

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

**In the Matter of Missouri-American)
Water Company's Application for a)
Certificate of Convenience and)
Necessity Authorizing It to Install,)
Own, Acquire, Construct, Operate,)
Control, Manage, and Maintain a)
Water System in Jefferson County,)
Missouri.)**

Case No. WA-2008-0125

STAFF RECOMMENDATION

COMES NOW the Staff of the Missouri Public Service Commission and, for its Staff Recommendation, states to the Missouri Public Service Commission as follows.

On October 24, 2007, Missouri-American Water Company filed an Application with the Commission, seeking an expansion of its service territory to authorize it to provide water and sewer service in a subdivision in Jefferson County known as Paradise Valley. On November 16, 2007, the Commission ordered the Staff to file its recommendation in this case by no later than December 3, 2007.

Attached hereto and incorporated herein as Attachment A is the Staff Memorandum in this case. The Staff recommends that the Commission grant Missouri-American's request for a certificate of convenience and necessity to provide water and sewer service to the proposed service area. The Staff also recommends that the Commission approve a connection charge of \$1,550 per new connection in Paradise Valley plus a surcharge of \$15 per month upon all customers in Paradise Valley, with said connection charge and surcharge to remain in effect until such time as Missouri-American recovers all of its new investment in Paradise Valley that is in

excess of \$400,000. The Staff makes other recommendations as set forth on pages 6 and 7 of the Staff Memorandum.

WHEREFORE, the Staff submits this Staff Recommendation for the Commission's consideration in this case.

Respectfully submitted,

/s/ Keith R. Krueger

Keith R. Krueger
Deputy General Counsel
Missouri Bar No. 23857

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed or hand-delivered, transmitted by facsimile or e-mailed to all counsel of record on this 4th day of December 2007.

/s/ Keith R. Krueger

ATTACHMENT A

STAFF MEMORANDUM

CASE NO. WA-2008-0125

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. WA-2008-0125
Missouri-American Water Company (Paradise Valley)

FROM: James Merciel – Water & Sewer Department
John Cassidy – Auditing Department
Steve Rackers – Auditing Department

<u>/s/ James A. Merciel, Jr.</u>	<u>12/3/07</u>
Project Coordinator	Date

<u>/s/ Keith R. Krueger</u>	<u>12/3/07</u>
General Counsel's Office	Date

SUBJECT: Recommendation Regarding Application for
Certificate of Convenience and Necessity

DATE: December 3, 2007

BACKGROUND

On October 24, 2007 (unless noted otherwise, all dates herein refer to the year 2007), Missouri-American Water Company ("MAWC" or "Company") filed an Application with the Commission, seeking an expansion of its Certificate of Convenience and Necessity ("Certificate") to provide water and sewer service in a subdivision in Jefferson County known as Paradise Valley.

On October 26, the Commission issued its **Order Directing Notice and Setting Intervention Date** requiring that notice of the Application be sent to the Missouri Department of Natural Resources (DNR), legislators, county officials, and newspapers serving the affected area. This order also set November 15 as the intervention deadline for interested parties. No applications to intervene were submitted by the established deadline, nor have any been submitted since.

On November 16, the Commission issued its **Order Directing Staff to File Recommendation** in which it ordered the Commission Staff ("Staff") to file a recommendation by December 3.

DESCRIPTION OF SERVICE AREA, AND STAFF'S INVESTIGATION

The proposed service area is an existing subdivision development known as Paradise Valley, located in Jefferson County near High Ridge. There are approximately 175 homes in the subdivision, with approximately 50 additional lots upon which new homes could be constructed. The Paradise Valley Residents Association ("Association") is an organization of the

homeowners in the subdivision. The Association owns and operates an existing stand-alone water system, which has water quality, pressure and capacity issues, and which needs substantial upgrades and improvements in order to meet construction and water quality standards of the Missouri Department of Natural Resources (“DNR”). Rather than undertaking the upgrade work, it is feasible to connect the existing distribution system to the water system that serves the Company’s St. Louis County service area, by constructing a pipeline extension and a booster station, at a cost estimated by the Company to be approximately \$633,400. The Company expects this work to be completed in May 2008.

The Company has entered into an Asset Purchase Agreement (Agreement) with the Association, which is contingent upon approval of this proposed expansion of MAWC’s service area, and which is attached to MAWC’s Application as Appendix 6. Some significant points of the Agreement include the following:

- The Company will acquire the subdivision water distribution system, but not the source-of-supply wells, nor customer-owned service lines.
- Each resident (customer) connected to the Paradise Valley subdivision water system at the time of the closing on the sale of assets would pay, in addition to existing quarterly rates in the Company’s St. Louis County service area tariff, a surcharge of \$15 per month, to be included on each of the customers’ quarterly bills. In addition, future customers connected to the Paradise Valley distribution system after the time of closing would pay a one time contribution-in-aid-of-construction (CIAC) charge of \$1,550 when making a connection to the water system. The surcharge and the CIAC charge would be used to offset that portion of the cost of the pipeline extension and booster station in excess of \$400,000, which is a negotiated amount that MAWC believes is reasonable for it to invest in this acquisition and extension project, and is referred to in the Agreement as the “Customer Fair Share Charge.” After the Customer Fair Share Charge portion of the cost is paid, by the terms of the Agreement, collection of the surcharge and CIAC charge would cease.
- The Company will set new meters for each customer, but customers who don’t presently have meters will need to install meter settings, at their expense, either in the yard or in the basement of the house, so that the Company can set a meter.
- The Company and the Association suspect that some customers may be served by service lines that they share with neighbors. The tariff rules that will apply require each customer to own and maintain an individual service line, and so shared service lines could become an issue between some neighbors. Resolution could mean that some customers will need to reconstruct some service lines, at their expense.

STAFF'S FINDINGS & CONCLUSIONS

As noted at the beginning of this Memorandum, Staff members from the Auditing and Water & Sewer Departments participated in the Staff's investigation of the Application. All Staff participants and the assigned attorney from the General Counsel's Office were provided the opportunity to review and comment on this Memorandum prior to it being filed. Jim Merciel of the Water & Sewer Department created the initial draft of this Memorandum, and comments received from the reviewers were incorporated therein to create this final version of the memo.

Although this acquisition, and the associated water system extension, could be considered to be within the Company's existing authorized service area serving St. Louis and Jefferson Counties, and the incremental pipeline extension considered as normal routine activity, the Staff believes that seeking approval of what is considered to be an expansion of the service area is reasonable and necessary for two reasons.

First, the Company's predecessors originally provided water service in certain areas of St. Louis County by local franchise authority that pre-dated the Public Service Commission's existence, and as such a specific authorized service area is not well-defined. In addition, the construction of MAWC's water system has been developing beyond St. Louis County into Jefferson County. For these reasons, the Company has been filing certain specific service area expansions in its tariff since 1995. The Staff believes that this service area expansion in Jefferson County needs to be authorized by the Commission.

Second, the Company, in the Application, seeks to fund this extension by using a combination of investment by the Company, and the Customer Fair Share Charge by means of the customer-paid recurring surcharge, and CIAC charge made at the time of connection, specific to the involved area, as noted above as a significant point of the Agreement, rather than the normal funding method of using the Company's tariff Rule 22.0, the water main extension rule, where the applicant for service pays the entire capital cost up front. Such a variance from the tariff needs approval. The Staff believes that this method of funding the extension is reasonable in view of the fact that it is a way to solve an existing problem that the involved residents are experiencing, and that the residents have agreed to pay the Customer Fair Share Charge through these proposed charges.

Except for the variance from the extension rule initially connecting this existing system, all currently approved rates and rules of the Company's tariff for its St. Louis County service area will apply to customers in Paradise Valley. However, as an existing system with existing service connections, and as noted above as significant points of the Agreement, an unknown number of customers may have service connections, service lines including service lines shared with neighbors, and meter settings that do not meet the Company's requirements. As provided in the Agreement, any such customers may need to install proper plumbing fittings for setting water meters, or to reconstruct service lines to meet the requirements. Some improper service line

issues may not be critical in providing safe and adequate service and proper metering, and there are ways for the Company to allow non-critical shortcomings to remain in service until a genuine service problem necessitates re-construction or modifications. The Company intends to install new Company-owned water meters for all of the Paradise Valley customers. The requirement of meter installation, and the existence of tariff requirements which include service lines, is in the Agreement, and the Company has stated to the Staff that it had discussed these issues with the Association.

The customers of the Association, including those who have meters and those who share a service line, are presently billed by the Association using a \$105 flat quarterly rate. In comparison, the typical MAWC customer in the St. Louis County service area with an average daily usage of 260 gallons pays approximately \$75 per quarter, which includes a customer charge and a fire service charge. The proposed \$15 per month surcharge, or \$45 per quarter, when added to the rates results in a total estimated average bill after this acquisition to \$120. This is an average increase to each customer of \$15 per quarter, or about a 14% increase. Actual bills calculated on metered usage would vary.

The addition of this proposed area would initially result in estimated annual funds for the company of \$84,000, based on the average bill, the surcharge, and the existing 175 customers. This amount is the sum of \$52,500 in ordinary revenue plus \$31,500 in surcharge funds used to directly offset capital investment. If 50 customers are added, then the Company would realize additional annual revenue of \$15,000 and CIAC charge from customers making new connections in the amount of \$77,500. The Staff believes that the funds generated from this expansion will support the \$400,000 investment plus service-area-wide operating expenses on an incremental basis, or at least will not be detrimental to the remainder of the Company's customers in the St. Louis County service area on any long term basis. The Staff also believes that the surcharge alone, without the CIAC charge to customers making new connections, could recover the customer share of capital in approximately seven (7) years, or sooner if new customers are connected. Notably, MAWC completed over \$64 million of new investment during 2006 and the level of investment to be addressed for Paradise Valley amounts to less than one percent of this recent year of investment completed by MAWC

As part of the next general rate case, the Staff will review the surcharge and customer connection fee to determine if they should be continued.

The acquisition of the existing system consists of components associated with water distribution systems. Except for replacement of obsolete utility plant, customary practice and the Company's tariff rules provide that distribution plant is normally contributed to the Company by developers or customers. The Staff therefore recommends that the Company book a contribution-in-aid-of-construction amount, equal to the net amount of plant in service less accumulated depreciation, to be recognized by MAWC for the purchase of the Paradise Valley Subdivision.

Based upon its review of the documents and information provided by the Company and the Staff's familiarity with the Company, this system, the area, and its analysis of the "*Tartan Energy Criteria*" as discussed in the following section, the Staff has concluded that the Company's request for a certificate should be granted.

THE TARTAN ENERGY CRITERIA

Staff analyzed the Company's ability to meet the *Tartan Energy* criteria, as slightly modified by the Staff, as has historically been done in evaluating service area certificate applications. Conclusions regarding this matter are set out below.

Is there a need for the proposed service, and is there a need for the Company to provide the proposed service? There is a need for service in the requested area in that existing residents have inadequate water service at present. Regarding the matter of whether there is a need for the Company to be the entity providing service, the proposed area is in proximity to the Company's existing system, and can be relatively easily connected by a water main extension project. The Staff believes that there is a need for service in the area, and it is logical for the Company to provide the service.

Is the Company qualified to provide the proposed service? The Staff believes that the Company has demonstrated technical and managerial ability to further develop and operate water systems, in that it has systems that presently exist and are running in this area as well as in other areas in the state, and employs a staff of utility professionals.

Does the Company have the financial ability to provide the proposed service? The Staff believes that the Company has the financial capability because it is a subsidiary of one of the largest water utility companies in the United States, which has an investment grade corporate credit rating. In addition, this is one of a great number of water main extension projects, and involves only a small fraction of the great number of new customers that are connected to MAWC's water system each year.

Is the Company's proposal economically feasible? The Staff believes that the proposed service area may be served as easily and feasibly as newly developed areas within the existing service, even though extraordinary funding and investment by the Company will be involved rather than the use of the normal water main extension practice.

Does the Company's proposal promote the public interest? The Staff believes the Company's proposal promotes the public interest because reliable central water service is desirable for this existing area which has water supply issues.

ADDITIONAL MATTERS

The Company will need to continue to keep its books and records in accordance with the Uniform System of Accounts, as is required of all regulated utilities. The Company will also need to prepare and file for approval new tariff sheets for its St. Louis County tariff to include a map, a written description of the service area expansion, and the surcharge and CIAC charge applicable within the Paradise Valley portion of the service area.

The Company, as a regulated utility, will need to continue to comply with obligations including, but not limited to: filing an annual report; paying an annual assessment fee; providing safe and adequate service at just and reasonable rates; complying with all relevant state and federal statutes and rules; and complying with all orders of the Commission.

The Company has no delinquencies with regard to filing its annual reports and paying annual assessments. Jim Merciel conducted a review of the Commission's Adjudication Division annual assessments records covering fiscal year 2001 through the second quarter of fiscal year 2008, and a review of the Commission's Electronic Filing and Information System (EFIS) annual report records covering calendar years 2002 through 2006. The Company does not have any compliance-related issues involving the Missouri Department of Natural Resources. Also, the Company is presently in good standing with the Missouri Secretary of State. There are no matters pending before the Commission that would have any direct impact upon this case.

STAFF'S RECOMMENDATIONS

Based upon the above, the Staff recommends that the Commission issue an order that:

1. Grants the Company's request for a Certificate of Convenience and Necessity to provide water and sewer service to the proposed service area, along with approval of the surcharge and CIAC charge as outlined herein;
2. Requires the Company to submit new tariff sheets for its St. Louis County water tariff to include a map of the revised service area, a written description of the revised service area, and the surcharge and CIAC charge. This tariff filing may not need to occur until 30 days prior to an expected closing date;
3. Requires the Company to notify the Commission within three (3) days after closing that it has closed on assets;
4. MAWC will capitalize all costs incurred by it associated with connecting the Paradise Valley Residents association to the existing MAWC system on its books and records. The Staff proposes to include all prudently incurred costs associated with the completed project in the cost of service calculated in MAWC's next rate proceeding. The treatment of the proposed \$15 monthly

- surcharge and the \$1,550 CIAC charge for new customers will be booked as contributions in aid of construction. These charges will be subject to review in future rate proceedings;
5. All customers of Paradise Valley that will become MAWC customers should receive water service in the exact same manner, using current tariff rates, as all of MAWC's current customers in the St. Louis County District.
 6. MAWC will install new meters for all former Paradise Valley customers, and if necessary work with customers that need to modify plumbing so that a meter may be installed, in accordance with the Agreement. The costs associated with installing and replacing meters will be recovered in accordance with the currently existing water tariffs that apply to all current St. Louis County District customers;
 7. MAWC will diligently work to ensure that each customer in the Paradise Valley area has an individual water service line, and that all existing shared water service lines either be eliminated to the extent practical, or dealt with within the provisions of the existing tariff;
 8. Recognizes that nothing in this recommendation or in any order issued by the Commission in this case shall bind the Commission on any ratemaking issue in any future rate proceeding. This includes any future review of the surcharge and CIAC charge paid at the time of making a new connection; and,
 9. MAWC will book CIAC equal to the net amount of plant in service less accumulated depreciation, acquired in the purchase of the Paradise Valley system assets.

After the Company submits tariff sheets in this case, the Staff will submit an additional recommendation regarding the approval of those sheets.

BEFORE THE PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI

AFFIDAVIT OF JAMES A. MERCIEL, JR.

STATE OF MISSOURI

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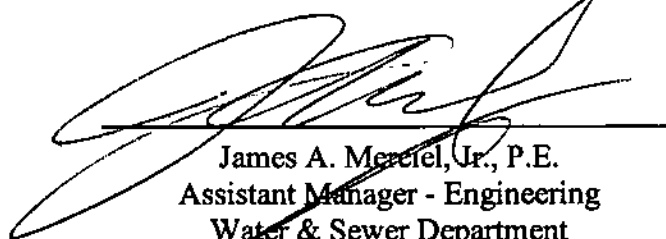
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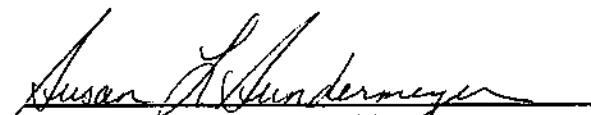
COUNTY OF CALLAWAY

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James A. Merciel, Jr., of lawful age, on his oath states: (1) that he is the Assistant Manager – Engineering in the Water and Sewer Department of the Missouri Public Service Commission; (2) that he participated in the preparation of the foregoing *Memorandum*; (3) that he has knowledge of the matters set forth in the foregoing *Memorandum*; and (4) that the matters set forth in the foregoing *Memorandum* are true and correct to the best of his knowledge, information and belief.


James A. Merciel, Jr., P.E.
Assistant Manager - Engineering
Water & Sewer Department
Utility Operations Division

Subscribed and sworn to before me this 3rd day of December 2007.


Notary Public