

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

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

**INITIAL BRIEF OF THE
OFFICE OF THE PUBLIC COUNSEL**

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PUBLIC COUNSEL'S INITIAL BRIEF

The Missouri Office of the Public Counsel ("OPC") offers this brief on the unresolved issues regarding Missouri American Water Company's ("MAWC" or "Company") requested rate changes. The majority of the contested issues were resolved in two separate agreements, the *Revenue Agreement*¹ and the *Usage Agreement*,² which were approved by the Missouri Public Service Commission ("Commission") on April 6, 2016.³ To resolve the remaining rate design issues, OPC seeks approval of the *Rate Design Agreement*⁴ as a just and reasonable resolution of the customer charges, rate consolidation, and allocation of sewer revenues.

By approving the *Revenue Agreement*, the Commission resolved all contested revenue requirement issues, increased MAWC's rate base by \$30.6 million, and enabled MAWC to recover all operating costs and an opportunity to earn a return on equity

¹ Non-Unanimous Revenue Requirement Stipulation and Agreement ("*Revenue Agreement*"), March 16, 2016, EFIS No. 227.

² Non-Unanimous Partial Stipulation and Agreement ("*Usage Agreement*"), March 24, 2016, EFIS No. 241.

³ *Order Approving Non-Unanimous Stipulation and Agreement*, April 6, 2016, EFIS No. 371.

⁴ Non-Unanimous Stipulation and Agreement on Rate Design, District Consolidation and Sewer Revenue ("*Rate Design Agreement*" or "*Agreement*"). Public Counsel continues to support the

("ROE") for its shareholders of between 9.5% and 9.75%.⁵ The *Revenue Agreement* provides MAWC with more than \$9 million in revenue above the amount recommended by the Staff's audit.⁶ The \$30.6 million increase also includes all Infrastructure System Replacement Surcharge ("ISRS") eligible investments made since the last rate case.

By approving the *Usage Agreement*, the Commission resolved all usage and usage-related issues including the parties' disagreements over the magnitude of MAWC's claims of declining usage. The parties were able to agree upon a level of usage all found to be a reasonable representative of usage upon which to set rates.

These stipulations provide MAWC with what it *needs* out of this case. The other requested changes by MAWC for higher customer charges and further consolidation of rate districts are not necessary because, under any of the proposed customer charges and rate consolidation scenarios, MAWC will be able to recover all of its costs and will have an opportunity to earn an additional 9.5% to 9.75% profit for its investors.

The Commission's approval of the *Revenue Agreement* and the *Usage Agreement* will provide significant benefits to MAWC's shareholders. The Commission's decisions on the remaining issues should balance those shareholder benefits by focusing on policies that address the welfare of the public. Regardless of the Commission's decision on rate design, MAWC will receive rates that allow for the recovery of MAWC's costs and an opportunity to earn a return that MAWC considers appropriate.

The Commission heard evidence on regulatory policy, the customer charge, rate consolidation, and a low-income rate. All of these issues require the Commission to

Rate Design Agreement with the exception of the customer charge – Public Counsel's position is that lower customer charges should be ordered rather than those proposed by the *Agreement*.

⁵ *Order Approving Non-Unanimous Stipulation and Agreement*, April 6, 2016, EFIS No. 371.

⁶ Cassidy Surrebuttal, MO PSC Exhibit (Ex.) 16, p. 2.

consider requested changes to MAWC's current rate design. The most important facts to recognize regarding customer charges and further consolidated rates are the following:

- Increasing the customer charge will shift more cost responsibility to **low-income** users because it shifts more costs to those who use less water and data suggests low-income customers typically use less water.
- Increasing the customer charge is contrary to the important public policy goals of encouraging **water and energy conservation** because it reduces a customer's ability and incentive to conserve their water usage.
- Consolidating rate tariffs as proposed by MAWC and the Staff will require certain municipalities and their residents, against their will, to **subsidize** costs incurred by other distant and separate municipal systems.

Missouri Courts have held that “[t]he dominant thought and purpose of the [public utility law] policy is the protection of the public while the protection given the utility is merely incidental.” *State ex rel. Crown Coach Co. v. Public Service Commission*, 179 S.W.2d 123, 126 (Mo. App. K.C. 1944). OPC asks the Commission to keep this purpose in mind as it decides the remaining issues.

A. MONTHLY CUSTOMER CHARGE

MAWC’s customer’s bills include both a monthly and quarterly *customer charge* regardless of the amount of water used and a *volumetric rate* paid per gallon or per hundred cubic feet (CCF) of water used. For example, customers in MAWC’s St. Louis Metro district with a 5/8” meter (used by most residential customers) pay a \$14.42 monthly customer charge regardless of usage and an additional \$0.32 per 100 gallons used.⁷ The issue to be decided is whether the Commission should lower, raise, or keep

⁷ P.S.C. MO NO. 13, 1ST Revised Sheet No. RT 1.1.

the customer charges unchanged. OPC urges the Commission to protect the public by ordering MAWC to adopt low customer charges.

Once the Commission sets the customer charges, the parties can calculate revenues MAWC will be virtually guaranteed to receive by applying the customer charges to the agreed-upon average number of monthly customers in each class. The remainder of MAWC's revenue requirement will be recovered through the volumetric rates. Regardless of the customer charge levels ordered, the volumetric rates will be set to recover the remaining revenue requirement in an average year using *agreed upon* levels of usage per class.⁸

Setting the customer charge is critically important when designing rates due to the far-reaching impacts on important public policy issues such as low-income affordability and water conservation. Before deciding what customer charges the Commission will order, it is important to understand the impacts of ordering low customer charges vs. high customer charges.

1. Low-Income Customers are Disproportionately Harmed by High Customer Charges

Rate designs with higher customer charges increase bills for low-income customers. This occurs because customers that use low amounts of water pay higher bills when the customer charge is higher⁹ and, according to MAWC's witness Mr. Paul Herbert, low-income customers are typically low-use customers.¹⁰ Low customer

⁸ Busch Rebuttal, MO PSC Ex. 11, pp. 2-3, February 11, 2016; *See also Usage Agreement*.

⁹ Hyman Direct, Ex. 4, p. 30.

¹⁰ Mr. Herbert testified "I've found that...where lot sizes are larger, the homes are bigger, they tend to use more water." "[I]n some of the demand studies that I've done that actually looked at low-density housing, as opposed to medium as opposed to high density, with...townhouses and that kind of thing. The use per customer is higher in...low-density neighborhoods." Tr. 619-620.

charges, on the other hand, help low-income ratepayers by reducing water bills and giving customers greater control over their bill.¹¹ For a customer on a fixed income, such as an elderly residential customer on a fixed income, having greater control over their bill helps their ability to respond to utility rate increases as necessary to maintain affordable utility service. Giving customers greater control over their bill helps at-risk populations avoid missed payments and service disconnections. Ordering MAWC to adopt low customer charges will provide monthly benefits for low-income families, low-income disabled customers, and low-income elderly customers. The best outcome would be for the Commission to adopt Staff's initial recommendation for customer charges in the \$9.00-\$11.00 range.¹² This would provide vulnerable customers with much-needed control over their bills. While Staff has since revised its recommendation and is now proposing higher customer charges, this does not limit the Commission's discretion in ordering the Staff's initial customer charge levels in the interest of good public policy.

2. Water Conservation Incentives are Decreased with High Customer Charges

Designing rates also provides the Commission with an opportunity to incentivize customers to conserve their water usage, which also results in energy savings.¹³ This can be accomplished by recognizing that customers respond differently to higher volumetric charges than they do to low volumetric charges.¹⁴ Rate designs with lower customer charges provide greater incentives to customers to conserve water usage than rate designs with higher customer charges because rate designs with low customer charges

¹¹ Marke Rebuttal, OPC Ex. 11, p.11.

¹² Staff Report on Class Cost of Service and Rate Design, Schedules 2-1, 2-2 and 2-3.

¹³ Hyman Direct, DE Ex. 4, p.3.

¹⁴ Marke Direct, OPC Ex. 9, p. 20.

have higher volumetric or usage rates. In other words, the cost per gallon of water used is higher.¹⁵ With higher volumetric rates, efficient water use provides greater payback to customers. Higher customer charges, on the other hand, are accompanied by a lower rate per gallon of water used. With a lower volumetric rate, a customer's water conservation efforts have less of an impact on the customer's bill. The Division of Energy's witness, Mr. Martin Hyman, explained:

Customers attempting to use water efficiently prior to the implementation of a higher customer charge would not, once such customer charge was implemented, receive the future savings they had anticipated. Similarly, customers could no longer anticipate as significant a level of savings from potential future water efficiency measures in comparison to a lower customer charge.¹⁶

Lower customer charges provide the best water conservation incentive for all customers across all of MAWC's districts and customer classes.¹⁷ Conversely, increasing the customer charge "does not send the appropriate price signal for purposes of encouraging efficient water consumption."¹⁸

MAWC's own rate design witness, Mr. Herbert, recognizes this negative impact of high customer charges when he acknowledged moving additional costs to the customer charge would adversely affect low-use customers and would provide little incentive to customers to conserve.¹⁹

Recent Commission decisions recognize the relationship between a high customer charge and its negative impact on efficiency and conservation efforts. In Empire District

¹⁵ Hyman Direct, DE Ex. 4, p. 3, 17.

¹⁶ Hyman Surrebuttal, DE Ex. 6, p. 32.

¹⁷ *Id.*

¹⁸ *Id.*, p.23.

Electric Company's last rate case, the Commission concluded "[s]hifting customer costs from variable volumetric rates--that a customer can reduce through energy efficiency--to fixed customer charge will reduce incentive efforts to conserve energy."²⁰ In Ameren Missouri's last rate case, the Commission addressed the issue of raising Ameren's customer charge from \$8.00 to \$8.50 and in denying the increase concluded "[r]esidential customers should have as much control over the amount of their bills as possible so that they can reduce their monthly expenses by using less power, either for economic reasons or because of a general desire to conserve energy."²¹ These same reasons apply to the requests in this case to implement higher customer charges. Ordering MAWC to adopt low customer charges promotes conservation and efficiency.

3. Customer Charges Should be Limited to the Minimum Costs Necessary to Serve a Customer

The Commission has provided recent guidance on the types of costs appropriate for recovery through a customer charge. In Ameren Missouri's most recent electric rate case, the Commission defined customer-related costs as "the minimum costs necessary to make electric service available to the customer, regardless of how much electricity the customer uses. Examples include meter reading, billing, postage, customer account service, and a portion of the costs associated with required investment in a meter, the service line drop, and other billing costs."²² According to the American Water Works

¹⁹ Herbert Direct, MAWC Ex. 7, p. 20.

²⁰ *In the Matter of The Empire District Electric Company for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area*, Case No. ER-2014-0351, Report and Order, p. 16.

²¹ *In the Matter of Union Electric Company, d/b/a Ameren Missouri's Tariff to Increase Its Revenues for Electric Service*, Case No. ER-2014-0258, Report and Order, p. 75 ("Union Electric").

²² *Id.*

Association's Cost Allocation Manual, customer-related costs include costs for the meter, service line, meter reading, and billing.²³

MAWC's rate design witness Mr. Herbert testified "there is little difference in the costs associated with customer costs" and "[a]ll customers have a similar service line and meter, all have their meter read for billing either monthly or quarterly, all are billed from a centralized billing facility, and all receive customer service from a shared call center."²⁴ While Mr. Herbert at first recognizes what costs are appropriate for recovery through a customer charge, his *proposed* customer charges depart from industry practice and propose to recover costs through the customer charge that are not customer-related, including costs for the uncollectible bills of customers that do not pay and costs for "unrecovered public fire." These additional costs, that are *not* customer-related, inflate MAWC's proposed customer charges for residential customers.²⁵ Public fire costs are not customer-related and the Commission's Staff recommends recovery of these costs through the volumetric rate rather than the customer charge.²⁶ Uncollectible accounts also do not fit the type of customer-related costs included in a customer charge because, unlike customer-related costs, MAWC's uncollectible expenses are not a dedicated customer cost and instead vary with the Company's level of revenues.²⁷ Thus, these costs are more appropriately recovered through a volumetric rate.²⁸ Both public fire and uncollectible costs are not customer-related in that they do not represent the "minimum

²³ Hyman Direct, DE Ex. 4, p.4.

²⁴ Herbert Rebuttal, MAWC Ex. 9, p.5.

²⁵ Hyman Surrebuttal, DE Ex. 6, p. 20; Herbert Direct, MAWC Ex. 7, Schedule F.

²⁶ Response to Order Directing Filing, April 7, 2016, EFIS No. 374.

²⁷ Hyman Surrebuttal, DE Ex. 6, p. 20.

²⁸ *Id.*

costs necessary to make [water] service available to the customer” as the Commission recently determined is appropriate for a customer charge.²⁹

Mr. Herbert calculated MAWC’s initially proposed \$17.40 customer charge for the 5/8” meter class as follows:

<u>Cost Function</u>	<u>Unit Cost Per Month</u>
Meters	\$3.05
Service Lines	\$1.32
Billing/Collecting	\$10.59
<u>Unrecovered Public Fire</u>	<u>\$2.46</u>
Total	\$17.42 ³⁰

If the “unrecovered public fire” costs were excluded, Mr. Herbert’s proposed customer charge would be reduced to \$14.96 per month for a 5/8” meter. If the uncollectible costs were also excluded, the proposed customer charge would be further reduced to \$13.76 per month.³¹ This revised calculation is as follows:

<u>Cost Function</u>	<u>Unit Cost Per Month</u>
Meters	\$3.05
Service Lines	\$1.32
<u>Billing/Collecting</u>	<u>\$9.39</u>
Total	\$13.76

This statewide customer charge is supported by the record and is consistent with recent Commission decisions on what is appropriate for recovery through the customer charge. Accordingly, if the Commission decides a statewide customer charge is appropriate

²⁹ *Union Electric*, Report and Order, p. 75.

³⁰ Herbert Direct, MAWC Ex. 7, Schedule F.

³¹ Mr. Herbert’s calculations did not separately list the uncollectible costs and instead combined it with billing costs. DE witness Mr. Hyman provided the missing detail and testified MAWC included \$3,338,336 in uncollectible accounts allocated to residential customers (Hyman Direct, DE Ex. 4, p. 13). If this amount is subtracted from Mr. Herbert’s total Billing/Collecting cost of service, and the unit cost per month is corrected accordingly, the Billing/Collecting unit cost per

across all districts, OPC urges the Commission to set the customer charge for the 5/8” meter at a rate that is between \$13.76 and the \$14.42 customer charged agreed to in the *Rate Design Agreement* and to apply a similar calculation for determining the appropriate customer charge for 3/4” meter customers.³²

4. The Rate Design Agreement

On March 22, 2016, OPC, the Missouri Industrial Energy Consumers (“MIEC”), City of Brunswick, City of St. Joseph, City of Joplin, and City of Warrensburg³³ entered into the *Rate Design Agreement*.³⁴ The Public Water Supply Districts Nos. 1 and 2 of Andrew County indicated they do not oppose the *Agreement*. The Commission’s Staff filed an objection to the *Agreement*, causing the *Rate Design Agreement* to become the unenforceable positions of the signatories. 4 CSR 240-2.115(2)(D). Despite the Staff’s objection, Staff witness Mr. Busch testified the *Rate Design Agreement* “is a fair approach for moving off of where we are today.”³⁵ OPC continues to support the *Agreement* with the caveat that all terms are interdependent and the resolution of any one issue is not necessarily OPC’s position on that issue unless the Commission approves the *Agreement* in its entirety.

The *Rate Design Agreement* resolves the remaining issues of customer charge, rate consolidation, and how to allocate sewer revenues. The *Agreement* is an attempt to

month is \$9.39 (\$29,613,896 - \$3,338,336 = \$26,275,560. A \$26,275,560 cost of service divided by 2,797,709 bills results in a \$9.39 unit cost).

³² OPC recognizes this is a slight departure from the *Rate Design Agreement* where the parties agreed to a \$14.42 statewide customer charge. This is OPC’s only departure from the *Rate Design Agreement*.

³³ The City of Warrensburg joined the Non-Unanimous Stipulation with its March 24, 2016 Joinder in Non-Unanimous Stipulation and Agreement on Rate Design, District Consolidation, and Sewer Revenue, EFIS No. 240.

³⁴ EFIS No. 235.

address concerns voiced by MAWC, the Staff, City of Brunswick, City of Joplin, City of St. Joseph, City of Warrensburg, MIEC and the OPC.

The *Rate Design Agreement* resolves the customer charge issue by providing MAWC with its request for a uniform customer charge across all districts for residential and small business meters. It sets a company-wide \$14.42 per month customer charge (5/8" meters) and a company-wide \$16.09 per month customer charge (3/4" meter). These are the current rates charged in MAWC's St. Louis Metro District. Setting the customer charge at these levels best minimizes the impacts of a shift to a uniform rate for the majority of MAWC's customers. The St. Louis Metro district is by far MAWC's largest district and setting the customer charge at the St. Louis Metro rate avoids a customer charge change for 81% of MAWC's customers.³⁶ For the other 19% of MAWC's customers, some will see a customer charge increase and others will see a customer charge decrease.

A customer charge for a 5/8" meter of between \$13.67 and \$14.42 is consistent with the customer charges of MAWC's affiliated companies in other states. OPC's proposed rate would be higher than the current customer charge of American Water's regulated water companies in Iowa (\$13.36), Kentucky (\$12.49), Maryland (\$9.76), Virginia (\$11.59) and New Jersey (\$13.60). It is lower than the customer charge of American Water's regulated water companies in Indiana (\$14.79), Michigan (\$15.46), Pennsylvania (\$15.00), Tennessee (\$15.66), and West Virginia (\$26.72 – this rate includes the first 1,500 gallons of water used).³⁷ A statewide customer charge in the

³⁵ Transcript (Tr.) 445.

³⁶ Tr. 229.

³⁷ Iowa-American Water Co., Seventeenth Revised Sheet No. 4; Kentucky-American Water Co., P.S.C. Ky No. 6, Thirty-Third Revised Sheet No. 50; Maryland American Water Co., Water-

\$13.67 to \$14.42 range is just and reasonable and OPC encourages the Commission to not allow the customer charge to be any higher than this range.

5. Other Considerations When Setting a Customer Charge

Mr. Herbert testified other considerations include rate impacts, “the understandability and ease of application of the rate structure, community and social influences, and the value of service.”³⁸ Mr. Hyman also testified that the customer charge level should be “limited by considerations of equity, fairness, gradualism, and efficiency.”³⁹

When deliberating on this issue, OPC urges the Commission to bear in mind the customer charge is meant to recover the incremental cost a utility incurs to serve an additional customer.⁴⁰ These would be the costs a customer would incur even if they did not use any water in the month. For example, if a customer is away from home for a month and does not disconnect his or her water service, that customer would still cause the company to incur minimum costs associated with a meter, service line, and billing. A customer charge limited to these customer-related costs is consistent with cost-of-service ratemaking while also recognizing important public policy reasons related to low-income affordability and water conservation.

P.S.C. MD No. 11, Fifteenth Revised Page No. 3; Virginia-American Water Co., Water-S.C.C. VA. No. 12, Twelfth Revised Page No. 1; New Jersey American Water Co., BPU No. 8 – Water, Fifth Revised Sheet No. 27; Indiana-American Water Co., I.U.R.C. No. W-20-A; Michigan-American Water Co., Thirteenth Revised Sheet No. 7.0; Pennsylvania-American Water Co., Supplement No. 284 to Tariff Water-PA P.U.C. No. 4, 20th Revised Page 9; Tennessee-American Water Co., TRA No. 19, Eleventh Revision of Sheet No. 4-R; and West Virginia-American Water Co., Thirty-First Revision of Original Sheet No. 7.

³⁸ Herbert Direct, MAWC Ex. 7, p.12.

³⁹ Hyman Direct, DE Ex. 4, p. 5.

⁴⁰ Tr. 783.

In the Commission's order resolving MAWC's last rate case, it noted the guiding purpose in setting rates is to protect the consumer against the natural monopoly of the public utility, generally the sole provider of a public necessity."⁴¹ Only a natural monopoly has the leverage to keep a customer subscribing to the service and paying a minimum fee despite not using the company's product. Low customer charges recognize this fact and protect customers accordingly. For these reasons, OPC encourages the Commission to adopt low customer charges for all districts.

B. RATE CONSOLIDATION

District consolidation is a misleading term because the individual water systems will forever remain separate – the only change will be requiring customers served by one water system to subsidize costs incurred by customers being served off another more costly water system. Since the MAWC and Staff consolidation proposals would be a change from the current manner in which rates are set and costs recovered, MAWC and the Staff have the burden of proving their proposed changes in rate recovery are just and reasonable and their proposed subsidies are not prejudicial, preferential, advantageous, or disadvantageous to any one group of customers over another. Sections 393.130 and 393.140 RSMo. The facts of this case demonstrate MAWC and the Staff have not satisfied their burden because each reason claimed by MAWC and the Staff for consolidation is not supported by the evidence.

1. Missouri Law Already Provides Cost-Sharing Relief for Newly Acquired Water and Sewer Systems

One of the primary arguments made to support the MAWC and Staff consolidation proposals is that rate consolidation allows costs to be shared among a

⁴¹ *Citing May Dep't Stores Co., 107 S.W.2d at 48 (1937).*

greater number of customers and assists customers in higher-cost water systems by requiring customers served by distant lower-cost water systems to provide subsidies.⁴²

There are two categories of high-cost systems – those already owned by MAWC and those MAWC may seek to acquire in the future. Of these, the only category relevant to this case is those high-cost systems already within MAWC’s service territory. Small water and sewer systems not owned by MAWC are already protected under Section 393.320 RSMo as it requires the Commission to make newly-acquired small water and sewer systems a part of an existing service area and preferably one that is contiguous to the small utility or closest geographically. The statute states in part:

Upon the date of the acquisition of a small water utility by a large water public utility...the small water utility shall, for ratemaking purposes, become part of an existing service area, as defined by the public service commission, of the acquiring large water public utility that is either contiguous to the small water utility, the closest geographically to the small water utility, or best suited due to operational or other factors. This consolidation shall be approved by the public service commission in its order approving the acquisition.

Section 393.320.6 RSMo. The Commission is required to consolidate the rate tariffs of newly acquired small systems with existing service area tariffs and the statute gives the Commission discretion in selecting the service area. Section 393.320 RSMo provides the same benefits MAWC and the Staff claim as a reason to approve their rate consolidation proposals; the costs of those new systems will be spread over a larger base of customers when that system is incorporated into an existing service area. Accordingly, there should be no concern about consolidation to address new MAWC acquisitions. Newly acquired high-cost systems are protected by Section 393.320 RSMo. The statute does not,

⁴² Tr. 119; *See also* Collins Direct, Ex. MIEC 5, p. 5.

however, address the needs of current high-cost water systems already owned by MAWC.

2. Addressing the Needs of MAWC's Existing High-Cost Systems

Two municipal parties, Brunswick and Riverside, have indicated their support for further consolidation as they are served by high-cost water systems and would benefit if the costs of their systems were shared among other water systems. The *Rate Design Agreement* entered into between OPC, MIEC, and the majority of the municipal parties addresses these concerns and provides specific relief for Riverside and Brunswick. The *Rate Design Agreement* consolidates the Brunswick water district with the St. Joseph water district, thereby spreading the high costs of Brunswick's 341-customer system with the much larger St. Joseph water district and its 28,389 customers.⁴³ The proposed St. Joseph/Brunswick rate consolidation will provide rate relief for Brunswick's customers in the form of rate reductions and is acceptable to both St. Joseph and Brunswick.

Understandably, no municipal party –specifically St. Joseph and Joplin - agreed to be consolidated with the aging Platte County water district. MAWC plans to replace this water treatment plant in 2017.⁴⁴ Any water system consolidated with Platte County would be required to subsidize the new treatment facility despite the fact that the new plant would serve Platte County customers only. When new plants had to be built in St. Joseph and Joplin, the City of Riverside (in the Platte County district) did not support rate tariff consolidation and opposed consolidation as unlawful and unreasonable.⁴⁵ Now that Platte County's treatment plant is due for replacement, Riverside has flipped positions on

⁴³ Marke Direct, OPC Ex. 9, p 6, 9.

⁴⁴ Tr. 318.

⁴⁵ Tr. 336.

what it now believes is lawful and reasonable. Time has passed since the plants were built in Joplin and St. Joseph and a considerable portion of the costs for the depreciation of those plants has been paid exclusively by Joplin and St. Joseph customers.⁴⁶ If the Commission were to now change its policy on rate consolidation and require a subsidy for Platte County, the Commission would be arguably providing preferential treatment for Platte County.

OPC proposes the Commission keep Platte County as a stand-alone district and consider the issue again in MAWC's next rate case. The true cost of the new Platte County plant will not be known until after the project is complete, which should occur before the Company's next rate case filing.⁴⁷ At that time, the prudently- incurred costs for the plant will be added to rate base for the first time and the *actual* impact of consolidating rate tariffs can be calculated without relying upon cost estimates. OPC recognizes Platte County's current water system has a high cost of service and poor water quality. For this reason, the *Rate Design Agreement* provides for a 5% reduction to Platte County's existing residential rates.

3. Consolidating Rate Tariffs of Distant Water Systems Violates Principles of Cost Causation

Water utilities are unique because the service is entirely local.⁴⁸ In fact, none of the presently structured eight MAWC water districts are interconnected and are spread across Missouri - often several hundred miles apart. Not only are the water sources and

⁴⁶ Tr. 181-182.

⁴⁷ Tr. 186.

⁴⁸ Marke Direct, Ex. OPC 7, pp. 4-14.

facilities separate and distinct, the customers served by each water district varies “across income levels, multi-family housing rates, housing ownership rates and poverty levels.”⁴⁹

These differences in water sources and facilities create cost differences between the districts, and consolidating distant and distinct water districts violates important principles of *cost causation*.⁵⁰ “Cost causation suggests that the cost causer pays the cost it imposed on the utility system.”⁵¹ Cost-based rates “are designed to prevent unjust or undue discrimination between rate classes or customers.”⁵² Staff witness Mr. Busch agreed “recovery of costs in correlation with their cause is the most equitable manner to determine the appropriate rates for any regulated service.”⁵³ Consolidating the rate tariffs of distant and distinct water systems when the costs between the separate systems are so remarkably different run afoul of Section 393.130 RSMo prohibiting the Commission from providing an “undue or unreasonable preference or advantage to any person, corporation or locality or to any particular description of service in any respect whatsoever...” It also violates Section 393.130 RSMo prohibiting the Commission from subjecting “any particular person, corporation or locality or any particular description of service to any undue or unreasonable prejudice or disadvantage in any respect whatsoever.” Subsidizing one customer’s cost of service by raising the rates of another customer creates preferences, advantages, and disadvantages. Those subsidies only violate Section 393.130 RSMo if they are “undue or unreasonable.” OPC asserts they are because those parties have not articulated a fact-based reasonable basis for such

⁴⁹ *Id.* p. 16.

⁵⁰ *Id.*

⁵¹ Marke Direct, Ex. OPC 9, p. 15.

⁵² *Id.*

⁵³ Tr. 419-420.

preferential rate treatment. In addition, MAWC’s customers spoke out at the local public hearings that they want to pay for the costs they cause the utility to incur to provide them with service and they do not want to subsidize the services of other water systems.⁵⁴

4. Consolidating Rate Tariffs Sends Inappropriate Price Signals and Leads to Overinvestment in Infrastructure

When water systems with different costs are consolidated for rate purposes, customers in low-cost districts will be required to purchase water at prices that exceed the real cost of their water consumption.⁵⁵ Likewise, customers in high-cost districts whose rates are suddenly being subsidized will receive a price signal that water is less expensive than it really is, leading to increased water consumption for the highest cost water systems.⁵⁶ These inappropriate and harmful price signals undermine conservation efforts where they are needed most - in the highest cost water systems.⁵⁷ Greater water usage in a high-cost area will only magnify the problem by requiring additional investment to keep up with the increased demand.

The muted price signals customers experience when they are being subsidized are similar to the muted price signals impacting the Company when subsidization leads to overinvestment. OPC’s witness Dr. Geoff Marke testified that rate consolidation leads to the “Averch-Johnson and Willisz (A-J-W)” effect, otherwise known as “gold plating.” Subsidizing a high-cost water system with a low-cost water system distorts the price signals to the Company. “By diminishing the price signal of any given investment, ratepayers are exposed to an increased risk of overpaying for systems they do not

⁵⁴ Tr. Vols. 4-14.

⁵⁵ Marke Direct, Ex. OPC 9, p. 21.

⁵⁶ *Id.*; See also Collins Direct, Ex. MIEC 5, p. 5.

⁵⁷ Marke Direct, Ex. OPC 9, p. 21.

need.”⁵⁸ Staff witness Mr. Busch testified “I do agree that when you start to consolidate rates, that there is some opportunity for the company to invest more than is necessary.”⁵⁹

MIEC witness Mr. Brian Collins echoed this concern and stated “[c]onsolidated pricing could provide the Company disincentives for cost control within high-cost operating districts because all costs would be averaged across the state.”⁶⁰ This would eliminate the Company’s need to maintain separate books and records for each operating district.⁶¹ As a result, MAWC management could be inhibited “from effectively managing each of its districts because district-specific costs will not be maintained or managed.”⁶² This leads to a “loss of transparent operating and financial data for each operating district” and makes it “very difficult to evaluate the efficiency and effectiveness of each operating district.”⁶³ Moreover, rate consolidation could result in MAWC acquiring new water systems “without adequate consideration as to whether the costs to operate those systems are economical since those costs would be rolled into existing rates under consolidated pricing.”⁶⁴

Maintaining appropriate price signals is a very important concern for addressing issues of conservation and overinvestment in infrastructure. The only way to maintain the appropriate price signals is to adhere to cost causation principles and require customers to pay their true costs of service by keeping separate water systems separate for rate purposes.

⁵⁸ Marke Direct, Ex. OPC 9, p. 24.

⁵⁹ Tr. 420.

⁶⁰ Collins Direct, Ex. MIEC 5, p. 6.

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id.*

⁶⁴ *Id.*

5. Consistency in Ratemaking Avoids Preferential Treatment

Mr. Larry Dority, counsel for the Public Water Supply Districts Nos. 1 and 2 of Andrew County, stated while “there is an understandable desire among regulatory agencies to keep...public policy options open,” it is “also important to recognize that some public policies don’t work if continuity is not maintained over the years.”⁶⁵ Mr. Dority went on to explain how in a prior MAWC rate case, this same consolidation issue was addressed and Commission employee Mr. Wes Henderson stated he did not think “it would be fair or proper to have single-tariff pricing in this case and then in the next case go back to district-specific and then in the next case go back to single-tariff pricing.”⁶⁶ By not “staying the course over the long term” the Commission’s policies will create “substantial inequities, depending on where each district happens to be in the construction cycle.”⁶⁷ This is a very important point. After ordering district-specific pricing in the last rate case, the Commission established that cost-causation was important and the treatment plants in St. Joseph and Joplin would be paid for by residents and businesses in those communities without subsidy assistance from other communities. Reversing that established policy now would be unjustly detrimental to the communities that have paid the costs of their facility upgrades without assistance from elsewhere. Accordingly, OPC urges the Commission to maintain consistency on this issue and maintain the eight separate water districts.

⁶⁵ Tr. 314.

⁶⁶ *Id.*

⁶⁷ *Id.*

C. LOW-INCOME TARIFF

MAWC proposed a low-income tariff in its surrebuttal testimony filed on March 4, 2016.⁶⁸ Because of the company's choice to raise the issue in surrebuttal testimony rather than its direct case, significant questions remain unanswered. In general, OPC is supportive of initiatives to assist low-income utility customers. However, because OPC represents all customers, any potential assistance program must balance the interests of all ratepayers. In this case, OPC does not support the company's proposed low-income tariff because 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.

The Commission has the authority to establish different rates and charges for reasonable service classifications. However, to avoid unjust discrimination between customers, differences in rates must be based upon differences in service. MAWC's proposed tariff establishing a low-income customer rate raises concern about unjust discrimination. Section 393.130 RSMo., states:

2. No ... water corporation or sewer corporation shall directly or indirectly by any special rate, rebate, drawback or other device or method, charge, demand, collect or receive from any person or corporation a greater or less compensation for ... water, sewer or for any service rendered or to be rendered or in connection therewith, except as authorized in this chapter, than it charges, demands, collects or receives from any other person or corporation for doing a like and contemporaneous service with respect thereto under the same or substantially similar circumstances or conditions.

3. No ... 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.

⁶⁸ MAWC Ex. 37.

Section 393.130(2) and (3) RSMo. The Missouri Supreme Court also addressed this in *State ex. rel. Laundry, Inc. v. Public Service Comm'n*:

Speaking to the subject of unjust discrimination by public utility corporations in respect to rates and service, the United States Supreme Court, through Mr. Justice Brewer, thus announced in *Western Union Telegraph Co. v. Call Publ. Co.*, 181 U.S. 92, 100: “All individuals have equal rights both in 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.**”

State ex. rel. Laundry, Inc. v. Public Service Comm'n, 34 S.W.2d 37, 45 (Mo. 1931) (emphasis added). The company’s proposed tariff establishes different charges for customers who are alike in all respects, except for income. While Missouri courts have not addressed this specific question, it is likely the different rates would be considered unduly discriminatory.

Even if legal, the company’s proposed low-income tariff lacks sufficient detail to determine whether the various ratepayers’ competing interests can be balanced. During the hearing, MAWC explained the company proposes to track and defer the costs of the program to be considered for recovery in a future rate case.⁶⁹ To the extent ratepayers are called upon to fund a low-income program, it must be designed so that it can reasonably be expected to balance the interests of those who receive support with the interests of all other ratepayers.

⁶⁹ Tr. Vol. 18, p. 825.

MAWC's proposal insufficiently details whether the program effectively aids low-income customers or evaluates the impact on all other ratepayers. Ms. Tinsley testified regarding the benefits of the company's proposed rate but failed to explain the assertion that "MAWC's proposed low income rate is designed to price water efficiently for qualifying low income customers in a way to support the efficient use of water and reduce, to the greatest extent possible our uncollectible accounts and shut off expenses."⁷⁰ The company presented no quantification of uncollectible accounts or shut-off expenses and did not present a plan to measure and track changes in those expenses occurring as a result of the low-income proposal. Nor does the company's proposal examine the costs or duration of the program. During the hearing, MAWC's witness testified they anticipate 17,376 out of 57,900 eligible customers would participate with a cost of \$960,000.⁷¹ If all eligible customers participated in the rate, the program cost could surpass \$3,000,000.⁷² Other than suggesting costs be deferred for future consideration, the Company did not offer any details as to how the program costs would be treated. Given the potential magnitude coupled with a lack of detail, the approval of the Company's plan would be pre-mature.

While OPC appreciates the company's willingness to discuss accommodations for low-income customers, the offered timeframe provides no opportunity to examine the proposal sufficiently. For these reasons, the Commission should reject MAWC's proposed low-income tariff. However, the Commission is empowered to aid low-income

⁷⁰ MAWC Ex. 37, p. 6.

⁷¹ Tr. Vol. 18, p. 842.

⁷² Dividing MAWC's estimated cost of \$960,000 by the estimated 17,376 participants equals \$55.25 per participant. If that cost is applied to all eligible low-income customers the annual cost is \$3,198,975. ($\$55.25 \times 57,900 = \$3,198,975$).

customers through other means; means that have already been recommended by OPC. In setting rates, the Commission can reject rate proposals that seek to collect increased mandatory minimum customer charges. Lower customer charges allow low-use customers more discretion over the charges incurred for service and preserves the conservation incentive. The company's proposed tariff reduces the mandatory minimum customer charge applicable to low-income customers.⁷³ As Ms. Tinsley testified, "discounting the fixed charges for low income customers keeps essential water service affordable to qualified customers, while sending appropriate pricing and demand-side efficiency signals through the volumetric charge."⁷⁴ The Commission should address the affordability of rates and proper incentives to all customers by setting the mandatory minimum customer charge as low as possible.

D. PURCHASED POWER

Cost allocation is an integral part of performing a Class Cost of Service Study. In this case, the allocation of purchased power expense is disputed. Every party, except MIEC, allocated this expense using Factor 1. The Staff's Class Cost of Service included the following explanation:

Factor 1 is the allocation of costs that vary with the amount of water consumed. This factor is used in the allocation of such costs as purchased water, **purchased power**, and chemicals. The costs are allocated to the customer rate classifications in proportion to the average daily consumption for each customer rate classification. **These types of costs vary with the amount of water consumed and are considered base costs.** Factor 1 is calculated by dividing the average daily consumption for each customer class by the average daily consumption for the entire district.⁷⁵

⁷³ MAWC Ex. 37, Schedule JMT-1.

⁷⁴ *Id.* at 5.

⁷⁵ Staff Ex. 3, p. 3 (emphasis added).

This definition is consistent with the testimony of MAWC's Mr. Herbert who explained how he allocated the purchased power expense even though he uses the term "purchased electric power."

Purchased water, **purchased electric power**, treatment chemicals and waste disposal are examples of **costs that tend to vary with the amount of water consumed and are thus considered base costs**. They are allocated to the several customer classifications in direct proportion to the average daily consumption of those classifications through the use of Factor 1.⁷⁶

The main commonality is that Factor 1 is used to allocate costs that vary with the amount of water consumed. This allocation method has been used by MAWC in previous cases.⁷⁷

MIEC witness Mr. Collins disputes the use of Factor 1 and suggests purchased power expense be allocated using Factor 3. As explained by Mr. Collins, Factor 3 "is tied primarily to average flow and maximum day demand requirements."⁷⁸

Using Factor 3 would allocate less cost to industrial/manufacturing customers and more cost to other customer classes.⁷⁹ Doing so would be an unwarranted departure from the company's previous practice. Ultimately, Mr. Collins' recommendation inappropriately re-allocates a single selected category of water utility costs away from his clients (Rate J customers) and places additional cost burdens on the other customer classes.⁸⁰ The Commission should reject that and instead allocate this expense using Factor 1 as proposed by all other parties.

⁷⁶ MAWC Ex. 7, p. 6 (emphasis added).

⁷⁷ Tr. Vol. 18, p. 606.

⁷⁸ *Id.*

⁷⁹ OPC Ex. 16, p. 5

⁸⁰ *Id.*, p. 6

E. CONCLUSION

During the evidentiary hearing, the Commission expressed its interest in a process that is transparent to the public. OPC strongly agrees with the Commission's concerns. This case presents an issue of consolidating rate districts leading to non-transparent rates in that they do not reflect the true cost of service. OPC urges the Commission to approve the *Rate Design Agreement* as a just and reasonable resolution of the customer charge issue, the rate consolidation issue, and the issue of how to allocate sewer revenue.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, emailed or hand-delivered to all counsel of record this 8th day of April 2016.

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