

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

In the Matter of the Petition of Missouri-American )  
Water Company for Approval to Establish an ) **Case No. WO-2018-0373**  
Infrastructure System Replacement Surcharge (ISRS) ) **Tariff No. YW-2019-0018**

**STAFF RECOMMENDATION**

**COMES NOW** the Staff of the Missouri Public Service Commission (Staff), by and through counsel, states as follows:

1. On August 20, 2018, Missouri-American Water Company (MAWC or Company) filed its *Petition to Establish an Infrastructure System Replacement Surcharge & Motion for Approval of Customer Notice (Petition)*.

2. MAWC's *Petition* requests an adjustment to its ISRS rates and charges for ISRS-eligible infrastructure system replacements and relocations made during the period of January 1, 2018 through September 30, 2018.

3. On August 23, 2018, the Commission set a deadline for intervention of September 6, 2018. The Commission further directed Staff to file a recommendation on MAWC's application no later than October 19, 2018.

4. The Empire District Electric Company (Empire Electric) filed a *Motion to Intervene* on September 7, 2018. Empire Electric withdrew its *Motion to Intervene* on September 25, 2018.

5. Commission Rule 4 CSR 240-3.650(11) states that the staff of the Commission may examine information of a water utility to confirm the underlying costs related to the proposed ISRS and to confirm proper calculation of the proposed charge.

6. Based on its examination and calculations as detailed in its attached Memorandum, Staff recommends the Commission approve incremental ISRS surcharge revenues in the amount of \$6,377,082. Please see, attached to Staff's Memorandum, Appendix A for the ISRS rate for each customer class and Appendix B for the revenue requirement calculation.

**WHEREFORE**, Staff recommends the Commission issue an Order in this case that: (1) Rejects the MAWC's ISRS tariff sheet (YW-2019-0018) P.S.C MO No. 13 10th Revised Sheet No. RT 10 cancelling 9th Revised Sheet No. RT 10 filed on August 20, 2018; and (2) approve the Staff's recommended ISRS surcharge revenues in this docket in the incremental pre-tax revenue amount of \$6,377,082.

Respectfully submitted,

**/s/ Jacob T. Westen**

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**CERTIFICATE OF SERVICE**

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile, or electronically mailed to all parties and or counsel of record on this 19th day of October, 2018.

**/s/ Jacob T. Westen**

## MEMORANDUM

**TO:** Missouri Public Service Commission Official Case File Case No.  
WO-2018-0373, Tariff No. YW-2019-0018 - Missouri-American Water Company

**FROM:** Jason Kunst, CPA, Utility Regulatory Auditor IV, Auditing Department  
Lisa M. Ferguson, Utility Regulatory Auditor V, Auditing Department  
Matthew J. Barnes, Utility Regulatory Auditor IV, Water and Sewer Department

/s/ Mark L. Oligschlaeger 10/19/18  
*Auditing Department / Date*

/s/ James A. Busch 10/19/18                      /s/ Jacob T. Westen 10/19/18  
*Water and Sewer Department / Date*                      *Staff Counsel's Office / Date*

**SUBJECT:** Staff Report and Recommendation Regarding the Petition of Missouri-American Water Company for Approval to Establish an Infrastructure Replacement Surcharge (ISRS)

**DATE:** October 19, 2018

### BACKGROUND

On August 20, 2018, Missouri-American Water Company (“Company” or “MAWC”) filed its *Petition for Approval to Establish an Infrastructure System Replacement Surcharge* (“Petition”) with the Missouri Public Service Commission (“Commission”). The Company submitted its Petition to the provisions of Sections 393.1000, 393.1003, 393.1000, RSMo, and Commission rules 4 CSR 240-2.060(1) and 4 CSR 240-3.650. These sections 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”). This is the first ISRS filing since the Company’s most recent general rate case, No. WR-2017-0285. MAWC submitted its Petition to reflect ISRS investment put into service for the period January 1, 2018 to July 31, 2018, with pro-forma ISRS costs updated through September 30, 2018. MAWC estimated in its Petition that it was entitled to an incremental increase of ISRS revenues in this case of \$7,437,064.

On August 23, 2018, the Commission issued its *Order Directing Notice, Setting Intervention Deadline and Directing Filing, and Suspending Tariff* establishing September 6, 2018 as the deadline to intervene in the instant case. The Commission directed Staff to file a report regarding its examination of the ISRS filing no later than October 19, 2018.

## **STAFF INVESTIGATION**

Commission rule 4 CSR 240-3.650(2) states, “an eligible water utility may file a petition with the commission to establish or change ISRS rate schedules that will allow for the adjustment of its rates and charges to provide for the recovery of costs eligible for infrastructure system replacements; provided that an ISRS, on an annualized basis, must produce ISRS revenues of at least one (1) million dollars, but not in excess of ten percent (10%) of the subject utility’s base revenue level approved by the Commission in the utility’s most recent general rate proceeding.” This filing meets the criteria of at least one (1) million dollars and does not exceed ten percent of the base revenue levels of \$318 million approved by the Commission in the most recent MAWC general rate case, No. WR-2017-0285.

In this Petition, MAWC filed to recover ISRS qualifying infrastructure replacement costs incurred during the period of January 1, 2018 through September 30, 2018. In its initial filing, MAWC provided estimated data for August 2018 and September 2018 plant investment. MAWC provided documentation supporting actual ISRS plant investment data for August 2018 and September 2018 during the course of Staff’s review and audit in this case.

As part of its examination of MAWC’s Petition, Auditing Staff reviewed supporting workpapers, and a sample of invoices for approximately 90% of total ISRS investment costs, as well as other applicable documentation, such as work order authorizations. Staff also conducted meetings and communicated with MAWC personnel to clarify MAWC’s Petition when necessary.

## **THE PETITION**

As stated in its Petition, MAWC “seeks to establish an ISRS rate 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 that are eligible for the ISRS, including recognition of net 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 requirements 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-2017-0285;
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.

Reimbursements that MAWC has subsequently 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 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 \$7,437,064 or an increase of 3.6% based on the base revenue level approved by the Commission in the most recently completed general rate case proceeding" on an annualized basis.

On October 11, 2018 MAWC provided Staff with updated work papers to include the actual ISRS investment through September 30, 2018. In addition to replacing the estimated August and September 2018 investment for proposed recovery, MAWC also removed \$63,295 of initially requested ISRS costs because the costs related to removing and replacing customer owned lead service lines was incorrectly included within MAWC's original ISRS Petition. MAWC's updated proposed rate schedule now indicates recovery of proposed ISRS revenue of \$7,276,936.

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

With the exception of the items listed and discussed in further detail below, Staff agrees with the methodology utilized by MAWC in the calculation of the ISRS revenue requirement for the purpose of this ISRS filing. In its calculation of the ISRS revenue requirement Staff utilized the following (all amounts described in this section represent rate base dollars):

1. Replacement of estimated costs included in the ISRS plant balances included in the Company's direct filing with actual costs for that period.
2. Removal of various non-ISRS eligible costs as described below.
3. Removal of MAWC's proposed net operating loss ("NOL") of \$9,368,663 that has been used to offset the deferred tax liability related to this ISRS investment. As of this date, Staff's understanding is that no amount of net NOL has actually been generated for income tax purposes by MAWC on an aggregate basis since January 1, 2018 (the beginning of this ISRS period). Alternatively, Staff has not been presented with any evidence that imputation of a "hypothetical" NOL amount into ISRS rate base in this case is required to comply with the normalization provisions of the Internal Revenue Service Code.

Staff agrees with MAWC's removal of the \$63,295 of costs for lead service line replacements, as described above. However, during the course of its review, Staff also discovered various costs that were charged to ISRS eligible projects that did not meet ISRS requirements:

1. Repairs to customer owned appliances and equipment of \$15,100
2. Duplicate charges of \$24,586
3. Installation of new service lines of \$22,708
4. Customer owned lead service line replacement costs (beyond the \$63,295 already removed by both MAWC and Staff) of \$48,508

Staff has removed the above costs (a total of \$110,902) and MAWC's hypothetical net operating loss, totaling \$9,480,012, from its calculation of the ISRS revenue requirement.

Attached to this Memorandum is a Reconciliation of MAWC's request and Staff's recommendation (*see* Attachment A).

### **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-2017-0285, and the ISRS revenues allocated to each affected customer class. Staff agreed with and used the Company's methodology for calculating

the ISRS rates, based on the Company's calculation of the ISRS revenue requirement. The ISRS rates are 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 Commission 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 assessment payments and is not delinquent for prior years' assessments. In addition, MAWC does not have any past due annual reports.

### **STAFF RECONCILIATION**

Commission rule 4 CSR 240-3.650(17) requires if an over or under recovery of ISRS revenues exists after the ISRS has been reset to zero, the amount of over or under recovery should be included in the water utility's next ISRS filing. The Commission approved overall pre-tax ISRS revenue of \$5,531,000 in MAWC's last ISRS filing, Case No. WO-2018-0059 of which \$2,500,315 was authorized to be collected prior to the effective date of rates of MAWC's last general rate proceeding, where the ISRS surcharge was reset. As of September 30, 2018, MAWC has collected \$2,023,005 of this ordered ISRS revenue. This demonstrates that MAWC has under-collected ISRS revenues by \$477,310. As a result of the reconciliation, Staff recommends including this amount of under-collected ISRS revenues in MAWC's ISRS rates.

### **STAFF'S CONCLUSIONS**

Based upon its investigation and calculations, Staff concludes that the Company's ISRS rates should be designed to recover annual ISRS revenues of \$6,377,082. Staff's calculations reflect the overall pre-tax weighted average cost of capital of 9.44% (tax grossed up rate of return) and MAWC's current depreciation rates, as reflected in the Stipulation and Agreement ordered by the Commission in Case No. WR-2017-0285, MAWC's last general rate case. Staff's calculations reflect the actual ISRS eligible investment placed in service from January 1, 2018 through September 30, 2018. Whereas MAWC included all associated accumulated reserve and deferred income tax through November 15, 2018 in its Petition, Staff believes it is appropriate to include those amounts as close to the effective date of the proposed tariff as possible; therefore, Staff has included the balance of these items as of November 30, 2018. In addition, no property taxes have been included in Staff's calculation as there will be no property tax liability from MAWC due within the next 12 months related to this ISRS investment.

Staff based its conclusions on an examination of work orders and supporting documentation for the projects included for recovery in the MAWC's proposed ISRS filing, as well as from a review of the Stipulation and Agreement in Case No. WR-2017-0285. As a result it is Staff's opinion that the project costs incorporated within this ISRS filing met the requirements of the governing statutes as summarized previously in this Memorandum in the discussion of the Company's Petition.

**STAFF'S RECOMMENDATION**

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

1. Rejects MAWC's ISRS tariff sheet (YW-2019-0018) filed on August 20, 2018.
2. Approves Staff's recommended ISRS surcharge revenues in this docket in the incremental pre-tax revenue amount of \$6,377,082.



**MAWC ISRS WO-2018-0373**  
**ISRS Revenue Requirement Calculation with Staff Adjustments**

**ISRS PLANT ADDITIONS**

	MAWC Filed Application	MAWC's Updated Position	Staff's Position	Amount of Lead Service Line Removed	Amount of Non ISRS Eligible Removed	Amount of Revenue Generating Removed	Amount of NOL Removed	Effect of Nov 30 Depreciation Date	Total Staff and MAWC Differences
<b><u>Plant Additions - Replacements</u></b>									
Gross Plant Additions	\$ 64,485,018	\$ 62,997,486	\$ 62,886,584	\$ (48,508)	\$ (39,686)	\$ (22,708)	\$ -	\$ -	\$ (110,902)
CIAC	\$ (2,319)	\$ (2,319)	\$ (2,318)	\$ -	\$ -	\$ -	\$ -	\$ 1	\$ 1
Deferred Taxes	\$ 459,213	\$ 448,062	\$ (8,889,734)	\$ -	\$ -	\$ -	\$ (9,337,796)	\$ -	\$ (9,337,796)
Accumulated Depreciation	\$ (403,131)	\$ (389,623)	\$ (425,946)	\$ (169)	\$ (199)	\$ (79)	\$ -	\$ (35,876)	\$ (36,323)
<b>Total Net Main Replacements</b>	<b>\$ 64,538,781</b>	<b>\$ 63,053,606</b>	<b>\$ 53,568,586</b>	<b>\$ (48,677)</b>	<b>\$ (39,885)</b>	<b>\$ (22,787)</b>	<b>\$ (9,337,796)</b>	<b>\$ (35,875)</b>	<b>\$ (9,485,020)</b>
<b><u>Plant Additions - Relocations</u></b>									
Gross Plant Additions	\$ 892,753	\$ 1,263,074	\$ 1,263,074	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
CIAC	\$ (1,004,055)	\$ (1,052,664)	\$ (1,052,050)	\$ -	\$ -	\$ -	\$ -	\$ 614	\$ 614
Deferred Taxes	\$ 19	\$ 1,479	\$ (29,388)	\$ -	\$ -	\$ -	\$ (30,867)	\$ -	\$ (30,867)
Accumulated Depreciation	\$ (4,481)	\$ (5,880)	\$ (6,622)	\$ -	\$ -	\$ -	\$ -	\$ (742)	\$ (742)
<b>Total Net Service Line Replacements and Insertion Projects</b>	<b>\$ (115,764)</b>	<b>\$ 206,009</b>	<b>\$ 175,014</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ (30,867)</b>	<b>\$ (128)</b>	<b>\$ (30,995)</b>
<b>TOTAL ISRS NET PLANT ADDITIONS</b>	<b>\$ 64,423,017</b>	<b>\$ 63,259,615</b>	<b>\$ 53,743,600</b>	<b>\$ (48,677)</b>	<b>\$ (39,885)</b>	<b>\$ (22,787)</b>	<b>\$ (9,368,663)</b>	<b>\$ (36,003)</b>	<b>\$ (9,516,015)</b>

**CALCULATION OF ISRS REVENUE REQUIREMENT**

	MAWC Filed Application	MAWC Updated Position	Staff's Position	Amount of Lead Service Line Removed	Amount of Non ISRS Eligible Removed	Amount of Revenue Generating Removed	Amount of NOL Removed	Effect of Nov 30 Depreciation Date	Total Staff and MAWC Differences
<b>Total ISRS net plant additions</b>	\$ 64,423,017	\$ 63,259,615	\$ 53,743,600	\$ (48,677)	\$ (39,885)	\$ (22,787)	\$ (9,368,663)	\$ (36,003)	\$ (9,516,015)
<b>Overall Pretax Rate of Return</b>	9.44%	9.44%	9.44%	9.44%	9.44%	9.44%	9.44%	9.44%	
<b>Revenue Requirement on Capital</b>	\$ 6,081,533	\$ 5,971,708	\$ 5,073,396	\$ (4,595)	\$ (3,765)	\$ (2,151)	\$ (884,402)	\$ (3,399)	\$ (898,312)
<b>Depreciation Expense</b>	\$ 817,820	\$ 827,918	\$ 826,376	\$ (674)	\$ (552)	\$ (316)	\$ -	\$ -	\$ (1,542)
<b>ISRS Undercollection</b>	\$ 537,711	\$ 477,310	\$ 477,310	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
<b>Revenue Requirement Before Interest Deductibility</b>	<b>\$ 7,437,064</b>	<b>\$ 7,276,936</b>	<b>\$ 6,377,082</b>	<b>\$ (5,269)</b>	<b>\$ (4,317)</b>	<b>\$ (2,467)</b>	<b>\$ (884,402)</b>	<b>\$ (3,399)</b>	<b>\$ (899,854)</b>

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

In The Matter of Petition of Missouri-American	)	
Water Company for Approval to Establish an	)	<b><u>Case No. WO-2018-0373</u></b>
Infrastructure System Replacement Surcharge	)	Tariff No. YW-2019-0018
(ISRS)	)	

**AFFIDAVIT OF MATTHEW J. BARNES**

State of Missouri    )  
                                  ) ss.  
County of Cole        )

**COMES NOW** Matthew J. Barnes, and on his oath declares that he is of sound mind and lawful age; that he contributed to the attached Staff Memorandum; and that the same is true and correct according to his best knowledge and belief.

Further the Affiant sayeth not.

  
\_\_\_\_\_  
**Matthew J. Barnes**

**JURAT**

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 19<sup>th</sup> day of October, 2018.



  
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**NOTARY PUBLIC**



