

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

In the Matter of the Application of	)	
Missouri-American Water Company for	)	
the Approval of an Agreement with the	)	
City of Kirkwood, Missouri, to Construct	)	<b>Case No. WO-2005-0286</b>
Transmission Mains and Points of	)	
Delivery and to Sell and Deliver Water for	)	
Resale and Related Tariff Sheets	)	

**STAFF RECOMMENDATION**

COMES NOW the Staff of the Missouri Public Service Commission, by and through its attorney, and, for its Staff Recommendation, states to the Missouri Public Service Commission as follows:

1. On February 24, 2005, Missouri-American Water Company applied for authority to build transmission mains and points of delivery to sell and deliver water to the City of Kirkwood, and filed a related tariff sheet, bearing an effective date of March 26, 2005.

2. The Commission initially ordered the Staff to file its Recommendation in this case no later than March 14, 2005, but extended this deadline several times as the parties negotiated to resolve outstanding issues in this case, and the Staff's Recommendation is now due on July 11, 2005. In addition, Missouri-American has several times extended the effective date of its tariff sheet, which currently bears an effective date of July 25, 2005.

3. Attached hereto as Attachment A is the Staff Memorandum, which sets forth the Staff's recommendation regarding the subject contract and the proposed tariff sheet.

4. The Staff recommends that the Commission issue its order approving the wholesale water supply contract between Missouri-American and the City of Kirkwood, on the condition

that any cost overruns related to the subject construction contracts will be offset by a portion of the net revenue benefits that accrue to Missouri-American as a result of the contract with the City of Kirkwood, as more fully described in the Staff Memorandum (Attachment A). The Staff further recommends that the Commission order Missouri-American to maintain records documenting the cost of the subject projects and to retain those records for use in its next rate case, and that the Commission order Missouri-American to maintain records documenting the annual net revenue benefits resulting from the special contract rate, and to retain those records for use in its next rate case.

**WHEREFORE**, the Staff submits its Recommendation herein and requests that the Commission issue an order approving the subject water supply contract between Missouri-American and the City of Kirkwood and the related tariff sheet, upon the conditions set forth herein.

Respectfully submitted,

DANA K. JOYCE  
General Counsel

/s/ Keith R. Krueger

Keith R. Krueger  
Deputy General Counsel  
Missouri Bar No. 23857

Attorney for the Staff of the  
Missouri Public Service Commission  
P. O. Box 360  
Jefferson City, MO 65102  
(573) 751-4140 (Telephone)  
(573) 751-9285 (Fax)  
[keith.krueger@psc.mo.gov](mailto:keith.krueger@psc.mo.gov)

## **Certificate of Service**

I hereby certify that copies of the foregoing have been mailed or hand-delivered, transmitted by facsimile or e-mailed to all counsel of record this 11th day of July, 2005.

**/s/ Keith R. Krueger**

Keith R. Krueger

# APPENDIX A

STAFF MEMORANDUM & ATTACHMENT

CASE No. WO-2005-0286

# Official Case File Memorandum

## MEMORANDUM

TO: Missouri Public Service Commission Official Case File  
Case No. WO-2005-0286  
Missouri-American Water Company

FROM: Dale W. Johansen – Project Coordinator  
Water & Sewer Department  
Greg Meyer – Auditing Department  
Steve Rackers – Auditing Department

/s/ Dale W. Johansen      July 11, 2005  
Project Coordinator      Date

/s/ Keith R. Krueger      July 11, 2005  
General Counsel's Office      Date

SUBJECT: Recommendation Regarding Application for the  
Approval of Agreement and Tariff

DATE: July 11, 2005

### THE APPLICATION

On February 24, 2005 (unless noted otherwise, all dates herein refer to the year 2005), Missouri-American Water Company (MAWC or Company) filed an "Application for the Approval of Agreement and Tariff" (Application), by which it is seeking the Commission's approval of a wholesale water supply contract with the City of Kirkwood (Kirkwood), which includes a special "competitive" wholesale water rate, and the Commission's approval of a related rate tariff sheet.

### STAFF'S INVESTIGATION

As noted at the beginning of this Memorandum, Staff members from the Auditing and Water & Sewer Departments and the General Counsel's Office participated in the Staff's investigation of the Application. All Staff participants and the assigned attorney from the General Counsel's Office were provided the opportunity to review and comment on this Memorandum prior to it being filed. Dale Johansen of the Water & Sewer Department created the initial draft of this Memorandum and comments received from the reviewers were incorporated therein to create this final version.

Staff's investigation of the Application and the related rate tariff sheet included a review of the Application, the subject wholesale water supply contract, the proposed tariff sheet and various supporting information that MAWC provided to the Staff.

In particular, the supporting information included an analysis of how the proposed "competitive" wholesale rate was calculated, and an economic analysis showing the potential net revenue benefits accruing to MAWC and/or its other customers as a result of the contract.

### **STAFF'S FINDINGS & CONCLUSIONS**

Based upon its review of the above-referenced documents and information, the Staff believes that the proposed special contract rate was calculated reasonably, is reasonable for the purposes for which it is sought, and will not be detrimental to the public interest. Particularly, as a result of its review of the economic analysis provided by MAWC in support of its proposed special contract rate, the Staff notes that certain net revenue benefits are expected to accrue under the contract rate each year it is in effect, with the expected benefits increasing each year of the contract. However, it is important to note that the analysis documenting the expected net revenue benefits is based on certain assumptions regarding, among other things, the estimated cost of constructing the facilities necessary for MAWC to provide service under the contract. In particular, one of the assumptions inherent in MAWC's analysis is that the cost of constructing the pipeline projects that are related solely to the new wholesale contract with Kirkwood will be approximately \$2.7 million.

As examples of the net revenue benefits expected to accrue under the contract rate, MAWC's analysis shows the following approximate benefits for the first five years of the contract:

- Year 1      \$218,525
- Year 2      \$230,560
- Year 3      \$248,530
- Year 4      \$267,010
- Year 5      \$286,180

Even though it is expected that net revenue benefits will accrue under the proposed special contract rate, the Staff is concerned that the current proposal before the Commission does not provide protections to MAWC's existing customers with regard to potential cost overruns (costs in excess of the \$2.7 million estimated construction cost that is inherent in MAWC's economic analysis) related to the construction of the various components of the overall project and the potential recovery of such cost overruns by MAWC.

To address its concern about cost overruns, the Staff believes it would be appropriate for a portion of the expected benefits that will accrue solely to MAWC until the end of its next general rate case to be used to offset any construction cost overruns that may exist with regard to this project. Specifically, the Staff believes it would be appropriate for any construction cost overruns to be reduced by the amount of \$187,620 annually for the time that exists between the date that the Company begins providing service to Kirkwood under the terms of the contract and the date that MAWC's rates change as a result of the Company's next general rate case.

The basis for this suggested approach is that MAWC's next general rate case will be the first opportunity for MAWC to request that the costs related to the subject project, including any cost overruns, be recovered through its customer rates, and, importantly, will also be the first opportunity for MAWC's existing customers to benefit from the net revenues that MAWC expects to realize under the contract. Additionally, it is important to note that the \$187,620 per year offset suggested by the Staff would only be used to offset construction cost *overruns*, and that the offset represents only 75% of the average annual net revenue benefit that MAWC expects to realize during the first five years of the contract.

In conjunction with its suggested approach regarding potential construction cost overruns, the Staff believes that MAWC should be required to maintain records documenting the cost of the subject construction projects and the annual net revenue benefits resulting from the special contract rate.

As an example of the Staff's suggested approach, if the contract is in effect for three years prior to the end of MAWC's next general rate case then a "cost overrun credit" of \$562,860 would exist for the purpose of reducing the construction cost overruns potentially recoverable through customer rates. To the extent that the cost of the subject construction projects exceeds the estimated cost by more than \$562,860, the potentially recoverable construction costs would be reduced by \$562,860, but MAWC would retain the remaining net revenues generated under the contract. To the extent that the construction cost overruns are less than \$562,860 but greater than zero, the construction cost overruns would be eliminated from potential recovery, but MAWC would retain the remaining net revenues generated under the contract. To the extent that there are no construction cost overruns related to the project, MAWC would retain the entire amount of the net revenue benefits generated under the contract. Specific examples of the three above scenarios are shown on Attachment 1 hereto.

### **ADDITIONAL MATTERS**

The Staff notes that MAWC is current with regard to the payment of its Commission assessments through fiscal year 2005, and that the Company has no deficiencies regarding the submission of its Commission annual reports through calendar year 2004. Dale Johansen of the Water & Sewer Department conducted the assessment payment and annual report submission reviews on behalf of the Staff.

Additionally, the Staff notes that it is not aware of any compliance-related matters involving MAWC and the Department of Natural Resources. Also, while MAWC does have other matters pending before the Commission, none of those matters are either directly or indirectly related to the subject matter of this case. Lastly, the Staff notes that the Company is currently in good standing with the Secretary of State.



### **STAFF'S RECOMMENDATIONS**

Based upon the above, the Staff recommends that the Commission issue an order that:

- Approves the wholesale water supply contract between MAWC and the City of Kirkwood, and the related pending rate tariff sheet, but only with the condition that any cost overruns related to the subject construction projects will be offset by a portion of the net revenue benefits that accrue as a result of the contract, as proposed herein;
- Requires MAWC to maintain records documenting the cost of the subject construction projects, with the records to be retained by MAWC for use in its next general rate case; and
- Requires MAWC to maintain records documenting the annual net revenue benefits resulting from the special contract rate, with the records to be retained by MAWC for use in its next general rate case.

# Memo Attachment 1

Examples of the Application of the Staff's  
Proposed Construction Cost Overrun Credit

## **Examples of the Application of the Staff's Proposed Construction Cost Overrun Credit**

Note: For all examples shown, the following assumptions apply: (1) service under the contract is provided for a period of three years prior to the end of MAWC's next general rate case, which results in a total cost overrun credit of \$562,860 ( $\$187,620 \times 3$ ) and total expected net revenue benefits of \$697,615 (sum of the expected net revenues for the subject years as shown on page 2 of the case file memo); and (2) the estimated cost of constructing the facilities needed solely to provide service under the new wholesale contract is \$2.7 million.

### **Example 1**

Construction Cost (30% above estimate)	\$3,510,000
Construction Cost Overrun (3,510,000 – 2,700,000)	\$ 810,000
Potentially Recoverable Cost Overrun (810,000 – 562,860)	\$ 247,140
Contract Revenue Benefits Retained by MAWC (697,615 – 562,860)	\$ 134,755

### **Example 2**

Construction Cost (15% above estimate)	\$3,105,000
Construction Cost Overrun (3,105,000 – 2,700,000)	\$ 405,000
Potentially Recoverable Cost Overrun (credit exceeds overrun)	N/A
Contract Revenue Benefits Retained by MAWC (697,615 – 405,000)	\$ 292,615

### **Example 3**

Construction Cost (same as estimate)	\$2,700,000
Construction Cost Overrun	N/A
Potentially Recoverable Cost Overrun	N/A
Contract Revenue Benefits Retained by MAWC (total net revenues generated)	\$ 697,615