Exhibit No.:	
Issues:	*Water StorageTank Financing; Water System and Tank Operations; AffiliatedCompanies*
Witness:	*Merciel*
Type of Exhibit:	*Cross Surrebuttal Testimony*
Sponsoring Party:	*MO PSC Staff*
Case Nos.:	*WC-2002-155*
	SC-2002-160

Missouri Public Service Commission

Utility Operations Division

CROSS SURREBUTTAL TESTIMONY
of
JAMES A. MERCIEL, JR.

Case Nos. WC-2002-155 and SC-2002-160

Warren County Water and Sewer Company

Jefferson City, Missouri
April 24,2002

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James A. Merciel, Jr.

Case Nos. WC-2002-155 and SC-2002-160

Warren County Water and Sewer Company

CROSS-SURREBUTTAL TESTIMONY

OF

JAMES A. MERCIEL, JR.

Case Nos. WC-2002-155 and SC-2002-160

Office of the Public Counsel

vs.

Warren County Water and Sewer Company

INTRODUCTION

Q. Please state your name and business address.

A. James A. Merciel, Jr., P. O. Box 360, Jefferson City, Missouri, 65102.

Q. Are you the same James A. Merciel, Jr. who filed rebuttal testimony in this case on March 27, 2002?

A. Yes.

PURPOSE OF TESTIMONY

Q. What is the purpose of your cross-surrebuttal testimony?

A. The purpose of this cross-surrebuttal testimony is to respond to some points made in the rebuttal testimony of Gary L. Smith, owner of Warren County Water and Sewer Company (Company). Those points pertain to the following matters:

1. Financing for a proposed water storage tank;
2. Water system operations; and
3. Consolidation of the Company and Mr. Smith's construction company, and common bookkeeping.

STORAGE TANK

Q. Where, in his rebuttal testimony, does Mr. Smith discuss tank construction, and financing?

A. In his rebuttal testimony, beginning on page 3, line 5, and continuing through page 4, line 19, Mr. Smith discusses events related to his company's plans to construct a new storage tank, its financing, and the associated rate impact. He also discusses tank operation, and makes additional comments pertaining to financing from page 13, line 20, through page 16, line 19.

Q. Do you agree with Mr. Smith's comments?

A. I generally agree with everything Mr. Smith says on page 3 of his testimony regarding the history of the tank proposal, but I do not agree with the comments on page 4 pertaining to the underearnings, or the claim that his loan approval was conditioned on a rate increase. Dana Eaves, of the PSC Staff Accounting Department will address some issues regarding rate increase requests submitted by the Company.

Q. Do you agree that the bank conditioned the loan upon a rate increase?

A. No, I don't, based on a conversation I had in 1999 with Mr. Dale Cope of Peoples Bank and Trust, which was a financial institution with which the Company had a loan application. I had called Mr. Cope to be sure that the bank understood that the Staff would not recommend approval of increased rates to support the tank until after the tank was completed and in service, and also to find out the status of the proposed financing. Mr. Cope understood this principle of ratemaking. He also said that an

application for a United States Department of Agriculture Rural Economic Community Development loan guarantee needed to be submitted, but that it was Mr. Smith's option to do so. During this same time, despite Mr. Cope's comments, Mr. Smith repeatedly told me that the bank would not approve financing unless adequate rates are in place. I took this to mean that Mr. Smith believed rates had to be pre-approved. I addressed this matter in a Staff Report filed in Case No. WA-96-449 on September 7, 1999. A copy of this report is included as Attachment 1.

Q. Did Mr. Smith seek funding from any other sources?

A. Yes. Correspondence that Mr. Smith has sent me in the past indicates that he was looking into other financial sources. However, for unknown reasons, he did not obtain financing, and the tank has not been constructed.

Q. Has the Staff ever assisted Mr. Smith in seeking financial assistance?

A. Yes, it has. The Staff regularly offers to speak with financial institutions when utilities are seeking financing, to discuss regulatory procedure. This was one of the purposes of my above-mentioned telephone call to Peoples Bank and Trust. There may have been other conversations between this bank and someone else from the Staff's Financial Analysis Department; I don't know for sure. More recently, I discussed with Mr. Smith the Environmental Improvement and Energy Resources Authority (EIERA) revolving loan program for small water and sewer companies, and sent him some application forms to prepare, which he did and returned to me. There is a history associated with this program, and it was "shut down" for a period of time. Prompted by Mr. Smith's application, both Dale Johansen of the Water and Sewer Department and I

spoke with EIERA to see if the program and funding is presently available. Unfortunately, it is not presently available.

WATER SYSTEM AND TANK OPERATION

Q. Do you have any comments on Mr. Smith's testimony regarding operation of the water system?

A. Yes. Mr. Smith discusses water pressure on page 13, line 18, through page 14, line 19 of his testimony. Most of his facts are correct, except that in reality there are hydraulic losses throughout the distribution system during high flow periods. Also, regardless of what Mr. Smith's observations have been, the tank level can and probably does decrease during extremely heavy flows, such as during main breaks. High flows or drops in the tank level, or both together, can cause some customers to experience low pressure. Although I would agree that these problems are not normal daily occurrences, I believe that they have occurred in the past.

Q. Are you aware of specific pressure problems?

A. Yes. As I discussed in my rebuttal testimony, customers at the high elevation area near the tank experience low pressure at times, and the Staff has observed this. Although the tank water level, and the resulting system pressure, was designed originally so that there would be more than 20 pounds per square inch (psi) at all points in the system, pressure problems do occur. I believe this is due to the combination of customer growth and the resulting higher demand, expansion/extension of the distribution system which increases the probability of leaks and the frequency of

main breaks, and the undersized storage tank. This is contrary to Mr. Smith's statement on page 14, lines 9 through 13, where he says additional homes do not affect system pressure.

Q. Do you have any comments regarding Mr. Smith's testimony on page 16, lines 10 through 19, about fire protection?

A. Yes. I think it is reasonable, as Mr. Smith says, to allow the fire department to use hydrants to fill a tanker. However, doing so could impact system pressure, since filling a tanker would be an unusually high flow, by creating a hydraulic load on the distribution system, and by decreasing the water level in the storage tank. The 10,000 gallons Mr. Smith says the fire department wants is one-third of the total tank volume. Depending on the rate of flow while a fire tanker is being filled, such activity could result in a water level decrease of something on the order of eight to ten feet, even with the well pumping, which is enough to decrease customers' pressure at the high elevations below the required 20 psi. Mr. Smith is correct when he says on line 16 and 17 that "(g)reater storage would enable the Company to provide fire protection."

CONSTRUCTION COMPANY

Q. Did you ever tell Mr. Smith that he should combine the Company with his construction company, or any other company, as he states, on page 5, line 4, the Staff advised him to do?

A. No, I have never said the companies should be combined, nor to my knowledge has anyone else from the Staff. An example of correspondence I have sent

to the Company is a fax letter, which was included as page 5 of Attachment 1 to my rebuttal testimony. This fax letter was sent following a review of the Company's contract for service, and the issues being discussed were installation of service lines and pressure sewer pump units, where work done by the Company, and work done by the customer (usually through a contractor such as Mr. Smith's construction company) sometimes get confused. Nowhere does this document advocate combining the Company with the construction company. Many, perhaps most, regulated small water and sewer utilities are owned by people who have other business activities. Sometimes the owners have separate companies, and sometimes non-utility work is done by the regulated utility. Either way, the Staff strongly advocates that adequate records need to be kept for proper accounting and for allocations of costs between the various activities.

SUMMARY

Q. Would you please summarize your testimony?

A. Yes. The storage tank size needs to be increased, for the reasons outlined in this testimony, in my rebuttal testimony, and in other previous cases. Despite some effort during approximately the past four years, the Company has not been able to accomplish the task, and today it is not progressing toward completing that task. Neither I nor any other Staff member has advised the Company to combine itself with any other company.

CONCLUSION

Q. Does this conclude your pre-filed cross-surrebuttal testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

Office of the Public Counsel, Complainant	)	
v.	)	Case No. WC-2002-155 Case No. SC-2002-160
Warren County Water and Sewer Company Respondents.	)	

AFFIDAVIT OF JAMES A. MERCIEL, JR.

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

James A. Merciel, Jr., of lawful age, on his oath states: that he has participated in the preparation of the foregoing Cross Surrebuttal Testimony, in question and answer form, consisting of 7 pages and 1 attachment, to be presented in the above case; that he has knowledge of the matters set forth in such answers; and that such answers are true to the best of his knowledge and belief.

James A. Merciel, Jr.

Subscribed and sworn to before me this 23th day of April 2002.

Notary Public

My commission expires _____

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

Warren Co.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the Application of Gary L. Smith d/b/a Incline Water & Sewer Company to Sell and Transfer its Franchise, Works or System to Warren County Water and Sewer Company, a Missouri Corporation, and to Expand its Operating Area, and for Such Other Related Matters.	))))))))	Case No. WA-96-449

MOTION TO FILE COMMISSION-ORDERED STATUS REPORT

COMES NOW the Staff of the Missouri Public Service Commission ("Staff"), and for its Motion to File Commission-Ordered Status Report states as follows:

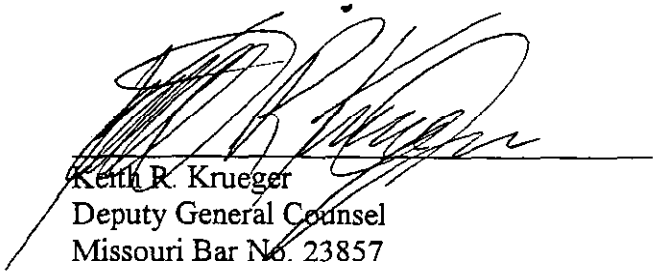
1. On July 20, 1999, the Missouri Public Service Commission ("Commission") issued an Order Directing Status Report, in which it ordered the Staff to file a report on the status of Warren County Water & Sewer Company's elevated water storage tank by no later than September 7, 1999, and to include a recommendation as to whether this case may be closed.

2. Staff has completed its investigation into the matter and has prepared its Staff Report, which it hereby offers for filing as directed in the order entered by the Commission on July 20, 1999.

WHEREFORE, the Staff respectfully requests that the Commission grant the Staff's Motion and accept for filing the attached Staff Report.

Respectfully submitted,

DANA K. JOYCE
General Counsel



Keith R. Krueger
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Missouri Bar No. 23857

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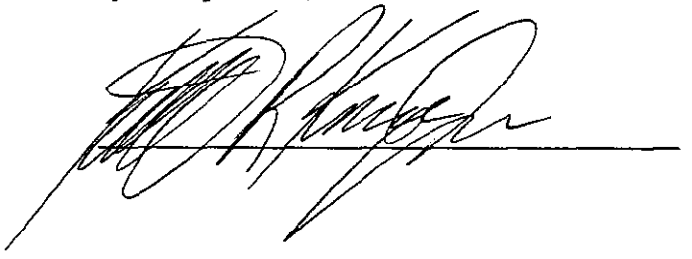
Certificate of Service

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record as shown on the attached service list this 7th day of September, 1999.



MISSOURI PUBLIC SERVICE COMMISSION

UTILITY OPERATIONS DIVISION

STAFF REPORT

Warren County Water and Sewer Company

CASE NO. WA-96-449

Prepared by

JAMES A. MERCIEL, JR., P. E.

Jefferson City, Missouri
September 7, 1999

MISSOURI PUBLIC SERVICE COMMISSION
STAFF REPORT OF INVESTIGATION

Warren County Water and Sewer Company
Case No. WA-96-449

Prepared by
James A. Merciel, Jr., P.E.

September 7, 1999

Introduction

In Case No. WA-96-449, Gary L. Smith d/b/a Incline Water & Sewer Company, a regulated utility owned and operated by Mr. Gary Smith as an individual, sought approval to expand its service area and to transfer utility assets to Warren County Water and Sewer Company, a corporation Mr. Smith had formed. The transfer of assets was approved by the Commission, and carried out by Mr. Smith. Gary L. Smith d/b/a Incline Water and Sewer Company and Warren County Water and Sewer Company will collectively be referred to herein as WCWS.

As a condition of the service area expansion, WCWS agreed to install a new water storage tank in a stipulation that was approved by the Commission in an Order Approving Stipulation and Agreement (Order) effective on June 30, 1998. Specifically, WCWS agreed to obtain required permits within 90 days of the effective date of the Order, and complete construction of the tank within 180 days after the required permits were obtained. WCWS also had filed a finance case, WF-97-271, for the purpose of obtaining approval to borrow up to $200,000 for the tank construction and related projects. An order approving a stipulation in that case became effective on October 30, 1998. The purpose of this report is to outline the status of construction of the new tank.

Background Information, and Overview of the Current Situation

This report could very simply be summed up by stating that the tank is not yet under construction. Even without specifying dates that construction permits were obtained, the tank should have been completed by March 27, 1999 according to the Order. WCWS did not seek an extension of this date. By the terms of the Commission's Order, the new service area that was conditionally granted in this case would have been automatically canceled when WCWS failed to complete construction by March 27, 1999.

It was well documented that there is a need for the tank to be placed in service; in fact it was brought out that within the next several years a need to construct a second tank for even more storage will exist. That time is fast approaching. The point is that regardless of any dates contained in the Order from the Commission, WCWS needed then, and today still needs to construct additional storage in order to provide good service to its customers.

WCWS has sought financing, as evidenced in the finance case. Peoples Bank and Trust (Bank) agreed to a proposed loan contingent upon several items. Among those items is that the United States Department of Agriculture Rural Economic Community Development (USDA) guarantee 80% of the loan balance. A representative of the Bank told me that an application for this guarantee needs to be submitted by WCWS, and it would then take another 30 to 60 days to obtain approval. WCWS claims that it prepared the application to USDA approximately two years ago, and the bank has the application. However, neither WCWS nor the bank submitted it to USDA due to other loans and financial situations. The Bank representative stated that WCWS needs to submit it, or at least make the call to go ahead with the submission.

WCWS also believes that financing is really not ready until the Commission has approved rates designed to cover the capital cost of the new tank. WCWS filed an informal rate case on April 7, 1999. The Staff has performed its audit, and presented a position to WCWS for its agreement. Finalization of the rate case is presently in negotiation between the Staff and WCWS. In its letter to WCWS dated August 27, 1999 outlining its position on the rate case, the Staff did indicate an amount of revenue that could be included **after the tank is constructed and placed in service.** WCWS apparently believes it needs to first get the Commission to approve a rate increase, then obtain the USDA guaranteed loan, and then construct the tank. The Staff has attempted to make it clear to WCWS that revenue associated with capital costs of utility plant cannot be included in rates until after the plant is placed into service.

Since before the Commission's Order was issued, WCWS had sought and studied bids for tank construction. After all of this time has passed, WCWS obtained an updated bid from Pittsburg Tank and Tower Company. WCWS appears to have accepted this bid by having signed the proposal, but it has not made the first payment of 10% of the bid amount in order to get the project started. Since tank construction takes several months, and is weather sensitive to a great extent, it would likely be next summer or fall before the tank could actually be in service, depending on weather and the contractor's schedule.

Staff Position

The Staff is of the opinion that WCWS has forfeited the expanded service area that was conditionally granted in this case. However, the need for service in the expanded area was adequately demonstrated, and it is likely the Staff would support a second attempt by WCWS to regain the service area after the tank issue is resolved.

The Staff is unable to detect any good reason why construction of the new tank has extended beyond the time frame outlined in the Commission's Order. Considering the need for the tank, the Staff is also of the firm opinion that WCWS should still pursue its construction, regardless of the history of this project. This would entail finalizing any details necessary to obtain the USDA loan guarantee, ultimately securing financing from the Bank or another financial institution, and executing a contract to construct the tank. The Staff has indicated the amount of additional

revenue it is willing to recommend after the tank is in service, based on the current bid. The Staff is available to work with WCWS to finalize or extend the current rate case, and discuss rates with any party involved with lending funds for the tank project. It must be noted that the Office of the Public Counsel must also be involved with resolution of the rate case, however OPC is aware of the quality of service issues, and the need for construction of the tank.

During the course of investigating this matter in order to prepare this report, WCWS has stated to the Staff that it is considering other financing options, and other options for construction of a new tank. The Staff is not opposed to any changes that would result in a "better deal," however, this is a project that has continued far beyond the time frames that were proposed, and even ordered by the Commission. Therefore, it is not appropriate to pursue options that would cause any further delays.

Conclusion

This case is not yet in a condition to be closed. The status of water tank construction is that the tank is not yet under construction, but the need for the tank has not gone away. Financing, construction proposals, and rates are such that this project should be able to proceed, albeit considerably later than what was anticipated in the Order, and in the stipulation that the Order approved. Therefore, WCWS should immediately take all appropriate action to begin construction of the water storage tank, and see that construction is completed as soon as possible. This will entail working with the Staff and Office of the Public Counsel to agree on finalization of the rate case, updating of the application for the USDA loan guarantee, and updating of construction permits as necessary. The Staff believes it has been, and is, doing everything it can to work with WCWS to take the capital cost of the new tank into consideration for inclusion in rates. All of this preliminary work should be able to be completed within 60 days, after which construction could begin as soon as the contractor can get started.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Mmatter of the Application of Gary L. Smith d/b/a Incline Water & Sewer Company to Sell and Transfer its Franchise, Works or System to Warren County Water and Sewer Company, a Missouri Corporation, and to Expand its Operating Area, and for Such Other Related Matters.	)))))))	Case No. WA-99-449

AFFIDAVIT OF JAMES A. MERCIEL, JR.

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

James A. Merciel, Jr., of lawful age, on his oath states: that he prepared the foregoing Staff Report, consisting of 3 pages, to be presented in the above case; that he has knowledge of the matters set forth in such report; and that the report is true to the best of his knowledge and belief.

James A. Merciel, Jr.

Subscribed and sworn to before me this 7th day of September 1999.

Notary Public

Joyce C. Neuner
Notary Public, State of Missouri
County of Osage
My Commission Exp. 06/18/2001

My commission expires

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WA-96-449
September 7, 1999

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