.

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-2024-0320
General Rate Increase for Water and Sewer	)	Case No. SR-2024-0321
Service Provided in Missouri Service Areas.	)	

MOTION TO ESTABLISH FUTURE TEST YEAR

Comes now Missouri-American Water Company (MAWC or Company), and, as its *Motion to Establish Future Test Year*, states as follows to the Missouri Public Service Commission (Commission):

SUMMARY

The process of setting rates for utilities necessarily concerns establishing rates for a future period. When setting new general rates, which will be prospective, the Commission is required to consider "all relevant factors."[1] The Commission has been said to "set rates in a forward looking process using a test year to evaluate the amount of revenue the utility needs to earn to recover its costs and to have a reasonable opportunity to earn a profit."[2] Moreover:

> . . . [r]ate making is designed to be forward looking. The goal is to choose a representative test year to estimate what costs will be when rates are in effect, not to make adjustments for past earning levels.[3]

The Commission cannot perform this function while ignoring those factors that will be in place during the period when the subject rates will be charged.

---

[1] Section 393.270(4), RSMo.; *State of Mo. ex rel. Pub. Counsel v. PSC of Mo.*, 397 S.W.3d 441, 448 (Mo. Ct. App. 2012) ("In reliance upon §393.270.4, Missouri courts have traditionally held that the Commission's 'determination of the proper rate for [utilities] is to be based on all relevant factors rather than on consideration of just a single factor.' Midwest Gas Users', 976 S.W.2d at 479.").

[2] *In the Matter of Union Electric Company*, 2015 Mo. PSC LEXIS 380, 47 (April 29, 2015). *See Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) and *Bluefield Water Works & Improv. Co. v. PSC of W. Va.*, 262 U.S. 679, 692-93 (1923).

[3] *Noranda Aluminum, Inc., et al. v. Union Electric Company, d/b/a Ameren Missouri*, 2014 Mo.PSC LEXIS 882, 29 (October 1, 2014), citing *State ex rel. Southwestern Bell Tele. Co. v. Pub. Serv. Comm'n*, 645 S.W.2d 44, 48 (Mo. App. W.D. 1982); *In the Matter of Union Electric Company*, 2015 Mo. PSC LEXIS 380, 43 (April 29, 2015).

The Commission has utilized a historical test year as the basis for this forward-looking assessment. However, this approach is not required, and there is no reason to continue to do so where a more appropriate approach – use of the future test year – is available and will more directly focus on this "forward looking process." As explained herein, a future test year is necessary to consider "all relevant factors," to reasonably estimate "what costs will be when rates are in effect," and to compensate MAWC for its investment in, and its operation and maintenance expense associated with, utility plant that will be providing service to its customers.

MAWC's rate base and overall expenses are increasing while residential usage per customer is declining as time moves forward. Therefore, the relationship between revenues, expenses and rate base that may exist in a historical test year, or even during a true-up period, will not exist in the first year rates will be in effect. This situation is most appropriately mitigated by the use of a future test year.

COMMISSION AUTHORITY

1. The Commission's authority as to rate making is described in Section 393.270.4, RSMo. The Commission is permitted to ". . . consider all facts which in its judgment have any bearing upon a proper determination of the question. . . ." Further, while Section 393.270.4, RSMo further requires that rates also consider "a reasonable average return upon capital actually expended" (emphasis added), there is no requirement that this capital be expended by a certain date. Certainly, the statute does not require that capital be expended five months prior to the date rates will be effective, such as would be common in a Missouri rate case utilizing a true-up period. Consistent with Section 393.270.4, RSMo, MAWC's future test year proposal is designed to base rates on capital that will be "actually expended" through the first year in which new rates set in this case will be in effect.

2. The Missouri Court of Appeals previously affirmed the Commission's authority to use forecasts to address the effects of inflation on rates based on historical information:

> There can be no argument but that the Company and its stockholders have a constitutional right to a fair and reasonable return upon their investment. That right carries as a corollary the duty by the Commission to consider all relevant factors including the effects of inflation. (Citations omitted)… <u>It is no answer to the foregoing duty to say that a forecast as to future inflation is merely speculative</u>. Despite that hazard, the Commission must make an intelligent forecast with respect to the future period for which it is setting the rate; rate making is by necessity a predictive science.[4]

3. Similarly, the Missouri Court of Appeals has further stated:

> In determining rates, the PSC may consider all facts that in its judgment have a bearing on the proper determination of rates. *See* Section 393.270.4; *State ex rel. Pub. Counsel*, 397 S.W.3d at 447-48. <u>Relevant facts, of course, include forecasts of future costs</u>.[5]

4. A decision on the appropriate test period and adjustments to be used when establishing rates is a factual determination.[6] The Commission's ability to adopt various methods of mitigating regulatory lag is something the Commission has previously acknowledged is within its charge.[7] A failure to examine forecasts of future costs would represent a failure to consider "all relevant factors" in setting rates as the Commission is charged to do under Section 393.270.4, RSMo.[8]

---

[4] *State ex rel Missouri Public Service Co. v Fraas*, 627 S.W.2nd 882, 86 (Mo.App.W.D. 1981) (emphasis added).
[5] *Kansas City Power & Light Company's Request v. Missouri Public Service Commission*, 509 S.W.3d 757, 771–72 (Mo.App. W.D. 2016), reh'g and/or transfer denied (Nov. 1, 2016), transfer denied (Feb. 28, 2017) (emphasis added).
[6] *State ex. rel. GTE North, Ins. v. Missouri Public Service Commission*, 835 S.W.2d, 356 (Mo.App.W.D., 1992).
[7] *See In the Matter of Laclede Gas Company's Tariff to Revise Natural Gas Rate Schedules,* 2002 Mo. PSC LEXIS 418, *4-6 (GR-2002-356) (Mo. P.S.C. March 19, 2002) ("Both the 'test year as updated' and the true-up are devices employed to reduce regulatory lag, which is 'the lapse of time between a change in revenue requirement and the reflection of that change in rates.'").
[8] *State of Mo. ex rel. Pub. Counsel v. PSC of Mo.*, 397 S.W.3d 441, 448 (Mo. Ct. App. 2012) ("In reliance upon §393.270.4, Missouri courts have traditionally held that the Commission's 'determination of the proper rate for [utilities] is to be based on all relevant factors rather than on consideration of just a single factor.' Midwest Gas Users', 976 S.W.2d at 479.").

TRADITIONAL APPROACH

5. It is common for the Commission to order an update to the original historic test year that will include known and measurable changes through a date after the filing of the rate case (an update period) but well before rates go into effect. Further, the Commission has established a true-up period in previous MAWC rate cases. The true-up period has generally been described as follows:

> The use of a True-Up audit and hearing in ratemaking is a compromise between the use of a historical test year and the use of a projected or future test year. It involves adjustment of the historical test year figures for known and measurable subsequent or future changes. However, while the "test year as updated" involves all accounts, the True-Up is generally limited to only those accounts necessarily affected by some significant known and measurable change, such as a new labor contract, a new tax rate, or the completion of a new capital asset. Both the "test year as updated" and the True-Up are devices employed to reduce regulatory lag, which is "the lapse of time between a change in revenue requirement and the reflection of that change in rates."[9]

6. Typically, the end of a true-up period would be approximately five months before the date new rates would be required to go into effect (the “operation of law date”). For example, in this case filed on July 1, 2024, the true-up period would end on or about December 31, 2024 – approximately five months prior to the May operation of law date.

NEED FOR FUTURE TEST YEAR

7. The first year new rates will be in effect as a result of this case is likely to be approximately the 12 months beginning about June 1, 2025, and ending about May 31, 2026. Allowing for a typical True-Up period that extends to December 31, 2024, is still months away from the first year new rates will be in effect. For new rates developed using an historical test year to be reasonable, the Commission must assume that costs, investment, and revenues will differ

[9] *In the Matter of Lake Region Water & Sewer Company*, Report and Order, 2010 Mo. PSC LEXIS 794, Case No. SR-2010-0110 (August 18, 2010).

from their historical test year levels in the same proportion through the year that new rates will be in effect.

8. Almost certainly, business conditions will differ between the historical test year and the rate year, causing both costs and revenues to diverge from the historical test year levels in differing proportions. This is consistent with the Company's experience as MAWC's costs and revenue have diverged in unequal proportion in the past. Further, use of the historical test year does not capture extensive levels of investment serving customers during the rate year.

9. There are two primary reasons for the divergence in expenses, investments, and revenues. First, rate base will not stay the same as it was in the historical test year, even if adjusted in a narrow true-up period. MAWC's planned, significant capital investment is one of the issues driving the need for rate relief in this proceeding. The Company anticipates placing in service approximately $163 million of investments in water and sewer facilities between January 2025 and May 2025 (the period between the likely true-up and the effective date of new rates). Of those investments, $65 million are not eligible for the Water and Sewer Infrastructure Rate Adjustment (WSIRA) and, if not included in this case, MAWC would receive no return on or off associated with these investment until its next general rate case.[10] The $98 million of investments that are eligible for WSIRA would not be reflected in a new WSIRA rate until several months after the expected effective date of rates in this case. The Company also plans to place an additional $409 million in capital investments in service during the future test year, including approximately $220 million of WSIRA eligible investments. Many of these WSIRA investments would not be reflected in a WSIRA rate until well after the end of the proposed future test year in this case. To not reflect plant that is in service during the relevant test year would result in rates that do not

[10] LaGrand Dir., p. 38.

reflect plant additions that will be used and useful and serving the customers during the relevant rate year.

10. Second, MAWC's usage is declining due to ongoing national and state conservation mandates and programs and shows no sign of abating anytime soon. Therefore, even if rate base and expenses in the rate year were the same as they were in the historical test year, revenue will not be the same but, instead will likely decline from historical test year levels.

11. Over approximately the last decade the Commission has held that a reasonable return on equity for the Company is between 9.50% and 10.00%. The Company has averaged an actual return on equity of 8.31% between 2014 and 2023 and fallen short of the reasonable return in every year. The last time the Company earned a return over 9.50% was in 2012, when there was a record drought in Missouri and across the country.[11] In the past, the Commission's test-year approach in rate cases has not been sufficient in evaluating "the amount of revenue the utility needs to earn to recover its costs and to have a reasonable opportunity to earn a profit."

FUTURE TEST YEAR

12. MAWC has used the following information to develop the future test year:

- Historical Test Year – 12 months ended December 31, 2023;
- True-Up Test Year – 12 months ended December 31, 2024; and,
- Future Test Year – 12 months ended May 31, 2026.

13. The future test year includes a forecast of revenue and expenses. Expenses are generally adjusted using known and measurable changes, adjustments based on Company experience, adjustments based on an inflation factor specifically targeted to a particular expense,

[11] LaGrand Dir., p. 21.

or adjustments based on reasonably projected changes.[12]

14. The Company's future test year also employs a 13-month average of planned changes to rate base. The forecast is composed of both specific projects that are scheduled to be in service during the future test year and projected levels of other activity such as main, services, and meter replacements, and similar project groupings. The use of this convention means that, if plant was added in equal increments in every month, only approximately one-half of the ending plant balance would be in rate base.[13]

15. To assess the accuracy of projections, the Company is proposing to include two reconciliations. First, thirty days after the end of the future test year there would be a reconciliation to compare the total rate base, annualized depreciation expense, income tax expense, payroll expense, employee benefits (other than pension and other post-retirement benefits expense if those costs are addressed with a tracker), and rate case expense to the amounts used to establish rates at the beginning of the future test year. If those amounts are less than what was used to establish rates at the beginning of the future test year the revenue requirement value of the differences would be placed into a regulatory liability to be returned to customers in the Company's next rate case.[14] The second reconciliation would include a compliance tariff filing to adjust base rates on a going-forward basis to reflect the same rate base and expense items described in the first reconciliation..

USED AND USEFUL AND KNOWN AND MEASURABLE

16. The future test year proposal satisfies both the commonly discussed "used and useful" and "known and measurable" theories. An October 2013 Report from National Regulatory Research Institute (NRRI) found that "[m]ost [future test year] states subject to a 'used and useful'

[12] Cifuentes Dir., p. 4-5.
[13] LaGrand, p. 8.
[14] LaGrand Dir., p. 9.

standard include major capital projects as part of the revenue requirement, as long as (a) the commission found the costs prudent and (b) a project is scheduled for in-service during the test year."[15] Such charges represent "capital actually expended" and are "used and useful" in the utility business. Further, the Commission need not merely trust the Company's statements that capital will be invested. Investment is something that can be reviewed, compared, and adjusted in the future, if investment does not meet levels used to establish rates.

17. The future test year further uses known and measurable amounts to determine the revenue requirement. The courts have stated that "the Commission must make an intelligent forecast with respect to the future period for which it is setting the rate; rate making is by necessity a predictive science." *State ex rel. Missouri Public Service Commission v. Fraas*, 627 S.W.2d 882, 886 (Mo.App. W.D. 1981). The Commission cannot ignore this direction by strict adherence to historical data , which ignores the revenues, expenses, and investment that will be experienced by the Company during the time rates will be in effect. The Company's process for determining the expense amounts to be included in rates includes known expenses at rates determined by a reasonable process, thus making them known and measurable.

DISCRETE ADJUSTMENTS

18. If the Commission should decide to not utilize a future test year, MAWC asks that the Commission permit the parties to present adjustments beyond the true-up period based upon projected or forecasted data ("discrete adjustments").

19. As stated above, the Company anticipates placing approximately $163 million of investments in water and sewer facilities between January 2025 and May 2025, that do not qualify

[15] *Future Test Years: Evidence from State Utility Commissions*, p. 12, NRRI Report No. 13-10, October 2013 (Microsoft Word - 20131016 FTY Survey Costello lgg 102513.doc (naruc.org)).

for the Water and Sewer Infrastructure Rate Adjustment (WSIRA).[16] Additionally, the decline in residential usage per customer will also negatively impact MAWC's opportunity to recover a reasonable return on the assets it has devoted to the public service.

20. In MAWC's last three general rate cases (Cases Nos. WR-2017-0285, WR-2020-0344, and WR-2022-0303), the Commission has permitted the parties to present adjustments beyond the true-up period based upon projected or forecasted data. *See In the Matter of Missouri-American Water Company's Request for Authority to Implement General Rate Increase*, Order Regarding Test Year, File No. WR-2017-0285 (August 9, 2017), *In the Matter of Missouri-American Water Company's Request for Authority to Implement General Rate Increase*, Order Setting Test Year and Adopting Procedural Schedule, File No. WR-2020-0344 (August 26, 2020), and *In the Matter of Missouri-American Water Company's Request for Authority to Implement General Rate Increase*, Order Setting Procedural Schedule, File No. WR-2022-0303 (August 17, 2022).

21. Consistent with that approach, MAWC is seeking, as an alternative, inclusion in its revenue requirement and rates discrete adjustments to certain rate base and expense items beyond the requested true-up date, through the operation of law date in this case. The proposed adjustments to rate base, cost of capital and expenses are described in the Direct Testimony of MAWC witness LaGrand.

22. In the absence of a future test year, the discrete adjustments will help present a more complete picture of the Company's operations as of the operation law date associated with this rate case.

[16] LaGrand Dir., p. 38.

CONCLUSION

23. The use of a future test year properly addresses the matching principle. In this rising cost and declining use environment, new rates based on an historical test year, even if selective items are adjusted in a true up, will neither be fully reflective of the rate year relationships nor provide the Company with a realistic opportunity to earn its authorized rate of return even in the year they are implemented. At the same time, any cost and revenue changes that mitigate or reduce the cost of service should also be reflected. Because the future test year best balances all rate elements, it best reflects the matching principle and should be adopted by the Commission in this case.

24. History shows that if the Company's request for a future test year is denied and the forecast revenues, expenses and investments are not taken into account in the setting of MAWC's rates, the Company will be denied a reasonable opportunity to earn the authorized rate of return, which the Commission determines is appropriate in this proceeding. Therefore, the Company respectfully requests that the Commission act expeditiously on this motion and grant the Company's request to adopt a future test year.

WHEREFORE, MAWC respectfully requests that the Commission issue its order

[*continued on following page*]

adopting a test year for use in this case of the twelve months ended May 31, 2026.

Respectfully submitted,

____
Dean L. Cooper, MBE #36592
BRYDON, SWEARENGEN & ENGLAND P.C.
312 E. Capitol Avenue
P.O. Box 456
Jefferson City, MO 65012
(573) 635-7166 telephone
dcooper@brydonlaw.com

Timothy W. Luft, Mo Bar #40506
Rachel L. Niemeier, Mo. Bar #56073
Corporate Counsel
MISSOURI-AMERICAN WATER COMPANY
727 Craig Road
St. Louis, MO 63141
(314) 996-2279 (Tim)
(314) 996-2390 (Rachel)
(314) 997-2451 (telefax)
Timothy. Luft@amwater.com
Rachel.Niemeier@amwater.com

ATTORNEYS FOR MISSOURI-AMERICAN WATER COMPANY

CERTIFICATE OF SERVICE

The undersigned certifies that a true and correct copy of the foregoing document was sent by electronic mail, on July 1, 2024, to the following:

Office of the General Counsel
staffcounselservice@psc.mo.gov

Office of the Public Counsel
opcservice@opc.mo.gov

____