

Exhibit No.:

Issues: AFUDC, Working Capital,
Pensions, Belleville Lab
Costs, Property Taxes, St.
Joseph Plant Retirement,
AWR Customer Lists,
Security AAO, Credits and
Billing Adjustments, Fuel
and Power and Chemicals,
CAM, Affiliated
Transactions, Lobbying Costs
Interest Synchronization
Witness: Edward J. Grubb
Exhibit Type: Rebuttal Testimony
Sponsoring Party: Missouri-American Water Company

Case No.: WR-2003-0500

Date Filed: November 10, 2003

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. WR-2003-0500

FILED

JAN 23 2004

REBUTTAL TESTIMONY

**Missouri Public
Service Commission**

OF

EDWARD J. GRUBB

ON BEHALF OF

MISSOURI-AMERICAN WATER COMPANY

JEFFERSON CITY, MISSOURI

Exhibit No. 44
Date 12-16-03 **Case No.** WR-2003-0500
Reporter SLKM

EXHIBIT

MAWC 41

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

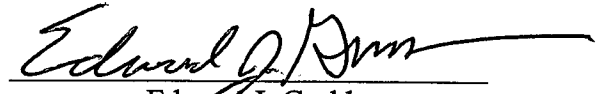
IN THE MATTER OF MISSOURI-AMERICAN
WATER COMPANY FOR AUTHORITY TO FILE
TARIFFS REFLECTING INCREASED RATES
FOR WATER SERVICE

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CASE NO. WR-2003-0500

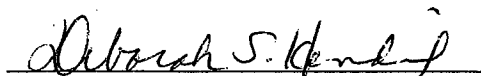
AFFIDAVIT OF EDWARD J. GRUBB

Edward J. Grubb, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Rebuttal Testimony of Edward J. Grubb"; that said testimony and schedules were prepared by him and/or under his direction and supervision; that if inquiries were made as to the facts in said testimony, he would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his knowledge.


Edward J. Grubb

State of Missouri
County of St. Louis
SUBSCRIBED and sworn to
before me this 6th day of November 2003.

DEBORAH S. HENDRIX
Notary Public-Notary Seal
STATE OF MISSOURI
St. Louis County
My Commission Expires: Aug. 11, 2007


Notary Public

My commission expires: 8/11/07

REBUTTAL TESTIMONY
EDWARD J. GRUBB
MISSOURI-AMERICAN WATER COMPANY
CASE NO. WR-2003-0500

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WITNESS INTRODUCTION

Q. PLEASE STATE YOUR NAME, TITLE AND BUSINESS ADDRESS.

A. Edward J. Grubb, Director Rates and Revenue for Missouri-American Water Company, 535 N. New Ballas Road, St. Louis, Missouri 63141.

Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THIS PROCEEDING?

A. Yes, I have submitted direct testimony in this proceeding.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to address and respond to various adjustments and recommendations to the Company's proposed revenue increase. The adjustments and recommendations were made by the Missouri Commission Staff ("Staff"), Office of Public Council ("OPC") and the Missouri Energy Group ("MEG"). The specific issues that I am addressing can easily be seen in the table of contents.

METHODOLOGY CHANGE IN CALCULATING AFUDC

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY ON THIS ISSUE?

A. Staff witness Hanneken has recommended to the Commission that the Company's AFUDC for the test year be reduced by \$481,699 and that the Company be ordered to adjust its method of calculating AFUDC in the future.

Q. HOW DOES THE STAFF PROPOSE TO CALCULATE AFUDC FOR THE PURPOSE OF AMOUNTS ALREADY ON MAWC'S BOOKS?

A. Staff is recommending to recalculate test year AFUDC by using short-term debt as the sole source of computing the calculation unless the level of CWIP exceeds the level of short-term debt. In that case, the overall cost of capital rate would be used to calculate AFUDC.

1 **Q. WHAT ARE SOME OF THE PROBLEM WITH STAFF'S CALCULATION OF THE**
2 **COMPANY'S AFUDC RATE?**

3
4 A. There are a number of problems with the calculation of the AFUDC rate. First, Staff assumes
5 that the Company can separate its cash between cash working capital and internal generated
6 funds. Secondly, even if we assume the Staff can separate the cash, Staff should deduct the
7 Company's cash working capital allowance in the last rate case from the short-term debt
8 outstanding for one element of the AFUDC rate. The third problem is in applying the rate of
9 return on rate base approved in the Company's last rate order to the excess of Construction
10 Work in Progress (CWIP) over short-term debt. The excess piece of CWIP should be based
11 on the weighted cost of common equity rate approved in the Company's last rate order.
12

13 **Q. WHY DO YOU BELIEVE THE WEIGHTED COST OF COMMON EQUITY RATE**
14 **SHOULD BE USED AS THE OTHER ELEMENT TO DETERMINE THE AFUDC**
15 **RATE?**

16
17 A. The Company's long-term debt and preferred stock financing normally are for plant in service
18 at the time of the financing. The excess of CWIP over short-term debt net of Cash Working
19 Capital allowance in the company's last rate case can only be equity dollars. Therefore, the
20 correct rate is the weighted cost of common equity approved in the Company's previous rate
21 order.
22

23 **Q. DO YOU BELIEVE THAT THE STAFF'S ADJUSTMENT IN THE CURRENT CASE**
24 **REPRESENTS RETROACTIVE RATEMAKING?**

25
26 A. Yes, I do. This Commission, along with other commissions, has provided guidance to the
27 utilities that they regulate as to what AFUDC is appropriate to use to capitalize debt and
28 equity for construction projects. This Commission in the past has allowed MAWC to use the
29 overall cost of capital authorized. In the last MAWC rate case (WR-2000-281), the
30 Commission made a change in prior AFUDC treatment by adjusting the cost of the St. Joseph
31 Treatment Plant. The Commission adjusted the cost of the new plant by \$1,289,674 to reflect

1 the actual carrying costs of MAWC's \$35 million in short-term debt as a result of the
2 construction of the plant. While it made an adjustment to the cost of the St. Joseph Treatment
3 Plant (single project adjustment), the remainder of the Company's AFUDC rate was left in
4 tact.

5
6 **Q. WHAT IS THE FINANCIAL CONSEQUENCE OF THE STAFF'S PROPOSED**
7 **CHANGE TO AFUDC AMOUNTS THAT ARE ALREADY ON THE COMPANY'S**
8 **BOOKS?**

9
10 A. The Company would be forced again to incur a write-off of an asset. Therefore, making this
11 adjustment now and applying it back into the test year is in the Company's view, retroactive
12 ratemaking.

13
14 **Q. IF THE COMMISSISON WERE TO MAKE A CHANGE TO THE AFUDC**
15 **CALCULATION, HOW SHOULD IT IMPLEMENT SUCH A CHANGE?**

16
17 A. The Company believes that if the Commission orders a change to the AFUDC capitalization
18 policy, the change should be made prospectively and not retroactively. Changing a
19 Commission policy and applying it in a way that results in a retroactive asset write-off is
20 unfair and unreasonable and not good regulatory policy.

21
22 This adjustment reminds me of the Staff's recent proposals for pension expense. There is a
23 continued effort to change regulatory treatment in order to lower rates and at the same time
24 cause the Company to under recover costs or to write-off assets. In a response to Company
25 data request 79, Staff stated that a consistent approach to ratemaking issues is important in the
26 setting of just and reasonable rates for Missouri utilities. Staff also noted that as
27 circumstances change and Commission rulings change, the Staff may change its position. The
28 Company agrees that circumstances can change. However, to change Commission regulatory
29 policy should require something more than the opportunity to gouge the utility. These types of
30 adjustments that the Staff is recommending are inconsistent with sound regulation.

1 **Q. IF THE COMMISSION DECIDES TO CHANGE THE POLICY REGARDING THE**
2 **CALCULATING OF AFUDC, WHAT IS THE COMPANY'S RECOMMENDATION?**

3
4 A. First the change should be made on a prospective basis.

5
6 Second, the calculation of AFUDC should be first based on deducting from the short-term
7 debt the level of working capital allowed in rate base. Then to the extent that short-term debt
8 is equal to or less than the CWIP, then the short-term debt rate should be used. If the level of
9 CWIP exceeds the level of short-term debt less working capital, then the last allowed
10 weighted cost of common equity should be used.

11
12 And finally, because of timing issues of calculating this each month and the closing process
13 for our accounting records each month, the calculation of the AFUDC rate needs to be done in
14 arrears and used in the subsequent month.

15
16 **WORKING CAPITAL REQUIREMENT**

17
18 **Q. MR. GRUBB, PLEASE DISCUSS THE ISSUES REGARDING WORKING CAPITAL.**

19
20 A. There are two issues regarding working capital. The first issue is regarding the appropriate lag
21 for Management Fees in the Lead/Lag Study. The second is the Staff's and the Missouri
22 Energy's (MEG) recommendation to exclude Depreciation and Deferred Taxes from the
23 Lead/Lag Study.

24
25 **Q. WHAT IS THE ISSUE RELATED TO THE LAG FOR MANAGEMENT FEES?**

26
27 A. Both the Company and Staff used a Lead/Lag Study approach in determining the level of
28 working capital in rate base. The determination of the amount of working capital for a
29 specific expense item in the study is calculated by multiplying the daily expense requirement
30 by the difference between the revenue lag and the expense lag for the category. For the
31 expense category Management Fees, the Company disagrees with the Staff position related to

1 the expense lag. The Company's expense lag for Management Fees is a negative 4.13 days
2 and the Staff's lag is a positive 42.30 days.

3
4 The Staff calculated its lag based on a strict review of the payment dates of the management
5 fees and did not determine what period of time the payments were applicable to in the
6 payment process. The management fees are paid in advance and the invoice clearly states this
7 fact.

8
9 **Q. HAVE YOU CALCULATED THE LAG UTILIZING THIS INFORMATION?**

10
11 A. Yes. Marked as Schedule EJG-1 and attached to my rebuttal testimony is the Company's
12 recalculated lag of a negative 3.31 days. This is slightly different from the Company's initial
13 rate filing. Due to the time and cost of preparing a Lead/Lag Study, the Company used the
14 lags from the last rate case with the exception of a few that I discussed in my Direct
15 Testimony. The lags that were used by the Company were taken from the Staff's
16 recommendation in the last MAWC rate case.

17
18 Correcting the lag for management fees would increase Staff's recommended level of
19 working capital by \$1.04 million.

20
21 **Q. WHAT IS THE ISSUE REGARDING THE STAFF'S AND MEG'S**
22 **RECOMMENDATION TO EXCLUDE DEPRECIATION AND DEFERRED TAXES**
23 **FROM WORKING CAPITAL?**

24
25 A. Depreciation and deferred taxes are both recognized by this Commission in the setting of
26 utility rates, both under operating expense and as a rate base reduction through the
27 accumulated balance sheet accounts. The issue that must be addressed and appropriately
28 recognized in the rate making process is that the Company experiences a considerable delay
29 in the recovery of the depreciation and deferred tax expense from the customers. Because of
30 this delay, a zero lag for depreciation and deferred taxes is required to correctly calculate the
31 Company's rate base.

1
2 **Q. WILL YOU PROVIDE US WITH AN ILLUSTRATION OF THE CONSIDERABLE**
3 **DELAY IN THE RECOVERY OF THE DEPRECIATION CHARGES THAT YOU**
4 **REFER TO IN YOUR PREVIOUS DISCUSSION?**
5

6 A. Yes. The investors supply cash to fund investment in the new plant such as mains, hydrants,
7 pumping equipment, etc. Depreciation expense represents the recovery of those cash
8 expenditures from customers who are receiving service. The investors are allowed to earn a
9 return on the plant in service less any depreciation charges that were collected from the
10 customers (accumulated depreciation). For example, if there is a lag of 63 (STL District
11 Revenue Lag) days between the time that customers receive service and when they pay for
12 that service, then depreciation charges will not be collected in cash from the customers until
13 an average of 63 days after service is provided. If this 63-day lag in the collection of
14 depreciation charges is not reflected in rate base, then the investors will not have the
15 opportunity to earn a return on their full investment. For an illustrative example of this issue,
16 I have attached to my testimony Schedule EJG-2.
17

18 **Q. WOULD YOU PLEASE EXPLAIN THIS EXHIBIT?**
19

20 A. Page 1 of 3 illustrates the purchase of an asset on January 1, 2003, at a cost of \$10,000. The
21 life of the asset is two (2) years. This illustration has been simplified, but the theory is the
22 same regardless of the cost or the service life of the asset. During this two (2) year life, the
23 traditional rate base for this asset would be the gross cost less the accumulated depreciation
24 and deferred taxes that have been recorded on the books. For this illustration, only
25 depreciation expense is being used in the example.
26

27 Page 2 of 3 illustrates the timing of the cash collection of the depreciation expense. The asset
28 was purchased and placed into service on January 1, 2003. The cash collection from the
29 customer will begin on March 4, 2003, which is 63 days after the asset was placed into
30 service. Therefore, there is a 63-day lag in the collection of the recorded depreciation. The
31 asset will be retired on December 31, 2004, and be fully depreciated and excluded from rate

1 base. The last cash collection will be on March 4, 2005.

2
3 **Q. PLEASE EXPLAIN WHAT PAGE 3 OF SCHEDULE EJG-2 SHOWS?**

4
5 A. This page illustrates that if rates were set using a rate base at December 31, 2003, the amount
6 in rate base would be \$5,000, which is the original cost of \$10,000 less the recorded
7 accumulated depreciation of \$5,000. As shown on page 2 of Schedule EJG-2, there is a lag of
8 63 days in the collection of the depreciation charges. Therefore, only \$4,137 has been
9 actually collected from the customers ($\$5,000 \times [365-63]/365$ days). Because the Company
10 only collected \$4,137 in depreciation charges, rates should be set on a rate base of \$5,863
11 ($\$10,000$ less \$4,137). This would be accomplished through a rate base that included \$5,000
12 for the net utility plant and a working capital allowance of \$863, which is calculated by
13 dividing the annual depreciation expense of \$5,000 by 365 days and multiplying that by the
14 difference in the revenue lag of 63 days and the lag for depreciation expense of zero days.
15 The result for this illustration is \$863 ($\$5,000/365 \times [36 - 0]$).

16
17 **Q. DOES THE ABOVE ILLUSTRATION FOR DEPRECIATION EXPENSE ALSO**
18 **APPLY TO DEFERRED TAXES?**

19
20 A. Yes, it does. The Company makes cash expenditures for an asset, begins recording deferred
21 taxes, but must wait 63 days before the deferred taxes are collected from the customers.

22
23 **Q. WHAT IS THE IMPACT IN RATE BASE OF INCLUDING DEPRECIATION AND**
24 **DEFERRED TAXES IN THE WORKING CAPITAL CALCULATION AT A ZERO**
25 **EXPENSE LAG?**

26
27 A. Based on the Company's original filing, Staff's rate base should be increased by
28 approximately \$5.055 million to properly state rate base.

29
30 **PENSION EXPENSE**
31

1 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY ON THIS ISSUE?**

2
3 A. Staff witness Gibbs has recommended to the Commission the recognition in rates of a level of
4 pension expense based upon the minimum contribution as required under the Employee
5 Retirement Income Security Act of 1974 ("ERISA"). The Company is proposing a level of
6 pension expense based on the requirements of the Financial Accounting Standard No. 87
7 ("FAS 87"). The FAS 87 standard utilizes accrual accounting to reflect the level of pension
8 expense of the Company. The difference between the Company and Staff on this issue is
9 approximately \$3.6 million.
10

11 **Q. WHICH METHODOLOGY HAS BEEN USED BY THIS COMMISSION TO SET**
12 **RATES IN PRIOR MAWC RATE CASES?**
13

14 A. This Commission has used the FAS 87 method for setting rates in the last 3 rate cases for
15 MAWC. However, the Staff has recommended in this case that the ERISA method be used.
16 Staff witness Gibbs states in his Direct Testimony that Staff supported the FAS 87 cost in
17 prior rate cases because the approach was consistent with how the costs associated with post-
18 retirement benefit costs (OPEB) are determined. OPEB costs are required to be based on
19 Financial Accounting Standard Board No. 106 as the result of Section 386.315, RSMo. FAS
20 106 is also based on the accrual accounting method for financial statement recognition.
21

22 **Q. WHY IS STAFF NOW RECOMMENDING CHANGING BACK TO USING ERISA**
23 **FOR RECOVERY OF PENSION EXPENSE?**
24

25 A. Staff believes that even with the recent significant devaluation of the stock market, the
26 amount of the ERISA payments still remains at or near zero. The Company believes that
27 Staff is taking a narrow view of the issue and has not considered the long-term impact on their
28 decision to move to using ERISA for rate recovery. I will discuss this part of the issue later in
29 my rebuttal testimony.
30

31 **Q. IS PENSION EXPENSE A COST THAT RISES AND FALLS FOR THE COMPANY?**

1
2 A. Yes. Because pension assets are linked to the markets and interest rates, the performance of
3 pension assets can vary from year to year. Thus, the current ERISA expense is not
4 necessarily representative of a utility's ongoing costs.
5

6 **Q. YOU MENTIONED EARLIER THAT IN PRIOR RATE CASES THE COMMISSION**
7 **HAS REFLECTED THE USE OF FAS 87 IN RATES. DID THEY REFLECT THE**
8 **APPROPRIATE LEVEL OF FAS 87 COSTS?**
9

10 A. The Commission in the last three MAWC rate cases has adopted the position of the
11 Commission Staff either through litigation or stipulation of the issue of the level of pension
12 costs. In prior rate cases, the Commission Staff adjusted the true FAS 87 costs by using
13 various adjustments. These adjustments served to reduce the cost of FAS 87. In all cases, the
14 Company disagreed with the Staff. The use of the Staff's adjustments only served to
15 artificially lower the true accrued cost of the pension expense in order to achieve the goal of
16 moving toward a lower cost that would have approximated the ERISA calculation.
17

18 **Q. WAS THE STAFF CONSISTENT IN APPLYING THE SAME METHODOLOGY IN**
19 **DETERMING THE LEVEL OF PENSION EXPENSE IN RATES?**
20

21 A. I have reviewed the Staff's position in the last three MAWC rate cases and counting the
22 current case the Staff has supported four different positions and calculations to arrive at their
23 recommendation for pension expense in the four cases.
24

25 **Q. DID YOU PREPARE A SCHEDULE SHOWING THE STAFF'S CALCULATION OF**
26 **PENSION COST UNDER FAS 87 FOR MISSOURI AMERICAN WATER'S LAST**
27 **THREE RATE CASES AND USING ERISA IN THE CURRENT CASE?**
28

29 A. Yes. Attached to my rebuttal testimony is Schedule EJG-3
30

31 **Q. HAS THE STAFF'S CALCULATION BEEN CONSISTENT IN THE LAST THREE**

1 **RATE CASES AND THE CURRENT CASE?**

2
3 A. No. As shown on the Schedule EJG-3, the Staff has used a different adjustment methodology
4 to the FAS 87 cost in calculating pension expense in each of the last three rates cases. In the
5 current case, they are abandoning entirely the FAS 87 cost and moving to the ERISA method
6 of calculating pension expense. The ultimate result of each of their calculations was to lower
7 the cost for ratemaking purposes. Staff has not been consistent and has used differing
8 adjusting schemes to negatively impact the true cost of the Company's pension expense.
9

10 **Q. HOW HAS THE STAFF'S CALCULATION OF PENSION EXPENSE CHANGED?**

11
12 A. In the rate case in 1995, Staff proposed an adjustment to the FAS 87 cost by assigning
13 MAWC's portion of the actual 1994 unrecognized gain in American Water's pension plan.
14 This adjustment lowered pension expense by 1.2% or \$3,260. In the 1997 rate case, Staff
15 changed its adjustment by not reflecting or assigning any unrecognized gain to MAWC. In
16 fact, there was an unrecognized loss in 1996 and not a gain. Had Staff used the same
17 methodology in the 1997 case as was used in the 1995 case, the pension expense would have
18 been increased by \$450,081 or over 200%. In the 2000 rate case, the Staff again changed its
19 adjustment. In the 2000 rate case, Staff used a five-year average of the unrecognized gains
20 and losses and then assigned a portion of it to MAWC. Had Staff utilized the same
21 adjustment method in the 2000 rate case that it used in the 1997 rate case, the pension expense
22 adjustment would have been increased by \$22,061 from the Staff recommendation in the 2000
23 rate case. Now, in the current case, the Staff is changing for the fourth straight rate case its
24 adjustment methodology. In this case, the Staff is moving back to ERISA and ignoring any
25 kind of an adjustment for unrecognized gains or losses.
26

27 This entire issue has become very frustrating for the Company because the Staff continually
28 searches for ways to reduce the amount of pension cost that will be included in rates. The
29 Company believes that consistency is an important characteristic of regulation. The Company
30 believes that the consistent use of FAS 87 for computing pension cost is the appropriate
31 manner for rate recovery.

1
2 **Q. EARLIER IN YOUR DISCUSSION OF THIS ISSUE, YOU TOUCHED ON THE**
3 **FUTURE LEVEL OF ERISA PAYMENTS. PLEASE ELABORATE.**
4

5 A. Currently, the Company is expecting that over the next four years, total pension payments
6 under ERISA will exceed pension cost under FAS 87 for MAWC by \$11,266,228. Shown
7 below is a table of the projected FAS 87 and ERISA payments anticipated over the next four
8 years.

9
10

Year	American Water		Missouri American	
	FAS 87	ERISA	FAS 87	ERISA
2004	\$44,400,000	\$45,850,000	\$6,100,560	\$ 5,726,521
2005	40,000,000	75,200,000	5,496,000	10,115,127
2006	35,000,000	70,450,000	4,809,000	9,679,830
2007	30,700,000	46,350,000	4,218,180	6,368,490

15
16

17 Marked as Schedule EJG-4 and attached to my rebuttal testimony is a letter that was received
18 by the Company from our actuaries Towers Perrin. The letter discusses the expected ERISA
19 payments and the FAS 87 costs over the next four calendar years and was used to arrive at the
20 numbers for the American Water System. The amounts shown under the columns headed
21 Missouri American are the expected amounts for the Company based on the amounts shown
22 for American Water.

23
24 If the Commission should agree with the Staff's recommendation to move to ERISA in this
25 case, the question we must ask ourselves is what will the Staff do in the next rate case? Since
26 the Staff has a shown a clear history of making expense reducing adjustments to the pension
27 cost that are not consistent from rate case to rate case, will the Staff move back to FAS 87 or
28 will Staff attempt to adjust the ERISA cost on some arbitrary basis to lower future pension
29 cost as it did in prior cases?

30
31 We believe that the Commission should consistently apply the FAS 87 method for computing
32 pension cost. We believe that the future ERISA payments will exceed the FAS 87 costs. If
33 the Commission adopts the Company's FAS 87 costs, the increase in the ERISA payments in

1 the future will be made by the Company and will serve to reduce the Pension Liability that
2 Mr. Gibbs discusses in his Direct Testimony.

3
4 **Q. DO YOU HAVE ANY OTHER COMMENTS?**

5
6 A. Yes. To help assist the Commission in evaluating the issue and to understand the future
7 direction of the FAS 87 and ERISA payments, the Company has contracted the services of
8 Mr. William J. Williamson of Towers Perrin. Mr. Williamson will address the differences in
9 FAS 87 and ERISA and explain the reasons for the increase in the level of ERISA payments
10 over the next few years.

11
12 **BELLEVILLE LAB WATER QUALITY TESTING COST ALLOCATION**

13
14 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY ON THIS ISSUE?**

15
16 A. The purpose of my rebuttal testimony is to briefly discuss the Staff's proposed adjustment to
17 the Company's test year level of water quality testing that is performed by the Bellville Lab.
18 First, the Company is using the services of Mr. Pat Baryenbruch to address the issue of
19 allocation of the costs associated with the Belleville Lab. Mr. Bayenbruch will address the
20 reasonableness and appropriateness of using a customer count allocation rather than the
21 number of test samples as recommended by the Staff.

22
23 The Staff's proposed adjustment reduces water quality testing approximately \$346,000.
24 Staff's adjustment is based on a comment in Mr. Cassidy's direct testimony that using an
25 allocation factor of test analyses is more appropriate than a customer count allocation. Mr.
26 Cassidy makes no assertion as to why the one allocation factor is more appropriate than the
27 other. Mr. Baryenbruch in his rebuttal testimony will address this issue in further detail.

28
29 **PROPERTY TAXES**

30
31 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY AS TO THIS**

1 **ISSUE?**

2

3 A. The Staff has not reflected the proper level of property taxes resulting from the true-up of

4 utility plant in service. The Company's proposed level of property taxes reflected an

5 adjustment to include property taxes on plant investments through the true-up period.

6 However, Staff witness Hanneken did not reflect property taxes on true-up plant in her

7 adjustment and instead only proposes to reflect the latest property tax bills to be paid prior to

8 December 31, 2003. The total difference between the Company and the Staff on this issue is

9 approximately \$593,000.

10

11 **Q. DO YOU AGREE WITH THE STAFF'S ADJUSTMENT?**

12

13 A. No. The Staff's adjustment ignores the matching of the level of property tax expense to the

14 level of Utility Plant in Service (UPIS) as of the end of the true-up period in this case

15 (November 2003). The level of Utility Plant in Service to be reflected in rates will be the

16 balance recorded on the books as of November 2003. The level of property tax to be

17 recovered in rates as proposed by Staff will be based on UPIS as of December 2002. This is

18 inconsistent with other true-up adjustments that are being proposed.

19

20 **Q. WHAT ARE THE OTHER TRUE-UP ADJUSTMENTS BEING PROPOSED?**

21

22 A. The Company and the Staff are proposing to true-up depreciation expense based on UPIS as

23 of November 2003. The Company and Staff are also proposing to true-up chemical and fuel

24 and power expense based on sales after a true-up for actual customers as of November 2003.

25 In all cases, the true-up being proposed relates back to the matching of investment, revenue

26 and expenses as of the end of November 2003. The one exception in the Staff's case is

27 property taxes.

28

29 **Q. WHAT LEVEL OF PROPERTY TAXES WILL THE COMPANY ACCRUE IN 2004**

30 **BASED ON THE TRUED-UP PLANT?**

1 A. The Company will begin accruing a level of property tax expense starting January 2004 based
2 on UPIS as of December 31, 2003. The new rates in this case will be based on that level of
3 UPIS at November 2003. The property tax level to be included in rates should be based on
4 the UPIS level reflected in rate base as of the true-up.

5
6 **Q. DO YOU BELIEVE THEN THAT PROPERTY TAXES SHOULD BE INCLUDED IN**
7 **THE TRUE-UP?**

8
9 A. Yes. Property taxes can be easily trued-up by calculating a ratio of the actual 2003 property
10 tax expense, divided by UPIS at December 2002. This ratio would then be multiplied by the
11 actual true-up UPIS to arrive at the true-up level of property taxes to be recovered in rates.

12
13 **Q. IN THE PAST, THE STAFF HAS ARGUED THAT THE AMOUNT OF PROPERTY**
14 **TAXES PAID BY THE COMPANY BEYOND THE TRUE-UP ARE NOT KNOWN**
15 **AND MEASUREABLE. DO YOU AGREE WITH THIS ARGUMENT?**

16
17 A. No, I do not. Utility Commissions have the responsibility of setting just and reasonable rates
18 that are both fair for the ratepayers and the utility. A utility must be given an opportunity to
19 earn its rate of return. The Staff's proposal for the recovery of property taxes in this case does
20 not provide the Company an opportunity to earn its authorized return. In fact, the Staff's
21 property tax adjustment places the Company at a disadvantage before the new rates are even
22 placed into effect.

23
24 **Q. REGARDING THIS ISSUE, WHAT DOES THE COMMISSION NEED TO BE ABLE**
25 **TO DETERMINE THAT THE COMPANY'S PROPOSED LEVEL OF PROPERTY**
26 **TAXES ARE APPROPRIATE FOR RATE RECOVERY?**

27
28 A. The Company believes that its proforma level of property taxes is known and measurable.
29 Therefore, the recovery of this expense in rates is appropriate.

30
31 First, the level of actual Utility Plant in Service at the end of December 2002 is known.

1 Second, the level of the actual true-up Utility Plant in Service will be known at the end of
2 November. Third, the actual property taxes for 2003 will be known at the end of November.
3 Using the actual property tax bills for 2003 and the actual Utility Plant in Service at the end of
4 2002, a composite property tax ratio can be calculated, which, is then multiplied by the actual
5 known true-up Plant in Service at November 2003 to calculate an appropriate level of
6 property taxes for rate recovery. If all components in the above calculation are based on
7 known and measurable data, then the results for ratemaking purposes should be considered by
8 this Commission to be a known and measurable calculation in setting rates.

9
10 **Q. MR. GRUBB, YOU STATED EARLIER THAT THE STAFF'S RECOMMENDATION**
11 **WOULD NOT PROVIDE THE COMPANY WITH AN OPPORTUNITY TO EARN**
12 **ITS AUTHORIZED. PLEASE EXPLAIN THIS STATEMENT.**

13
14 **A.** The setting of rates should be based on the matching principle. In this case, the Utility Plant
15 in Service is being matched with the actual customers and the level of depreciation expense to
16 be calculated on the plant. As part of the cost, the Company will be incurring property taxes
17 on the actual true-up plant of which the Staff is recommending that the Company not recover
18 in rates at this time.

19
20 By not allowing the recovery of these property taxes, the Staff's revenue requirement will
21 cause the Company to immediately earn below the authorized return to be set by the
22 Commission. Again, not fully matching revenues, expenses and investment in the setting of
23 rates causes this to occur.

24
25 **Q. HAVE YOU HAD THE OPPORTUNITY TO PERFORM A HISTORICAL**
26 **COMPARISON OF THE STAFF METHODOLOGY AND THE METHODOLOGY**
27 **PROPOSED BY THE COMPANY?**

28
29 **A.** Yes. Attached is Schedule EJG-5. This schedule compares the Company's methodology and
30 the Staff's recommended methodology for recovery of property taxes. The schedule's
31 analysis and comparison uses seven years of data to calculate annual levels of property taxes

1 to be reflected for rate recovery assuming the Company filed annual rate cases. This analysis
2 shows that using the Company's method, the Company would have under collected in rates
3 property taxes by \$543,269. Using the Staff's methodology, the Company would have under
4 collected in rates property taxes by \$3,475,047 (an astonishing 540% difference between the
5 two methods).

6
7 Ratemaking is not exact science and once rates are set, many factors and issues can occur that
8 can cause the Company's revenues and expenses to change. However, the rate setting process
9 should recognize a level of expenses that will reflect the Company's level of expenses that are
10 appropriate for recovery. Using the Staff's methodology for calculating property taxes
11 woefully falls short in meeting the intended objective in the setting of rates. I believe that the
12 Commission should accept the Company's calculation as the appropriate basis of recovery of
13 property taxes.

14
15 **Q. IF THE COMMISSION ADOPTS THE STAFF'S ADJUSTMENT FOR PROPERTY**
16 **TAXES, SHOULD ANY ADDITIONAL ADJUSTMENT BE INCLUDED IN THE**
17 **REVENUE REQUIREMENT?**

18
19 **A.** Yes. If Staff's level of property taxes is used, then an adjustment to working capital must also
20 be made. The adjustment that is needed should change the payment lag for property taxes to
21 be consistent with Staff's property tax expense proposal. As previously mentioned, Staff is
22 proposing to include in rates a level of property tax expense that was paid in December 2003.
23 Rates in this case will go into effect in April 2003. Therefore, working capital should reflect
24 the fact that the Company will pay the property taxes in December 2003 and not recover those
25 taxes until starting in April 2004. The expense lag for property taxes should be changed to
26 zero to reflect the payment near the start of the rate year. Using Staff's accounting schedules,
27 this results in an increase in the Staff's recommended rate base by approximately \$5 million.

28
29 **RECOVERY OF OLD ST JOSEPH TREATMENT PLANT RETIREMENT**

30
31 **Q. PLEASE DESCRIBE THE DISAGREEMENT RELATED TO THE OLD ST. JOSEPH**

TREATMENT PLANT.

A. When the new St. Joseph treatment plant came on-line, the old plant was retired and taken out of service. However, the old plant was not fully depreciated. On the day the old St. Joseph treatment plant was retired, its book value (investment minus depreciation) was \$2,832,906. In Case No. WR-2000-281, the Commission denied MAWC recovery of those undepreciated amounts associated with the retirement of the old St. Joseph treatment plant and directed that the remaining plant balance and the related cost of removal be written off. The actual cost of removal was in the amount of \$344,955.

Q. IN STAFF WITNESS STEPHEN M. RACKERS' DIRECT TESTIMONY, HE INDICATES THAT RECOVERY OF THE UNDEPRECIATED BALANCE OF THE OLD ST. JOSEPH TREATMENT PLANT IS "INAPPROPRIATE FOR INCLUSION IN THIS CASE." UPON WHAT DOES MR. RACKERS BASE THIS POSITION?

A. Mr. Rackers states that he has been "advised by Counsel that this matter is the subject of a continued court appeal process of a prior Commission Order."

Q. ARE YOU FAMILIAR WITH THE "COURT APPEAL PROCESS" TO WHICH MR. RACKERS REFERS?

A. Yes. The Cole County Circuit Court opinion that reversed the Commission's decision in Case No. WR-2000-281 as to this issue is discussed in my Direct Testimony on pages 17-20.

Q. WHAT ARE THE IMPLICATIONS OF THE EXISTING CIRCUIT COURT ORDER THAT REVERSES THE COMMISSION'S DECISION?

A. I believe that is a legal matter that is best suited for the legal briefs and attorneys.

Q. FROM A RATE MAKING PERSPECTIVE, WHAT DO YOU BELIEVE THE COMMISSION SHOULD DO WITH THE DEPRECIATION AND COST OF

REMOVAL ASSOCIATED WITH THE OLD ST. JOSEPH TREATMENT PLANT?

A. I believe that the Commission should provide for a recovery of these amounts.

Q. WHY?

A. The very existence of these amounts is a function of the depreciation rates set by the Commission. To not allow recovery of the amounts would allow the Commission to in essence “trap” MAWC’s investment and deny recovery of prudent investment.

Q. IN AN IDEAL WORLD, WOULD THERE EVER BE UNDEPRECIATED AMOUNTS AT THE CLOSE OF THE USEFUL LIFE OF A PIECE OF UTILITY PLANT?

A. No. As the Commission stated in its decision in Case No. WR-2000-281, “If the accounting convention were perfect, an asset would be fully depreciated at the time it is actually retired, that is, removed from service. . . . In the case of the old St. Joseph treatment plant, the accounting convention yielded an imperfect result and the plant was not yet fully depreciated at the moment of its retirement.” (Report and Order, p. 50). Because of the estimates and unknowns involved with depreciation analysis, it is not unheard of for the depreciation rates to miss their goal to some extent. In this case, the Commission’s past analysis proved incorrect and the depreciation rates failed to match capital recovery with capital consumption.

Q. HOW ARE DEPRECIATION RATES SET FOR RATE MAKING PURPOSES?

A. A water corporation, such as MAWC, must utilize the depreciation rates which are established by the Commission. Section 393.240, RSMo 2000. Thus, the “imperfect result” as to the old St. Joseph treatment plant depreciation is the result of the Commission ordered depreciation rates and a failure to match depreciation to the life of the plant is based upon the Commission’s own decisions. A denial of the amounts at issue requires MAWC to suffer the consequences of the inadequacy of Commission established depreciation rates. This is not reasonable.

1
2 **Q. SHOULD THE COMMISSION HAVE BEEN AWARE OF THE POTENTIAL FOR**
3 **THIS MISMATCH PRIOR TO CASE NO. WR-2000-281?**
4

5 A. Yes. In the Company's last rate case before Case No. WR-2000-281, the potential for
6 unrecovered depreciation amounts as to the old St. Joseph treatment plant was specifically
7 raised as an issue by the Commission Staff. *In the Matter of Missouri-American Water*
8 *Company's Tariff Designed to Increase Rates for Water Service*, Case No. WR-97-237
9 (1997). In Case No. WR-97-237, the Commission Staff highlighted the fact that the value of
10 the old plant would not be depreciated by the time the new St. Joseph treatment plant came on
11 line and, thus, suggested that a depreciation reserve deficiency existed.¹ The Staff
12 recommended that the Commission authorize a ten year amortization of this reserve
13 deficiency in order to smooth the impact on ratepayers. At the urging of the OPC and other
14 intervenors, the Commission chose to not address the deficiency in Case No. WR-97-237
15 stating "Presumably, MAWC will have made a start on the new St. Joseph plant by the time
16 of its next rate case. At that time the Commission may have evidence to support such an
17 amortization proposal." *Id.* As a result, the Commission was instead faced with the actual
18 retirement and the resulting reserve deficiency in Case No. WR-2000-281.
19

20 **Q. WHAT DID THE COMMISSION FIND AS TO THE NEW ST. JOSEPH**
21 **TREATMENT PLANT?**
22

23 A. The Commission found that MAWC's decision to construct the new plant and facilities was
24 reasonable. It stated that the "management of MAWC did use due diligence to address all
25 relevant factors and information known or available to it when it assessed the situation and
26 reached the decision to build a new treatment plant and develop a new ground water source of
27 supply in St. Joseph. Consequently, the Commission must conclude that the decision to build

¹ In Case No. WR-97-237, the Staff had prepared a depreciation study which reflected the then
St. Joseph treatment plant being retired within the next three to four years. (Salser Sur., Ex. 8,
p. 3).

1 the new plant and related facilities was not imprudent.” (Case No. WR-2000-281, Report and
2 Order, p. 45-46).

3
4 **Q. WHAT ARE THE POLICY IMPLICATIONS FOR UTILITIES IF A UTILITY WILL**
5 **BE FORCED TO LOSE ANY UNDEPRECIATED AMOUNTS WHEN PROPERTY IS**
6 **REPLACED?**

7
8 A. If the Commission is going to disallow recovery of the amount of a utility’s investment that
9 has not been fully depreciated, the Commission will send a strong message that decisions as
10 to new construction should not be based on needs of its customers, but rather, on the status of
11 depreciation accounts.

12
13 **Q. ARE YOU FAMILIAR WITH THE TERMS “RETURN ON” AND “RETURN OF”?**

14
15 A. Yes. There are generally two types of recovery associated with a public utility’s rates. A
16 public utility receives both a “return on” its reasonable investments, as well as a “return of”
17 its reasonable expenses.

18
19 **Q. WHAT TYPE OF RETURN IS MAWC SEEKING IN REGARD TO THE OLD ST.**
20 **JOSEPH TREATMENT PLANT AMOUNTS?**

21
22 A. MAWC, as earlier specified in my Direct Testimony, is only seeking a “return of” the
23 amounts at issue. MAWC proposes to receive this return of the amounts through the use of a
24 20-year amortization. Using this approach results in an annual amortization of \$158,893.

25
26
27
28 **INPUTTED REVENUES FROM AWR FOR CUSTOMER LISTS**

29
30 **Q. MR. CASSIDY RECOMMENDS A DISALLOWANCE OF \$100,000 TO**
31 **REFLECT THE VALUE OF MAWC’S SERVICES RENDERED TO AWR IN**

1 **CONNECTION WITH THE AWR SERVICE LINE PROTECTION**
2 **PROGRAM OFFERING TO MAWC'S CUSTOMERS. WHAT SERVICES**
3 **DID MAWC PERFORM FOR AWR IN THIS REGARD?**

4
5 A. MAWC provided a list of customers, which AWR used for four mailings in 2003.
6 MAWC's president, Mr. Eric Thornburg, also provided a cover letter that
7 accompanied the AWR brochure in these mailings.

8
9 **Q. IS MAWC IN ANY WAY INVOLVED IN THE PROVISION OF THIS**
10 **SERVICE BY AWR?**

11
12 A. No. Customers with this service who experience a service line leak must contact
13 AWR. AWR then arranges for an independent contractor to perform the repair.
14 MAWC plays no role in this process.

15
16 **Q. DO YOU AGREE WITH MR. CASSIDY'S ADJUSTMENT, AND IF NOT,**
17 **WHY?**

18
19 A. The adjustment is inappropriate for several reasons:

- 20
21 • MAWC's limited involvement in the offering of this program was a public
22 service to customers and the promotion of a solution to a customer service
23 problem, for which the demand of compensation would have been
24 inappropriate.
- 25
26 • The arbitrary value independent of customer benefit that Mr. Cassidy ascribes
27 to MAWC's involvement is grossly excessive.

1 **Q. IN WHAT RESPECT IS MAWC’S INVOLVEMENT IN THIS PROGRAM**
2 **BENEFICIAL TO ITS CUSTOMERS?**

3
4 A. This AWR program is not something unrelated to customer satisfaction with utility
5 service. The problem of customer ownership of service lines and concurrent
6 responsibility for repair of those lines has been a consistent and serious cause of
7 customer dissatisfaction for many years. So much so, in fact, that in the St. Louis
8 entity, the Staff filed multiple Complaint cases attempting to force the Company to
9 address the customer repair responsibility problem, and even went so far as to sue the
10 Company in an unsuccessful attempt to force the Company to maintain service lines.
11 St. Louis County Water Company v. Public Service Commission, 579 S.W.2d 633
12 (Mo.App. E.D. 1979).

13
14 **Q. HAS THE STAFF OR THE COMMISSION COMMENTED ON THE VALUE**
15 **TO CUSTOMERS OF A WATER SERVICE LINE PROTECTION**
16 **PROGRAM?**

17
18 A. Yes. Both the Staff and the Commission have acknowledged this. When the Missouri
19 Legislature enacted legislation that put into effect the mandatory program in St. Louis
20 County, there was a Staff Complaint case contesting the question of whether the
21 charge was to be imposed on all customers or just on property owners. In that Case,
22 the Commission stated in its Report and Order validating the imposition of the charge
23 on all customers that, “In general, a water service line replacement program is very
24 beneficial to property owners, who might otherwise find themselves responsible for
25 extremely costly repairs.” In testimony in that case Mr. Hubbs of the Staff argued
26 that primary benefits were to owners as opposed to renters, but he also conceded that,
27 “...I do not say this to imply that there are no benefits to the residential customer who
28 rents from the residential landlord. The stability of continued water service, and of

1 possibly not having to move because of a dramatic change in the residential landlord's
2 economic position, can both be significant benefits to the renter. (Surrebuttal
3 Testimony, Case WC-2002-146, W.R. Hubbs, Ex. 2, p. 22).
4

5 **Q. WHAT THEN WAS THE COMPANY'S MOTIVE FOR ASSISTING AWR**
6 **WITH THE PROGRAM OFFERING?**
7

8 A. We did this because customer dissatisfaction with failing service lines is a significant
9 source of customer concern, and to the extent that we can eliminate that through a
10 repair program, it both helps the customers and ultimately reduces the calls and
11 complaints associated with service line failures.
12

13 **Q. WITH RESPECT TO MR. CASSIDY'S DETERMINATION THAT THIS**
14 **SHOULD RESULT IN A \$100,000 REDUCTION IN THE COMPANY'S**
15 **REVENUE REQUIREMENT, DO YOU UNDERSTAND WHERE AND HOW**
16 **HE CAME UP WITH \$100,000?**
17

18 A. He indicates that the \$100,000 is an "estimate" but does not describe how he
19 developed the amount. It is obvious that the figure is completely arbitrary.
20

21 **Q. WHY DO YOU SAY THAT IT IS OBVIOUS THAT THE FIGURE IS**
22 **"ARBITRARY?"**
23

24 A. MAWC provided AWR with a mailing list. The \$100,000 amount is grossly in excess
25 of the cost of similar lists on the open market. Our research shows that customer lists
26 can be purchased for \$37 to \$75 per 1,000 customers. For MAWC with 112,000
27 customers outside of the St. Louis district, that totals to between \$4,200 and \$8,400.
28 We believe the \$8,400 valuation is appropriate because it represents the price at which

1 a purchaser could use the list an unlimited number of times. AWR has sent four
2 mailings to MAWC customers (April 3, 2003, June 16, 2003, August 11, 2003, and
3 October 15, 2003). Mr. Cassidy's \$100,000 valuation translates into a cost of almost
4 \$900 per 1,000 customers. This is more than ten times the market price.

5
6 **Q. DO YOU ATTRIBUTE ANY VALUE TO THE NOTE FROM MAWC**
7 **PRESIDENT MR. ERIC THORNBURG THAT ACCOMPANIED THE AWR**
8 **MAILING?**

9
10 A. No. There was absolutely no incremental cost to MAWC in connection with this
11 letter. There is no reasonable way to place a value on Mr. Thornburg's letter.

12
13 **Q. WHY DID MR. THORNBURG SEND THIS LETTER PROMOTING A**
14 **SERVICE OFFERED BY AWR?**

15
16 A. The letter was sent as a convenience to customers. We know from the experience
17 with our St. Louis County district that service line protection is a service that
18 customers value. We wanted to make other MAWC customers aware of the
19 opportunity to receive the same service from a trustworthy provider. We believe that
20 customers who want the peace of mind associated with service line protection were
21 very happy to have this arrangement presented to them.

22
23 **SECURITY COST AAO**
24

25 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY ON THIS**
26 **ISSUE?**

27 A. Staff witness Rackers has recommended to the Commission that the Company not be allowed
28 to recover: 1) legal costs associated with the security accounting authority order (AAO)
29 proceedings (Case No. WO-2002-273); 2) deferred carrying costs associated with the security

1 AAO resulting from a proposed change in the methodology for calculating Allowance for
2 Funds Used During Construction (AFUDC); and, 3) the costs associated with a return on the
3 unamortized balance of the AAO costs. The Staff is recommending to the Commission that
4 the AAO cost be recovered over a 10-year period.

5
6 OPC witness Bolin has recommended that the Company not be permitted to receive a "return
7 on" of the unamortized costs associated with the Security AAO Deferral.

8
9 **Q. PLEASE BRIEFLY DISCUSS THE SECURITY AAO.**

10
11 A. In Case No. WO-2002-273, the Commission authorized the Company to defer certain costs
12 associated with security measures taken by the Company in the aftermath of the September
13 11, 2001 terrorist attacks. The Company was authorized to defer the costs for a two-year
14 period ending on September 11, 2003. The Company was also authorized to amortize the
15 costs over a 10-year period. The Company began amortizing the costs in December 2002
16 upon receipt of the Commission's Report and Order. The Company stopped deferring costs
17 associated with the one-time costs and the capital expenditures placed into service after
18 September 11, 2003.

19
20 **Q. DO YOU AGREE WITH THE PROPOSED ADJUSTMENTS MADE BY STAFF OR**
21 **THE OPC?**

22
23 A. No, I do not.

24
25 **Q. WHY DO YOU DISAGREE WITH THE STAFF RECOMMENDATION?**

26
27 A. First, it seems inherently unfair to not recover the costs associated with a proceeding before
28 the Commission in one fashion or another. All of the legal fees for the AAO proceeding were
29 prudently incurred and should be recovered. These types of legal fees are similar to the legal
30 fees incurred by a utility to litigate a rate proceeding before the Commission. They are costs
31 associated with the fact that the Company is regulated by the Commission and must

1 participate in regulatory proceedings before the Commission. Because it is a corporation,
2 MAWC is required by Commission Rule 4 CSR 240-2.040 to appear before the Commission
3 through licensed attorneys. Prudently incurred legal fees associated with a rate case have
4 historically been recognized in rates via an amortization. The Company believes these costs
5 are similar and therefore should be recovered as part of the AAO costs or part of the rate
6 proceeding costs, since it is this proceeding that will determine what level of the AAO
7 deferral will be recovered in rates.

8
9 Second, the Company believes that the adjustment to the amount of the deferral related to the
10 calculation of the carrying costs is inappropriate. I have discussed this issue in further detail
11 in the section of my rebuttal testimony labeled Methodology Change in Calculating AFUDC.
12

13 Finally, Staff has recommended that the unamortized balance be excluded from rate base. Mr.
14 Rackers makes this recommendation based on a Commission decision involving Missouri Gas
15 Energy ("MGE") (GR-98-140). The issue in that case was a service line replacement deferral.
16 The Company believes that costs associated with the security AAO are different from the
17 issue in the MGE case. The Company incurred the costs to provide security to its production
18 and distribution systems, its offices, its customers and its employees. The Company incurred
19 these costs with the sole purpose continuing to provide safe and adequate water service to its
20 customers. In the MGE case, the AAO was done to replace assets that had been in place and
21 providing service to its customers for years and were now worn out.
22

23 In prior AAO cases, the Commission has found that the exclusion of the deferral from rate
24 base represents a sharing of the costs. The Company believes that the Commission can use
25 this standard if the deferral represents amounts that are both a benefit to the ratepayers and the
26 shareholders. There are instances where a deferral only benefits the ratepayers while other
27 deferrals benefit both the ratepayer and the shareholder. In the case of the Security AAO, the
28 benefits are solely accruing to the ratepayers. The security expenditures were made to protect
29 our customers and the assets that serve them. Therefore, rate base treatment of the
30 unamortized balance is appropriate.
31

1 **Q. IN YOUR DISCUSSION ABOVE REGARDING THE SHARING BETWEEN THE**
2 **RATEPAYER AND THE SHAREHOLDER, HAS THE COMPANY EVER**
3 **PRESENTED AN OPPORTUNITY FOR THIS COMMISSION TO SHARE A**
4 **CUSTOMER BENEFIT WITH THE COMPANY?**

5
6 A. Yes. The Commission had an opportunity to do so in the last St. Louis County Water
7 Company rate case (Case No. WR-2000-844). In that case, the Company proposed to the
8 Commission that the customers share the actual savings resulting from the merger/acquisition
9 with the Company. The Commission denied that request. Since the Commission has denied
10 this type of request, we believe that a more careful review of rate base treatment for deferrals
11 should be made with an eye towards affording an opportunity to recover the full cost of
12 deferrals.

13
14 **Q. MR. RACKERS HAS RECOMMENDED TO THE COMMISSION THAT THE**
15 **DEFERRED INCOME TAXES ASSOCIATED WITH THE AAO DEFERRAL**
16 **SHOULD BE INCLUDED AS A RATE BASE REDUCTION. DO YOU AGREE WITH**
17 **THIS?**

18
19 A. No, I do not. Reducing rate base by the amount of the deferred taxes associated with the
20 Security AAO, when at the same time the Staff is recommending exclusion from rate base the
21 unamortized balance of the costs, is simply wrong. I know of no other Commission that takes
22 advantage of shareholder funds that create a tax deduction and then uses that tax deduction in
23 the form of a deferred tax liability and then takes that liability away from the Company and
24 use it as a rate base reduction when the associated asset is excluded from rate base. I ask the
25 Commission to reevaluate its policy. If a deferral is excluded from rate base, then the
26 associated deferred income taxes should remain with the shareholder and not be used to
27 reduce rate base. Staff's adjustment is tantamount to double dipping the Company.

28
29 **Q. DO YOU AGREE WITH THE OPC'S RECOMMENDATION TO DISALLOW A**
30 **"RETURN ON" OF THE SECURITY AAO COSTS?**

1 A. No. The above discussion of rate base treatment and the return on of a deferral is equally
2 appropriate in response to OPC witness Bolin's testimony.

3
4 **REVENUES RELATED TO CREDITS AND BILLING ADJUSTMENTS**

5
6 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY ON THIS POINT?**

7
8 A. The Company, during its review of the Staff's originally filed case, discovered that it
9 appeared the Staff did not take into consideration in developing its present rate level of
10 revenues the appropriate level of test year credits and billing adjustments. From the initial
11 review of the Staff's case, the Company believes that the Staff's revenues were inadvertently
12 overstated by \$970,000. The Company provided to the Staff during the prehearing conference
13 week a schedule detailing what it thought the issues were in the Staff's revenue calculation.
14 Subsequent to the prehearing conference, the Company and the Staff have had discussions
15 regarding the issues. The Company and Staff have agreed on a number of the required
16 adjustments but some additional discussions are still needed to determine if the parties
17 disagree and, if so, in what instances.

18
19 **Q. WHEN DO YOU THINK THESE ISSUES WILL BE RESOLVED?**

20
21 A. The Company is hoping that the issues can be resolved by the end of the week of November
22 10th. However, if the issues are not resolved within the very near future, the Company will
23 seek to file supplemental rebuttal testimony addressing these issues.

24
25 **FUEL AND POWER AND CHEMICAL EXPENSE**

26
27 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY ON THIS POINT?**

28
29 A. The purpose of my rebuttal testimony is similar to the points made related to revenues and the
30 related credits and billing adjustments. The Staff and the Company are still working together
31 to resolve some revenue and billing determinant differences. Once these issues are addressed,

1 the position of the Staff and Company for fuel and power and chemical expense can then be
2 finalized.

3
4 **COST ALLOCATION MANUAL (CAM)**
5

6 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY ON THIS POINT?**
7

8 A. The purpose of my rebuttal testimony as to the Cost Allocation Manual (CAM) is to address
9 the concerns that Staff has relating to the Company's CAM as expressed in the Direct
10 Testimony of Staff witness John P. Cassidy.
11

12 **Q. WHAT ISSUES HAS MR. CASSIDY RAISED IN REGARD TO THE CAM?**
13

14 A. On page 29 of his Direct Testimony, Mr. Cassidy cites "significant problems that plague the
15 Company's CAM." Mr. Cassidy takes issue with the entire manual by noting it does not
16 contain every detailed piece of information he needs for his rate case investigation. Mr.
17 Cassidy confuses the purpose of the CAM with a data request he has made in the rate case.

18 **Q. WHAT DO YOU BELIEVE THE PURPOSE OF THE CAM TO BE?**
19

20 A. The purpose of the CAM is to act as a reference manual to provide American Water
21 employees and external parties with a clear understanding of how Service Company expenses
22 are assigned to affiliate companies. We believe the CAM does that quite effectively.
23

24 **Q. HOW DID THE COMPANY GO ABOUT CREATING THE CAM?**
25

26 A. In assembling the CAM, we closely followed the Commission's Order in the last St. Louis
27 County Water Company rate case (Case No. WR-2000-844). In that case, the Commission
28 adopted the recommendation of Public Counsel witness Mr. Dittmer and directed St. Louis
29 County Water Company to "prepare and maintain" "the Cam described by Mr. Dittmer. We
30 included in the CAM the information Mr. Dittmer specified. The Commission Order did not

1 specify the CAM should include information Mr. Cassidy now finds lacking.

2
3 By its nature, a reference manual is not meant to be updated each and every month. What Mr.
4 Cassidy wants is more of a schedule with all supporting workpapers that will allow him to
5 audit the assignment of actual Service Company expenses to affiliate companies. This does
6 not belong in the CAM. It should be a data request Mr. Cassidy makes as part of a rate case
7 investigation.

8 We believe the CAM clearly explains how Service Company expenses are assigned and
9 complies with the Commission order.

10
11 **Q. WHAT RECOMMENDATIONS IS STAFF MAKING REGARDING THE CAM?**

12
13 A. Staff witness Cassidy is making six recommendations. They are found on pages 32 and 33 of
14 his Direct Testimony.

15
16 First, Mr. Cassidy wants the CAM to clearly identify the total costs of the Service Company
17 by month. This is not the purpose of a Cost Allocation Manual. A CAM should be used as a
18 reference manual to provide employees and external parties with a clear understanding of how
19 Service Company expenses are assigned to affiliated companies. Mr. Cassidy's request here
20 should be to make sure that the Company's financial systems could produce such a report for
21 review by third parties. The Company's financial system can maintain and produce the
22 information, however, the Company does not believe it is appropriate to include this
23 information in the CAM.

24
25 Second, Mr. Cassidy wants the CAM to clearly identify the allocation basis used to distribute
26 costs each month. The CAM already accomplishes this.

27
28 Third, Mr. Cassidy wants the CAM to identify the costs borne by each entity taking service
29 from the Service Company by month. Again, this is not the purpose of a CAM. The financial
30 system can produce the information but it is not appropriate to include it in the CAM.

1
2 Fourth, Mr. Cassidy wants the CAM to identify the costs by month and identified by cost pool
3 with the corresponding allocation basis. Again, this is not the purpose of a CAM. The CAM
4 would explain how this is done. The financial system would produce the information, but it is
5 not appropriate to include it in the CAM.
6

7 Fifth, Mr. Cassidy wants the Commission to Order the Company to provide monthly cost
8 reports that shows the allocated costs along with the monthly allocation calculations broken
9 down by Service Company function. The Company does not have an issue with doing this,
10 however, we would recommend to the Commission that this reporting process be done on an
11 annual basis. The Company proposes to meet with Staff and discuss the format and timing of
12 the requested reports on an annual basis.
13

14 Finally, Mr. Cassidy is recommending that the Company maintain a monthly expense detail
15 report of the total Service Company expenses that can be examined by Staff to determine if
16 the expenses being allocated are reasonable and appropriate. The Company believes that this
17 review is more appropriate in the context of the rate case review process or some other
18 proceeding before the Commission.
19

20 **AFFILIATED TRANSACTION ISSUE**

21

22 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY ON THIS POINT?**
23

24 **A.** I would like to address the Direct Testimony of Staff witness Cassidy related to his discussion
25 of affiliated transactions and his ultimate recommendation that the Commission should
26 promulgate an affiliate transaction rule similar to the one that applies to certain Missouri gas
27 and electric utilities.
28

29 **Q. WHAT DOES MR. CASSIDY DISCUSS IN REGARD TO AFFILIATE**
30 **TRANSACTIONS?**
31

1 A. On pages 10-17 of his Direct Testimony, Mr. Cassidy identifies and discusses the corporate
2 structure of American Water ("AW"), its relationship to the new ownership in RWE, the
3 relationship of American Water to its subsidiaries and he also discusses the structure and cost
4 allocation process of American Water Works Service Company, Inc. ("Service Company")
5

6 **Q. DO YOU AGREE WITH MR. CASSIDY'S TREATMENT OF THESE ISSUES?**
7

8 A. I agree with his discussion on the referenced pages with the exception of one area of
9 discussion on page 16. There, Mr. Cassidy alleges that the Service Company costs are not
10 being charged to American Water's non-regulated companies on an equal and consistent basis
11 in comparison to AW's regulated operating companies.
12

13 **Q. WHY DO YOU DISAGREE WITH MR. CASSIDY ON THIS POINT?**
14

15 A. The Service Company was originally designed to provide services to the regulated entities of
16 the American System. Offices and functional areas of the Service Company were set-up and
17 developed to meet the needs of the regulated companies. The labor costs of the Service
18 Company are billed to the regulated companies either directly or through an allocation process
19 based on the number of customers that benefit from the services. Overheads for those charges
20 are then added to the labor costs. The overhead costs are comprised of office costs, support
21 costs and labor overhead costs such as employee benefits and taxes.
22

23 When services by the Service Company are performed for the non-regulated companies (there
24 are only four at the present time, as compared to 20 regulated companies), the Service
25 Company bills those entities based on the direct billing of labor costs and actual work
26 performed. Added to the labor costs is the same overhead rate that is used for the regulated
27 operations which includes office costs, support costs and labor overhead costs such as
28 employee benefits and taxes. Therefore, I believe that the billing process is fair and
29 reasonable and that the regulated and non-regulated companies receive an appropriate amount
30 of billed charges for the services rendered by the Service Company.
31

1 **Q. WHAT IS THE COMPANY'S RESPONSE TO THE STAFF'S RECOMMENDATION**
2 **THAT THE COMMISSION PROMULGATE AN AFFILITATE RULE?**

3
4 A. MAWC does not believe that an affiliate transaction rule is necessary at this time. With the
5 exception of the relationship with American Water Capital Corp (AWCC), MAWC has no
6 more or different relationship with the non-regulated businesses of American Water than it
7 did 10 years ago. MAWC does not transact any business with any American affiliate on an
8 on-going basis, with the exception of the Service Company and AWCC.

9
10 **Q. IS MAWC WILLING TO WORK TOWARD AN AFFILIATE TRANSACTION**
11 **RULE?**

12
13 A. Yes. The Company does understand the Staff's position on this issue. The Company is
14 willing to work with Staff and assist the Commission in promulgating an affiliate transaction
15 rule that is fair and reasonable and does not place undue cost or burden on the Company or its
16 customers. The rule should provide the Commission and Staff with the comfort they need to
17 confirm that any transactions that do occur between MAWC and an affiliate is done in a fair
18 manner so that neither the customers of the Company, nor the Company itself, are advantaged
19 or disadvantaged inappropriately by the transaction. MAWC believes that this can be
20 accomplished, but will require something more tailored to the specific situation than merely
21 adopting the gas and electric rules for the water industry.

22
23 **LOBBYING EXPENSE**
24

25 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY ON THIS ISSUE?**

26
27 A. Staff witness Hagemeyer has recommended a disallowance of \$55,372 of expenses associated
28 with the Company's Governmental Affairs department. Mr. Hagemeyer has cited prior
29 Commission decisions regarding disallowing rate recovery of costs for governmental relations
30 efforts. The Company believes that governmental relations efforts are a normal business
31 expense that benefits both the ratepayers and the Company.

1
2 **Q. WHAT IS THE STAFF'S BASIS FOR ITS ADJUSTMENT?**

3
4 A. Staff reviewed the Company's job description of the Director of Governmental Affairs and,
5 based on a literal reading of the job description, concluded that 50% of the activities of that
6 entire department is related to "lobbying." The Company later responded to Staff Data
7 Request 264, which requested further clarification of the duties of the Director. The
8 Company responded to the request, but was not able to give an exact percentage of time that
9 the Director of Governmental Affairs devotes to "lobbying" efforts. Instead, the Company
10 discussed the many duties that this individual has. At the prehearing conference, discussions
11 with Staff indicated that an estimate of the amount of time that the Director devotes to
12 lobbying would have been sufficient. The Company has since updated the response to Staff
13 Data Request 264 and indicated that the Director devotes approximately 5% of his time to
14 actual lobbying efforts.

15
16 As noted in the Company's response to Staff Data Request 264, the Director Governmental
17 Affairs devotes a majority of his time to being a liaison between the Company and the 100+
18 municipalities throughout the State of Missouri. The relationship between Mr. Brown and
19 the municipalities covers areas such as water service issues, franchise agreements, wholesale
20 contracts, negotiations for water service to new areas, levy district proposals and construction.
21 Communication of Company water issues is necessary for providing better service to the
22 customers of the municipalities. None of these tasks are related to lobbying efforts.

23
24
25 **Q. DOES THE COMPANY EMPLOY ANYONE ELSE TO PERFORM LOBBYING**
26 **EFFORTS FOR THE COMPANY?**

27
28 A. Yes. The Company uses the firm of Gamble and Schleimer to perform the majority of the
29 Company's lobbying efforts. The cost of these efforts is recorded below the line in the
30 Company's financials and is not a part of the rate request.

1 **Q. WHAT IS THE IMPACT TO THE STAFF'S ADJUSTMENT IF THE 5% FACTOR IS**
2 **USED TO DETERMINE THE EXPENSE DISALLOWANCE?**

3
4 A. The Staff's disallowance would be reduced from \$55,372 to \$5,537. The Company would not
5 take issue with the Staff's position in the case, if its adjustment reflected the 5% disallowance
6 of the Governmental Affairs Department costs, totaling \$5,537.

7
8 **INTEREST SYNCHRONIZATION**
9

10 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY ON THIS ISSUE?**
11

12 A. The purpose of my rebuttal testimony is to highlight for the Commission that the Staff's
13 income tax calculation has an excessive amount of interest deduction due to the use of a
14 consolidated capital structure.

15
16 **Q. WHAT IS THE STAFF'S BASIS FOR ITS INCOME TAX CALCULATION?**
17

18 A. The Staff used the standard methodology in computing the interest deduction in the
19 calculation of income taxes. That calculation is the weighted cost of debt times the proposed
20 rate base.

21
22 **Q. WHAT IS THE PROBLEM WITH THAT APPROACH IN THIS CASE?**
23

24 A. The problem with the Staff's calculation is that the weighted cost of debt from the
25 consolidated capital structure was used. Company witness Ahern is addressing the issue of
26 the Staff's use of a consolidated capital structure.

27
28 The Staff's calculation of the interest deduction amounts to approximately \$17,670,000.
29 Using the Company's weighted cost of debt based on its own capital structure, the amount of
30 the interest deduction for calculating income taxes is approximately \$15,583,000, or a
31 difference of \$2,087,000. This additional tax deduction reduces income taxes by

1 approximately \$801,000, which translates into a lower revenue requirement of approximately
2 \$1.3 million.

3
4 **Q. WHY IS IT MORE APPROPRIATE TO USE MAWC'S SPECIFIC WEIGHTED**
5 **COST OF DEBT, RATHER THAN THE CONSOLIDATED WEIGHTED COST OF**
6 **DEBT?**

7
8 A. The reason that interest is synchronized in the calculation of income taxes is so that the
9 ratepayers receive the proper tax deduction based on the actual level of debt used to fund rate
10 base. Generally speaking, the use of a hypothetical capital structure will result in either too
11 much or too little of an interest deduction. In this case, Staff is proposing too much of a
12 deduction because the consolidated capital structure it is using has 67.53% debt, whereas the
13 Company's capital structure, at November 30, 2003, will only have 56.38% debt.

14
15 In this case, Staff's use of the consolidated capital structure results in assigning an interest
16 deduction from one legal entity within the American System, American Water, to another,
17 MAWC, which results in \$2,087,000 too much of an interest deduction which artificially
18 reduces income taxes by \$801,000.

19
20 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

21 A. Yes.

Exhibit No.:

Issues: AFUDC, Working Capital,
Pensions, Belleville Lab
Costs, Property Taxes, St.
Joseph Plant Retirement,
AWR Customer Lists,
Security AAO, Credits and
Billing Adjustments, Fuel
and Power and Chemicals,
CAM, Affiliated
Transactions, Lobbying Costs
Interest Synchronization

Witness: Edward J. Grubb

Exhibit Type: Rebuttal Testimony

Sponsoring Party: Missouri-American Water Company

Case No.: WR-2003-0500

Date Filed: November 10, 2003

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. WR-2003-0500

**SCHEDULES TO ACCOMPANY THE
REBUTTAL TESTIMONY**

OF

EDWARD J. GRUBB

ON BEHALF OF

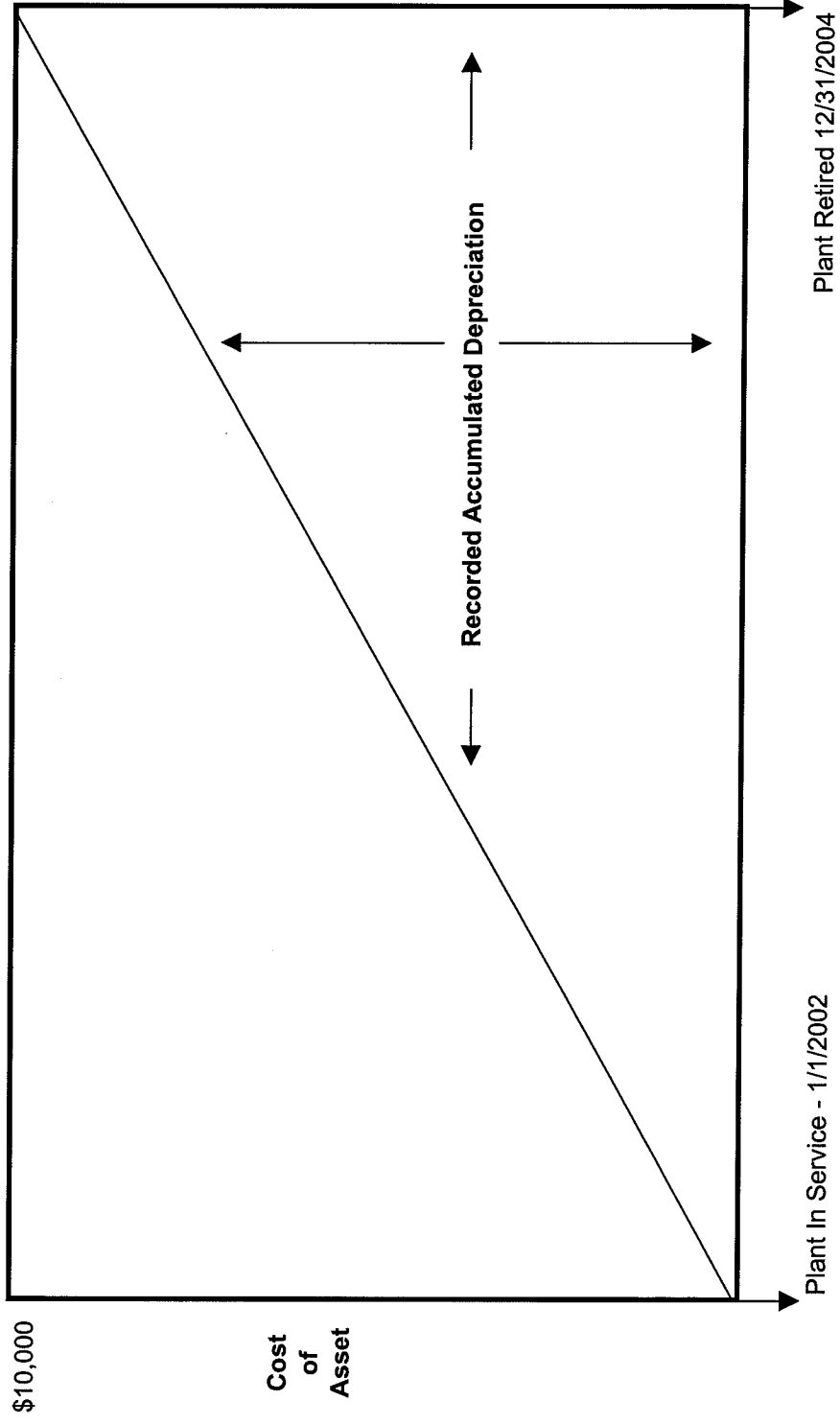
MISSOURI-AMERICAN WATER COMPANY

JEFFERSON CITY, MISSOURI

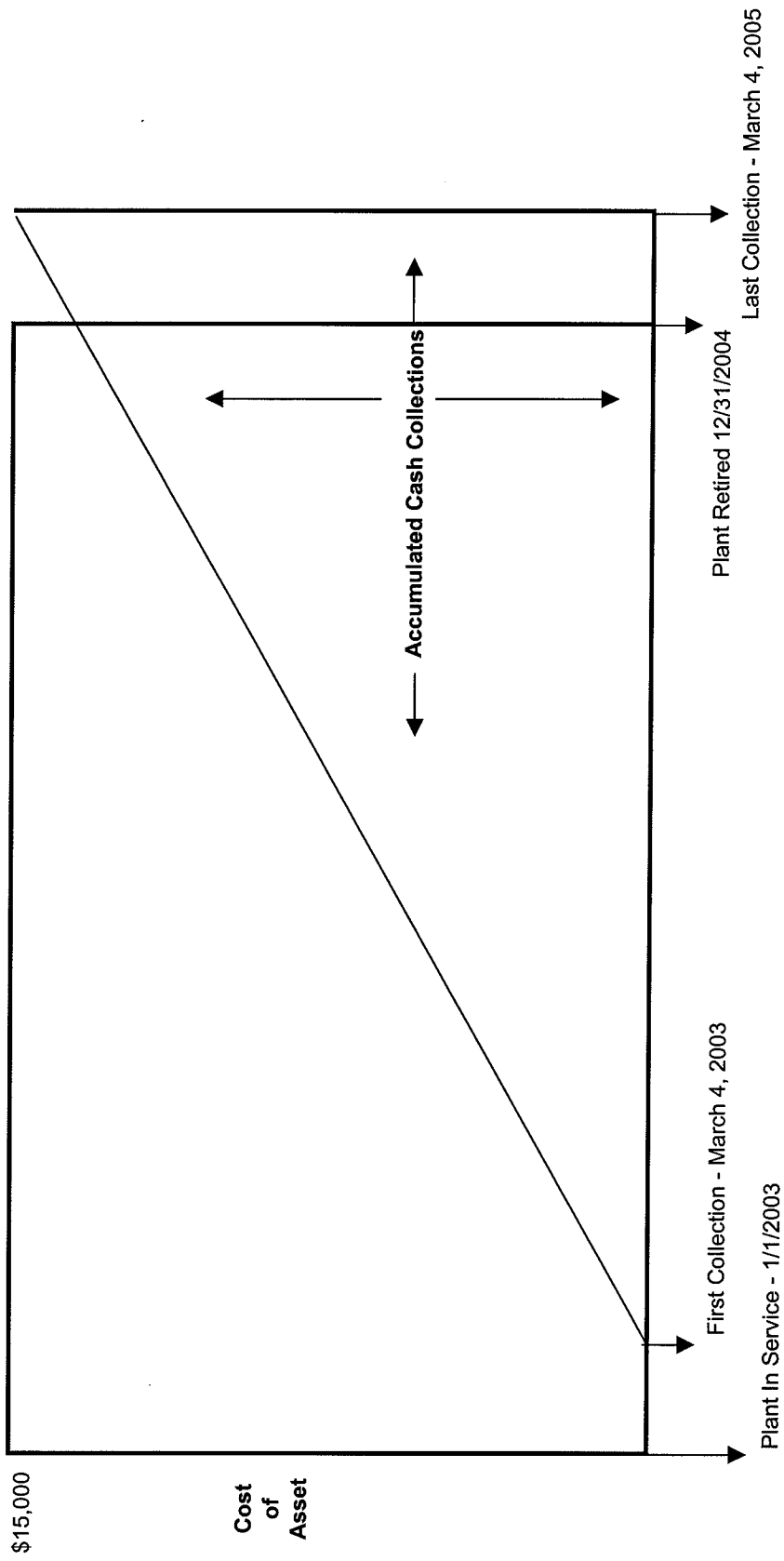
Missouri American Water
Case No. WR-2003-0500
Calculation of Management Fees Expense Lag

For the Month of		Service Period								
Month	Amount	Date Paid	Amount	Total Amount	Beginning	Ending	Avg No. of days	Payment Lag	\$ Days	
July 02	1,292,338.73	17-Jul-02	876,709.80	1,292,338.73	6/30/02	7/31/02	15.50	1.50	1,315,064.70	
		15-Aug-02	415,628.93		6/30/02	7/31/02	15.50	30.50	12,676,682.37	
August	970,461.79	15-Aug-02	970,461.79	970,461.79	7/31/02	8/31/02	15.50	(0.50)	(485,230.90)	
September	981,277.00	15-Aug-02	321,876.94	981,277.00	8/31/02	9/30/02	15.00	(31.00)	(9,978,185.14)	
		12-Sep-02	648,584.85		8/31/02	9/30/02	15.00	(3.00)	(1,945,754.55)	
		08-Oct-02	10,815.21		8/31/02	9/30/02	15.00	23.00	248,749.83	
October	1,110,100.43	08-Oct-02	981,277.00	1,110,100.43	9/30/02	10/31/02	15.50	(7.50)	(7,359,577.50)	
		08-Nov-02	128,823.43		9/30/02	10/31/02	15.50	23.50	3,027,350.61	
November	1,044,691.73	08-Nov-02	1,044,691.73	1,044,691.73	10/31/02	11/30/02	15.00	(7.00)	(7,312,842.11)	
December	1,142,107.85	08-Nov-02	65,408.70	1,142,107.85	11/30/02	12/31/02	15.50	(37.50)	(2,452,826.25)	
		09-Dec-02	979,283.03		11/30/02	12/31/02	15.50	(6.50)	(6,365,339.70)	
		10-Jan-03	97,416.12		11/30/02	12/31/02	15.50	25.50	2,484,111.06	
January 03	971,862.28	10-Jan-03	971,862.28	971,862.28	12/31/02	1/24/03	12.00	(2.00)	(1,943,724.56)	
February	967,247.92	10-Jan-03	170,245.57	967,247.92	1/24/03	2/21/03	14.00	(28.00)	(4,766,875.96)	
		31-Jan-03	797,002.35		1/24/03	2/21/03	14.00	(7.00)	(5,579,016.45)	
March	1,233,436.13	31-Jan-03	4,614.36	1,233,436.13	2/21/03	3/28/03	17.50	(38.50)	(177,652.86)	
		28-Feb-03	962,633.56		2/21/03	3/28/03	17.50	(10.50)	(10,107,652.38)	
		08-Apr-03	266,188.21		2/21/03	3/28/03	17.50	28.50	7,586,363.98	
April	1,172,451.30	08-Apr-03	1,172,451.30	1,172,451.30	3/28/03	4/25/03	14.00	(3.00)	(3,517,353.90)	
May	854,705.93	08-Apr-03	60,984.83	854,705.93	4/25/03	5/23/03	14.00	(31.00)	(1,890,529.73)	
		09-May-03	793,721.10		4/25/03	5/23/03	14.00	-	-	
June	1,007,503.92	09-May-03	317,745.37	1,007,503.92	5/23/03	6/27/03	17.50	(31.50)	(10,008,979.16)	
		09-Jun-03	536,960.56		5/23/03	6/27/03	17.50	(0.50)	(268,480.28)	
		10-Jul-03	152,797.99		5/23/03	6/27/03	17.50	30.50	4,660,338.70	
			<u>12,748,185.01</u>						Overall Expense Lag	<u><u>(3.31)</u></u>

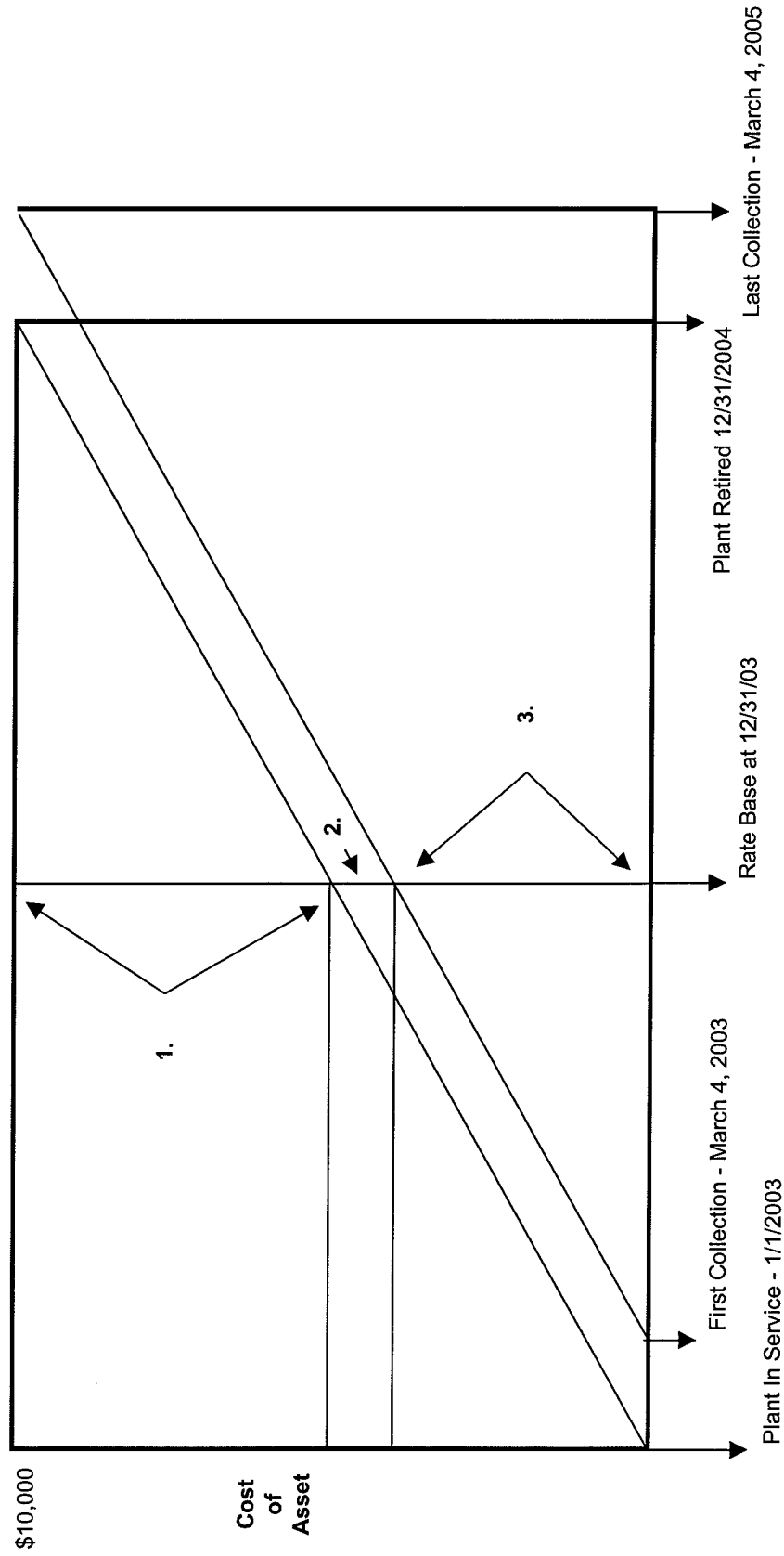
Missouri American Water
Case No. WR-2003-0500



Missouri American Water
Case No. WR-2003-0500



Missouri American Water
Case No. WR-2003-0500



Note 1: This section of graph represents the amount in rate base of \$5,000 (UPIS less accumulated depreciation)
 Note 2: This section of graph represents the amount of the accumulated depreciation being deducted from base that has yet to be collected from the ratepayers as of the 12/31/03 date. This amount is \$863.
 Note 3: This section of graph represents the amount of rate base deduction that has been collected from ratepayers as of the 12/31/03 date. This amount is \$4,137

MISSOURI AMERICAN WATER COMPANY

CASE NO. WR-2003-0500

COMPARISON OF STAFF PROPOSED PENSION COST IN LAST 3 RATE CASES AND CURRENT CASE

Case WR-95-205 and SR-95-206 1995 Rate Case (1)	Case WR-97-237 and SR-97-238 1997 Rate Case (2)	Case WR-2000-281 and SR-2000-282 2000 Rate Case (3)	Case WR-2003-0500 and WC-2004-168 2003 Rate Case (4)
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AMERICAN SYSTEM

UNRECOGNIZED (GAINS) LOSSES

\$	(562,000)	Not Used by Staff	\$	(4,162,467)
----	-----------	-------------------	----	-------------

FAS 87 COSTS

	9,744,625	5,652,084		6,205,643
--	-----------	-----------	--	-----------

UNRECOGNIZED (GAINS) / LOSSES

	(112,400)	Not Used by Staff		(832,493)
--	-----------	-------------------	--	-----------

PERCENTAGE OF MISSOURI AMERICAN TO TOTAL COMPANY

	2.90%	2.83%		2.65%
--	-------	-------	--	-------

MISSOURI AMERICAN TOTAL:

FAS 87 COSTS ALLOCATED

ALLOCATION FROM CORPORATE

ALLOCATION OF UNRECOGNIZED (GAINS) / LOSSES

ERISA CALCULATION

TOTAL COST BEFORE OPERATION AND MAINTENANCE RATIO

\$	282,594	\$	159,954	\$	164,450
	(3,260)		31,861		26,178
			-		(22,061)
\$	279,334	\$	191,815	\$	168,567
					466,177
					466,177

(1) Staff assigned a portion of the unrecognized gain for 1994 to MAWC based on an allocation factor of 2.90%

(2) Staff did not assign any portion of an unrecognized gain to MAWC. Had Staff utilized the same adjustment in the 1997 rate case that was used in the 1995 rate case, the adjustment would have been to increase the pension expense by \$450,081. This was based on an unrecognized loss for 1996 in the amount of \$15,904,000 multiplied by the 2.83% allocation factor for MAWC.

(3) Staff in the 2000 rate case calculated a five year average of the unrecognized gains and then assigned a portion to MAWC. Had Staff utilized the same adjustment in the 2000 rate case that was used in the 1997 case, the pension expense would have been increased by \$22,061 from the Staff recommendation in the 2000 rate case.

(4) Staff in the 2003 rate case is recommending to move to the ERISA calculation and away from the FAS 87 calculation. Had Staff utilized the same adjustment in the 2003 that it proposed in the 2000 rate case, pension expense would have been increased by \$229,334.

Towers Perrin

November 7, 2003

Mr. Edward J. Grubb
Director, Rates and Revenues
Missouri - American Water Company
535 North New Ballas Road
St. Louis, MO 63141

Dear Ed:

AMERICAN WATER – PENSION PROJECTIONS

As requested, we have provided a current five-year projection for the American Water Works Pension Plan including:

- The estimated minimum required cash contributions under ERISA and the Internal Revenue Code
- The estimated accounting costs under FAS 87

Projections of Minimum Required Cash Contributions

The minimum required contribution for plan year 2002 and the estimated minimum required contributions for the next five plan years are shown below:

Plan Years Beginning on July 1 st	Estimated Minimum Required Contributions (\$ in millions)
2002	\$12.4 (actual)
2003	15.1
2004	76.6
2005	73.8
2006	67.1
2007	25.6

As you can see, there is projected to be a large increase in the contribution for the plan year beginning July 1, 2004. This increase is attributable to a change in the interest rate that is allowed to be used under ERISA and the Internal Revenue Code. In simplified terms, current law will require that we (as the Plan's actuary) use a lower interest rate for the 2004 plan year than we have been allowed to use for the 2002 and 2003 plan years. Using a lower interest rate will result in a significantly higher past service obligation

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(which is roughly the present value of benefits earned to date) for the plan and, therefore, a higher required contribution.

FAS 87 Projections

The accounting costs under FAS 87 for 2003 and for the next five years are shown below:

Fiscal Year	Estimated Pension Cost (\$ in millions)
2003	\$32.6 (actual)
2004	44.4
2005	40.0
2006	35.0
2007	30.7
2008	28.9

Basis of Analysis

Both the expected cash contributions and the expected accounting costs are based on demographic data as of June 30, 2002. This is the most recently available data from American Water.

Both the projected cash contributions and the projected accounting costs are based on actual assets as of January 1, 2003. We developed estimated asset values as of subsequent dates using the following approach:

- We assumed that the investment return was -2% for the period from January 1, 2003 to March 31, 2003. This was our best estimate of the Plan's investment return for this three-month period because this was the actual return for capital markets for this period, reflecting the allocation of Plan assets during this period.
- Beginning April 1, 2003 we assumed an annual return of 8.75% for the remainder of 2003 as well as all of 2004, 2005, 2006 and 2007.

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Both the expected cash contributions and the expected accounting costs reflect our understanding of all plan provisions in effect today, including any substantive changes that will be effective between now and January 1, 2004.

The assumptions and methods used in the projections are summarized below.

For the minimum required cash contribution:

- 9.00% interest rate for determining the Actuarial Accrued Liability
- 5.00% compensation increase rate per year
- Projected unit credit funding method
- 5-year smoothing method (see actuarial report for description)
- Current liability interest rates used for projections are summarized below. They represent estimates of the highest allowable rates that American can use based on no change in the 30-year Treasury bond yield in effect for March 2003 of 4.95%. The interest rates in the below table assume that the current law does not change.

Plan Year Beginning July 1 st	Rate
2002 (actual)	6.80%
2003	6.45%
2004	5.39%
2005	5.25%
2006	5.20%
2007	5.20%

For the FAS 87 pension cost:

- 6.75% discount rate for 2003 and 6% discount rate for fiscal years 2004 through 2008.
- 4.75% compensation increase rate per year
- 8.75% expected return on asset rate
- 1983 GAM mortality

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- Minimum required contributions were assumed to be made quarterly, consistent with current practice.

All other methods and assumptions are the same as those detailed in our actuarial report for the plan year beginning July 1, 2002 and fiscal year 2003.

Please note that actual costs for 2004 and beyond will differ from these projections if any of the following occurs:

- Actual experience differs from assumed experience;
- Plan provisions change (including, for example, mergers or transfers or spinoffs involving other plans);
- Actuarial assumptions and/or methods change;
- The number of active participants changes.

Please do not hesitate to call if you have any questions.

Sincerely,

WJW:nd

**Missouri American Water
Case No. WR-2003-0500**

Year	Actual Property Tax	Utility Plant	Property Tax Ratio	Proforma Property Tax	Under / (Over) Calculation (1)	Under / (Over) Calculation (2)
1997	\$ 6,031,145	\$ 602,563,678	0.010740	\$ 6,116,416	\$ (85,271)	\$ 215,696
1998	6,532,733	634,034,666	0.010842	6,471,534	61,199	501,588
1999	6,922,028	671,164,847	0.010917	6,874,204	47,824	389,295
2000	7,302,117	773,629,490	0.010880	7,327,107	(24,990)	380,089
2001	8,780,114	802,627,051	0.011349	8,417,089	363,025	1,477,997
2002	9,290,496	846,372,465	0.011575	9,109,014	181,482	510,381
					<u>\$ 543,269</u>	<u>\$ 3,475,047</u>

(1) This column uses the Company's method for rate recovery.

(2) This column uses the Staff's method for rate recovery.