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Property Tax Tracker,
Lead Service Line Replacements,
Revenue Requirement
Witness: Amanda C. McMellen
Sponsoring Party: MoPSC Staff
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MISSOURI PUBLIC SERVICE COMMISSION

FINANCIAL & BUSINESS ANALYSIS DIVISION

AUDITING DEPARTMENT

REBUTTAL TESTIMONY

OF

AMANDA C. MCMELLEN

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2020-0344

Jefferson City, Missouri
January 2021

1 **REBUTTAL TESTIMONY**

2 **OF**

3 **AMANDA C. MCMELLEN**

4 **MISSOURI-AMERICAN WATER COMPANY**

5 **CASE NO.WR-2020-0344**

6 Q. Please state your name and business address.

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

8 Q. By whom are you employed and in what capacity?

9 A. I am a Utility Regulatory Supervisor in the Auditing Department for the
10 Missouri Public Service Commission (“Commission”).

11 Q. Are you the same Amanda C. McMellen who contributed to Staff’s Cost of
12 Service Report and filed Direct testimony on November 24, 2020 in this case?

13 A. Yes, I am.

14 **EXECUTIVE SUMMARY**

15 Q. Please summarize your rebuttal testimony in this proceeding.

16 A. In this testimony, I will address the Direct Testimony of Missouri-American
17 Water Company (MAWC) witnesses Brian W. LaGrand and Jeffrey T. Kaiser regarding
18 engineered coatings (tank painting). I also provide policy testimony responding to MAWC’s
19 request for a property tax tracker mechanism to account for the impact on property tax expense
20 of additional plant investments and changes due to assessment methodology. I will also address
21 Staff’s position regarding rate base treatment of the deferral for the customer owned lead service
22 line replacements (LSLR). Lastly, I will provide a list of changes and/or corrections to
23 Staff’s direct revenue requirement calculation for MAWC in this proceeding.

1 **Engineered Coatings**

2 Q. What is an MAWC's position regarding engineered coatings (tank painting)?

3 A. As described in the Direct Testimony of MAWC witnesses Mr. LaGrand and
4 Mr. Kaiser, MAWC's position is to remove these costs from expense and capitalize
5 them instead.

6 Q. Is MAWC's current position different than what it proposed in the past?

7 A. Yes. In previous cases, MAWC proposed treating these costs as an expense.

8 Q. What is Staff's position regarding engineered coatings?

9 A. Staff's position is that these costs should continue to be treated as expenses and
10 normalized using a five-year average ending December 31, 2019, as explained in the
11 Staff's Cost of Service Report, page 56, lines 2 through 6.

12 Q. What is Staff's rationale for treating these costs as an expense?

13 A. Staff relies on guidance from the Uniform System of Accounts for
14 Class A and B Water Utilities 1973 from the National Association of Regulatory Utility
15 Commissioners 1976 Revision Utility Plant Instructions 8 Structures and Improvements
16 H.29 Painting, first cost. This guidance requires water utilities to capitalize the cost of tank
17 painting for tanks prior to the tanks being put in-service. Since none of MAWC's engineered
18 coating costs included in this case are associated with first-time tank painting, Staff's position
19 is to continue to include the entirety of engineered coating costs as expenses.

20 **Customer Owned Lead Service Line Replacements (LSLR)**

21 Q. Please explain MAWC's LSLR program.

22 A. In Case No. WU-2017-0296, MAWC requested, and was granted, special
23 accounting treatment in the form of an Accounting Authority Order (AAO) to defer costs related

1 to replacing customer owned lead service lines. It is not a normal utility policy or practice to
2 replace or repair property that is not owned by the utility, and therefore this MAWC action was
3 considered extraordinary. In that case, the Commission granted MAWC the authority to defer
4 and book the costs for LSLR with carrying costs calculated using a short term borrowing rate.¹

5 Q. In Case No. WU-2017-0296, did the Commission determine the future
6 ratemaking treatment to be provided to the AAO deferrals?

7 A. No. While the Commission identified the appropriate account to which MAWC
8 should book the AAO (NARUC Account 186) in that case, an AAO is not a ratemaking
9 decision; an AAO simply authorizes a utility to book costs in separate accounts for future
10 consideration. However, the Commission did address ratemaking treatment of the LSLR
11 deferral in MAWC's rate case, Case No. WR-2017-0285, which was pending at the time the
12 Commission issued its order in Case No. WU-2017-0296.

13 Q. Did the Commission grant ratemaking treatment of the LSLR AAO in Case
14 No. WR-2017-0285?

15 A. Yes. The Commission stated the following in its Report and Order for Case
16 No. WR-2017-0285:

17 MAWC is permitted to amortize over ten years the \$1,668,796 incurred for the
18 LSLR Program from January 1, 2017, through December 31, 2017. MAWC's long-term
19 debt rate as calculated in Staff's Cost of Service Report shall also be applied to the
20 LSLR Program amount to be amortized.²

21 Q. What is MAWC's position regarding the balance of the LSLR AAO in this case?

¹ Case No. WU-2017-0296 Commission Report and Order page 10

² Case No. WR-2017-0285 Commission Report and Order pages 22-23

1 A. In Mr. LaGrand's Direct Testimony, on page 31, lines 1 through 11, he states
2 that MAWC is proposing a change in treatment to include the regulatory asset in rate base, and
3 to not seek to accrue carrying costs on the deferred amounts.

4 Q. What is Staff's position regarding the rate base treatment of the LSLR AAO?

5 A. Staff disagrees with MAWC's proposed change, and continues to recommend
6 including carrying costs at the long-term debt rate in the AAO balance, but not to include any
7 costs in rate base. Including the carrying costs in the AAO balance at MAWC's long-term debt
8 rate provides MAWC sufficient recovery of the costs to replace the customer owned service
9 lines. Under MAWC's proposal, MAWC would earn an equity return on the LSLR regulatory
10 asset balance as if the LSLR balance was a piece of property owned by MAWC and used in
11 providing service to customers. The service lines between the meter or property line and the
12 customer's residence will not become property of MAWC; allowing MAWC to earn an equity
13 return on the lines would be unreasonable.

14 Q. Has there been any changes related to LSLR since the last rate case?

15 A. Yes. MAWC filed Case No. WT-2020-0353 to revise tariffs to gain ownership
16 and responsibility for maintenance of certain segments of the water service line between the
17 company-owned main to the customer premise in its St. Louis County service area. Prior to the
18 tariff change, a customer in St. Louis County owned and was responsible for the entirety of the
19 Water Service Line, from the company-owned main, to the customer's premise. In all of
20 MAWC's other service territories, the Customer is only responsible for the portion of the
21 Water Service Line from the meter to the premise. The tariffs were approved and became
22 effective August 21, 2020.

23 Q. How do the new tariffs affect LSLRs?

1 A. MAWC will now own and maintain the portion of the lines explained above
2 which were previously owned by the customer. Since MAWC will now own the portion of the
3 lines, the costs associated with replacing a lead service line will be booked as plant in service,
4 and no longer included in the LSLR.

5 **REQUEST FOR PROPERTY TAX TRACKER**

6 Q. Is MAWC requesting special accounting treatment in the form of a tracker
7 mechanism for costs that are currently not given special accounting treatment?

8 A. Yes. MAWC is requesting special accounting for property taxes in the form of
9 a tracker to account for the ongoing impact on property tax expense of additional investments
10 and changes due to assessment methodology

11 Q. What is a “tracker”?

12 A. The term “tracker” refers to a rate mechanism in which the amount of a particular
13 cost of service item actually incurred by a utility is “tracked” and compared to the amount of
14 that item currently included in a utility’s rate levels. Any over-recovery or under-recovery of
15 the item in rates compared to a utility’s actual expenditures is then booked to a regulatory asset
16 or liability account, and would be eligible to be included in the utility’s rates in its next general
17 rate proceeding through an amortization to expense.

18 Q. Should use of trackers be a common occurrence in Missouri rate regulation of
19 utilities?

20 A. No. Rates are normally developed in Missouri to allow a utility an opportunity
21 to recover its cost of service, measured as a whole, on an ongoing basis from the utility’s
22 customers. Under this approach, with rare exceptions, neither utilities nor utility customers are
23 allowed to be reimbursed through the rate case process for any prior under- or over-recovery of

1 costs experienced by the utility in rates, either measured for its cost of service as a whole or for
2 individual costs or service components. Further, the use of trackers violates the matching
3 principle, can unreasonably skew ratemaking results, and can dull a utility's incentive to operate
4 efficiently. For these reasons, use of trackers to provide reimbursement in rates to utilities or
5 customers of any under- or over-recovery of individual rate component items is rare, and should
6 be dependent on unique and unusual circumstances.

7 Q. Under what circumstances might Staff consider the use of a tracker?

8 A. Use of trackers may be justified under the following circumstances: (1) when
9 the applicable costs demonstrate significant fluctuation and up-and-down volatility over time,
10 and for which accurate estimation is difficult; (2) new costs for which there is little or no
11 historical experience, and for which accurate estimation is accordingly difficult; or (3) costs
12 imposed upon utilities by Commission rule. In addition, in all cases the costs should be material
13 in nature.

14 Q. In this case, why does MAWC assert that property taxes should be subject
15 to a tracker?

16 A. MAWC contends that property tax increases are outside its control,³ and thus,
17 property taxes should be subject to a tracker. MAWC uses a 2017 change in St. Louis County's
18 methodology of assessing the value of utility property as an example of why property taxes
19 should be tracked.

20 Q. How do taxing authorities typically levy property taxes on utilities?

21 A. Taxing authorities typically levy property taxes by multiplying a calculation of
22 the assessed value of the utilities' taxable property assets by the applicable tax rate.

³ Direct Testimony of MAWC witness Mr. LaGrand, page 40.

1 The asset valuation takes into account an estimated amount of depreciation of the asset over the
2 asset's useful life. In a similar manner to how the Commission determines the amount of
3 depreciation expense for assets based upon an estimate of the assets' useful life,
4 Staff understands that taxing authorities place the utilities' taxable assets into different
5 categories based upon assumptions concerning the assets' useful lives for purposes of
6 determining the utilities' assessed property value.

7 Q. Does Staff consider MAWC's property tax costs to fall under the circumstances
8 for a tracker listed above?

9 A. No, in several respects. First, utilities have incurred property taxes on an annual
10 basis for many years. Property taxes, when considered as a category of cost, are routine and
11 ongoing, and should be considered to be among the most "ordinary" of costs incurred
12 by a utility.

13 Second, the changes in assessment practices highlighted by MAWC in witness LaGrand's
14 Direct Testimony on page 40, lines 14 through 19, appear to be the result of discretionary
15 judgments by the taxing authorities that, for the most part, are not unprecedented when taking
16 into account the assessment practices of other Missouri county taxing authorities.

17 Q. Has MAWC requested special accounting treatment for property taxes
18 in the past?

19 A. Yes. As described in Mr. Meyer's testimony,⁴ MAWC requested an AAO in
20 Case No. WU-2017-0351, specifically for the methodology change in St Louis County, as
21 described above, and for changes in other counties. The Commission denied granting of the
22 AAO. In that case, the Commission found that the level of increase in property tax for MAWC

⁴ Direct testimony of MIEC witness Mr. Meyer page 21, line 17 through page 22, line 27

1 at issue in that case was not extraordinary, and thus, did not meet the standards for
2 granting an AAO.⁵

3 Q. Based upon the above, should a tracker be granted to MAWC for the property
4 tax amounts at issue in this case?

5 A. No. In general, Staff views taxing authorities' changing the assessment
6 methodologies of utility assets as part of these bodies' ordinary discretion, and should not be
7 considered to be significant fluctuations. Staff's position is consistent with the
8 Commission's Report and Order in Case No. WU-2017-0351 on page 15 which states
9 the following: "There is nothing unusual or extraordinary about paying property taxes to
10 warrant an AAO. It is a recurring expense."⁶

11 **CORRECTIONS TO STAFF'S DIRECT FILING**

12 Q. Is Staff aware of changes and/or corrections to Staff's direct
13 revenue requirement?

14 A. Yes. After its direct filing on November 24, 2020, Staff became aware of certain
15 changes and/or corrections to the direct revenue requirement amount.

16 Q. What are the changes and/or corrections?

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

18 o Customer Usage – Revisions to normalized average gallons –
19 See Ashley Sarver's and Jarrod Robertson's rebuttal testimonies for further explanation;

20 o Meter Numbers – Correction of error to include SLR charge meters in
21 St Louis County – See Ashley Sarver's rebuttal testimony for further explanation;

⁵ *Id.* at 20.

⁶ Case No. WU-2017-0351, *Report and Order*, issued December 20, 2017, page 15, EFIS Item 67.

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1 o Other Operating Revenues – Correction of errors and updated
2 information provided to Staff – See Ashley Sarver’s rebuttal testimony for further explanation;

3 o Water Loss – Correction of errors – See Ashley Sarver’s rebuttal
4 testimony for further explanation;

5 o Employee Expenses – Change in methodology – See Ali Arabian’s,
6 Courtney Barron’s and Jane Dhority’s rebuttal testimonies for further explanation;

7 o Labor and Related Costs – Updated information provided to Staff –
8 See Ali Arabian’s rebuttal testimony for further explanation;

9 o Maintenance Expenses – Updated information analyzed by Staff –
10 See Angela Niemeier’s rebuttal testimony for further explanation;

11 o Accumulated Deferred Income Tax (“ADIT”) – Correction of error
12 relating to the Tax Cuts and Jobs Act, revision of ADIT amounts in rate base, and amortization
13 of regulatory assets. See Keith Foster’s and Kim Bolin’s rebuttal testimonies for
14 further explanation;

15 o Current Income Tax calculation – Addition of repairs expense deduction
16 per the IRS code. See Keith Foster’s rebuttal testimony for further explanation;

17 o Pensions and Other Post-Employment Benefits – Updated information
18 provided to Staff. See Keith Foster’s rebuttal testimony for further explanation.

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

21 A. Staff’s overall revenue requirement has changed from a decrease of \$19,923,654
22 in its direct filing to an increase of \$5,205,401. Staff’s revised recommendation is comprised

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1 of a revenue requirement for all MAWC water operations of (\$1,346,486) and for all sewer
2 operations of \$6,551,887.

3 Q. Does this conclude your rebuttal testimony?

4 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)
Implement General Rate Increase for Water) Case No. WR-2020-0344
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 *Rebuttal 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