

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

In the Matter of the Petition of)
 Missouri-American Water Company for) File No. WO-2015-0211
 Approval to Change its Infrastructure)
 System Replacement Surcharge (ISRS))

MAWC’S BRIEF

COMES NOW Missouri-American Water Company (MAWC) and, as its Brief, states as follows to the Missouri Public Service Commission (Commission):

MAWC will address the questions found in the Order to Brief Annualization, issued on June 5, 2015, and the two issues found in the List of Issues provided by the parties on May 22, 2015.

The Brief is organized as follows:

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FACTS

The testimony filed by MAWC and the Staff of the Commission (Staff) is in general agreement as to the following:

- 1) That \$25,892,662 is the amount that equals “ten percent of [MAWC’s] base revenue level approved by the commission in [MAWC’s] most recent general rate proceeding.” Section 393.1003(1), RSMo (Exh. 1, Tinsley Dir., p. 3; Exh. 3, Oligschlaeger Dir., p. 4);
- 2) There is no dispute that MAWC’s current request for \$1,919,991, in additional infrastructure system replacement surcharge (ISRS) revenues is associated with eligible infrastructure system replacements (Exh. 1-4); and,
- 3) That the development of MAWC’s current ISRS included \$1,665,202 of reconciliation related to previous under recovery or under collection of authorized ISRS dollars. (Exh. 1, Tinsley Dir., p. 7; Exh. 2, Tinsley Reb., p. 1; Exh. 3, Oligschlaeger Dir., p. 5)

ORDER TO BRIEF ANNUALIZATION QUESTIONS

a. How the ISRS is annualized; and

b. How the ISRS, on an annualized basis, will produce ISRS revenues not in excess of” \$25,892,662.

ISRS Revenue Requirement

MAWC’s “investment” in eligible infrastructure system replacements is something different from the amount that the Company seeks to recover through the ISRS (the ISRS revenue requirement). The Company’s investment increases its utility plant in service (UPIS). Once that plant is “in-service,” there is a cost that is associated with the investment. That cost includes the depreciation expense and property taxes associated with the investment. Further,

utility ratemaking assumes that a utility will only make a profit by earning a return on the amount invested. Thus, the ISRS revenue requirement includes a return component. In the absence of an ISRS, the utility would have to forego a return on its infrastructure investment until the Company's next rate case.

The ISRS essentially develops a revenue requirement -- return, depreciation expense, and property taxes associated with the investment in eligible infrastructure replacement¹ -- and provides the Company with an opportunity to recover that revenue requirement between general rate cases (subject to various limitations).

Appendix A1 of MAWC's Petition to Change Its Infrastructure System Replacement Surcharge² indicates that during the period relevant for this ISRS matter (10/1/2014-3/31/2015), MAWC made *investments* in eligible infrastructure replacements that totaled \$16,595,039 and *investments* in facilities relocations in the amount of \$590,480, for a total investment of \$17,185,519. After the various puts, takes, and calculations associated with determining the ISRS revenue requirement associated with that new plant, MAWC determined that this new investment drove an additional ISRS revenue requirement in the amount of \$2,267,861. MAWC reduced its request from that amount to the \$1,919,991, based on its understanding of the ISRS cap. (Exh. 1, Tinsley Dir., p. 7)

Similar to a revenue requirement in a general rate case, an ISRS revenue requirement is an amount that will be recovered on an annual basis. The items that make up the ISRS revenue requirement (return, depreciation, and property taxes) are all items that will occur year after year

¹ 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. See Section 393.1000(1), RSMo.

² The Petition was incorporated by reference in Ms. Tinsley's Direct Testimony (Exh. 1, p. 3).

(as long as the plant is in-service and until it has been fully depreciated). However, in the case of an ISRS revenue requirement, it need not go on for this full length of time because the ISRS revenue requirement will be rolled into base rates at the next general rate case and the ISRS reset to zero.

Hearing Hypothetical

At the hearing, in explaining how they understand the “annualized” ISRS limit (Section 393.1003.1, RSMo), the parties presented the following hypothetical:

. . . if a company were able to ramp up its installation of ISRS-eligible plant such that it drove an ISRS rate in year one equal to its cap, \$25 million for example, it potentially could recover that 25 million in year one, year two, year three, which would ultimately be a total of 75 million in my example. It couldn't add any more ISRS-eligible plant after the first year, but -- but it's our belief -- and I'll turn it over to Staff and OPC from there -- that that is an annual cap number that we're comparing to.

(Tr. 53-54)

The hearing hypothetical assumes: 1) that the amount that is 10% of the base revenue level approved by the commission in the hypothetical company's most recent general rate proceeding is \$25 million; and, 2) That the company in the hypothetical could place in service enough eligible infrastructure replacements to drive a \$25 million ISRS revenue requirement in year 1. The second of these assumptions is extremely unlikely.³ However, if it were possible, and the assumed billing determinants were actually experienced so no reconciliation were necessary,⁴ the hypothetical company could potentially bill and receive \$75 million in ISRS

³ It was discussed above that in this case, approximately \$17,185,519 in plant investment was required to drive an ISRS revenue requirement of \$2,267,861. Using a straight ratio for comparison purposes –

$$\frac{\$2,267,861}{\$17,185,519} = \frac{\$25,000,000}{X}$$

- you can see that it might take somewhere in the neighborhood of \$189,446,344 of plant investment to drive a \$25 million ISRS revenue requirement.

⁴ In other words, the ISRS was designed to produce \$25 million and did in fact produce \$25 million.

revenues over a three year period (\$25 million per year, for each of 3 years) because in each year the ISRS revenue requirement of \$25 million would be equal to the ISRS cap. Of course, this would necessarily also mean that the hypothetical company would have no ability to make further investment in eligible infrastructure replacement in years 2 and 3.

The following table could be used to summarize the hearing hypothetical –

TABLE 1	Eligible Infrastructure Replacements	ISRS Revenue Requirement*	Actual Recovery
Year 1	\$189,446,344	\$25,000,000	\$25,000,000
Year 2	\$0	\$25,000,000	\$25,000,000
Year 3	\$0	\$25,000,000	\$25,000,000
Total		\$75,000,000	\$75,000,000

* Assumes that “ten percent of [the hypothetical company’s] base revenue level approved by the commission in [the hypothetical company’s] most recent general rate proceeding” is equal to \$25,000,000.

Question for the Commission

Taking the hearing hypothetical one more step to include a need for reconciliation, we can frame up the question that is before the Commission. Instead of assuming perfect rate design in this hypothetical (revenue requirement = actual recovery), we next assume that actual recovery in Year 1 (as determined after a reconciliation) is \$1 million *more* than what the rate was designed to recover.⁵ Thus, in year 2, after subtracting the \$1 million over recovery, the ISRS rate is designed to collect \$24 million. There is no controversy about this result.

Table 2	Eligible Infrastructure Replacements	ISRS Revenue Requirement*	Actual Recovery
Year 1	\$189,446,344	\$25,000,000	\$26,000,000
Year 2	\$0	\$24,000,000**	

* Assumes that “ten percent of [the hypothetical company’s] base revenue level approved by the commission in [the hypothetical company’s] most recent general rate proceeding” is equal to \$25,000,000.

** \$25,000,000 ISRS revenue requirement, minus the \$1,000,000 over recovery from Year 1 (the reconciliation impact).

⁵ For some reason, usage is assumed to have increased over what was experienced at the time of the last rate case.

The controversy develops if the hypothetical company under recovers in Year 1. We again assume imperfect rate design, but this time actual recovery in Year 1 (as determined in the reconciliation) is \$1 million *less* than what the rate was designed for.⁶ Then, in Year 2, after adding the \$1 million under recovery, the ISRS rate should be designed to collect \$26 million. *However, under Staff's interpretation of the ISRS statute, the Commission would be required to limit the ISRS Revenue Requirement to \$25 million (10% of base revenues).*

<i>Table 3</i>	Eligible Infrastructure Replacements	ISRS Revenue Requirement*	Actual Recovery
Year 1	\$189,446,344	\$25,000,000	\$24,000,000
Year 2	\$0	\$26,000,000**	

* Assumes that “ten percent of [the hypothetical company’s] base revenue level approved by the commission in [the hypothetical company’s] most recent general rate proceeding” is equal to \$25,000,000.

** \$25,000,000 ISRS revenue requirement, plus the \$1,000,000 under recovery from year 1 (the reconciliation impact).

This is the situation before the Commission. Should a reconciliation amount associated with prior under recovery be counted in determining the impact of the ISRS cap? If Staff's interpretation is followed, the reconciliation process will have no effect and be idle verbiage⁷ in the second situation outlined above.

LIST OF ISSUES

I. Revenue Reconciliation and 10% Cap

Should the amount of ISRS revenues authorized by the Commission associated with reconciliation of prior under or over collections be included or excluded from the ISRS revenue cap calculation for MAWC in this proceeding?

The issue for the Commission is one of statute and rule interpretation. That is, whether the reconciliation amount should be included in determining how the revenue requirement relates

⁶ For some reason, usage is assumed to have decreased below what was experienced at the time of the last rate case

⁷ See the Statutory Interpretation section below.

to the cap. If MAWC is correct, then its full \$1.9 million request should be included in the new ISRS rate. If Staff is correct, only \$254,789 of that request should be included in the ISRS rate.

Legislative Intent

The Court of Appeals, in the context of the natural gas ISRS statute, has stated as follows in regard to the legislative intent of the ISRS:

This interpretation is consistent with the obvious legislative intent, which is to permit the gas company to timely recover its costs for government-mandated infrastructure system replacement projects via a rate adjustment outside of a general rate case for a limited period of time.

Laclede d/b/a Missouri Gas Energy, 417 S.W.3d 815, 823 (Mo.App.W.D. 2014) (emphasis added).

Statutory Interpretation

"When determining the meaning of statutory language, the whole act must be taken into consideration, and the words of one section or statute must be read in the context of other statutes on the same subject as well as with cognate sections." *Laclede*, quoting *In re KCP & L Greater Mo. Operations Co.*, 408 S.W.3d 175, 186 (Mo. App. 2013.)

The Commission's goal in construing a statute should be "to ascertain the intent of the legislature from the language used and, if possible, give effect to that intent." *Id.* at 820. The Commission should further "presume that the legislature intended for each word and phrase of a statute to have effect and that the legislature did not include 'idle verbiage or superfluous language.'" *Id.*

Analysis of the Statute

Staff's interpretation of the statutes would thwart the legislative intent -- to allow the utility to timely recover its costs for infrastructure system replacement projects, by way of a rate adjustment outside of a general rate case - based on a failure to recover authorized amounts due

to the rate design. In other words, because of the inexactness of the rate design and declining usage, Staff would deny MAWC timely recovery of costs associated with MAWC's infrastructure system replacement projects. (Exh. 1, Tinsley Dir., p. 5)

The statutes do not intend for the ISRS cap to apply to a combination of the ISRS costs and the revenues reconciliation amounts. Section 393.1003.1, RSMo, states as follows:

Notwithstanding any provisions of chapter 386 and this chapter to the contrary, as of August 28, 2003, a water corporation providing water service in a county with a charter form of government and with more than one million inhabitants may file a petition and proposed rate schedules with the commission to establish or change ISRS rate schedules that will allow for the adjustment of the water corporation's rates and charges to provide for the recovery of costs for eligible infrastructure system replacements made in such county with a charter form of government and with more than one million inhabitants; provided that an ISRS, on an annualized basis, must produce ISRS revenues of at least one million dollars but not in excess of ten percent of the water corporation's base revenue level approved by the commission in the water corporation's most recent general rate proceeding. An ISRS and any future changes thereto shall be calculated and implemented in accordance with the provisions of sections 393.1000 to 393.1006. ISRS revenues shall be subject to refund based upon a finding and order of the commission, to the extent provided in subsections 5 and 8 of section 393.1006.

(emphasis added)

The adjustments to which the limitation applies are the "costs for eligible infrastructure system replacements." "ISRS costs" are defined as "depreciation expenses and property taxes that will be due within twelve months of the ISRS filing." Section 393.1000(5), RSMo. There is no mention of amounts necessary to reconcile previous under or over collection of ISRS revenues.

Further, Section 393.1006.5(1) states that "An ISRS shall be calculated based upon the amount of ISRS costs that are eligible for recovery during the period in which the surcharge will be in effect and upon the applicable customer class billing determinants utilized in designing the water corporation's customer rates in its most recent general rate proceeding." (emphasis added)

Again, there is no mention of the use of revenues reconciliation amounts in the calculation of the ISRS costs.

Reconciliation is treated separately in Section 393.1006.5(2), which states: “At the end of each twelve-month calendar period that an ISRS is in effect, the water corporation shall reconcile the differences between the revenues resulting from an ISRS and the appropriate pretax revenues as found by the commission for that period and shall submit the revenues reconciliation and a proposed ISRS adjustment to the commission for approval to recover or refund the difference, as appropriate, through adjustment of an ISRS.”

In her opening, counsel for Staff relied upon language in the *Laclede* case indicating that there is a single ISRS. The Court in *Laclede* did state that “the phrase ‘an ISRS’ also is used in a manner that refers to the initial ISRS and all changes thereto as a *single entity*.” Id. at 823.

However, the reconciliation is treated by the statutes and the Commission’s rule as something other than the “initial ISRS” or “changes”:

- Section 393.1006.5(2) that the recovery or refund resulting from a reconciliation shall be effectuated through an “adjustment” of an ISRS;
- Section 393.1006.3, RSMo provides a limit of two “change[s]” in a twelve month period. A reconciliation is not counted against this limitation; and,
- Commission Rule 4 CSR 240-3.650(19) specifically differentiates by stating that an eligible water utility may file a “petition with the commission seeking to *establish, change or reconcile* an ISRS. . . .” (emphasis added)

A reconciliation adjustment is neither the initial establishment of an ISRS nor a “change” to the ISRS.

The statute and the Commission’s rules further recognize this differentiation between the recovery of ISRS costs and the revenues reconciliation amounts. Section 393.1006.6(1) states that a “water corporation that has implemented an ISRS pursuant to the provisions of sections 393.1000 to 393.1006 shall file revised rate schedules to reset the ISRS to zero when new base rates and charges become effective for the water corporation following a commission order establishing customer rates in a general rate proceeding that incorporates in the utility's base rates eligible costs previously reflected in an ISRS.” Revenues reconciliation amounts, however, do not go to zero in the rate case. Commission Rule 4 CSR 240-3.650(17) describes a different result.

Staff’s approach denies MAWC the opportunity for recovery of ISRS costs based solely on the fact that prior ISRS rates were set assuming a customer usage level greater than that which MAWC experienced, resulting in the non-recovery of authorized ISRS costs in prior periods. Staff uses this previous non-recovery to further the non-recovery by adding both the currently authorized ISRS costs with the unrecovered prior revenues. Staff’s approach would result in MAWC’s non-recovery of \$1,665,202 in revenues associated with eligible infrastructure system replacements.

Staff’s interpretation of the ISRS statute is contrary to the “obvious legislative intent”, as stated by the Court of Appeals and would result in the statutory reconciliation process set out in Section 393.1006.5(2), RSMo having no effect. The Commission should instead determine that the reconciliation process operates independent of the limitation found in Section 393.1003.1, RSMo.

II. Regulatory Asset

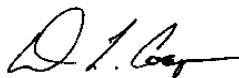
If MAWC is prohibited from recovering ISRS amounts due to the application of the ISRS cap, should it be authorized to record its under recovery in a regulatory asset

account for consideration in MAWC's next rate case, or next ISRS filing after its ISRS has been set to zero?

If Staff's approach is upheld by the Commission, the Commission should authorize MAWC to record its \$1,665,202 of under recovery due to the prior reconciliation in a regulatory asset for consideration in MAWC's next rate case, or its next ISRS filing after its ISRS has been set to zero. As identified above, Commission Rule 4 CSR 240-3.650(17) provides for the tracking of over and under recovery of ISRS revenues for consideration in future ISRS. If the Commission should agree with Staff's interpretation of the ISRS statute, MAWC will have \$1,665,202 of under recovery due to the reconciliation. The Company should be allowed to book this amount in a regulatory asset for future consideration.

WHEREFORE, MAWC respectfully requests that the Commission consider this Brief.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been sent by electronic mail this 12th day of June, 2015, to:

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