Exhibit No.:	
Issue:	*AFUDC and Phase-In*
Witness:	*STEPHEN M. RACKERS*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Surrebuttal Testimony*
Case No.:	*WR-2000-281 et al.*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

STEPHEN M. RACKERS

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2000-281 et al.

Jefferson City, Missouri
May, 2000

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OF

STEPHEN M. RACKERS

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2000-281 et al.

Q. Please state your name and business address.

A. Stephen M. Rackers, 815 Charter Commons Drive, Suite 100 B, Chesterfield, Missouri 63017.

Q. Are you the same Stephen M. Rackers who previously filed direct and rebuttal testimony in this case?

A. Yes, I am.

Q. By whom are you employed and in what capacity?

A. I am a Regulatory Auditor V in the Accounting Department, in the St. Louis Office, for the Staff (Staff) of the Missouri Public Service Commission (Commission).

Q. What is the purpose of your surrebuttal testimony?

A. My surrebuttal testimony will respond to the rebuttal testimonies of the following individuals and topics:

1) Missouri-American Water Company (MAWC or Company) witness James E. Salser regarding allowance for funds used during construction (AFUDC) and phase-in;

2) Company witness James M. Jenkins regarding the financial impact of phase-in;

3) Company witness Harold Walker regarding recovery of phase-in deferrals;

4) Company witness William M. Stout regarding the impact of district specific pricing; and,

5) Office of Public Counsel (OPC) witness Russell W. Trippensee regarding phase-in.

AFUDC

Q. Do you agree with Mr. Salser's comments related to AFUDC on pages 5 through 7 of his rebuttal testimony?

A. No. Mr. Salser relies on two arguments in his rebuttal testimony. The first argument is simply that the Staff has not previously proposed an adjustment to the methodology that the Company has used for many years to calculate its AFUDC rate. The second argument is that the Company would be required to reduce its net income and experience a reduction in its return on equity, over a five-month period, if the Staff's adjustment is accepted.

Q. Are either of these arguments a valid reason for not accepting the Staff's adjustment?

A. No. Regardless of how long the Company has used a methodology, when the Staff becomes aware of an inappropriate practice that materially affects the cost of service, the Staff has a duty to bring the situation to the Commission's attention. The Company's methodology is not validated simply because the Staff has not previously proposed an adjustment.

In addition, Mr. Salser's calculations regarding the return on equity are inappropriate and misleading. Rates are not set for five-month intervals. The returns on equity proposed by the various parties reflect annual returns. The five-month return provided by Mr. Salser is not comparable to these annual returns on equity.

Q. Have you calculated the annual return on equity including the adjustment for AFUDC?

A. Yes. The annual return on equity, including an adjustment for the write-off of disallowed AFUDC, would be 7.88% for the twelve months ending September 30, 2000. This level is substantially higher than the return cited by Mr. Salser.

PHASE-IN

Q. Do you agree with Mr. Salser's comments regarding phase-in on pages 7 and 8 of his rebuttal testimony?

A. No. Mr. Salser's conclusions regarding the Staff's inclusion of accumulated depreciation and deferred taxes in the first year phase-in rate base are incorrect. These amounts were included to reflect the fact that the plant would be in service prior to the effective date of the rates from this case and prior to the start of the phase-in. The Staff assumed that the plant would go into service approximately six months prior to the effective date of the rates and the start of the phase-in. As a result, depreciation and deferred taxes would have accumulated prior to the start of phase-in. The amounts that accumulate beyond the true-up cut-off date are not usually included as offsets to rate base. However, since the Commission granted the Company an Accounting Authority Order (AAO), allowing the deferral of depreciation and a continuation of AFUDC, recognition of rate base offsets beyond the true-up cut-off date is appropriate.

Q. If the Commission allows recovery of the deferred depreciation and continued capitalization of AFUDC, according to the AAO, would recognition of these amounts, in phase-in, be appropriate?

A. Yes. However, consistent with the Staff's recommendation of no recovery of the amounts accumulated according to the AAO, these offsets should be removed from the phase-in calculation.

Q. Are there other problems with Mr. Salser's proposal to include half of the first year phase-in deferrals in rate base?

A. Yes. Mr. Salser is suggesting that it is appropriate to recognize half of the annual depreciation and deferred income tax expense as well as phase-in deferrals in the calculation of the rate base, but only for the new St. Joseph Treatment Plant (SJTP). If this concept was consistently applied to all the other plant investments, total company rate base would be reduced by over $2 million for a half year of depreciation and deferred taxes on other plant in service. It would be inappropriate to apply the concept suggested by Mr. Salser to only one of the Company's investment items.

Q. What is your response to Company witness Jenkins' rebuttal testimony regarding phase-in and financial earnings on pages 5 and 6.

A. The Staff is mindful of the fact that its phase-in proposal may cause a reduction in the level of earnings reported on the Company's financial statements. However, this proposal is being recommended in light of the severe level of increased rates that would be experienced absent a phase-in. In addition, although reported earnings may be initially reduced, the Staff's proposal accumulates deferrals that will be reflected in the Company's rates and reported financial statement earnings in the future. As Mr. Jenkins recognizes in his testimony, these deferrals will receive a carrying cost equal to the rate of return until fully reflected in rates. This compensates the Company for the time value of money during the general period.

Q. What is your response to Company witness Walker's rebuttal testimony on page 23, regarding the recovery of regulatory deferrals?

A. Mr. Walker's statements insinuate that the Commission may not allow recovery of phase-in deferrals in the future. Such a statement is totally baseless. In the previous two phase-ins ordered by the Commission, involving Union Electric Company and Kansas City Power and Light Company, all amounts deferred were reflected in the cost of service and rates. There is no reason to believe that the Commission or its Staff would not propose to reflect amounts previously deferred, under an ordered phase-in plan for MAWC, in the cost of service.

Q. Is Mr. Walker's statement on page 23 of his rebuttal testimony about the Company being forced to continue deferrals or forgo recovery of deferrals due to future rate increases required by future plant additions correct?

A. No. This statement is incorrect and baseless. Nothing in the Staff's phase-in proposal prevents the Company from filing a rate increase to address future plant additions or other changes in the cost of service. Any rate case filing during the phase-in period would require an examination of the total cost of service. However, this examination would not prevent recovery of amounts already deferred. Again, the past actions of the Commission and/or the Staff provide no basis for the insinuation that amounts deferred under an ordered phase-in plan for MAWC would not be reflected in the cost of service.

Q. In response to Company witness Stout and other parties in this case, is the Staff recommending that phase-in be expanded beyond the new SJTP?

A. Yes. The Staff recommends that the revenue requirements be phased-in for districts experiencing significant increases in rates. This will help mitigate the rate shock to customers that result from significant plant additions and the adoption of district specific pricing. The allocation of the phased-in revenue requirements to customer classes is discussed in the surrebuttal testimony of Staff witness Randy Hubbs. This method of phase-in for the revenue requirement is easier to implement than a phase-in of discrete plant items, as the Staff previously recommended for the SJTP.

Q. During what period of time would the Staff recommend that the cost of service be phased-in?

A. The Staff recommends that the revenue requirement be phased-in over a five-year period. As stated in my direct testimony, a five-year phase-in should provide the Company with a higher level of confidence than a longer period would provide. However, the length of the phase-ins can be increased if the Commission determines that the level of rate increase is still too severe. Regardless of the length of the phase-in, the Staff recommends that the Company be allowed to earn a carrying charge, equal to the rate of return authorized by the Commission, on any amounts deferred.

Q. Is it necessary for a phase-in to contain an automatic rate reduction as OPC witness Trippensee states on pages 3 through 5 of his rebuttal testimony?

A. No. Mr. Trippensee's proposal assumes that the cost of service over the life of the phase-in will not increase as a result of other factors by the amount of the amortization of deferrals following the final year of the phase-in. I believe that since the Company will continue to be in a construction mode, its cost of service will also continue to increase. At this point, the level of increase is uncertain. However, the Staff intends to examine the change in the cost of service during the phase-in and has asked the Commission to order the Company to provide monitoring reports to facilitate this effort. The positive aspect, of ordering an automatic reduction in rates, for the year following the full recovery of phase-in deferrals, is that the Company will be required to take action, such as filing a rate case, or it will experience a significant rate reduction. I believe the Company will almost certainly file a rate case to address this situation. Without an automatic rate reduction provision, the Staff or another party will have to take action, such as filing a complaint case, to address the possible overearnings situation. Although OPC's proposal will require initial action on the part of the Company, either proposal will result in an audit being performed to address the change in the cost of service.

Q. Does this conclude your direct testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

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

AFFIDAVIT OF STEPHEN M. RACKERS

STATE OF MISSOURI	)	
	)	ss.
COUNTY OF COLE	)	

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

Stephen M. Rackers

Stephen M. Rackers

Subscribed and sworn to before me this 25th day of May 2000.

Sharon S Wiles

SHARON S WILES
NOTARY PUBLIC STATE OF MISSOURI
COLE COUNTY
MY COMMISSION EXP. AUG. 23,2002