

STATE OF IOWA
DEPARTMENT OF COMMERCE
UTILITIES BOARD

IN RE: IOWA-AMERICAN WATER COMPANY	DOCKET NOS. SPU-2021-0014, TF-2021-0098
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FINAL DECISION AND ORDER

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I. PROCEDURAL HISTORY

On September 24, 2021, Iowa-American Water Company (Iowa-American) filed with the Utilities Board (Board) an application for approval of the acquisition of the sanitary sewer and wastewater utility of the City of Blue Grass, Iowa, (Application) identified as Docket No. SPU-2021-0014. The Board will use the term “sanitary sewer” to describe the sanitary sewer and wastewater utility throughout this order because that is the term used in Iowa Code § 476.84. Iowa-American filed direct testimony and exhibits in support of the Application and a corresponding proposed sanitary sewer tariff that is identified as Docket No. TF-2021-0098.

On September 28, 2021, the Office of Consumer Advocate (OCA), a division of the Iowa Department of Justice, filed an appearance. On October 12, 2021, OCA filed an objection and request for docketing.

On October 25, 2021, the Board issued an order docketing and suspending the application and proposed sanitary sewer tariff and setting a scheduling conference to consider a procedural schedule and hearing date. In the October 25, 2021 order, the Board also requested additional information.

A scheduling conference was held on October 29, 2021, with representatives from Iowa-American and OCA participating.

On November 2, 2021, Iowa-American filed a response to the October 25, 2021 order. The response included an Original Tariff Sheet No. 58, reserved for future use, and revised minimum filing requirements.

On November 22, 2021, the Board issued an order establishing a procedural schedule and setting the matter for hearing on March 24, 2022.

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On December 6, 2021, OCA filed a motion to require written notice of rate increase, which included OCA data requests as an Attachment A. On December 10, 2021, Iowa-American filed a response to OCA's motion. On January 25, 2022, the Board issued an order denying OCA's motion to require written notice of rate increase.

On December 29, 2021, the Iowa Association of Municipal Utilities (IAMU) filed a petition to intervene and an objection. On January 12, 2022, Iowa-American filed a response to IAMU's petition to intervene and an objection; OCA filed a response on January 20, 2022. On January 25, 2022, the Board issued an order granting IAMU's petition to intervene and addressing IAMU's objection.

On December 30, 2021, OCA filed direct testimony and exhibits. On February 14, 2022, Iowa-American filed rebuttal testimony and exhibits.

On January 6, 2022, Iowa-American filed an application for confidential treatment for information filed confidentially by OCA on December 30, 2021. On March 28, 2022, the Board issued an order granting Iowa-American's application for confidential treatment.

On February 22, 2022, the Board issued an order requesting additional information.

On February 24, 2022, OCA filed rebuttal testimony and exhibits. On March 4, 2022, Iowa-American filed a response to the February 22, 2022 order requesting additional information.

On March 7, 2022, Iowa-American filed a motion for leave to file sur-rebuttal testimony and exhibit, which included the testimony and exhibit. The motion was granted at hearing.

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Parties filed their witness lists on March 7, 2022, and then filed statements of issues on March 10, 2022.

On March 24, 2022, an evidentiary hearing was held. At the conclusion of the hearing, the Board stated that briefs would be scheduled based upon the filing of the transcript. On April 5, 2022, hearing transcripts were filed in the docket.

On April 12, 2022, the Board issued an order setting a briefing schedule. The order included specific legal issues the Board requested the parties brief.

On April 26, 2022, initial briefs were filed by Iowa-American, OCA, and IAMU. On May 10, 2022, reply briefs were filed by Iowa-American, OCA, and IAMU.

II. BOARD JURISDICTION

Iowa-American, a rate-regulated water utility, is requesting approval to acquire a sanitary sewer utility owned by the City of Blue Grass, Iowa (Blue Grass). The Blue Grass system serves approximately 725 residential and commercial customers. To acquire the system, Iowa-American states it entered into an arms-length negotiation of an Asset Purchase Agreement (APA) with Blue Grass, which included negotiating the terms, assets, prices, and rates to be charged customers. Iowa-American states the negotiated purchase price is \$2 million. Additionally, as part of the APA, Blue Grass agreed to adopt rates as reflected in the APA and proposed sanitary sewer tariffs filed in Docket No. TF-2021-0098.

Pursuant to Iowa Code § 476.84, the Board has been granted regulatory authority to approve the acquisition of water, sanitary sewer, and storm water utilities by a rate-regulated utility with a fair market value of \$500,000 or more. Iowa Code

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§ 476.84.2(a) prohibits the sale without Board approval. In addition, this paragraph states if the utility to be acquired is a city utility, the public utility shall not acquire the city utility until the city has first met the requirements of Iowa Code § 388.2A.

Specifically, Iowa Code § 476.84(2)(a) provides that:

A public utility shall not acquire, in whole or in part, a water, sanitary sewer, or storm water utility with a fair market value of five hundred thousand dollars or more from a non-rate-regulated entity ... unless the board first approves the acquisition. In addition, if the utility to be acquired is a city utility, then the public utility shall not acquire the city utility until the city has first met the requirements of section 388.2A.

Additionally, Iowa Code § 476.84(2)(b) states:

If a water, sanitary sewer, or storm water utility that is the subject of an acquisition meets the requirements of paragraph “a”, then the acquiring public utility may apply to the board, prior to the completion of the acquisition, for advance approval of a proposed initial tariff for providing service to customers of the acquired utility.

One of the primary issues to be considered by the Board is the extent to which the Board can inquire into a city’s compliance with Iowa Code § 388.2A. The specific requirements that a city must comply with are set out in Iowa Code § 388.2A(2).

A. Iowa-American

Iowa-American argues that it is not the Board’s role to replace Blue Grass’ judgment about compliance with the requirements in Iowa Code § 388.2A, and under Iowa statutes, a municipality is empowered to manage its own affairs. (Iowa-American Initial Brief, p. 5.) Iowa-American argues that it presented the verification by the city that it has complied with those requirements and that is sufficient to satisfy Iowa Code § 476.84(2)(a). (*Id.*) Iowa-American witness Simmons provided with his direct

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testimony an “Affidavit of Compliance” that was signed by Blue Grass Mayor Brad Schutte. (IAWC Simmons Direct Exhibit 1.) Within the affidavit, Mayor Schutte affirms the City of Blue Grass complied with the requirements of Iowa Code § 388.2A. (*Id.* at p. 1.)

B. OCA

OCA states that the Board has jurisdiction over Iowa-American, even if the Board must make factual determinations related to Blue Grass’ conduct. (OCA Initial Brief, p. 5.) Specifically, OCA states:

Even if Iowa-American cannot control the conduct of the City, Iowa-American determines whether to pursue a sewer system acquisition and can assess and enforce any apparent compliance issues as part of the transaction, and had direct control over its presentation of evidence in this case and could have corrected evidentiary deficiencies caused by the City. The Board should hold Iowa-American to account for its failure and outright refusal to do so.

(*Id.*)

OCA argues that Iowa-American can only bring a municipal acquisition case if the city has complied with Iowa Code § 388.2A. (*Id.*) OCA states if the Board determines Blue Grass did not meet the Iowa Code § 388.2A requirements, the Board could dismiss the case as improperly brought; however, OCA proposes the Board allow Iowa-American to fill possible evidentiary gaps created by any non-compliance. (*Id.* at pp. 5-6.)

C. IAMU

IAMU proposes the Board require compliance with Iowa Code § 388.2A by enforcing the requirements of 199 Iowa Administrative Code (IAC) 41.5 in determining compliance. (IAMU Initial Brief, p. 5.) IAMU argues that the Board “would not be

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administering section 388.2A or directly regulating the city that is attempting to sell its utility.” (*Id.* at p. 8.) IAMU states the Board cannot ignore clear evidence of a city’s material non-compliance; however, the Board’s role would be in the resulting regulatory approval and not the city’s compliance. (*Id.* at p. 5.) IAMU suggests the Board can either deny the application or allow ratemaking principles to address any deficiencies. (*Id.*)

IAMU asserts the Board cannot order the city to comply with Iowa Code § 388.2A; however, IAMU argues the Board could “withhold approval of the acquisition by the acquiring public utility until the acquiring public utility is able to correct the material acts or omissions and submit updated filings or a new petition.” (*Id.* at p. 5.) IAMU suggests the Board could also provide for ratemaking principles related to cost recovery or return on equity that would address the regulated utility’s rates or service after the transaction. (*Id.* at pp. 5-6.)

IAMU suggests that the rate-regulated utility should work with the city to make sure that Iowa Code § 388.2A is complied with prior to the rate-regulated utility filing an application with the Board. (*Id.* at p. 8.) IAMU proposes the Board use a “substantial compliance” approach, not a zero-tolerance policy, when reviewing the filing requirements to allow for good faith efforts and avoid a “gotcha” approach. (*Id.* at p. 9.)

D. Board Discussion

The Board does not have jurisdiction over a municipal sanitary sewer utility pursuant to Iowa Code § 476.1(4). The Board does not consider the language in Iowa Code § 476.84(2)(a) that the public utility shall not acquire the city utility until the city

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has first met the requirements of Iowa Code § 388.2A to be a specific grant of authority for the Board to review compliance by a city utility with Iowa Code § 388.2A.

The interpretation of the statute, that the Board is allowed or required to review the city's compliance with the pre-vote requirements in Iowa Code § 388.2A, would require the Board to second guess the city or the voters who have approved the sale of the utility. Without a specific grant of authority in Iowa Code § 476.84, the Board finds its review of Blue Grass' compliance with Iowa Code § 388.2A to be complete if the city provides verification that the city has complied with those statutory requirements, such as an affidavit of compliance. (See IAWC Simmons Direct Exhibit 1.)

Because the acquisition by Iowa-American of the Blue Grass sanitary sewer utility is a case of first impression before the Board under the provisions of Iowa Code § 476.84, the Board's decision on this issue will determine the Board's review of a city's actions in the future. The rate-regulated utility must file the information required in 199 IAC 41.5, minimum filing requirements, because the Board requires that information in deciding issues regarding just and reasonable rates; however, the Board will not review the information for the purpose of determining whether the city complied with Iowa Code § 388.2A.

Based upon the above discussion, the Board has determined its inquiry with regard to the acquisition of the Blue Grass sanitary sewer utility by Iowa-American is limited to a determination of the issues in Iowa Code § 476.84(2)(b), (c), and (d).

In this case, Iowa-American filed the certificate of compliance of the mayor of Blue Grass, which meets the requirements of verification of compliance with Iowa Code § 388.2A. Further inquiry would require the Board to second guess the city's actions

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and in some instances could be prohibited by Iowa Code § 388.2A(6). The Board does not interpret Iowa Code § 476.84(2)(a) as providing the Board specific statutory authority to review the actions taken by Blue Grass to comply with Iowa Code § 388.2A.

III. AT-RISK SYSTEM

Iowa Code § 476.84(2)(e) provides that if the utility being acquired is considered to be an at-risk system, the final order must be issued within 180 days after the filing of the application. Iowa-American witness Frank Grage testified that it is Iowa-American's belief that the Blue Grass sanitary sewer and wastewater utility is not considered to be at-risk in accordance with Iowa Code § 455B.199D. (Grage Direct Testimony, p. 5.) OCA did not provide any evidence or dispute Iowa-American's assertion that the Blue Grass utility was not at-risk.

Based upon the evidence in the record, the Board finds that the Blue Grass sanitary sewer utility is not an at-risk system as described in Iowa Code § 455B.199D. The Board therefore is not required to issue the final order regarding the acquisition within 180 days of September 24, 2021, the date that Iowa-American filed its application with the Board asking for approval to acquire the Blue Grass sanitary sewer utility.

IV. ACQUISITION

Iowa Code § 476.84(2)(b) provides that the acquiring rate-regulated utility may apply to the Board, prior to the completion of the acquisition, for advance approval of a proposed initial tariff for providing service to customers of the acquired utility. In this case, Iowa-American's proposed sanitary sewer tariff includes proposed rates for metered and unmetered sanitary sewer service.

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Iowa Code § 476.84(2)(c) provides that in reviewing the acquisition, the Board shall specify in advance after a contested case proceeding the ratemaking principles that will apply when the costs of the acquisition are included in regulated rates. This paragraph also states that the lesser of the sale price or the fair market value of the acquired utility, established pursuant to Iowa Code § 388.2A(2), shall be used in determining advance ratemaking principles, and the Board is not limited to traditional ratemaking principles or cost recovery mechanisms.

Iowa Code § 476.84(2)(d) provides that in determining ratemaking principles, the Board shall find that the acquisition will result in just and reasonable rates to all customers, including customers of the acquiring utility. This section states that the Board, in making the required finding, may consider any factor that affects future rates, including, but not limited to, the purchase price and the projected costs of improvements necessary to provide service.

A. Iowa-American

Iowa-American argues that Iowa Code § 476.84(2)(c) “would not exist if the Board were intended to have authority over the negotiated purchase price.” (Iowa-American Initial Brief, p. 5.) According to Iowa-American:

If the Board believes the purchase price and ratemaking principles do not result in just and reasonable rates, then it could approve the transaction subject to ratemaking principles that will result in just and reasonable rates while utilizing the lesser of the sale price or the fair market value of the acquired utility in determining those principles.

(*Id.*)

B. OCA

OCA asserts that the Board has “broad authority” over the acquisition price under Iowa Code § 476.84 and the just and reasonable standard. (OCA Initial Brief, p. 13.)

OCA points out the ambiguity between Iowa Code §§ 476.84(2)(c) and 476.84(2)(d) with regard to the purchase price. (*Id.* at pp. 13-14.) Paragraph 476.84(2)(c) appears to require the Board to use the lesser of the purchase or fair market value in setting rates; however, paragraph 476.84(2)(d) provides that the Board may use any factor, including the purchase price, in finding that rates are just and reasonable. (*Id.*) OCA argues that Iowa Code § 476.84(2)(d) “makes it clear that the just and reasonable standard continues to be paramount, even with respect to the purchase price in acquisition cases.” (*Id.* at 13.) OCA interprets this to mean that the Board can require ratemaking principles that limit what a rate-regulated utility can recover in rates, whether it be the full purchase price or part of the purchase price. (*Id.*)

C. IAMU

IAMU argues that “[t]he Board does not have the authority to modify the acquisition price, but the Board does have the authority to limit the recovery of that price in the rates of the regulated utility.” (IAMU Initial Brief, p. 10.) IAMU further states, “the Board is not required to approve the recovery of the full acquisition price by the rate-regulated utility if doing so would result in unjust and unreasonable rates.” (*Id.*)

D. Board Discussion

The Board finds that it does not have jurisdiction over the purchase price agreed to between the municipal utility and the rate-regulated utility. The Board’s jurisdiction is over what is the depreciable value of the system to include in establishing just and reasonable rates. The purchase price is a negotiated price that is not necessarily based upon evidence provided in a contested case proceeding, and whether to establish a ratemaking principle that establishes the acquisition price for ratemaking purposes is an

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evidentiary question for the Board to determine based upon the record in the contested case. A mandate to use the lesser of the purchase price or fair market value established by the appraisals required in Iowa Code § 388.2A without evidentiary support is not consistent with the Board's ratemaking authority in Iowa Code chapter 476 to set rates for utility service that are just and reasonable.

In this case, the acquisition price was negotiated between Blue Grass and Iowa-American. The issue before the Board, which will be discussed later in this order, is whether the \$2 million purchase price will be used to set rates.

V. REGULATORY ISSUES

Because this is the first sanitary sewer utility acquisition presented to the Board under the provisions of Iowa Code § 476.84, the Board has not had the opportunity to address the provisions in Iowa Code § 476.84(2) regarding setting just and reasonable rates or advance ratemaking principles in this context. Statutory construction requires the Board to give effect to each of the provisions discussed with regard to rates and advance ratemaking principles. The policy behind adoption of Iowa Code § 476.84 appears to be to encourage acquisition of small systems by a rate-regulated utility that has the resources to manage the system and is better able to spread the costs of required upgrades to the sanitary sewer system.

The Board recognizes that as a case of first impression, this acquisition has proceeded without prior Board decisions regarding how traditional ratemaking principles are to be applied to the acquisition of a sanitary sewer utility by Iowa-American. The most recent similar acquisition approved by the Board was the Blue Grass water utility

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by Iowa-American, prior to the enactment of Iowa Code § 476.84. Iowa-American filed a proposed tariff, identified as Docket No. TF-2016-0334, to implement the purchase of the Blue Grass water utility that continued the then-existing rates for Blue Grass water customers for three years. On April 26, 2017, the Board approved the tariff.

Iowa-American provided what the Board characterized as a “rudimentary cost analysis” showing that the proposed rates would cover the estimated cost-of-service for the Blue Grass water utility. In the order, the Board stated that the decision to continue the rates appeared to have been a part of arms-length negotiations and the approved rates would not have any effect on the rates charged to existing Iowa-American customers. The Board found that on this basis, approving a tariff for Blue Grass water customers to continue paying existing rates was reasonable.

Iowa-American has not proposed to address the acquisition of the Blue Grass sanitary sewer utility in the same manner as the acquisition of the Blue Grass water utility. There appear to be two primary reasons for the difference in the approach taken by Iowa-American for the sanitary sewer utility acquisition. First is the enactment of Iowa Code § 476.84, and second is the need to upgrade the sanitary sewer system to meet IDNR requirements.

The Board addressed some of the jurisdictional issues that are raised by the enactment of Iowa Code § 476.84 above and addresses the regulatory issues below. Iowa-American has presented the Board with a non-traditional approach to setting rates for Blue Grass sanitary sewer customers by including in proposed rates the cost of assets not used and useful or in-service. Iowa-American witness Simmons testified that “[t]he resulting increased rates allow the Company the opportunity to

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reasonably recover the purchase price, the additional capital investments necessary to comply with Department of Natural Resources requirements, and the risk of variability in operating costs..." (IAWC Simmons Direct p. 11). Iowa Code § 476.84(2)(c) states that the Board, in adopting applicable ratemaking principles, is not limited to traditional ratemaking principles or traditional cost-recovery mechanisms. The Board addresses the regulatory issues necessary to consider the acquisition and to set just and reasonable rates below, with the understanding that the Board is not bound by the way the Board traditionally sets rates.

In considering the rates to be charged by Iowa-American to sanitary sewer customers, the Board must determine that the rates are just and reasonable. In determining just and reasonable rates, the Board addresses the components of rates that it considers necessary to arrive at just and reasonable rates. Those components are: the initial depreciable value of the system that will be the rate base used to set rates, the rate of return to apply to the initial depreciable value, the operation and maintenance costs included in rates, and the issue of whether to allow recovery of assets not used and useful. Those relevant issues are addressed below.

A. Initial Depreciable Value

With its initial application, Iowa-American requested two advance ratemaking principles: (1) "that the ratemaking treatment of the acquisition will be determined in the Company's next general rate case in accordance with the traditional ratemaking principles generally applicable to determine a rate-regulated public utility's revenue requirement," and (2) "establish the initial depreciable value as an advanced ratemaking

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principle” pursuant to Iowa Code § 476.84(2)(c). (Iowa-American application, pp. 2-3; IAWC Simmons Direct, pp. 13-14.)

In this case, Iowa-American has proposed a ratemaking principle that sets the initial depreciated value of the acquired facility at the \$2 million acquisition price, representing the lesser of the fair market value or the purchase price. Iowa-American believes this ratemaking principle is mandated by 199 IAC 41.5(4)(c). (IAWC Simmons Direct, p. 16.)

Although the Board does not interpret the language in Iowa Code § 476.84(2)(c) to be a mandate that the Board is required to establish the initial depreciable value as the lesser of the fair market value as determined by Iowa Code § 388.2A or the acquisition price, the Board finds that the evidence in this case supports a finding that the \$2 million acquisition price is the initial depreciable value for setting just and reasonable rates for sanitary sewer service.

The Board agrees with OCA that net book value calculations should be provided to support the proposed initial depreciable value; however, the evidence presented by OCA is not persuasive on this issue. In addition, as discussed in this section, the Board is determining just and reasonable rates using non-traditional ratemaking principles, and the Board has found that the \$2 million acquisition price is a reasonable value for the assets acquired. The Board makes this determination based upon the record in this case that insufficient evidence was introduced to support an alternative valuation; however, in future cases, the Board will require additional evidence to support using the negotiated purchase price as the initial depreciable value of the assets, or any other initial depreciable value proposed for the acquired assets. The additional evidence can

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be a net book value study or similar evidence showing the value of the assets being acquired.

B. Just and Reasonable Rates

Iowa-American proposes metered rates that include a monthly fixed charge of \$39.48 for all meter sizes and a variable charge of \$0.74124 for each 100 gallons, after the first 2,500 gallons. (Tariff, Original Sheet No. 57, Docket No. TF-2021-0098.) Iowa-American has also proposed a non-metered rate for customers taking sanitary sewer service without a meter, which will be discussed below.

According to Iowa-American, if the Board finds the purchase price and ratemaking principles do not result in just and reasonable rates, then the Board could approve the transaction subject to ratemaking principles that will result in just and reasonable rates while utilizing the lesser of the sale price or the fair market value of the acquired utility in determining those principles.

OCA points out the ambiguity between Iowa Code §§ 476.84(2)(c) and 476.84(2)(d) with regard to the purchase price. Paragraph 476.84(2)(c) appears to require the Board to use the lesser of the purchase price or fair market value in setting rates; however, paragraph 476.84(2)(d) provides that the Board may use any factor, including the purchase price, in finding that rates are just and reasonable. OCA argues that the Board could adopt a ratemaking principle that limits Iowa-American's recovery of some or all of the purchase price in rates.

IAMU asserts that "the Board should set the rates in Blue Grass in this proceeding and should determine whether the rates IAW will be charging in Blue Grass after the acquisition are just and reasonable." (Petition to Intervene and Objection, p.

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4.) IAMU argues that the legislature clearly allowed for the possibility of the outcome where the Board limits the recovery of the purchase price in the rates of the rate-regulated utility by providing that the rate-regulated utility is not required to complete the acquisition if the rates approved by the Board are not acceptable. (IAMU Initial Brief, p. 10.)

Iowa Code § 476.84(2)(b) provides that if the sanitary sewer utility that is the subject of the acquisition meets the requirements of Iowa Code § 476.84(2)(a), the acquiring public utility may apply to the Board, prior to the completion of the acquisition, for advance approval of a proposed initial sanitary sewer tariff. Although the language in Iowa Code § 476.84(2)(b) might appear to create a separate method for setting initial rates, the rates set by the Board, even if approved before the acquisition is complete, have to meet the just and reasonableness standard.

Iowa Code § 476.84(2)(c) establishes standards for the Board in setting advance ratemaking principles. The statute states that the Board shall establish in advance in a contested case proceeding the ratemaking principles that will apply. Ratemaking principles are requirements that have been adopted by the Board, or by statute, to follow in setting just and reasonable rates.

This statute states that the lesser of the fair market value of the acquired facility or the purchase price is to be used in “determining applicable ratemaking principles.” As stated above, the Board does not interpret this provision, as Iowa-American does, to require a ratemaking principle that establishes the lesser value as the value of the acquired assets to be used to set rates. Requiring the Board to adopt a negotiated purchase price for setting rates is not consistent with the Board’s mandate to

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set just and reasonable rates, which are required to be set based upon the evidence in the record of a contested case proceeding. Evidence may support the negotiated purchase price or some other value for the acquired system. Negotiated rates, or the fair market value determination, do not establish just and reasonable rates without further evidence of the value of the acquired system.

This paragraph also provides that the Board is not bound by traditional ratemaking principles or traditional cost-recovery mechanisms in establishing ratemaking principles related to the acquisition. This language provides the Board flexibility to establish advance ratemaking principles that fit a specific fact situation where necessary, without being subject to questions about not following precedent.

Iowa Code § 476.84(2)(d) requires the Board, in determining applicable advance ratemaking principles, to find that “the proposed acquisition will result in just and reasonable rates to all customers of the public utility, including but not limited to existing customers of the public utility” and the Board may consider any factor it concludes may affect future rates, including “the price paid for the acquired utility and the projected cost of reasonable and prudent changes to the acquired utility in order to provide adequate services and facilities to customers.” This language creates flexibility for the Board in determining whether to use the purchase price in setting rates, the fair market value, or a different initial depreciable value.

For purposes of implementing Iowa Code § 476.84, the Board will only look at evidence presented in this docket to determine just and reasonable rates that may be charged by the acquiring utility. The Board is not basing its decision on whether the

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rates proposed by Iowa-American are just and reasonable solely on an agreement between a municipality and a rate-regulated utility.

Based upon the record in this case, the Board finds that the rates proposed by Iowa-American are just and reasonable. The Board has found that the \$2 million purchase price is the initial depreciable value of the assets acquired. The Board understands that if Iowa-American purchases the Blue Grass sanitary sewer system, it is required by IDNR to make more than \$3 million worth of upgrades within the first few years after the purchase. Based upon this requirement and Iowa-American's testimony that it will install the upgrades, the Board finds that the rates approved will include amounts in excess of the cost-of-service for the first year that rates are in effect. The Board adopts this non-traditional ratemaking principle for setting rates by allowing the approved rates to recover amounts for the upgrades that are not used and useful or in service in the first year. There is evidence in the record that the approved rates may not recover all of the costs of the upgrades in subsequent years. Iowa-American proposes to keep the rates set at the proposed rates until the next general rate case proceeding.

The rates approved by the Board include Iowa-American's return on equity approved in Iowa-American's last general rate case proceeding. The rates also include estimated operation and maintenance (O&M) costs for operating the sanitary sewer system once it is acquired. The O&M costs are estimates based upon Iowa-American's current costs of operating its water system and Iowa-American's anticipated costs of operating the sanitary sewer system. The Board finds that the estimated O&M costs are just and reasonable. Based on the evidence in the record as found to be

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reasonable, the Board will approve the rates proposed by Iowa-American as just and reasonable.

Because the Board is adopting non-traditional ratemaking in setting the rates for sanitary sewer service, the Board will require Iowa-American to file an annual report on the upgrades it has installed until it files its next general rate case proceeding. The reports will be due within 30 days of the anniversary of the execution of the purchase of the sanitary sewer assets from Blue Grass.

C. Alternative Funding Sources

OCA witness Tessier proposes the Board require Iowa-American to pursue Clean Water Act State Revolving Fund (SRF) loans for sanitary sewer and wastewater infrastructure expenditures. (OCA Tessier Direct, p. 17.) Iowa-American, through a data request by OCA, states:

Iowa-American will evaluate and consider the costs and benefits of State Revolving Fund (SRF) financing for the proposed nutrient reduction and disinfection projects after the construction plans are complete, current qualifications for financing are known, and in consideration of the overall resulting debt and equity ratios of the sewer system and based on market conditions at that time.

(OCA Tessier Direct Exhibit 1, IAWC Response to OCA DR 8.)

Mr. Tessier also proposes that Iowa-American attempt to procure federal financing and grants. (OCA Tessier Direct, p. 18.) Mr. Tessier testifies that out of the \$1.2 trillion federal infrastructure law, Iowa is to receive \$638 million for water and wastewater improvements. (*Id.*)

Mr. Tessier further proposes that the Board require Iowa-American to “evaluate any government or charitable funding available for sanitary sewer and wastewater

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capital investments and provide regular updates on the Company's efforts to secure such funding." (*Id.* at p. 20.) This will be similar to the Board's order in Iowa-American's last water rate case. (*Id.*)

Iowa-American witness Simmons testified that "[t]he Company is willing to explore all financing options that will save its customers money and not hinder its credit-worthiness or ability to attract capital." (IAWC Simmons Reply, p. 12.) Mr. Simmons further states that if Iowa-American was to use the full SRF funding, 60% of the sanitary sewer rate base would be from the plant improvements, which is outside the target metrics and may make it more difficult to acquire capital for the sanitary sewer system. (*Id.*)

Mr. Simmons proposed two options:

1. Require the Company to seek SRF funding while allowing flexibility to maintain its overall financial targets, which are reviewed and set in rate cases. IAWC would finance the majority, approximately \$2.5 million, of the upgrade using SRF loans; or
2. Establish a ratemaking principle that IAWC's combined overall capitalization, debt and equity, will apply to water and wastewater in the next rate case and require the Company to seek SRF funding for the full project.

Mr. Simmons stated that Iowa-American would prefer the latter option. (*Id.*)

OCA witness Kruger does not agree with Iowa-American's assertion that it will be difficult for Iowa-American to attract capital. Mr. Kruger testifies that the "IAWC-Blue Grass Sewer system will not be applying for capital loans based upon the capital structure of IAWC-Blue Grass Sewer division," and the SRF funds are a low-interest loan from the state to help with specific sanitary sewer projects. Mr. Kruger states it is not appropriate for Iowa-American to include the SRF-funded projects within "the same

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'bucket' as all other rate base containing a profit margin for the investor-owned utility." (OCA Kruger Rebuttal, pp. 7-8.)

Mr. Simmons testifies that SRF loan repayments are generally 20 to 30 years; however, recovery can be up to 80 to 100 years in length. Mr. Simmons states "[t]he terms of acquiring this capital for an 80% debt system will not be favorable and may require a much higher return to compensate for poor credit metrics." (IAWC Simmons Surrebuttal, p 8.)

The Board finds that pursuing the lowest cost of capital options, such as SRF and other state or federal financing or grants, is in the best interest of Iowa-American's customers. SRF, and similar funds, allows the utility to have lower cost of debt for eligible projects. The Board finds that it is reasonable for Iowa-American to use a combined capital structure instead of separating the capital structure between service types, which should address the issue of using a higher amount of debt to fund sanitary sewer plant upgrades. Iowa-American will be required to seek all available SRF and other state or federal financing or grants. Additionally, the Board will require Iowa-American to file an annual update on Iowa-American's efforts to receive funding until it files its next general rate case proceeding. The updates will be due within 30 days of the anniversary of the execution of the purchase of the sanitary sewer assets from Blue Grass.

D. Other Advance Ratemaking Principles

In direct testimony, OCA witness Kruger proposed additional advance ratemaking principles: (1) "In future rate proceedings, the depreciation lives related to the \$2 million purchase price for the legacy system should not be depreciated faster

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than the level of depreciation IAWC used in calculating its year-one revenue requirement, an average rate of 2.38% per year”; (2) “IAWC shall maintain separate financial books for each sewer system acquired prior [to] the next rate proceeding and charge distinct rates for each system acquired”; (3) “Until its next rate proceeding, IAWC shall maintain a regulatory liability account to track all revenues exceeding the first-year authorized revenue requirement computed by IAWC in its Minimum Filing Requirement 41.5(3)(e),” which should include interest as computed for interest applied to refunds in temporary rates (Iowa Code § 476.6(9)); (4) “IAWC should only be allowed to earn a return on the \$2 million purchase price of no higher than the Company’s cost of debt until the Company can prove it has delivered the benefits of the acquisition.”

Iowa Code § 476.84(2)(c) authorizes the Board to approve the acquisition of a city sanitary sewer utility and to establish advance ratemaking principles that will apply when the costs of the acquired utility are included in regulated rates. Each of the four OCA proposed advance ratemaking principles is discussed below.

1. Fixed Rate of Depreciation

OCA witness Kruger proposes that the average depreciation rate for the Blue Grass legacy system be set at or below 2.38%. (OCA Kruger Direct, p. 4.) Mr. Kruger states that this will prevent Iowa-American from accelerating depreciation in the future, which will help alleviate higher rate impacts. (*Id.* at pp. 10-11.)

Iowa-American proposes that there be periodic depreciation studies to allow for the most accurate measure of depreciation. (IAWC Simmons Reply, p. 11.) This would allow for the depreciation rate to be reviewed during Iowa-American’s next general rate case.

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The Board recognizes that if a depreciation rate is accelerated, ratepayers will need to pay more to account for the higher amortization amount recovered through the revenue requirement. The Board does not agree that the depreciation amount should be limited within this proceeding. By allowing the depreciation rate to be reviewed during Iowa-American's subsequent general rate case proceedings, parties will be able to review the evidence supporting the requested depreciation rate and a determination regarding the appropriate depreciation schedule will be made at that time.

2. Separate Books and Rates for Future Sanitary Sewer Utilities

OCA proposes the Board adopt a ratemaking principle that prohibits Iowa-American from recovering the acquisition price of the Blue Grass sanitary sewer system from other sanitary sewer customers. OCA is concerned that other customers would be subsidizing Blue Grass' costs. (OCA Kruger Direct, pp. 24-25; OCA Kruger Rebuttal, p. 6.)

OCA also proposes that the Board order Iowa-American to keep separate books for all future sanitary sewer utility acquisitions. OCA states the Board required Iowa-American to keep separate books when it acquired the Blue Grass water utility, and the Board should do the same in this case.

Iowa-American agrees to maintain separate books until Iowa-American's next general rate case proceeding. (Tr. 224¹; Iowa-American Reply Brief, pp. 8-9.) Iowa-American does not agree that the Blue Grass system should be kept separate indefinitely. (Iowa-American Reply Brief, pp. 8-9.) Iowa-American argues that keeping

¹ "Tr." shall refer to the transcript of the hearing held March 24, 2022.

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all systems separate would be complex and inconsistent with current utility practice. (*Id.*)

At the March 24, 2022 hearing, Iowa-American witness Simmons testified that whether each utility would have separate rates would be assessed on a case-by-case basis. (Tr. 155.) Mr. Simmons testified that he had no concerns regarding subsidization of one utility to another. (Tr. 121-22.)

Board rule 199 IAC 21.17 states:

Separate books for acquired sanitary sewage disposal service assets. A utility acquiring the whole or any substantial part of a sanitary sewage system with a fair market value of \$500,000 or more from a non-rate-regulated entity described in Iowa Code section 476.1(4) shall maintain separate books and records for the acquired system until the utility's next general rate case, unless otherwise ordered by the board.

As Board rules already require Iowa-American to keep separate books until its next general rate case, the Board finds that it is not necessary to address this proposed ratemaking principle in this docket, and this proposed ratemaking principle can be raised by OCA in Iowa-American's next general rate case proceeding. In general, most utilities do not charge separate rates based on the utility system, but rather based on customer class. In the case of separate rates, the Board will deny OCA's proposed ratemaking principle that requires Iowa-American to have separate rates for each sanitary sewer utility. This is an issue that OCA can raise in Iowa-American's next general rate case proceeding.

3. Regulatory Liability Account

OCA argues that Iowa American's proposed rates produce revenues that exceed the revenue requirement for Year One. This is partly due to Iowa-American recovering

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through its proposed rates the costs of assets that are not yet used and useful. According to OCA, this violates the used and useful regulatory principle. Therefore, OCA proposes the Board approve a ratemaking principle that requires Iowa-American to allocate any excess revenues (above OCA witness Kruger's calculated year-one revenue requirement of \$308,923) to a regulatory liability account to offset rate base in the next rate case proceeding. OCA further recommends interest be applied to the account. (Kruger Direct, pp. 18-19, 22.) Iowa-American is agreeable to this advance ratemaking principle as long as it is true-up with any revenue deficiency. Iowa-American argues that this is a more balanced approach. (IAWC Simmons Reply, pp. 10-11.)

OCA argues that the excess revenues produce a 31.5% windfall to Iowa-American when using Iowa-American's revenue requirement of \$367,325 for the first year. (OCA Kruger Direct, p. 16.) OCA also points out that the approved rates produce a large revenue shortfall for the next two years due to the significant amount of investment that Iowa-American proposed to address the IDNR requirements. (OCA Kruger Direct, p. 9.)

OCA does not agree with Iowa-American's proposal to true-up the regulatory liability account for any revenue deficiency. OCA states that Iowa-American's proposal is essentially a revenue stabilization mechanism, which the Board denied in Iowa-American's previous two rate cases. (OCA Initial Brief, pp. 23-24; OCA Reply Brief, pp. 6-7.) OCA states that it would withdraw this ratemaking principle if the Board were to accept Iowa-American's modification to this principle by allowing recovery of any revenue deficiency. (OCA Initial Brief, p. 24.)

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The Board finds that adoption of the non-traditional ratemaking principle to allow rates in the first year, and possibly other years, to recover costs associated with upgrades to the sanitary sewer system that are not used and useful and in service addresses the issue of whether a regulatory asset account is necessary. The Board understands by approving the rates proposed by Iowa-American, the rates will recover revenue in excess of the cost-of-service for the first year.

The Board does not consider it reasonable to adopt OCA's proposed advance ratemaking principle to track the costs and revenues of the upgrades because the Board is approving rates that include plant not currently in service and used and useful. The Board does not consider it good regulatory policy in this case to allow for adjustments for rates in the next general rate case proceeding to reflect either a revenue deficiency or an over-collection of revenue. Any issues regarding whether Iowa-American has met its IDNR requirements can be addressed in the next general rate case proceeding. As mentioned above, the Board will require Iowa-American to file annual reports to allow the Board and OCA to follow Iowa-American's progress in meeting the IDNR requirements.

4. Limited Return Until Customer Benefits Delivered

OCA proposes that the Board allow Iowa-American to earn a return equal to its cost of debt of 5.62% for the acquisition assets until Iowa-American demonstrates it has provided Blue Grass sanitary sewer customers with certain benefits, such as cheaper operating and maintenance expenses and less costs for future investments. (Kruger Direct, p. 14.) Iowa-American argues that limiting the return on investment is essentially a penalty to Iowa-American and diminishes the earnings from Iowa-American's

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investments into the Blue Grass sanitary sewer utility. (Iowa-American Reply Brief, pp. 7-8.)

The Board has set rates in this order that include the return on equity to be applied to sanitary sewer plant rate base approved by the Board in Iowa-American's last general rate case proceeding. The Board found use of that return reasonable based upon the evidence in the record. The Board will not adopt OCA's proposed return.

E. Unmetered Sanitary Sewer Service Charges

Included with its Application, Iowa-American proposes to include a charge for unmetered sanitary sewer service in its sanitary sewer tariff, identified as Docket No. TF-2021-0098. (Tariff, Original Sheet No. 57.) Iowa-American proposes to charge \$50.60 per month for residential customers and \$109.90 per month for commercial customers. (*Id.*) This charge would only be applicable to customers who do not receive water from metered sources. (IAWC Simmons Direct, pp. 10-11.) The charge would be based upon the average bill of a similarly situated customer's average usage of the same customer type. (*Id.*)

Initially, OCA recommended the Board deny the proposed sanitary sewer tariff because there are no unmetered customers in Blue Grass. (OCA Tessier Direct, p. 16.) OCA's proposal included the caveat that Iowa-American could propose an unmetered sanitary sewer service charge during Iowa-American's next rate case. (*Id.* at pp. 16-17.)

Iowa-American witness Simmons testified that while Blue Grass does not currently have unmetered sanitary sewer customers, due to Scott County ordinances,

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there is a possibility Iowa-American would have future unmetered sanitary sewer customers. (IAWC Simmons Reply, p. 13.)

In reply testimony, OCA witness Tessier was agreeable to the unmetered sanitary sewer tariff because the tariff may be needed at some point. (OCA Tessier Rebuttal, pp. 8-9.)

Board Rule 21.11 requires metered measurement of sanitary sewage with minimal exceptions. Specifically, rule 21.11 states in part “provide flat rate or estimated service for the following: (1) Temporary service; or (2) The disposal at the sewage treatment plant of delivered sewage where the amount of sewage can be readily estimated.” During the hearing, Iowa-American witness Simmons testified that if a customer falls under the unmetered sanitary sewer classification, Iowa-American would classify it as temporary and Iowa-American would attempt to “get a meter in place because we intend to meter...” (Tr. 134-35.)

The Board finds that this practice is consistent with Board Rule 21.11 and will require Iowa-American to include language in its sanitary sewer tariff that adopts Iowa-American’s proposal for unmetered sanitary sewer service.

F. Regulatory Expenses

Iowa-American proposes to track the regulatory expenses associated with this proceeding for the Board’s consideration in its next rate case. (IAWC Simmons Reply, p. 9.) Iowa-American witness Simmons testified that Board, OCA, and outside counsel expenses are generally capitalized as a part of the acquisition. (*Id.*)

OCA witness Kruger disagrees with Iowa-American witness Simmons’ assertion that regulatory expenses are generally capitalized. (Kruger Rebuttal, pp. 3-4.) Mr.

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Kruger testified that Iowa-American “is proposing to treat regulatory and legal expenses incurred in this case like it would for a general rate case.” (*Id.*)

At hearing, Iowa-American witness Simmons testified that the regulatory expense is put into rate base and then recovered from customers “over the same period of time as the acquisition.” (Tr. 122.) While not asking for the recovery of the regulatory expenses at this time, Iowa-American witness Simmons testified that Iowa-American is requesting to have a regulatory asset account for the regulatory expense, which would then be discussed at its next rate case. (*Id.* at p. 123.)

OCA agrees recovery of regulatory expense should be reserved until Iowa-American’s next general rate case proceeding. (OCA Initial Brief, pp. 29-30.) OCA does state “[t]he Board should be aware that if approved, this regulatory expense would add to the already significant costs this acquisition will impose on customers.” (*Id.* at p. 30.)

The Board can find no statutory support for allowing Iowa-American to recover regulatory costs associated with the acquisition of the Blue Grass sanitary sewer system in future rates. Iowa Code chapter 476 allows recovery of general rate case expenses from customers. Iowa Code § 476.84 does not contain a similar provision. The Board will deny the proposal to address recovery of regulatory expenses associated with the acquisition of the Blue Grass sanitary sewer system in Iowa-American’s next general rate case proceeding.

VI. BOARD CONCLUSIONS

Based upon the findings discussed above, the Board will approve the acquisition of the Blue Grass sanitary sewer system by Iowa-American. This is the first acquisition of a sanitary sewer system by a rate-regulated utility pursuant to Iowa Code § 476.84. In this order, the Board addresses legal issues necessary to provide guidance in setting just and reasonable rates for future acquisitions and to establish advance ratemaking principles that are required for setting just and reasonable rates for Blue Grass customers. The Board is not approving the APA because that is a commercial transaction between Iowa-American and Blue Grass over which the Board does not have jurisdiction. The Board's authority and responsibility is to set just and reasonable rates for the sanitary sewer service and identify any other requirements that should be included in the sanitary sewer tariff. Even though the Board is adopting rates Iowa-American included in its proposed sanitary sewer tariff, the Board is not basing that decision on the agreement between Iowa-American and Blue Grass. The decision is based upon the evidence presented in this contested case proceeding.

Iowa-American will be required to file a revised proposed sanitary sewer tariff in compliance with this order that, once approved, will go into effect on the date of the execution of acquisition. Iowa-American will be required to file the revised proposed sanitary sewer tariff for Board approval once there is a date known on which the transfer of ownership will occur.

The Board understands that the cost of this first acquisition pursuant to the requirements in Iowa Code § 476.84 have been extensive. Based upon the decision made in this order, the costs of future acquisitions should be greatly reduced. The

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intent of the statute is to provide a way for small municipal sanitary sewer systems to shift the costs of necessary and expensive upgrades of their sanitary sewer systems to a rate-regulated utility that will make the necessary upgrades.

By bringing the municipal sanitary sewer customers within the jurisdiction of the Board, the customers have rates for service that have been determined by the Board to be just and reasonable based upon the requirements of Iowa Code § 476.84 and the statutory requirements for setting rates in Iowa Code chapter 476. The Board is reviewing the minimum filing requirements in 199 IAC 41.5 to determine whether revisions to the current rules should be proposed. If the Board determines revisions should be proposed, the revisions will be addressed in a new rule-making docket and provided to stakeholders for comment.

VII. ORDERING CLAUSES

IT IS THEREFORE ORDERED:

1. The Utilities Board approves Iowa-American Water Company's acquisition of the sanitary sewer and wastewater utility owned and operated by the City of Blue Grass, Iowa.
2. The sanitary sewer and wastewater utility owned and operated by the City of Blue Grass, Iowa, is determined not to be an at-risk system.
3. Iowa-American Water Company shall file a revised sanitary sewer tariff in Docket No. TF-2021-0098 consistent with this order for Utilities Board approval at least ten days prior to the date the sanitary sewer and wastewater utility is to be transferred to Iowa-American Water Company.

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4. Based on the evidence provided in this docket, the advance ratemaking principle of setting the initial depreciable value of the sanitary sewer and wastewater utility assets at \$2 million is approved.

5. The rates approved for sanitary sewer and wastewater service are a fixed monthly charge of \$39.48 for all meter sizes and a variable charge of \$0.74124 for each 100 gallons, after the first 2,500 gallons.

6. The Utilities Board approves Iowa-American Water Company's use of unmetered sanitary sewer and wastewater service in its sanitary sewer tariff as a temporary rate. The monthly rates approved for unmetered service are \$50.60 for residential service and \$109.90 for commercial sanitary sewer and wastewater service.

7. Iowa-American Water Company shall file an annual report identifying the upgrades to the sanitary sewer and wastewater utility installed during the previous 12 months until it files its next general rate case proceeding. Iowa-American Water Company shall file the first annual report within 30 days of the anniversary of the execution of the purchase of the sanitary sewer and wastewater utility assets of the City of Blue Grass, Iowa.

8. Iowa-American Water Company shall seek all available state revolving funds and any other eligible state or federal financing or grants for sanitary sewer and wastewater utility upgrades. Iowa-American Water Company shall file an annual report on Iowa-American Water Company's efforts to receive state, federal, or other grants or funding until it files its next general rate case proceeding. The first annual report shall be due within 30 days of the anniversary of the closing of the purchase of the sanitary sewer and wastewater utility assets of the City of Blue Grass, Iowa.

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9. Except as specified in Ordering Clause No. 4, the advance ratemaking principles proposed by Iowa-American Water Company and the Office of Consumer Advocate, a division of the Iowa Department of Justice, are not approved.

10. Iowa-American Water Company's proposal to address recovery of regulatory expenses associated with the acquisition of the sanitary sewer and wastewater utility owned and operated by the City of Blue Grass, Iowa, in Iowa-American Water Company's next general rate case proceeding is not approved.

UTILITIES BOARD

Geri Huser Date: 2022.07.12
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Richard Lozier Date: 2022.07.11
15:22:40 -05'00'

ATTEST:

Louis Vander Streek Louis Vander Streek
2022.07.12 11:33:37
-05'00'

Josh Byrnes Date: 2022.07.11
16:38:27 -05'00'

Dated at Des Moines, Iowa, this 12th day of July, 2022.