

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of the Application of Ozark Meadows,)
Aqua Development Company, d/b/a Aqua Missouri,)
Inc. Request for Increase in Annual Sewer System) **Case No. SR-2010-0023**
Operating Revenues MPSC Sewer Utility Small)
Company Rate Increase Procedures.)

**BRIEF AND SCENARIOS OF THE STAFF OF THE
MISSOURI PUBLIC SERVICE COMMISSION**

PURSUANT TO COMMISSION ORDER

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INTRODUCTION: SCOPE OF ANALYSIS AND SUMMARY

On July 15, 2009, the Missouri Public Service Commission (“the Commission”) received rate increase request letters from Aqua Development Company d/b/a Aqua Missouri, Inc., Aqua RU, Inc. d/b/a Aqua Missouri, Inc., and Aqua Missouri, Inc. (collectively referred to hereinafter as “Aqua” or “the Company”). These requests were designated by the Commission as Case Nos. SR-2010-0023, WR-2010-0025, SR-2010-0026 and WR-2010-0027, respectively, and shall be referred to hereinafter as “the Rate Cases.” On December 16, 2009, the Staff of the Commission (“Staff”) filed notices informing the Commission that Staff and the Company had reached an agreement regarding disposition of the Rate Cases. On March 24, 2010, following a series of local public hearings and an on-the-record presentation, the Commission issued an *Order Approving the Non-unanimous Agreements and Approving Tariffs*.

On March 15, 2010, the Commission issued an order directing the parties to the Rate Cases to file briefs addressing certain legal and social policy issues that the Commission may wish to consider in future Aqua proceedings. In specific, the parties were ordered (1) to “file briefs delineating the legal arguments and the social policy implications associated with the issue of whether the Commission should grant [the Company]...the authority to, or require it to, consolidate all of its rate districts for the purpose of setting rates,” and (2) to “file a scenario for the Commission, using [only] the auditing and accounting from the [Rate Case] files, to demonstrate how the total revenue requirement recommended in the Staff/Company Disposition Agreements would have been implemented if all of [Aqua’s] water and sewer districts were consolidated into a single district.”

The purpose of this brief is to respond to the directives contained in the Commission’s March 15, 2010 order. In doing so, Staff will address the legal and social policy implications

associated with the application of single-tariff pricing versus district-specific pricing and will present for the Commission's review a scenario illustrating the effects of single-tariff pricing under the financial conditions present at the time of the Rate Cases. In addition, Staff will provide for the Commission's information a second, alternative scenario, illustrating the effects of the consolidation of *select* rate districts.

In summary, Staff's position is that the need for a single-tariff pricing structure should be evaluated on a case-by-case basis. Staff believes it would be inappropriate to make an overarching policy declaration indicating that rates should be set on a district-specific basis or, in the alternative, that single-tariff rates are appropriate in all situations. The conditions affecting individual systems should remain open for debate on a case-by-case basis.

As a disclaimer, while there are many variations of district-specific pricing and single-tariff pricing within the various industries regulated by the Commission, the comments contained in this brief are only meant to address pricing structures and strategies in the water and sewer industries. The electric and natural gas industries are unique and have developed pricing structures that correspond to the needs of those industries. Any comments in this brief made regarding the appropriateness of any pricing structure should not be applied to any industry outside of the water and sewer industries without additional independent analysis.

DEFINITIONS AND BACKGROUND

A. WHAT IS DISTRICT-SPECIFIC PRICING?

District-specific pricing ("DSP"), alternatively referred to as spatial or geospatial pricing, is commonly defined as a pricing structure that considers only the cost of providing utility service to a specific geographic region or service territory in establishing rates. Under DSP, each specific area has its own unique rate and such rates are generally derived according to each

area's unique cost of service. This type of structure is generally used in situations where a utility provides service to multiple service territories that are not physically interconnected.

B. WHAT IS SINGLE-TARIFF PRICING?

Single-tariff pricing ("STP") is commonly defined as a pricing structure that combines the costs to serve all the systems in a multi-system utility and charges a uniform rate to all customers in the same rate classification (i.e. the residential class) regardless of the district in which they are located. Thus, all residential customers under the STP structure will pay the same rate. One of the best non-utility examples of a single-tariff pricing rate is that used for first-class postage.

C. THE AQUA ENTITIES: COMPANY LOGISTICS

Aqua America is a large, national corporation that provides water and wastewater service to customers in thirteen (13) states, stretching from Maine to Missouri. Aqua Missouri is a regional subsidiary of Aqua America and has approximately three-thousand (3,000) water and sewer customers spread throughout the State of Missouri.

Aqua Missouri's water customers are located in nine (9) water rate districts. These districts include the "Lake Carmel" district, near Eugene, the "Maplewood" district, near Sedalia, the "White Branch" district, near Warsaw, and six (6) additional separate systems/districts in Taney and Christian counties in southwest Missouri. Each system has its own rate structure and all are geographically separate, meaning that there are no physical interconnections. Currently, certain districts pay a single rate for service provided to multiple systems located within that district. Other districts (those located in Taney and Christian counties) pay a single rate that directly corresponds to the one system located within each of those respective districts.

Most of the Company's sewer customers are located in one district encompassing large portions of unincorporated Cole and Calloway counties, in and around the Jefferson City area. This district is comprised of more than sixty (60) separate sewer systems and all of those systems are combined to determine this district's rate. Prior to purchase by Aqua, many of these systems were operated by a non-regulated entity (a county-wide sewer district) that charged a uniform flat rate to all customers located within its service territory. This approach was not changed once this service territory fell under Commission jurisdiction. Reasons for consolidation in this manner include the facts that all of these systems are within the boundary of one contiguous service area, are maintained by the same operators, and serve relatively few customers (4-100 per system). If these systems were parceled out in an attempt to engage in "true" district-specific pricing (or in this case, system-specific pricing), it would be difficult to properly allocate operating costs to individual systems. Procedurally, a rate case (or cases as the result would be) would be nearly impossible. In effect, sixty (60) separate rate cases would have to be processed and the resulting time and effort would be unmanageable. Additionally, rates for the various customers in this service area would vary wildly, ranging from extremely low rates for customers connected to those facilities with relatively low operating cost to very high rates associated with systems that serve only a few customers and/or present higher system costs.

Other sewer service areas include "Maplewood," near Sedalia, and "Ozark Meadows," near Laurie; these districts operate under purely district-specific rates.

DISCUSSION OF LEGAL IMPLICATIONS

A. GENERAL LEGAL FRAMEWORK

In September 1999, the United States Environmental Protection Agency ("EPA") in collaboration with the National Association of Regulatory Utility Commissioners ("NARUC")

issued a report entitled *Consolidated Water Rates: Issues and Practices in Single Tariff Pricing* (“*the EPA Report*”). Although this report focuses largely upon the regulatory and social policy implications of DSP versus STP rates, *the EPA-Report* also comments, to a limited extent, on the legal implications associated with these regulatory decisions.

It appears that the vast majority of legal challenges to rate design decisions involving the application of DSP versus STP rates are based upon state statutes prohibiting, to differing degrees, discriminatory pricing in utility ratemaking. Charles Phillips describes price discrimination as “...occur[ing] when a seller establishes for the same product or service different rates that are not justified entirely by differences in cost, or the same rate where differences in cost would justify differences in price. . .” *The EPA-Report*, p. 23. Under this definition, because the cost to serve any one consumer varies from the cost to serve any other consumer it is clear that *both* district specific and single-tariff pricing are discriminatory to the extent that an average rate (either district-specific or system-specific) is applied to regionalized group of ratepayers. As recognized by the Commission in the 2000 rate increase request of the Missouri-American Water Company¹ (“MAWC”), “[i]n moving to a pricing system in which cost causers are cost payers, a perfect correlation will never be achieved. Any time a ratepayer pays an average rate, the correlation between cost and rates will be imperfect, because no two ratepayers are exactly similarly situated.” *Report and Order on Second Remand*, p. 12.

It is for this reason that regulators must focus not on *whether* rate design principles are discriminatory, but rather on the *extent* to which they are discriminatory. This very concept is

¹ Case No. WR-2000-281. Referred to hereinafter as “the 2000 MAWC rate case”.

codified in the State of Missouri in Section 393.130.3, RSMo (2000)², which provides the applicable legal standard in prohibiting undue or unreasonable discrimination:

No gas corporation, electrical corporation, water corporation or sewer 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.

Unfortunately, “undue discrimination”³ is not well defined and does not point regulators or the courts to particular solutions. For this reason, courts in this jurisdiction had a difficult time determining what constitutes “undue” or “unreasonable” discrimination or disadvantage, although they have provided the Commission with limited guidance on several occasions.

B. THE 2000 MISSOURI-AMERICAN RATE CASE

1. INTRODUCTION

The decision reached by the Commission in the 2000 MAWC rate case represented a divergence in the Commission’s previous trend towards the implementation of single-tariff pricing in this jurisdiction. The 2000 case was filed by MAWC primarily in order to recover the expense of a new water treatment facility in the company’s St. Joseph service territory. Many intervenors, especially those located in other districts, opposed the concept of having to pay higher rates to subsidize the installation of a facility that would exclusively benefit the St. Joseph area. The evidence presented in the case indicated that while a rate increase was warranted for most districts in MAWC’s service territory that the rates in the Joplin district had been

² Unless otherwise noted, all references contained herein refer to the Missouri Revised Statutes (2000), as currently supplemented.

³ For the purposes of this brief and the legal analysis contained herein, the term “undue discrimination” is used interchangeably with the phrase “undue or unreasonable prejudice or disadvantage” contained in Section 393.130.

generating revenues in excess of that district's cost of service (i.e. a rate reduction may have been warranted). Ultimately, the Commission permitted the rates paid by consumers in the Joplin area to remain unchanged, while it increased those paid by consumers in other districts. In approving what would technically be classified as either a "hybrid" or "modified DSP" rate design⁴, the Commission stated as follows:

...In this matter, the evidence showed that moving to unmitigated district-specific pricing would result in unreasonable rates in some districts. The evidence showed that the ratepayers in Joplin were paying rates higher than the cost of supplying service to them. They asserted that their rates should be reduced. The evidence showed that a rate reduction would result in unreasonable rates in other districts and the evidence did not show that the rates in Joplin prior to the case (and continued unchanged) were unreasonable. For that reason, the Commission did not reduce the rate for Joplin, but did not apportion to Joplin any of the overall rate increase granted to Missouri-American.

The Commission acted lawfully in determining that district-specific pricing was appropriate, and acted lawfully in apportioning the rate increase as it did. The Commission did not unlawfully discriminate against Joplin or the other "over earning" districts [by] not granting them a rate decrease.

Report and Order on Second Remand, pp. 15-16.

2. HISTORY OF RESULTING LITIGATION

The Commission's decision in the 2000 MAWC rate case initiated what would result in approximately eight (8) years of subsequent litigation. After the issuance of the Commission's initial *Report and Order* on August 31, 2000, multiple parties, including the City of Joplin, filed writs of review in Cole County Circuit Court, seeking review of the Commission's decision⁵. On

⁴ These terms are meant to signify a pricing structure that is neither a "pure" single-tariff rate, nor a "pure" district-specific rate, but rather a rate design in which ratepayers in the Joplin district were admittedly subsidizing those in other areas.

⁵ Multiple writs were filed in several counties. The Missouri Supreme Court ultimately determined proper venue to be in Cole County. The Cole County cases were heard in two groups, with the decision in the following group being relevant to the present discussion: Case Nos. 00CV325217 (Joplin), 00CV325222 (Ag Processing), and 00CV325220 (Gilster Mary-Lee Corporation).

October 3, 2002, Judge Thomas Brown remanded the *Report and Order* to the Commission for more detailed findings of fact (discussed in further detail below).

Shortly thereafter, MAWC filed with the Commission a subsequent general rate increase request⁶ and the parties to that action entered into a stipulation resolving, among other items, the issues regarding Joplin's rate impact on a going-forward basis. On May 27, 2004, the Commission issued its *Second Report and Order*, finding moot the issues remanded by the Cole County Circuit Court in light of the stipulation filed and approved in the subsequent rate case. Joplin then sought a second writ of review, in which Judge Brown issued a decision in concurrence with the Commission's conclusions that Joplin's contentions were moot. Joplin appealed. On December 6, 2005, the Court of Appeals for the Western District of Missouri entered its opinion, finding standing under an exception to the mootness doctrine and remanding the case to the Commission with orders to comply with the Cole County Circuit Court's previous order (in the first writ) mandating additional findings of fact to support the Commission's original rate design decision⁷.

On December 5, 2007, the Commission issued its *Report and Order on Second Remand*. Shortly thereafter, Joplin filed another writ of review in Cole County⁸, which ultimately entered an order finding the *Report and Order on Second Remand* to be both lawful and reasonable. Joplin appealed⁹, but voluntarily dismissed the appellate action prior to briefing.

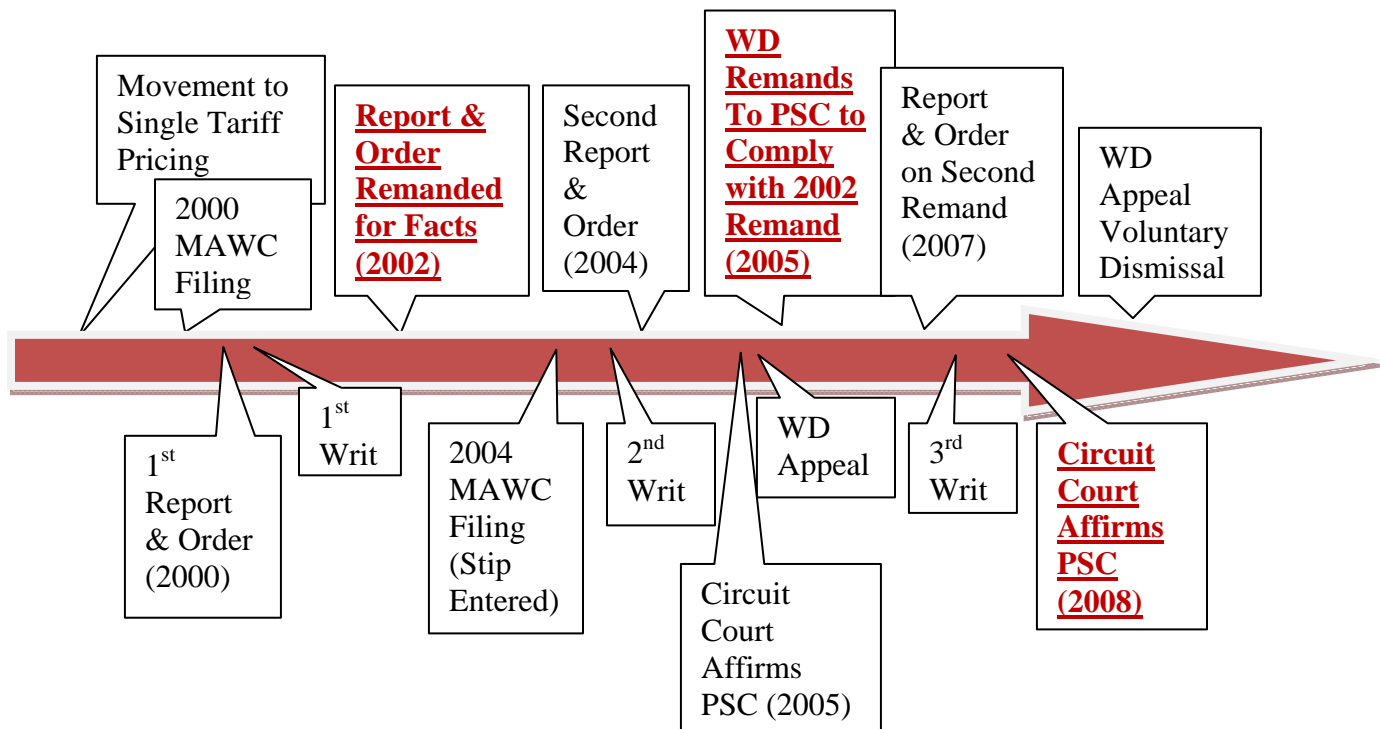
For the Commission's reference, the relevant MAWC litigation events are depicted in the following timeline. The decisions that are in bold and underlined represent the opinions "left standing" after the termination of the litigation.

⁶ Case No. WR-2003-0500.

⁷ Case No. APWD64944. Reported at 186 S.W.3d 290 (Mo. App. W.D. 2005).

⁸ Case. No. 08ACCC00082.

⁹ Case No. APWD70218.



3. POST-LITIGATION STATUS OF LAW

For as much notoriety as was, and is, garnered by the 2000 MAWC rate case, the Commission has been left with little to no resulting law resolving the issues related to any discriminatory effect of district-specific versus single-tariff pricing.

As indicated above, in his decision remanding the Commission's *Report and Order*, Judge Brown did not find the Commission's rate design decision to violate any statutory prohibition *per se*, but rather stated as follows:

[t]he Commission's refusal to permit the use of the same system-wide DSP cost allocation method granted to all other district in the MAWC system, **in the absence of justification**, violates Section 393.130.3, RSMo, because the Joplin District locale pays in excess of its district specific cost of service, subsidizes the other water districts which pay less than cost of service, and, therefore, suffers undue and unreasonable prejudice and disadvantage.

State of Missouri ex rel. City of Joplin v. Missouri Pub. Serv. Comm'n, Amended Findings of Fact, Conclusions of Law and Judgment, p. 16 (Sept. 19, 2001) (emphasis added). In this respect, the Court's decision was based upon the Commission's failure to justify its rate design decision, as opposed to any explicit statutory violation.

An analysis of the 2005 Court of Appeals decision shows that the majority of the opinion addressed the issue of standing, and not the merits of the Commission's decision regarding MAWC's rate design. As argued by the Commission during the 2005 review of the Commission's *Report and Order on Second Remand*, the Court of Appeals took three actions in its previous decision: (1) It reversed the Commission's order finding the Joplin's argument regarding rates to be moot; (2) It remanded the case to the Commission for new findings of fact and conclusion of law; and (3) It stated that **if** the Commission could not justify the rate design for Joplin, it **could** declare the rates unlawful.

Because the 2008 appeal was voluntarily dismissed by Joplin, the decision of the Cole County Circuit Court is final, and stands to date. This decision declared the Commission's *Report and Order on Second Remand* to be lawful, reasonable, and supported by substantial and competent evidence.

C. OTHER CASES OF INTEREST REGARDING UNJUST DISCRIMINATION

Although the litigation resulting from the 2000 MAWC rate case produced little tangible guidance for use by the Commission in future rate design decisions, the discriminatory effect of previous regulatory decisions (on both state and federal levels) have been explored previously by several courts on a limited number of occasions.

1. STATE HOLDINGS

In *State ex rel. Laundry, Inc., et al. v. Public Service Commission et al.*, 34 S.W.2d (Mo. 1931) the Court examined the permissibility of treating one group of customers differently than another. In *Laundry*, the plaintiffs were two laundry companies that used large quantities of water for industrial purposes but that were billed at the rate of a residential consumer, as opposed to that of a “manufacturer”. *Id.* at 40. The plaintiffs claimed that by giving a discounted “manufacturers rate” to others, but not to them, the defendants unjustly discriminated against the plaintiff corporations. *Id.* at 38.

More specifically, the Court stated as follows:

The gist and gravamen of the complaint filed herein is that the St. Louis County Water Company, by its failure and refusal to classify the complainants as manufacturers, or rather to extend to complainants the scheduled ‘manufacturers’ rate,’ has thereby wrongfully, unlawfully, unjustly, and unreasonably discriminated against complainants, in favor of other consumers and users of water who are similarly situated, under a regulation or charge theretofore established or fixed by the St. Louis County Water Company, in violation of a rule of the common law, and of the statutory law of this state.

Id. at 41. Although the decision was based upon a challenge regarding rate *class* discrimination as opposed to rate *district* discrimination the Court did examine the permissibility of treating one group of customers differently than another.

In reaching its decision in *Laundry* the Court reaffirmed the principle that “[t]he public duty must be discharged for the equal benefit of all, and obviously to permit discrimination or inequality in the service or charges is to ignore the public obligation.” *Id.* at 44. In applying this standard, the Court found that while it is perfectly acceptable to charge a group or area more for a similar service if it costs more to provide that service, that to lower the rates of one group or area by artificially inflating the rates of other groups or areas creates unduly preferential

treatment, and is discriminatory towards the group with increased or inflated rates. Although the analysis provided in *Laundry* deals with customer class designation and is not placed in the context of Section 393.130.3, such analysis may be analogous to the issue raised in geographic grouping in that by implementing single-tariff pricing, and thus equalizing rates across multiple districts (through subsidies), a utility raises the rates of some, while in effect lowering the rates of others. The court in *Laundry* recognized that this equalization could go too far, thus constituting an abrogation of a utility's public obligation and discriminating against some, while giving undue preference to others.

In *State of Missouri ex rel. City of West Plains, et al. v. Public Service Commission, et al.*, 310 S.W.2d 925 (Mo. Banc 1958) Western Light & Telephone Company, Inc. ("Western") filed with the Commission a rate increase request, in which it included in its tariffs a rate schedule authorizing it to "add to its basic rates in each community the pro rata amount of the occupational tax levied on the community." *Id.* at 927. The Commission issued an order approving the request and allowing Western to recover the applicable taxes through a surcharge on customer's bills. *Id.* Prior to the submission of these tariffs the Company was collecting certain tax revenues on a systemwide basis, although many municipalities located within that system levied different levels of taxes (some in fact levied none). *Id.* at 929. Under this approach, some consumers, based upon the area in which they lived, were beneficiaries of improvements derived from a municipality's use of the tax revenue and some were not. *Id.* In approving the tariffs in the case then under review the Commission found that the prior practice had been unjustly discriminatory as to those consumers who, based on the area in which they lived, received little or no benefit from the submission of the taxes. *Id.* at 930.

Upon review, the Missouri Supreme Court recognized that “...the theory of ratemaking on a system wide basis assumes that inequities of a sort will exist within the system and that a rough balance of such inequities will usually result, so that the discrimination remaining is not unjust discrimination.” *Id.* Despite such recognition the Court upheld the Commission’s attempt to remedy any prior discrimination stating, that “[i]t would seem to follow that the commission’s order permitting and directing Western to treat license and occupation taxes henceforth so as to place the burden of those taxes on the respective subscribers who received the benefits therefrom, on its face, eliminated the unjust discrimination which thereforeto existed as to the nonbeneficiary consumers.” *Id.* In this respect, the Court concurred with the Commission’s assessment that unjust discrimination can exist when consumers are forced to pay for a service from which they receive no benefit.

2. A FEDERAL PERSPECTIVE

Perhaps the most tangible “test” for undue rate design discrimination was affirmed by the Supreme Court of the United States in a case in which it reviewed the jury instructions presented in a civil matter appealed from the Supreme Court of Nebraska. In *Western Union Telegraph Company v. Call Publishing Company*, 181 U.S. 92 (1901) the Court examined a case in which the plaintiff, a company that published a daily newspaper in Lincoln, Nebraska, alleged that its telegraph service provider, Western Union, charged a competing newspaper a lesser rate for the same telegraph services, a practice allegedly constituting undue price discrimination. The plaintiff brought suit in state court, based not upon a statutory prohibition of unjust discrimination, but rather on state common law allegedly predicated upon such principles. After the close of evidence, the instructions presented to the jury included the following:

You are instructed that not every discrimination in rates charged by a telegraph company is unjust. In order to constitute an

unjust discrimination, there must be a difference in rates under substantially similar conditions as to service; the rate charged must be a reasonable rate; under like conditions it must render its services to all patrons on equal terms; it must not so discriminate in its rates to different patrons as to give one an undue preference over another.

It is not an undue preference to make one patron a less rate than another where exist differences in conditions affecting the expense or difficulty in performing the services which fairly justify the difference in rates; and where it is shown that a difference in rate exists, but there is also a substantial difference in conditions affecting the difficulty or expense of performing the service, no cause of action arises without evidence to show that the difference in rates is disproportionate to the difference in conditions.

...the question that you have particularly to direct your attention to is how far [a] difference in condition justified the difference in rates charged; to what extent, if any, the difference in rates charged the rival companies was disproportioned to the difference in conditions under which the services were rendered...

Western Union, 181 U.S. at 97.

The Court also provided guidance as to certain cost causation factors that must be examined by the jury. Those factors included the increased cost of operating plant associated with any increased work, the difference in the time required to perform the work, “the charges made by the company for other services unless made under circumstances,” and “the general operating expenses of the company as affected by rates charged.” *Id.* at 98.

Based upon these instructions and the evidence presented at hearing the Nebraska jury returned a verdict for the plaintiff. Defendants appealed, arguing that an interstate carrier cannot be subject to state common law distinctions. The Supreme Court disagreed. In affirming the state court decision the Supreme Court of the United States stated as follows:

No one can doubt the inherent justice of the rules thus laid down. Common carriers, whether engaged in interstate commerce or in that wholly within the state, are performing a public service. They are endowed by the state with some of its sovereign powers, such

as the right of eminent domain, and so endowed by reason of the public service they render. As a consequence of this, all individuals have equal rights both in respect to service and charges. Of course, such equality of right does not prevent differences in the modes and kinds of service and different charges based thereon. **There is no cast iron line of uniformity which prevents a charge from being above or below a particular sum, or requires that the service shall be exactly along the same lines. But that principle of equality does forbid any difference in charge which is not based upon difference in service, and, even when based upon difference of service, must have some reasonable relation to the amount of difference, and cannot be so great as to produce an unjust discrimination.**

Id. at 99-100 (emphasis added).

D. LEGAL CONCLUSION

In conclusion, it unfortunately appears that there exists no one controlling legal standard that can be used to evaluate what constitutes “undue or unreasonable prejudice or disadvantage” within the confines of Section 393.130.3. Based upon certain guiding cases the Commission can however discern a number of helpful principles to apply in the exercise of its discretion:

1. The Commission has a duty, first and foremost, to set just and reasonable rates;
2. Any Commission decision, including those involving single-tariff versus district-specific pricing, must be supported by competent and substantial evidence adduced in the case in which the decision is rendered;
3. Some amount of rate discrimination will always exist. This discrimination can however be deemed to become overly burdensome in cases in which differences in pricing are not based upon factors affecting service and/or rational distinctions in costs incurred in providing those services to consumers; and
4. Due to system-specific cost causation factors there is likely no one rate design philosophy that can be appropriately applied to all companies and/or all consumers at all times.

With these factors in mind, perhaps the Missouri State Court of Appeals in *West Plains* stated it best:

We are able to discern no legitimate reason or basis for the view that a utility must operate exclusively either under a systemwide rate structure or a local unit rate structure, or the view that an expense item under a systemwide rate structure must of necessity be spread over the entire system regardless of the nature of the item involved. Experts in utility rates may well conclude that a ‘hybrid system’ or a ‘modified system’ of rate making, wherein certain expense items are passed on to certain consumers and certain items are thereby treated on a local unit basis and others on a systemwide basis, is the system which will produce the most equitable rates. And it would appear to be the province and duty of the commission, in determining the questions of reasonable rates, to allocate and treat costs (including taxes) in the way in which, in the commission's judgment, the most just and sound result is reached.

West Plains, 310 S.W.2d at 933.

DISCUSSION OF SOCIAL POLICY IMPLICATIONS

As stated above, subject to certain legal thresholds and evidentiary limitations, the authority to approve a rate structure that reflects district-specific rates, single-tariff rates, or some combination thereof, falls largely within the discretion of regulators. For this reason, it is imperative that regulators understand the social policy issues and implications associated these decisions.

A. ARGUMENTS FOR SINGLE-TARIFF PRICING

Many arguments exist both for and against either district-specific or single-tariff pricing. *The EPA Report*¹⁰ provides a helpful summary of the arguments in favor of single-tariff pricing, in stating that such strategy:

- Mitigates rate shock to utility customers
- Lowers administrative costs to the utilities
- Provides incentives for utility regionalization and consolidation
- Physical interconnection is not considered a prerequisite
- Addresses small-system viability issues
- Improves service affordability for customers
- Provides ratemaking treatment similar to that for other utilities
- Facilitates compliance with drinking water standards
- Overall benefits outweigh overall costs

¹⁰ *The EPA Report*, p. vii.

- Promotes universal service for utility customers
- Lowers administrative cost to the commission
- Promotes ratepayer equity on a regional basis
- Encourages investment in the water supply infrastructure
- Promotes regional economic development
- Encourages further private involvement in the water sector

Despite these advantages, it is important to note that “single-tariff pricing is a *pricing* strategy, not a *costing* strategy. Single-tariff pricing can appear to *lower* costs when in reality it simply *allocates* costs differently.” *The EPA Report*, pp. 4-5 (emphasis in original). In Staff’s observation, many of the larger water companies in Missouri that operate multiple systems have expressed an interest in a single-tariff pricing approach in the past.

B. ARGUMENTS THAT SUPPORT DISTRICT-SPECIFIC PRICING

In the alternative, there are also many arguments against single-tariff pricing (and by default, in support of a district-specific or hybrid pricing strategy). As contained in *the EPA Report*,¹¹ opponents to the STP pricing strategy argue that such structure:

- Conflicts with cost-of-service principles
- Provides subsidies to high-cost customers
- [Is] not acceptable to all affected customers
- [Is] considered inappropriate without physical interconnection
- Distorts price signals to customers
- Fails to account for variations in customer contributions
- Justification has not been adequate in a specific case (or cases)
- Discourages efficient water use and conservation
- Encourages growth and development in high-cost areas
- Undermines economic efficiency
- Provides unnecessary incentives to utilities
- [Is] not acceptable to other agencies or governments
- [Is] insufficient statutory or regulatory basis or precedents
- Overall costs outweigh overall benefits
- Encourages overinvestment in infrastructure

¹¹ *The EPA Report*, p. vii.

Of the factors listed above, “[t]he primary disadvantages of single-tariff pricing are that it appears to undermine economic efficiency, distort price signals to customers, and *manifest an inconsistency with traditional cost-of-service principles.*” *The EPA Report*, pp. 5-6 (emphasis added) (internal citations omitted). In addition, some view STP as a means of subsidizing high-cost users at the expense of low-cost users. *Id.* Analysts have also identified “secondary disadvantages” of STP that “*absent other incentives or safeguard [...] can provide some water utilities with incentives to overinvest in individual systems, disincentives for cost control, and a competitive advantage in the course of acquisitions.*” *Id.* (emphasis in original). In Staff’s opinion, much of the contact that Staff has traditionally had with the residential public tends to suggest a general public preference for district-specific pricing.

C. STAFF’S POLICY POSITION

In this case Staff has been asked to look into the concept of expanding Aqua’s use of single-tariff rates. Staff does not believe that further expansion of the Company’s single-tariff rates is necessary at this time.

There exists one key disadvantage of STP that trumps all arguments to the contrary: the notion that the STP strategy offends the traditional notions of cost of service ratemaking. Explained further, a basic economic premise embodied in traditional cost of service ratemaking is that of cost causation. Fundamentally, this means that the payer of a regulated service should be the entity that “causes” the cost. In Staff’s opinion, the recovery of costs in correlation with their cause is the most equitable manner to determine the appropriate rates for any regulated service. Staff would concede that economic principles do not always prove to be realistic in practice, and for reasons including rate stability, rate shock, and need for investments other pricing structures may need to be considered in certain system-specific circumstances.

One advantage of STP is that the pricing strategy generally helps to spread costs to a larger customer base. While this may be important in situations where the Missouri Department of Natural Resources is requiring systems to upgrade their facilities, this allocation may also be used as a tool to camouflage the actual overall impact of capital expenditures, as in general it is easier from a public perception standpoint to pass along higher costs when the actual customer impact is minimal. This could mean that a company, similar to Aqua America, that has easier access to capital and has proven willing and able to expand its operations would benefit from spreading costs through a smaller overall rate increase to a large customer base as opposed to a substantial rate increase to a smaller (more upset) subset of consumers.

In conclusion, if rates are to increase because of district-specific spending by the Company, then customers located within that system should shoulder the burden of those costs. As stated in the 2000 MAWC rate case “[t]he main benefit of district specific pricing is that the consumers in a given district pay simply for the costs to serve that district. Generally, consumers are willing to pay for the services that they receive. Also, DSP should theoretically help to keep the Company from building extravagant, unnecessary facilities. It is this accountability that drives a Company towards efficient investment.” MAWC rate case, OPC Witness Busch Direct, p 5. Having the cost causer pay for its service is the most appropriate way to develop rates for water and sewer companies. However, as indicated above Staff is cognizant that there are specific situations in which this basic economic principle may need to be applied with flexibility. Thus, it is Staff’s position that the need for a single-tariff pricing structure should be evaluated on a case-by-case basis. Staff believes that it would be inappropriate to make an over-arching policy declaration indicating that rates shall be set on a district-specific basis or, in the alternative, that single-tariff rates are appropriate in all situations. There will be situations where

an STP rate is appropriate and should be considered by the Commission. The conditions affecting individual systems should remain open for debate on a case-by-case basis.

In addition, in situations where district-specific pricing exists, should the Commission elect to switch to a single-tariff rate, customer education should be a key part of the ratemaking and rate implementation process. Whereas an advantage of STP is that it helps mitigate rate shock, a disadvantage of moving from DSP to STP is that certain customers in low-cost service territories may experience severe price increases as an effect of the equalization of the company's rates. Though customers generally accept the idea of paying higher rates to pay for an improved system, the implementation of single-tariff pricing may mean that rates will increase despite a particular system not receiving any improvements and/or increases in operating expenses. Customers generally do not understand that reasoning. For this reason, if approved, it will be imperative for the Commission to explain to effected customers why the STP pricing structure is in the best interest of all customers.

APPLICATION: CASE SCENARIOS

SCENARIO 1: CONSOLIDATION OF CURRENT RATE DISTRICTS

As ordered by the Commission, Staff has prepared in conjunction with this brief a series of exhibits demonstrating the effects of single-tariff pricing on the rates charged to Aqua's customers. These exhibits were prepared by Staff using only the information that formed the basis of the disposition agreements approved by the Commission in the Rate Cases.

By way of background, Aqua currently bills some customers, based on district, a "metered" water rate. The metered rates are comprised of both a customer charge and a commodity charge. Aqua also bills some customers, based on district, a "flat," non-metered rate, incorporating in some districts a "full-time" rate and a "part-time" rate.

As indicated in Appendix A, application of an STP rate in Aqua's metered water districts would result in a residential customer charge of \$23.89 and a residential commodity charge of \$5.17 per 1,000 gallons of usage. *See* Appendix A-1. For those metered customers, this STP rate would result in an average residential bill (based on a 6,000 gallon average usage with 2,000 gallons included in the monthly minimum) of \$44.58 per month. *See* Appendix A-2. Compared to rates currently charged to these metered customers, the average STP bill would range anywhere from \$28.83 (39.27%) less expensive per month per residential customer (Lakewood Manor) to \$21.69 (**94.76%**) more expensive per month per residential customer (Maplewood and Lake Carmel). *Id.* Broken down further, application of an STP rate would result in a monthly customer charge of \$23.89, which ranges from \$13.00 (35.23%) less expensive per month per residential consumer (Lakewood Manor) to \$18.10 (**312.67%**) more expensive per month per residential customer (Maplewood and Lake Carmel). *See* Appendix A-3. Application of an STP rate (based on a 6,000 gallon average usage with 2,000 gallons included in the monthly minimum) would result in a monthly commodity charge (for those residential metered customers) of \$5.17 per 1,000 gallons, which ranges from \$16.67 (44.63%) less expensive per month per residential metered customer (Spring Valley) to \$4.57 (28.33%) more expensive per month per residential customer (Riverside Estates). *See* Appendix A-4.

As far as non-metered, flat rate customers are concerned, application of an STP flat rate would result in a monthly water bill of \$51.86 for full-time residents and \$41.49 for part-time residents. *See* Appendix A-5. Compared to current non-metered water rates, the STP rates would range from \$1.78 (3.55%) more expensive per month per residential consumer (Rankin Acres) to \$1.14 (2.15%) less expensive (White Branch). *Id.*

Aqua's residential sewer customers, dependent upon service location, currently pay either a metered rate or a monthly flat rate. As stated above, most of the Company's sewer customers are located in one district encompassing large portions of unincorporated Cole and Calloway counties, in and around the Jefferson City area. Though the Company's Lake Carmel system is combined with the Maplewood system for the purpose of setting *water* rates, for purpose of establishing *sewer* rates Lake Carmel is combined with those sewer customers located in and around Jefferson City. As a result, Aqua residential customers located in the Jefferson City and Lake Carmel areas currently pay a flat monthly sewer rate of \$53.22. Staff does not propose to alter this rate under Staff's Scenario 1.

Staff's Scenario 1, if implemented, would affect the rates paid for sewer service in Aqua's *metered* sewer districts. These districts, which currently operate under purely district-specific pricing, include "Maplewood," near Sedalia, and "Ozark Meadows," near Laurie. For these metered sewer customers, application of an STP rate would result in a residential customer charge of \$6.39 and a residential commodity charge of \$3.732 per 1,000 gallons of usage. *See* Appendix A-7 and A-8. This STP rate would result in an average residential sewer bill of \$28.78 per month. *See* Appendix A-6. Compared to rates currently charged to these customers, the average STP bill would range anywhere from \$24.53 (46.02%) less expensive per month per residential customer (Ozark Meadows) to \$5.56 (23.95%) more expensive per month per residential customer (Maplewood). *Id.* Application of an STP rate would result in a monthly customer charge of \$6.39, which ranges from \$29.67 (82.29%) less expensive per month per residential consumer (Ozark Meadows) to \$2.84 (78.89%) more expensive per month per residential customer (Maplewood). *See* Appendix A-7. Finally, use of single-tariff pricing would result in a monthly commodity charge of \$3.732 per 1,000 gallons, which ranges from

\$2.73 (13.86%) more expensive per month per residential customer (Maplewood) to \$5.14 (29.81%) more expensive (Ozark Meadows). *See* Appendix A-8.

In Staff's opinion, systemwide application of an STP rate would result in an outcome that is inequitable for several reasons, including the production of severe rate shock in certain districts (Maplewood and Lake Carmel). Because many of the systems are not similar in customer population, geographic size, physical location, physical layout, or system maintenance requirements, many "cost-causers" would receive a substantial subsidy from the larger, well-established systems. The Ozark Mountain rate district currently has three (3) sparsely populated and geographically separate rural subdivisions while the current Maplewood district is a high density retirement community. Lakewood Manor with thirty-five (35) customers would receive a substantial reduction in rates at the expense of the approximate four hundred (400) customers in the current Maplewood district. The Maplewood customers tend to be senior citizens with a fixed income; yet, these customers would be faced with significant percentage increases (**94.76%** on average, **312.67%** in commodity charges).

For these reasons and the policy ramifications discussed above, Staff recommends that the Commission not apply single-tariff pricing in the manner contained in Scenario 1. Staff is of the opinion that application in this manner would result in customers, particularly in the current Maplewood district, paying rates that are far beyond their current cost of service and which may be found to be inequitable.

SCENARIO 2: CONSOLIDATION OF SELECT DISTRICTS

In addition to Scenario 1, displayed in Appendix A, Staff has developed a second water consolidation scenario ("Scenario 2") based on the alternative approach displayed in Appendix B. Staff's alternative scenario combines the current Lake Taneycomo Acres ("LTA"), Riverside Estates and Spring Valley rate districts into one consolidated rate district and combines the

current Lakewood Manor and Ozark Mountain rate districts into a second consolidated rate district. Staff's hybrid approach does not contemplate or propose any change to the rates currently charged in Aqua's other rate districts (i.e., the Maplewood and Lake Carmel district). For the reasons stated above, this scenario should not be construed as a recommendation that the Commission approve district consolidation within the Company's service territory, but rather as an alternative intended to alleviate some of the inequities present in Staff's Scenario 1 should the Commission desire to mandate consolidation in the future. Consistent with Staff's position, Staff's Scenario 2 also demonstrates how ratemaking approaches should be considered on a case-by-case basis to determine the most reasonable approach for any particular company or district.

Under Staff's alternative proposal, consolidation of the current LTA, Riverside Estates, and Spring Valley rate districts would result in a residential customer charge of \$25.64 and a residential commodity charge of \$6.13 per 1,000 gallons of usage. *See* Appendix B-2 and B-3. This consolidation would result in an average residential water bill of \$50.15 per month. *See* Appendix B-1. Compared to rates currently charged to these customers, the rates adjustments resulting from Staff's alternative proposal would range anywhere from \$10.94 (17.91%) less expensive per month per residential customer (Spring Valley) to \$16.31 (48.19%) more expensive per month per residential customer (Riverside Estates). *Id.* Consolidation in this manner would result in a monthly customer charge of \$25.64, which ranges from \$3.89 (13.18%) less expensive per month per residential consumer (Spring Valley) to \$8.68 (51.17%) more expensive per month per residential customer (Riverside Estates). *See* Appendix B-2. This treatment would result in a monthly commodity charge of \$6.13 per 1,000 gallons, which ranges from \$7.05 (22.34%) less expensive per month per residential customer (Spring Valley) to \$7.63

(45.20%) more expensive per month per residential customer (Riverside Estates). *See* Appendix B-3.

Under the second phase of Staff's alternative proposal, consolidation of the current Lakewood Manor and Ozark Mountain rate districts would result in a residential customer charge of \$36.02 and a residential commodity charge of \$7.72 per 1,000 gallons of usage. *See* Appendix B-5 and B-6. Consolidation in this manner would result in an average residential water bill of \$66.90 per month. *See* Appendix B-4. Compared to rates currently charged to these customers, the average bills issued under this alternative proposal would range anywhere from \$6.51 (8.87%) less expensive per month per residential customer (Lakewood Manor) to \$6.67 (11.07%) more expensive per month per residential customer (Ozark Mountain). *Id.* Consolidation in this manner would result in a monthly customer charge of \$36.02, which ranges from \$.87 (2.36%) less expensive per month per residential consumer (Lakewood Manor) to \$6.19 (20.75%) more expensive per month per residential customer (Ozark Mountain). *See* Appendix B-5. Consolidation in this manner would result in a monthly commodity charge of \$7.72 per 1,000 gallons, which ranges from \$5.64 (15.45%) less expensive per month per residential customer (Lakewood Manor) to \$0.48 (1.57%) more expensive (Ozark Mountain). *See* Appendix B-6.

Staff's alternative proposal presents a number of advantages when compared to systemwide consolidation. Staff's Scenario 2, which groups systems into geographic-based regional STP districts, would help to attain economies of scale larger than those currently utilized, would help to address small-system viability issues, would help mitigate future rate shock for customers within each regional STP district, and would allow customers in the

Maplewood and Lake Carmel to retain their existing rates, thus avoiding the huge rate shock resulting from the state-wide STP rates.

CONCLUSION

As the Commission stated in the 2000 MAWC case, “[a]lthough assigning costs to the cost causer is generally a sound tenet, there are times when it cannot be reasonably applied....This Commission does not believe that cost causation and cost recovery should be entirely unrelated in rates, but they cannot always be directly related, if fair and reasonable rates are to be achieved.” *Report and Order on Second Remand*, pp. 15-17.

Having the cost causer pay for its service is the appropriate and most economically efficient way to develop rates for water and sewer companies. However, as indicated above, Staff is cognizant that there are specific situations when reasons this basic economic principle may need to be modified. As shown above, there may be situations in which a modified or hybrid approach promotes a more equitable outcome than an “all or nothing” pricing policy. Staff believes that it would be reckless to make an over-arching policy declaration indicating that rates shall be set on a district-specific basis or, in the alternative, that single-tariff rates are appropriate in all situations. It is Staff’s position that the need for a single-tariff pricing structure should be evaluated on a case-by-case basis. There will be situations where an STP rate is appropriate and should be considered by the Commission. Staff believes that the conditions affecting individual systems should remain open for debate on a case-by-case basis and at this time does not support any changes to Aqua’s current rate structure.

Respectfully submitted,

/s/ Eric Dearmont

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Missouri Bar No. 60892

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CERTIFICATE OF SERVICE

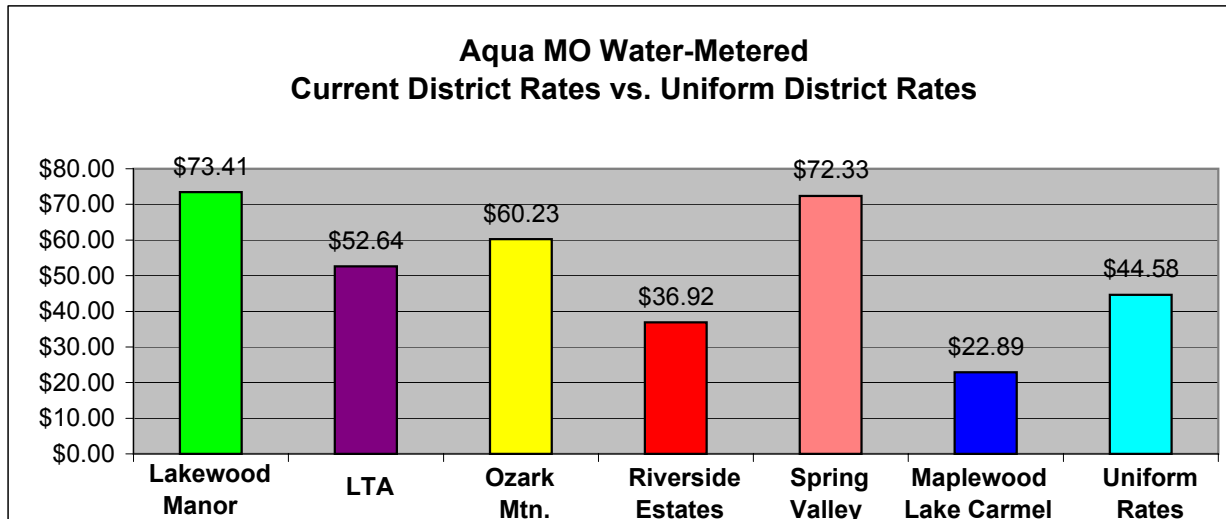
I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 1st day of September, 2010.

/s/ Eric Dearmont

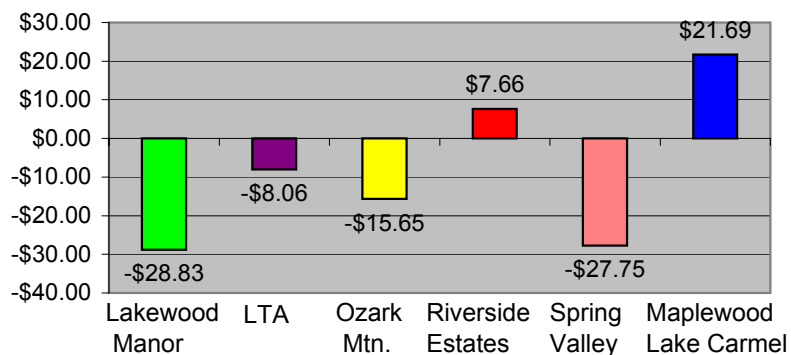
Scenario 1
Current Water Metered Rates vs. Uniform Rates

	<u>Commission Approved</u>		<u>Uniform Rates</u>		<u>\$ Difference</u>		<u>% Difference</u>	
	<u>Customer</u>	<u>Commodity</u>	<u>Customer</u>	<u>Commodity</u>	<u>Customer</u>	<u>Commodity</u>	<u>Customer</u>	<u>Commodity</u>
Water District	Charge	Rate	Charge	Rate	Charge	Rate	Charge	Rate
Lakewood Manor	\$36.89	\$9.13	\$23.89	\$5.17	-\$13.00	-\$3.96	-35.24%	-43.35%
LTA	\$27.76	\$6.22	\$23.89	\$5.17	-\$3.87	-\$1.05	-13.94%	-16.85%
Ozark Mountain	\$29.83	\$7.60	\$23.89	\$5.17	-\$5.94	-\$2.43	-19.91%	-31.95%
Riverside Estates	\$20.80	\$4.03	\$23.89	\$5.17	\$3.09	\$1.14	14.86%	28.34%
Spring Valley	\$34.97	\$9.34	\$23.89	\$5.17	-\$11.08	-\$4.17	-31.68%	-44.63%
Maplewood/Lake Carmel	\$5.79	\$2.85	\$23.89	\$5.17	\$18.10	\$2.32	312.61%	81.47%

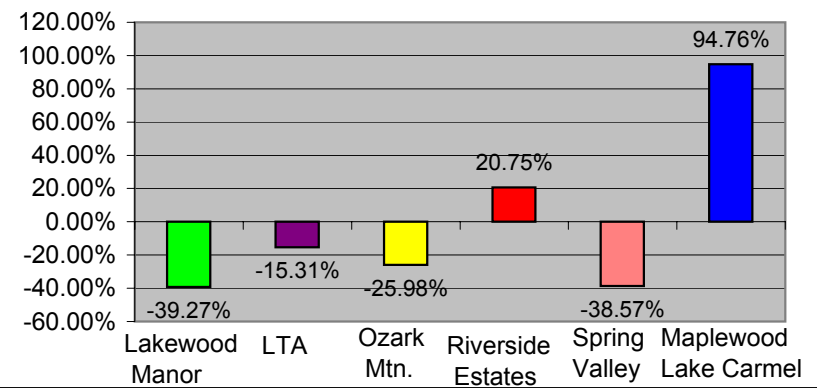
Scenario 1
Aqua Missouri, Inc.
Total Current District Water Metered Rates vs. Uniform Water Rates
Based on 6,000 Gallons Usage



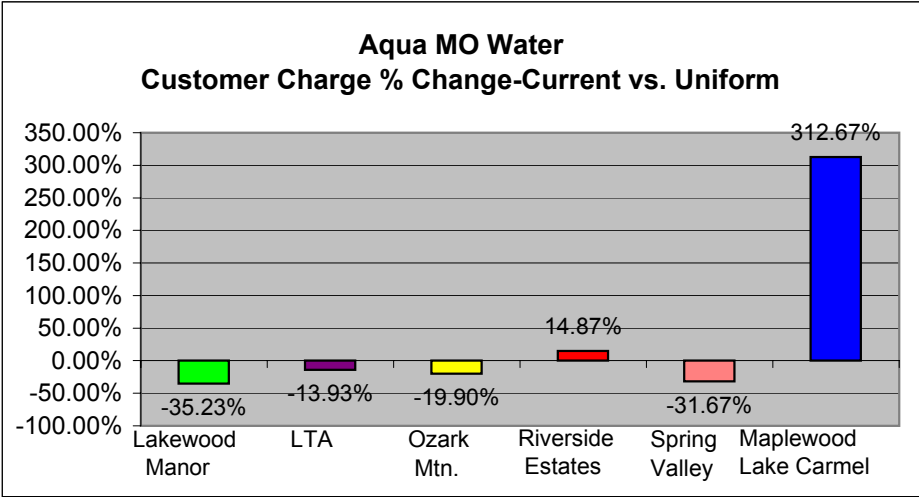
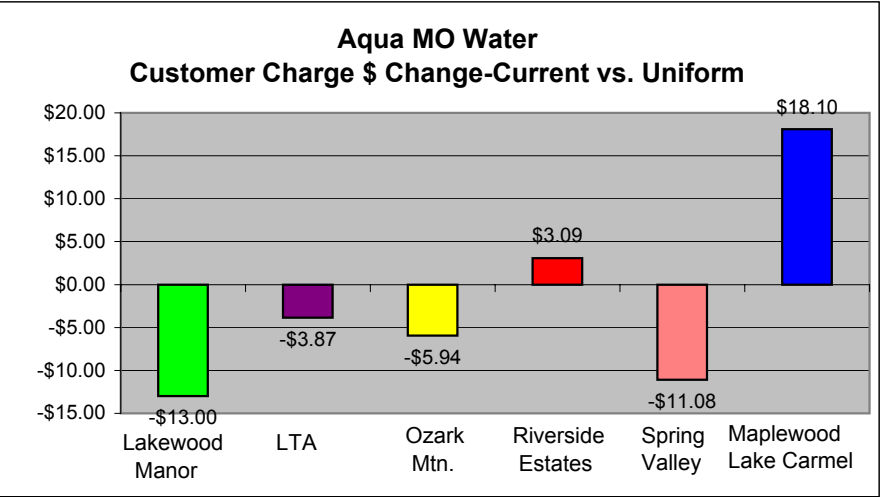
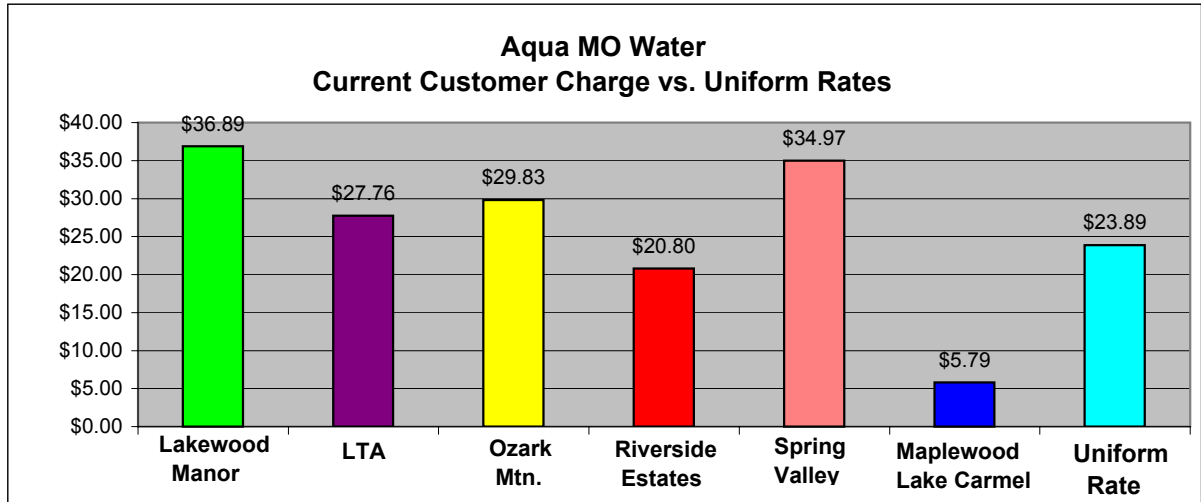
**Aqua MO Water
\$ Change-Current vs. Uniform**



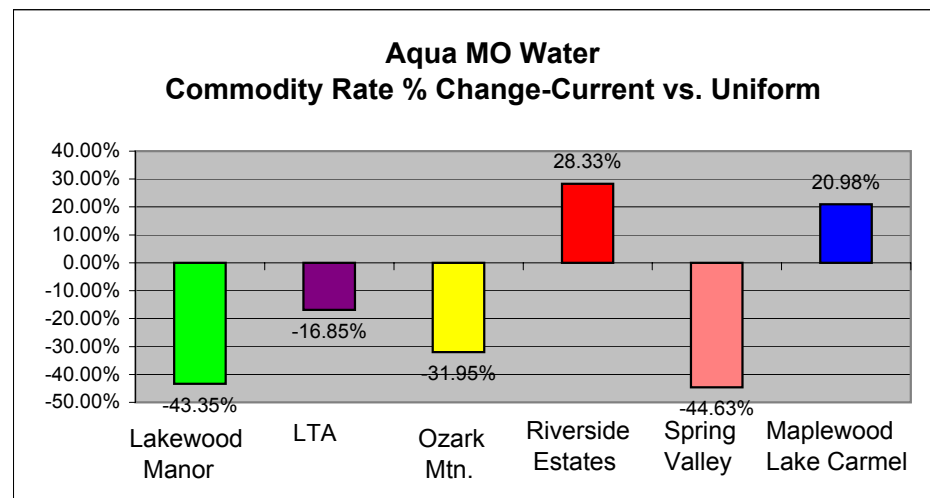
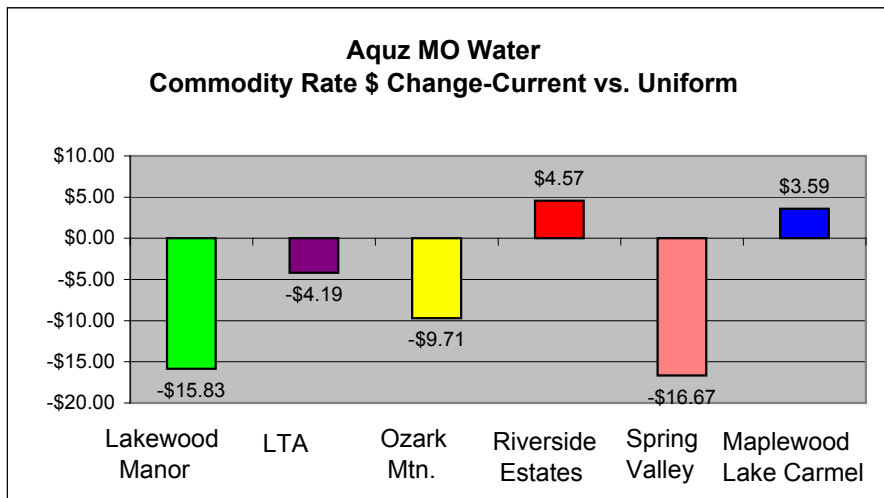
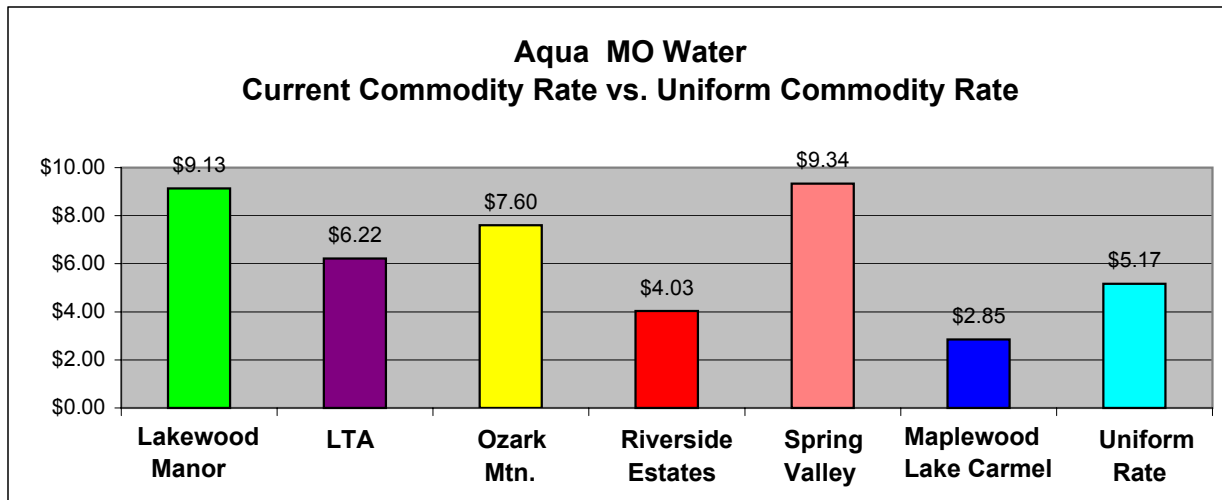
**Aqua MO Water
% Change-Current vs. Uniform**



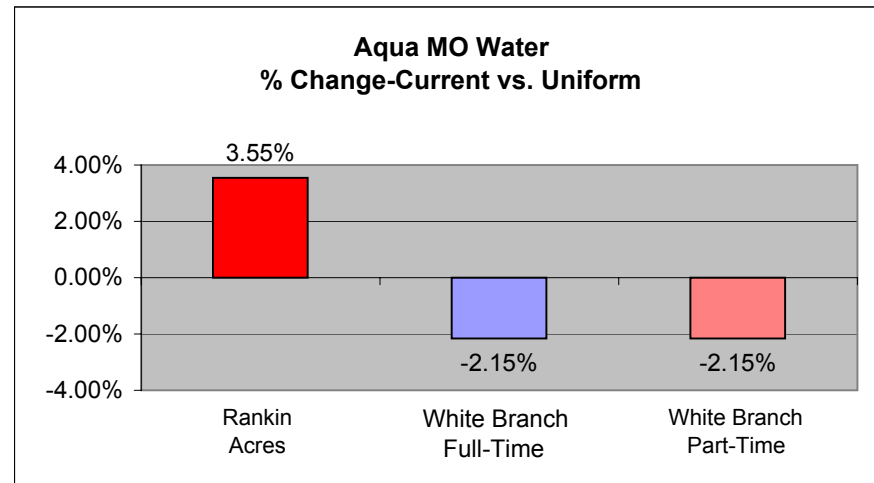
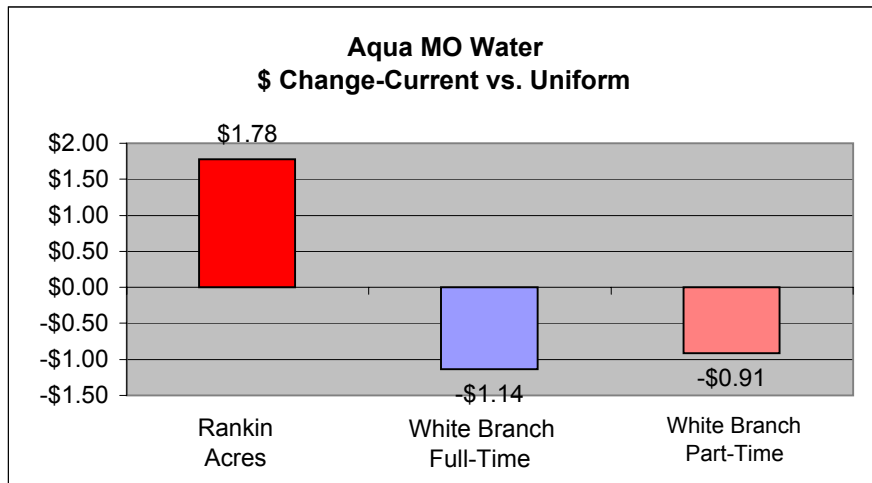
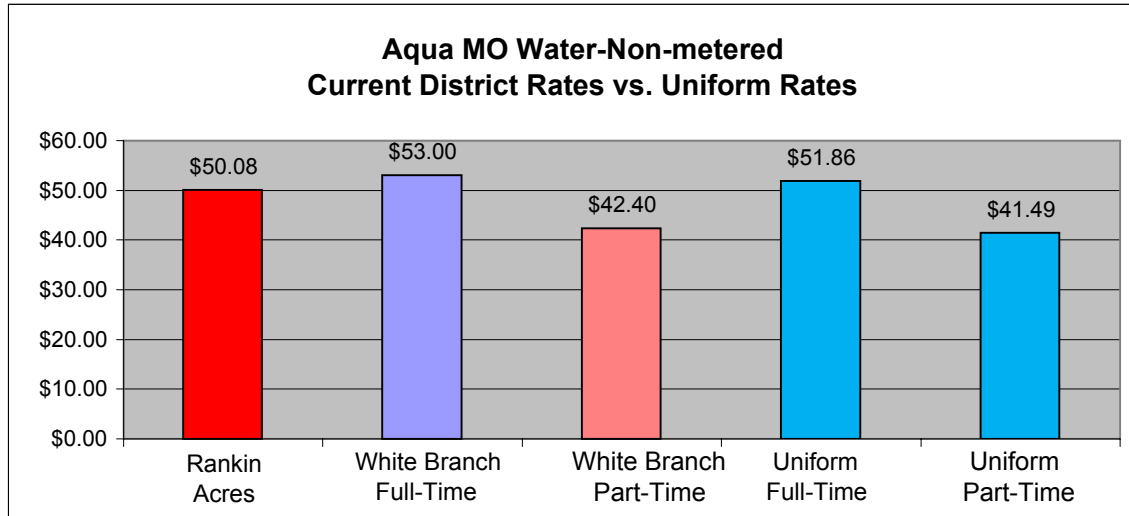
Customer charge includes 2,000 gallons

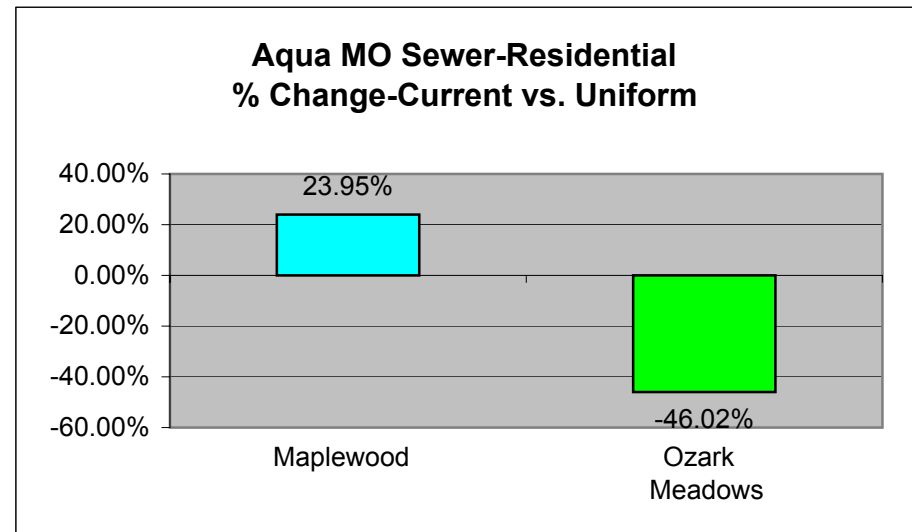
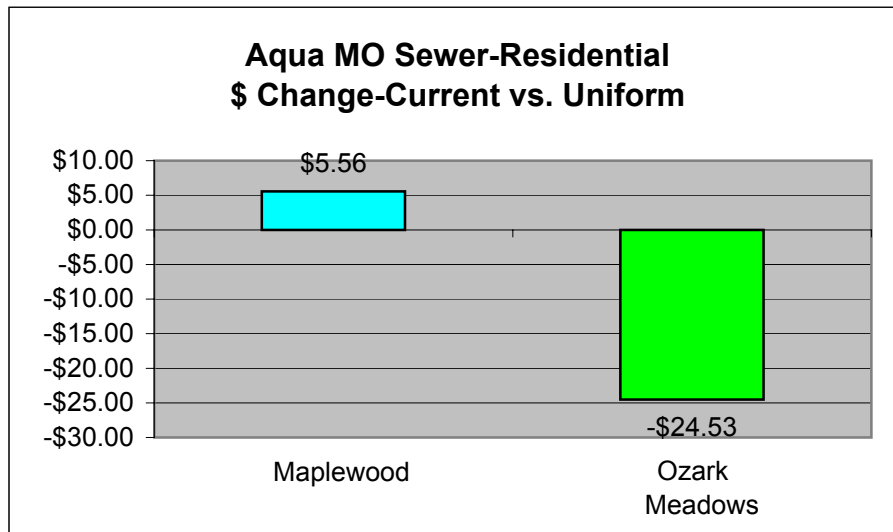
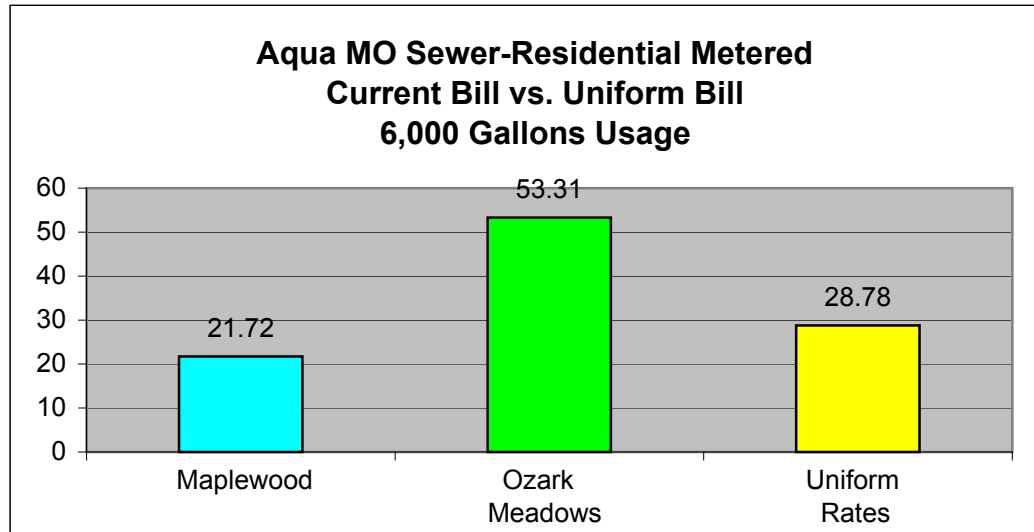


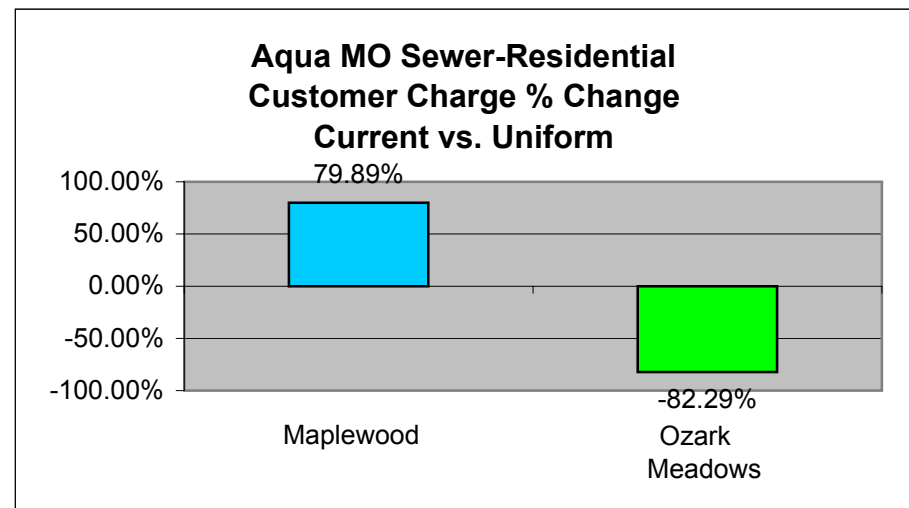
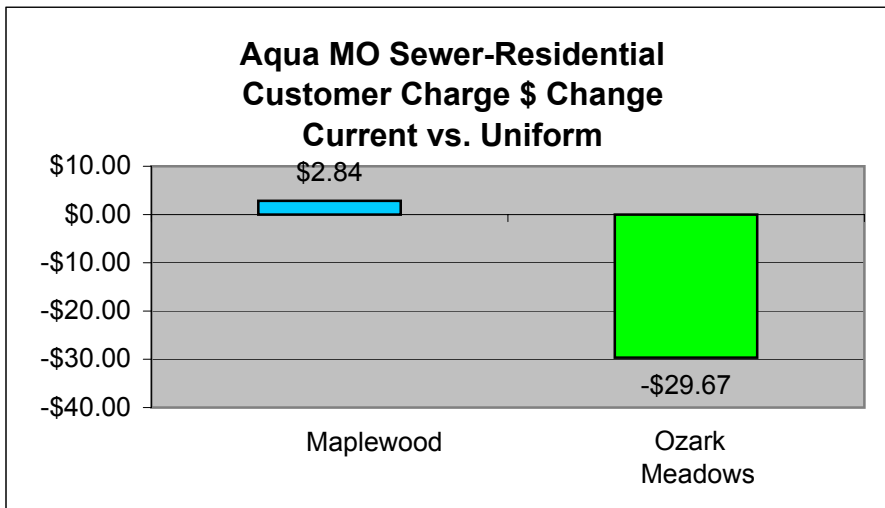
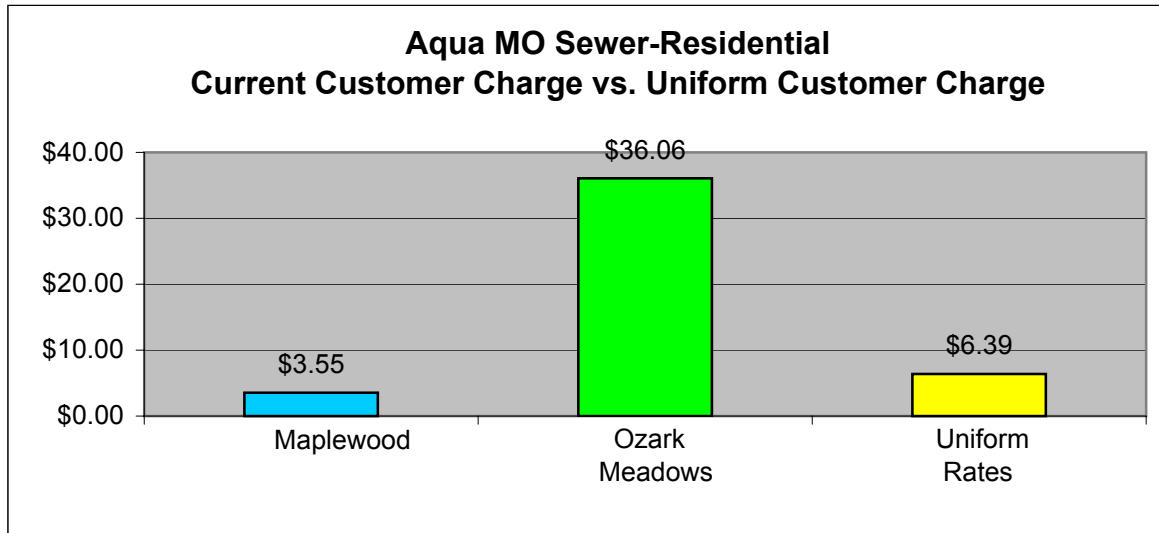
Customer charge includes 2,000 gallons

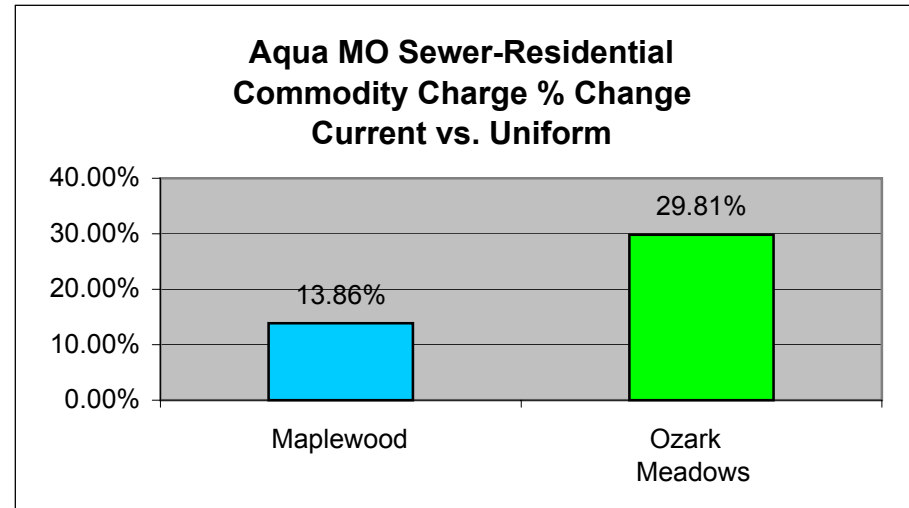
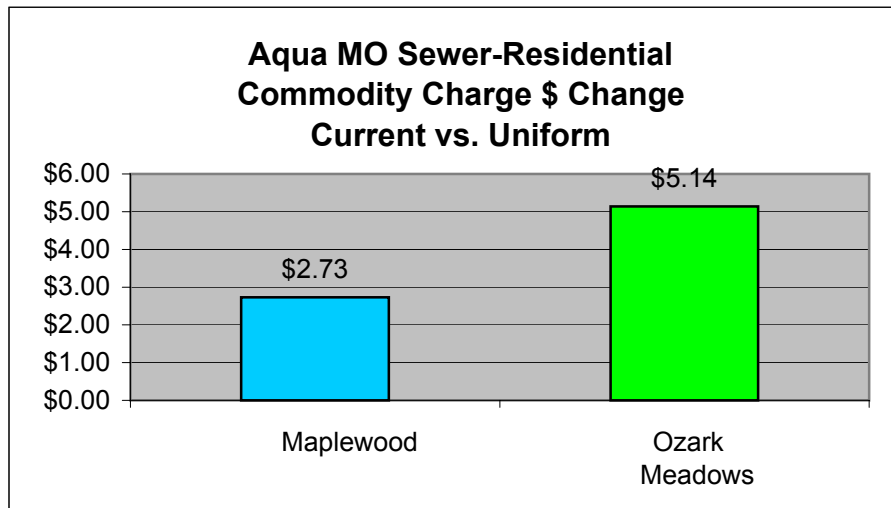
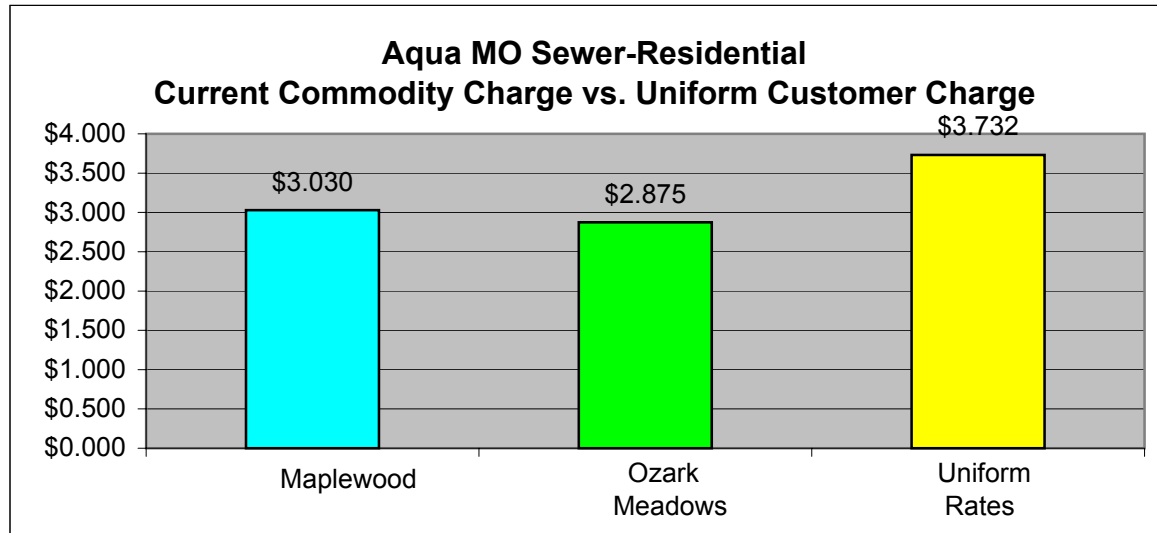


Scenario 2
Aqua Missouri, Inc.
District Water Non-Metered Rates vs. Uniform Water Non-Metered Rates

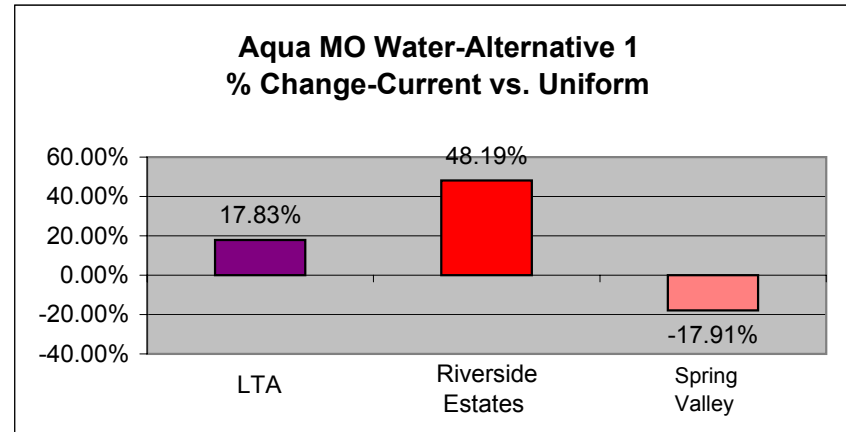
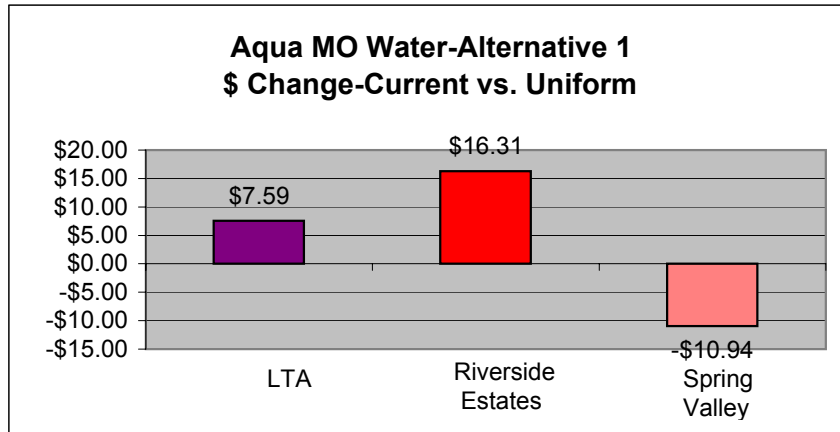
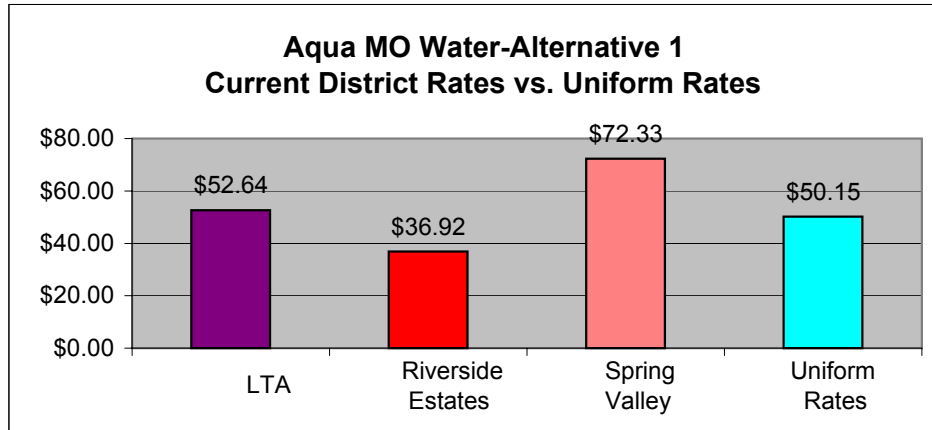




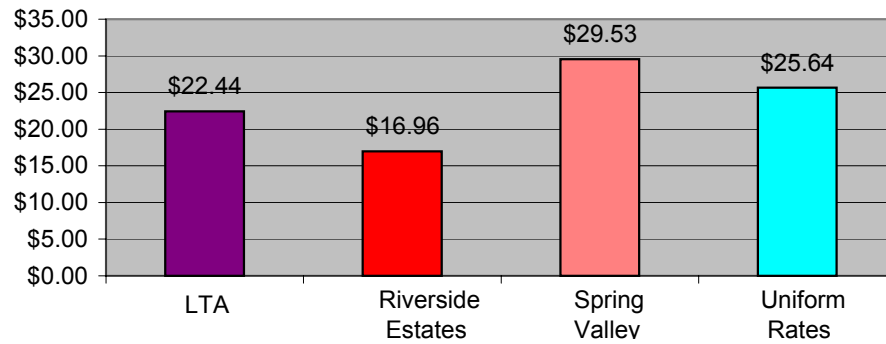




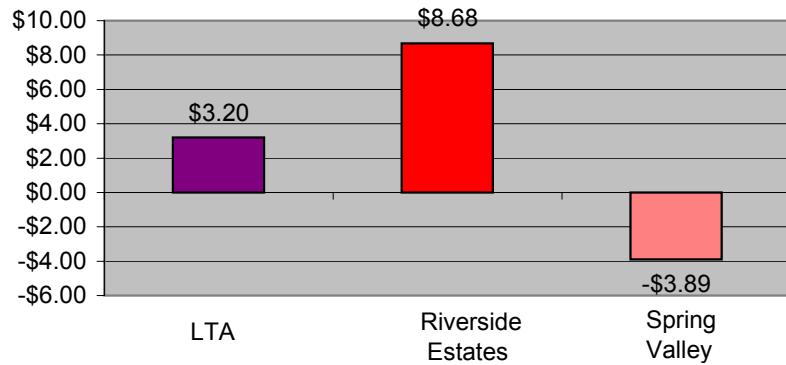
Scenario 2
Aqua Missouri, Inc.
Selected Districts Watered Metered Rates vs. Modified Uniform Water Rates
Based on 6,000 Gallons Usage



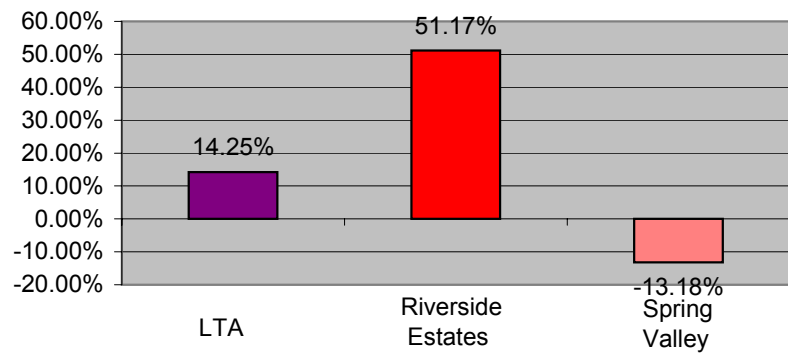
**Aqua MO Water-Alternative 1
Current Customer Charge vs. Uniform Rates**

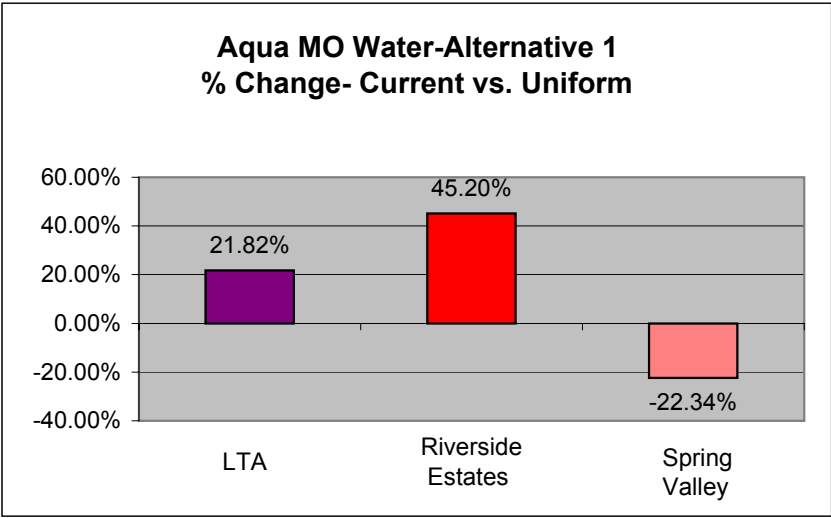
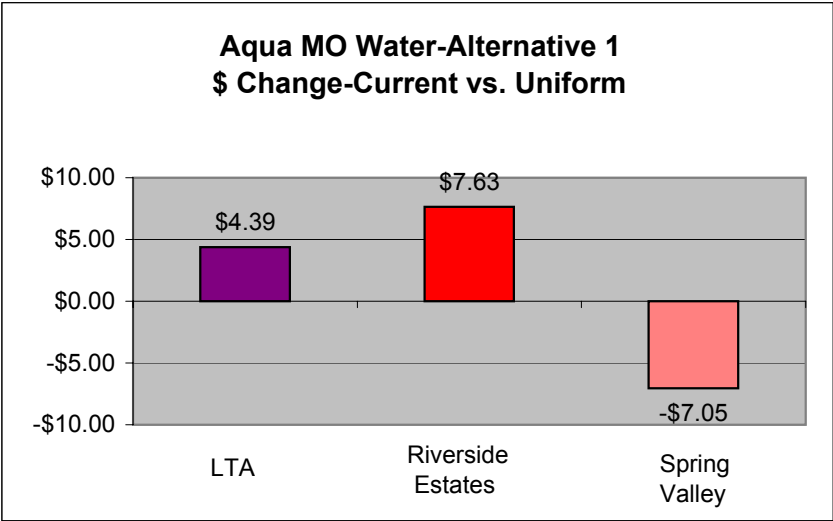
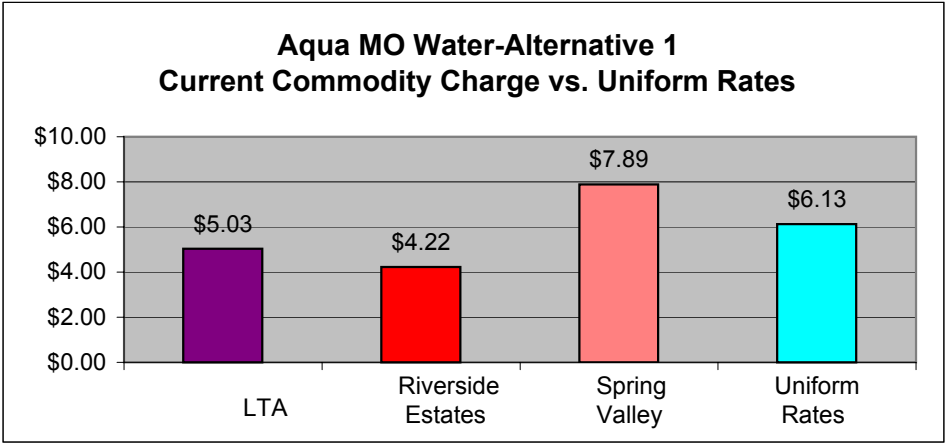


**Aqua MO Water-Alternative 1
\$ Change-Current vs. Uniform**

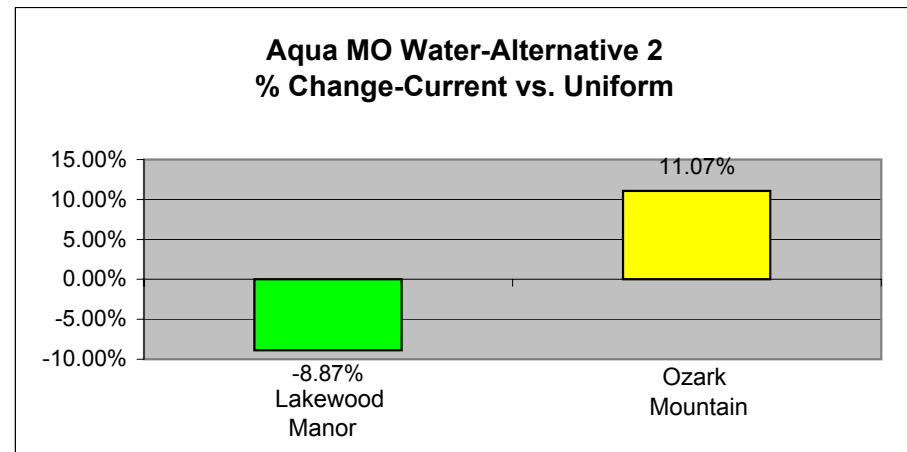
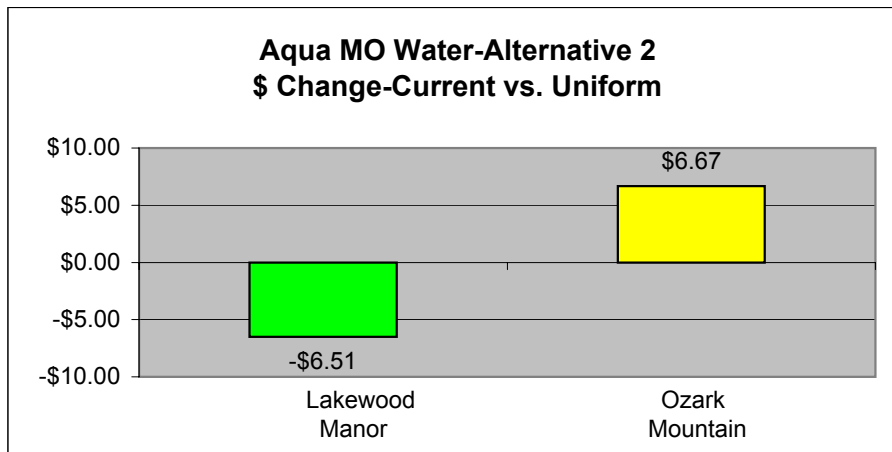
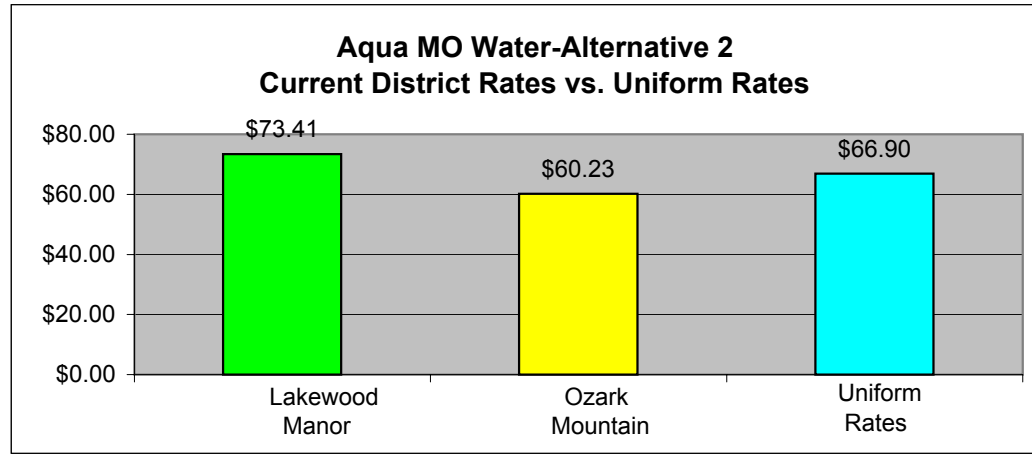


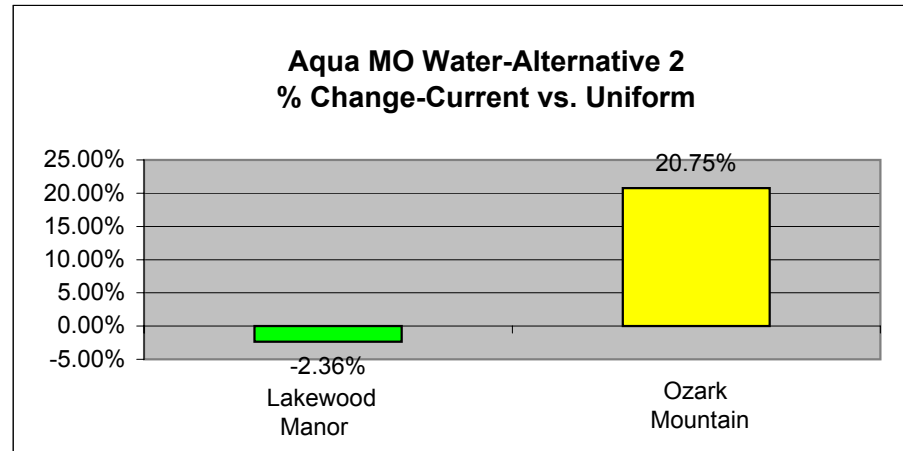
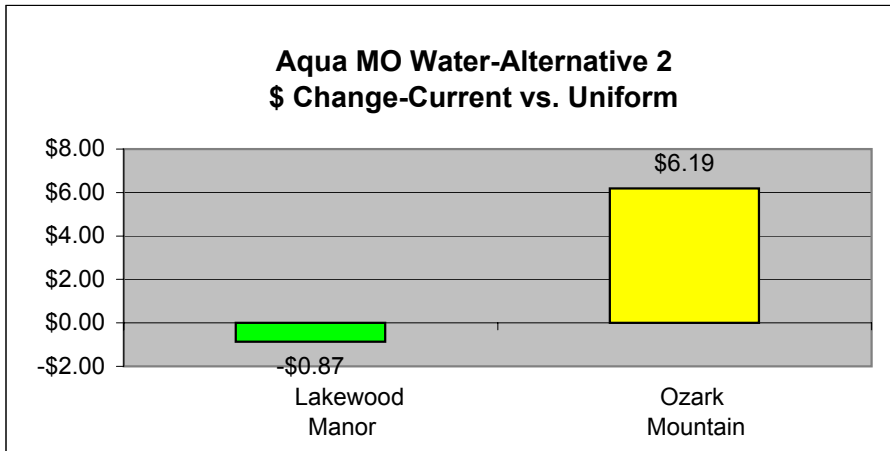
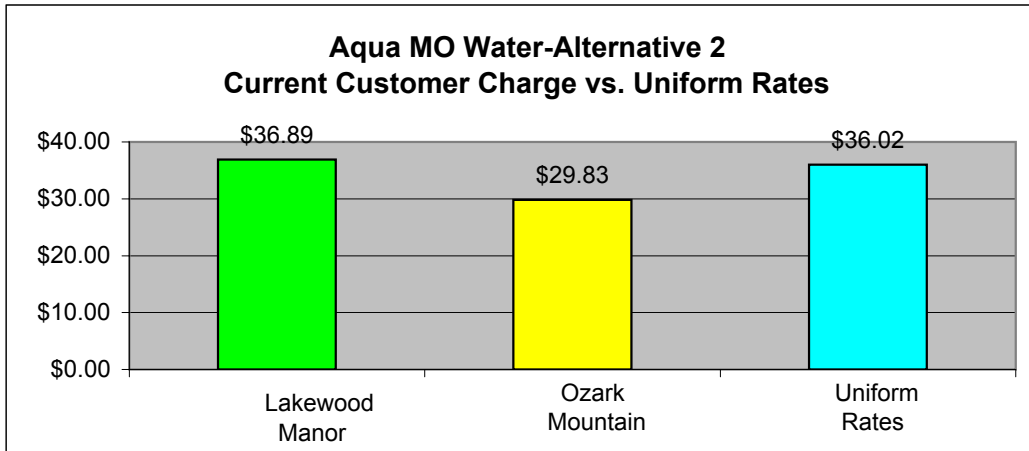
**Aqua MO Water-Alternative 1
% Change- Current vs. Uniform**



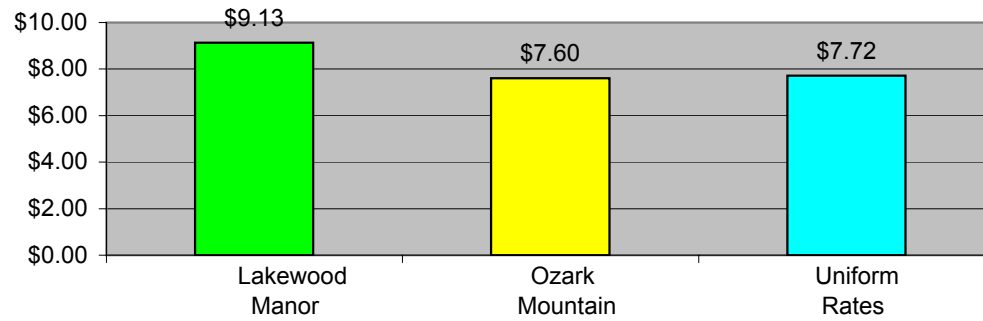


Scenario 2
Aqua Missouri, Inc.
Selected Districts Watered Metered Rates vs. Modified Uniform Water Rates
Based on 6,000 Gallons Usage





Aqua MO Water-Alternative 2
Current Commodity Charge vs. Uniform Rates



Aqua MO Water-Alternative 2
\$ Change Current vs. Uniform



Aqua MO Water-Alternative 2
% Change Current vs. Uniform

