

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

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

Raftelis Financial Consultants, Inc. and Lashly & Baer, P.C., as Consultant and Legal Counsel, respectively, to the Rate Commission of the Metropolitan St. Louis Sewer District, respectfully submit this Prehearing Conference Summary regarding the outstanding issues in the Wastewater Rate Change Proposal submitted to the Rate Commission by the Metropolitan St. Louis Sewer District (the "District") on May 10, 2011.

BACKGROUND

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 FY 2016 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 the requirements of the Consent Decree.

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. 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 District's position is that the District Rate Change Proposal is necessary for it to comply with the Clean Water Act and with the Consent Decree. A "Detail Sheet" submitted to the Board of Trustees on June 9, 2011, purports to describe the major Consent Decree components and includes a 23-year schedule to achieve compliance with the Clean Water Act. The District estimates the capital program required to achieve compliance with the Consent Decree will cost \$4.7 billion in 2011 dollars, including certain remaining master planning work, as well as design and construction of remedial measures required to achieve compliance; implementation of the District's CSO Long Term Control Plan recently approved by the State of Missouri; use of green infrastructure in abating CSO discharges; a Capacity, Management, Operations and Maintenance program designed to manage the collection system and progress reporting.

Under the Charter, and in its Report, the Rate Commission will have eight different factors to consider. This 2011 Wastewater Rate Change case comes down mainly to one factor: Does the District Wastewater Rate Change Proposal impose a fair and reasonable burden on all classes of ratepayers? Various elements affect the District's proposal. The testimony from the Rate Consultant and Intervenors raises the issue of whether, when all these elements are considered together, the District is being overly conservative on the various elements which together lead to a larger Rate Change Proposal than may actually be necessary.

CIRP FINANCING

a. Appropriation versus Cash Flow Basis

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. The actual expenditure of these appropriations occurs over the life of the project. Whether

unexpended or unencumbered, the funds will not have been applied to the CIRP and the impeded cost of the 40% unexpended portion has resulted in a charge borne by the ratepayers. A comparison of a cash flow basis rather than the current appropriation basis shows that the District will appropriate over the period from fiscal years 2013 to 2016 (after adjusting from inflation) an excess of nearly \$44 million.

Intervenor Barnes Jewish Hospital (“BJH”) suggests that cash expenditure is more accurate than appropriation method and results in somewhat lower increases. If the District uses a cash expenditure basis, its proposed rate increase for the rate period could be lowered by 3% per year.

b. Structuring of Debt Service

The District’s 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 payments only, before the principal begins. The Rate Consultant believes that therefore, there could be a restructuring of debt in the proposal, so that there are lower rates in the next two years.

OPERATION AND MAINTENANCE

Factors related to the District’s personnel costs and benefits for which the District is projecting a significant increase over the forecast period raise concern. Specifically, although testimony indicated that the increase was due in part to Other Post–Employment Benefit expenses, this does not appear to be included in the District Rate Change Proposal. The Rate Consultant believes the District should relook at this. In addition, there is the issue regarding the District’s change in pension plan. Although Ms. Zimmerman testified that the change in the pension plan was adopted to reduce the District’s pension costs, this does not appear in the District Rate Change Proposal. The Rate Consultant believes that the effect of the change in the

pension plan should be incorporated into the District's rate model and the District Rate Change Proposal adjusted as appropriate.

There has also been concern raised regarding the pay increases for employees included in the District Rate Change Proposal. An examination of the agreements with its employees reveals that the District does not have a contractual obligation to increase the pay of its employees. St. Louis City and St. Louis County have had pay freezes, while District employees continued with pay increases.

Both the Intervenors Missouri Industrial Energy Consumers ("MIEC") and BJH have proposed that alternative interest rates be utilized. While the Rate Consultant agrees that there should be transparency regarding the District's choice of interest rates, the Consultant has not proposed a certain rate. The Consultant believes that 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. The Rate Consultant testified that the District has not provided any reference to planned rate increase from their electric and gas providers, nor has it provided any information regarding negotiation of longer term electric power contracts.

QUALIFYING FOR CREDIT RATING

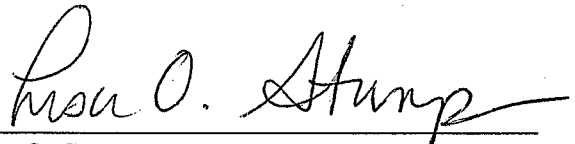
The District Rate Change Proposal is designed to generate debt service coverage for proposed revenue bonds consistent with rating agencies' expectations for "AA" rated large metropolitan wastewater systems. In addition, the District is seeking to maintain a strong liquidity position. The District's coverage ratios generally exceed the medians contained in the January 18, 2011 Fitch 2001 Water and Wastewater Medians. Thus, it ought to be determined

whether the ratios are higher than necessary, thereby resulting in rates than are higher than required.

CONCLUSION

All of these factors, as well as those mentioned by the Intervenors, bear upon whether the District Rate Change Proposal is fair and reasonable. If, in fact, there is an issue that the size of the rate increase is so unreasonable as to be excessive, under a recent case interpreting the Hancock Amendment, the District Rate Change Proposal could face Hancock Amendment issues. In Arbor Investment Co. LLC v. City of Hermann, a case decided by the Missouri Supreme Court in May 2011 involving the City of Hermann, the court discussed the situation of whether the charge are so excessive as to be effectively unrelated to the service provided. The court notes that "If the fee is so exorbitant that it cannot be said to bear a reasonable relationship to the service, at least that excess amount cannot be said to be paid for the service itself." This would affect the factor asking whether the District Rate Change Proposal is in compliance with existing law.

Respectfully Submitted,



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CERTIFICATE OF SERVICE

The undersigned certifies that on the 28th day of September, 2011:

An electronic copy of the foregoing instrument was e-mailed to the Secretary of the Rate Commission c/o jfenton@stlmsd.com.

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At the request of the Rate Commission Counsel, one paper original and associated Exhibits are held at the Rate Commission office for Commissioner review.

An electronic copy of the foregoing instrument was e-mailed to:

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