

**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-2007-0272</u>
Change its Infrastructure System Replacement)	Tariff File No. YW-2007-0496
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 January 19, 2007 (unless noted otherwise, all dates herein refer to the year 2007), 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 January 24, the Commission issued its **Order Directing Notice and Setting Intervention Date**, in which it established February 13 as the date by which applications to intervene in the instant case were to be filed. No requests to intervene were filed by the established deadline, nor have any been filed since.

3. On January 25, the Commission issued its **Order Suspending Tariff, Reserving Hearing Date, and Directing Filing**, in which it suspended MAWC's proposed ISRS tariff sheet until May 19. In that order, the Commission also directed the Staff to examine MAWC's

proposed ISRS and to file a report regarding that examination no later than March 20. Additionally, the Commission directed that responses to the Staff's report be filed no later than March 30 and reserved April 20 as the date for a hearing or presentation, if one becomes necessary.

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 5 of its Memorandum, and the Staff's workpapers related to its 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 5 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 Staff 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 20th day of March 2007.

/s/ Keith R. Krueger

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

AFFIDAVIT OF DALE W. JOHANSEN

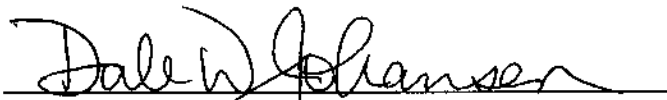
STATE OF MISSOURI)

) SS

CASE NO. WO-2007-0272

COUNTY OF COLE)

COMES NOW Dale W. Johansen, being of lawful age, and on his oath states the following: (1) that he 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 *Official Case File Memorandum* that is included in the following appendix; (3) that he has knowledge of the information presented in the foregoing Staff Recommendation and the following *Official Case File Memorandum*, and in the attachments to the memorandum; and (4) that the information presented in the foregoing Staff Recommendation and the following *Official Case File Memorandum*, and in the attachments to the memorandum, is 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 20th day of March 2007.


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-2007-0272

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MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. WO-2007-0272 - - - Missouri-American Water Company

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

<u>/s/ Dale W. Johansen</u>	<u>03/20/07</u>
Project Coordinator	Date

<u>/s/ Keith R. Krueger</u>	<u>03/20/07</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: March 20, 2007

BACKGROUND

On January 19, 2007 (unless noted otherwise, all dates herein refer to the year 2007), 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 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 January 24, the Commission issued its **Order Directing Notice and Setting Intervention Date**, in which it established February 13 as the date by which applications to intervene in the instant case were to be filed. No requests to intervene were filed by the established date, nor have any been filed since.

On January 25, the Commission issued its **Order Suspending Tariff, Reserving Hearing Date, and Directing Filing**, in which it suspended MAWC's tariff sheet, YW-2007-0496, until May 19. In that order, the Commission also directed the Staff to examine MAWC's proposed ISRS and to file a report regarding that examination no later than March 20. Additionally, the Commission directed that responses to the Staff's report be filed no later than March 30 and reserved April 20 as the date for a hearing or presentation, if one becomes necessary.

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 comments received from the reviewers were incorporated into that draft in developing this final version of the Memorandum.

The Staff's investigation of 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 submissions, 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 \$2,580,388 or an increase of 1.6% 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") that was approved in the Company's 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 was also agreed to in that Stipulation, MAWC will forgo the revenues applicable to Rate J customers and will not collect them from any other class of water customers.

STAFF'S REVENUE CALCULATION

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. 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-2007-0043. The Staff has reviewed MAWC's tariff filing, YW-2007-0496, and has determined that the ISRS rates proposed should be accepted as filed, and may replace the existing ISRS rates as of the requested effective date of May 19, or as of the effective date of the Commission's order approving the tariff filing if that is sooner.

MAWC's proposed rates are consistent with the rates calculated by the Staff (the Staff's calculations are shown in Attachment A attached hereto). Even though the Staff's calculation revises Net Contributions in Aid of Construction for facilities relocations due to a formula error found in the Company's workpapers, this revision was so small that it did not result in a need to change the Company's proposed rates.

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 (Case No. WR-2003-0500) and the ISRS revenues allocated to each affected customer class. The Company has provided such rate schedules. The ISRS rate schedule proposed by the Company, and confirmed by the Staff's calculation, is shown as 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 \$2,580,388 as requested by the Company. Although the Staff's determination of additional annual ISRS revenues was slightly higher than that proposed by the Company, the difference was so small that it did not result in a need to change the Company's proposed rates. As noted previously, the Staff's 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 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 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, the Staff notes that MAWC is current on its quarterly payments for its fiscal year 2007 assessment and has no delinquencies for prior assessments. 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 that:

1. Approves MAWC's Petition to implement revised ISRS rate schedules;
2. Approves the Staff's determination that the Company is entitled to receive ISRS revenues in the amount of \$2,580,388 on an annual basis, as requested by the Company and as shown in Attachment A hereto; and
3. Approves MAWC's revised ISRS tariff sheet pending in Tariff File No. YW-2007-0496, to be effective as of the requested effective date of May 19, or as of the effective date of the Commission's order approving that tariff sheet if that is sooner.

Memo Attachment A

Revenue Requirement and Customer Class Allocation Calculations

**Staff's Recalc
Total for
ISRS#4 Filing**

ISRS Activity:

Water Utility Plant Projects--Replacement Mains, and Associated Valves and Hydrants (RM) RSMo 393.1000 (8a):

<u>Task Orders Placed in Service (TOPS):</u>	
STLC-Replacement Mains and Associated Valves and Hydrants	\$ 17,559,479
Net Contributions in Aid of Construction	32,838
Deferred Taxes	(41,042)
Accumulated Depreciation	(92,498)
Total Net 393.1000 (8a)	17,458,778

Water Utility Plant Projects--Main Cleanings and Relinings (RM) RSMo 393.1000 (8b):

<u>Task Orders Placed in Service (TOPS):</u>	
STLC-Main Cleanings and Relinings	0
Net Contributions in Aid of Construction	0
Deferred Taxes	0
Accumulated Depreciation	0
Total Net 393.1000 (8a)	0

Water Utility Plant Projects--Facilities Relocations (FR) RSMo 393.1000 (8c):

<u>Task Orders Placed in Service (TOPS):</u>	
STLC-Relocated Facilities	2,922,379
Net Contributions in Aid of Construction	(1,361,213)
Deferred Taxes	(10,042)
Accumulated Depreciation	(11,607)
Total Net 393.1000 (8c)	1,539,517

Accumulated Depreciation and Deferred Taxes on Investment in Current ISRS

Depreciation for ISRS-2 Case No. WO-2006-0284	(288,931) ¹
Deferred Taxes ISRS-2 Case No. WO-2006-0284	(319,082) ²
Depreciation for ISRS-3 Case No. WO-2007-0043	(128,671) ³
Deferred Taxes ISRS-3 Case No. WO-2007-0043	0 ⁴
Total	(736,684)

Total ISRS Rate Base	18,261,611
Overall Rate Of Return per Last Order	7.70%
Return on Investment Required	1,406,144
Income Tax Conversion Factor	1.623080
Revenue Requirement Before Interest Deductibility	2,282,284

Total ISRS Rate Base	18,261,611
Embedded Cost of Debt per Last Order	3.400%
Interest Expense Deduction	620,895
Combined Federal and State Income Tax Rate	38.388626%
Income Tax Reduction due to Interest	238,353
Tax Conversion Factor	1.623080
Revenue Requirement Impact - Interest Deductibility	386,866

Total Revenue Requirement on Capital	1,895,418
Depreciation Expense	291,007
Property Taxes	426,392
Less Over Collection from Previous ISRS (i.e., Case No. WO-2006-0284)	- ⁵

Total ISRS Revenues	\$ 2,612,817
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Allocation of Revenue by Class	
Mains less than or equal to 12"	
Rate A & Oth	\$ 2,352,580
Rate A & Oth	212,642
Total Rate A & Oth	2,565,222
Rate J	0 ⁶
Rate D	427
Rate B	15,065

Grand Total Revenues Collected in Proposed ISRS	\$ 2,580,714
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Rate J Code	32,103
Total ISRS Revenues	2,612,817

NOTE(s):

- ¹ Depreciation Expense associated with the previous ISRS filing, Case No. WO-2006-0284 represents Jul-Dec 2006 expense.
² Deferred Income Tax associated with the previous ISRS filing, Case No. WO-2006-0284 represents Jan-Dec 2006 expense.
³ Depreciation Expense associated with the previous ISRS filing, Case No. WO-2007-0043 represents Jul-Dec 2006 expense.
⁴ No Deferred Taxes are associated with the previous ISRS filing, Case No. WO-2007-0043, since fully accounted for in that filing.
⁵ There will be no consideration of any over/under-collection associated with the previous ISRS until it has been in effect for 12 months, April 2007. Likewise, there will be no consideration of any over/under-collection associated with ISRS, Case No. WO-2007-0043, until it has been in effect for twelve months, October 2007.
⁶ Per Final Stipulation and Agreement in Case No. WR-2003-0500, Company agrees not to collect for Rate J customers until next general rate case.

Missouri-American Water Company
Case No. WO-2007-0272
Issue: Property Taxes
Source: Workpapers

	ISRS #4 ² Jul - Dec 2006	ISRS #3 ¹ Jan - Jun 2006	Total
Total Investment	20,481,858	18,916,369	39,398,227
Less: Retirements	(707,553)	(584,624)	(1,292,177)
Net Change in Property Base	19,774,305	18,331,745	38,106,050
Property Tax Rate	1.1190%	1.1190%	
Property Tax Expense	221,267	205,125	426,392

	2006
Real Estate Tax Paid	5,244,520
Utility Plant- Self Constructed	468,695,488
Rate	1.1190%

Represents Total Real Estate Tax Paid	5,964,764
Less: Parcel Tax	(720,244)
RE Tax on Self-Constructed Property	5,244,520

NOTES:

¹ Property Tax for Jan-Jun 2006 was not recovered in previous ISRS case, Case No. WO-2007-0043

² Represents additional investment made in 2006 for which Company is seeking recovery of Property Tax

Depr Differential	Year 1	1.22%
	After Year 1	2.44%

Composite Tax Rate: 38.3886256%

Mains, Valves and Hydrant Replacements

	Jul 1 - Dec 31 2006	Total
Additions	17,559,479	17,559,479
Less: Reimbursements	32,970	32,970
Additions - net	17,526,509	17,526,509
Bonus Depreciation Rate	0.00%	0.00%
Bonus Depreciation	0	0
Deferred Tax on Bonus Depr (35%)	0	0
Adjusted Tax Basis	17,526,509	17,526,509
Jul 1 - Dec 31 2006	41,042	41,042
Total Deferred Taxes	41,042	41,042

Relocations

	Jul 1 - Dec 31 2006	Total
Additions	2,922,379	2,922,379
Less: Reimbursements	(1,365,927)	(1,365,927)
Additions - net	4,288,306	4,288,306
Bonus Depreciation Rate	0.00%	0.00%
Bonus Depreciation	0	0
Deferred Tax on Bonus Depr (35%)	0	0
Adjusted Tax Basis	4,288,306	4,288,306
Jul 1 - Dec 31 2006	10,042	10,042
Total Deferred Taxes	10,042	10,042

Mains, Valves and Hydrant Replacements

Gross Investment - Replacements	17,559,479
Depreciation Expense - Replacements	280,147
Composite Depreciation Rate:	1.595419%

	Jul 1 - Dec 31 2006	Total
Reimbursements	32,970	32,970 (a)
Amortization	132 ¹	
Accumulated Amortization	132	132 (b)
Gross CIAC	32,970 (a)	
Less: Accum Amort. - CIAC	(132) (b)	
Net CIAC	32,838	

Relocations

Gross Investment - Relocations	2,922,379
Depreciation Expense - Relocations	40,338
Composite Depreciation Rate:	1.380318%

	Jul 1 - Dec 31 2006	Total
Reimbursements	(1,365,927)	(1,365,927) (c)
Amortization	(4,714) ¹	
Accumulated Amortization	(4,714)	(4,714) (d)
Gross CIAC	(1,365,927) (c)	
Less: Accum Amort. - CIAC	4,714 (d)	
Net CIAC	(1,361,213)	

¹ All Reimbursements are assumed to be spread evenly throughout the last 6 months of the year; therefore, the amortization is divided by four to arrive at the accumulated amortization.

Missouri-American Water Company
Case No. WO-2007-0272
Issue: Net Depreciation Expense
Source: Workpapers

	Replacements	Relocations	Total
Base Depreciation Expense	280,147	40,338	320,485
Reimbursements	32,970	(1,365,927)	
Composite Depreciation Rate	1.595419%	1.380318%	
Depreciation Expense to be Removed	526	(18,854)	(18,328)
Depreciation Expense Associated with Retirements			(11,151)
Net Depreciation Expense			<u>291,007</u>

Memo Attachment B

Tariffed Rate Calculations

Missouri-American Water Company
Case No. WO-2007-0272
Issue: Tariff Rates
Source: Workpapers

	ISRS Recovery Revenue Requirement	2003 Bill Analysis Sales (CCF) ²	Rate per CCF	Rate per 1000 Gal.
Rates A & K	2,565,222	56,372,211	\$0.0455	\$0.0607
Rate B	15,065	2,236,698	\$0.0067	\$0.0089
Rate D	427	126,134	\$0.0034	\$0.0045
Rate J	0	9,441,890	N/A	N/A
	2,580,714			

² Per billing determinants approved in determining rates per Commission order in Case WR 2003-0500 and Per Stipulation 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 Combined Rate Use on Tariff ¹	Current ISRS Rates per Above ²	Proposed Combined Rate Use on Tariff
Rate Per CCF			
Rates A & K	\$0.1198	\$0.0455	\$0.1653
Rate B	\$0.0233	\$0.0067	\$0.0300
Rate D	\$0.0116	\$0.0034	\$0.0150
Rate J	N/A	N/A	N/A
Rate Per 1000 Gal			
Rates A & K	\$0.1597	\$0.0607	\$0.2204
Rate B	\$0.0311	\$0.0089	\$0.0400
Rate D	\$0.0155	\$0.0045	\$0.0200
Rate J	N/A	N/A	N/A

Notes:

¹ Combined Rate as approved in Case Nos. WR-2006-0284 and WO-2007-0043

² As calculated above.