

STATE OF IOWA
DEPARTMENT OF COMMERCE
BEFORE THE IOWA UTILITIES BOARD

IN RE:

IOWA-AMERICAN WATER COMPANY

DOCKET NO. RPU-2020-0001

REPLY BRIEF OF THE OFFICE OF CONSUMER ADVOCATE

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May 4, 2021

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TABLE OF CONTENTS

	<u>Page</u>
TABLE OF CONTENTS.....	i
TABLE OF AUTHORITIES	iii
INTRODUCTION	1
ARGUMENT.....	1
I. THE BOARD SHOULD ADOPT OCA’S RECOMMENDED REVENUE REQUIREMENT	1
A. Introduction.....	1
B. Revenues	2
1. Declining Usage Per Customer and Revenue Growth.....	2
C. Expenses	3
1. Labor and Labor-Related Expense – Vacant Positions.....	3
2. Labor and Labor-Related Expense – Performance Pay	5
3. Support Services	6
4. Inflation Factor.....	8
5. Interest Synchronization	9
D. Rate Base – Cash Working Capital.....	10
E. Non-Recurring Expenses	11
1. Amounts Related To The Tax Cuts And Jobs Act.....	11
2. Return Of Unprotected EADIT To Customers	12
3. COVID-Related Expenses	13
a. Late Payment Fees.....	14
b. Liquidity Loan Interest.....	15

TABLE OF CONTENTS

	<u>Page</u>
<i>c. Deadline For Recording COVID-19 Expenses</i>	17
II. THE BOARD SHOULD SET RATES TO MORE EVENLY SPREAD THE FINAL REVENUE INCREASE ACROSS ALL CUSTOMER CLASSES.....	17
III. IOWA-AMERICAN’S PROPOSAL TO RECOVER COSTS OF LEAD SERVICE LINE REPLACEMENT IN QIP IS PREMATURE AND SHOULD BE REJECTED.....	19
IV. THE BOARD SHOULD REJECT IOWA-AMERICAN’S PROPOSED LOW-INCOME WATER ASSISTANCE (LIWA) PROGRAM BECAUSE THE LIWA IS CONTRARY TO IOWA-LAW, IS BAD POLICY, AND MOST IMPORTANTLY, IS NOT JUSTIFIED.....	22
V. THE BOARD SHOULD DENY THE QIP; HOWEVER, IF THE BOARD ALLOWS A VERSION OF THE QIP TO CONTINUE, IT SHOULD MAINTAIN THE THRESHOLD AND ADOPT THE CHANGES RECOMMENDED BY OCA	24
VI. THE BOARD SHOULD REJECT THE REVENUE STABILIZATION MECHANISM	29
VII. THE BOARD SHOULD ADOPT OCA’S RECOMMENDATIONS REGARDING OTHER TARIFF CHANGES PROPOSED BY IOWA-AMERICAN	31
A. Tax Reconciliation Rider	31
B. Service Line Ownership.....	31
C. Waiver Of Fees	32
D. Company Liability	32
VIII. THE BOARD SHOULD ADOPT OCA’S CAPITAL STRUCTURE AND COST OF CAPITAL.....	33
CONCLUSION.....	37

TABLE OF AUTHORITIES

<u>Case Law and Administrative Decisions</u>	<u>Page(s)</u>
<i>In re: Iowa-American Water Co.</i> , Docket Nos. ARU-2020-0123 and SPU-2020-0003, “Compliance Filing – COVID-19 Regulatory Asset Accounting as of March 31, 2021,” (IUB, Apr. 30, 2021)	14
<i>In re: Iowa-American Water Co.</i> , Docket Nos. ARU-2020-0123 and SPU-2020-0003, “Covid Deferral Through March 2021” (IUB, Apr. 30, 2021).....	23
<i>In re: Iowa-American Water Co.</i> , Docket No. RPU-2013-0002, “Final Decision and Order,” (IUB, Feb. 28, 2014).....	27, 28, 29
<i>In re: Iowa-American Water Co.</i> , Docket No. RPU-2016-0002, “Final Decision and Order,” (IUB, Feb. 27, 2017).....	25, 26, 27, 34
<i>In re: Iowa-American Water Co.</i> , Docket No. TF-2017-0029, “Order Approving Tariff with Modifications,” (IUB, Sept. 18, 2017).....	26
<i>In re: Interstate Power and Light Co.</i> , “Motion to Withdraw Filing,” Docket No. TF-2016-0026 (IUB, Jul. 8 2016).....	32
<i>In re: Interstate Power and Light Co.</i> , “Final Decision and Order,” Docket No. RPU-2019-0001 (IUB Jan. 8, 2020).....	13
<i>In re: Iowa Electric Light and Power Co.</i> , 1973 WL 36174, 2 P.U.R. 4th 288	23
<i>In re: Winter Moratorium Extension</i> , Docket No. SPU-2020-0003, “Order Authorizing Regulatory Accounts and Establishing Additional Reporting Instructions,” (IUB, May 1, 2020).....	14
<i>In re: Winter Moratorium Extension</i> , Docket No. SPU-2020-0003, “Order Addressing Regulatory Asset Account Plans and Contested Case Proceedings,” (IUB, Aug. 6, 2020).....	15
Tennessee Public Utility Commission, Docket No. 18-00039, “Final Order Resolving Phase Two Issues,”	13
Tennessee Public Utility Commission, Docket No. 18-00040, “Commission Order”	13

TABLE OF AUTHORITIES

<u>Statutory Law</u>	<u>Page(s)</u>
Iowa Code § 476.33(4)(b).....	30
Iowa Code § 476.52	28
 <u>Rules and Regulations</u>	
199 IAC chapter 10	20
199 IAC chapter 19.....	20
 <u>Other Authorities</u>	
49 CFR parts 191, 192, 193, and 199	20

INTRODUCTION

On August 28, 2020, Iowa-American Water Company (Iowa-American, Company, or IAWC) filed with the Iowa Utilities Board (Board) its Application for Revision of Rates (Application) that would allow Iowa-American a permanent annual increase in its Iowa retail water revenue of approximately \$3.95 million, or about 9.5 percent over its current revenues. The proceeding was heard by the Board on March 3 and March 4, 2021 and initial post-hearing briefs were filed by Iowa-American and Office of Consumer Advocate (OCA) on April 19, 2021. OCA hereby replies to Iowa-American's Initial Brief.

ARGUMENT

I. THE BOARD SHOULD ADOPT OCA'S RECOMMENDED REVENUE REQUIREMENT.

A. Introduction.

Iowa-American developed its revenue requirement using a future test year. Iowa-American proposed pro forma adjustments that increased and decreased test year results to reflect what the Company asserts to be known or projected changes in cost and investment levels so that its revenue requirement and final rates would be representative of the costs it would incur and the revenues it would collect while the rates are in effect. OCA does not agree that Iowa-American's proposed revenue requirement is representative of the costs and revenues that are likely to exist in the future. Rather, Iowa-American's proposed revenue requirement would result in rates that are not just and reasonable. In its testimony and exhibits, OCA accepted some of the pro forma adjustments proposed by Iowa-American, rejected others, and proposed additional adjustments of its own.

B. Revenues.

OCA disagrees with adjustments made by Iowa-American to adjust test year revenues for declining usage. The Company's adjustments substantially reduce the test year's revenue with the potential result being windfall profits at the expense of ratepayers. OCA Witnesses Kruger and Dismukes explain OCA's position through their testimony and accompanying exhibits.

1. Declining Usage Per Customer and Revenue Growth

In an attempt to increase revenue, Iowa-American is requesting an adjustment for declining usage per customer. OCA objects to the Company's proposed revenue adjustment for declining use because it focuses on use per customer instead of overall usage. Such an adjustment would reduce test year revenue with the potential for windfall profits at the expense of ratepayers. OCA Witness Dismukes showed that since 2015, revenues have actually increased each year, despite declining use per customer. (OCA Dismukes Direct Testimony, p. 19). Iowa-American tries to suggest that Dr. Dismukes' calculations are not representative of revenue per customer because they did not include adjustments for rate changes and weather normalization. However, Dr. Dismukes provided testimony and exhibits supporting his conclusion that the factors of rate changes and weather are most important when looking at a one- or two-year period; over a longer timeframe, his information is representative of trends. (OCA Dismukes Direct Exhibits 6 and 7).

Iowa-American has made similar claims regarding a declining use adjustment in both of its last two rate cases, Docket Nos. RPU-2013-0002 and RPU-2016-0002. In the 2013 rate case, Iowa-American requested a reduction in test year billing determinants of 2.4 percent based on claimed decreases in usage per customer, while in the most recent 2016 rate case, the Company requested a test year billing determining adjustment of \$328,239 based on claimed decreases in

residential usage per customer, in addition to a Revenue Stabilization Mechanism (RSM). (OCA Dismukes Direct Testimony, p. 17). The Board rejected Iowa-American's adjustments in these cases recognizing that while usage per customer can decrease, it does not necessarily translate into a decrease in revenues. *Id.* at 17-18. The important metric to note in this case should continue to be the changes in *revenue*, not the changes in usage. *Id.* at 19. Overall, total billed revenues have increased by 8 percent since 2016, and normalized revenues have grown annually since 2015. *Id.* By focusing exclusively on use per customer and ignoring factors such as customer growth, overall sales, and the billing determinants used in rate cases, Iowa-American only gives a partial picture of any potential effect that declining use per customer has on the company's revenue. Accordingly, the Board should reject Iowa-American's proposed adjustment for declining use just as it did in Iowa-American's previous rate cases.

C. Expenses.

OCA disagrees with several expense adjustments made by Iowa-American that result in a reduction of the test year's revenue and possible windfall profits for the Company at the expense of ratepayers. OCA Witness Kruger explains OCA's positions through his testimony and accompanying exhibits.

1. Labor and Labor-Related Expense – Vacant Positions

Iowa-American calculates its labor and labor-related expenses based on 77 full time equivalent (FTE) employees, which includes three current vacation positions that the company has not filled. (IAWC Cephas Direct Exhibit 4). Iowa-American's rates should not be based on labor expenses that include these vacant positions. (OCA Kruger Rebuttal Testimony, pp. 13-14; OCA Kruger Rebuttal Exhibit 1, Schedule C, p. 3). Doing so will allow the Company to recover

revenues from its customers for expenses that it will never have to incur. *Id.* OCA proposed an adjustment for vacant positions that reduced Iowa-American's projected staffing by one position.

Iowa-American argues that OCA's proposed adjustment "ignores the big picture." (IAWC Initial Brief, p. 23). The Company argues that it has taken great strides to control overall labor and labor-related expenses since the Company's last rate case, which has resulted in a \$95,000 reduction to the labor and labor-related expense. OCA is aware that Iowa-American is proposing \$95,000 less in labor and labor-related *expense* in this proceeding, despite claiming to have more employees. However, expense is not the only component of labor and labor-related activity proposed by Iowa-American. Company employees are not suddenly working for less money. Rather, Iowa-American has changed the amount of labor and labor-related expenses it *capitalizes* compared to the last rate case. (OCA Kruger Rebuttal Testimony, p. 21). This change gives Iowa-American the appearance of reducing labor and labor-related expenses when in reality, the Company is now recovering a larger percentage of labor and labor-related expenses through rate base and is earning a return on and recovery of the expense. *Id.* In total, Iowa-American is paying more for labor today than in 2016. *Id.*

Iowa-American also argues that OCA ignored the fact that when positions are unfilled, current or temporary workers must pick up overtime hours to compensate for the lack of employees. OCA's adjustment fully appreciated this fact and OCA Witness Kruger's Reply Testimony accounted for IAWC's Witness Nielsen's "Table No 1," which showed that even when Iowa-American had less than full employment in January 2021, its overtime labor amount was actually less than the amount it budgeted for in the future test year. (OCA Kruger Rebuttal Testimony, p. 13). OCA's adjustment is conservative given the fact that it eliminates only one lower paid position and makes a slight adjustment to overtime labor. *Id.* Historical trends

indicate the Company will likely have more than one vacant position and if Iowa-American has full employment, as was the case in 2015, the Company's overtime labor was more than \$200,000 less than its forecast for the future test year. *Id.*

Given this information, OCA's adjustment is more than reasonable and the Board should adopt OCA Witness Kruger's adjustments for vacant positions as presented in his Rebuttal Testimony. (OCA Kruger Rebuttal Testimony, pp. 13-14; OCA Kruger Rebuttal Exhibit 1, Schedule C, p. 3).

2. Labor and Labor-Related Expense – Performance Pay

Iowa-American seeks to include labor expense related to performance pay for eligible employees in its calculations of revenue requirement. Because of the way the Company's performance pay plans are structured, Iowa-American does not actually pay any incentives unless certain company financial targets are achieved, regardless of whether operational metrics are met. OCA objects to the inclusion of these performance pay plan costs in the revenue requirement calculation. Not only have the expenses related to performance pay nearly quadrupled since 2015, but the plans have been structured to be contingent upon the Company's financial performance, giving Iowa-American's shareholders the primary benefit while ratepayers pay 100 percent of the costs. (IAWC Nielsen Reply Testimony, p. 21; Tr. 342).

According to American Water Works' (AWW's) Schedule 14 A, which was filed with the Securities and Exchange Commission (SEC) on March 31, 2020, AWW designed its compensation philosophy for all employees, including Iowa-American employees, who are eligible for annual performance pay, based on the "principle elements of the executive compensation," which is to benefit shareholders. (OCA Kruger Rebuttal Testimony, pp. 16-17). AWW's shareholders have realized the financial benefits that these performance plans are

designed to achieve; shareholders have enjoyed a more than 700 percent return since 2008, and the Company has consistently increased its dividend over the same time period. *Id.* at 17. While AWW's shareholders have seen the value of their stock prices nearly octuple since 2008, the Company's ratepayers have seen the cost for the same gallons of water used in 2008 nearly double in Iowa-American's proposed test year period. *Id.* at 19-20.

As OCA attempted to make abundantly clear in its initial brief, OCA does not object to Iowa-American offering performance pay plans to its employees, nor does OCA have reason to conclude that the Company's total compensation package, including performance pay, is unreasonable. However, Iowa-American's performance pay plans result in an asymmetrical benefit to shareholders at the expense of ratepayers. (OCA Kruger Rebuttal Testimony, p. 20). Iowa-American is proposing to include 100 percent of the performance pay plan cost as a cost of service where the benefits of performance pay are first and foremost realized by shareholders in the form of the Company's overall financial performance. *Id.* Because Iowa-American only pays performance pay incentives to employees when the parent company's financial earnings targets are met, it is only fair for shareholders to bear the cost for these added benefits, not ratepayers. *Id.*

OCA recommends that the Board exclude performance pay plans from the revenue requirement calculations and allow the costs for those plans to be assumed by the shareholders who directly benefit from them.

3. Support Services

OCA objects to Iowa-American's proposal to include an adjustment to its revenue requirement calculation that projects an increase of nearly \$200,000 in service company costs attributable to the sale of New York American Water Company (NYAW). In November 2019,

AWW agreed to sell NYAW, consisting of approximately 126,000 customers, to Liberty Utilities. Iowa-American claims that there will be a reallocation of Service Company charges to the Company that will occur as a result of the pending sale and that those charges should be recognized in this case. (IAWC Baryenbruch Reply Testimony, pp. 4-5). However, as OCA Witness Kruger explained in his Direct and Rebuttal Testimony, the sale of NYAW is not complete and therefore, the associated expenses are highly speculative and uncertain. Iowa-American initially claimed the sale of NYAW to Liberty Utilities would be complete at the end of 2020. OCA Witness Kruger identified several hurdles the sale must clear before completion, one of those hurdles being resistance to the sale by the New York Legislature. On April 20, 2021, the New York State Senate passed a bill that would create the Nassau County Water Authority.¹ The Authority was to then start the process of municipalizing NYAW. *Id.* AWW first announced the sale of NYAW to Liberty in November 2019, and given the level of resistance it has seen, it appears the sale is far less certain today than it was then. Moreover, the process of municipalization may take even longer time to sort out. Given all of the unknown variables associated with the divestiture of NYAW, it would be inappropriate for the Board to approve any increase in revenues related to the *potential* loss of NYAW customers.

The unknown costs associated with this sale alone make inclusion of a \$200,000 adjustment for service company costs inappropriate. That said, there are additional reasons why this adjustment should not be recognized. First, while recognizing the loss of AWW customers due to the sale of NYAW, Iowa-American Witness Baryenbruch testified that AWW's total customers have increased steadily by more than 181,000 from 2015 to 2019, or approximately 45,300 customers per year, from both organic growth and new system acquisitions. (IAWC

¹ See <https://patch.com/new-york/merrick/state-senate-passes-bill-privatize-new-york-american-water>.

Baryenbruch Reply Testimony, p. 13). This average annual growth represents roughly 36 percent of the loss of customers in the NYAW sale. (OCA Kruger Rebuttal Testimony, p. 26). Moreover, based on AWW's 3rd Quarter 10-Q, it appears AWW has obtained approximately 66,100 new customers in 2020, through November 4, 2020, which represents more than half the number of customers AWW stands to lose through the sale of NYAW. These customers will all add revenue to the system and the addition of those customers will alter the service company costs assigned to Iowa-American that are associated with the sale. If Iowa-American is to single out the NYAW sale without recognizing any potential customer growth, it will assign too many service company charges to Iowa-American ratepayers.

OCA recommends that the Board reject the inclusion of the nearly \$200,000 in service company costs attributable to the sale of NYAW, as proposed by OCA Witness Kruger. (OCA Kruger Direct Testimony, pp. 21-22; OCA Kruger Rebuttal Testimony, pp. 23-28).

4. Inflation Factor

OCA objects to Iowa-American's forecasted inflation adjustment calculations for O&M expenses, and more specifically, the inclusion of 2020 as a representative year for comparing O&M expenses because historically Iowa-American's O&M expenses have shown no correlation to inflation. OCA Witness Kruger's Direct Testimony, Figure 1, illustrates this fact graphically from 2010 to 2019 where Iowa-American's O&M expenses actually decreased four years and increased five years. (OCA Kruger Direct Testimony, p. 17, Figure 1). Overall, the Company's O&M expenses increased less than 0.3% per year on average, inclusive of salary and wage increases. (OCA Kruger Direct Testimony, p. 17). Iowa-American relies on preliminary actual O&M expenses for 12 months, ending December 31, 2020, to justify its forecasted inflation adjustment for O&M expenses for test year 2021-22. (IAWC Simmons Reply Testimony, p. 9).

Given the impact that the COVID-19 pandemic has had on all areas of life, including Iowa-American's operations, the preliminary actual results for 2020 may contain several anomalous circumstances that would likely need to be normalized if 2020 were used as a historic test year. (OCA Kruger Direct Testimony, pp. 16-18; OCA Kruger Rebuttal Testimony, pp. 21-23; Tr. 345-348).

Iowa-American's test year forecasted O&M expenses as proposed are nearly 10 percent higher than O&M expenses in 2019. In contrast, OCA recommends an increase of 4.3 percent compared to 2019, which outpaces the Company's historic growth trends for O&M expenses. (OCA Kruger Rebuttal Testimony, p. 22; Tr. 345-348). The forecasted O&M expenses need no adjustment for inflation. *Id.*, at 23, Table III.

5. Interest Synchronization

While Iowa-American and OCA agree that an interest synchronization adjustment is appropriate, the difference between the Company's approach to an interest synchronization adjustment and OCA's approach is based on the size of rate base and long-term debt amounts that are used to make the revenue requirement calculation. Consistent with its position in past rate cases, OCA recommends an adjustment for interest synchronization to match the interest on long-term debt with OCA's proposed capital structure and rate base. (OCA Kruger Direct Testimony, p. 22). Iowa-American Witness Simmons agrees an interest synchronization adjustment is necessary when adjustments are made to rate base items like the adjustments OCA proposed. (Tr. 178). OCA recommends that the Board adopt its interest synchronization methodology as proposed by OCA Witness Kruger. (OCA Kruger Direct Testimony, p. 22).

D. Rate Base – Cash Working Capital.

Cash working capital represents the amount of money necessary for the company to have at its disposal to pay regular expenses as they come due. In its initial brief, Iowa-American argued that OCA Witness Kruger's calculation for collection lag days was incorrect, claiming that Mr. Kruger double-counts uncollectibles that the Company has already written off as being uncollectible. (IAWC Initial Brief, p. 46). However, as Mr. Kruger explained in his rebuttal testimony, when the Company writes off certain accounts receivable balances as uncollectible, there are other billed revenues from the same day of the uncollectible write-off that will become uncollectible in the future. (OCA Kruger Rebuttal Testimony, p. 33). The annual level of uncollectibles will always remain in the daily accounts receivable balance and needs to be removed on a daily basis to calculate proper collection lag. *Id.*, at 33-34.² The Board should adopt OCA's cash working capital calculation as described by OCA Witness Kruger. (OCA Kruger Rebuttal Testimony, pp. 28-35).

In addition, the Board should adopt OCA's proposal to assign 50 percent of Iowa-American's service company costs at 12.00 expense lag days to match that of salaries and wages and 50 percent of the service company costs at 43.87 expense lag days to match that of contracted services. (OCA Kruger Rebuttal Testimony, p. 38; *see also* OCA Kruger Rebuttal Testimony, pp. 33-37, Table V and Table VI). This proposal more closely matches the time period with when Iowa-American will actually incur these expenses with the time period that

² For example, if Customer A receives a bill on January 1 and pays on January 20 the bill remains outstanding for 20 days and is then cleared from Accounts Receivable when the payment is received. However, assume Customer B receives a bill on January 1 but never pays the bill and the Company eventually writes it off as uncollectible on May 1. The Company proposes to recognize 120 days of outstanding daily accounts receivable, but only one day of daily uncollectible expense on May 1. Since Customer B never paid, the uncollectible amount existed for the same period of time as the daily accounts receivable balance. OCA's calculation recognizes the uncollectible balance existed for the same duration as the accounts receivable balance. Since the Company will never receive the cash for the uncollectible balance, it should be removed from the daily accounts receivable balance.

Iowa-American should remit funds to AWW to cover these expenses. (OCA Kruger Rebuttal Testimony, p. 39). Properly aligning these time periods will eliminate the time value of the money AWW currently enjoys by having these expenses pre-paid and encourages fairness between how the Company treats its affiliated companies and how it treats outside vendors. *Id.*

E. Non-Recurring Expenses.

1. Amounts Related To The Tax Cuts And Jobs Act

Iowa-American proposes to flow the final calculated amount of income tax expense rate reduction benefits through the Non-Recurring Expense Rider over a 3-year period. This amount represents the income tax savings realized by the Company due to the Tax Cuts and Jobs Act (TCJA). Iowa-American currently refunds this amount annually to its customers through an offset of the Qualified Infrastructure Plant (QIP) tracker and accelerated amortization of the Davenport Floodwall. The Company should not be allowed to extend the amortization period for these funds just because it cannot use them to offset other projects. (OCA Kruger Direct Testimony, p. 36).

In its “Order Approving Tariff,” issued in Docket No. TF-2018-0280, the Board approved Iowa-American’s proposal to utilize TCJA credits to offset the QIP Surcharges and accelerate amortization of the Davenport Floodwall, but also indicated that any remaining amount of TCJA Credit after offsetting the QIP Surcharge and Davenport Floodwall shall be returned to customers in the form of a bill credit. *Id.* The three-year amortization dilutes the value of these TCJA savings for the customers that paid the excessive tax rates. *Id.* OCA recommends offsetting the QIP surcharge under-recovery, which OCA calculates as \$16,984, with the current portion of the TCJA credits, resulting in an estimated refund of TCJA benefits of \$526,019. *Id.*

2. Return Of Unprotected EADIT To Customers

As OCA Witness Kruger explained in his testimony in this case, there are two categories of Excess Accumulated Deferred Income Tax (EADIT): protected and unprotected. (OCA Kruger Direct Testimony, p. 38). Protected EADIT generally arise from plant-related assets because they are related to the book and tax timing differences associated with depreciation expense. *Id.* Unprotected EADIT generally consists of all other book timing differences other than depreciation. *Id.*, at 39. The IRS allows for the return of unprotected EADIT to customers at any rate, but requires protected EADIT to be normalized. *Id.* at 37. Typically, companies use the Average Rate Assumption Method (ARAM) to return protected EADIT to customers over the life of the asset. *Id.*

Iowa-American, however, is proposing to provide the estimated \$6.3 million of TCJA benefits associated with ***unprotected*** EADIT to customers using the ARAM method, regardless of the protected or unprotected classification, which amortizes the amount over the remaining lives of the assets. (IAWC Wilde Direct Testimony, p. 13). Based on Iowa-American's proposed methodology, it will take more than 40 years for customers to receive the benefits of the unprotected EADIT. (OCA Kruger Rebuttal Testimony, p. 43).

In contrast, OCA is proposing to flow back the excess ***unprotected*** EADIT to customers over a time period that will align the return of those funds as closely as possible to the customers that made those contributions. *Id.* at 44. Iowa-American is asking the Board to allow it to keep those customer funds and return them to customers in a way that is consistent with the investment that created the excessive contributions. *Id.* However, Iowa-American fails to address the likely potential that a large majority of the customers who provided those funds will never see the total benefit of their return if 40+ years go by before the money is fully refunded.

Id. Tying the return of excess **unprotected** EADIT to the investment lives that created them is **not** required by the IRS. *Id.* at 45. These are simply funds that are owed to Iowa-American's customers for overpayments due to the TCJA; the life of the assets should have no bearing on the return of EADIT funds. *Id.* at 45-47.

It is worth noting that the Board recently approved a settlement involving Interstate Power and Light Company's natural gas and electric rate cases which included a flow back of **unprotected** EADIT over a 12-month period.³ *Id.* at 47-48. Tennessee Public Utility Commission (T-PUC) adopted a 3-year flow back of **unprotected** EADIT in two different litigated proceedings one involving Tennessee American Water Company,⁴ one of Iowa-American's counterparts, and the other involving Piedmont Natural Gas.⁵ *Id.* at 48.

The ratepayer contributed **unprotected** EADIT serves as an opportunity for Iowa-American to provide immediate relief to its customers during a difficult time. *Id.* at 48-49. A three-year return of **unprotected** EADIT would serve to provide Iowa-American the necessary rate relief while still providing customers with a bill reduction, if the Board adopts OCA's position. *Id.* at 49.

3. COVID-Related Expenses

Iowa-American identified various incremental costs and savings related to the COVID-19 pandemic that it proposes to recover through rates. (IAWC Simmons Direct Exhibit 6 Workpaper; OCA Kruger Direct Testimony, p. 43, Table X). While OCA has agreed with many

³ *In re: Interstate Power and Light Co.*, "Final Decision and Order," Docket No. RPU-2019-0001, p. 19 (IUB Jan. 8, 2020).

⁴ Tennessee Public Utility Commission, Docket No. 18-00039 "Final Order Resolving Phase Two Issues". In Response to OCA DR No. 210 (*see* OCA Kruger Direct Exhibit 2), Iowa-American provided a list of customer counts for all AWW jurisdictions. Based on the response, Iowa and Tennessee represented 1.92% and 2.36% respectively, of AWW's 3.4 million customers. Based on customer size proportionate to AWW, it appears Tennessee American Water Company would provide a similar comparison to Iowa-American in terms of capital procurement. (OCA Kruger Rebuttal Testimony, p. 48).

⁵ Tennessee Public Utility Commission, Docket No. 18-00040, "Commission Order," pp. 14-15.

of the cost categories identified by Iowa-American, OCA disagrees with the Company's proposed method of including all late payment fees in the tracking account and the proposal to charge ratepayers for interest on the short-term liquidity loan secured by American Water Capital Corporation to cover COVID-related costs. (OCA Kruger Direct Testimony, pp. 43-49; OCA Kruger Rebuttal Testimony, pp. 49-56).

Moreover, OCA questions whether a COVID-tracker is even needed. On April 30, 2021, Iowa-American filed its COVID-19 expenditures through March 31, 2021.⁶ The COVID-19 expenditures actually decreased from the December 31, 2020 amount of \$315,639 to \$184,185. The decrease is largely attributed to a reduction in incremental uncollectible expenses above last authorized and additional employee travel savings. IAWC's most recent COVID expenses include \$244,489 in foregone late payment fees and \$126,292 in debt carrying costs; OCA has substantially objected to the majority of both of these expenses. After removing these expenses, COVID-19 *expenses* actually become COVID-19 *savings*.

a. Late Payment Fees

In its initial brief, Iowa-American emphasizes a May 20, 2020, Board Order in support of its ability to recover the waived portion of customer's bills. (IAWC Initial Brief, p. 74). Specifically, Iowa-American cites the following language:

If an investor-owned utility waives a portion of a customer's past-due bill, the utility may include those amounts in a regulatory asset account established pursuant to Board order in Docket Nos. ARU-2020-0150, ARU-2020-0156, ARU-2020-0123, and ARU-2020-0225, issued on May 1, 2020.⁷

⁶ See *In re: Iowa-American Water Co.*, Docket Nos. ARU-2020-0123 and SPU-2020-0003, "Compliance Filing – COVID-19 Regulatory Asset Accounting as of March 31, 2021," (IUB, Apr. 30, 2021).

⁷ See *In re: Winter Moratorium Extension*, Docket No. SPU-2020-0003 "Order Authorizing Regulatory Accounts and Establishing Additional Reporting Instructions," Ordering Clause 6 (IUB, May 1, 2020).

Iowa-American asserts that this language allows the Company to include waived portions of customers' past-due bills in the regulatory account. (IAWC Simmons Reply Testimony, p. 23). Iowa-American's reliance on this excerpt for support is misplaced for two reasons. First, the Board's Order did not expressly address late payment fees to be included as part of the regulatory asset account, but rather past-due bills. (OCA Kruger Rebuttal Testimony, p. 49). Second, if it is implied that late payment fees are part of past due bills, inclusion in a regulatory asset account does not mean the Company gets to automatically recover those costs. *Id.* In the same docket, the Board issued an Order wherein the Board stated that "[r]ecovery of amounts related to the pandemic included in the regulatory asset accounts authorized by the Utilities Board shall be addressed in a contested case proceeding."⁸ Iowa-American should not be allowed to recover 19.56% APR⁹ on the balance of late payment fees resulting from the pandemic. *Id.* at 50. OCA does not dispute the Company should be allowed to recover late payment fees included in currently effective rates, \$124,191. *Id.* However, any additional funds recovered through the COVID expense rider beyond that amount is simply taking advantage of the situation to collect 19.56% APR on overdue bills, many of which will be written off and included as part of the incremental uncollectible expense line item included as part of the COVID-19 expense recovery. *Id.*

b. Liquidity Loan Interest

At the onset of the COVID-19 pandemic, American Water Capital Corporation (AWCC) secured a 12-month loan on March 20, 2020, with a maturity date of March 19, 2021, and a variable interest rate. (OCA Kruger Direct Testimony, pp. 45-46). AWCC allocated \$9.6

⁸ See *In re: Winter Moratorium Extension*, "Order Addressing Regulatory Asset Account Plans and Contested Case Proceedings," Docket No. SPU-2020-0003, p. 7 (IUB, Aug. 6, 2020).

⁹ 1.5% per month compounded 12 months.

million of the term loan to Iowa-American along with \$98,895 of associated interest through November 30, 2020. OCA does not argue against the prudence of AWCC initially taking out this loan, but rather contends that AWCC should have sought to repay the loan when it became clear the need for liquidity did not materialize. OCA's best indication of when AWCC no longer felt the pressure of liquidity fears is on April 29, 2020, when AWCC announced the largest *increase* to its cash dividend in the history of the Company. OCA objects to the inclusion of interest allocated to Iowa-American related to this loan beyond this date and proposes that the Board disallow all interest expense related to this loan that were incurred after April 29, 2020.

When faced with this identical issue, the Kentucky Public Service Commission (K-PSC) issued an Order denying Iowa-American's sister company, Kentucky American Water Company's (KWAC's) request for recovery of any interest on its allocated portion of the same loan. (OCA Kruger Rebuttal Testimony, p. 53). Specifically, the K-PSC stated:

Given the uncertainty of the financial markets at the onset of the COVID-19 pandemic, the Commission notes that AWCC's decision to obtain a \$500 million draw on its 364-day term loan credit facility might have been a reasonable action. However, as the pandemic progressed, the \$19.6 million dollars allocated to Kentucky-American were not used and remain in Kentucky-American's cash reserves. **Kentucky-American did not adequately explain why the \$19.6 million debt allocation was not returned to AWCC within the first few months once Kentucky-American realized that the pandemic's impact on the financial markets had not materialized, particularly as there is no prepayment penalty.** For the reasons discussed above regarding materiality, Kentucky-American failed to establish that the Term-Loan Interest expense is material to its financial position and warrants deferral accounting. . . . Additionally, **Kentucky-American did not demonstrate that the allocation of the AWCC loan was necessary given that the loan proceeds remain in a cash reserve account untouched and that the associated interest expense is not material.** For these reasons, the Commission finds that Kentucky-American's request to establish a regulatory asset for the recovery of its Term-Loan Interest expense should be denied. (Emphasis added).

Iowa-American's position in this case appears to be nearly identical to the situation the K-PSC considered in December 2020. The Kentucky Commission recognized the pandemic's impact on the financial markets did not materialize as anticipated and the Company should have sought to repay the loan after that realization became clear. Similarly, the Board should not allow Iowa-American to hold ratepayers responsible for paying interest on an unnecessary loan and should disallow the recovery of all interest expenses related to this loan after April 29, 2020, as explained by OCA Witness Kruger. (OCA Kruger Direct Testimony, pp. 44-46; OCA Kruger Rebuttal Testimony, pp. 50-54).

c. Deadline For Recording COVID-19 Expenses

Iowa-American asks that the Board allow the Company continue to record any COVID-related expenses through December 31, 2021, with the opportunity to extend that deadline if necessary. (IAWC Initial Brief, p. 77). However, the review of Iowa-American's COVID-19 expenses should occur with the review of rate case expenses in this proceeding and the filing of reply briefs represents the end of time to incur rate case expenses. (OCA Kruger Rebuttal Testimony, p. 54). OCA suggests that if Iowa-American believes its COVID-19 expenses will continue to grow significantly beyond the filing of reply briefs, despite what the evidence shows in this case, the Company can continue to report those expenses and ask the Board to include them in a regulatory asset. (OCA Kruger Rebuttal Testimony, p. 55; Tr. 368-369).

II. THE BOARD SHOULD SET RATES TO MORE EVENLY SPREAD THE FINAL REVENUE INCREASE ACROSS ALL CUSTOMER CLASSES.

In its rate design, Iowa-American's proposed volumetric rate calculation is based on using set allocators, or flat-rate ratios, that automatically assign the largest portion of any rate increase to the first usage block, which always results in the allocation of the largest rate increase

to residential customers. Iowa-American Witness Rea testified that there is no mathematical formula available to develop rates that perfectly match the cost of service and is instead an iterative, or trial-and error, process. (IAWC Rea Reply Testimony, pp. 9-10). Given that there is no available mathematical formula and rate development is instead a judgment call, OCA cautions against the Board's reliance on these allocators without additional review and proof of the appropriateness of designing rates using this particular set of allocators. (OCA Tessier Direct Testimony, p. 13; OCA Tessier Rebuttal Testimony, pp. 12-13).

Once the Board approves the final revenue increase, Iowa-American will need to re-run its Class Cost of Service (CCOS) study to properly present the revenue allocations across customer groups. (OCA Tessier Rebuttal Testimony, p. 12). Based on those results, a "trial-and-error" analysis will need to be conducted using a significant number of flat-rate ratio combinations in order to determine the most cost-effective and prudent final rates that reasonably spread the proposed increases across all customer groups while also balancing revenue recovery. *Id.* Various rate options need to be presented for the Board to be able to judge the most prudent and cost-effective rates that strike the appropriate balance between revenue recovery and customer impact. *Id.* Adjusting the flat-rate ratios will allow the proposed rate increases and the associated increased revenue recovery to be more evenly distributed across customer groups and will result in rates that more closely follow the sound rate design principles of gradualism and non-discrimination, which are important to Iowa-American. (Tr. 290-291).

Since Iowa-American based its rate case on a future test year, the Board is required to conduct a subsequent proceeding to review the Company's performance following the first 12-months at the new rate. 199 IAC 26.6. At that time, the Board will consider the effectiveness of the new rates at collecting projected revenues. If the revenues collected from the rate classes are

not reasonably consistent with the Company's approved revenue projections, the Board may adjust the rates and direct Iowa-American to present alternatives to the final flat-rate ratios that would more accurately collect the prudent and justified revenues from customers.

III. IOWA-AMERICAN'S PROPOSAL TO RECOVER COSTS OF LEAD SERVICE LINE REPLACEMENT IN QIP IS PREMATURE AND SHOULD BE REJECTED.

Iowa-American's plan to address lead is incomplete and half-baked. It is premature to allow recovery of plan expenditures until Iowa-American provides an inventory.

Iowa-American admits that it does not yet have the inventory of lead service lines required by the new EPA lead and copper rules. (Tr. 68). Iowa-American states that its plan is to "replace lead service lines that are found as [Iowa-American replaces] mains throughout the service territory. If this method does not result in the replacement of its stated replacement goals of 1,400 lines per year, Iowa-American will then proceed to other methods." (IAWC Initial Brief, p. 43). Iowa-American never bothers to systematically explain what these "other methods" would be. This is too haphazard to be considered a plan. It's certainly not consistent with Iowa-American's claim that imminent risk of "severe illness" or "loss of life" is at stake. (IAWC Initial Brief, p. 43). If lives were truly at stake, a responsible utility like Iowa-American would not just replace lead service lines as it found them; it would target replacement based on severity of risk. Iowa-American's plan does not do that.

Iowa-American has presented evidence about the risk of lead nationally and in Iowa generally.¹⁰ However, this case isn't about the average national or even Iowa water system; it is quite specifically focused on Iowa-American's system. OCA does not understand Iowa-American's reluctance to focus on the specifics of its system. The record shows that Iowa-

¹⁰ See IAWC Initial Brief, p. 42, footnote 168.

American should be proud of the way it has managed the risk of lead exposure in its system.

Iowa-American's testing program has not detected a single instance in which its customers were exposed to lead in drinking water in the past 10 years. (OCA Tessier Direct Exhibit 4, Response to OCA DRs 174-175). Iowa-American's current process is working.

Iowa-American attempts to draw an analogy to leaking gas lines and seems to suggest that OCA would require an explosion before it would allow the costs of a line replacement to be put into rates. (IAWC Initial Brief, p. 42). This is absurd. Even so, OCA is game to play along because the gas analogy is illuminating. The fact is, no one, not the Board and not OCA, waits for an explosion. Gas utilities and others operating gas lines in Iowa manage risk through rigorous inspection and testing programs. These inspection and testing programs are supervised by the Board.¹¹ The record in this case shows that Iowa-American has been managing the risk of lead exposure through testing, and when necessary, water treatment. (OCA Tessier Direct Exhibit 4, Response to OCA DRs 174-175). There is simply no urgency to race ahead with approval of Iowa-American's plan before the Board has all of the information. The costs Iowa-American is proposing are significant. (OCA Tessier Direct Exhibit 4, Response to OCA DR 179). The Board should not rush and has the time to get this right.

¹¹ See 49 CFR parts 191, 192, 193, and 199; 199 IAC chapters 10 and 19. See also, <https://iub.iowa.gov/regulated-industries/pipeline-safety>.

In its Initial Brief, Iowa-American suggests that the Board should require OCA to explain what additional information OCA seeks.¹² OCA believes Iowa-American was being glib. Nevertheless, OCA is once again game to play along. Put simply, OCA wants to see Iowa-American's inventory of lead service lines, and so should the Board. Iowa-American discussed preparing a lead inventory during the last rate case. (Docket No. RPU-2016-0002, *Iowa-American Water Co.*, Tr. 83-84). It does not explain why it could not present an inventory in this case. Only after seeing an inventory can OCA and the Board consider whether Iowa-American's plan regarding lead service lines is reasonable. The Board should refuse to allow Iowa-American to recover any lead replacement costs until Iowa-American submits an updated plan based on its inventory. There is no reason for the Board to pre-approve spending under a plan Iowa-American admits is incomplete.

Iowa-American's arguments about this issue are both confusing and disturbing. On the one hand, Iowa-American urges the Board to act immediately because it claims the threat to public health is urgent and imminent. On the other hand, the record demonstrates that Iowa-American believes that its own water is completely safe. Iowa-American admits that its current practice in at least part of its territory is to leave lead service lines in place when it finds them and to notify the customer and conduct testing. Iowa-American appears to consider testing to be adequate protection in these situations. (Tr. 275). In addition, OCA believes that if Iowa-

¹² (IAWC Initial Brief, p. 43, footnote 177). This footnote is *a lot*. OCA struggles with how to respond. For starters, it appears that Iowa-American does not understand the issue of burden of proof. It is a utility's burden to demonstrate that its rate proposals reflect investments which are reasonable and prudent and will result in rates which are reasonable and just. When OCA demonstrates that a utility has failed to meet this burden, it does not then become OCA's job to do the utility's homework for it.

Iowa-American then compounds its misunderstanding by conflating its own failure to meet its burden of proof with the issue of single-issue ratemaking. Iowa-American proposes to recover the costs of its lead replacement program automatically between rate cases through its QIP. Iowa law does not guarantee any utility automatic recovery of investments made between rate cases on the broad scale contemplated by the QIP. If Iowa-American wants this special treatment, it must prove that its proposal is reasonable. It's failure to make this showing in this case in no way precludes OCA from challenging anything in future rate cases or other proceedings.

American truly believed its water system posed an imminent threat to public health, it would have expedited completion of the inventory it was first asked about in its 2016 rate case. (*See* Docket No. RPU-2016-0002, *Iowa-American Water Co.*, Tr. 83-84). If Iowa-American truly believes that its water system presents an imminent threat to public health, why, after four years, does it still not have an inventory?

OCA is deeply disturbed by Iowa-American's attempt to create a false panic about the safety of its own water. OCA agrees that lead service lines are an ongoing issue worthy of serious attention. As such, the Board should insist on a complete and detailed plan and inventory before pre-approving a significant, multi-year capital project. Iowa-American has inexplicably failed to provide it.

IV. THE BOARD SHOULD REJECT IOWA-AMERICAN'S PROPOSED LOW-INCOME WATER ASSISTANCE (LIWA) PROGRAM BECAUSE THE LIWA IS CONTRARY TO IOWA-LAW, IS BAD POLICY, AND MOST IMPORTANTLY, IS NOT JUSTIFIED.

OCA shares Iowa-American's concern for its most vulnerable customers. However, OCA must oppose the LIWA because it is contrary to Iowa law and is bad policy because it will make the problem of affordability worse in the long run by adding to rate increases. OCA will not repeat those arguments here, but refers the Board to its Initial Brief. (OCA Initial Brief, pp. 33-40, 41-43)

In this Reply Brief, OCA will focus on the fact that Iowa-American has not justified the radical step of creating a direct subsidy in the record in this case. As OCA explained in its Initial Brief, significant new government funds have recently been appropriated to help customers struggling to afford their water bills. (OCA Initial Brief, pp. 40-41; OCA Tessier Rebuttal Testimony, pp. 35-40). Before proposing the radical step of imposing a rate subsidy to address this problem, Iowa-American should have fully explained the available government funds and

demonstrated that they are inadequate to address the problem. Iowa-American has failed to do so.¹³ OCA remains concerned that the LIWA, by discounting customer bills, could displace or limit customer eligibility for government funds. The Board should not proceed with the LIWA unless the Board can be sure that the LIWA would not displace government funds. The record in this case is inadequate to support such a determination. (OCA Tessier Direct Testimony, pp. 18-23; OCA Tessier Rebuttal Testimony, pp. 28-39).

OCA notes that Iowa-American's most recent filing in the COVID tracker docket indicates that the new government funds have had a substantial impact on the matter of affordability. Iowa-American appears to show that its uncollectible balance is lower than the amount of uncollectible expenses included in its revenue requirement in its last rate case.¹⁴ Even if Iowa-American meant to indicate in the ARU filing that, in the midst of a historic crisis, its uncollectible expense is only \$126,729 more than its test year revenue allocation, this does not justify the radical solution of imposing a rate subsidy.

As OCA noted in its Initial Brief, OCA does not believe it is appropriate for Iowa-American to force its customers to contribute to the subsidy. (OCA Initial Brief, p. 38 (citing *In re: Iowa Electric Light and Power Co.*, 1973 WL 36174, 2 P.U.R. 4th 288 at 295, Docket No. U-351 (ISCC, Oct. 15, 1973)). Before taking such a drastic step, Iowa-American should more fully explore the possibilities of its 100% voluntary customer contribution fund known as H₂O to Help Others. Many Iowa utilities have customer contribution funds in which customers can voluntarily make tax-deductible contributions to assist other customers struggling to pay utility

¹³ OCA acknowledges that Iowa-American could not have provided all of the details about these new programs because key details have not yet been released by responsible government agencies. This supports OCA's view that the LIWA is at best premature. Iowa-American could not prove, and the Board could not conclude, that the new programs will be inadequate to address the problem until important details about the programs are released.

¹⁴ *In re: Iowa-American Water Co.*, Docket Nos. ARU-2020-0123 and SPU-2020-0003, "Covid Deferral Through March 2021" (IUB, Apr. 30, 2021) (appearing to show a negative balance for the line item "Uncollectible expense (above last authorized)").

bills.¹⁵ OCA acknowledges that the recent contribution level to the H₂O to Help Others program has been inadequate. However, OCA does not believe that Iowa-American has demonstrated that it has adequately promoted the program. OCA offered suggestions about how Iowa-American could better promote the program. (OCA Tessier Rebuttal, pp. 37-39). OCA believes that Iowa-American's customers should be given a better opportunity to voluntarily contribute to a program like H₂O to Help Others before they are forced to contribute through rates to the LIWA.

In summary, OCA agrees with Iowa-American that water affordability is an important issue worthy of further consideration. OCA is ready willing and able to discuss appropriate solutions with Iowa-American or the Board. Unfortunately, the LIWA is not an appropriate solution because it is contrary to Iowa law, will make the problem worse in the long run by adding to rate increases, and is not justified in light of additional sources of available funds discussed in the record in this case. The Board should reject the LIWA.

V. THE BOARD SHOULD DENY THE QIP; HOWEVER, IF THE BOARD ALLOWS A VERSION OF THE QIP TO CONTINUE, IT SHOULD MAINTAIN THE THRESHOLD AND ADOPT THE CHANGES RECOMMENDED BY OCA.

In its Initial Brief, OCA explained that the Board should deny the QIP because it has failed to produce meaningful or quantifiable customer benefits. OCA also explained why the Board should maintain the threshold and impose the changes and conditions proposed by OCA if it allows a version of the QIP to continue. (OCA Initial Brief, pp. 43-50).

OCA will not repeat those points in this Reply Brief. However, one point bears repeating. Since the QIP was implemented in the last rate case, Iowa-American's O&M expenses have increased by \$2 million to \$3 million. (Tr. at 20-21, 31-33). This is important

¹⁵ See <https://iub.iowa.gov/records-information/board-reports/utility-customer-contribution-funds-report>.

because when the Board approved the QIP in Iowa-American's last rate case, the Board expressed hope that the QIP would result in reductions in O&M expenses over time.¹⁶ The fact is that since the QIP was first implemented in the last rate case, O&M expenses have not decreased but have substantially increased. In fact, O&M expenses have increased so substantially that Iowa-American cites them as one of the primary drivers of its proposed rate increase in this case. (Tr. 20; IAWC Moore Direct Testimony, p. 7). It was reasonable at the time for the Board to expect that increased main replacement driven by the QIP would reduce O&M expense. Unfortunately, Iowa-American has failed to deliver this expected benefit of the QIP and refuses to commit to providing any tangible, quantifiable benefits to customers from the QIP in future years.

The Board should not be distracted by Iowa-American's attempt to put its increasing O&M expense in a more favorable light by comparing the proposed O&M expense to the amount approved in 2010.¹⁷ The fact is that Iowa-American's O&M expenses have *increased* dramatically since the QIP was adopted in the 2016 rate case. Iowa-American's proposed O&M expense is approximately 20% higher than the 2016 O&M expense. (Kruger Direct Exhibit 1, Schedule C, p. 5) The Board should understand that the situation is probably even worse than it appears. Iowa-American is capitalizing more of its labor expenses which likely appeared as O&M expenses in prior rate cases. Without this change, the increase in O&M expenses in this rate case would likely be even greater. (OCA Kruger Rebuttal, p. 21). The Board should reject the QIP because expenses are getting worse, not better, for customers.

¹⁶ *In re: Iowa-American Water Co.*, Docket No. RPU-2016-0002, "Final Decision and Order," pp. 22-23 (IUB, Feb. 27, 2017); *see also*, OCA Initial Brief, p. 44, footnote 32.

¹⁷ *See* IAWC Initial Brief, p. 2. OCA Initial Brief, p. 44 (citing *In re: Iowa American Water Co.*, Docket No. RPU-2016-0002, Final Decision & Order at 22-23 (Feb. 27, 2017)).

QIP investment was supposed to generate O&M savings through reduced leaks, breaks, and service interruptions. Although O&M savings should also be expected from the continuation of the QIP and should be specifically accounted for in a future test year rate application, Iowa-American does not commit to providing customers with any tangible, quantifiable benefits of the QIP. Rather, IAWC projects a significant increase in O&M expenses. The QIP will allow Iowa-American to increase customer rates annually up to 15% without even filing a rate case. The Board should not approve the QIP as proposed because Iowa-American has refused to explain how the Board could check whether the QIP is actually working to deliver benefits for Iowa-American's customers.

OCA takes this opportunity to respond to certain points in Iowa-American's Initial Brief. First, OCA wishes to refute Iowa-American's claim that there was no record support for the threshold in the last case. (IAWC Initial Brief, p. 35, footnote 136). It is true that OCA did not propose or testify about the threshold in that case. The Board explained in its Final Decision and Order that it intended to use the QIP to promote infrastructure replacement beyond "business as usual."¹⁸ The Board arrived at the threshold approach in the course of the tariff implementation process because the eligibility criteria proposed by Iowa-American did "not sufficiently distinguish between "business as usual" and the increased infrastructure spending that the Board wishes to encourage by implementing the QIP."¹⁹ The Board imposed the threshold because it concluded that the threshold was necessary to encourage Iowa-American to increase its rate of infrastructure replacement beyond the "business as usual" rate. It is the Board's prerogative to impose conditions and modifications on utility rate proposals the Board deems necessary to

¹⁸ *In re: Iowa-American Water Co.*, Docket No. RPU-2016-0002, "Final Decision and Order," p. 24 (IUB, Feb. 27, 2017).

¹⁹ *In re: Iowa-American Water Co.*, Docket No. TF-2017-0029, "Order Approving Tariff with Modifications," p. 3 (IUB, Sept. 18, 2017).

fulfill the requirements of Iowa law, including the requirements that the utility provide service that is reasonably adequate and charge rates that are reasonable and just. The fact that the threshold was not directly addressed in testimony in no way means the Board's decision was unsupported in the record. While OCA encourages the Board to deny the QIP in its entirety in this case, OCA agrees with the Board's rationale for the threshold and urges the Board to maintain the threshold if it allows the QIP to continue.

OCA is also concerned about a sense of entitlement displayed by Iowa-American that has crossed into inappropriate threats. Iowa-American appears to believe that it is entitled to the QIP simply because it believes it shouldn't have to wait to recover investments made between rate cases. (*See* IAWC Initial Brief, pp. 34-35). The Board has already repeatedly rejected this view.²⁰ Of greatest concern to OCA are Iowa-American's apparent threats to withhold funding for an appropriate level of infrastructure replacement if Iowa-American does not get its way in this rate case. Iowa-American seems to consider increasing its rate of infrastructure replacement to be something "over and above the minimum required of Iowa-American to provide safe and adequate service." Iowa-American suggests that if it does not get its way on the QIP "replacement will likely wait until infrastructure fails and must be replaced." (IAWC Initial Brief, p. 46). OCA believes that Iowa-American fundamentally misunderstands the Board's view about the need for increased infrastructure replacement. Iowa-American has long testified that it believes it needs to increase its rate of infrastructure replacement to approximately 1-1.25% to match the 100-year average useful life of its infrastructure. (IAWC Simmons Direct Testimony, p. 32; *see also, In re: Iowa-American Water Co.*, Docket No. RPU-2013-0002

²⁰ *In re: Iowa-American Water Co.*, Docket No. RPU-2016-0002, "Final Decision and Order," p. 24 (IUB, Feb. 27, 2017). ("As the Board previously stated in its orders in Iowa-American's last two rate cases, regulatory lag is not a sufficient justification for the proposed QIP.")

“Final Decision and Order,” pp. 28, 34-35 (IUB, Feb. 28, 2014) (describing company testimony that the company hoped to increase its rate of infrastructure replacement to 1 percent.)) As the Board noted in its decision in Iowa-American’s 2013 rate case, Iowa-American made a management decision to maintain a 0.3% infrastructure replacement rate in the past.²¹ Management decisions regarding infrastructure replacement are well within the scope of a management deficiency determination by the Board.²² OCA asserts that a utility fails to satisfy its obligation to provide reasonably adequate service if it waits to replace aging infrastructure until it fails if waiting would impose additional costs on customers. If the Board agrees, it should remind Iowa-American that it could face management efficiency penalties in future rate cases if it makes good on its threats.

Finally, OCA wishes to correct a misunderstanding Iowa-American appears to have about OCA’s proposal with respect to Iowa-American’s cost of debt. In its Initial Brief, Iowa-American seems to believe that OCA proposes to deny Iowa-American recovery of its cost of debt. (IAWC Initial Brief, pp. 40-41.) OCA Witness Munoz does no such thing. Mr. Munoz includes Iowa-American’s actual, historical cost of debt in his cost of capital calculation. What Mr. Munoz says is simply that it would be unfair to also allow Iowa-American to use its inflated cost of debt as its allowed return on the QIP because the QIP is forward looking. Setting the QIP return based on the historical cost of debt which is inflated by high interest rate legacy debt would amount to something like double recovery of these high, historical debt costs. (OCA Munoz Direct Testimony, pp. 19-21). If the Board allows the QIP to continue, it should set the return based on the forward-looking debt cost proposed by OCA Witness Munoz. This will in no

²¹ *In re: Iowa-American Water Co.*, Docket No. RPU-2013-0002, “Final Decision and Order,” pp. 34-35 (IUB, Feb. 28, 2014).

²² *See* Iowa Code § 476.52.

way affect Iowa-American's ability to recover the costs of its legacy debt, or any other debt, through rates.

VI. THE BOARD SHOULD REJECT THE REVENUE STABILIZATION MECHANISM.

Iowa-American proposed an unprecedented new automatic adjustment clause it calls the Revenue Stabilization Mechanism (RSM). The Board should reject the RSM because it is unjustified, unfair and unnecessary. In addition, it may be inconsistent with the intent of the recent future test year legislation.

The RSM would do much more than true up revenues; it would allow Iowa-American to automatically recover increases in its production costs. (IAWC Rea Direct Testimony, p. 37; OCA Dismukes Direct Testimony, pp. 7-9). The Board previously rejected a production cost tracker proposed by Iowa-American because the Board found that the costs were not significant enough to merit a tacker.²³ Nothing has changed. (OCA Dismukes Direct Testimony, pp. 35-36; OCA Dismukes Rebuttal Testimony, pp. 10-12).

The RSM also appears to be lopsided and unfair in how it "trues up" revenues. As OCA Witness Dismukes explained in his Direct and Rebuttal testimony, "The Company's claims that the RSM explicitly accounts for growth in customers are false since the RSM explicitly accounts for customers acquired through acquisitions but does not contain any adjustment to account for any growth in customers that is not associated with acquisitions. In other words, the RSM will allow the Company to retain upside revenue growth from customer growth but will assess customers any downside risk in decreasing sales volumes/revenues." (OCA Dismukes Rebuttal Testimony, p. 6.; *see* OCA Dismukes Direct Testimony, p. 14, ll. 14-16) In its Initial Brief,

²³ *In re: Iowa-American Water Co.*, Docket No. RPU-2013-0002, "Final Decision and Order", pp. 38-39 (IUB, Feb. 28, 2014).

Iowa-American refutes Dr. Dismukes' claim, but offers no record citation for the proposition that customer growth other than acquisition growth is properly accounted for in the RSM. (IAWC Initial Brief, pp. 16-17). Iowa-American had the opportunity to respond to this concern first raised by Dr. Dismukes in his Direct Testimony and repeated in his rebuttal Testimony, but did not do so, either in rebuttal testimony or at the hearing. (OCA Dismukes Direct Testimony, p. 14; OCA Dismukes Rebuttal Testimony, p. 6; Tr. at 197). To say the least, Iowa-American has left the record unclear on this important aspect of the RSM.

Most importantly, the RSM is simply unnecessary. The risk addressed by the RSM is simply not significant enough to justify a new tracker and the additional regulatory burden that would entail. (OCA Dismukes Direct Testimony, pp. 13-40; OCA Dismukes Rebuttal Testimony, pp. 5-13). As OCA Witness Dr. Dismukes explained, total billed revenues have increased by eight percent since 2016, and normalized²⁴ revenues have grown on a year-over-year basis each year since 2015. (OCA Dismukes Direct Testimony, p. 19). The revenue instability Iowa-American complains of is simply not significant enough to justify a radical new regulatory mechanism like the RSM and the regulatory burden it would place on the Board and OCA.

Finally, the RSM appears to be inconsistent with Iowa's recent future test year legislation. Iowa Code § 476.33(4)(b) directs the Board to conduct a single subsequent proceeding to determine whether the actual costs and revenues are reasonably consistent with those approved by the Board. The RSM would have the Board true up costs and revenues not just once, but each year. If the legislature had intended for the Board to undertake the time, expense and regulatory burden of an annual proceeding, it would have said so. Instead, the

²⁴ As Dr. Dismukes explains, the IAWC normalized 2017 revenues to remove the impact of the Company's conversion of residential and commercial customers. (OCA Dismukes Direct Testimony, p. 19, footnote 37).

legislature specified that the Board conduct a single subsequent proceeding once after the conclusion of the rate case. (OCA Initial Brief, pp. 53-54).

As the Board embarks on its first subsequent proceedings in Docket Nos. RPU-2019-0001 and RPU-2019-0002, *Interstate Power and Light Company*, it should consider whether a similar proceeding could be justified every year. That is what the RSM would require.²⁵

VII. THE BOARD SHOULD ADOPT OCA’S RECOMMENDATIONS REGARDING OTHER TARIFF CHANGES PROPOSED BY IOWA-AMERICAN.

A. Tax Reconciliation Rider.

Iowa-American proposes that the Board authorize the Company to annually compare its actual taxes and EADIT to that in base rates and the difference will be reconciled in the TCJA rider. While OCA does not necessarily object to Iowa-American’s proposal, OCA recommends that the Board ensure the continued use of the tariffs are for TCJA reasons. (OCA Tessier Direct Testimony, p. 43). OCA recommends that Iowa-American file updated tariff sheets to reflect appropriate changes for the future use of this rider, not eliminate the tariffs. *Id.* at 44.

B. Service Line Ownership.

Iowa-American has proposed revisions to its tariff which would, upon passage of a local ordinance allowing the Company to own a portion of the line, provide for a gradual process of assuming responsibility for the line upon failure or replacement. (IAWC Initial Brief, p. 81). While Iowa-American states that it “believes that cities alone have the ability to dictate ownership and it is unclear what role the Board or OCA will have in the matter,” the Company

²⁵ If anything, the annual RSM true up proceeding would be even more burdensome than a subsequent proceeding. The RSM, by imposing a new rate surcharge, would require precise determinations by the Board regarding costs and revenues, whereas a subsequent proceeding requires only that the Board consider whether costs and revenues are “reasonably consistent” with the Board’s prior determination. In addition to the reasons OCA has presented in this case, OCA is opposed to the RSM because of the significant regulatory burden it would place on OCA and the Board.

nevertheless asks the Board to adopt tariff changes before cities amend their ordinances. *Id.* As OCA explained in its initial brief, Iowa-American's proposal is backwards. Tariffs are amended to reflect changes in ordinances, not to precede them. Iowa-American has been unable to articulate exactly why it needs the Board to approve these tariff changes before the cities have had an opportunity to vote on whether or not ordinances need to be changed. (OCA Initial Brief, p. 57).

C. Waiver Of Fees.

Iowa-American proposes to change its tariff to extend its flexibility to waive certain fees. While OCA is not categorically opposed to tariff language to allow for the waiver of fees, the language proposed by the Company could invite a discriminatory application of the flexibility it is attempting to achieve. Iowa-American Witness Simmons testified at the hearing in this proceeding that the Company would be open to altering this language to adopt certain standards explaining how fee waivers would be applied as to ensure no discriminatory treatment would occur. (Tr. 184-85). OCA asks that the Board require Iowa-American to alter its tariff language to address this issue before seeking Board approval.

D. Company Liability.

Iowa-American proposes changes to its tariff that limit the Company's liability. (IAWC Simmons Direct, p. 51). These proposed changes are similar to those identified in Board Docket TF-2016-0026 involving Interstate Power and Light Company (IPL).²⁶ (OCA Tessier Direct Testimony, p. 51). OCA's position regarding the limitation of liability in this proceeding is consistent with OCA's position in the IPL proceeding: any issues regarding the limitation of liability involve industry-wide concerns and as such are best addressed in the Board's review of

²⁶ *In re: Interstate Power and Light Co.*, Docket No. TF-2016-0026, "Motion to Withdraw Filing," p. 2 (IUB, Jul. 8 2016).

its administrative rules, or within a separate rulemaking or notice of inquiry docket. *Id.* at 51-52. OCA recommends the Board reject Iowa-American's proposed tariff change regarding this issue and defer a decision to a separate proceeding where it can be given the level of scrutiny and consideration it deserves.

VIII. THE BOARD SHOULD ADOPT OCA'S CAPITAL STRUCTURE AND COST OF CAPITAL.

OCA Witness Munoz presented the only reasonable and factual recommendation regarding capital structure and cost of capital. The Board should adopt OCA's recommendations regarding cost of capital and capital structure because they are the only reasonable, evidence-based recommendations in the record.

Iowa-American falsely claims that OCA Witness Munoz recommendation regarding the disputed equity infusion is an attempt to relitigate the double leverage issue. (IAWC Initial Brief, p. 50.) This is nothing but an attempt by Iowa-American to distract the Board from the true issue: Iowa-American's refusal to provide evidentiary support for the disputed equity infusion. (Tr. 257-262; OCA Munoz Direct Exhibit 1, IAWC Response to OCA DR 54, subpart C). OCA Witness Munoz accepted all equity infusions which could be supported by retained earnings or paid in capital. When OCA Witness Munoz determined that the equity infusions of \$15 million could not be explained or justified by any other means, he asked Iowa-American to explain the source of the funds. Iowa-American responded simply that the funds would come from "Iowa-American's parent company." With nothing else to go on, Mr. Munoz assigned these unexplained capital infusions the capital cost of the parent company. (OCA Munoz Direct Testimony, pp. 12-15; OCA Munoz Direct Exhibit 1, Response to OCA DR 54, subpart C; Tr. 257-262). This is not relitigating double leverage; it is using the only evidence Iowa-American provided. Iowa-American does not even attempt to argue that the disputed

capital infusions will in fact be equity. Iowa-American's only defense is its assertion that "if dollars are infused as equity, they become equity." (IAWC Initial Brief, p. 53). Thus, Iowa-American would have the Board believe that capital is equity in the sole and unreviewable determination of the utility. This, and not Mr. Munoz' position, disregards the Board's precedent from the last case in which the Board explained that although it would no longer apply the double leverage adjustment, the Board would still guard against potential abuses.²⁷ Mr. Munoz position represents an attempt to account for capital infusions with the only evidence Iowa-American was willing to provide. Iowa-American has refused to provide any evidence or explanation that the capital infusions it claims as equity will in fact be funded with equity. The Board should not allow Iowa-American to treat these unsubstantiated funds as equity and should adopt Mr. Munoz' recommended capital structure.²⁸

Iowa-American also argues against Mr. Munoz recommendation about the capital infusions because it claims it would reduce Mr. Munoz' equity ratio from the 50.598% shown in his direct testimony. (IAWC Initial Brief, p. 49). This is beside the point. If the Board agrees, as Mr. Munoz has shown, that Iowa-American has failed to explain the source of its claimed equity infusions, it cannot treat them as standard utility equity. More importantly, even if Iowa-American is correct and the effect would be to reduce Mr. Munoz' equity ratio, the adjusted ratio computed by Iowa-American of 48.46% is still well within the range of recently authorized equity ratios for Iowa-American affiliate utilities. (*See* OCA Hearing Exhibit 1, p. 3 (showing,

²⁷ *In re: Iowa-American Water Co.*, Docket No. RPU-2016-0002, "Final Decision and Order," p. 42 (IUB, Feb. 27, 2017).

²⁸ OCA notes that Iowa-American misstates the record at page 53 of its Initial Brief. Iowa-American quotes a portion of the transcript in which Mr. Munoz misstated his position on the issue of equity infusions. Mr. Munoz clarified and corrected this misstatement later in the proceeding. (Tr. 266-268).

for example, Virginia-American Water receiving an authorized ROE of 9.25% and an authorized equity ratio of 46.09% in 2020)).

Iowa-American also claims that Mr. Munoz' capital structure contains another error related to use of end-of-test-year adjustments. Consistent with past practice in other future test year rate cases, Mr. Munoz adjusted his capital balances to reflect changes to be effective at the end of the test year. This is not an error. Mr. Munoz makes these adjustments because the capital structure embedded in rates will be used to set rates not just for the future test year period, but also going forward into future years. OCA believes that it would be inappropriate to use a capital structure the Board and the utility knows will change to set rates to apply for future years.

Regarding return on equity, Iowa-American's dissatisfaction with the DCF model is misplaced. Iowa-American points out that some of the proxy companies in Mr. Munoz' DCF analysis yielded ROE results that even OCA admits are low. Iowa-American seems to suggest that this renders the entire result of Mr. Munoz' DCF analysis unreliable. (IAWC Initial Brief, p. 57). Iowa-American's position is unreasonable and fails to account for outlier results in the CAPM analysis presented by Iowa-American's equity witness. Iowa-American Witness Bulkley's CAPM and ECAPM analyses contained several sample companies which yielded ROEs in excess of 12%, some of which approached 15%. (IAWC Bulkley Reply Exhibit 3; *see also*, OCA Munoz Direct Testimony, pp. 41-49). OCA wonders whether Iowa-American has fully considered the implication of its criticism. If the test for reliability of a model, be it DCF, CAPM or ECAPM, is whether the model contains any sample companies with high or low results, Ms. Bulkley's own models also fail the test. In contrast, Mr. Munoz adjusts his DCF proxy results to ensure any outlying scores are properly removed from his DCF analysis. (OCA Munoz Direct Exhibit 3; OCA Munoz Rebuttal Testimony at 15). As Mr. Munoz explained at

the hearing, this is why we use averages, medians or some other measure of tendency to ascertain cost of equity.

Finally, OCA Witness Munoz explains several factors the Board must consider regarding the risk faced by Iowa-American. First, Mr. Munoz refutes the claims of Iowa-American Witness Bulkley that Iowa-American faces additional risks that are not adequately reflected in the proxy companies. Mr. Munoz explains that in fact, Iowa-American faces less risk than the proxy companies and that this justifies a ROE at the low end of the range. Second, Mr. Munoz explains that if the Board allows the trackers proposed by Iowa-American, it should reflect the significant reduction in risk the trackers will confer by reducing Iowa-American's allowed return on equity. (OCA Munoz Direct Testimony, pp. 49-52; OCA Munoz Rebuttal Testimony, pp. 15-20).

CONCLUSION

The Office of Consumer Advocate respectfully requests that for the reasons discussed above, the Board: (1) accept OCA's recommended revenue requirement is correct; (2) reject Iowa-American's revenue calculations; (3) adopt OCA Witness Munoz's cost of capital recommendations; (4) reject Iowa-American's recovery of lead service line replacement costs through the QIP; (5) reject Iowa-American's Low-Income Water Assistance Program; (6) reject Iowa-American's proposed QIP or adopt the changes proposed by OCA and maintain the threshold; (7) reject Iowa-American's proposed RSM; and (8) reject Iowa-American's proposed tariff changes regarding Tax Cuts and Jobs Act Credits, Designation of Service Line Ownership, Waiver of Certain Fees, and Company Liability.

Respectfully submitted,

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