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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

STEPHEN M. RACKERS

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2007-0216

Jefferson City, Missouri
July 2007

SMR Exhibit No. 6
Case No(s) WR-2007-0216
Date 8-14-07 Rptr PF

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STEPHEN M. RACKERS**

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1 **SECURITY AAO**

2 Q. Please describe the Security AAO.

3 A. In Case No. WO-2002-273, the Missouri Public Service Commission
4 (Commission) approved the deferral of costs related to the improvement and enhancement of
5 security at MAWC's facilities. The Company was allowed to accumulate the deferral for two
6 years following the terror attacks of September 11, 2001, through September 11, 2003.

7 Q. Is the Staff proposing recovery of all the cost deferred by MAWC, as
8 sponsored by Company witness Petry?

9 A. No. The Staff opposes the inclusion in the deferral of the legal costs
10 associated with Case No. WO-2002-273 and any cost deferred after the September 11, 2003
11 cut-off ordered by the Commission.

12 Q. Please explain the Staff's opposition to the inclusion of the legal costs
13 associated with Case No. WO-2002-273.

14 A. Ordered Item 5 of the Commission's Report And Order in Case No.
15 WO-2002-273 states, "That Missouri-American Water Company is hereby granted authority
16 to defer and book to Account 186 expenditures relating to security improvements and
17 enhancements beginning September 11, 2001, and continuing through September 11, 2003."
18 Legal costs associated with processing Case No. WO-2002-273 are not expenditures for
19 security improvements or enhancements to MAWC's facilities and should not be included in
20 the deferral.

21 Q. To the best of your knowledge, have the costs of processing an AAO case
22 ever been included in an AAO deferral?

23 A. No. The costs included in the deferral are those costs specifically incurred to
24 address the purpose of the AAO. For instance, an application by St. Louis County Water for

1 an AAO to defer costs related to infrastructure replacement was the subject of
2 Case No. WO-98-223. The costs associated with processing that case were not included in
3 the deferred cost that the Company sought to recover.

4 Q. What treatment is the Staff proposing for any deferrals to the Security AAO
5 past the September 11, 2003 cut-off date?

6 A. In compliance with the Commission's Order in Case No. WO-2002-273, the
7 Staff proposes to disallow any deferrals after the September 11, 2003 cut-off date. The Staff
8 is currently waiting for additional information regarding these deferrals and may revise its
9 recommendation for disallowance, based on this information.

10 Q. Does the Staff agree with the Company's inclusion of the unamortized
11 balance of the Security AAO in rate base, as sponsored by Mr. Petry?

12 A. No. The Staff proposes to follow the treatment prescribed by this
13 Commission for other AAOs regarding the unamortized balance. This treatment was first
14 prescribed by the Commission in its Order in Case No. GR-98-140 involving Missouri Gas
15 Energy's service line replacement deferrals. In that case, the Commission deemed it proper
16 for the ratepayers and shareholders to share the effect of regulatory lag by allowing the
17 Company to earn a return of, but not a return on, the deferred balance. The Staff believes
18 this regulatory treatment, which has been accepted by the Commission for other AAOs,
19 should be adopted for the Security AAO.

20 **JOPLIN SURCHARGE**

21 Q. Please describe the Joplin Plant Improvement Surcharge?

22 A. The Company is proposing to increase rates, beginning January 1, 2008, for a
23 surcharge to recover a return on the balance of construction work in progress (CWIP)
24 associated with the Joplin water treatment plant improvement project, that is not expected to

1 be in service until December 31, 2008. In his direct testimony, Company Witness,
2 James M. Jenkins touts this mechanism as a way to reduce the cost and possibly eliminate
3 rate shock associated with this project.

4 Q. What is the Staff's response to the Company's proposal?

5 A. The Staff is opposed to this mechanism, because it would recognize plant in
6 rates that is not completed and currently being used to serve customers. In a prior St. Louis
7 County Water (currently owned by MAWC) rate case, Mr. Jenkins proposed to include
8 future plant beyond the true-up cut-off date and the operation of law date. The Commission
9 denied this request stating:

10 The Commission finds that County Water's proposed plant
11 adjustments to rate base are not known and measurable and distort the
12 matching of revenues, expenses and rate base. (WR-95-145)

13 Until the plant is completed it is not capable of providing service to ratepayers and
14 therefore, should not be included in rates. The final cost of the project will not be known and
15 measurable until construction is completed, which is currently estimated to be
16 December 31, 2008. In addition, Mr. Jenkins is only proposing to recognize a single cost
17 item in the determination of the surcharge. His mechanism makes no provision to balance
18 the effect of this single item against possible offsetting changes in the cost of service. His
19 proposal distorts the matching of revenues, expenses and rate base.

20 Q. Does the proposed Joplin Surcharge even provide the benefits described by
21 Mr. Jenkins?

22 A. No. The Staff does not believe the Company's proposal is less costly for
23 ratepayers or that it prevents rate shock.

24 Q. Do Mr. Jenkins' claims regarding a reduction in project costs accurately
25 reflect the cost borne by ratepayers?

1 A. No. The final cost of the project will be reduced as a result of capitalizing less
2 accumulated funds used during construction (AFUDC). However, this reduction in cost
3 associated with AFUDC is replaced by the up-front collection of revenues, through the
4 surcharge, for the return on plant which is not yet in service. Also, the surcharge will be
5 collected in advance of when the AFUDC would be recovered following completion of the
6 project. Mr. Jenkins statements regarding cost reductions do not consider the time value of
7 money associated with the advance collection through the surcharge as compared with the
8 recovery of AFUDC over the life of the completed Joplin treatment plant.

9 Q. Is the AFUDC rate lower than the rate of return that Mr. Jenkins uses to
10 calculate the Joplin Surcharge?

11 A. Yes. The AFUDC rate is lower than the rate of return proposed by
12 Mr. Jenkins. As recognized by the Commission in Case No. WR-2000-281, the AFUDC rate
13 considers short-term debt before any other form of financing for CWIP. The rate of
14 return used by Mr. Jenkins relies on a capital structure which includes no short-term debt.
15 His mechanism will charge a higher financing cost than would be incurred under traditional
16 rate-making.

17 Q. Will the completion of the Joplin water treatment plant project result in rate
18 shock for customers?

19 A. As Mr. Jenkins concedes on page 15 of his testimony, this is unknown. The
20 65% rate increase cited by Mr. Jenkins is in comparison to current rates. As a result of this
21 case, the Company is proposing approximately a 25% increase in rates for Joplin customers.
22 In addition, as Mr. Jenkins reveals, the Joplin water treatment plant improvement project is
23 only one component of cost increase that will likely be experienced by the customers in this
24 district. Also, customer growth will allow the cost increase to be spread over a larger base

1 and reduce the effect on an individual customer. All these items will reduce the percentage
2 increase resulting specifically from the Joplin treatment plant improvement project.

3 While the percentage of increase resulting from this project will be large, the increase
4 in actual monthly cost cited by Mr. Jenkins is approximately \$10.50 per month. The Staff
5 does not wish to indicate that this amount is insignificant; however it is likely to be more
6 manageable than other increases in costs being experienced by customers, such as heating
7 and cooling costs.

8 Q. Are there other reason's why the Staff believes Mr. Jenkins' mechanism will
9 not reduce rate shock?

10 A. Yes. Mr. Jenkins is proposing to increase rates four times, approximately
11 every three months, prior to the Joplin facility being completed. In December of 2008, Staff
12 would expect the Company to propose another rate increase to include the completed Joplin
13 plant and other cost changes in permanent rates. The Staff believes customers will find these
14 continuous rate increases no less shocking than a single larger increase after the project is
15 complete.

16 Q. Is there another alternative to reduce the size of the rate increase resulting
17 from including the completed Joplin project in rates?

18 A. Yes. At the time the project is complete and the cost is known and
19 measurable, a phase-in is a possible method of dealing with the rate increase.

20 Q. On page 13 of his testimony, Mr. Jenkins compares his proposed surcharge to
21 the Infrastructure System Replacement Surcharge (ISRS). Is this an appropriate comparison?

22 A. No. The ISRS only reflects recovery associated with plant that is completed
23 and providing service to customers. Mr. Jenkins' proposal seeks a return on future plant that
24 is still under construction. In addition, the ISRS allows for offsetting items in the

1 determination of the surcharge. The ISRS surcharge includes a reduction for accumulated
2 depreciation and deferred taxes. Mr. Jenkins' mechanism only considers the increase cost
3 associated with a return on future plant that is not in-service. Finally, the ISRS provides a
4 process where any over recovery can be measured and used to reduce future surcharges.
5 Mr. Jenkins' mechanism has no process to determine if the surcharge collections are more
6 than the amount that would have been recovered from ratepayers under a traditional approach
7 and no provision for returning these funds to ratepayers.

8 Q. Please summarize your testimony regarding the surcharge.

9 A. Based on the problems I have discussed above, The Staff opposes the
10 surcharge proposed by Mr. Jenkins to collect a return on future plant from Joplin customers.
11 Mr. Jenkins states on page 19, that the Company has the resources and capabilities to see a
12 project such as the Joplin water treatment plant improvement through to completion. The
13 Staff believes seeing a project through should also involve providing the financing while the
14 project is under construction, rather than asking ratepayers to provide an up-front payment to
15 fund CWIP.

16 Q. Does this conclude your rebuttal testimony?

17 A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

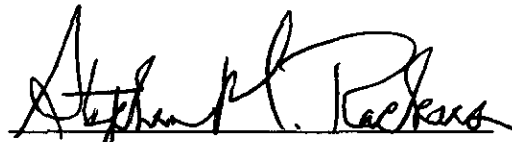
OF THE STATE OF MISSOURI

In the Matter of Missouri-American Water)
Company's request for Authority to) Case No. WR-2007-0216
Implement a General Rate Increase for)
Water Service provided in Missouri)
Service Areas)

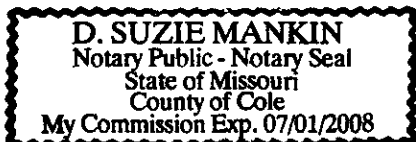
AFFIDAVIT OF STEPHEN M. RACKERS

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Stephen M. Rackers, being of lawful age, on his oath states: that he has participated in the preparation of the following Rebuttal Testimony in question and answer form, consisting of 7 pages to be presented in the above case; that the answers in the following Rebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.


Stephen M. Rackers

Subscribed and sworn to before me this 8th day of July, 2007.




Notary Public