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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, 2018

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1 **I. INTRODUCTION AND QUALIFICATIONS**

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

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

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

7 A. I am.

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

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

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

13 A. No.

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

16 A. Yes.

17 **II. PURPOSE OF REBUTTAL**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

³ Ibid., line 28.

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

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

9 A. No.

10 **Q. PLEASE EXPLAIN.**

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

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

⁴ Ibid. page 11, line 25-page 12, line 20.

⁵ 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.

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

16 Pricing of water services should accurately reflect the true costs of
17 providing high-quality water and wastewater services to consumers to
18 maintain infrastructure and plan for upcoming repairs, rehabilitation, and
19 replacement of that infrastructure.⁸

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

22 Ideally, full-cost pricing:

⁶ Staff Cost of Service Report – page 10, line 27.

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

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

⁹ EPA Publication 816-R-05-006 January 2006.

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

9
10 This same white paper does acknowledge that “single-tariff pricing can make rates
11 more stable and affordable,” but also acknowledges that STP “removes the direct
12 link between a small system’s cost structure and its rates, and it therefore may be
13 less efficient than other options.”¹⁰ The authors acknowledge that STP can make
14 rates for the small-system customers affordable and mitigate rate shock. However,
15 in my opinion, affordability is a subjective and relative issue that would need to be
16 fully evaluated when consolidating districts. In fact, for lower-income customers,
17 affordability is addressed in other ways, including life-line rates and low-income
18 discount rates. Programs such as these are targeted at ratepayers who are deservedly
19 in need.

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

¹⁰ Ibid at page 35.

1 that range from \$750,000 to \$1,000,000. Let us assume further that neighborhood
2 A was built five years ago while neighborhood B was built 25 years ago. Both
3 neighborhoods have the same number of homes. Now assume that both
4 neighborhoods are served by a major water utility like MAWC. However,
5 neighborhood B's system has to be upgraded to comply with the Clean Water Act.
6 The question that rises to the forefront is, why should neighborhood A, the
7 neighborhood of homes with lower values (and by inference, lower median incomes
8 of the households who own those homes), have to pay for the upgrades to
9 neighborhood B who can clearly afford to pay for those upgrades? Neighborhood
10 A may not like it, but affordability is subjective and relative. It has to be
11 acknowledged that the opposite is also true (i.e., if neighborhood A had to have the
12 upgrade investments, it would be reasonable to expect that neighborhood A would
13 rejoice in sharing those costs with its wealthy neighbors down the road, but the
14 subjective issue does not go away, and I'm certain that even though neighborhood
15 B could afford it, they would not like it either). Setting rates based on affordability
16 sends the wrong message and hampers efficient use of resources.

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

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

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

1 since the spread of the costs associated with any increases to a specific
2 district are limited to the customer base in that district.¹¹

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

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

¹¹ Staff Cost of Service Report at page 12, Lines 1-6

¹² Heppenstall Direct Testimony, Schedule A, Page II-2, Column 9

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

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

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

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

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

¹³ 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.

¹⁴ Staff Cost of Service Report at page 12 lines 7-13.

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

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

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

16 **Q. WHAT DO YOU CONCLUDE?**

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

20 **Q. IN YOUR DIRECT TESTIMONY, YOU INDICATED THAT A RATE OFF-**
21 **SET MIGHT BALANCE OUT TO SOME DEGREE THE**
22 **UNREASONABLENESS OF THE CONSOLIDATED TARIFF PRICING**
23 **(CTP) PROPOSAL BY MAWC. DOES THIS OFF-SET PROPOSAL STILL**

1 **APPLY IN LIGHT OF STAFF’S PROPOSAL FOR THREE-DISTRICT**
2 **RATE DESIGN?**

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

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

13 A. As stated in my direct testimony at pages MJM-14, Line 21 through MJM-15 line
14 22, the rate offset could be depreciated capital investment since 2000 for each of
15 the four cities in total and divide that amount by the estimated consumption for the
16 period of the offset. I would offer now that the period would be through the test
17 year approved by the Commission in this case. That amount would be applied as a
18 credit to the Coalition Cities on their customers’ bills. As I stated in direct, this
19 would then mean that as MAWC implements its capital plan over the credit period,
20 the Coalition Cities are only paying for capital investment for similar plant. This is
21 the basic issue for the Coalition Cities -- having to pay for significant capital
22 investments in other districts that they themselves have already paid. The Cities
23 would still be paying for the net balance of the value of the infrastructure that was

1 made in their respective systems. The off-set is simply netting against the new
2 investment in other systems. Again, the total of this credit would have to be added
3 to the other systems' rates to make it revenue neutral to match the Company's
4 approved revenue requirement.

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

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

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

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

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

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

25 **Q. WHAT KINDS OF ANALYSIS WOULD YOU EXPECT TO FIND THAT**
26 **WOULD COMPLY WITH THE COMMISSION'S DIRECTIVE?**
27

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

16 **VI. MAYOR ROSE'S POSITION**

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

20 A. Mayor Rose's position of supporting the Company's proposed consolidated tariff
21 is not based on any specific analysis and does not reflect widely adopted
22 methodology for rate design. Her position is that water is water and should be the

1 same price regardless of where it is served. Respectfully, if the Commission adopts
2 that logic, why would it not apply to electric, gas, and any other utilities. Consider
3 electricity, if Mayor Rose’s logic were to prevail, every utility should charge the
4 same rates per kilowatt since a kilowatt is a kilowatt no matter where it is sold.
5 Unfortunately, costs do vary by locale, region, and across different companies.
6 Simply to say, “It is unjust and unreasonable in this day and age for a resident to
7 pay a different amount for her water just because she lives in a particular area,”¹⁵
8 ignores the reality of the economy. Respectfully, the Commission should not give
9 Mayor Rose’s position any weight in its determination in this case.

10 **VII. SUMMARY AND RECOMMENDATION**

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

12 A. Staff’s conclusion and recommendation that the Commission maintain the status
13 quo with respect to having the Commission adopt three districts for Cost of Service
14 rate design purposes is inconsistent, unsubstantiated, and ignores widely accepted
15 cost-causation rate-design principles. Further, the Commission directive that the
16 issue of single-tariff pricing be fully analyzed by the parties has not occurred, and
17 therefore, the Commission does not have sufficient information to base its decision
18 whether to accept Staff’s or the Company’s proposals. Therefore, I recommend that
19 the Commission reject Staff and the Company’s proposals and adopt the eight-
20 district proposal I submitted in my direct testimony. If the Commission nonetheless
21 adopts either Company’s statewide rate tariff or Staff’s three-district rate design, it

¹⁵ Direct testimony of Mayor Kathleen Rose, Page 3, lines 1-2.

1 should also adopt a rate-offset for the Coalition Cities as discussed above and in
2 my direct testimony.

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

4 **A. Yes.**