

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

In the Matter of Missouri-American Water)	
Company's Request for Authority to)	Case No. WR-2008-0311
Implement a General Rate Increase for)	SR-2008-0312
Water and Sewer Service Provided in)	
Missouri Service Areas.)	

**RESPONSE OF THE CITY OF JOPLIN TO COMMISSION'S
ORDER REGARDING TRUE-UP**

COMES NOW the City of Joplin, by and through counsel, and pursuant to this Commission's Order of October 7, 2008, responds as follows regarding the appropriate period for true-up in the above-captioned matter.

The current case was filed by Missouri American Water on March 31, 2008 with the Commission. Missouri American Water proposed a test year of calendar year 2007 for purposes of determining the proper rates to be set by this Commission on a going forward basis. The City of Joplin does not object to the test year of calendar year 2007; however, the City of Joplin does object to an additional nine (9) month true-up period as an extension on to that test year.

The current case is set for hearing before this Commission commencing on October 30, 2008. Based upon the issues presented to the Commission in this case, it is imperative for all parties to understand the specific and exact amount of additional plant put into service prior to commencement of the evidentiary hearing on October 30, 2008. However, based upon Missouri American Water's position that true-up should go through September 30, 2008, that information is not yet available with only three weeks to go until the hearing. Moreover, even if such information were provided immediately, there is limited time to evaluate the position prior to that October 30, 2008 hearing.

Conversely, using a test year of calendar year 2007 and a true-up period of six (6) months far more standard to cases before this Commission (concluding June 30, 2008), would allow Missouri

American Water to immediately produce complete, full and accurate information regarding plant put in service by that cut off date. While the time frame is tight, it may be possible to have meaningful discovery on that additional plant prior to the beginning of the hearing on October 30, 2008.

The entire true-up process, in and of itself, should not even occur in rate cases due to the ability to do a fully adjusted test year which is capped at a six (6) month period beyond that test year (June 30, 2008 in this case). Attached to this Response are portions of City of Joplin's expert's Rebuttal Testimony submitted by Michael J. Ileo, Ph.D., to this Commission on September 30, 2008.

The City of Joplin supports the testimony of Dr. Ileo and urges this Commission to adopt Dr. Ileo's position and not authorize any true-up period, or in the alternative to cap that true up period at June 30, 2008.

The use of any true-up period is questionable based upon precedent of the Missouri Court of Appeals regarding test year issues. In *State ex rel. Southwestern Bell Telephone Company v. Public Service Commission of Missouri*, 645 S.W.2d 44 (Mo. App. W.D. 1982), the Western District Court of Appeals reviewed the general concept of using true-up vis-a-vis a test year:

In this case the Commission has adopted and applied an approach widely used and approved with respect to CWIP generally. The special question for consideration here is whether any reason exists to mandate different treatment where the work in progress will be completed within a short time (here within a period of four and one-half months from the end of the test period). Even though that span of time be short and the facility may be expected to be in use before the commencement of the new period for which rates are being set, nevertheless there is good reason not to include the short term construction in the rate base.

The accepted way in which to establish future rates is to select a test year upon the basis of which past costs and revenues can be ascertained as a starting point for future projection. In the case of construction work in progress, whether long term or short term, the

facility has not been in use during the test year and hence no revenues from the use of that facility or reduction in expenses accruing from that facility has been reflected in the test year figures. Thus, to put into the equation the cost of those facilities without consideration of counterbalancing benefits would warp the projections. This consideration is well expressed in *New England Tel. & Tel. Co. v. Public Utilities Commission*, 448 S.2d at 294:

“It is immaterial that some of the construction work in progress is likely to be completed and go into service in the near future. A basic assumption of the test-year concept is that, over all, the test year is representative of the foreseeable future. The elements that go into the test-year computations of income and expense are not scrutinized individually to determine the degree of likelihood that particular items will recur or disappear or change in the relatively near future. To permit such scrutiny would be to make the test-year concept unworkable as a device for prediction of net revenues.”

Id. at 53. As can be seen, the Western District Court of Appeals has directly called into question the concept of a true-up to a test year. In *State ex rel. Southwestern Bell*, the “true up” period was four and one-half months, unlike the period proposed by Missouri American Water, which is double that: nine months. Missouri American Water had another option, they could have waited to file their rate case until all the plant was in service and then use a test year of September 30, 2007 through September 30, 2008. It chose not to and should not get to bootstrap that extra time period into its self-selected test year of calendar 2007.

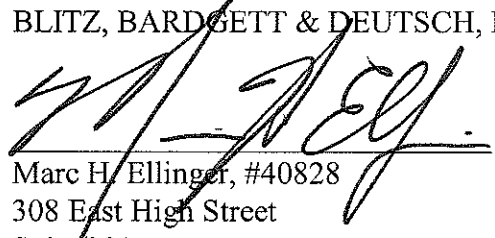
This Commission should adopt the reasoning of the Western District Court of Appeals in *State ex rel. Southwestern Bell* and deny the use of a true-up period whatsoever. In the alternative, it should limit the true up period to an amount that is fixed and known prior to the filing of direct testimony in the case; in this case, the latest possible date being June 30, 3008.

WHEREFORE, Intervenor City of Joplin prays that this Commission either hold that no true up should be authorized for this case or, in the alternative, limit the true up period to an amount that is fixed and on the books as of the date of filing of testimony in this case, June 30, 2008, and for such other relief as this Commission deems appropriate.

Respectfully submitted,

BLITZ, BARDGETT & DEUTSCH, L.C.

By:



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CERTIFICATE OF SERVICE

I hereby certify that true copies of the above and foregoing were sent to each of the following persons via electronic mail, on this 9th day of October, 2008:

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Exhibit No.:
Issue: Cost Allocation, Rate Design & Related Matters
Witness: Michael J. Ileo
Party: City of Joplin, MO
Type of Exhibit: Rebuttal Testimony

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

*Attachments
to
Response*

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

CASE NO. WR-2008-001
CASE NO. SR-2008-0312

**REBUTTAL TESTIMONY AND SCHEDULES
OF MICHAEL J. ILEO, PH.D.**

**ON BEHALF OF
THE CITY OF JOPLIN, MISSOURI**

SEPTEMBER 30, 2008

Technical Associates, Inc.

1 Q. WILL YOU ILLUSTRATE THE INABILITY TO CONDUCT MEANINGFUL
2 ANALYSES?

3 A. Yes. In the first instance, the undetailed true-up estimate of \$4.015 million for
4 Joplin serves to transform an aggregate 9.24% revenue decrease (i.e., -\$1.223/\$13.320)
5 into an aggregate 20.96% revenue increase (i.e., \$2.792/\$13.320). If the true-up estimate
6 is inaccurate by $\pm 25\%$, then such a projection error could mean that Commission Staff
7 will have actually proposed a revenue increase for Joplin of nearly 29%; i.e.,
8 $[(1.25 \times \$4.015) - \$1.223] / \$13.320$.

9 Further, the distribution of the true-up amount among USOA may have a material
10 impact on Joplin residential rates. Under the $\pm 25\%$ estimation error scenario, for
11 example, the proposed flat commodity rate in the CCOSS of Commission Staff for Joplin
12 could rise from \$2.5504 to \$4.2448 per 1,000 gallons if all of the true-up amount
13 pertained to USOA excluded from Commission Staff's calculations of customer costs.
14 The derivation of the \$4.2448 is based on data in Commission Staff CCOSS Schedule 1-1
15 and 2-SJOP as presented in Schedule MJI-2 to my testimony.

16 Given present residential prices of MAWC in Joplin as reported earlier in my
17 testimony, a commodity rate rise to \$4.2448 would be of substantial concern. However,
18 this and many other potential outcomes are shrouded in great uncertainty, which is
19 removable only upon necessary full documentation from Commission Staff regarding its
20 true-up estimates.

21
22 **3.0 FULLY-ADJUSTED TEST YEAR**

23
24 Q. IS THERE AN ALTERNATIVE TO REQUIRING COMMISSION STAFF TO
25 DOCUMENT ITS TRUE-UP ESTIMATES?

26 A. Yes. A more effective solution to the uncertainties posed by the current true-up
27 process is to replace it with a procedure that far better comports with the goals of sound
28 regulatory practice. More specifically, I recommend that the Commission adopt for
29 ratemaking in the future a fully-adjusted test year, where all adjustments would be limited
30 to anticipated experience within the period extending six months beyond the close of the
31 per books test year.

1 If the indicated fully-adjusted test year were in place for this proceeding, none of
2 the uncertainties and burdens described earlier in my testimony would prevail. All
3 parties would focus on the 2007 test year of the Company, including its proposed
4 adjustments for expected events through June 30, 2008. No true-up at some point in the
5 future on a retrospective basis would be required, such that additional testimony and
6 hearings would become unnecessary. Put otherwise, the Commission would render its
7 decision based on the best available information through June 30, 2008, evaluated solely
8 within the present context of this case without some future and unknown true-up process.
9 And it follows, accordingly, that the true-up estimates of Commission Staff would also
10 become unnecessary.

11
12 **Q. WHAT IS THE BASIS OF YOUR RECOMMENDATION?**

13 A. As I read the August 18, 2008 Cost of Service Report of Commission Staff,
14 specifically at Pages 2 and 3, no statute, rule, or precedence governs the true-up process.
15 Thus, a host of uncertainties arise at the outset. The referenced discussion of
16 Commission Staff also notes that “true-ups involve the filing of additional sets of
17 testimony and the scheduling of additional evidentiary hearings,” which creates further
18 obstacles to and burdens for a meaningful rate case participation by a party such as
19 Joplin.

20 Based on the referenced discussion, moreover, the need for a true-up process
21 appears to be rooted in MAWC’s request for a fully-adjusted test year through September
22 30, 2008, largely involving plant that it expects to place in service between December 31,
23 2008 and that date. Commission Staff, on the other hand, has applied an update period
24 beyond the 2007 test year of March 31, 2008 in its revenue requirement determinations,
25 albeit coupled with highly tentative true-up estimates presumably as a means of filling
26 the void for the period of April 1, 2007 through September 30, 2008. These tentative and
27 undocumented estimates are indicative of Commission Staff’s position that “it would not
28 be able to perform a true-up audit” within the confines of this case given its initial
29 procedural scheduling. Commission Staff’s concerns were addressed by a June 30, 2008
30 Order of the Commission, “which rescheduled the evidentiary hearing and true-up

1 hearing dates.” Thus, with the layering of future evidence and hearings on top of present
2 uncertainties, the burdens for Joplin (undue in my judgment) have mounted.

3 While not so stated in its Cost of Service Report, Commission Staff’s position
4 appears to rest on the view that a retrospective audit is essential if a test year is to be
5 fully-adjusted for anticipated events extending as far as nine months beyond the close of
6 the per books period. While I share the concerns of Commission Staff, I also submit that
7 the adoption of my recommendation will address this concern in a balanced manner that
8 obviates the need for retrospective true-up audits, new testimony and protracted hearings,
9 and related events that effectively serve to bar meaningful rate case participation.

10
11 **Q. WHEN YOU SAY, DR. ILEO, THAT YOU SHARE COMMISSION STAFF’S**
12 **CONCERNS, TO WHAT DO YOU REFER?**

13 A. Regulated utilities are afforded an opportunity rarely enjoyed by competitive
14 firms; i.e., the ability to begin recovering with near certainty the investment costs of new
15 plant and equipment, including allowances for funds used during construction. Sound
16 regulatory practice necessitates, therefore, considerable assurance that this new
17 investment meets such standards as prudently incurred, used and useful, and honest and
18 efficient management. The longer the period between the close of the per books test year
19 and the end of the fully-adjusted test year, the greater is the scrutiny required to ensure
20 that these regulatory standards have been fulfilled with respect to projected new plant and
21 equipment. Retrospective true-up audits serve to address these matters, but they also
22 impose a significant and unnecessary burden on the regulatory process.

23
24 **Q. WHY DO YOU CHARACTERIZE RETROSPECTIVE TRUE-UP AUDITS AS**
25 **IMPOSING AN UNNECESSARY BURDEN ON THE REGULATORY PROCESS?**

26 A. The need for retrospective true-up audits should not arise in the context of a rate
27 case, as the responsibility of demonstrating that projected new investment costs meet the
28 standards referenced in my previous answer should rest solely with the applicant utility.
29 If this demonstration is found to be highly speculative or otherwise unreasonable, then
30 the forecasted new investment should not be allowed in determining revenue
31 requirements within the context of the rate case at issue. Relative to what occurs in

1 competitive markets, a strict adherence to the indicated decision-making framework is
2 fully consistent with sound regulatory practice.

3 Recall, again, that unregulated businesses bear great risk when undertaking new
4 investment projects. To illustrate, when General Motors retools a manufacturing plant,
5 considerable uncertainty exists as to how and when corresponding investment costs are to
6 be recovered. Automobile, truck, and related market conditions over an extended period
7 of time will ultimately determine these outcomes.

8 Regulated utilities, on the other hand, are nearly certain that they will be able to
9 recover new investment costs assuming prudence and other regulatory standards have
10 been fulfilled. This recovery, moreover, will occur in a known and measurable manner;
11 i.e., annual depreciation over a given time period plus a fair return on the undepreciated
12 portion of the investment. Recovery also will begin shortly after the new investment is
13 placed into service. The only uncertainty confronted by a regulated utility is precisely
14 when recovery will start, which will depend on its ability to demonstrate reasonableness.
15 An initial failure in this regard, moreover, is easily rectified in a subsequent rate case.

16 Against this backdrop, I submit that retrospective true-up audits are unwarranted,
17 inconsistent with sound regulatory practice, and impose an undue burden on a participant
18 such as Joplin. Adoption of the fully adjusted test year procedure without true-ups that I
19 propose will remedy present circumstances. Further in this regard, if Commission Staff
20 concludes that the only way to meet reasonableness standards is by way of a true-up, then
21 the corresponding projected new plant and equipment should be disallowed for
22 ratemaking within the context of the proceeding in question.

23
24 **Q. PLEASE DESCRIBE THE UNDUER BURDEN PLACED ON JOPLIN.**

25 A. The undue burden attributable to retrospective true-up audits is of twofold nature.
26 First, until the true-up phase of this case begins, and despite the present large volume of
27 materials that have required consideration, Joplin is unable to gauge the comparative
28 revenue and rate impacts that it will confront under the proposals of the Company relative
29 to those of Commission Staff. Second, in order to reach the point in time when such
30 comparative analyses can be meaningfully performed and addressed, an expenditure of
31 considerable resources is required.

1 Q. WHY WAS SIX MONTHS AFTER THE CLOSE OF THE PER BOOKS TEST
2 YEAR SELECTED IN YOUR FULLY-ADJUSTED TEST YEAR PROPOSAL?

3 A. In my professional experience, such a six-month timeframe is frequently utilized
4 by regulatory authorities. Moreover, it strikes a balance between the March 31, 2008
5 update period currently employed by Commission Staff and the September 30, 2008
6 projection period proposed by the Company.

7
8 Q. SHOULD THE COMMISSION DECIDE TO CONTINUE WITH A TRUE-UP
9 PROCEDURE, ARE THERE OTHER MEANS OF EASING RATE CASE
10 PARTICIPATION BURDENS?

11 A. Yes. Along with the adoption of the presentation and documentation methods
12 recommended in my Direct Testimony, the implementation of a bifurcated proceeding
13 would ease the burdens of participating in a rate case involving MAWC should the
14 Commission wish to continue with the true-up process. Phase I would be directed at
15 establishing overall and District revenue requirements for the Company, while Phase II
16 would address customer class cost of service and rate design issues. Thus, an intervenor
17 such as Joplin with limited resources would be able to tailor its rate case participation in
18 Phases I and II to matters of primary interest without confronting the considerable
19 uncertainty that currently exists.

20 With a bifurcated proceeding, for example, the difficulties encountered in meeting
21 current rebuttal stage requirements would be substantially lessened. Presently, only
22 roughly a 30 to 45 day period has been available to address the direct case filings of
23 parties other than MAWC depending on whether August 18 or September 3, 2008 is
24 considered. Normally, such a period of time would be adequate if coupled with an
25 expeditious response timeframe; e.g., 7 to 10 days. However, given the complexities and
26 expansiveness of the revenue requirement, cost allocation, and rate design issues at hand
27 (as exhibited in the submissions of Commission Staff), as well as that an expeditious
28 discovery response period has not been adopted, 30 to 45 days for the preparation of
29 rebuttal testimony has been insufficient -- especially with the uncertainties of the true-up
30 procedure. A separation of issues into Phase I and II would greatly ameliorate these
31 difficulties.

1 **Q. WOULD A BIFURCATED PROCEEDING TAKE LONGER TO PROCESS?**

2 A. Yes, at least in overall terms and if a nine-month timeframe is utilized as the true-
3 up standard. But at the same time, revenue requirement findings by the Commission will
4 be both made and put into effect sooner, such that regulatory lag will be shortened from a
5 revenue requirement perspective. On the other hand, MAWC's customers will confront
6 two sets of rate changes; i.e., Phase I findings implemented at presently authorized rate
7 structures in an across-the-board manner, and Phase II findings that institute new rate
8 designs.

9 For reasons suggested, a fully-adjusted test year using a six-month adjustment
10 period without a true-up is preferable to a bifurcated proceeding. Relative to present
11 circumstances, however, both types of regulatory procedures will better accommodate
12 rate case participation by parties representing vital public interests such as Joplin.

13
14 **4.0 RATE INCREASE PHASE-INS**

15
16 **Q. WHY DO YOU REQUEST THAT THE COMMISSION PERMIT A PHASING-IN
17 OF THE RATE INCREASES THAT MAY RESULT FROM THIS CASE?**

18 A. My proposal is largely directed at Joplin, although it may be equally applicable to
19 other MAWC Districts; e.g., the Company proposes revenue increases of about 20% or
20 more for each of its three Sewer Districts and six of its ten present Water Districts as
21 reported in Appendix A of its Minimum Filing Requirements attached to Mr. Petry's
22 March 31, 2008 Direct Testimony.

23 With particular respect to Joplin, I noted in my Direct Testimony (Page 6) that it
24 sustained roughly a 62% increase in aggregate rates less than a year ago. Further given
25 the evidence to date in this proceeding, a significant probability exists that Joplin will
26 confront another substantial (double-digit percent) rate hike. MAWC requests, for
27 example, that Joplin revenues be increased by nearly 39%. Albeit that the final position
28 of Commission Staff in this regard remains unknown, the revenue increase implicit in its
29 current true-up estimate for Joplin is about 21%, and 29% if this estimate is subject to a
30 +25% projection error.

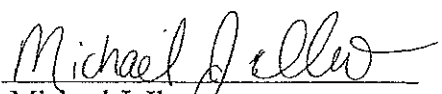
BEFORE THE PUBLIC SERVICE COMMISSION
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IN THE MATTER OF MISSOURI-AMERICAN)
WATER COMPANY FOR AUTHORITY TO)
FILE TARIFFS REFLECTING INCREASED)
RATES FOR WATER AND SEWER SERVICE)
_____)

CASE NO. WR-2008-0311
CASE NO. SR-2008-0312


AFFIDAVIT OF MICHAEL J. ILEO

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



Michael J. Ileo

State of Virginia
City of Richmond
SUBSCRIBED and sworn to
Before me this 30th day of September 2008.



Notary Public

My commission expires: 3/31/10
Registration No.: 270986