Exhibit No.:	
Issue:	*Accounting Authority Order, Phase-In*
Witness:	*STEPHEN M. RACKERS*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Rebuttal Testimony*
Case No.:	*WR-2000-281 et al.*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL 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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STEPHEN M. RACKERS

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STEPHEN M. RACKERS

MISSOURI-AMERICAN WATER COMPANY

CASE NOS. WR-2000-281 & SR-2000-282

Q. Please state your name and business address.

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

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 Missouri Public Service Commission (Commission).

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

A. Yes.

Q. What is the purpose of your rebuttal testimony?

A. My testimony will rebut the direct testimony of Missouri-American Water Company (MAWC or Company) witness James E. Salser, regarding recovery of depreciation expense and allowance for funds used during construction (AFUDC) deferred and capitalized according to the accounting authority order (AAO) granted by the Commission, in its Order effective April 4, 2000, related to the new St. Joseph Treatment Plant (SJTP). I will also discuss a phase-in proposal to address the significant increases to various classes within districts under a district specific rate design.

AAO

Q. Please provide a summary of your discussion regarding the AAO.

A. My discussion of the AAO will address the following topics:

1) Description of the AAO,

2) Provisions of the Uniform System of Accounts for Water Utilities (USOAW),

3) Commission guidance,

4) The Company's need for an AAO and

5) The Staff's recommendation regarding recovery.

Q. Please describe the AAO requested by the Company.

A. The Company requested an AAO to continue to capitalize AFUDC after the completion of the SJTP construction project and defer depreciation expense. The AAO would continue from the in-service date of the SJTP until the effective date of the rates from this case. This discussion appears on pages 9 through 12 and Schedule JES-2 of Mr. Salser's direct testimony.

Q. Please define AFUDC and depreciation.

A. AFUDC represents the cost to the utility to finance a project during the construction phase and is added to the cost of the plant addition. Absent Commission authority, the capitalization of AFUDC would cease upon completion of a construction project. Depreciation expense represents the systematic capital recovery of an asset over its useful life. Absent Commission authority, depreciation expense would begin to be reflected as an increase in the operating expenses of the utility upon completion of the project.

Q. Please describe the accounting and regulatory treatment requested by the Company.

A. The Company has asked that the AFUDC be booked to the appropriate plant accounts and amortized over twenty years. With regard to the depreciation expense, the Company requested a deferral to Account 186 – Miscellaneous Deferred Debits and an amortization over the estimated service life of the SJTP.

Q. Does the USOAW provide authority to continue the capitalization of AFUDC and defer depreciation expense?

A. No. The USOAW does not provide such authority. As previously stated, the USOAW directs that upon completion of construction, capitalization of AFUDC shall cease. The USOAW also provides for three situations in which the use of Account 186 is proper. The first situation exists when a debit is not provided for elsewhere and the Commission has provided the authorization to book deferrals to this account. The second situation exists when a cost is unusual or extraordinary, not included in other accounts, and is in the process of being amortized. The instructions in the USOAW state that Commission approval must be obtained to treat an item as extraordinary. To date, the Commission has not made such a finding. In addition, these costs are not currently being amortized. The amortization process is part of the authority requested by the Company from the Commission. The third situation exists regarding costs the proper disposition of which is uncertain. The instructions in the USOA for Water Companies contain no uncertainty regarding the treatment of depreciation expense. The USOAW directs the charging of depreciation to specific expense and clearing accounts. Deviation from these instructions would require authority granted by the Commission.

Q. Has the Commission provided guidance in its orders as to the limited circumstances in which deferring costs as a means of reducing regulatory lag is appropriate?

A. Yes. In Case Nos. EO-91-358 & 360, involving Missouri Public Service Company the Commission stated:

> Lessening the effect of regulatory lag by deferring costs is beneficial to a company but not particularly beneficial to ratepayers. Companies do not propose to defer profits to subsequent rate cases to lessen the effects of regulatory lag, but insist it is a benefit to defer costs. Regulatory lag is a part of the regulatory process and can be a benefit as well as a detriment. Lessening regulatory lag by deferring costs is not a reasonable goal unless the costs are associated with an extraordinary event.
>
> Maintaining the financial integrity of a utility is also a reasonable goal. The deferral of costs to maintain current financial integrity, though, is of questionable benefit. If a utility's financial integrity is threatened by high costs so that its ability to provide service is threatened, then it should seek interim rate relief. If maintaining financial integrity means sustaining a specific return on equity, this is not the purpose of regulation. It is not reasonable to defer costs to insulate shareholders from risks. If costs are such that a utility considers its return on equity unreasonably low, the proper approach is to file a rate case so that a new revenue requirement can be developed which allows the company the opportunity to earn its authorized rate of return. Deferral of costs just to support the current financial picture distorts the balancing process used by the Commission to establish just and reasonable rates. Rates are set to recover ongoing operating expenses plus a reasonable return on investment. Only when an extraordinary event occurs should this balance be adjusted and costs deferred for consideration in a later period.

This discussion by the Commission highlights several positions, which are pertinent to the Company's request in this case. Especially important is the requirement that an item must be extraordinary to justify a deferral and the goal of maintaining a company's financial integrity.

Q. Is the need for an AAO justified by the occurrence of an extraordinary event in this case?

A. No. While the cost of the SJTP project is significant, it is not an extraordinary event. This is a construction project, which was planned by, and under the full control of, the Company's management. The project was deemed by the Company as the most appropriate means of fulfilling its requirement to provide safe and adequate service to ratepayers. The USOAW refers to extraordinary items as those relating to events that are not typical or customary business activities of the company. Construction of facilities to provide service is certainly a typical and customary business activity of MAWC.

Q. Is the AAO necessary to maintain the financial integrity of the Company during the period between the in-service date of the SJTP and the date when rates from this case will become effective?

A. No. Although the Commission stated in the above cited Order that the proper response to maintaining financial integrity would be the filing of interim rates, the interest coverages and the returns on equity that are expected to be realized do not justify the granting of an AAO. Based on actual and budgeted financial results, which do not include an AAO or a rate increase, for the 12 months ending April 30, May 31, June 30, July 31, August 31 and September 30 of 2000, the Company will experience interest coverages of 3.33, 3.16, 3.03, 2.93, 2.85 and 2.72, respectively.

Q. What is the required level of interest coverage for MAWC?

A. Based on the Company's bond agreement, the required level of annual interest coverage is 1.5 for 12 consecutive months. As can be seen from the above numbers, the interest coverages realized are well in excess of the required level.

Q. What level of return on equity will the Company realize during this period?

A. Based on actual and budgeted financial results, for the 12 months ending April 30, May 31, June 30, July 31, August 31 and September 30 of 2000, the Company will experience returns on average equity of 13.71%, 12.54%, 11.46%, 10.68%, 9.83% and 9.14%, respectively. For only one of the 12-month periods during which the AAO would be in effect are the projected returns on equity below the range proposed by the Staff in this case (Direct Testimony of Roberta A. McKiddy, Schedule 30). During two of the 12-month periods during which the AAO would be in effect the returns on equity are projected to be in excess of the 11.654% level proposed by the Company in this case (Direct Testimony of James E. Salser, p. 9). The average return on equity projected to be realized during the annual periods ending April 30, May 31, June 30, July 31, August 31 and September 30 of 2000 is 11.22%.

Q. What is the Staff's recommendation regarding the recovery of the amounts deferred under the AAO?

A. The Staff recommends that the Commission deny recovery of the amounts deferred under the AAO. As previously discussed, the Staff does not believe that the construction and placing into service of the SJTP constitutes an extraordinary event. In addition, the expected financial results during the period of time the AAO will be in effect do not appear to threaten the financial integrity of the Company.

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 Rebuttal Testimony in question and answer form, consisting of 7 pages to be presented in the above case; that the answers in the foregoing Rebuttal 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

Subscribed and sworn to before me this 30 day of May 2000.

TONI M. WILLMENO NOTARY SEAL NOTARY PUBLIC STATE OF MISSOURI

TONI M. WILLMENO
NOTARY PUBLIC STATE OF MISSOURI
COUNTY OF CALLAWAY
My Commission Expires June 24, 2000