

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

In the Matter of the Application/Petition of)	
Missouri-American Water Company for)	
Approval to Reconcile its Infrastructure)	
System Replacement Surcharge (ISRS))	<u>File No. WO-2016-0098</u>

STAFF’S RECOMMENDATION

COMES NOW the Staff of the Missouri Public Service Commission (“Staff”), by and through counsel, and, for its *Staff Recommendation* on the petition that initiated the above case, states:

1. On October 28, 2015, Missouri-American Water Company (“MAWC”) filed a petition seeking Commission approval of MAWC’s proposed reconciliation schedule, claiming an under-collection of \$5,870,309, for the period of September 25, 2012, through September 30, 2015.

2. On October 28, 2015, the Commission entered an *Order Directing Notice*, directing Staff to investigate the petition and file a recommendation with the Commission no later than December 28, 2015.

3. On December 23, 2015, MAWC filed its *Supplement to Application*, amending its initial filing to include information sufficient to satisfy the filing requirements of Commission Rule 4 CSR 240-3650(21).

4. Staff recommends approval of a cumulative ISRS reconciliation in the amount of \$4,272,324. The primary difference between Staff and MAWC calculations arise from the methodologies applied: Staff calculated a daily revenue requirement based on the current authorized ISRS revenue, whereas MAWC’s calculation spread

the annual authorized revenue to each month based upon historical sales. Staff believes MAWC's proposed methodology results in an overstatement of actual under-collected ISRS revenue. Additional cost differentials are addressed on Page 5 of Staff's Report.

5. Staff recommends a waiver of Commission Rules requiring a water utility to file a proposed ISRS rate schedule accompanying its reconciliation filing. Commission Rule 4 CSR 240-3.360(16) states "[a]t the end of each twelve-month calendar period that an ISRS is in effect, the eligible water utility...shall submit the reconciliation and a proposed ISRS rate schedule revisions to the commission for approval to recover or refund the difference; as appropriate." Staff notes that MAWC's petition does not seek an adjustment of its current ISRS rate to recover its alleged under-collection. Commission Rule 4 CSR 240-2.015 allows the Commission to waive its rule for good cause. Good cause "generally means a substantial reason amounting in law to a legal excuse for failing to perform an act required by law."¹ Staff believes a waiver to the filing requirements of 4 CSR 240-3.360(16) is warranted because MAWC has filed a general rate case, Case No. WR-2015-0301 and new base rates are expected to become effective by June 2016: changing the ISRS rates months before such rates will be reset to zero is unduly burdensome on the parties, who are already actively engaged in addressing this issue in WR-2015-0301.

6. The Office of Public Counsel ("OPC") cited concerns with MAWC's application arguing a deficiency due to the inclusion of data in addition to the twelve-month calendar period of September 2014 through September 2015. While MAWC's filing succeeds in identifying the differences between ISRS revenues and the

¹ *Black's Law Dictionary* 692 (6th ed. 1990).

appropriate pretax revenues over the twelve-month period in Appendix A of its *Application*, as this complaint arises from 4 CSR 240-3.650(16), this issue would be resolved by approving the waiver requested in Paragraph 5. Furthermore, in addition to the good cause justification identified in Paragraph 5, Staff notes MAWC is not seeking recovery or alteration to its ISRS present rate, and its inclusion of the September 2014 through September 2015 ISRS revenue figure with the outstanding revenue figures from September 2012 through August 2014 does not prejudice a party.

7. Staff recommends that the Commission direct MAWC to file a new tariff designed to discontinue any ISRS charges no later than sixty (60) days before MAWC expects to reach the maximum twelve (12)-month ISRS revenue of \$25,892,662, in accordance with the Commission's *Report and Order*, EFIS No. 35 in WO-2015-0211.

WHEREFORE, Staff hereby submits its recommendation for Commission's consideration and asks the Commission to issue an order approving Staff's ISRS reconciliation amount, waiving a portion of Commission Rule 4 CSR 240-3.360(16) filing requirement, and directing MAWC to file a new tariff designed to discontinue any ISRS charges not later than sixty days before MAWC expects to reach the maximum twelve (12)-month ISRS revenue of \$25,892,662.

Respectfully submitted,

/s/ William Hampton Williams II

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed with first-class postage, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 29th day of December, 2015.

/s/ William Hampton Williams II

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. WO-2016-0098
Missouri-American Water Company

FROM: Karen Lyons, Commission Staff-Auditing Department

<u>/s/ Karen Lyons 12/28/15</u> Auditing Unit/ Date	<u>/s/Hampton Williams 12/28/15</u> Staff Counsel's Office/ Date
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SUBJECT: Staff Report and Recommendation Regarding MAWC's Petition for Approval to Reconcile its Infrastructure System Replacement Surcharge (ISRS)

DATE: December 28, 2015

BACKGROUND

On October 28, 2015, Missouri-American Water Company (MAWC or "Company") filed a Petition for Approval to Reconcile its Infrastructure System Replacement Surcharge ("Application") with the Missouri Public Service Commission ("Commission") to implement a change in MAWC's Infrastructure System Replacement Surcharge (ISRS). MAWC's proposed reconciliation produces a cumulative under-recovery amount of \$5,870,309 for the period of September 25, 2012 through September 30, 2015. MAWC's petition did not include revised ISRS rate schedules to support the proposed under recovery.

RSMo §§ 393.1000, 393.1003 and 393.1006 ("ISRS statute") and Commission Rule 4 CSR 240-3.650 provide eligible water corporations with the ability to recover certain ISRS costs outside of a formal rate proceeding. The recovery is accomplished through a surcharge, or an extra fee added to MAWC's regular customer bills for the provision of water utility service.

Unlike most ISRS filings, MAWC is not requesting costs associated with additional ISRS related plant investment in this filing. Instead, the purpose of this revision is to comply with the following Commission rule relating to an ISRS reconciliation:

4 CSR 240-3.650 Water Utility Petitions for Infrastructure System Replacement Surcharges

PURPOSE: This rule sets forth the definitions, parameters and procedures relevant to the filing and processing of petitions pertaining to an infrastructure system replacement surcharge (ISRS), including the information that an eligible water utility must provide when it files a petition and associated rate schedules to establish, change or reconcile an ISRS.

The Commission Rule 4 CSR 240-3.650 (16) further states:

At the end of each twelve (12)-month period that an ISRS is in effect, the eligible water utility shall reconcile the differences between the revenues resulting from the ISRS and the appropriate pretax revenues as found by the commission for that period, and shall submit the reconciliation and proposed ISRS rate schedule revisions to the commission for approval to recover or refund the difference, as appropriate.

ISRS Legislation General Requirements:

RSMo § 393.1003 has three general requirements that must be met for a water corporation to establish an ISRS. These requirements are related to the timing of the ISRS filing in relation to the utility's general rate proceeding and to the size (both minimum and maximum) of the annual ISRS revenues.

The first general requirement reflected in RSMo § 393.1003 imposes a cap on the size of a water corporation's ISRS to 10% of the base revenues ordered by the Commission in its last rate case ("10% base revenue cap"). RSMo §393.1003(1) states:

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.

In its June 17, 2015 *Report and Order* in Case No. WO-2015-0211 the Commission ordered that MAWC was entitled to receive cumulative ISRS surcharge revenues (ISRS 10 through ISRS 15) in the amount of \$25,892,662, which represents 10% of base revenue authorized in MAWC's last rate case, Case No. WR-2011-0337¹. The Commission also ordered that MAWC track its ISRS revenues and file a new tariff 60 days before MAWC expected to reach the 10% ISRS cap:

¹ The Commission authorized base revenue of \$258,926,618 in Case No WR-2011-0337.

Therefore, in order to effectuate the intent of the ISRS statutes and allow MAWC a real opportunity to recover the maximum revenue but not allow MAWC to recover more than the maximum revenue, the Commission will order that MAWC track its ISRS revenues. No later than 60 days before MAWC expects to reach the maximum revenue allowed under the ISRS statutes, which is \$25,892,662 in this instance, MAWC must file a new tariff designed to discontinue any ISRS charges associated with the revenues the Commission is authorizing in this case.²

MAWC's current ISRS and subsequent ISRS changes that are currently being charged to customers is shown below:

MAWC's CURRENT ISRS

Case No. WO-2012-0401	New ISRS (ISRS 10)	\$3,736,587
Case No. WO-2013-0406	ISRS change (ISRS 11)	\$5,827,176
Case No. WO-2014-0055	ISRS change (ISRS 12)	\$2,973,943
Case No. WO-2014-0237	ISRS change (ISRS 13)	\$4,113,382
Case No. WO-2015-0059	ISRS change (ISRS 14)	\$7,321,583
Case No. WO-2015-0211	ISRS change (ISRS 15)	<u>\$1,919,991</u>
	MAWC's total current ISRS	\$25,892,662

A second general requirement of the ISRS statute is found in RSMo § 393.1003.2 wherein it states:

The commission shall not approve an ISRS for a water corporation in a county with a charter form of government and with more than one million inhabitants that has not had a general rate proceeding decided or dismissed by issuance of a commission order within the past three years, unless the water corporation has filed for or is the subject of a new general rate proceeding.

The Commission's order deciding MAWC's last general rate proceeding, Case No. WR-2011-0337, was issued on March 7, 2012. MAWC's current ISRS began with ISRS 10 which was approved effective September 25, 2012. MAWC filed a *Request for Authority to Implement a General Rate Increase for Water and Sewer Service* on July 31, 2015, Case No.

² Case No. WO-2015-0211 Report and Order, Page 12.

WR-2015-0301. MAWC's current ISRS application falls within the three-year window allowed by RSMo § 393.1003.2.

Finally, RSMo § 393.1003.3 states:

In no event shall a water corporation collect an ISRS for a period exceeding three years unless the water corporation has filed for or is the subject of a new general rate proceeding; provided that the ISRS may be collected until the effective date of new rate schedules established as a result of the new general rate proceeding, or until the subject general rate proceeding is otherwise decided or dismissed by issuance of a commission order without new rates being established.

MAWC began collecting its ISRS beginning with ISRS 10 on September 25, 2012. On July 31, 2015, MAWC filed a *Request for Authority to Implement a General Rate Increase for Water and Sewer Service* provided by MAWC. Since MAWC is currently seeking a rate increase MAWC meets the three (3) year requirement addressed in RSMo § 393.1003.3.

Scope of Staff's ISRS Examination

In its Application, MAWC filed a reconciliation of the over or under recovery of ISRS revenues during the period of September 25, 2012 through September 30, 2015 in adherence to Commission Rule 4 CSR 240-3.650(16) that states:

At the end of each twelve (12)-month period that an ISRS is in effect, the eligible water utility shall reconcile the **differences between the revenues resulting from the ISRS and the appropriate pretax revenues** as found by the commission for that period, and shall submit the reconciliation and proposed ISRS rate schedule revisions to the commission for approval to recover or refund the difference, as appropriate. (emphasis added)

4 CSR 240-3.650(1)(F) defines "ISRS revenues" as:

(R)evenues produced through an ISRS, exclusive of revenues from all other rates and charges.

The rule requires the reconciliation of the amount of ISRS revenue MAWC actually collected from customers in prior periods with the amount of MAWC's authorized ISRS revenues for the same periods to account for over or under collection of ISRS revenue. This reconciliation addresses the amount of cumulative revenues authorized by the Commission in MAWC's ISRS 10 through ISRS 15 and are reflected in the table above.

The scope of Staff's examination of MAWC's ISRS application consisted of reviewing the accuracy of MAWC's calculation of the over-or under-recovery. Staff reviewed MAWC's supporting workpapers and submitted data requests for additional data through November 2015. The methodology traditionally used by Staff in ISRS cases allows for consideration of all relevant items to be updated during its review. In this case, Staff updated the reconciliation data through November 30, 2015. This methodology is consistent with past reviews conducted by the Staff, and is consistent with Staff's view that the calculation of the ISRS revenue requirement should closely reflect the revenue requirement at the effective date of the ISRS rates.

To determine the level of over-or under-collection, Staff compared the amount of MAWC's actual billed ISRS revenues to the Commission authorized ISRS revenues for the period of September 25, 2012 through November 30, 2015. To determine the level of ISRS revenue billed by MAWC, Staff requested the journal entries booked into the ISRS revenue accounts by the Company. During the course of reviewing the journal entries, Staff became concerned about a number of entries that reduced the amount of per book ISRS revenue. Examples of notable journal entries that reduced the level of ISRS revenue are related to uncollectible expense, sales tax, gross receipts tax, and primacy fees. Also, many journal entries were recorded that reclassified ISRS revenue into "deferred" and "base" revenue accounts. While Staff has concerns about MAWC's current accounting practices for ISRS revenue, it does not have enough information to make any recommendations for changes in these practices at this time. Although Staff accepted MAWC's billed ISRS revenue amount for purposes of this case, Staff is concerned that MAWC's reported ISRS revenues are not consistent with the Commission Rule 4 CSR 240-3.650(1)(F) which states that revenues produced through an ISRS are exclusive of revenues from all other rates and charges. Staff will review this issue further in MAWC's next ISRS application.

Staff also examined MAWC's reconciliation to verify the accuracy of the Company's calculations. MAWC begins the reconciliation process by allocating the current annual authorized ISRS revenue requirement to each calendar month of the year based on the historical ratio of sales recorded in each month. For example, according to MAWC's reconciliation, January sales during 2010 through 2014 are 6.7% of annual sales on average. So if the currently authorized revenue requirement were \$1,000, MAWC would assign \$67 as the target ISRS revenue for January and calculate the January over- or under-collection based on that \$67. This method was repeated for each month in the reconciliation period of September 25, 2012 through September 30, 2015 to determine the cumulative under recovery of ISRS revenues in MAWC's application. MAWC's method is contrary to Staff's standard practice of comparing actual billed ISRS revenues to the Commission authorized ISRS revenues to determine the level of over or under collection of ISRS revenues. Staff's methodology is consistent with the methodology used by Staff in prior MAWC ISRS filings as well as in past ISRS filings made by other Missouri utilities.

Staff has performed a final reconciliation of the ISRS revenue previously collected by the Company to ensure that either the Company or its customers are made whole for any under collections or over-collections that may have occurred. Staff performed this reconciliation for

the time period from September 25, 2012 through November 30, 2015, which is the period of time the ISRS 10 through 15 has been in effect. Based upon this reconciliation, Staff verified that the Company has under-collected ISRS related revenues from its customers by an amount of \$4,272,324.

RECOMMENDATION

Based upon the rationale stated above, Staff recommends the Commission issue an order in this case that:

1. Approves Staff's recommended cumulative ISRS reconciliation amount of \$4,272,324 and,
2. Consistent with the Commission Report and Order in ISRS Case No. WO-2015-0211, MAWC must file a new tariff designed to discontinue any ISRS charges no later than 60 days before MAWC expects to reach the maximum ISRS revenue of \$25,892,662.

