

## MEMORANDUM

**TO:** Missouri Public Service Commission Official Case File  
Case No. WR-2011-0336 --- Missouri-American Water Company

<b>FROM:</b> <u>/s/ James M. Russo</u>	<u>08/25/2011</u>
Water and Sewer Department	Date
<u>/s/ Paul R. Harrison</u>	<u>08/25/2011</u>
Auditing Department	Date
<u>/s/ Rachel Lewis</u>	<u>08/25/2011</u>
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:** August 25, 2011

### **BACKGROUND**

On June 22, 2011, 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, to provide eligible water corporations with the ability to recover certain infrastructure system replacement costs outside of a formal rate case. Such costs are recovered through an Infrastructure System Replacement Surcharge ("ISRS").

On June 23, 2011, the Commission issued its **Order Suspending Tariff, Directing Notice and Setting Intervention Date**, in which it established July 8, 2011 as the date by which applications to intervene in the instant case were to be filed. The City of Jefferson, Missouri filed a **Petition to Intervene Pursuant to 4 CSR 240-2.075** on July 6, 2011 and on July 14, 2011 withdrew its Application. The Commission suspended MAWC's tariff sheet, YW-2011-0644, until October 20, 2011. On August 5, 2011, Staff filed a **Request for Extension of Time** of fifteen (15) days to allow time for Staff to receive and review adequate information from the Company regarding actual costs for June and July 2011. On August 5, 2011, the Commission ordered MAWC to file a response to Staff's request for Extension of Time no later than August 9, 2011. MAWC filed its response to the Commission's order on August 11, 2011 and the Commission issued an order on August 12, 2011 granting Staff's Motion for Extension of Time until September 6, 2011.

**\*\* Denotes Highly Confidential Information \*\***

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**APPENDIX A**

## **STAFF'S INVESTIGATION**

Staff members from the Commission's 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 Staff Counsel's Office were provided the opportunity to review and comment on this Memorandum prior to its filing.

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 requests 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 \$2,712,260 or an increase of 1.1% above the base revenue level approved by the Commission in its most recently completed general rate proceeding" on an annualized basis.

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

Except for the items listed and discussed below, 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 the following:

1. Replacement of any estimated costs included in the ISRS plant balances reflected in the Company's original filing with actual incurred amounts;
2. An adjustment to remove replacement plant additions of \$3,124,080 and relocation plant additions of \$287,889 from ISRS rate base that were included in MAWC's original ISRS request due to duplicate work orders being incorrectly included in plant in service by MAWC. This adjustment resulted in a revenue decrease of approximately \$530,000 compared to MAWC's original filed position.
3. The inclusion of deferred taxes up through the end of July 2011; and,

4.  $\frac{**}{**}$

Staff is also proposing to include deferred income tax reserves through the end of July 2011 in this ISRS case to reflect the actual levels that will exist for these items at that time. In its original filing, the Company included, and Staff agrees with, amounts reflecting additional depreciation reserves through the end of July 2011 in this ISRS case.

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## THE ISRS RATES SCHEDULES

The Company's 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. 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 A to this Memorandum.

## 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 2011 assessment and has no delinquencies for prior years' assessments. In addition, MAWC does not have any past due annual reports.

## STAFF'S CONCLUSIONS

Staff concludes that the Company's ISRS rates should be designed to recover annual ISRS revenues of \$2,180,819, based on Staff's calculations and investigation, including 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, WO-2010-0190 and WO-2011-0106, as well as various discussions with Company personnel. Staff's calculations are shown in Appendix B to this Memorandum. These calculations reflect MAWC's capital structure as filed in its last rate case, a 10% return on common 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

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service from February 2011 through July 2011. 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.

### **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 \$2,180,819 as shown in Appendix B; and,
4. Approves the compliance filing of MAWC's revised ISRS tariff sheet P.S.C. MO. No. 6, 12 Revised Sheet No. RT 18.0, Canceling 11 Revised Sheet No. RT 18.0 pending in Tariff File No. YW-2011-0106, to be effective on October 20, 2011.

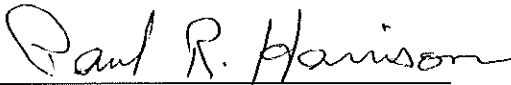
**BEFORE THE PUBLIC SERVICE COMMISSION**  
**OF THE STATE OF MISSOURI**

In the Matter of Missouri-American Water     )  
Company's Infrastructure System                )  
Replacement Surcharge (ISRS)                 )     Case No. WR-2011-0336

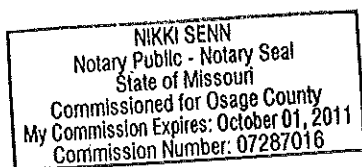
AFFIDAVIT OF PAUL R. HARRISON

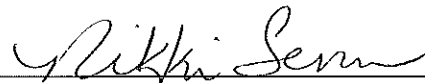
STATE OF MISSOURI     )  
                                      )     ss.  
COUNTY OF COLE     )

Paul R. Harrison, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Staff Recommendation in memorandum form, to be presented in the above case; that the information in the Staff Recommendation was developed by him; that he has knowledge of the matters set forth in such Staff Recommendation; and that such matters are true and correct to the best of his knowledge and belief.

  
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Paul R. Harrison

Subscribed and sworn to before me this 25<sup>th</sup> day of August, 2011.



  
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Notary Public

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

Missouri-American Water Company     )  
("MAWC"), pursuant to Commission     )  
Rule 4 CSR 240-2.020, files this Notice     )  
of Intended Case Filing – Infrastructure     )  
System Replacement Surcharge (ISRS).     )

Case No. WR-2011-0336

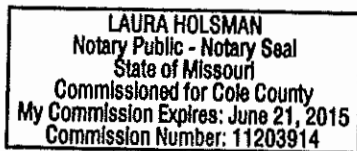
**AFFIDAVIT OF JAMES M. RUSSO**

STATE OF MISSOURI     )  
                                      ) ss  
COUNTY OF COLE     )

James M. Russo, being of lawful age, and on his oath states the following: (1) that he is a member of the Staff of Missouri Public Service Commission; (2) that he participated in the preparation of Appendix A which is attached to this Staff Memorandum; (3) that he has knowledge of the matters set forth in this Staff Memorandum and the documents included in the attached appendices; and (4) that the matters set forth in this Staff Memorandum and the documents included in the attached appendices are true and correct to the best of his knowledge, information and belief.

  
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James M. Russo

Subscribed and sworn to before me this 24<sup>th</sup> day of August, 2011.



  
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Notary Public

Missouri-American Water Company  
Case No. WR-2011-0336  
ISRS Rate Design Calculation  
St. Louis District

	ISRS Recovery Revenue Requirement	Sales (CCF)	Rates per CCF	Rates per 1,000 gallons
Rate & Other	\$ 2,176,507	51,451,803	\$ 0.0423	\$ 0.0562
Rate B	\$ 1,620	2,131,491	\$ 0.0008	\$ 0.0010
Rate J	\$ 2,603	6,659,721	\$ 0.0004	\$ 0.0005
Total	\$ 2,180,730			



**Missouri-American Water Company**  
**ISRS Revenue Requirements Calculation**  
**WR-2011-0336**  
St. Louis District

		Total for ISRS-9 Filing
<b><u>ISRS Activity:</u></b>		
<b><u>Water Utility Plant Projects--Replacement Mains, and Associated Valves and Hydrants (RM) RSMo 393.1000 (8a):</u></b>		
Task Orders Placed in Service (TOPS):		
STLC-Replacement Mains and Associated Valves and Hydrants	\$	16,731,294
Net Contributions in Aid of Construction		(342,056)
Deferred Taxes		(18,560)
Accumulated Depreciation		(127,724)
<b>Total Net 393.1000 (8a)</b>		<b>16,242,954</b>
<b><u>Water Utility Plant Projects--Main Cleanings and Relinings (RM) RSMo 393.1000 (8b):</u></b>		
Task Orders Placed in Service (TOPS):		
STLC-Main Cleanings and Relinings		0
Net Contributions in Aid of Construction		0
Deferred Taxes		0
Accumulated Depreciation		0
<b>Total Net 393.1000 (8a)</b>		<b>0</b>
<b><u>Water Utility Plant Projects--Facilities Relocations (FR) RSMo 393.1000 (8c):</u></b>		
Task Orders Placed in Service (TOPS):		
STLC-Relocated Facilities		454,107
Net Contributions in Aid of Construction		(194,806)
Deferred Taxes		(294)
Accumulated Depreciation		(1,347)
<b>Total Net 393.1000 (8c)</b>		<b>257,661</b>
<b><u>Accumulated Depreciation and Deferred Taxes on Investment in Current ISRS</u></b>		
Depreciation for ISRS-8 Case No. WO-2011-0106		(218,713)
Deferred Taxes ISRS-8 Case No. WO-2011-0106		(54,991)
<b>Total</b>		<b>(273,704)</b>
<b>Total ISRS Rate Base</b>		<b>16,226,911</b>
<b>Overall Rate Of Return per Last Order</b>		<b>8.17%</b>
<b>UOI Required</b>		<b>1,325,739</b>
<b>Income Tax Conversion Factor</b>		<b>1.623077</b>
<b>Revenue Req. Before Interest Deductibility</b>		<b>2,151,777</b>
<b>Total ISRS Rate Base</b>		<b>16,226,911</b>
<b>Embedded Cost of Debt per Last Order</b>		<b>3.210%</b>
<b>Interest Expense Deduction</b>		<b>520,884</b>
<b>Combined Federal and State Income Tax Rate</b>		<b>38.388630%</b>
<b>Income Tax Reduction due to Interest</b>		<b>199,960</b>
<b>Tax Conversion Factor</b>		<b>1.623077</b>
<b>Revenue Req Impact - Interest Deductibility</b>		<b>324,551</b>
<b>Total Revenue Requirement on Capital</b>		<b>1,827,226</b>
<b>Depreciation Expense</b>		<b>217,366</b>
<b>Property Taxes</b>		<b>136,137</b>
<b>Add Under Collection from Previous ISRS</b>		
<b>Total ISRS Revenues</b>		<b>\$ 2,180,730</b>
<b><u>Allocation of Revenue by Class</u></b>		
<b>Mains less than or equal to 12"</b>	Rate A & Oth	\$ 2,116,464
<b>Mains greater than 12"</b>	Rate A & Oth	60,044
	Total Rate A & Oth	2,176,507
	Rate J	2,603
	Rate B	1,620
<b>Grand Total Revenues Collected in Proposed ISRS</b>		<b>\$ 2,180,730</b>