. There is insufficient data to make the determination of main function and a small mains adjustment in this case would in essence be a random adjustment. A study should be completed to determine if a new class of customer needs to be created.

**(B) What is the appropriate basis upon which to allocate purchase power expense?**

Purchased power should be allocated to factor 1. Factor 1 is the allocation of costs that vary with the amount of water consumed. Purchased power varies with the amount of water consumed, more power is required in periods of high demand and less power is required in periods of low demand.

**Rates:**

**(A) Commodity Charge**

**i) Should the commodity charge be set as a declining block rate or should the commodity charge be uniform for all levels of usage?**

The commodity charge should be uniform for all levels of usage. Uniform block rates clearly inform customers of what they will pay for increased usage. As an alternative, Staff is willing to accept the Company's proposed two and three block for certain customer classes as a move toward Staff's position.

**ii) Should commodity rates be uniform across all classes in a district?**

No, commodity rates that are uniform across all classes in a district results in at least one customer class paying for a portion of costs that should be allocated to other customer classes. Commodity rates should be based on the costs allocated to each customer class within a district.

**(B) Customer Charge**

**i) What is the appropriate way to establish the customer charge?**

The customer charge should be based on district specific costs related to meters, services and billing and collection. This is consistent with the American Water Works Association Principles of Water Rates, Fees, and Charges (AWWA M1) description on page 114 of the manual.

**ii) Should the customer charge be uniform across the districts?**

No. A uniform customer charge will not properly allocate the meter, services and billing and collection costs associated with the customer charge portion of a customer's bill. The customer charge should be based on the costs allocated to each specific district and not a blend of all the districts costs.

**iii) Should the customer charge include some amount of usage?**

No, the customer charge should be solely based on the meter, services and billing and collection costs. The inclusion of usage would result in the either the customer charge being

different for different classes of customers in a district or different classes of customers in the district paying for other customer classes water cost in the district.

**Class Identification/Cost of Service:** What is the appropriate way in which to identify the customer classes?

Staff has no position on this issue. However, Staff does support participating in a working group to resolve this issue.

**Phase-in:**

**(A) Is a phase-in of rates appropriate or lawful?**

A phase-in may be appropriate because of the large rate increases for Brunswick and Warren. In lieu of a revenue contribution from the St. Louis district, Staff would not oppose a phase-in. Any phase-in of rates should be limited to the Brunswick water district and the Warren County sewer district.

**(B) Which, if any, districts should have their rate increase phased in?**

Brunswick water district and Warren County sewer district.

**(C) How should any carrying cost associated with a phase-in deferral be recovered and from whom?**

Carrying costs associated with a phase-in should be paid by the district. Staff agrees with OPC's methodology and calculation if a phase-in is ordered. The phase-in for Warren and Brunswick should be over three years, with 50% of the deficiency collected in the first year, and the balance and carrying costs to be collected in approximate equal amounts in years two and three.

**MSD Rate:** What is the appropriate rate to charge MSD for customer usage information?

The Staff supports the agreement filed by MAWC and MSD providing that MSD will pay MAWC \$350,000 per year.

**Allocation of Costs to Contract Sales Customers:** What, if any, adjustment should be made to the Class Cost of Service Studies associated with contract sales?

Any adjustments need to include the usage (volume of water) and revenues at imputed sale price.

**Revenue Imputation:** If a Triumph Foods revenue imputation is approved, how should the imputation be treated in offsetting costs to determine class revenue requirements?

Revenue should not be imputed as stated above. But if revenue is imputed, the offsets should be spread among all the classes.

**City of Riverside Services Issue:** Should the Parkville rate be reduced due to inadequate water service in the City of Riverside?

Staff has no position on this issue. Staff did not file testimony on this issue and reserves the right to assert a final position based upon the testimony provided at hearing.

**WHEREFORE,** Staff respectfully submits its Statement of Position on the issues of this case to the Commission.

Respectfully submitted,

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### **Certificate of Service**

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 23<sup>rd</sup> day of October 2008.

/s/ Shelley Syler Brueggemann