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PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA
CHARLESTON

At a session of the PUBLIC SERVICE COMMISSION OF WEST VIRGINIA in the City of Charleston on the 21st day of December, 2001.

CASE NO. 01-0326-W-42T

WEST VIRGINIA-AMERICAN WATER COMPANY
Rule 42T application to increase water
rates and charges.

COMMISSION ORDER

On March 5, 2001, the West Virginia-American Water Company (Company), a corporation, tendered for filing revised tariff sheets reflecting increased rates and charges of approximately 12.8% annually, or $11,778,871, for furnishing water service to approximately 163,000 customers in the Counties of Boone, Braxton, Cabell, Fayette, Kanawha, Lewis, Lincoln, Logan, Mercer, Putnam, Raleigh, Summers, Wayne and Webster, to become effective on April 4, 2001. As required by West Virginia Code § 24-2-3a, at least thirty (30) days prior to filing its application to increase rates, the Company filed with the Commission a notice of its intent to file a general rate case. (Notice of Intent January 31, 2001).

With its revised tariff sheets, the Company filed Tariff Form Number 6 (Certificate of Notice to the Public of Change in Tariff) and Tariff Form Number 8 (Public Notice of Change in Rates). In Tariff Form Number 8, the Company advised that this filing will also directly or indirectly affect customers of the following entitites who, under agreements approved by the Public Service Commission, are charged water rates which are in whole, or in part, based on the Company's rates: Boone County Public Service District and the Town of Danville, both in Boone County; Cumberland Road Public Service District, Lashmeet Public Service District, and Oakvale Road Public Service District, all in Mercer County; Kanawha County Regional Development Authority in Kanawha County; Lewis County Economic Development Authority in Lewis County; Jumping Branch-Nimitz Public Service District in Summers County; New Haven Public Service District in Fayette County; the Putnam County Building Commission and Putnam-Union Public Service District, both in Putnam County; and Salt Rock Water Public Service District in Cabell County.

The Company said that a significant portion of the requested rate increase, about $4 million, or nearly 35% of the requested additional revenue, is directly attributable to the

Company's construction projects to serve new customers or upgrade service to existing customers.

The Company also asked to modify its minimum bill for residential customers, reducing the monthly water allowance from 1,500 gallons to 1,000 gallons. Further, the Company asked the Commission to approve a new tariff, under which standby service will be available to certain large commercial, industrial, or resale customers, who have an alternate source of water if the alternate source cannot provide sufficient water. In addition, the Company proposed to increase private fire protection rates by 13.1%.

Several letters of protest were filed with the Commission in conjunction with the Company's March 5, 2001, filing.

On March 7, 2001, the Consumer Advocate Division (CAD) of the Commission petitioned to intervene, asserting that it was required by statute to represent the interests of residential ratepayers in utility rate cases and related proceedings. The Company's rate case constitutes a proceeding with the potential for adverse impact upon the Company's residential ratepayers, the CAD said.

On March 20, 2001, Lavalette Public Service District (Lavalette PSD) petitioned to intervene, asserting that it purchases the water it distributes from the Company, and it wished to protect its interests, and those of its customers.

No protests to either Lavalette PSD's or the CAD's motion to intervene were filed with the Commission.

On April 2, 2001, the Commission issued a "Commission Order Suspending Rates and Charges and Setting Procedural Schedule." Therein, the Commission made the Company a respondent to this proceeding; suspended the revised tariff sheets and the use of the rates and charges stated therein until 12:01 a.m., December 31, 2001; directed that petitions to intervene should be filed with the Commission's Executive Secretary on or before May 5, 2001; directed that objections to petitions to intervene shall be filed within seven (7) days after the petition to intervene has been filed with the Commission; directed the Company to give notice of the aforesaid suspension and deadlines for the filing of petitions to intervene by posting and publication; established a procedural schedule, including a due date of April 25, 2001, at 4:00 p.m. for the Company's direct testimony; and granted the CAD's and Lavalette's respective petitions to intervene.

On April 5, 2001, the Commission received a "Motion to Modify Procedural Schedule" from the Company requesting an extension of the direct testimony deadline of the Company from the current due date of April 25, 2001, until Friday, May 25, 2001. As cause,

the Company stated that the additional time would assist the Company in preparing useful and informative testimony for the benefit of the Commission and the other parties; that the Company did not believe the extension would prejudice any party to the case; and that although Commission Staff did not agree to the modification of this schedule, the CAD and Lavalette PSD were not opposed.

On April 6, 2001, the Commission issued a "Commission Order Modifying Procedural Schedule" which set a procedural schedule for use in this case.

The Commission received petitions to intervene from the South Putnam Public Service District (April 3, 2001); the Boone County Public Service District (April 13, 2001); the Putnam County Commission (May 3, 2001); the City of Hurricane (May 4, 2001); and a petition to intervene out of time from, collectively, Flexsys America LP; E.I. duPont de Nemours and Company; Clearon Corporation; and as amended on July 2, 2001, the Dow Chemical Company; Elementis Specialities, Inc.; Great Lakes Chemical Corporation; and, FMC Corporation (Industrial Intervenors) (June 28, 2001). No protests were filed to the petitions to intervene by the South Putnam Public Service District, Boone County Public Service District, or the Putnam County Commission.

On May 9, 2001, the Commission received the prepared direct testimony of the following witnesses for the Water Company: Chris E. Jarrett, Michael A. Miller, Roy L. Ferrell, Sr., Kendall K. Mitzner, Edwin L. Oxley, Paul R. Herbert, Eugene Trisko, and James E. Salser.

On May 10, 2001, the Company filed a response in opposition to the petition to intervene filed by the City of Hurricane (City). The Company argued that the City is not a customer of the Company and that the City has not demonstrated the requisite "legal interest" to intervene in this case. In its response filed May 18, 2001, the City noted that while the City itself does not directly purchase from the Company, several of its subdivisions do. Additionally, the City averred that it had been advised by the South Putnam Public Service District, upon whom the City has relied in the past for supplemental water supplies, that in severe drought conditions the South Putnam Public Service District may not be in a position to supply the City with sufficient supplemental water to meet all of Hurricane's needs. As such, in the event that the South Putnam Public Service District is unable to supply the City with sufficient supplemental supply, the City will have to consider alternatives which would include constructing upgrades to its treatment and supply facilities or securing an alternative supply from another source. Additionally, the City argued that through its purchases from the South Putnam Public Service District, it will be directly affected by any standby charges that might be imposed upon the South Putnam Public Service District by the Company. Finally, the City argued that its intervention would have no effect upon the proceeding as it is represented by counsel that is already appearing in this matter.

On May 21, 2001, the Water Company submitted affidavits of publication. The Water Company noted that all publications had been made, but that an affidavit of publication had not yet been received from the Logan Banner. On June 5, 2001, the Water Company filed an affidavit of publication from the Logan Banner.

On July 5, 2001, the Commission issued an order in this matter which set a new evidentiary and protest hearing schedule; granted petitions to intervene from the South Putnam Public Service District, the Boone County Public Service District, the Putnam County Commission, the City of Hurricane, and the Industrial Intervenors; rescinded the portion of the Commission's Order of April 2, 2001, directing the Division of Administrative Law Judges to conduct protest hearings in this matter and to prepare a notice of the evidentiary hearing; required the Commission's Executive Secretary to give notice of the revised procedural schedule in this case by publishing a notice; and required the Company to give notice of the aforesaid modified procedural schedule by posting.

On August 8, 2001, the Commission received a letter from counsel for the Water Company objecting in advance to a possible Staff request for an extension of time to file its direct testimony in this case. The Company stated it had no objection to a delay in the filing of the direct testimony of Ms. Diane Calvert, but that it did not believe an extension of time should be permitted for other Staff witnesses.

On August 8, 2001, the Commission received the "Motion of Commission Staff for Extension in Filing Date of Its Direct Testimony." Staff requested an extension of its direct testimony filing date from August 13, 2001, until August 17, 2001. As cause, Staff stated that a car accident on August 2, 2001, involved one of the members of Commission Staff whose work is closely intertwined with the other pieces of Staff's testimony and exhibits.

On both August 8 and 9, 2001, the Commission received letters from the Company which agreed to an extension of time for the work of the Commission Staff member involved in the car accident, but objected to an extension for the filing of the testimony of any other Staff members.

On August 9, 2001, the Commission also received the "West Virginia-American Water Company's Motion To Compel Responses From South Putnam Public Service District." The Water Company's motion sought updated information on a consultant hired by the South Putnam Public Service District.

On August 9, 2001, the Commission received the "Supplemental Response of South Putnam Public Service District, Lavalette Public Service District, and the City of Hurricane to WV-American Water Company's First Request for Information." The Supplemental Response addressed the "Motion to Compel" of the Company, rendering it moot.

On August 10, 2001, the Commission issued an order granting the Staff motion by extending the Staff direct testimony filing date until August 17, 2001. The deadline for rebuttal testimony for all parties was extended until August 31, 2001.

On August 13, 2001, the CAD filed the "Direct Testimony of Lafayette K. Morgan, Jr." and the "Direct Testimony of Randall R. Short."

On August 13, 2001, the Public Systems[1] filed the "Direct Testimony of Christopher M. Miranda" and the "Direct Testimony of Ernest Harwig."

On August 13, 2001, the Boone County PSD filed a letter stating that it would not file any prefiled Direct Testimony in this case, nor did it plan to call any witnesses.

The Company filed a letter on August 13, 2001, objecting to the possibility of any intervenor not filing Direct Testimony, but instead filing Rebuttal Testimony thereby removing the Company's ability to respond to any critique of its Direct Testimony.

On August 15, 2001, the Boone County PSD, by counsel, filed a letter stating that the Boone County PSD would not be filing rebuttal testimony, but that it reserved the right to cross-examine any witness at the hearing.

On August 17, 2001, Staff filed the "Direct Testimony of Diane Davis Calvert", "Employee Pensions and Benefits Prepared by Robert R. MacDonald"; the "Direct Testimony of Steven Kaz"; "Direct Testimony Prepared by Thomas L. Wagner, Utilities Analyst Supervisor"; and the "Staff Rule 42 Exhibit for the year ended December 31, 2000, prepared by Thomas L. Wagner, Utilities Analyst Supervisor, Utilities Division."

On August 28, 2001, Staff filed the "Supplemental Direct Testimony of Diane Davis Calvert."

On August 30, 2001, the Company filed the Rebuttal testimony of Chris E. Jarrett, Michael A. Miller, Roy L. Ferrel, Sr., Kendall K. Mitzner, Edwin L. Oxley, and Eugene Trisko. The Rebuttal Testimony of Paul R. Herbert and the Supplemental Rebuttal Testimony of Paul R. Herbert were filed on August 31, 2001, and September 4, 2001, respectively.

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[1]The "Public Systems" group consists of the South Putnam Public Service District, the Lavalette Public Service District, and the City of Hurricane.

The Public Systems filed the Rebuttal Testimony of Christopher M. Miranda on August 31, 2001.

On September 6, 2001, the Boone County PSD filed a letter, by counsel, advising that it wished to withdraw and would not be participating in the hearing.

On September 10, 2001, the Commission held the hearing in this matter, as previously scheduled. The parties were present and represented as follows: West Virginia-American Water Company by Michael A. Albert, Esq., Christopher L. Callas, Esq., and John Phillip Melick, Esq.; Industrial Customers by T.D. Kauffelt, Esq. and Mark Kauffelt, Esq.; Public Systems by Robert R. Rodecker, Esq.; the CAD by David A. Sade, Esq.; and Commission Staff by Meyishi Blair, Esq. The hearing was reduced to a transcript of 176 pages, (Tr. I). A public protest hearing was held the evening of September 10, 2001. That proceeding was reduced to a transcript of 21 pages, (Tr. II). At the hearing, the parties informed the Commission that most aspects of the case had settled and a written stipulation would be forthcoming.

On September 27, 2001, Staff, the CAD, the Public Systems, and the Company filed a "Joint Stipulation and Agreement for Settlement." The cover letter accompanying the filing noted that:

> Paragraph 10 of the Joint Stipulation indicates that the Parties have not yet reached agreement on the appropriate form of the Company's proposed standby service tariff. Accordingly, they request that they be permitted to continue their negotiations on this issue and to submit either a further stipulation or a status report and request for additional hearing by October 12, 2001.

On October 12, 2001, Staff, the CAD, and the Company filed a "Supplemental Stipulation and Agreement For Settlement" (Supplemental Stipulation). The Supplemental Stipulation addressed recommendations concerning the appropriate Standby Service Tariff (Agreed Standby Tariff or Standby Tariff). The cover letter for the Supplemental Stipulation stated that the Public Systems had not yet decided whether to join the stipulation, but that the Industrial Intervenors had decided definitely not to sign the Supplemental Stipulation. The letter further stated that the Industrial Intervenors planned to file a brief only on the Standby Service Tariff issue and not on the other aspects of the Company's rate case.

On October 22, 2001, the Industrial Intervenors filed a "Brief on Behalf of Industrial Intervenors" arguing against the Standby Tariff on several grounds.

On October 22, 2001, the Public Systems filed a letter stating they would not file an initial brief, but reserved the right to file a reply brief.

On October 22, 2001, the Company filed its "West Virginia-American Water Company's Post-Hearing Brief on the Standby Service Tariff Issue."

On November 1, 2001, the Public Systems filed the "Public Systems' Reply Brief." The Public Systems stated that although they had signed onto the Initial Joint Stipulation they had not signed onto the Supplemental Stipulation due to concern that any Standby Service Tariff adopted by the Commission in this case may serve as the "template" for a Standby Service Tariff that could be made applicable to the Resale Class in the future. The Public Systems support the positions of the Industrial Intervenors and oppose the adoption by the Commission of the Agreed Standby Tariff, or any other Standby Service Tariff in this proceeding. However, the Public Systems do not agree with the Industrial Intervenors' assertions that there are not substantial differences between the industrial customer class and the resale customer class regarding justification of a Standby Service Tariff. The Public Systems also agreed with the Industrial Intervenors that the Agreed Standby Tariff is discriminatory and anti-competitive. The Public Systems argued that the Commission should not approve the Standby Tariff for reasons similar to those argued by the Industrial Intervenors.

On November 1, 2001, the Company filed the "West Virginia-American Water Company's Reply Brief on the Standby Service Tariff Issue."

On November 1, 2001, the Industrial Intervenors filed the "Reply Brief on Behalf of Industrial Intervenors."

On November 5, 2001, the Water Company filed a "Motion to Strike Public Systems' 'Reply' Brief." The Water Company argues that on November 1, 2001, counsel for the Public Systems filed a reply brief full of arguments and positions that had not previously been offered in this case and that, significantly, are not even remotely in the nature of a reply to the points raised in the initial briefs of the Industrial Intervenors and the Company.

On November 8, 2001, the Public Systems filed a letter in response to the "Motion to Strike Public Systems' Reply Brief." The Public Systems argued that the motion to strike the Public Systems' reply brief should be denied and the Company instructed that if it desires to respond to such brief, it should do so within the time remaining under Rule 18.3 of the Commission's Rules of Practice and Procedure.

On November 13, 2001, the Commission received a letter from counsel for the Company. Therein the Company described a meeting held on October 25, 2001, attended

by the Commission, Staff, and the CAD to discuss the cost of increased security and other measures which the Company believes are necessary to guard against the problems facing the Company from threats and potential acts of terrorism against its customers, plant, and personnel. The Company stated that although it had some specific steps in mind, it could not publicly detail such steps and related costs associated with protective measures and security construction, as such public disclosure would be counter productive to the anti-terrorism actions taken by the Company. The Company stated that following the October 25, 2001, meeting it had had the opportunity to review the situation further and to more closely calculate the costs which it had incurred in 2001 and which it will face in the upcoming year from increased threats from terrorism. The Company argued that because of the magnitude of those costs and the extraordinary nature of the potential risks, it would be appropriate for the Commission to grant rate treatment for those additional costs and capital expenditures in the currently pending rate case. The Company calculated a total revenue requirement of $3,648,332 for security improvements and ongoing activities which the Company is planning to implement or has already implemented for customer, plant, and personnel security and protection. Based on that calculation, the Company requested that the Commission provide rate recovery in the form of a surcharge or rider to the Company's new rates at the time the requested rates in the pending rate case are implemented or that the Commission permit the increase to be imbedded in the rates approved in the 2001 rate case. The Company stated under such an approach it would be willing to file quarterly reports of the actual capital and operation and maintenance costs incurred and true-up the surcharge or rates on a going-forward basis. The Company noted that such an approach would result in approximately a 3.5% rate increase over the rates proposed in the Joint Stipulation currently before the Commission in the 2001 rate case. The Company further noted that the Company's published notice in this case actually gave notice of a request for rates in excess of the amount of revenue requirement in the Joint Stipulation pending before the Commission, even when combined with the amount requested in the supplement filing. The Company argued that due to the extremely sensitive nature of the security measures and the damage that could be done by public disclosure of the nature or extent of the security measures which the Company will be constructing or adopting, the Company should not be required to detail in a public filing the exact nature of the capital expenditures or ongoing operation and maintenance expenses that it incurs in providing such security. The Company noted, however, it was prepared to provide all the supporting information to the Staff or other parties for review and inspection at its offices, subject to a confidentiality and protective agreement.

On November 13, 2001, the Company filed a letter in response to the November 8, 2001, letter from counsel for the Public Systems.

On November 14, 2001, counsel for the Public Systems filed a letter in response to the November 13, 2001, letters from the Company regarding security measures and regarding the filing and content of reply briefs in this matter.

On November 19, 2001, the Industrial Intevenors filed a letter (dated November 16, 2001) in which they opposed the 3.5% rate increase requested by the Company for security measures.

On November 20, 2001, the Company filed a letter regarding the request for a rate increase to cover the costs of increased security. The Company noted that other jurisdictions in which American Water's subsidiaries operate are favorably considering the inclusion of such costs in rates. The Company further noted that (1) the Federal Energy Regulatory Commission has issued a statement of policy authorizing the recovery of security expenses; (2) the Company did not seek to permanently embed security costs in the rates requested in this case; (3) the intervenors know that any rate case filed in 2002 would be based on 2001 as a test year, with the rates not coming on line until the end of 2002 or early 2003; (4) many of the security costs which are reasonable and necessary will be incurred in 2002; (5) under the intervenors' approach, such security costs would not be eligible for inclusion in this case or the next case, but would only be recognized in a rate filing in 2003 based on a 2002 test year; (6) and that if recovering recognition of the security costs is denied, the Company will request that post-construction AFUDC be imposed on the capital expenditure portion of these costs until it is included in rates, thus making rates even higher when they are ultimately imposed and requiring a different mix of customers bearing those costs, bypassing to some extent current customers who will benefit from these security measures being imposed for their protection.

On November 27, 2001, the CAD filed a letter regarding the security costs in which it strongly opposed the Company's request. The CAD recognized that the Company has to make additional security-related expenditures, but that doing so does not require or justify unilateral modification of the stipulation or the imposition of a surcharge. The CAD argued that the Company must learn to live within its means while carrying out its various responsibilities to the public.

On December 12, 2001, the Commission received a letter from the public opposing additional security-related rate increases. Three additional protests were received on December 13, 2001.

DISCUSSION

There are currently three issues before the Commission stemming from the March 5, 2001, rate increase filed by the West Virginia-American Water Company. The first is

whether to approve the "Joint Stipulation and Agreement for Settlement" (Joint Stipulation), filed September 27, 2001. The second is whether to approve the "Supplemental Stipulation and Agreement for Settlement" (Supplemental Stipulation) filed October 12, 2001, which addresses the adoption of a Standby Tariff for use by the Company. The third is the funding treatment of the $3,648,332 worth of security measures requested by the Company in its November 13, 2001, filing.

Joint Stipulation

The Joint Stipulation filed September 27, 2001, was signed by the West Virginia-American Water Company, the Commission Staff, the Consumer Advocate Division, and the Public Systems. The only intervenors that did not sign onto the agreement were the Industrial Intervenors. The pertinent provisions of the Joint Stipulation are as follows:

1. The Company originally requested an increase in operating revenues of $11,778,871.00 (12.8% annually) for furnishing water service to approximately 163,000 customers in Kanawha, Putnam, Lincoln, Boone, Lewis, Webster, Mercer, Summers, Fayette, Braxton, Logan, Raleigh, Cabell, and Wayne Counties.

2. At the hearing held on September 10, 2001, the parties presented the outline of their Joint Stipulation.

3. As part of the Stipulation the parties agreed that rates and charges should be increased across-the-board by 5%, effective December 31, 2001.

4. The rate increase represents an incremental increase in the Company's current revenue requirement of $4,552,238.00, according to calculations prepared by the Company and Staff.

5. Under the stipulation the Company will be permitted to amortize its expenses associated with the current rate case over a 3-year period.

6. The Company will be permitted to amortize the full amount of its costs associated with its efforts to acquire the Parkersburg Municipal System over a 20-year period but will not be permitted to include the unamortized portion of that cost in its rate base.

7. The Company will not be permitted to make a general rate filing in which the resultant changes in the Company's rates and charges would be implemented sooner than December 31, 2002.

8. The single outstanding issue at the time of the Joint Stipulation was stand-by service. The parties noted that they were continuing to negotiate that issue.

The Commission understands that the Joint Stipulation was reached through the negotiations and compromises of the signatories. The Commission has carefully reviewed the stipulation and finds that it is a reasonable compromise and settlement of the rate issues currently pending before us. The Commission notes that although the Industrial Intervenors did not sign on as signatories to the Joint Stipulation, they did not file an objection to it.

The Commission shall adopt the Joint Stipulation as filed September 27, 2001.

Supplemental Stipulation Concerning the Standby Service Tariff

On October 12, 2001, Staff, the CAD, and the Company filed the "Supplemental Stipulation and Agreement for Settlement." The Public Systems did not join the Supplemental Stipulation as a signatory nor did the Industrial Intervenors. Under the terms of the Supplemental Stipulation the parties agreed to the following:

1. The Supplemental Stipulation does not affect the revenue requirement agreement embodied in the Joint Stipulation.

2. The stand-by tariff will apply only to large industrial and commercial customers and not to sale for resale customers. The Agreed Stand-by Tariff does not apply to existing industrial and commercial customers that operate and use an existing alternative source of supply as of the effective date of the Agreed Stand-by Tariff. However, if such a customer were to develop an additional alternative source of supply or increase the capacity of an existing alternative source of supply, and consequently the customer reduced its monthly purchases from the Company, the Agreed Stand-by Tariff would apply to the additional capacity of the alternative source(s) of supply. In this way, the Agreed Stand-by Tariff does not have any revenue impact on the Company's current rate case.

3. Regarding nomination of firm stand-by demand requirements the Agreed Stand-by Tariff permits a stand-by service customer to nominate its "Maximum Day Demand Requirement" annually. The nominated amounts are at the discretion of the stand-by service customer, and are not tied to the capacity of the customer's alternative source of supply. With the exception that where a stand-by service customer's actual maximum day demand during a stand-by event exceeds prior nomination; the stand-by service customer's new maximum day demand requirement will be re-nominated at the level of its actual maximum day demand during the stand-by event. Such re-nomination will continue in effect for a 12-month period following

the stand-by event, at which time, the stand-by service customer will again be permitted to make a re-nomination, with annual re-nomination opportunities thereafter.

4. The calculation of the "Excess Demand Charge", the penalty for making a maximum day demand requirement nomination that proves to be less than the stand-by service customer's actual maximum day demand during a stand-by event, has been limited to the number of months (not to exceed 6 months) since the stand-by service customer's most recent nomination or, if no renomination has been made, since the beginning of the standby service agreement. The payment of the Excess Demand Charge may be made either by a lump sum in the month following the standby event or in equal monthly installments over a period to be selected by the customer not to exceed 24 months together with a carrying charge of 8% per annum on the outstanding balance.

5. "Simplification of Nomination." Instead of requiring the standby service customer to nominate its average day, maximum day, and maximum hour demands and to pay a demand charge based on all three of these components, the Agreed Standby Tariff uses only a maximum day demand charge calculated to incorporate the average-day and maximum-day costs associated with standby service. In addition, the maximum day demand charge produces slightly less revenue than the aggregate of the average day demand, maximum day demand, and maximum hour demand charges previously used.

6. The Agreed Standby Tariff provides that water used by an industrial or commercial customer on a regular basis in the normal course of its operations is considered "Non-Standby Water" and is priced through the rate blocks in the Company's general tariff. Increases may be made to the use of Non-Standby Water through notification to the Company. The parties to the Supplemental Stipulation noted that the Industrial Intervenors were involved in the negotiations leading to the Supplemental Stipulation but had elected not to join in the agreement.

The Standby Tariff will not apply to Sale For Resale (SFR) customers. Additionally, the Commission notes that the Standby Tariff will not affect the Industrial Intervenors and current industrial and commercial customers due to the inclusion of a grandfathering provision. However, the Standby Tariff will affect industrial and commercial companies should they develop an additional alternative source of supply or increase the capacity of an existing alternative source of supply, and subsequently reduces its monthly purchases from the Company.

The Industrial Intervenors and the Public Systems expressed objections to the Supplemental Stipulation on several grounds. See, Industrial Intervenor filings made October 22, 2001, and November 1, 2001; and the Public Systems filing of November 1, 2001.[2] As the Public Systems and the Industrial Intervenors were of a similar mind in their objections to the Supplemental Stipulation, the Commission shall refer to them collectively as "opponents." Below, the Commission shall summarize those objections and address them.

The first point of objection was a concern that the Standby Tariff is unfair in that the Company proposes applying the Standby Tariff to all industrial and large commercial customers who build secondary sources of water after the tariff takes effect, regardless of whether they request the Company to maintain capacity for their emergency use. The Industrial Intervenors argued that industries should not be charged for expenses that they do not ask the Company to incur on their behalf and that an industrial customer should be able to approach the Company and to buy water until the emergency is over, understanding that water might not be available because the demand is unexpected. The Industrial Intervenors further stated that it would be more fair to not have penalties, standby fees, the creation of excess capacity, or recriminations if the water is not available, as such a situation would be much fairer than forcing industry to buy "protection" that it does not want or need.

The Commission notes that an industrial or commercial customer is free to choose not to place itself in a position to utilize the Company as a secondary source and, thus, avoid being impacted by the Standby Tariff.

The parties in opposition to the Supplemental Stipulation also argued that the Standby Tariff is discriminatory. The Industrial Intervenors argued that the South Putnam Public Service District should be an entity required to utilize a Standby Tariff. The Industrial Intervenors argued that the Company is seeking to penalize industries who only want emergency water, if it is available, and ignore a customer (South Putnam) whose standby event is a regular summer occurrence. The Industrial Intervenors argued that the Company proposes a Standby Tariff out of its fear that industrial customers may construct secondary sources of water. The Industrial Intervenors further argued that the Standby Tariff is not a revenue-recovery device, but instead is a device to force industrial customers to remain on the Company's water system.

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[2] The Public Systems stated: "The Public Systems support in part the positions of the Industrial Intervenors and oppose the adoption by the Commission of the Agreed Standby Tariff, or any other standby service tariff, in this proceeding." However, the Public Systems disagreed sharply with the Industrial Intervenors on the assertions that there are not substantial differences between the industrial customer class and the resale customer class regarding the justification of a standby service tariff.

The Company noted in its "Reply Brief on the Standby Tariff Issue" filed November 1, 2001, that:

> as frequently happens in the context of settlement negotiations, the Company decided it is better to give a little on the Standby Tariff issue in order to gain the Staff's support of it. This is no different than the Company's agreement to make many other changes to the initially-filed Standby Tariff, changes that almost uniformly limit the tariff's application to benefit the Industrials. The nature of a stipulated settlement is that all the parties give ground on their initial positions in order to reach a mutually-agreed result that serves the interest of the parties and the public. The Company has never wavered from the position it advanced in its prefiled testimony – that the Standby Tariff should apply to all large customers, including the SFR class – and does not foreclose the possibility that the Company and Staff may one day resolve the Staff's concerns with the application of a Standby-type Tariff to SRF customers. [Id. at page 8.]

Additionally, the Company noted that it would have an opportunity to oppose a SFR customer's construction of additional capacity through a certificate case, an option that would not be available where an industrial customer chose to develop an alternative source of supply. Transcript pp. 104-105.

The Commission agrees that industrial and commercial customers represent a unique class of customer, when compared to SFR customers, in that the economic impact of a SFR customer switching to a secondary source will be subject to Commission scrutiny in a future proceeding, whereas a switch by an industrial or commercial customer will not. As such, the Commission concludes that the differentiation between the two classes creates a clean demarcation as embodied in the Standby Tariff.

The Industrial Intervenors argue that the Standby Tariff is unnecessary since the Company's plant is already built to meet peak demand. As such, the Company's request for a Standby Tariff is unnecessary in that the Company does not have to build additional capacity because of the possibility of sporadic heavy industrial consumption. The needed excess capacity already exists because it was required, and paid for, by the Company's regular customers, including industrial customers. The opponents argued that sale for resale customers who create costs have those costs recovered from the entire sale for resale class and that the Company knows how to recover such costs without a Standby Tariff. The Industrial Intervenors believed that this lesson can be applied to the industrial class as well, and the cost can be factored into rates for the industrial class.

The Commission believes that the issue is not whether the utility lacks sufficient capacity to meet a large industrial or commercial customer's need for reserve capacity; it is whether there are costs associated with making capacity available and who should bear such costs. The Commission agrees with the Company's "Reply Brief on the Standby Service Tariff Issue," (filed November 1, 2001) at page 9: "[T]he indisputable concept that large customers who leave the Company's system, but nevertheless expect large amounts of water available to them on a moment's notice, shift the cost of providing that standby service to other customers. ... [T]here unquestionably is a cost associated with the backup service."

The opponents to the Supplemental Stipulation argued that the Standby Tariff is unsupported by the evidence and that since under the stipulated terms the Standby Tariff would not apply to existing customers, then the Company must not feel it is necessary to recover money for excess capacity that has been created for those customers as secondary sources. The Industrial Intervenors argued that there was also no evidence presented indicating that excess capacity would have to be built or maintained for customers who build secondary sources in the future.

The Standby Tariff, as contained in the Supplemental Stipulation, is the mechanism the Company, Staff, and the CAD have recommended to assess the costs associated with backup service to cost causing customers. As stated in the Company's "Reply Brief on the Standby Service Tariff Issue", (filed November 1, 2001) at page 10:

> The Company has shown that the Agreed Standby Tariff is a valid ratemaking mechanism applied on several occasions by other public utility commissions for the same purpose. Moreover, it is obviously designed to match the costs associated with standby service with the customers responsible for imposing those costs, one of the Commission's primary ratemaking goals.

Finally, the opponents to the Supplemental Stipulation argued that the Standby Tariff is anti-competitive and illegal. The Industrial Intervenors noted that their use of river water in their industrial process would have made them subject to the proposed Standby Tariff if such tariff did not contain a grandfathering provision, they further noted that other industrial customers who build secondary water sources after the Standby Tariff takes effect will not be so lucky. The Industrial Intervenors stated that industries considering West Virginia as a location for a new facility will view the Standby Tariff as a barrier to the installation of a needed secondary water source, or as a threat of million dollar penalties if a secondary source fails. The Industrial Intervenors further stated that such scenarios will not encourage industry to locate in West Virginia, and, in a close case, may tip the location decision to another state.

Concerning anti-competitive activity, the Industrial Intervenors argued that the sole purpose for the Standby Tariff is to stop industrial customers from building secondary sources. In this way the Industrial Intervenors argued that the Company is attempting to crush competition in violation of Section 2 of the Sherman Anti-Trust Act, 15 USC Section 2.

The Commission disagrees that the Joint Stipulation and the Standby Tariff are illegal or anti-competitive. In the first instance, the Commission is not the proper forum to address an alleged violation of the Sherman Anti-Trust Act. In any event, the Standby Tariff does not force an industrial customer to enter, or conversely to not enter, into its provisions. That choice remains with the industrial or commercial customer. All the Standby Tariff does is to assign the costs of maintaining Standby Service to the users of that Standby Service.

The Commission is unpersuaded by the arguments of the Industrial Intervenors and the Public Systems and shall accordingly adopt the "Supplemental Stipulation and Agreement for Settlement" as filed on October 12, 2001.

Treatment of Security Costs

In the November 13, 2001, letter filed by the Company, a request was made for rate treatment for the additional costs and capital expenditures involved in providing upgraded maintenance and security in light of the events of September 11, 2001.

The Commission is concerned about the very real possibility of harm to the State's utility infrastructure in light of the events of September 11, 2001. To this end, the Commission sees the need for heightened security. The Commission is also aware that heightened security may well lead to higher costs. Furthermore, the Commission is also acutely aware of the need not to publicize steps being taken by the Company to ensure the safety of the public water supply. However, the Commission is not prepared at this time to grant rate recovery to the Company in the form of a surcharge or rider to the rates contained in the current ongoing rate case. Instead, since the Commission will consider the initial amount, carrying cost and timing of recovery of all security related costs that are unusual or extraordinary (as compared to costs that represent normal, historic operations) in the Company's next rate case, we shall direct the Company to defer the actual costs of additional security. The Commission directs this deferral in recognition of the fact that we shall provide the Company with the opportunity to recover its deferred costs in future rates. Accordingly, the Company may request recovery of these deferred costs when it files its next rate case. This will give the Commission and interested parties an opportunity to review the reasonableness and prudence of the Company's actions, the actual level of plant additions and operating costs incurred and the extent to which deferred costs are unusual or

extraordinary as compared to normal, historic operations. The Commission will allow recovery of reasonable deferred costs in future rate cases after our review of the actual level of unusual or extraordinary security costs, the prudence of the costs and the appropriate timing for such recovery, but only to the extent that the Commission finds that the costs are reasonable, necessary, and prudent.

The Commission notes that there is an outstanding November 5, 2001, "Motion to Strike Public Systems' 'Reply' Brief" filed by the Company. The Commission considered all arguments made by all parties in this case. The motion shall be denied.

FINDINGS OF FACT

1. On March 5, 2001, the West Virginia-American Water Company (Company), a corporation, tendered for filing revised tariff sheets reflecting increased rates and charges of approximately 12.8% annually, or $11,778,871, for furnishing water service to approximately 163,000 customers in the Counties of Boone, Braxton, Cabell, Fayette, Kanawha, Lewis, Lincoln, Logan, Mercer, Putnam, Raleigh, Summers, Wayne and Webster, to become effective on April 4, 2001.

2. On April 2, 2001, the Commission issued a "Commission Order Suspending Rates and Charges and Setting Procedural Schedule." Therein, the Commission made the Company a respondent to this proceeding; suspended the revised tariff sheets and the use of the rates and charges stated therein until 12:01 a.m., December 31, 2001; directed that petitions to intervene should be filed with the Commission's Executive Secretary on or before May 5, 2001; directed that objections to petitions to intervene shall be filed within seven (7) days after the petition to intervene has been filed with the Commission; directed the Company to give notice of the aforesaid suspension and deadlines for the filing of petitions to intervene by posting and publication; established a procedural schedule, including a due date of April 25, 2001, at 4:00 p.m. for the Company's direct testimony; and granted the CAD's and Lavalette's respective petitions to intervene.

3. On May 9, 2001, the Commission received the prepared direct testimony of the following witnesses for the Water Company: Chris E. Jarrett, Michael A. Miller, Roy L. Ferrell, Sr., Kendall K. Mitzner, Edwin L. Oxley, Paul R. Herbert, Eugene Trisko, and James E. Salser.

4. On May 21, 2001, the Water Company submitted affidavits of publication. The Water Company noted that all publications had been made, but that an affidavit of publication had not yet been received from the Logan Banner. On June 5, 2001, the Water Company filed an affidavit of publication from the Logan Banner.

5. On July 5, 2001, the Commission issued an order in this matter which set a new evidentiary and protest hearing schedule; granted petitions to intervene from the South Putnam Public Service District, the Boone County Public Service District, the Putnam County Commission, the City of Hurricane, and the Industrial Intervenors; rescinded the portion of the Commission's Order of April 2, 2001, directing the Division of Administrative Law Judges to conduct protest hearings in this matter and to prepare a notice of the evidentiary hearing; required the Commission's Executive Secretary to give notice of the revised procedural schedule in this case by publishing a notice; and required the Company to give notice of the aforesaid modified procedural schedule by posting.

6. On August 13, 2001, the CAD filed the "Direct Testimony of Lafayette K. Morgan, Jr." and the "Direct Testimony of Randall R. Short."

7. On August 13, 2001, the Public Systems filed the "Direct Testimony of Christopher M. Miranda" and the "Direct Testimony of Ernest Harwig."

8. On August 17, 2001, Staff filed the "Direct Testimony of Diane Davis Calvert", "Employee Pensions and Benefits Prepared by Robert R. MacDonald"; the "Direct Testimony of Steven Kaz"; "Direct Testimony Prepared by Thomas L. Wagner, Utilities Analyst Supervisor"; and the "Staff Rule 42 Exhibit for the year ended December 31, 2000, prepared by Thomas L. Wagner, Utilities Analyst Supervisor, Utilities Division."

9. On August 28, 2001, Staff filed the "Supplemental Direct Testimony of Diane Davis Calvert."

10. On August 30, 2001, the Company filed the Rebuttal testimony of Chris E. Jarrett, Michael A. Miller, Roy L. Ferrel, Sr., Kendall K. Mitzner, Edwin L. Oxley, and Eugene Trisko. The Rebuttal Testimony of Paul R. Herbert and the Supplemental Rebuttal Testimony of Paul R. Herbert were filed on August 31, 2001, and September 4, 2001, respectively.

11. The Public Systems filed the Rebuttal Testimony of Christopher M. Miranda on August 31, 2001.

12. On September 6, 2001, the Boone County Public Service District filed a letter, by counsel, advising that it wished to withdraw and would not be participating in the hearing.

13. On September 10, 2001, the Commission held the hearing in this matter, as previously scheduled. The parties were present and represented as follows: West Virginia-American Water Company by Michael A. Albert, Esq., Christopher L. Callas, Esq., and John Phillip Melick, Esq.; Industrial Customers by T.D. Kauffelt, Esq. and Mark Kauffelt, Esq.;

Public Systems by Robert R. Rodecker, Esq.; the CAD by David A. Sade, Esq.; and Commission Staff by Meyishi Blair, Esq. The hearing was reduced to a transcript of 176 pages, (Tr. I). A public protest hearing was held the evening of September 10, 2001. That proceeding was reduced to a transcript of 21 pages, (Tr. II). At the hearing, the parties informed the Commission that most aspects of the case had settled and a written stipulation would be forthcoming.

14. On September 27, 2001, Staff, CAD, the Public Systems, and the Company filed a "Joint Stipulation and Agreement for Settlement."

15. On October 12, 2001, Staff, the CAD, and the Company filed a "Supplemental Stipulation and Agreement For Settlement."

16. On October 22, 2001, the Industrial Intervenors filed a "Brief on Behalf of Industrial Intervenors" arguing against the Standby Tariff on several grounds.

17. On October 22, 2001, the Public Systems filed a letter stating they would not file an initial brief, but reserved the right to file a reply brief.

18. On October 22, 2001, the Company filed its "West Virginia-American Water Company's Post-Hearing Brief on the Standby Service Tariff Issue."

19. On November 1, 2001, the Public Systems filed the "Public Systems' Reply Brief."

20. On November 1, 2001, the Company filed the "West Virginia-American Water Company's Reply Brief on the Standby Service Tariff Issue."

21. On November 1, 2001, the Industrial Intervenors filed the "Reply Brief on Behalf of Industrial Intervenors."

22. On November 5, 2001, the Water Company filed a "Motion to Strike Public Systems' 'Reply' Brief."

23. On November 8, 2001, the Public Systems filed a letter in response to the "Motion to Strike Public Systems' Reply Brief."

24. On November 13, 2001, the Commission received a letter from counsel for the Company. Therein, the Company requested that the Commission provide rate recovery in the form of a surcharge or rider to the Company's new rates at the time the requested rates in the pending rate case are implemented or that the Commission permit the increase to be

imbedded in the rates approved in the 2001 rate case to cover increased security costs stemming from the events of September 11, 2001.

25. On November 13, 2001, the Company filed a letter in response to the November 8, 2001, letter from counsel for the Public Systems regarding the Company's motion to strike.

26. On November 14, 2001, counsel for the Public Systems filed a letter in response to the November 13, 2001, letters from the Company regarding security measures and regarding the filing and content of reply briefs in this matter.

27. On November 19, 2001, the Industrial Intevenors filed a letter (dated November 16, 2001) in which they opposed the 3.5% rate increase requested by the Company for security measures.

28. On November 20, 2001, the Company filed a further letter regarding the request for a rate increase to cover the costs of increased security.

29. On November 27, 2001, the CAD filed a letter regarding the security costs in which it strongly opposed the Company's request.

30. On December 12, 2001, the Commission received a letter from the public opposing additional security-related rate increases. Three additional protests were received on December 13, 2001.

31. An industrial or commercial customer is free to choose not to place itself in a position to utilize the Company as a secondary source and, thus, avoid being impacted by the Standby Tariff.

32. Industrial and commercial customers represent a unique class of customer, when compared to SFR customers, in that the economic impact of a SFR customer switching to a secondary source will be subject to Commission scrutiny in a future proceeding, whereas a switch by an industrial or commercial customer will not.

33. The issue is not whether the utility lacks sufficient capacity to meet a large industrial or commercial customer's need for reserve capacity; it is whether there are costs associated with making capacity available and who should bear such costs.

34. The Commission agrees with the Company's "Reply Brief on the Standby Service Tariff Issue," (filed November 1, 2001) at page 9: "[T]he indisputable concept that large customers who leave the Company's system, but nevertheless expect large amounts of

water available to them on a moment's notice, shift the cost of providing that standby service to other customers. ... [T]here unquestionably is a cost associated with the backup service."

35. The Standby Tariff, as contained in the Supplemental Stipulation, is the mechanism the Company, Staff, and the CAD have recommended to assess the costs associated with backup service to cost causing customers.

36. The Commission disagrees that the Joint Stipulation and the Standby Tariff are illegal or anti-competitive.

37. The Commission is not the proper forum to address an alleged violation of the Sherman Anti-Trust Act.

38. The Standby Tariff does not force an industrial customer to enter, or conversely to not enter, into its provisions.

39. The Commission understands the need for heightened security for the State's utility infrastructure. The Commission is also aware that heightened security may well lead to higher costs.

CONCLUSIONS OF LAW

1. It is reasonable for the Commission to approve and adopt the "Joint Stipulation and Agreement for Settlement" filed September 27, 2001, and signed by the West Virginia-American Water Company, the Commission Staff, the Consumer Advocate Division, and the Public Systems. The pertinent provisions of the Joint Stipulation are as follows:

A. The Company originally requested an increase in operating revenues of $11,778,871.00 (12.8% annually) for furnishing water service to approximately 163,000 customers in Kanawha, Putnam, Lincoln, Boone, Lewis, Webster, Mercer, Summers, Fayette, Braxton, Logan, Raleigh, Cabell, and Wayne Counties.

B. At the hearing held on September 10, 2001, the parties presented the outline of their Joint Stipulation.

C. As part of the Stipulation the parties agreed that rates and charges should be increased across-the-board by 5%, effective December 31, 2001.

D. The rate increase represents an incremental increase in the Company's current revenue requirement of $4,552,238.00, according to calculations prepared by the Company and Staff.

E. Under the stipulation the Company will be permitted to amortize its expenses associated with the current rate case over a 3-year period.

F. The Company will be permitted to amortize the full amount of its costs associated with its efforts to acquire the Parkersburg Municipal System over a 20-year period but will not be permitted to include the unamortized portion of that cost in its rate base.

G. The Company will not be permitted to make a general rate filing in which the resultant changes in the Company's rates and charges would be implemented sooner than December 31, 2002.

2. The Joint Stipulation represents a reasonable compromise and settlement of the rate issues currently pending before the Commission in this case.

3. It is reasonable for the Commission to approve and adopt the "Supplemental Stipulation and Agreement for Settlement" filed on October 12, 2001, by the Staff, the CAD, and the Company, the terms of which are summarized as follows:

A. The Supplemental Stipulation does not affect the revenue requirement agreement embodied in the Joint Stipulation.

B. The stand-by tariff will apply only to large industrial and commercial customers and not to sale for resale customers. The Agreed Stand-by Tariff does not apply to existing industrial and commercial customers that operate and use an existing alternative source of supply as of the effective date of the Agreed Stand-by Tariff. However, if such a customer were to develop an additional alternative source of supply or increase the capacity of an existing alternative source of supply, and consequently the customer reduced its monthly purchases from the Company, the Agreed Stand-by Tariff would apply to the additional capacity of the alternative source(s) of supply. In this way, the Agreed Stand-by Tariff does not have any revenue impact on the Company's current rate case.

C. Regarding nomination of firm stand-by demand requirements the Agreed Stand-by Tariff permits a stand-by service customer to nominate its "Maximum Day Demand Requirement" annually. The nominated amounts are at the discretion of the stand-by service customer, and are not tied to the capacity of the customer's alternative source of supply. With the exception that where a stand-by service customer's actual maximum day demand during a stand-by event exceeds prior nomination; the stand-by service customer's new maximum day demand requirement will be re-nominated at the level of its actual maximum day demand during the stand-

by event. Such re-nomination will continue in effect for a 12-month period following the stand-by event, at which time, the stand-by service customer will again be permitted to make a re-nomination, with annual re-nomination opportunities thereafter.

D. The calculation of the "Excess Demand Charge", the penalty for making a maximum day demand requirement nomination that proves to be less than the stand-by service customer's actual maximum day demand during a stand-by event, has been limited to the number of months (not to exceed 6 months) since the stand-by service customer's most recent nomination or, if no renomination has been made, since the beginning of the standby service agreement. The payment of the Excess Demand Charge may be made either by a lump sum in the month following the standby event or in equal monthly installments over a period to be selected by the customer not to exceed 24 months together with a carrying charge of 8% per annum on the outstanding balance.

E. "Simplification of Nomination." Instead of requiring the standby service customer to nominate its average day, maximum day, and maximum hour demands and to pay a demand charge based on all three of these components, the Agreed Standby Tariff uses only a maximum day demand charge calculated to incorporate the average-day and maximum-day costs associated with standby service. In addition, the maximum day demand charge produces slightly less revenue than the aggregate of the average day demand, maximum day demand, and maximum hour demand charges previously used.

4. While the Commission understands the need for the Company to undertake additional activities in order to ensure a safe water supply, the Commission believes that the best way to address any expenses that may arise from such activities is to defer the actual costs incurred on its books of account as a regulatory asset for presentation in the next Company rate case.

ORDER

IT IS THEREFORE ORDERED that the September 27, 2001, "Joint Stipulation and Agreement for Settlement" and the October 12, 2001, "Supplemental Stipulation and Agreement For Settlement" are hereby adopted by the Commission in resolution of the March 5, 2001, rate case filed by the West Virginia-American Water Company. The rates and charges contained therein shall be effective for service rendered on and after December 31, 2001.

IT IS FURTHER ORDERED that the West Virginia-American Water Company shall defer the actual costs incurred in increasing the security of its systems from hostile attack on its books of account as a regulatory asset for presentation in the next Company rate case.

IT IS FURTHER ORDERED that within thirty (30) days of the date of this order the West Virginia-American Water Company shall file with the Commission a proper tariff setting forth the Company's rates and charges as approved herein.

IT IS FURTHER ORDERED that the Company's November 5, 2001, "Motion to Strike Public Systems' 'Reply' Brief" is hereby denied.

IT IS FURTHER ORDERED that upon entry of this order, this case shall be removed from the Commission's docket of open cases.

IT IS FURTHER ORDERED that the Commission's Executive Secretary serve a copy of this order upon all parties of record by United States First Class Mail and upon Commission Staff by hand delivery.

A True Copy, Teste:

Sandra Squire

Sandra Squire
Executive Secretary

ARC
JJW/lfg
010326cf.wpd

PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA
CHARLESTON

CASE NO. 01-0326-W-42T

WEST VIRGINIA-AMERICAN WATER COMPANY
Rule 42T tariff filing to increase
rates and charges.

JOINT STIPULATION
AND AGREEMENT FOR SETTLEMENT

Pursuant to West Virginia Code § 24-1-9(f) and Rule 13(d) of the Public Service Commission's Rules of Practice and Procedure, West Virginia-American Water Company ("Company"), the Staff of the Public Service Commission of West Virginia ("Staff"), the Consumer Advocate Division of the Public Service Commission ("CAD"), South Putnam Public Service District ("SPPSD"), Lavalette Public Service District ("LPSD"), the City of Hurricane (together with SPPSD and LPSD, the "Public Systems," and together with the other parties listed above, collectively referred to herein as the "Parties") join in this Joint Stipulation and Agreement for Settlement ("Joint Stipulation").

This Joint Stipulation proposes and recommends a settlement among the Parties of the Company's pending general rate case, PSC Case No. 01-0326-W-42T. In this Joint Stipulation, the Parties have agreed and recommend that the Public Service Commission ("Commission") fix a fair and reasonable set of rates to meet Company's current cost of service as detailed below. In support of this Joint Stipulation, the Parties state that:

1. On March 5, 2001, the Company filed revised tariff sheets reflecting increased operating revenues of $11,778,871, or approximately 12.8% annually, for furnishing

water service to approximately 163,000 customers in Kanawha, Putnam, Lincoln, Boone, Lewis, Webster, Mercer, Summers, Fayette, Braxton, Logan, Raleigh, Cabell and Wayne Counties, such rates originally to become effective April 4, 2001.

2. On April 2, 2001, in accordance with the provisions of W. Va. Code § 24-2-4a, the Commission entered an Order that, among other things, suspended the rates and charges and deferred their use until 12:01 a.m. on December 31, 2001, instituted a formal investigation into the reasonableness of the rates contained in the revised tariff sheets and the supporting data filed by the Company, established a procedural schedule for the filing of testimony and for the hearing, and required publication of a notice of suspension of the increased rates and charges and the opportunity to intervene.

3. During the course of this proceeding, the Public Systems, a group of large industrial customers represented by Kauffelt & Kauffelt (the "Industrial Intervenors"), Boone County Public Service District ("BCPSD") and the County Commission of Putnam County ("PCC") filed petitions to intervene. Through Commission Orders dated April 6, 2001 and July 5, 2001, the Commission granted each of these petitions to intervene. On September 6, 2001, counsel for BCPSD advised the Commission that it wished to withdraw from the case. Counsel for the PCC has not participated in the case or in the negotiations that led to this Joint Stipulation and did not appear at the hearing held on September 10, 2001 (the "Hearing").

4. The Company has satisfied all posting and publication requirements specified in Commission Orders in this case and has provided evidence thereof to the Commission in advance of the Hearing.

5. The Company and the Public Systems filed both direct and rebuttal testimony and exhibits in this case. The Staff, the CAD and the Industrial Intervenors filed direct testimony and exhibits in this case. During the Hearing, all of the pre-filed direct and rebuttal testimony in this case was admitted into evidence and additional testimony was adduced in connection with the Company's proposed standby service tariff described in paragraph 10 below.

6. In addition to the testimony and exhibits and the update and revisions to the Company's case filed on May 9, 2001, the Company submitted the necessary information and data in support of the rates and charges filed pursuant to Rule 42 of the Tariff Rules. The Staff, the CAD, the Public Systems and the Industrial Intervenors also undertook extensive discovery, both of a formal and informal character, including an examination of the books and records of the Company and a review of extensive data responses and other documents provided by the Company.

7. During the weeks preceding the Hearing, the Parties have attempted to negotiate a resolution of this case. Specifically, during prehearing conferences held on August 27 and September 7 and in other correspondence and telephone discussions, the Parties attempted to address or eliminate certain of these issues and to reach a settlement. Based on these negotiations, the Company, the Staff and the CAD reached an agreement in principle for settlement of this rate case on September 7, 2001, the elements of which (with the exception of the standby service tariff issue described in paragraph 10 below) are embodied in this Joint Stipulation. The Public Systems subsequently joined in this agreement. The Industrial Intervenors have not joined in this agreement.

8. At the Hearing, Michael A. Miller, Vice-President of the Company, explained and sponsored the settlement embodied in this Joint Stipulation and answered questions about the settlement.

9. The Parties agree that, as a result of the settlement reached on the issues in this general rate case, the proposed rates and charges for all customers of Company attached as Exhibit 1 to this Joint Stipulation are fair and reasonable and recommend that those rates be approved by the Commission to be effective on December 31, 2001. The particulars of the settlement proposed in this Joint Stipulation are as follows, all of which the Parties believe to be elements of a fair and reasonable resolution of this case:

a. The Company's rates and charges should be increased across-the-board by 5%, effective on December 31, 2001, as shown in the schedule of rates and charges attached hereto as Exhibit 1. In his testimony sponsoring the settlement, Mr. Miller noted that in stipulated settlements of prior Company rate filings, the Company, the Staff and the CAD frequently have arrived at a revenue requirement that they all agreed to be fair and reasonable, given the totality of the Company's case, without actually agreeing specifically among themselves on the exact calculation of that revenue requirement. In essence, each party has been comfortable with the agreed-to revenue requirement based on the positions it took in the case and during settlement discussions. The same approach was used in reaching the agreement embodied by this Joint Stipulation. As shown in the respective cost of service calculations prepared by the Company and the Staff and attached as Exhibits 2 and 3 hereto, the rate increase agreed to in this Joint Stipulation represents an incremental increase in the Company's current revenue requirement of $4,552,238. The CAD adopts the Staff calculation

shown in Exhibit 3. Neither the Public Systems nor the Industrial Intervenors have taken a position on the appropriate calculation of the Company's revenue requirement.

b. The Company will be permitted to amortize its expenses associated with this rate case over a three-year period.

c. The Company will be permitted to amortize the full amount of its costs associated with its effort to acquire the Parkersburg municipal system over a 20-year period but will not be permitted to include the unamortized portion of that cost in its rate base.

d. The Company will not be permitted to make a general rate filing in which the resultant changes in the Company's rates and charges would be implemented sooner than December 31, 2002.

10. At the Hearing, the Company, the Staff and the CAD represented that they also had reached an agreement concerning the Company's proposed standby service tariff. During conversations since the Hearing, however, the Company, the Staff and the CAD have identified several outstanding issues relating to the standby service tariff. In an effort to resolve these outstanding issues, the Company, the Staff and the CAD have exchanged proposals and counter-proposals, but no consensus has been reached at this time. The Parties agree to continue settlement negotiations on the standby service tariff and, in the event that the issue has not been resolved, to ask the Commission to set a separate hearing for the sole purpose of considering the standby service tariff. To this end, the Parties will submit a proposed settlement of the standby service tariff issue or a status report and request for hearing by October 12, 2001. Because much of the briefing currently required by the Commission will relate to the standby service tariff issue, and because there is a possibility

of an agreement on the issue, the Parties also request that the current briefing schedule be postponed until the Parties have completed their settlement efforts. For purposes of the continuing settlement discussions among the Company, the Staff and the CAD on the standby service tariff issue, the Company, the Staff and the CAD agree that the standby service tariff will not be applicable to sale for resale customers.

11. The Parties state that this Joint Stipulation addresses all issues raised in the Company's rate case except for the standby service tariff issue. The Parties do not believe that this issue affects the revenue increment agreed to in this case or the other elements of the agreement specified in paragraph 9 hereof. Based on the record and the testimony adduced at the Hearing, the Parties propose that the Commission accept this Joint Stipulation in complete resolution of those issues.

12. The Joint Stipulation is entered into subject to the acceptance and approval of the Commission. It results from a review of any and all filings in these proceedings and extensive negotiation. It reflects substantial compromises by the Parties and the modification of their respective positions asserted in this case, and is being proposed to expedite and simplify the resolution of these proceedings and other matters. It is made without any admission or prejudice to any positions which any Party might adopt during subsequent litigation.

13. The Parties adopt the Joint Stipulation as being in the public interest, without adopting any of the compromise positions set forth herein as ratemaking principles applicable to future regulatory proceedings, except as may otherwise be provided herein. The Parties acknowledge that it is the Commission's prerogative to accept, reject, or modify any

stipulation. However, in the event that the Joint Stipulation is modified or rejected by the Commission, it is expressly understood by the Parties that they are not bound to accept the Joint Stipulation as modified or rejected, and may avail themselves of whatever rights are available to them under law and the Commission's Rules of Practice and Procedure.

WHEREFORE, the Parties, on the basis of all of the foregoing, respectfully request that the Commission make appropriate findings of fact and conclusions of law adopting and approving the Joint Stipulation in its entirety, including the attachment(s) thereto.

Respectfully submitted,

Michael A. Albert, Esq.,
John Philip Melick, Esq.
Christopher L. Callas, Esq.
Counsel for West Virginia-American
Water Company

Meyishi Blair, Esq., Counsel for
Staff of the Public Service
Commission of West Virginia

David A. Sade, Esq., Counsel for
Consumer Advocate Division of the
Public Service Commission of West Virginia

Robert R. Rodecker, Esq.
Counsel for the Public Systems

West Virginia-American Water C pany
Charleston, West Virginia

Twenty-Second R sion of Original Sheet No. 7
Canceling
Twenty-First Revision of Original Sheet No. 7
P.S.C. W. Va. No. 1

Applicable in the entire territory served by the West Virginia-American Water Company, except those communities noted on Original Sheet No. 7-a.

AVAILABILITY OF SERVICE

Available for general domestic, commercial, industrial and wholesale service.

RATE

	First	1,500	gallons used per month at the minimum charge
(A)	Next	28,500	gallons used per month $6.8943 per 1,000 gallons
(A)	Next	870,000	gallons used per month $4.5015 per 1,000 gallons
(A)	Next	8,100,000	gallons used per month $3.4586 per 1,000 gallons
(A)	All over	9,000,000	gallons used per month $2.5204 per 1,000 gallons

MINIMUM CHARGE

No bill will be rendered for less than the following amount according to the size of each meter installed, to-wit: for customers having multiple meter settings, the minimum charge will be sum of the minimum charges for each of the individual meters:

(A)	3/4 inch meter or less*	$ 15.55	per month
(A)	1 inch meter	$ 38.09	per month
(A)	1-1/2 inch meter	$ 75.66	per month
(A)	2 inch meter	$ 120.78	per month
(A)	3 inch meter	$ 226.02	per month
(A)	4 inch meter	$ 376.35	per month
(A)	6 inch meter	$ 752.21	per month
(A)	8 inch meter	$1,203.26	per month

*All residential customer shall be served through a 5/8" meter, provided, however, that the Company may install a larger meter when reasonably necessary. This restriction shall not apply to residential meters currently in service.

(A) INDICATES ADVANCE

Issued: _____ Effective: December 31, 2001

Issued by:

Michael A. Miller, Vice President

Issued under authority of an Order of the Public Service Commission of West Virginia in Case No. 01-0326-W-42T.

West Virginia-American Water C .pany
Charleston, West Virginia

Fourteenth Revisi of Original Sheet No. 7-a
Canceling
Thirteenth Revision of Original Sheet No. 7-a
P.S.C. W.VA. No. 1

Applicable in the following areas:

- Winifrede, Carbon and Decota communities of Kanawha County
- Coopers Hollow Road at Winifrede

AVAILABILITY OF SERVICE

Available for general domestic, commercial and industrial service.

RATE

	First	1,500	gallons used per month at the minimum charge
(A)	Next	28.500	gallons used per month $6.8943 per 1,000 gallons
(A)	Next	870,000	gallons used per month $4.5015 per 1,000 gallons
(A)	Next	8,100,000	gallons used per month $3.4586 per 1,000 gallons
(A)	All over	9,000,000	gallons used per month $2.5204 per 1,000 gallons

MINIMUM CHARGE

No bill will be rendered for less than the following amount according to the size of each meter installed, to-wit: for customers having multiple meter settings, the minimum charge will be sum of the minimum charges for each of the individual meters:

(A)	3/4 inch meter or less*	$ 15.55	per month +	$10.00 =	$ 25.55	per month
(A)	1 inch meter	38.09	per month +	10.00 =	48.09	per month
(A)	1-1/2 inch meter	75.66	per month +	10.00 =	85.66	per month
(A)	2 inch meter	120.78	per month +	10.00 =	130.78	per month
(A)	3 inch meter	226.02	per month +	10.00 =	236.02	per month
(A)	4 inch meter	376.35	per month +	10.00 =	386.35	per month
(A)	6 inch meter	752.21	per month +	10.00 =	762.21	per month
(A)	8 inch meter	1,203.26	per month +	10.00 =	1,213.26	per month

*All residential customers shall be served through a 5/8" meter, provided, however, that the Company may install a larger meter when reasonably necessary. This restriction shall not apply to residential meters currently in service.

(A) INDICATES ADVANCE

Issued:_____ Effective: December 31, 2001

Issued by:

Michael A. Miller, Vice President

Issued under authority of an Order of the Public Service Commission of West Virginia in Case No. 01-0326-W-42T.

West Virginia-American Water Company
Charleston, West Virginia

Twelfth Revision of Original Sheet No.7-b
Cancelling
Eleventh Revision of Original Sheet No. 7-b
P.S.C. W.Va. No. 1

Applicable in the entire territory served by the West Virginia-American Water Company.

AVAILABILITY OF SERVICE

Available for wholesale service.

RATE

	First	1,500	gallons used per month at the minimum charge
(A)	Next	28,500	gallons used per month $7.0258 per 1.000 gallons
(A)	Next	870,000	gallons used per month $4.2355 per 1.000 gallons
(A)	Next	8.100,000	gallons used per month $3.7462 per 1.000 gallons
(A)	All over	9,000.000	gallons used per month $2.7064 per 1,000 gallons

MINIMUM CHARGE

No bill will be rendered for less than the following amount according to the size of each meter installed. to-wit; for customers having multiple meter settings. the minimum charge will be sum of the minimum charges for each of the individual meters:

(A)	3/4 inch meter or less*	$ 19.34	per month
(A)	1 inch meter	47.59	per month
(A)	1 - 1/2 inch meter	94.66	per month
(A)	2 inch meter	151.44	per month
(A)	3 inch meter	282.94	per month
(A)	4 inch meter	471.23	per month
(A)	6 inch meter	941.98	per month
(A)	8 inch meter	1.506.86	per month

(A) INDICATES ADVANCE

Issued:_____

Effective: December 31. 2001

Issued by:

Michael A. Miller. Vice President

Issued under authority of an Order of the Public Service Commission of West Virginia in Case No. 01-0326-W-42T.

West Virginia-American Water Company
Charleston, West Virginia

Fifteenth Revision of Original Sheet No. 8
Canceling
Fourteenth Revision of Original Sheet No. 8
P.S.C. W.Va. No. 1

Applicable in entire territory served by the West Virginia-American Water Company.

AVAILABILITY OF SERVICE

Available for private fire protection service.

RATE

Where connections, hydrants, sprinklers, etc., on private property are maintained by consumer:

		Per Annum
(A)	2 inch Service Line with hydrants, sprinklers, and/or hose connections----------	$ 62.62
(A)	3 inch Service Line with hydrants, sprinklers, and/or hose connections----------	142.38
(A)	4 inch Service Line with hydrants, sprinklers, and/or hose connections----------	249.98
(A)	6 inch Service Line with hydrants, sprinklers, and/or hose connections----------	633.65
(A)	8 inch Service Line with hydrants, sprinklers, and/or hose connections----------	1,039.12
(A)	10 inch Service Line with hydrants, sprinklers, and/or hose connections----------	1,843.51
(A)	12 inch Service Line with hydrants, sprinklers, and/or hose connections----------	2,583.25

These terms are payable monthly in advance.

PROMPT PAYMENT DISCOUNT OR DELAYED PAYMENT PENALTY

None

(A) INDICATES ADVANCE

Issued:_____ Effective: December 31, 2001

Issued by:

Michael A. Miller, Vice President

Issued under authority of an Order of the Public Service Commission of West Virginia in Case No. 01-0326-W-42T.

Exhibit 2

WEST VIRGINIA-AMERICAN WATER COMPANY
CASE NO. 01-0326-W-42 T
REVENUE REQUIREMENT

	AMOUNT $
RATE BASE	372,030,414
RATE OF RETURN	8.16%
RETURN ON RATE BASE	30,367,355
OPERATION & MAINTENANCE EXPENSE	37,166,071
DEPRECIATION & AMORTIZATION	11,399,736
TAXES - OTHER THAN INCOME	9,781,284
FEDERAL INCOME TAXES	6,458,642
STATE INCOME TAXES	1,645,051
TOTAL REVENUE REQUIREMENT	96,818,139
GOING LEVEL REVENUE	92,265,901
INCREASE (DECREASE)	4,552,238

WEST GINIA-AMERICAN WATER COMPANY
CASE NO. 01-0326-W-42 T
STAFF REVENUE REQUIREMENT

Exh 3

	ORIGINAL STAFF RECOMMENDATION $	ADJUSTMENTS $	STIPULATED AMOUNT $
RATE BASE	376,517,441	151,100	376,668,541
RATE OF RETURN	7.47%	0.58% *	8.05%
RETURN ON RATE BASE	28,135,575	2,200,496	30,336,071
OPERATION & MAINTENANCE EXPENSE	35,098,189	1,983,424	37,081,613
DEPRECIATION & AMORTIZATION	11,399,736	0	11,399,736
TAXES - OTHER THAN INCOME	9,442,742	257,156	9,699,897
FEDERAL INCOME TAXES	5,613,969	991,610	6,605,579
STATE INCOME TAXES	1,356,547	338,696	1,695,243
TOTAL REVENUE REQUIREMENT	91,046,757	5,771,381	96,818,138
GOING LEVEL REVENUE	92,265,901	0	92,265,901
INCREASE (DECREASE)	(1,219,144)	5,771,381	4,552,237

* Reflects Return on Equity of 9.25%

CERTIFICATE OF SERVICE

I, Christopher L. Callas, as counsel for West Virginia-American Water Company, do hereby certify that I served the foregoing on the parties of record by hand-delivering a copy of the same to them this 27th day of September 2001, addressed as follows:

Meyishi Blair, Esq.
Staff Counsel
Public Service Commission
201 Brooks Street
P. O. Box 812
Charleston, West Virginia 25323

David A. Sade, Esquire
Consumer Advocate
Public Service Commission
700 Union Building
723 Kanawha Boulevard, East
Charleston, WV 25301

Robert R. Rodecker, Esquire
1210 Bank One Center
P. O. Box 3713
Charleston, WV 25337

T. D. Kauffelt, Esquire
Kauffelt & Kauffelt
Kanawha Valley Building
P. O. Box 3082
Charleston, WV 25331

Jennifer Scragg
Putnam County Commission
3389 Winfield Road
Winfield, WV 25213

Christopher L. Callas

PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA
CHARLESTON

CASE NO. 01-0326-W-42T

WEST VIRGINIA-AMERICAN WATER COMPANY
Rule 42T tariff filing to increase
rates and charges.

SUPPLEMENTAL JOINT STIPULATION
AND AGREEMENT FOR SETTLEMENT

Pursuant to West Virginia Code § 24-1-9(f) and Rule 13(d) of the Public Service Commission's Rules of Practice and Procedure, West Virginia-American Water Company ("Company"), the Staff of the Public Service Commission of West Virginia ("Staff"), and the Consumer Advocate Division of the Public Service Commission ("CAD," and together with the Company and the Staff, the "Parties") join in this Supplemental Joint Stipulation and Agreement for Settlement ("Supplemental Stipulation"). In support of this Supplemental Stipulation, the Parties state as follows:

1. This Supplemental Stipulation is a supplement to the Joint Stipulation and Agreement for Settlement among the Parties and the Public Systems submitted to the Commission on September 27, 2001 (the "Initial Stipulation").[1] In the Initial Stipulation, the Parties and the Public Systems proposed a settlement among them of the Company's pending general rate case, PSC Case No. 01-0326-W-42T, and recommended that the

[1] South Putnam Public Service District, Lavalette Public Service District, and the City of Hurricane (collectively, the "Public Systems") joined in the Initial Stipulation and were included in the definition of the term "Parties" therein. As indicated in Paragraph 5 below, the Public Systems have not yet joined this Supplemental Stipulation, and therefore the term "Parties" in this Supplemental Stipulation does not include them.

Commission fix a fair and reasonable set of rates to meet Company's current revenue requirement as detailed therein. This Supplemental Stipulation does not affect the revenue requirement agreement embodied in the Initial Stipulation or the recommendations to the Commission stated therein.

2. In Paragraph 10 of the Initial Stipulation, the Parties and the Public Systems represented that they had not yet resolved all outstanding issues related to the Company's proposed standby service tariff ("Standby Tariff"). The Parties and the Public Systems agreed to continue settlement negotiations on the Standby Tariff issue and to submit to the Commission by October 12, 2001 either (i) a proposed settlement of the Standby Tariff issue, or (ii) a status report and request for hearing on the Standby Tariff issue.

3. As a result of further negotiations, the Parties have reached agreement on the Standby Tariff issue. Attached as Exhibit 1 hereto is the form of the Standby Tariff that the Parties agree and recommend should be approved for filing and implementation by the Company effective December 31, 2001 (the "Agreed Standby Tariff").

4. In addition to numerous technical, definitional and drafting changes, the Agreed Standby Tariff includes several substantive changes from the version initially filed by the Company. These changes limit the application of the Agreed Standby Tariff, and therefore make it more favorable from the perspective of an industrial or commercial customer to which it might apply. The following changes are among the most significant substantive changes in the Agreed Standby Tariff:

a. Inapplicability to Sale for Resale Customers. In accordance with the agreement stated in Paragraph 10 of the Initial Stipulation, the Agreed Standby Tariff

applies only to large industrial and commercial customers, and not to sale for resale customers.

b. Inapplicability to Existing Alternative Sources. The Agreed Standby Tariff does not apply to existing industrial or commercial customers that operate and use an existing alternative source of supply as of the effective date of the Agreed Standby Tariff. However, if such a customer were to develop an additional alternative source of supply or increase the capacity of an existing alternative source of supply, and consequently the customer reduced its monthly purchases of water from the Company, the Agreed Standby Tariff would apply to the additional capacity of the alternative source(s) of supply. See Exhibit 1 at Section B.9. One effect of this change is to ensure that the Agreed Standby Tariff does not have any revenue impact on the Company's current rate case.

c. Nomination of Firm Standby Demand Requirements. The Agreed Standby Tariff permits a standby service customer to renominate its "Maximum Day Demand Requirement" annually. Id. at Section C.3. The nominated amounts are at the discretion of the standby service customer, and are not tied to the capacity of the customer's alternative source of supply. Id. at Section C.2. The only exception to this provision involves an instance in which a standby service customer's actual maximum day demand during a standby event exceeds its prior nomination. In this instance, the standby service customer's new Maximum Day Demand Requirement will be renominated at the level of its actual maximum day demand during the standby event. This renomination will continue in effect for a twelve-month period following the standby event, at which time the standby

service customer will again be permitted to make a renomination, with annual renomination opportunities thereafter. Id. at Section C.6.

d. Reduced Excess Demand Charge. The calculation of the "Excess Demand Charge" – the penalty for making a Maximum Day Demand Requirement nomination that proves to be less than the standby service customer's actual maximum day demand during a standby event – has been limited to the number of months (not to exceed six months) since the standby service customer's most recent nomination or, if no renomination has been made, since the beginning of the standby service agreement. Id. at Section B.2. In addition, the standby service customer will have the option of paying the Excess Demand Charge either (i) in a lump sum during the month following the standby event, or (ii) in equal monthly installments over a period to be selected by the customer not to exceed 24 months, together with a monthly carrying charge of 8% per annum on the outstanding balance. Id. at Section C.6.

e. Simplification of Nomination. Instead of requiring the standby service customer to nominate its average day, maximum day, and maximum hour demands and to pay a demand charge based on all three of these components, the Agreed Standby Tariff uses only a maximum day demand charge calculated to incorporate the average-day and maximum-day costs associated with standby service. Id. at Sections B.6 and D.2. In addition, the maximum day demand charge produces slightly less revenue than the aggregate of the average day demand, maximum day demand, and maximum hour demand charges previously used. The use of a single maximum day demand charge also avoids the potential for a standby service customer to prolong the duration of the standby event through the

unnecessary use of extremely low amounts of standby water during the remainder of the month (thereby artificially depressing the actual average day demand during a standby event).

f. "Non-Standby Water". The Agreed Standby Tariff provides that water used by an industrial or commercial customer on a regular basis in the normal course of its operations is considered "Non-Standby Water" and is priced through the rate blocks in the Company's general tariff. Id. at Section B.7. Any standby service customer may increase its use of Non-Standby Water through notification to the Company, and any additional water used after such notification will not be subject to the Agreed Standby Tariff. Id. at Section B.8.

5. The Industrial Intervenors were involved in the negotiations leading to this Supplemental Stipulation, but they have elected not to join in it. Counsel for the Public Systems has indicated that his clients have not yet had an opportunity to consider the Agreed Standby Tariff, and therefore they have taken no position on the Standby Tariff issue at the time of filing of this Supplemental Stipulation.

6. The Parties agree that the implementation of the Agreed Standby Service Tariff as recommended in this Supplemental Stipulation is a fair and reasonable resolution of the Standby Tariff issue.

7. This Supplemental Stipulation is entered into subject to the acceptance and approval of the Commission. It results from a review of all filings in these proceedings and extensive negotiation. It reflects substantial compromises by the Parties on the Standby Tariff issue and the modification of their respective positions asserted in this case, and is

being proposed to expedite and simplify the resolution of these proceedings and other matters. It is made without any admission or prejudice to any positions which any Party might adopt during subsequent litigation.

8. The Parties adopt the Supplemental Stipulation as being in the public interest, without adopting any of the compromise positions set forth herein as ratemaking principles applicable to future regulatory proceedings, except as may otherwise be provided herein. The Parties acknowledge that it is the Commission's prerogative to accept, reject, or modify any stipulation. However, in the event that the Supplemental Stipulation is modified or rejected by the Commission, it is expressly understood by the Parties that they are not bound to accept the Supplemental Stipulation as modified or rejected, and may avail themselves of whatever rights are available to them under law and the Commission's Rules of Practice and Procedure.

WHEREFORE, the Parties, on the basis of all of the foregoing, respectfully request that the Commission make appropriate findings of fact and conclusions of law adopting and approving the Supplemental Stipulation in its entirety, including the exhibit thereto.

Respectfully submitted,

Michael A. Albert, Esq.,
John Philip Melick, Esq.
Christopher L. Callas, Esq.
Counsel for West Virginia-American
Water Company

Meyishi Blair by Laura Wilson Short

Meyishi Blair, Esq., Counsel for
Staff of the Public Service
Commission of West Virginia

Ana C. Sade

David A. Sade, Esq., Counsel for
Consumer Advocate Division of the
Public Service Commission of West Virginia

Exhibit 1
Agreed Standby Service Tariff Applicable to Industrial and Commercial Customers Only

STANDBY SERVICE

A. APPLICABILITY

This rate is available to any Standby Service Customer, as hereinafter defined, throughout the territory served by the Company.

B. DEFINITIONS

For purposes of this Standby Service Tariff, the following definitions shall apply:

1. "Alternative Source of Supply" means any external or internal source of water supply other than water supplied by the Company, or any upgrade or modification to increase the capacity of an alternative source of supply placed in service after December 31, 2001 that, in either case, gives the customer an aggregate available average capacity of 100,000 gallons of water per day.

2. "Excess Demand Charge" means, with respect to any Excess Standby Event, a charge equal to the difference between the actual maximum day usage of Standby Water used during the Excess Standby Event and the Maximum Day Demand Requirement last nominated by or for the Standby Service Customer, multiplied by the applicable demand charge and further multiplied by the number of months (not to exceed six months) since the Standby Service Customer's most recent nomination or, if no renomination has been made, since the beginning of the standby service agreement.

3. "Excess Standby Event" means any Standby Event during which the amount of Standby Water used by the Standby Service Customer exceeds its existing Maximum Day Demand Requirement.

4. "Existing Alternative Source" means any Alternative Source of Supply actually used and operated by or on behalf of a customer of the Company on December 31, 2001.

5. "Existing Alternative Source Customer" means an existing large commercial or industrial customer of the Company that has an Existing Alternative Source.

6. "Maximum Day Demand Requirement" means, with respect to any nomination or renomination made or deemed made pursuant to Sections C.2, C.3, C.4 or C.6 below, the maximum day demand of Standby Water nominated by or for the Standby Service Customer.

7. "Non-Standby Water" means any water of the Company used by a Standby Service Customer or an Existing Alternative Source Customer on a regular basis in the normal course of its operations as reasonably determined by the Company.

8. "Standby Event" means any period during which a Standby Service Customer uses water provided by the Company (other than Non-Standby Water) because the availability of water from the Standby Service Customer's Alternative Source of Supply has been interrupted or curtailed, including but not limited to any situation in which an Alternative Source of Supply is taken off line for maintenance or repair of the Alternative Source of Supply itself or other components of the Standby Service Customer's operations.

9. "Standby Service Customer" means (i) a new or prospective large commercial or industrial customer that has an Alternative Source of Supply; (ii) an existing large commercial or industrial customer that does not have an Existing Alternative Source but that thereafter develops or obtains an Alternative Source of Supply; and (iii) an Existing Alternative Source Customer that, through the development of another Alternative Source of Supply or an upgrade or modification to the capacity of its Existing Alternative Source or both, increases the total monthly capacity of its Alternative Source(s) of Supply and consequently reduces its monthly purchases of water from the Company from the average monthly usage over the six-month period preceding the month during which the additional Alternative Source of Supply or the upgrade or modification of the Existing Alternative Source is placed into service. Any successor-in-interest to the ownership or operation of an Alternative Source of Supply (including to the ownership or operation of an upgraded or modified Existing Source of Supply as described in clause (iii) of the preceding sentence) shall also be deemed a Standby Service Customer.

10. "Standby Water" means, as the context requires, (i) any water expected to be provided by the Company to a Standby Service Customer during an expected Standby Event in excess of the average daily amount of Non-Standby Water expected to be used during the expected Standby Event, or (ii) any water actually provided by the Company to a Standby Service Customer during an actual Standby Event in excess of the average daily amount of Non-Standby Water, if any, used during the 30-day period preceding the beginning of the Standby Event.

C. TERMS AND CONDITIONS

1. Standby service will be available on a firm basis only.

2. Each Standby Service Customer shall notify the Company in writing on a form to be furnished by the Company within ten days of the in-service date of its Alternative Source of Supply or an upgrade or modification of an Existing Source of Supply and shall therein make application for standby service if it wishes to remain connected to the Company's water system or to remain a Company customer. The notification shall include the maximum day capacity of each Alternative Source of Supply and the Standby Service Customer's nomination of its Maximum Day Demand Requirement. The nomination of the Maximum Day Demand Requirement shall be at the Standby Service Customer's discretion and the Standby Service Customer may make a renomination on that basis as provided in Section C.3 below, but the Company shall have no obligation to guarantee service above the nominated levels. Each Standby Service Customer that increases the

aggregate capacity of its Alternative Source(s) of Supply, through the upgrade or modification of an Existing Alternative Source or the development of another Alternative Source of Supply or both, shall likewise notify the Company of the increase in its aggregate additional capacity within ten days of the in-service date of the upgrade or modification of the Existing Alternative Source or the additional Alternative Source of Supply.

3. Upon its acceptance and execution by the Company, the application shall become the standby service agreement between the Company and the Standby Service Customer. The term of a standby service agreement shall be ten years from the date of acceptance and execution by the Company or another reasonable term agreed to by the Standby Service Customer and the Company. Except as provided in the last sentence of Section C.6 below, the Standby Service Customer may renominate its Maximum Day Demand Requirement on each anniversary date of the agreement.

4. Any customer that retains a connection to the Company's system but that fails to notify Company as required in Section C.2 above shall nonetheless be deemed a Standby Service Customer as though an application for standby service had been made and accepted by the Company. In this case, the Company shall nominate the Standby Service Customer's Maximum Day Demand Requirement by determining the average day demand based on the capacity of the Standby Service Customer's Alternative Source of Supply and then calculating the maximum day demand with reference to the ratio between that figure and average day demand for industrial customers established in the Company's most recent customer class demand study.

5. To the extent possible, each Standby Service Customer shall (i) make written notification to the Company of its intention to obtain Standby Water from the Company as soon as practicable, (ii) provide with that notice the expected daily quantities of Standby Water and the expected duration of the Standby Event, and (iii) provide to the Company within 30 days of the beginning of the Standby Event a written description of the cause of the interruption or curtailment of its Alternative Source(s) of Supply that occasioned the Standby Event. Each Standby Service Customer shall make written notification to the Company of its intention to cease obtaining Standby Water from the Company and the anticipated end of each Standby Event.

6. In the case of an Excess Standby Event, (i) the Standby Service Customer's actual usage of Standby Water during the Excess Standby Event shall be the basis for the Company's determination of the Standby Service Customer's new Maximum Day Demand Requirement for a period of twelve months beginning with the month next following the month during which the Excess Standby Event occurred, at the end of which period the Standby Service Customer shall have the opportunity to renominate its Maximum Day Demand Requirement; and (ii) the Standby Service Customer shall pay an Excess Demand Charge, at its election, either (x) in a lump sum during the month next following the month during which the Excess Standby Event occurred, or (y) in equal monthly installments over a period to be selected by the customer not to exceed 24 months, together with a monthly carrying charge of 8% per annum on the outstanding balance. The Standby Service Customer shall forfeit its right to annual renomination described in Section C.3 above during the

period described in clause (i) of the first sentence of this Section C.6 and shall thereafter be entitled to annual renomination on each anniversary of the end of the twelve-month period described in such clause.

7. Each Standby Service Customer shall pay the Company the cost, including installation, of all metering equipment, including meter interface units, that the Company, in its judgment, determines to be necessary to properly implement this standby service tariff and to monitor the Standby Service Customer's compliance with its terms and conditions.

8. All Non-Standby Water provided to a Standby Service Customer will be billed pursuant to the Company's general tariff. A Standby Service Customer or an Existing Alternative Source Customer may at any time inform the Company that it intends to increase its use of Non-Standby Water due to an expected increase in the size, scope or pace of its operations or a change in its processes or procedures that will require the Standby Service Customer or Existing Alternative Source Customer to take more Non-Standby Water. If such a notification is made and is accompanied by such information to the Company as it may reasonably request to demonstrate that the requested increase is not attributable to an expected interruption or curtailment of an Alternative Source of Supply, the subsequent increased usage by the Standby Service Customer or Existing Alternative Source Customer will be considered to be Non-Standby Water and will not be subject to the standby service tariff.

D. RATE

Each Standby Service Customer shall pay to the Company service charges, demand charges and consumption charges, calculated as follows:

1. Unless a Standby Service Customer already pays a service charge by virtue of its purchase of Non-Standby Water, each Standby Service Customer shall pay a monthly service charge that is identical to that which would otherwise be applicable under the Company's general tariff.

2. Each Standby Service Customer shall pay the following monthly demand charge applied to the Standby Service Customer's nominated Maximum Day Demand Requirement at the time the Company renders the bill:

Maximum Day Demand $69.92 per thousand gallons

3. Each Standby Service Customer shall pay consumption charges for all Standby Water delivered during a Standby Event at the rate of $0.326 per thousand gallons.

CERTIFICATE OF SERVICE

I, Christopher L. Callas, as counsel for West Virginia-American Water Company, do hereby certify that I served the foregoing on the parties of record by hand-delivering a copy of the same to them this 12th day of October 2001, addressed as follows:

Meyishi Blair, Esq.
Staff Counsel
Public Service Commission
201 Brooks Street
P. O. Box 812
Charleston, West Virginia 25323

David A. Sade, Esquire
Consumer Advocate
Public Service Commission
700 Union Building
723 Kanawha Boulevard, East
Charleston, WV 25301

Robert R. Rodecker, Esquire
1210 Bank One Center
P. O. Box 3713
Charleston, WV 25337

T. D. Kauffelt, Esquire
Kauffelt & Kauffelt
Kanawha Valley Building
P. O. Box 3082
Charleston, WV 25331

Jennifer Scragg
Putnam County Commission
3389 Winfield Road
Winfield, WV 25213

Christopher L. Callas

030353comg010204.wpd

PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA
CHARLESTON

At a session of the PUBLIC SERVICE COMMISSION OF WEST VIRGINIA in the City of Charleston on the 2nd day of January, 2004.

CASE NO. 03-0353-W-42T

WEST VIRGINIA-AMERICAN WATER COMPANY
Tariff Rule 42 application to increase
water rates and charges.

COMMISSION ORDER

The Commission is herein presented with the first fully litigated rate case brought by the West Virginia American Water Company (Company) since 1994. After an evidentiary hearing and review of all submitted testimony and argument, the Commission herein authorizes a return on equity of 7.00%, an overall return of 6.63, on a rate base of approximately $394,150,000, and a revenue requirement of approximately $98,885,000.

Procedure

On March 11, 2003, the Company tendered for filing revised tariff sheets reflecting increased rates and charges of approximately 16.4% annually, or $15,550,687, for furnishing water utility service to approximately 164,000 customers in Boone, Braxton, Cabell, Clay, Fayette, Harrison, Kanawha, Lewis, Lincoln, Logan, Mason, Mercer, Putnam, Raleigh, Summers, Wayne and Webster Counties, to become effective on April 11, 2003. In addition to increased commodity rates, the filing requested the institution or increase of certain non-commodity charges, such as the delayed payment penalty, a returned check charge, a tap fee, a reconnection fee, and a leak adjustment rate (collectively referred to as "cost causer" or Customer Specific tariff items).

In addition to its own customers, customers of the following utilities or entities would be directly or indirectly affected by the rate application because these utilities or entities, under agreements approved by the Public Service Commission, are charged water rates which are based on the Company's rates, either in whole or in part: Boone County Public Service District, Cumberland Road Public Service District, the Town of Danville, the Town of Eleanor, Jumping Branch-Nimitz Public Service District, the Kanawha County Regional

Development Authority, Lashmeet Public Service District, the Lewis County Economic Development Authority, New Haven Public Service District, Oakvale Road Public Service District, the Putnam County Building Commission, Putnam-Union Public Service District and Salt Rock Water Public Service District.

In its filing the Company asserted that it had complied with the notice requirements of Rule 10.1.b of the Commission's Rules for the Construction and Filing of Tariffs (Tariff Rules).

The Commission notes that throughout the course of this proceeding it has received a large number of letters filed in protest of the Company's proposed rate increase. The volume of letters prompted the Commission to hold a number of public comment hearings in cities across the Company's service area.

On March 13, 2003, the Consumer Advocate Division of the Public Service Commission (CAD) filed a petition to intervene in this proceeding, asserting that this application constitutes a major proceeding with the potential for an adverse impact upon the Company's ratepayers.

On March 17, 2003, the Company filed a Motion for Approval of Procedures and a Protective Agreement for Security Costs and Related Information. The Company sought to prevent the unauthorized disclosure of protective measure materials, capital, operational and maintenance costs, and other information that have been or may be generated incident to the Company's ongoing efforts to safeguard its customers, facilities, and personnel from potential threats and acts of terrorism.

On March 18, 2003, Commission Staff (Staff) filed its Initial Joint Staff Memorandum, indicating that its investigation of this application had begun. Additionally, Staff asserted that the Company had recently failed to timely comply with procedural deadlines.

On March 26, 2003, the Brotherhood of Locomotive Engineers filed a letter objecting to the proposed rate increases and a notice of intervention in this proceeding. However, the petition to intervene filed by the Brotherhood of Locomotive Engineers did not comply with the requirements of the Commission's Rules of Practice and Procedure (Procedural Rules).

Also on March 26, 2003, the Company responded to the Initial Joint Staff Memorandum, taking issue with the allegation regarding its failure to timely comply with deadlines.

On March 28, 2003, Flexys America, LP, filed a petition to intervene herein as a major customer of the Company.

On March 31, 2003, the State of West Virginia, by its Attorney General, filed a petition to intervene in this proceeding.

Also on March 31, 2003, the Company filed a request with the Commission for an enlargement in the procedural schedule of the time between the filing of prepared direct testimony and prepared rebuttal testimony. The Company requested this change in order to allow the Company sufficient time to thoroughly review and respond to the direct testimony of the intervenors and Staff in the Company's rebuttal testimony.

On April 1, 2003, Lavalette Public Service District (Lavalette PSD) filed a petition to intervene in this proceeding, as a resale customer of the Company.

On April 2, 2003, the Commission issued its Order suspending the revised tariff sheets and increased rates and charges requested by the Company until 12:01 a.m., January 6, 2004, unless otherwise ordered by the Commission. The petition to intervene filed by the CAD was granted. The petition to intervene filed by the Brotherhood of Locomotive Engineers was not granted because of its failure to comply with the Commission's Procedural Rules. The Brotherhood of Locomotive Engineers was granted twenty (20) days from the date of the April 2, 2003, Order to file a petition to intervene in compliance with the Commission's Procedural Rules. Additionally, the Commission order established a procedural schedule for processing and resolving this case, which, among other things, set this matter for evidentiary hearing to begin on September 8, 2003. Finally, the Commission referred the handling of discovery matters, including ruling on the Company's March 17, 2003, motion, to the Division of Administrative Law Judges (ALJ).

On April 3, 2003, the Kanawha County Commission filed a petition to intervene in this proceeding. The Kanawha County Commission filed an amended and supplemental petition to intervene on April 8, 2003. Also on April 8, 2003, the Regional Development Authority of Charleston filed a petition to intervene.

On April 9, 2003, Supervising Attorney Caryn W. Short and Earl E. Melton, P.E., Director of the Commission's Engineering Division, filed a letter with the Commission's Executive Secretary authorizing Staff Attorney C. Terry Owen and Chief Utilities Manager James W. Ellars, P.E., to have access to protected materials during the litigation of this proceeding. The authorization was filed in accordance with the provisions of Paragraph 2.B. of the proposed protective agreement filed by the Company with its March 17, 2003, motion.

Also on April 9, 2003, Staff filed its response to the Company's March 17, 2003, motion regarding protective treatment, stating that Staff had reviewed the proposed protective agreement and did not object to its approval by the Commission. Staff represented that it had been authorized by the CAD to state that the CAD had no objection to the protective agreement as proposed by the Company. On April 9, 2003, the CAD filed a letter stating it did not object to the Company's protective agreement as filed March 17, 2003.

On April 9, 2003, the Company filed its "Certificate of Posting, Publication, and Separate Mailing of Notice to Customers of Change in Tariff."

On April 10, 2003, the Commission's Chief ALJ issued a "Procedural Order on Discovery Matters." That order approved the use of the protective agreement proposed by the Company in its filing of March 17, 2003.

The South Putnam Public Service District (South Putnam PSD) filed a petition to intervene on April 14, 2003.

A petition to intervene was also filed on April 15, 2003, by Clearon Corporation, E.I. DuPont de Nemours and Company, Elementis Specialties, and Union Carbide Corporation (collectively, the Industrial Intervenors).

The Commission received a petition for leave to intervene on April 21, 2003, from the Brotherhood of Locomotive Engineers, West Virginia State Legislative Board. Also on April 21, 2003, the Commission received a single petition to intervene from the Boards of Education of Boone, Braxton, Kanawha, Lincoln, and Putnam Counties.

The City of Charleston filed a petition to intervene on April 24, 2003.

The Company filed, on April 29, 2003, a request for modification of the procedural schedule to allow additional time in which to review the direct testimony of the other parties.

The Cabell County Board of Education filed a petition to intervene on May 1, 2003.

On May 1, 2003, the Company filed its direct testimonies and associated exhibits of Roy L. Ferrell, Sr.; Paul R. Herbert; Chris E. Jarrett; Michael A. Miller; Kendall Mitzner; Paul R. Moul; and Edwin L. Oxley. Additionally, the Company filed a revised Rule 42T exhibit along with revised supporting work papers.

On May 7, 2003, the Company filed affidavits of publication of its proposed tariff changes in all of the required locations except Charleston, Logan, and Weston. The Company noted that it had confirmed publication in those areas and would provide affidavits of publication once they were available.

On May 7, 2003, the Company filed a correction to a portion of the direct testimony of Chris E. Jarrett.

On May 8, 2003, the Company filed copies of its annual reports along with the annual reports of the American Water Company.

On May 13, 2003, the Commission received a "Petition to Intervene" from the Board of Education of Wayne County (Wayne County BOE). The Wayne County BOE stated that it wished to intervene on the same basis as asserted by the Boards of Education of Boone, Braxton, Cabell, Kanawha, Lincoln, and Putnam Counties (previously approved by the Commission). (Hereinafter the respective Boards of Education shall be referred to collectively as, the BOE.)

The Commission issued an order on May 14, 2003, which granted several petitions to intervene[1], set a procedural schedule for use in this case, and set forth a schedule of public comment and protest hearings. Additionally, the order required the Company to publish notice of the hearings scheduled in this case.

On May 15, 2003, Staff filed its authorization for access to the protected materials of the Company.

The Company filed the remaining affidavits of publication on May 19, 2003.

Also on May 19, 2003, the Company filed a "Motion for Clarification of Commission Order of May 14, 2003." Therein, the Company requested that (1) the Commission require the testimony to be filed by Staff, CAD, and any interveners on August 19, 2003, be the direct testimony of Staff, CAD, and any interveners, addressing the substantive issues raised in the Company's testimony filed on May 1, 2003, and (2) the Commission require that the rebuttal testimony to be filed on September 9, 2003, be limited to issues raised by parties other than the Company in the August 19, 2003, testimony.

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[1]The order did not address the Petition to Intervene of the Wayne County BOE.

On May 20, 2003, the City of South Charleston filed a "Petition to Intervene." The City of South Charleston requested permission to join with the intervention of the City of Charleston (collectively, the Cities).

On June 11, 2003, the Commission issued an order clarifying its previous procedural schedule in response to the May 19, 2003, motion by the Company. Inadvertently, the Commission included incorrect dates in its second ordering paragraph. The Commission corrected its error via an order issued on June 18, 2003.

The BOE filed an objection on June 12, 2003, to certain information requested by the Company through interrogatories. The Cities also filed an objection on June 18, 2003, to requests made of them through interrogatories by the Company.

On June 15, 2003, the Commission issued an order scheduling an additional public comment hearing for August 26, 2003, in Flatwoods, West Virginia.

The BOE filed objections to certain items within the Company's second request for information through a filing made August 1, 2003.

The Company filed a motion to compel on August 6, 2003, to require the BOE to respond to the Company's second request for information.

On August 7, 2003, Staff filed a response to the Company's August 5, 2003, letter regarding synergy savings.

The CAD filed a motion for leave to file supplemental direct testimony on August 13, 2003. The Company filed its reply to the response of the BOE to the Company's motion to compel on August 18, 2003.

The BOE responded to the Company's motion to compel through its own filing made August 14, 2003.

The Company submitted its affidavits evidencing statewide publication on August 15, 2003.

On August 18, 2003, the Commission conducted the first of several hearings for the purpose of taking public comment on the Company's proposed rate increase. The first meeting was held in Princeton. Additional hearings were held August 21 in Huntington, August 26 in Flatwoods and in Weston, August 27 in Fayetteville, and August 28 in Charleston.

On August 19, 2003, the BOE filed the "Direct Testimony of Dr. Ronald Duerring" and the "Direct Testimony of D. Wayne Trimble."

On August 19, 2003, Staff filed a response to the CAD motion for leave to file supplemental direct testimony.

On August 19, 2003, Commission Staff filed the direct testimonies of Diane Davis Calvert, James W. Ellars, Dixie L. Kellmeyer, Robert R. McDonald, Paul P. Stewart, and Staff's Rule 42 Exhibit.

The CAD filed the direct testimonies of David E. Peterson, Scott J. Rubin, and Randall R. Short on August 19, 2003.

The City of South Charleston filed the "Direct Testimony of Mayor Richard A. Robb on August 19, 2003.

The Lavalette and South Putnam PSDs filed a letter on August 19, 2003, stating that they did not plan to file direct testimony.

The "Direct Testimony of Susan Blake" was filed by the County Commission of Kanawha County and Regional Development Authority on August 19, 2003.

The City of Charleston filed the "Direct Testimony of Mayor Danny Jones" on August 19, 2003.

On August 19, 2003, the CAD filed the "Supplemental Direct Testimony of Scott J. Rubin."

On August 19, 2003, the Chief ALJ issued an order requiring the BOE to provide full and complete responses to the requests filed by the Company on August 27, 2003, in resolution of a discovery dispute.

On August 19, 2003, the "Direct Testimony of Ernest Harwig" was filed on behalf of the Industrial Intervenors.

On August 21, 2003, the Company filed "West Virginia-American Water Company's Motion to Strike Certain Proffered Testimony of CAD Witness Scott J. Rubin and Request for Expedited Ruling." The Company argued that the CAD witness was advancing an extra-legal position. The Company further argued that CAD witness Mr. Rubin's,

radical public policy argument, if given credence in this case as a legitimate basis of rate design, would fundamentally and forever alter the role of this Commission in evaluating and setting rates for utility services, and would require this Commission to engage in wide-ranging legislative policy-making far beyond its jurisdiction. Accordingly, in order that all parties may focus their efforts and testimony prior to and during the hearing in this case on matters properly within this Commission's purview, the Company respectfully requests an expedited ruling on this motion.

By letter filed August 25, 2003, the Cities suggested bringing the parties together for the purpose of discussing outstanding issues.

On August 28, 2003, the Commission issued an order denying the Company's August 21, 2003, motion to strike the testimony of the CAD regarding Affordability.

On August 29, 2003, the CAD filed corrected schedules to the testimony of Randall R. Short.

Between September 2 and September 8, 2003, the Commission received the transcripts for the public comment hearings held in Charleston, Fayetteville, Flatwoods, Huntington, Princeton, and Weston.

On September 9, 2003, the following documents were filed with the Commission:
From the Company: the rebuttal testimonies of (1) Patrick L. Baryenbruch (along with the "West Virginia-American Water Company Assessment of Service Company Services" prepared by Baryenbruch & Company, Test Year Ended December 31, 2003) ; (2) Roy L. Ferrell, Sr.; (3) Paul R. Herbert; (4) Chris E. Jarrett; (5) Christopher K. McKenna (along with the "West Virginia-American Water Company Customer Survey" prepared by Madonna Young Opinion Research, August 2003); (6) Michael A. Miller; (7) Paul R. Moul; (8) Edwin L. Oxley; (9) James E. Salsar (10) Eugene M. Zdrojewsky, Jr.; (11) Thomas M. Zepp
From the BOE: the rebuttal testimony of D. Wayne Trimble
From the CAD: rebuttal testimony of Scott J. Rubin
From the Industrial Intervenors: rebuttal testimony of Ernest Harwig
From the City of Charleston: rebuttal testimony of Mayor Danny Jones
From the City of South Charleston: rebuttal testimony of Mayor Richard A. Robb

On September 9, 2003, Staff filed "Staff's Motion for Leave to File Supplemental Direct Testimony Out of Time." Staff moved to provide the supplemental direct testimony

of James W. Ellars in that it addressed certain security cost data that Staff had not had sufficient time to address in its direct testimony. Additionally, Staff submitted the rebuttal testimony of Diane Davis Calvert.

On September 10, 2003, the Company filed a "Motion to Strike Rebuttal Testimony of [Consumer Advocate Division witness] Scott J. Rubin." The Company stated that such testimony responded to a document (the Madonna Young report) provided to the CAD as a supplemental data response on August 8, 2003. The Company argued that the CAD had violated the provisions of the Commission's orders of June 11 and 18, 2003, regarding the content of filed testimony.

On September 12, 2003, the CAD filed its "Response of the Consumer Advocate Division to the West Virginia-American Water Company's Motion to Strike Rebuttal Testimony of Scott J. Rubin and Counter-Motion to Strike the Rebuttal Testimony of Christopher K. McKenna and Eugene M. Zdrojewski." The CAD argued that the rebuttal testimonies of Company witnesses McKenna and Zdrojewski were improperly filed.

On September 15, 2003, the Company filed a reply to the CAD response to Company's motion to strike.

The Commission entered an order on September 16, 2003, granting Staff's motion for leave to file supplemental direct testimony out of time as well as denying the motion to strike the testimony of CAD witness Rubin.

On September 17 through September 23, 2003, this matter came before the Commission for an evidentiary hearing. The parties were present and represented as follows: (1) the Company by Michael A. Albert, Esq., John Philip Melick, Esq., and Christopher L. Callas, Esq.; (2) Staff by C. Terry Owen, Esq. and Leslie J. Anderson, Esq.; (3) the CAD by Billy Jack Gregg, Esq. and David A. Sade, Esq.; (4) Attorney General by Silas B. Taylor, Esq.; (5) BOE by James V. Kelsh, Esq.; (6) the Cities by Lee F. Feinberg, Esq. and Susan J. Riggs, Esq.; (7) Industrial Intervenors by Mark E. Kauffelt, Esq.; (8) Kanawha County Commission by Raymond Keener, III, Esq.; (9) Lavalette PSD and South Putnam PSD by Robert R. Rodecker, Esq.; (10) Regional Development Authority of Charleston by Martin J. Glasser, Esq.; and (11) West Virginia State Legislative Board, Brotherhood of Locomotive Engineers by Susan K. Conner, Esq.

Each day of hearing was reduced to a transcript as follows:

Tr. Vol. I, September 17, 2003, 231 pages;
Tr. Vol. II, September 18, 2003, 198 pages;
Tr. Vol. III, September 19, 2003, 176 pages;
Tr. Vol. IV, September 22, 2003, 268 pages; and
Tr. Vol. V, September 23, 2003, 214 pages.

At the hearing, Company witness Michael A. Miller specified adjustments to the Company's case which brought the Company's total request down to approximately $14.9 million. Tr. Vol. II at pp. 96-97.

On September 22, 2003, the Kanawha County Commission filed the direct testimony of its president, Kent Carper.

On September 26, 2003, the CAD filed its Post Hearing Exhibit No. 1. The Staff's Post Hearing Exhibit No. 1 was filed on September 29, 2003.

On September 30, 2003, per an in-hearing Commission request, the CAD filed a copy of a U.S. Supreme Court decision referred to in the hearing.

On October 15, 2003, the Company filed a copy of its interim synergy statement as required by Case No. 01-1691-W-PC.

The CAD filed its Revised Post Hearing Exhibit No. 1 on October 16, 2003.

The Company filed a revision of its Exhibit 10 (Exhibit 10A) on October 20, 2003. Such filing was made in response to the October 16, 2003, submission of CAD witness Peterson.

Initial Briefs were filed by the following parties on November 3, 2003: the Company, the BOE, Cities, Industrial Intervenors, Kanawha County Commission, Lavalette PSD and South Putnam PSD, the CAD, and Staff;

On November 3, 2003, the CAD filed errata sheets identifying a number of corrections to the transcript.

On November 5, 2003, the Office of the Attorney General filed a letter stating that no initial brief would be submitted by the Attorney General's office.

Reply Briefs were filed by the following parties on November 17, 2003: the Company; BOE, the Cities, Kanawha County Commission, the CAD, and Staff.

On November 19, 2003, the West Virginia Office of the Attorney General filed a letter containing comments in lieu of a reply brief.

On November 20, 2003, the Company filed a letter responding to the Staff initial and reply brief arguments. Staff responded by a letter filed November 25, 2003.

DISCUSSION

The Commission has not decided a fully litigated rate case filed by the Company since Case No. 94-0138-W-42T. In this case the Commission has the opportunity to address a wide range of issues that, hopefully, will assist in narrowing the contested issues in future Company rate case filings.

While the Company has filed requests for rate increases since 1994, those cases have resulted in settlements between the participants which either eliminated or significantly reduced any outstanding issues between the parties to the cases.

The last Company rate filing prior to this case was designated Case No. 01-0326-W-42T. In that filing, the Company had originally requested a 12.8% increase in rates. The Commission entered an order on December 21, 2001, adopting a Joint Stipulation and Agreement for Settlement, along with a corresponding Supplemental Stipulation and Agreement for Settlement. As part of those joint stipulations, the signatory parties agreed that the rates and charges would be increased across-the-board by 5%, effective December 31, 2001. Further, the Company agreed to not make a general rate filing which would result in any change in the Company's rates and charges sooner than December 31, 2002. Issues that were not fully stipulated in that case included the adoption of a Stand-By Tariff and the appropriate treatment of new security related costs being incurred by the Company.

In its December 21, 2001, order in Case No. 01-0326-W-42T, the Commission approved a modified Stand-By Tariff over the objection of several intervenors to the case. Additionally, the Commission ordered the Company to defer the actual costs incurred in increasing the security of the Company's systems on its books of account as a regulatory asset for presentation in the Company's next rate case.

Subsequent to the 2001 rate case, the Company and Thames Water Aqua Holdings GMBH (Thames) filed a petition seeking the Commission's consent and approval of the acquisition of the outstanding common stock of American Water Works Company, Inc.

(AWW), the parent company and controlling shareholder of the Company, by Thames, a wholly owned subsidiary of RWE Aktiengesellschaft (RWE). See Case No. 01-1691-W-PC (the Acquisition Case). As part of a settlement reached by the parties to that case, which the Commission adopted with certain modifications in an order entered on October 23, 2002, the parties agreed that the Company would file its next general rate case no earlier than March 7, 2003, based on a 2002 historical test year, with any changes in the Company's rates and charges from such case to be implemented no earlier than January 1, 2004. Id. at p.40 and Conclusion of Law No. 8 at p. 48. The parties to the Acquisition Case agreed, among other things, that RWE, Thames, AWW, and the Company would make no attempt to allocate or assign to the Company any portion of the purchase price in connection with the transaction or to recover from the Company's customers any portion of the acquisition premium or purchase price for the AWW common stock or any other costs associated with the acquisition. Id. at Joint Stipulation and Agreement for Settlement, p. 7, paragraphs M and L.

In the Company's present filing it originally requested a little over a 16% increase in rates (later revised to an increase of slightly less than 15%). In order to determine the proper disposition of the Company's request, the Commission reviewed all testimonies, briefs, motions, letters of protest and support, and other filings made by the parties, intervenors, and protestants. Additionally, the Commission presided over six public protest hearings and one evidentiary hearing which extended over a five day hearing. The Commission has given careful consideration to all issues raised in this case in reaching its decision. Those issues are addressed on the following pages.

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Affordability

Part of the CAD's proposal for the Commission's disposition of this case included an argument that the Commission should not authorize any increase in rates because the Company's rates were already too high and customer bills at any higher rate level would not be affordable.

The Commission is legislatively charged to consider the interests of the state as a whole in addition to the interests of the individual utilities and ratepayers. West Virginia Code §24-1-1(a) reads in part:

> (a) It is the purpose and policy of the Legislature in enacting this chapter to confer upon the public service commission of this state the authority and duty to enforce and regulate the practices, services and rates of public utilities in order to:
>
> (1) Ensure fair and prompt regulation of public utilities in the interest of the using and consuming public;
>
> (2) Provide the availability of adequate, economical and reliable utility services throughout the state; . . .
>
> (4) Ensure that rates and charges for utility services are just, reasonable, applied without unjust discrimination or preference . . . and based primarily on the costs of providing these services.

West Virginia Code §24-1-1(b) states that in carrying out these purposes "[t]he public service commission is charged with the responsibility for appraising and balancing the interests of current and future utility service customers, the general interests of the state's economy and the interests of the utilities subject to its jurisdiction in its deliberations and decisions."

Even so, the specific concept of Affordability as the sole reason to deny a rate increase as raised by the CAD is an issue of first impression for this Commission.

The CAD asserts that the Company's customers have been subjected to fifteen rate increases over the last ten years, totaling $38.8 million, and averaging approximately $3.8 million per year. Testimony of David Peterson, CAD Exhibit 3, p. 3. Furthermore, the CAD noted that in 1996, a residential customer of the Company using 4,500 gallons of water per month had a bill of $23.53. Under present rates, CAD argued that customers pays $36.23

for that same usage level. In the current case, the Company, prior to revising its request, is proposing that rates for that same residential customer be increased an additional 16.7% to $42.29 per month. Direct Testimony, Randall R. Short, p. 13.

The CAD presented extensive testimony to address the ability of West Virginia ratepayers to afford the Company's present rates in addition to the day-to-day costs of maintaining a household. The CAD concluded that the Commission should deny any increase in this case until such time as the income of the Company's customers improves or the Company can show that it requires additional revenue to avoid financial distress.

The Attorney General urges the Commission to give as much consideration to the welfare and dignity of the Company's customers as the Company demands be given to its parent-company's investors. Considering the relative impact of a rate increase on both groups, as set forth in detail by the Consumer Advocate, it is manifestly "just and reasonable" to reject the Company's request for a rate increase. Letter of the Attorney General, November 19, 2003, at p. 2.

South Putnam PSD and Lavalette PSD argued to discredit the Affordability concept.

The Kanawha County Commission argued in favor of it.

The highest courts of West Virginia and the United States have made clear that utility investors are constitutionally entitled to a reasonable opportunity to make a fair rate of return on their investments to serve the public. In Bluefield Water Works & Improvement Co. v. Public Service Commission, 262 U.S. 679 (1933), the United States Supreme Court established the tests which a rate order must meet in order to avoid being unconstitutionally confiscatory, and set forth the three tests generally referred to today as the comparable earnings test, the financial integrity test, and the capital attraction test. As the Court stated regarding the constitutionally-required return:

> The return should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under efficient and economic management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

Bluefield, 262 U.S. at 692-93. Rates which, in end result, do not meet the requirements of the comparable earnings, financial integrity, and capital attraction tests "are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment." Id. at 690.

The Court reiterated this concept in Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944):

> [T]he return to the equity owner should be commensurate with returns on investment in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

Hope, 320 U.S. 591, 603. Thus, the Court in Hope reiterated the three tests set out in Bluefield, with the exception that the test of a reasonable return on the "fair value" of utility's rate base was replaced with the test of a reasonable return to the equity owner. Hope left intact the "end results test" of its decision in Bluefield, including the requirement of a sufficient return to the equity owner.

As stated by the Company, "[t]he affordability analysis would turn the Commission's historic ratemaking practice on its head, and would require a radical departure from the filing requirements in the Tariff Rules." It also does not go without notice that the CAD is contending that the Company's current rates are unreasonable but that the Company is entitled to a rate increase if the Commission rejects CAD's Affordability argument. The Company was correct in its assessment that the Company's current rates are not the result of rampant and uncontrolled rate increases, but rather stem from stipulated recommendations to the Commission involving the Staff and the CAD. Company Initial Brief at p. 5.

The Bluefield and Hope cases were quoted extensively by the parties in this matter. Under the current state of the law the Commission can not find the basis to deny a rate increase based solely upon the concept of Affordability. Utilities making a reasonable and prudent investment in plant are entitled to a return on that investment. Clearly, the Commission can protect the public against "rampant and uncontrolled" rate increases that result from inefficiency and/or imprudent management decisions. The costs of such inefficiencies or imprudent decision can be eliminated in the determination of revenue requirements. The CAD and other parties are free to provide evidence of inefficiency or imprudent expenditures. However, it simply flies in the face of long standing regulatory legal principles and due process rights if a party explicitly or implicitly accepts expenses as being prudently incurred and yet argues that a utility should not be given the opportunity to recover such prudent expenses.

While the Commission is sensitive to the continuing difficulties of citizens of the State of West Virginia to pay increasing bills, Affordability is not an exclusive issue the Commission can utilize to justify denying the Company a return on its investment, including

a reasonable level of profit. However, the Commission intends to examine carefully each cost element that the Company believes is driving its request for a rate increase.

The CAD's request that the Commission should deny any increase in this case until such time as the income of the Company's customers improves or the Company can show that it requires additional revenue to avoid financial distress shall be denied.

RATE OF RETURN

Return on Equity

The Public Service Commission has long held that rates should be set which allow a public utility an opportunity to earn a sufficient level of revenue that will enable the utility to attract capital in the competitive money market, yet which also balance this ability with the interest of the consuming public in receiving fair and reasonable rates. Bluefield Water Works and Improvement Company v. Public Service Commission, 320 U.S. 679 (1923); Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 591, 64 S.Ct. 281 (1944); Permian Basin Area Rate Cases, 390 U.S. 747, 88 S.Ct. 1344 (1968); Monongahela Power Company v. Public Service Commission, 276 S.E.2d 179 (W. Va. 1981).

As we previously stated, rate cases in general require the Commission to consider the interest of not only the investors, but also the consumers when determining a reasonable rate of return. Case No. 94-0138-W-42T, at pp. 47-48. The rate of return should be sufficient to assure confidence in the financial condition of the utility and to enable to the utility to maintain its credit and to raise money for the proper discharge of its duties. Id.

That said, the determination of an appropriate cost of common equity is generally one of the most contentious issues in a rate proceeding and it is certainly true in this case. It is not unusual to find that the witnesses presenting testimony on the cost of common equity capital use the same or similar methodologies, but end up with significantly different results. Indeed, this Commission has noted in the past that, "all of these methods represent artful analyses rather than exact science and none of them can be said to produce a finite "correct answer" to the exclusion of the others. These studies are useful in providing trends and data that is susceptible to interpretation, but the ultimate answer regarding investor expectations must rely heavily on the judgement of the Commission." Appalachian Power Company, Case No. 91-026-E-42T (Commission Order, November 1, 1991), at p. 4.

In determining the cost of common equity for a regulated utility, it is generally accepted that one must look at investor expectations of that utility's stock price, earnings, dividends and book value, among other things. When a stock is publicly traded such a

determination benefits from observation of the stock's experience in the market place. However, the Company's stock is not publicly traded. Instead, all of its stock is owned by its parent company and, accordingly, the cost of equity capital witnesses in this case had to make various assumptions when determining the appropriate return on equity.

The following is an overview of the positions of the return on equity witnesses:

Paul R. Moul presented evidence on behalf of the Company on the issue of rate of return on equity. Mr. Moul recommended that the Company be afforded an opportunity to earn a rate of return on common equity within the range of 10.00% to 11.50%. The Company then elected to seek a return on common equity of 10.25%. Direct Testimony, Paul R. Moul, p.1.

Mr. Moul relied upon four methodologies to arrive at his return recommendation. He used a Discounted Cash Flow Model (DCF), Risk Premium Analysis (RP), a Capital Asset Pricing Model (CAPM), and a Comparable Earnings Analysis (CE). In determining a reasonable range for return on common equity, he analyzed a proxy group of six water companies and a second proxy group of ten natural gas utilities. Based upon his utilization of the DCF and RP analyses by themselves he arrived at his recommendation. More specifically, his findings were:

		Water Group	Gas Group	Average
DCF		9.52%	11.47%	10.50%
RP		11.75%	12.00%	11.88%
CAPM		14.65%	14.69%	14.67%
CE		14.80%	14.80%	14.80%

Direct Testimony, Paul R. Moul, p. 4.

The average of the DCF and RP models for the Water Group was 10.64%. With the addition of the Gas Group, the average for those two models rose to 11.19%.

The DCF model seeks to determine the value of an asset as the present value of future expected cash flows discounted at the appropriate risk-adjusted rate of return. According to Mr. Moul, the DCF methodology has limitations. Direct Testimony, Paul R. Moul, pp. 19-33. The DCF model has two major components: the dividend yield and the expected or reasonable growth rate. Mr. Moul utilized 5.25% as the growth rate for the Water Group and 5.75% for the Gas Group. He used 3.73% and 4.99% as the dividend yield components

for the Water Group and the Gas Group respectively. With these factors, he also adjusted the outcome of the model upward with an adaptation of his interpretation of the Modigliani and Miller (M&M) theories. Mr. Moul argued that DCF determined costs of equity should be adjusted to reflect the role of leverage in a firm's capital structure. The M&M theory attaches higher risk to investments which are more highly leveraged with debt. Mr. Moul's adaptation of this theory assumes that a premium should attach to the DCF model results which would reflect the additional risk resulting from the utilization of a book value capital structure, rather than a market value capital structure. Direct Testimony, Paul R. Moul, pp. 30-31.

RP analysis is the determination of the cost of equity capital by reference to corporate bond yields to which a premium is added to reflect the increased risk of common equity over debt capital. Mr. Moul's study indicated that 7% is a reasonable bond yield to estimate the prospective long-term debt cost rate for an A-rated public utility bond. Direct Testimony, Paul R. Moul, p. 33. He also determined that a reasonable risk premium for the water group is 4.75% and the corresponding risk premium for the Gas Group would be 5.00%. Direct Testimony, Paul R. Moul, p. 37.

CAPM takes the yield on a risk-free interest bearing obligation and adds to it a return representing a premium that is proportional to the systematic risk of an investment. There are three components to the model, the risk free rate of return, the beta measure of systematic risk, and the market risk premium. Mr. Moul utilized yields on long-term Treasury bonds for his risk free rate of return. His analysis used a 5.00% risk free rate of return. He utilized a "leveraged beta" measure of systematic risk of .77 for the Water Group and a beta of .84 for the Gas Group.

Randall R. Short provided testimony on return on common equity on behalf of the CAD. He utilized the DCF and CAPM analyses to arrive at his recommendation. He recommended 8.25% as a reasonable rate of return on common equity for the Company, a return selected from a range of reasonableness between 8.20% and 8.50%. Direct Testimony, Randall R. Short, p. 2. His DCF analysis produced a dividend yield component of 3.2% and a dividend growth rate range of 5.0% to 5.25%. Direct Testimony, Randall R. Short, p. 27. This was extended to a within range average of 8.33% as a fair and reasonable rate of return on common equity.

Mr. Short's CAPM analysis started with 1.15% and 5.21%, representing short-term three month U.S. Treasury bills and thirty year U.S. Treasury bonds. Mr. Short utilized a beta of 0.62. He based his beta upon the Value Line beta coefficients for the companies in his water utility group. Value Line betas are derived from a regression analysis between weekly percentage changes in the market price of a stock and weekly percentage changes

in the New York Stock Exchange Composite Index over a period of five years. He applied the beta to both geometric and arithmetic average market risk premiums for large company stocks, which he obtained from the 2003 Yearbook, reported by Ibbotson Associates. His calculations produced a second range of reasonable rates of return on common equity spread between 5.12% and 9.18%, with an average being 7.20%. Direct Testimony, Randall R. Short, p. 31.

Diane Davis Calvert presented cost of equity testimony on behalf of the Staff. Staff recommends 6.67% rate of return on equity based on a range of 5.66% to 7.34%. Staff relied upon three approaches to determine a rate of return on common equity. It utilized the DCF and CAPM models as well as an end result analysis to assure that the Company would be given a reasonable opportunity to generate sufficient revenue to pay its operating and maintenance expenses, to pay its interest expense, and to internally generate an adequate cash flow for capital improvements.

In Ms. Calvert's DCF analysis, she determined an average dividend yield of 3.10% and an expected dividend yield growth rate of 3.74% for a total expected return on common equity of 6.84%. Her calculations were based upon a sample group of seven water companies. Direct Testimony, Diane D. Calvert, pp. 7-8, Appendix DDC-1, Schedule 3.

Ms. Calvert's CAPM analysis utilized historic and projected 13-week U.S. Treasury bill rates as the risk free return component. Her expected rate of return on the market was calculated by determining the difference between the arithmetic mean of the return on common stocks, as measured by the Standard & Poor's 500 Composite Index, and the risk free T-Bill rate. The risk free return component was 1.458%. The market premium or expected rate of return was 8.4%. Ms. Calvert utilized beta coefficients ranging from .50 to .70, with an average beta of .60. The betas were taken from Value Line Investment Survey, August 1, 2003. The application of these values to the CAPM formula produced rates of return ranging from 5.66% to 7.34% with an average of 6.50% as a reasonable rate of return on equity. Direct Testimony, Diane D. Calvert, pp. 8-10, Appendix DDC-1, Schedule 3.

Ms. Calvert applied her recommended rate of return on equity to the Company's rate base, operating and maintenance expenses, debt expense, dividend expense payout history and internally generated funds historical requirements to determine whether the recommended rate of return on common equity was reasonable. Her recommended return of 6.67% will provide long-term interest coverage of 2.14 times and total interest coverage of 2.10 times. The Company's Indenture of Mortgage requires debt coverage of 1.5 times the long-term interest expense. During the last five years, the Company has averaged a 75.98% dividend payout rate. The Staff recommended rate of return would allow for a

dividend of $7.966 million at the 75.98% dividend payout rate. The Staff's recommendation will also provide for the internal generation of 95.66% of the average 2004-2005 projected total capital expenditures of the Company. Direct Testimony, Diane D. Calvert, pp. 14-16, Appendix DDC-1, Schedule 5, Sheets 1-3, Schedule 6, Sheets 1-3.

While the Cities did not provide a numerical analysis of the appropriate return on equity, they did submit an extensive argument on the issue. The Cities noted that in the Company's last fully litigated cost of equity case (the 1994 case) the Commission set 10.65% as the Company's equity rate. Since that time, other investments have fallen between 260 and 400 basis points. "Yet Mr. Moul's cost of equity range actually contemplates that while the investment market falls across the board by 260 - 400 basis points, WVAWC's 10.65% of 1994 ought to be raised to as much as 11.5% in 2003." Initial Brief of the Cities at p. 15.

The Cities also cited Permian Basin, the more recent United States Supreme Court case on rate of return. The Cities noted that therein the Court followed Bluefield and Hope, and additionally stated:

> The Commission . . . is instead obliged at each step of its regulatory process to assess the requirements of the broad public interests entrusted to its protection by Congress. Accordingly, the 'end result' of the Commission's orders must be measured as much by the success with which they protect those interests as by the effectiveness with which they 'maintain . . . credit and . . . attract capital.' [Permian Basin at pp. 790-791.]

The Court specifically stated a list of three 'determinations" for a reviewing body to make:

> First, it must determine whether the Commission's order, viewed in light of the relevant facts and of the Commission's broad regulatory duties, abused or exceeded its authority. Second, the court must examine the manner in which the Commission has employed the methods of regulation which it has itself selected, and must decide whether each of the order's essential elements is supported by substantial evidence. Third, the court must determine whether the order may reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed, and yet provide appropriate protection to the relevant public interests, both existing and foreseeable. [Permian Basin at pp. 791-792.]

The Cities continued by noting that in Monongahela Power Co., the West Virginia Supreme Court cited standards set forth in Bluefield and Hope but then set forth in its entirety the standard of review in Permian Basin. The Court went on to say Permian Basin essentially incorporates the just and reasonable rate requirement set by West Virginia Code §24-2-4. Thus, the Cities argued, Permian Basin, with its emphasis on providing protection to the relevant public interests, is the guiding principle as set forth by this State's highest court. Cities Initial Brief, November 3, 2003.

The wide range of recommended equity costs in these proceedings demonstrates why the Commission has, on numerous occasions, stated that recommendations of expert witnesses on cost of common equity are useful as guides, but, due to the subjective nature of the various inputs into each expert's recommendation, the determination of an appropriate cost of common equity for a utility must rest principally with the Commission's best judgement. See, The Potomac Edison Company, Case No. 79-230-E-42T, (Interim Order, November 21,1979) at p. 7; Virginia Electric and Power Company, Case No. 79-040-E-42T, 67 ARPSCWV 277 (Final Order, February 1, 1980); Monongahela Power Company, Case No. 80-058-E-42T, (Interim Order, July 18, 1980) at p. 8; Monongahela Power Company, Case 90-504-E-42T (Commission Order, June 11, 1991) at p. 24; GTE South, Inc., Case No. 90-522-T-42T (Commission Order, May 31, 1991) at p. 17; Appalachian Power Company, Case 91-026-E-42T (Commission Order, November 1, 1991) at p. 4; Mountaineer Gas Company, Case No. 93-0005-G-42T (Commission Order, October 29, 1993) at p. 9.

The Commission is presented with a range of 6.67% at the low end to 10.25% at the high end of the parties' recommendations. While the 6.67% recommended by Staff is hotly contested by the Company, there is little contest in the way of charges of errors or inconsistencies. We do not find any errors in Staff's analysis or attempts to throw out data that would inflate Staff's recommendation. On the other hand, we have several problems with the Company's position that attempts to elevate the high end of our range of considerations on this issue using methods that have never been adopted by this Commission or that attempt to effectively leverage-up the rate base of the Company in the form of a rate of return component that offsets the effect of our long standing policy of using original cost rate base.

The Commission believes that Mr. Moul, testifying on behalf of the Company, has simply stretched his analysis upward at every opportunity to produce a recommended range of returns on equity that are clearly excessive and not consistent with investor expectations. For example, his choice of a Gas Group results in higher return targets in nearly every analysis that he made. The most striking example of this is the comparison of his water group DCF, where he arrives at a 9.52% recommended Return on Equity and his Gas Group DCF, where his answer is 11.47%. On this point, regarding a reliance on the Gas Group,

the Commission concurs with the Cities' argument regarding the Company's use of a Gas Group in the determination of its return on equity: The Company used far riskier ventures in natural gas companies with returns substantially higher than the Water Group and claimed that the groups were comparable. But natural gas investment is far riskier and not comparable to water. The Cities Reply Brief at p. 7.

Additional examples of the Company witness raising his sights above what a reasonable analysis produces can be found in the market value adjustments that he makes. His water group DCF analysis would be only 8.98%; however, he leverages this number up by 54 basis points, or .54%, to reflect the fact that stockholders pay market prices for stock and those market prices may exceed the book value of a utility's rate base. Thus, the Company asks us to effectively depart from our long-standing use of an original cost rate base. We could do this by simply applying the derived rate of return, before market price leveraging, to an inflated rate base that exceeds book value or, in the alternative chosen by the Company, we can continue to use original cost rate base and apply an inflated rate of return to that rate base.

The Company witness has further inflated his DCF analysis by using earnings per share growth rates rather than the dividend growth rates that have been historically used by the Commission in its DCF analysis. The Company witness ' water group dividend growth rate is either a 2.5% historic growth rate or a 2.83% projected growth rate. While there can be disagreement regarding the choice of historic or projected growth rates in the DCF formula, clearly there is not a huge difference in either dividend growth rate. However, the Company witness stretches his recommendation by turning to growth in earnings per share. Here, he takes a measure that has not been historically used by this Commission and suggests that we consider it in evaluating a DCF indicated return on equity. The historic earnings per share he uses is 3.6%, a full 110 basis points above the historic growth in dividends. His projected growth in earnings per share jumps to 6.71%, or more than 320 basis points above the historic growth in dividends.

Looking at the Company witness' sample water group, and using his yield plus historic growth in dividends results in a DCF indicated return on equity of 6.23%. Even using his historic growth in earnings per share produces only an indicated return on equity of 7.33%.

The Company witness' other models for determining a return on equity suffer from a similar effort to simply raise the numbers. For example, in his Capital Asset Pricing Model, he incorporates a projected market premium of 14.71% based on a projected market return of 19.71% less a risk free rate of 5%. This is a full 830 basis points above his historical market premium of 6.4% based on a historical market return of 12.2% less a

historical long-term treasury rate of 5.8%. As a further example, in his Capital Asset Pricing Model, he applies his market value adjustment to leverage his water group beta from .6 to .77. As we have explained above, this market value adjustment is completely unacceptable and unreasonable.

In addition, the Commission agrees with the Staff that the CAPM depends on a determination of an objective and sustainable risk free component. The Company seeks a risk free component of 5%, based on long term treasury bonds. In today's market, with secured savings accounts receiving annual interest of less than 1%, with secured Certificates of Deposit receiving annual interest around 2%, and with short term treasury bonds yielding less than 2%, we simply do not find any credibility in the Company witness' support of a 5% risk free component.

Looking at the Company witness' CAPM stripped of his efforts to leverage unrealistic rates of return through his adjustment to attempt to compensate investors for the fact that they may be paying market prices in excess of the book value rate base used by a regulatory commission, we see a water group beta of .6. Even accepting his excessive risk free component of 5%, his CAPM at a .6 beta would be 8.84%, far below the 10.00% to 11.5% rate of return on equity range which he supports. More importantly, adjusting his CAPM analysis to reflect a more realistic risk free component even using 2% as a short term rate (which is higher than the short term rate used by Staff) results in a return on equity of 7.04%.

Clearly, while we must acknowledge the Company witness' recommendations as being the high end of the range of recommendations made in this case, the Commission finds significant subjective modifications to the empirical data adopted by the Company witness that not only render his recommendations as being on the high side, they simply place his 10.0% to 11.5% return on equity recommendation outside of any range of reasonableness.

With regard to the CAD witness' recommendation of an 8.25% return on equity, the Commission also finds that Mr. Short fails to support some of the components of his recommendation. We find this to be particularly troublesome with regard to his use of multiple growth rates in his DCF model and his use of multiple risk free components in his Capital Asset Pricing Model. Historically, the Commission has used growth in dividends as the growth rate component in a DCF model. We believe that this is consistent with the use of dividend yield in the model. There is a balance between investor expectations of dividends and the market price. Specifically, we do not find support for the growth rate in the DCF analysis recommended by Mr. Short, and believe that it represents a highly subjective selection from among a number of growth rate considerations. In his CAPM, Mr.

Short again mixes a risk free component based on short-term three month U.S. Treasury bills and thirty year U.S. Treasury bonds. The Commission finds that his use of excessive growth rates as part of his analysis and his use of a 30 year U.S. Treasury bond rate, which we do not consider to be a reasonable measure of the risk free component of the Capital Asset Pricing Model, similarly renders his recommend 8.25% cost of equity to be too high.

Turning to the Staff's recommended return on equity, the Commission finds that the 6.67% recommendation is based on the most realistic and objective measures of investor expectations and market risks. We also find that the end result tests performed by Staff are not, as the Company asserts, the means to the end goal of determining a fair and reasonable rate of return. Instead, these end result analyses help the Commission to determine if a given capital structure, debt costs, and return on equity produce sufficient interest coverage, dividend potential, and internal cash flows to enable the Company to meet the comparable earnings, financial integrity, and capital attraction tests set forth in the Bluefield and Hope cases. Indeed, upon a review of the end results of the Staff's recommended return on equity, particularly with regard to the net income available for preferred dividends and remaining for common stock holders after payment of preferred dividends, the Commission finds that a return on equity in excess of the Staff's recommended 6.67% is needed.

Upon consideration of the testimony and briefs of the parties, the Commission shall set a return on equity capital at a rate of 7.00%. The Commission's rate is at the lower end of the scale as presented by the parties but believes its decision adequately balances the concerns of the Company regarding investor perceptions of the riskiness of the water industry with the need to ensure that the ratepayers pay rates reflecting no more than a fair rate of return, and also will be sufficient to comply with the Hope and Bluefield tests set forth previously in this discussion.

Capital Structure and Resulting Rate of Return

The capital structure issue addresses the sources of capital supporting the net assets (rate base) of the utility. A company's capital structure will normally depict the amount of capital acquired by an entity through retained earnings, other paid in capital contributions from stockholders, the issuance of debt, and the issuance of stock. Capital structure quantifies short-term and long-term debt, as well as preferred and common equity - and establishes a relationship between the various capital sources for subsequent use in a formulaic approach to determine a composite cost of capital.

To determine cost of capital, each type of capital is calculated as a percentage of the total capital structure. The cost rate for each type of capital (long term debt, short term debt, preferred stock, and common stock) is then multiplied by that type of capital's percentage

of the total capital structure to derive a weighted cost of capital for each type. Those weighted costs are then added to reach a total cost of capital or rate of return. The inclusion of short-term debt in the capital structure is a contentious one because the inclusion of short-debt in the capital structure lowers the overall cost of capital and rate of return. By including short-term debt in the capital structure, the percentage of total capital for the higher cost forms of capital is reduced and, therefore, the overall cost of capital for a company is also reduced.

Testimony and other evidence pertaining to capital structure was introduced by three expert witnesses in this proceeding, Michael A. Miller on behalf of the Company, Randall R. Short for the CAD, and Diane Davis Calvert for Staff.

In this case, the Company used a test year ending December 31, 2002. The Company began its analysis using a capital structure for the twelve months ending coincidentally with its test year. The 2002 capital structure was then adjusted to reflect the Company's financial activity projections for 2003 and its estimate for the level of retained earnings through 2003. The Company included post-test year adjustments and argued that such an adjusted capital structure would be in place at the time the rates were placed into effect. Direct Testimony, Michael A. Miller, p. 2. These adjustments resulted in a decrease in short-term debt from $20,327,894 to $15,374,000, a reduction of $4,953,894. Long-term debt was reduced from $224,801,974 to $224,055,276, a reduction of $746,698. Preferred equity was reduced from $2,250,000 to $2,227,704, a reduction of $22,296. Common equity was increased from $162,182,738 to $164,448,999, an increase of $2,266,261. The increase in common equity reflects undistributed net income or retained earnings. See Company Exhibit MAM-1. The Company exhibited the following percentages and costs associated with the various classifications of debt and equity capital sources:

Capital source	% of Structure	Effective Cost
Short-term debt	3.786%	3.50%
Long-term debt	55.172%	6.73%
Preferred stock	.549%	8.57%
Common stock	40.494%	10.25%

Miller Direct, MAM-1, Page 1 of 3.

The Company projected a cost rate of 3.50% for short-term debt, relying upon a Value Line projection for 2004 - again, the time frame in which the proposed tariff rates will become effective. The amount of the short-term debt was adjusted downward to reflect the

repurchase of a portion of that short-term debt with cash generated in 2003. The cost of long-term debt was calculated by determining the actual cost of fourteen issues of general mortgage bonds varying in interest rates from 10% to 4%. This amount was adjusted to reflect sinking fund payments during 2003. The cost of preferred stock was determined by calculating the cost of the series of preferred stock issue with interest rates varying from 4.625% to 8.85%. This amount was also adjusted to reflect sinking fund payments. Mr. Miller's cost of common equity was selected from the range of returns recommended by the Company's witness Paul Moul. Mr. Miller selected 10.25% from the range 10.00% to 11.50%. Direct Testimony, Michael A. Miller, p. 7.

The Company argued that Staff would have the Company incur short-term debt for no reason other than the fact that short-term interest rates are low. The Staff does not indicate to what use the borrowed funds should be put, other than to marginally reduce the weighted cost of capital. Needlessly incurring debt will increase the Company's total capitalization and interest expense, to the ultimate detriment of the ratepayers. Company Reply Brief at p. 10.

The Company acknowledged that the anticipated rate for short-term debt reflected in its filing is too high in light of the most recent actions of the Federal Reserve and other market conditions. The Company was therefore willing to accept the CAD's short-term debt rate of 1.462% and recommended the following adjusted capital cost components and overall rate of return:

Class of Capital	Amount	% of Total	Effective Cost	Weighted Cost
Short-term Debt	15,374,000	3.786%	1.46%	0.06%
Long-term Debt	224,055,276	55.172%	6.73%	3.71%
Preferred Stock	2,227,704	0.549%	8.57%	0.05%
Common Equity	164,448,999	40.494%	10.25%	4.15%
Total Capital	406,105,979	100.000%		7.90%

Company Initial Brief, November 3, 2003 at pp. 10-12.

Randall R. Short, on behalf of the CAD, argued for a different capital structure. He recommended that the Commission utilize the following structure:

Capital Source	% of Structure	Effective Cost
Short-term debt	4.25%	1.462%
Long-term debt	55.18%	6.726%
Preferred stock	0.55%	8.550%
Common stock	40.02%	8.250%

Direct Testimony, Randall R. Short, p. 15.

Mr. Short utilized an average actual capital structure. His recommended structure was determined by averaging the Company's actual reported capital structure over the four quarters ending June 30, 2003. Direct Testimony, Randall R. Short, pp. 15-16. There were, however, substantial differences between Mr. Short and the Company with regard to the cost of short-term debt and common equity. Mr. Short recommended 1.462% as the short-term debt cost, rather than the 3.50% proposed by the Company. The CAD witness differed in approach from the Company by utilizing an average cost of short-term debt for the period January 2003 through June of 2003. Mr. Short asserted that this treatment was correct as short-term debt costs have declined significantly over the past two years, ending in an actual short-term debt cost rate to the Company of 1.24% as of June 30, 2003. Mr. Short disputed the Company's use of 3.5%, pointing out that it is substantially higher than any short-term rate the Company has incurred during the past two years and does not reflect current or projected rates. In support of this position, he testified that the August 1, 2003 issue of Blue Chip Financial Forecasts reported commercial paper rates varying from 1.0% to 2.2% for the next six quarters. Direct Testimony, Randall R. Short, pp. 17-18.

The CAD argued that the conjectural nature of the Company's hypothetical capital structure can be seen in the Company's projected cost rate for short-term debt. The CAD asserted that the Company projected a cost rate for short-term debt of 3.5%, Tr. Vol. I, p. 184. That amount is almost three times the Company's current cost of short-term debt (1.2%), and more than double the historic rates used by Staff and CAD (1.4% and 1.46% respectively). Tr. Vol. IV, p. 167. The CAD further asserted that short-term debt costs have declined significantly over the last two years as the Federal Reserve Board has attempted to stimulate economic activity by reducing the federal funds rate. Use of the most recent actual capital structure in setting rates avoids rates based on speculation and the CAD urged its adoption in this case. CAD Initial Brief at pp. 11-12.

The Staff's testimony regarding capital structure was presented by Diane Davis Calvert. She recommended that the Commission use the Company's actual capital structure as of December 31, 2002 (the end of the test year), with two adjustments. Ms. Calvert used long-term debt and preferred stock balances net of their unamortized issuance expenses. She also recommended that the level of short-term debt be adjusted to reflect the average balance outstanding during the test year. The Staff's witness recommended that the Commission adopt the following capital structure:

Capital source	% of Structure	Effective Cost
Short term debt	4.63%	1.40%
Long term debt	55.01%	6.73%
Preferred stock	.55%	8.56%
Common stock	39.81%	6.67%

Direct Testimony, Diane Davis Calvert, Appendix DDC-1, Schedule 1.

Ms. Calvert calculated her short-term debt percentage by determining the average daily balance outstanding in short-term debt during the test year. Direct Testimony, Diane D. Calvert, p. 3; see also Schedule 1, Sheet 2. The cost of her short-term debt, 1.40%, represents the actual average cost incurred by the Company for the latest three months available at the time of the preparation of her testimony - April through June of 2003. She argued that using the most recent cost information available is consistent with adjusting test year expenses for known and measurable changes. Direct Testimony, Diane D. Calvert, p. 3.

The Commission notes that the other parties did not provide a detailed analysis of capital structure and rate of return although the Cities adopted the Staff's capital structure and corresponding calculation of rate of return. Cities Initial Brief at p. 26.

The chart below shows the respective positions of the parties:

	Company[2]		CAD		Staff	
Type	% of Total	Cost Rate	% of Total	Cost Rate	% of Total	Cost Rate
Common Equity	40.494	10.25%	40.017	8.250%	39.81	6.67%
Preferred Stock	0.549	8.57%	0.552	8.550%	0.55	8.56%
Long Term Debt	55.172	6.73%	55.180	6.726%	55.01	6.73%
Short Term Debt	3.786	1.46%	4.251	1.462%	4.63	1.40%
Return		7.90%		7.122%		6.47%

The Commission has reviewed the arguments presented by the parties. The Commission also appreciates the criticisms the parties have levied upon the respective arguments of opposing parties on these issues. The Commission is of the opinion that it would be on defendable ground were it to fully adopt the absolute position of CAD, the Company, or Staff. Clearly, the components of capital, stated on a percentage basis, as recommended by Staff, CAD, and the Company are very close. The Staff's position is the most defensible from the standpoint of being tied to a known structure at a point occurring within the test year. Furthermore, the Staff's proposed modification to this point-in-time approach as it relates to short-term debt is reasonable. Clearly, unlike the other components of capital structure which are not likely to shift significantly from month to month, short-term debt can change significantly from month to month and the choice of an average rather than a point-in-time snapshot of short-term debt is reasonable. However, the Commission concludes that based on the record in this case each of the capital structures are so similar that none would be determined to be imprudent.

In such a position, the Commission believes the wisest choice is to look for a compromise position or middle ground between the recommendations offered. Indeed, the CAD position represents a middle ground between the position of the Company and Staff with regard to capital structure. However, we shall not simply adopt the CAD position as a compromise. In this case, for the capital structure, and no other issue, the Commission shall split the difference between the positions of the Company and Staff. With regard to cost of capital rates, there is little difference on any of the capital components other than short term debt and equity. We have already explained that we are adopting a return on

[2] As adjusted in the Company's Initial Brief to reflect adoption of the CAD's short-term debt rate.

equity of 7.0%. With regard to short term debt, we shall adopt the Staff's recommended 1.40%. Accordingly, the Commission shall utilize the following capital structure, cost of capital and overall rate of return:

	DECISION		
Type	% of Total	Effective Cost	Weighted Cost
Common Equity	40.15	7.00%	2.81%
Preferred Stock	.55	8.56%	.05%
Long Term Debt	55.09	6.73%	3.71%
Short Term Debt	4.21	1.40%	.06%
Rate of Return			6.63%

OPERATION AND MAINTENANCE AND OTHER EXPENSES

There are two Operation and Maintenance (O&M) issues that reverberate throughout several of the other O&M issues in this case: (1) Capitalized Payroll and (2) the number of Company employees. The Commission shall address these items first so that later issues (e.g., group insurance, OPEB's, pension costs, ESOP, and 401(k) expenses, and a number of tax calculations) contingent upon Capitalized Payroll and level of Company employees may be resolved in an abbreviated manner.

Capitalized Payroll Ratio

Other than return on equity, the capitalized payroll issue has the largest impact on the Company's revenue requirement in this case. The Company has requested that its capitalized payroll – that is, the percentage of payroll dollars that will be capitalized, as opposed to expensed – be set at 23.19% in this case, a reduction from the 28.58% which was actually capitalized in the test year. Company Exhibit MAM-B at 16. The Company argues in its Initial Brief that a blind adherence to the test year capitalized payroll ratio of 28.58% will limit the Company's reasonable opportunity to achieve whatever authorized rate of return the Commission decides is appropriate in this case. The Company argues that it is not going to capitalize this amount of labor in the 2004 rate year given its demonstrated construction requirements and capital spending plan. If the level of capital payroll reflective of the rate year is not recognized, the Company must absorb this difference in its financial performance or offset the shortfall by making reductions in other areas. Company Initial Brief.

Staff argued in its Initial Brief that Staff and the Company have consistently used historical test year percentages in its analysis of going level payroll. Staff believes that the Company's use of estimated expense/capitalization ratios would violate the matching principal and further argued that the Company's use of capital budgets as a measure of going level payroll violates the known and measurable standard. Direct Testimony, Kellmeyer, p. 6.

The CAD argued in its Initial Brief that the test year ratio be retained, based on evidence showing that the Company's construction budget for the foreseeable future will remain relatively stable and that any forecasts are merely speculative. The CAD notes that a lower labor capitalization ratio results in a higher labor expense ratio and higher revenue requirements to be paid by current ratepayers. To avoid this, the CAD recommends that rates in this proceeding should be set based on test year actual expense/capitalization ratios.

Utilizing the Company's ratio of 23.19% steps outside of the 2002 test year and violates the matching principle. Furthermore, even if the percentage capitalized does decrease due to lower construction activity, such lower construction activity may result in lower total payroll costs. Thus, the Company's argument that the actual 2004 capitalization ratio, which is lower than the amount reflected in this order, will negatively affect its financial performance (i.e. achieved rate of return) is not accurate. Accordingly, the Commission shall retain the historic capitalized payroll ratio of 28.58%. This adjustment from the Company's requested level of operation and maintenance expenses has the effect of lowering those expenses by approximately $900,000. In addition, there are related effects on payroll related costs such as Employee Insurance, Pensions and OPEB's which amount to approximately $340,000.

The Commission shall maintain the use of the current capitalized payroll ratio of 28.58%.

Employee Levels

The Company is requesting that the payroll expense used in this case be based on a level of 323 employees. Staff recommended the Commission disallow eight (8) of those positions from going level wages (an adjustment of approximately $240,350). Company witness Miller explained that while the Company has been reducing employee levels, it concluded that it needs all 323 positions requested in this case. Rebuttal Testimony, Miller, p. 23. Mr. Miller further explained that because the Company was undergoing an assessment of whether the eight positions were needed, it delayed immediately hiring persons to fill those vacancies.

The Company's testimony showed that the vacancies reviewed by Staff have since been filled and that there have not been any new vacancies to offset those employment positions. Tr. Vol. V, p. 203. As this modification to the test year is known and measurable the Commission shall accept the Company's employee level of 323.

Affiliate Charges

The BOE raised this issue regarding the possible level of profit contained in charges made to the Company by its affiliates. The BOE did not simply suggest an adjustment to affiliated charges based on its calculation of profit levels achieved by affiliates, but it requested the Commission deny the affiliated charges requested in the amount of $5,570,617. The BOE argued that conclusionary statements by Company personnel, that there are no such profits, is simply not enough. The BOE cited West Virginia Code § 24-2-3 in that it does not require utilities to merely demonstrate that services from affiliates are provided on a competitive basis, at which point the affiliate can retain any profit it may have earned on such transactions, but that it requires a demonstration of the level of profits so that the Commission can consider the level of profit in determining the Company's overall rate of return. C&P Tele. Co. v. Pub. Serv. Comm'n., 171 W.Va. 494, 300 S.E.2d 607 (1982). BOE Initial Brief at p. 8.

The Company countered that it did not decline to produce information regarding service company billings but that the BOE could have requested any information it needed but failed to do so. Additionally, the Company noted that the Commission has never required the Company to produce such information in the past. Company Reply Brief at p. 27.

The Commission shall not deny the $5,570,617 in affiliate charges as requested by the BOE. This particular expense item has been contained and previously approved in prior rate cases. The question of excessive affiliated profits has not been raised in previous rate cases even though the CAD and Commission Staff have, for years, investigated all aspects of the Company's rate cases without this issue coming to the forefront. In this case, the BOE has raised the issue but only as a conjecture – there is no verification that a problem exists. In other words, the Company made a *prima facie* case for inclusion of the affiliated charges which the Cities failed to rebut.

However, the Company is hereby placed on notice that the Commission may, in the future, opt to open an investigation into the level and content of the affiliate charges to review those charges on an on-going basis.