

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

In the matter of the Petition of Missouri-)	
American Water Company for Approval to)	<u>Case No. WO-2007-0043</u>
Change Its Infrastructure System Replacement)	Tariff No. YW-2007-0070
Surcharge (ISRS).)	

**RECOMMENDATION REGARDING THE PETITION OF
MISSOURI-AMERICAN WATER COMPANY TO CHANGE
ITS INFRASTRUCTURE SYSTEM REPLACEMENT SURCHARGE**

COMES NOW the Staff of the Missouri Public Service Commission ("Staff"), by and through counsel, and for its Recommendation Regarding the Petition of Missouri-American Water Company to Change Its Infrastructure System Replacement Surcharge ("Staff Recommendation") states the following to the Missouri Public Service Commission ("Commission").

1. On August 3, 2006, Missouri-American Water Company ("MAWC") filed a petition to change its Infrastructure System Replacement Surcharge ("ISRS"), pursuant to the provisions of Sections 393.1000, 393.1003 and 393.1006, RSMo, and Commission Rules 4 CSR 240-2.060(1) and 4 CSR 240-3.650.

2. On August 4, 2006, the Commission issued its **Order Directing Notice and Setting Intervention Date**, in which it established August 24, 2006 as the date by which applications to intervene in the instant case were to be filed. Ag Processing, Inc. filed a timely application to intervene, but subsequently withdrew it. Utility Workers Union Local 335, AFL-CIO also filed a timely application to intervene, which the Commission granted on September 20, 2006.

3. On August 15, 2006, the Commission issued its **Order Suspending Tariff**, in which it suspended MAWC's proposed ISRS tariff sheet until December 2, 2006. On that same date, the Commission also issued its **Order Directing Filing**, in which it directed the Staff to examine MAWC's proposed ISRS and to file a report regarding that examination no later than October 3, 2006.

4. The Staff's report of its examination of MAWC's proposed ISRS and its recommendations to the Commission regarding this case are set out in the Staff's Official Case File Memorandum ("Memorandum"), which is included as Appendix A attached hereto. The Staff's recommendations are set out on Page 4 of its Memorandum, and two workpapers related to the Staff's examination of the Company's petition are included as attachments to the Staff's Memorandum.

WHEREFORE, the Staff respectfully requests that the Commission issue an order consistent with the recommendations set out on Page 4 of the Staff's Memorandum.

Respectfully Submitted,

/s/ Keith R. Krueger

Keith R. Krueger
Deputy General Counsel
Missouri Bar No. 23857

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Missouri Public Service Commission

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CERTIFICATE OF SERVICE

I hereby certify that copies of this Recommendation have been mailed with first class postage, hand-delivered, transmitted by facsimile or transmitted via e-mail to all counsel and/or parties of record this 3rd day of October 2006.

/s/ Keith R. Krueger

BEFORE THE PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI

AFFIDAVIT OF DALE W. JOHANSEN

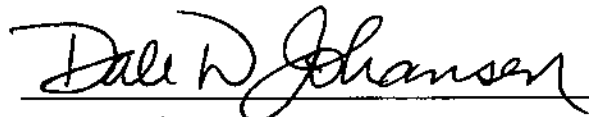
STATE OF MISSOURI)

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Case No. WR-2007-0043

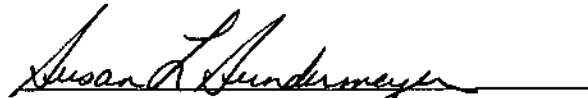
COUNTY OF COLE)

Dale W. Johansen, of lawful age, on his oath states: (1) that he is the Manager of the Missouri Public Service Commission's Water & Sewer Department; (2) that he participated in the preparation of the foregoing Staff Recommendation and the documents included in the following appendix; (3) that he has knowledge of the matters set forth in the foregoing Staff Recommendation and the documents included in the following appendix; and (4) that the matters set forth in the foregoing Staff Recommendation and the documents included in the following appendix are true and correct to the best of his knowledge, information and belief.



Dale W. Johansen – Manager
Water & Sewer Department
Utility Operations Division

Subscribed and sworn to before me this 3rd day of October 2006.



Notary Public

My Commission Expires: 9-21-10



SUSAN L. SUNDERMEYER
My Commission Expires
September 21, 2010
Callaway County
Commission #06942086

APPENDIX A

STAFF MEMORANDUM & ATTACHMENTS

CASE NO. WO-2007-0043

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MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. WO-2007-0043 - - - Missouri-American Water Company

FROM: Dale W. Johansen – Project Coordinator
Water & Sewer Department
Roberta A. Grissum – Auditing Department
James Russo – Water & Sewer Department

<u>/s/ Dale W. Johansen</u>	<u>10/03/06</u>
Project Coordinator	Date
<u>/s/ Keith R. Krueger</u>	<u>10/03/06</u>
General 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: October 3, 2006

BACKGROUND

On August 3, 2006, Missouri-American Water Company ("Company" or "MAWC") filed MAWC's 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 and 393.1006, RSMo, and Commission Rules 4 CSR 240-2.060(1) and 4 CSR 240-3.650. Sections 393.1000, 393.1003 and 393.1006, in conjunction with Commission Rule 4 CSR 240-3.650, provide eligible water corporations with the ability to recover certain infrastructure system replacement costs without the need to file a formal rate case. Such costs are recovered through an Infrastructure System Replacement Surcharge ("ISRS").

On August 4, 2006, the Commission issued its Order Directing Notice and Setting Intervention Date, in which it established August 24, 2006 as the date by which applications to intervene in the instant case were to be filed. Ag Processing, Inc. filed a timely application to intervene, but subsequently withdrew it. Utility Workers Union Local 335, AFL-CIO also filed a timely application to intervene, which the Commission granted on September 20, 2006.

On August 15, 2006, the Commission issued its Order Suspending Tariff, in which it suspended MAWC's proposed ISRS tariff sheet until December 2, 2006. On that same date, the Commission also issued its Order Directing Filing, in which it directed the Staff to examine MAWC's proposed ISRS and to file a report regarding that examination no later than October 3, 2006.

STAFF'S INVESTIGATION

As noted at the beginning of this Memorandum, Staff members from the Auditing and Water & Sewer Departments participated in the Staff's investigation of the Petition. All Staff participants as well as their respective supervisors and the assigned attorney from the General Counsel's Office were provided the opportunity to review and comment on this Memorandum prior to its filing. Roberta A. Grissum of the Auditing Department created the initial draft of this Memorandum and incorporated comments received from the reviewers in developing this final version of Staff's recommendation.

The 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, 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 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 represent 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-2003-0500;
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 consist only of the following:

1. mains and associated valves and hydrants installed as replacements for existing facilities that have worn out or were in deteriorated condition;
2. main cleaning and/or relining projects; and
3. 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.

The Staff notes that any reimbursements MAWC received for these projects have been recognized as a reduction of the ISRS investment in the calculation of the ISRS revenue requirement.

In its Petition, the Company requested 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 \$2,007,216 or an increase of 1.2% based on the base revenue level approved by the Commission in its most recently completed general rate proceeding" on an annualized basis. As agreed to in the Stipulation and Agreement (the "Stipulation and Agreement") that was approved in its last general rate case (Case No. WR-2003-0500), MAWC's proposed rate schedule will not charge the current ISRS rate to its Rate J customers. As agreed to in that Stipulation and Agreement, MAWC will forgo the revenues applicable to Rate J customers and will not collect them from any class of water customers.

STAFF'S REVENUE CALCULATION

Except as noted below, Staff agrees with and has adopted the methodology utilized by Company for the calculation of the ISRS revenue requirement for purposes of this ISRS filing. The Staff and MAWC agree that the Company's calculation of the revenue requirement should include the additional deferred taxes and depreciation that have accumulated since the implementation of the current ISRS in Case No. WO-2006-0284. This adjustment reduces the ISRS revenue requirement that the Company requested.

THE ISRS RATE SCHEDULES

The 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 and the ISRS revenues allocated to each affected customer class. Company has provided such rate schedules. The ISRS rate schedule proposed by the Company was adjusted to reflect the changes to the revenue requirement as previously discussed and is shown in Attachment B to this Memorandum.

STAFF'S CONCLUSIONS

Based on its investigation and calculations, the Staff believes the Company's ISRS rates should be designed to recover additional annual ISRS revenues of \$1,961,076. The Staff's determination of this amount and the supporting calculations are shown in Attachment A to this Memorandum. These calculations reflect MAWC's overall rate of return (7.70%) agreed to in its most recent general rate case (Case No. WR-2003-0500), multiplied by MAWC's ISRS investment in replacement mains, associated valves and hydrants and facilities relocations (less contributions in aid of construction collected to offset the cost of such replacements and relocations) minus the associated interest expense based on the weighted cost of debt (3.40%) agreed to in MAWC's most recent rate case. In its calculations, the Staff also reduces the ISRS investments by deferred income taxes and the associated accumulated depreciation. The Staff's determination of the ISRS revenues also includes the annual depreciation expense on the ISRS investment less any depreciation expense associated with plant retirements and contributions in aid of construction related to the replacement and relocation of facilities.

Based on a review of the work orders and supporting documents for the projects included for recovery in the Company's proposed ISRS filing, the Staff believes the projects do meet the requirements of the governing statutes as summarized previously in this Memorandum in the discussion of the Company's Petition.

ASSESSMENTS AND ANNUAL REPORTS

In accordance with established practice regarding the submission of Staff recommendations to the Commission, the Staff did review 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, the Staff notes that MAWC has no delinquent assessments for fiscal year 2006 and is also current on its quarterly payments for its fiscal year 2007 assessment (it is making quarterly payments). Likewise, MAWC does not have any past due annual reports.

STAFF'S RECOMMENDATIONS

Based on the above, the Staff recommends that the Commission issue an order in this case that:

1. Approves MAWC's Petition to implement ISRS rate schedules; and
2. Approves the Staff's determination that the Company is entitled to receive ISRS revenues in the amount of \$1,961,076, on an annual basis, as shown in Attachment A hereto.

Memo Attachment A

Revenue Requirement and Customer Class Allocation Calculations

ISRS Activity

Water Utility Plant Projects - Replacement Mains and Associated Valves and Hydrants (RM) RSMo 393.1000 (8a): Task Orders Placed in Service

St. Louis County District - Replacement Mains and Associated Valves and Hydrants	\$ 14,604,803
Net Contributions in Aid of Construction	\$ (57,276)
Deferred Income Taxes	\$ (138,496)
Accumulated Depreciation	\$ (70,920)
Total Net 393.1000 (8a)	\$ 14,338,112

Water Utility Plant Projects - Facilities Relocations (FR) RSMo 393.1000 (8c): Task Orders Placed in Service

St. Louis County District - Relocated Facilities	\$ 4,311,566
Net Contributions in Aid of Construction	\$ (1,584,911)
Deferred Income Taxes	\$ (25,908)
Accumulated Depreciation	\$ (16,274)
Total Net 393.1000 (8c)	\$ 2,684,472

Accumulated Depreciation and Deferred Taxes on Investment in Current ISRS:

Depreciation for ISRS-2	\$ (288,931)
Deferred Taxes for ISRS-2	\$ (159,541)
Total Accumulated Depreciation & Deferred Taxes on Investment in Current ISRS	\$ (448,472)

Total ISRS Rate Base	\$ 16,574,112
Overall Rate of Return per Last R&O	7.70%
Return on Investment Required	\$ 1,276,207
Income Tax Conversion Factor	1.62308
Revenue Requirement Before Interest Deductibility	\$ 2,071,385

Total ISRS Rate Base	\$ 16,574,112
Embedded Cost of Debt per Last R&O	3.40%
Interest Expense Deduction	\$ 563,520
Combined Federal & State Income Tax Rate	0.383886256
Income Tax Reduction Due to Interest Expense	\$ 216,328
Income Tax Conversion Factor	1.62308
Revenue Requirement - Interest Expense Deductibility	\$ 351,117

Revenue Requirement After Interest Deduction	\$ 1,720,269
Depreciation Expense	\$ 257,341
Property Tax	\$ - ²
Total ISRS Revenue Requirement	\$ 1,977,609

Allocation of Revenue by Class:

Mains Less Than or Equal to 12 "	Rate A & Other	\$ 1,843,587	
Mains Greater Than 12 "	Rate A & Other	\$ 109,511	
Total Rate A & Other		\$ 1,953,098	
Mains Greater Than 12 "	Rate J	\$ 16,533	¹
	Rate D	\$ 220	
	Rate B	\$ 7,759	
Total ISRS Revenues		\$ 1,977,609	
	Eliminate Rate J	\$ (16,533)	¹
Total Revenues to Be Collected Through Proposed ISRS		\$ 1,961,076	

¹ Per Final Stipulation & Agreement in Case No. WR-2003-0500, Company agrees not to collect for Rate J customers until next general rate case.

² Property Taxes will not be considered in this ISRS filing since all plant replacements and relocations in this filing will not be subject to property tax assessment or taxes until Calendar Year 2007.

Memo Attachment B

Tariffed Rate Calculations

Missouri American Water Company
Case No. WO-2007-0043
Issue: Tariff Rates
Source: Workpapers

	ISRS Recovery Revenue Requirement	2003 Bill Analysis Sales (CCF) (1)	Rate per CCF	Rate per 1000 Gal.
Rate A & Oth	\$ 1,953,098	56,372,211	\$ 0.0346	\$ 0.0461
Rate B	\$ 7,759	2,236,698	\$ 0.0035	\$ 0.0047
Rate D	\$ 220	126,134	\$ 0.0017	\$ 0.0023
Rate J	<u>\$ 16,533</u>	9,441,890	NA	
	\$ 1,977,609			

(1) Per billing determinants approved in determining rates per Commission order in Case WR 2003-0500 and Per Stipulation and Agreement in Case No. WR-2003-0500, the Company agreed to not recover any ISRS eligible replacements for Rate J customers until next rate case

	Auth by PSC WO-2006-0284 Current Rate	(1) Current ISRS Rater Per Above	Combined Rate Use on Tariff
Rate Per CCF			
Rate A & Oth	0.0852	\$ 0.0346	\$ 0.1198
Rate B	0.0198	\$ 0.0035	\$ 0.0233
Rate D	0.0099	\$ 0.0017	\$ 0.0116
Rate J		\$ -	\$ -
Rate Per 1000 Gal			
Rate A & Oth	\$ 0.1136	\$ 0.0461	\$ 0.1597
Rate B	\$ 0.0264	\$ 0.0047	\$ 0.0311
Rate D	\$ 0.0132	\$ 0.0023	\$ 0.0155
Rate J		\$ -	\$ -

(1) ISRS rate based on current filing by Company, added to previously approved rate