

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. WO-2012-0401 - - Missouri-American Water Company

FROM: /s/ James Russo 08/24/2012
Water and Sewer Unit Date

/s/ Leslie Rose 08/24/2012
Auditing Unit Date

/s/ Rachel Lewis 08/24/2012
Staff Counsel's Office Date

SUBJECT: Staff Report and Recommendation Regarding the Petition of Missouri-American Water Company to Change its Infrastructure System Replacement Surcharge

DATE: August 24, 2012

BACKGROUND

On June 27, 2012, Missouri-American Water Company ("Company" or "MAWC") filed its **Petition to Change its Infrastructure System Replacement Surcharge** ("Petition") with the Missouri Public Service Commission ("Commission"). The Company submitted its Petition pursuant to the provision of Sections 393.1000, 393.1003, 393.1006, RSMo, and Commission Rules 4 CSR 240-2.060(1) and 4 CSR 240-3.650. Sections 393.1000, 393.1003 and 393.1006, in conjunction with Commission Rule 4 CSR 240-3.650, provide eligible water corporations with the ability to recover certain infrastructure system replacement costs without the need to file a formal rate case. Such costs are recovered through an Infrastructure System Replacement Surcharge ("ISRS").

On June 28, 2012, the Commission issued its **Order Suspending Tariff, Directing Notice and Setting Intervention Date**, in which it established July 18, 2012 as the date by which applications to intervene in the instant case were to be filed. There were no applications to intervene filed by July 18, 2012, nor to date. The Commission directed Staff to file a report regarding its examination if the ISRS filing no later than August 24, 2012. The Commission also suspended MAWC's tariff sheet, YW-2012-0814, until October 25, 2012.

STAFF'S INVESTIGATION

Staff members from the Auditing and Water & Sewer Units participated in the Staff's investigation of the Petition. All Staff participants as well as their respective supervisors and the assigned attorney from the Chief Staff Counsel's Office were provided the opportunity to review and comment on this Memorandum prior to its filing.

Staff's investigation into the Petition included a review of the Petition, its supporting documentation, Chapter 393 RSMo, and Commission Rule 4 CSR 240-3.650(2), as well as additional data provided by MAWC. In conjunction with this investigation, Staff also reviewed information regarding the payment

history for MAWC's annual assessment fees and the status of MAWC's annual report filings, which are discussed later in this Memorandum.

THE PETITION

Specifically, as stated in its Petition, MAWC "requests an adjustment to its rates and charges through a change to its ISRS rate schedule 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 which are eligible for the ISRS, including recognition of 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 replacements 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-2011-0337;
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.

Staff notes that any reimbursement MAWC received for these projects was recognized as a reduction of the ISRS investment in the calculation of the ISRS revenue requirement.

In its Petition, the Company requested an adjustment to its rates and charges through the implementation of an ISRS rate schedule. The Company indicates that its proposed revised rate schedule will "produce ISRS revenues of \$4,073,205 or an increase of 2.1% above the base revenue level approved by the Commission in its most recently completed general rate proceeding" on an annualized basis. In addition, "The ISRS proposal includes an adjustment of \$337,451 to reflect an under collection from previous ISRS surcharges."

STAFF'S REVENUE CALCULATION

Staff recommends that the Commission reject the tariff sheet YW-2012-0814 MAWC filed on June 27. In its investigation, Staff identified an error in MAWC's depreciation calculation that affected the utility's calculation of its revenue requirement and tariff rates. In addition, MAWC's calculations included estimates of amounts of plant for the months of June and July 2012. Instead of asking MAWC to file a revised submission, Staff asked MAWC to send updated work papers to correct the depreciation calculation, and to send workpapers to provide actual June and July expense. MAWC provided the correct and updated information, so Staff recommends the Commission order MAWC to file with the Commission a new tariff sheet reflecting an ISRS rate for each customer class as reflected in Appendix B to this Memorandum.

Staff is proposing to include additional deferred income tax reserves through the month of the effective date of rates in this ISRS case to better reflect the actual levels that will exist for these items at that time. In its original filing and subsequent information that was provided, the Company included additional depreciation reserves through the month of the effective date of rates in this ISRS case. Staff agrees with the inclusion of the additional depreciation reserves through the month of the effective date of rates in this ISRS case. This methodology is consistent with Staff's view that the calculation of the ISRS revenue requirement should closely reflect the revenue requirement at the 120-day effective date of the ISRS rates.

Staff also agrees with the Company's updated calculation of \$253,280 for under-collection of ISRS revenues based on a calculated reconciliation of the revenues collected as a result of its previous ISRS case (WO-2011-0106) until the rates from its most recent rate case (WR-2011-0337) became effective. The above calculations are shown in Appendix A to this Memorandum, attached and incorporated herein by reference. Staff notes that Appendix A originates from the Company, and because Staff agrees with the Company's revised calculation, Staff did not alter Appendix A.

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-2011-0337, and the ISRS revenues allocated to each affected customer class. Staff has utilized the Company's methodology for calculating the majority of the ISRS rates, and has determined such rates based on the Company's calculation of the revenue requirement as reflected in Appendix A 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 assessment fees and the status of MAWC's annual report filings. Based on its review of this information, Staff found that MAWC is delinquent on its quarterly payments for its fiscal year 2013 payments due to the implementation of new software; however, Staff understands that the Company intends to rectify this in a timely manner. There are no delinquencies for prior years' assessments. In addition, MAWC does not have any past due annual reports.

STAFF'S CONCLUSIONS

Based on its investigation and calculations, Staff concludes that the Company's ISRS rates should be designed to recover annual ISRS revenues of \$4,189,656. These calculations reflect MAWC's capital structure as filed in its last rate case, a 10% return on equity and MAWC's current depreciation rates, all according to the Stipulation and Agreement approved by the Commission in Case No. WR-2011-0337. The calculations reflect the actual ISRS investment placed in service from January 2012 through July 2012, which is after the December 31, 2011 true-up cut-off date in MAWC's last rate case.

Staff based its conclusions on an examination of work orders and supporting documents for the projects included for recovery in the Company's proposed ISRS filing, a review of the Stipulation and Agreement in Case No. WR-2011-0337, the ISRS filing from Case No. WO-2011-0106, as well as various discussions with Company personnel. As a result, Staff concluded that the projects meet the requirements of the governing statutes as summarized previously in this Memorandum in the discussion of the Company's Petition.

STAFF RECOMMENDATIONS

Based on the above, the Staff recommends that the Commission issue an order that:

1. Finds that MAWC's filed petition is in compliance with the requirements of sections 393.1000 to 393.1006 RSMo;
2. Approves MAWC's Petition to implement ISRS rate schedules with the above adjustments to revenue requirement;
3. Approves Staff's determination that the Company is entitled to receive ISRS surcharge revenues in the amount of \$4,189,656 as shown in Appendix A;
4. Rejects the ISRS tariff sheet (YW-2012-0841) filed by MAWC on June 27, 2012; and
5. Requires MAWC to file with the Commission a tariff sheet reflecting an ISRS rate for each customer class as reflected in Appendix B no later than ten days of the effective date of any order issued in this case.

From Retirement File

	Jan - May 2012	Jun - Jul 12	Total
Plant Retirements	1,144,604	660,674	1,805,278
Depreciation Expense	16,115	9,332	25,446

From Investment File

REPLACEMENTS	Jan - May 2012	Jun - Jul 12	Total
Plant Additions (replacements)	20,541,136	14,615,633	35,156,769
Accumulated Depreciation	181,967	89,458	271,425
Depreciation Expense	291,108	207,327	498,435
Reimbursements	(369,968)	(14,824)	(384,792)
RELOCATIONS	Jan - May 2012	Jun - Jul 12	Total
Plant Additions (relocations)	1,035,676	925,956	1,961,631
Accumulated Depreciation	10,636	5,563	16,198
Depreciation Expense	14,504	12,906	27,410
Reimbursements	(376,886)	(443,807)	(820,693)

Composite Depreciation	1.40% On Relocation Mains
Depreciation on Relocation Reimbursements	11,490
Relocation Reimbursements	820,693

Overall Composite Depr Rate	Year 1	1.42% On all additions	Year 2	Year 3
Tax Depreciation Rates		2.00%	4.00%	4.00%
Bonus Depreciation		50.00%		
Depr Differential	Year 1	1.29%		
	After Year 1	2.58%		

	Replacements	Relocations	Total	Percentage
Investments <= 12" - Jan - May 12	20,335,009	439,995	20,775,004	96.577%
Investments <= 12" - Jun - Jul 12	14,494,290	578,625	15,072,916	
Investments > 12" - Jan - May 12	206,127	595,681	801,808	3.423%
Investments > 12" - Jun - Jul 12	121,343	347,330	468,673	
	35,156,769	1,961,631	37,118,400	100.000%

Missouri-American Water Company
ISRS Revenue Requirements Calculation
 St. Louis District

		Total for ISRS-10 Filing
<u>ISRS Activity:</u>		
<u>Water Utility Plant Projects--Replacement Mains and Associated Valves and Hydrants (RM) RSMo 393.1000 (8a):</u>		
<u>Task Orders Placed in Service (TOPS):</u>		
STLC-Replacement Mains and Associated Valves and Hydrants	\$ 35,156,769	
Net Contributions in Aid of Construction	(382,551)	
Deferred Taxes	(6,641,967)	
Accumulated Depreciation	(271,425)	
Total Net 393.1000 (8a)		<u>27,860,826</u>
<u>Water Utility Plant Projects--Main Cleanings and Relinings (RM) RSMo 393.1000 (8b):</u>		
<u>Task Orders Placed in Service (TOPS):</u>		
STLC-Main Cleanings and Relinings	0	
Net Contributions in Aid of Construction	0	
Deferred Taxes	0	
Accumulated Depreciation	0	
Total Net 393.1000 (8a)		<u>0</u>
<u>Water Utility Plant Projects--Facilities Relocations (FR) RSMo 393.1000 (8c):</u>		
<u>Task Orders Placed in Service (TOPS):</u>		
STLC-Relocated Facilities	1,961,631	
Net Contributions in Aid of Construction	(816,820)	
Deferred Taxes	(218,662)	
Accumulated Depreciation	(16,198)	
Total Net 393.1000 (8c)		<u>909,951</u>
<u>Accumulated Depreciation and Deferred Taxes on Investment in Current ISRS</u>		
		<u>0</u>
Total		<u>0</u>
Total ISRS Rate Base		28,770,777
Overall Rate Of Return per Last Order		8.17%
UOI Required		2,350,572
Income Tax Conversion Factor		1.623077
Revenue Req. Before Interest Deductibility		<u>3,815,159</u>
Total ISRS Rate Base		28,770,777
Embedded Cost of Debt per Last Order		3.090%
Interest Expense Deduction		889,017
Combined Federal and State Income Tax Rate		38.388630%
Income Tax Reduction due to Interest		341,281
Tax Conversion Factor		1.623077
Revenue Req Impact - Interest Deductibility		<u>553,926</u>
Total Revenue Requirement on Capital		3,261,233
Depreciation Expense		483,476
Property Taxes		191,668
Add Under Collection from Previous ISRS		<u>253,280</u>
Total ISRS Revenues		<u>\$ 4,189,656</u>
Allocation of Revenue by Class		
Mains less than or equal to 12"	Rate A & Oth	\$ 4,046,244
Mains greater than 12"	Rate A & Oth	129,171
	Total Rate A & Oth	4,175,416
	Rate J	8,203
	Rate B	6,038
Grand Total Revenues Collected in Proposed ISRS		<u>\$ 4,189,656</u>

Missouri-American Water Company
Tariff Rates
ISRS # 10 Filing
St. Louis District

	ISRS Recovery Revenue Requirement	2010 Bill Analysis Sales (CCF) (1)	Rate per CCF	Rate per 1000 Gal.
Rate A & Oth	4,175,416	56,294,378	\$ 0.0742	\$ 0.0992
Rate B	6,038	2,365,075	\$ 0.0026	\$ 0.0035
Rate J	8,203	5,752,615	\$ 0.0014	\$ 0.0019
	4,189,656			

(1) Per billing determinants approved in determining rates per Commission order in Case WR 2011-0337

	Current Rate	Adjustment to Current Rate (1)	Proposed Rate Use on Tariff
Rate Per CCF			
Rate A & Oth	\$ -	\$ 0.0742	\$ 0.0742
Rate B	\$ -	\$ 0.0026	\$ 0.0026
Rate J	\$ -	\$ 0.0014	\$ 0.0014
Rate Per 1000 Gal			
Rate A & Oth	\$ -	\$ 0.0992	\$ 0.0992
Rate B	\$ -	\$ 0.0035	\$ 0.0035
Rate J	\$ -	\$ 0.0019	\$ 0.0019

(1) Calculated per above

Missouri-American Water Company
Property Tax Calculation
ISRS # 10 Filing
St. Louis District

	<u>Jan - Jul 2012</u>
Total Investment	37,118,400
Less: Retirements	(1,805,278)
Net Change in Property Base	35,313,122
Property Tax Rate	0.0054
Property Tax Expense	191,668

<u>Description</u>	<u>STL Excluding Jefferson Co</u>
Total Tax Payments through 12/31/11	5,649,535
Utility Plant in Service @ 12/31/10	1,029,294,583
Materials & Supplies @ 12/31/10	3,112,282
Actual Property Tax Base @12/31/10	1,032,406,866
Allocate Corporate balance:	
Allocation Factor	69.42%
Allocation	<u>8,467,018</u>
Allocated Property Tax Base at 12/31/10	<u>1,040,873,883</u>
2011 Tax per \$1 of Taxable Property	0.005428

Missouri-American Water Company
Cost of Service / Rate Design
ISRS # 10 Filing
St. Louis District
Cost of Service Allocation for Transmission Costs Per 2011 Case

	Rate A & Other	Rate J	Rate B
Total Factor for ISRS	90.070%	5.720%	4.210%

Tariff Design

	Non-ISRS Revenues Per Last Order	ISRS Revenues	Proposed % Increase
Rate A and K Customers	182,648,964	4,175,416	2.29%
Rate J Customers	6,909,444	8,203	0.12%
Rate B Customers	3,232,546	6,038	0.19%
	192,790,954	4,189,656	

Missouri-American Water Company
Net CIAC Calculation
ISRS # 10 Filing
St. Louis District

Mains, Valves and Hydrant Replacements

Gross Investment - Replacements	35,156,769
Depreciation Expense - Replacements	498,435
Composite Depreciation Rate:	1.417750%

	Jan - May 12	Jun - Jul 12		Total
Reimbursements	(369,968)	(14,824)	0	(384,792) (a)
Amortization (1)	(1,347)	(895)		(2,242)

Accumulated Amortization	(1,347)	(895)	0	(2,242) (b)
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Gross CIAC	(384,792) (a)
Less: Accum Amort. - CIAC	2,242 (b)
Net CIAC	(382,551)

Relocations

Gross Investment - Relocations	1,961,631
Depreciation Expense - Relocations	27,410
Composite Depreciation Rate:	1.397295%

	Jan - May 12	Jun - Jul 12		Total
Reimbursements	(376,886)	(443,807)		(820,693) (c)
Amortization (1)	(2,327)	(1,547)		(3,873)

Accumulated Amortization	(2,327)	(1,547)	0	(3,873) (d)
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Gross CIAC	(820,693) (c)
Less: Accum Amort. - CIAC	3,873 (d)
Net CIAC	(816,820)

Missouri-American Water Company
Depreciation Expense Calculation
ISRS # 10 Filing
St. Louis District

	Replacements	Relocations	Total
Base Depreciation Expense	498,435	27,410	525,845
Reimbursements	(384,792)	(820,693)	
Composite Depreciation Rate	1.4178%	1.3973%	
Depreciation Expense to be Removed	(5,455)	(11,467)	(16,923)
Depreciation Expense Associated with Retirements			(25,446)
Net Depreciation Expense			<u><u>483,476</u></u>

Appendix B

Missouri-American Water Company
Case No. WO-2012-0401
ISRS Rate Design Calculation
St. Louis District

ISRS Revenues:

	ISRS Recovery Revenue Requirement	Sales (CCF)	Rates per CCF	Rates per 1,000 gallons
Rate A & Other	\$ 4,175,416	56,294,378	\$ 0.0742	\$ 0.0992
Rate B	\$ 6,038	2,365,075	\$ 0.0026	\$ 0.0034
Rate J	\$ 8,203	5,752,615	\$ 0.0014	\$ 0.0019
Total	\$ 4,189,657			

New ISRS Rate:

	Rates per CCF	Rates per 1,000 gallons
Rate A & Other	\$ 0.0742	\$ 0.0992
Rate B	\$ 0.0026	\$ 0.0034
Rate J	\$ 0.0014	\$ 0.0019