Exhibit No.:	
Issue(s):	*Regulatory Deferrals, Capitalized Depreciation Costs, Amortization Expense*
Witness:	*Amanda C. McMellen*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Surrebuttal Testimony*
Case No.:	*WR-2020-0344*
Date Testimony Prepared:	*February 9, 2021*

MISSOURI PUBLIC SERVICE COMMISSION

FINANCIAL & BUSINESS ANALYSIS DIVISION

AUDITING DEPARTMENT

SURREBUTTAL TESTIMONY

OF

AMANDA C. MCMELLEN

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2020-0344

Jefferson City, Missouri
February 2021

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Q. Please state your name and business address.

A. Amanda C. McMellen, P.O. Box 360, Suite 440, Jefferson City, MO 65102.

Q. Have you previously contributed to Staff's Cost of Service Report and filed direct testimony on November 24, 2020, as well as filed rebuttal testimony on January 15, 2021 in this case?

A. Yes, I have.

EXECUTIVE SUMMARY

Q. Please summarize your surrebuttal testimony in this proceeding.

A. In this testimony, I will address the rebuttal testimony filed in this case by Missouri-American Water Company (MAWC) witness Brian W. LaGrand regarding regulatory deferrals, capitalized depreciation costs, and amortization expense. I will also provide a list of changes and/or corrections to Staff's rebuttal revenue requirement calculation for MAWC in this proceeding.

REGULATORY DEFERRALS

Q. What regulatory deferrals does MAWC include in rate base?

A. Mr. LaGrand stated in his rebuttal testimony on page 22, lines 7 through 11 that MAWC included four regulatory deferrals in rate base. They are: the pipeline funded by

Emerald Point, receivership fees related to Hickory Hills, the acquisition costs of Woodland Manor and the deferred costs for customer-owned lead service line replacements.

Q. Please provide a brief history regarding the Emerald Pointe pipeline costs that MAWC included in rate base as part of this rate case?

A. MAWC purchased the Emerald Pointe water and sewer assets in March, 2014. As part of its rate proceeding in Case Nos. WR-2013-0017/SR-2013-0016, Emerald Pointe retired its wastewater treatment plant and constructed two new lift stations and a pipeline to transport all wastewater to the City of Hollister for treatment. The lift stations and section of pipeline up to the Emerald Pointe flow meter were owned by Emerald Pointe, which was then transferred to MAWC. The section of pipeline from the Emerald Pointe flow meter to the City of Hollister's wastewater treatment plant is owned and maintained by the City of Hollister but was paid for by Emerald Pointe and one or more other parties. Emerald Pointe did not own or maintain the pipeline from the Emerald Pointe flow meter to the City of Hollister. MAWC did not assume ownership or responsibility for the maintenance of the section of pipeline owned by the City of Hollister when it acquired Emerald Pointe.

Q. Does Staff agree with Mr. LaGrand that the unamortized balance of the cost of the pipeline was given rate base treatment in previous cases, as he stated in his rebuttal testimony on page 23, lines 4 through 5?

A. Yes. However, Staff erroneously included the costs for this section of pipeline in rate base in the Emerald Pointe rate case (Case Nos. WR-2013-0017/SR-2013-0016) and the case transferring assets from Emerald Pointe to MAWC (Case Nos. WO-2014-0113/SO-2014-0116). It is important to note that rate base treatment of this section of pipeline was not litigated in the Emerald Pointe rate case. It was not discussed in the Staff

Recommendation Memo filed on January 24, 2014, in any filed testimony, or in the *Notice of Company/Staff Partial Agreement Regarding Disposition of Revenue Increase Request and Request for Hearing* filed on March 14, 2013. In the previous two MAWC rate cases (Case Nos. WR-2015-0301/SR-2015-0302 and WR-2017-0285/SR-2017-0286), Staff corrected this error and believes including the unamortized balance related to the pipeline donated to the City of Hollister in the 2014 Emerald Pointe rate case was Staff's mistake.

Q. Does Staff believe it is appropriate to include any amount of the Emerald Pointe pipeline owned by the City of Hollister in rate base, given that MAWC does not own or maintain that section of the pipeline?

A. No. Since MAWC does not own or maintain these assets, it is inappropriate to include the regulatory deferral (unamortized balance) for these costs in rate base. It is inappropriate for MAWC to earn a return on an item it does not own, that was contributed to another entity, or in which it has no outstanding investment and is not an asset on the utility's books and records.

Q. Has Staff included an amortization of the Emerald Pointe regulatory asset in the cost of service in this case?

A. Yes. Staff has included an annual level of amortization expense in the cost of service based on a 50-year amortization, which is also recommended by Mr. LaGrand in his direct testimony on page 30, lines 5 through 6.

Q. Do you agree with Mr. LaGrand that the Commission ordered MAWC to establish a regulatory asset in Case No. WA-2016-0019/SA-2016-0020 for Hickory Hills as stated in his rebuttal testimony on page 24, lines 10 through 14?

A. Yes. Staff agrees that the Commission ordered MAWC to book a regulatory asset in the amount recommended by Staff, split equally between water and sewer, with the regulatory asset to be amortized over a five-year period, beginning the first month following the effective date of the order, which was December 1, 2015.

Q. Has Staff included the Hickory Hills regulatory asset in the cost of service in this case?

A. Yes. Staff has included an annual level of amortization expense in both the Hickory Hills water and sewer costs based on a five-year amortization, which is also recommended by Mr. LaGrand in his direct testimony on page 30, lines 9 through 10.

Q. What is Mr. LaGrand's proposal for rate base treatment of the unamortized balance for Hickory Hills?

A. Mr. LaGrand proposes in his rebuttal testimony starting on page 24, line 16 through page 25, line 4 to include the full purchase price of the Hickory Hills system in rate base.

Q. Does Staff agree with Mr. LaGrand's proposal to include the unamortized balance in rate base?

A. No. The unamortized balance does not meet Staff's requirements for inclusion in rate base as it is not capital in nature, not associated with costs that are amortized over a long period of time, and is not significant to MAWC.

Q. What is Mr. LaGrand's proposal for rate base treatment of the unamortized balance for Woodland Manor?

A. Mr. LaGrand proposes in his rebuttal testimony on page 25, lines 11 through 14 to include the full purchase price of the Woodland Manor system in rate base.

Q. Does Staff agree with Mr. LaGrand's proposal to include the unamortized balance in rate base?

A. No. The unamortized balance is not capital in nature, is not associated with costs that are amortized over a long period of time, and is not significant to MAWC.

Q. Do you agree with Mr. LaGrand's statement in his rebuttal testimony on page 25, lines 18 through 20 that the Commission ordered, in Case No. WR-2017-0285/ SR-2017-0286, the deferred balance for customer-owned lead service line replacements (LSLR) to be included in rate base?

A. No. The quote from the Report and Order dated May 2, 2018 on page 23 is as follows:

> Therefore the Commission will permit MAWC to amortize over ten years the $1,668,796 incurred for the LSLR Program from January 1, 2017, through December 31, 2017. MAWC's long-term debt rate as calculated in Staff's Cost of Service Report shall also be applied to the LSLR Program amount to be amortized.

Q. What is Staff's position regarding the recovery of LSLR costs?

A. Based on the Commission Report and Order referenced above, Staff's position has not changed. As stated in my rebuttal testimony on page 4, lines 5 through 13, Staff's position is that the deferred balance should not be included in rate base.

CAPITALIZED DEPRECIATION

Q. What is capitalized O&M depreciation, and why does Staff make an adjustment for this item?

A. Depreciation expense is calculated on all MAWC-owned plant in service. For certain O&M plant accounts, such as power-operated equipment, Staff recommends that a portion of depreciation expense be capitalized during the year when those assets are partially used for capitalized construction projects. For projects in which the same power-operated equipment is used for maintenance work, the depreciation should be recorded as an expense. Staff's position is that that portion of depreciation expense for these O&M assets that is applicable to the time that those O&M assets were used for construction projects should be capitalized by MAWC on a going forward basis.

Q. Please indicate all MAWC Universal System of Accounts (USOA) plant in service accounts that Staff proposes to adjust to exclude from the depreciation expense annualization an appropriate portion of ongoing capitalized depreciation.

A. Staff proposes to remove a capitalized portion from the annualization of depreciation expense from the following USOA plant in service accounts: 392, 392.1, 392.2, 392.3, and 392.4 for transportation equipment; account 393 for stores equipment; account 394 for tools, shop, and garage equipment; and account 396 for power-operated equipment. Again, Staff performed this adjustment to address the fact that for a portion of time during any given year, MAWC uses these assets for capital projects rather than entirely for O&M projects.

Q. Does Staff calculate this adjustment for all regulated utilities or just water utilities?

A. It has been Staff's practice to calculate this adjustment for all utility types. For instance, at a minimum Staff has reflected this adjustment in its cost of service calculations in recent cases involving Union Electric Company, d/b/a Ameren Missouri, Liberty Utilities (Midstates Natural Gas), Laclede Gas Company and its Missouri Gas Energy operating unit, Kansas City Power & Light Company, KCP&L-Greater Missouri Operations Company, The Empire District Electric Company, and Raytown Water Company.

Q. In general, how does Staff determine the ongoing amount of capitalized depreciation that should be removed from the annualization of depreciation expense?

A. In other rate cases, Staff submits a data request to the utility that it is auditing seeking the amount of depreciation expense that has been booked to each account and will ask for that amount to be divided amongst the amount of time those assets were used for construction, expense, and non-utility for a specified time period.

Q. How does that determination work based on that information?

A. In general, this division is determined by assigning labor costs to capital and expense items. Once Staff receives the response to this data request, Staff will adopt this assignment if appropriate or develop a ratio of how much of the depreciation expense should be designated for construction purposes. Staff will then apply that ratio to each account mentioned above, and that ratio will reflect the amount of the adjustment that will be removed from annualized depreciation expense. That portion which is removed from annualized depreciation expense is the amount that is expected to be capitalized based on Staff's evaluation of the actual historical usage of the investment being examined.

Q. What is Staff's rationale for making this adjustment?

A. Staff maintains that MAWC should follow the guidelines given in the 1976 Revisions of Uniform System of Accounts for Class A & B Water Utilities 1973 National Association of Regulatory Utility Commissioners guide. On page 98, under account 403 Depreciation Expense, the USOA states: "Note B – Depreciation Expense applicable to transportation equipment, shop equipment, tools, work equipment and power operated equipment and other general equipment may be charged to clearing accounts as necessary in order to obtain a proper distribution of expenses between construction and operation."

Q. Is there additional guidance that confirms the above treatment for utilities in other sectors?

A. Yes. The Federal Energy Regulatory Commission (FERC) USOA for Electric Utilities also states on page 399 under section 403 depreciation "Note B: Depreciation Expense applicable to transportation equipment, shop equipment, tools, work equipment and power operated equipment and other general equipment may be charged to clearing accounts as necessary in order to obtain a proper distribution of expenses between construction and operation."

Q. Does Staff propose a capitalized depreciation adjustment in this case?

A. Yes. Although MAWC has not been tracking the use of assets in accounts 392, 393, 394, and 396, Staff made an adjustment based on Staff's overall capitalization ratio. In Staff's opinion in this case and the previous two MAWC rate cases (Case Nos. WR-2015-0301 and WR-2017-0285), MAWC should be tracking the distribution of expenses between construction and expense. Therefore, Staff recommends that the Commission order MAWC to begin tracking the amount of time the assets in USOA accounts 392, 393, 394, and 396 are being used for expense versus capital purposes and to capitalize a proportionate amount of depreciation expense associated with the use of those assets in capital projects on a going forward basis.

Q. Does Staff agree with Mr. LaGrand that capitalizing depreciation causes intergenerational equity issues?

A. No. By capitalizing depreciation, current and future customers are paying their proportionate share of this cost.

AMORTIZATION EXPENSE

Q. Has MAWC made any changes regarding amortization expense?

A. Yes. As Mr. LaGrand stated on page 37, lines 10 through 15 of his rebuttal testimony, MAWC included as regulatory assets additional investments for the St. Louis Metropolitan Sewer District that it did not include in the original data supplied to Staff.

Q. How do you respond?

A. Once the data has been updated and provided, Staff will review for possible inclusion in amortization expense in the true-up.

Q. Does Staff agree with Mr. LaGrand, as he stated on page 37, lines 5 through 7 of his rebuttal testimony, that the low-income pilot program should be amortized and included in this case?

A. Yes. Staff and MAWC agree on the amount of annual amortization of $6,208 (which represents a three-year amortization) for the low-income pilot program as of June 30, 2020, which will be updated through December 31, 2020 in the true-up.

Q. Does Staff agree with Mr. LaGrand, as he stated on page 38, lines 1 through 22 of his rebuttal testimony, that the regulatory assets for amortized allowance for funds used during construction (AFUDC) should be included in this case?

A. No. To Staff's knowledge, no other utility has proposed to Staff that these type of regulatory assets be included, nor has the Commission approved this treatment. MAWC has not shown why including these regulatory assets is appropriate.

CORRECTION TO STAFF'S REBUTTAL FILING

Q. Is Staff aware of changes and/or corrections to its rebuttal revenue requirement?

A. Yes. After its rebuttal filing on January 15, 2021, Staff became aware of certain changes and/or corrections to the rebuttal revenue requirement amount.

Q. What are the changes and/or corrections?

A. The following issues will be corrected and reflected in Staff's surrebuttal filings:

- Customer Usage – Update residential, industrial and Lawson usage – See Ashley Sarver's and Jarrod J. Robertson's surrebuttal testimonies for further explanation;
- Water Loss – See Andrew Harris' and Ashley Sarver's surrebuttal testimonies for further explanation;
- Dues and Donations – Update expense. See Courtney Barron's surrebuttal testimony for further explanation;
- Labor and Related Costs – Updated employee hours and labor related expenses. See Ali Arabian's and Courtney Barron's surrebuttal testimonies for further explanation;
- Insurance Expense – Correction for insurance other than group and D&O premiums. See Caroline Newkirk's surrebuttal testimony for further explanation;
- Maintenance Expenses – Update building maintenance and maintenance supplies and services expense. See Angela Niemeier's surrebuttal testimony for further explanation;
- Uncollectible Expense – Update expense. See Caroline Newkirk's surrebuttal testimony for further explanation;
- Rate Case Expense – Service Company Labor and update to expense. See Paul K. Amenthor's surrebuttal testimony for further explanation;

- o Outside Services – Adjustment to expense. See Kimberly K. Bolin's surrebuttal testimony for further explanation;
- o Pension and OPEBs – Update balances. See Keith D. Foster's surrebuttal testimony for further explanation;
- o Accumulated Deferred Income Tax (ADIT) – Corrected amortization. See Kimberly K. Bolin's testimony for further explanation.

Q. How do all the changes and/or corrections affect Staff's overall revenue requirement?

A. Staff's overall revenue requirement has changed from an increase of $5,205,401 in its rebuttal filing to an decrease of $2,072,180. Staff's revised recommendation is comprised of a revenue requirement for all MAWC water operations of ($8,052,918) and for all sewer operations of $5,980,738.

Q. Does this conclude your surrebuttal testimony?

A. Yes.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Missouri-American Water	)	
Company's Request for Authority to	)	Case No. WR-2020-0344
Implement General Rate Increase for	)	
Water and Sewer Service Provided in	)	
Missouri Service Areas	)	

AFFIDAVIT OF AMANDA C. McMELLEN

STATE OF MISSOURI	)	
	)	ss.
COUNTY OF COLE	)	

COME NOW AMANDA C. McMELLEN and on her oath declares that she is of sound mind and lawful age; that she contributed to the foregoing *Surrebuttal Testimony of Amanda C. McMellen*; and that the same is true and correct according to her best knowledge and belief, under penalty of perjury.

Further the Affiants sayeth not.

/s/ Amanda C. McMellen
AMANDA C. McMELLEN