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December 9, 1999

FILED²

DEC 9 1999

Missouri Public
Service Commission

Mr. Dale Hardy Roberts
Public Service Commission
P. O. Box 360
Jefferson City, MO 65102

**RE: Missouri-American Water Company - Consolidated Case Nos. WR-2000-281
SR-2000-282**

Dear Mr. Roberts:

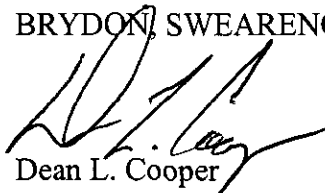
Enclosed for filing in the above-referenced proceeding please find an original and fourteen copies of MAWC's Reply to Public Counsel's Response to MAWC's Motion for Accounting Authority Order and Suggestions in Opposition to MAWC's Motion for Accounting for Authority Order; and, MAWC's Reply to Suggestions in Opposition to Missouri-American's: 1. Recommendation Concerning Proper Test Year; and 2. Motion for True-Up Audit and Hearing. Please stamp the enclosed extra copy of each pleading "filed" and return same to me.

If you have any questions concerning this matter, then please do not hesitate to contact me. Thank you very much for your attention to this matter.

Sincerely,

BRYDON, SWEARENGEN & ENGLAND P.C.

By:


Dean L. Cooper

DLC/rhg
Enclosures

cc: Office of the Public Counsel
Mr. Keith Krueger
Ms. Shannon Cook
Mr. Louis Leonatti
Mr. Jim Fischer
Mr. Leland Curtis
Mr. Brent Stewart
Mr. Chuck Brown

Mr. Joseph Moreland
Mr. Stu Conrad
Ms. Lisa Robertson

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

FILED²

DEC 9 1999

*Missouri Public
Service Commission*

In the Matter of Missouri-American)	
Water Company's Tariff Sheets Designed)	
to Implement General Rate Increases for)	Case No. WR-2000-281
Water and Sewer Service provided to)	Case No. SR-2000-282
Customers in the Missouri Service Area)	
of the Company.)	

**MAWC'S REPLY TO PUBLIC COUNSEL'S RESPONSE
TO MAWC'S
MOTION FOR ACCOUNTING AUTHORITY ORDER AND
SUGGESTIONS IN OPPOSITION
TO MAWC'S: MOTION FOR ACCOUNTING AUTHORITY ORDER**

COMES NOW Missouri-American Water Company ("MAWC" or "Company") and, for its Reply to the Office of the Public Counsel's ("OPC") Response to Missouri-American Water Company's Motion for Accounting Authority Order and Ag Processing Inc., A Cooperative ("AGP"), Friskies Petcare, A Division of Nestle USA ("Friskies") and Wire Rope Corporation of America Inc.'s ("Wire Rope") Suggestions in Opposition to Missouri-American's: Motion for Accounting Authority Order,¹ states to the Missouri Public Service Commission ("Commission") as follows:

1. On November 19, 1999, MAWC filed its Direct Testimony (excluding rate design testimony which was filed on November 29, 1999), Recommendation Concerning Proper Test Year, Motion for True-Up Audit and Hearing and Motion for Accounting Authority Order ("AAO"). This Motion for AAO requested authorization from the Commission: 1) to continue the capitalization of Allowance for funds Used During Construction ("AFUDC") and to defer the accrual of depreciation expense on the St. Joseph treatment plant and related facilities from their in-service date until the

¹ MAWC previously addressed AGP, Friskies and Wire Rope's opposition to its Recommendation Concerning Proper Test Year and Motion for True-Up Audit and Hearing in a separate pleading.

effective date of a Commission rate order which includes the St. Joseph treatment plant and related facilities in MAWC's rate base and includes depreciation expense in MAWC's operating expenses; and, 2) to use a rate of 7.22% to capitalize AFUDC on the St. Joseph treatment plant and related facilities from its in-service date until the effective date of a Commission rate order including the St. Joseph treatment plant and related facilities in MAWC's rate base.

2. On November 29, 1999, MAWC received AGP, Friskies and Wire Rope's opposition to its Motion for Accounting Authority Order. On or about November 29, 1999, the OPC filed its response to MAWC's Motion for Accounting Authority Order.

COMMISSION STANDARD

3. The Commission has previously stated that in order to issue "an Accounting Authority Order to permit the deferral of such costs, the costs incurred by the utility must result from an event or circumstance that is extraordinary, unusual and unique, and not recurring. *See In re The Application of Missouri Public Service for the Issuance of an Accounting Authority Order*, 1 Mo. P.S.C. 3d 200, 205 (1991). Extraordinary costs would include costs associated with Acts of God such as storm damage, fire or flood. However, extraordinary might also include costs resulting from man-made decisions that result in significantly changed business conditions." (*In the Matter of the Application of United Water Missouri Inc.*, Case No. WA-98-187 (April 20, 1999).

4. Alternatively stated, the "... issuance of AAO's have historically been tied to the occurrence of extraordinary items, events impacting a utility that are unusual in nature and infrequent in occurrence." (*In Re St. Louis County Water Company*, 4 Mo.P.S.C. 3d 94, 98 (September 19, 1995). In the *St. Louis County* case, the Commission granted an AAO for an infrastructure replacement program designed to address "deterioration of County Water's distribution system" and the resulting "escalating expenses." The Commission found that "the infrastructure program represents a significant and unusual increase in County Water's business-as-usual construction

expenditures, and is extraordinary in nature.” *St. Louis County* at 98.

OPC RESPONSE

5. The OPC’s response primarily opposes the issuance of an AAO on the basis that: 1) the construction of the St. Joseph Treatment Plant and related facilities is not an extraordinary event; and, 2) “regulatory lag” is an inherent part of the regulatory process.

6. The OPC states that “although the size of this project is extremely large and could result in a dramatic impact on rates, it is simply a construction project, and as such, involves the most typical categories of investment and expense that any water company experiences.” (OPC Response, p. 2). It cannot be said that construction of a treatment plant and facilities, which includes a change in the source of supply, is a typical and customary business activity. As was examined in detail in Commission Case No. WA-97-46, this construction resulted from factors that the Commission has indicated are appropriate bases for AAOs.

7. The testimony in Case No. WA-97-46 revealed that there were capacity, reliability, process control and safety deficiencies with the existing St. Joseph treatment plant (which is over 100 years old) that made it necessary to take the dramatic steps of changing the source of supply and construction of a treatment plant at a new location. Both extreme low water (drought) on the river and extreme high water (flooding) had left the City of St. Joseph without water twice within the last decade (Acts of God). While improvements had been made to temporarily address this problem, the only real solution was to move the treatment plant out of the flood plain and eliminate the river as a source of supply. Additionally, increased regulatory requirements enacted by Congress and implemented by the Environmental Protection Agency and the Missouri Department of Natural Resources relating to the treatment of the water drove this construction. These regulations were man-made decisions that are resulting in extraordinarily changed conditions for water utilities, and are similar in effect to the gas safety rules which have lead to AAOs in the natural gas industry.

8. Because of the significant amounts of money necessary to address the issues, failure to provide AAO treatment of the post-in-service AFUDC and deferred depreciation will have a substantial adverse impact upon the financial condition of the Company and guarantee that it will not have an opportunity to earn its Commission established return. The St. Joseph 2000 Project represents "a significant and unusual increase" in MAWC's construction expenditures (See *In Re St. Louis County Water Company*, 4 Mo.P.S.C. 3d 94, 98 (September 19, 1995)). The discontinuance of the capitalization of AFUDC and the commencement of depreciation on the St. Joseph treatment plant and related facilities prior to such rate order will cause earnings erosion for MAWC of approximately \$347,000 per month. The St. Joseph treatment plant and related facilities, net of post-in-service AFUDC, represent over 40% of the proposed rate base in this case. Pro forma present rate earnings for the period April through September 2000, would be only \$61,000 without consideration for post-in-service AFUDC and deferred depreciation expense. Without consideration for post-in-service AFUDC and deferred depreciation expense, MAWC would receive approximately .08% return on rate base for this five month period or approximately 1.6% of its reasonable earnings. These impacts are far too large and devastating to dismiss as a mere consequence of regulatory lag.

9. Additionally, it must be remembered that the Commission's decision granting an AAO does not grant recovery. It merely preserves the issue so that it can be considered within the context of a rate case. *In the matter of the application of Missouri Public Service*, 1 Mo.P.S.C.3d 200, 203-204 (1991) ("By seeking a Commission decision [regarding the issuance of an AAO] the utility would be removing the issue of whether the item is extraordinary from the next rate case. All other issues would still remain, including, but not limited to, the prudence of any expenditures, the amount of recovery, if any, whether carrying costs should be recovered, and if there are any offsets to recovery."). Thus, by this application, MAWC seeks only to maintain the status quo as to the accounting treatment for these expenses and not suffer an immediate detrimental impact as of the

in-service date of the St. Joseph treatment plant and facilities. Issues would remain which can be addressed within the present rate case and when the recoverability of the amounts are before the Commission for its decision.

10. This process is supported by the Missouri Court of Appeals. The Court of Appeals has stated that an AAO preserves the expenses for a rate case where they can be addressed by the Commission. In *State ex rel. Office of the Public Counsel v. Public Service Commission*, 858 S.W.2d 806, 812 (Mo.App. 1993), the Court of Appeals took note of the fact that an AAO only authorizes an accounting entry on the books of the utility. The deferred expenditures, along with all other items of revenue and expense, are considered together in a subsequent rate case.

11. The Court of Appeals more recently confirmed this position in *Missouri Gas Energy v. Public Service Commission*, Case No. WD 54710 (Mo.App.W.D., August 18, 1998). The Court stated as follows:

In the *Public Counsel* case, the court made it clear that AAOs are not the same as ratemaking decisions, and that AAOs create no expectation that deferral terms within them will be incorporated or followed in rate application proceedings. *Public Counsel*, 858 S.W.2d at 813. The whole idea of AAOs is to defer a final decision on current extraordinary costs until a rate case is in order. At the rate case, the utility is allowed to make a case that the deferred costs should be included

12. A granting of this motion will merely maintain the status quo with regard to MAWC's books until MAWC has the opportunity to present the post-in-service AFUDC and deferred depreciation expenses to the Commission for decision within the context of this rate case. If, on the other hand, the AAO is not granted, it will have an immediate detrimental impact on MAWC's financial condition as of the in-service date of the St. Joseph treatment plant and facilities.

AGP, FRISKIES AND WIRE ROPE

13. AGP, Friskies and Wire Rope not only oppose the granting of the requested AAO, they also indicate that MAWC should file a "second rate case at a time when it can utilize a test year

which includes the St. Joseph plant in rate base” and propose that alternatively MAWC dismiss this case or agree to extend the operation of law date by seven months. This proposal is unacceptable as it would essentially require that the St. Joseph treatment plant and related facilities be “in-service” for a period of approximately one year before an operation of law date.

14. Without permission to book post-in-service AFUDC and to defer depreciation expense as stated above, MAWC’s earnings will be reduced approximately \$347,000 each month the St. Joseph treatment plant is “in-service” and not included in rates. Without an AAO, this is potentially a loss of \$1.56 million dollars for MAWC and would result in an approximate .08% return on rate base for that four and a half month period. If, as AGP, Friskies and Wire Rope propose, the St. Joseph treatment plant must be “in-service” for twelve months before it is included in rates, MAWC would suffer financially to the tune of \$4.164 million.

15. AGP, Friskies and Wire Rope additionally indicate that the accounting treatment requested by MAWC is “contrary to the Uniform System of Accounts and generally accepted accounting principles.” (AGP Opposition, p. 3). This is not the case. Financial Accounting Standard No. 71, “Accounting for Regulated Industries,” which was issued by the Financial Accounting Standards Board in 1982, contemplates accounting authority orders and allows deferral of costs by a utility on its financial statements under certain conditions. As a result of this recognition of the AAO process, this Commission has addressed AAOs many times. The granting of an AAO is not contrary to generally accepted accounting principles.

16. Lastly, AGP, Friskies and Wire Rope allege that MAWC states no reason why this AAO will be in the best interest of its customers. The interest of MAWC’s customers is served by the improvements to the utility systems from which they receive service and a sound financial base. Forcing a utility to suffer losses of the size indicated in the absence of the requested AAO is a huge

disincentive for investment in water systems, as well as other utility systems in the State of Missouri.

SUMMARY

17. In the short term, the requested deferral will not raise rates. No rates will be changed until the effective date of a Commission order wherein the Commission has reviewed the expenses which are the subject of this request in the context of MAWC's overall rates. If after such review MAWC is granted recovery of the subject expenses, the process will enable MAWC to make the substantial investments that are, and will be, necessary to address aging infrastructure and increased regulatory demands in the water industry. The benefit to the customer is found in safer and more efficient utility systems for the customer's use.

WHEREFORE, MAWC respectfully requests that the Commission issue an Accounting Authority Order:

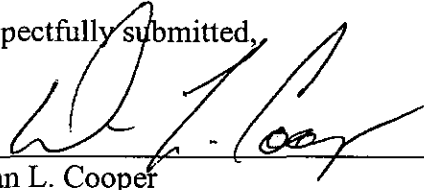
(a) authorizing MAWC to continue the capitalization of AFUDC and to defer the accrual of depreciation expense on the St. Joseph treatment plant and related facilities from their in-service date until the effective date of a Commission rate order which includes the St. Joseph treatment plant and related facilities in MAWC's rate base and includes depreciation expense in MAWC's operating expenses;

(b) authorizing MAWC to use a rate of 7.22% to capitalize AFUDC on the St. Joseph treatment plant and related facilities from their in-service dates until the effective date of a Commission rate order including the St. Joseph treatment plant and related facilities in MAWC's rate base; and,

(c) including such further relief as the Commission deems appropriate in the

circumstances.

Respectfully submitted,


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ATTORNEYS FOR MISSOURI-AMERICAN
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Certificate of Service

I hereby certify that a true and correct copy of the above and foregoing document was sent by U.S. Mail, postage prepaid, or hand-delivered on this 9th day of December, 1999, to the following:

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