Exhibit L&B 112

BEFORE THE RATE COMMISSION OF THE METROPOLITAN ST. LOUIS SEWER DISTRICT

For Consideration of a Wastewater	)
Rate Change Proposal	)
by the Rate Commission	)
of the Metropolitan	)
St. Louis Sewer District	)

PREHEARING CONFERENCE REPORT OF RAFTELIS FINANCIAL CONSULTANTS, INC., RATE CONSULTANT, AND LASHLY & BAER, P.C., LEGAL COUNSEL TO THE RATE COMMISSION

Raftelis Financial Consultants, Inc. and Lashly & Baer, P.C., as Rate Consultant and Legal Counsel, respectively, to the Rate Commission of the Metropolitan St. Louis Sewer District ("Rate Commission"), respectfully submit this Prehearing Conference Report regarding the Wastewater Rate Change Proposal submitted to the Rate Commission by the Metropolitan St. Louis Sewer District (the "District").

The Rate Commission is to determine whether the District's Rate Change Proposal and any Alternative Proposal meets the criteria or factors for recommendation contained in §§ 7.040 and 7.270 of the Charter Plan.

The Prehearing Conference Report is to identify, define, resolve or settle the issues raised by the prepared testimony and to describe the participant's position, if any, on each of the criteria and factors for recommendation.

THE DISTRICT RATE CHANGE PROPOSAL

The District's Proposed Rate Change Proposal for a Wastewater Rate Change (the "District Rate Change Proposal") proposes the use of $945,000,000 in bond financing and $171,000,000 in cash financing to fund its Capital Improvement and Repairs Program ("CIRP") through FY2016; to provide the funds needed to comply with regulatory requirements relating to deficiencies in the District's wastewater system, including sewers, pump stations, and treatment plants; and to satisfy certain requirements of the Consent Decree between the District and the Environmental Protection Agency ("EPA").[1]

The District proposes to finance the required capital improvements by a combination of wastewater user charge revenues, available fund balances, revenue bond proceeds, Missouri Clean Water State Revolving Fund loan proceeds, potential commercial paper proceeds, grants and contributions, other operating revenues, and interest income. The impact of the District Rate Change Proposal on wastewater rates if principally funded by bond financing is set forth in Tables 1-1 – 1-3 of Exhibit MSD 1.

In the event that the voters of the District do not approve bond financing for the CIRP in order to comply with the terms of the Consent Decree, the District proposes cash financing. The financial analysis supporting the development of the alternative cash financing rate is contained in Tables G-1 through K-10 in Ex. MSD 18Z. These tables correspond to the same tables in Ex. MSD 4A for a bond financed CIRP.

It is the District's position that the District Rate Change Proposal and CIRP have been carefully developed and the District Rate Change Proposal allows the Rate Commission to meet the requirements of the Charter. The District states that the CIRP is necessary to meet the requirements in the Consent Decree and comply with the Clean Water Act. A "Detail Sheet" submitted to the District's Board of Trustees (the "Board") on June 9, 2011, purports to describe

---

[1] The Rate Change Proposal relies upon certain assumptions with respect to conditions, events, and circumstances that may occur in the future. Although considered reasonable, some of these anticipated conditions, events and circumstances may not occur resulting in potential differences in revenues and costs than currently projected. For example, lower revenues could result from a greater decrease in the customer base than currently anticipated while higher than anticipated inflation rates would place upward pressure on operation and maintenance costs. See Ex. MSD 1, Section 1.2.

the major Consent Decree components and includes a 23 year schedule to achieve compliance with the Clean Water Act. The District states that if the Consent Decree requirements are not met, the District will be subject to the cost of stipulated penalties as outlined in the Consent Decree.

STANDARD FOR RECOMMENDATION

Upon receipt of a Rate Change Notice from the District, the Rate Commission is to recommend to the District's Board changes in a wastewater, stormwater, or tax rate necessary to pay: (i) interest and principal falling due on bonds issued to finance assets of the District; (ii) the costs of operation and maintenance; and (iii) such amounts as may be required to cover emergencies and anticipated delinquencies. See Charter Plan, § 7.040.

Any change in a rate recommended to the Board by the Rate Commission pursuant to § 7.270 of the Charter Plan is to be accompanied by a statement of the Rate Commission that the proposed rate change: (i) is consistent with constitutional, statutory, or common law as amended from time to time; (ii) enhances the District's ability to provide adequate sewer and drainage systems and facilities, or related services; (iii) is consistent with and not in violation of any covenant or provision relating to any outstanding bonds or indebtedness of the District; (iv) does not impair the ability of the District to comply with applicable Federal or State laws or regulations as amended from time to time; and (v) imposes a fair and reasonable burden on all classes of ratepayers.

The Prehearing Conference Report is to identify, define, resolve or settle the issues raised by the prepared testimony and to describe the participant's position, if any, on each of the criteria and factors for recommendation.

All parties agree that the issues raised by the prepared testimony relate to the criteria set forth in Section 7.270(v) of the Charter – whether the District Rate Change Proposal imposes a fair and reasonable burden on all classes of ratepayers. See Ex. MSD 108; Ex. AARP 95; Ex. CCM 96; Ex. LB97; Ex. MIEC 99; Ex. BJH 100; and Ex. RM102. None of the Intervenors claim that the District Rate Change Proposal does not meet the other factors and criteria of Section 7.040 or 7.270. Id.

The Rate Commission, in its Rate Recommendation Report, will be required to provide affirmative support that its rate recommendation meets each factor and criteria. Although the issues herein are discussed in the context of compliance with Section 7.270(v), the issues may also affect the discussion of compliance with the other factors and criteria in Sections 7.040 and 7.270.[2]

LENGTH OF DISTRICT RATE CHANGE PROPOSAL

The District Rate Change Proposal is for the period of FY 2013 through FY 2016. It is the District's position that given the conditions in the Consent Decree, a four year rate cycle provides the optimal combination of clarity of the CIRP and regulatory requirements. This approach affords the District a greater ability to recognize and adjust to trends which will affect future rate proposals. The four year rate cycle also demonstrates sound financial security and a positive credit consideration for bond investors; and limits the public funds spent on additional rate proceedings.

[2] For example, we noted at the Prehearing Conference that if the Rate Commission finds that the rates in the District Rate Change Proposal are so unfair and unreasonable as to be excessive, there may be an issue under the Hancock Amendment thereby affecting factor 7.270(i), whether the District Rate Change Proposal is consistent with existing law.

The District noted that originally it had a five year proposal, but later reduced it to four years. The District states that this will allow it to make a rate proposal with better information and less long-term assumptions than with a five year rate proposal.

It is Intervenor Barnes Jewish Hospital's ("BJH") position that the District's proposed level of funding is too far reaching in timeframe to perform the work needed as it is presently known. Rate increases for FY 2014-FY 2016, based on a CIRP schedule that is not finalized and has not been fully approved by the EPA is premature. BJH recommends that the Rate Commission approve only the portion of the rate increase that can be determined to be fair and reasonable with the information available at this time, and revisit the remainder of the rate increase request when the Sanitary Sewer Overflow (SSO) Control Master Plan is in its near final form. BJH asserts that the District should use a rate increase assumption of only 8.5% for the first year of the rate proposal period (FY 2013) rather than the District's proposed 11-12% annual increase and determine the rates for the remaining period FY 2014-FY 2016 at a later hearing.

Intervenor Missouri Industrial Energy Consumers ("MIEC") agrees with BJH on the one year issue. MIEC states that the while the District's estimated costs for FY 2013 are reasonably measureable, the CIRP costs are not known at this time, especially since the District has yet to prepare the SSO Plan that needs to be submitted to the EPA by December 31, 2013. The SSO Plan will provide a schedule of specific projects for the elimination of many overflows; however, according to Mr. Hoelscher during the surrebuttal technical conference, a draft of the SSO Plan is not available. See Ex. MSD 90. Thus, it is MIEC's position that it is unfair and places an unreasonable burden on the District's ratepayers for the Board to approve a rate increase based upon an SSO Plan which has not been reviewed by the Rate Commission, much less drafted.

MIEC further states that the rate increase should only be for one year due to the current economic conditions, the levels of bad debt expense and that the amount of customer sales are relatively unknown at this time. MIEC recommends that the rate increase be awarded for one year (or two year, at the most) at the rate of 9.6% rather than the District proposed 12%.

MIEC also notes that the District's failure to timely disclose information required in the Consent Decree settlement document and its failure to disclose the details underlying the Black & Veatch electronic model clearly raise questions with regard to the accuracy of the District's entire filing. Based upon these transparency issues alone, MIEC argues the Rate Commission should recommend only a one year rate increase.

MIEC recommends that if in fact the Rate Commission approves the four year Rate Change Proposal, it should modify the District's proposed rate increase to reduce the proposed increases of over 60%, or $128.8 million dollars, to 49%, or $105.6 million dollars, for the next four years. See Ex. MIEC 89. Thus it is MIEC's position that the proposed adjustments result in a series of increases of 9.6% in each of the four years instead of the 11-12% increases that the District originally proposed.

The District states that a shorter rate proposal will affect the bond rating agencies' perception of the District. Specifically, once rating levels are established, the rating analysts look for consistency in financial performance moving forward. In addition, the effect of a less than four year rate change would significantly impact the District's revenue by reducing the amount available from bond funding.

The District asserts that unlike the shorter rate proposal recommended by MIEC and BJH, the current District Rate Change Proposal period of FY 2013-FY 2016 enhances the District's ability to meet the initial milestones contained in the Consent Decree. The duration of the District Rate Change Proposal coincides exactly with expected approval of the SSO Control Master Plan. In December 2013, when the information becomes final, the District will begin development of its next rate proposal, which will include this additional information. According to the District, a one year rate proposal would only result in the District bringing back to the Rate Commission next year a proposed FY 2013-FY 2016 project list with the same projects as are currently listed for this District Rate Change Proposal.

According to the District, a less than four year rate change cycle hinders the Rate Commission from complying with sections 7.270(2)-(4) of the Charter and would also come at a significant cost to the District's ratepayers. Traditionally, the rate proceedings expense to the ratepayers has been approximately $800,000 in contracted expenses, not including the cost of District staff time.

The Rate Consultant recognizes that a shorter proposal would result in increasingly accurate assumptions; however, the Rate Consultant is concerned with the time and expense associated with more frequent rate change proposals and believes that these two factors must be balanced. The Rate Consultant does not believe that the District's use of a four year plan in the District Rate Change Proposal is unreasonable given the expense of the Rate Change Proceedings and its historical use of five year rate change proposals.

Intervenors American Association of Retired Persons ("AARP") and Consumers Council of Missouri ("CCM") concur and support the other Intervenors' recommendation that the proposed rate increase be approved for only the first year, FY 2013. AARP and CCM note that the Consent Decree contains much greater specificity about the projects that would be required through FY 2013, than it does about investments over the following four years of the plan.

Intervenor Robert Mueller concurs and supports the findings of fact and recommendations of the other Intervenors.

CIRP FINANCING

(a) Appropriation Versus Cash Flow Financing

The District Rate Change Proposal was developed on an appropriation basis. As such, the contract price of a project is assumed appropriated at the time the contract is awarded. Karl Tyminski has stated that most projects are appropriated (or encumbered) at the time they are approved by the Board, except large multi-year projects where the District would sometimes use a phased appropriation over time. Mr. Tyminski further stated that with respect to the encumbrances in a larger project, it is possible to encumber on an annualized basis to spread the expenses over time but it is much more difficult for a series of smaller projects because of their nature and number and when such projects are initiated.

The actual expenditure of these appropriations occurs over the life of the project. This timing mismatch results in annual variance fluctuations over and under the proposed annual appropriations. Or, as described by Mr. Tyminski, a series of projects are constantly moving in and out of that program or forward and back in the program. Brian Hoelscher testified, "economic conditions created additional funds which could be used to complete projects beyond the original program budget." See Ex. MSD 9B.

Of the 53 projects scheduled for fiscal year 2013, 21 of the projects are expected to require more than twelve months to complete and none will require more than 24 months. Projects over twelve months are assumed to have 60% of the costs expended in the first fiscal year with the remaining 40% expended in the following fiscal year.

According to the District, if too much revenue is collected, the District will move forward and expedite the Consent Decree compliance-related work or continue the CIRP with reduced use of debt in future years.

The Charter Plan provides that at the end of each fiscal year, the unexpended and unencumbered parts of all appropriations shall revert to the funds from which appropriated. See Charter Plan §7.050. Whether unexpended or unencumbered, the funds will not have been applied to the CIRP and the imbedded cost of the 40% unexpended portion has resulted in a charge borne by the ratepayers. A comparison of cash flow basis rather than the current appropriation basis shows that the District will appropriate over the period from FY 2013 to FY 2016 (after adjusting for inflation) an excess of nearly $44 Million. See Ex. MSD 18A4.

A potential concern of the appropriation of funds prior to approval by the Board of Trustees for multi-year projects is the risk of issuing more bonds, issuing bonds earlier or allowing bonds to remain outstanding longer than is otherwise reasonably necessary to accomplish the governmental purposes of the bonds. Indeed, nearly $44 million to fund the CIRP will be carried over to the next Rate Period. Under Internal Revenue Service regulations, this over issuance may result in special yield and expenditure restrictions.

As such, it is the position of the Rate Consultant that the District Rate Change Proposal should include financing of the CIRP on a forecasted cash flow, rather than appropriation, basis. As evidenced in Exhibit MSD 86B, this would result in a reduced rate increase of 8.9% in FY 2013, followed by increases of 12.6%, 11.7% and 13.2% in FY 2014, FY 2015 and FY 2016, respectively. Ultimately, in FY 2016 the total rates are slightly lower due to this change than in the District's proposal, and the FY 2013 increase in particular is over 2% lower.

Intervenor BJH suggests that cash expenditure is more accurate than the appropriation method and results in a somewhat lower increase. It is BJH's position that if the District uses a cash expenditure basis, its proposed rate increase for the rate period could be lowered by 3% per year. By switching to a cash expenditure basis and modifying its growth and inflation assumptions, these changes would increase the rate by only 8% per year versus the 11-12% increases that the District has suggested, while still meeting the requirements under the Consent Decree agreed to by the District.

Intervenor MIEC agrees with BJH and its recommendation for the use of a cash expenditure method rather than the appropriation method proposed in the District Rate Change Proposal. Intervenors AARP and CCM have not filed testimony with respect to this issue.

Intervenor Robert Mueller concurs and supports the findings of fact and recommendations of the other Intervenors.

(b) Qualifying for Credit Rating

In order to finance the major capital improvements scheduled for FY 2013 through FY 2016, the District seeks to issue additional revenue bonds in the total aggregate amount of $805,000,000. Under the authority of Section 250.120 RSMo., once the voters have approved revenue bonds, the District has the authority to raise rates to pay principal and interest on the bonds and to meet the costs of maintenance and operation of the facilities.

The District Rate Change Proposal is designed to generate debt service coverage for proposed revenue bonds consistent with rating agencies' expectations for "AA" rated large metropolitan wastewater systems. Under certain financial conditions lower investment grade bond ratings may not provide access to credit. It is the District's position that a 13% annual increase in the proposed rate change is necessary to reflect that level of cash balances and resulting bond coverage ratios required through FY 2016 to minimize a possible deterioration in the District's bond rating.

The District's senior lien bond debt service coverage is projected at 2.34 for FY 2016 while total debt service coverage is projected at 1.66. This compares to bond covenant minimum debt service requirements of 1.25 and 1.15 above net annual revenues respectively. At a minimum, the District has projected debt service coverage on senior and total lien bonds to be 2.20 and 1.50, which still exceed the bond covenant minimum debt service requirements.

A minimum level of net revenues is also required to comply with the Maximum Annual Debt Service Requirement (additional bonds test) and Debt Service Requirement (annual rate covenant debt service coverage). The District's projections to meet the minimum debt service requirements in 2016 require net revenues to be at least $130,808,000 for the additional bonds test on total debt and $119,825,000 for the annual rate covenant debt service requirement. Net revenue for 2016 under the 2012 proposed rates, however, is only $51,324,500. Part of the District Rate Change Proposal is required to meet minimum debt service coverage requirements.

The level of cash balances and bond coverage ratios reflected in the District Rate Change Proposal are based on guidance provided by PFM, the District's bond financial advisory firm. The District's debt service obligations are determined by existing bond ordinances and future use of debt based on the structure of these ordinances.

Fitch publishes annually a report that discusses a comprehensive list of metrics related to financial performance, debt security and debt burden. The latest edition of these medians is shown in Exhibit MSD 67H. By definition, the median statistic indicates that half of the credit population has statistics higher than the metric and half of the credit population has statistics lower than the metric. The projected senior lien debt coverage metric is 1.8 times for "AA" rated bonds, while total (or "all-in" as used in the Fitch report) projected coverage is 1.5 times for "AA" rated bonds. Additional bonds tests are generally not considered a metric but the District's 2004 Master Resolution requires 1.25 times maximum debt service for senior lien bonds, and 1.15 times, levels considered adequate, but must be viewed in the context of other credit metrics.

The Rate Consultant testified that the District's coverage ratios generally exceed the medians contained in the January 18, 2011 Fitch 2001 Water and Wastewater Medians. The District has projected ratios for debt service coverage on senior lien debt of 2.54 and on all outstanding debt of 1.66 for the four year period. The District's outstanding debt at the end of FY 2012 is expected to be $775,000,000. The issuance of an additional $945,000,000 will result in an outstanding total debt of $1,720,000,000. The additional debt will then represent 55% of the total outstanding debt. The annual debt service requirement resulting from existing and proposed debt is expected to increase from $38,404,300 in 2011 to $111,467,300 in 2016. See Section 3.5.5 and Table 3-10 of the Wastewater Rate Proposal.

The Rate Consultant believes that the relative proportion of debt and cash financing of the CIRP proposed by the District is reasonable. The District's annual revenue requirements to be met by its rate revenues include operation and maintenance expenses, debt service, cash financing of the CIRP and contributions to fund balances. The debt service coverage generated by the District will be used for cash financing of the CIRP and the contributions to fund balances. As such, a reduction in bonds to be issued for funding the CIRP will result in an increase in the annual cash financing required and increase the required rate increases. Increasing the amount of bonds issued to finance the CIRP will reduce the cash financing requirement but increase the annual debt service and the coverage levels necessary to be generated, which would exceed the cash needed to fund the CIRP and the contributions needed for fund balances.

It is Intervenor MIEC's position that municipal bond market spreads relative to Treasury bonds have been large since the financial market turmoil that occurred in 2008 and that Treasury bond interest rates are forecasted to increase relative to current rates. MIEC states that such increase in Treasury bond rates; however, will likely reflect a recovery in the economy with a normalization of yield spreads between Treasury bonds and municipal bonds. It is further MIEC's position that while Treasury bond interest rates may increase, the municipal bond yield spread will likely contract and yields will either hold steady or possibly decline.

Intervenors BJH, AARP and CCM have not filed testimony with respect to this issue.

Intervenor Mr. Mueller concurs and supports the findings of fact and the recommendations of the other Intervenors.

(c) Bond Interest Rates and Structuring of Debt Service

The District projects that it will issue over $857 million of incremental revenue bonds to finance the CIRP. The District assumes that the revenue bond issuance will be amortized over 30 years. The District assumes a 5.5% interest rate for all bonds anticipated to be issued over the four years of the District Rate Change Proposal. The District's total outstanding debt consists of 100% revenue bonds.

The District's outstanding debt at the end of FY 2012 is expected to be $775,000,000. The issuance of an additional $945,000,000 will result in an outstanding total debt of $1,720,000,000. The additional $945,000,000 will then represent 55% of the total outstanding debt. The annual debt service requirement resulting from existing and proposed debt is expected to increase from $38,404,300 in 2011 to $111,467,300 in 2016. <u>See</u> Section 3.5.5 and Table 3-10 of the Wastewater Rate Proposal.

It is Intervenor MIEC's position that the 30-year bond interest rate of 5.5% is substantially overstated. MIEC recommends reducing the 30-year bond debt interest expense to 4.65%, which was the highest interest rate projection that the District was able to provide any evidence to support in this rate proceeding. It is MIEC's position that a debt interest expense of 4.65% will still overstate the debt service cost of new revenue bond issuances during the forecast period.

It is Intervenor BJH's position that the District should lower the revenue bond issuance amount from $805 million to $727 million over the rate period and maintain the State Revolving Loan proceeds as shown in the District Rate Change Proposal.

Intervenors AARP and CCM support the adjustments presented in the testimony of BJH expert Ms. LaConte and MIEC witness Mr. Gorman. <u>See</u> Ex. BJH 88, Ex. MIEC 29 and Ex. MIEC 63.

Intervenor Mr. Mueller concurs and supports the findings of fact and the recommendations of the other Intervenors.

The District Rate Change Proposal contemplates equal payments of principal and interest. Historically, however, and based on testimony at the Surrebuttal Technical Conference, the District's financial advisor testified that there will in fact be some years of interest only payments before the principal begins.

The Rate Consultant believes that therefore, the District should assume that any new debt will have interest only payments during the period covered by the Rate Proposal. This change would result in reduced rate increases of 8.5%, 11.5%, 11.3% and 11.6% in FY 2013, FY 2014, FY 2015 and FY 2016, respectively, as shown in Exhibit MSD 86C.

OPERATION AND MAINTENANCE

(a) Inflation Rate

In 2004, the District's Board issued revenue bonds to fund 100% of its then Operation and Maintenance (O&M) expense and for the accumulation of a reasonable operating reserve. The total cumulative increase in normal O&M expense over the FY 2012 amount is $23,337,800. The total increase in O&M expense during the same period for additional expenses related to proposed regulatory related facilities is $17,698,800, for a total increase of $40,675,600. This amount exceeds the $36,233,300 of additional revenue provided by the currently approved wastewater rates without allowing for additional operating reserve deposits. The District Rate Change Proposal will be required to meet increased O&M expenses.

The District's O&M expense inflation rates are based on a composite of inflation indices specific to the type of cost. The District's cost increases due to inflation for the District's wastewater revenue projections are based on the following annual percentage increases:

• Wages, Salaries and Overtime	2011-2016	3.0%
• Personnel Services and Benefits[3]	2011	3.5%
	2012-2016	3.0%
• Group Insurance	2011-2015	10%
	2016	6.0%
• Supplies, including Chemicals	2011	3.5%
	2012-2016	3%
• Electric and Gas	2011-2012	3.5%
	2013	3%
	2014-2016	5.5%

[3] Except group insurance and pension.

• Contractual Services	2011-2012	3.5%
	2013	3%
	2014-2016	4.5%
• Bond and Liability Insurance	2011-2016	5%
• Capital Outlay	2011-2012	3.5%
	2013-2016	3.0%
• Pension	2011	8.4%;
	2012	9.3%
	2013	10.2%
	2014	11.4%
	2015-2016	5.0%

MSD Director of Finance, Janice Zimmerman testified that the inflation variances represent a conservative projection of O&M expense as these categories represent 46% of the District's total O&M projected change.

Routine capital improvements to be financed as capital outlay costs (500 accounts) are projected to increase from $2,387,600 in 2011 to $2,770,900 in 2016. The District used an annual rate of inflation of 3%. See Ex. MSD 1, Section 3.5.2.

The District states that the inflation assumptions used for contractual services, machinery and equipment parts, chemical supplies, operational construction and building costs and energy costs are based on indices more closely related to these expenses than the Consumer Price Index (CPI) used by Intervenor MIEC. The District states that several District O&M expenses are unrelated to inflation and are based on short-term historical trends for investment market conditions. Further, the District provides that its use of more closely correlated indices and projections provide a reasonable assumption as to the future O&M inflation expense.

It is Intervenor MIEC's position that the District makes an unsupported assumption (with no justification at all) that its O&M expense should include an annual base inflation factor of 3%

for routine capital improvements. MIEC asserts that the CPI is generally the best measure for adjusting payments to consumers when the intent is to allow consumers to purchase at today's prices, a market basket of goods and services, including housing costs, equivalent to one that they could purchase in an earlier period.

MIEC asserts that as supported by independent sources, the District's assumption is overstated and should be reduce to 2.25% See Ex. MIEC 29. MIEC states that the total impact from this reduction is a decline in projected O&M expense levels of approximately $16 million between the period 2012 thorough 2016. Id. Moreover, MIEC asserts that the District unnecessarily increased the General Counsel expense in year 2011 through 2016 without adequate justification. MIEC recommends growing the General Counsel expense at the rate of general inflation, this adjustment further reduces the District's projected O&M expenses by $6.3 million between 2012 through 2016. Id.

Intervenor BJH proposes that O&M expense should increase by 2.3% each year, excluding Rate Commission cost, Additional O&M cost, Civil Service Commission cost, and Group Insurance Cost, all of which should increase the same as proposed in the District Rate Change Proposal. This assertion is based on the average CPI from FY 2006-FY 2012 at 2.3%. See Ex. MSD 18G. In the second year, BJH recommends lowering the increase to 5% for Other Post Employment Benefit (OPEB) cost and Pension cost, recognizing that the District has switched from a defined benefit pension plan to a defined contribution pension plan.

It is the Rate Consultant's position the District should review and look closer at its choice of rates and provide more transparency. For example, the District's projected inflation for electric and gas is noticeably greater than historic levels. Historically all utilities (which includes water and all other utilities) have increased by .90% while the District is projecting that gas and electric, which are a majority of all utility costs, will increase by 3.5% in FY 2012, 3.0% in FY 2013, and 5.5% in FY 2014 through FY 2016. The Rate Consultant testified that the District has not provided any reference to planned rate increases from their electric and gas providers, nor has it provided any information regarding negotiation of longer term electric power contracts. The Rate Consultant has not proposed any specific inflation rate.

Intervenors AARP and CCM concur with a more reasonable inflation factor of 2.25% as opposed to 3% used in the District Rate Change Proposal.

Intervenor Robert Mueller concurs and supports the findings of fact and the recommendations of the other Intervenors.

(b) Expense Costs

(i) Pension

Personnel services and benefits and group insurance on a combined basis increased at a rate of 0.98% in FY 2006 through FY 2012, but the District is projecting an increase at a rate of 4.56 to 6.52% over their forecast period. This increase appears to be in part due to OPEB expenses, which are being escalated by 10% a year, though that escalation rate is not listed in the District Rate Change Proposal. The Rate Consultant believes the District should relook at this.

The Response to the Rate Commission's Second Discovery Request states that the District's 2011 Operating Budget was prepared prior to the changes in the District's plan from a defined benefit to a defined contribution plan and does not reflect the associated impacts. See Response to Q. 1(e). During the First Technical Conference, Jan Zimmerman testified that the change in the pension plan was adopted to reduce the District's pension costs.

It is the Rate Consultant's position that the effect of this change in the District's pension plan should be incorporated into the District's rate model and the District Rate Change Proposal should be adjusted as appropriate.

(ii) Wages

The District Rate Change Proposal contemplates pay increases for employees over the rate period (3% for wages, salaries and overtime). An examination of the agreements with District employees reveals that the District does not have a contractual obligation to increase pay of its employees.

In 2009, St. Louis County enacted a wage freeze and prohibited merit pay increases for all employees since that time. Since October 2008, there have been no across the board pay increases in the City of St. Louis. Further, the City initiated mandatory furloughs for FY 2010 and FY 2011; eliminated shift differential pay for firefighters; reduced vacation and holiday pay for firefighters; and suspended longevity step increases for police officers and firefighters.

(iii) Total Budget

It is Intervenor MIEC's position that the District's CIRP budget should be reduced by approximately 10% to adjust for the fact that the District's estimates of the CIRP are highly uncertain and the current cost projections are not reliable. MIEC points to Mr. Hoelscher's testimony that, because of the economic conditions, the District received bids for capital work that "in some cases was 40% below traditional costs." See Ex. MSD 9B. Therefore, additional funds were available which were used to complete contingency projects beyond the original program budget. Id. In light of this situation, MIEC asserts that the District is overstating its budget for projects, sometimes up to 40%. In short, ratepayers have already paid more for projects that, in actuality, cost much less.

MIEC asserts that by including overstated cost estimates in the District Rate Change Proposal, the District will have a reduced incentive to manage costs. MIEC states that this is unacceptable. If sewer rates spike dramatically, especially in this economic climate, businesses could re-evaluate their decision to maintain offices and plants in the St. Louis area. Due to the uncertainty of the CIRP program, the budget, and the associated inflation with the CIRP, MIEC recommends the District reduce the CIRP estimated expenses by 10%.

Intervenors AARP and CCM concur with Mr. Gorman's recommended adjustments that would correct the budgets for the CIRP, which were overstated by approximately 10%. See Ex. MIEC 89.

Intervenor Mr. Mueller concurs and supports the findings of fact and the recommendations of the other Intervenors.

The Rate Consultant believes that the District should update the District Rate Change Proposal to reflect the adopted FY 2012 budget as well as include the adjustments to pension expenses related to the new adopted plan in place of the previous plan. While there is a lack of clarity in some of the assumptions used by the District for inflation factors, that in itself does not make them unreasonable. The assumptions used by the District do not appear unreasonable to the Rate Consultant and are similar to assumptions they have used for similar municipal utility clients when projecting expenses as part of recent projects.

(c) Bad Debt Expense

The District has assumed that bad debt provisions will increase steadily over the four year District Rate Change Proposal period as rate increases overtake the efficacy of the enhanced collection efforts. The District states that when examining the District's bad debt provision, it should be noted that the District does not have the ability to incent payment through shut off of water services. Service shut off is the strongest collection tool available to water utilities. The

District states that the lack of this tool must be considered by the Rate Commission. Without the ability to shut off water service there is no way to shut off sewer service without causing health and safety issues for the community and incurring a great cost. MSD Executive Director, Jeff Theerman testified at the Prehearing Conference on September 28, 2011 that while the Missouri Revised Statutes do allow a sewer district to contract with any water corporation to terminate water services to any customer premises for nonpayment of a sewer bill, the City of St. Louis is exempt from such provision. See Mo. Rev. Stat. §§ 393.015-.016 (Supp. 2009). St. Louis County is also exempt from this provision when its population is more than one million inhabitants. Id. Further, Mr. Theerman testified that water companies are hesitant to enter into such agreements because they do not like to turn off water service to paying customers.

The District Rate Change Proposal assumes the level of the bad debt provision will decrease in FY 2012 and FY 2013 due to the initial impact of the more aggressive collection efforts implemented in FY 2011. The District states that while the enhanced collection efforts will be in place in an attempt to address delinquent customer bills through FY 2016, it is anticipated that bad debt will rise later in the rate cycle due to the impact of the proposed rate increases.

It is Intervenor MIEC's position that bad debt expense is substantially overstated. MIEC states that the bad debt expense should reflect the normalized historical levels of customers' failure to pay their bills. From the period 2006 to 2010, the District's actual bad debt expense is represented with a factor of approximately 3.18% of the actual total wastewater revenue billings. See Ex. MIEC 29. It is MIEC's position that the District's expense is based on a highly abnormal factor of 3.96%. MIEC recommends using a normal factor of 3.18% (a number still much higher than other Missouri utility companies) to reflect historical actual debt expense, a new enhanced collection procedure now implemented by the District to improve the abnormal level of debt expense experienced in the economic recession, and the projection that the economy will improve over the next four years while rates are in effect. Moreover, as the MIEC's review of the electronic model uncovered, the District should have reflected a decrease (instead of an increase) in the bad debt expense in 2013.

Intervenor BJH's position is that the District should use a bad debt expense escalator of 3% per year rather than the District proposed 3.96%.

Intervenors AARP and CCM support the adjustments of MIEC, as they correct excessive bad debt expense assumptions. AARP and CCM support the adjustments contained in the testimony of BJH witness Ms. LaConte and MIEC witness Mr. Gorman. See Ex. BJH 88, Ex. MIEC 29 and Ex. MIEC 63.

Intervenor Mr. Mueller concurs and supports the findings of fact and the recommendations of the other Intervenors.

The Rate Consultant's position is that the District's use of bad debt expense in the District Rate Change Proposal is not unreasonable.

WATER USAGE LEVELS/BILLED VOLUME

As part of the District Rate Change Proposal, the District has provided assumptions for the future billed volume and water usage. The assumptions are based on two factors. First, nationwide water consumption rates are decreasing and second, water conservation efforts for both residential and non-residential efforts is a major factor which contributes to a steady decline in billed volume for water usage at water and wastewater utilities nationwide. The District proposes that the Rate Commission should appropriately consider this trend and adopt the assumption given by the District in the District Rate Change Proposal.

The District Rate Change Proposal includes a forecast of a decline in wastewater usage during the forecast period FY 2011 through FY 2016. Specifically, it is projected to decrease approximately 1.9% during this period, based on historical data.

The District Rate Change Proposal projects the number of metered customers to decrease nearly 0.2% from 348,200 in 2011 to 347,600 in 2016 and the number of unmetered customers is projected to decrease nearly 2.3% from 77,400 in 2011 to 75,600 in 2016. The total number of customer accounts is expected to decrease at an average rate of 0.1% per year throughout the six-year study period. The projected change in the number of customers is based on the historical trend in customer accounts between 2006 and 2010.

Intervenor MIEC suggests that economic activity within the service territory suggests that economic activity has bottomed out and will likely improve during the period rates will be in effect. Hence, MIEC believes it is not reasonable to assume that District sales will continue to decline. Rather, an increase in economic activity will more likely produce an increase in sales and revenue at current rates. MIEC believes it more reasonable to assume that as the economy recovers, increased usage by customers will recover, at which point those customers will again start making discretionary investment in water conservation equipment. The MIEC consultant testified that this will have the dual impact of increasing sales relative to the 2011 depressed level, but again show a decline in use per customer as those customers reap the benefit of those discretionary water conservation appliance investments. According to the MIEC consultant, it is simply not rational to expect that sales will decline due to harsh economic times, but customers would make discretionary investment to reduce water consumption. It is MIEC's position that the forecast should include increased revenues. MIEC asserts that the total impact of this adjustment is over $1 million per year in revenue at the current rates. See Ex. MIEC 63.

It is the Rate Consultant's opinion that the District's long term reduction in water consumption used for wastewater billing is consistent with the experience of wastewater utilities throughout the United States, and as such, agrees with the District. The Rate Consultant believes the District's forecast of continued decline in contributed wastewater volumes is not unreasonable.

It is BJH's position that the District's customer count would remain relatively the same throughout the rate period. Usage would decline by 0.76% by FY 2013, and then remain the same through FY 2016.

Intervenors AARP and CCM have not filed testimony with respect to this issue.

Intervenor Mr. Mueller concurs and supports the findings of fact and the recommendations of the other Intervenors.

Respectfully submitted,

Lisa O. Stump

Lisa O. Stump
LASHLY & BAER, P.C.
714 Locust Street
St. Louis, Missouri 63101
Tel: (314) 621-2939
Fax: (314) 621-6844