

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

In the Matter of Missouri-American Water)	
Company's Request for Authority to Implement)	Case No. WR-2010-0131
a General Rate Increase for Water and Sewer)	SR-2010-0135
Service Provided in Missouri Service Areas.)	

STAFF'S STATEMENT OF POSITION

COMES NOW the Staff of the Missouri Public Service Commission ("Staff"), by and through counsel, and submits its Statement of Position on the issues of this case respectfully stating the following:

REVENUE REQUIREMENT

Rate of Return Issues

1. **Capital Structure:** What capital structure, MAWC stand alone or American Water consolidated, should be used for determining MAWC's rate of return?

The appropriate ratemaking capital structure for MAWC is the consolidated capital structure of American Water Works Company, Inc. as of September 30, 2009.

2. **Long Term Debt Cost:** What cost of long term debt should be used for determining MAWC's rate of return?

The appropriate cost of long term debt for MAWC is 6.18%.

3. **Return on Common Equity:** What return on common equity should be used for determining MAWC's rate of return?

The proper return on common equity is in the range of 8.95 percent to 9.55 percent with a mid-point of 9.25 percent. The appropriate overall rate of return for MAWC on its jurisdictional utility rate base is in the range of 7.39 percent to 7.65 percent with a mid-point of 7.52 percent.

Rate Base Issues

4. **Cedar Hill Sand Creek Sewage Treatment Plant:** Should the capital and depreciation expense costs associated with the capacity expansion project of Cedar Hill Sand Creek sewage treatment facility be disallowed for ratemaking in this proceeding?

Yes, a portion of the capital and depreciation expense costs associated with the expansion project of the Cedar Hill Sand Creek sewage treatment facility should be disallowed for ratemaking in this proceeding based on unused capacity. Recovery of these costs may be possible in future rate proceedings as additional customers are connected. The Staff is not contesting the prudence or timing of the construction of the plant, thus the Company will not have to write the asset off its books. Inclusion of all of the costs of the expansion without the new customers available to pay results in both rate shock and an undesirable impact upon existing customers in that they are being required to pay the entire cost of an expansion project that is necessary to serve future customers.

5. **Cash Working Capital:** What is the appropriate amount to be included in MAWC's rate base for cash working capital?

The appropriate amount to be included in MAWC's rate base for Cash Working Capital (CWC) should be an amount that is calculated using the appropriate lags purposed by the Staff as described below.

Management Fee Expense Lag

The appropriate lag to be used when calculating the cash working capital required for rate base as it relates to the management fee expense for MAWC is a positive 23.99 days. Cash working capital is included in rate base to compensate investors for the lag between the time service is rendered and revenue is received for that service. In this instance, the management fee is charged by an affiliate in advance. On the other hand, MAWC's non-affiliated vendors provide goods and services on credit. MAWC's affiliate should not get preferential treatment by requesting prepayment of services it provides. The appropriate expense lag for management fee is the same

as that for other third-party vendors who supply goods and services to the utility on an arm's length basis – a positive 23.99 days.

Cash Voucher Lag

The appropriate lag to be used when calculating the cash working capital required for rate base as it relates to the cash vouchers lag for MAWC is a positive 23.99 days. The receipt and payment of third-party invoices are handled by MAWC's affiliate service instead of on a district by district level. The Staff opposes the calculation of the cash vouchers lags on a district level, as this is not representative of the operations at MAWC.

Service Lag for St. Louis Metro District

The appropriate lag to be used when calculating the cash working capital required for rate base as it relates to the service lag for St. Louis Metro (SLM) is a positive 37.43 days. The service lag is the midpoint of the period of time elapsed from the beginning of the first day service is provided to the last day of a service period. The SLM District has both monthly and quarterly customer and the Staff used a weighted average based on the percentage of revenues in each customer class.

Unemployment Tax Lag

The appropriate lag to be used when calculating the cash working capital required for rate base as it relates to the unemployment taxes lag is a positive 60.78 days. The Staff proposed a weighted average of these unemployment taxes (FUTA & SUTA) based on a percentage of the dollar amount paid. FUTA & SUTA are paid quarterly and a 60.78 days lag accurately reflects this. The Staff used the 11.32 day lag for FICA calculated by the Company.

Collections Lag for Brunswick and Cedar Hill Districts

The Staff believes the collection lag should be calculated by dividing the actual average daily

accounts receivable balance by the Staff's annualized revenues. MAWC has demonstrated poor cash recovery practices in the Brunswick and Cedar Hill Districts and the Staff has proposed a 50% reduction the collection lag in these districts in order to reflect a normal collection pattern. It is also the position of the Staff to update the actual average daily account receivable balance as of the true-up date April 30, 2010 in calculation of the collection lag for all twelve (12) districts.

6. **Rate Base for Security Deferral:** Should the unamortized balance of deferred security costs be included in rate base?

The Staff opposes MAWC's recommendation that the unamortized balance of the security related deferrals be included in rate base. In other cases involving AAOs, the Commission has allowed a return of, but not a return on, the deferred expense. This is because AAOs protect shareholder earnings and not customers. Costs are deferred so that the expenses do not reduce earnings in the year they are incurred.

Accumulated Deferred Income Taxes Associated with the Security AAO:

7. Should accumulated deferred income taxes associated with the Security AAO be included as an offset to rate base?

Accumulated deferred income taxes associated with the Security AAO should be included as an offset to rate base regardless of the rate base treatment given the unamortized balance of the AAO. Deferred taxes are simply the result of timing differences between when a company deducts certain expenses on its tax return and when it deducts the expense for ratemaking purposes. The deferred tax reserve represents, in effect, a prepayment of income tax by Missouri-American customers and therefore should be an offset to rate base in recognition of the customers' prepayment.

8. Does this change if the unamortized balance of the security AAO is not included in rate base?

No, as explained in the answer to question 7. above.

9. **OPEB Contribution to External Fund (related to St. Louis County Water Company Amount):** Should the regulatory asset, associated with the unrecovered St. Louis County Water Company FAS 106 transition cost be included in rate base?

The Staff has researched and reviewed this alleged deferral and has found no evidence of Commission ordered rate treatment for this deferral. The only discussion of this deferral that the Staff found was in Case No. WR-94-166 (St. Louis County Water Company) by Company witness James Jenkins in his Direct Testimony, pages 44-45. The Staff can find no evidence that Mr. Jenkin's proposal to include this deferral in rate base was adopted in either the Stipulation and Agreement or the Commission Order for that case or any subsequent MAWC rate case.

10. **Comprehensive Planning Study:** Should the costs incurred by MAWC as part of its Comprehensive Planning Study be included in rate base?

The Staff takes no position on this issue at this time. The Staff believes this is an issue for true-up and will review the costs incurred as part of the true-up audit.

11. **Business Transformation Costs:** What is the appropriate accounting treatment for costs currently being incurred by MAWC for implementing its Business Systems conversion?

The Staff takes no position on this issue at this time. The Staff believes this is an issue for true-up and will review the costs incurred and the appropriate accounting treatment as part of the true-up audit.

12. **Pension and OPEB Trackers (related to Service Company costs):** Should the current MAWC Pension and OPEB Trackers be extended to include the Service Company Pension and OPEB costs?

The Staff is opposed to including the Service Company Pension and OPEB expenses as part of the Pension and OPEB trackers because the Company is requesting ratemaking treatment for the costs of another American Water Works Company (AWW) subsidiary (the Service Company) that is a non-regulated subsidiary. The Service Company is a non-regulated wholly-owned subsidiary of American Water Works Company, which provides services to AWW's other

wholly-owned subsidiaries. The Service Company provides services to MAWC and in return MAWC compensates the Service Company for said services.

Tank Painting Tracker:

13. Should the existing tank painting tracker be continued?

No. The Staff believes that tank painting expense is a planned on-going maintenance cost that is incurred every year just like any other maintenance costs the Company incurs. While the expense level for tank painting may fluctuate year to year, this type of maintenance activity does not require special ratemaking treatment that would allow the Company guaranteed dollar for dollar recovery of the expense. Instead, a normalized level of tank painting expense can be established and included in the cost of service.

14. Should the balance of the current Tank Painting Tracker be included in rate base?

Yes. If the Company has incurred this cost and the cost has not been recovered through rates, the Company is entitled to earn a return on this amount. Likewise, if the Company has not expended the money for this expense, then the ratepayer should be compensated for the money not expended but collected through rates by including the liability as an offset to the rate base.

Revenue Issues

15. **Customer Water Usage Normalization (Usage per Customer per Day):** What is the appropriate method to use to normalize customer water usage?

The appropriate method to normalize customer usage data is using a six (6) year average. The Staff used known usage numbers provided by the Company to compute an average usage per customer for the years of 2002 through 2009. Data for the years of 2003 and 2006 were excluded from the calculations because the Company has found the data to be unreliable due to billing method changes that occurred in those years. Averaging the actual usage from the current decade allows for the varying rainfall amounts and temperatures that occurred in that time

period, for each service area, and is therefore the most reliable prediction method to use. Further, trends in water usage due to conservation practices or lawn size/irrigation practices may be unique to any given service area, and would also be accounted for in an average of actual usages.

16. **Revenue Normalization (Weather):** What is the appropriate weather-normalized revenue to be used for purposes of this case?

The Staff did not file testimony on this issue and reserves the right to assert a final position based upon the testimony provided at hearing.

17. **Revenue Associated with Economic Development:** Should an adjustment to revenues be made related to the Contract rates paid by Triumph Foods, LLC and Nestle/Purina in St. Joseph pursuant to the Economic Development Rider tariff?

No adjustment to revenues should be made because of the special contract. The Commission order in WT-2004-0156 approving the contract found the contract was in the public interest. There is no evidence to indicate a change in circumstances since the Economic Development Rider, under which the special contract with Triumph was permitted, allows any party to request a Commission review of the appropriateness of the special rate in Triumph's contract. The purpose of the review would be to determine whether the alternative rate in the contract is still in the best interests of all the customers in the St. Joseph District

18. **MSD Contract Revenue:** What is the appropriate amount of compensation MAWC should receive for the billing data provided by MAWC to MSD?

The Staff did not file testimony on this issue and reserves the right to assert a final position based upon the testimony provided at hearing.

Expense Issues

19. **Amortization of OPEB Assets (related to St. Louis County Water Company and Service Company):** 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 Service Company and the former St. Louis County Water Company?

As it is the Staff's policy to exclude costs incurred by the Company previous to the current rate case's test year, the Staff recommends no amortization of regulatory assets associated with prior deferrals of OPEB costs for the St. Louis County Water District. As stated above, the Staff has researched and reviewed this alleged deferral and has found no evidence of Commission ordered rate treatment that permits amortization of this deferral in Case No. WR-95-205 or any subsequent MAWC rate case.

The Staff is opposed to including the Service Company Pension and OPEB expenses as part of the Pension and OPEB trackers because the Company is requesting ratemaking treatment for the costs of another American Water Works Company (AWW) subsidiary (the Service Company) that is a non-regulated subsidiary. The Service Company is a non-regulated wholly-owned subsidiary of American Water Works Company, which provides services to AWW's other wholly-owned subsidiaries. The Service Company provides services to MAWC and in return MAWC compensates the Service Company for said services.

20. **Tank Painting Expense:** What is the appropriate level of expense to be included in MAWC's cost of service related to tank painting expense?

The Staff has recommended an annual tank painting expense, before the amortization of the tank painting tracker, of \$1,362,620. The Staff based its recommended level of tank painting expense upon a two-year average of tank painting expenses (2008 and 2009). The Staff reviewed five years of tank painting history and believes a two year average is appropriate.

21. **Fuel & Power (related to Ameren Rate Increase):** Should the test year fuel and power expense be adjusted to reflect any increase to be authorized AmerenUE in its current rate case?

The Staff has not included in its filing the effect of any increase as a result of the current AmerenUE rate case (Case No. ER-2010-0036) because at the time of the Staff's filing the

results of the AmerenUE case are not known and measurable. The Staff believes this issue should be decided as part of the true-up audit and hearing if the results of the AmerenUE rate case are known and measurable at the time of the true-up proceedings.

Rate Case Expense:

22. What is the appropriate level of rate case expense to be included in MAWC's cost of service?

The Staff proposes the amount of the rate case expense incurred by MAWC through April 30, 2010 associated with the consolidated Case No. WR-2010-0311 be allowed at this time. Any additional costs that are reasonably incurred rate case expense will be considered for inclusion later as the case progresses.

23. Should rate case expense be normalized or amortized and should prior rate case expense be recovered in this rate case?

The Staff is proposing to normalize current rate case expense over a two-year period. The Staff opposes the inclusion of any prior rate case expense for recovery based upon any type of amortization.

24. **Depreciation Expense:** What are the appropriate depreciation rates and resulting depreciation expense to be authorized in this case?

The Staff recommends that the Commission order the depreciation rates proposed in Schedule GCG-1 and provided here as Attachment 1.

The Staff also recommends that MAWC be ordered to follow the guidance provided by the Commission in its Report and Order in the matter of the tariff filing of The Empire District Electric Company to implement a general rate increase in Case No. ER-2004-0570. Specifically, the Staff requests that the Company be ordered to maintain a separate accounting of amounts it accrues for recovery of initial investment in plant from the amounts it accrues for the cost of removal. The Staff does not believe that the Company has fully accounted for costs that would

be associated with the adoption of its lifespan approach to depreciation. The Staff also disagrees with the Company's amortization of general plant accounts and believes it is the Company's responsibility to follow the Commission rules regarding record keeping as stated 4 CSR 240-50.030 Uniform Systems of Accounts - Water Companies.

25. **Bad Debt Expense:** What is the appropriate level of bad debt expense to be included in MAWC's cost of service?

The appropriate level of bad debt expense to be included in MAWC's cost of service should be derived by annualizing the bad debts using the ratio of bad debts to revenues which is a similar method used by MAWC. However, the Company has also applied a bad debt factor-up which would be applied to any increase in rates determined by the Commission. The Staff does not believe there is a sufficient direct relationship between bad debts and revenues and to warrant an additional amount for bad debts by applying a bad debt expense factor up.

The Staff does not agree with Company's analysis of using uncollectible reserves because uncollectible reserves are based on an estimated percentage of the sales revenue or accounts receivables and does not show any reductions for collections. The Staff's analysis is based on actual bad debt write offs after all appropriate recovery actions have been taken, resulting in the lack of indication of a direct relationship between bad debts and revenues.

ADEQUACY OF SERVICE AND OTHER ISSUES

Main Extensions:

26. Are the existing tariff provisions and Company policies appropriate for customer charges, contributions and refunds for main extensions?

Yes, existing tariff provisions with respect to customer charges, company participation, contributions, and refunds, should remain as they exist in each of the company's service districts.

27. Are the existing tariff provisions and Company policies appropriate for developer charges, contributions and refunds for main extension?

Yes, existing tariff provisions with respect to charges, company participation, contributions, and refunds for developers should remain as they exist in each of the company's service districts.

28. How should the construction of main extensions beyond that necessary for service in a new development or projects be apportioned?

Construction costs for capacity beyond that necessary to serve the applicant should be capitalized by the company.

29. **Residential Fire Sprinkler Service:** Are the current tariff provisions and Company policies appropriate for adequate residential fire sprinkler service?

Current tariffs do not address residential fire protection service. A new rule needs to be developed that will provide for adequate metering of all water flowing through the customer's service line for domestic water use, and either direct metering or flow detection for connections to residential fire protection systems.

Sufficiency of Fire flow, related infrastructure maintenance, improvement and quality of service (Riverside issues):

30. Is the water service provided by MAWC in the Riverside District safe and adequate?

The Staff takes no position at this time with regard to adequacy of service in the Riverside portion of the Company's Platte County service area, but believes further study is reasonable by the formation of a workgroup if necessary.

31. How should contributions made by the City of Riverside to MAWC for water system improvements/expansion be treated for ratemaking purposes?

Assets contributed to the Company by developers, customers, municipalities, or others, to the extent that the Company has no investment in such assets, should be treated as contributions for ratemaking purposes, and not included in rate base.

Metering of certain large volume customers in St. Joseph District:

32. Should MAWC be required to install and maintain additional metering for the five large, industrial customers and the Water Districts in its St. Joseph District?

The Staff did not file testimony on this issue and reserves the right to assert a final position based upon the testimony provided at hearing.

33. If so, how should the additional costs associated with installing and reading such meters, as well as analyzing the data from such meters, be recovered?

The Staff did not file testimony on this issue and reserves the right to assert a final position based upon the testimony provided at hearing.

RATE DESIGN/COST OF SERVICE

Class Cost of Service Studies:

34. What is the appropriate basis upon which to allocate costs within a district to each customer class?

The appropriate basis upon which to allocate costs within a district to each customer class is the methodology used in the Staff's Class Cost of Service Study, which is the base-extra capacity method as described in the American Water Works Association Manual.

35. Should there be a small mains adjustment?

Yes, except for the large industrial customers being served on mains smaller than 12" in the St. Louis Metro District. There is insufficient data to make the determination of main function for these customers and a small mains adjustment in this case would in essence be a random adjustment. A study should be completed to determine if a new class of customer needs to be created.

36. What is the appropriate basis upon which to allocate purchase power expense?

Purchased power should be allocated to factor 1. Factor 1 is the allocation of costs that vary with the amount of water consumed. Purchased power varies with the amount of water consumed,

more power is required in periods of high demand and less power is required in periods of low demand.

37. What is the appropriate basis upon which to allocate corporate costs?

It is appropriate to allocate corporate costs such as labor through factor 15.

38. What is the appropriate basis upon which to allocate administrative and general (A&G) costs?

It is appropriate to allocate A & G costs through factor 15 and for pensions and benefits through factor 16.

39. What is the appropriate basis upon which to allocate revenues and/or costs associated with the Economic Development Rider Contract Customers?

Revenues and costs should be spread among the industrial class.

Inter-District Support or Revenue Contribution:

40. Should any district provide a revenue support or a subsidy so that another district may be provided service that is priced below that district's cost of service?

Yes.

41. If so, which district(s) should receive support and which district should be required to provide that support?

The St. Louis Metro District should contribute to the Brunswick water district and Warren County sewer district. The cost of service in these districts is excessively high based on the results of the Staff's CCOS study resulting in increases 97% for Brunswick and almost 363% for Warren County. The St. Louis Metro District is the logical district to provide any subsidy because of its large size and the overall impact being minimal on customers.

Parkville should receive no support because the results of the Staff's CCOS indicate the overall increase to the district of approximately 18%, with the highest increase to any customer class of this district at slightly more than 70%.

Phase-in:

42. Is a phase-in of rates appropriate or lawful?

A phase-in may be appropriate because of the large rate increases for Brunswick and Warren County. In lieu of a revenue contribution from the St. Louis district, the Staff would not oppose a phase-in. Any phase-in of rates should be limited to the Brunswick water district and the Warren County sewer district.

43. Which, if any, districts should have their rate increase phased in?

Brunswick water district and Warren County sewer district.

44. How should any carrying cost associated with a phase-in deferral be recovered and from whom?

Carrying costs associated with a phase-in should be paid by the district. The Staff agrees with OPC's methodology and calculation if a phase-in is ordered. The phase-in for Warren County and Brunswick should be over three years, with 50% of the deficiency collected in the first year, and the balance and carrying costs to be collected in approximate equal amounts in years two and three.

Rates:

(A) Commodity Charge

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

The commodity charge should be uniform for all levels of usage. Uniform block rates clearly inform customers of what they will pay for increased usage. As an alternative, the Staff is willing to accept the Company's proposed two and three block rates for certain customer classes as a move toward the Staff's position.

46. Should commodity rates be uniform across all classes in a district?

No, commodity rates that are uniform across all classes in a district results in at least one customer class paying for a portion of costs that should be allocated to other customer classes.

(B) Customer Charge

47. What is the appropriate way to establish the customer charge?

The customer charge should be based on district specific costs related to meters, services and billing and collection. This is consistent with the American Water Works Association Principles of Water Rates, Fees, and Charges (AWWA M1) description on page 114 of the manual.

48. Should the customer charge be uniform across the districts?

No. A uniform customer charge will not properly allocate the meter, services and billing and collection costs associated with the customer charge portion of a customer's bill. The customer charge should be based on the costs allocated to each specific district and not a blend of all the districts costs.

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

Any rate increase or decrease resulting from this case should be spread or allocated based upon the percentage increase or decrease for each customer class within each district as in Staff's Rate Design.

50. **Low Income Provision:** Should MAWC be authorized to include a low income provision in its tariffs?

No. The Staff believes that there are other means for the Company to provide relief to low-income customers.

51. **MSD Rate:** What is the appropriate rate to charge MSD for customer usage information?

The Staff did not file testimony on this issue and reserves the right to assert a final position based upon the testimony provided at hearing.

Consolidated Tariff:

52. Should existing tariff rules and regulations be consolidated into one tariff?

The Staff believes that consolidation of the company's rules and regulations is reasonable, with separate provisions for rates, charges, main extension refunds to customers, and company participation in main extensions; and, also with other provisions that are necessary because of unique circumstances in any one service district such as service line ownership/maintenance, and fire hydrant placement requirements.

53. Miscellaneous Fees

Miscellaneous fees should be set on the average of the water districts excluding St. Louis Metro and Warren County. Warren County miscellaneous fees should be the same as St. Louis Metro. Water usage from hydrants should be district specific.

WHEREFORE, Staff respectfully submits its Statement of Position on the issues of this case to the Commission.

Respectfully submitted,

/s/ Jennifer Hernandez

Jennifer Hernandez
Associate Staff Counsel
Missouri Bar No. 59814

Attorney for the Staff of the
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102
(573) 526-7393 (Telephone)
(573) 751-9285 (Facsimile)
jennifer.hernandez@psc.mo.gov (e-mail)

Certificate of Service

I hereby certify that copies of the foregoing have been mailed first class postage prepaid, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 13th day of May 2010.

/s/ Jennifer Hernandez