BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

INITIAL BRIEF OF MISSOURI INDUSTRIAL ENERGY CONSUMERS

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Comes now the Missouri Industrial Energy Consumers (MIEC) and for its initial post-hearing brief states as follows:

A. INTRODUCTION

Between February 28 and March 8, various parties filed four separate Stipulations and Agreements, each of which was unanimous or can be treated as unanimous under Commission Rule 4 CSR 240-2.115(2)(C). If accepted and approved by the Commission, those agreements will greatly reduce the scope of issues to be determined by the Commission. This brief will address two of the issues remaining for determination:

- How should the costs of lead service line replacements be assigned to customer classes? (Issue 5.a.xi on the Amended List of Issues filed February 23)
- Should the Commission keep the current water district structure, adopt single tariff pricing for the water customers, or return to eight water districts? (Issue 6.a on the Amended List of Issues filed February 23)
- If the Commission orders consolidated tariffs for water service, should it also order the implementation of the Coalition City Offset Mechanism to allow certain service areas to avoid paying certain capital investment costs? (Issue 6.b.i on the Amended List of Issues filed February 23)

B. ASSIGNMENT OF LEAD SERVICE LINE REPLACEMENT COSTS

Only two parties took an affirmative position on this issue in pre-filed testimony (MIEC and Missouri American Water Company (MAWC)). Only the MIEC stated a position in its Position Statement.[1] MIEC's position is simple: "Each class should bear only the costs of lead service lines associated with that class."

In his Direct Testimony, MIEC witness Brian Collins stated: "Because these costs are associated with residential service lines, these costs should be allocated to the residential customer class and recovered in residential class rates."[2] No other party addressed the issue in direct testimony.

OPC witness Geoff Marke responded to this statement in his Rate Design Rebuttal Testimony: "As it stands, OPC does not have a recommendation as to how to allocate these costs but reserves the right to raise this issue again in surrebuttal testimony. Finally, Mr. Collins is mistaken if he believes lead service lines are limited to residential customers."[3] Despite Dr. Marke's statement in his Rate Design Rebuttal Testimony about raising the issue in surrebuttal testimony, OPC did not do so.

In response to Dr. Marke's point that not all lead service lines serve residential customers, in his Surrebuttal Testimony, Mr. Collins stated: "To the extent there are lead service line replacement costs related to non-residential customers, it would be appropriate

[1] In its Position Statement on this issue, the Office of the Public Counsel (OPC) stated: "It is unclear based on what is in the record, but if the idea is to socialize these costs, then industrial and commercial customers should not be shielded from these costs." Because no party filed testimony advocating that these costs should be socialized, this vague statement does not actually establish a position.

[2] Exhibit 503, Collins Direct, page 12.

[3] Exhibit 206, Marke Rate Design Rebuttal, page 8.

and consistent with cost causation to allocate those specific costs for non-residential services to non-residential customers."[4]

MAWC, in the Rebuttal Testimony of witness Constance Heppenstall, proposed an allocation of the costs of lead service lines "based on Factor 9 which allocates costs based on the relative cost of services by size and customer classification."[5] It appears that the primary driver of Ms. Heppenstall's recommendation to use the Factor 9 allocator for lead service line replacement costs is the Company's position that these costs should be recorded to Account 345 in the Uniform System of Accounts. She observes that costs in Account 345 have historically been allocated using Factor 9 allocator, and concludes by stating, without any support whatsoever, that it is impractical to record work related to services by customer class.

In response to Ms. Heppenstall's suggestion that lead service lines replacement costs be allocated using Factor 9, Mr. Collins stated: "I recommend that the cost of lead service line replacement costs be directly assigned to the classes responsible for the costs. Direct assignment of these unique costs is preferable to the historical allocation because it will better ensure that costs follow the benefits."[6]

As noted above, Ms. Heppenstall's position on the use of the Factor 9 allocator is driven by the Company's position that lead service line replacement costs should be recorded to Account 345. MAWC's testimony on why Account 345 should be used is quite brief: "Restoration costs are normally capitalized to plant as part of overall project costs and [service line replacements] should be treated no differently. As such, they should be recorded in the same manner as all restoration costs and be allocated across customer

[4] Exhibit 505, Collins Surrebuttal, page 6.

[5] Exhibit 16, Heppenstall Rebuttal, page 16.

[6] Exhibit 505, Collins Surrebuttal, page 7.

classes…."[7] MAWC's position on Account 345 has more to do with the Company's dispute with Staff over recovery of these costs, and less to do with a firm conviction that lead service line replacement costs should be allocated to all classes using Factor 9.

This distinction was made clear when Ms. Heppenstall testified at the evidentiary hearing. During cross examination, Ms. Heppenstall agreed that it is better to directly assign costs to customer classes than to allocate them, when it is possible to do so.[8] In response to questions from Chairman Hall, she reiterated that it would be better to directly assign the costs of lead service line replacements to the classes responsible for the specific lines replaced.[9] She also confirmed that she understood earlier questions about direct assignment to be specific to the lead service line replacement cost issue.[10] Again, she asserted the caveat that direct assignment is preferable "[i]f its possible…." But she admitted that some other witness, someone from the Company rather than her, would be able to address the question of whether it is possible to track the costs by class.[11] Importantly, no witness from the Company – or from any other party – has claimed that the lead service line replacement costs cannot be tracked by class.

In fact, the only testimony in the record about whether these costs can be tracked by class is from MIEC witness Collins. In response to questions from Chairman Hall, Mr. Collins explained in detail how service line replacement costs can be tracked by class:

> I believe it is possible and should be relatively straightforward. For example, there should be a work order associated with each service line replacement, and it should identify the service address and the customer account number. And as a result, I think it should be relatively simple to designate each work

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[7] Exhibit 20, Jenkins Rebuttal, page 21.

[8] Transcript Volume 17, page 643.

[9] *Ibid*., page 651.

[10] *Ibid*.

[11] *Ibid*.

> order as either residential, commercial or industrial. And I would also think that an accounting subaccount associated with the lead service line replacement cost should be able to be created under the existing account 435 services. Then once each work order is complete, the company should be able to assign the total cost of each work order to that subaccount by class. … [I]f there ever was an instance where direct assignment is possible, I think this would be it.[12]

The Staff, although it did not take a position on this issue in testimony, agreed with the MIEC position on direct assignment at the hearing:

> [D]irectly assigning them to the appropriate class, more in line with what Mr. Mills said MIEC's position is, is I think the best way to do it, if possible. You're taking the – replacing lead service lines from residential, then it's a residential issue. If it's taking it from commercials, it should be commercial class. If there's any for industrials, then that should be spread along the industrial class. I think that is – that would be the best way to do it.[13]

C. APPROPRIATE WATER DISTRICT STRUCTURE

The parties have suggested three approaches to establishing rate structures to the Commission: 1) revert to the eight-district structure that existed before the last rate case (Case No. WR-2015-0301); 2) maintain the three-district structure that was established in the last rate case; or 3) establish a single pricing district with single tariff pricing (STP) that covers the entire state. The MIEC strongly supports the middle approach because it allows for many of the benefits of consolidation without the drastic and inequitable cross-subsidies created by single district pricing.

These subsidies are inequitable because they ignore other geographically derived differences and because they ignore cost causation. The overwhelming effect of single district pricing is to require customers in St. Louis County to subsidize customers in other districts. People choose to live in different locations, and businesses choose to establish themselves in

[12] Transcript Volume 18, pages 892-893.

[13] Transcript Volume 17, page 678.

different locations, based on a whole host of different factors: transportation, traffic, property taxes, utility costs, crime, etc. Some people and businesses recognize that utility costs in a small rural community may be more in than those in metropolitan areas due to economies of scale, yet they make that choice. Single tariff pricing will charge customers in metropolitan areas more in order to subsidize customers in small rural communities who chose to locate in that community after evaluating all the pros and cons, including utility costs. This is patently unfair to people who chose urban or suburban areas, accepting traffic congestion, higher crime rates and the like along with economies of scales for water utility service. Requiring suburban customers, who generally have a much greater density than rural customers and enjoy economies of scale, to pay the same price as rural customers ignores all the other complicated social, geographical and economic consequences of the choices that people and businesses have chosen to make. Artificially creating winners and losers in communities across the state through massive subsidies is well beyond the role that a public utility commission should play.

MIEC witness Collins, in his Direct Testimony, explains why single tariff pricing is inequitable:

> First, there is no common or economic cost structure across the three Company districts throughout the state. Specifically, the districts are not interconnected to the same (or group of same) water treatment plants. Water treatment plants serving the districts are supplied from district-specific raw water sources (including both groundwater and surface water), which impact water treatment costs. Contrary to power plants in a geographically dispersed electric system, which Ms. Heppenstall compares to water treatment plants for justification of the Company's consolidated pricing proposal, a water treatment plant in Joplin or St. Joseph, for example, cannot provide treated water to the St. Louis Metro District since those districts are not interconnected. The water treatment plants, distribution networks, pumping equipment and even the electric utilities serving the various MAWC territories are distinct across the state, and the various geographic characteristics of each MAWC service territory impact costs related to storage, pressure, pumping, chemicals and other costs associated with providing water service in those areas.
>
> Second, consolidated pricing ignores the differences in costs of providing service in each non-interconnected water district including, but not limited to, water treatment and supply, labor force, and delivery. Consolidated

> pricing also ignores the differences in rate base investment that have occurred to provide water service in each operating district. Consolidated pricing is inconsistent with traditional cost of service principles and ignores the concept of cost causation. In essence, consolidated pricing results in price subsidies to customers in a high-cost district at great cost to customers in a low-cost district. For example, the cost to install water pipe in a district with rocky soil is higher than the cost to install water pipe in a district without rocky soil. Under consolidated pricing, the customers in the lower-cost district with non-rocky soil would subsidize a portion of the cost to install pipe in the higher-cost district with rocky soil.
>
> Moreover, the unjust cross-subsidies created by consolidated pricing could erode the efficiency of the water system. These rate subsidies would erode the economic incentive for customers in high-cost districts to be more efficient in placing demands on the water utility because the prices they pay do not accurately reflect the cost of receiving water service. Hence, customers with subsidized prices may impose greater and less efficient demand on a high-cost district, which could cause greater cost at the high-cost district and increase customer subsidies to bring that district price down to the consolidated rate. To better reflect cost causation, it is appropriate for the Company's rates in each district to be compensatory and free of subsidies.[14]

The Staff also recognizes the inequities of the single tariff approach, as well as those created by the eight (or more) district approach. In its Staff Report on Cost of Service and Rate Design, the Staff summarized the reasons it supports the current three district approach:

> Staff recommends that the Commission maintain the current, three water district structure that it approved in the previous rate case. Changing the district structure in this case is not in the best interest of the ratepayers for the below reasons.
>
> First, the current district structure has the benefits of both the DSP and STP approaches. The districts are large enough to absorb large, necessary rate base investments without extreme customer rate impact. The costs customers pay are more aligned with each district. The operating characteristics of the individual systems in each district generally exhibit similar operating characteristics determined by source of supply (surface water, alluvial wells, or deep wells), and by geographic location.
>
> Second, the current size of the districts is logistically more manageable, both from an operations and regulatory perspective. This has allowed MAWC to continue to invest in smaller systems without causing rates to increase to dramatically. However, by maintaining three districts, there is still some restraint on the company from overspending on any given project since the spread of the costs associated with any increases to a specific district are limited to the customer base in that district.

[14] Exhibit 503, Collins Direct, pages 5-6.

> Third, the difficulty in developing rates on a district-specific basis is the need to allocate corporate costs to each separate service territory. Corporate costs are a substantial portion of the cost of service for MAWC. Trying to determine the most equitable manner to allocate those costs to each service territory (especially the very small service territories) is difficult when attempting to determine the true cost of service to those service territories. Combining service territories alleviates some of the need for precision. Corporate costs are allocated to a larger grouping of service territories via the district in which they are assigned.
>
> Fourth, MAWC continues to increase the number of service territories in which it provides service by purchasing small water and sewer systems. In order to keep these small systems in proper working order so that they can continue to provide safe, adequate, and reliable service to their customers, investment is needed or will need to be made in the future. When improvements need to be made, the higher cost of upgrades must be spread over the smaller customer base, which may cause rates to increase dramatically.[15]

In the Direct Testimony of witness Marke, OPC makes many of the same points that the Staff and the MIEC made.[16] In his Rate Design Rebuttal Testimony, Dr. Marke states that OPC agrees with Staff and MIEC that the current three-district pricing structure should be maintained.[17] Public counsel maintained that position in surrebuttal testimony.[18]

The cities of St. Joseph, Jefferson City, and Warrensburg (Coalition Cities)[19] also oppose single tariff pricing for many of the same reasons as Staff, MIEC and OPC, but rather than maintaining the current three-district structure, the Coalition Cities recommend a return to eight-district pricing. The Coalition Cities also recommend that the Commission consider an "offset mechanism" (Issue 6.b.i on the Amended List of Issues filed February 23). However, even in surrebuttal testimony, the Coalition Cities had not developed the offset mechanism concept beyond a general theoretical concept. In his Surrebuttal Testimony, Coalition cities

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[15] Exhibit 104, Staff Cost of Service and Rate Design Report, pages 11-12.

[16] Exhibit 202, Marke Rate Design Direct, pages 1-12.

[17] Exhibit 206, Marke Rate Design Rebuttal, page 2.

[18] Exhibit 207, Marke Surrebuttal, page 11.

[19] Although Joplin was initially in the coalition, it withdrew prior to the fling of surrebuttal testimony.

witness Michael McGarry explained that "there are many nuances with respect to timing, cost allocation, and rate design that need to be worked out."[20] Accordingly, there is nothing concrete that can be adopted in this case to implement an Offset Mechanism.

In the Rebuttal Testimony of James Busch, Staff explained an additional reason why the current three district pricing structure should be maintained:

> A major reason why Staff does not believe further consolidation should be considered at this time is that the Commission just approved consolidation in the previous rate case. Those rates have not even been in effect for two years. With a major change in rate design, it makes sense to allow time for the effects of that change to flow through and allow for customers to become accustomed to the new structure. One of the basic principles of rate design is stability. Constantly changing rate design does not allow for stability and could lead to greater customer confusion and dissatisfaction.

One of the reasons that the Company cites to support its single tariff pricing proposal is a claim that single tariff pricing will enable it to take over small and possibly troubled water systems.[21] But the testimony at the evidentiary hearing made clear that single tariff pricing provides no greater incentive in this regard than does the current three district pricing. In response to questions from Commissioner Kenney, Staff witness Busch testified:

> Q. Well, do you think it would be a benefit if we had a single tariff or a consolidated tariff? Would it benefit all of these small water and sewer cases that we deal with that have this tremendous rate shock?
> A. I think what you have right now enables that. I really do. I think the zones allow the Company and it allows them to absorb those distressed systems.[22]

Similarly, OPC witness Marke testified on cross examination:

> Q. Dr. Marke, you had some questions from Commissioner Kenney about the acquisition of small troubled water and sewer companies. Are you aware of any such systems that Missouri-American declined to acquire under the current three-zone rate structure solely because they don't have single tariff pricing?
> A. I have -- I know of none.[23]

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[20] Exhibit 331, McGarry Surrebuttal, page 7.

[21] Exhibit 18, Jenkins Direct Testimony, page 40.

[22] Transcript Volume 17, pages 700-701.

[23] Ibid., page 706.

In short, adopting single tariff pricing in this case would create large unjustified subsidies, risk confusing customers who have not really had time to adjust to the significant shifts made in the last case, and is unnecessary to accomplish the goal of incentivizing the Company to take over troubled water systems.

D. CONCLUSION

For the reasons set forth herein, the Commission should order that the costs of lead service line replacements be directly assigned to the customer classes that the replaced lines served, and maintain the current three-district rate structure.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been emailed this 26th day of March, 2018, to all counsel of record.

/s/ Lewis Mills