BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri-American Water Company's Tariff Sheets Designed to Implement General Rate Increases for Water and Sewer Service provided to Customers in the Missouri Service Area of the Company.	))))))	Case No. WR-2000-281, et al. (Consolidated)

REPLY BRIEF OF STAFF

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When plant is in service, a utility company is entitled to a return on its investment, through inclusion in rate base, and a return of the investment, through depreciation. When plant is prematurely retired, the company receives a return of the investment, through amortization of the prematurely retired plant, but it does not receive a return on the investment. This is the rationale for the Commission's decision in *GTE North, Inc.*, Case No. TR-89-182, which OPC cited in its Initial Brief at pp. 45-46.

In the instant case, however, it would be improper to amortize the prematurely retired plant at this time, because of the uncertainty over the amount that should be amortized, which is discussed above. The Company should have an opportunity to receive a return on its of investment, pending the determination of the amount to be amortized.

In the present case, where the Company would not receive a return of its investment until after the depreciation study is complete, it is appropriate to allow the Company to receive a return on its investment, through inclusion in rate base, until the depreciation study is complete. When the depreciation study is complete, it should have the opportunity to receive a return of its investment through amortization of the properly determined balance of the plant account, the reserve for depreciation and the costs of removal and demolition.

ISSUE NO. 3: AFUDC CAPITALIZATION RATE

<u>Should MAWC's rate base be adjusted to reflect a different capitalization rate for AFUDC?</u>

The Company contends that the AFUDC on the SJTP (for the pre-in-service period) that ought to be included in the Company's rate base should be a fictitious amount that is determined by applying the rate of return from the Company's last previous rate case to the outstanding balances of the CWIP. The Staff, on the other hand, contends that the AFUDC should be determined, to the extent possible, by determining the actual carrying charges that the Company incurred in constructing the SJTP. These actual carrying charges would reflect the fact that the Company uses short-term debt as the principal means of financing its construction projects.

As of December 31, 1999, the Company had approximately $35 million of short-term debt outstanding. This is not an insignificant sum of money. In fact, it is nearly half of the construction cost of this project that the Company has, in its argument on the AAO issue, described as "extraordinary."

The interest rates on the Company's short-term debt are not included anywhere in the Company's determination of its required rate of return. The only sources of financing that are included there are long-term debt, preferred stock and common equity. The same is true for the Staff's and OPC's determination of the Company's required rate of return.

The Company insists that the interest rates on its short-term debt must not be included in the determination of the carrying charges on the CWIP, either. In fact, the Company does not think these short-term interest rates (which are lower than the interest rate on the long-term debt) should be considered in any way in this rate case. That is, the interest rates actually associated with loans of up to $35 million should just be ignored. Instead, the Commission should assume that the CWIP was financed with only common and preferred equity and long-term debt. This is a fiction, it is contrary to the facts, and it should not be sanctioned.

The Company argues that it is "inappropriate" for the Commission to "penalize" the Company by applying the interest rates on the loans that were actually used to finance the CWIP in the determination of AFUDC. But doing so would not "penalize" the Company at all. It is no more appropriate for the Commission to use fictitious carrying charges on the CWIP (based on the rates from an old case) than it would be for the Commission to use a fictitious construction cost (based on the rates that existed at another time).

If the actual cost of a construction project is $70 million, it is not appropriate to include $71 million in rate base, merely because the Company assumed that this would be done. For the same reason, if the actual carrying charges on CWIP are those that relate to short-term debt, it is not appropriate to use the carrying charges that relate to the Company's other sources of financing, merely because the Company assumed that this would be done.

The Company may have believed that AFUDC would be based on the rate of return from the last previous rate case, but it did not incur these costs, to finance its construction projects.

The AFUDC should be determined by first applying the interest rates associated with short-term debt. To the extent that the CWIP exceeds short-term debt, the rate of return from the Company's last previous rate case should be used. Applying the correct interest rates to the CWIP results in an adjustment of $1,289,674. (Ex. 109, Accounting Sch. 4-3, Adjustment No. P-20.2).