BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri-American Water	)	
Company's Request for Authority to Implement	)	Case No. WR-2015-0301
General Rate Increase for Water and Sewer	)	Case No. SR-2015-0302
Service Provided in Missouri Service Areas.	)	

MISSOURI-AMERICAN WATER COMPANY'S REPLY BRIEF

COMES NOW, Missouri-American Water Company (MAWC or Company), and, for its Reply Brief in this matter, states as follows to the Missouri Public Service Commission (Commission):

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1. Consolidated Tariff Pricing (CTP)

A. Consolidated Tariff Pricing is Lawful

In the Initial Post-Hearing Brief of the Missouri Industrial Energy Consumers, City of Joplin, City of St. Joseph, City of Warrensburg, and City of Brunswick (Joint Brief of MIEC, et al.), the signatories (with the notable exception of City of Brunswick) take the unusual and erroneous position that the Commission lacks the lawful authority to implement Consolidated Tariff Pricing. In this regard, MIEC, et al.'s legal analysis is deficient, misleading and belied by their own conduct in this case. MIEC, et al.'s analysis is misleading in that it omits a key word from the Commission's statutory mandate and it paraphrases holdings from appellate decisions that are inconsistent with the actual language of the Court.

For example, MIEC, et al., quotes Section 393.130.3 as follows:

> 3. **No . . . water corporation . . . shall make or grant any undue or unreasonable preference or advantage to any . . . locality**, or to any particular description of service in **any respect whatsoever, or subject any . . . locality** or any particular description of service to **any undue or unreasonable prejudice or disadvantage in any respect whatsoever**.

(Joint Brief, MIEC et al., p. 5)

However, this quote omits the words "person" and "corporation" as follows:

> 3. No . . . water corporation . . . shall make or grant any undue or unreasonable preference or advantage to any person, corporation or locality, or to any particular description of service in any respect whatsoever, or subject any particular person, corporation or locality or any particular description of service to any undue or unreasonable prejudice or disadvantage in any respect whatsoever. (emphasis added.)

The omission of these words is significant because the prohibition against undue preference or advantage applies to persons and corporations, as well as locations. MIEC, et al.,

perpetuate their subterfuge by misstating the holding in the *City of Cape Girardeau* case.[1] In that case, the Missouri Court of Appeals found the word "person" of great significance in its analysis of the Commission's discretion in setting rates on a "system-wide" basis. The Court said as follows:

> (W)hat the City has seemingly chosen to ignore throughout these proceedings is that Section 393.130(3) forbids discrimination against persons as well as locations. The Commission's order and report made it clear that it was aware of this dual obligation and in this case chose to emphasize equity to the individual user by maintaining a rate system designed on the basis of costs to a class of customer than to area. For this reason we view the issue as a question of reasonableness, and will treat it with more detail infra. We cannot hold as a matter of law that the City was entitled to the relief it sought merely by showing a lower cost of service to the City area as a whole.[2]

Thus, the *City of Cape Girardeau* case clearly permits the Commission to establish rates based on the cost to serve an entire class of customers (e.g., residential customers) and not solely based on the cost to serve a particular location.[3]

Next, MIEC, et al., ignore the actual holding of the Supreme Court in the *City of West Plains* case[4] and claim that the Court's approval of the Commission's decision to assess municipal taxes to the municipalities imposing such taxes somehow prevents the Commission from setting rates for utility service on a system-wide basis. Nothing could be further from the truth. MIEC, et al., conveniently disregard the plain language of the Supreme Court's decision as follows:

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[1] *State ex rel Cape Girardeau, Missouri v. Public Service Commission*, 567 SW2d 450 (Mo. Ct. App. E.D. 1978).
[2] Id at 453 (emphasis added).
[3] MIEC, et al., also make the unsupported and incorrect statement at page 9 of their Joint Brief that "(t)he Commission is bound by statute to set water rates for each district based upon the recognized cost to render water service to each district." (emphasis in Brief) Not only do they not reference any statute, the one statute that they selectively quote on page 5 does not contain the word "cost" and clearly does not require the setting of rates on district specific costs. In fact, there has never been a time since 1993 when the rates for MAWC were set on a true district specific basis. They have involved some rate mitigation technique such as consolidation or revenue subsidy.
[4] *State ex rel City of West Plains, Missouri v. Public Service Commission*, 310 SW2d 925 (Mo. Banc 1958).

> We are able to discern no legitimate reason or basis for the view that a utility must operate exclusively either under a system-wide rate structure or a local unit rate structure, or the view that an expense item under a system-wide rate structure must of necessity be spread over the entire system regardless of the nature of the item involved.[5]

It is clear from the Supreme Court's language that the Commission has the legal authority to spread rates on a system-wide basis. In the *City of West Plains* case, it is important to note that the actual costs of providing utility service were spread on a system-wide basis, while only the municipal taxes were assigned to the localities assessing those taxes. It is also instructive to note that the telephone company in the *City of West Plains* case served thirty-six (36) exchanges extending from "Atlanta in north Missouri to West Plains and Willow Springs in the south, so that many of the various exchanges were relatively far removed from the localities of other exchanges in Western's system."[6]

The *City of Grain Valley* case[7] cited in MIEC, et. al's brief simply reaffirms the same principle enunciated by the Supreme Court in the *Laundry* case,[8] which was quoted in MAWC's Initial Brief. In other words, customers receiving the same or similar service should be charged the same rates. Under Consolidated Tariff Pricing, similarly situated customers are charged the same rate for water service. There are many similarities in the manner in which MAWC's districts are operated. All of the districts pump their treated water through transmission lines to distribution areas that include mains, booster pump stations and storage facilities. All of the districts provide water to individual customers through a service line and meter. All of the districts rely on a centralized workforce for billing, accounting, engineering, administration and regulatory matters. All of the districts rely on a common source of funds for financing, working

[5] Id at 933.
[6] Id at 928.
[7] *State ex rel City of Grain Valley v. Missouri Public Service Commission*, 778 SW2d 287 (Mo. App. W.D. 1989).
[8] *State ex rel. Laundry, Inc. v. Public Service Commission*, 34 SW2d 37 (Mo. Banc 1937).

capital and plant construction. Inasmuch as the cost of operations are related to functions in which the operating characteristics are the same, the use of equal rates is appropriate. (MAWC Exh. 7, Herbert Direct, p. 17)

Finally, MIEC, et al., cite the *City of Joplin* case as "particularly instructive."[9] However, their discussion of the case is misleading and deficient. First, it is misleading because, as Joplin's attorney admitted in her opening statement, that case wasn't ultimately decided on the interpretation of Section 393.130.3. (Tr., p. 277) It is deficient because it fails to give the factual background which distinguishes the *City of Joplin* case from the present case. In MAWC's 2000 rate case[10], the Commission found that it would move away from Single Tariff Pricing (STP) toward District Specific Pricing (DSP). But, in doing so, the Commission would adhere "to the principle that no district will receive a rate decrease." (Report and Order, p. 58) Accordingly, the Commission did not reduce rates in the Joplin district, acknowledging that the Joplin district would be paying approximately $800,000 more in rates than its district specific cost of service. Significantly, the Commission also went on to say, "The Commission decision herein should not be read to suggest that the Commission agrees with those parties that contend that STP is not lawful in Missouri," and quoted from the *City of West Plains* case to support its conclusion. (Report and Order, p. 59)

On appeal, the Circuit Court of Cole County found that the Commission's decision not to reduce rates in the Joplin district was not supported by findings of fact or conclusions of law.[11] The Circuit Court stated as follows:

> After hearing extensive evidence, the Commission decided it would not use the STP method in setting the Company's Missouri system rates. Instead, the Commission decided that it would use the DSP method to set

[9] *State ex rel City of Joplin v. Public Service Commission*, 186 SW3d 290 (Mo. App. W.D. 2005).
[10] Case No. WR-2000-281 (issued August 31, 2000).
[11] Circuit Court Case No. 00CV325217, et al. (issued September 19, 2001) (copy attached as Appendix A).

> the Company's Missouri system rates. The Commission also, however, stated that it will "adhere to the principle that no district [in the system] will receive a rate decrease as a result of rate design." (Report and Order, p. 58). This statement is supported by no findings of fact, nor is it explained or elaborated upon in conclusions of law. (Findings of Fact, Conclusions of Law, and Judgment, p. 14)

The Court then reversed the Commission's decision and remanded it to the Commission for further findings of fact and/or conclusions of law. However, the Court's Order did not hold that the Commission lacked the legal authority to implement Single Tariff Pricing. In fact, in an earlier appeal of the same Commission Report and Order[12], the Circuit Court held as follows:

> The Commission is not required in this case or any given case to adopt either a systemwide rate structure, such as STP, or a local unit rate structure, such as DSP. Nor must an expense item under a systemwide rate structure necessarily be spread over the entire system, regardless of the nature of the item involved. The Commission is also free to adopt a "hybrid system," or a "modified system," under which certain expense items are passed on to customers on a systemwide base, and other expense items are passed on to customers on a local unit basis. The Commission may allocate a treat costs in the way in which, the Commission's judgment, the most just and sound result in reached. *State ex rel City of West Plains v. Public Service Commission,* 310 S.W.2d 925, 933 (Mo. Banc 1958).[13]

Thus, the Circuit Court narrowly held that the Commission's decision to move toward District Specific Pricing, but excepting Joplin from that decision, was not supported by adequate findings of fact and conclusions of law.

When the case eventually made its way to the Court of Appeals in 2005, the question before the Court was whether this rate issue from the Commission's 2000 Rate Order was moot because of an intervening rate case. The Court of Appeals, citing an exception to the mootness doctrine, held that the issue was not moot and remanded the matter to the Commission to issue findings of fact and conclusions of law as to its rate determination in the 2000 rate case. What

[12] Circuit Court Case No. 00CV325014 (issued May 25, 2001) (copy attached as Appendix B).
[13] Id at p. 16.

the Court of Appeals did not say, much less hold, is that the Commission lacks the lawful authority to adopt Single Tariff Pricing or Consolidated Tariff Pricing.

It is also telling that two of the signatories to the Non-Unanimous Stipulation and Agreement on Rate Design, District Consolidation and Sewer Revenue (Non-Unanimous Stipulation on Rate Design) did not join MIEC, et al., in their contention that Consolidated Tariff Pricing is unlawful. In fact, Public Counsel candidly admitted in its opening statement that "consolidation is legal, so long as the record supports the Commission conclusion that such consolidation is not undue or unreasonable." (Tr., p. 255) The Non-Unanimous Stipulation on Rate Design is also significant for the fact that MIEC, et al., are engaging in some degree of consolidation themselves. MIEC, et al., attempt to justify their apparent unlawful conduct by claiming the consolidation of the Brunswick district and other "small" districts with larger districts is permitted by Section 393.320.6, RSMo. (MIEC, et al., Joint Brief, p. 35) However, this statute only applies prospectively, to the acquisition of new, small water systems. In the case of Brunswick, it has been part of MAWC's system since approximately 1993. Moreover, if MIEC, et al., truly believe that Section 393.320.6, RSMo., lawfully permits the Commission to consolidate existing small districts with large districts, then all of the small districts of the Company (i.e., those will less than 8,000 customers) may also be consolidated with the larger districts. Taking MIEC's legal argument to its logical conclusion, it would therefore be lawful and appropriate to consolidate Warrensburg and the Branson area water systems with Joplin, to consolidate Brunswick and Riverside with St. Joseph, and to consolidate Mexico and the smaller water systems in the eastern part of the state with the St. Louis Metro district, which is very similar to what Staff has proposed in this case. (The only district not qualifying as a small water system being Jefferson City.)

The simple truth of the matter is the Commission has the lawful authority to establish Consolidated Tariff Pricing or Single Tariff Pricing.

B. Consolidated Tariff Pricing is Reasonable

Having failed to establish a legitimate legal prohibition to Consolidated Tariff Pricing, MIEC, et al., now joined by Public Counsel, take the position that any consolidation other than that contained in their Non-Unanimous Stipulation on Rate Design would be unreasonable. However, the contentions and criticisms raised by MIEC, et al., and Public Counsel have already been addressed in MAWC's and Staff's Initial Briefs. Nevertheless, some of those criticisms are again addressed here.

MIEC, et al., and the Public Counsel contend that Consolidated Tariff Pricing violates the basic principles and goals of utility ratemaking, primarily relying on cost of service as their guiding principle and ignoring public policy as well as other factors that are equally or more appropriate in designing rates. While cost is certainly a factor to consider in the setting of rates, it is not the sole determinant. For example, other considerations include the impact of changes from the present rate structure, the understandability and ease of application of the rate structure, community and social influences, and the value of service. (MAWC Exh. 7; Herbert Direct, p. 12) Even MIEC witness Collins recognizes that despite the true cost of service, affordability must also be taken into account and, in some instances (such as Brunswick) rate mitigation through either consolidation or a revenue contribution, is appropriate. (Tr., p. 731, 733, 752) In addition, it is abundantly evident from the record that the district specific cost of service is heavily reliant upon the allocation of joint and common costs which may or may not be reflective of the actual cost of providing service in each district. (Staff Exh. 11; Busch Rebuttal, p. 14; MAWC Exh. 13; McDermott Rebuttal, p. 10-11) Therefore, it is not appropriate to draw any

hard and fast conclusions regarding the cost of providing service in each district or whether a "subsidy" is flowing from one district to another. (Tr., p. 415)

Next, MIEC, et al., argue that the justifications provided by Staff and Company for consolidation are hypothetical and not supported by evidence in the case. To some degree, the benefits of consolidation are hypothetical simply because any significant consolidation of MAWC's districts has not yet occurred, so there is no track record to put a fine point on the extent of the benefits of consolidation. Nevertheless, that does not mean there is no evidence in the record to justify consolidation. First, one need look no further than the Non-Unanimous Stipulation on Rate Design, which implicitly acknowledges the need for some consolidation. Presumably, the signatories to the Non-Unanimous Stipulation on Rate Design saw some benefit to consolidation or they would have not proposed it in their Stipulation. No one can seriously argue that spreading costs over a larger customer base will not mitigate the rate increase, than if those costs must be spread over a smaller customer base. That is an obvious fact of economies of scale. MAWC witnesses Herbert and McDermott have provided ample testimony and evidence as to the benefits of and justification for CTP based on their many years of experience in the public utility industry. Staff witness Busch has over 19 years of expertise in utility regulation, the last eight (8) years as Manager of the Staff's Water and Sewer Department. As a result, Mr. Busch has a unique and compelling perspective on the need for consolidation. (Tr., p. 428) Finally, Public Counsel witnesses Smith and Marke even acknowledge the numerous arguments in favor of Single Tariff Pricing (OPC Exh. 15, Smith Sch. RCS-16, p. 3 of 5; Tr., p. 691-692)

MIEC, et al., refer to the Western District Court of Appeals decision in *State ex Rel. Public Counsel v. Missouri Public Service Commission*, 289 S.W.3d 240, 254 (2009) for the

proposition that it was unreasonable for the Commission to approve consolidation of districts on the alleged fact that the cost to serve the Company's residential customers throughout the state was the same. (Joint Brief, p. 12) That case, however, is distinguishable from the present case in that the Commission based its decision to consolidate the districts of Atmos Energy Corporation solely on the basis of similar costs, when in fact there was no evidence in the record to support that finding. In the present case, there is sufficient evidence to support consolidation based on factors in addition to cost. For example, consolidated pricing mitigates rate shock[14], lowers administrative costs[15], addresses small system viability issues[16], improves service affordability for customers[17], and promotes universal service for utility customers[18]. All of these are sufficient and valid reasons to consolidate districts and equalize pricing.

MIEC, et al., challenge the notion that Consolidated Tariff Pricing mitigates rate shock. Yet MIEC, et al., as signatories to the Non-Unanimous Stipulation on Rate Design recognize that without consolidation and a revenue shift (i.e., from water to sewer) customers in some districts would suffer rate shock under a pure district specific cost based rate. MIEC witness Collins readily concedes that pure district specific pricing will result in "high-level" increases for some districts, and that will require some sort of "rate mitigation." (Tr., p. 731-733) In fact, even though the Commission announced a policy to "move toward District Specific Pricing" in 2000, it has never achieved full District Specific Pricing for MAWC simply because the resulting rates would be difficult for some districts to afford (most notably Brunswick). (Tr., p. 682-683) As Staff witness Busch succinctly stated, "I believe the more consolidation you do, the less likely

[14] MAWC Exh. 7; Herbert Dir., p. 16; MAWC Exh. 12; McDermott Dir., p. 15-16; Staff Exh. 9; Busch Dir., p. 8.
[15] MAWC Exh. 7; McDermott Dir., p. 16-17; Staff Exh. 9; Busch Dir., p. 8; Staff Exh. 12; Busch Sur., p. 15.
[16] MAWC Exh. 12; McDermott Dir., p. 7-9, 14-15; Staff Exh. 11; Busch Rate Design Reb., p. 10; Tr. P. 428-431, 464, 465, 472, 504.
[17] MAWC Exh. 12; McDermott Dir., p. 15-16; Staff Exh. 11; Busch Rate Design Reb., p. 8-9; Tr. 389, 424-425, 464, 506.
[18] MAWC Exh. 12; McDermott Dir., p. 10-11, 13; Staff Exh. 11; Busch Reb., p. 8.

you are to have rates that are unaffordable." (Tr., p. 505)

MIEC, et al., dispute there is a national trend toward consolidation citing Public Counsel witness Marke who testified that the majority of states do not leave Single Tariff Pricing. (Joint Brief, p. 25; Tr., p. 222-223) MIEC, et al., is playing a semantics game by focusing solely on Single Tariff Pricing, which involves a uniform, statewide rate, and ignoring Consolidated Tariff Pricing, where two or more districts are consolidated into one rate. Dr. Marke is well aware of this distinction and was careful to limit his testimony to states with only Single Tariff Pricing. (Tr., p. 230) Company witness McDermott was quick to clarify that his analysis of national trends was broader in scope. Thus, although he used the term "Single Tariff Pricing" in the title of his schedules, his analysis included Consolidated Tariff Pricing as well. (Tr., p. 641) So, while MIEC, et al., are technically correct that Illinois and California do not have STP, these states do have Consolidated Tariff Pricing. (Tr., p. 656, 660, 736) In short, when viewed in terms of Consolidated Tariff Pricing, Dr. McDermott's trend analysis is correct.

Finally, MIEC, et al., and Public Counsel continue to raise the "hypothetical" risk of over-investment which could result from consolidated pricing. The risk is hypothetical because there is no evidence that MAWC has engaged in any gold-plating of its system. Several witnesses vaguely referred to MAWC's 2000 rate case as an example of imprudence in the design and/or construction of the water treatment facility in St. Joseph, Missouri. However, a review of the Commission's Report and Order reveals no finding of imprudence. In fact, the Commission found:

> On the basis of the record made in this case, the Commission finds and concludes that the management of MAWC did use due diligence to address all relevant factors and information known or available to it when it assessed the situation and reached the decision to build a new treatment facility plant and develop a new groundwater source of supply in St. Joseph. Consequently, the Commission must conclude that the decision to

build the new plant and related facilities was not imprudent. Therefore, the total project cost of $70,097,840 shall be recognized in rate base.

(Report and Order, p. 45-46) Furthermore, this finding was affirmed on appeal by the Circuit Court of Cole County (Appendices A and B, pages 13 and 10, respectively.) Moreover, any risk of over-investment can be adequately addressed, as Staff suggests, by the Company filing its five-year construction plan with the Commission.

C. The Best Options for Consolidation

Given the long term goals of rate stability and simplicity, lower administrative costs, addressing small system viability issues, and promoting universally available service for all customers, the best options for consolidation are:

1. Consolidated Tariff Pricing for all districts except St. Joseph and Joplin. (MAWC Exh. 51R1) This option has the fewest number of rate increases for residential customers being consolidated and using 3,000, 5,000 and 8,000 gallons of water. It also preserves District Specific Pricing for St. Joseph and Joplin, the two of the most vocal opponents of CTP.

2. Consolidated Tariff Pricing for all districts. (MAWC Exh. 53R1) Again, this option results in the next fewest number of rate increases for residential customers being consolidated and using 3,000, 5,000 and 8,000 gallons of water. This option also achieves the greatest amount of consolidation and sends a clear message to other regulated water companies as well as others interested in investing in the water utility business that Missouri is focused on the long term run view of serving the state on a total Company basis, while promoting investment in the necessary infrastructure to provide safe and reliable water service.

3. Staff's Consolidated Tariff Pricing for three (3) geographic districts. (MAWC Exh. 49R1) This option achieves substantial consolidation of the Company's 19 existing water districts. This consolidation is based on the similar geographic and operational characteristics of the districts and, to the extent costs vary between those geographic regions, Staff's proposed consolidated pricing reflects those cost variances. It also results in the second fewest number of rate increases on residential customers being consolidated and using 3,000, 5,000 and 8,000 gallons of water.

D. The Non-Unanimous Stipulation on Rate Design is the Least Desirable Option for Consolidated Pricing in this Case

Signatories tout their Non-Unanimous Stipulation on Rate Design as the best option for resolving Consolidated Tariff Pricing and other rate design issues. They even dub it the "Consumer Stipulation," and ridicule Riverside as the only consumer party to voice opposition to the Stipulation. (Joint Brief, p. 32)[19] However, such characterization ignores the charge of the Commission's Staff to balance the interests of the customers and the Company. It also ignores the fact that a number of municipalities chose not to intervene in this case even though MAWC's proposed consolidation was clearly evident in its initial filing. The fact of the matter is that the Non-Unanimous Stipulation and Agreement is the least desirable option for consolidated pricing that has been presented to the Commission in this case. Although the Non-Unanimous Stipulation on Rate Design does propose to: 1) consolidate some non-interconnected districts with substantially different cost structures; 2) subsidize residential customers in the Riverside district by arbitrarily reducing their rates by 5%; and 3) subsidize sewer customers by shifting

[19] MIEC, et al., also chastise the City of Riverside for changing position on the issue of CTP. (Joint Brief, p. 37) MIEC, et al., fail to note that Public Counsel, St. Joseph and Warrensburg at one or more times in the past have supported Consolidated Tariff Pricing. (OPC Exh. 9; Marke Sch. GM-2; Tr., p. 710) Yet, MIEC, et al., find no problem with their change of position.

revenues from some water customers -- it "falls short" of the mark (as stated by Staff). (Staff Brief, p. 21)

Staff succinctly summarized the failings of the Non-Unanimous Stipulation on Rate Design as follows:

> This plan would not alleviate cost allocation problems with the current district design, nor would it spread costs over a larger customer population in any significant way. Further, maintaining the status quo does not sufficiently support the future acquisition of struggling small water and sewer companies by other utilities. Companies seeking to acquire struggling sewer and water companies prefer consistently. Moving toward fewer districts, and basing the composition of the districts on clearly articulated terms, as Staff's plan does, provides consistency. Maintaining the status quo does not.

(Staff Brief, p. 21-22)

The Non-Unanimous Stipulation on Rate Design really does nothing more than maintain the status quo and perpetuates the Balkanization of water service in this state. While it may address the parochial interests of its signatories, it fails to address the broader public policy goals that this Commission must address.

E. Now is the Time to Consolidate

In an effort to dissuade the Commission from addressing the public policy issues associated with Consolidated Tariff Pricing, MIEC, et al., argue that this is an issue that should be resolved by the legislature. (Joint Brief, p. 29-32) Similarly, MIEC, et al., seek to postpone a decision in this case by suggesting the Commission should wait until replacement of the Platte County Treatment Plant has been completed to determine whether there is any rate shock that needs to be mitigated. (Joint Brief, p. 27-28) Neither of these suggestions is a valid reason to delay a decision on the important public policy considerations of Consolidated Tariff Pricing.

As the Commission is well aware, consolidation is an issue that has been raised in virtually all of MAWC's rate cases since its acquisition of the Missouri Cities properties in approximately 1993. However, this issue has only been fully litigated in 2 of those cases since 1993 -- once in 2000 (when Commission decided on a 3 to 2 vote to "move toward" District Specific Pricing) and the present case. In between, the parties, through stipulation, have mostly cobbled together a patchwork rate design that included some District Specific Pricing, some consolidation, and some outright revenue "subsidies" between districts. In fact, although the Commission announced a policy of moving toward District Specific Pricing in 2000, MAWC has never fully achieved DSP, and is no closer today than it was in 2000. And as long as small districts (like Brunswick) exist, it is a safe bet that full District Specific Pricing will never be realized. Adding to the small districts' lack of economies of scale is the more recent issue of the long term viability of stand-alone, small water and wastewater systems, particularly as they struggle to comply with more stringent water and effluent quality requirements. Consolidating rates helps spread out those costs to a much larger customer base, which means all MAWC customers and more Missouri citizens will have access to safe and adequate water at just and reasonable rates. This extremely important public policy determination has to take precedence over the concerns of cost causation. (Staff Exh. 11; Busch Rate Design Reb., p. 8) This is the primary, if not sole, issue that keeps Staff witness Busch up at night and has caused him to change his view of the world. (Tr., p. 428) Waiting another 15 years to address the issue is not a responsible option. As noted by Staff witness Busch, now is the perfect time to address this issue when no one district is likely to experience rate shock.

> "If the Commission were to wait until one district was on the verge of experiencing rate shock, then the outcry from the other districts would be

very vocal and the movement toward consolidation would be harder to justify." (Staff Exh. 12; Busch Sur., p. 11-12)

Likewise, waiting for the legislature to act is unnecessary. First, there is no assurance the legislature will address this issue. Second, and as explained earlier in this (and MAWC's Initial Brief), the Commission has the lawful authority to set rates on a consolidated basis. Moreover, the Commission is the proper agency to weigh the evidence and arguments both for and against consolidated pricing and make the difficult policy decisions regarding the most appropriate rate design for promoting safe and reliable water service throughout the state.

F. A Revenue Contribution from the Water Systems to the Sewer Systems is Appropriate

All of the parties to the case recognize the need for a revenue contribution from the water operations to the sewer operations in order to keep sewer rates reasonable and affordable. The Non-Unanimous Stipulation on Rate Design proposes to shift $565,000 from the Joplin and St. Louis Metro water districts in proportion to their relative revenue requirement (approximately 10% from Joplin and 90% from St. Louis). Staff also proposes a revenue contribution of $565,000 from water to sewer, but proposes that 80% of this amount come from Staff's District 1 and 10% come from Districts 2 and 3 each. (Tr., p. 405)

The problem with both of these proposals is that there is an additional revenue shortfall of approximately $700,000 attributable to the Arnold sewer system that neither the signatories to the Non-Unanimous Stipulation on Rate Design or the Staff are willing to address. Staff claims that this shortfall is the direct result of a rate increase cap that the Company agreed to with Arnold City officials when it was acquiring the Arnold system. (Staff Brief, p. 11-12) On the contrary, the shortfall is created by Staff's unwillingness to limit the amount of corporate costs

that it allocates to all water and sewer districts. Ironically, Staff is well aware of this problem at page 19 of its Brief when it says:

> Allocating corporate costs to small, newly acquired companies is difficult. Small water and sewer systems do not typically share the same corporate costs of large companies such as MAWC. Yet, when MAWC acquires small water and sewer systems, the small systems must pay for call centers and other MAWC corporate costs. In these situations, it is difficult for Staff to find the most equitable method to allocate the corporate costs of these small systems. (footnote submitted)

In short, Staff agrees that it is allocating too many corporate costs to the small water and sewer districts. As a result, the Staff's cost of service for these small districts is overstated and, in some cases, substantially overstated. The Company attempted to address this problem by limiting the amount of corporate costs to $20 per customer to be allocated to these small districts, but Staff objected and the ultimate Agreement on Revenue Requirement reflects Staff's "full" allocation of corporate costs to all the water and sewer districts.

Even though Staff recognizes that it has likely allocated too many costs to the small water and sewer districts (which would include Arnold), it flatly states, "There is no public policy reason why other ratepayers should cover this deficiency [in the Arnold district]." (Staff Brief, p. 12) On the contrary, the same public policy reasons why Staff is reluctant to raise rates for the other sewer districts applies equally to raising rates 40+ percent in the Arnold district. There is no legitimate ratemaking reason for treating the Arnold district any differently than the other sewer districts simply because Company's management made a commitment to the City of Arnold to limit any increases in the residential sewer rates to a maximum of $33.58, during the first four years of MAWC's ownership. Moreover, if Staff is truly concerned about the Company's willingness to acquire small water and sewer systems in the future, its position with regard to the Arnold sewer rates is clearly sending the wrong message. The more reasonable and

appropriate approach in this case is to increase the sewer revenue contribution from $565,000 to $1.3 million and recover that shortfall proportionately from all MAWC water customers.

2. Rate Design

A. Customer Charges

Various parties take issue with the Company's proposed customer charges, generally claiming that they are "too high," adversely impact low-income customers, do not promote conservation of water and energy and/or recover more than their incremental cost of serving the customer. Those criticisms, however, are simply not valid, as will be shown herein.

Public Counsel is concerned with the "negative impact of high customer charges." (Public Counsel Brief, p. 8) (emphasis added) Similarly, Division of Energy is concerned about the "sharp, relative increase in residential customer charges . . . could lead to rate shock . . ." (Division of Energy Brief, p. 9) (emphasis added) Even Staff notes that, "(o)ne area of tension in this case is the Company's desire to substantially increase the customer charge component for each class in order to ensure recovery of fixed costs." (Staff Brief, p. 7) (emphasis added) Hyperbole aside, the Company's proposed customer charges are neither too high nor do they represent a sharp or substantial increase over existing charges. In this case, the Company is seeking to establish a uniform statewide customer charge, starting with a rate of $16.90 for a 5/8" meter customer (typically a residential or small commercial user) and increasing the rate as the size of the meter increases. These rates, while more than what the Company currently charges in its St. Louis Metro, Mexico, Warrensburg, Platte County, St. Joseph, Emerald Pointe and Tri-States districts, are nevertheless less than it currently charges in its Joplin, Jefferson City, Brunswick, Spring Valley, LWM, Ozark Mountain LTA, and MRSS districts. (MAWC Exh. 48R1, p. 6 of 7) Additionally, the Company's current customer charges recover approximately

21.5% of its existing revenues. Its proposed customer charges, if adopted by the Commission, would recover approximately 24.5% of its proposed revenues. (Tr., p. 612) An approximate 3% increase in customer charge revenues is hardly sharp or substantial when the overall water revenues in this case are increasing by approximately 11%. (MAWC Exh. 52) Moreover, Staff's own customer charge for its District 1 (which includes St. Louis Metro) is $16.50 for a 5/8" meter customer, which is only 40 cents less than that proposed by Company.

Public Counsel worries that an increase in customer charges will shift more cost responsibility to low-income users. (Public Counsel Brief, p. 5) However, Public Counsel's concerns for the low-income user rings hollow, given its opposition to the low-income tariff. In essence, Public Counsel proposes to arbitrarily reduce the customer charges for over 450,000 customers to address the needs of approximately 55,000 low-income customers. This is the regulatory equivalent of driving a thumb tack with a sledgehammer. A better and more targeted way to address Public Counsel's concern for low-income customers is to implement the low income tariff proposed by Company.

Public Counsel and Division of Energy also claim that increasing the customer charge is contrary to the goal of encouraging water and energy conservation. (Public Counsel Brief, p. 5, 9; DE Brief, p. 9) They theorize that lowering the customer charge, and increasing the volumetric charge, will send a better price signal to customers to conserve their use of water. The first problem with Public Counsel's and Division of Energy's "theory" is that they do not quantify the resulting increase in volumetric charges that would result from a reduction in the customer charge. For example, if volumetric charges for 100 gallons of water are only increasing by 10 or so cents, there is no evidence to show whether this increase will have a real impact on the customers' usage habits. Second, the demand for water is, to some extent,

inelastic. (Tr., p. 615-616) In other words, there is a certain base or non-discretionary amount of water use that customers will use regardless of its price. Finally, even if Public Counsel and Division of Energy are successful in causing customers to conserve, they have ignored the other side of the equation by refusing to accept or support a declining use adjustment or a Revenue Stabilization Mechanism (RSM), which would give the Company more of a realistic opportunity to recover the revenue requirement established in this case. Public Counsel witness Marke candidly noted in responding to a question from the bench regarding inclining block rates, "We don't want to be put in a position where the Company is coming immediately back for a rate case because they are not collecting their revenue requirement based off those blocks." (Tr., p. 788-789) Yet, that is exactly the position that Public Counsel and Division of Energy are putting the Company in by proposing to recover more of the revenue requirement through the volumetric rates.

Neither Public Counsel nor Division of Energy performed a Class Cost of Service Study in this case. Instead, they have taken positions ranging from recommending a "low" customer charge to one based on Staff's initial Cost of Service Study. Alternatively, they propose the statewide customer charges contained in the Non-Unanimous Stipulation on Rate Design, which are simply a reflection of the Company's existing customer charges in its St. Louis Metro District. Public Counsel and Division of Energy argue that only the incremental costs associated with serving a customer should be recovered through the customer charge. (Public Counsel Brief, p. 14; DE Brief, p. 8-9) However, neither party has prepared and presented an incremental cost study in this case. More importantly, Public Counsel witness Marke admitted that incremental or marginal cost studies are rarely used in utility regulation. In fact, Dr. Marke quotes, with approval, from Company witness McDermott's testimony as follows:

> "Notice, however, that if the Commission were to set the price at marginal cost, the Company would not recover its sunk costs and would never invest in the system in the future. Therefore, regulation makes a legal requirement that all prudently incurred costs, including sunk costs, must be recovered through rates and the process by which this is done is the ECOSS [Embedded Cost of Service Study]."

(OPC Exh. 12; Marke Surrebuttal, p. 4)

Thus, not only is there no record support for an incremental, cost based customer charge, there is no ratemaking support for such an approach either.

Failing to establish a cost-based customer charge, Public Counsel and Division of Energy then "cherry-pick" Mr. Herbert's Class Cost of Service Study by eliminating the uncollectible expense and public fire costs from his calculations of customer related costs. Ironically, Public Counsel witness Smith was critical of MIEC witness Collins for a similar cherry-picking approach when Mr. Collins proposed to reallocate the power costs to the various classes of service. Mr. Smith's criticism is equally applicable here, as Public Counsel's and Division of Energy's approach would "inappropriately reallocate a single selected category of water utility costs away from . . . [the customer charge] and place additional cost burdens on the other . . . [volumetric rate elements]." (Public Counsel Exh. 16; Smith Rate Design Reb., p. 5-6) More importantly, the costs associated with bad debts and public fire service are appropriately recovered through a fixed customer charge rather than the variable commodity rate. Uncollectible accounts do not vary with usage; they vary with the number of customers. Thus, by using an allocation factor based on the number of customers to allocate uncollectible accounts, the result is more closely aligned with the write-offs by class as shown in the following table:

	Write-offs	Percent
Residential	$3,945,329	94.36%
Commercial	230,248	5.51%
Industrial/Other	1,005	0.02%
Private Fire Service	4,488	0.11%
Total	$4,181,070	100.00%

(MAWC Exh. 9; Herbert Reb., p. 9)

This table clearly shows that the residential class is primarily responsible for uncollectible accounts and those costs are properly allocated to customer costs based on the number of customers. Allocating uncollectible accounts to volumetric rates, as proposed by Public Counsel and Division of Energy, would unfairly impact large users by requiring them to pay a disproportionate share of the costs. (MAWC Exh. 9; Herbert Rebuttal, p. 9) Public fire costs are also appropriately recovered in the customer charge.[20] The Company does not have public fire hydrant rates, so the costs associated with public fire must be recovered from other classes. Since public fire costs are fixed costs, and do not vary at all with water usage, these costs must be recovered through customer charges. (Tr., p. 615) Mr. Herbert's study allocated public fire costs based on the size the meter so that customers with larger meters will pay more for public fire and recognizes that customers with larger meters generally have higher property values. (MAWC Exh. 9; Herbert Reb., p. 4) Allocating public fire costs (like uncollectible accounts) on volumetric rates would unfairly burden the large users by assigning a disproportionately greater share of those costs to the large users.

Public Counsel and Division of Energy also urge the Commission to adopt Staff's initial recommendation for customer charges in the $9-$11 range. (Public Counsel Brief, p. 8; DE

[20] Staff also excludes public fire costs from its customer charge calculation. This appears to be the only difference between Staff's and Company's approach to establishing an appropriate customer charge.

Brief, p. 8, 13) However, those charges were based on a significantly lower revenue requirement than the $30.6 million revenue requirement agreed to by the parties in this case and contained errors that Staff corrected later. As a result, Staff no longer supports those customer charges and now recommends, based on an updated and corrected Cost of Service Study, customer charges significantly in excess of the $9-$11 range implied in its initial Cost Study. (Tr., p. 807-808)

As a final alternative, Public Counsel and Division of Energy suggest that the customer charges proposed in the Non-Unanimous Stipulation be adopted. However, those customer charges are not cost based and are simply a reflection of the existing customer charges in the St. Louis Metro district.[21] Moreover, adoption of those customer charges produces nearly $1.6 million less revenue than the Company's existing customer charges produce. (MAWC Exh. 50R1, p. 3 of 7) Given the fact that the Company's revenue requirement is being increased approximately $30.6 million, it is hardly reasonable to expect that the costs associated with providing service to the customer have actually declined, yet that is the practical result of the proposed customer charges contained in the Non-Unanimous Stipulation on Rate Design.

It is clear from the foregoing that the only appropriate customer charges to be established in this case are those resulting from the Company's updated Class Cost of Service Study, which are as follows:

5/8-Inch	$ 16.90
3/4-Inch	18.90
1-Inch	22.90
1 1/2-Inch	32.70
2-Inch	44.50
3-Inch	76.00

[21] Public Counsel attempts to justify these customers charges by referencing the customer charges of MAWC's affiliated companies in other states. (Public Counsel Brief, p. 13-14) First, these charges are not in the record of this case. Second, and more importantly, these comparisons are irrelevant and misleading, as we don't know what the cost bases are for these rates, nor do we know if these states have adopted future test years, declining use adjustments or Revenue Stabilization Mechanisms which would offset some of the risk of assigning more revenue recovery to volumetric rates.

4-Inch	111.50
6-Inch	210.10
8-Inch	328.30
10-Inch	486.00
12-Inch	676.00

(MAWC Exh. 48R1)

B. Volumetric Rates

It appears the only issue with respect to volumetric rates is whether the non-residential customers in districts other than the St. Louis Metro District should remain on a declining block rate structure as proposed by Staff (and supported by Public Water Supply Districts of Andrew County) or move to a uniform rate block structure as proposed by Company and Division of Energy. The Company currently has a single block volumetric rate for residential customers in all of its water districts and no party has proposed to change that. The Company also has a single block rate for the non-residential customers in its St. Louis Metro district (which would include commercial, industrial, Sale for Resale, Other Public Authority) and no one has proposed to change that. The Company's proposes in this case to implement a single block rate design for the volumetric rates in all districts that is similar to the existing rate structure in its St. Louis Metro district. The Staff, on the other hand, proposes to continue the declining block rate structure for all non-residential customer rate classifications in its Water Districts 2 (St. Joseph, et al.) and 3 (Joplin, et al.).

In addition to the simplicity of a single block volumetric rate, Division of Energy witness Hyman correctly notes that uniform volumetric rates can better encourage efficient consumption through a relatively simple and equitable design. (DE Exh. 4; Hyman Rate Design Direct, p. 14) Company agrees and urges the Commission to adopt a uniform or single block rate structure for the volumetric rates for all non-residential customer classifications in all districts.

3. Low-Income Tariff

MAWC's proposal for a low-income tariff was addressed in initial briefs by the Commission Staff (Staff), Office of the Public Counsel (OPC), and the Missouri Division of Energy (DE).

While none of these parties supported the state-wide low-income tariff proposed by the Company, Staff and DE both provided support for a pilot program. Staff suggested a pilot low income tariff applicable in the Company's St. Joseph service area "to further study the feasibility of such a program." (Staff Brief, p. 26) DE stated its belief "that the pilot program has the potential to help low-income customers with water affordability and is therefore worth pursuing on a pilot basis." (DE Brief, p. 15)

OPC's Initial Brief opposed the low income program in total arguing that "there are outstanding questions regarding the legality of the low-income rate and the impact this proposal, if deemed legal, would have on other ratepayers." (OPC Brief, p. 23) OPC opined that "it is likely the different rates [proposed by MAWC] would be considered unduly discriminatory." (Id. at p. 24)

OPC's argument as to legality is based on its suggestion that the difference in rates for low-income customers would not be based upon a difference of service. MAWC acknowledges that the question as to whether a low income rate (i.e. the differentiation of customers based on income level, household size, and other related factors) would establish different "circumstances or conditions" or an "undue or unreasonable preference or advantage" has not been addressed by the Courts in Missouri.

However, OPC does not address the possibility of establishing the low-income tariff as a pilot program (or experimental rate plan). *See In the Matter of a Proposed Regulatory Plan of*

Kansas City Power & Light Company, 242 P.U.R.4th 492, Case No. EO-2005-0329 (Mo.PSC 2005); *See also State ex rel. Laclede Gas Co. v. PSC*, 535 S.W.2d at 567, n.1 (noting the Missouri Supreme Court "has long held" that the Commission has the power to grant interim test or experimental rates "as a matter of necessary implication from practical necessity").

The purpose of pilot programs is to evaluate the effectiveness of different types of programs. (DE Brief, p. 15) Thus, that approach would have the advantage of providing a means to address the OPC's second concern – what the impact of such a program will be.

For example, something less than a state-wide program – a pilot program – offered in a limited geographic area, may be appropriate for the purpose of experimenting with the costs, administrative requirements, delivery systems, marketing, and participation rates. Such an experimental program might also provide a basis to assess the possible connection between a low-income tariff and a reduction in bad debt expense. (Tr., p. 849-850, 851-852)

Moreover, establishing a sunset for the program would further support the experimental nature of the program. An appropriate sunset date might be the effective date of new rates in MAWC's next general rate case. That would ensure that the program is reviewed in MAWC's next rate case and allow the Commission to adjust as necessary at that point in time.

Consequently, if the Commission seeks to implement a pilot low-income tariff program, MAWC would suggest that the Commission:

- Authorize a residential low income program providing eligible low-income customers with an 80 percent (80%) discount on the customer charge for a residential, 5/8-inch meter;
- Identify the service area or areas in which the program will be applicable;

- Direct that customers establish eligibility by contacting the local community action agency and establishing that they would qualify for the Missouri Low Income Home Energy Assistance Program (LIHEAP), whether or not they actually participate in LIHEAP;

- Require customers to reestablish eligibility on an annual basis;

- Authorize MAWC to defer costs associated with this program as follows:

> MAWC will be authorized to record on its books a regulatory asset, which represents the actual discounts provided to those customers participating in a Low Income Program along with any third party administration costs. MAWC shall maintain this regulatory asset on its books until the effective date of rates resulting from MAWC's next general rate proceeding. The amortization period for the deferred regulatory asset associated with a Low Income Program will be determined in the next MAWC rate proceeding.

- Identify a sunset date, such as the effective date of rate in MAWC's next general rate case; and,

- Direct MAWC to file a tariff consistent with the above.

4. Union Issues

The Union Issues were addressed in initial briefs of MAWC, the Commission Staff (Staff), and the Utility Workers of America, Local 335 (UWUA Local 335).

Similar to MAWC, Staff focused on the absence of any allegation that MAWC is providing unsafe or inadequate service and concluded, as to the unfilled bargaining unit positions, that "so long as the result is safe and adequate service at just and reasonable rate, the public interest is satisfied." (Staff Brief, p. 27) Further, in regard to the valve maintenance proposals, Staff stated its expectation that MAWC continue to provide safe and adequate service, and pointed out that "in the event that the Company should fail to do so, Staff would promptly initiate an action before the Company to compel MAWC to undertake any necessary improvements in its facilities and methods. (*Id*., p. 28)

UWUA Local 335's Initial Brief does not allege any current delinquency in the provision of safe and adequate service. It merely speculates as to the potential of some future inadequacy and proposes requirements based on that speculation. A Commission order under these circumstances would be an attempt by the Commission to manage the Company, something it has no authority to do.[22]

UWUA Local 335 attempts to support its proposal concerning unfilled positions by citing Commission orders in two Ameren rate cases where the Commission authorized additional money for training and workforce development.[23] However, UWUA Local 335 neglects to mention a more recent Ameren rate case, ER-2014-0258, where the Commission cited the case law indicating that it did not have the authority to manage the company and, thereafter, found as follows as to union-proposed workforce mandates:

> The evidence presented by the Union does not demonstrate that Ameren Missouri has failed to provide safe and adequate service. Therefore, the Commission will not dictate to the company how many new employees it must hire, nor will it determine whether it must use its internal workforce or outside contractors to perform the company's work.

In the Matter of Union Electric Company, Report and Order, Case No. ER-2014-0258, pp. 56-60 (April 29, 2015).

MAWC is providing safe and adequate service, meets the high standards required by the Missouri Department of Natural Resources, and the Partnership for Safe Water. (MAWC Exh.

[22] The Missouri Court of Appeals has stated:

> The powers of regulation delegated to the Commission are comprehensive and extend to every conceivable source of corporate malfeasance. Those powers do not, however, clothe the Commission with the general power of management incident to ownership. The utility retains the lawful right to manage its own affairs and conduct its business as it may choose, as long as it performs its legal duty, complies with lawful regulation, and does no harm to public welfare.

State ex rel Harline v. Public Service Commission, 343 S.W.2d 177, 182 (Mo. App. 1960).

[23] *In the Matter of Union Electric Company*, Report and Order, Case No. ER-2008-0318 (January 27, 2009); and *In the Matter of Union Electric Company*, Report and Order, ER-2011-0028 (July 13, 2011).

43, pp. 10-11) Accordingly, the Commission should decline the Union's invitation to intrude into management's clear right and authority to manage the day-to-day affairs of the Company.

5. Riverside Water Issue

The City of Riverside makes reference in its Initial Brief to the water issues that have been experienced by some customers in the Platte County district and suggests that "MAWC should take every reasonable action to investigate the cause of the quality issue, including proactively surveying their customers to determine how widespread the problem is in the water distribution system." (Riverside Brief, p. 3)

What Riverside refers to is a calcium issue that has been experienced in three subdivisions within the Platte County service area. (Tr., p. 121) In some homes, the calcium settles out in large amounts. (*Id.*) One house can have a significant issue, while the house next door has no problem. (*Id.*) This is a significant for those that experience it, but it is not a health issue. (Tr., p. 121)

MAWC has performed surveys, both by telephone and electronic mail, to determine the extent of the problem. (Tr., p. 124) Additionally, MAWC worked with elected officials to hold a town meeting in the Platte County District in early March to address these issues separate and apart from the rate case. (Tr., p. 160, 189-190) Currently, it appears that two percent (2%), or less, of the Platte County District customers are experiencing this severe problem. (Tr., p. 160)

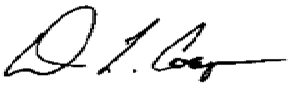
MAWC has already done a lot of things to attempt to identify the cause and to help the customers. (Tr., p. 159) However, the Company is still trying to identify the problem. It believes the recarbonation system will help solve the issue, and is also checking phosphate levels and various other parameters. (Tr., p. 125) MAWC has also put in test loops of different

plumbing materials, collected samples, done flushing, added filters, among other things. (Tr., p. 161)

Consistent with Riverside's request, MAWC has, and will continue to, provide attention to the issues discussed by Riverside, until such time as those issues have been addressed. Moreover, MAWC will keep the Staff, OPC, and City of Riverside, informed as to its progress.

WHEREFORE, MAWC respectfully requests that the Commission consider this Reply Brief and, thereafter, issue such order as it shall find to be reasonable and just.

Respectfully submitted,



William R. England, III, MBE#23975
Dean L. Cooper, MBE #36592
BRYDON, SWEARENGEN & ENGLAND P.C.
312 E. Capitol Avenue
P.O. Box 456
Jefferson City, MO 65012
(573) 635-7166 telephone
(573) 635-3847 facsimile
dcooper@brydonlaw.com

ATTORNEYS FOR MISSOURI-AMERICAN WATER COMPANY

CERTIFICATE OF SERVICE

The undersigned certifies that a true and correct copy of the foregoing document was sent by electronic mail, on April 22, 2016, to the parties.