

**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-2020-0410</u>
Infrastructure System Replacement Surcharge)	Tariff No. YW-2021-0048
(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 28, 2020, 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 Infrastructure System Replacement Surcharge (“ISRS”) rates and charges for ISRS-eligible infrastructure systems replacements and relocations made during the period of April 1, 2020, through September 30, 2020. As MAWC’s ISRS has been in effect for a twelve month period,¹ MAWC’s request included a reconciliation adjustment in this case in the amount of \$1,023,667, indicating it has experienced an aggregate under-recovery of ISRS revenues since the last reconciliation.

3. On August 31, 2020, the Commission set a deadline for intervention of September 30, 2020 (the August 31st Order). No parties intervened.

4. The August 31st Order also directed Staff to file a recommendation on MAWC’s *Petition*.

¹ Pursuant to Commission Rule 20 CSR 4240-3.650(16), at the end of each twelve (12)-month period that an ISRS is in effect, the eligible water utility shall reconcile the differences between the revenues resulting from the ISRS and the appropriate pretax revenues as found by the Commission for that period.

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 \$3,429,008.² As is further explained in its Memorandum, Staff reviewed MAWC's proposed reconciliation adjustment, and agrees with its quantification.

7. Staff notes that consistent with the Commission's Report and Order in Case No. WO-2015-0211, reconciled amounts are "separate from, not a part of, the eligible costs of which recovery counts toward maximum revenue."³

WHEREFORE, Staff recommends the Commission issue an Order in this case that (1) Rejects MAWC's ISRS tariff sheet (YW-2021-0048) P.S.C. MO No. 13 14th Revised Sheet No. RT Cancelling Revised Sheet No. RT 10, filed on August 28, 2020; (2) approves Staff's recommended ISRS surcharge revenues in this docket in the incremental pre-tax revenue amount of \$3,429,008, with a total current and cumulative ISRS surcharge of \$34,523,721;⁴ (3) orders MAWC submit a reconciliation on a monthly basis, as proposed in its *Petition*; and (4) orders MAWC to file a new tariff sheet designed

² This amount includes an adjustment of \$1,047,302 to ensure MAWC's cost recovery for eligible ISRS projects does not produce revenues in excess of 10% of its base revenue level approved by the Commission in Case No. WR-2017-0285, consistent with Section 393.1003, RSMo, and Commission Rule 20 CSR 4240-3.650(2).

³ Report and Order, *In the Matter of the Petition of Missouri-American Water Company for Approval to Change its Infrastructure System Replacement Surcharge (ISRS)*, Case Number WO-2015-0211 (June 17, 2015), P. 10.

⁴ When separating the aggregate reconciled amounts for this ISRS, Staff's recommended cumulative ISRS surcharge revenues result in MAWC's total ISRS revenues equaling its 10% maximum revenue threshold prescribed by statute and Commission rule.

to discontinue ISRS charges authorized in this case, should it appear that MAWC will reach its ISRS revenue cap.

Respectfully submitted,

/s/ Mark Johnson

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Attorney for the Staff of the
Missouri Public Service Commission

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 27th day of October, 2020.

/s/ Mark Johnson

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. WO-2020-0410, Tariff No. YW-2021-0048
Missouri-American Water Company

FROM: Amanda C. McMellen, Utility Regulatory Supervisor, Auditing Department
Ali Arabian, Utility Regulatory Auditor, Auditing Department
Matthew J. Barnes, Senior Utility Regulatory Auditor, Water and Sewer
Department

/s/ Kimberly K. Bolin 10/27/2020
Auditing Department / Date

/s/ James A. Busch 10/27/2020 /s/ Mark Johnson 10/27/2020
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 Change its Infrastructure System Replacement
Surcharge ("ISRS")

DATE: October 27, 2020

BACKGROUND

On August 28, 2020, 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 20 CSR 4240-2.060(1) and 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. 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 four ISRS cases, Case Nos. WO-2018-0373, WO-2019-0184, WO-2019-0389, and WO-2020-0190.

In the current case, MAWC submitted its Petition to reflect ISRS investment that had been placed into service for the period April 1, 2020, to July 31, 2020, with estimated ISRS costs through September 30, 2020, also included. MAWC estimated in its Petition that it was entitled to an incremental increase of ISRS revenues in this case of \$5,277,622, or an increase of 2.6% based on the base revenue level approved by the Commission in its most recent rate case. On August 31, 2020, the Commission issued its *Order Directing Notice, Setting Intervention Deadline, Directing Filing, and Suspending Tariff* establishing September 30, 2020, 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 27, 2020.

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 being based upon ISRS-eligible plant additions producing a revenue requirement of at least one (1) million dollars. In addition, the cumulative amount of ISRS revenues that will result from this petition does not exceed ten percent of the base revenue levels of \$318,256,160 approved by the Commission in the most recent MAWC general rate case, Case No. WR-2017-0285, as will be discussed in more detail later in the Staff Recommendation.

In its Petition, MAWC filed to recover ISRS qualifying infrastructure replacement costs incurred during the period of April 1, 2020, through July 31, 2020. In its initial filing, MAWC estimated data for August 2020 and September 2020 plant investment for its request. MAWC provided supporting documentation for the investments made in April 2020 through July 2020 in response to Staff Data Request No. 1 on September 24, 2020. MAWC subsequently provided Staff with additional documentation to support additions placed into service in April 2020 through September 2020, with the final batch of supporting documentation received October 14, 2020.

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.

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.

The Company's Petition indicates that its proposed rate schedule (including some estimates) will "produce ISRS revenues of \$5,277,622, or an increase of 2.6% based on the base revenue level approved by the Commission in its most recently completed general rate proceeding" on an annualized basis. The Petition also includes, pursuant to Section 393.1006(2), RSMo, a reconciliation amount to recover the difference between revenues resulting from the ISRS and the appropriate pretax revenues as found by the Commission. To ensure the Company does not collect

more than the 10% base revenue cap during a 12 month period, the Company, in its Petition, states that it will file monthly reports in this case which show the trailing 12 months of ISRS revenues. The Company further provides that these reports will be filed within 30 days of the end of each calendar month after the effective date of new ISRS rates in this case, and will cease to be filed once ISRS rates are reset to zero in the Company's pending rate case. If it appears MAWC may reach the revenue cap, MAWC states that it will file a new tariff sheet designed to discontinue ISRS charges authorized in this case.

STAFF'S REVENUE CALCULATION

After review of its Petition, and the additional documentation supporting additions placed into service in April 2020 through September 2020, Staff agrees with the methodology and amounts utilized by MAWC in the calculation of the ISRS revenue requirement for the purpose of this ISRS filing, with one exception. The one difference being that Staff replaced MAWC's estimate of costs associated with ISRS plant additions for August and September 2020 with the costs associated with the actual cost of additions for those months. With that substitution, Staff's recommended ISRS revenue requirement for MAWC in this petition is \$3,429,008, or an increase of 1.7% based on the base revenue level approved by the Commission in its most recently completed general rate proceeding. The Company's original petition, MAWC estimated it was entitled to an incremental increase of ISRS revenues in this case of \$5,277,622 which included an adjustment of \$2,872,281 to reflect an under collection from previous ISRS surcharges, along with a revenue cap adjustment of -\$282,779. However, after replacing MAWC's ISRS cost estimates for August and September 2020 with actual costs, and review of MAWC's updated workpapers, the adjustment for under collection from ISRS reconciliation was updated to \$1,023,667, causing the Company's proposed ISRS revenue to be updated to \$3,429,008. Further, MAWC's updated workpapers reflect a negative adjustment to its ISRS revenue requirement of \$1,047,302 to ensure that its cumulative annualized ISRS rate recovery will not exceed the statutory ISRS revenue cap of no more than 10% of MAWC's base revenue level approved in its most recent general rate proceeding.

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.

NET OPERATING LOSSES

Net operating losses ("NOLs") occur when a business entity's total available tax deductions for a year exceed the amount of taxable income the business incurs for the same period. The amount of excess tax deductions is termed an "NOL" and, under the current Internal Revenue Service ("IRS") Code ("Code"), that amount may be available to offset taxable income that may be incurred in later years.

Following issuance of the Commission's Report and Order in Case No. WO-2018-0373, MAWC made a request for a Private Letter Ruling ("PLR") with the IRS, generally inquiring whether the Commission's treatment of NOLs in setting MAWC's ISRS rates constituted a violation of the normalization restrictions contained within the Code. The PLR request was filed with the IRS on June 6, 2019.

The PLR was issued by the IRS in early December 2019, and was filed with the Commission on December 9, 2019. Staff through its analysis concludes that within the PLR the IRS determined that the Commission's actions in reflecting a full deduction of applicable accelerated depreciation amounts without offset for an NOL amount in ISRS did constitute a violation of the Code's normalization restrictions. However, the IRS also ruled that the Commission's treatment of reflecting a full deduction of applicable repair allowance amounts did not violate the normalization restrictions within the Code.

Consistent with its understanding of the IRS' rulings in the recent PLR, and with the Commission's Report and Order issued in Case No. WO-2020-0190, due to the continuing existence of an NOL on MAWC's books during this ISRS period Staff has removed any deduction for accelerated depreciation associated with ISRS plant additions from its calculation of MAWC's ISRS revenue requirement.

In the last ISRS case, OPC filed for a rehearing following issuance of the Commission's Report & Order because it believed the Commission erred by ordering the NOL be included in the ISRS rate calculations. The Commission denied the rehearing. OPC then filed an appeal with the Missouri Court of Appeals in regard to that proceeding which has not been decided as of the date of this recommendation.

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 A1 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 been in effect for a twelve month period so a reconciliation of ISRS revenues is required in this case. In the Company's updated workpapers, it calculated a reconciliation adjustment in this case in the amount of \$1,023,667, indicating it has in the aggregate under-recovered ISRS revenues in that amount since the last reconciliation was performed. Staff agrees with this quantification.

Taking into account the current and prior ISRS reconciliation adjustments applicable to MAWC since its last general rate case, the total increase in ISRS rates since that rate case is \$34,523,721. On its face, this amount appears to be greater than 10% of MAWC's base revenues awarded in its last general rate case, and hence exceed the 10% ISRS cap. However, in a previous MAWC ISRS proceeding, Case No. WO-2015-0211, the Commission ruled that cumulative reconciliation amounts should be excluded from ISRS rate cap calculations. The cumulative ISRS reconciliation amount for MAWC since its last rate case is \$2,698,106 (\$477,310 (WO-2018-0373) + \$1,197,129 (WO-2019-0389) + the current reconciliation amount mentioned above: \$1,023,667). When the reconciliation amount is subtracted from the total of other ISRS rate increases awarded to MAWC since its last general rate case, the resulting amount of cumulative ISRS revenues is \$31,825,616, which is equal to MAWC's ISRS 10% rate cap threshold. As previously discussed, MAWC included an adjustment of \$1,047,302 in the calculation in the current ISRS amount to reduce the amount of ISRS recovery that would otherwise be justified to avoid exceeding the 10% rate cap threshold. Staff agrees with this adjustment amount.

Further, as MAWC has met the 10% cap threshold with this ISRS, Staff believes it is appropriate for MAWC to provide a reconciliation on a monthly basis, as proposed by MAWC in its Petition, to ensure that it does not exceed the threshold. Staff also agrees that should it appear MAWC may reach the revenue cap, MAWC should file a new tariff sheet designed to discontinue ISRS charges authorized 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 \$3,429,008. 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, 2020, through September 30, 2020. In addition, property taxes on plant placed in service prior to December 31, 2019, 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-2021-0048) filed on August 28, 2020;
2. Approves Staff's recommended ISRS surcharge revenues in this docket in the incremental pre-tax revenue amount of \$3,429,008 with a total current and cumulative ISRS surcharge of \$34,523,721
3. Orders MAWC submit a reconciliation on a monthly basis, as proposed in its Petition.
4. Orders MAWC to file a new tariff sheet designed to discontinue ISRS charges authorized in this case, should it appear that MAWC will reach its ISRS revenue cap.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Petition of Missouri-)
American Water Company for Approval to) **Case No. WO-2020-0410**
Change an Infrastructure System Replacement) **Tariff No. YW-2021-0048**
Surcharge (ISRS))

**AFFIDAVIT OF AMANDA C. MCMELLEN, ALI ARABIAN AND
MATTHEW J. BARNES**

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

COME NOW Amanda C. McMellen, Ali Arabian and Matthew J. Barnes and on their oath declares that they are of sound mind and lawful age; that they contributed to the foregoing *Staff Recommendation* in memorandum form; and that the same is true and correct according to their best knowledge and belief, under penalty of perjury.

Further the Affiants sayeth not.

/s/ Amanda C. McMellen
Amanda C. McMellen

/s/ Ali Arabian
Ali Arabian

/s/ Matthew J. Barnes
Matthew J. Barnes

Missouri-American Water Company
Case No. WO-2020-0410
Staff's ISRS Rate Design Calculation
St. Louis District

	ISRS Recovery		Rate per 1000 Gal.
	Revenue Requirement	Billing Determinants Sales (000 Gal) (1)	
Rate A	\$ 3,418,781	32,207,358	\$ 0.10615
Rate B	\$ 2,908	1,609,828	\$ 0.00181
Rate J	\$ 7,319	4,227,969	\$ 0.00173
	<u>\$ 3,429,008</u>	<u>38,045,155</u>	

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

Proposed ISRS Rate Design Per 1,000 Gallons			
	<u>Current Rate</u>	<u>Adjustment to Current Rate (2)</u>	<u>Proposed Rate Use on Tariff</u>
Rate Per 1000 Gal			
Rate A	\$ 0.96287	\$ 0.10615	\$ 1.06902
Rate B	\$ 0.01460	\$ 0.00181	\$ 0.01641
Rate J	\$ 0.01400	\$ 0.00173	\$ 0.01573

(2) Calculated per above

Proposed ISRS Rate Design Per 100 Gallons			
	<u>Current Rate</u>	<u>Adjustment to Current Rate</u>	<u>Proposed Rate Use on Tariff</u>
Rate Per 100 Gal			
Rate A	\$ 0.09629	\$ 0.01062	\$ 0.10690
Rate B	\$ 0.00146	\$ 0.00018	\$ 0.00164
Rate J	\$ 0.00140	\$ 0.00017	\$ 0.00157