

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

In the Matter of the Petition of Missouri-American)	
Water Company for Approval to Change an)	<u>File No. WO-2019-0389</u>
Infrastructure System Replacement Surcharge)	Tariff No. YW-2020-0035
(ISRS))	

STAFF RECOMMENDATION

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

1. On August 26, 2019, Missouri-American Water Company (MAWC or Company) filed its *Petition to Change Its 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 systems replacements and relocations made during the period of April 1, 2019, through September 30, 2019.
3. On August 27, 2019, the Commission set a deadline for intervention of September 25, 2019 (the August 27 Order). No parties intervened.
4. The August 27 Order also directed Staff to file a recommendation on MAWC's *Petition*.
5. Commission Rule 20 CSR 4240-3.650(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 \$6,112,222.

WHEREFORE, Staff recommends the Commission issue an Order in this case that (1) rejects MAWC's ISRS tariff sheet (YW-2020-0035) P.S.C MO No. 13 12th Revised Sheet No. RT 10 cancelling 11th Revised Sheet No. RT 10 filed on August 26, 2019; (2) approves Staff's recommended ISRS surcharge revenues in this docket in the incremental pre-tax revenue amount of \$6,112,222, and; (3) directs MAWC to continue in future ISRS filings to provide Staff with actual supporting documentation for previously estimated ISRS investments a minimum of two weeks prior to Staff's recommendation filing date.

Respectfully submitted,

/s/ Alexandra L. Klaus

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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 25th day of October, 2019.

/s/ Alexandra L. Klaus

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. WO-2019-0389, Tariff No. YW-2020-0035
Missouri-American Water Company

FROM: Amanda C. McMellen, Utility Regulatory Auditor V, Auditing Department
Ali Arabian, Utility Regulatory Auditor II, Auditing Department
Angela Niemeier, Utility Regulatory Auditor I, Auditing Department
Matthew J. Barnes, Utility Regulatory Auditor IV, Water and Sewer Department

/s/ Kimberly K. Bolin 10/25/19
Auditing Department / Date

/s/ James A. Busch 10/25/19
Water and Sewer Department / Date

/s/ Alexandra L. Klaus 10/25/19
Staff Counsel's Office / Date

SUBJECT: Staff Report and Recommendation Regarding the Petition of Missouri American Water Company for Approval to Change its Infrastructure System Replacement Surcharge ("ISRS")

DATE: October 25, 2019

BACKGROUND

On August 26, 2019, Missouri-American Water Company ("Company" or "MAWC") filed its *Petition for Approval to Change its Infrastructure System Replacement Surcharge* ("Petition") with the Missouri Public Service Commission ("Commission"). The Company submitted its Petition pursuant to the provisions of Sections 393.1000, 393.1003, 393.1006, RSMo 2016, and Commission rules 4 CSR 240-2.060(1) and 3.650.¹ 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. Instead, these investments in infrastructure are recovered through an Infrastructure System Replacement Surcharge ("ISRS"). Since the Company's most recent general rate case, Case No. WR-2017-0285, MAWC has completed two ISRS cases, Case Nos. WO-2018-0373 and WO-2019-0184.

In the current case, MAWC submitted its Petition to reflect ISRS investment that had been placed into service for the period April 1, 2019, to July 31, 2019, with estimated ISRS costs through September 30, 2019 also included. MAWC estimated in its Petition that it was entitled to an incremental increase of ISRS revenues in this case of \$7,314,179, or an increase of 3.6% based on the base revenue level approved by the Commission in the most recent rate case.

¹ Effective August 28, 2019, the Commission moved from the Department of Economic Development to the Department of Commerce and Insurance, and Commission rules moved from 4 CSR 240 to 20 CSR 4240. Rule references after August 28 have been updated accordingly.

On August 27, 2019, the Commission issued its *Order Directing Notice, Setting Intervention Deadline, Directing Filing, and Suspending Tariff* establishing September 25, 2019, 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 25, 2019.

STAFF INVESTIGATION

Commission rule 20 CSR 4240-3.650(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, Case No. WR-2017-0285.

In its Petition, MAWC filed to recover ISRS qualifying infrastructure replacement costs incurred during the period of April 1, 2019, through July 31, 2019. In its initial filing, MAWC estimated data for August 2019 and September 2019 plant investment for its request. MAWC provided supporting documentation for the investments made in April through July in response to Staff Data Request No. 0002 on September 18, 2019. MAWC subsequently provided Staff with additional documentation to support additions placed into service in August through September 2019, with the final batch of supporting documentation received October 15, 2019.

As part of its examination of MAWC's Petition, Auditing Staff reviewed supporting workpapers, descriptions of ISRS projects, MAWC's accounting entries, and a sample of invoices representing approximately 66.67% of total ISRS investment costs, as well as other applicable documentation, such as work order authorizations. Staff communicated with MAWC personnel to clarify MAWC's Petition when necessary. After reviewing invoices, Staff discovered that MAWC has changed its ISRS project bidding procedures used with third party vendors in that it has switched from a unit pricing bidding process to a lump sum bidding process. Also, a significant amount of the invoices provided were electronically entered into the MAWC system. While the supporting information provided by MAWC during the course of its audit was adequate, Staff intends to discuss with MAWC personnel its data needs for future ISRS audits to ensure Staff continues to receive timely and detailed supporting information concerning requested ISRS costs.

THE PETITION

As stated in its Petition, MAWC:

. . . seeks to change its 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's Petition indicates that its proposed rate schedule (including some estimates) will "produce ISRS revenues of \$7,314,179 or an increase of 3.6% based on the base revenue level approved by the Commission in its most recently completed general rate proceeding" on an annualized basis. MAWC's requested ISRS revenue requirement in this petition decreased by approximately \$531,929 after substituting actual August and September ISRS cost information for the earlier projected cost amounts.

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 MAWC's proposed net operating loss ("NOL") of \$27,890,892 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 April 1, 2019, (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.²

During the course of its review, Staff did not discover any costs that were charged to ISRS eligible projects that did not meet ISRS requirements:

A Reconciliation of MAWC's requested revenue requirement and Staff's recommended revenue requirement is attached as Attachment 1 to this memorandum.

² MAWC and Staff signed a Partial Stipulation and Agreement, and The Office of the Public Counsel ("OPC") has affirmatively indicated it does not oppose the Partial Stipulation and Agreement, relating to this item. More specifically, the Parties have agreed that "ISRS Rates will be set in this case without recognition of the Deferred Tax Asset (NOL) proposed by MAWC" and that certain actions will be taken should the IRS issue a private letter ruling identifying a normalization violation. See WO-2019-0389, EFIS Item No. 4, Partial Stipulation and Agreement (filed October 22, 2019).

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 Attachment 2 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 year's assessments. In addition, MAWC does not have any past due annual reports.

STAFF RECONCILIATION

Commission rule 20 CSR 4240-3.650(16) requires a water utility to reconcile the differences between the revenues resulting from the ISRS and the ISRS revenues that were approved by the Commission at the end of each twelve month period that an ISRS is in effect. At this time, MAWC's ISRS has not been in effect for a twelve month period so a reconciliation of ISRS revenues was not required in this case.

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 \$6,112,222. Staff's calculations reflect the overall 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 approved and ordered by the Commission on May 2, 2018, 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 April 1, 2019, through September 30, 2019. In addition, property taxes on plant placed in service prior to December 31, 2018, will be due within 12 months of this ISRS filing. As such, Staff has included these property taxes in this ISRS revenue requirement.

Staff based its conclusions on an examination of work orders and supporting documentation for the projects included for recovery in 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 conclusion

that the project costs incorporated within this ISRS filing meet 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-2020-0035) filed on August 27, 2019.
2. Approves Staff's recommended ISRS surcharge revenues in this docket in the incremental pre-tax revenue amount of \$6,112,222 with a total current and cumulative ISRS surcharge of \$21,369,026.
3. Directs MAWC to continue in future ISRS filings to provide Staff with actual supporting documentation for previously estimated ISRS investment a minimum of two weeks prior to Staff's recommendation filing date.

MAWC ISRS WO-2019-0389

ISRS Revenue Requirement Calculation with Staff Adjustments

ISRS PLANT ADDITIONS

	MAWC Filed Application	MAWC's Updated Position	Staff's Position	Amount of NOL Removed	Total Staff and MAWC Differences
Plant Additions - Replacements					
Gross Plant Additions	\$ 54,736,333	\$ 54,279,919	\$ 54,279,919	\$ -	\$ -
CIAC	\$ -	\$ (1,019)	\$ (1,019)	\$ -	\$ -
Deferred Taxes	\$ (528,817)	\$ (529,811)	\$ (7,659,138)	\$ (7,129,327)	\$ (7,129,327)
Accumulated Depreciation	\$ (303,712)	\$ (301,535)	\$ (301,535)	\$ -	\$ -
Total Net Main Replacements	\$ 53,903,804	\$ 53,447,554	\$ 46,318,226	\$ (7,129,328)	\$ (7,129,328)
Plant Additions - Relocations					
Gross Plant Additions	\$ 321,643	\$ 169,239	\$ 169,239	\$ -	\$ -
CIAC	\$ (363,715)	\$ (227,477)	\$ (227,477)	\$ -	\$ -
Deferred Taxes	\$ 3,218	\$ 2,347	\$ 33,929	\$ 31,582	\$ 31,582
Accumulated Depreciation	\$ (1,140)	\$ (631)	\$ (631)	\$ -	\$ -
Total Net Relocations	\$ (39,994)	\$ (56,522)	\$ (24,940)	\$ 31,582	\$ 31,582
Accumulated Deprec. and Deferred Tax on Investment in Current ISRS					
Accumulated Deprec. prior to ISRS	\$ (904,111)	\$ (904,111)	\$ (904,111)	\$ -	\$ -
Deferred Taxes prior to ISRS	\$ (7,147)	\$ (7,147)	\$ (7,147)	\$ -	\$ -
Total Accumulated Deprec. and Deferred Tax on Investment in Current ISRS	\$ (911,258)	\$ (911,258)	\$ (911,258)	\$ -	\$ -
TOTAL ISRS NET PLANT ADDITIONS	\$ 52,952,552	\$ 52,479,774	\$ 45,382,028	\$ (7,097,746)	\$ (7,097,746)

CALCULATION OF ISRS REVENUE REQUIREMENT

	MAWC Filed Application	MAWC Updated Position	Staff's Position	Amount of NOL Removed	Total Staff and MAWC Differences
Total ISRS net plant additions	\$ 52,952,552	\$ 52,479,774	\$ 45,382,028	\$ (7,097,746)	\$ (7,097,746)
Overall Pretax Rate of Return	9.44%	9.44%	9.44%	9.44%	9.44%
Revenue Requirement on Capital	\$ 4,998,721	\$ 4,954,091	\$ 4,284,063	\$ (670,027)	\$ (670,027)
Depreciation Expense	\$ 664,837	\$ 631,030	\$ 631,030	\$ -	\$ -
ISRS Undercollection	\$ 1,650,621	\$ 1,197,129	\$ 1,197,129	\$ -	\$ -
Revenue Requirement Before Interest Deductibility	\$ 7,314,179	\$ 6,782,250	\$ 6,112,222	\$ (670,027)	\$ (670,027)

Missouri-American Water Company
Case No. WO-2019-0389
Staff's ISRS Rate Design Calculation
St. Louis District

	ISRS Recovery Revenue Requirement	2019 Bill Analysis Sales (100 Gal) (1)	Rate per 1000 Gal.
Rate A	\$ 6,091,130	32,207,358	\$ 0.18912
Rate B	\$ 5,997	1,609,828	\$ 0.00373
Rate J	\$ 15,095	4,227,969	\$ 0.00357
	\$ 6,112,222	38,045,155	

(1) Per billing determinants in Case WR 2017-0285

	Current Rate	Adjustment to Current Rate (2)	Proposed Rate Use on Tariff
Rate Per 1000 Gal			
Rate A	\$ 0.47220	\$ 0.18912	\$ 0.66132
Rate B	\$ 0.00851	\$ 0.00373	\$ 0.01224
Rate J	\$ 0.00813	\$ 0.00357	\$ 0.01170

(2) Calculated per above

Proposed ISRS Rate Designs Per 100 Gallons			
	Company	Staff	Difference
Rate A	\$ 0.06982	\$ 0.06613	\$ 0.00369
Rate B	\$ 0.00149	\$ 0.00122	\$ 0.00027
Rate J	\$ 0.00143	\$ 0.00117	\$ 0.00026

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI


In the Matter of the Petition of)
Missouri-American Water Company for) Case No. WO-2019-0389
Approval to Change an Infrastructure System)
Replacement Surcharge (ISRS))

AFFIDAVIT OF ALI ARABIAN

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

COMES NOW ALI ARABIAN and on his oath declares that he is of sound mind and lawful age; that he contributed to the foregoing *Staff Recommendation in Memorandum form*; and that the same is true and correct according to his best knowledge and belief.

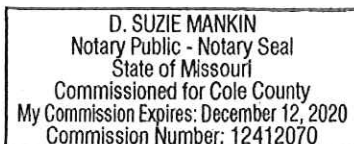
Further the Affiant sayeth not.



ALI ARABIAN

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 25th day of October 2019.





Notary Public

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the Petition of)
Missouri-American Water Company for) Case No. WO-2019-0389
Approval to Change an Infrastructure System)
Replacement Surcharge (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 foregoing *Staff Recommendation in Memorandum form*; and that the same is true and correct according to his best knowledge and belief.

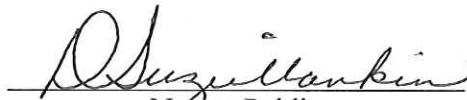
Further the Affiant sayeth not.


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 25th day of October 2019.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 12, 2020
Commission Number: 12412070


Notary Public