

STATE OF IOWA
DEPARTMENT OF COMMERCE
UTILITIES BOARD

IN RE: IOWA-AMERICAN WATER COMPANY	DOCKET NOS. RPU-2020-0001, TF-2020-0250
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FINAL DECISION AND ORDER

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I. PROCEDURAL HISTORY

On August 28, 2020, Iowa-American Water Company (Iowa-American) filed with the Utilities Board (Board) an Application for Revision of Rates and associated testimony and exhibits, identified as Docket No. RPU-2020-0001. Iowa-American's proposed tariff revisions have been identified as Docket No. TF-2020-0250. Iowa-American's application is based on a future test year of July 1, 2021, through June 30, 2022.

Iowa-American is an investor-owned water utility, which is a subsidiary of American Water Works, Inc. (American Water). Iowa-American provides water service to customers in and around Clinton, Davenport, Dixon, Bettendorf, LeClaire, Riverdale, Blue Grass, Panorama Park, and surrounding parts of Scott County, Iowa.

Iowa-American states the annual cost to serve its nearly 67,000 customers during the future test year period will be approximately \$45.5 million, and its proposed

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rates are designed to recover no more than that amount. The annual revenue requirement proposed by Iowa-American is approximately \$3.7 million, or 8.9 percent, greater than the amount authorized by the Board in Iowa-American's last rate case, Docket No. RPU-2016-0002, which became effective on March 24, 2017.

Iowa-American proposes to eliminate special rates that are currently in effect for customers in the City of Blue Grass and the City of Clinton's Board of Park Commissioners. Iowa-American proposes to modify the existing Qualified Infrastructure Plant (QIP) rider and to implement a new Revenue Stabilization Mechanism (RSM). Iowa-American also proposes to implement a new low-income water assistance program. Iowa-American did not institute temporary rates.

On September 10, 2020, the Office of Consumer Advocate (OCA), a division of the Iowa Department of Justice, filed a Motion for Supplemental Notice to Blue Grass Customers. Iowa-American filed a response on September 11, 2020.

On September 14, 2020, OCA filed an Objection and Request for Corrective Filing. Iowa-American filed a response on September 17, 2020.

On September 25, 2020, the Board issued an order docketing Iowa-American's proposed tariff, denying OCA's motions for supplemental notice and corrective filing, providing notice of hearing, and establishing a procedural schedule.

On October 15 and 21, 2020, the Board held in-person consumer comment meetings in Clinton and Davenport, respectively. The Board held a virtual consumer comment meeting on October 28, 2020.

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On December 11, 2020, and February 18, 2021, the Board issued orders requiring additional information from Iowa-American. Iowa-American filed its responses on January 11 and February 25, 2021, respectively.

On March 3 and 4, 2021, the Board held a hearing on Iowa-American's application. Iowa-American and OCA each filed initial briefs on April 19, 2021, and reply briefs on May 4, 2021.

On May 18, 2021, Iowa-American filed its report of actual rate case expenses. Iowa-American reported actual rate case expenses of \$816,707. OCA did not file an objection to Iowa-American's rate case expenses.

II. INCOME STATEMENT ISSUES

A. Declining Usage

To determine its test year water sales for the residential class, Iowa-American forecasted the number of customers and the amount of water that would be used per customer. Iowa-American multiplied the forecasted number of customers by the forecasted usage per customer in order to forecast sales for the test year. (Iowa-American Simmons Direct, pp. 10-11.) To forecast usage per customer, Iowa-American witness Gregory Roach performed a regression analysis for the period 2010 through 2019. Mr. Roach's analysis normalized the data to account for the impact of weather.

The results of Mr. Roach's regression analysis showed a decline in usage of 922 gallons per customer per year, or 77 gallons per customer per month (GPCM). Mr. Roach stated the declining usage he observed for Iowa-American is consistent with trends across the water industry nationally, and that he expects the trend will continue into the future. (Iowa-American Roach Direct, pp. 5-23.)

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OCA witness David Dismukes used a different methodology to forecast usage per customer. Mr. Dismukes used the same data as Mr. Roach, but instead of performing a regression analysis over the period 2010 through 2019, he calculated the average decline per year over the time period 2017 through 2019. The results of Mr. Dismukes' analysis showed a decline in usage of 44 GPCM for the residential class. Mr. Dismukes argues that his calculation of a 44 GPCM decline in usage should be used to forecast test year water sales instead of Mr. Roach's 77 GPCM decline. (OCA Dismukes Direct, pp. 31-33.) In its initial brief, OCA argues the Board should not allow any adjustment for declining usage, because customer growth will offset the effect of declining usage. (OCA Initial Brief, pp. 5-6.)

Board Analysis

In Iowa-American's last rate case, which was based on a historic test year, the Board denied Iowa-American's proposal to adjust test year sales to account for declining usage. The Board reasoned that any decline in usage was already reflected in the test year data, and any adjustment would be based on speculation about future usage. *In re: Iowa-American Water Company*, Docket No. RPU-2016-0002, Final Decision and Order, p. 6. (February 27, 2017). In this future test year rate case, Iowa-American's forecast for test year water sales is a function of the forecasted usage per customer and the forecasted number of customers. Although arguments exist that customer growth may offset declining usage, Iowa-American's methodology takes customer growth into account. Accounting for customer growth is an important consideration when reviewing a proposed declining usage adjustment.

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Both Iowa-American and OCA stated usage can be sensitive to weather fluctuations. (Iowa-American Rea Direct, p. 34; OCA Dismukes Reply, pp. 6, 15.) However, OCA's methodology does not normalize the data to account for the impact of weather, and it relies on fewer data points than Iowa-American's methodology. The Board finds the methodology used by Iowa-American is reasonable and provides a more comprehensive view of customer usage than OCA's methodology. The Board will approve Iowa-American's declining usage adjustment.

B. Performance Pay

Iowa-American has an Annual Performance Plan (APP) that is available to nearly all employees, and a Long-Term Performance Plan (LTPP) that is restricted to high-ranking employees. Iowa-American calculates the amount of the APP based on a variety of financial and operational metrics, but no performance pay is awarded under the APP unless financial targets are met. The LTPP contains no operational metrics and is awarded based on financial performance alone. (OCA Kruger Direct, pp. 11-12.)

OCA objects to Iowa-American's inclusion of performance pay in its labor expense. OCA argues the benefits of the performance pay plans accrue primarily to shareholders, because payment under the plans is completely contingent on financial performance. OCA argues it is not reasonable for ratepayers to bear 100 percent of the cost of performance pay when the plans are designed primarily to deliver value to shareholders. (*Id.*, pp. 11-16.)

Iowa-American argues that performance pay is necessary to provide employees with a market-based compensation package. Iowa-American states its compensation structure would not be competitive with peer utilities and other companies without it.

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Iowa-American disputes OCA's assertion that the benefits of performance pay accrue primarily to shareholders. Iowa-American argues that in order to achieve the plan's financial targets, Iowa-American must keep costs down. Iowa-American also argues that achieving financial goals makes it easier to access capital at reasonable rates. Iowa-American further notes that performance pay has been included in labor expense in its prior rate cases without objection from OCA. (Iowa-American Nielsen Reply, pp. 17-20.) OCA counters that employee eligibility for performance pay has greatly expanded in recent years and so has the cost. (OCA Kruger Reply, pp. 14-15.)

Board Analysis

Performance pay can be a necessary part of a competitive compensation package and if Iowa-American's compensation package is not competitive with the market, customers could ultimately suffer. Strong financial performance also helps ensure that Iowa-American can access capital at a reasonable cost, which helps keep costs down for customers. In addition, there are some components of the performance plans that are focused on customer benefits, such as customer satisfaction, water quality, and efficiency improvements. (OCA Kruger Direct, p. 14.)

However, the fact that payment is only made if financial metrics are achieved demonstrates that the plans are not primarily designed to deliver customer benefits. It is not reasonable for customers to pay 100 percent of the costs of such plans. A reasonable compromise is to allow Iowa-American to include 50 percent of its performance pay costs in its labor expense to be recovered from customers, with the remaining 50 percent funded by shareholders.

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The Board finds that Iowa-American's performance pay plans benefit both shareholders and customers. The Board will, therefore, allow Iowa-American to include 50 percent of its overall performance pay costs in its labor expense. The Board will make a corresponding adjustment to the portion of performance pay costs that are capitalized. That adjustment will be discussed in further detail under Section III of this order.

C. Vacant Positions

Iowa-American includes 77 full-time equivalent (FTE) positions in its labor expense. As of January 13, 2021, Iowa-American employed 76 FTEs. Iowa-American states that it creates employment positions because there is an identified need for the work. If a planned position goes unfilled, the work must be made up by current employees working overtime or by hiring additional temporary workers. Iowa-American stated planned projects may also have to be delayed with negative impacts to customer service if positions are not filled. (Iowa-American Nielsen Reply, pp. 14-15.)

OCA argues Iowa-American almost always has at least one employee vacancy. OCA therefore argues the Board should allow only 76 FTEs to be included in labor expense. OCA also argues that Iowa-American's forecasted overtime costs of \$535,115 are overstated because they are based on overtime costs from 2017 through 2019, when Iowa-American did not have full employment. OCA argues that test year overtime costs should be set at \$521,820, which matches Iowa-American's actual overtime costs in 2021, when it had 76 FTEs. (OCA Kruger Reply, p. 13.)

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Board Analysis

It is normal for the number of vacant positions in a business to fluctuate. Being unable to fund a needed position may increase costs and negatively impact customers. OCA does not dispute that there is a business need for 77 FTEs. Denying funding for all needed positions would increase the chances that business needs would go unmet and that customers would be negatively impacted. The Board finds it is reasonable to include 77 FTE positions in Iowa-American's labor expense.

OCA's proposed adjustment to overtime costs rests on an assumption that overtime costs correspond directly with the number of vacant positions. The Board finds it more likely that the number of vacant positions is one of many factors that drive overtime costs. Further, as previously stated, the fact that the Board is allowing funding for 77 FTEs does not mean that Iowa-American will always be at full employment. The Board finds that Iowa-American's methodology for forecasting overtime costs based on actuals from recent years is reasonable.

D. Inflation Adjustment

Iowa-American's revenue requirement calculation includes an inflation adjustment, based on an economic index, for certain categories of operation and maintenance expenses that could not be separately forecasted, such as postage, transportation, and miscellaneous expenses. As a check on the reasonableness of its inflation adjustment, Iowa-American compared its preliminary actual operations and maintenance expenses for 2020 to its projected expenses for 2020, which included an inflation adjustment. Iowa-American states the actual expense aligned quite well with its projection. (Iowa-American Simmons Reply, pp. 8-9.)

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OCA asserts that Iowa-American's operation and maintenance expenses have been relatively immune to the effects of inflation, and no adjustment is needed. (OCA Kruger Direct, pp. 16-17.) OCA disputes Iowa-American's assertion that preliminary actual results from 2020 could serve as a meaningful check on the reasonableness of its inflation projection. OCA asserts 2020 was an anomalous year due to the impact of the COVID-19 pandemic, and Iowa-American likely experienced above-normal costs. (OCA Kruger Reply, p. 22.)

Board Analysis

Forecasting costs is appropriate in a future test year case; however, the Board finds that Iowa-American's use of a blanket inflation adjustment for certain categories of costs is too simplistic and speculative to be reasonable. It is not reasonable to assume that the level of inflation indicated by a broad index represents a minimum amount of inflation that will be applicable to all categories of costs. The Board agrees with OCA that comparing Iowa-American's inflation projections to its preliminary actuals from 2020 is not a meaningful check on the reasonableness of the projections. The likely impact of the COVID-19 pandemic on 2020 costs makes the usefulness of the comparison questionable. The Board will deny Iowa-American's inflation adjustment.

E. Support Services Expense

Iowa-American's parent company, American Water, has subsidiary water utility companies in 15 states. American Water provides administrative and technical support services to its subsidiaries through a service company. The service company allocates support services costs to each subsidiary. Iowa-American forecasts an increase in the amount of support services costs that will be allocated to Iowa-American during the test

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year. Approximately \$200,000 of the increase in support services costs is due to American Water's planned sale of its subsidiary, New York-American Water Company (New York-American). With the loss of New York-American's customer base, total support services costs will be allocated among fewer customers, resulting in an increase in Iowa-American's allocation. (OCA Kruger Reply, pp. 23-24.)

OCA objects to Iowa-American's inclusion in operating expense of the \$200,000 increase in support services costs that is attributable to the sale of New York-American. OCA states the sale has not occurred to date, and there is substantial uncertainty whether it will occur at all. OCA argues the forecasted increase in support services costs due to the sale is too speculative. OCA also argues that Iowa-American has not properly accounted for offsetting reductions in variable support services costs that would occur if the sale is finalized. OCA finally argues the loss of New York-American's customer base would be offset in only a few years by customer growth among American Water's other subsidiaries. (*Id.*, pp. 23-28.)

Iowa-American states the increase in support services costs is relatively small on a per-customer basis. Even with the increase attributable to the sale of New York-American, Iowa-American asserts that support services costs are reasonable when compared to other utilities. Iowa-American also disputed OCA's assertions that offsetting reductions to variable support services costs have not been taken into account. Finally, Iowa-American notes that its customers have benefited for years from economies of scale produced by growth among American Water's subsidiaries. Iowa-American argues it should not be penalized for the infrequent occurrence of a decrease

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in American Water's overall customer base. (Iowa-American Baryenbruch Reply, pp. 5-16.)

Board Analysis

American Water's decision to sell New York-American and reallocate the costs for support services to the remaining subsidiaries will temporarily increase the costs allocated to Iowa-American customers. Iowa-American has provided no evidence that the sale would benefit Iowa-American customers. Because the sale provides no benefits to Iowa-American customers, they should not have to bear the resulting increase in costs. The Board finds the proposed increase to be inappropriately speculative given the fact that there is no evidence in the record that the sale of New York-American has occurred. The Board will deny the increase in support services costs attributable to the sale of New York-American.

F. Uncollectible Expense

Iowa-American forecasts uncollectible expense for the future test year in the amount of \$488,891. To arrive at its forecast, Iowa-American first calculated an uncollectible rate for the years 2017 to 2019 by dividing net charge-offs by billed revenue. Iowa-American calculated a three-year average uncollectible percentage and applied it to proposed rate revenues. (Iowa-American Cephas Direct, p. 17.)

OCA states Iowa-American's methodology for calculating uncollectible expense is improper because there is no true correlation between Iowa-American's revenues and its uncollectible expense. OCA also notes that in Iowa-American's recent rate cases, the Board has denied Iowa-American's proposals to adjust uncollectible expense to reflect the percentage of revenue increase. OCA argues the proper methodology for

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calculating uncollectible expense is to calculate the average uncollectible expense amount over the last five years. OCA calculates this amount to be \$484,756. Because the difference between the two proposals is insignificant, OCA does not propose any adjustment to Iowa-American's proposed uncollectible expense amount. (OCA Kruger Direct, pp. 18-20.)

Board Analysis

Iowa-American and OCA recommend different methodologies for calculating uncollectible expense; however, the methodologies produce outcomes that are not meaningfully different. OCA's methodology appears to be more consistent with the methodology the Board has approved in Iowa-American's previous rate cases. However, the Board finds there is inadequate discussion in the record about the merits of the two methodologies to determine which is more appropriate. Because OCA agrees that Iowa-American's proposed amount of uncollectible expense is reasonable, the Board will approve it. The Board is not making a determination about the appropriateness of Iowa-American's methodology for calculating the amount.

G. Tax Gross-Up

Iowa-American proposes a tax gross-up factor of 1.418595. (Iowa-American Simmons Direct, Exhibit 3.) Iowa-American's methodology for calculating the tax gross-up factor takes into account the uncollectible expense amount Iowa-American predicts it will incur in the test period. (OCA Kruger Direct, p. 49.) Iowa-American acknowledges the Board has previously denied its proposed methodology in historic test year cases, but argues the methodology is appropriate now, because Iowa-American is using a future test year. (Iowa-American Simmons Reply, pp. 27-28.)

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OCA argues Iowa-American's proposed methodology is inappropriate regardless of whether a historic or future test year is used. OCA argues that including uncollectible expense in the calculation of the tax gross-up factor is a speculative adjustment that does not properly reflect the amount of actual income tax Iowa-American will pay due to an increase in revenue. OCA argues that if uncollectible expenses materialize, they will not be known and measurable in totality until several months after the conclusion of the future test year. (OCA Kruger Reply, pp. 56-57.) OCA also presented evidence that while Iowa-American's revenues have steadily grown since 2010, its uncollectible expenses have fluctuated year over year. (OCA Kruger Direct, p. 19.) OCA proposes a tax gross-up factor of 1.403351, which does not include an adjustment to gross revenues to account for uncollectible expense. (*Id.*, p. 50.)

Board Analysis

Iowa-American has not presented adequate evidence to justify its assumption that an increase in rates will lead to a corresponding increase in uncollectible expense. OCA presented evidence to the contrary. The amount of uncollectible expense Iowa-American will experience in a given year is more likely driven by broad economic conditions facing customers rather than an increase in Iowa-American's revenue requirement. The Board finds Iowa-American's proposed adjustment to the tax gross-up factor to account for uncollectible expense is too speculative to be considered reasonable. The Board will approve OCA's proposed tax gross-up factor of 1.403351.

H. Interest Synchronization

Interest synchronization is an adjustment to recognize the income tax effect of differences between the test period interest expense reported by a utility and the

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interest expense included in the overall return on rate base. Iowa-American and OCA agree that such an adjustment needs to be made. Iowa-American includes the synchronized interest when determining the revenue requirement using future test year values and states no further adjustment needs to be made. (Tr. 279-283.¹) OCA matches interest on long-term debt with the proposed capital structure and rate base. (OCA Kruger Direct, p. 22.)

No written testimony was provided by Iowa-American on this issue. At hearing, Iowa-American witness Cade Simmons stated that instead of building the tax calculation with book interest and then making an interest synchronization adjustment, Iowa-American made its interest synchronization adjustment as part of its development of the revenue requirement. (Tr. 281-282.) In its reply brief, Iowa-American argued OCA's methodology would result in interest synchronization being applied twice. (Iowa-American Reply Brief, p. 26.)

Board Analysis

OCA's calculation is consistent with the calculation done in past rate cases and with the calculation used in the settlement of Interstate Power and Light Company's (IPL) recent electric rate case based on a future test year. Iowa-American did not introduce adequate evidence into the record to explain why its methodology is correct or why OCA's methodology is incorrect. Because OCA's methodology is consistent with past practice, the Board will approve OCA's methodology. This calculation will include the rate base and cost of debt approved by the Board.

¹ "Tr." shall refer to the transcript of the hearing held March 3 and 4, 2021.

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III. RATE BASE

A. Capitalized Labor and Labor-Related Expense

OCA estimates that \$64,913 of capitalized performance pay is included in the 13-month average rate base. Consistent with its argument to deny recovery of performance pay, OCA proposes to remove \$64,913 from rate base. (OCA Kruger Direct, pp. 22-23.)

Board Analysis

As discussed in the Board's analysis under the performance pay section above, an adjustment is required for capitalized performance pay. The Board's decision to authorize Iowa-American's recovery of 50 percent of its performance pay costs, requires an adjustment to the capitalized performance pay, or reduction of \$32,456, from rate base.

B. Cash Working Capital

Cash working capital represents the average amount of investor-supplied capital used to cover the day-to-day cash needs of the utility. Cash working capital is included in rate base to compensate investors for the use of their funds that are required by the utility for daily operations. To determine the appropriate amount of cash working capital to include in rate base, Iowa-American performed a lead/lag study that analyzed actual receipt and payment activities for the 12-month period ending December 31, 2019. (Iowa-American Simmons Direct, p. 23.) Iowa-American proposes to include \$1,481,453 for cash working capital in rate base. Iowa-American bases this amount on a lead/lag study consisting of 46.65 revenue lag days. (OCA Kruger Direct, p. 24.)

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OCA disputes two components of Iowa-American's lead/lag study, which are discussed below.

1. Collection lag days

OCA disputes the way Iowa-American calculated the collection lag days, which is a component of revenue lag days. Iowa-American calculated its collection lag days to be 28.28 days. To calculate that amount, Iowa-American removed the annual amount of 2019 uncollectible expense from the sum of the daily accounts receivable balances. OCA asserts this methodology is improper, because it mismatches a period of daily balances against an annual expense total. Instead of using the annual amount of 2019 uncollectible expense, OCA asserts Iowa-American should have used the sum of the daily balances in Iowa-American's "Allowance for Uncollectibles" balance sheet. OCA asserts this methodology allows a proper comparison between corresponding daily amounts. OCA's methodology results in 25.03 collection lag days. (*Id.*, pp. 25-27.)

Iowa-American states the accounts receivable balance is adjusted monthly to remove bad debts, and OCA's proposed methodology would, therefore, double count bad debts. Iowa-American states its methodology for calculating collection lag days is the same methodology the Board approved in Iowa-American's last two rate cases. (Iowa-American Simmons Reply, pp. 5-8.)

Board Analysis

The parties presented little information in the record to justify why their proposed methodology for calculating collection lag days is superior to the methodology proposed by the other party. Both methodologies appear to be reasonable. Iowa-American's methodology for calculating collection lag days is consistent with the methodology

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Iowa-American used in Docket Nos. RPU-2013-0002 and RPU-2016-0002, and the result it produces appears to be reasonable. The Board will approve Iowa-American's methodology. If the methodology for calculating collection lag days is an issue in future rate cases, the parties will be required to provide more detailed analysis and arguments supporting their positions.

2. Expense lead days for service company costs

OCA also objects to the way Iowa-American accounts for American Water service company costs in the lead/lag study. Iowa-American prepays service company costs an average of 4.61 days in advance of receiving services. OCA argues prepaying service company costs is inappropriate, because competitive contracted services do not require prepayment. OCA argues that prepaying costs to the service company indirectly results in a profit for Iowa-American at the expense of ratepayers. (OCA Kruger Direct, p. 27.)

Iowa-American's service company costs consist of both labor-related and non-labor-related costs. OCA proposes to assign 50 percent of Iowa-American's service company costs at 12.00 expense lag days to match the lag days Iowa-American assigns to salaries and wages, and 50 percent at 43.87 expense lag days to match the lag days Iowa-American assigns to contracted services. OCA argues this proposal would match the time period when American Water incurs service expenses with the time period when Iowa-American should remit funds to cover those expenses. OCA argues Iowa-American's proposal to prepay service company expenses by 4.61 days is unfair to ratepayers. (OCA Kruger Reply, pp. 35-39.)

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Iowa-American argues that prepayment of service company costs supports expenses incurred by the service company on behalf of Iowa-American and produces a billing result that is reasonable overall. Iowa-American states the Board approved the same treatment of service company costs in the lead/lag study in Iowa-American's last rate case. (Iowa-American Simmons Reply, pp. 7-8.)

Board Analysis

The Board has reviewed the proposals for lead/lag costs as submitted by Iowa-American and OCA and reviewed the rationale for when to pay a service company. The Board finds it difficult to perceive a reasonableness standard for prepay without some offsetting value being received by the customers. It is unlikely Iowa-American would be required to prepay for comparable services if it obtained them in the marketplace instead of from its parent company. Given a lack of evidence establishing any value to the customer, the Board finds that Iowa-American's customers should not be required to pay for services obtained from the parent company on terms that are not competitive with the market. The Board will therefore approve OCA's proposed methodology, which excludes prepayment of service company costs to Iowa-American's parent company.

IV. RATE OF RETURN

A. Return on Equity

The Board is required to determine a fair and reasonable overall rate of return to apply to rate base in setting just and reasonable rates for a rate-regulated public utility. The overall rate of return is determined based upon a return on equity (ROE) and a utility's capital structure. There are two landmark United States Supreme Court cases that describe the legal principles upon which a fair and reasonable ROE is based. The

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two cases are *Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923), and *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

The standard described in the *Bluefield* case is as follows:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding, risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

Bluefield Water Works & Improvement Co., pp. 692-693.

The *Hope* court expanded on the guidelines to be used to assess the reasonableness of the allowed return. The *Hope* court recognized that revenues must cover the capital costs of the utility and stated:

From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

Hope Natural Gas Co., p. 603.

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The ROE set by the Board needs to be at a level that is commensurate with the returns of companies with comparable risks. If the ROE is set below an investor's expected return, it will invest its capital elsewhere; however, if the ROE is set above the investor's expected return, customers are impacted by being charged higher rates than necessary.

Because the ROE is an economics and finance concept, utilities and other parties file the testimony of expert witnesses that use different models and the witness's expertise to support the appropriate ROE. The expert witnesses typically use a discounted cash flow (DCF) model, the risk premium model, and the capital asset pricing model (CAPM) in their ROE analysis. Other models are also used by some expert witnesses. In this case, the OCA witness recommends an ROE of 9.0 percent, and the Iowa-American witness recommends an ROE of 10.5 percent.

Iowa-American witness Ann E. Bulkley provided an updated ROE analysis in reply testimony that she asserts supports an ROE range of 9.75 percent to 10.6 percent. (Iowa-American Bulkley Reply, pp. 40-42.) Ms. Bulkley uses three types of models to produce her recommended ROE of 10.5 percent: (1) the DCF model; (2) a CAPM and an Empirical CAPM (ECAPM); and (3) the expected earnings approach. These models were applied to a proxy group of water and natural gas companies with risks Ms. Bulkley considered similar to that of Iowa-American. Ms. Bulkley provided alternative results for several of her analyses based on including or excluding New Jersey Resources Corp. (NJR) from the proxy group. Ms. Bulkley states the results of her models support her recommended ROE range, and her range is reasonable and conservative when considering the evidence that the average yields on

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30-year treasury bonds have increased since Ms. Bulkley filed her reply testimony. (Tr. 136.)

Ms. Bulkley recommends an ROE close to the top end of her proposed ROE range to reflect the fact that, in her opinion, Iowa-American's business risks are greater than the average risk of the proxy group. She states Iowa-American faces risks associated with: (1) small size, (2) significant capital spending, (3) environmental and water quality regulation, and (4) declining usage. (Iowa-American Bulkley Direct, pp. 68-90.)

Ms. Bulkley criticizes the ROE analysis provided by OCA witness Marcos Munoz. She argues his analysis includes only one data point based on his 9.0 percent DCF result, which would place Iowa-American at the low end of the range of authorized returns for water utilities in the U.S. since 2010. She acknowledges Mr. Munoz uses his CAPM analysis as a supplement to his DCF, but she urges the Board to view his CAPM analysis with caution because: (1) it uses the geometric average to calculate the historical risk premium when the arithmetic average should be used; (2) it does not reflect the inverse relationship between interest rates and risk premium; and (3) the historical risk premium does not reflect changes in volatility in the market. (Iowa-American Bulkley Reply, pp. 8-10.)

Mr. Munoz recommends an ROE of 9.0 percent. This ROE represents the average results of Mr. Munoz's DCF model, which he argues is the Board's preferred method. (OCA Munoz Direct, pp. 5, 41.) As a check on the reasonableness of his result, Mr. Munoz performed a CAPM analysis that produces a 9.5 percent ROE. (*Id.*, pp. 33-39.) Both the DCF model and the CAPM were applied to a proxy group of

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natural gas and water companies. Mr. Munoz considers natural gas companies to be riskier than water companies, which made his results higher than they otherwise would have been. Mr. Munoz explains that the CAPM results were impacted by the higher betas for natural gas companies, with two natural gas companies having betas in excess of one. (*Id.*, p. 38.) Betas measure the price movements of a firm's stock in relation to the price movements of the overall stock market. (*Id.*, p. 37.) Mr. Munoz stated the average beta for the natural gas companies was 0.925, while the average beta for the water companies was 0.80. The average CAPM ROE result for the water proxy group is 9.1 percent, which is close to OCA's 9.0 percent recommended ROE. (*Id.*, p. 38.)

Mr. Munoz stated Ms. Bulkley's analysis contains several flaws. His criticisms of Ms. Bulkley's ROE analysis are generally as follows:

- a. It fails to properly account for high outliers.
- b. It relies on inconsistent analysts' estimates.
- c. It relies only on earnings per share growth forecasts.
- d. The use of the CAPM, ECAPM, and expected earnings analyses inflated the ROE estimates. (*Id.*, pp. 41-49.)

Mr. Munoz also argues against making a business risk adjustment. He states Iowa-American's business risks are similar, if not lower, than the proxy group because the proxy group includes holding companies that own non-utility assets and operate in multiple regulatory jurisdictions with different regulatory treatment. The proxy group also includes natural gas companies that have broader risks due to mining, exploration, transport, and gas supply. (OCA Munoz Reply, pp. 15-16.) OCA instead argues that if the Board approves Iowa-American's proposed RSM and proposed modifications to the

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QIP rider, the Board should set an ROE at the lower end of the range to reflect the lower risk that would result from those decisions. (*Id.*, pp. 18-19).

Board Analysis

Both Ms. Bulkley and Mr. Munoz use a version of the DCF model and the CAPM as the market-based models in their ROE analyses. Ms. Bulkley also uses the ECAPM and the expected earnings model; Mr. Munoz does not. These models are applied to a proxy group of comparable water and natural gas companies. In determining an ROE for a utility, the Board has relied on the DCF model, the CAPM, and the risk premium model. The parties did not provide a risk premium analysis in this docket.

Ms. Bulkley and Mr. Munoz stated the size of the proxy group was a concern with their analyses given the limited number of water companies available. Both witnesses also stated it would be appropriate to include natural gas companies due to the similarities between the two industries.

There are differences between the proxy groups used by each of the expert witnesses in their analyses, one being the exclusion of American Water by Ms. Bulkley; however, the witnesses agree that the proxy groups are similar and are not the real driver in the difference between each of their proposed ROEs.

The Board's preferred DCF model has been previously labeled by the Board as the "FERC DCF" model, which is the model used by Ms. Bulkley. This version increases the dividend yield by one-half the growth rate. It represents a compromise between the continuous compounding DCF model where there is no growth applied to the dividend yield, and the constant growth DCF model where the full growth rate is applied to the dividend yield. However, the final determination of an ROE in a rate case

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is not the result of a rigid and mechanical application of that model or any particular formula. The Board uses the evidence admitted into the record to determine an appropriate ROE range of reasonableness and a particular ROE for a utility.

In this case, Ms. Bulkley argues that Mr. Munoz's DCF result of 9.0 percent is too low. This is primarily due to: (1) using market data from before the COVID-19 pandemic; (2) relying on historical growth estimates; (3) including DCF results below 7.0 percent; and (4) not reflecting the effects of current market conditions in his results. Ms. Bulkley also disagrees with Mr. Munoz's use of sustainable growth estimates; she finds them to be somewhat circular since an estimate of the earned return on common equity is required. (Iowa-American Bulkley Reply, p. 61.)

Mr. Munoz has issues with Ms. Bulkley's DCF results primarily due to including high-end outliers for SJW Group and South Jersey Industry. Ms. Bulkley includes DCF estimates of 12.65 percent to 16.19 percent for SJW Group and 15.51 percent to 17.76 percent for South Jersey Industry. (OCA Munoz Direct, p. 42.) Mr. Munoz states Ms. Bulkley's DCF results reflect inconsistent estimates of earnings per share by various sources. Mr. Munoz urges the Board to be cautious and to not rely on arbitrary and inconsistent results to determine the approved ROE. Mr. Munoz warns that an ROE based upon inconsistent results can award a return that is speculative, higher than normal, and above Iowa-American's cost, which would be unfairly paid by Iowa-American's customers. (*Id.*, p. 43.)

Iowa-American's recommended ROE of 10.5 percent is in excess of the authorized ROEs for Iowa-American affiliates and the most recent decisions for other water utilities, as shown in Figure 7 of Ms. Bulkley's reply testimony. (Iowa-American

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Bulkley Reply, p. 36.) The ROEs approved in 2019 for water utilities range from 9.6 percent to 9.8 percent. In 2020, the ROEs approved were 8.8 percent to 9.6 percent. OCA's recommended ROE of 9.0 percent is below the level of ROEs recently approved by other state regulatory agencies, with the exception of one, and below the approved ROEs of other American Water subsidiaries. (OCA Hearing Exhibit 1, p. 3.) The Board finds the recommended ROEs provided by Ms. Bulkley and Mr. Munoz are outside of a reasonable range of ROEs based upon the analyses and compared to the ROEs approved by other state regulatory agencies. An ROE for Iowa-American should be set at a level that is supported by the evidence, allows Iowa-American to attract capital, and results in rates that are just and reasonable.

The Board finds the upper end of a reasonable range based upon the evidence in the record is 10.0 percent. This upper end is based upon using the midpoint of the results produced by Ms. Bulkley's additional CAPM analysis provided in her reply testimony and the CAPM analysis provided by OCA. The Board excluded the results of Ms. Bulkley's CAPM analysis and ECAPM analysis that ranged from 11.42 percent to 12.51 percent (without NJR in the proxy group), because these results far exceeded the top end of Ms. Bulkley's own recommended range of 9.75 percent to 10.6 percent and do not align with the ROEs recently approved for water companies.

The Board also excluded the results produced by Ms. Bulkley's expected earnings model. The Board has previously denied the comparable earnings model, a model similar to the expected earnings model, because it is an accounting-based model. The Board stated that this model relies on earned returns which is not a relevant measure of the cost of equity since it is not based on market data.

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In re: Interstate Power and Light Company, Docket No. RPU-2008-0001, Final Decision and Order, p. 61 (February 2013, 2009). OCA also notes that the book returns used in the expected earnings model ignore capital markets and do not react to market changes. (OCA Munoz Direct, p. 49.) The Board agrees.

The Board finds the lower end of a reasonable range based upon the evidence in the record is 9.2 percent. This lower end is based upon giving equal weight to the average of Mr. Munoz's DCF results of 9.0 percent and the average of Ms. Bulkley's DCF results, after removing what the Board considers to be high and low DCF result outliers from Ms. Bulkley's DCF results, of 9.4 percent.

Based upon a range of 9.2 percent to 10.0 percent that the Board has found to be reasonable, the Board finds that the midpoint of that range, 9.6 percent, is an ROE that will allow Iowa-American to attract capital and will result in just and reasonable rates. A 9.6 percent ROE is the current ROE approved by the Board for Iowa-American and is consistent with the ROEs approved by the Board in recent rate cases for electric and natural gas utilities.

The Board has not made an adjustment to the ROE based upon greater business risks facing Iowa-American, as proposed by Ms. Bulkley. (Iowa-American Bulkley Direct, pp. 68-90.) Both Iowa-American and OCA selected a proxy group that has similar risks to Iowa-American's, and the Board is not persuaded that an adjustment due to isolated factors is necessary. This is consistent with the Board's decision on business risk adjustments in Iowa-American's last two rate cases. *In re: Iowa-American Water Company*, Docket No. RPU-2013-0002, Final Decision and Order,

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pp. 18-19 (February 28, 2014); *In re: Iowa-American Water Company, Final Decision and Order*, Docket No. RPU-2016-0002, p. 36 (February 27, 2017).

OCA argues that if the Board approves Iowa-American's proposed RSM and modifications to the QIP rider, then a downward adjustment to ROE would be warranted due to lower business risk. The Board will authorize Iowa-American to continue to utilize the QIP rider, without substantial modifications, and is denying the RSM. Therefore, no downward adjustment needs to be considered by the Board. The Board will discuss Iowa-American's continued use of the QIP rider and its decision regarding the RSM later in this order. The Board will approve an ROE of 9.6 percent.

B. Capital Structure

The Board is required to determine what the appropriate capital structure is for Iowa-American to determine the overall rate of return to be applied to rate base. Applying the overall rate of return to rate base provides one part of the revenue requirement calculation to be recovered in rates from customers.

Iowa-American's capital structure is made up of two types of capital: (1) long-term debt and (2) common equity. Each type of capital has its own cost rate that reflects the different level of risk associated with the capital. Long-term debt generally has the lowest risk and the lowest cost because the interest payments are contractual, and the holders of long-term debt are first in line in the event of bankruptcy. Common equity generally has the highest cost, because shareholders will only receive residual earnings through dividends and are last in line in the event of bankruptcy.

In this case, Iowa-American proposes a 13-month average capital structure based on a future test year ending June 30, 2022. This reflects all changes expected to

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occur, including planned equity infusions in the amount of \$15 million. (Iowa-American Simmons Direct, pp. 12-17.) Iowa-American states a common equity ratio of 52.28 percent is in line with Ms. Bulkley's peer group utilities, is below Iowa-American's actual 2019 year-end common equity ratio of 52.99 percent, and is in line with the Board approved common equity ratio of 52.04 percent in Iowa-American's last rate case, Docket No. RPU-2016-0002. (Iowa-American Simmons Reply, p. 3.) Iowa-American's proposed capital structure is as follows:

	Ratio	Cost Rate	Weighted Cost
Long-Term Debt	47.72%	5.62%	2.68%
Common Equity	<u>52.28%</u>	<u>10.50%</u>	<u>5.49%</u>
	100.00%		8.17%

Mr. Munoz also supports a 13-month average capital structure based upon long-term debt and common equity for a test year ending June 30, 2022. (OCA Munoz Direct, pp. 8-9.) However, Mr. Munoz argues long-term debt should be adjusted to include new debt issuances as if they were outstanding during the entire test period and remove retired debt issuances as if they were retired for the entire year. (*Id.*, pp. 9-11.)

Mr. Munoz uses Iowa-American's proposed common equity balance but makes an adjustment to reflect that it is unclear what sources of funds were used by American Water for the equity infusion portion of common equity. Without new common share issuances, American Water may use proceeds from debt or other contributed capital as the source of funds for the equity infusions. Therefore, Mr. Munoz argues the equity infusions should be treated separately as a combination of debt and equity in the capital

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structure to protect against manipulation by American Water. (*Id.*, pp. 12-14). The capital structure Mr. Munoz recommended for Iowa-American is as follows:

	Ratio	Cost Rate	Weighted Cost
Long-Term Debt	49.402%	5.397%	2.666%
Common Equity	43.812%	9.000%	3.943%
Equity Infusions	<u>6.786%</u>	<u>7.416%</u>	<u>0.503%</u>
	100.000%		7.112%

Board Analysis

There are two main differences between the capital structures recommended by Iowa-American and OCA. The first difference is that Iowa-American uses a 13-month average long-term debt balance, while OCA adjusts long-term debt to reflect new issues as if they existed for the entire test year and removes retired issues as if they were retired for the entire year. The second difference is that OCA makes an adjustment for equity infusions.

The Board finds Iowa-American's capital structure that is based on a 13-month average balance for both long-term debt and common equity, and the resulting long-term debt cost rate, is more appropriate than OCA's capital structure that includes adjustments to long-term debt but does not make similar adjustments to common equity. Iowa-American's 13-month average capital structure better matches the proposed 13-month average rate base.

The Board also finds that OCA's adjustment to common equity to reflect a mixed rate for the equity infusions is not reasonable. OCA applies American Water's capital structure to the equity infusions arguing that Iowa-American did not provide in the

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record the source of funds used for the equity infusions. OCA's proposed adjustment was intended to address possible manipulation of the capital structure. As pointed out by Iowa-American, OCA's proposal is similar to a double leverage adjustment where the capital structure of the parent company is applied to the common equity portion of the utility's capital structure. The Board denied the double leverage adjustment in Iowa-American's last rate case. *In re: Iowa-American Water Company*, Docket No. RPU-2016-0002, Final Decision and Order, pp. 41-42 (February 27, 2017). The Board stated in that case that if manipulation was evident, the Board may impose a hypothetical capital structure. The Board is aware of OCA's concerns regarding capital structure manipulation but sees no evidence in this case that Iowa-American's proposed capital structure is unreasonable or manipulated. Iowa-American's common equity ratio is reasonable compared to the common equity ratios of the proxy group and similar to the common equity ratio the Board approved in Iowa-American's last rate case. (Iowa-American Bulkley Reply, p. 15.) Based upon the above analysis, the Board will adopt the capital structure proposed by Iowa-American.

V. COST OF SERVICE

Iowa-American provided a class cost of service study (CCOSS) as part of its application. The CCOSS allocated Iowa-American's proposed total revenue requirement to various cost categories. The resulting revenue requirement for each cost category was then allocated to customer classes based on class allocation factors that differ depending on the nature of the costs. Iowa-American stated that its CCOSS was performed in accordance with generally accepted principles and procedures. The

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methodology Iowa-American used to perform its CCROSS is generally the same as it used in its last rate case.

Iowa-American's CCROSS allocated costs across the following customer classes: Residential, Commercial, Industrial, Public Authorities, Miscellaneous Sales, Public Fire, and Private Fire. In Docket No. RPU-2013-0002, the Board ruled that 25 percent of the costs allocated to the Private Fire class should be reallocated to the other classes. The Board determined that this reallocation was appropriate, because having adequate private fire service benefits all customers, not just those customers utilizing the service. The Board ruled that half of the 25 percent reallocation should be recovered through fixed meter charges and half should be recovered through volumetric rates. The Board affirmed this decision in Docket No. RPU-2016-0002. Iowa-American's CCROSS in this case allocated private fire costs in accordance with the Board's prior decisions.

OCA disagreed with Iowa-American's proposed revenue requirement but did not offer any specific objections to the methodology used in the CCROSS. The parties agreed that if the final revenue requirement the Board approves in this case differs from the revenue requirement proposed by Iowa-American, then Iowa-American will need to re-run the CCROSS using the approved revenue requirement.

Board Analysis

The Board finds that Iowa-American's methodology for assigning costs to customer classes is reasonable and consistent with past practice, including its treatment of private fire costs. The Board will require Iowa-American to re-run the CCROSS using the final revenue requirement approved in this case when it calculates final rates as part of its compliance filing.

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In its December 11, 2020 Order Requiring Additional Information, the Board required Iowa-American to provide definitions for the customer classes that are referenced in its current tariff and to explain why those classes are not defined in the tariff. Iowa-American's January 11, 2021 response provided the requested definitions and explained that the definitions follow the American Water Works Association descriptions of revenue classifications. Iowa-American stated the Board has never required that customer classes be defined in Iowa-American's tariff and that doing so would remove flexibility and require ongoing maintenance. Iowa-American stated including class definitions in the tariff is unnecessary because class is not a defining characteristic used for billing, tariff usage, or eligibility.

The Board does not agree that defining customer classes in Iowa-American's tariff is unnecessary or that customer class is not used for billing purposes. The QIP rider tariff sheet provides different surcharge amounts based on a customer's class. A customer should be able to understand why Iowa-American has assigned them to a particular class and why their QIP rider surcharge may be higher or lower than another customer. Defining customer classes in the tariff may have been unnecessary before the QIP rider was approved in Docket No. RPU-2016-0002, but it is necessary now. The Board will require Iowa-American to include definitions for each customer class in its compliance tariff in order to provide greater transparency about how customers are categorized into classes.

VI. RATE DESIGN

Iowa-American's rate design proposal included five elements: (1) eliminating the provision of free water for municipal uses in Clinton; (2) maintaining the monthly meter

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charges at current levels; (3) consolidating the existing Quad Cities/Clinton district and the Blue Grass district so that the same rates apply to all customers; (4) using the decrease indicated for the Private Fire class to mitigate the increase indicated for the Residential class; and (5) setting volumetric charges in a way that reflects the class revenue requirement allocations from the CCOSS as closely as possible. Each of these five elements will be discussed in turn.

1. Iowa-American proposes to eliminate a special rate schedule that currently allows free water for certain municipal uses in the city of Clinton. Iowa-American explained that in 1972, it entered into an agreement with the Clinton Board of Park Commissioners that provided for 500,000 gallons of free water usage for certain city accounts. The agreement was approved by the Board's predecessor, the Iowa State Commerce Commission.

Iowa-American stated that the Clinton Board of Park Commissioners no longer exists, and the only remaining vestige of the agreement is in Iowa-American's tariff. Iowa-American stated the allowance for free water usage is no longer reasonable. OCA did not object to the elimination of the special rate and noted that it has always believed all cities should be treated equally.

Board Analysis

The Board agrees that similarly situated cities served by Iowa-American should be treated equally. Because the agreement with the Clinton Board of Park Commissioners providing for special treatment no longer exists, the tariff should be modified to provide for equal treatment. The Board finds that Iowa-American's proposal to eliminate the special rate for the Clinton Board of Park Commissioners is reasonable.

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2. The second element of Iowa-American's rate design proposal is to leave unchanged the existing fixed monthly charge. The fixed monthly charge is based on a customer's meter size. Customers with 5/8-inch meters, which is the most common meter size for residential customers, are assessed a fixed monthly charge of \$14.00. The charge increases as meter size increases. OCA agreed with Iowa-American's proposal to leave these charges unchanged.

Board Analysis

The Board finds that the fixed charge continues to be an appropriate method for Iowa-American to recover a portion of its fixed costs, independent of the volume of water used by a customer, because those fixed costs are incurred independent of the amount of water used. Therefore, the Board finds this element of Iowa-American's rate design proposal is reasonable.

3. The third element of Iowa-American's rate design proposal is to eliminate the special rate schedule that is currently in effect for customers in the city of Blue Grass and to incorporate those customers into Iowa-American's consolidated rate schedule. Iowa-American acquired the Blue Grass water system after the conclusion of its last rate case. The acquisition agreement provided that Blue Grass customers' then-current rates would be frozen for three years. The Board issued an order on April 26, 2017, in Docket No. TF-2016-0334 that approved a rate schedule applicable to Iowa-American customers in Blue Grass. In accordance with the acquisition agreement, the Blue Grass rate schedule mirrored the existing municipal rates.

Blue Grass customers currently pay a fixed monthly charge of \$15.89, regardless of meter size. They pay no volumetric charge for the first 2,500 gallons per month and

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\$0.568 per 100 gallons thereafter. The rates for Blue Grass customers will have remained unchanged for four years by the time the rates approved in this docket will go into effect. Iowa-American stated that incorporating Blue Grass customers into the consolidated rate schedule would increase the typical Blue Grass residential customer's bill from \$24.41 per month to \$42.70 per month. Iowa-American stated that consolidating rates ultimately benefits all customers by spreading costs and improving rate stability.

OCA agreed with Iowa-American that it is reasonable to consolidate Blue Grass customers into the general rate schedule. OCA stated that Blue Grass customers received notice of the three-year rate freeze when they voted to approve the acquisition. OCA stated that Iowa-American's consolidation proposal reasonably balances the interests of customers in Blue Grass with the interests of customers in Clinton and the Quad Cities.

Board Analysis

Incorporating Blue Grass customers into Iowa-American's consolidated rate schedule is consistent with the Board's preference that similarly situated customers should pay the same rates. The Board finds that Iowa-American's proposal to eliminate the special rate schedule currently in effect for Blue Grass is reasonable and appropriately balances the interests of Iowa-American's customers.

4. The fourth element of Iowa-American's rate design proposal is to use the decrease indicated by the CCOSS for the Private Fire class to mitigate the increase indicated for the Residential class. Iowa-American's CCOSS indicated a decrease of \$363,353, or 33.4 percent, for the Private Fire class. Iowa-American proposes to

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instead leave Private Fire rates unchanged and use the difference to mitigate the \$3,861,453, or 15 percent, increase indicated for the Residential class. OCA did not object to this proposal.

Board Analysis

Iowa-American's mitigation proposal will help avoid rate shock for the residential class. As stated above, 25 percent of the costs allocated to the Private Fire class are reallocated to other classes. The fact that other classes subsidize the Private Fire class lends additional strength to the appropriateness of Iowa-American's mitigation proposal.

5. The final element of Iowa-American's rate design proposal is to set volumetric rates that come as close as possible to producing the amount of revenue indicated for each class in the CCOSS, after applying the Private Fire class mitigation adjustment. Iowa-American utilizes a declining block rate structure for its volumetric rates. As a customer's usage increases through four usage blocks, the volumetric rate that applies to water used in each usage block decreases. The declining block rate structure applies to all customer classes, except for Private Fire customers, who pay only a fixed monthly charge based on the size of their meter. A typical residential customer is usually only subject to the first usage block rate, whereas a large industrial customer may be subject to all four usage block rates.

Iowa-American stated this declining block rate structure makes it difficult to calculate volumetric rates that produce exactly the targeted amount of revenue for each class. Iowa-American therefore used a trial-and-error approach to test different volumetric rate combinations against the class revenue targets. Iowa-American stated the volumetric rates it proposed come as close as reasonably possible to producing the

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targeted revenue amount for each class. Iowa-American stated that if the Board approves a different revenue requirement than that proposed by Iowa-American, then the CCROSS should be re-run and rates should be reset so as to reflect the revised class revenue targets as closely as possible.

OCA objected to this element of Iowa-American's rate design proposal. OCA stated that the goal of setting the volumetric rates should not be to come as close as possible to producing the targeted revenue amount for each class. Instead, OCA stated that Iowa-American should seek to more equally balance the overall increase across customer classes. OCA stated this approach would support gradualism and help avoid rate shock. After the Board has approved a final revenue requirement in this case, OCA stated that Iowa-American should be required to re-run the CCROSS and calculate several volumetric rate alternatives. OCA stated Iowa-American should then present those rate alternatives to the Board so the Board can determine which alternative strikes the most appropriate balance between cost-based revenue recovery and customer impact.

Board Analysis

Iowa-American proposes to use the decrease indicated for the Private Fire class to offset the increase indicated for the Residential class. This mitigation measure will help promote gradualism and avoid rate shock. Instead of proposing discrete mitigation measures, OCA proposes that volumetric rates should be designed from the start to more evenly balance the overall revenue increase across classes. OCA's approach would be a deviation from the Board's well-established preference that the cost of serving a customer class be allocated to that class and reflected in rates.

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Where appropriate, the Board has allowed specific adjustments to this cost-based approach to avoid rate shock or to support public policy. Going beyond the use of discrete mitigation measures during the revenue requirement allocation process, and instead designing rates with the goal of evenly distributing increases across classes, is not consistent with the Board's preferred approach to rate design. The Board finds that Iowa-American's proposal to set volumetric rates that come as close as possible to producing the amount of revenue indicated for each class in the CCOS, after applying the Private Fire mitigation adjustment, is reasonable.

VII. QUALIFIED INFRASTRUCTURE PLANT RIDER

In Docket No. RPU-2016-0002, the Board authorized Iowa-American to utilize a QIP rider to recover costs associated with qualifying investments in between rate cases. The QIP rider allows Iowa-American to recover, through a surcharge that is calculated annually, the cost of capital, depreciation, and taxes associated with investments in certain types of qualifying infrastructure. Iowa-American is allowed to recover carrying charges on these investments at its cost of debt.

Qualifying investments are those that replace aging infrastructure and do not increase Iowa-American's revenue. The categories of qualifying investments are defined in the QIP tariff. Except for investments required by government mandates, Iowa-American may only seek recovery of amounts that exceed a \$4.2 million initial annual threshold. The threshold was designed to ensure that the QIP rider is being used to encourage accelerated replacement of aging infrastructure, rather than routine or business-as-usual investments. Iowa-American's cumulative recovery through the

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QIP rider between rate cases is capped at 15 percent of its authorized revenue requirement.

Each year, Iowa-American files a report of its qualifying investments and its calculation of the annual QIP rider surcharge. The report and the calculation of the surcharge is subject to approval by the Board. At the conclusion of a general rate case, investments that Iowa-American had been recovering through the QIP rider at Iowa-American's cost of debt are moved to rate base, and Iowa-American recovers on those investments at its weighted average cost of capital.

Iowa-American has proposed several changes to the QIP rider that it asserts will make the rider more useful, keep costs down, and further the goal of accelerating the replacement of aging infrastructure. OCA argues that the QIP rider has not benefited customers and should be discontinued. In the alternative, OCA proposes several changes to the QIP rider that it suggests would benefit customers.

A. Continued Use of QIP Rider

OCA first proposes that the QIP rider should be discontinued. OCA argues that use of the QIP rider has not reduced operation and maintenance expenses or resulted in reliability improvements. OCA acknowledges that, since approval of the QIP rider, Iowa-American has extended the period of time between rate cases; however, OCA states Iowa-American has not offered any evidence to show this longer period is due to the use of the QIP rider. OCA argues that automatic adjustment mechanisms like the QIP rider should be approved only if they are justified by tangible and quantifiable benefits to customers. OCA argues there is no basis in the record to find that the QIP rider passes that test. (OCA Tessier Direct, pp. 44-46.)

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Iowa-American responds that the QIP rider has produced tangible benefits to customers. Iowa-American has doubled its preventative maintenance-related infrastructure investments in qualified categories without increasing the frequency of its rate cases. Iowa-American argues that the Board's intent in approving the QIP rider was to stimulate investment in certain types of infrastructure and to extend the length of time between rate cases. Iowa-American argues that both goals have been achieved. (Iowa-American Simmons Reply, pp. 16-17.)

Board Analysis

The Board approved Iowa-American's use of the QIP rider in Docket No. RPU-2016-0002 in order to encourage Iowa-American to replace aging infrastructure and to reduce rate case expenses. *In re: Iowa-American Water Company*, Docket No. RPU-2016-0002, Final Decision and Order, p. 23 (February 27, 2017). It appears from the evidence in the record that use of the QIP rider has achieved those goals. Iowa-American has used the QIP rider to accelerate its preventative maintenance investments. Iowa-American also has reduced the frequency of its rate cases. Iowa-American may not be able to prove the reduced frequency of rate cases is exclusively due to the use of the QIP rider, but it is logical to conclude that the QIP rider was at least a contributing factor. Based upon the benefits achieved through the QIP rider, the Board finds that continued use of the QIP rider is reasonable.

B. Earnings Test, Stay-Out Limitation, and Annual Cap

OCA proposes that if the QIP rider will remain in use, the Board should require several modifications to help ensure that its use benefits customers and not just Iowa-American. OCA first proposes that Iowa-American should be required to report its

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actual earnings each year prior to implementing the annual QIP rider surcharge. If Iowa-American has earned more than its authorized return, it should not be allowed to implement a QIP rider surcharge for the coming year. (OCA Tessier Direct, pp. 29-30.)

Iowa-American argues that implementing an earnings test would introduce uncertainty to the recovery process and make it more difficult to attract capital. This would be contrary to the goal of increasing investment in infrastructure replacement. (Iowa-American Simmons Reply, p.17.)

OCA next argues that the Board should impose a “stay-out” limitation that would condition Iowa-American’s use of the QIP rider on its ability to extend the period of time between rate cases. OCA does not suggest what period of time between rate cases should be required. OCA argues that if extending the period of time between rate cases is used as a justification for the QIP rider, then there should be an incentive for Iowa-American to actually achieve that result. (OCA Tessier Direct, pp. 31-32.)

Iowa-American counters that rate case filings can be triggered by many factors. The QIP rider allows more timely recovery of specific types of investments, but it is not a perfect tool for avoiding rate cases, due to other changes in Iowa-American’s financial condition. (Iowa-American Simmons Reply, p. 18.)

Finally, OCA proposes that the Board should impose an additional cap on the amount of QIP rider surcharges. The QIP rider currently contains a provision limiting the cumulative recovery between rate cases to no more than 15 percent of Iowa-American’s approved revenue requirement. OCA suggests there should also be an annual cap that limits the increase in QIP rider recoveries from one year to the next. OCA proposes the annual cap should be set at 3 percent of Iowa-American’s approved

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revenue requirement. In the first year, QIP rider recovery would be limited to 3 percent of the revenue requirement. In the second year, QIP rider recovery would be limited to the prior year's recovery, plus no more than 3 percent of the revenue requirement, and so on. (OCA Tessier Direct, pp. 30-31.)

Iowa-American stated the imposition of a 3 percent annual cap would not hinder its ability to implement its strategic capital spending plan, as long as the revenue requirement the Board approves in this case is not significantly less than what Iowa-American proposed. (Iowa-American Simmons Reply, pp. 17-18.)

Board Analysis

Imposing an earnings test could frustrate the goal of accelerating the replacement of aging infrastructure. That accelerated investment is less likely to occur if Iowa-American is unable to utilize the QIP rider in a given year due to exceeding its approved rate of return in the prior year. Imposing a stay-out limitation would not be appropriate because the QIP rider cannot mitigate all factors that might create the need for a rate case. The QIP rider likely contributed to Iowa-American's ability to extend the amount of time between rate cases, but it cannot be counted on to do so under all circumstances. The Board finds that OCA's proposals for a QIP rider earnings test and stay-out limitation are not reasonable.

The Board finds that OCA's proposal for an annual QIP rider cap of 3 percent of Iowa-American's approved revenue requirement is reasonable. The existing 15 percent cumulative cap protects customers by limiting the total amount that Iowa-American may recover through the QIP rider between rate cases. Adding an annual cap of 3 percent will add another level of protection for customers against large increases in the QIP

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rider surcharge from one year to the next. An annual cap will promote gradualism and help avoid rate shock. The Board will approve OCA's proposal for a 3 percent annual cap.

C. Tax Gross-Up

OCA proposes the Board should eliminate the current tax gross-up of the QIP rider. OCA argues that allowing the QIP rider recovery to be grossed up for taxes creates significant additional cost for customers. OCA states natural gas tracker mechanisms, which are authorized under 199 Iowa Administrative Code 19.18, are not allowed to include a tax gross-up factor. OCA argues Iowa-American presented no justification for why the QIP rider should be treated differently. (OCA Tessier Reply, pp. 22.)

Iowa-American states the Board denied the same argument from OCA when the Board approved Iowa-American's initial QIP rider tariff. (Iowa-American Simmons Reply, p. 19.)

Board Analysis

OCA argues that the QIP rider should not include a tax gross-up because it creates additional costs and because natural gas trackers do not include a tax gross-up. The Board addressed the same arguments from OCA when the Board approved Iowa-American's compliance tariff in Iowa-American's last rate case. In its order approving the tariff, the Board acknowledged that the QIP rider is modeled after the natural gas tracker mechanism, but found that it does not need to be identical to that tracker. The Board pointed to the fact that the QIP rider mechanism contains an investment threshold that must be exceeded before recovery is allowed, while the natural gas

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tracker does not. *In re: Iowa-American Water Company*, Docket No. TF-2017-0029, Order Approving Tariff with Modifications, p. 5 (September 18, 2017). OCA presented evidence in this case that the QIP rider tax gross-up creates additional costs for customers, but the Board knew that would be the case when it approved the tax gross-up in 2017. OCA has not adequately justified its position that the Board should reverse its prior decision to allow the QIP rider tax gross-up. The Board finds that the tax gross-up of the QIP rider is reasonable and should continue.

D. Lead Service Line Replacement

OCA proposes the Board not allow Iowa-American to recover the costs of replacing lead service lines through the QIP rider until Iowa-American has submitted an inventory of lead service lines and a written plan for replacing lead service lines that prioritizes high risk service lines first. OCA argues the plan must also recognize that Iowa-American should pursue any government or charitable funds available for lead service line replacement. OCA states Iowa-American has not presented any evidence that there is a current threat to public health from lead in the company's water system. OCA states the costs of lead service line replacement are estimated to be \$8.4 million through 2024 and would increase Iowa-American's rate base by almost 6 percent. (OCA Tessier Direct, pp. 47-49.)

Iowa-American states its approved tariff already allows recovery through the QIP rider for service lines that are replaced "to address water problems that have been documented as presenting a significant health or safety concern for customers." (Iowa-American Simmons Reply, p. 20, citing Tariff Sheet No. 4H.) Iowa-American states the potential for lead in drinking water is a significant health concern, and replacement of

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lead service lines is in the best interest of customers. (Iowa-American Nielsen Reply, pp. 6-8.) Iowa-American argues that OCA's proposal would delay the replacement of lead service lines and increase the potential for harm to customers. (*Id.*, p. 9.)

Board Analysis

The Board finds that lead service line replacement is currently authorized for QIP rider recovery under the terms of Iowa-American's tariff. Iowa-American submitted sufficient evidence that lead service lines have been recognized as a significant public health threat. (*Id.*, pp. 6-8.) The Board supports Iowa-American's business decision to replace lead service lines even if lead contamination in water has not been documented. OCA has persuaded the Board that recovery of lead service line replacement costs through the QIP rider should be documented and an inventory and plan prepared and provided to the Board and OCA; however, replacements should not be halted until a written plan has been approved. The Board will deny OCA's proposal in this regard.

The Board will require Iowa-American to submit a plan and inventory for Board approval within 60 days of the date of this order. The plan shall detail Iowa-American's goals and strategy for replacing lead service lines during the next five years. The plan shall also include an evaluation of any government or charitable funding available for lead service line replacement and a description of Iowa-American's efforts to secure such funding. The Board expects Iowa-American to seriously pursue any available funding opportunities. Finally, the plan shall identify any lead service line requirements of the federal Environmental Protection Agency (EPA) that require action by

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Iowa-American. This portion of the plan will be deemed confidential and held confidential upon filing.

Once approved by the Board, the five-year plan and inventory shall be updated each year at the time Iowa-American makes its annual QIP rider surcharge filing. The updated plan shall include a report of Iowa-American's lead service line replacement activities over the last year, a report of any actions taken to comply with EPA requirements related to lead service lines, and a report of Iowa-American's efforts to secure government or charitable funding for lead service line replacements. The required content of the plan and the requirement for annual reporting shall be memorialized in Iowa-American's tariff.

In order to ensure that Iowa-American's lead service line replacement program proceeds as cost-effectively as possible, the Board will limit Iowa-American's recovery through the QIP rider to those lead service line replacements that occur due to the service line being disturbed by Iowa-American or due to some other circumstance that presents an increased likelihood of lead contamination in drinking water. Additional proactive efforts to locate and replace lead service lines — for instance by searching tap records — will not be eligible for QIP rider recovery until such efforts are approved as a component of Iowa-American's lead service line replacement plan. The imposition of the 3 percent annual cap on QIP rider increases, in addition to the existing 15 percent cumulative cap, will further ensure that the cost of lead service line replacement does not become too burdensome on customers.

The Board will also require that Iowa-American ensures equal treatment of its customers when it comes to replacement of lead service lines due to breaks or leaks.

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Iowa-American Hearing Exhibit 6 contains diagrams and explanations of how various types of service line replacements are handled in Clinton and the Quad Cities. In Clinton, if a break or leak occurs on a lead service line, the company will replace the entire service line from the water main to the house at the company's cost. In the Quad Cities, if a break or leak occurs on a lead service line, the customer is responsible for replacing the entire service line at the customer's cost. The exhibit illustrates that the reason for the differing treatment is the fact that in Clinton, the company owns a portion of the service line, whereas in the Quad Cities, the entire service line is owned by the customer. Iowa-American stated it plans to pursue changes to local ordinances in the Quad Cities so that ownership of service lines in the Quad Cities would be the same as the ownership structure in Clinton. The Board will address Iowa-American's proposed tariff changes designed to facilitate that change in ownership structure later in this order.

Iowa-American did not adequately explain why the different ownership structures justify the different treatment of broken or leaking lead service lines. It is not clear why Iowa-American will not pay to replace a broken or leaking lead service line in the Quad Cities but will pay to replace a broken or leaking lead service line in Clinton, even if the break is on the customer-owned portion of the line. Customers in the Quad Cities pay the same rates as customers in Clinton and should be treated equally unless there is a valid reason for treating them differently. Iowa-American has not persuaded the Board that a valid reason exists. The Board will require that Iowa-American treat its customers in the Quad Cities the same as it treats its customers in Clinton when it comes to replacement of broken or leaking lead service lines.

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E. Investment Threshold and Annual Reconciliation

Iowa-American proposes to eliminate the existing \$4.2 million annual investment threshold. Only qualifying investments above this threshold are eligible for recovery through the QIP rider. Iowa-American states the threshold prohibits it from recovering between rate cases a significant amount of qualifying investments that would otherwise be eligible and that have been put into service to benefit customers. Iowa-American states it will be difficult to compete for capital from American Water against affiliates that utilize QIP riders without a similar threshold. Iowa-American states that if the threshold is not removed, along with the adoption of other changes proposed by the company, it may be forced to file more frequent rate cases or reduce its discretionary investment back to pre-QIP rider levels. (Iowa-American Simmons Direct, pp. 31-35.)

OCA states removing the threshold would only be appropriate if the Board requires the other changes proposed by OCA. OCA states that without the threshold, the QIP rider would be much more similar to a natural gas tracker, and there would be no justification for allowing a tax gross-up for one and not the other. (OCA Tessier Direct, p. 36.)

Iowa-American also proposes to add a mechanism to the QIP rider that annually reconciles the amount of revenue intended to be collected with the amount of revenue actually collected. The annual over- or under-balance would be applied to the calculation of the next year's surcharge. Iowa-American states the annual reconciliation will protect both the customer and the company from imperfections in sales forecasts when setting the annual surcharge amount. (Iowa-American Simmons Direct, p 42.) OCA did not object to the proposal for an annual reconciliation.

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Board Analysis

The purpose of the QIP rider is to promote accelerated replacement of aging infrastructure. The Board imposed the threshold to ensure that the rider was being used to facilitate investments above Iowa-American's then-current levels. The Board determined that \$4.2 million was a reasonable estimate of Iowa-American's "business-as-usual" investment level. Therefore, only investments in excess of that level were eligible for recovery through the rider. The purpose of the QIP rider has not changed, nor has the need for the threshold changed.

The evidence shows the QIP rider has been a success. Iowa-American has approximately doubled its preventative maintenance-related investments in qualified categories without increasing the frequency of its rate cases. (Iowa-American Simmons Reply, p. 16.) The threshold has not prevented Iowa-American from achieving the purposes of the QIP rider. The Board finds that the existing QIP rider investment threshold is reasonable and should continue. The Board will deny Iowa-American's proposal to eliminate the threshold.

The Board finds that an annual reconciliation of the QIP rider is reasonable and will lessen the impact of forecasting imperfections. The Board will approve the proposal for an annual reconciliation.

F. Rate of Return

The QIP rider currently allows Iowa-American to recover a rate of return on its investments at Iowa-American's cost of debt. Iowa-American proposes the Board should instead allow recovery of a return on its investment at Iowa-American's weighted average cost of capital (WACC) like it does for investments included in rate base.

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Iowa-American argues the level of return allowed on an investment should not differ based on whether the investment was made before or after a rate case. (*Id.*, p. 40.)

OCA opposes Iowa-American's proposal and argues that the Board should actually lower the authorized return on the QIP rider. OCA argues that Iowa-American's proposed 5.62 percent average cost of debt is much higher than current corporate bond rates, because Iowa-American carries large principal balances in relatively old mortgage bonds with high interest rates. OCA argues Iowa-American should instead recover a return on QIP rider investments at its incremental cost of debt, which OCA defines as the approximate cost to issue new debt. OCA estimates Iowa-American's incremental cost of debt to be 3.98 percent, based on the cost of debt of American Water. OCA argues it makes more sense to allow Iowa-American to recover a return on QIP rider investments between rate cases at a rate that reflects Iowa-American's current borrowing costs rather than a rate that is impacted by large amounts of old debt. (OCA Tessier Direct, pp. 34-35.)

Board Analysis

When the Board approved the creation of the QIP rider in Docket No. RPU-2016-0002, it found that recovering a return at Iowa-American's average cost of debt was appropriate, because it would allow Iowa-American to receive a return on its infrastructure investments between rate cases without eliminating the need for rate cases altogether. The Board found that allowing a return at the average cost of debt has worked successfully for natural gas tracker mechanisms. The Board also reasoned that recovering a return at the average cost of debt was only a temporary circumstance, because Iowa-American would be allowed to earn its WACC once the QIP rider

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investments are moved into rate base at the conclusion of a rate case. *In re: Iowa American Water Company*, Final Decision and Order, pp. 24-25 (February 27, 2017). These same considerations apply now. The QIP rider appears to be achieving its goal of encouraging accelerated replacement of aging infrastructure. Neither party has justified making a significant change to the authorized rate of return. The Board finds that it is reasonable to continue the QIP rider's rate of return at the average cost of debt. The Board will not approve either of the competing proposals from Iowa-American or OCA regarding changes to the rate of return.

G. Eligible Investments

Iowa-American proposes to expand the list of infrastructure categories that are eligible for recovery through the QIP rider to include booster pumps, variable frequency drives (VFD), and power generators. Iowa-American states this equipment requires routine replacement in order to maintain safe and reliable service. Booster pumps and VFDs transfer flow between pressure zones in the distribution system. The pumps and VFDs are powered by generators. Iowa-American has 30 booster pumps and 24 VFDs. It plans to replace one pump and VFD each year for an average annual expenditure of \$67,500. Iowa-American has seven generators. It intends to replace one generator every five years for an average annual expenditure of \$17,500. Iowa-American proposes that investments in these categories of infrastructure should be eligible for recovery through the QIP rider. (Iowa-American Kull Direct, pp. 20-21.)

OCA opposes Iowa-American's proposal, and states the intent of the QIP rider is to encourage additional investment to replace aging infrastructure. OCA argues Iowa-American has not adequately demonstrated that the categories of infrastructure

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spending it proposes to add to the QIP Rider further that goal. (OCA Tessier Direct, pp. 36-37.)

Board Analysis

Iowa-American stated booster pumps, VFDs, and power generators require “routine replacement” to ensure reliable service. (Iowa-American Kull Direct, p. 21.) The purpose of the QIP rider is to encourage Iowa-American to accelerate its replacement of aging infrastructure without otherwise increasing Iowa-American’s annual revenue requirement. Iowa-American did not adequately demonstrate that accelerated replacement of this equipment is planned or needed. Iowa-American has not adequately justified that the proposed additional categories of investment are consistent with the purpose of the QIP rider. The Board will deny Iowa-American’s proposal to add more categories of investment to the QIP rider.

H. State Revolving Fund

When the Board approved Iowa-American’s initial QIP rider tariff, the Board stated it expected Iowa-American to take advantage of low-cost financing when it is available and feasible. The Board required that Iowa-American include a summary of its efforts to obtain funding from the State Revolving Fund (SRF) when it submits its annual QIP rider surcharge calculation. *In re: Iowa-American Water Company*, Order Approving Tariff With Modifications, Docket No. TF-2017-0029, pp. 6-7 (September 18, 2017). This reporting requirement is currently reflected in Iowa-American’s tariff.

Iowa-American proposes to remove the reporting requirement from the tariff. Iowa-American states the nature of the QIP rider does not align well with the requirements of obtaining financing through the SRF. Iowa-American states the

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applications, studies, and reporting requirements of SRF loans make it prohibitive for small-value projects to qualify individually. (Iowa-American Simmons Reply, pp. 20-21.)

OCA opposes Iowa-American's proposal and argues that the requirement to seek low-cost financing should be expanded beyond the SRF to include all possible sources of low-cost financing from governmental agencies or charitable organizations. (OCA Tessier Direct, p. 38; OCA Tessier Reply, pp. 23-24.) Iowa-American replies that expanding the existing requirement to apply to all possible sources of governmental or charitable funding would require Iowa-American to hire additional employees to navigate the administrative process and would not be cost effective. (Iowa-American Simmons Reply, pp. 20-21.)

Board Analysis

Iowa-American successfully used the SRF program to obtain a low-cost loan for an \$8 million ultraviolet disinfection project that covered more than two years' worth of QIP rider investment. (*Id.*) This demonstrates that pursuing SRF financing is in the best interest of Iowa-American's customers and is a worthwhile endeavor. The SRF program is run by a professional staff that is experienced in assisting applicants through the administrative process of obtaining financing. The Board is not persuaded that the application process is too difficult for Iowa-American to navigate.

The current requirement to seek and report on SRF financing is reasonable and is likely benefiting customers. The Board sees no reason to modify it. Expanding the requirement to include all possible sources of governmental or charitable funding is too open-ended to be considered reasonable. The Board will deny Iowa-American's

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proposal to eliminate the requirement. The Board will deny OCA's proposal to expand the requirement to all possible sources of governmental or charitable funding.

VIII. REVENUE STABILIZATION MECHANISM

Iowa-American proposes to implement an RSM that would allow the company to collect an annual revenue amount consistent with the approved revenue requirement in this case, regardless of the volume of water actually used by customers. Each month, Iowa-American would compare the amount of revenue collected from each customer class to the amount of revenue authorized for each customer class in this case. Iowa-American would also compare actual production costs that vary with sales volume to the amount of variable production costs included in the approved revenue requirement.

(Iowa-American Rea Direct, pp. 41-42.)

If actual revenue is less than what the Board approved, the difference less the change in variable production costs would be deferred to a regulatory asset. If actual revenue is greater than what the Board approved, the difference, less the change in variable production costs, would be deferred to a regulatory liability. By January 30 of each year, Iowa-American would reconcile any net over- or under-collection that accrued during the previous calendar year. (*Id.*, p. 42.)

If the annual reconciliation shows an under-collection has occurred, Iowa-American would institute a volumetric surcharge, based on historic use, to recover the under-collected amount. The surcharge would be in effect from April 1 through the end of the calendar year. If the annual reconciliation shows an over-collection has occurred, Iowa-American would return the over-collection via a one-time bill credit that is equal in amount for all members of the customer class. Iowa-American would provide the credit

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as soon as administratively feasible. If Iowa-American experiences growth through an acquisition, it would separately track revenues and variable production costs resulting from the acquisition and would exclude them from the RSM until they could be recognized in the company's next rate case. (*Id.*, pp. 42-44.)

Iowa-American asserts that having its revenue recovery tied directly to its sales volume is problematic in two ways. First, it penalizes the company for encouraging conservation by its customers. If Iowa-American sells less water, it will generate less revenue. (*Id.*, pp. 37-38.) Second, it denies Iowa-American a reasonable opportunity to reliably recover its approved revenue requirement due to weather variability and due to a long-term decline in use per customer. The majority of Iowa-American's costs are fixed, but the majority of its revenue is collected through volumetric rates. This limits Iowa-American's ability to reduce costs in response to a decline in use and increases the chances that Iowa-American will not recover its approved revenue requirement. This inability to recover its approved revenue requirement affects Iowa-American's ability to plan, manage, and raise capital for facilities needed to provide safe water at a reasonable cost. (*Id.*, pp. 33-37.)

Iowa-American states that implementing an RSM would remove its incentive to sell as much water as possible. It also states that the use of a volumetric surcharge to recoup under-collections, and a fixed credit to return over-collections, would ensure that customers continue to have an incentive to conserve water. According to Iowa-American, the RSM would also reduce the impact of weather variability and declining use on Iowa-American's revenue recovery. Iowa-American states the revenue requirement approved by the Board in this case will represent the amount of revenue

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the company needs in order to operate, maintain, and invest in its system in a prudent and efficient manner. Iowa-American asserts it is, therefore, in customers' best interest to ensure that the authorized level of revenue is actually recovered. (*Id.*, pp. 36-37.)

Iowa-American states several state regulatory commissions have approved mechanisms similar to the RSM, including for Iowa-American affiliates. Iowa-American states the National Association of Regulatory Utility Commissioners has recognized the problem of declining use for water utilities and has expressly supported the development of alternative recovery mechanisms. (*Id.*, pp. 38-41.)

OCA opposes the implementation of an RSM. OCA states Iowa-American presently has no meaningful programs to encourage water conservation and has not committed to implementing any. (OCA Dismukes Direct, pp. 40-41.) OCA asserts that the decline in use per customer is less precipitous than calculated by Iowa-American, and the trend may be levelling off. OCA further asserts that trends in use per customer are less relevant to the question of the RSM than trends in overall revenue recovery. OCA states Iowa-American's overall revenues have been growing and will likely continue to grow. (*Id.*, pp.19-20.) Iowa-American counters that focusing on its revenue growth is misleading, because that revenue growth is due, at least in part, to rate increases. (Iowa-American Rea Reply, pp. 14-15.)

OCA's primary argument is that approving the RSM would constitute a significant shifting of risk from Iowa-American to its customers. OCA states the traditional regulatory framework affords a utility the opportunity to generate a particular revenue stream, but Iowa-American's proposal would constitute a guaranteed generation of the revenue stream. OCA states the risk associated with revenue generation is traditionally

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borne by the utility and its shareholders. This is because the utility can control that risk, to some extent, by controlling the frequency and timing of its rate cases. (OCA Dismukes Direct, pp. 12-13.)

OCA states the RSM would shift the risk of revenue shortfalls to customers, even shortfalls that are unrelated to efficiency improvements or weather variability. OCA cites a hypothetical example of a decline in water sales due to an economic recession. In that circumstance, customers would be surcharged to make up the revenue shortfall, even though the shortfall was unrelated to efficiency or weather, and even though the surcharge would be occurring at a time when customers could least afford it.

OCA argues that Iowa-American's proposal to shift revenue risk from the utility to its customers is not justified by any corresponding benefits that would accrue to the customers or safeguards to protect them from rate shock. OCA provides examples of customer protections from other jurisdictions that include caps on the amount of revenue shortfalls that can be collected in a given period or earnings test provisions that limit a utility's ability to recover shortfalls if it is exceeding its approved rate of return. (*Id.*, pp. 43-48.)

Board Analysis

The Board agrees with OCA that the RSM would shift risk from Iowa-American to its customers, and that Iowa-American did not demonstrate sufficient tangible benefits that would accrue to customers in exchange for taking on the added risk. Iowa-American also has not proposed adequate safeguards to limit the amount of a shortfall that customers may be required to cover and the rate shock that may result.

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Iowa-American asserted that guaranteeing recovery of its authorized revenue requirement will enable it to better plan, maintain, and invest in its facilities to provide safe and reliable water at reasonable rates. That may be true, but Iowa-American has not proposed any metrics by which the Board can judge whether those outcomes have been achieved or any penalties if they are not achieved. In Iowa-American's last rate case, the Board denied Iowa-American's request for an RSM because, among other reasons, "[t]he proposed RSM does not include measurable goals by which the mechanism, if approved, could be periodically evaluated." *In re: Iowa-American Water Company*, Docket No. RPU-2016-0002, Final Decision and Order, p. 30 (February 27, 2017). The same is true in this case. The Board finds that Iowa-American has not demonstrated tangible benefits for customers or proposed measurable goals sufficient to justify shifting revenue generation risk to customers. The Board will not approve Iowa-American's proposed RSM.

IX. NON-RECURRING EXPENSE RIDER

Iowa-American proposes to recover several non-recurring expenses through the creation of a non-recurring expense rider. Iowa-American proposes that the following items would flow through the rider: (1) current rate case expense and unrecovered rate case expense from Docket No. RPU-2016-0002; (2) current income tax savings resulting from the Tax Cuts and Jobs Act of 2017 (TCJA); (3); unrecovered QIP rider reconciliation balances from 2018 and 2019; (4) catch-up period excess accumulated deferred income tax (EADIT); and (5) certain expenses related to the COVID-19 pandemic. (Iowa-American Simmons Direct, p. 25.) Iowa-American proposes to net these items and return the remaining balance to customers over three years.

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Iowa-American argues that some of the items are too small to recover individually through volumetric rates, and it is in ratepayers' best interest to consolidate the items together and recover them through a single factor. (*Id.*, pp. 30-31.)

A. Rate Case Expense

Iowa-American proposes to recover its rate case expense from this proceeding, as well as \$19,472 of unrecovered rate case expense from Docket No. RPU-2016-0002, through the non-recurring expense rider. Iowa-American states that recovering these amounts through a rider, as opposed to base rates, will ensure that Iowa-American recovers only what is approved by the Board. Iowa-American proposes to net the amounts against other items included in the non-recurring expense rider. (*Id.*, pp. 25-27.) OCA states it is not opposed to combining current and prior rate case expense for inclusion in the non-recurring expense rider, but OCA recommends that all individual items included in the rider should be quantified and identified in the tariff for the sake of transparency. (OCA Kruger Direct, pp. 30, 49.)

Board Analysis

Recovering rate case expense through a rider ensures that Iowa-American will recover no more than the amount approved by the Board. Including current and prior rate case expense as items to be netted and returned through the rider is simple and efficient. The Board agrees with OCA that each rate case expense amount should be identified in the non-recurring expense rider tariff. The Board will approve Iowa-American's proposal to include current and prior rate case expense as items to be netted and recovered through the non-recurring expense rider over three years. The Board will approve an amount for current rate case expense in Section XI of this order.

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B. TCJA Current Income Tax Accrual

The TCJA lowered the corporate income tax rate from 35 percent to 21 percent. (*Id.*, p. 36.) On July 12, 2018, the Board issued an order in Docket No. TF-2018-0280 approving Iowa-American's proposed methodology for passing on to customers the benefits of this lower tax rate. The Board approved Iowa-American's proposal to use the current income tax savings of the TCJA to offset the QIP rider surcharge and to accelerate the amortization of the Davenport floodwall. The Board also approved Iowa-American's proposal to provide a bill credit to customers for any TCJA credits that remained after offsetting the QIP rider surcharge and amortizing the floodwall. *In re: Iowa-American Water Company*, Docket No. TF-2018-0280, Order Approving Tariff, pp. 2-6 (July 12, 2018).

Iowa-American fully amortized the floodwall in June 2020. Iowa-American estimates that by the time rates determined in this proceeding take effect, Iowa-American will have accrued a TCJA savings balance of \$543,003 for return to customers. (Iowa-American Simmons Direct, p. 27.) Iowa-American proposes to include this amount in the non-recurring expense rider. The balance would be netted against other items included in the rider and would be returned to customers over three years. (*Id.*, pp. 30-32.)

OCA objects to Iowa-American's proposed three-year time frame for returning the remaining TCJA balance to customers and recommends a one-year time frame instead. OCA states Iowa-American has been refunding TCJA savings to customers annually through the QIP rider surcharge offset and the accelerated floodwall amortization. OCA argues there is no good reason to now prolong ratepayers' receipt

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of these funds by an additional two years just because Iowa-American can no longer use them to offset other projects. (OCA Kruger Direct, pp. 35-36.)

Board Analysis

Returning the TCJA balance over one year is consistent with the Board's decision in Docket No. TF-2018-0280 and will allow customers to receive the amounts they are due sooner. The Board finds that Iowa-American's desire to align the return period of this amount with the return period of other amounts included in the non-recurring expense rider does not justify delaying customers' receipt of these funds by two years. The Board will require Iowa-American to return the TCJA savings balance to customers over one year.

C. QIP Rider Under-Recoveries

Sheet No. 4H of Iowa-American's approved QIP rider tariff provides that Iowa-American shall track the amount of QIP rider over- or under-recovery by year and reconcile the cumulative amount during its next rate case. Iowa-American states that it experienced QIP rider under-recoveries for 2018 and 2019 in the amounts of \$18,916 and \$27,505, respectively. Iowa-American seeks to include those under-recovery amounts, totaling \$46,421, in the non-recurring expense rider to be netted against other items. (Iowa-American Simmons Direct, p. 28.)

OCA does not oppose Iowa-American's recovery of QIP rider reconciliation amounts; however, OCA states that Iowa-American miscalculated the annual under-recovery amounts due to the use of an incorrect tax gross-up factor. OCA asserts the correct amount of the cumulative QIP rider under-recovery for 2018 and 2019 is \$16,984. (OCA Kruger Direct, pp. 32-34.) Iowa-American agreed with this calculation

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in its reply testimony and initial brief. (Iowa-American Simmons Reply, pp. 29-30; Iowa-American Initial Brief, p. 66.)

OCA recommends the cumulative QIP rider under-recovery of \$16,984 be netted against the \$543,003 balance of TCJA savings. Netting these two items would result in a balance of \$526,019 to be returned to customers over a one-year period. OCA states it generally does not prefer to use TCJA credits as a catch-all expense reimbursement, but doing so is appropriate in this instance, because the QIP rider under-recovery amount is de minimis, and the Board has previously approved the use of Iowa-American's TCJA funds to offset QIP rider investments. (OCA Kruger Direct, p. 34.)

Board Analysis

The Board will approve Iowa-American's recovery of \$16,984 of QIP rider under-recoveries from 2018 and 2019. The Board finds that it is reasonable to offset this amount against the balance of TCJA savings. Doing so is consistent with the Board's prior decision to use TCJA savings to offset the QIP rider surcharge.

D. Excess Accumulated Deferred Income Tax

Iowa-American's current rates are based on a corporate income tax rate of 35 percent. The TCJA reduction of the corporate income tax rate means that the accumulated deferred income taxes Iowa-American accrued at a 35 percent rate will now come due at a 21 percent rate. The difference between what Iowa-American would have paid at a 35 percent rate and what it will pay at a 21 percent rate constitutes EADIT and must be returned to customers. (*Id.*, pp. 36-37.)

The Internal Revenue Service (IRS) classifies EADIT as either "protected" or "unprotected." Protected EADIT generally arises from plant-related assets as a result of

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book versus tax timing differences associated with depreciation expense. Unprotected EADIT generally consists of all timing differences other than depreciation. The IRS subjects protected EADIT to normalization requirements that determine the period of time over which it must be returned to customers. Utilities typically use the Average Rate Assumption Method (ARAM) to return protected EADIT to customers over the useful life of the underlying assets, in compliance with the IRS normalization requirements. The IRS allows unprotected EADIT to be returned to customers over any time period. (*Id.*, pp. 36-39.)

Iowa-American proposes to return EADIT to customers through the non-recurring expense rider. Iowa-American proposes to use ARAM to amortize all plant-related EADIT, regardless of whether the EADIT is classified as protected or unprotected. Iowa-American proposes to use a 20-year amortization period for non-plant-related unprotected EADIT. Using this amortization methodology, Iowa-American calculated a “catch-up period” EADIT amortization balance that represents EADIT deferred from January 1, 2018, through the presumed start date of new rates on July 1, 2021. This “catch-up period” EADIT balance totals \$917,229, prior to tax gross-up. Iowa-American proposes to net this “catch-up period” EADIT balance against other items included in the non-recurring expense rider for return to customers over three years. Iowa-American states that its proposed amortization methodology will thereafter produce an annual credit of \$315,909, starting on July 1, 2021. (Iowa-American Wilde Direct, pp. 13-14.)

Iowa-American argues that it is in the long-term best interest of customers to use ARAM to amortize all plant-related EADIT, regardless of whether it is classified as

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protected or unprotected. Iowa-American argues that using ARAM aligns the amortization of tax benefits with the useful lives of the investments that gave rise to the benefits. Iowa-American argues this methodology promotes intergenerational equity by ensuring that future ratepayers, who will pay for those investments over the remainder of the investments' useful lives, will receive a fair share of the tax benefits. Iowa-American argues that using a shorter amortization period would provide disproportionate tax benefits to current ratepayers to the detriment of future ratepayers. (*Id.*, p. 14-16.) Iowa-American also argues that, because EADIT is treated as an offset to rate base, returning EADIT rapidly would result in a larger rate base and, thus, a greater revenue requirement. (*Id.*)

OCA opposes Iowa-American's proposal to use ARAM to amortize all plant-related EADIT, regardless of whether it is classified as protected or unprotected. OCA instead argues that all unprotected EADIT should be returned to customers over three years through the non-recurring expense rider. OCA states the total amount of unprotected EADIT is \$4,488,678, prior to tax gross-up. (OCA Kruger Direct, pp. 40-43; OCA Kruger Reply, pp. 48-49.)

OCA argues the EADIT balance was funded by ratepayers through rates that were based on a higher amount of corporate income tax than Iowa-American will actually pay. Contrary to Iowa-American's assertions, OCA argues that intergenerational equity is actually promoted by returning EADIT rapidly and ensuring that the ratepayers who funded the EADIT balance are the ones who will receive the tax benefits. (OCA Kruger Direct, pp. 40-43.) OCA states Iowa-American's proposal to tie the return of tax benefits to the useful lives of the underlying assets means that, for

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many assets, it would take more than 40 years for customers to receive the full tax benefits. (OCA Kruger Reply, p. 43.)

OCA agrees that returning EADIT rapidly will result in a larger rate base; however, OCA argues that Iowa-American's customers have higher borrowing costs than Iowa-American. OCA argues that customers would, therefore, benefit more from receiving tax benefits rapidly than they would from letting Iowa-American retain the EADIT balance over a longer period of time in order to hold down rate base. (OCA Kruger Direct, pp. 40-43.)

OCA also notes that Iowa-American is the second utility to file a rate case in Iowa since the enactment of the TCJA. The other utility, IPL, filed a settlement agreement that provided for the return of unprotected EADIT over one year. The Board approved the settlement agreement. OCA also points to litigated cases before the Tennessee Public Utility Commission in which the commission adopted three-year periods for returning unprotected EADIT to customers of Piedmont Natural Gas and Tennessee-American Water Company. (OCA Kruger Reply, pp. 47-48.)

OCA additionally notes that Iowa-American's combined effective tax rate will change in 2022 due to the phasing out of federal deductibility on Iowa's state income tax rates. OCA proposes Iowa-American should track the impact of the change in effective tax rates and refund any over-collections. (OCA Kruger Direct, pp. 50-51.) Iowa-American states it is not opposed to OCA's proposal and believes it would be appropriate for both taxes and EADIT. Iowa-American proposes to annually compare its actual taxes and EADIT against the amount included in base rates and reconcile any

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over- or under-collection through the non-recurring expense rider. (Iowa-American Simmons Reply, p. 30.)

Board Analysis

Iowa-American and OCA agree that protected EADIT should be returned to customers using ARAM, in accordance with IRS normalization requirements. They disagree over the proper methodology for returning unprotected EADIT, which may be returned over any time period. Iowa-American proposes to return unprotected EADIT over a significantly longer period than proposed by OCA.

As OCA pointed out, it would take more than 40 years to return tax benefits associated with many of Iowa-American's assets if the Board adopted Iowa-American's proposed methodology. That time period is too long. The Board finds that OCA's proposal to return unprotected EADIT over three years is the more reasonable approach. Doing so will help ensure that the same ratepayers that funded the EADIT balance will receive the associated tax benefits. It is also consistent with the methodology the Board approved in the settlement of IPL's recent rate case. The Board will approve Iowa-American's proposal to include EADIT as an item to be netted in the non-recurring expense rider; however, the Board will require that Iowa-American return the entire balance of unprotected EADIT over three years.

The Board will also approve the proposals from Iowa-American and OCA to annually reconcile Iowa-American's actual taxes and EADIT. Iowa-American shall flow any over- or under-collection through the non-recurring expense rider.

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E. COVID-19 Expenses

On May 1 and August 6, 2020, the Board issued orders in Docket No. ARU-2020-0123 that authorized Iowa-American to track expenses and savings related to the COVID-19 pandemic for potential recovery at a later date as part of a contested case proceeding. Iowa-American has accrued a net total of \$184,185 of deferred COVID-19 expenses as of March 31, 2021. This amount consists of foregone reconnection fees, waived late payment fees, uncollectible expenses, carrying costs related to a liquidity loan, and miscellaneous expenses related to supplies, signage, sanitizers, and personal protective equipment. The costs were netted against any applicable savings. Iowa-American seeks to recover this balance by including it as an item in the non-recurring expense rider. OCA disputes the amount Iowa-American should be allowed to recover for waived late payment fees and for carrying costs on the liquidity loan. OCA also argues Iowa-American should be precluded from deferring any additional COVID-19 expenses beyond the date reply briefs were filed in this case.

1. Late payment fees

OCA disagrees with Iowa-American's deferral of \$244,489 in waived late payment fees. OCA argues that Iowa-American's current rates were designed with \$124,191 of late payment fee revenue included. OCA argues that any additional recovery of late payment fees above that amount would constitute a profit stream for the company. OCA states Iowa-American collected approximately \$32,000 of late payment fees from customers in January, February, and early March of 2020, prior to late payment fees being waived. OCA argues that Iowa-American should be allowed to recover no more than approximately \$92,000 for late payment fees, which represents

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the difference between the amount OCA asserts is included in current rates and the amount Iowa-American actually collected in the first months of 2020, less any amounts Iowa-American actually collected in November and December 2020 after the waiver of late payment fees ended. (OCA Kruger Direct, pp. 43-45.)

Iowa-American states late payment fee charges are included in its approved tariff and are a component of its cost of service and authorized revenue requirement. Iowa-American states late payments create actual costs for the company. Late payment fees are designed to allow the company to recover those costs from specific customers, rather than through base rates. Iowa-American argues that denying its ability to recover the actual amount of late payment fees that would have been applied absent Board action would constitute the denial of an approved charge and would limit Iowa-American's ability to recover its authorized revenue requirement.

Board Analysis

Although \$124,191 was included in Iowa-American's revenue requirement for late payment fees in its last rate case, the evidence in the record shows that Iowa-American actually recovered more than that amount in 2017, 2018, and 2019. (OCA Kruger Direct, Exhibit 2, DR 168.) Those recoveries were made pursuant to Iowa-American's approved tariff. OCA has not justified its position that Iowa-American should be allowed to recover no more than \$124,191 in late payment fees for 2020 when it has recovered more than that amount in each of the three prior years. The Board sees no reason why Iowa-American should not be allowed to recover the actual amount of late fees it would have charged under its tariff, absent the Board's waiver of those fees. The

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Board finds that Iowa-American should be allowed to recover the full \$244,489 of waived late payment fees.

2. Interest on liquidity loan

American Water secured a short-term liquidity loan in March 2020 to ensure adequate liquidity for its subsidiaries during the COVID-19 pandemic. Of the total amount of the loan, \$9.6 million was allocated to Iowa-American. Interest on Iowa-American's allocation totals \$126,292 through March 31, 2021. On April 29, 2020, American Water declared a 10 percent increase in its cash dividend, raising the dividend from \$0.50 to \$0.55. This was American Water's largest cash dividend per share declared in the last 10 years. (*Id.*, pp. 45-46.)

OCA does not dispute the prudence of American Water's decision to secure the loan; however, OCA argues American Water should have continuously evaluated whether it continued to need the loan, especially since the loan did not have a prepayment penalty. OCA argues American Water's decision to increase its dividend less than six weeks after securing the loan is evidence that significant liquidity concerns no longer existed, and the loan should have been retired. OCA argues that Iowa-American ratepayers should not be responsible for paying interest on the loan that accrued after the dividend increase was declared on April 29, 2020. (OCA Kruger Reply, pp. 51-53.) OCA therefore argues that Iowa-American should be allowed to recover no more than \$15,513 for interest on the loan. (OCA Kruger Direct, p. 48.)

In support of its position, OCA points to a December 30, 2020 decision of the Kentucky Public Service Commission (PSC). The Kentucky PSC denied Kentucky-American Water's request for recovery of interest expense on its allocation of the same

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COVID-19 liquidity loan secured by American Water. The Kentucky PSC stated Kentucky-American Water had not demonstrated the loan was necessary given the fact that the loan proceeds sat untouched in a cash reserve account. OCA noted that Iowa-American similarly has not used any of the loan proceeds allocated to it. (OCA Kruger Reply, pp. 53-54.)

Iowa-American argues that volatility and uncertainty in the commercial paper market during the pandemic, especially in the early months, created significant risks to American Water and its subsidiaries. Iowa-American states the liquidity loan served as an insurance policy to protect Iowa-American and its customers in the event that the pandemic created an inability to access funds needed to supply water. Iowa-American disagrees with OCA's argument that issuing a dividend is evidence of a lack of significant liquidity concerns. Providing a consistent dividend is important to demonstrate the financial health of the company. Without a consistent dividend, Iowa-American argues that its cost of capital would increase to the detriment of its customers. (Iowa-American Simmons Reply, pp. 24-25.)

Board Analysis

The Board recognizes Iowa-American's need for liquidity in the early days of the pandemic. There were legitimate concerns about the commercial paper market during this time that could justify American Water's decision to secure the liquidity loan and allocate a portion of it to Iowa-American. However, Iowa-American has not adequately demonstrated that the loan remained necessary beyond the early days of the pandemic. The fact that American Water announced an increase to its cash dividends shortly after the loan was secured suggests that liquidity was no longer a concern significant enough

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to warrant recovering interest from Iowa-American's customers. The fact that Iowa-American did not use the proceeds of the loan also weighs in favor of denying a portion of the interest expense.

The Board finds it is not reasonable for Iowa-American to recover interest expense on the liquidity loan that accrued after April 29, 2020, and will deny that portion of Iowa-American's COVID-19 recovery proposal.

3. Continuation of COVID-19 deferrals

OCA argues that Iowa-American's authority to defer COVID-19 expenses should end at the date reply briefs were filed in this proceeding. (OCA Kruger Direct, pp. 46-47.) Iowa-American argues that its authority to defer COVID-19 expenses should continue through at least December 31, 2021. Iowa-American asserts that the end date of the pandemic is still uncertain, and incremental costs will continue to be incurred beyond the date reply briefs were filed. Iowa-American specifically notes that arrears only become uncollectible expenses with the passage of time. (Iowa-American Simmons Reply, pp. 25-27.)

Board Analysis

The financial impacts of the COVID-19 pandemic felt by Iowa-American will likely continue beyond the date of this order. The Board finds it is reasonable for Iowa-American to continue to defer costs related to COVID-19 through December 31, 2021.

X. MISCELLANEOUS ISSUES

A. Service Line Ownership

Iowa-American proposes changes to its tariff regarding the ownership of service lines. Iowa-American explains that ownership of service lines varies from city to city

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based on local ordinances. Ownership in Clinton follows the industry standard where the company owns the portion of the service line from the water main to the shutoff valve, and the customer owns the portion of the service line from the shutoff valve to the home. In other cities such as Davenport, for example, the local ordinance provides that the customer owns the service line all the way from the water main to the home. Iowa-American states this creates inequities because customers have different responsibilities for breaks or leaks in the service line based on the city they live in. (Iowa-American Simmons Direct, pp. 49-51.)

The tariff change proposed by Iowa-American provides that, in cities like Davenport, Iowa-American will take over ownership of the portion of the service line from the water main to the shutoff valve upon: (1) change in local ordinance; and (2) failure of the service line. Iowa-American states it is in discussions with Davenport and other cities about changing their local ordinances. (*Id.*, p. 51.) OCA argues Iowa-American's proposed tariff change is premature. OCA argues the tariff should be changed after a city changes its ordinance, not before. (OCA Initial Brief, pp. 55-57.)

Board Analysis

The Board finds that Iowa-American's proposed tariff change regarding ownership of service lines is premature. When asked about Iowa-American's progress toward changing local ordinances, Iowa-American witness Brad Nielsen stated, "We thought it was better to ask the Board first before we started to heavily engage with municipalities regarding an ordinance change." (Tr. p. 403.) A simpler and more logical approach would be to update the tariff when a local ordinance is changed. Updating the tariff after an ordinance change would make it easier for customers to understand the

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current ownership status in their city. The Board will deny Iowa-American's proposed tariff change regarding service line ownership at this time.

B. Limitation on Liability

Iowa-American proposes revisions to its tariff to limit the company's liability for injuries to customers arising from the provision of water service. The proposed revision addresses two aspects of potential liability. The first proposed limitation specifies that Iowa-American is not liable for damages caused by, and claims of injury that occur in, equipment and pipes that are owned or controlled by the customer, and that the customer will indemnify Iowa-American for all such damage that is not caused by the sole negligence of Iowa-American. Iowa-American also proposes revisions which provide that Iowa-American will not be liable for failure or defect in Iowa-American's facilities or equipment, including the result of a failure to warn or train, unless caused by the gross negligence or willful misconduct of Iowa-American. (Iowa-American Simmons Direct, p. 51.)

Iowa-American states these liability provisions are like those set out in other Iowa utilities' tariffs, including MidAmerican Energy Company and IPL, and are consistent with Iowa law, which allows liability limitations in contracts. Iowa-American indicates that such provisions benefit all customers by reducing insurance and other costs that are included in rates. (Iowa-American Simmons Reply, p. 34.)

OCA notes that Iowa-American's proposed tariff changes are similar to the liability issues raised in Docket No. TF-2016-0026 involving proposed changes to IPL's tariff. *In re: Interstate Power and Light Co.*, Motion to Withdraw Filing, Docket No. TF-2016-0026, p. 2 (July 8, 2016). OCA reiterates the concerns it raised in the IPL

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docket that issues regarding limitations on liability are industrywide concerns that should be addressed in a general proceeding, such as the Board's review of its administrative rules. OCA asserts that a separate proceeding should be initiated to address this complicated issue of broad applicability. (OCA Tessier Direct, pp. 51-52.)

Board Analysis

The Board finds that Iowa-American's proposed limitations on liability to customers have the potential to significantly impact those customers and, therefore, require the development of a full record explaining those impacts. The Board attempted to inquire further into this issue at hearing, and Iowa-American indicated that the subject could be addressed through the post-hearing briefs. (Tr. 182-183.) The only evidence provided by Iowa-American is that the limitations on liability will reduce insurance costs. Without consideration of the cost to customers directly injured, or an explanation of the impact of differences in the proposed language and the language of limitations on liability previously approved by the Board, there is insufficient justification to support approval of these proposed tariff changes at this time.

C. Waiver of Fees

Iowa-American requests a tariff modification allowing it to waive certain fees. Iowa-American currently has flexibility in its tariffs that allows the waiver of after-hours fees and fees for landlords when a tenant vacates. Iowa-American is seeking this tariff change so it has discretion to grant further concessions in instances in which a field visit is not required so that it can waive attendant fees. For example, if a customer calls at 6 p.m. to make an account change that does not require a site visit, then Iowa-American would like discretion to waive the after-hours fee, which would not apply if the customer

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had called just a few minutes sooner. In the alternative, Iowa-American requests that the Board allow for waiver or modification of the fee, with reasonable cause shown, such as when the requested action does not cause significant expense to Iowa-American, but that such waiver or modification shall not result in a charge of less-than-actual cost. (Iowa-American Simmons Reply, pp. 32-33.)

OCA indicates that it is not categorically opposed to tariff revisions allowing greater discretion in the waiver of fees, but is concerned that the proposed tariff language could invite the discriminatory application of this flexibility. OCA requests that the Board require further modifications to the tariff to establish standards for the application of fee waiver flexibility to ensure that such waivers are applied in a nondiscriminatory manner. (OCA Tessier Direct, pp. 50-51; OCA Reply Brief, p. 32.)

Board Analysis

The Board agrees with the parties that allowing further discretion for Iowa-American to waive customer fees where appropriate will be beneficial to customers, so long as such discretion is not applied in a discriminatory manner. The Board finds that additional language establishing more clearly the factors to be considered for the granting of such waivers is appropriate prior to the approval of such revisions. The Board will deny the tariff provisions related to waivers at this time, but encourages OCA and Iowa-American to continue to work to achieve appropriate tariff revisions for fee waivers that can be submitted to the Board for review in the near future.

D. Low-Income Water Assistance Program

Iowa-American proposes to implement a Low-Income Water Assistance Program (LIWAP) that provides 12 monthly discounts of 80 percent of the \$14.00 fixed 5/8-inch

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meter customer charge to qualifying customers. Customers that are approved for assistance by community action agencies in their area would automatically be registered for Iowa-American's LIWAP discount. (Iowa-American Simmons Direct, p. 46.)

Iowa-American proposes to set up a regulatory asset account to accrue the costs of LIWAP, which would then be addressed in Iowa-American's next rate case. Iowa-American proposes to set a limit of 1,500 customers annually, which would be a maximum cost of about \$200,000 each year. (*Id.*, pp. 48-49.) In reply testimony, Iowa-American stated it is willing to be flexible on the caps of LIWAP. (Iowa-American Simmons Reply, p. 12.) Raising the cap on the number of customers eligible for the program without increasing the cost cap would result in a reduction in the amount of the monthly benefit. Raising the cost cap would increase the cost of the program to customers when Iowa-American eventually seeks to recover the costs of the program through rates.

OCA asserts the proposed LIWAP would constitute an unreasonable preference in violation of Iowa Code § 476.5. OCA states there are approximately 5,600 customers in Iowa-American's service territory that qualify for the Low-Income Home Energy Assistance Program (LIHEAP). OCA states LIWAP would shift costs to other customers, including, as initially proposed, customers eligible for enrollment in LIHEAP but ineligible for LIWAP due to the cap on the number of eligible customers. (OCA Tessier Direct, pp. 19-20.) OCA argues Iowa Code §§ 476.3, 476.5, and 476.7, as well as Board precedent, prohibit such direct subsidization of the rates of some customers by other customers. OCA asserts Iowa-American should undertake additional efforts to

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promote contribution to its voluntary customer contribution program, H₂O to Help Others, or seek other methods to address affordability that do not transfer costs to other ratepayers.

Board Analysis

The Board finds that Iowa-American has not established a sufficient basis for the approval of LIWAP. The Board acknowledges Iowa-American's openness to revisions to increase eligibility and any program cost cap; however, such revisions are likely to be problematic. Increasing eligibility without increasing the cost cap would lessen the individual benefit to the point where it would likely not be meaningful to program participants. Increasing the cost cap to allow all eligible customers to receive the proposed 80 percent discount on the fixed customer charge would significantly increase the costs of the program and the burden that is shifted to other customers.

The fundamental problem with LIWAP, regardless of the eligibility requirements or cost cap, is that it would force some customers to subsidize others on the basis of economic need. Iowa-American has not persuaded the Board that such a subsidy is appropriate and that the resulting rates would be reasonable and just. The Board suggests Iowa-American work to expand its current voluntary H₂O to Help Others program to improve the level of donations and continue to provide information to customers about any additional public or private charitable programs to address affordability rather than redistributing costs to other current or future customers. The Board finds Iowa-American's proposed LIWAP is not reasonable.

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XI. RATE CASE EXPENSES

On May 18, 2021, Iowa-American filed its report of actual rate case expenses through the date reply briefs were filed, in accordance with 199 Iowa Administrative Code (IAC) 26.4.² Iowa-American's actual rate case expenses, not including expenses incurred by the Board and OCA, are \$816,707. OCA did not file an objection to Iowa-American's rate case expenses. The expenses of the Board and OCA through the filing of reply briefs total \$637,531.74.

Board Analysis

Iowa Code § 476.6(5) provides that the Board shall allow recovery of rate case expenses to the extent the Board deems the expenses reasonable and just. Iowa-American's rate case expense amount of \$816,707 is less than the estimate of \$865,187 that Iowa-American filed with its application. The amount is also reasonably consistent with the rate case expenses Iowa-American incurred in its last rate case. In Docket No. RPU-2016-0002, Iowa-American reported rate case expenses of \$821,126 through the filing of reply briefs, not including expenses incurred by the Board and OCA. The Board approved Iowa-American's recovery of that amount, plus an additional \$43,345 that Iowa-American incurred while litigating the reasonableness of the rate case expenses. *In re: Iowa-American Water Company*, Docket No. RPU-2016-0002, Final Decision and Order, pp. 48-54 (February 27, 2017).

Iowa-American's expenses include \$61,374 for its expert witness, Ann Bulkley. Iowa-American did not provide the number of hours Ms. Bulkley worked on the case or

² Rule 26.4 has been renumbered to Rule 26.7, effective June 23, 2021.

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a calculation of her hourly rate. This information must be provided pursuant to 199 IAC 26.4(2), and it is needed in order to determine the reasonableness of the expenses associated with using Ms. Bulkley as an expert witness. The Board has previously reminded Iowa-American of the need to track an expert witness' time on an hourly basis, even if the expert witness is paid on a flat-fee basis. *In re: Iowa-American Water Company*, Docket No. RPU-2013-0002, Final Decision and Order, p. 63 (February 28, 2014).

The Board will require Iowa-American to report the number of hours worked by Ms. Bulkley and her hourly rate within 20 days of the date of this order. The Board will consider the reasonableness of the expenses associated with using Ms. Bulkley as an expert witness after receiving the required information. The Board will approve the expenses associated with Ms. Bulkley at this time, subject to the submission of additional information and the Board's review of its reasonableness.

Iowa-American's overall rate case expenses appear to be reasonable. They are consistent with the amount approved by the Board in Iowa-American's last rate case, and there has been no objection from OCA. The Board will therefore approve Iowa-American's recovery of \$816,707 for its own expenses, subject to the additional review of the \$61,374 associated with Ms. Bulkley, as well as \$637,531.74 for Board and OCA expenses. Therefore, the total amount of rate case expense from this docket to be included in the non-recurring expense rider is \$1,454,238.74.

XII. COMPLIANCE FILING

The Board will approve a revenue requirement of \$43,813,200 and require Iowa-American to file a compliance tariff consistent with the decisions in this order. At the

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same time it files its proposed compliance tariff, Iowa-American shall file an updated cost of service study, revenue allocation, rate calculations, and proof of revenue consistent with this order. The proof of revenue shall be provided in the same format as the document Iowa-American filed as Attachment 8 of 12 as part of its January 11, 2021 response to the Board's December 11, 2020 Order Requiring Additional Information. The proof of revenue shall show the percentage increase by customer class.

XIII. SUBSEQUENT PROCEEDING

The Board will conduct a subsequent proceeding pursuant to Iowa Code § 476.33(4)(b) and 199 IAC 26.6. Iowa-American shall make a filing in Docket No. RPU-2020-0001 to initiate the subsequent proceeding within 90 days of the conclusion of the 12-month period beginning on the first day of the month following the month in which rates approved by the Board become effective.

The filing will be required to comply with 199 IAC 26.6 and include an update of the cost of service study, revenue allocation, resulting rates, and revenue verifications, based upon methodologies approved by the Board in this order, with actual costs, revenues, and sales applicable during the 12 months beginning on the first day of the month following the month in which rates approved by the Board become effective. The filing shall contain a calculation of Iowa-American's return on equity based upon the updated information. Iowa-American's calculations shall be consistent with the methodologies approved by the Board in this order.

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XIV. ORDERING CLAUSES

IT IS THEREFORE ORDERED:

1. The proposed tariff filed by Iowa-American Water Company on August 28, 2020, identified as Docket No. TF-2020-0250, and docketed for further investigation on September 25, 2020, is denied as unjust, unreasonable, and unlawful.

2. The Utilities Board approves a revenue requirement of \$43,813,200. Within 20 days of the date of this order, Iowa-American Water Company shall file a tariff consistent with the decisions in this order and the attached schedules A through F.

3. At the same time it files its proposed compliance tariff, Iowa-American Water Company shall file an updated cost of service study, revenue allocation, rate calculations, and proof of revenue consistent with this order. The proof of revenue shall be provided in the same format as the document Iowa-American Water Company filed as Attachment 8 of 12 as part of its January 11, 2021 response to the Utilities Board's December 11, 2020 Order Requiring Additional Information. The proof of revenue shall show the percentage increase by customer class.

4. The Utilities Board approves Iowa-American Water Company's proposed adjustment for declining usage.

5. The Utilities Board denies Iowa-American Water Company's proposal to include the full costs of performance pay in rates. Half of overall performance pay costs shall be included in rates, and a corresponding adjustment shall be made to capitalized labor expenses included in rate base, as described in this order.

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6. The Utilities Board approves Iowa-American Water Company's proposal to include the costs of 77 full-time equivalent positions and \$535,115 in overtime expenses in rates.

7. The Utilities Board denies Iowa-American Water Company's proposed inflation adjustment for categories of costs that were not separately forecasted.

8. The Utilities Board denies Iowa-American Water Company's proposed increase in service company costs that is attributable to the sale of New York-American Water. The portion of increased service company costs attributable to the sale shall be removed from the revenue requirement.

9. The Utilities Board approves Iowa-American Water Company's forecasted amount of uncollectible expense.

10. The Utilities Board approves a tax gross-up factor of 1.403351.

11. The Utilities Board approves the interest synchronization calculation provided by the Office of Consumer Advocate, a division of the Iowa Department of Justice.

12. The Utilities Board approves Iowa-American Water Company's methodology for calculating collection lag days in the lead/lag study.

13. The Utilities Board approves the methodology proposed by the Office of Consumer Advocate, a division of the Iowa Department of Justice, for calculating expense lead days for service company costs in the lead/lag study.

14. The Utilities Board approves a return on equity of 9.6 percent.

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15. The Utilities Board approves Iowa-American Water Company's proposal to use actual 13-month averages to determine the long-term debt balance.

16. The Utilities Board approves Iowa-American Water Company's proposed capital structure of 47.72 percent long-term debt and 52.28 percent common equity.

17. The Utilities Board denies the proposal from the Office of Consumer Advocate, a division of the Iowa Department of Justice, to treat equity infusions from American Water Works, Inc., as a combination of debt and equity. The equity infusions shall be treated as equity.

18. The Utilities Board approves Iowa-American Water Company's class cost of service study methodology, including its treatment of Private Fire costs. Iowa-American Water Company shall continue to treat Private Fire costs in the same manner in future rate cases. Iowa-American Water Company's proposed compliance tariff shall include definitions for each customer class.

19. The Utilities Board approves Iowa-American Water Company's proposed rate design methodology. Iowa-American Water Company shall submit a revised volumetric rate proposal as part of its compliance filing based on the revenue requirement approved in this order.

20. The Utilities Board approves Iowa-American Water Company's continued authorization to utilize the Qualified Infrastructure Plant rider and rules as follows on the parties' proposed modifications:

- a. Denies the proposal from the Office of Consumer Advocate, a division of the Iowa Department of Justice, to implement an earnings test.
- b. Denies the proposal from the Office of Consumer Advocate, a division of the Iowa Department of Justice, to implement a stay-out limitation.

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- c. Approves the proposal from the Office of Consumer Advocate, a division of the Iowa Department of Justice, to implement an annual cap of 3 percent of Iowa-American Water Company's approved revenue requirement.
- d. Denies the proposal from the Office of Consumer Advocate, a division of the Iowa Department of Justice, to eliminate the tax gross-up.
- e. Denies the proposal from the Office of Consumer Advocate, a division of the Iowa Department of Justice, to require the submission of a lead service line replacement plan and inventory prior to allowing recovery of the costs of lead service line replacement.
- f. Requires that within 60 days of the date of this order, Iowa-American Water Company shall submit a lead service line replacement plan and inventory, as described in this order, to the Utilities Board for approval. The Office of Consumer Advocate, a division of the Iowa Department of Justice, may file comments on the plan and inventory within 60 days of the date it is filed. After an initial plan is approved, Iowa-American Water Company shall file periodic plan updates as described in this order.
- g. Requires that Iowa-American Water Company's recovery of the costs of lead service line replacements be limited to replacements that occur due to service lines being disturbed by Iowa-American or due to some other circumstance that presents an increased likelihood of lead contamination in drinking water. Additional proactive efforts to locate and replace lead service lines, for instance by searching tap records, shall not be eligible for recovery, until such efforts are approved as a component of Iowa-American Water Company's lead service line replacement plan.
- h. Requires that Iowa-American Water Company's treatment of broken or leaking lead service lines be consistent for all customers.
- i. Denies Iowa-American Water Company's proposal to eliminate the annual investment threshold.
- j. Approves Iowa-American Water Company's proposal to implement an annual reconciliation.
- k. Denies the proposals from Iowa-American Water Company and the Office of Consumer Advocate, a division of the Iowa Department of Justice, to modify the rate of return. The rate of return shall continue to be set at Iowa-American Water Company's cost of debt.
- l. Denies Iowa-American Water Company's proposal to expand the categories of investments eligible for recovery. The eligible categories of investment shall remain the same as those reflected in Iowa-American Water Company's currently approved tariff.
- m. Denies Iowa-American Water Company's proposal to eliminate the requirement to seek financing from the State Revolving Fund for infrastructure projects and to report on its efforts to do the same.

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21. The Utilities Board denies Iowa-American Water Company's proposal to implement a revenue stabilization mechanism.

22. The Utilities Board approves Iowa-American Water Company's proposal to implement a non-recurring expense rider, consistent with this order.

23. Iowa-American Water Company shall return current income tax savings resulting from the Tax Cuts and Jobs Act of 2017 through the non-recurring expense rider over one year after offsetting cumulative Qualified Infrastructure Plant rider under-recoveries.

24. Iowa-American Water Company shall return unprotected excess accumulated deferred income taxes through the non-recurring expense rider over three years.

25. Iowa-American Water Company shall annually reconcile its actual taxes and excess accumulated deferred income taxes against the amount included in rates and flow any over- or under-collection through the non-recurring expense rider.

26. The Utilities Board approves Iowa-American Water Company's proposal to recover \$244,489 of waived late payment fees resulting from the COVID-19 pandemic through the non-recurring expense rider.

27. The Utilities Board approves the proposal from the Office of Consumer Advocate, a division of the Iowa Department of Justice, to limit the recovery of interest expense resulting from the COVID-19 liquidity loan to \$15,513.

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28. The Utilities Board denies the proposal from the Office of Consumer Advocate, a division of the Iowa Department of Justice, to discontinue Iowa-American Water Company's authority to defer costs associated with the COVID-19 pandemic. Iowa-American Water Company's authority to defer costs associated with the COVID-19 pandemic shall continue through December 31, 2021.

29. The Utilities Board denies Iowa-American Water Company's proposal to revise its tariff language pertaining to service line ownership.

30. The Utilities Board denies Iowa-American Water Company's proposal to revise its tariff language pertaining to limitations on liability.

31. The Utilities Board denies Iowa-American Water Company's proposal to revise its tariff language pertaining to the waiver of fees.

32. The Utilities Board denies Iowa-American Water Company's proposal to implement a Low-Income Water Assistance Program.

33. The Utilities Board approves Iowa-American Water Company's recovery of \$1,454,238.74 in current rate case expense through the non-recurring expense rider, as described in this order. Within 20 days of the date of this order, Iowa-American Water Company shall file a report documenting the number of hours worked by its expert witness, Ann Bulkley, and her hourly rate. The Utilities Board's approval of expenses associated with Ms. Bulkley is subject to Iowa-American Water Company's submission of the additional information and the Utilities Board's review of the reasonableness of the expenses.

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34. The Utilities Board will conduct a subsequent proceeding pursuant to Iowa Code § 476.33(4)(b). Iowa-American Water Company shall initiate the subsequent proceeding by making a filing as required in 199 Iowa Administrative Code 26.6.

35. This order constitutes the final decision of the Utilities Board in Docket No. RPU-2020-0001.

UTILITIES BOARD

Geri Huser Date: 2021.06.28
15:27:11 -05'00'

Richard Lozier Date: 2021.06.28
15:09:46 -05'00'

ATTEST:

Anna Hyatt Date: 2021.06.28
16:06:46 -05'00'

Josh Byrnes Date: 2021.06.28
15:04:36 -05'00'

Dated at Des Moines, Iowa, this 28th day of June, 2021.