

**Before the Public Service Commission  
Of the State of Missouri**

In the Matter of Missouri-American Water )  
Company’s Request for Authority to Implement ) **Case No. WR-2020-0344**  
General Rate Increase for Water and Sewer )  
Service Provided in Missouri Service Areas. )

**Public Counsel’s Position Statement**

The Office of the Public Counsel (OPC) offers its position statements in response to the pre-filed list of issues as follows:

1. **Test Year** – What is the appropriate test year (historic or future test year), update, true-up period and discrete adjustments, if any, that the Commission should employ for purposes of determining Missouri American Water Company’s (MAWC) cost of service in this case?

As the Staff of the Missouri Public Service Commission (Staff), the Office of the Public Counsel, Missouri Energy Consumers Group, the City of St. Joseph, the Municipal League of Metro St. Louis, and the Missouri Industrial Energy Consumers jointly proposed, the Commission should employ a historic test year of the 12-months ended December 2019, an update period of the six months ending June 2020, and, only to update various known and measurable cost-of-service components, a true-up period of the six months ending December 31, 2020.<sup>1</sup> At a minimum, the Commission should expressly reject MAWC’s proposed future test year. A historic test year conforms to the Public Service Commission’s (PSC) matching principle and “known and measurable” standards for ratemaking.<sup>2</sup> Conversely, MAWC’s requested future test year is a request to reach forward in time to speculate on future investments and expenses beyond the ratemaking period. Given the asymmetry of information between this Commission and the Company, the risk of rates being higher than necessary through a future test year is very real.<sup>3</sup>

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<sup>1</sup> *Joint Proposed Procedural Schedule and Procedures* filed August 13, 2020.

<sup>2</sup> Direct Testimony of Geoff Marke, p. 11.

<sup>3</sup> *Id.* at 7.

Consider also that the historic test year has served the Commission, ratepayers, and utilities well, while enacting the future test year now would represent a fundamental departure from Missouri ratemaking practice. Of all times to consider such a shift, an ongoing economic depression and pandemic, this is perhaps the worst.<sup>4</sup>

2. **Allocations** – What is the appropriate method to allocate MAWC corporate costs to the water and sewer districts?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

3. **Rate Base**

- a. Emerald Pointe & City of Hollister Pipeline – Should the unamortized amount of the cost of the pipeline be included in rate base?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

- b. Cost of Acquisitions – Should the unamortized amounts of the Hickory Hills and Woodland Manor acquisitions be included in rate base?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

- c. Lead Service Line Replacements – Should the deferred balance of customer-owned lead service line replacements be included in rate base?

No, the Commission should not include the deferred balance of customer-owned lead service line replacements in MAWC's rate base. The Commission previously ordered that MAWC can only include carrying costs at the long-term debt rate in an accounting authority order (AAO) balance.<sup>5</sup> There is no reason to depart from this practice.

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<sup>4</sup> *Id.* at 11-12.

<sup>5</sup> Surrebuttal of Geoff Marke, p. 16-17; *Report and Order*, WR-2017-0285, p. 23 (May 2, 2018).

- d. Capitalized Depreciation – Should MAWC capitalize a portion of depreciation expense on tools and equipment partly used on capital projects?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

- e. Cash Working Capital –  
i. What is the appropriate expense for lead or lag treatment for Service Company expenses?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

- ii. What should the lead and lag treatment for income tax expense be in cash working capital?

As stated in the rebuttal testimony of John Riley, the expense lag for federal income taxes should be 365 days to reflect ratepayers paying an expense that never results in a cash outlay if a tracker is not used.<sup>6</sup> Riley explains the rationale for this adjustment in the following explanation of what CWC actually entails:

“The measurement of the amount of funds, on average, required for the **payment** of a utility’s **day-to-day** expenses.” The income tax returns prove that MAWC and its parent company do not pay federal income tax. None. There is no day-to-day expense. You cannot deny the fact that payment from the ratepayer is being collected to pay for these taxes, but the taxes themselves are never actually paid to the federal government. It is interest free money.<sup>7</sup>

Because MAWC is collecting these funds but never actually paying them to the federal government, the lag between collection and payment should be treated as a full year (*i.e.* 365 days).

- iii. American Water Works Service Company Prepaid Billing – Should the Commission authorize MAWC to recover its prepaid billing and payment arrangement as a service expense?

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<sup>6</sup> Rebuttal Testimony of John Riley, p. 3. Staff’s expense lag of 52.88 days can be used for the state income tax portion of the CWC calculation. *Id.*

<sup>7</sup> Rebuttal Testimony of John Riley, p. 4.

No. MAWC's prepaid billing arrangement is unduly preferential to its affiliate American Water Works Service Company relative to its interactions with non-affiliates.<sup>8</sup>

f. ADIT –

- i. Should MAWC's booked Accumulated Deferred Income Tax (ADIT) include a reduction for net operating loss?

No. Including a net operating loss (NOL) in the calculation of MAWC's ADIT would be inappropriate due to the income tax expense built into the case.<sup>9</sup> OPC witness John Riley explains in his direct testimony as follows:

ADIT only makes up a part of MAWC's total income tax expense to be included in MAWC's revenue requirement. The remaining income tax expense, which Staff refers to as the "current income tax expense" can be thought of as the income tax the utility will still be expected to remit to the IRS even though it is using accelerated depreciation instead of straight line depreciation. However, even though this remaining income tax expense is included in MAWC's revenue requirement, it still does not end up being paid as taxes.<sup>10</sup>

Incidentally, the NOL itself forms the very basis for why MAWC does not have to remit any portion of the current income tax that has been included in base rates. The NOL provides this for MAWC by reducing MAWC's tax liability to zero.<sup>11</sup> As such, "any NOL offset MAWC might claim would be completely negated by the current income tax portion of the income tax expense built into rates that exists independently of ADIT."<sup>12</sup>

Were the Commission to fail to account for the current income tax expense when considering the application of the NOL to ADIT, the Company would receive an unjust windfall paid for by its customers. To illustrate, consider the following:

Right now, MAWC's revenue requirement will include income tax expense calculated as though MAWC were using straight-line depreciation method. When

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<sup>8</sup> Rebuttal Testimony of Robert Schallenberg, p. 3.

<sup>9</sup> Direct Testimony of John Riley, p. 2.

<sup>10</sup> *Id.* at 4.

<sup>11</sup> *Id.*

<sup>12</sup> *Id.*

MAWC actually goes to remit its taxes to the IRS, however, it will calculate those taxes as though it were using accelerated depreciation thus leaving a sizable amount of the money that MAWC collected from ratepayers to cover its tax expenses in MAWC's possession. That amount of money represents the ADIT. At the same time, MAWC will employ its NOL to reduce the remaining portion of its tax liability to zero. Thus, MAWC will effectively retain all of the income expense included in rates for its own use. Because the NOL is already going to be used to reduce MAWC's remaining income tax liability to zero, allowing MAWC to also reduce the ADIT portion of its income tax expense by the same amount would effectively be double dipping.<sup>13</sup>

Obviously, the Commission should not permit this kind of double dipping by the Company.

Moreover, the OPC's position is supported by federal Internal Revenue Service (IRS) private letter rulings, as evidenced in Mr. Riley's surrebuttal testimony.<sup>14</sup>

The portion of current income tax expense that is built into MAWC's rates, and thus collected from customers, but never paid to the federal government has resulted in the Company collecting more than \$84 million in free money over a three-year period.<sup>15</sup> The Commission has not yet recognized that quantity in rate base, and has instead inured to the Company's benefit.<sup>16</sup> Allowing MAWC to offset its ADIT with an NOL in a manner that ignores this huge regulatory tax benefit would ignore ratepayer contributions to MAWC and be unjust. Therefore, the Commission should not permit MAWC to reduce MAWC's booked ADIT with an NOL.

- ii. If so, would there be an effect on the level of excess ADIT to be flowed back to rate payers?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

4. **Excess ADIT** – What is the appropriate treatment for the flow back of unprotected excess ADIT to rate payers?

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<sup>13</sup> *Id.* at 5.

<sup>14</sup> Surrebuttal Testimony of John Riley, p. 6.

<sup>15</sup> *Id.* at 9.

<sup>16</sup> *Id.*

The Commission should flow the unprotected excess ADIT back to customers using a three-year amortization period.<sup>17</sup> Because MAWC does not expect to file another rate case for at least three years, this amortization period represents a clean cutoff to coincide with the next rate adjustment.<sup>18</sup> The Company’s contrary proposal to employ ARAM represent a far too slow of a return of what are essentially depreciating expenses to ratepayers.<sup>19</sup>

5. **Usage Normalization** – What is the appropriate level of normalized annual usage that the Commission should adopt for calculating normalized revenues for each rate class and service territory?

The appropriate level of normalized annual usage that the Commission should use when setting MAWC’s rates, as calculated by OPC witness Lena Mantle, is as follows in terms of gallons per customer:<sup>20</sup>

	Residential	Commercial
St. Louis County	6,596	42,151
All other Customers	4,727	23,356

Mantle derived these numbers by reviewing MAWC’s historical usage, noting that MAWC’s residential use per customer has shifted from continually declining to remaining stable or slightly increasing beginning in 2015. Mantle averaged the annual data from 2017 through 2019.<sup>21</sup> By averaging three years, Mantle incorporates recent data,<sup>22</sup> and gives that data the most weight as opposed to equally weighting data from eleven years ago prior to the advent of MAWC’s installation of advanced meter infrastructure (“AMI”) and with considerably more quarterly

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<sup>17</sup> Rebuttal Testimony of John Riley, p. 6.

<sup>18</sup> *Id.* at 7.

<sup>19</sup> *Id.*

<sup>20</sup> Direct Testimony of Lena Mantle, p. 3.

<sup>21</sup> *Id.* at 5.

<sup>22</sup> Surrebuttal Testimony of Lena Mantle, p. 4.

billing.<sup>23</sup> Mantle's approach also avoids probable statistical noise by excluding unusual water usage in 2020 during the COVID-19 pandemic while minimizing the amount of uncertain data in her calculations.<sup>24</sup>

6. **Water Utility Revenues** – What are the appropriate revenues to use to determine the increase or decrease in water service revenue requirement?
  - a. Residential Revenue – What is the appropriate number of meters for fixed or customer charge to be used for revenues?
    - i. Non-Residential Revenues – What is the appropriate annualized number of meters level for each revenue class?

OPC takes no position on these issues, but reserves the right to advocate a position at hearing and briefing.

7. **Sewer Utility Revenues** – What are the appropriate revenues to use to determine the increase or decrease in sewer service revenue requirement?
  - a. What is the appropriate number of units to be used for fixed or customer charge?

OPC takes no position on these issues, but reserves the right to advocate a position at hearing and briefing.

#### 8. **Rate of Return/Capital Structure**

- a. Return on Common Equity – What is the appropriate return on common equity to be used to determine the rate of return?

The appropriate return on equity (ROE) that the Commission should use to set MAWC's rates and determine its rate of return is 9.25% applied to a capital structure of either a common equity ratio of 41.1% or 39.18% (depending on the Commission's decision on AFUDC).<sup>25</sup> Murray's independent analysis of MAWC's relationship with its parent company, American Water Works (American Water), and the water utility industry generally, support the Commission authorizing an ROE as low as 8.25%. However, Murray also recognizes that MAWC competes

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<sup>23</sup> Surrebuttal Testimony of Lena M. Mantle, p. 5-6.

<sup>24</sup> Rebuttal Testimony of Lena Mantle, p. 10; Surrebuttal Testimony of Lena Mantle, p. 3.

<sup>25</sup> Direct Testimony of David Murray, p. 3-5.

with the other American Water state affiliates for capital, and so he supplemented his analysis with considerations of what was a zone of reasonableness for ROEs that would ensure that MAWC has the opportunity to earn a competitive return while still maintaining lower rates for customers.<sup>26</sup>

Murray started by reviewing relevant investment industry research on American Water and the overall water utility industry since 2018. He then performed a cost of equity (COE) analysis on American Water and a group of proxy utilities using a multi-state discounted cash flow analysis and Capital Asset Pricing Model.<sup>27</sup> After determining that American Water's COE is anywhere from 5% to 7%, he then reviewed stock valuation and dividend information for American Water and other proxy utilities to evaluate his COE conclusion. When considering the current low cost of capital market, and how investors are valuing American Water, he applied this Commission's "zone of reasonableness" concerns, and concluded that a 9.25% ROE was fair and proper for MAWC to attain its authorized return so long as MAWC leverages its capital structure with more debt to maximize customer savings.<sup>28</sup>

Murray's recommendation is also supported by American Water's COE being substantially similar to the Empire District Electric Company (Empire).<sup>29</sup> Empire received an allowed ROE of 9.25% through this Commission's latest order in a contested rate case, ER-2019-0374.<sup>30</sup> The Commission reached this result based, in large part, on Murray's recommendations that used the same methodology he employs now. A 9.25% ROE is also higher than the average ROE for water utilities of 8.82%, based on Murray's review of four utility rate cases nationwide over the first nine

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<sup>26</sup> *Id.*

<sup>27</sup> *Id.* at 7.

<sup>28</sup> *Id.* at 4 & 16-20.

<sup>29</sup> *Id.* at 29.

<sup>30</sup> *Id.* at 3.



months of 2020.<sup>31</sup> A 9.25% ROE recommendation is then not only reasonable and substantiated by American Water's structure and capital markets, but consistent with past Commission practice.

- b. Capital Structure – What capital structure should be used to determine the rate of return?

The Commission should set MAWC's ratemaking capital structure based on its parent company, American Water. Setting MAWC's capital structure based on its parent company better represents the debt capacity made possible by MAWC's low-risk water and wastewater utility assets. Doing so relieves customers of paying for a more costly, equity-rich capital structure with no attendant benefits in exchange for that equity. Setting the capital structure based on MAWC as a standalone company ignores the reality that MAWC is not truly standalone. In actuality, American Water targets a capital structure for ratemaking purposes to generate higher cash flow to service debt loaned to American Water from its financial affiliate, AWCC.

OPC witness Murray recommends that the Commission set MAWC's capital structure at 41.10% equity and 58.9% long-term debt, if the Commission also order MAWC to use short-term debt for its Allowance for Funds Used During Construction (AFUDC) rate.<sup>32</sup> Alternatively, if the Commission does not order MAWC to use short-term debt for its AFUDC rate, Murray recommends a capital structure of 39.18% common equity, 56.16% long-term debt, and 4.66% short-term debt. Murray recommends that the Commission set MAWC's capital structure based on its parent company because the inextricable financial connection between the two companies. MAWC is not raising capital and incurring debt on its own from third-parties like a standalone company.<sup>33</sup> Instead, loans from AWCC make up approximately 97% of MAWC's debt.<sup>34</sup>

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<sup>31</sup> *Id.* at 5.

<sup>32</sup> *Id.* at 32.

<sup>33</sup> Rebuttal Testimony of David Murray, p. 3.

<sup>34</sup> *Id.* at 4.

American Water also receives loans from AWCC, to purchase equity in MAWC and other affiliates.<sup>35</sup> All of MAWC's debt financing relies on American Water in this manner.<sup>36</sup> This relationship enables American Water to leverage more debt at the holding company level, while making the lower state affiliates like MAWC appear to have more common equity.<sup>37</sup> The appearance of more equity translates into higher than necessary capital costs being charged to ratepayers and therefore, a higher than reasonable margin provided to MAWC's sole shareholder, American Water.<sup>38</sup>

Adjusting MAWC's AFUDC practices is important to consumers because currently MAWC does not use its short-term debt to capitalize construction work in progress. This results in customers paying higher, long-term capital costs for AFUDC and MAWC's ultimate return.<sup>39</sup>

- c. Debt/Preferred Stock Rates/Costs – What Debt/Preferred Stock Rates/Costs should be used to determine the rate of return?

Please refer to OPC's position on capital structure above. Murray's recommended capital structure does not include any preferred stock, and excluded it from his determination of MAWC's targeted capital structure.<sup>40</sup>

9. **Amortizations** –

- a. AFUDC regulatory amortization – What is the appropriate treatment of AFUDC regulatory amortization in this case?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

10. **Main Break Expense** – What is the appropriate amount of main break expense to be included in the cost of service?

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<sup>35</sup> Direct Testimony of David Murray, p. 33.

<sup>36</sup> *Id.* at 37.

<sup>37</sup> *Id.* at 34-35.

<sup>38</sup> Rebuttal Testimony of David Murray, p. 9.

<sup>39</sup> Direct Testimony of David Murray, p. 32.

<sup>40</sup> Rebuttal Testimony of David Murray, p. 2.

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

11. **Maintenance Expense** – What is the appropriate amount of Maintenance Expense other than main break expense should be included in the cost of service calculation?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

12. **Outside Services** – What is the appropriate amount of expense related to outside services that should be included in the cost of service calculation?

Zero, i.e., exclude the \$4,112,876 because MAWC has not supported the expense.<sup>41</sup>

13. **Postage Expense** – What is the appropriate amount of postage expense to include in the cost of service calculation?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

14. **Tank Painting Expense** –

- a. Tank Painting Expense – What is the appropriate amount for tank painting expense to be included in the cost of service calculation?
- b. Capitalization – Should tank painting expense be capitalized going forward?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

15. **Income Tax Gross Up Factor** – Should the income tax gross-up factor include consideration of uncollectibles and PSC assessment?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

16. **Service Company Costs** –

- a. Sale of New York American – Should service company costs be increased to account for the sale of New York American by American Water Works?

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<sup>41</sup> Rebuttal Testimony of Robert Schallenberg, p. 6.

No. The sale has not closed; therefore, any change in the allocation of affiliate costs from New York American to other utility affiliates, including MAWC, is not known and measurable. Furthermore, MAWC is not obtaining any benefit in services commensurate with increasing the cost of those services by reallocation. Rather than changing the allocation of its costs among the remaining utilities, the costs allocated to New York American should be applied as an offset to American Water Works Company's gain on the sale of New York American.<sup>42</sup>

- b. American Water Works Officer Expense – Should the Commission authorize MAWC to recover officer expense for American Water Works's corporate officers?

No. MAWC has its own officers and there is no showing of MAWC benefiting from American Water's officers.<sup>43</sup>

- c. Credit Line Fee Charge – Should the Commission authorize MAWC to recover credit line fee charges with American Water Service Company as a service expense?

No. MAWC should not be responsible for AWCC Credit Line Fees for AWCC's credit line because MAWC does not have direct access to that line. MAWC should not be responsible for fees AWCC pays to have a credit line available to it that MAWC neither needs nor uses, and MAWC has not shown that it paying its affiliate AWCC's credit line fees is reasonable to MAWC.<sup>44</sup>

#### 17. **Property Tax** –

- a. Property Tax Expense - What is the appropriate level of property tax to be included in rates?
- b. Property Tax Tracker - Should the Commission implement a property tax tracker?

OPC takes no position on these issues, but reserves the right to advocate a position at hearing and briefing.

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<sup>42</sup> *Id.* at 7.

<sup>43</sup> *Id.* at 6.

<sup>44</sup> *Id.* at 8.

18. **Purchased Power** – What is the appropriate allocator for purchased power costs?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

19. **Insurance Other than Group** – What is the appropriate amount of insurance expense to recover in rates?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

20. **Uncollectible Expense** – What is the appropriate amount of uncollectible expense to recover in rates?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

21. **Pension & OPEBs** –

- a. What is the appropriate amount of Pension & OPEB expenses to be included in rates?
- b. What is the appropriate amount to include in OPEBs for retiree reimbursements?

OPC takes no position on these issues, but reserves the right to advocate a position at hearing and briefing.

22. **Lobbying Expense** – What is the appropriate amount of payroll tied to lobbying expense?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

23. **Incentive Compensation (APP & LTPP)** – Should incentive compensation related to earnings per share (EPS) and other financial goals be included in the cost of service calculation?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

24. **Employee Benefits (ESPP)** – What is the appropriate treatment of the ESPP in regard to the cost of service calculation?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

**25. Payroll Expense –**

- a. Employee Positions – Should the Commission include currently vacant and temporary payroll positions when calculating MAWC’s operating expense?

No. As OPC witness Keri Roth states in her rebuttal, “ratepayers should not be responsible for paying rates that include unfilled positions.”<sup>45</sup> This includes the currently un-filled, temporary summer positions that the Company alleges that it intends to fill again. As Ms. Roth points out in her surrebuttal, “there is no guarantee or commitment that the positions will continue from year-to-year, and [the expenses are] therefore not known and measureable.”<sup>46</sup>

- b. Service Company Payroll – What level of payroll for American Water Service Company personnel should the Commission include in rates?

None, because MAWC has not showed why payroll should be allocated amongst the Service Company and MAWC instead of being a direct charge to MAWC for services rendered.<sup>47</sup>

**26. Employee / Management Expense –** What level of employee / management expense should be included in the calculation of cost of service?

The Commission should exclude \$655,546 in management expense.<sup>48</sup> This amount relates to expenses that are not proper to include in rates supported by captive Missouri customers. OPC witness Amanda Conner performed an audit of Evergy’s management and employee expense, and excluded amounts related to domestic and international travel for events that had no measurable benefit for Missouri customers, other state’s rate case expenses, alcohol, and other expenses that

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<sup>45</sup> Rebuttal Testimony of Keri Roth, p. 3.

<sup>46</sup> Surrebuttal Testimony of Keri Roth, p. 2.

<sup>47</sup> Rebuttal Testimony of Robert Schallenberg, p. 6.

<sup>48</sup> Surrebuttal Testimony of Amanda Conner, p. 6.

MAWC has not convincingly showed has a legitimate business purposes for Missouri customers.<sup>49</sup>

Conner came to her ultimate recommended disallowance by employing the Tone at the Top auditing methodology. Accordingly, she applied a percentage of officer disallowance for both MAWC manager expense, and American Water expenses allocated to MAWC.<sup>50</sup>

**27. Credit Card Fee Expense** – Should the Commission include credit card fees in the calculation of cost of service?

The Commission should include credit card fees in MAWC’s cost of service, provided that the Commission concurrently do so with Staff’s recommended performance tracking and communication plans.<sup>51</sup> With Staff’s recommendations, parties should be able to verify whether including credit card fees in rates induces adoption of credit card payment options as purported.

**28. Dues and Donations** – What is the appropriate amount of dues and donations expense to be included in the cost of service calculation?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

**29. Rate Case Expense** –

a. Sharing of Cost – Should rate case expense be shared?

If the Commission authorizes any amount of rate case expense to be collected in rates, it should have MAWC and its ratepayers share the expense equally. Such a 50/50 sharing is consistent with recent Commission practice, and the Missouri’s Supreme Court just upheld the practice this year.<sup>52</sup> The Commission has ordered the sharing of rate case expense in part because of the concerns raised by OPC witness Amanda Conner. Conner notes that, unlike other expenses

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<sup>49</sup> *Id.*; Direct Testimony of Amanda Conner p. 6-8.

<sup>50</sup> Surrebuttal Testimony of Amanda Conner, p. 7.

<sup>51</sup> Rebuttal Testimony of Amanda Conner, p. 3.

<sup>52</sup> Direct Testimony of Amanda Conner p. 3; *Spire Missouri, Inc. v. Pub. Serv. Comm’n*, SC97834 (Feb. 9, 2021).

that ratepayers drive and influence, the Company's decision to file for a rate case is the primary influencer of rate case expense.

She further explains, "There is a direct correlation between the expenses incurred and the benefits realized by shareholders."<sup>53</sup> Therefore, without a sharing of rate case expense, a utility has the incentive to raise as many issues as possible to maximize potential benefits. Sharing rate case expense counters this impulse by incentivizing utilities to only raise issues when they are absolutely necessary and legitimate.<sup>54</sup> For all of these reasons, it is reasonable for MAWC to bear some burden for the rate case expense it incurs for the case it initiated and wanted.

b. Expense - What amount of rate case expense should be borne by the ratepayers?

Notwithstanding the foregoing, the Commission should not include any amount of rate case expense in MAWC's rates because MAWC did not initiate this rate case for the benefit of both itself and its customers.<sup>55</sup> Rather, MAWC initiated this case primarily to retain its infrastructure system replacement surcharge (ISRS). Missouri law requires that a utility with an ISRS have a rate case at least once every three years.<sup>56</sup> It has since been approximately three years since MAWC's last rate case. When Staff initially performed its revenue requirement and class cost of service analysis, it found that MAWC's water and sewer operations actually warranted a rate decrease. It was only after an update and true-up that Staff is recommending any increase, and meanwhile OPC continues to advocate that the Commission should not raise rates during an ongoing COVID-19 pandemic and resulting economic depression. Therefore, based on MAWC's financial state at filing, but for the ISRS, it is doubtful that MAWC would have initiated this rate case.

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<sup>53</sup> Rebuttal Testimony of Amanda Conner, p. 1-2.

<sup>54</sup> *Id.*

<sup>55</sup> Surrebuttal Testimony of Amanda Conner p. 5.

<sup>56</sup> Mo. Rev. Stat. § 393.1003.3 (2003).



- c. Normalization Period – What is the appropriate normalization period for recovering rate case expense?

If the Commission authorizes any amount of rate case expense to be collected in rates, it should normalize that amount over a three-year period.<sup>57</sup> This period is reasonable given that MAWC has recently come in for a rate case every three years to continue utilizing its ISRS, and will likely continue to do so in the future.<sup>58</sup>

30. **PSC Assessment** – What is the proper methodology and amount that should be included for the Missouri Public Service Commission assessment?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

31. **Production Costs**

- a. Purchased Water – What is the appropriate amount of purchased water expense to recover in rates?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

32. **Leases** – What is the appropriate level of expense for leases to include in the cost of service calculation?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

33. **Transportation** – What is the appropriate level of expense to include in the cost of service calculation for transportation related to fuel?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

34. **Waste Disposal** – What is the appropriate amount to include in the cost of service calculation for waste disposal expense?

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<sup>57</sup> Direct Testimony of Amanda Conner, p. 6.

<sup>58</sup> See Mo. Rev. Stat. § 393.1003.3.

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

**35. Valve/Hydrant Maintenance** – How should valve and hydrant maintenance be recorded in the general ledger moving forward?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

**36. AFUDC** –

- a. AFUDC Calculation – What is the proper calculation of the Allowance for Funds Used During Construction (AFUDC) rate?

It should be based on including MAWC’s lowest cost of cash used to fund construction.

AFUDC should give 100% weight to the short-term debt rate for construction work in progress (CWIP) balances that are equal to or less than the amount of short-term debt carried on MAWC’s books. For CWIP balances that exceed the level of short-term debt, the AFUDC rate is based on long-term capital costs with the equity rate based on the most recent allowed ROE. Therefore, if MAWC is not utilizing short-term debt to initially fund its CWIP, this causes a higher rate base to be charged to ratepayers.<sup>59</sup>

- b. Rate Base Adjustment – Should rate base be adjusted to reflect a corrected AFUDC rate?

Yes. MAWC’s rate base should be adjusted for going forward based on revising the AFUDC historically applied to capitalize historical construction costs.<sup>60</sup>

- c. Adjustment to Capital Structure – If short-term debt is not applied to Construction Work In-Progress (CWIP) first, then should short-term debt be included in MAWC’s capital structure?

Yes.<sup>61</sup>

**37. COVID-19 Accounting Authority Order** –

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<sup>59</sup> Rebuttal Testimony of Robert Schallenberg, p. 4.

<sup>60</sup> *Id.* at 4-5.

<sup>61</sup> Surrebuttal Testimony of David Murray, p. 7.

- a. Recovery – How much, if any, of MAWC’s COVID-19 AAO should the Commission approve for recovery in MAWC’s rates?

The Commission should not approve recovery of any portion of MAWC’s COVID-19 AAO. OPC witness Keri Roth explains the purpose of an AAO in her surrebuttal testimony:

AAOs are used only under extraordinary circumstances. As described in the Uniform System of Accounts (“USOA”) for Class A and B Water Utilities 1973 (including 1976 revisions), an extraordinary item is related to the effects of events and transactions which have occurred during the current period and which are not typical or customary business activities of the company.<sup>62</sup>

Roth goes on to acknowledge that, while the COVID-19 pandemic has certainly had an extraordinary effect on millions of individuals and business, “the dollar amounts proposed to be recovered by MAWC are immaterial compared to the Company’s total cost of service.”<sup>63</sup> This immateriality of the actual dollar amounts included in MAWC’s AAO is determinative of the “effect” the pandemic had on the Company under the language of the USOA.<sup>64</sup>

MAWC does not meet the 5% standard for materiality for extraordinary items as defined in the USOA for gas and electric utilities.<sup>65</sup> For example, the Company’s total deferred operating expenses amount to a mere \$537,567, which represents only 0.23% of the \$229,157,246 in overall operating expenses reported in its 2019 annual report.<sup>66</sup> Likewise, MAWC’s deferred term loan interest total of \$611,519 is only 1.66% of the overall interest expense reported in its 2019 annual report totaling \$36,829,485.<sup>67</sup>

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<sup>62</sup> Surrebuttal Testimony of Keri Roth, p. 4.

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

<sup>65</sup> *Id.*

<sup>66</sup> *Id.* at 5.

<sup>67</sup> *Id.* at 6.

Another state commission has addressed the issue of a water utility requesting a COVID-19 AAO and have subsequently denied recovery under the same or similar grounds as now argued by the OPC. As Roth explains in her surrebuttal testimony:

Kentucky-American Water Company (“Kentucky-American”) filed an application with the Kentucky Public Service Commission (“KY PSC”) to establish a regulatory asset for certain expenses related to the COVID-19 emergency. The KY PSC denied Kentucky-American’s request to establish a regulatory asset for various reasons ranging from immaterial dollar amounts, uncollectible amounts written off during the proposed deferral period were from services rendered prior to the COVID-19 state of emergency being declared, and Kentucky-American’s claim of “lost revenues” does not meet the requirements that would allow for GAAP recognition as a regulatory asset. Because the KY PSC denied the regulatory asset, they also denied Kentucky-American’s proposed expense offset Kentucky-American requested to defer “lost revenue” and expenses related to reconnection fees, forgone late payment fees, incremental operating expenses, uncollectible expense, term-loan interest expense, and travel/conference savings. Expenses totaled \$1,055,890 as of September 30, 2020 and \$1,196,603 as of October 30, 2020.<sup>68</sup>

This Commission should adopt the same position as its Kentucky counterpart and deny MAWC recovery of any portions of its COVID-19 AAO.

- b. Interest Expense – Should interest expense be recoverable in rates as part of the COVID-19 AAO agreed to in Case No. WU-2020-0417?

No, the Commission should reject any rate recovery of interest expense related to the COVID-19 AAO. MAWC ostensibly sought a \$500 million term loan at the beginning of the COVID-19 pandemic to maintain liquidity. However, as Murray discovered through discovery, MAWC instead use the loan proceeds to “provide capital to its subsidiaries, including MAWC, for purposes of funding capital expenditures.”<sup>69</sup> MAWC did not actually need the loan for liquidity, and MAWC should not recover ongoing capital expenditures as part of an AAO for extraordinary expenses. Furthermore, the Commission should recognize that MAWC will already recover its

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<sup>68</sup> *Id.* at 5.

<sup>69</sup> Rebuttal Testimony of David Murray, p. 12.

short-term interest expense through its AFUDC rate. Providing MAWC recovery of interest expense in an AAO is double recovery.

- c. Amortization – Over what period should the COVID-19 AAO be amortized?

Because the OPC take the position that the Commission should deny recovery of any portion of MAWC’s COVID-19 AAO, the OPC declines to take a position now over what period the Commission should amortize such an AAO.

**38. System Delivery –**

- a. Water Loss – What is an acceptable level of water loss for the MAWC systems?
- b. Water Loss Applied to Production Costs – What is the appropriate water loss to apply to chemicals, and fuel and power expense?
- c. Main Break Audit – Should MAWC conduct annual audits regarding its water main breaks?
- d. Water Loss Audit – Should MAWC conduct period audits for service areas with greater than 20% lost or unaccounted for water?

OPC takes no position on these issues, but reserves the right to advocate a position at hearing and briefing.

**39. Depreciation** – What are the appropriate depreciation rates and resulting expense that should be applied?

The Commission should order the continued use of the currently existing depreciation rates agreed to and ordered in Case No. WR-2017-0285.<sup>70</sup> In addition, the Commission should not allow the use of “General Plant Amortization” or “Vintage Year Accounting” for general plant accounts.<sup>71</sup> The use of such types of accounting threatens “the ability to perform any sort of prudence review of plant added into these accounts because it fails to track retirement units and original costs.”<sup>72</sup> As OPC witness John Robinett explains:

In addition, General Plant Amortization will only produce historical data for depreciation that matches the amortization period for the selected account. This is

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<sup>70</sup> Rebuttal Testimony of John Robinett, p. 1.

<sup>71</sup> *Id.* at 3.

<sup>72</sup> *Id.*

a problem because the amortization periods may or may not match the useful life of the assets. In other words, the data will only show the retirements booked in strictly dollar amounts and will not show retirement of any actual physical assets unless the Commission orders otherwise. Therefore, any future depreciation study cannot properly analyze the lives of the assets, since they are not being tracked, to develop the appropriate depreciation rate.<sup>73</sup>

For these reasons, the Commission should not permit MAWC to employ General Plant Amortization for general plant accounts.

Should the Commission still decide that General Plant Amortization is appropriate, then the Commission should still order MAWC to continue specifying the original cost and associated retirement units for all additions to the accounts receiving General Plant Amortization accounting treatment, and further place MAWC under a standing order to treat all general plant that exceeds the amortization period as retired for ratemaking purposes.<sup>74</sup>

**40. Affiliate Transactions** – Should MAWC be required to file a Cost Allocation Manual with the Commission?

Yes. It should be guided by existing standards for other regulated utilities and informed by stakeholder input, and to be approved by the Commission within six months of the date it issues its Report and Order for this case.<sup>75</sup>

**41. Low-Income Pilot Program** –

a. Should the Commission maintain the current Low-Income Rate pilot program?

Yes. OPC recommends that the program continue as is and that the Commission order the Company to “meet with Staff and OPC at least once a year and approximately six months before MAWC files its next rate case to discuss the data and whether meaningful changes are warranted to be addressed in the Company’s direct testimony.”<sup>76</sup>

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<sup>73</sup> *Id.* at 4.

<sup>74</sup> *Id.* at 6.

<sup>75</sup> Direct Testimony of Geoff Marke, p. 16-19; Surrebuttal Testimony of Geoff Marke, p. 17-19.

<sup>76</sup> Surrebuttal Testimony of Geoff Marke, p. 15-16.

- b. Should the Commission authorize MAWC to expand its Low-Income Rate pilot program?

No. MAWC's pilot program participation has fluctuated at levels too extreme to draw any meaningful conclusions from. Further data is needed and greater input is necessary from both Staff and OPC before any expansion is considered. Targeted arrearage management programs like Ameren Missouri's Keeping Current program or MAWC's current H20 bill credit programs should be used instead to address low income concerns.<sup>77</sup>

- c. What is the appropriate design of the Low Income Rate?

The Commission should maintain the current low-income rate as is. The Commission should address whether or not the current design (a subsidy of the customer charge component of the bill) is the most appropriate design for a low-income rate in MAWC's next rate case when parties can examine the data against a reasonable and statistically significant sample size.

**42. Inclining Block Pilot Program –**

- a. Should the Commission re-authorize MAWC's inclining block pilot program in its Mexico service area?
- b. What are the appropriate blocks for the inclining block rate pilot program?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

**43. Revenue Stabilization Mechanism (RSM) –**

- a. Should the Commission approve a Revenue Stabilization Mechanism for MAWC? And if so, how should the RSM be structured in terms of revenue requirement, included customer classes, the calculation of refunds, the inclusion of production costs, or other factors?

The Commission should not approve a revenue stabilization mechanism (RSM) and deny MAWC's application thereof. A RSM shifts the century long balance of risks and responsibility between the public and their water utility towards a relationship where MAWC has no risk from

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<sup>77</sup> *Id.* at 16.

reduced sales, while customers maintain their responsibility to support MAWC's revenue requirement regardless of usage.<sup>78</sup> Currently, if earnings increase in between rate cases, then MAWC enjoys the increased profits whether the increase is due to the Company maximizing efficiencies or increased customer usage. Conversely, customers enjoy stable rates, which send stable price signals but could decrease MAWC revenues due to customer actions or other variables. However, decreased revenues does not necessarily result in lower earnings. Earnings can increase if costs are reduced more than the revenue reduction. Absent a RSM, the Company has a constant incentive to maximize savings and customers know what to expect with their bills. As OPC witness Lena Mantle observes, a RSM "distorts the incentives that have worked well for both the utility and customers" in exchange for a relationship whereby MAWC eliminates the risk of reduced revenues with no commensurate benefit for customers. Missouri's customers should still have the same quality of water and service regardless of the RSM, but with the RSM they gain the added burden of frequently changing rates to satisfy MAWC's desire for consistent, guaranteed revenues.

The Commission should also deny the RSM because MAWC does not need it. A RSM is not a right. Mantle observes, that MAWC's financials as of the Staff's direct filing showed that MAWC could still earn a 9.55% return on equity even if the Commission reduced authorized revenues by \$25.8 million.<sup>79</sup> Staff's position at surrebuttal is that the Commission should still decrease MAWC's water rates. American Water's stock price rose 25% in 2020 alone, even as the economy tanked.<sup>80</sup> Although MAWC may cry that it supposedly has failed to collect the entirety of its authorized revenues for every year but one from 2010 to 2019, it is notable that MAWC does

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<sup>78</sup> Rebuttal Testimony of Lena Mantle, p. 13.

<sup>79</sup> *Id.* at 15.

<sup>80</sup> *Id.* at 24.



not allege that it was concurrently failing to make a profit.<sup>81</sup> Rather, MAWC has earned its authorized ROE, and has continued to make earnings beyond what is necessary to maintain safe and adequate service. If MAWC had a RSM since 2010, its overearnings would have been \$52 million greater despite no difference in service from MAWC.<sup>82</sup>

Furthermore, MAWC's proposed RSM is inherently inequitable. It discourages water efficiency because "customers are responsible for any reduction in revenue if their neighbors reduce their usage between rate changes" for the RSM.<sup>83</sup> An individual customer may see reduced bills one year due to efforts they make to change their personal use patterns, only to not have the same pricing signal reward the next year because MAWC did not earn the revenue set in the last rate case, regardless of MAWC's earning status. Similarly, a customer can have no change in usage and still pay more in one year as compared to the next. If later MAWC is over collecting through the RSM, there is a refund but all customers get the same amount credited to them regardless of usage.<sup>84</sup> The entire RSM represents an inequitable situation for all customers and an unjustified boon for MAWC.

However, if the Commission does approve a RSM, it should consider certain design features for the benefit of customers and administrative oversight. The Commission should set revenue requirements amongst each customer class, and separate the RSM charges between classes such that no customer class is responsible for the revenues of another class. The Commission can then shift cost recovery between classes during subsequent rate cases. The Commission should include all customer classes available under Section 386.266, RSMo in the RSM to minimize

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<sup>81</sup> *Id.* at 15-16.

<sup>82</sup> *See* Schedule Direct Testimony of John Watkins, Schedule JMW-1 (comparing sum of actual revenues provided with authorized revenues).

<sup>83</sup> Rebuttal Testimony of Lena Mantle, p. 18.

<sup>84</sup> *Id.* at 18-20.

charges to customers, and the Commission should calculate annual refunds for over collection as a lump sum provided to customers pro rata based on their usage in the accumulation period. The OPC takes no position at this time on whether production costs should be included in the RSM.

- b. If so, is there a change in business risk that may be taken into account in setting MAWC's authorized return on equity?

Yes. As Murray explains, the Commission can make a commensurate adjustment to MAWC's return in exchange for the absence of risk following the grant of a RSM. Should the Commission approve MAWC's RSM, it should either lower the equity ratio in MAWC's capital structure to recognize MAWC's heightened debt capacity, or lower MAWC's allowed ROE by the amount represented by a one-step upgrade to American Water's credit rating.<sup>85</sup> Of the two options, Murray recommends that the Commission utilize the second because of the inability to calculate how much more debt MAWC could leverage with a RSM. Murray looked at a third of the difference between an "A" and "BBB" rated bond, and determined that a commensurate reduction in ROE in exchange for a RSM is 10 basis points.<sup>86</sup>

#### 44. Water Rate Design

- a. Single Tariff Pricing / District Specific Pricing – Should the Commission keep the current water district structure, or adopt single tariff pricing for the water customers?

The Commission should not adopt single tariff pricing for MAWC's water customers. Single tariff pricing stifles the principles of cost causation in rate making, sends inappropriate price signals, and enhances the potential for overinvestment in future capital. To mitigate the foregoing concerns, the Commission should return MAWC to a zonal district pricing scheme similar to what was in place from 2015 to 2017, and should in no case further consolidate St. Louis County with other districts. Any water systems MAWC acquired since MAWC's last water rate case should be

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<sup>85</sup> Rebuttal Testimony of David Murray, p. 42-43.

<sup>86</sup> *Id.*

consolidated into either MAWC’s Joplin or St. Joseph former districts based on their proximity to the district. “Although far from ideal, this allows for a reasonable sharing of costs that reflect operational expenses and much more accurately characterize MAWC’s cost causative capital expenditures.”<sup>87</sup> Districts where MAWC has an ISRS should remain separate from districts that do not.<sup>88</sup>

- b. Industrial Class – Should MAWC create an industrial customer class (Rate L)? Should the Commission eliminate Rate J and begin the migration of customers that do not qualify for a new Rate L to Rate A?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

- c. Class Costs –

- i. What is the appropriate cost of service for each customer class?

OPC witness Dr. Geoff Marke recommends that the Commission should ultimately make no revenue change to MAWC’s rates at this time, and possibly a rate reduction to MAWC’s customers if nothing else.<sup>89</sup> Given the uncertainty surrounding the economy any rate reduction should be applied solely to residential users in Rate A.

- ii. What is the appropriate methodology for conducting the class cost of service study

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

- d. Customer Charge – What is the appropriate customer charge for each customer classification?

OPC supports Staff’s recommended fixed charges.

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<sup>87</sup> Rate Design Direct Testimony of Geoff Marke, p. 1-2.

<sup>88</sup> *Id.*

<sup>89</sup> Revenue Requirement Direct Testimony of Geoff Marke, p. 4-5.

- e. Commodity Charge – What is the appropriate commodity charge for each customer classification?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

- f. Sunnydale Rate Designation – Should Sunnydale be placed on Rate J, or in the alternative, Rate J1?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

**45. Sewer Rate Design**

- a. Sewer Districts – What is the appropriate rate structure for the sewer service districts?

OPC takes no position on this issue, but reserves the right to advocate a position at hearing and briefing.

**Wherefore**, the OPC offers its position statements in response to the pre-filed list of issues.

Respectfully,

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**CERTIFICATE OF SERVICE**

I hereby certify that a true and correct copy of the foregoing was served, either electronically or by hand delivery or by First Class United States Mail, postage prepaid, on this 18<sup>th</sup> Day of February 2021, with notice of the same being sent to all counsel of record.

/s/ Caleb Hall