BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri-American Water Company's Request for Authority to Implement A General Rate Increase for Water and Sewer Service Provided in Missouri Service Areas.	))))	Case No. WR-2011-0337 SR-2011-0338

MAWC'S STATEMENT OF POSITION

COMES NOW Missouri-American Water Company (MAWC or Company), and for its Statement of Position, states the following to the Missouri Public Service Commission (Commission) concerning the issues contained in the Joint Issues List, filed on February 9, 2012:

A. Rate Base Issues:

1. Cash Working Capital

What is the appropriate amount of Cash Working Capital to include in Rate Base?

MAWC Position: Cash working capital is included in a company's rate base to compensate investors for "upfront" capital that is required in order to fund the daily operations of the business. The timing difference between incurring expenses and the receipt of the revenue will result in either a net (lead) or lag. There is a difference between Company and Staff in this case as to the appropriate calculation of the expense lag for Service Company fees to be used in the Lead/Lag Study. In addition, there is a general difference between Company and Staff as to the appropriate calculation of the revenue lag (i.e., the time between provision of service and receipt of revenues from customers). Lastly, there is a specific difference between Staff and Company as to the collection lag related to sewer service provided in the Cedar Hill District. The Company believes its lead/lag study for these items more accurately reflects the actual experience of the Company in the provision of service, payment of expenses and receipt of revenues and, therefore, its study should be adopted by the Commission.

Tierney Dir., pp. 3-4, Tierney Reb., pp. 2-8; Tierney Sur., pp. 1-6.

2. Tank Painting Tracker

Should the Tank Painting Tracker be discontinued? If not, at what level should the Tank Painting Tracker be continued?

MAWC Position: Tank painting costs from year to year can vary dramatically due to complexity, weather, and timing issues. The Company spent between $1,000,000 and $1,600,000 on tank painting annually during the years 2007 – 2011.

The seasonal timing of tank painting and variability from year to year of the tanks to be painted makes the tracker a good mechanism to establish average annual expenditures that may not be accurately captured in either a calendar or “test” year. The tracker is intended to act as a balancing mechanism to insure that the costs of the tank painting program, and only the costs of that program, are appropriately recovered.

The Company conducted an analysis of the life expectancies of all of its interior and exterior tank coatings. This analysis resulted in the assignment of a life expectancy of each coating on each tank in all of the Company’s districts. Following this analysis, it was determined that an optimal level of annual tank painting expense in the future is $1,600,000. Accordingly, the Tank Painting Tracker should be continued and adjusted to an annual amount of $1,600,000.

Tinsley Dir., pp. 6-7; Weeks Dir., pp. 8-17; Weeks Reb., pp. 1-5; Weeks Sur, pp.1-4.

3. Accrued Pension Liability

What is the appropriate amount of accrued Pension Liability to include in Rate Base?

MAWC Position: Please see the following discussion concerning the *Pension Tracker* issue.

4. Pension Tracker

Should the Pension Tracker be modified as proposed by Staff?

Should the Pension Tracker apply to Service Company employees as well as MAWC employees?

MAWC Position: There is currently in place a tracker mechanism to track actual pension and OPEB costs for MAWC employees in comparison to the levels included in rates. This tracking mechanism protects customers and Company from wide variations that can exist in expected costs at the time rates are set from what actually occurs beyond that point in time. MAWC's pension expense tracker was first approved in Case No. WR-2007-0216. It has subsequently been renewed without significant change in Cases Nos. WR-2008-0311 and WR-2010-0131.

Staff recommends keeping the tracker, but dramatically changing the mechanism. There are currently two distinct factors in the calculation – one for tracking the estimated expense level to the actual expense level, and the other for tracking the time value of money related to differences in the recorded expense level and actual cash contributions. The two factors work together to compute correctly the return of and return on components as designed.

Staff argues that it has suddenly discovered a "flaw" in the existing pension tracker mechanism. Staff recommends that in the future the tracker should look at only the pension cash investment. In other words, for ratemaking purposes, pension costs would be put on a cash basis rather than an accrual basis. Accrual accounting more accurately reflects cost causation and more fairly associates revenue requirements with the parties who have created those costs.

Staff indicates that the current tracker is appropriate for calculating cash requirements for the difference between FAS 87 recorded expense and actual cash contributions. That is exactly the intent of the second component of the existing pension tracker mechanism. This is not a “flaw”. It is working correctly and exactly as intended.

Further, the Company has proposed that this tracker mechanism be extended to those pension and OPEB costs that are incurred by the American Water Service Company (Service Company) and passed through in its charges to MAWC. This proposal is appropriate because: 1) the type of pension and OPEB costs incurred by the Service Company are exactly the same as those which are subject to the MAWC tracker; 2) like MAWC pension and OPEB costs, those same costs of the Service Company are highly volatile, subject to wide variations and not subject to simple estimation or normalization; and 3) these Service Company costs are known and easily auditable.

Tinsley Dir., pp. 3-5; Williams Reb., pp. 3-7; Williams Sur., pp. 18-22.

5. Acquisition Adjustment

How should the rate base of acquired small systems be established?

How should acquisition premiums and discounts be treated?

MAWC Position: Under traditional ratemaking treatment, assets acquired in a purchase transaction are recorded at their depreciated net original cost. The Commission has previously described its approach as follows:

> Missouri has traditionally applied the net original cost standard when considering the ratemaking treatment of acquisition adjustments. That means that the purchasing utility has not been allowed to recover an acquisition premium from its ratepayers. But it also means that ratepayers do not receive lower rates through a decreased rate base when the utility receives a negative acquisition adjustment. Even if a company acquires an asset at a bargain price, it is allowed to put the asset into its rate base at its net original cost. Similarly, ratepayers do not share in the gains a utility may realize from selling assets at prices above their net original cost. Those gains flow only to the utility's shareholders.[1]

Public Counsel opposes this rate treatment where there is an acquisition discount (i.e. where the net original cost exceeds the purchase price). Retaining rate base at net original cost as the result of an acquisition protects the customers and provides the Company an incentive to achieve as low a purchase price as possible. It is further equitable in that it balances the interest of the acquiring utility and its customers by applying the same fair treatment whether the acquisition is made at a premium or discount. Finally, the disallowance of acquisition discounts would clearly serve as a disincentive to utility acquisitions.

Williams Reb., pp. 13-15; Williams Sur., pp. 26-35.

6. Security Costs – AAO

Should the unamortized balance of the security costs regulatory asset be included in Rate Base?

MAWC Position: In Commission Case No. WO-2002-273, the Commission authorized MAWC to defer certain costs associated with security measures instituted by MAWC in

[1] *In the Matter of the Joint Application of UtiliCorp United Inc. and St. Joseph Light & Power Company*, Second Report and Order, Case No. EM-2000-292 (February 26, 2004).

shortly after September 11, 2001. The Company began to amortize the deferred expenses over a ten year period beginning in December of 2002. The Company included in rate base the unamortized balance of the regulatory asset associated with security costs. Staff did not include the unamortized balance of the Security AAO in rate base.

Amortization of an asset account provides for the return of the amount expended over a period of time. Inclusion of the unrecovered portion of costs in rate base provides for a return on that investment. Recovery of only the amortization over a long period of time does not allow a Company to be made whole. As it does not allow the Company to recover the time value of money associated with recovering an expense over a ten year period. The Commission has stated previously that this is a question that it may address on a case by case basis (See *State ex rel. Aquila, Inc. v. Public Service Commission*, 2010 Mo. App. LEXIS 499 (Mo.App. W.D. 2010)).

In this case, the subject expenditures were made for the purpose of protecting MAWC's customers and the assets and the employees that serve them. The costs incurred by MAWC to enhance its security were urgent in nature and were undertaken as a result of an emergency for which MAWC had no responsibility and could not have been foreseen. The sole result of this investment of capital was the continued provision of safe and adequate service to MAWC's customers, as the security expenditures were made to protect our customers and the assets that serve them. Therefore, rate base treatment of the unamortized balance is appropriate.

Thakadiyil Reb., pp. 1-2.

7. OPEB Contribution to External Fund (related to St. Louis County Water Company Amount)

Should the regulatory asset (Tracker) associated with the unrecovered St. Louis County Water Company FAS 106 transition cost be included in rate base?

MAWC Position: Yes. Both Company and Staff have included in their cases an annual amortization amount of the regulatory asset associated with the deferral of OPEB costs for the St. Joseph and Joplin Districts from July 1, 1994, up through the effective date of the Commission's Report and Order in its Case No. WR-95-205. This deferral resulted from the issuance of Statement No. 106 by the Financial Accounting Standards (FAS) Board converting the accounting for post retirement benefits (OPEBs) from the pay-as-you-go method to the accrual method. This change in method resulted in unrecovered booked expenses that were approved by the Commission for deferral and recovered through a twenty year amortization.

However, Staff did not include the unamortized deferred balance in rate base. Thus, while there would be a return of the invested amounts, there would not be a return on those amounts. This would be the first case since the Order issued in the 1995 case that the Staff has not recommended rate base treatment. Exclusion of this item from recovery would result in the Company having to write-off to expense the deferred amount at the time new rates become effective, which is estimated to be $23,924.

At the same time, the Company also deferred the same type of unrecovered OPEB expenses for the then St. Louis County Water Company and began amortizing that deferral over a twenty year period from the date FAS 106 was first adopted for financial reporting purposes. In Commission Case No. WR-94-166, St. Louis County

Water proposed to include the amortization of the deferral over 19.33 years. The case was settled and the Order issued did not specifically reference the OPEB deferral and amortization.

The amortization of the St. Louis County Water Company asset continues and MAWC believes that recovery of the annual amortization amount ($44,056) is appropriate. Likewise, rate base treatment of the unamortized deferral of $44,056 at December 31, 2011, is appropriate. Such treatment has never been disallowed by previous Commission orders and is consistent with the precedent established by the Commission's treatment and approval of the St. Joseph and Joplin deferrals. Exclusion of this item from recovery would result in the Company having to write-off to expense, the deferred amount at the time new rates become effective, which is estimated to be $25,699.

Finally, in its Order in Case No. WR-2008-0311, the Commission approved the amortization of a similar item related to the original MAWC and Missouri Cities properties. A deferral in the amount of $752,918 had been recorded on the Company's books since 1994 and included in rate base in all subsequent rate proceedings but amortization of this amount had never been approved. The parties agreed, and the Commission approved, amortization of this amount over a five-year period. Staff, in its filing, however, excluded from recovery in the current proceeding the $150,584 of amortization expense reflected in the test year and excluded from rate base the 12/31/2011 balance of $288,619. Exclusion of this item from recovery would result in the Company having to write-off to expense at the time new rates become effective approximately $225,875.

<u>B. Cost of Capital Issues</u>:

<u>1. Capital Structure</u>

What is the appropriate capital structure for ratemaking purposes?

MAWC Position: The appropriate capital structure for calculating MAWC's weighted average cost of capital is its stand-alone capital structure as of December 31, 2011, which represents the actual capital financing its jurisdictional rate base to which the overall rate of return set in this proceeding will be applied. As of December 31, 2011, MAWC's actual stand-alone capital structure is comprised of 49.18% long-term debt, 0.26% preferred stock and 50.57% common equity.

MAWC's stand-alone capital structure is reasonable for ratemaking purposes because it is consistent with the capital structure ratios maintained, on average, by other water companies. The Commission should not use American Water's consolidated capital structure because MAWC is a separate corporate entity that issues its own debt based on its own credit risk and common stock, and therefore, maintains an independent capital structure.

Ahern Dir., pp. 27-31; Ahern Reb., pp. 3-12; Ahern Sur., pp. 4-13; Rogers Reb., All; Rogers Sur., All.

<u>2. Return on Equity</u>

What is the appropriate return on common equity for ratemaking purposes?

MAWC Position: Based upon the common equity cost rates resulting from the use of multiple cost of common equity models – the Discounted Cash Flow (DCF), the Risk, Premium Model (RPM) and the Capital Asset Pricing Model (CAPM) – consistent with the Efficient Market Hypothesis, the proper business risk-adjusted return on common equity for MAWC is 11.85% applicable to MAWC's December 31, 2011, common equity ratio, as determined by MAWC witness Pauline M. Ahern, CRRA.

Taking into account the cost rates for long-term debt (6.28%), preferred stock (9.35%) and common equity, the appropriate *pro forma* weighted cost of capital, or fair rate of return, for MAWC applicable to its jurisdictional water utility rate base is 9.10% as of December 31, 2011.

Ahern Dir., All; Ahern Reb., All; Ahern Sur., All; Williams Dir., pp. 6-15.

C. Revenue Issues:

1. Revenue (Water Usage Volumes)

How should the volume of water used by residential and commercial customers be calculated?

MAWC Position: In establishing rates for MAWC, it is important to calculate a "normalized" level of usage (i.e., gallons per day per customer). A "normal" usage level should represent the customers' usage that would occur based on average weather patterns. In the past, the Company employed the services of Dr. Edward Spitznagel Jr., who performed a multi-variate model to predict a normalized level of consumption. Dr. Spitznagel's modeling assumptions took into account not only temperatures, but precipitation and drought tolerance indices as well. As accurate as Dr. Spitznagel's approach proved to be, any model with such a great number of factors and variables can be complicated to perform, difficult to understand and costly.

Accordingly, in this case, the Company is proposing an alternative, but nevertheless accurate, method that analyzes the residential customer base-line usage pattern from ten (10) years of "non-weather" months (i.e., winter months with little or no outdoor use) usage and then adds to this base-line amount the ten (10) year average of a customers' discretionary usage (e.g., lawn watering, etc.). This type of analysis is appropriate because the Company has experienced a significant and continuing decline in residential water usage. This trend is common throughout the United States and is attributable to a number of factors including the prevalence of low flow (water efficient) plumbing fixtures and appliances, conservation ethic of the customers, conservation programs implemented by the utility or other entitles, and price elasticity. In order to account for this undeniable trend in declining residential customer usage, Company witness Dunn performed a linear regression analysis on ten (10) years of historical "base" residential customer usage to create a best fit trend line for each district. He then performed a separate analysis of the discretionary usage (i.e., usage above the base-line or winter usage) to normalize for weather affects. The trend projection of base usage was then added to the ten (10) year average of discretionary usage to determine the projected residential customers' usage.

Staff and MIEC propose normalizing residential usage and revenues based on a simple 4 or 6 year average, respectively. The problem with both of these approaches is that a simple average does not adequately capture the significant decline in residential usage. Inasmuch as the customers' base-line usage can account for as much as 65% to 95% of the customers' total usage, a simple average that does not take into effect this trend in declining usage will invariably overstate revenues.

With respect to commercial usage, MAWC used actual, test year usage for each district's commercial customers. This is because commercial usage does not exhibit the sensitivity to weather that residential usage exhibits. Moreover, use of the most recent commercial usage reflects the decline in customers and usage which has been experienced by MAWC from 2007 to 2010. MIEC's proposal to use a simple average of commercial customer usage from 2002 to 2007 ignores the decline in the economy and the decline in customer usage and is not representative of MAWC's commercial customers that remain on its system. For example, the number of commercial customers in St. Louis County has declined from 19,427 in 2007 to 16,914 in 2010. In St. Charles County, the number of commercial customers declined from 909 in 2007 to 664 customers in 2010. This drastic decline in commercial customers not only reduces the total customer usage, but it also has resulted in a reduction in usage per customer. Therefore, using a simple average of commercial customer usage from 2002 to 2007 is not valid as it does not represent usage patterns of the commercial customer group of today.

Dunn Dir., pp. 9-15; Dunn Sur., pp. 1-4; Naumick Dir., All; Naumick Reb., All; Spitznagel Reb., All.

2. Other Water/Sewer Revenue (Billing for municipals)

Should the revenues received by the Company for providing billing services to municipalities be treated as an offset to revenue requirement as Staff has proposed?

MAWC Position: No. First, this revenue is generated at little or no incremental cost. Customers are paying their actual cost of service and are not disadvantaged by the service provided to municipalities. More importantly, it is a known and measureable certainty that the Company is exiting this business and that no billing services revenue will be generated after that exit is complete in 2012. Revenue from the provision of billing services to municipalities will be negligible during the time that new rates are in effect. The only other revenue generation will be the minimal amount associated with the provision of meter reading information to municipalities and sewer districts as required by law.

Williams Reb., pp. 7-8.

3. MSD Contract

Is the compensation received by the Company under its contract with MSD adequate? If not, should an additional amount of revenue be imputed to the Company in this case?

MAWC Position: MAWC provides certain billing data to the Metropolitan St. Louis Sewer District (MSD) pursuant to Section 249.645 RSMo. The rate which MSD pays for this service is contained in an existing tariff as well as the subject of a contract between MAWC and MSD. The existing compensation received by MAWC under its contract with MSD is adequate and no additional amount of revenue should be imputed to the Company in this case. Significantly, neither the Company nor MSD is proposing to change the contract or the tariff rate in this case. The existing tariff rate is the result of a Stipulation entered into between MAWC and MSD and approved by the Commission in Case No. WR-2007-0216. The contract between MAWC and MSD (which incorporates the tariff rate) was approved by the Commission in Case No. WO-2008-0240. MSD is currently paying a rate that is significantly above the incremental cost of providing this billing data, although not as much as its fully allocated costs. As long as the revenue MAWC receives from providing this service exceeds the marginal cost of providing this service, it benefits other water customers of MAWC.

Public Counsel is proposing to either increase the rate that MSD pays under the existing tariff, or to simply impute additional revenues that MAWC should hypothetically receive from MSD for providing the billing data. The Company is opposed to any change in the existing tariff rate as 1) it is well above the incremental costs of providing this data; 2) it is the result of an arms-length negotiation; and 3) it is reasonable under the circumstances. Furthermore, MAWC is opposed to imputing or hypothecating revenue for ratemaking purposes when there is no evidence that the existing rate is unreasonable and there is no likelihood the Company will actually receive this additional revenue from MSD.

Williams Reb., pp. 11-13.

D. Expense Issues:

1. Chemical Expense

What prices and what quantities should be used in calculating chemical expense?

MAWC Position: Staff has used 2011 chemical prices in its chemical expense calculation. In determining MAWC' s chemical expense, the Commission should instead utilize the chemical prices that are in effect now, and will be in effect at such time as new rates become effective in this case. Those prices are known and measurable as the result of contracts that were in place and provided to Staff prior to the end of 2011.

Further, MIEC contends that the Company should be using test year quantities per system delivery applied to the pro forma system delivery as the basis for chemical expense for the period when rates in this case will be in effect, rather than a three year historical average of chemical quantities per thousand gallons of system delivery, as was used by Staff and the Company. By using a three year average of chemical quantities, the Company and Staff have appropriately normalized the amount of chemicals used in the test year. Chemical quantities not only depend upon the amount of water treated, but also on the conditions of the water being treated. For example, when there is increased raw water turbidity, the Company will treat the water with more coagulants. The system delivery may still be low, but the amount of chemicals used will be higher than normal. It is therefore necessary to account for the variations in chemical quantities used in the pro forma adjustment in order to reflect a normal year

Thakadiyil Reb., pp. 3-4.

<u>2. Tank Painting Expense</u>

What is the appropriate amount of tank painting expense?

MAWC Position: The Tank Painting Tracker should be continued and adjusted to an annual amount of $1,600,000. See Rate Base Issue 2 above. In addition, the appropriate amount of tank painting expense to include in Company's cost of service is $1,600,000.

Tinsley Dir., pp. 6-7; Weeks Dir., pp. 8-17; Weeks Reb., pp. 1-5; Weeks Sur, pp.1-4.

<u>3. Bad Debt Expense – Bad Debt Factor Up</u>

What is the appropriate amount of bad debt expense? Should bad debt expense be projected to increase with any increase in revenue requirement?

MAWC Position: Both Staff and Company have included in their cases an allowance for bad debt expense. However, Company proposes to further adjust bad debt expense to include the bad debts attributable to the additional revenues that will result from a rate increase in this case. Company believes there is a relationship between revenues and bad debt expense. In other words, as revenues increase, bad debt expense increases as well. Therefore, by applying the bad debt ratio to pro forma or anticipated revenues resulting from this case, the bad debt expense amount that is reflected in rates will more accurately reflect the actual bad debt expense to be incurred during the time rates set in this case will be in effect.

Thakadiyil Dir., pp. 7-8; Thakadiyil Reb., pp. 6-7, Thakadiyil Sur., pp. 1-7.

4. Service Company Expense

What is the appropriate amount of Service Company expense to include in MAWC's revenue requirement?

MAWC Position: MAWC has agreed to the Staff position on this issue. Thus, it is no longer a matter in dispute.

5. Rate Case Expense

What is the appropriate amount of rate case expense?

MAWC Position: The Commission has previously found that a regulated utility is "entitled to recover its reasonable and prudently incurred cost of presenting this rate case to the Commission. Such costs are routinely accepted as a cost of doing business for which the company will be allowed to recover its costs in rates . . . ." *Missouri Gas Energy*, 12 Mo. PSC 3d 581, 623 (September 21, 2004). "Disallowing prudently incurred rate case expense can be viewed as violating the company's procedural rights." *In re St. Joseph Light & Power Company*, 2 Mo.P.S.C.3d 248, 260 (1993); *See also In re St. Joseph Light & Power Company*, 3 Mo.P.S.C.3d 207, 214 (1994).

Staff suggests that rate case expenses should be "normalized" (as opposed to "amortized") and, thus, has not included unamortized (and therefore unrecovered) amounts of rate case expense from a prior rate case (expenses relating to WR-2010-0131) in its current cost of service for this case.

Rate case expenses are easily measured and do not require estimation. Further, it is difficult to predict the cost to develop, prepare and present a rate case. Those costs may differ depending upon whether a settlement is reached or a hearing is held. Moreover, there is always uncertainty as to what issues may be raised by the parties. For this reason, rate case expense is appropriate for amortization rather than normalization and past unrecovered amounts should be included in the revenue requirement on a going-forward basis.

Further, MAWC has incurred (and will continue to incur) significant expenses relating to this rate case (WR-2011-0337) past Staff's October 18,, 2011 cut-off date. Work continues to be performed by MAWC, its outside consultants, and legal team relating to the case.

The Staff's proposal would deny MAWC recovery of a portion of its expenses from this case, as well as past cases. The Commission should instead allow recovery of all rate case expenses incurred up to the final conclusion of the rate case amortized over two (2) years.

Tierney Reb., pp. 16-18.

6. Incentive Compensation

What is the appropriate amount of incentive compensation expense related to AIP and LTIP for employees of MAWC and Service Company?

MAWC Position: The appropriate amount of incentive compensation expense related to the annual incentive plan (AIP) and Long-Term Incentive Plan (LTIP) for employees (both MAWC and Service Company) is contained in MAWC's initial rate case filing. As described in testimony, the Company's compensation strategy is to challenge and motivate eligible employees to perform at their highest level, and promote the creation of value to the customer and shareholder. One way the incentive compensation plans accomplish these goals is by placing a portion of the employee's total cash compensation at-risk; that is, a certain percentage of the employee's compensation is subject to that employee's performance versus specific goals establish for her/him.

While Staff and Public Counsel have proposed the elimination of portions of the incentive compensation plan expense, no such elimination is warranted. MAWC described the operations of the incentive plans, detailing the plan's customer service, quality, cost containment, environmental and other objectives that result in direct customer benefits. Because they drive efficiency, reliability and quality service to MAWC's customers, the AIP and LTIP should be encouraged by the Commission.

Mitch Reb, pp. 2-19.

<u>7. Income Taxes</u>

What is the appropriate income tax rate?

MAWC Position: MAWC has an effective tax rate of 38.86%. However, because Staff prepares its revenue requirements calculations district by district and, many districts do not have enough net income on an individual basis to be subjected to MAWC's actual tax bracket and a 15% tax rate is reflected in the current Staff calculation. MAWC believes that the actual total Company effective tax rate of 38.86% should be used in calculating the Company's revenue requirement.

<u>8. Amortization of OPEB Assets (related to St. Louis County Water Company)</u>

What is the appropriate level of expense to be included in MAWC's cost of service for recovery of the regulatory asset created by OPEBs associated with the former St. Louis County Water Company?

MAWC Position: MAWC and Staff have both included the current asset balance related to the deferral of OPEB costs for the St. Joseph and Joplin Districts in the cost of service. In addition, the Company has proposed to include the amortization of the deferral of the OPEB costs associated with the Service Company and the former St. Louis County Water Company. This is the "expense side" of the rate base issue identified above as "OPEB Contribution to External Fund (Related to St. Louis County Water Company Amount)." The rationale for including the amortization of these OPEBs is consistent with the Commission's decision in its Case No. WR-95-205.

9. Pension Expense

What is the appropriate amount of pension expense?

MAWC Position: Please see the above discussion concerning the *Pension Tracker* issue.

10. Non-Revenue Water

What is the appropriate amount of non-revenue water?

MAWC Position: The Infrastructure Leakage Index (ILI) performance indicator should be utilized to determine the appropriate level of non-revenue water (NRW) for a given system. This performance indicator is an output of the International Water Association/American Waterworks Association (IWA/AWWA) best practice water audit methodology developed during the period 1997 – 2000. This methodology is also recommended as a best management practice by the AWWA Water Loss Committee and is detailed in the AWWA publication "M36 - Water Audits and Loss Control Programs," 3rd Edition. ILI features robust performance indicators that allow for an objective gauging of loss levels. The development of this methodology drew on the best practices of the various water auditing approaches used around the world and crafted them into a single, standard best management practice methodology that could be applied across the differing system characteristics. The ILI performance indicators give a reliable assessment of water loss standing from operational, financial, and water resource management perspectives. The ILI performance indicators were applied to each district for the test year and the results were within acceptable limits. Accordingly, as long as the ILI method indicates each district is in an acceptable range, the actual system delivery should be used rather than using sales volumes and NRW to calculate system delivery.

Weeks Reb, pp.5-8; Weeks Sur, pp.5-6.

11. Roark Sewer Plant Operating Expenses

What is the appropriate amount of Roark Sewer Plant operating expenses?

MAWC Position: The Company misclassified $393,946 of plant operation expense as chemicals. This amount was disallowed by Staff because the Company could not provide support for the chemical expense.

Based on the 2010 Roark Water & Sewer, Inc. annual report that was filed with the Commission, $393,946 of plant operation expense was incurred during the test year. The expenses include contracted maintenance expenses, repairs of sewer plant and utility bills.

The Company pays the City of Branson to have the Roark wastewater treated. Based on the usage included in the Company's filing for Roark Water, the annualized level of expense for this contracted maintenance service alone would be $288,739 or more than 70% of the total test year plant operation expenses. An ongoing level for all plant operation expense, based on test year expense of $393,946, is reasonable. These are normal operating expenses and will continue to be incurred under MAWC ownership.

Staff should reclassify the expenses in their respective accounts and allow the Company recovery of plant operation expense in the amount of $393,946.

Thakadiyil Reb., pp. 13-14.

<u>12. Platte County Water Treatment Facility Depreciation Rate</u>

Should the rate of depreciation be accelerated on the Platte County Water Treatment Facility in order to account for the Company's anticipated retirement date for that facility?

MAWC Position: There is a known change in the life characteristics of the Platte County Water Treatment facility in this case, so the depreciation rate should be revised from the currently approved depreciation rates. The Platte County Water Treatment Facility will be retired by May 2018, as renovations to the plant will be required and it is not practical or advisable to make those renovations at this site. Consequently, based on the definition of depreciation, the remaining service value of the facility should be recovered by May 2018.

Dunn Dir., pp. 16-19; Spanos Reb., All.

<u>13. Belleville Laboratory Expense</u>

What is the appropriate amount of Belleville Laboratory expense to allocate to MAWC?

MAWC Position: The Belleville Lab is a water quality testing facility located in Belleville, Illinois that is operated by American Water Works Service Company. This facility performs sample testing for the American Water operating companies including MAWC. Those Belleville Lab costs directly attributable to MAWC are charged accordingly. The indirect costs are allocated to each of the operating companies based on the number of customers they serve.

The Staff proposes an adjustment that would represent an allocation of the indirect costs based on an average of the number of test analyses performed on all samples that were submitted to the Belleville Lab over the last five calendar years.

The current allocation method for Belleville Lab costs is functioning effectively and is widely accepted by regulators. Any perceived benefits from changing to multiple allocation methods would be offset by the overall impact on a service company system that is providing benefits for MAWC's customers. The Commission should not accept Staff's proposal to reallocate Belleville Lab costs based on test analyses performed.

Williams Reb., pp. 8-11.

14. Fuel & Power Expense

What is the appropriate amount of fuel and power expense?

MAWC Position: There are discrepancies between the percentages used by MAWC and MIEC for the Ameren Electric general increase. Also, MIEC excluded the October 2010 fuel adjustment charge, which was included in MAWC's pro forma adjustment. Additionally, subsequent fuel adjustments charges authorized by the Public Service Commission in April 2011 and September 2011 that were not included in the pro-forma adjustment, but should be included in the true-up adjustment.

Lastly, Staff has erroneously excluded the reclassification of heating expenses posted to the fuel and power expense account during the test year. An adjustment was made to reclassify the expenses from fuel and power to heating. Staff accepted the

Company's adjustment to reduce fuel expense, but ignored the adjustment require to increase heating expense in the same amount.

Tierney Reb., pp. 19-20.

E. Rate Design and Miscellaneous Issues:

1. Cost of Service/Revenue Requirements

How should rates be designed in order to collect the revenue requirement from each customer class (i.e., district specific, single tariff or hybrid)?

Should any district provide a revenue support or subsidy to another district? If so, which districts should receive support and which districts should be required to provide that support?

Should water service provide a revenue support or subsidy to sewer?

MAWC Position: MAWC has proposed to recover its total intrastate revenue requirement through consolidated tariff pricing "CTP" (or sometimes referred to as single tariff pricing or "STP"). In that regard, the Company retained the services of Paul Herbert, President of the Valuation and Rate Division of Gannett Fleming, Inc., to perform a class cost of service study which allocates the Company's statewide cost of providing water service to the following customer classifications: Rate A, consisting of residential, commercial, small industrial and other public authorities customers; Rate B, consisting of sales for resale customers; Rate J, consisting of large users; and Rate F, private fire protection customers. MAWC is proposing to recover the statewide costs associated with providing water service based on a consolidated or single tariff for each customer classification. A class cost of service study was not performed for the various sewer districts since these districts are made up of predominantly residential customers. Nevertheless, the Company is proposing consolidated tariff pricing for its sewer districts as well.

MAWC believes that CTP is appropriate for its nineteen (19) different water districts and its seven (7) sewer districts. CTP achieves a number of public policy benefits including but not necessarily limited to: 1) providing better incentives for standardized water quality among all districts; 2) providing incentives for large water companies to purchase small, underperforming water and sewer companies; 3) promoting state economic development goals; 4) improving the affordability of water and sewer service for all customers; 5) resulting in lower administrative and regulatory costs; and 6) creating a consistent regulatory approach for all utilities. All of these benefits are described in detail in the testimony of MAWC witness Dr. Karl McDermott.

Under a historic, embedded cost approach to determining a utility company's cost of service, there are going to be differences in costs such that some districts will appear to be higher cost than others. Moreover, allocations of common costs can also affect the cost differentials between districts. Common costs include management fees, corporate headquarter costs, office costs, customer service costs, depreciation expense, capital structure and income tax expense. The allocations of these common costs, while reasonable, are subject to judgment and may not result in the development of district specific revenue requirements which reflect precisely the costs of serving each area. If prices (or rates for service) are going to set based on historic, embedded costs using subjective allocations of common costs, it may be appropriate for lower cost districts to provide support to higher cost districts because cost based rates for higher cost Districts may not be just and reasonable. An inter-district revenue contribution in the setting of rates is therefore appropriate as it addresses a number of public policy goals such as: 1) avoiding rate shock; 2) promoting gradualism in rate increases; 3) promoting fairness and 4) avoiding the impact of a drastic change in the existing rate structure. If, however, rates are set on a total company cost of service (as proposed by the Company) and thus statewide costs are allocated to the various customer classes, each customer class recovers its indicated cost of service and there is no argument over the appropriate assignment or allocation of costs to districts and the issue of inter-district subsidies does not present itself.

Finally, MAWC is proposing a revenue contribution from its water operations to its sewer operations in the amount of $1.4 million. The Company is making this proposal because the results of the class cost of service study conducted by Mr. Herbert indicates that sewer rates would require substantial increases to existing customers of up to almost 400%. The Company believes that such dramatic rate increases are not reasonable and is therefore recommending a revenue contribution from its water operations to its sewer operations to mitigate the rate increases to its sewer customers.

Williams Dir., pp. 22-29; Williams Sur., pp. 37-47; Herbert Dir., All; Herbert Reb., pp. 9-12; Herbert, Sur., pp. 4-7; McDermott Dir., All; McDermott Reb., All; McDermott, Sur., All.

<u>2. Class Cost of Service & Rate Design</u>

What are the proper allocations for costs not directly assigned to a particular system?

MAWC Position: If the Company's proposal for Consolidated Tariff Pricing is accepted, it is unnecessary to allocate common costs to the various districts. If, however, CTP is not adopted and either district specific pricing or pricing based on a consolidation of less than all districts is adopted by the Commission, then it is important to properly allocate common costs to either the districts or group of districts. Common costs which must be assigned or allocated to each operating district in order to establish district specific revenue requirements include management fees, corporate headquarter costs, office costs, customer service costs, depreciation expense (developed on the basis of company-wide depreciation rates), capital structure and income tax expense (based on total company financing and tax provisions). The Company allocates these common costs primarily on the number of customers served, but also uses other factors, such as number of employees, payroll, etc., where appropriate. The allocation of common costs, while reasonable, is subject to judgment and may not result in the development of district specific requirements which reflect precisely the cost of serving each area. Nevertheless, if the Commission decides to use district specific costs for the purpose of establishing district specific rates, then the cost allocation factors used by the Company are the most appropriate.

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

MAWC Position: The appropriate basis upon which to allocate costs to each customer class is through the use of the Base Extra Capacity Method as described in the 2000 and prior Water Rates Manuals published by the American WaterWorks Association (AWWA). The Base Extra Capacity Method is a recognized method for allocating costs of providing water service to customer classifications in proportion to each customer classification's use of the commodity, facility and services. It is generally accepted as a sound method for allocating the cost of water service and has been used by the Company in previous cases. Mr. Herbert uses the Base Extra Capacity Method in performing his class cost of service study and develops the relative cost responsibility of each class of customers.

Herbert Dir., pp. 3-11; Herbert Reb., pp. 3-6; Herbert Sur., pp. 2-4.

What is the appropriate way to establish the customer charge?

MAWC Position: An appropriate customer charge is one that recovers the "fixed" costs of providing service, before any commodity (i.e., water) is provided. In Mr. Herbert's class cost of service study, the customer costs include the operation and maintenance costs associated with meters and services; the depreciation, return and taxes on meters and services; billing and collecting costs including meter reading; and the reallocated costs of public fire service which are not covered through hydrant charges. Customer costs also include a portion of administrative and general costs allocated to the customer cost components as explained and supported in the AWWA Water Rates Manual. Mr. Herbert's development of the customer charge is consistent with the AWWA Rates Manual. Based on his analysis, the 5/8 inch minimum charge was set at $16.80 per month and $30.90 per quarter (for St. Louis County customers that are billed quarterly). The increases to the larger size meters (i.e., ¾ inch through 12 inch meters) were based on the ratio of the larger meters to the 5/8 inch meter.

Herbert Dir., pp. 12-13; Herbert Reb., pp. 6-9; Herbert Sur., pp. 3.

Should the customer charge be uniform across all districts?

MAWC Position: Yes. MAWC proposes uniform customer charges applicable to all service areas, based on the customer costs indicated by its statewide cost of service study. Uniform customer charges make sense because all customers have a service line and a meter. All customers have their meters read each month (except for St. Louis

County quarterly billed customers) and all customers are billed from a common billing center. Furthermore, uniform customer charges are easier to administer and explain to customers.

Herbert Dir., pp. 12-13; Herbert Reb., pp. 6-9.

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

MAWC Position: In this case, MAWC is proposing a single block, or uniform, volumetric rate for each of the customer classifications (i.e., Rate A, Rate B and Rate J Schedules). Commodity charges are designed to recover the "variable" costs of producing water and, when designed correctly, there is no difference in the cost per gallon of providing water for the first gallon of usage in a particular customer class to the last gallon of water used. The Company's statewide class cost of service study has appropriately allocated the fixed charges to the customer charge and the variable costs to the commodity charge as well as appropriately allocated those costs among the various customer classifications. Accordingly, a single block, or uniform, commodity charge within each customer classification is appropriate.

Herbert Dir., pp. 13-14; Herbert Reb., pp. 10-11; Herbert Sur., pp. 3-4.

How should any rate increases or rate decreases resulting from this case be spread or allocated?

MAWC Position: Any rate increase resulting from this case should be based upon the Company's statewide or consolidated cost of service. The first step is to establish an appropriate rate for the miscellaneous (or activity) fees. In this case, the Company is proposing uniform fees for certain activities such as: connection (turn-on) fee, returned check charge, hydrant inspection fee, service inspection fee, etc. Once rates are set for these activities, the revenues to be derived therefrom are deducted from the total Company revenue requirement and the remaining revenue requirement is allocated to the various classes of customers and recovered through a combination of customer charges and commodity rates as indicated by Mr. Herbert's Statewide Class Cost of Service Study.

Herbert Dir., p. 11-17; Herbert Reb., All; Herbert Sur., All; Weeks Dir., pp. 17; Weeks Sur., pp. 4-5.

3. Continuous Property Records

Is the Company adequately maintaining Continuous Property Records (CPR)?

MAWC Position: Yes. MAWC has an adequate CPR system. The Company property records go back to 1939 when utilities began maintaining their property records. Like all other utilities across the United States, property records have evolved from hard documented ledger sheets to various electronic fixed asset systems. These transitions require a considerable amount of time and effort for the accounting department to process and maintain, as well as the requirement of space to store records. The degree of detail in MAWC's archives meets all the necessary requirements of record retention and is similar to that of other utilities.

Spanos Sur., All.

4. Customer Billing and Service

Is the Company in compliance with the Commission's Rule 4 CSR 240-13.015, in providing bills to customers within the appropriate billing period? If not, what must the Company do to comply with the rule?

MAWC Position: Yes. However, there are a few instances when MAWC's process of checking meter reads at several levels and, if there are anomalies, correcting the bill before it is generated and sent to the customer will result in what may appear to be a longer than 35 day billing period.

Weeks Reb., pp. 9-10; Weeks Sur., p. 17.

Are the Company's Customer Billing procedures adequate in other respects?

MAWC Position: Yes. MAWC should continue the current process. First, by checking the reads and working service orders, the Company is correcting bills prior to them being sent to the customer. Under Chapter 13, it is permissible to send corrected bills outside the 35 day window. Second, this process is effective in reducing estimated or out-of-range bills, which likewise results in a reduction in calls and reactive service orders. Thus, the process presently in place has a positive impact on customer satisfaction and on reducing costs.

Weeks Reb., p. 11.

Is the Company providing adequate Customer Service?

MAWC Position: Yes. In 2011, 91% of customers rated the overall performance of the telephone representative they spoke with as "excellent" or "very good."

Cooper Sur., p. 9.

Does the Company have appropriate prevention and detection controls in place to ensure adequate Customer Service?

MAWC Position: Yes. The Customer Service Center (CSC) considers several measures in determining the quality of customer service representative (CSR) performance. First, MAWC conducts a customer survey of customers' experiences with their service requests. The survey is organized specifically to measure and evaluate customers' experiences with the CSRs on the telephone. CSC also maintains a quality monitoring program designed to capture a random sample of calls handled by each CSR each month and evaluates them. Some calls are recorded for review by quality assurance specialists; some calls are reviewed via supervisors in side-by-side sessions with their team members.

Cooper Sur., pp. 9-10.

Should the Company continue to routinely meet with Staff to ensure compliance with Commission rules and to address any Customer Service issues raised by Staff?

MAWC Position: Yes. The CSC hosts visitors to its Alton and Pensacola locations throughout the year to facilitate discussion of performance, review training and sit side-by-side with CSRs to review call handling procedures and proficiency. Staff has participated in such visits in the last few years. CSC would welcome additional visits by Staff to discuss and review customer issues.

Cooper Sur., p. 9; Weeks Sur., p. 17.

<u>5. Union Issues</u>

Should the Company expand its Valve Exercise Program?

MAWC Position: No. MAWC should continue to perform valve maintenance as it does presently in St. Louis. There has been no indication of service issues associated with the valve operation process, there is no regulatory requirement to operate valves, and the cost to implement a full scale program would be significant and is not reflected in either the Company's or Staff's cost of service in this case.

Weeks Reb., pp. 14-15.

Is MAWC appropriately utilizing union workers?

MAWC Position: Yes. The installation of new mains is capital investment work that varies based on a number of factors, including budgets; relocation needs driven by state, county and local road work; and, work driven by developers. The staffing level required to meet these needs is currently adequate and so vacancies do not need to be filled. In addition, the size of maintenance crews required to repair water mains has been reduced by one position for typical types of main breaks, which resulted in that employee being available for construction. Meter testing is work that MAWC is beginning to outsource, so those positions do not need to be filled at this time. This reduction in headcount is driving cost savings for the business. The work is being done by a contractor at lower cost. All operating districts outside of St. Louis already outsource this work due to its specialized nature and irregular workload. An evaluation of the cost of outsourcing the work in St. Louis indicated that it would also be cost effective.

Dunn Sur., pp. 4-8; Weeks Reb., pp. 12 -13.

6. MAWC/PSC Small Water System Acquisition Policy

Should the Commission develop a policy regarding the acquisition of small water and/or sewer systems by the Company?

MAWC Position: Any such policy would need to be developed through a rulemaking (Chapter 536, RSMo) and be applicable to all parties, state-wide such that an even playing field is maintained.

7. Riverside – Public Safety and Adequacy of Service

Is the service provided in Riverside adequate from a public safety perspective? If not, what must the Company do?

MAWC Position: Yes. The water service provided by MAWC in the City of Riverside (as it is within all MAWC's districts) is safe and adequate and meets all state and federal quality of service requirements. Further, the existing mains provide the fire flows for which they are designed. Replacing mains that are not displaying other service issues solely for the purpose of increasing fire flows would increase the rate base upon which rates are set and potentially result in premature retirement of mains that are still capable of providing the service for which they were designed.

Dunn Reb., pp. 1 - 7; Dunn Sur., pp. 5-6.

8. Empire Special Contract

Should the January 19, 2012, Stipulation and Agreement as to a Special Contract for The Empire District Electric Company be approved? If the Stipulation and Contract is not approved, should the Company's interruptible tariff remain in effect?

MAWC Position: Yes. The Interruptible Industrial Water Supply Agreement (Agreement) between MAWC and The Empire District Electric Company (Empire) submitted in this case should be approved. This Agreement calls for Empire to pay the lesser of MAWC's: A) fully loaded production costs covering the operating expenses, taxes and capital costs of producing water for its Joplin District; or B) rate for manufacturers and large quantity of water approved by the Commission and applicable to the Joplin District. This Agreement is very similar to the existing Agreement that exists between MAWC and Empire and embodied in an interruptible tariff currently on file with and approved by the Commission. The new Agreement primarily extends the term of the existing contract for twenty-five (25) years. Approval of the Agreement will not affect MAWC's revenue requirement in this case. If the new Agreement is not approved, then, at the very least, MAWC believes that the existing interruptible tariff needs to be included in any revised tariffs that will be filed as a result of this case.

Williams Sur., pp. 35-37.

9. Special Accounting for Business Transformation Project/Request for AAO

What is the appropriate accounting treatment to use for the Business Transformation Project at this time?

MAWC Position: The Commission should authorize the Company to defer the booking of depreciation expense on its Business Transformation assets until the effective date of rates that include these assets in the Company's cost of service. This will more appropriately match cost recovery with expense incurrence. Also, in order to provide the Company the opportunity to earn a reasonable return on its investment, the Commission should authorize the Company to continue the accumulation of AFUDC on its Business Transformation assets until those assets are included for recovery in rates.

The Commission should authorize a twelve year depreciable life for the Business Transformation investment costs ultimately incurred. Twelve years corresponds closely to the useful life of the Company's previous information systems.

Williams Dir., pp.31-37; Williams Reb., pp.15-17; Williams Sur., pp.2-17.

10. Jefferson City Upgrades

What is the status of the Jefferson City upgrades?

MAWC Position: MAWC generally agrees with the status as described in the Direct Testimony of City of Jefferson witness Robert Rennick. MAWC does not believe that there is an issue to be decided by the Commission in regard to this matter.

WHEREFORE, MAWC respectfully requests that the Commission consider these statements of position.

Respectfully submitted,

____

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CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been sent by electronic mail this 15th day of February, 2012, to:

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