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Joplin, Jefferson City, Warrensburg  
Case No: WR-2017-0285 et.al.

**BEFORE THE PUBLIC SERVICE COMMISSION**

**STATE OF MISSOURI**

**REBUTTAL TESTIMONY**

**OF**

**MICHAEL J. MCGARRY, SR.**

**CITIES OF ST. JOSEPH, JOPLIN, JEFFERSON CITY, WARRENSBURG  
MISSOURI**

**JANUARY 24, 2017**

Coalition  
of Cities Exhibit No. 330  
Date 3-2-18 Reporter MM  
File No. WR-2017-0285  
SR-2017-0286

BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI

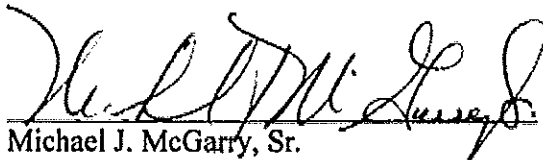
In the Matter of Missouri-American Water Company's )  
Request for Authority to Implement a General Rate ) Case No. WR-2017-0285, et al.  
Increase for Water and Sewer Service Provided in )  
Missouri Service Areas )

AFFIDAVIT OF MICHAEL J. McGARRY, SR.

STATE OF SOUTH CAROLINA )  
 ) ss.  
COUNTY OF Greenville )

I, Michael J. McGarry, Sr., of lawful age, and being duly sworn, do hereby depose and state:

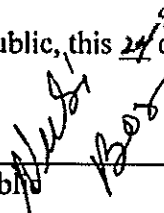
1. My name is Michael J. McGarry, Sr. I am principal of MJM Consulting, LLC.
2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony.
3. I hereby swear and affirm that my answers contained in the attached rebuttal testimony to the questions therein propounded are true and correct to the best of my personal knowledge, information and belief.

  
Michael J. McGarry, Sr.

Subscribed and sworn to before me, a Notary Public, this 24<sup>th</sup> day of January, 2018.

My Commission expires:

9/25/27

  
Notary Public

9/25/27

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**I. INTRODUCTION AND QUALIFICATIONS**

**Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

A. My name is Michael J. McGarry, Sr. My business address is 105 Chariot Lane, Simpsonville, South Carolina 29681.

**Q. ARE YOU THE SAME MICHAEL MCGARRY WHO SUBMITTED DIRECT TESTIMONY IN THIS CASE?**

A. I am.

**Q. ON WHOSE BEHALF ARE YOU TESTIFYING?**

A. I am appearing on behalf of the joint coalition of the cities of St. Joseph, Joplin, Jefferson City and Warrensburg. I refer to this group as the "Coalition Cities."

**Q. ARE YOU SPONSORING ANY EXHIBITS IN CONNECTION WITH YOUR TESTIMONY?**

A. No.

**Q. WAS THIS REBUTTAL TESTIMONY PREPARED BY YOU OR UNDER YOUR DIRECTION?**

A. Yes.

**II. PURPOSE OF REBUTTAL**

**Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

A. The purpose of my rebuttal testimony is to comment on several of Staff's conclusions concerning its recommendation that the Commission maintain the current three-district pricing structure for MAWC's customers. I will discuss my rate-offset proposal which should be adopted if the Commission continues to consolidate, or further consolidates, the company's rates. I will also comment on

the recommendation of Riverside Mayor Kathleen Rose on the issue of consolidated tariff pricing (i.e., single-district pricing).

**III. SUMMARY OF FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS**

**Q. PLEASE SUMMARIZE YOUR FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS.**

A. I found that Staff's approach to consolidated tariff pricing (CTP) by maintaining the three-district approach, while preserving status quo, is both unfair and unreasonable for many customers in the state. This approach does not address the Coalition Cities' concern that I raised in my direct testimony,<sup>1</sup> namely, that the Coalition Cities are now being asked to shoulder the substantial capital investment of other districts, some of which are hundreds of miles apart, with no benefit to their constituents. With respect to Mayor Rose's position on district-specific pricing, Mayor Rose asks the Commission to ignore long-standing principles of cost causation in rate making. Respectfully, her position is not substantiated by any reason other than spreading out costs over many unrelated customer bases and should, therefore, be set aside in this proceeding.

**IV. STAFF'S COST OF SERVICE REPORT**

**Q. WHAT IS THE MISSOURI STAFF'S POSITION ON CONSOLIDATED TARIFF PRICING?**

A. In its report titled "REPORT ON CLASS COST OF SERVICE AND RATE DESIGN" filed on December 13, 2017, in this proceeding, Staff states that its

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<sup>1</sup> See Direct Testimony of Michael J. McGarry Sr. at page MJM-12 lines 1-5.

objectives for Class Cost of Service and Rate Design for MAWC's (the Company's) rates include "to continue utilizing the existing rate districts for water and sewer districts."<sup>2</sup> Staff's plan to accomplish this objective is for the Commission to adopt Staff's proposed districts.<sup>3</sup>

**Q. DOES STAFF STATE WHAT PURPOSE IT HOPES TO ACHIEVE WITH ITS OBJECTIVE?**

A. Yes. Staff states that it has a two-fold purpose: (1) take the results from a Class Cost of Service Study (CCOS) and design rates for each customer class in each service territory that will give the utility an opportunity to collect its Commission approved revenue requirement; and (2) design rates that will be used to collect the appropriate levels of revenue from each service territory and from each customer class. Unfortunately, Staff deviates from this purpose by proposing the three-district approach, which consolidates numerous service territories into the three districts.

**Q. WHAT IS STAFF'S REASONING FOR PROPOSING THE THREE-DISTRICT APPROACH TO RATE DESIGN?**

A. Staff argues that the three-district approach has the benefits of both district-specific pricing and single-tariff pricing approaches, which is that the current size of the districts is logistically more manageable, both from an operations and regulatory perspective, which has allowed MAWC to continue to invest in smaller systems without causing rates to increase too dramatically. Staff also argues that

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<sup>2</sup> REPORT ON CLASS COST OF SERVICE AND RATE DESIGN MISSOURI-AMERICAN WATER COMPANY CASE NO. WR-2017-0285 Page 1, line 13.

<sup>3</sup> Ibid., line 28.

maintaining three districts provides some restraint on the company from overspending on any given project (a noted deficiency of single/consolidated pricing). Staff argues that developing rates on a district-specific basis is hampered by having to determine the appropriate way to allocate corporate costs to separate service territories. Finally, Staff argues that using three districts helps to mitigate rate shock to smaller systems that require investment to improve their systems.<sup>4</sup>

**Q. DO YOU AGREE WITH STAFF’S REASONING TO SUPPORT A THREE-DISTRICT TARIFF?**

A. No.

**Q. PLEASE EXPLAIN.**

A. Staff’s rationale for the three-district approach is inconsistent, does not follow generally accepted rate design principles, and is not supported by any substantive analysis. Again, it is important to state that a single/consolidated pricing tariff, such as Staff’s three-district proposal, is a public policy issue that deals with only one issue—affordability—and **is not** designed to reflect true cost-causation rate making. Cost-causation rate making is generally regarded as the most desirable way to design rates.<sup>5</sup>

**Q. HOW IS STAFF’S RATIONALE INCONSISTENT?**

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<sup>4</sup> Ibid. page 11, line 25-page 12, line 20.

<sup>5</sup> American Water Works Association, - *Water Rates, Fees and Charges – Seventh Edition* Page 3 “As a manual of standard practice, AWWA advocates the use of the generally accepted cost-based principles and methodologies for establishing rates, charges, and fees...” See also Financing Sustainable Water from [Alliance for Water Efficiency https://www.financingsustainablewater.org/building-rates/steps-rate-design](https://www.financingsustainablewater.org/building-rates/steps-rate-design). Also, Primer on Water Pricing – Janice A. Beecher, Ph.D - November 1, 2011.

A. Staff's Cost of Service Report states: "The current district approach has the benefits of both district-specific pricing and single-tariff pricing approaches."<sup>6</sup> This statement is inconsistent. District-specific pricing's specific benefit is establishing rates on a cost-causation basis. Single-district pricing ignores this concept in favor of a *spread-the-pain* type of rate making. As I stated in my direct, the customers who are subsidizing the three-district approach are burdened with costs that are not theirs.<sup>7</sup> I am sure, if asked, they would have a different opinion about the so-called benefits of the three-district approach. A general precept in rate design is that the most advantageous approach is to send the appropriate price signal to customers so that they can make informed, reasonable choices about their consumption of a product, in this case, the natural resource water. It is widely accepted that cost-causation pricing, and thus, district-specific pricing, promotes efficient use of resources by sending customers the correct cost signals by which they can make informed decisions about use. The U.S. Environmental Protection Agency states the position in this manner:

Pricing of water services should accurately reflect the true costs of providing high-quality water and wastewater services to consumers to maintain infrastructure and plan for upcoming repairs, rehabilitation, and replacement of that infrastructure.<sup>8</sup>

Further support is provided in an EPA white paper from January 2006 titled, "Setting Small Drinking Water System Rates for a Sustainable Future"<sup>9</sup>:

Ideally, full-cost pricing:

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<sup>6</sup> Staff Cost of Service Report – page 10, line 27.

<sup>7</sup> See my Direct testimony MJM-13, lines 10 to MJM-14, line 4.

<sup>8</sup> <https://www.epa.gov/sustainable-water-infrastructure/pricing-and-affordability-water-services>

<sup>9</sup> EPA Publication 816-R-05-006 January 2006.



- Ensures rates are a sufficient and stable source of funds. Charging for the full cost of delivering water will ensure your system's financial health, enabling you to provide safe water now and in the future.
- Provides information on costs to customers. How much you ask your customers to pay sends a signal to them about the value of the product they are purchasing. Charging for the full cost of the service your system provides will help customers recognize the value of the service and be more mindful of their water use.

This same white paper does acknowledge that "single-tariff pricing can make rates more stable and affordable," but also acknowledges that STP "removes the direct link between a small system's cost structure and its rates, and it therefore may be less efficient than other options."<sup>10</sup> The authors acknowledge that STP can make rates for the small-system customers affordable and mitigate rate shock. However, in my opinion, affordability is a subjective and relative issue that would need to be fully evaluated when consolidating districts. In fact, for lower-income customers, affordability is addressed in other ways, including life-line rates and low-income discount rates. Programs such as these are targeted at ratepayers who are deservedly in need.

The question is as follows: why should customers in one part of the company's service area, whose median income might be lower than another area, have to subsidize the rates of the wealthier in that more affluent area? For example, take two neighborhoods with their own water systems. The median home price of one neighborhood (labeled in this example as neighborhood A) is \$150,000 while another neighborhood (neighborhood B), geographically one-mile away, has homes that range from \$750,000 to \$1,000,000. Let us assume further that

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<sup>10</sup> Ibid at page 35.

neighborhood A was built five years ago while neighborhood B was built 25 years ago. Both neighborhoods have the same number of homes. Now assume that both neighborhoods are served by a major water utility like MAWC. However, neighborhood B's system has to be upgraded to comply with the Clean Water Act. The question that rises to the forefront is, why should neighborhood A, the neighborhood of homes with lower values (and by inference, lower median incomes of the households who own those homes), have to pay for the upgrades to neighborhood B who can clearly afford to pay for those upgrades? Neighborhood A may not like it, but affordability is subjective and relative. It has to be acknowledged that the opposite is also true (i.e., if neighborhood A had to have the upgrade investments, it would be reasonable to expect that neighborhood A would rejoice in sharing those costs with its wealthy neighbors down the road, but the subjective issue does not go away, and I'm certain that even though neighborhood B could afford it, they would not like it either). Setting rates based on affordability sends the wrong message and hampers efficient use of resources.

**Q. ARE THERE OTHER REASONS YOU FIND STAFF'S RATIONALE INADEQUATE?**

A. Yes. Staff states the following as its second reason for the three-district approach:

The current size of the districts is logistically more manageable, both from an operations and regulatory perspective. This has allowed MAWC to continue to invest in smaller systems without causing rates to increase to (sic) dramatically. However, by maintaining three districts, there is still some restraint on the company from overspending on any given project

since the spread of the costs associated with any increases to a specific district are limited to the customer base in that district.<sup>11</sup>

Unfortunately, but with all due respect to Staff, this statement is a hodgepodge of logic for which Staff offers no substantive analysis or support. For example, the first sentence about the current size of the districts being “more manageable” is linked with MAWC’s ability to invest in smaller systems without causing rates to rise. This logic step is a huge leap at best. As the Commission knows (and I alluded to in my direct testimony), MAWC’s ability to acquire smaller systems certainly has more to do with the company’s assessment of the financials of these smaller systems and MAWC’s ability to raise capital for the acquisition. Certainly, MAWC has not been hampered in acquiring smaller systems by the current size of the districts. It would be a stretch to say that either of these reasons is influenced by the manageability of the size of the districts. As to the second point of not “causing rates to increase dramatically,” I would maintain that the company’s proposed 33% increase in this case is dramatic.<sup>12</sup>

Staff continues by arguing that a three-district approach would restrain the company from “overspending” on projects. A noted deficiency of the STP approach is the fear that utilities would *gold plate* projects and overspend because the impacts are lessened when spread over multiple systems (who may gain nothing from the project). To try to address this concern, the Commission is requiring the company to submit a five-year capital plan to its Staff for review. This oversight is needed, and it may help mitigate the concern of whether the

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<sup>11</sup> Staff Cost of Service Report at page 12, Lines 1-6

<sup>12</sup> Heppenstall Direct Testimony, Schedule A, Page II-2, Column 9

company is overspending, or gold plating, its system.<sup>13</sup> However, single tariff or consolidated pricing also makes it easier for the Company to bury and hide expenses in massive and consolidated financials. Further, the filing of a five-year capital plan does not mean that Staff, Public Counsel or other parties will have the time and resources to fully evaluate each element of such a plan until a subsequent rate case, after the capital has been expended and new facilities are permanently in place. A five year capital plan would at least provide an opportunity, if my recommendation for at least eight districts is adopted, for Staff to more effectively evaluate whether smaller systems are getting what they need in terms of capital resources to provide safe and reliable service.

**Q. IS STAFF'S REASON THAT CONSOLIDATED PRICING MAKES IT EASIER TO ALLOCATE COSTS AMONG THE VARIOUS SERVICE TERRITORIES A SUBSTANTIVE ISSUE?**

A. No. In its third reason, Staff argues the following:

The difficulty in developing rates on a district-specific basis is the need to allocate corporate costs to each separate service territory. Corporate costs are a substantial portion of the cost of service for MAWC. Trying to determine the most equitable manner to allocate those costs to each service territory (especially the very small service territories) is difficult when attempting to determine the true cost of service to those service territories.<sup>14</sup>

I am somewhat perplexed at this reasoning. The Company's and Staff's Cost of Service models already have allocators for MAWC's corporate costs. These

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<sup>13</sup> It is thought that a utility may gold-plate because it has an incentive to spend capital to increase ratebase and then earn a larger return for its shareholders.

<sup>14</sup> Staff Cost of Service Report at page 12 lines 7-13.

allocators are built from data from the individual systems, which is then aggregated into a System (in the case of the Company) or District (in the case of Staff). Again, the benefit of district pricing prevails here as the individual districts are allocated their respective share of corporate costs. In my opinion, the Commission should disregard Staff's proposed reasoning here as the work to establish a corporate allocator at an eight-district level is no different from three. The advantage to having at least eight districts is that it more appropriately allocates those costs and sends a more appropriate cost-causation signal to the districts.

**Q. WHAT ARE YOUR COMMENTS ON STAFF'S FOURTH REASON FOR RECOMMENDING THREE DISTRICTS?**

A. Here Staff argues that rate shock of upgrades is a reason for consolidating smaller systems with larger. In theory and certainly by the math, having large capital expenditures over a small number of customers could produce rate shock, such as St. Joseph experienced in 2000, for example. However, Staff in this case has only made a statement of the possibility but has not provided any substantive analysis.

**Q. WHAT DO YOU CONCLUDE?**

A. I disagree with Staff's reasoning and recommend that the Commission reject Staff's three-district approach as well as the Company's consolidated tariff in favor of a more appropriate, cost-causation related approach of using at least eight districts.

**Q. IN YOUR DIRECT TESTIMONY, YOU INDICATED THAT A RATE OFF-SET MIGHT BALANCE OUT TO SOME DEGREE THE**

**UNREASONABLENESS OF THE CONSOLIDATED TARIFF PRICING  
(CTP) PROPOSAL BY MAWC. DOES THIS OFF-SET PROPOSAL  
STILL APPLY IN LIGHT OF STAFF'S PROPOSAL FOR THREE-  
DISTRICT RATE DESIGN?**

- A. Yes. The same conditions exist in a three-district approach as a CTP approach. There are systems across the districts that have already made substantial investments in infrastructure prior to this case but will be expected to share the burden of planned investments in older or newly acquired systems. This creates cross-subsidizations between systems that have no logical relationship to each other either from geography, size or operating characteristics and is fundamentally unfair to the districts, namely the Coalition Cities of St. Joseph, Joplin, Jefferson City and Warrensburg, that have already been bearing the costs of improvements in their own service territories.

**Q. WHAT WOULD THE OFF-SET INCLUDE?**

- A. As stated in my direct testimony at pages MJM-14, Line 21 through MJM-15 line 22, the rate offset could be depreciated capital investment since 2000 for each of the four cities in total and divide that amount by the estimated consumption for the period of the offset. I would offer now that the period would be through the test year approved by the Commission in this case. That amount would be applied as a credit to the Coalition Cities on their customers' bills. As I stated in direct, this would then mean that as MAWC implements its capital plan over the credit period, the Coalition Cities are only paying for capital investment for similar plant. This is the basic issue for the Coalition Cities -- having to pay for

significant capital investments in other districts that they themselves have already paid. The Cities would still be paying for the net balance of the value of the infrastructure that was made in their respective systems. The off-set is simply netting against the new investment in other systems. Again, the total of this credit would have to be added to the other systems' rates to make it revenue neutral to match the Company's approved revenue requirement.

V. **COMMISSION'S DIRECTIVE FROM WR-2015-0301**

Q. **PLEASE EXPLAIN YOUR STATEMENT THE STAFF'S POSITION WAS NOT BASED ON A SUBSTANTIVE ANALYSIS.**

A. In its Report and Order in Case WR-2015-0301, dated May 26, 2016, the Commission stated the following:

Full single-tariff pricing is an attractive option, but since none of the parties proposed that option during the case it was not fully considered by the parties. Because of that lack of scrutiny, the option has many unknowns, and the Commission is not willing to take that leap at this time.

The Commission may need to make take that leap in Missouri-American's next rate case as it will likely be facing the prospect of a major new capital construction project in the Platte County district, a district that will have difficulty affording a major capital expense. **For that reason, the Commission will expect the parties to fully examine single-tariff pricing in the next rate case. (emphasis added)**

In my opinion, the Staff report does not fulfill the Commission's requirement to "fully examine single-tariff pricing in the next case." Beyond just a little more than two pages in its report (pages 10–12), that simply state Staff's reasoning, no other analysis or documented support for the Staff's position is found.

**Q. WHAT KINDS OF ANALYSIS WOULD YOU EXPECT TO FIND THAT WOULD COMPLY WITH THE COMMISSION'S DIRECTIVE?**

A. I would expect that foundational research documents, whitepapers, and other analysis would have been used to support the issue. Certainly, the American Water Works Association Water Rates, Fees, and Charges Manual M1 (a recognized authoritative document) should have been referenced. Further, I would expect a detailed review showing impacts on individual systems based on the Company's projected capital spending to establish the rate-shock issue. A comparison of three-, five- and eight-district approaches would have provided the Commission with some relative comparison of what would happen within and among the districts. An update similar to PRH-6 from WR-2015-301 would have been very useful. Documentation showing the linkage between the Company's acquisition of smaller systems and the number of districts would have been very useful, as well. I could go on, but my point is simply that none of this documented support exists in this case as of this writing. Therefore, the Commission's directive has not been satisfied, and as such, the record heretofore is incomplete in this regard. Therefore, I recommend that the Commission adopt the former eight-district approach.

**VI. MAYOR ROSE'S POSITION**

**Q. YOU MENTIONED THAT YOU HAD COMMENTS RELATED TO MAYOR KATHLEEN ROSE'S TESTIMONY. PLEASE STATE THOSE COMMENTS.**



A. Mayor Rose's position of supporting the Company's proposed consolidated tariff is not based on any specific analysis and does not reflect widely adopted methodology for rate design. Her position is that water is water and should be the same price regardless of where it is served. Respectfully, if the Commission adopts that logic, why would it not apply to electric, gas, and any other utilities. Consider electricity, if Mayor Rose's logic were to prevail, every utility should charge the same rates per kilowatt since a kilowatt is a kilowatt no matter where it is sold. Unfortunately, costs do vary by locale, region, and across different companies. Simply to say, "It is unjust and unreasonable in this day and age for a resident to pay a different amount for her water just because she lives in a particular area,"<sup>15</sup> ignores the reality of the economy. Respectfully, the Commission should not give Mayor Rose's position any weight in its determination in this case.

## **VII. SUMMARY AND RECOMMENDATION**

### **Q. PLEASE STATE YOUR SUMMARY AND RECOMMENDATION.**

A. Staff's conclusion and recommendation that the Commission maintain the status quo with respect to having the Commission adopt three districts for Cost of Service rate design purposes is inconsistent, unsubstantiated, and ignores widely accepted cost-causation rate-design principles. Further, the Commission directive that the issue of single-tariff pricing be fully analyzed by the parties has not occurred, and therefore, the Commission does not have sufficient information to base its decision whether to accept Staff's or the Company's proposals. Therefore,

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<sup>15</sup> Direct testimony of Mayor Kathleen Rose, Page 3, lines 1-2.

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I recommend that the Commission reject Staff and the Company's proposals and adopt the eight-district proposal I submitted in my direct testimony. If the Commission nonetheless adopts either Company's statewide rate tariff or Staff's three-district rate design, it should also adopt a rate-offset for the Coalition Cities as discussed above and in my direct testimony.

**Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

A. Yes.