

## MEMORANDUM

TO: Missouri Public Service Commission Official Case File  
Case No. WO-2011-0106 - - - Missouri-American Water Company

FROM: /s/ James J. Russo 02/18/2011  
Water and Sewer Department Date

/s/ Lisa M. Ferguson 02/18/2011  
Auditing Department Date

/s/ Rachel Lewis 02/18/2011  
Staff Counsel's Office Date

SUBJECT: Staff Report and Recommendation Regarding the Petition of Missouri-American Water Company to Change its Infrastructure System Replacement Surcharge

DATE: February 18, 2011

### BACKGROUND

On December 22, 2010, Missouri-American Water Company ("Company" or "MAWC") filed its Petition to Change its Infrastructure System Replacement Surcharge ("Petition") with the Missouri Public Service Commission ("Commission"). The Company submitted its Petition pursuant to the provision of Sections 393.1000, 393.1003, 393.1006, RSMo, and Commission Rules 4 CSR 240-2.060(1) and 4 CSR 240-3.650. Sections 393.100, 393.1003 and 393.1006, in conjunction with Commission Rule 4 CSR 240-3.650, provide eligible water corporations with the ability to recover certain infrastructure system replacement costs without the need to file a formal rate case. Such costs are recovered through an Infrastructure System Replacement Surcharge ("ISRS").

On December 23, 2010, the Commission issued its Order Suspending Tariff, Directing Notice and Setting Intervention Date, in which it established January 14, 2011 as the date by which applications to intervene in the instant case were to be filed. The Utility Workers Union of America Local 335 filed a Petition to Intervene Out of Time Pursuant to 4 CSR 240-2.075 on February 4, 2011. The Utility Workers Union of America Local 335 represents approximately 300 MAWC workers and is concerned with the impact the proposed change to the ISRS could have on jobs, pensions, and other terms and conditions of employment. The Commission also suspended MAWC's tariff sheet, YW-2011-0312, until April 21, 2011.

### STAFF'S INVESTIGATION

As noted at the beginning of this Memorandum, Staff members from the Auditing and Water & Sewer Departments participated in Staff's investigation of the Petition. All Staff participants as well as their respective supervisors and the assigned attorney from the Chief Staff Counsel's Office were provided the opportunity to review and comment on this Memorandum prior to its

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filing. Lisa M. Ferguson of the Auditing Department created the initial draft of this Memorandum and comments received from the reviewers were incorporated into that draft in developing this final version of the Memorandum.

Staff's investigation into the Petition included a review of the Petition and the supporting documentation, Chapter 393 RSMo, and Commission Rule 4 CSR 240-3.650(2), as well as additional data provided by MAWC. In conjunction with this investigation, the Staff also reviewed information regarding the payment history for MAWC's annual assessment fees and the status of MAWC's annual report filings, which are discussed later in this Memorandum.

### **THE PETITION**

Specifically, as stated in its Petition, MAWC "requests an adjustment to its rates and charges through a change to its ISRS rate schedule to provide for the recovery of costs for infrastructure system replacements and relocations eligible for ISRS recognition. The proposed ISRS rate schedule should reflect the appropriate pre-tax ISRS revenues necessary to produce net operating income equal to MAWC's weighted cost of capital multiplied by the net original cost of the requested infrastructure replacements which are eligible for the ISRS, including recognition of accumulated deferred income taxes and accumulated depreciation associated with the aforesaid infrastructure system replacements. MAWC also seeks to recover all state, federal and local income or excise taxes applicable to such ISRS income and to recover all other ISRS costs such as depreciation expense and property taxes due within 12 months of this filing."

In its Petition, MAWC indicates that all of the eligible infrastructure system replacements meet the following criteria:

1. They replace and/or extend the useful life of existing infrastructure;
2. They are currently in service and used and useful;
3. They do not increase revenues by directly connecting to new customers since all ISRS projects represented replacements of existing facilities or relocations of existing facilities;
4. They were not included in MAWC's rate base in its most recently completed general rate case, Case No. WR-2010-0131;
5. The costs related to such projects have not been reimbursed to the utility; and
6. They were not included in any other MAWC ISRS filing.

MAWC also indicates that the water utility plant projects on which it seeks to base the ISRS are either:

1. Mains and associated valves and hydrants installed as replacements for existing facilities that have worn out or were in a deteriorated condition; or
2. Main cleaning and/or relining projects; or
3. Infrastructure facility relocations due to the construction or improvement of a highway, road, street, public way or other public work required by or on behalf of the United States, the State of Missouri, a political subdivision of the State of Missouri, or another entity having the power of eminent domain.

Staff notes that any reimbursements MAWC received for these projects was recognized as a reduction of the ISRS investment in the calculation of the ISRS revenue requirement.

In its Petition, the Company requested an adjustment to its rates and charges through the implementation of an ISRS rate schedule. The Company indicates that its proposed rate schedule will "produce ISRS revenues of \$4,349,656 or an increase of 1.8% above the base revenue level approved by the Commission in its most recently completed general rate proceeding" on an annualized basis. In addition, "The ISRS proposal includes an adjustment of \$631,225 to reflect an under collection from previous ISRS surcharges."

### **STAFF'S REVENUE CALCULATION**

Except for the items listed and discussed below, the Staff agrees with and has adopted the methodology utilized by the Company for the calculation of the ISRS revenue requirement for purposes of this ISRS filing. Staff's calculations utilized:

1. Replacement of any estimated costs included in the ISRS plant balances reflected in the Company's original filing with actual incurred amounts,
2. The exclusion of \$142,836 of property taxes that related to 2010 plant included in MAWC's most recent rate case, as well as ISRS eligible investments made subsequent to January 1, 2011, on which property taxes will not be paid until December 2012, over twelve months following the ISRS filing.
3. The inclusion of under collected revenues that were determined based on the final reconciliation of the two prior ISRS filings as further explained below,
4. The inclusion of deferred taxes up through the effective date of this ISRS as explained below, and
5. \*\* [REDACTED] \*\*

Staff is proposing to include an amount for under collection of ISRS revenues based on a calculated reconciliation of the previous two ISRS cases (WO-2009-0379 and WO-2010-0190). Staff did not include over or under collections of ISRS revenues as a result of Case No. WO-2008-0249 because Staff has already addressed this issue through a reconciliation that was included as part of MAWC ISRS Case No. WO-2009-0379.

Staff is also proposing to include additional deferred income tax reserves through the month of the effective date of rates in this ISRS case to better reflect the actual levels that will exist for these items at that time. In its original filing, the Company included and Staff agrees with reflecting additional depreciation reserves through the month of the effective date of rates in this ISRS case.

\*\* [REDACTED]

## **THE ISRS RATE SCHEDULES**

The proposed ISRS rate schedules include a volumetric rate for each affected customer class with the rate to be determined through the use of the customer class billing determinants from the Company's last rate case, Case No. WR-2010-0131 and the ISRS revenues allocated to each affected customer class. The Staff has utilized the Company's methodology for calculating the majority of the ISRS rates, but has determined such rates based on Staff's calculation of the revenue requirement as reflected in Appendix B to this Memorandum.

## **STAFF'S CONCLUSIONS**

Based on its investigation and calculations, Staff concludes that the Company's ISRS rates should be designed to recover annual ISRS revenues of \$3,624,121. The Staff's calculations are shown in Appendix A to this Memorandum. These calculations reflect MAWC's capital structure as filed in its last rate case, a 10% return on equity and MAWC's current depreciation rates, all according to the Stipulation and Agreement as ordered by the Commission in Case No. WR-2010-0131. Staff's calculations reflect the actual ISRS investment placed in service from May 2010 through January 2011, which is after the April 30, 2010 true-up cut-off date in MAWC's last rate case.

Staff based its conclusions on an examination of work orders and supporting documents for the projects included for recovery in the Company's proposed ISRS filing, a review of the Stipulation and Agreement in Case No. WR-2010-0131, the ISRS filings from Case Nos. WO-2009-0379 and WO-2010-0190, as well as various discussions with Company personnel. As a result, Staff believes the projects meet the requirements of the governing statutes as summarized previously in this Memorandum in the discussion of the Company's Petition.

## **ASSESSMENTS AND ANNUAL REPORTS**

In accordance with established practice regarding the submission of Staff recommendations to the Commission, Staff reviewed the payment history for MAWC's annual assessment fees and the status of MAWC's annual report filings. Based on its review of this information, Staff found that MAWC is current on its quarterly payments for its fiscal year 2010 assessment and has no delinquencies for prior years' assessments. In addition, MAWC does not have any past due annual reports.

## **STAFF RECOMMENDATIONS**

Based on the above, Staff recommends that the Commission issue an order that:

1. Finds that MAWC's filed Petition is in compliance with the requirements of Sections 393.1000 to 393.1006 RSMo;

2. Approves MAWC's Petition to implement ISRS rate schedules with the above adjustments to revenue requirement;
3. Approves Staff's determination that the Company is entitled to receive ISRS surcharge revenues in the amount of \$3,624,121 as shown in Appendix A; and
4. Approves the compliance filing of MAWC's revised ISRS tariff sheet P.S.C. MO. No. 6, 11<sup>th</sup> Revised Sheet No. RT 18.0, Canceling 10<sup>th</sup> Revised Sheet No. RT 18.0 pending in Tariff File No. YW-2011-0106, to be effective on April 21, 2011.