

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

In the Matter of Missouri-American Water)	
Company's Request for Authority to)	
Implement a General Rate Increase for)	Case Nos. WR-2011-0337
Water and Sewer Services Provided in)	 SR-2011-0338
Missouri Service Areas.)	

STAFF'S STATEMENT OF POSITIONS

COMES NOW the Staff of the Missouri Public Service Commission, by and through counsel, and for its *Statement of Positions on the Issues*, states as follows:

A. Rate Base Issues:

1. Cash Working Capital

What is the appropriate amount of Cash Working Capital to include in Rate Base?

The appropriate amount to be included in MAWC's rate base for Cash Working Capital (CWC) should be the amount calculated by Staff using the appropriate Service Company fee lag.

The appropriate lag to be used when calculating the CWC required for rate base as it relates to the Service Company expense lag for MAWC is a positive 40.27 days. CWC is included in rate base to compensate investors for the lag between the time service is rendered and the time revenue is received for that service. In this instance, the Service Company fee is charged by Service Company, an affiliate, in advance. However, a large majority of MAWC's non-affiliated vendors provide goods and services on credit. MAWC's affiliate should not get preferential treatment by requesting prepayment for the services it provides. Therefore, the appropriate expense lag for the Service Company is the same as that for other third-party vendors who supply goods and services to the utility on an arm's length basis.

2. Tank Painting Tracker

Should the Tank Painting Tracker be discontinued? If not, at what level should the Tank Painting Tracker be continued?

Yes, the Tank Painting Tracker should be discontinued. 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. Instead, a normalized level of tank painting expense can be established and included in the cost of service.

If a tank painting tracker is to be continued, Staff asserts that \$1,370,136 should be the level used to set the tank painting tracker.

3. Accrued Pension Liability

What is the appropriate amount of accrued Pension Liability to include in Rate Base?

Staff asserts that the accrued pension liability should not be included in the cost of service calculation because it is not an accurate measurement of MAWC's net rate base investment in pension funding at any point in time.

4. Pension Tracker

Should the Pension Tracker be modified as proposed by Staff?

Should the Pension Tracker apply to Service Company employees as well as MAWC employees?

Yes, the Pension Tracker should be modified as proposed by Staff, by basing MAWC's recovery of pension expense in rates on its minimum ERISA fund contribution amounts and then comparing that value to MAWC's allocated share of AWW pension fund contributions over time. However, pension costs associated with Service Company employees should not be included in MAWC's Pension Tracker.

5. Acquisition Adjustment

*How should the rate base of acquired small systems be established?
How should acquisition premiums and discounts be treated?*

Acquired small systems should be included in rate base at net book value. Acquisition premiums and discounts should not be recognized in rate base for acquisitions made by the Company.

6. Security Costs – AAO

Should the unamortized balance of the security costs regulatory asset be included in Rate Base?

No. The amortization of the Security Costs – AAO has been decreased to 10 years instead of 20 years as recommended by Staff in previous rate cases and with a 10-year amortization, the Company should not be allowed rate base treatment of the unamortized amount.

7. OPEB Contribution to External Fund (related to St. Louis County Water Company Amount)

Should the regulatory asset (Tracker) associated with the unrecovered St. Louis County Water Company FAS 106 transition cost be included in rate base?

No. The Company has not been able to provide any source documents (stipulations or Commission orders) setting out the amount or the treatment of the related St. Louis County Water Company FAS 106 costs. Therefore, those unrecovered costs should not be included in rate base.

B. Cost of Capital Issues:

1. Capital Structure:

What is the appropriate capital structure for ratemaking purposes?

The appropriate capital structure for ratemaking purposes is the consolidated capital structure of American Water Works Company, Inc. (AWW), MAWC's parent, as of December 31, 2010, consisting of 42.95 percent common equity, 0.29 percent preferred stock, and 56.76 percent long-term debt.

2. Return on Equity:

What is the appropriate return on common equity for ratemaking purposes?

The appropriate return on equity for ratemaking purposes is a range from 8.95% to 9.95%, midpoint 9.45%, as developed by Staff's systematic analysis of a group of water utilities of comparable risk.

C. Revenue Issues:

1. Revenue (Water Usage Volumes)

How should the volume of water used by residential and commercial customers be calculated?

The appropriate method to normalize residential customer usage data is a four (4) year average. Staff used known usage numbers provided by the Company to compute an average usage per customer for the year 2007 forward. This was done to exclude data from 2006, because the Company has found the data to be unreliable due to billing method changes that occurred in that year. Staff does not disagree with the Company's opinion regarding the 2006 data. 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 are also be accounted for in an average of actual usages.

Commercial usage is proposed to be the actual usage as reported by the Company for the test year period. No normalization is proposed by Staff for commercial customers.

2. Other Water/Sewer Revenue (Billing for municipals)

Should the revenues received by the Company for providing billing services to municipalities be treated as an offset to revenue requirement as Staff has proposed?

Staff is proposing to include MAWC's test year Billing Service revenues from various municipalities in Staff's adjusted total revenues amount to offset the associated test year expenses incurred from the provision of this service. Staff's adjustment reflects the matching principle in accounting in which expenses for a period are determined by matching them with specific revenues as they are incurred. Staff opposes the omission of these revenues from the Company's cost-of-service under the premise that the associated expenses are negligible, or because these revenues will be eliminated in the future.

3. MSD Contract

Is the compensation received by the Company under its contract with MSD adequate? If not, should an additional amount of revenue be imputed to the Company in this case?

Staff takes no position on this issue but reserves the right to do so at hearing if appropriate.

D. Expense Issues

1. Chemical Expense:

What prices and what quantities should be used in calculating chemical expense?

Staff is opposed to incorporating the chemical prices that became effective January 1, 2012, in its chemical expense adjustment because this is far outside the test year period ending December 31, 2010. Although Staff will true-up Chemical Expense, per the Commission's *Order Regarding True-Up Period* filed on August 24, 2011, this update will reflect changes in volumes of water sold, but not changes in the prices of chemicals.

2. Tank Painting Expense

What is the appropriate amount of tank painting expense?

Staff recommends an annual tank painting expense, before the amortization of the tank painting tracker, of \$1,370,136. Staff based its recommended level of tank painting expense upon a three-year average of tank painting expenses (2008, 2009 and 2010). Staff reviewed five years of tank painting history and determined a three-year average is appropriate in this case.

3. Bad Debt Expense – Bad Debt Factor Up

What is the appropriate amount of bad debt expense? Should bad debt expense be projected to increase with any increase in revenue requirement?

Staff is proposing to normalize Bad Debt expense using a net charge off to billed revenues ratio over a three (3) year period. Staff's position is that there is no direct correlation between the level of uncollectibles and a rate increase, therefore, Staff is opposed to any gross-up of rate increases for bad debt expense.

4. Service Company Expense:

What is the appropriate amount of Service Company expense to include in MAWC's revenue requirement?

Staff is proposing an adjustment in the amount of \$409,383 to eliminate Service Company costs allocated to MAWC for (1) membership dues, charitable contributions, and other miscellaneous expenses Staff believes should not be recoverable in rates; (2) one-time costs excluded by the Company; (3) other disputable items excluded by the Company; and (4) Other Benefit Overhead expenses related to Business Transformation that are to be capitalized. Staff's adjustments to Service Company expenses related to Incentive Compensation and Belleville Lab Allocations are addressed as separate issues.

In addition to the aforementioned adjustments, Staff proposes to exclude other Company-proposed adjustments to Service Company expense as follows:

- a. Amortization of One-Time Costs. Staff was unable to determine the benefit to ratepayers of this annual expense of \$52,014 related to a three-year amortization and, therefore, recommends these costs be excluded from this case.
- b. Annualization of Service Company Payroll. Staff was unable to verify the Company's labor expense increase for 2011 in the Company's books and so Staff proposes to use the wages as of December 31, 2010.
- c. Business Transformation Hardware Lease Expenses. Staff proposes to exclude the \$41,199 in Service Company costs for hardware lease expenses related to American Water's Business Transformation Project (BTP) since this project is not yet in-service.
- d. Information Technology Services (ITS) Increases in Depreciation and Maintenance Expense for 2011. The Company included \$400,070 for depreciation expense increases and \$331,073 for maintenance expense increases estimated for 2011 for the Service Company's Information Technology Services (ITS). Staff proposes to exclude these increases as all of the estimated expenses fall outside of the test year ending December 31, 2010, and are not among the items agreed for true-up.

- e. Other Expense. The Company included \$145,365 for an anticipated inflationary factor of 1.3% in 2011. Staff proposes to exclude this estimated expense that lies outside of the test year.
- f. Increase for Additional Customers with Acquisitions. The Company included an additional \$390,033 as an increase in Service Company expense for the additional customers included with MAWC's acquisitions. Staff proposes excluding this adjustment as it does not take into account the changes in the parent Company's customer counts across all operating companies.

5. Rate Case Expense

What is the appropriate amount of rate case expense?

Staff is proposing to normalize current Rate Case expense over a two-year period. The amount of the Rate Case expense incurred by MAWC throughout the duration of this case is being allowed at this time. Staff's current adjustment reflects Rate Case expenses as of October 18, 2011; however, this date will be "trued-up" and any additional rate case expenses that are reasonably incurred through the end date of the true-up period will be considered for inclusion as the case progresses. Staff opposes including Rate Case expense from prior rate cases for recovery in this case.

6. Incentive Compensation

What is the appropriate amount of incentive compensation expense related to AIP and LTIP for employees of MAWC and Service Company?

Staff is proposing an adjustment in the amount of \$1,161,958 to eliminate the amount associated with the financial component of the 2010 AIP payout for the Service Company costs allocated to MAWC. Staff proposes that if AWW chooses to reward Service Company employees an AIP payout based upon financial goals then stockholders, not ratepayers, should be responsible for costs.

Staff is proposing an adjustment in the amount of \$629,321 to eliminate the amount associated with executive compensation for stock options and restricted stock units Long Term Incentive Plan (LTIP) for the Service Company costs allocated to MAWC in Other Benefit Overheads. Staff did not include these since these transactions do not represent a cash expense and because these payments are based upon financial goals primarily benefiting shareholders.

The appropriate amount of incentive compensation expense related to the Annual Incentive Plan (AIP) and the LTIP for employees of MAWC is that calculated by Staff. Staff included \$671,650 of incentive compensation related to AIP in the cost of service, calculated based on each employee's individual goals and adjusted for any goals that Staff asserted were not necessary for safe and adequate water service or that provided no benefit to the ratepayer. Staff eliminated all of the MAWC LTIP because LTIP is primarily a shareholder benefit focusing on shareholder return and stock price goals and there is no actual cash payout associated with the LTIP.

7. Income Taxes

What is the appropriate income tax rate?

The IRS tax table should be used based upon net income of each district and on a consolidated basis for MAWC. Once the net income reaches \$18.3 million dollars, the federal income tax rate of 35% and state income tax of 6.25% is used. The combination of both determines the composite tax rate of 38.3886%.

8. Amortization of OPEB Assets (related to St. Louis County Water 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 former St. Louis County Water Company?

No. The Company has not been able to provide any source documents (stipulations or Commission orders) setting out the amount or the treatment of the related St. Louis County Water Company FAS 106 costs. Therefore, those unrecovered costs should not be included in expense as an amortization.

9. Pension Expense

What is the appropriate amount of pension expense?

Pension expense should be treated in rates on a going forward basis using a minimum ERISA calculation.

10. Non-Revenue Water

What is the appropriate amount of non-revenue water?

Adjustments made to the cost of water production in consideration of non-revenue water should be based on the physical characteristics of the particular water system that are related to unavoidable losses as well as a determination of actual known losses as best as can be measured or estimated for that particular system. Further, if any production or sales quantities are used to make any such adjustment, then those quantities should be normalized for ordinary average customer water use and with appropriate exclusion of unavoidable losses, measured or estimated known losses, and exported water. Finally, a methodology for use to make such adjustments should be developed by Staff, Missouri water utilities and stakeholders in the context of informal sessions outside of this rate case proceeding.

11. Roark Sewer Plant Operating Expenses

What is the appropriate amount of Roark Sewer Plant operating expenses?

The appropriate amount of Roark Sewer Plant operating expense for this case is \$259,376 based upon Staff's analysis of the Branson Municipality's receipts received from the Company for wastewater treatment and additional operating expenses which Staff has already included in this case.

12. Platte County Water Treatment Facility Depreciation Rate

Should the rate of depreciation be accelerated on the Platte County Water Treatment Facility in order to account for the Company's anticipated retirement date for that facility?

No.

13. Belleville Laboratory Expense

What is the appropriate amount of Belleville Laboratory expense to allocate to MAWC?

The Belleville Lab costs proposed by Staff in this case are based on a five-year average of actual test analyses performed by the laboratory. Staff's test analyses allocation methodology best represents the true nature of work performed at Belleville Lab for MAWC and for all the other American Water operating companies. Staff used an average of the

number of test analyses Belleville Lab performed on water samples over the last five calendar years ending December 31, 2010.

14. Fuel & Power Expense:

What is the appropriate amount of fuel and power expense?

Staff's adjustment annualized fuel and power costs for each MAWC district based on the current cost of electricity and the normalized system delivery. The average power cost per 1,000 gallons of water production was developed for each district based on the adjusted cost (to include 2011 fuel and power provider rate increases) and test year ending December 31, 2010 system delivery. Each district specific average cost per gallon was multiplied by the annualized system delivery to calculate the annualized fuel and power cost for each district. The annualized system delivery also reflects the normalized water loss percentages for those districts that recorded an actual water loss. The fuel and power expense will be included in the true-up for this case using costs and system delivery for the true-up period ending December 31, 2011.

E. Rate Design and Miscellaneous Issues

1. Cost of Service/Revenue Requirements

How should rates be designed in order to collect the revenue requirement from each customer class (i.e., district specific, single tariff or hybrid)?

Staff's hybrid rate design proposal of creating three large districts for water customers and four large districts for sewer customers is the appropriate method to design rates in order for the Company to collect its revenue requirement. After revenue requirement is determined for each district, then Staff's Class Cost of Service should be used to determine the appropriate revenue responsibility for each customer class.

Should any district provide a revenue support or subsidy to another district? If so, which districts should receive support and which districts should be required to provide that support?

Under Staff's hybrid rate design proposal, there is no revenue support or subsidy required from one district to another. Staff's proposal creates larger districts and spreads the costs for the systems within each district among all customers in the newly created district. This eliminates the need to provide revenue support from one area to another area.

Should water service provide a revenue support or subsidy to sewer?

Based on the results of Staff's cost of service, revenue support needs to be provided from the water customers to sewer customers. The amount of the revenue support should be approximately \$1.8 million.

2. Class Cost of Service & Rate Design

What are the proper allocations for costs not directly assigned to a particular district?

In the last several MAWC rate cases, Staff has proposed that indirectly assigned corporate costs should be allocated to the MAWC districts based upon different allocation factors depending upon the causes that required the costs to be incurred. For example, Staff recommends payroll and payroll-related benefits should be allocated among the districts based upon a labor allocation factor. Belleville Lab costs are another example; Staff recommends these costs be allocated based upon the average number of test analyses performed per district.

What is the appropriate basis upon which to allocate costs to each customer class?

The appropriate basis upon which to allocate costs to each customer class within a district is the base-extra capacity method described in the American Water Works Association manual.

What is the appropriate way to establish the customer charge?

The customer charge should be based on hybrid 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.

Should the customer charge be uniform across all 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 hybrid district and not a blend of all the districts costs.

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 set as a declining block rate. Declining block rates is fairly easy for the customer to understand, is designed to recover the costs of serving different classes of customers, and maintains equity between customer classes.

How should any rate increases or rate 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 hybrid district as in Staff's Rate Design.

3. Continuous Property Records

Is the Company adequately maintaining Continuous Property Records (CPR)?

The Company has not demonstrated that it is adequately maintaining a CPR in compliance with the USOA and Commission Rule.

4. Customer Billing and Service

Is the Company in compliance with the Commission's Rule 4 CSR 240-13.015, in providing bills to customers within the appropriate billing period? If not, what must the Company do to comply with the rule?

Staff maintains that the Company is not in compliance with the Commission's Rule 4 CSR 240-13.015. The Staff and Company disagree on the interpretation of this rule, specifically in 4 CSR 240-13.015(C), the meaning of the word "corrected." Staff asserts that, taking into consideration the definitions of (B), (F) and (T), the Company is not providing a corrected bill. Staff asserts that the Company has not yet rendered or mailed the customer a bill and has not made a "written demand" for payment by the customer; therefore, a corrected bill is not being provided the customer. It is Staff's position that the Company should discontinue its practice of billing residential customers in excess of 35 days except for "initial, corrected or final bills" in order to comply with the rule.

Are the Company's Customer Billing procedures adequate in other respects?

Staff asserts that, in other respects, the Company's customer billing procedures are not adequate and need to be addressed. During its review, Staff was made aware of a variety of customer billing issues where

customers had difficulties addressing their billing situation with the Company and finding resolution to their billing issue.

Is the Company providing adequate Customer Service?

Staff asserts that there are some cases where the Company is not providing adequate customer service. Throughout its review, Staff has received information from customers regarding inadequate customer service when contacting the Company. It is Staff's position that customers are paying for adequate customer service and should be receiving adequate customer service.

Does the Company have appropriate prevention and detection controls in place to ensure adequate Customer Service?

Staff maintains that the Company does not have appropriate prevention and detection controls in place to ensure adequate customer service. Throughout its review, Staff received concerns from customers regarding a variety of customer service issues, i.e., billing issues, inaccurate information provided by Company personnel, and call center problems.

Should the Company continue to routinely meet with Staff to ensure compliance with Commission rules and to address any Customer Service issues raised by Staff?

Staff's position is that the Company and Staff should meet periodically to ensure compliance with Commission rules and to address any customer service quality issues. Staff maintains that the periodic meetings between it and the Company would benefit the Company and its customers.

5. Union Issues

Should the Company expand its Valve Exercise Program?

Staff takes the position that there is no need for the Commission to address this matter, since there are no rule violations, no significant demonstrated issues to address, and no cost-benefit analysis supporting a change in existing procedure.

Is MAWC appropriately utilizing union workers?

Staff takes no position on this issue.

6. MAWC/PSC Small Water system Acquisition Policy

Should the Commission develop a policy regarding the acquisition of small water and/or sewer systems by the Company?

Staff's position is the Commission should not develop such a policy. Rather, the Commission should continue to evaluate a standard of "not detrimental to the public interest" based on the issues that exist in each individual certificate or acquisition case that comes before it. This holds true for large companies seeking to expand, small companies seeking to either expand or begin a business, and large companies or small companies acquiring small systems whether or not the small system being acquired is a "troubled system." Any such policy of general applicability would have to be developed in a rulemaking proceeding. (Staff did not file testimony on this issue.)

7. Riverside – Public Safety and Adequacy of Service

Is the service provided in Riverside adequate from a public safety perspective? If not, what must the Company do?

Staff's position is MAWC is providing safe and adequate domestic water service in Riverside that meets state and federal standards. Further, MAWC appears to be working with Riverside with respect to meeting requirements for system performance related to new construction and construction of necessary system upgrades undertaken by MAWC. No program or regulations exist that address upgrades specific to fire flow requirements created since original construction except that the "main extension rule" is available to anyone requesting such an upgrade. A working group created from MAWC's previous rate case did not agree upon any change to existing procedure. (Staff did not file testimony on this issue.)

8. Empire Special Contract

Should the January 19, 2012, Stipulation and Agreement as to a Special Contract for The Empire District Electric Company be approved? If the Stipulation and Contract is not approved, should the Company's interruptible tariff remain in effect?

Yes, the January 19, 2012, Stipulation and Agreement as to a Special Contract for The Empire District Electric Company should be approved. Yes, the Company's interruptible tariff should remain in effect. (Staff did not file testimony on this issue.)

9. Special Accounting for Business Transformation Project/Request for AAO

What is the appropriate accounting treatment to use for the Business Transformation Project at this time?

No special accounting treatment, such as an accounting authority order or any other type of deferral, is necessary for the cost of the Business Transformation Project. Staff asserts that when the Business Transformation Project assets are completed, the assets should be included in plant in service and begin depreciating at the rate currently approved by the Commission.

10. Jefferson City Upgrades

What is the status of the Jefferson City upgrades?

Staff's position is that Jefferson City upgrades are being accomplished as has been agreed to by working groups created from past rate cases, and there is no need for the Commission to further address this issue at this time. (Staff did not file any testimony on this issue.)

Respectfully submitted,

s/ Kevin A. Thompson

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served, either electronically or by hand delivery or by First Class United States Mail, postage prepaid, on this **15th day of February, 2012**, on the parties of record as set out on the official Service List maintained by the Data Center of the Missouri Public Service Commission for this case.

s/ Kevin A. Thompson