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December 4, 2003

Mr. Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
P.O. Box 360
Jefferson City, Missouri 65102

RE: *In the Matter of a Proposed Rule to Establish Procedures for Water Utilities to Establish an Infrastructure System Replacement Surcharge*
Case No. WX-2004-0093

Mr. Roberts:

Enclosed are the original and eight (8) copies of the Comments of Missouri-American Water Company for filing in the above-referenced matter. A copy of the foregoing Comments has been hand-delivered or mailed this date to parties of record.

Thank you for your attention to this matter.

Sincerely,

BRYDON, SWEARENGEN & ENGLAND P.C.

By: Dean L. Cooper

DLC/jar
Enclosure(s)
cc: Dana K. Joyce, General Counsel
Office of the Public Counsel

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of a Proposed Rule to Establish Procedures for Water Utilities to Establish an Infrastructure System Replacement Surcharge	)))))	Case No. WX-2004-0093

COMMENTS OF MISSOURI-AMERICAN WATER COMPANY

COMES NOW Missouri-American Water Company ("MAWC"), pursuant to the Notice published in the November 3, 2002, Missouri Register, Vol. 28, No. 21, and respectfully submits the following comments in response to the Missouri Public Service Commission's ("Commission") proposed Infrastructure System Replacement Surcharge Rule:

1. The stated purpose of the Proposed Rule is to implement those provisions of House Bill 208 ("HB 208") that authorize water utilities to institute an infrastructure system replacement surcharge ("ISRS"). *See* Sections 393.1000 to 393.1006 (RSMo. Supp. 2003). At the outset, MAWC questions why any rules are necessary to implement these statutory provisions. Even a cursory comparison would show that the ratemaking procedures and requirements set forth in these provisions are already far more comprehensive, detailed and precise than any to be found elsewhere in either the statutes governing the Commission's powers or, for that matter, the Commission's own rules. In view of these considerations, the addition of an entirely new layer of procedures and requirements is neither necessary nor advisable. Nevertheless, if rules are to be adopted it is essential that they be consistent with both the letter and spirit of the relevant provisions of HB 208.

2. It is well-established and recognized by the Commission that, as an administrative body and a servant of the legislature which created it, the Commission can only administer the law as given to it by the Missouri General Assembly. The Commission cannot legislate. *Atchison, T. & S.F. Ry. Co. v. Public Service Comm'n*, 192 S.W. 460 (Mo. banc 1917); *Inter-City Beverage Co. v. Kansas City Power and Light Co.*, 889 S.W.2d 865 (Mo. App. W.D. 1994). By promulgating the proposed rule, which is the subject of this matter, the Commission has violated this fundamental legal principle because it has gone well beyond the scope of House Bill 208, the legislation that authorizes the involved Infrastructure System Replacement Surcharge ("ISRS").

3. The comprehensive ISRS provisions of HB 208 were developed by the legislature as a way to streamline the regulatory process associated with rate recovery of certain non-revenue producing infrastructure expenditures within St. Louis County, Missouri. In essence, this streamlining occurs by enabling Missouri-American to obtain rate recovery of such expenditures, subject to a number of conditions designed to protect the interests of customers, without the necessity of filing a costly and time-consuming, full-blown general rate proceeding.

4. To ensure that the recovery process for these expenditures does, in fact, remain streamlined, the ISRS provisions of HB 208 define exactly what kind of expenditures may be included in an ISRS, what kind of procedures are to be followed when establishing ISRS rates (including procedures for providing notice of the ISRS filing), and what method is to be used for calculating ISRS rates. Sections 393.1000 to 393.1006. In addition, the ISRS provisions contain very explicit language prohibiting the introduction of extraneous issues. This includes language setting out the specific

factors and information that may be considered by the Commission when establishing ISRS rates, *see* sections 393.1006.2.(2) and 393.1006.4, as well as provisions prohibiting an examination or consideration of any other revenue requirement or ratemaking issues when establishing such rates. Section 393.1006.2(2). It also includes language specifically limiting the Commission's rulemaking authority in this area to only those rules that "are consistent with, and do not delay the implementation of, the provisions of sections 393.1000 to 393.1006.

Notwithstanding these clear directives, by the General Assembly, however, the Proposed Rule nevertheless contains a number of provisions that seek to impose additional procedural requirements, redefine what costs are subject to the ISRS mechanism, or alter the prescribed method for calculating ISRS revenues and rates. These unauthorized, unlawful and unreasonable provisions include the following:

A. Sections (1) through (7), (10), (12) and (15) through (17) of the Rule unnecessarily re-state certain of the ISRS provisions contained in HB 208;

B. Section 393.1006.1(2) of HB 208 specifically provides that upon the filing of an ISRS, "the commission shall publish notice of the filing." Section (8) of the Proposed Rule, however, imposes additional notice requirements that are nowhere to be found in the ISRS provisions of House Bill 208. These include requirements in subsections (A) and (B) of Section (8) that the utility provide both an initial one-time notice and an annual notice to all customers who would be affected by the ISRS; as well a requirement in subsection (C) that the utility include a line-item surcharge on the bills of all affected customers which identifies the amount and existence of the ISRS.

By proposing these new notice requirements, the Proposed Rule seeks to transform the *Commission's* obligation under HB 208 to publish a *single* notice whenever a ISRS is filed into one in which the *utility* would now be required to notify its customers on *multiple* occasions. Moreover, rather than provide such notice through the statutorily-mandated method of "publication," the utility would be required to send individual notices to each affected customer, both on an annual as well as a monthly basis in the form of a separate line item on the customer's bill.

Each of these additional notice requirements conflicts with the specific requirements of HB 208. While separate line-item billing of the ISRS would have been required under an earlier version of the ISRS bill legislation, (See section 393.1003.1 of Senate Bill 125 as Introduced), this provision was removed prior to final passage of House Bill 208. The line-item billing requirement in the Rule is inconsistent with House Bill 208 and, therefore, in violation of section 393.1006.10. It is worth noting that in other states utilizing a mechanism similar to an ISRS; i.e., a Distribution System Improvement Charge ("DSIC"), the charge is set-off as a separate line item and, MAWC contemplated such a billing structure when it originally envisioned the ISRS process. In other words, while MAWC does not believe the Commission has authority to require line item billing of the ISRS surcharge, it is not opposed to establishing such a billing structure. MAWC estimates that the line item billing requirement will cause additional re-programming costs amounting to approximately $10,000. The timing of these re-programming costs may be relevant due to the fact that according to section 393.1006.10, no rules regarding the ISRS provisions may delay the implementation of sections 393.1000 to 393.1006. In addition, the requirement in the Emergency Rule to

provide customers an initial notice, and annual notices thereafter, regarding ISRS filings is not found anywhere in the ISRS provisions of House Bill 208 and this is contrary to the provisions of section 393.1006.10. MAWC estimates that this notice requirement will cause additional costs to be borne by St. Louis County customers amounting to approximately $195,000 per year (assuming two ISRS filings per year and notice to be provided to all of Missouri American's approximately 335,000 St. Louis County customers by way of a separate mailing). However, having noted the foregoing, MAWC recognizes that proper communication from the Company to its customers is important. It was always Missouri American's intent to educate customers on the ISRS and its benefits. The concern is that the suggested notice requirements under the rule are probably not permitted under the statute and are much more cumbersome and expensive than what is necessary. Regardless of what the prevailing legal requirements might be, it is difficult to envision any circumstances where it would be appropriate to subject utilities and their customers to these additional costs and inconveniences. Such an imposition of unnecessary costs is even less defensible, however, when it is being pursued (as this one is) in direct violation of a legislative directive that mandates use of a different and much less expensive form of notice. For all of these reasons, MAWC respectfully request that the Commission modify both Sections (8) and (9) of the Proposed Rule so as to eliminate the unauthorized notice requirements.

C. Section (14) of the proposed Rule provides that an eligible water utility "... may effectuate a change in an ISRS no more often than two (2) times during every twelve (12) month period, with the first such period beginning on the effective date of

the rate schedules that establish an initial ISRS." This is inconsistent with the statutory language, found in section 393.1006.3, which provides that "A water corporation may effectuate a change in its rate pursuant to this section no more often than two times every twelve months," and therefore violates section 393.1006.10. Missouri American's concern is that the language change is unnecessary and may be intimating a limitation as to Missouri American's ability to file an ISRS.

D. Subsection (G) of section (18) of the Proposed Rule seeks to impermissibly change the meaning of "net original cost of eligible infrastructure system replacements" as used in section 393.1000.1(a). It does so by including parenthetical language in subsection (G) which is apparently designed to imply that the "net original cost of infrastructure system replacements" means the "total cost [of such replacements] less the net book value of any related facility retirements."

There is simply nothing in the express language of HB 208, however, to suggest that "the net book value of related facility retirements" may be taken into consideration when calculating ISRS revenues. To the contrary, Section 393.1000(1)(a) could not be more clear or more precise when it says that ISRS revenues should be calculated based on "the net original cost of *eligible infrastructure system replacements,* including recognition of accumulated deferred income taxes and accumulated depreciation associated with *eligible infrastructure system replacements which are included in a currently effective ISRS.*" "Eligible infrastructure system replacements" are, in turn, defined as "utility plant projects" that "***[d]o not*** increase revenues by directly connecting the infrastructure replacement to new customers," Section 393.1000(1)(B) 3, and that

"were ***not included*** in the water corporation's rate base in its most recent general rate case." Section 393.1000(1)(B) 4 (*emphasis supplied*).

Given this clear statutory language, it is completely untenable to suggest, as the Proposed Rule does, that the "net original cost of *eligible* infrastructure replacements" means something other than the original cost (net of depreciation) of the specific infrastructure replacement facilities that are *eligible* for inclusion in an ISRS charge.[1] This is particularly true where the alternative meaning being proposed explicitly requires that the cost of retired facilities be considered, notwithstanding the fact that such facilities:

(a) have ***never been included*** in an ISRS;

(b) will ***never even be eligible*** for such inclusion;

(c) ***have increased revenues*** by directly connecting (at some point in the past) infrastructure replacements to new customers; and

(d) ***were included*** in the water corporation's rate base in its most recent general rate case proceeding.

By sharing all of the above characteristics, retired utility plant is the very antithesis of the kind of facilities that may lawfully be considered when determining

[1]Suggesting that there is some ambiguity about the meaning of the term "net original cost" is akin to suggesting that there is something inherently unclear about the term "return on equity" or "net salvage costs." The fact is that net original cost is a well-understood term that is commonly used in regulatory parlance to mean the original cost or value of a plant item, net of any depreciation that has accrued on that item. In that regard, it is instructive to note that the Proposed Rule evidences no confusion at all as to what the term "net original cost" means when it comes to the cost of retired facilities. For in specifying how the costs of retired facilities are to be accounted for, the Proposed Rule speaks in terms of recognizing the "net book value" of such facilities. Since "net book value" and "net original cost" are interchangeable terms for original cost less depreciation, the Proposed Rule confirms that the "net original cost of eligible infrastructure replacements" as used in section 393.1000(1)(a) means the original cost of such eligible facilities, less any depreciation that has accrued on such facilities at the time they are reflected in an ISRS filing. Indeed, the only error that the Proposed Rule makes is to suggest that language which is expressly applicable only to the net original cost of *eligible* facilities somehow permits a consideration of the net original cost of *ineligible* facilities.

ISRS revenues. In each and every instance, such facilities fail to meet the explicit criteria set forth in HB 208 for ISRS conclusion and no amount of definitional tinkering can alter that basic fact.

Moreover, the Proposed Rule's attempt to consider the costs of retired utility plant also runs afoul of Section 393.1006.4, which specifically addresses and limits the factors that the Commission may consider when determining appropriate ISRS revenues. By expressly providing that the Commission shall only consider "the current depreciation rates applicable to the *eligible infrastructure system replacements,*" subsection (6) of this statutory provision necessarily precludes any consideration of the depreciation rates applicable to retired utility plant. That is the very kind of unauthorized consideration that must be undertaken, however, if the Proposed Rule's approach for determining net original cost is to be used.

In view of these considerations, there is nothing – absolutely nothing – in the ISRS provisions of HB 208 to indicate that the net book value of *non-eligible* infrastructure retirements may be considered when determining what level of ISRS revenues is necessary to permit recovery of *eligible* infrastructure replacement costs. To the contrary, the language of those provisions expressly precludes the consideration of such a factor.[2] As a result, the Proposed Rule's attempt to alter the meaning of net original cost must be rejected for what it is – a transparent effort to interject into the

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[2]Even if the cost of retirements could be legally considered in calculating ISRS revenues, it would not be appropriate to do so under generally accepted accounting principles. As one authoritative text on utility accounting has stated, book depreciation "is provided for the purpose of recovering the original investment in the assets concerned, and not for providing for their replacement." Accounting for Public Utilities, Matthew Bender publisher, copyright 2003, Section 6.03 page 6-5. In proposing that the "net original cost" of replacement facilities be reduced to reflect the undepreciated book value of retired facilities, the Proposed Rule is effectively trapping depreciation dollars for the purpose of replacing facilities, contrary to generally accepted accounting principles.

ISRS process the very kind of extraneous revenue requirement and ratemaking issues that are expressly forbidden by the clear language of HB 208.

E. In addition to the deficiencies described above in Section 18 there are a number of other provisions in the Proposed Rule that either conflict with or exceed the lawful parameters of H.B. 208. For example, Section (11) of the Proposed Rule states that the Staff of the Commission may examine the information provided by the utility to determine whether the underlying costs are in compliance with the provisions of the Proposed Rule as well as the ISRS provisions of H.B. 208. Section 393.1006.2(2) of H.B. 208, however, states that the only information to be examined by the Commission Staff is that necessary to confirm whether the underlying costs are in accordance with the ISRS provisions of H.B. 208. The Commission may not alter this express statutory limitation by rewriting the provision in a way that requires the utility to also demonstrate that its underlying costs are in accordance with whatever additional requirements are in the Proposed Rule. The words "the provisions of this rule and" should accordingly be eliminated from section (11) of the Proposed Rule.

The same deficiency is also found in section (13) of the Proposed Rule that seeks to require that utilities comply with the provisions of the Proposed Rule as well as the ISRS provisions of H.B. 208 in order to obtain Commission approval of an ISRS filing. Unless the Commission has included in its Proposed Rule requirements that are inconsistent with the ISRS provisions of H.B. 208 – a result that in and of itself would violate the express limitation on its rulemaking powers found in section 393.1006.10 – there should be no need to comply with anything more than what is specifically required

by those ISRS provisions. Accordingly, the words "this rule and" should be eliminated from section (13) of the Proposed Rule.

Subsections (I), (M) and (N) of section (18) of the Rule introduce additional items to be reviewed during the ISRS process beyond those provided for in the ISRS provisions of House Bill 208. These provisions of the proposed rule are inconsistent with section 393.1006.2(2) of House Bill 208 and therefore in violation of section 393.1006.10. Additional costs would result from these additional requirements with no apparent commensurate benefit. For example, subsection (I) requires a redundant explanation as to how customers are benefiting from infrastructure replacements. HB 208 already contemplates the permitted infrastructure replacements to be a benefit to the customer or else the dollars associated therewith would not be allowed recovery via the ISRS in the first place. It is clearly not an item of information that H.B. 208 requires the utility to provide to support its ISRS filing. The same is also true of subsection (M)'s requirement concerning the utility's efforts to seek reimbursement of relocation costs and subsection (N)'s requirement that the utility explain how its replacements are being funded. While some of this information might conceivably be of some relevance to a subsequent prudence review that may be conducted in a general rate case, they are not the kind of informational items that a utility is required to provide to support an ISRS filing. These provisions of the Proposed Rule are therefore inconsistent with section 393.1006.2(2) of House Bill 208 and in violation of section 393.1006.10 and should accordingly be eliminated.

5. In light of these problems with the proposed ISRS Rule, the Commission should withdraw the rule and, if it still believes a rule is necessary, promulgate a rule that is consistent with the terms of House Bill 208.

WHEREFORE, MAWC respectfully requests the Commission withdraw its proposed ISRS rule.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the above and foregoing document was sent by U.S. Mail, postage prepaid, or hand-delivered, on this 4th day of December, 2003, to the Commission's General Counsel and the Office of the Public Counsel.