

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

In the Matter of Missouri-American Water Company’s)
Request for Authority to Implement a General Rate) Case No. WR-2017-0285
Increase for Water and Sewer Service Provided in)
Missouri Service Areas.)

**RESPONSE OF MISSOURI-AMERICAN WATER COMPANY TO THE
HOMEBUILDERS OF ST. LOUIS AND EASTERN MISSOURI’S
APPLICATION FOR REHEARING**

COMES NOW Missouri-American Water Company (“MAWC” or the “Company”), and for its Response to the Application for Rehearing filed by the Homebuilders of St. Louis and Eastern Missouri (“HBA”) states to the Missouri Public Service Commission (“Commission”) as follows:

1. The gist of the HBA’s Application for Rehearing is that the Tax Cut and Jobs Act P.L. 119-97 (TCJA) will have an impact upon MAWC’s cost of service and resulting revenue requirement and that this impact has not adequately been taken into consideration by the Commission in establishing just and reasonable rates for MAWC in its May 2, 2018, *Report and Order* issued in the above-referenced matter. The HBA’s Application for Rehearing must fail for several reasons.

2. First, it should be noted that the HBA was not a party to the instant rate case, despite the case being on file with the Commission since June 30, 2017, and subject to widespread publicity appearing in media of general publication regarding the filing of the case, including the potential impact the TCJA would have upon MAWC’s revenue requirement. Nevertheless, the Commission Staff, the Office of Public Counsel, and no less than 16 intervenors participated in this case and, after extensive discovery and the filing of prepared direct, rebuttal and surrebuttal testimony, entered into a Stipulation and Agreement, which, among other things, established an appropriate revenue requirement for MAWC.¹ That Stipulation also addressed certain known and measureable impacts of the TCJA (such

¹ Stipulation and Agreement, filed March 1, 2018, Case No. WR-2017-0285.

as the reduction in the corporate income tax rate from 35% to 21%) and created a separate tracker mechanism to “capture all other direct income tax financial impacts” that will occur as a result of the TCJA, but will not be not known and measurable until well after conclusion of this case.² Significantly, the tax impacts on Contributions In Aid of Construction (CIAC) occurring as a result of the TCJA did not become effective until January 1, 2018. The Commission determined that the revenues, expenses and investments of the Company to be used in determining its revenue requirement case were to be based on a test year ending December 31, 2016, updated for known and measureable items as of June 30, 2017, and a true-up ending December 31, 2017.³ Thus, the tax impacts of the TCJA on Contributions In Aid of Construction are outside the historic and updated test period used by the Commission in establishing just and reasonable rates in this case.

3. The HBA is correct in stating that the TCJA, among other things, eliminates the tax exemption for CIAC and that CIAC will no longer be treated as a contribution to capital, but will be treated as ordinary, taxable income. The change from a contribution to capital to taxable income will increase MAWC’s income tax expense and its revenue requirement, all other things being equal. However, the TCJA also allows water companies to take depreciation expense on (and an income tax deduction for) plant constructed with CIAC. This would have the opposite effect on the Company’s revenue requirement by increasing its tax deduction for depreciation expense and reducing its tax expense.⁴ These impacts on MAWC’s revenue requirement, however, are not known and measurable, and will not be known and measureable for some time. For example, facilities funded by CIAC could

² Id. at ¶ 10.

³ Order Regarding Test Year, issued August 9, 2017, Case No. WR-2017-0285.

⁴ The HBA is incorrect in stating that the TCJA’s limitation on interest expense of 30% of adjustable, taxable income will also impact MAWC, because MAWC is exempt from this 30% limitation on interest deductibility (IRS Code 163(j); <https://www.law.cornell.edu/uscode/text/26/163>).

have a useful life of forty (40) to fifty (50) years and the depreciation expense associated with those facilities will impact MAWC's tax expense for each of those years.

4. The fact of the matter is that the tax impacts of the TCJA on MAWC's cost of service, as it relates to CIAC, are outside the historic test period in the current case, are not known and measureable and, therefore, are appropriately excluded from consideration in establishing just and reasonable rates in the context of this case.

5. Second, the HBA alleges that "MAWC has recently begun requiring HBA's homebuilder members make an advance payment to MAWC of the entire Federal and Missouri tax purportedly owed by MAWC relating to CIAC." This is misleading because MAWC's tariffs have always required it to collect the "tax impact" associated with CIAC. Since there was no tax impact associated with CIAC prior to passage of the TCJA, there was no reason to collect any taxes on CIAC. MAWC's tariff specifically provides:

Taxable Advances or Contributions in Aid of Construction

Effective June 12, 1996, the Company shall not accept into its system any taxable Advances or Contributions in Aid of Construction, whether in cash or property (except amounts paid for remote meter reading service), unless accompanied by an amount equal to the Tax Impact of such acceptance
...⁵

A version of this tariff provision has been in MAWC's tariffs (or its predecessor's, i.e., St. Louis County Water Company, tariffs) since at least 1986, and has not been materially revised or changed. This tariff provision clearly requires applicants seeking to extend the Company's facilities, such as HBA's members, to contribute the necessary funds (either cash or property) to cover the cost of extending the water facilities, including any associated tax expense. Since some of the tax impacts of CIAC are not immediately known, the Applicant for extensions of service is required to pay an estimate of the cost of

⁵ MAWC Tariff PSC MO No. 13, Sheet R 65, attached hereto as Attachment A.

the extension plus the related tax expense. The estimated tax expense includes any offsetting reductions in future years' tax liability, such as the additional, deductible depreciation expense attributable to plant funded by CIAC. If the actual cost of the extension, plus the tax impact, is less than the estimated amount, MAWC will refund to the Applicant the difference. For example, Tariff Rule 23 "Extension of Company Mains" provides, among other things:

The Applicant shall pay to Company such estimated costs prior to the Company scheduling the work. If after completion of the main extension, the initial payment provided to the Company is above the Applicant's percent of the total cost of the project, as determined by the Company, the Company will refund the excess to the Applicant. If the initial payment provided by the Applicant to the Company is below the Applicant's percent of the total actual cost of the project, the Company will bill the shortfall to the Applicant.⁶

Thus, Applicants are required to pay only the actual cost of the main extension, plus tax expense attributable to the CIAC, no more and no less.

6. The HBA also argues that "requiring HBAs homebuilder members to pay taxes based on the estimated cost of inspection fees for projects is outside of the existing MAWC tariff." Again, the HBA is wrong. MAWC's existing tariff specifically includes "inspection fees" as one of the costs to be included in CIAC. Rule 23, A.5 of "Extension of Company Mains" provides as follows:

The Applicant/Company funding ratio of 95/5 for St. Louis Metro District and 86:14 for all other districts, will only apply to the cost for main extensions and may include, but is not limited to, all material and labor costs of piping, public fire hydrants (as applicable), valves, fittings, casing pipe, inspection fees, testing (including but not limited to: bacteriological, chlorination, de-chlorination, pressure and flushing), water used for flushing purposes, and all overheads charged to all materials, labor, services, etc. provided by the Company. (emphasis added)

Similarly, Rule 23, B.3 describes the costs to be included in the Company's proposal of estimated costs to be included in the main extension:

⁶ Tariff Rule 23.B.4 (a copy of Company's Rule 23, i.e., Tariff PSC MO No. 13, Sheets R 48-55, is attached hereto as Attachment B).

The proposal will include the costs related to the facilities specified in the provision A.1. plus the Company's anticipated costs of materials, labor, labor related expenses (such as pension and welfare costs), supervision, engineering, inspection fees, insurance, tools, easements, permits, appropriate taxes, and other miscellaneous expenses (such as stores expenses, administrative salaries, overhead expenses, transportation expenses, water used for flushing purposes and construction equipment expenses and similar expenses). The Company may at its discretion charge up to five percent (5%) for contingencies. The cost contained in the proposal is based on the Company's estimate of the actual cost of the job. (emphasis added)

Clearly, inspection fees are to be included in the total cost to be recovered through a CIAC.

7. It should also be noted that Company and Staff have recently engaged in discussions regarding this Tariff Sheet R 65 in light of the TCJA and have determined that, while the purpose of the tariff is appropriate and reasonable, the actual formula contained therein may need to be revised to ensure that applicants for extension of service pay only the "net" increased tax expense associated with CIAC. Consequently, the Company anticipates making a revised tariff filing with the Commission within the next thirty (30) days that will revise the formula contained in Rate Sheet R 65 and will serve a copy on the HBA. Company believes this is the proper proceeding for the HBA to raise any concerns it has regarding the Company's tariff provision as it pertains to the tax impact in CIAC.

WHEREFORE, in light of the foregoing, MAWC requests the Commission deny HBA's Application for Rehearing, and for such other relief as is appropriate in the circumstances.

/s/ William R. England, III
William R. England, III #23975
Dean L. Cooper #36592
Diana C. Carter #50527
BRYDON, SWEARENGEN & ENGLAND P.C.
P.O. Box 456
Jefferson City, MO 65012
(573) 635-7166 telephone
trip@brydonlaw.com

Timothy W. Luft, Mo Bar 40506
MISSOURI-AMERICAN WATER COMPANY
727 Craig Road
St. Louis, MO 63141
(314) 996-2279
Timothy. Luft@amwater.com

CERTIFICATE OF SERVICE

I hereby certify that the foregoing document was filed in EFIS on this 1st day of June, 2018, with notification of the same sent to all counsel of record.

/s/ William R. England, III