

**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI**

In the Matter of Missouri-American Water	)	
Company's Request for Authority to Implement	)	Case No. WR-2020-0344
General Rate Increase for Water and Sewer	)	Case No. SR-2020-0345
Service Provided in Missouri Service Areas.	)	

**MOTION TO ESTABLISH FUTURE TEST YEAR**

**COMES NOW** Missouri-American Water Company (MAWC, Missouri-American, or Company), and, moves the Missouri Public Service Commission (Commission) to establish a future test year for use in this case, as described herein:

**SUMMARY**

MAWC's rate base and expenses are increasing, while the Company continues to experience a declining trend in revenues year-over-year. Therefore, the relationship between revenues, expenses and rate base that may exist in an historical test year will not exist in the first year rates take effect. The use of a fully forecasted test year is designed to restore a proper matching of these items for this period to produce rates that most accurately reflect the revenues, expenses and investments during the period the rates are to be effective. Use of a future test year is considered a "best practice" for water companies by public utility regulators and is within the Commission's authority in establishing just and reasonable rates. MAWC, therefore, requests herein that the Commission establish rates based on a future test year covering the first year that new rates are expected to be in effect (i.e., the 12 months ending May 31, 2022). Moreover, the Company seeks a Commission determination on the use of a future test year as expeditiously as possible. The Company's request to adopt a future test year will impact the processing and reconciliation of this case therefore, time is of the essence.

## AUTHORITY

1. Nearly forty years ago, the Missouri Court of Appeals for the Western District affirmed the Commission's authority to use forecasts to address the effects of inflation on selling rates based on historical information:

There can be no argument but that the Company and its stockholders have a constitutional right to a fair and reasonable return upon their investment. That right carries as a corollary the duty by the Commission to consider all relevant factors including the effects of inflation. (Citations omitted)... It is no answer to the foregoing duty to say that a forecast as to future inflation is merely speculative. Despite that hazard, the Commission must make an intelligent forecast with respect to the future period for which it is setting the rate; rate making is by necessity a predictive science.<sup>1</sup>

2. More recently, the Missouri Court of Appeals for the Western District specifically addressed the Commission's authority to use a future test year in a Kansas City Power & Light Company (KCPL) rate case appeal.<sup>2</sup> KCPL proposed to include in its revenue requirement projected increases in regional transmission organization costs and property taxes. In its Report and Order, the Commission chose to not include projected costs in KCPL's revenue requirement because: 1) the projected future costs were not presented until surrebuttal testimony, violating the Commission's rule that such evidence should be a part of the Company's direct testimony; 2) it found the estimates of future costs to be unreliable; and 3) the Commission had doubts as to whether it had authority to grant the requested relief. As to the matter of whether the Commission has the authority to adopt a future test year, the Court of Appeals answered that question in the affirmative:

---

<sup>1</sup> *State ex rel Missouri Public Service Co. v Fraas*, 627 S.W.2<sup>nd</sup> 882, 86 (Mo.App.W.D. 1981).

<sup>2</sup> *Kansas City Power & Light Company's Request v. Missouri Public Service Commission*, 509 S.W.3d 757, 771-72 (Mo.App. W.D. 2016), reh'g and/or transfer denied (Nov. 1, 2016), transfer denied (Feb. 28, 2017).

In determining rates, the PSC may consider all facts that in its judgment have a bearing on the proper determination of rates. *See* Section 393.270.4; *State ex rel. Pub. Counsel*, 397 S.W.3d at 447-48. Relevant facts, of course, include forecasts of future costs. *See Fraas*, 627 S.W.2d at 886 ("the Commission must make an intelligent forecast with respect to the future period for which it is setting the rate; rate making is by necessity a predictive science").<sup>3</sup>

3. In MAWC's most recent rate case, MAWC also requested that the Commission establish a future test year. While the Commission did not authorize a future test year in that proceeding, it specifically rejected the notion that it was not authorized to do so. The Commission stated that, "A decision on the appropriate test period and adjustments to be used when establishing rates is a factual determination. *State ex. rel. GTE North, Ins. v. Missouri Public Service Commission*, 835 S.W.2d, 356 (Mo.App.W.D., 1992)" As a result, the Commission adopted Staff's Suggestions in that case, which directed parties to use a historic test year of the twelve (12) months ending December 2016 with an update period of six (6) months ending June 2017, and a true-up period of six (6) months ending December 2017. Significantly, the Commission also allowed parties to present further adjustments for the Commission's consideration based upon projected and forecasted data past December 2017.<sup>4</sup>

4. In this case, MAWC has proposed with its initial filing, the use of a future test year. Unlike the KCPL case referenced above, all information concerning that future test year has been included with the Company's direct testimony and the basis for its future test year projections are explained in testimony, supportable, and reliable.

---

<sup>3</sup> *Kansas City Power & Light Company* at 771-72.

<sup>4</sup> *Order Regarding Test Year*, Case No. WR-2017-0285, et al., issued August 9, 2017.

## TRADITIONAL APPROACH

5. It is common for the Commission to order an update to the original historic test year that will include known and measurable changes through a date after the filing of the rate case. Further, the Commission has commonly established a True-Up period. The True-Up period has been described as follows:

The use of a True-Up audit and hearing in ratemaking is a compromise between the use of a historical test year and the use of a projected or future test year. It involves adjustment of the historical test year figures for known and measurable subsequent or future changes. However, while the "test year as updated" involves all accounts, the True-Up is generally limited to only those accounts necessarily affected by some significant known and measurable change, such as a new labor contract, a new tax rate, or the completion of a new capital asset. Both the "test year as updated" and the True-Up are devices employed to reduce regulatory lag, which is "the lapse of time between a change in revenue requirement and the reflection of that change in rates."<sup>5</sup>

6. Commonly, the end of the true-up period would be approximately five months before the date new rates would be required to go into effect. For example, in this case, a common true-up period would end on or about December 31, 2020 – approximately five months prior to the May operation of law date.

## IMPACT OF HISTORIC TEST YEAR

7. The first year new rates will be in effect as a result of this case is likely to be the 12 months beginning about June 1, 2021, and ending approximately May 31, 2022. Even if a True-Up period that extends to December 31, 2020 is allowed for selected items, it is still far short of the first year new rates will be in effect. For new rates developed using an historical test year to be reasonable, the Commission must assume that costs, investment, and revenues will differ from

---

<sup>5</sup> *In the Matter of Lake Region Water & Sewer Company*, Report and Order, 2010 Mo. PSC LEXIS 794, Case No. SR-2010-0110 (August 18, 2010).

their historical test year levels in the same proportion through the year that new rates will be in effect (the “rate year”).

8. Almost certainly, business conditions will differ between the historical test year and the rate year, causing both costs and revenues to diverge from the historical test year levels in differing proportions. This is consistent with the Company’s experience as MAWC’s costs and revenue have diverged in unequal proportion in the past.

9. There are several reasons for the divergence in expenses, investments, and revenues. First, Missouri-American’s revenues are declining due to a persistent, nationwide trend of declining use per customer that is fueled by national and state conservation mandates and programs, and which shows no sign of abating anytime soon. Over the period of 2010-2019, including a record drought in 2012, MAWC under-collected its authorized revenue by approximately \$52 million.<sup>6</sup> Therefore, even if rate base and expenses in the rate year were the same as they were in the historical test year, revenue will not be the same but will, instead, decline from historical test year levels.

10. Second, and equally significant, rate base will not stay the same as in the historical test year, even if adjusted in a narrow true up period. MAWC’s planned, significant capital investment is one of the issues driving the need for rate relief in this proceeding. The Company has invested or plans to invest \$950 million in its water and sewer facilities since the true-up date in its last rate case (i.e., December 31, 2017) through May 31, 2022. To not reflect plant that is in service during the relevant test year would result in rates that do not reflect plant additions that will be used and useful and serving the customers during the relevant rate year.

---

<sup>6</sup> The amount is net of production costs and does not include industrial customers.

11. Missouri-American's investment requirements are anticipated to continue on a similar pace for an extended period and O&M may increase modestly, while use per customer continues to decline by approximately two percent per year; thereby undermining the fundamental rate making matching principle.

### **FUTURE TEST YEAR**

12. MAWC proposes to use the following information and process to develop the future test year:

- a normalized and fully historical base year (that reflects actual revenues, expenses, and rate base for the 12 months ended December 31, 2019);
- consideration of changes to those cost elements through a verifiable link period (January 1, 2020 to May 31, 2021); and then,
- an assessment of the period covering the first year that new rates are expected to be in place (12 months ending May 31, 2022).

13. The future test year includes a forecast of revenue, and expenses. Expenses are adjusted for changes to categories of expenses where they can be reasonably forecasted. For other expenses, an inflation factor is used to adjust costs for the future period. The Company's future test year also employs a 13-month average of planned changes to rate base. The forecast is composed of both specific projects that are scheduled to be in service during the future test year and projected levels of other activity such as main and service replacements, meter replacements and similar such project groupings. Further, the Company is using a 13 month average of rate base additions for the future test year rate base. The use of this convention means that, if plant was added in equal increments in every month, only approximately one-half of the ending plant balance would be in rate base. For large projects, MAWC has added the plant to rate base on the

projected in-service date of the additions.

### **NARUC “BEST PRACTICE” FOR WATER UTILITIES**

14. The use of a future test year is not a novel concept in utility regulation. Eleven of the fourteen states in which American Water has regulated operations authorize the use of a future test year (California, Hawaii, New York, Iowa, Illinois, Indiana, Kentucky, Tennessee, Pennsylvania, Virginia, and West Virginia). Moreover, the future test year is considered a “best practice” for water companies by public utility regulators. In 2005, the National Association of Regulatory Utility Commissioners (“NARUC”) adopted a resolution stating, in part, the following:

WHEREAS, To meet the challenges of the water and wastewater industry which may face a combined capital investment requirement nearing one trillion dollars over a 20-year period, the following policies and mechanisms were identified to help ensure sustainable practices in promoting needed capital investment and cost-effective rates: a) the use of prospectively relevant test years; b) the distribution system improvement charge; c) construction work in progress; d) pass through adjustments; e) staff-assisted rate cases; f) consolidation to achieve economies of scale; g) acquisition adjustment policies to promote consolidation and elimination of non-viable systems; h) a streamlined rate case process; i) mediation and settlement procedures; j) defined timeframes for rate cases; k) integrated water resource management; l) a fair return on capital investment; and m) improved communications with ratepayers and stakeholders...

15. In July 2013, NARUC’s Board of Directors reiterated the use of the 2005 Resolution as a best practice for water companies. NARUC found:

RESOLVED, That the Board of Directors of the National Association of Regulatory Utility Commissioners, convened at its 2013 Summer Meeting in Denver, Colorado, identifies the implementation and effective use of sound regulatory practice and the innovative regulatory policies identified in the Resolution Supporting Consideration of Regulatory Policies Deemed as “Best Practices” (2005) as a critical component of a water and/or wastewater utility’s reasonable ability to earn its authorized return; and be it further

RESOLVED, That NARUC recommends that economic regulators carefully consider and implement appropriate ratemaking measures as needed so that

water and wastewater utilities have a reasonable opportunity to earn their authorized returns within their jurisdictions; and be it further

RESOLVED, That the Committee on Water stands ready to assist economic regulators with the execution of a sound regulatory environment for regulated water utilities, and will continue to monitor progress on this issue at future national committee meetings until satisfactorily improved.

16. At its November 2013 annual meeting, NARUC again adopted yet another resolution affirming its support of prospective test years for water and sewer utilities.

### **CONCLUSION**

17. The use of a future test year properly addresses the matching principle. In this rising cost, declining use environment, new rates based on an historical test year, even if selective items are adjusted in a True Up, will neither be fully reflective of the rate year relationships nor provide the Company with a realistic opportunity to earn its authorized rate of return even in the year they are implemented. At the same time, any cost and revenue changes that mitigate or reduce the cost of service should also be reflected. Because the future test year best balances all rate elements, it best reflects the matching principle and is a well-understood and successful ratemaking tool, and should be adopted by the Commission in this case.

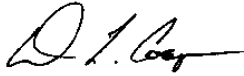
18. Further, as history shows, if the Company's request for a future test year is denied and the forecast revenues, expenses and investments are not taken into account in the setting of MAWC's rates, the Company will be denied a fair opportunity to earn the authorized rate of return, which the Commission determines is appropriate in this proceeding.

19. The Company respectfully requests that the Commission act expeditiously on this motion as time is of the essence. The Company's request to adopt a future test year will impact the processing and reconciliation of this case.



**WHEREFORE**, MAWC respectfully requests the Commission issue an order adopting a future test period covering the first year that new rates are expected to be in effect (the 12 months ending May 31, 2022).

Respectfully submitted,



Dean L. Cooper, MBE #36592  
William R. England, III, MBE #23975  
Jennifer L. Hernandez, MBE #59814  
**BRYDON, SWEARENGEN & ENGLAND  
P.C.**  
312 E. Capitol Avenue  
P.O. Box 456  
Jefferson City, MO 65012  
(573) 635-7166 telephone  
[dcooper@brydonlaw.com](mailto:dcooper@brydonlaw.com)

Timothy W. Luft, Mo Bar 40506  
MISSOURI-AMERICAN WATER  
COMPANY  
727 Craig Road  
St. Louis, MO 63141  
(314) 996-2279  
(314) 997-2451 (telefax)  
[Tim.Luft@amwater.com](mailto:Tim.Luft@amwater.com)

**ATTORNEYS FOR MISSOURI-AMERICAN WATER COMPANY**

**CERTIFICATE OF SERVICE**

The undersigned certifies that a true and correct copy of the foregoing document was sent by electronic mail or by U.S. Mail, postage prepaid, on June 30, 2020, to the following:

Office of the General Counsel  
Governor Office Building  
Jefferson City, MO 65101  
[staffcounsel@psc.mo.gov](mailto:staffcounsel@psc.mo.gov)

Office of the Public Counsel  
Governor Office Building  
Jefferson City, MO 65101  
[opc@opc.mo.gov](mailto:opc@opc.mo.gov)

