Call Center

As explained in the Direct Testimony of Company witness Miller, effective May 29, 2001, customer inquiry and billing functions for the Company are being performed at the Call Center in Alton, Illinois. Mr. Miller explained that call center functions were consolidated throughout the entire American Water System as a cost saving measure.

Mr. Miller explained that in the 2001 rate case, the Company included a request to recover, through a ten-year amortization, the estimated transition and set-up cost for the move to the call center. However, since the actual transition costs exceeded the estimate included in the last rate case, the Company proposed in this case to reflect the actual transition costs, reduced by the $80,368 per year amortization recorded for 2002 and 2003 and recovered in rates over the last two years. Rebuttal Testimony, Miller, p. 36.

The Company proposed to adjust the amortization amount to $162,146 per year to recoup the unrecovered balance over the remaining eight-year amortization period implemented incident to the 2001 rate case. The Company asserted that the Staff position imputes a higher amortization amount than the Staff recommended in the 2001 rate case to arrive at a remaining balance to be amortized. This position is incorrect in that it presumes the Company recovered in rates in 2001 and 2003 the increased amortization imputed by Staff. Company Initial Brief pp. 38-40.

Both the CAD and the Cities recommended this cost not be passed on to ratepayers at all. The Cities stated that the move to Illinois had not proven to be a savings to ratepayers. Cities Initial Brief, at p. 21. The CAD added, among other things, that the move to Illinois was not something that either the Commission or ratepayers requested. Rather, it was part of an overall corporate strategy to further centralize operations. CAD Initial Brief at p. 41.

Staff is recommending an adjustment $90,250 to reflect annual amortization of the Call Center transition costs. Staff stated that it agreed with the total call center transition costs claimed by the Company, but that the Company erroneously computed the prior years' and going-level amortization. Staff witness Kellmeyer explained that the Company recorded the accumulated two prior years' amortization as $160,736 based on an estimate from a prior case; however, the total cost of the call center transition is actually higher than the estimated costs in the prior case. Direct Testimony, Kellmeyer, p. 9.

Staff asserted that once the amortization period was set at ten years, the Company should have begun a 10-year amortization based on actual costs as booked in line with traditional depreciation accounting.

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The Commission agrees with the Staff position on this issue for the reasons set forth by Staff in its testimony and briefs. We have allowed the amortization of the Call Center transition costs in the past and we shall not change horses in mid-stream as suggested by the CAD and the Cities. However, as suggested by Staff, the annual amortization of an item that has been deferred by the Commission should be related to the actual cost of the deferred amount and the amortization period, in this case 10 years. The Company's accounting for amortization of deferred costs should not be controlled by estimates of annual amortization expense that it made in prior rate cases. Instead, the amortization rate was established by the Commission at 10% and the Company's annual amortization expense should be based on 10% of the actual costs deferred.

The Commission shall allow the Staff's adjustment of $90,250 for annual amortization of Call Center transition costs.

Comprehensive Planning Study

The Company routinely performs a comprehensive planning study ("CPS") on five-year intervals to assess the need for treatment plant improvements to meet new emerging regulations, to identify areas of its distribution system that may need to be replaced or upgraded, and to determine the impact that system growth has on plant and distribution system performance. The CPS includes a short-term capital project in a separate list and a longer 10 to 15 year horizon for use in long-range planning. In the 1994 Company rate case the Company witness testified that a good CPS can be used as much to avoid or postpone construction as to implement it and that the CPS allows the Company to take a long range view of the system to avoid duplicating or improperly sequencing expenditures. In the 1994 case the Company argued that the cost of the CPS should have been capitalized into rate base and depreciated over its five year useful life.

Company witness Miller argued that it is unfair for its shareholders to absorb the carrying cost of the CPS investment over a number of years until all of the costs are eventually transferred to construction projects and recovered in rates over the life of those construction projects. Mr. Miller further stated that this process creates a bookkeeping problem in tracking and charging these costs to specific projects. Rebuttal Testimony, Miller, pp. 42-43. As an alternative, Mr. Miller proposed that the Commission establish a utility plant account for these regular studies and permit the Company to capitalize those costs upon completion of the study. Id. at p. 43.

In rebuttal testimony and at hearing, Company witness Miller suggested a compromise by which the Commission established a utility plant account for these type of studies and permit the Company to capitalize the associated costs upon their completion.

A period of 50 years would be allowed for recovery of the costs as a reasonable rate of depreciation. The CAD found this compromise to be acceptable. CAD Initial Brief at p. 44.

Staff is recommending $0 for comprehensive planning study costs whereas the Company is requesting $179,038. Staff does not agree with the Company's request for amortization of these costs and for including the cost of the study in a newly created rate base account. Staff witness Kellmeyer explained that the Commission has historically required the Company to transfer these costs to specific projects identified in the Comprehensive Planning Study Costs and to recover these costs through the annual depreciation allowance. Direct Testimony, Kellmeyer, p. 12.

In the 1994 case the Commission decided that the costs associated with the study should be allocated to the related construction work orders. Once the related projects have been completed and placed into service, the preliminary and final engineering costs could begin to be recovered through annual depreciation allowance over the service life of the facility. The Commission shall adopt the Staff position and maintain the same treatment of the costs as developed in the 1994 Company rate case. Such treatment is consistent with the Commission authorized System of Accounts. The System of Accounts provides for an account for "Preliminary Survey and Investigation Charges." The instructions for the use of this account state:

> This account shall be charged with all expenditures for preliminary surveys, plans, investigations, etc., made for the purpose of determining the feasibility of projects under contemplation. If construction results, this account shall be credited and the appropriate utility plant account charged. If work is abandoned, the charge shall be to account 426, Miscellaneous Income Deductions, or to the appropriate operating expense account.

Clearly, the Company should be capitalizing an appropriate share of its planning study when construction results from the study. If the study included projects that have been abandoned and are no longer under consideration, the Company can request specific approval for expensing an appropriate share of its planning study related to abandoned projects.

ESOP and 401(k)

These items are contingent upon employee levels and the Capitalized Payroll Ratio. The Commission shall adjust these items consistent with its payroll decisions above.

Great Lakes Chemical Plant

The Great Lakes Chemical Plant closed in March 2002, stopped using water entirely in February 2003, and has demolished its facility. In its adjustment, the Company removed both test year revenues associated with this industrial customer as well as test year expenses related to associated variable production costs. Company Exhibit RLF-B at 21-23.

Staff included $177,000 in revenues since, according to Staff, it is not now known or measurable as to whether there will be new customers to take the place of Great Lakes. Staff Initial Brief at p. 33.

This issue concerns the loss of an industrial customer of the Company and brings into application two concepts of ratemaking. The first is the test year concept. Under Rule 42 of the Commission's Tariff Rules a utility filing for a rate increase is required to provide financial information regarding what is known as the historical test year. The historical test year provides the Commission with a "snap-shot" of what the utility's financial condition is for the purpose of determining whether the utility's requested rate increase is reasonable. See, West Virginia-American Water Company, Case No. 94-0138-W-42T (Commission order entered December 22, 1994, at page 55). Because it is difficult to predict how a utility's financial condition will change, the Commission in the past has limited information regarding the utility's financial condition to the historical test-year unless an adjustment to the test year financial information, that a utility or any other party to the proceeding is proposing, is known and measurable and does not violate the basic principal of matching test year rate base and test year expense units to test year revenue units.

The matching principal is the second basic ratemaking concept which requires careful evaluation before adjustments from the test year data are allowed. Since average test year plant balances, by definition, satisfy the matching principal, adjustments to rate base are not considered unless they can be demonstrated as being non-revenue producing and non-expense reducing. Id. and West Virginia-American Water Company, Case Nos. 92-0113-W-PC and 92-0250-W-42T (Commission order entered May 19, 1992, at p. 2 and at Conclusion of Law No. 3 at p. 4).

There is no controversy that the Great Lakes Chemical plant was a customer during the test year and that both the revenues from that customer and the expenses related to serving that customer are in the test year financial statements. There is no controversy that this specific customer has ceased doing business and will not return as a customer of the Company at its previous location. The Company, therefore, asks us to treat its proposed adjustment as a "known and measurable" adjustment to test year revenues and expenses. However, the Commission notes that making adjustments to test year units of revenue and/or

expenses based on factors such as the loss (or gain) of a single customer starts us down the perilous trail of converting an historic test year to a future test year. The use of future test years have been rejected by this Commission in the past. Furthermore, the second of the ratemaking concepts, matching, causes us to be very reluctant to make adjustments related to customer turnover. Customers, particularly residential customers, but also commercial and industrial customers, enter and leave a utility's service territory with some frequency. To attempt to track the revenues and expenses associated with entering and exiting customers would not be efficient or particularly meaningful.

The Commission understands that the specific customer is no longer in operation. However, as noted above, some customers are lost and some are gained during any given period of time. Additionally, existing customers may increase their levels of usage. The matching principal, when coupled with the test year principal, tells us that the level of service provided by the Company during the test year matches revenue, expenses and rate base investment necessary to provide the level of service to all customers during the test year. When parties propose changes from the level of service performed during the test year offsetting changes in expenses and investment must be considered. Clearly, this starts down the slippery slope that could ultimately lead to projected test years. This Commission has expressed it preference for historic test years rather than projected test years many times in the past. While there may be instances of customers so large as to create a devastating impact on a utility requiring the Commission to recognize the loss of such customer, and make adjustments that result in at least a partially projected test year, the Commission is not convinced that such loss has occurred in this instance.

The Commission shall adopt the Staff position.

Incentive Compensation

The Company argued that its Long-Term Incentive Plan is part of the overall compensation package for executives and is integral to efforts to attract and retain talented and capable individuals. Company Exhibit MAM-B at 26-27.

The Cities argued that the Company wants to build $139,070 in additional executive compensation into its rates but such amount is not known and measurable since it is entirely based on Company performance. Additionally, bonuses awarded to executives for putting more money in shareholder pockets should be borne by shareholders, not ratepayers. Cities Initial Brief at p. 22.

The CAD argued that testimony from Company witness Miller made clear that the payments in question were made to certain management employees in furtherance of

corporate financial goals. Tr. Vol I, p. 206-208. Stockholders are the primary beneficiaries when the Company's financial performance targets are met. They should be the ones who pay for executive bonuses, not ratepayers. CAD Initial Brief at p. 40.

The Commission does not find the position of the CAD and the Cities to be persuasive. Indeed, incentive compensation is a known and measurable expense in this case. It was contained in the test year and shall be allowed for ratemaking purposes. The Commission understands the arguments made by the Cities that bonuses awarded to executives for putting more money in the shareholder pockets should be borne by shareholders, not by ratepayers. Looking at the situation from a slightly different perspective, however, it appears that it is the "incentive" and not the compensation that draws the ire of the Cities and the CAD. The Commission realizes that the Company could very well do away with its long-term incentive plan and instead spread the money in the form of salaries. In the present case, no party objected to the overall salary expense and it is unlikely that the addition of an additional $139,070 to the current salary expense would have triggered any outrage among the parties. Furthermore, at the bottom line, the Commission realizes that all employees of the Company are working not only to provide clean, safe, and potable water to the citizens of West Virginia but are also working as employees of the stockholders with an end towards maximizing stockholder wealth. The incentive compensation is merely a different means of providing such motivation. To the extent employee incentives result in efficiencies and/or increased productivity stockholders are benefitted, but eventually such benefits will be reflected in lower revenue requirements and lower rates. Thus, both stockholders and ratepayers benefit from increased productivity and operating efficiencies.

The Commission rejects the Cities and CAD arguments and will allow the inclusion of the costs of the Long-Term Incentive Plan in the revenue requirements in this case.

Employee Insurance Expenses and OPEB Expenses

These items are contingent upon employee levels and the Capitalized Payroll Ratio. The Commission shall adjust these items consistent with it s payroll decisions above.

Pension Costs

In calculating the Company's pension contributions for 2004, the Company took its known funding requirements for February and May 2004 and annualized them through the last two quarters of 2004. The Company suggested that the latest and most accurate information (the Company's current funding requirement), rather than outdated expenses first incurred in 2002, should be used. Initial Brief, at pp. 43 and 44. The CAD disagreed

that such figures were known and measurable and additionally recommended application of the appropriate Capitalized Payroll Ratio. CAD Initial Brief.

The Commission agrees that this item is affected by the employee levels and the Capitalized Payroll Ratio. Additionally, the Commission shall adopt the Company's position regarding the use of the 3rd and 4th quarters of 2003 to annualize those figures for use in the final two quarters of 2004. Stepping outside the test year in this instance is reasonable given that the 3rd and 4th quarters of 2003 are the latest and most accurate information available and, as such, constitute known and measurable adjustments related to the level of service provided during the test year.

Rate Case Expense

This issue concerns the disposition of rate case expenses from the 2001 Company rate case which came into being after submission of the Joint Stipulation in that case.

The Company proposed a three-year amortization of rate case expense, the same method approved in the 2001 Rate Case. Because only two years have passed since the conclusion of that case, the Company proposed to add the unamortized portion of its actual rate case expense in the 2001 Rate Case to the estimated rate case expense in this case, and then to amortize the combined balance over three years. Company Exhibit RLF-A at 18-20 and Exhibit RLF-6; Company Exhibit RLF-B at 23-29.

Staff disagreed with the Company's proposal to include the entire amount of the excess of the actual expense over the estimated amounts (1) since it is impossible to know exactly what was included in the last rate case as that was stipulated and (2) since the Company did not propose to reduce an expense to be included in current rates because such actual expense was less than the amount included in the prior case. Direct Testimony, Kellmeyer, pp. 11-12.

Company witness Ferrell disagreed with Staff's approach and does not believe it is impossible to say exactly what was included in rates since the last rate case was settled. Mr. Ferrell indicated that Staff's position on this issue limits the Company to the estimated amounts in the 2001 rate case and not the actual expenses incurred. Mr. Ferrell asserted that the 2001 rate case did not limit the Company's recovery to estimated amounts. Rebuttal Testimony, Ferrell, pp. 23-26.

Staff does not believe the Company should be allowed to defer the difference between the actual and estimated rate case expense into the current rate case. This would be retroactive ratemaking. Staff Initial Brief.

The CAD argued that in Case No. 01-0326-W-42T the Company had amortized, over a 3-year period, the rate case expenses totaling approximately $341,000. The additional $171,000 is for litigation costs associated with activities that took place after the execution of the Joint Stipulation. CAD pointed out that the 2001 Joint Stipulation states that it is all inclusive and addresses all issues raised in the Company's rate case, except for the standby service tariff issue. Initial Brief at p. 43.

The BOE recommended the following innovation: "Sound public policy also favors sharing the cost of rate cases evenly between shareholders and ratepayers. Without such costs being borne, in part, by the shareholders, there is no check upon or incentive for the Company to control rate case expense." The BOE advocated a $135,149 decrease to the pro forma revenue requirement, which includes corresponding adjustments for taxes and uncollectibles. BOE Initial Brief at p. 16.

This issue is similar to the Call Center issue decided above. The only disagreement between the Company and the Staff is whether the amortization of the 2001 rate case costs should have been booked at 33 1/3% of the actual rate case costs or 33 1/3% of the costs that were estimated at the time the 2001 case was settled. The Commission finds that when expenses are deferred and are subject to a specified amortization rate, it is appropriate to apply the amortization rate to the actual amounts deferred. We are not convinced that this continual deferral and amortization is preferable to simply establishing a fair and reasonable annual amount, based on a reasonable average, for expense items like rate case expense that vary greatly from year to year. However, we are convinced that the position of the CAD and BOE are not reasonable and would not allow the Company a reasonable opportunity to recover its expenses. Staff supports a deferral and amortization approach in this case and has calculated the unamortized balance of the 2001 rate case appropriately by applying the intended amortization rate to actual expenses deferred.

The Commission will adopt the Staff position on this issue in this case.

Security Costs/Synergy Savings

In the Commission's December 21, 2001, order in the Company's 2001 rate case (Case No. 01-0326-W-42T) the Commission stated the following regarding treatment of security costs:

> 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.

In its Initial Brief, Staff described its recommendation for treatment of security issues by recommending an additional $2.75 million in rate base to reflect security related capital additions that were identified within the evaluation of synergy savings. Staff recommended corresponding decreases in the Company's ongoing annual security operation and maintenance expenses in the amount of $627,000 which were likewise identified by the Company within its evaluation of synergy savings. Staff stated that it was not aware of any party in this case objecting to Staff's treatment of these savings and rate base additions. Initial Brief at pp. 22-23.

The Commission is aware that these items do not adhere strictly to standard ratemaking concepts related to the use of an historic test year and the matching principal as described above. However, in this case all parties are in agreement that these adjustments are appropriate. Furthermore, both the need for additional security and the synergy savings were brought on by extraordinary events for which the Commission believes the current treatment, as agreed to by the parties, is warranted. The Commission shall be proactive in matters regarding security measures given the current world climate. In this instance, the ratepayers coincidentally will benefit since the security costs are lower than expected, due in part to synergy savings.

For the above reasons the Commission finds it reasonable to step outside of the test year and include an additional $2.75 million in rate base and to decrease the Company's ongoing annual security operation and maintenance expenses in the amount of $627,000.

Service Company Allocation (Management Fee Allocation)

The Company's charges for the various administrative tasks performed by the Service Company are based upon an allocation of the Service Company costs to the participating utility operating entities of American Water Works. According to the CAD, joint and common services are billed to participating companies based on a formula that uses the relative number of customers served by each participating company. As of December 1, 2001, the factor for allocating costs to the Company was 6.15%. On October 1, 2002, that factor was reduced to 5.77% and was reduced again on March 1, 2003 to 5.67%. Since the Company's allocation factor has now been reduced, it is necessary to reflect the impact of the reduction as a going level expense adjustment. CAD Initial Brief. The Cities concurred with this assessment. Cities Initial Brief at p. 21.

The Company argued that the CAD recommended that the Commission modify the level of management fees included in the case by applying the latest allocation factors (effective March 1, 2003), a change which occurred after the test year. Company Initial Brief at pp. 45-46. The Company did not include any of the known and measurable increases in management fees because it has historically not requested inflation-related post-test year adjustments to management fees. This has historically been the Staff position as well. Because the Commission does not typically allow post-test year inflationary adjustments to management fee expense, it would be unfair to simultaneously adjust test year management fees for allocation factor changes that occurred post-test year. Company Initial Brief at pp. 45-47.

The billing percentage utilized as the Service Company allocation is now known and measurable as it was reduced on March 1, 2003, to 5.67%. This constitutes a known and measurable adjustment to the test year and the Commission shall adopt it by reducing the test year expense by $160,580.

The Commission shall adopt the CAD position.

Taxes – Consolidated tax savings adjustment

The CAD noted that the Company is not challenging the Commission's long-standing practice of recognizing tax savings arising from the Company's participation with corporate affiliates in filing a consolidated income tax return, as the Company did in the 1994 rate

case. The CAD also noted that the Commission has required jurisdictional utilities to reflect consolidated tax savings in rates by requiring them to calculate an effective tax rate reflecting tax losses of unregulated affiliates. The CAD then asserted that the problem with the Company's calculation is that it reflects only tax losses generated by the parent company and by the sub-holding company Greenwich. It ignores losses generated by other unregulated affiliates. Staff argues that there is no justification for excluding losses generated by any unregulated affiliates when calculating the system effective tax rate. Because of an apparent declining trend in the available tax savings for years 1997 through 2001, CAD recommended using a three-year average of the savings, just as the Company used in its filing. The three-year average tax savings is 17.56% resulting in an effective tax rate of 28.85%. CAD Initial Brief at pp. 47-48.

The Company cautioned the Commission against the inclusion of non-regulated affiliates in the consolidated tax savings calculation as recommended by the CAD. Regulated American Water subsidiaries, such as the Company, do not share in the profitability or loss status of the contract services performed by affiliated companies for non-affiliated utilities for profit. The Company recommended that the position shared with the Staff in this case be used – namely the Commission's continued use of a historic consolidated tax savings calculation that includes only the American Water parent and the Greenwich subholding company. Initial Brief at pp. 55-56.

The Commission is not persuaded by the CAD to deviate from the position previously taken by the Commission on this issue.

The Commission shall adopt the Company's position on this matter.

Uncollectible Accounts

Both the CAD and the Staff argued that the Company's uncollectible accounts should be normalized by using a 3 year average. CAD Initial Brief at p. 36.

The Company opposed the position of the CAD and Staff. The Company testified that a great many of the accounts now being charged off reflect aged receivables of 200 to 400 days due to the Commission's Water Rules requiring the Company to extend payment terms to customers who demonstrate difficulty in paying. The ratio of uncollectible expense to revenue has continued to increase and there is no indication the Company can reduce that ratio given the current Water Rules and the requirements of the Commission relating to charge-offs. Initial Brief at pp. 49-50.

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Staff recommended an uncollectible expense of $1,200,385, whereas the Company had requested $1,598,081 for this item.

Ms. Kellmeyer explained that Staff disagreed with the Company's use of the test year percent of uncollectibles to total revenue. Staff instead used a three year average. Direct Testimony, Kellmeyer, p. 10. Staff advocated a three year averaging of the uncollectible expense, since those expenses tend to fluctuate from year to year and an average should provide, a more reasonable idea of what those expenses will be on an ongoing annual basis.

The Commission has long held that uncollectibles should be averaged since the test year might be unusual and that the use of an average would smooth out any such anomaly. In Hope Gas Inc., the Commission stated:

> Staff made an adjustment to reflect a three-year average of uncollectibles. Hope argues that the trend on uncollectibles is upward and argues that Staff's use of a three year average understates the amount. We believe that the three year average of uncollectibles should generally be used in all rate cases. The average helps eliminate the impact of an unusual year. A three year period is a reasonable period for developing an uncollectible average because it captures current trends and economic conditions while still providing normalization or leveling of anomalous occurrences and should be consistently used in rate cases whenever feasible.

Hope Gas, Inc., Case No. 93-0004-G-42T (Commission Order October 29, 1993) at p. 22.

In Wheeling Electric, the Commission held:

> Wheeling contends that because its uncollectibles have been increasing, the ALJ erred in replacing the test year uncollectible expense of $203,000 with an average of the uncollectible expenses incurred during 1984, 1985 and 1986. The average, which is $92,000, was recommended by Staff. Instead, according to Wheeling, there should be no averaging, and the test year expense should be increased by $4,000 to $207,000. At a minimum, Wheeling argues, the ALJ should have used a four (4) year, rather than three (3) year average, and should have omitted the 1985 uncollectible data, since that year's data is unrepresentatively low.
>
> The Commission has generally approved the averaging methodology when determining a proper level for uncollectible accounts. Because the uncollectible account expenses have not been steadily trending either upward or downward over the last five (5) years, but rather, have varied, the Commission concludes that averaging of past uncollectible expenses was

> reasonable. However, the Commission is persuaded by Wheeling's contention that the ALJ should have used a longer period in developing the average. We shall not, however, exclude the 1985 data simply because it is lower than other years. Therefore, we shall increase the Staff recommended allowance for uncollectible accounts by $21,000 based on a five (5) year average uncollectible percentage.

Wheeling Electric Company, Case No. 86-587-E-42T (Commission Order August 5, 1988) at pp. 7-8.

Write-offs for uncollectibles are, to a degree, in the control of management. Uncollectibles are the type of expenses with a tendency to fluctuate from one period to another, oftentimes without predictable consistency. As such, it is reasonable to normalize through the use of a three-year average.

Additionally, the Commission looks ahead to its decision regarding the cost causers (Customer Specific) tariff items and believes that the implementation of some of those tariffs will assist in reducing the level of uncollectible accounts; reversing the perceived trend of the Company.

In the instant case, the Commission shall adopt the Staff position and continue its use of the three year average for use in determining uncollectibles, as described in Hope Gas Inc..

Use Fees

The Company asserted that Staff eliminated approximately $170,000 of use fees to be paid to the Lewis County Economic Development Authority in 2003, suggesting that these fees should be capitalized as part of the Lewis County project. The Company agreed that this resolution would be acceptable if the Commission authorizes the Company to defer the amounts capitalized until such time as the revenue is recognized in rates. The Company asserted that none of the other parties disputes this resolution of the issue. Company Initial Brief at p. 39.

Staff did not reflect an increase for use fees to be paid the Lewis County Economic Development Authority in 2003 (about $174,000), since the new customers are not yet being served and since the Company did not include the revenues from this project. Direct Testimony, Kellmeyer, pp. 7-8. Staff recommended that the Lewis County use fees be capitalized as part of the construction cost. Id.

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Additionally, Staff disagreed with the Company's amortization of use fees that the Company deferred in 2002 and 2003 (approximately a $24,643 adjustment). Staff explained that while WVAWC asserted that all revenues from these projects were included in the last rate case, but not all of the use fees, the last rate case was settled. Therefore, it is impossible to know exactly what revenues and expenses were included. Moreover, Staff asserted that any attempt to correct prior period deficiencies is improper retroactive ratemaking. Id. at p. 8. Staff noted that the Company did not have the prior approval of the Commission to defer this amount nor did the Company suggest a decrease in any expense item that may have been less than what was included in the prior case. Staff Initial Brief.

The Commission shall not include the 2003 use fees paid to the Lewis County Economic Development Authority in this case. The Company's operation of the Lewis County project and the revenue from the new Lewis County customers are not included in test year costs or revenue. Granting the Company's treatment would violate the test year matching of revenues and expenses.

The Commission shall adopt the Staff position on this issue.

Use Fees – From Prior Period

The Company annualized its 2002 test year use fee payments and included that total amount ($3,484,824) in its rate filing. A portion of this annual amount ($24,643) represents a 37-year amortization of use fees that were inadvertently omitted from the Company's 2001 Rate Case filing. The total deferred amount of these use fees for 2002 and 2003 is $911,791. Company Exhibit MAM-A at 23-25.

Staff explained that while the Company asserted that all revenues from the projects were included in the last rate case, but not all of the use fees, the last rate case was settled. Therefore, it is impossible to know exactly what revenues and expenses were included. Staff asserted that any attempt to correct prior deficiencies is improper retroactive ratemaking. No prior approval by the Commission to defer the amount was granted by the Commission. Staff Initial Brief at p. 37-38.

The CAD argued that the Company has submitted no evidence to indicate that it has ever received an appropriate accounting directive from the Commission authorizing deferral of the use fees. Today's rate payers should not be held responsible for making the Company whole for costs it could have and should have recovered in the past. CAD Initial Brief at p. 34.

The Company argued that the Staff and CAD positions smack of "gotcha" rate-making and that the Staff and CAD opposition to this relatively insignificant annual amortization amount is hypertechnical and unjust. Company Initial Brief at p. 39.

The Commission agrees that the Company's attempt to reach backward to correct previous deficiencies constitutes improper retroactive ratemaking. Furthermore, the Commission did not grant the Company leave to defer the requested amounts. The Commission understands the Company's argument suggesting that the Staff and CAD position constitutes "gotcha" rate-making. However, the Commission sees a far larger "gotcha" were it to adopt the Company's position. Specifically, doing so would open the door for a utility to "lowball" (intentionally or unintentionally), its figures within a stipulation case only to later return to obtain a "bump" in those figures.

The Commission shall adopt the Staff and CAD positions regarding this issue.

Wages

In this case, there is a dispute between the parties with regard to reflecting anticipated future wage increases to non-union employees as going level adjustments to test year payroll expenses. The Commission has faced this issue before. In the Company's 1994 rate case, the Commission stated:

> [W]age increases for non-union employees have not been approved by the Company's Board of Directors and are not covered under any collective bargaining agreement. CAD argues that neither of the proposed increases are known and measurable. ... Staff and CAD cite the Mountaineer Gas Company, Case No. 93-0005-G-42T as authority for making the adjustments in the Company case. In that case, the Commission rejected similar proposed increases by the Mountaineer Gas Company. The Company argues that its position can be distinguished from the Mountaineer case. It argues that W.Va. Water has an established performance, appraisal and development plan which establishes criteria for payroll which takes it beyond the mere budgeted numbers deemed insufficient in Mountaineer Gas. ... The Company argues that its salary levels are calculable with a reasonable degree of certainty and must be recognized in its revenue requirements. Concerning the Huntington Division union employees, the Company argues that it is naive to expect that these employees can be denied a raise despite the recent raise granted to union employees in other Divisions of the Company. Those union employees were granted a 3.5% increase. We are generally reluctant under our known and measurable standard to grant recovery of employee costs that are not already

> agreed to under a contract or at least approved by the Company's board of directors and specified in direct correspondence to affected employees. We do agree with the Company here that the agreement with the union in the West Virginia Division helps to solidify the fact that the union workers in the Huntington Division will receive payroll related concessions. We will accordingly allow wage increases for the Huntington Division union workers and comparable non-union employees which are the same as those granted the union workers in the Company's West Virginia Division.

1994 Company rate case order at pp. 25-26. The issue is once again before the Commission. The CAD cited Mountaineer Gas Company, Case No. 93-0005-G-42T (October 29, 1993) and argued that a proposed wage increase for the Company's non-union salaried employees is speculative and should be disallowed. The Company's Board of Directors has not approved this increase as yet and the Company's policy is subject to change on its own whim. Tr. Vol. IV, p. 56.

The Commission believes that the Company has demonstrated similar and consistent treatment of its union and non-union employees. Such treatment was the basis for our decision in the Company's 1994 rate case. The CAD presented no evidence to demonstrate any pattern or instance where the Company failed to provide non-union employees with wage adjustments that were consistent with and comparable to wage adjustments negotiated for union employees. Therefore, we see no reason to depart from our historic treatment of this issue for the Company.

The Commission shall grant the treatment requested by the Company consistent with the Commission's treatment of this issue in the 1994 Company rate case.

Waste Disposal Expense

The Company is seeking an adjustment based upon the expected costs of operating the Company's new Kanawha Valley sludge disposal system, and budgeted costs for waste handling at the Company's other water treatment plants.

The Company adjusted its test year waste disposal expense by $145,601, for a total going-level expense of $954,207. The going-level adjustment is comprised of two components: (1) a normalizing increase over test year expense of $292,366 to reflect additional amounts the Company's engineering staff has recommended will need to be spent on an annual basis for the disposal of waste materials at production facilities other than the Kanawha Valley Treatment Plant; and (2) a decrease over test year expense of $146,765 relating to the difference between actual 2002 Kanawha Valley Treatment Plan waste

disposal billings and the estimated waste disposal expenses associated with the Company's residuals handling facility scheduled to go on line in early 2004. The difference between these two figures, a $145,601 net increase, represents the total going-level adjustment to waste disposal expense.

The Company argued that the use of lower projected waste disposal expense for the Kanawha Valley Treatment Plant associated with the residuals facilities (rather than the test year expense for Kanawha Valley Treatment Plant waste disposal expense) is acceptable if, but only if, the Commission permits the inclusion in rates of the capital investment associated with the residuals facility as the Company has requested. Company Initial Brief at p. 51-53.

According to the BOE, these claimed expenses clearly violate the known and measurable principle, and should be denied. BOE Initial Brief at p. 16.

The CAD argued the Company's proposed waste disposal expense adjustment does not constitute a known and measurable change and should be rejected. The CAD pointed out that support for its position can be found in the Company's testimony where the Company admitted at the hearing that it has deferred budgeted waste disposal activities in an attempt to conserve cash. Tr. Vol. III, p. 165.

Staff recommended a net increase of $26,746 for this expense item. Staff asserted that the Company's adjustment to going-level expense for facilities other than the Kanawha Valley Treatment Plant violates the known and measurable test. Staff did not include the Company's proposed expense reduction to reflect lower O&M costs associated with the residuals facilities at the Kanawha Valley Treatment Plant because it is not known and measurable and because Staff excluded this facility from the Company's going-level rate base as expense reducing. Staff Initial Brief at pp. 44-45.

The Commission finds that this adjustment does violate the known and measurable test. The adjustment for the treatment facilities other than the Kanawha Valley Treatment Plant represent nothing more than budget expectations based on the Company's engineers estimates of future expenses. These types of estimates simply do not rise to the level of certainty that should accompany appropriate going level expense adjustments in a historic test year rate case. Furthermore, while the expectation for the Kanawha Valley facility is different than the adjustment for other treatment facilities, it represents a future test year concept where expenses are adjusted downward and plant investment is adjusted upward. Clearly, the matching of test year expense units with test year revenue units and test year investment levels does not comport with the adjustment proposed by the Company for the Kanawha Valley Treatment Plant sludge handling costs.

The Commission shall reject the Company's proposed speculative adjustments and shall adopt the Staff position on this issue.

Workers' Compensation

The Company submitted that when the Company's base rate increase of 15% and the effect of a favorable modification to the Company's claims experience rating are aggregated, they generate a Workers' Compensation rate of 3.29%. This is the Company's current rate and the one that will be in effect until further notice. The net effect of these changes reduces the adjustment for Workers' Compensation expense included in the Company's direct testimony by $93,275. The Company asserted that the Staff, the CAD, and the BOE have concurred in this result. Company Initial Brief at p. 44.

As the newly generated Workers' Compensation rate of 3.29% for the Company is now known and measurable, the Commission shall adopt that rate. The net effect of that change will reduce the adjustment for Workers' Compensation expense included in the Company's direct testimony by $93,275.

RATE BASE

The term "rate base" refers, generally speaking, to a utility's investment in utility plant. Principally, a utility's rate base is financed by investor-supplied capital and consists of numerous elements, including utility plant in service, utility plant held for future use, certain elements of construction work in progress (completed and in service), and certain unclassified plant in service. The rate base generated by adding these elements together is then generally adjusted for items such as accumulated depreciation; depletion and amortization; contributions in aid of construction; customer advances for construction; working capital; and deferred federal incomes, among other things. After all necessary elements are properly added to or subtracted from rate base, the net rate base represents the amount of utility plant and other capitalized items to which the rate of return authorized by a utility commission will be applied to generate the return component which will be included in the utility's rates. This return component will include allowance for interest costs, dividends on preferred stock, and a return on equity. Generally, for utility plant to be included in rate base, it must be used and useful (i.e., used by the utility in providing service to its customers).

Rule 42 of the Commission's Tariff Rules requires that, in rate filings before the Commission, rate base be stated as a 13-month average. This average of rate base as of the beginning of the test year and as of the end of each month of the test year generally properly matches rate base to revenues and expenses of the test year.

Departure from a 13-month average rate base has been permitted by the Commission in certain circumstances. For example, for electric utilities, year end rate base has been permitted for items such as pollution control equipment which is considered to be non-revenue producing and non-expense reducing. The principle behind the different treatment reflects the fact that, generally, when utility plant is placed in service, it usually results either in additional revenues or greater operating efficiencies by replacing older, outdated plant with newer and more productive plant, thereby, reducing the utility's expenses. Thus, such plant is generally not permitted in rate base until the revenues to be generated by that plant or the expense reductions generated by that plant can also be reflected in rates at the same time that the return on that rate base is reflected in rates.

Terminal Treatment of 2002 Rate Base Additions

The CAD recommended reducing rate base by $3.941 million arguing that none of the 2002 projects were related to bringing service to ill-served areas, and are normal recurring plant replacements, such as mains and services. CAD Initial Brief at p. 21.

While we require the filing of an average test year rate base, the Commission has allowed going level adjustments to rate base under certain conditions. For example, in Hope Gas, Inc., Case No. 93-0004-G-42T (October 29, 1993) we allowed year end rate base as appropriate only in the very narrow range of cases where there is substantial test year investment which is non-revenue producing and non-expense reducing. In the Company's 1994 rate case the Commission stated the following:

> The Commission has traditionally regulated utilities using a 13 month average test year rate base. The CAD in this case argues that the Commission should use its traditional 13 month average for rate base. Staff allowed terminal rate base treatment only on certain rate base which it viewed as non-revenue producing, non-expense reducing additions, including those budgeted for 1995. The Company requested year end or terminal rate base treatment for its entire rate base. In the last several West Virginia Water stipulated cases, the Company was afforded the Staff calculation of rate base, which allowed terminal treatment for non-revenue producing, non-expense reducing additions to plant, including those budgeted for the future. The Commission does not view the stipulated cases as having any precedential value. The mere fact that the Commission approves a stipulation does not indicate Commission approval of a particular rate treatment for rate base. The Commission has no problem with allowing appropriate going level adjustments from test year rate base when they are known and do not violate matching principle. However, the line between "known and measurable" and "reasonably expected" is

difficult to draw. Staff and the Company suggest a very broad line and CAD suggests a fine line. The Commission is prepared to allow the Staff methodology, in this case, only because the stipulated agreements permitted it in prior cases. However, we put the Company on notice that such treatment will not be granted in its next rate case unless the Company can demonstrate the need, prudence, and reasonable certainty of construction expenditures. Furthermore, the non-revenue test must be met for any projects not afforded the special treatment for investments in ill-served areas. The current record does not justify the Commission abandoning its traditional ratemaking philosophy regarding year end rate base.

The Commission is concerned with the difficulties that the Company apparently suffers in actually achieving its rate of return as authorized by the Commission. The Commission is also sensitive to the fact that the Company is having an ever increasing rate base needed to service its customers but has a very slow increase in sales. The Commission is also sensitive to the large unmet water needs in West Virginia, in which the Company may be a key player in providing service. We are, therefore, willing to consider alternative treatments to rate base in the future. One possibility that the parties should review and examine in the next rate case is a possibility of a special experimental allowance for West Virginia Water Company of an Allowance For Funds After Construction (AFFAC). A possible AFFAC adjustment might allow the Company to accrue the dollars spent after construction on non-revenue producing, non-expense reducing plant that could be recovered in later rate cases. The Commission is willing to consider an AFFAC mechanism but only on the plant that is truly non-revenue producing non-expense reducing. The Commission is concerned that the Company or other advocates of special rate treatment actually prove that any qualifying rate base be actually non-revenue producing, non-expense reducing. The Commission is willing to consider other experimental innovative ratemaking treatments to address the special problems West Virginia Water has regarding its rate base.

Another issue in this case revolves around West Virginia Water's participation in certain projects to better serve ill-served areas. In this case, there were Kanawha County projects, as well as a Winifrede/Decota project, for which the Staff advocated special rate base treatment. Even though these projects produced revenue, the Staff allowed special treatment to include these projects as terminal rate base for the portion exceeding three and one half times annual revenue(excess investment).We will approve of this special innovative treatment for the Company for these projects in this case. We will

> also consider similar treatment for other ill-served or under served areas in the future. However, we view this as an experimental innovative ratemaking treatment for West Virginia Water Company due to its unique situation. In the future, any such special treatment must be requested as part of the certificate of the project in order to later qualify for the excess investment terminal rate base treatment in later rate cases. Again, the Commission is not attempting to depart from its traditional ratemaking philosophies for all utilities, but merely for West Virginia Water as an experimental innovative response to what the Commission perceives to be special difficulties for the Company.

1994 Company rate case order at pp. 55-58.

Clearly, the Commission has set parameters for terminal treatment of certain rate base items for the Company and we believe those have been met in this case for the rate base adjustments advocated by Staff. The Commission does not believe that the CAD has provided any reason for us to reject the Staff's recommended adjustments that conform to the Commission's past practice of allowing non-revenue producing and non-expense reducing plant additions during and even after the end of the test year to be given terminal rate base treatment.

The Commission shall reject the CAD's position on terminal rate base treatment.

Acquisition Adjustments

This issue revolves around the debit (or positive) acquisition adjustment balances that occur when a utility pays more than book value for another utility's assets and the credit (or negative) acquisition adjustment balances that occur when a utility pays less than book value for another utility's assets.

Staff recommends the Commission reduce rate base by $450,804 for treatment of negative acquisition adjustments. Staff witness Kellmeyer explained that an acquisition adjustment occurs when the acquisition price is different than the book value of the acquired utility. Tr., Vol. 5 at p. 169. Ms. Kellmeyer further explained that when a utility pays more than book value for the acquired company, the ratepayers should not be made to pay more for the purchased utility than its original cost minus depreciation. Id. at pp. 169-170. Ms. Kellmeyer explained that when a company pays less than book value for a utility and then brings the plant over to the company's books at the book value of the acquired utility, then its books show more dollars than the acquiring company has actually spent. Id. at pp. 170-171. In such instances, Staff does not believe the ratepayers should pay on a rate base that reflects more dollars than the utility's actual outlay. Id.

Ms. Kellmeyer further explained that Rule 2 of the Commission's Water Rules requires utilities to follow the Uniform System of Accounts. Ms. Kellmeyer stated that the Uniform System of Accounts requires Commission approval for disposing of the difference between the actual book value of the utility or company that is being acquired and the purchase price. Id. at pp. 193-194.

Staff argued the following in its Initial Brief:

> Mr. Miller seems to argue that the Company is surprised by this turn of events, or that the Commission had some responsibility to tell it in advance of the unavailability of excess acquisition adjustments for rate base purposes. Or, on the other side of the coin, he seems to be surprised that there is not some automatic allowance of purchase price in rate base when the assets have been acquired at less than book value. Mr. Miller should be well aware, however, that the Uniform System of Accounts clearly requires that acquisition adjustments, both positive and negative shall be disposed of as directed by the Commission. Furthermore, Staff does not understand his position that in future cases the Commission should look at the circumstances of the acquisitions and indicate its acceptance of the purchase price and outline the ratemaking treatment to be afforded any acquisition adjustment. Clearly, the Company must record the acquisition adjustment in Account 114 pursuant to the Uniform System of Accounts. All amounts with regard to each property acquisition should remain in Account 114 until the proper disposition, either amortization or some other treatment, is ordered by the Commission. Thus, the Commission has already prescribed such treatment in the System of Accounts, and the Company should seek the appropriate accounting disposition of each property acquisition where either a positive or negative acquisition adjustment balance results. The Staff, in this case, is simply doing the Company's job for it by identifying property acquisition credits and recommending that they be treated as contributions in aid of construction. Indeed, if property is given to the utility at no cost, say by a developer who installs water plant as part of an alternative extension agreement, there is no dispute that the company is required to record a contribution in aid of construction to that its rate base reflects the actual acquisition cost, or zero. This issue is no different, except that instead of acquiring property at no cost, the company is acquiring it as less than net book cost. If, in the first situation, a $10,000 piece of property is given to the utility at zero cost, and the utility offsets the $10,000 value with a $10,000 contribution in aid of construction to arrive at a net zero rate base value, then clearly it would make no sense if the company pays $1,000 for that property

it would be allowed a rate base of $10,000. The Staff's position merely identifies the $9,000 credit (negative) acquisition adjustment that results from this transaction and disposes of that credit by treating it as a contribution in aid of construction. As in the first instances, where rate base value of property acquired for a zero amount is zero, in the second instance the rate base value of property acquired for $1,000 should be $1,000.

Staff Initial Brief.

The Company noted that Staff proposed to reduce rate base by increasing contributions in aid of construction for negative acquisition adjustments. The Company expressed concern over Staff's selective application of this concept in that Staff only recommended modification to contributions in aid of construction for negative acquisition adjustments, i.e., where the Company purchases a utility system for less that its per-book rate base. The Company recommended the Commission should either deny the Staff's proposed increase to contributions in aid of construction or require equal treatment for both positive and negative acquisition adjustments. Company Initial Brief at pp. 68-69.

A recent example of the Commission's treatment of an acquisition adjustment can be found in the 2001 East Bank acquisition case (West Virginia-American Water Company and East Bank Water Department, Case No. 00-1719-W-PC (Commission Order February 6, 2001)) wherein the Commission ordered the following treatment:

> IT IS FURTHER ORDERED that the Company record the book cost of the assets acquired and related contributions and accumulated depreciation, adjusted for any prior depreciation on contributions, as stated on the books and records of the Town of East Bank at the time of closing. Any amount paid in excess of the net book value of the acquired assets, as adjusted, should be recorded in account 114, Utility Plant Acquisition Adjustments, and be amortized over 20 years. Any amount of asset book value in excess of the amount paid will be considered as a contribution. Lastly, any necessary rate recognition relating to this acquisition will be given the appropriate treatment in the Company's next general rate case after closing.

The treatment outlined above is consistent with Staff's argument and with the Commission's treatment of this issue.

The Commission shall adopt the Staff position on this issue and shall reduce rate base by $450,804 for treatment of the negative acquisition adjustments.

Capital Projects

The BOE argued that rate base should be increased only by $1,450,000 for capital projects. A corresponding adjustment to the Company's depreciation expense results in a net $7,070,490 reduction to the Company's rate base. The BOE argued that the Commission should require the Company to use internally generated funds for capital projects by including internally generated funds in rate base, thereby offsetting the Company's capital projects which have been included in rate base in this filing. Should the Commission do so, this will have the effect of institutionalizing a mechanism which will help minimize the Company's rate base, and thereby stave off future rate increases. BOE Initial Brief at p. 13.

The Commission was not convinced by the BOE's arguments and shall not adopt its position regarding this issue.

Cash Working Capital

Working cash is the capital contributed by investors which must be used to pay for expenditures of a company due to the lag time before revenues to pay for such expenditures are received from the customers. Cash working capital is included in rate base in order to provide the investors with a return on this supplied capital. Depending on the timing of expense payments relative to collection of revenues, a utility may actually receive reimbursement before paying an expense, and this results in a negative cash working capital requirement which should be reflected as a reduction to rate base. On the other hand, when a utility must pay expenses prior to collecting the associated revenues, the result is a positive cash working capital requirement that should be added to rate base.

A lead/lag study measures the differences between the time services are rendered until the time revenues for those services are received, on the one hand, and the time that expenses are incurred for providing utility services and the time when payment is rendered by the utility for those expenses, on the other hand. The difference between these periods is expressed in terms of days. For example, a utility may have an average revenue lag of 45 days, or it supplies service for 45 days before it receives revenue from customers. At the same time, the utility may have an expense lead of 40 days, or it waits 40 days after expenses are incurred before it actually pays out the cash for those expenses. In this example, the 5 days difference between this lag and lead represents the period of time that investor supplied working capital must be available to cover expenses. The number of days calculated multiplied by the average daily operating expenses produces the cash working capital required for operations.

The Company's lead/lag study actually shows that while its revenue lag is 45.23 days, its expense lead (the number of days it carries expenses as payables before it must actually pay the expense) is 47.79 days. Thus, on average there is no investor supplied working cash. Instead, customers are actually providing the Company with funds before they are needed to pay expenses by an average of 2.56 days worth of expenses. Based on this analysis, the Company is requesting a ($575,000) rate base allowance for cash working capital.

The CAD argued that the Company's 2002 lead/lag study showed that on average, customers, rather than investors, provide working funds that enable the Company to pay its day-to-day operating expenses. Thus, a negative rate base allowance for cash working capital is appropriate in this case. CAD Initial Brief at pp. 23-24. However, the CAD analyzed the lead/lag data differently to arrive at a larger rate base offset than the one requested by the Company.

The Company argued that the CAD was including items in its lead/lag study that should not be included. For example, the depreciation component of the Company's cost of service represents the return of capital invested by the Company's shareholders in utility plant, less salvage plus cost of removal. Thus, the Company argues, the CAD's lead lag analysis is faulty and there is absolutely no basis to conclude that this cost of service component should be "returned" to the ratepayers. CAD's recommendation that the 1% interest charge on late payments would generate sufficient revenues to compensate the Company for late payments by its customers is inappropriate. The Company argued that (1) it imputes revenues from the proposed 1% interest charge, a recommendation that reduces the CAD's revenue requirement to be collected from general water sales, and at the same time reduces the revenue requirements through a decrease in the Company's cash working capital allowance; (2) it is a mis-assumption regarding the application of a 1% interest charge to 22.5% of revenues; and (3) the delayed payment penalty is not meant to compensate the Company but to deter late payments and is not, as noted in Water Rule 4.3.5, interest. Company Initial Brief at p. 63.

The Commission agrees with the Company's analysis: The CAD has attempted to include depreciation expense in the lead/lag study. The Commission's position on this matter is to deny the depreciation expense in the lead/lag study, as depreciation expense is a non-cash item and should not be included in the lead/lag analysis.

We shall provide for a negative cash working capital component of rate base premised on the lead lag study presented by the Company and supported by Staff, adjusted for changes in revenue and expense components reflected in this decision.

Customer Information Services

The Company included in rate base a post test year addition consisting of the Kanawha Valley Customer Information System CIS at a cost of $2,529,832. Company witness Roy L. Ferrell, Sr. explained that the Company began using the initial version of this software in November 1998, and the installation of the initial version was completed in 1999. Rebuttal Testimony, Ferrell, pp. 7-8. Mr. Ferrell further explained that the costs associated with the initial version have been recognized in rate base for ratemaking purposes in prior rate cases. Id. Since that time the Company has gone through the installation of several upgrades. According to Mr. Ferrell, the Company has capitalized the costs of these new upgrades, but will not close the project to utility plant until 2003 because minor costs continue to trickle in. Id.

Mr. Ferrell explained that the Company and its customers have already received a majority of the improvements from this project, since most were realized when the Company converted to the Call Center. Mr. Ferrell further explained that these efficiencies and savings were already incorporated in test-year expenses. Id. Mr. Ferrell stated that only the cost of the needed software upgrades and application adjustments carried over to 2003. Id. Mr. Ferrell asserted that since the savings (expense reductions) associated with the programs are already built into the case, it would be unfair for Staff to accept these savings and deny the associated investment. Id. at pp. 6-7.

The Company argued that the Commission should expect the Company to invest in the most modern and efficient replacement plant available. The fact that a new utility plant such as software may offer assorted attributes in comparison with the replaced plants should not come at the cost of post-test year rate base recognition. It is unfair for Staff to disallow rate base and at the same time recognize the savings generated by those initiatives. Company Initial Brief at pp. 60-61.

Staff does not believe that any of the CIS investment should be included in rate base since the Kanawha Valley Customer Information System is expense reducing and, therefore, would be more of a future test year adjustment rather than the type of non-revenue producing/non-expense reducing rate base adjustment historically allowed by the Commission. Staff Initial Brief. Staff recommends a corresponding reduction in rate base of $2,529,832.

Staff witness Kellmeyer, explained that the Company, in its Utility Management report filed on March 11, 2003, stated that the comprehensive information systems created operating efficiencies and productivity improvements which allow the Company to respond more quickly to the needs of customers and eliminates multiple handling of paper records.

Direct Testimony, Kellmeyer, pp. 15-16. Based on this information, Ms. Kellmeyer concluded that this post test year project was expense reducing and, thus, should not be included in rate base. Id.

Staff asserted that this post test year addition should not be allowed since the system was not in service in the historical test year. Ms. Kellmeyer stated that she believed that the savings that are in the case are associated with the software that was previously purchased and not with the software purchased in 2003. Tr., Vol. 5, at p. 162. Therefore, there may be further expense reduction once the system is placed into service. Furthermore, if there is no further expense reduction, then Staff would question the prudence of such expenditure. Tr., Vol. 5 at p. 163. Thus, WVAWC's post-test-year addition of this project to rate base is not supported under the test for when post test year adjustments are allowed as set forth in the 1994 Company rate case order at p. 55. Staff Initial Brief.

The Cities agreed with the Staff position regarding this issue. Cities Initial Brief at p. 20.

The Commission agrees with the Staff regarding this issue. The software was not installed until July of 2003 and thus lies outside of the test year. Additionally, the decision to upgrade software is not on par with on-going pipeline maintenance and consequently shall not be afforded the terminal rate base consideration given to pipeline maintenance.

Pre-payments (Insurance, Expenses, Taxes, Misc.)

This issue arose due to a misunderstanding of whether prepayments were reflected in the Company's lead lag study. If prepayments were included in the lead lag study, the expense leads would be greatly reduced in recognition of the fact that expenses are paid in advance rather than in arrears. This would tend to reduce the number of days expenses are carried as payables before they are paid which would in turn increase the net cash working capital requirement. Under these circumstances, it would not be appropriate to also include prepayments as a separate rate base item. The Company explained that it had not reflected the prepayments in its lead/lag study and therefore, it is appropriate to separately include prepayments in rate base.

This issue appears to have resolved itself and the Commission shall adopt the Company's position on this matter.

Residuals Plant

The CAD noted that the Charleston residuals handling facility is still under construction and its completion date and final cost are still unknown. As the facility is not yet used and useful in providing service to customers and its final cost impact is unknown, the CAD recommended reducing rate base by $2.526 million. CAD Initial Brief.

The Company pointed out the fact that the Commission has certificated the facility in part because the Kanawha Valley Treatment Plant will no longer be allowed to discharge treatment residuals into the Charleston Sanitary Board's wastewater system after April 2004, making this a "hard deadline" for the completion of the project. The Company noted that it will not recognize whatever savings the residuals facility may generate over test year waste disposal expense until it comes on line in 2004, eliminating any "mismatching" concerns between the claimed expense savings and the recovery of investment needed to generate those savings. Thus, the Company requested the Commission authorize an inclusion in rate base of $2,152,394. Company Initial Brief at pp. 61-62.

Staff recommended removal of $2,152,394 from rate base since it is expense reducing and, therefore, does not comply with the Commission's post rate base adjustment policy. Staff asserted that the Company's contention that the cost of the new residual facility will be the same as the current costs of using the City of Charleston, is only an estimate. Staff argued that there is a significant change in operations associated with this facility, with one expense being significantly reduced and other expenses (capital costs and operation and maintenance of the new facility) being increased. Staff argued it is this sort of estimation and guessing that can turn an historic test year adjusted for known and measurable changes into a projected test year. Staff Initial Brief at pp. 31-32.

The Commission shall adopt the Staff position on this issue and reduce rate base by $2,152,394.

Sutton River Crossing

The CAD argued that the Sutton River Crossing replaced a badly deteriorated 8-inch river crossing pipe with a new 12-inch pipe. The project was completed after the end of the test year and added $93,000 to plant in service. CAD argued that this post-year addition fails the "non-expense reducing" test, and should be excluded from rate base in this case. CAD Initial Brief at p. 22-23.

The Commission does not see any distinction between this issue and the other terminal treatment issues discussed above. We believe that the Company has demonstrated

that this rate base addition is non-revenue producing. Furthermore, there is no evidence of significant test year expenses that will be eliminated by the investment in the new river crossing are that are of such magnitude as to lead us to reject our terminal rate base treatment of this item.

We shall allow the Sutton River Crossing in rate base.

REVENUE REQUIREMENT RELATED ISSUES

Cost Causers/Customer Specific Tariff Items

The Cost Causer tariff items, which we shall hereafter refer to as Customer Specific tariff items, were introduced by the Company in this rate case as a "fairness" issue. Implementation of Specific Customer tariffs would assign certain identified costs to the individual customers "causing" those costs, and the revenue generated from them would serve to decrease the amount the Company must recover under its general water tariff from all customers. Company Initial Brief at p. 66. The Commission shall address each of the Specific Customer tariff items in turn.

Customer Specific Tariff Item – Account Activation

The proposed $20 account activation charge covers the cost to physically turn on water at a customer's residence.

Staff does not believe the Company's proposed $20.00 account activation charge should be approved. This charge, if approved, will bring in approximately $736,000 in additional revenue. Staff argued that it is not a reasonable practice for a utility to charge a new customer for the privilege of becoming a customer since there is not a lot of real incremental cost associated with signing up a new customer. Direct Testimony, Stewart, p. 10.

Company witness Mr. Herbert explained that this charge is intended to recover the same costs associated with the reconnection charge. Rebuttal Testimony, Herbert, pp. 6-7. Mr. Herbert asserted that the Company does not believe that customers who need water service will be impeded by a $20.00 account activation charge. Furthermore, the Company believes such charge will offset the costs associated with a serviceman having to physically turn on water. Lastly, this charge will discourage over use by customers who request service to be discontinued for a period of time to avoid minimum bill charges only to request that service be reconnected after a short period of time. Id.

The Commission agrees with Staff on this issue. While the Commission shall allow the Reconnection Charge (discussed below), the Company's proposal to charge a customer for the privilege of becoming a customer is unreasonable.

Customer Specific Tariff Item - Delayed Payment Penalty

Water Rule 4.3.e reads as follows:

> Each bill shall bear upon its face the latest pay date and the date it shall be a delinquent bill if not paid. On all current usage billings not paid by the latest pay date, ten percent (10%) will be added to the net current amount unpaid. This delayed payment penalty is not interest and is to be collected only once for each bill where it is appropriate.
>
> 1. When a utility receives a customer payment at a time when both a delinquent bill and a current bill are outstanding, the utility will apply the payment first to the current bill, and apply any leftover amounts to the delinquency. Provided, that this rule shall not apply to payments from customers whose delinquencies have been addressed in a deferred payment agreement. If a termination notice has been issued then the payment should first be applied to the delinquent amount that is the subject of the termination notice.

The Company proposes that its tariff provision be modified to provide for a 10% delayed payment penalty and to state that the penalty would be a one-time charge of 10% on the unpaid amount if payment is not received after 21 days from the date of the bill. The Company has projected that it is likely to generate revenues of approximately $2.1 million at current rates. Company Ex. PRH-A at 4.

The BOE support the inclusion of this Customer Specific tariff item. The BOE argued that Staff and CAD fail to recognize that the delayed payment penalty, as adopted by the Commission in its recent revision to the Water Rules, is explicitly intended to be punitive toward the customer to encourage prompt payment. BOE Initial Brief at p. 17.

The Commission shall permit language corresponding to that contained in the rule for use in the Company's tariff.[3] However, in the interest of notice to the customers, the Commission shall require the Company to provide either a billing insert or a separate mailing to customers explaining that the Company will apply a new 10% penalty charge on the unpaid portion of any bill that remains outstanding for more than 20 days after the bill is mailed to the customer. The Company shall not impose the Delayed Payment Penalty until such notice has been provided to the customers and an affidavit of such notice has been submitted to the Commission. Additionally, for all bills which will be subject to the new delayed penalty provision, the Company shall include on all customer billing statements both the amount due if paid timely as well as the date and the amount of the bill if paid late. For example:

Amount due and owing:	$40.00
If paid after March 20, 2004:	$44.00

Customer Specific Tariff Item - Leak Adjustment Fee

The Company proposed to increase the incremental cost of water used in "leak adjustment" situations from the current level of $0.27 per 1,000 gallons to $1.55 per 1,000 gallons. The Company's proposal would bring in approximately $120,000 in additional revenue.

Staff does not believe the Company's proposal is reasonable and recommends that the Company be given permission to increase the incremental cost of water from the current level of $0.27 per 1,000 gallons to $0.30 per 1,000 gallons. Staff's proposal will bring in approximately $3,000 in additional revenue (a difference of $117,000). Staff Initial Brief.

Staff explained that the key word in this issue is "incremental"--the short-run variable cost to produce additional water. Direct Testimony, Stewart, p. 11. Staff witness Stewart noted that the unusual "consumption" of water caused by a leak on the customer's premises

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[3] The Commission is aware of certain situations in which a customer's income and payment due date are out of sync to the degree that the customer may always make a monthly bill payment but such payment is consistently late. There may be circumstances under which it is a hardship for the customer to alter his/her bill paying schedule. The Company should consider placing the customer on a different billing cycle or granting an exemption from the penalty provision where such conditions exist or the Commission may consider such exemption on a case by case basis.

is not expected to place such a burden on the Company so as to require the Company to buy a new pump, hire a new plant operator, or even pay overtime. Moreover, Staff noted that the purpose of a leak adjustment rate is to be fair to both the utility and the customer: The customer should not be harshly penalized for a leak event over which he had no control and for which he has demonstrated a willingness to fix, and the Company should be compensated for its cost of producing additional, unanticipated volumes of water lost by the customer. Mr. Stewart noted that a leak of 10,000 to 20,000 gallons would involve only a very small amount of power and chemicals instead of creating a need for additional labor, overheads, etc. Id. at pp. 11-12. Mr. Stewart recommended that the rate be set at $0.30 per 1,000 gallons, which is consistent with Staff's Rule 42 exhibit for purchased water, fuel and power, chemicals and waste disposal. Id.

CAD witness Scott J. Rubin recommended that this rate be related to the base cost of water and recommended that the rate be 35% of the base cost or about $0.97 per thousand gallons. Direct Testimony, Rubin, pp. 38-39.

Mr. Herbert asserted that the Company does not believe the incremental cost of water, which Staff focuses on, recovers enough costs. Rebuttal Testimony, Herbert, p. 9. Mr. Herbert further stated that the Company believes Mr. Rubin's approach is more in line with the Company's; however, the Company does not agree with his 25% factor. Instead, the Company believes a 50% factor is more reasonable and would be acceptable to the Company. Mr. Herbert concluded by stating that the Company recommends that the leak adjustment rate be no less than $1.51 per 1,000 gallons using the Company's approach or no less than 40% of the unit base costs using CAD's approach. Id. at p. 9.

The Commission shall adopt the Staff position on this issue. The Company's calculation of the leak adjustment fee includes fixed costs contrary to Water Rule 4.4.c., which reads, in part, as follows:

> 4.4.c. Leaks on the customer's side of the meter–
>
> > 2. The policy shall provide for a recalculated bill to reflect the utility's incremental cost of treating or purchasing the water, ...

Such calculation of the cost of treating or purchasing water does not include fixed costs.

The Commission shall utilize a $0.30 per thousand gallons as the incremental cost of water for the Company when determining its leak adjustment fee.

Customer Specific Tariff Item - Reconnection Charge

Staff agrees with the Company's proposed $20.00 reconnect charge, which is supported by Water Rule 4.8.c[4]. This charge will bring in approximately $234,000 in additional revenue. However, Staff argued that while it agrees with this proposed charge, it does not believe that customers who require deferred payment agreements should be required to pay the reconnect fee in full as a condition of resuming service. Direct Testimony, Stewart, p. 10. Instead, Staff recommends that this fee be added to the past due balance and recovered as part of the deferred payment agreement. Id.

The CAD recommended rejection of the fee except in cases where disconnection of service is seasonal or voluntary. The Industrial Intervenors and the BOE both supported the provision as requested by the Company.

The Commission shall allow the $20.00 reconnection charge. However, the Commission shall not allow the double recovery of reconnection charges in instances where the Company has a disconnection agreement with a sewer company. For example: Suppose Customer Smith is delinquent to both his Sewer Utility and to the Water Company. The Sewer Utility, through its agreement with the Water Company, requests disconnection of Customer Smith. Upon reconnection, Customer Smith is required to pay the reconnection charge to the Sewer Company. The Sewer Company passes its reconnection charge on to the Water Company per their disconnection agreement. The Water Company may not also collect its own reconnection charge from Customer Smith even though the Company had planned to disconnect Customer Smith for his delinquency to the Company.

Additionally, the Commission shall adopt the Staff's recommendation and allow the reconnection charge to be added to the past due balance and recovered as part of any

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[4] Water Rule 4.8.c. "Charge for reconnection" reads as follows:

1. Whenever the supply of water is turned off for violation of rules, non-payment of bills, or fraudulent use of water, the utility may make a charge as set forth in its tariff for reestablishment of service.

2. If service is discontinued at the request of the customer, the utility may refuse service to such customer, at the same premises, if requested within eight (8) months of the date service was discontinued, unless the customer shall first pay the reconnection charge set forth in the utility's tariff.

deferred payment agreement that may be entered into between the customer and the Company. The Company's tariff provision shall reflect the above modifications.

Customer Specific Tariff Item - Returned Check Charge

Company's proposed return check charge of $15.00 would bring in approximately $36,000 in additional revenue, whereas Staff's recommended $7.00 returned check charge would bring in approximately $16,800 in additional revenue.

In Little Creek Public Service District, Case No. 01-0970-PWD-T (August 10, 2001), the Commission allowed a return check charge and stated the following:

> It is established Commission policy to permit utilities to charge their customers for bad checks an amount that does not exceed the amount that the utility's bank charges the utility for such check, provided that such charge may not exceed $15.00. See Union William Public Service District, Case Nos. 94-0110-PSD-42A and 94-0111-PWD-42A (Commission Order March 10, 1995); Page-Kincaid Public Service District, Case No. 95-0345-PWD-T (Commission Order June 15, 1995); Chattaroy Public Service District, Case No. 96-1343-PSWD-T (Commission Order December 9, 1996). The Commission's policy is based on reasoning that a utility should be permitted to recover a bad check fee directly from the customer incurring the charge in order to directly match the cost causer to the cost, rather than spreading the cost throughout the entire customer base.

However, the Commission has limited such charge to the actual fee imposed by the bank. More recently, the Commission raised the maximum amount of the returned check charge to $25.00 due to a statutory amendment and when requested by the utility. Marshall County Public Service District, Case No. 03-0869-PWD-T-PW (Commission order entered August 20, 2003). However, the Commission continued to limit the amount of the returned check charge which a utility may charge to the actual bank charge.

The Commission shall allow the returned check charge requested by the Company not to exceed the actual returned check charge charged to the Company by its bank.

Customer Specific Tariff Item - Service Connection Charge (Tap Fee)

The Company requested a tap fee of $450 for 3/4 inch connection and $500 for one-inch connection. Taps for large sizes would be the actual costs for such connections under the Company's proposal.

The Commission concurs with Staff's assessment that since the Company, as a large investor-owned utility, does not have the same limited access to capital sources and the same need to live off of day to day cash flow as many publicly operated utilities, then the Company should recover all capital costs involved in providing service to new customers in the same manner that it recovers any other capital expenditure, which is through return on rate base. Direct Testimony, Stewart.

The Commission shall deny the Company's request for a Service Connection Charge.

Huntington Sanitary Board Revenues

The CAD argued that a simple reading of the unambiguous language of the "Service Agreement" entered into by the Company and the Huntington Sanitary Board, for the provision of certain billing and accounting activities, reveals that the Company is not complying with the terms of the contract and the Commission's order. Accordingly the CAD recommends that the Commission increase the Company's revenues by $127,051. CAD Initial Brief at p. 26.

The Company argued that in his rebuttal testimony, Company witness Ferrell explained in detail why the CAD's proposed adjustment has absolutely no basis, is undercut by the plain language of the Company's Commission-approved contract with the Huntington Sanitary Board, and otherwise fails to meet the known and measurable standard. Company Exhibit RLF-B at 39-42. The Company argued that it proved that the contractual rate is still an accurate, cost-based calculation of its cost to provide sewer billing services to the Huntington Sanitary Board. Id. at 41; Company Exhibit RLF-B at Rebuttal Exhibit RLF-4. The Company urged the rejection of Rubin's adjustment.

The Commission agrees that Company witness Ferrell's recalculation of the cost of providing billing services to the Huntington Sanitary Board, containing a $0.79 figure, continues to be justified. Company Exhibit RLF-B at 39-42 and Rebuttal Exhibit RLF-4. The Commission shall reject the CAD argument on this issue.

Miscellaneous Service Revenues

The CAD argued that the Company's level of miscellaneous service revenues should be increased to account for the increase in the amount of rent the Company receives for housing the Southeast Region Service Company. CAD Initial Brief.

The Commission shall adopt the CAD position on this issue and add $25,388 to revenues as a known and measurable change.

TAXES

Federal and State Unemployment, FICA taxes, Interest Synchronization Adjustment, and State Business and Occupation taxes

The Commission shall adjust the above items consistent with the Commission's previous payroll decisions herein regarding employee levels and the Payroll Expense Ratio, among others.

Property Tax

According to the Company, both Staff and the CAD have agreed to a final figure of $4,312,687 ($7,655 more than the Company's initial estimate) for this item. Company Initial Brief at p. 54, 55.

The Commission shall adopt the $4,312,687 figure as agreed to by the Company, CAD, and Staff as it represents the actual 2003 property tax liability figure.

RATE DESIGN/COST ALLOCATION ISSUES

Cost Allocation

While CAD's primary recommendation is that the Commission not award the Company any increase, CAD argued that if the Commission rejects this recommendation, then the Commission should adopt CAD's rate design based on CAD's class cost of service study. Direct Testimony, Rubin, pp. 47-48; and Supplemental Direct Testimony, Rubin, pp. 2-3. CAD stated that it produced a cost of service study based on the fundamental principles of the "base-extra capacity method" laid out by the American Water Works Association. The CAD study showed that several classes were earning below the overall Company return, and that the tail block for consumption was priced below the base cost of producing water. The CAD recommended that if any increase is granted in this case, that the Commission first cover that revenue requirement with any new revenue from the Cost Causer/Specific Customer tariffs, and then use the results of CAD's cost of service study as a guide in spreading the remainder of revenue requirement to the various customer classes and rate blocks. CAD Initial Brief at p. 50.

Staff did not agree with CAD's class cost of service study and recommended that any rate adjustment ordered by the Commission be spread equally across the board to all classes. Rebuttal Testimony, Calvert,(Staff Exhibit No. 6).

Staff explained that CAD's class cost of service study uses the "base-extra capacity" method. Rebuttal Testimony, Calvert, p. 3. Ms. Calvert further explained that the Commission in Case No. 94-0138-W-42T made clear that it would consider which of two methods was the more appropriate class cost of service study in the Company's next rate case which involved a class cost of service study. The two methods referred to were the "base-extra capacity" method and the "commodity-demand"method. See 1994 Company rate case, (December 22, 1994), Conclusion of Law No. 31 at p. 70 and pp. 50-51.

Staff averred that since the 1994 case, Staff has prepared both a "base-extra capacity" and "commodity demand" study when the Company has requested other than a straight percentage increase. Since these subsequent cases have been stipulated, the issue of which method should be used has not been decided by the Commission. Rebuttal Testimony, Calvert, pp. 4-5. Ms. Calvert stated that in every other water case that included a class cost of service study, the "commodity-demand" type study has been used by the Commission. Id. Ms. Calvert noted that the CAD did not present both methods for the Commission's consideration in this case. Furthermore, the CAD did not offer a justification for the Commission to switch to the "base-extra" capacity method for the Company, when it is inconsistent with the method the Commission uses with other water utilities. Id. at p. 6. Thus, Staff recommended that the Commission not adopt CAD's proposed "base-extra capacity" method without having before it a "commodity-demand" study making appropriate comparisons and findings regarding the impacts of each study. Id.

Furthermore, Staff noted that CAD's study does not allocate storage tanks in accordance with the procedure last approved by the Commission. See, the 1994 Company rate case order, at Conclusion of Law No. 32, at p. 71. Nor did the CAD study allocate working capital in the manner last approved by the Commission. Id. at p. 51. Moreover, the CAD study did not allocate transmission and distribution mains in the manner last approved by the Commission. Id. at Conclusion of Law No. 30, p. 71. Since the CAD has departed from the procedures last approved by the Commission, Staff believes the CAD needed to identify all areas of departure and to explain and support departures, which the CAD did not do. Rebuttal Testimony, Calvert, p. 11. Thus, Staff does not believe it would be appropriate to adopt the CAD's class cost of service study and recommends that any rate adjustment granted by the Commission be spread equally across the board to all classes of customers. Id.

The Company, the Industrial Intervenors, the Cities, and the BOE all advocated the use of an across the board spread of rates.

In the 1994 Company rate case order, the Commission stated the following regarding cost allocation:

The cost allocation studies in this filing were "base extra-capacity" studies. The Company filed a "base extra-capacity" study consistent without requirement in the rules that it continue to use the same methodology as was used in the last case. The Commission has often used peak demand/commodities studies (peak responsibility) in municipal water cases. The Commission is interested in having as much consistency in allocation studies as is reasonable and workable among water utilities. We, therefore, believe that West Virginia Water should file with its next rate case not only a "base extra-capacity" study but also a study using the "peak demand/commodity" (peak responsibility) analysis. The Commission intends to determine what method is appropriate to use for West Virginia Water in the future.

For the reasons discussed above, the Commission shall reject the CAD's cost of service study. And, although the 1994 rate case only directed that the Company submit its cost of service study utilizing both formats, the Commission notes that it is not disposed in future Company rate filings to move from an across-the-board methodology without first having had the opportunity to compare both methods. Henceforth, all parties should be aware that it will be necessary that both methods are presented to the Commission in any future requests to move from the across-the-board methodology.

RATE IMPACT

The results of our decisions herein, as summarized in Appendix A, reflect an overall revenue requirement of $98,783,000 before additional B&O taxes and uncollectibles. Since going level revenues are $97,057,000, our decisions herein reflect that the Company should be granted an increase of $1,828,000, after considering additional B&O taxes and uncollectibles on the increased revenue.

Before considering usage rates, the Commission must consider the revenue impact of the Customer Specific Tariff items which we have approved and which will be a new revenue source for the Company. The Customer Specific Tariff Item that will generate the most revenue is the delayed payment penalty. The Company had estimated that this provision would result in increased revenue of $2.1million. However, this projected effect was based on the Company's expectation of an overall increase in usage revenues of nearly $15 million. The Commission has determined that the delayed payment penalty will produce less revenue since we are not granting a usage rate increase in this case. Adjusting the Company's projection on a pro-rata basis, we conclude that the Delayed Payment Penalty will produce $1.8 million.

In addition to the delayed payment penalty we have approved the Reconnection Charge and the Returned Check Charge, which should produce approximately $251,000. Therefore, in total, the Customer Specific Tariff items should produce approximately $2,111,000. Considering the need for an overall increase of $1,828,000, and the additional revenue which we have estimated to be produced by the Customer Specific tariff items, the net remaining increase required is actually a decrease of $283,000.

As discussed above, the Commission would not adopt the rate design recommendations made by the CAD based on the Class Cost of Service Study as filed by CAD witness Rubin. Since both Staff and the Company were supporting an across the board percentage change in rates, the Commission would adopt such methodology in this case. However, before designing rates, we must look at the overall revenue requirement, the increase required, and the amount of revenue that will be generated by the Customer Specific tariff items which we are approving in this case. After considering the effect of the Customer Specific new revenue sources, there remains a negative $283,000 for rate design consideration. This amount represents approximately two tenths of a percent of the Company's total operating revenue. More importantly, this number is dependent on the estimated effect of the Customer Specific tariff items. While we have estimated that the delayed payment penalty may produce $1.8 million, we believe that the notice by which we have required the Company to apprize its customers of the penalty, as well as customer reaction to the penalty itself, could well push that revenue down by some amount. Considering the uncertainty of the revenue effect of the Customer Specific tariff items, and the very small balance left in this case for usage rate design, the Commission shall order no change in the Company's usage rates.

FINDINGS OF FACT

PROCEDURE

1. 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). The Company used a test year ending December 31, 2002.

2. Affidavits of publication were filed evidencing that the Company had complied with the notice requirement of Tariff Rule 10.1.b.

3. Throughout the course of this proceeding the Commission has received a large number of letters filed in protest of the Company's proposed rate increase.

4. 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. 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.

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

6. 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 a correction to a portion of the direct testimony of Chris E. Jarrett.

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

8. The Commission issued an order on May 14, 2003, which, among other things, set a procedural schedule and a schedule of public comment hearings. Additionally, the order required the Company to publish notice of the hearings scheduled in this case.

9. 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.

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

11. 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.

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

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

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

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

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

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

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

19. 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."

20. 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.

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

22. 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 R. 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

23. 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.

24. On September 10, 2003, the Company filed a "Motion to Strike Rebuttal Testimony of [Consumer Advocate Division witness] Scott J. Rubin."

25. The Commission entered an order on September 16, 2003, granting Staff's motion for leave to file supplemental direct testimony out of time and denying various motions of the parties to strike submitted testimony.

26. 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.

27. 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.

27. 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.

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

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

30. 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.

31. 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.

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

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

DISCUSSION

34. The Commission has not decided a fully litigated rate case filed by the Company since Case No. 94-0138-W-42T.

35. 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.

36. 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. An issue not fully stipulated in that case addressed the appropriate treatment of new security related costs being incurred by the Company.

37. In its December 21, 2001, order in Case No. 01-0326-W-42T, the Commission, among other things, 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.

38. Subsequent to the 2001 rate case, the Company and Thames Water Aqua Holdings GMBH filed a petition seeking the Commission's consent and approval of the acquisition of the outstanding common stock of American Water Works Company, Inc., the parent company and controlling shareholder of the Company, by Thames, a wholly owned subsidiary of RWE. See Case No. 01-1691-W-PC.

39. As part of a settlement reached by the parties to Case No. 01-1691-W-PC, 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.

Affordability

40. 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.

41. 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.

42. 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 pay $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.

43. 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.

44. The Attorney General argued that 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.

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

46. The Kanawha County Commission argued in favor of the Affordability concept.

RATE OF RETURN
Return on Equity

47. When a stock is publicly traded such a determination benefits from observation of the stock's experience in the market place.

48. The Company's stock is not publicly traded. All of its stock is owned by its parent company.

49. 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.

50. The Discounted Cash Flow Model (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.

51. Risk Premium (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.

52. Capital Asset Pricing Model (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.

53. Mr. Moul relied upon four methodologies to arrive at his return recommendation. He used DCF, RP, 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.

54. 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 rate of return on common equity.

55. 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. Staff's recommended return of will provide long-term interest coverage of 2.14 times and total interest coverage of 2.10 times.

56. 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.

57. 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.

58. The Company seeks a risk free component of 5%, based on long term treasury bonds.

Capital Structure and Resulting Rate of Return

59. 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.

60. The Company acknowledged that the anticipated rate for short-term debt reflected in its filing was too high in light of the most recent actions of the Federal Reserve and other market conditions. The Company therefore accepted 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.

61. Randall R. Short, on behalf of the CAD, 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.

62. 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.

63. 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.

64. 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.

65. 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.

66. Parties other than the Company, Staff, and CAD 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.

OPERATION AND MAINTENANCE AND OTHER EXPENSES

Capitalized Payroll Ratio

67. 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.

68. 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. Company Initial Brief.

69. Staff argued 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.

70. 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.

Employee Levels

71. The Company is requesting that the payroll expense used in this case be based on a level of 323 employees. At the close of the hearing, the Company confirmed that there had not been any additional vacancies to offset the eight employment positions. Tr. Vol. V at p. 203.

72. Staff recommended the Commission disallow eight (8) of those positions from going level wages (an adjustment of approximately $240,350).

73. The BOE raised the 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.

74. 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 and 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.

Call Center

75. As explained in the Direct Testimony of Company witness Miller, effective May 29, 2001, customer inquiry and billing functions for the Company are being performed at the Call Center in Alton, Illinois. Mr. Miller explained that call center functions were consolidated throughout the entire American Water System as a cost saving measure.

76. Staff is recommending an adjustment of $90,250 to reflect annual amortization of the Call Center transition costs. Staff stated that it agreed with the total call center transition costs claimed by the Company, but that the Company erroneously computed the prior years' and going-level amortization. Staff witness Kellmeyer explained that the Company recorded the accumulated two prior years' amortization as $160,736 based on an estimate from a prior case; however, the total cost of the call center transition is actually higher than the estimated costs in the prior case. Direct Testimony, Kellmeyer, p. 9. Staff

asserted that once the amortization period was set at ten years, the Company should have begun a 10-year amortization based on actual costs as booked in line with traditional depreciation accounting.

Comprehensive Planning Study

77. The Company routinely performs a comprehensive planning study on five-year intervals to assess the need for treatment plant improvements to meet new emerging regulations, to identify areas of its distribution system that may need to be replaced or upgraded, and to determine the impact that system growth has on plant and distribution system performance.

78. In rebuttal testimony and at hearing, Company witness Miller suggested a compromise by which the Commission established a utility plant account for these type of studies and permit the Company to capitalize the associated costs upon their completion. A period of 50 years would be allowed for recovery of the costs as a reasonable rate of depreciation. The CAD found this compromise to be acceptable. CAD Initial Brief at p. 44.

79. Staff is recommending $0 for comprehensive planning study costs whereas the Company is requesting $179,038.

80. In the 1994 case the Commission decided that the costs associated with the study should be allocated to the related construction work orders. Once the related projects have been completed and placed into service, the preliminary and final engineering costs could begin to be recovered through annual depreciation allowance over the service life of the facility.

Great Lakes Chemical Plant

81. The Great Lakes Chemical Plant closed in March 2002, stopped using water entirely in February 2003, and has demolished its facility. In its adjustment, the Company removed both test year revenues associated with this industrial customer as well as test year expenses related to associated variable production costs. Company Exhibit RLF-B at 21-23.

82. Staff included $177,000 in revenues since, according to Staff, it is not now known or measurable as to whether there will be new customers to take the place of Great Lakes. Staff Initial Brief at p. 33.

83. The Great Lakes Chemical plant was a customer during the test year and both the revenues from that customer and the expenses related to serving that customer are in the test year financial statements. Further more, the Great Lakes Chemical plant has ceased doing business and will not return as a customer of the Company at its previous location.

Incentive Compensation

84. The Company argued that its Long-Term Incentive Plan is part of the overall compensation package for executives and is integral to efforts to attract and retain talented and capable individuals. Company Exhibit MAM-B at 26-27.

85. The Cities argued that the Company wants to build $139,070 in additional executive compensation into its rates but such amount is not known and measurable since it is entirely based on Company performance. Additionally, bonuses awarded to executives for putting more money in shareholder pockets should be borne by shareholders, not ratepayers. Cities Initial Brief at p. 22.

86. The CAD argued that as stockholders are the primary beneficiaries when the Company's financial performance targets are met, they should be the ones who pay for executive bonuses, not ratepayers. CAD Initial Brief at p. 40.

87. In the present case, no party objected to the overall salary expense.

Pension Costs

88. In calculating the Company's pension contributions for 2004, the Company took its known funding requirements for February and May 2004 and annualized them through the last two quarters of 2004. The Company suggested that the latest and most accurate information (the Company's current funding requirement), rather than outdated expenses first incurred in 2002, should be used. Company Initial Brief, at pp. 43 and 44.

Rate Case Expense

89 The Company proposed a three-year amortization of rate case expense, the same method approved in the 2001 Rate Case. Because only two years have passed since the conclusion of that case, the Company proposed to add the unamortized portion of its actual rate case expense in the 2001 Rate Case to the estimated rate case expense in this case, and then to amortize the combined balance over three years. Company Exhibit RLF-A at 18-20 and Exhibit RLF-6; Company Exhibit RLF-B at 23-29.

90. The disagreement between the Company and the Staff regarding rate case expense is whether the amortization of the 2001 rate case costs should have been booked at 33 1/3% of the actual rate case costs or 33 1/3% of the costs that were estimated at the time the 2001 case was settled.

Security Costs/Synergy Savings

91. In Case No. 01-0326-W-42T the Commission directed:

> 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.

92. In its Initial Brief, Staff described its recommendation for treatment of security issues by recommending an additional $2.75 million in rate base to reflect security related capital additions that were identified within the evaluation of synergy savings. Staff recommended corresponding decreases in the Company's ongoing annual security operation and maintenance expenses in the amount of $627,000 which were likewise identified by the Company within its evaluation of synergy savings. Staff stated that it was not aware of any party in this case objecting to Staff's treatment of these savings and rate base additions. Initial Brief at pp. 22-23.

Service Company Allocation (Management Fee Allocation)

93. The CAD recommended that the Commission modify the level of management fees charged by the Service Company by applying the latest allocation factors (effective March 1, 2003), a change which occurred after the test year. Company Initial Brief at pp. 45-46.

Taxes – Consolidated tax savings adjustment

94. The CAD noted that the Company is not challenging the Commission's long-standing practice of recognizing tax savings arising from the Company's participation with corporate affiliates in filing a consolidated income tax return, as the Company did in the 1994 rate case. CAD Initial Brief at pp. 47-48.

95. The Company recommended that the position shared with the Staff in this case be used – namely the Commission's continued use of a historic consolidated tax savings

calculation that includes only the American Water parent and the Greenwich subholding company. Initial Brief at pp. 55-56.

Uncollectible Accounts

96. Both the CAD and the Staff argued that the Company's uncollectible accounts should be normalized by using a 3 year average. CAD Initial Brief at p. 36.

97. Staff recommended an uncollectible expense of $1,200,385, whereas the Company had requested $1,598,081 for this item. Staff Initial Brief.

Use Fees

98. Staff did not reflect an increase for use fees to be paid the Lewis County Economic Development Authority in 2003 (about $174,000), since the new customers are not yet being served and since the Company did not include the revenues from this project. Direct Testimony, Kellmeyer, pp. 7-8. Staff recommended that the Lewis County use fees be capitalized as part of the construction cost. Id.

99. Staff disagreed with the Company's amortization of use fees that the Company deferred in 2002 and 2003 (approximately a $24,643 adjustment). Staff noted that the Company did not have the prior approval of the Commission to defer this amount nor did the Company suggest a decrease in any expense item that may have been less than what was included in the prior case. Staff Initial Brief.

Use Fees – From Prior Period

100. The Company annualized its 2002 test year use fee payments and included that total amount ($3,484,824) in its rate filing. A portion of this annual amount ($24,643) represents a 37-year amortization of use fees that were inadvertently omitted from the Company's 2001 Rate Case filing. The total deferred amount of these use fees for 2002 and 2003 is $911,791. Company Exhibit MAM-A at 23-25.

101. Staff asserted that any attempt to correct prior deficiencies regarding use fees is improper retroactive ratemaking. No prior approval by the Commission to defer the amount was granted by the Commission. Staff Initial Brief at p. 37-38.

Wages

102. The CAD cited Mountaineer Gas Company, Case No. 93-0005-G-42T (October 29, 1993) and argued that a proposed wage increase for the Company's non-union salaried employees is speculative and should be disallowed. The Company's Board of Directors has not approved this increase as yet and the Company's policy is subject to change on its own whim. Tr. Vol. IV, p. 56.

Waste Disposal Expense

103. The Company is seeking an adjustment based upon the expected costs of operating the Company's new Kanawha Valley sludge disposal system, and budgeted costs for waste handling at the Company's other water treatment plants.

104. The CAD argued the Company's proposed waste disposal expense adjustment does not constitute a known and measurable change and should be rejected. The CAD pointed out that support for its position can be found in the Company's testimony where the Company admitted at the hearing that it has deferred budgeted waste disposal activities in an attempt to conserve cash. Tr. Vol. III, p. 165.

105. Staff recommended a net increase of $26,746 for this expense item. Staff asserted that the Company's adjustment to going-level expense for facilities other than the Kanawha Valley Treatment Plant violates the known and measurable test. Staff Initial Brief at pp. 44-45.

Workers' Compensation

106. The Company submitted that when the Company's base rate increase of 15% and the effect of a favorable modification to the Company's claims experience rating are aggregated, they generate a Workers' Compensation rate of 3.29%. This is the Company's current rate and the one that will be in effect until further notice. The net effect of these changes reduces the adjustment for Workers' Compensation expense included in the Company's direct testimony by $93,275. The Company asserted that the Staff, the CAD, and the BOE have concurred in this result. Company Initial Brief at p. 44.

RATE BASE

Terminal Treatment of 2002 Rate Base Additions

107. The CAD recommended reducing rate base by $3.941 million arguing that none of the 2002 projects were related to bringing service to ill-served areas, and are normal recurring plant replacements, such as mains and services. CAD Initial Brief at p. 21.

Acquisition Adjustments

108. Staff witness Kellmeyer explained that an acquisition adjustment occurs when the acquisition price is different than the book value of the acquired utility. Tr., Vol. 5 at p. 169. Staff recommends the Commission reduce rate base by $450,804 for treatment of negative acquisition adjustments.

Capital Projects

109. The BOE argued that the Commission should require the Company to use internally generated funds for capital projects by including internally generated funds in rate base, thereby offsetting the Company's capital projects which have been included in rate base in this filing. BOE Initial Brief at p. 13.

Cash Working Capital

110. The CAD argued that the Company's 2002 lead/lag study showed that on average, customers, rather than investors, provide working funds that enable the Company to pay its day-to-day operating expenses. Thus, a negative rate base allowance for cash working capital is appropriate in this case. CAD Initial Brief at pp. 23-24.

Customer Information Services

111. Staff does not believe that any of the Customer Information Services investment should be included in rate base since the Kanawha Valley Customer Information System is expense reducing and, therefore, would be more of a future test year adjustment rather than the type of non-revenue producing/non-expense reducing rate base adjustment historically allowed by the Commission. Staff Initial Brief. Staff recommends a corresponding reduction in rate base of $2,529,832.

Residuals Plant

112. The CAD noted that the Charleston residuals handling facility is still under construction and its completion date and final cost are still unknown. As the facility is not yet used and useful in providing service to customers and its final cost impact is unknown, the CAD recommended reducing rate base by $2.526 million. CAD Initial Brief.

113. Staff recommended removal of $2,152,394 from rate base since it is expense reducing and, therefore, does not comply with the Commission's post rate base adjustment policy. Staff Initial Brief at pp. 31-32.

Sutton River Crossing

114. The CAD argued that the Sutton River Crossing replaced a badly deteriorated 8-inch river crossing pipe with a new 12-inch pipe. The project was completed after the end of the test year and added $93,000 to plant in service. CAD argued that this post-year addition fails the "non-expense reducing" test, and should be excluded from rate base in this case. CAD Initial Brief at p. 22-23.

REVENUE REQUIREMENT RELATED ISSUES

Cost Causers/Customer Specific Tariff Items

115. The Cost Causer tariff items, which we shall hereafter refer to as Customer Specific tariff items, were introduced by the Company in this rate case as a "fairness" issue. Implementation of Specific Customer tariffs would assign certain identified costs to the individual customers "causing" those costs, and the revenue generated from them would serve to decrease the amount the Company must recover under its general water tariff from all customers. Company Initial Brief at p. 66.

Customer Specific Tariff Item – Account Activation

116. The proposed $20 account activation charge covers the cost to physically turn on water at a customer's residence.

Customer Specific Tariff Item - Delayed Payment Penalty

117. The Company proposes that its tariff provision be modified to provide for a 10% delayed payment penalty and to state that the penalty would be a one-time charge of 10% on the unpaid amount if payment is not received after 21 days from the date of the bill. The Company has projected that it is likely to generate revenues of approximately $2.1 million at current rates. Company Ex. PRH-A at 4.

118. The BOE argued that Staff and CAD fail to recognize that the delayed payment penalty, as adopted by the Commission in its recent revision to Water Rule 4.3.e, is explicitly intended to be punitive toward the customer to encourage prompt payment. BOE Initial Brief at p. 17.

Customer Specific Tariff Item - Leak Adjustment Fee

119. The Company proposed to increase the incremental cost of water used in "leak adjustment" situations from the current level of $0.27 per 1,000 gallons to $1.55 per 1,000 gallons. The Company's proposal would bring in approximately $120,000 in additional revenue.

120. Staff does not believe the Company's proposal is reasonable and recommends that the Company be given permission to increase the incremental cost of water from the current level of $0.27 per 1,000 gallons to $0.30 per 1,000 gallons. Staff's proposal will bring in approximately $3,000 in additional revenue (a difference of $117,000). Staff Initial Brief.

121. Staff recommended that the incremental rate be set at $0.30 per 1,000 gallons, which is consistent with Staff's Rule 42 exhibit for purchased water, fuel and power, chemicals and waste disposal. Direct Testimony, Stewart, at pp. 11-12.

Customer Specific Tariff Item - Reconnection Charge

122. Staff agrees with the Company's proposed $20.00 reconnect charge, which is supported by Water Rule 4.8.c. This charge will bring in approximately $234,000 in additional revenue. However, Staff argued that while it agrees with this proposed charge, it does not believe that customers who require deferred payment agreements should be required to pay the reconnect fee in full as a condition of resuming service. Direct Testimony, Stewart, p. 10. Instead, Staff recommends that this fee be added to the past due balance and recovered as part of the deferred payment agreement. Id.

Customer Specific Tariff Item - Returned Check Charge

123. Company's proposed return check charge of $15.00 would bring in approximately $36,000 in additional revenue, whereas Staff's recommended $7.00 returned check charge would bring in approximately $16,800 in additional revenue.

Customer Specific Tariff Item - Service Connection Charge (Tap Fee)

124. The Company requested a tap fee of $450 for 3/4 inch connection and $500 for one-inch connection. Taps for large sizes would be the actual costs for such connections under the Company's proposal.

Huntington Sanitary Board Revenues

125. The CAD argued that a simple reading of the unambiguous language of the "Service Agreement"entered into by the Company and the Huntington Sanitary Board, for the provision of certain billing and accounting activities, reveals that the Company is not complying with the terms of the contract and the Commission's order. Accordingly the CAD recommends that the Commission increase the Company's revenues by $127,051. CAD Initial Brief at p. 26.

126. The Company argued that in his rebuttal testimony, Company witness Ferrell explained in detail why the CAD's proposed adjustment has absolutely no basis, is undercut by the plain language of the Company's Commission-approved contract with the Huntington Sanitary Board, and otherwise fails to meet the known and measurable standard. Company Exhibit RLF-B at 39-42.

Miscellaneous Service Revenues

127. The CAD argued that the Company's level of miscellaneous service revenues should be increased to account for the increase in the amount of rent the Company receives for housing the Southeast Region Service Company. CAD Initial Brief.

TAXES
Property Tax

128. Both Staff and the CAD have agreed to a final figure of $4,312,687 ($7,655 more than the Company's initial estimate) for property tax. Company Initial Brief at p. 54, 55.

RATE DESIGN/COST ALLOCATION ISSUES
Cost Allocation

129. While CAD's primary recommendation is that the Commission not award the Company any increase, CAD argued that if the Commission rejects this recommendation, then the Commission should adopt CAD's rate design based on CAD's class cost of service study. Direct Testimony, Rubin, pp. 47-48; and Supplemental Direct Testimony, Rubin, pp. 2-3.

130. Staff did not agree with CAD's class cost of service study and recommended that any rate adjustment ordered by the Commission be spread equally across the board to all classes. Rebuttal Testimony, Calvert,(Staff Exhibit No. 6).

131. The Company, the Industrial Intervenors, the Cities, and the BOE all advocated the use of an across the board spread of rates in the event of a change in rates.

CONCLUSIONS OF LAW

DISCUSSION
Affordability

1. 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).

2. 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."

3. 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.

4. 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. Bluefield Water Works & Improvement Co. v. Public Service Commission, 262 U.S. 679 (1933). Therein 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. 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.

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

6. The Commission concludes 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.

7. 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.

8. It flies in the face of long standing regulatory legal principles and due process rights for a party to explicitly or implicitly accept expenses as being prudently incurred and yet argues that a utility should not be given the opportunity to recover such prudent expenses.

9. 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.

RATE OF RETURN

Return on Equity

10. 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).

11. 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.

12. When determining a rate of return, "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.

13. Permian Basin 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.]

14. The 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.

15. 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.

16. The Company used 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.

17. The CAPM depends on a determination of an objective and sustainable risk free component.

18. 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.

19. 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.

20. With regard to the CAD witness' recommendation of an 8.25% return on equity, the Commission also concludes 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 CAPM.

21. The CAD witness' 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 CAPM, similarly renders his recommend 8.25% cost of equity to be too high.

22. The Staff's 6.67% return recommendation is based on the most realistic and objective measures of investor expectations and market risks.

23. 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.

24. 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 concludes that a return on equity in excess of the Staff's recommended 6.67% is needed.

25. The Commission's return on equity capital rate of 7.00% is at the lower end of the scale as presented by the parties but 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 is sufficient to comply with the Hope and Bluefield tests set forth previously in this discussion.

26. Upon consideration of the testimony and briefs of the parties, the Commission concludes it is reasonable to set return on equity capital at a rate of 7.00%.

Capital Structure and Resulting Rate of Return

27. 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.

28. 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.

29. 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.

30. In this case, for the capital structure, and for no other issue, the Commission concludes that it is reasonable to split the difference between the positions of the Company and Staff.

31. It is reasonable to adopt the Staff's recommendation regarding the cost of short term debt of 1.40%.

32. 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

33. There are two Operation and Maintenance issues that reverberate throughout several of the other O&M issues in this case: (1) Capitalized Payroll and (2) the number of Company employees.

Capitalized Payroll Ratio

34. Utilizing the Company's ratio of 23.19% steps outside of the 2002 test year and violates the matching principle.

35. 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 effects on payroll related costs such as Employee Insurance, Pensions and OPEB's which amount to approximately $340,000.

Employee Levels

36. As the Company's requested modification to the test year is known and measurable the Commission shall accept the Company's employee level of 323.

Affiliate Charges

37. West Virginia Code § 24-2-3 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 the utility demonstrate 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).

38. The Affiliated Charges 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.

Call Center

39. The Commission agrees with the Staff position on this issue for the reasons set forth by Staff in its testimony and briefs. The annual amortization of an item that has been deferred by the Commission should be related to the actual cost of the deferred amount and the amortization period, in this case 10 years. The Company's accounting for amortization of deferred costs should not be controlled by estimates of annual amortization expense that it made in prior rate cases. Instead, the amortization rate was established by the Commission at 10% and the Company's annual amortization expense should be based on 10% of the actual costs deferred. Accordingly, the Commission concludes it is reasonable to allow the Staff's adjustment of $90,250 for annual amortization of Call Center transition costs.

Comprehensive Planning Study

40. It is reasonable to adopt the Staff position regarding the comprehensive planning study and maintain the same treatment of the costs as developed in the 1994

Company rate case. Such treatment is consistent with the Commission authorized System of Accounts.

ESOP and 401(k)

41. The ESOP and 401(k) expense items are contingent upon employee levels and the Capitalized Payroll Ratio. The Commission shall adjust these items consistent with its payroll decisions above.

Great Lakes Chemical Plant

42. Under Rule 42 of the Commission's Tariff Rules a utility filing for a rate increase is required to provide financial information regarding what is known as the historical test year. The historical test year provides the Commission with a "snap-shot" of what the utility's financial condition is for the purpose of determining whether the utility's requested rate increase is reasonable. See, West Virginia-American Water Company, Case No. 94-0138-W-42T (Commission order entered December 22, 1994, at page 55). Because it is difficult to predict how a utility's financial condition will change, the Commission in the past has limited information regarding the utility's financial condition to the historical test-year. The Commission may allow an adjustment to the test year financial information that a utility or any other party to the proceeding is proposing, if it is known and measurable and does not violate the basic principal of matching test year rate base and test year expense units to test year revenue units.

43. Since average test year plant balances, by definition, satisfy the matching principal, adjustments to rate base are not considered unless they can be demonstrated as being non-revenue producing and non-expense reducing. See, the 1994 Company rate case order and West Virginia-American Water Company, Case Nos. 92-0113-W-PC and 92-0250-W-42T (Commission order entered May 19, 1992, at p. 2 and at Conclusion of Law No. 3 at p. 4).

44. Making adjustments to test year units of revenue and/or expenses based on factors such as the loss (or gain) of a single customer starts down the perilous trail of converting an historic test year to a future test year.

45. Customers, particularly residential customers, but also commercial and industrial customers, enter and leave a utility's service territory with some frequency. To attempt to track the revenues and expenses associated with entering and exiting customers would not be efficient or particularly meaningful. Additionally, existing customers may increase their levels of usage.

46. The Commission has a preference for historic test years rather than projected test years.

47. While there may be instances of customers so large as to create a devastating impact on a utility requiring the Commission to recognize the loss of such customer, and make adjustments that result in at least a partially projected test year, the Commission is not convinced that the loss of the Great Lakes Chemical plant creates such an instance.

48. It is reasonable for the Commission to adopt the Staff's position regarding the loss of the Great Lakes Chemical plant as a customer.

Incentive Compensation

49. Incentive compensation is a known and measurable expense in this case. It was contained in the test year and shall be allowed for ratemaking purposes.

50. All employees of the Company are working not only to provide clean, safe, and potable water to the citizens of West Virginia but are also working as employees of the stockholders with an end towards maximizing stockholder wealth. The incentive compensation is merely a different means of providing such motivation. To the extent employee incentives result in efficiencies and/or increased productivity stockholders are benefitted, but eventually such benefits will be reflected in lower revenue requirements and lower rates. Thus, both stockholders and ratepayers benefit from increased productivity and operating efficiencies.

51. The Commission concludes that it is reasonable to reject the Cities and CAD arguments and allow the inclusion of the costs of the Long-Term Incentive Plan in the revenue requirements in this case.

Employee Insurance Expenses and OPEB Expenses

52. The Employee Insurance and OPEB expense items are contingent upon employee levels and the Capitalized Payroll Ratio. The Commission shall adjust these items consistent with its payroll decisions above.

Pension Costs

53. Pension Costs are affected by the employee levels and the Capitalized Payroll Ratio and the Commission shall adjust them accordingly. Additionally, it is reasonable to adopt the Company's position regarding the use of the 3rd and 4th quarters of 2003 to annualize those figures for use in the final two quarters of 2004. Stepping outside the test year in this instance is reasonable given that the 3rd and 4th quarters of 2003 are the latest

and most accurate information available and, as such, constitute known and measurable adjustments related to the level of service provided during the test year.

Rate Case Expense

54. The Commission concludes that when expenses are deferred and are subject to a specified amortization rate, it is appropriate to apply the amortization rate to the actual amounts deferred. We are not convinced that this continual deferral and amortization is preferable to simply establishing a fair and reasonable annual amount, based on a reasonable average, for expense items like rate case expense that vary greatly from year to year. However, we are convinced that the position of the CAD and BOE are not reasonable and would not allow the Company a reasonable opportunity to recover its expenses. Staff supports a deferral and amortization approach in this case and has calculated the unamortized balance of the 2001 rate case appropriately by applying the intended amortization rate to actual expenses deferred. The Commission will adopt the Staff position on this issue in this case.

Security Costs/Synergy Savings

55. Although the Staff's recommended treatment of the Security Costs/Synergy Savings do not adhere strictly to standard ratemaking concepts related to the use of an historic test year and the matching principal as described above, in this case all parties are in agreement that these adjustments are appropriate. Furthermore, both the need for additional security and the synergy savings were brought on by extraordinary events for which the Commission believes the current treatment, as agreed to by the parties, is warranted.

56. It is reasonable to step outside of the test year and include an additional $2.75 million in rate base and to decrease the Company's ongoing annual security operation and maintenance expenses in the amount of $627,000.

Service Company Allocation (Management Fee Allocation)

57. The billing percentage utilized as the Service Company allocation is now known and measurable as it was reduced on March 1, 2003, to 5.67%. This constitutes a known and measurable adjustment to the test year and the Commission shall adopt it.

Taxes – Consolidated tax savings adjustment

58. It is reasonable for the Commission to adopt the Company's position regarding consolidated tax savings, as described herein.

PUBLIC SERVICE COMMISSION
OF WEST VIRGINIA

Uncollectible Accounts

59. The Commission has long held that uncollectibles should be averaged since the test year might be unusual and that the use of an average would smooth out any such anomaly. Hope Gas, Inc., Case No. 93-0004-G-42T (Commission Order October 29, 1993) at p. 22.

60. Write-offs for uncollectibles are, to a degree, in the control of management. Uncollectibles are the type of expenses with a tendency to fluctuate from one period to another, oftentimes without predictable consistency. As such, it is reasonable to normalize through the use of a three-year average.

Use Fees

61. The Company's operation of the Lewis County project and the revenue from the new Lewis County customers are not included in test year costs or revenue. Granting the Company's treatment would violate the test year matching of revenues and expenses.

Use Fees – From Prior Period

62. The Company's attempt to reach backward to correct previous deficiencies regarding use fees constitutes improper retroactive ratemaking. Furthermore, the Commission did not grant the Company leave to defer the requested amounts.

Wages

63. The Company has demonstrated similar and consistent treatment of its Union and non-union employees. Such treatment was the basis for our decision in the Company's 1994 rate case. The CAD presented no evidence to demonstrate any pattern or instance where the Company failed to provide non-union employees with wage adjustments that were consistent with and comparable to wage adjustments negotiated for union employees. Therefore, we see no reason to depart from our historic treatment of this issue for the Company.

Waste Disposal Expense

64. The adjustment for the treatment facilities other than the Kanawha Valley Treatment Plant represent nothing more than budget expectations based on the Company's engineers estimates of future expenses. These types of estimates simply do not rise to the level of certainty that should accompany appropriate going level expense adjustments in a historic test year rate case.

Workers' Compensation

65. As the newly generated Workers' Compensation rate of 3.29% for the Company is now known and measurable, it is reasonable for the Commission to adopt that rate.

RATE BASE

66. The term "rate base" refers, generally speaking, to a utility's investment in utility plant. Principally, a utility's rate base is financed by investor-supplied capital and consists of numerous elements, including utility plant in service, utility plant held for future use, certain elements of construction work in progress (completed and in service), and certain unclassified plant in service. The rate base generated by adding these elements together is then generally adjusted for items such as accumulated depreciation; depletion and amortization; contributions in aid of construction; customer advances for construction; working capital; and deferred federal incomes, among other things. After all necessary elements are properly added to or subtracted from rate base, the net rate base represents the amount of utility plant and other capitalized items to which the rate of return authorized by a utility commission will be applied to generate the return component which will be included in the utility's rates. This return component will include allowance for interest costs, dividends on preferred stock, and a return on equity. Generally, for utility plant to be included in rate base, it must be used and useful (i.e., used by the utility in providing service to its customers).

67. Rule 42 of the Commission's Tariff Rules requires that, in rate filings before the Commission, rate base be stated as a 13-month average. This average of rate base as of the beginning of the test year and as of the end of each month of the test year generally properly matches rate base to revenues and expenses of the test year.

68. Departure from a 13-month average rate base has been permitted by the Commission in certain circumstances.

Terminal Treatment of 2002 Rate Base Additions

69. While we require the filing of an average test year rate base, the Commission has allowed going level adjustments to rate base under certain conditions. See, e.g., Hope Gas, Inc., Case No. 93-0004-G-42T (October 29, 1993) and the 1994 Company rate case order.

70. The CAD has not provided a compelling reason for us to reject the Staff's recommended adjustments that conform to the Commission's past practice of allowing non-revenue producing and non-expense reducing plant additions during and even after the end of the test year to be given terminal rate base treatment.

Acquisition Adjustments

71. Staff's position regarding acquisition adjustments is consistent with the Commission's position in West Virginia-American Water Company and East Bank Water Department, Case No. 00-1719-W-PC (Commission Order February 6, 2001).

Capital Projects

72. The Commission was not convinced by the BOE's arguments regarding the treatment of capital projects and concludes that it is reasonable to not adopt the BOE's position on this issue.

Cash Working Capital

73. Working cash is the capital contributed by investors which must be used to pay for expenditures of a company due to the lag time before revenues to pay for such expenditures are received from the customers. Cash working capital is included in rate base in order to provide the investors with a return on this supplied capital. Depending on the timing of expense payments relative to collection of revenues, a utility may actually receive reimbursement before paying an expense, and this results in a negative cash working capital requirement which should be reflected as a reduction to rate base. On the other hand, when a utility must pay expenses prior to collecting the associated revenues, the result is a positive cash working capital requirement that should be added to rate base.

74. A lead/lag study measures the differences between the time services are rendered until the time revenues for those services are received, on the one hand, and the time that expenses are incurred for providing utility services and the time when payment is rendered by the utility for those expenses, on the other hand. The difference between these periods is expressed in terms of days.

75. The CAD has improperly included depreciation expense in the lead/lag study.

Customer Information Services

76. The CIS software was not installed until July of 2003 and thus lies outside of the test year. Additionally, the decision to upgrade software is not on par with on-going pipeline maintenance and consequently it is reasonable not to afforded it the terminal rate base consideration given to pipeline maintenance.

Pre-payments (Insurance, Expenses, Taxes, Misc.)

77. The pre-payments issue appears to have resolved itself and adoption of the Company's position on the matter is therefore reasonable.

Residuals Plant

78. The Commission concludes that it is reasonable to adopt the Staff position on the residuals plant rate base issue and reduce rate base by $2,152,394.

Sutton River Crossing

79. The Commission concludes that the Company has demonstrated that the Sutton River Crossing is non-revenue producing. Furthermore, there is no evidence of significant test year expenses that will be eliminated by the investment in the new river crossing are that are of such magnitude as to lead us to reject terminal rate base treatment of this item.

REVENUE REQUIREMENT RELATED ISSUES

Customer Specific Tariff Item – Account Activation

80. The account activation tariff, whereby a new customer is charged $20 for the privilege of becoming a customer, is unreasonable.

Customer Specific Tariff Item - Delayed Payment Penalty

81. It is reasonable to permit use of a delayed payment penalty corresponding to that contained in Water Rule 4.3.e for use in the Company's tariff. However, in the interest of notice to the customers, the Commission shall require the Company to provide either a billing insert or a separate mailing to customers explaining that the Company will apply a new 10% penalty charge on the unpaid portion of any bill that remains outstanding for more than 20 days after the bill is mailed to the customer. The Company shall not impose the Delayed Payment Penalty until such notice has been provided to the customers and an affidavit of such notice has been submitted to the Commission. Additionally, for all bills which will be subject to the new delayed penalty provision, the Company shall include on all customer billing statements both the amount due if paid timely as well as the date and the amount of the bill if paid late. For example:

Amount due and owing:	$40.00
If paid after March 20, 2004:	$44.00

Customer Specific Tariff Item - Leak Adjustment Fee

82. Water Rule 4.4.c. reads, in part, as follows:

> 4.4.c. Leaks on the customer's side of the meter–
>
> > 2. The policy shall provide for a recalculated bill to reflect the utility's incremental cost of treating or purchasing the water, ...

The Commission concludes that the calculation of the cost of treating or purchasing water as described in the rule does not include fixed costs.

Customer Specific Tariff Item - Reconnection Charge

83. It is reasonable to allow the inclusion of a $20 reconnection fee, subject to disallowance of double recovery and subject to inclusion of the charge within deferred payment agreements, as described herein.

Customer Specific Tariff Item - Returned Check Charge

84. It is reasonable to allow the returned check charge requested by the Company not to exceed the actual amount of the returned check fee charged to the Company by its bank. See, e.g., Little Creek Public Service District, Case No. 01-0970-PWD-T (August 10, 2001), and Marshall County Public Service District, Case No. 03-0869-PWD-T-PW (Commission order entered August 20, 2003).

Customer Specific Tariff Item - Service Connection Charge (Tap Fee)

85. The Company, as a large investor-owned utility, does not have the same limited access to capital sources and the same need to live off of day to day cash flow as many publicly operated utilities. As such, it is reasonable to deny the Company's request for a Service Connection Charge.

Huntington Sanitary Board Revenues

86. The Commission concludes that Company witness Ferrell's recalculation of the cost of providing billing services to the Huntington Sanitary Board, containing the $0.79 figure, continues to be justified.

Miscellaneous Service Revenues

87. It is reasonable to adopt the CAD position on the issue of Miscellaneous Service Revenues as a known and measurable change.

TAXES

Federal and State Unemployment; FICA; Interest Synchronization Adjustment; State Business and Occupation taxes

88. It is reasonable to adjust Federal and State Unemployment taxes, FICA taxes, the Interest Synchronization Adjustment, and State Business and Occupation taxes consistent with the Commission's previous payroll decisions herein regarding employee levels and the Payroll Expense Ratio, among others.

Property Tax

89. It is reasonable to adopt the $4,312,687 figure as agreed to by the Company, CAD, and Staff as it represents the actual 2003 property tax liability figure.

RATE DESIGN/COST ALLOCATION ISSUES

Cost Allocation

90. The Commission, in Case No. 94-0138-W-42T, made clear that it would consider which of two methods was the more appropriate class cost of service study in the Company's next rate case which involved a class cost of service study. The two methods referred to were the "base-extra capacity" method and the "commodity-demand"method. See 1994 Company rate case, (December 22, 1994), Conclusion of Law No. 31 at p. 70 and pp. 50-51.

91. The CAD did not offer a justification for the Commission to switch to the "base-extra" capacity method for the Company.

92. In the 1994 Company rate case order, the Commission stated the following regarding cost allocation:

> The cost allocation studies in this filing were "base extra-capacity" studies. The Company filed a "base extra-capacity" study consistent without requirement in the rules that it continue to use the same methodology as was used in the last case. The Commission has often used peak demand/commodities studies (peak responsibility) in municipal water cases. The Commission is interested in having as much consistency in allocation studies as is reasonable and workable among water utilities. We, therefore, believe that West Virginia Water should file with its next rate case not only a "base extra-capacity" study but also a study using the "peak demand/commodity" (peak responsibility) analysis. The Commission intends to determine what method is appropriate to use for West Virginia Water in the future.

93. It is reasonable to reject the CAD's cost of service study for reasons discussed herein.

RATE IMPACT

94. The results of our decisions herein, as summarized in Appendix A, reflect an overall revenue requirement of $98,783,000 before additional B&O taxes and uncollectibles. Since going level revenues are $97,057,000, our decisions herein reflect that the Company should be granted an increase of $1,828,000, after considering additional B&O taxes and uncollectibles on the increased revenue.

95. The Commission has determined that the delayed payment penalty will produce less revenue since we are not granting a usage rate increase in this case. Adjusting the Company's projection on a pro-rata basis, we conclude that the Delayed Payment Penalty will produce $1.8 million.

96. In addition to the delayed payment penalty we have approved the Reconnection Charge and the Returned Check Charge, which should produce approximately $251,000. Therefore, in total, the Customer Specific Tariff items should produce approximately $2,111,000.

97. Considering the need for an overall increase of $1,828,000, and the additional revenue which we have estimated to be produced by the Customer Specific tariff items, the net remaining increase required is actually a decrease of $283,000.

98. A negative $283,000 represents approximately two tenths of a percent of the Company's total operating revenue. Additionally, this number is dependent on the estimated effect of the Customer Specific tariff items.

99. Considering the uncertainty of the revenue effect of the Customer Specific tariff items, and the very small balance left in this case for usage rate design, the Commission shall order no change in the Company's usage rates.

ORDER

DISCUSSION

Affordability

IT IS THEREFORE ORDERED that 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, is hereby denied for the reasons stated herein.

RATE OF RETURN

Return on Equity

IT IS FURTHER ORDERED that the return on equity capital for the Company is hereby set at a rate of 7.00%.

Capital Structure and Resulting Rate of Return

IT IS FURTHER ORDERED that the following capital structure, cost of capital, and overall rate of return is hereby authorized for use by the Company:

	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

Capitalized Payroll Ratio

IT IS FURTHER ORDERED that the Company shall maintain the use of the current capitalized payroll ratio of 28.58%.

Employee Levels

IT IS FURTHER ORDERED that the Company is authorized to use an employee level of 323.

Affiliate Charges

IT IS FURTHER ORDERED that the BOE recommendation that the Commission reject $5,570,617 in affiliate charges is hereby denied.

Call Center

IT IS FURTHER ORDERED that the Staff adjustment of $90,250 for annual amortization of Call Center transition costs, is hereby adopted.

Comprehensive Planning Study

IT IS FURTHER ORDERED that the Company shall continue to maintain the same treatment of the comprehensive planning study costs as ordered in the Company's 1994 rate case, Case No. 94-0138-W-42T.

Great Lakes Chemical Plant

IT IS FURTHER ORDERED that the Company's requested treatment of the loss of the Great Lakes Chemical plant as a customer is hereby denied and the Staff's recommended treatment is hereby adopted.

Incentive Compensation

IT IS FURTHER ORDERED that the Company's requested treatment of its Long-Term Incentive Plan as described in this case is hereby adopted.

Pension Costs

IT IS FURTHER ORDERED that the Company's requested treatment of pension costs is hereby adopted for use in this case.

Rate Case Expense

IT IS FURTHER ORDERED that the Company's treatment of its rate case expense is herein denied and instead the Staff treatment is herein adopted.

Security Costs/Synergy Savings

IT IS FURTHER ORDERED that the agreed upon treatment of ongoing annual security operations and maintenance expenses, as described herein, is hereby approved.

Service Company Allocation (Management Fee Allocation)

IT IS FURTHER ORDERED that 5.67% is hereby authorized for use as the Service Company allocation.

Taxes – Consolidated tax savings adjustment

IT IS FURTHER ORDERED that the use of the CAD's position regarding consolidated tax savings, is hereby denied.

Uncollectible Accounts

IT IS FURTHER ORDERED that the use of a three year average for determining uncollectables is hereby adopted for use in this case.

Use Fees

IT IS FURTHER ORDERED that the Staff's position, as described herein, regarding the 2003 use fees paid to the Lewis County Economic Development Authority, is hereby adopted for use in this case.

Use Fees – From Prior Period

IT IS FURTHER ORDERED that the Staff and CAD position regarding use fees for prior periods, as described herein, is hereby adopted for use in this case.

Wages

IT IS FURTHER ORDERED that the Company's requested treatment for its non-union employees is hereby adopted for use in this case.

Waste Disposal Expense

IT IS FURTHER ORDERED that the Staff position regarding waste disposal expense is hereby adopted for use in this case.

Workers' Compensation

IT IS FURTHER ORDERED that the Workers' Compensation rate of 3.29% is hereby authorized for use in this case.

RATE BASE

Terminal Treatment of 2002 Rate Base Additions

IT IS FURTHER ORDERED that the terminal rate base adjustments recommended by Staff as described herein are hereby adopted for use in this case.

Acquisition Adjustments

IT IS FURTHER ORDERED that the Staff's position regarding acquisition adjustments is hereby adopted for use in this case.

Capital Projects

IT IS FURTHER ORDERED that the BOE recommendation regarding capital projects is not adopted for use in this case.

Cash Working Capital

IT IS FURTHER ORDERED that a negative cash working capital component of rate base premised on the lead lag study presented by the Company and supported by Staff, adjusted for appropriate changes in revenue and expense components, is hereby adopted for use in this case.

Customer Information Services

IT IS FURTHER ORDERED that the Staff position rejecting terminal rate base consideration for the Customer Information Services is hereby adopted.

Pre-payments (Insurance, Expenses, Taxes, Misc.)

IT IS FURTHER ORDERED that the pre-payments issue, resolved as described herein, is hereby adopted.

Residuals Plant

IT IS FURTHER ORDERED that the Staff recommendation as described herein regarding rate base treatment of the residuals plant is hereby adopted.

Sutton River Crossing

IT IS FURTHER ORDERED that the inclusion of the Sutton River Crossing in rate base as recommended by the Company, is hereby adopted.

REVENUE REQUIREMENT RELATED ISSUES

Customer Specific Tariff Item – Account Activation

IT IS FURTHER ORDERED that use of the account activation Customer Specific tariff is hereby denied.

Customer Specific Tariff Item - Delayed Payment Penalty

IT IS FURTHER ORDERED that inclusion of a delayed payment penalty tariff, as described and containing the explicit conditions contained herein, is hereby approved.

Customer Specific Tariff Item - Leak Adjustment Fee

IT IS FURTHER ORDERED that $0.30 per thousand gallons is hereby adopted for use as the Company's incremental cost of water when determining its incremental leak adjustment.

Customer Specific Tariff Item - Reconnection Charge

IT IS FURTHER ORDERED that the $20 reconnection fee tariff, subject to disallowance of double recovery and subject to inclusion of the charge within deferred payment agreements, as described herein, is hereby approved.

Customer Specific Tariff Item - Returned Check Charge

IT IS FURTHER ORDERED that the returned check charge tariff item is hereby approved under the conditions discussed herein.

Customer Specific Tariff Item - Service Connection Charge (Tap Fee)

IT IS FURTHER ORDERED that the Company request to include a Service Connection charge in its tariff is hereby denied.

Huntington Sanitary Board Revenues

IT IS FURTHER ORDERED that the CAD proposal for treatment of Huntington Sanitary Board revenues is hereby denied.

Miscellaneous Service Revenues

IT IS FURTHER ORDERED that the CAD position regarding the Miscellaneous Service Revenues, as described herein, is hereby adopted.

TAXES

Property Tax

IT IS FURTHER ORDERED that the property tax liability figure discussed herein is hereby adopted.

RATE DESIGN/COST ALLOCATION ISSUES

Cost Allocation

IT IS FURTHER ORDERED that the use of the CAD proposed cost of service study is hereby denied.

RATE IMPACT

IT IS FURTHER ORDERED that the Company's per gallon usage rates remain unchanged.

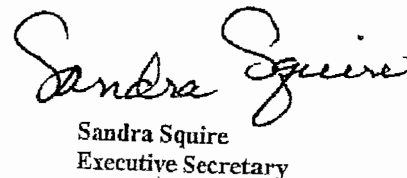
IT IS FURTHER ORDERED that the Company continue to charge its current per gallon usage rates on and after the date of this order.

IT IS FURTHER ORDERED that the Company file tariff sheets, which shall include the Customer Specific tariff items herein approved, consistent with the resolution of the issues in this order, within 10 days of the date of this order.

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
Executive Secretary

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Appendix A
Sheet 1 of 3

West Virginia American Water Company
Case No. 03-0353-W-42T
Revenue Requirements per Commission Order

Return on equity	7.00%
Overall rate of return	6.63%
	$ (000)
Rate Base	394,150
Return on rate base	26,132
Federal income taxes	5,458
State income taxes	860
Operation and Maintenance Expenses	41,955
Depreciation	12,586
Taxes other than income taxes	11,792
Total before additional B&O and uncollectibles	98,783
Going-Level Revenue	97,057
Net increase required before additional B&O and uncollectibles	1,726
Additional uncollectibles	23
Additional B&O	79
Total increase required	1,828
Additional New Miscellaneous Service Revenue:	
Delayed Payment Penalty	1,860
Reconnection Charge	234
Bad Check Charge	17
Total Additional New Miscellaneous Service Revenue	2,111
Balance Needed from Usage Rates	(283)

Appendix A
Sheet 2 of 3

West Virginia American Water Company
Case No. 03-0353-W-42T
Detail of Revenue Requirements Components

Rate Base:	$ (000)
Rate Base per Company Revised Rule 42	396,287
Commission Order Adjustments:	
Security related investment	2,750
Customer Information System	(2,530)
Residuals treatment facilities	(2,152)
Acquisition adjustment	(451)
Accumulated depreciation related to other adjustments	308
Working capital related to revenue and expense adjustments	50
Staff adjustments to deposits, ITC, deferred taxes and OPEB's	(112)
Rate Base per Commission Order	394,150

Depreciation Expense:	$ (000)
Depreciation per Company Rule 42	12,894
Commission Order Adjustments:	
Security related investment	80
Customer Information System	(336)
Residuals treatment facilities	(52)
Depreciation per Commission Order	12,586

Operating Revenue:	$ (000)
Going level revenue per Company Revised Rule 42	94,791
Commission Order Adjustments:	
Add municipal B&O taxes (staff adjustment)	2,046
Great Lakes Chemical Co. adjustment	195
Operating rents adjustment	25
Going level revenue per Commission Order	97,057

Appendix A
Sheet 3 of 3

West Virginia American Water Company
Case No. 03-0353-W-42T
Detail of Revenue Requirements Components

Taxes Other Than Income Taxes (Other Taxes):	$ (000)
Other taxes at going level per Company Rule 42	9,892
Commission Order Adjustments:	
Add municipal B&O taxes (staff adjustment)	1,857
State B&O taxes (staff adjustment)	90
Tax adjustments related to other revenue and expense adjustments	(47)
Other taxes at going level per Commission Order	11,792

Operation and Maintenance Expenses:	$ (000)
O&M expenses per Company Rule 42	45,062
Commission Order Adjustments:	
Great Lakes Chemical Co. adjustment	18
Adjust to test year capitalized payroll rate	(912)
Other payroll related adjustments (except Workers Comp.)	(345)
Call center adjustment	(11)
Comprehensive planning study adjustment	(179)
Rate Case Expense	(54)
Security related "synergy" savings	(623)
Service company allocation adjustment	(162)
Adjustment to reflect average uncollectible rate	(398)
Use fee adjustment	(199)
Waste disposal adjustment	(119)
Workers Compensation adjustment (rate and capitalization ratio)	(123)
O&M expenses per Commission Order	41,955