

Exhibit No.
Issues: Reasons for rate request,
Overall Rate of Return, Capital
Structure, Joplin Plant
Improvement Charge, Rate
Design
Witness: James M. Jenkins
Type of Exhibit: Direct
Sponsoring Party: Missouri-American Water Company
Case No. WR-2007-XXXX
SR-2007-XXX
Date: December 15, 2006

MISSOURI PUBLIC SERVICE COMMISSION

**CASE NO. WR-2007-XXXX
SR-2007-XXX**

DIRECT TESTIMONY

OF

JAMES M. JENKINS

ON BEHALF OF

MISSOURI-AMERICAN WATER COMPANY

MAWC
Exhibit No. 13
Case No(s) WR-2007-XXXX
Date 8-14-07 Rptr af

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

IN THE MATTER OF MISSOURI-AMERICAN)
WATER COMPANY FOR AUTHORITY TO)
FILE TARIFFS REFLECTING INCREASED)
RATES FOR WATER AND SEWER)
SERVICE)

CASE NO. WR-2007-XXXX
CASE NO. SR-2007-XXX

AFFIDAVIT OF JAMES M. JENKINS

James M. Jenkins, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Direct Testimony of James M. Jenkins"; that said testimony and schedules were prepared by him and/or under his direction and supervision; that if inquiries were made as to the facts in said testimony and schedules, he would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his knowledge.

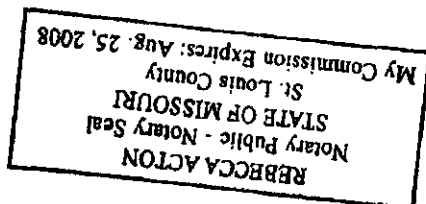

James M. Jenkins

State of Missouri
County of St. Louis
SUBSCRIBED and sworn to
Before me this 13 day of December 2006.



Notary Public

My commission expires: 8/28/08



**DIRECT TESTIMONY
JAMES M. JENKINS
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WR.2007.XXXX
SR.2007.XXX**

TABLE OF CONTENTS

I.	Witness Introduction	1
II.	Purposes of Testimony	3
III.	Relief Requested and Summary of Witness	3
IV.	Reason for Rate Request	5
V.	Overall Rate of Return and Capital Structure	8
VI.	Joplin Plant Improvement Charge	11
VII.	Rate Design	19

**DIRECT TESTIMONY
OF
JAMES M. JENKINS
MISSOURI-AMERICAN WATER COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION**

WITNESS INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. James M. Jenkins, 727 Craig Road, Creve Coeur, Missouri 63141.

**Q. WHAT POSITION DO YOU HOLD IN REGARD TO MISSOURI-AMERICAN
WATER COMPANY?**

A. I hold the position of Vice President and Chief Financial Officer for Missouri-American Water Company (MAWC or Company). I am also Vice President, Finance for American Water's Central Region. The subsidiaries within the Central Region include utilities in Indiana, Illinois, Iowa, Missouri, and Ohio. My primary focus is to direct the Company's finance, accounting, budgeting and rate administration functions within the Central Region.

**Q. PLEASE DESCRIBE YOUR QUALIFICATIONS AND EXPERIENCE IN THE
FIELDS OF GENERAL ACCOUNTING, UTILITY ACCOUNTING AND RATE
REGULATION.**

A. I graduated from the University of Illinois, at Urbana/Champaign in 1983 with a Bachelor of Science Degree in Accounting and in 1992 received a M.B.A. Degree, with highest honors, from the University of Illinois, at Springfield. I have been a Certified Public Accountant since 1985, and currently hold a license to practice in the States of Illinois and Missouri.

JAMES M. JENKINS
DIRECT TESTIMONY

1 Between 1983 and 1984, I was employed by McGladrey and Pullen as a staff accountant
2 participating in financial audits and completing tax returns for firm clients.

3 Between 1984 and 1993, I was employed by the Illinois Commerce Commission and
4 worked on a wide range of regulatory issues in the electric, gas, telephone and water
5 industries. I joined the Illinois Commerce Commission's Accounting Department as a
6 staff accountant in November 1984. In April 1987, I was promoted to the position of
7 Auditing Section Chief responsible for directing the Auditing Staff's review of rate case
8 filings, fuel reconciliation clauses and miscellaneous regulatory accounting issues. In
9 November 1989, I was promoted to Director of Accounting responsible for all
10 administrative, policy and supervisory functions within the Accounting Department. I
11 held the position of Director of Accounting until joining St. Louis County Water
12 Company in June 1993.

13 I began my career with St. Louis County Water Company in June, 1993 as an Assistant
14 Manager in the Corporate Accounting Department. In December 1994, I was promoted
15 to Manager of Rates within the Rates and Operations Analysis Department. At St. Louis
16 County Water Company, I was responsible for the numerous accounting and financial
17 areas contained within Company rate case filings performing both technical and
18 supervisory functions.

19 I was elected to Vice President and Treasurer for both Missouri-American Water
20 Company and St. Louis County Water Company in June 1999. I was elected Vice
21 President and Treasurer for Jefferson City Water Works Company, Inc. in May 2000. All

JAMES M. JENKINS
DIRECT TESTIMONY

1 of these Companies were subsequently merged, with Missouri-American Water Company
2 becoming the surviving Company. In these positions, I was responsible for directing the
3 finance, treasury, business development and rate administration functions of all three
4 companies. In 2004, after RWE acquired American Water, I was elected to my current
5 position.

6 I am a member of the American Institute of Certified Public Accounts and past member
7 of the NARUC Staff Subcommittee on Accounts. I have also served as the Vice
8 Chairperson of the Rates and Revenue Committee of the National Association of Water
9 Companies.

10 **PURPOSE OF TESTIMONY**

11 **Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?**

12 A. I will provide an overview of the relief MAWC is requesting as well as identify the
13 witnesses who will testify. I will generally describe the reasons why MAWC is seeking rate
14 relief at this time. I will further discuss the Company's overall rate of return and expected
15 capital structure. I will also address an optional Joplin Plant Improvement Charge related to
16 the Joplin (Blendville) Water Treatment Plant Rehabilitation and Improvement Project (the
17 "Project"). Finally, I will discuss the Company's proposal as to rate design.

18 **RELIEF REQUESTED AND SUMMARY OF WITNESSES**

19 **Q. WHAT RELIEF IS MAWC SEEKING IN THIS CASE?**

20 A. MAWC is seeking a rate increase to produce additional annual water revenues of \$41.4
21 million, or an overall 24.8% increase, and additional annual sewer revenues of \$74,000, or

JAMES M. JENKINS
DIRECT TESTIMONY

1 an overall 25.7% increase. In addition, MAWC is seeking the approval of certain tariff
2 changes.

3 **Q. WHAT WITNESSES WILL BE FILING DIRECT TESTIMONY IN SUPPORT OF**
4 **MAWC'S PROPOSED TARIFF SHEETS AND WHAT SUBJECTS WILL THEY BE**
5 **ADDRESSING?**

6 A. 1) James M. Jenkins, Vice President and Chief Financial Officer, will testify regarding the
7 need for the rate increase, overall rate of return, proposed capital structure, Joplin Plant
8 Improvement Charge and rate design.

9 2) Edward J. Grubb, Manager of Rates and Regulation, will testify concerning revenues,
10 pensions, OPEBs, Support Services (Management Fees), other selected pro forma expense
11 adjustments, income taxes, Consolidated Bill Tariff, ISRS Information, Customer Class
12 Definitions, Depreciation Rates and the Minimum Filing Requirements.

13 3) Alan J. DeBoy, Director of Engineering, will testify concerning capital additions since
14 the last rate case and the cost of the Joplin Production Improvements.

15 4) Donald Petry, Senior Financial Analyst, will testify concerning rate base, labor and other
16 selected pro forma expense adjustments.

17 5) Pete Thakadiyil, Financial Analyst, will testify to selected proforma expense adjustments.

18 6) Greg Weeks, General Manager, will testify concerning operating facilities throughout the
19 state.

20 7) Pauline Ahern, Consultant with AUS, will testify concerning cost of equity.

21 8) John Spanos, Consultant with Gannett Fleming, will testify concerning the proposed
22 depreciation rates.

1 9) Professor Edward Spitznagel, Consultant, will testify on weather normalization and the
2 continued decrease in customer utilization for the St. Louis County, St. Joseph, St. Charles
3 and Joplin Districts.

4 **REASONS FOR RATE REQUEST**

5 **Q. WHEN WERE MAWC'S BASE RATES LAST ADDRESSED IN A GENERAL**
6 **RATE CASE?**

7 A. The Commission addressed the Company's base rates by its Order issued in Case No. WR-
8 2003-0500 on April 6, 2004, over two and a half years ago. The Commission Order
9 approved a decrease of \$350,000 for MAWC's Joplin district and all other districts' total
10 revenues remained unchanged.

11 **Q. WHEN DID THIS COMMISSION LAST AUTHORIZE AN INCREASE IN BASE**
12 **RATES FOR THE COMPANY?**

13 A. Prior to the merger, the Company consisted of three separate legal entities doing business as
14 MAWC. These entities consisted of MAWC, which included Brunswick, Joplin, Mexico,
15 Parkville Water and Sewer (Platte County), St. Charles, St. Joseph, and Warrensburg
16 Districts; St. Louis County Water Company; and Jefferson City Water Works Company.
17 MAWC's last rate increase was effective September 20, 2000. St. Louis County's last rate
18 increase was effective May 18, 2001. Jefferson City's last rate increase was effective
19 December 1, 2000. All three entities were formally merged on December 31, 2001. The
20 merger was approved by the Commission in Case No. WM-2001-309.

21 **Q. SINCE BASE RATES WERE ADDRESSED IN CASE NO. WR-2003-0500, HAVE**
22 **THERE BEEN ADJUSTMENTS TO MAWC'S RATES?**

JAMES M. JENKINS
DIRECT TESTIMONY

1 A. Yes. An infrastructure system replacement surcharge (ISRS) was authorized by the
2 Missouri General Assembly in 2003 for the Company's St. Louis District only. Since the
3 last base rate case (WR-2003-0500) or April 6, 2004, MAWC pursuant to Commission
4 approval has adjusted the ISRS charge two times such that the Company's rates in the St.
5 Louis District today for residential customers, in total, are 6.21% or \$1.27 per month higher
6 than their current base rates at present rates.

7 **Q. WOULD YOU COMMENT ON THE IMPACT THIS RECENT RATE HISTORY**
8 **HAS HAD ON THE COMPANY'S RETURNS?**

9 A. Yes. First, by statute, the ISRS is tied directly to actual increased costs associated with
10 specific eligible infrastructure replacements that produce no revenues. Therefore, the ISRS
11 addresses costs associated with eligible infrastructure replacements. It does not address all
12 investments made by Company since its last rate case, and it does not eliminate or address
13 existing deficiencies in MAWC's returns.

14 **Q. PLEASE DESCRIBE THE RATE INCREASE REQUESTED BY MAWC IN THIS**
15 **PROCEEDING.**

16 A. MAWC seeks a rate increase that would produce additional annual water revenues of
17 approximately \$41.4 million, or approximately 24.8%. The Company also seeks an
18 increase in sewer rates to produce additional annual revenues of approximately \$74,000 or a
19 25.7% increase.

20 **Q. WHY DOES THE COMPANY SEEK A RATE INCREASE?**

21 A. In 2006, the Company's expects to earn approximately 8% on book equity. This equity
22 return is 330 basis points below the current cost of common equity recommended by Ms.
23 Ahern in this case. We have filed this case to reverse this deficiency and to start earning

JAMES M. JENKINS
DIRECT TESTIMONY

1 better and appropriate returns. The Company's ability to provide water service is dependent
2 on a consistent level of adequate earnings. Adequate earnings are those which justify the
3 investment of capital in the Company. Revenues must be sufficient to cover operating
4 expenses, such as employee payroll and benefits, taxes, depreciation, and costs associated
5 with maintenance and operation, and, thereafter, provide for the payment of capital costs
6 which include interest and dividends. Revenues generated by the current rates the Company
7 is authorized to charge for water and sewer service will not adequately accomplish this task.
8 On a pro forma present rates basis, the Company's earned return on its rate base investment
9 is only 4.44% versus the proposed level of 8.52%. Therefore, a water rate increase of
10 approximately \$41.4 million and a sewer rate increase of approximately \$74,000 is being
11 requested.

12 **Q. WHAT ARE THE REASONS FOR THE COMPANY FILING A REQUEST FOR AN**
13 **INCREASE IN RATES?**

14 **A.** The water rate increase is primarily due to the following factors:

- 15 • **Infrastructure investments** - Across the state, the company has invested almost \$200 million in
16 our communities -- including replacing and installing water lines, meters, hydrants and
17 improvements at water treatment, pumping and storage facilities, all of which enhance customer
18 service and support local economic development.
- 19 • **Property taxes and Depreciation** - Increases in utility plant contribute to the rate increase
20 because such investments drive higher property tax and depreciation charges.
- 21 • **Increases in operations costs** - MAWC has experienced significant increased costs for
22 chemicals, fuel, labor and liability insurance over the past two years. The cost of chemicals
23 alone has increased by approximately 80% in the last three years.
- 24 • **Rate of Return** - Like all water utilities, MAWC must continually invest in the water plants,
25 towers and pipelines that serve our communities. In order to attract the capital needed to fund
26 these improvements, the Company must earn a fair rate of return. This rate increase will allow
27 MAWC to earn a fair rate of return which will allow us to continue with infrastructure
28 investment needs across the state.
29

RATE OF RETURN AND CAPITAL STRUCTURE

Q. WHAT CAPITAL STRUCTURE IS THE COMPANY PROPOSING TO UTILIZE TO DETERMINE THE COST OF CAPITAL FOR RATEMAKING PURPOSES?

A. The Company is proposing a capital structure which reflects the expected sources of capital during the first year rates will be in effect. The recommended capital structure consists of 46.91% of common equity, 0.42% of preferred stock and 52.67% of long-term debt. The Company requests an 8.52% overall rate of return which is calculated by adding the component costs of the capital structure, weighted by their respective proportions to total capitalization. The Company's capital structure is set forth on Schedule JMJ-1.

Q. HOW DID YOU ARRIVE AT THIS STRUCTURE?

A. The beginning point was the actual capital structure that existed at June 30, 2006. The capital structure was then adjusted to reflect changes expected to occur by the end of the true-up period.

Q. WHAT ADJUSTMENTS DID THE COMPANY MAKE TO ARRIVE AT 6.04% AS THE EMBEDDED COST OF LONG-TERM DEBT?

A. The Company began with its long-term debt capital in place as of June 30, 2006 and made adjustments to 1) retire five tax-exempt debt issues early and replace them with one lower coupon tax-exempt debt issue and 2) replace short-term bank debt with long-term debt in the normal course of business. These adjustments are reflective of the expected debt to be in place during the first year of new rates. As a result of these expected adjustments and other actual changes, and depending upon changing interest rates, the Company's embedded costs of debt will be 6.04%

1 **Q. PLEASE EXPLAIN THE ADJUSTMENTS TO RETIRE FIVE TAX-EXEMPT**
2 **DEBT ISSUES.**

3 **A. As approved in WF-2006-0331, the Company expects to retire five tax-exempt debt**
4 **issues which have coupon rates ranging from 5.50% to 5.85%. Depending on market**
5 **interest rates, the Company expects to retire these tax-exempt debt issues in December**
6 **2006 in order to lower the Company's overall embedded cost of debt. Assuming the**
7 **Company replaced this debt at 4.85%, the ratepayers would save approximately \$380,105**
8 **in interest expense on an annual basis. The \$380,105 in annual savings would extend**
9 **through January 1, 2023, or the natural maturity date of the 5.50% bond with a current**
10 **principal amount of \$4,835,000. From that time until November 1, 2026, the ratepayers**
11 **would continue to receive savings in decreasing amounts until the natural maturity dates**
12 **of the five tax-exempt issues to be retired. The Company's calculation of the annual**
13 **savings is set forth on Schedule JMJ-2.**

14 **Q. HOW DOES THE COMPANY PROPOSE TO TREAT THE UNAMORTIZED**
15 **DEBT ISSUANCE COSTS RELATED TO THE FIVE TAX-EXEMPT DEBT**
16 **ISSUES THAT ARE BEING RETIRED EARLY?**

17 **A. The Company proposes to continue recovering these costs in the capital structure using**
18 **the existing amortization schedules for each of the five tax-exempt debt issues. Such**
19 **costs are in the public interest and the Company is entitled to full recovery.**

20 **Q. PLEASE EXPLAIN THE FIRST LONG-TERM DEBT INSTRUMENT THE**
21 **COMPANY INTENDS TO ISSUE.**

22 **A. As approved in Commission Case No. WF-2006-0331, the Company intends to issue up**
23 **to \$57,480,000 of long-term debt in December 2006. The purpose of this debt issue is to**

1 fund the retirement of the five tax-exempt debt issues previously discussed in this
2 testimony. This debt instrument will be a tax-exempt instrument issued through the State
3 of Missouri (EIERA). The Company has included the proposed debt issue within the
4 embedded cost of debt calculation at an annual coupon rate of 4.85%. In addition, the
5 Company proposes to recover the expected \$1,519,905 of debt issuance costs over the
6 thirty-year life of this new issuance consistent with prior practice of the MOPSC. The
7 debt rate and issuance costs can easily be adjusted to actual amounts before the operation
8 of law date in this proceeding.

9 **Q. PLEASE EXPLAIN THE SECOND LONG-TERM DEBT INSTRUMENT THE**
10 **COMPANY INTENDS TO ISSUE.**

11 **A.** The Company intends to issue up to \$47,000,000 of long-term debt by March 2007. The
12 purpose of this debt issue is to help finance used and useful utility property that will be
13 devoted to public service. The Company has included the proposed debt issue within the
14 embedded cost of debt calculation at an annual coupon rate of 6.149%. In addition, the
15 Company proposes to recover the expected \$340,750 of debt issuance costs over the
16 expected life of this new issuance consistent with prior practice of the MOPSC. The debt
17 rate, life and issuance costs can easily be adjusted to actual amounts before the operation
18 of law date in this proceeding.

19 **Q. WHAT ADJUSTMENTS DID THE COMPANY MAKE TO ARRIVE AT 9.16%**
20 **AS THE EMBEDDED COST OF PREFERRED STOCK?**

21 **A.** The Company began with its preferred stock in place as of June 30, 2006 and made
22 adjustments to remove all of the mandatory redemptions through the true-up period.

1 Q. PLEASE EXPLAIN THE COMMON EQUITY INFUSION THE COMPANY IS
2 PROPOSING.

3 A. The Company intends to receive an equity infusion of \$68,000,000 before the true-up
4 period in this case. The Company will sell shares of stock to its parent, American Water
5 Works Company, in exchange for the equity infusion. American Water Works Company
6 currently owns 100% of the outstanding common stock of the Company. The funds from
7 this equity infusion will be used to help finance used and useful utility property that will
8 be devoted to public service and to pay down short-term debt. This equity infusion is
9 necessary to maintain a reasonable level of equity in the Company.

10 Q. PLEASE EXPLAIN ANY OTHER ADJUSTMENTS THE COMPANY MADE TO
11 THE COMMON EQUITY BALANCE.

12 A. The Company began with its common equity balance in place as of June 30, 2006 and
13 made adjustments to reflect the expected retained earnings balance at the end of the true-
14 up period. This adjustment is necessary in order to ensure the common equity balance is
15 consistent with going-level operations.

16 Q. WHAT IS THE BASIS OF THE 11.30% RATE ASSIGNED TO MAWC'S
17 COMMON EQUITY COMPONENT?

18 A. The common equity cost component has been developed based upon a recommendation
19 by Ms. Pauline Ahern of AUS Consultants – Utility Services, MAWC's consultant in this
20 area, who has concluded that MAWC should be afforded an opportunity to earn a return
21 on common equity between 11.025% and 11.575, with a midpoint of 11.30%.

22 JOPLIN PLANT IMPROVEMENT CHARGE

1 Q. PLEASE SUMMARIZE THE JOPLIN PLANT IMPROVEMENT CHARGE
2 OPTION PROPOSED IN THIS PROCEEDING.

3 A. The Company has initiated the planning and construction of a three-year, \$44 million Water
4 Treatment Plant Rehabilitation and Improvement Projects located in the Joplin District. The
5 Company expects to place the raw water transmission piping, the intakes and a pump station
6 into service by April 2007 at a cost of approximately \$10 million. The remaining \$34
7 million attributable to the Joplin Project is expected to be completed and in-service by
8 December 2008. Under traditional rate of return rate ratemaking, once the Project is in
9 service and included in rate base, Joplin District customers would experience a significant
10 rate increase as the construction costs plus accrued financing costs (AFUDC, or Allowance
11 for Funds Used During Construction) begin to be recovered. In order to mitigate the
12 possible rate shock, the Company is presenting the Commission with an option for Joplin
13 customers to pay for improvements to the Joplin Plant over time instead of all at once upon
14 completion of this project in December 2008. The Joplin Plant Improvement Charge option
15 will allow the Company to earn a current return on a portion of the construction work in
16 progress ("CWIP") related to the Project in lieu of accruing AFUDC on the entire project
17 cost. The Joplin Plant Improvement Charge would be filed quarterly with the Commission
18 to reflect updated CWIP on the Project. This Plant Improvement Charge would continue
19 until the Project is included in rate base and reflected in the Company's base rates. In
20 addition to mitigating customer rate shock, the Joplin Plant Improvement Charge would also
21 be a less costly alternative than traditional ratemaking with AFUDC treatment, because
22 there would be no need to include 100% of the AFUDC in rate base.

1 **Q. DOES THE OPTIONAL JOPLIN PLANT IMPROVEMENT CHARGE EXHIBIT**
2 **SIMILARITIES WITH OTHER COMMISSION-APPROVED COST RECOVERY**
3 **MECHANISMS?**

4 A. Yes. This charge would be calculated in a manner that is similar to the Infrastructure
5 System Replacement Surcharge ("ISRS") in its components and application, except there
6 would be no depreciation expense or property tax components in the Plant Improvement
7 Charge. This charge would apply only to the Joplin district. The mechanics and schedules
8 of the Joplin Plant Improvement Charge will be described later in my testimony.

9 **Q. PLEASE DESCRIBE THE ANTICIPATED TIMING OF THE JOPLIN PLANT**
10 **IMPROVEMENT CHARGE.**

11 A. The initial charge would go into effect on January 1, 2008, based on the applicable CWIP
12 balance for the Project at December 31, 2007. At the beginning of each quarter through
13 2008, the improvement charge would be increased based on the applicable CWIP balance at
14 the end of the preceding three months. Once construction is completed, and the capital
15 investment for the project is reflected in base rates, the Joplin Plant Improvement Charge
16 would cease.

17 **Q. PLEASE DESCRIBE THE JOPLIN PROJECT.**

18 A. As more fully described by Company witness Alan DeBoy in his direct testimony, the
19 Company has initiated the planning and construction of the Water Treatment Plant
20 Rehabilitation and Improvement Project, located in the Joplin District. The construction
21 timetable calls for completion of the three-year Project by the end of 2008. Total projected
22 cost of the Project is estimated to be \$44 million, including AFUDC. The Joplin
23 (Blendville) Water Treatment Plant last received significant improvements in 1959. The

1 property and some of the structures date back to a much earlier period, in fact, before 1900.
2 The reliability, age and condition of the production infrastructure raise concerns. The
3 planned improvements will address the reliability concerns and meet all applicable
4 environmental requirements. Plant improvements planned include design and construction
5 of an Ultra Violet (UV) Disinfection system to meet current environmental regulations.
6 Existing clarification and filtration facilities will be updated with new controls and
7 instrumentation. The Chemical Building and chemical mixing system will also be updated
8 as part of this project. Additional clarification and filtration facilities will also be
9 constructed to increase water treatment capacity to 21 million gallons per day (MGD) from
10 the current plant capacity of 16 MGD. A one million gallon ground storage tank will be
11 added to increase treated water storage capacity.

12 **Q. PLEASE DESCRIBE THE CUSTOMARY BASE RATE TREATMENT OF LARGE**
13 **CAPITAL PROJECTS SUCH AS THAT DESCRIBED HERE.**

14 A. The Uniform System of Accounts provides for the capitalization of financing costs on a
15 utility's investment in projects under construction in the form of AFUDC (Allowance for
16 Funds Used During Construction). When utility plant previously under construction is
17 placed in service, the accrual of AFUDC on the utility plant ceases and depreciation
18 expense commences. The AFUDC accumulated during the construction period is included
19 in the original cost of utility plant for rate base and depreciation purposes. Upon placing the
20 utility plant in rate base and subsequent approval by the PSC, customers begin paying in
21 rates for the return on and the return of the cost of the plant (including accrued AFUDC).
22 Customers pay for the plant costs, including the accrued AFUDC, over the life of the plant.

1 Since the Company advances the funds during the lengthy construction period, it is allowed
2 to recover the carrying cost of these funds over the entire service life of the plant.

3 **Q. PLEASE EXPLAIN THE EFFECTS ON THE CUSTOMER OF BASE RATE**
4 **TREATMENT OF THE PROJECT COSTS UTILIZING AFUDC.**

5 A. Under traditional utility ratemaking procedures, the customers experience no impact on
6 their water bills in the years during which a project such as this one is being constructed,
7 because the Company does not earn a return on plant that is not "in service." In return for
8 advancing the funds during the construction period, financing costs are allowed to accrue
9 until the plant is placed in service. For the Joplin Project, it is estimated that AFUDC
10 would add approximately \$3.1 million, or 9% to the plant improvements scheduled to be
11 placed into service by December 2008.

12 **Q. ONCE THE PROJECT IS PLACED IN SERVICE, WHAT IS THE ESTIMATED**
13 **INCREASE TO THE JOPLIN DISTRICT CUSTOMERS UNDER THE**
14 **TRADITIONAL RATE BASE AFUDC APPROACH?**

15 A. The Joplin District customers would experience an estimated increase of 64.5% solely
16 attributable to the inclusion of the Project (and its accrued AFUDC) in rate base. At present
17 rates this project alone would require the average residential customer to pay an additional
18 \$10.51 per month solely for this project.

19 **Q. WILL THIS INCREASE RESULT IN RATE SHOCK TO THE JOPLIN DISTRICT**
20 **CUSTOMERS?**

21 A. It could. Also, it is important to recognize the 64.5% increase is solely for the Joplin project
22 and this district like all other MAWC districts will encounter additional increases
23 attributable to continued infrastructure investments and inflationary increases that will be

1 captured in future rate filings. The Company is proposing its Joplin Plant Improvement
2 Charge option to allow Joplin customers to pay for these improvements over time instead of
3 all at once upon the expected completion of this project in December 2008.

4 **Q. PLEASE DESCRIBE THE CONCEPT OF INCLUDING CWIP IN RATE BASE**
5 **RELATED TO THE JOPLIN PLANT IMPROVEMENT CHARGE.**

6 A. Including CWIP in rate base is an alternative to capitalizing AFUDC. Both approaches are
7 simply alternatives to the payment and recovery of the Company's financing costs. In
8 essence, the Improvement Charge enables the utility to be compensated for the use of its
9 funds on a current basis by allowing the utility to earn a return on the invested funds
10 through inclusion in the utility's rate base.

11 **Q. DOES THE USE OF EARNING A RETURN ON CWIP RATHER THAN**
12 **ACCRUING AFUDC MITIGATE A ONE-TIME RATE SPIKE TO CUSTOMERS?**

13 A. The use of CWIP would certainly help mitigate the one-time rate spike to customers. The
14 Joplin Plant Improvement Charge will also send the right price signals to Joplin customers
15 and allow customers to adjust to rising prices over time as opposed to a one-time 64.5%
16 increase. With AFUDC, the financing costs continue to accrue during the construction
17 period. Once in service, the entire cost of the project including the accrued AFUDC is
18 assessed to customers.

19 **Q. HAVE YOU ESTIMATED THE RATE IMPACT ON JOPLIN DISTRICT**
20 **CUSTOMERS OF THE PLANT IMPROVEMENT CHARGE OPTION?**

21 A. Yes. The initial January, 2008 charge to the average Joplin District residential customer is
22 estimated to be \$1.95 on a monthly basis, resulting in a 12% increase to those customers
23 (based on present rates). The April, 2008 Improvement Charge is estimated to be an

JAMES M. JENKINS
DIRECT TESTIMONY

1 additional \$1.95 per month, or 11 % increase; in July, 2008 an additional \$1.95 per month,
2 or 10% increase; and in October, 2008 an additional \$1.95 per month or a 9% increase. The
3 Company's calculations are set forth on Schedule JMJ-3.

4 **Q. HAVE YOU ESTIMATED THE RATE IMPACT ON THE JOPLIN DISTRICT**
5 **CUSTOMERS ONCE THE PLANT IS PLACED INTO SERVICE?**

6 A. Yes. As discussed previously, under the traditional rate base approach, customers would
7 experience an estimated rate increase of 64.5% for the Joplin Project improvements
8 scheduled to be placed into service by December 2008. Moreover, the rate base associated
9 with this project would be \$34 million, which includes \$3.1 million of AFUDC. In contrast,
10 the cumulative effect of the series of smaller increases plus recognizing the final increase
11 for depreciation, property taxes, and the reduced AFUDC under the Improvement Charge
12 approach is 61.2%, less than the 64.5% increase under the traditional ratemaking approach.
13 Moreover, with the Improvement Charge, the rate base would be \$32.2 million,
14 approximately \$1.7 million less than the project cost with the total accrual of AFUDC. The
15 Company's calculations are set forth on Schedule JMJ-4.

16 **Q. WHICH APPROACH IS LESS COSTLY TO CUSTOMERS OVER THE LIFE OF**
17 **THE PROJECT?**

18 A. The Joplin Plant Improvement Charge option is less costly to customers over the life of the
19 Project. If the Improvement Charge is placed in effect as the Company proposes, the long
20 term water rates to Joplin customers will be lower than they would be otherwise. Since the
21 customers would begin financing this cost earlier than under normal ratemaking
22 circumstances, the amount of AFUDC recorded as utility plant will be reduced, and the final

1 impact is expected to be \$1.7 million less than the rate base number would otherwise be,
2 with attendant lower water rates.

3 **Q. PLEASE COMMENT ON THE FACT THAT THE CUSTOMERS WILL BEGIN**
4 **PAYING THE FINANCING COSTS ON THE PLANT BEFORE IT IS IN SERVICE.**

5 A. First, it is important to re-emphasize that both alternatives are simply dealing with the
6 recovery of financing costs on the plant. Under the Improvement Charge option, prior to
7 the in-service date, customers would be paying only the financing costs of the project, not
8 the principal cost of the project itself. A fundamental utility regulatory concept is that
9 customers should be charged only for those costs of facilities from which benefit is derived.
10 Implied in this idea is the principle that costs incurred by a utility in financing construction
11 must be charged to the ultimate beneficiaries, that is, the customers who actually will
12 benefit from the use of the facilities. In the past, it has been argued that the allowance of
13 CWIP in rate base violates this concept because the burden of payments is shifted partially
14 from future to present customers. This argument was most often presented in the context of
15 electric generating plants being constructed to serve future load growth, often ten years in
16 the future. However, that argument has less validity where the construction work is short-
17 term and is primarily designed to improve present service, as is the case here. There is
18 clearly a nexus between the present Joplin District customers and the Joplin Project, which
19 purpose is to refurbish and modernize the water treatment plant, increase its efficiency, and
20 update it to comply with environmental requirements. Bottom line, this "pay-as-you go"
21 strategy would result in a savings of \$1.7 million dollars to the Joplin ratepayers.

1 Q. DOES THE JOPLIN PLANT IMPROVEMENT CHARGE ALTERNATIVE
2 TRANSFER SOME OF THE RISK OF OWNERSHIP OF THE NOT YET
3 COMPLETED WATER TREATMENT PLANT TO CUSTOMERS?

4 A. No. The Company has the resources and capability to see a project such as this through to
5 completion. Moreover, given the fact that the construction is on an existing plant, the
6 chances of the customers paying for facilities that do not end up in service are minimal.

7 RATE DESIGN

8 Q. WHAT PERCENTAGE INCREASE IS MAWC PROPOSING?

9 A. MAWC is proposing that the increased revenue requirement be recovered through an across
10 the board increase of approximately 25% on water and sewer revenues.

11 Q. IS THIS INCREASE BASED ON A DISTRICT COST OF SERVICE STUDY?

12 A. No. The Company believes there are other factors that should be taken into account when
13 determining district and class revenue requirements and designing rates.

14 Q. WHAT FACTORS ARE THOSE?

15 A. Rate stability, affordability, and customer acceptability.

16 Q. HOW DOES THE COMPANY'S PROPOSAL ADDRESS THESE FACTORS?

17 A. MAWC's proposal for an across the board increase places an equal cost responsibility on
18 each customer – that is, every customer's bill will receive approximately the same
19 percentage increase over their existing bill at the same usage level. This proposal is
20 supported by the concept of gradualism which means that rates should increase on a gradual
21 basis and avoid drastic changes when possible. The Company believes the across the board

JAMES M. JENKINS
DIRECT TESTIMONY

1 increase is affordable and recovers the same level of revenue, but does not adversely affect
2 any specific group of customers.

3 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

4 **A. Yes, it does.**

**Missouri-American Water Company
Proforma Capital Structure
Case No. WR-2007-XXXX**

<u>Class of Capital</u>	<u>Amount</u>	<u>Percent to Total</u>	<u>Cost Rate</u>	<u>Weighted Cost of Capital</u>
Long-Term Debt	331,235,000	52.67%	6.04%	3.18%
Preferred Stock	2,644,000	0.42%	9.16%	0.04%
Common Equity	<u>295,030,381</u>	<u>46.91%</u>	<u>11.30%</u>	<u>5.30%</u>
Total Capitalization	<u><u>628,909,381</u></u>	<u><u>100.00%</u></u>		<u><u>8.52%</u></u>

[illegible]

**Missouri-American Water
Joplin Plant Improvement Charge**

	Rate Effective 01/01/08 As of Dec 07	Rate Effective 04/01/08 As of Mar 08	Rate Effective 07/01/08 As of Jun 08	Rate Effective 10/01/08 As of Sep 08
CWIP Balance (1)	\$ 7,909,504	\$ 7,909,504	\$ 7,909,504	\$ 7,909,504
Less Accum Depreciation	0	0	0	0
Less Deferred Income Tax	0	0	0	0
Net Rate Base	7,909,504	7,909,504	7,909,504	7,909,504
Overall return	8.52%	8.52%	8.52%	8.52%
Utility operating income	673,890	673,890	673,890	673,890
Tax Gross-up Factor	1.64179	1.64179	1.64179	1.64179
Rev Req on Investment	1,106,386	1,106,386	1,106,386	1,106,386
Interest Deduction	(251,522)	(251,522)	(251,522)	(251,522)
Income Tax Rate	38.38863%	38.38863%	38.38863%	38.38863%
Income Tax Reduction	(96,556)	(96,556)	(96,556)	(96,556)
Tax Gross-up Factor	1.64179	1.64179	1.64179	1.64179
Rev Req on Interest Ded	(158,525)	(158,525)	(158,525)	(158,525)
Depreciation Expense	0	0	0	0
Property Taxes	0	0	0	0
Operating Expenses	0	0	0	0
Annual Rev Requirement	\$947,861	\$947,861	\$947,861	\$947,861
Cumulative Rev Req	\$947,861	\$1,895,722	\$2,843,583	\$3,791,444
Percent Increase	11.97%	10.69%	9.66%	8.81%
Cumulative % Increase	11.97%	23.94%	35.91%	47.88%
Quarterly Increment				
Residential Incr / Month	\$1.95	\$1.95	\$1.95	\$1.95
Residential Incr / Day	\$0.07	\$0.07	\$0.07	\$0.07
Cumulative Increase				
Residential Incr / Month	\$1.95	\$3.90	\$5.85	\$7.80
Residential Incr / Day	\$0.07	\$0.14	\$0.21	\$0.28

(1) To the extent actual capital expenditures exceed the levelized CWIP included in the Plant Improvement Charge, AFUDC will continue to accrue on this difference.

**Missouri-American Water
Joplin Plant Improvement Charge**

	Rate Effective Full Increase W/ Charge As of Dec 08	Rate Effective Full Increase W/O Charge As of Dec 08	AFUDC Savings
Total Cost of Project	\$ 32,192,456	\$ 33,925,962	\$ 1,733,506
Less Accum Depreciation	433,365	456,767	
Less Deferred Income Tax	(86,508)	(91,166)	
Net Rate Base	31,845,599	33,560,362	
Overall return	8.52%	8.52%	
Utility operating income	2,713,245	2,859,343	
Tax Gross-up Factor	1.64179	1.64179	
Rev Req on Investment	4,454,579	4,694,441	
Interest Deduction	(1,012,690)	(1,067,220)	
Income Tax Rate	38.38863%	38.38863%	
Income Tax Reduction	(388,758)	(409,691)	
Tax Gross-up Factor	1.64179	1.64179	
Rev Req on Interest Ded	(638,259)	(672,627)	
Depreciation Expense	866,729	913,533	
Property Taxes	163,715	172,556	
Operating Expenses	1,030,444	1,086,089	
Annual Rev Requirement	\$4,846,764	\$5,107,903	
Percent Increase	61.21%	64.50%	
Residential Incr / Month	\$9.97	\$10.51	
Residential Incr / Day	\$0.33	\$0.35	