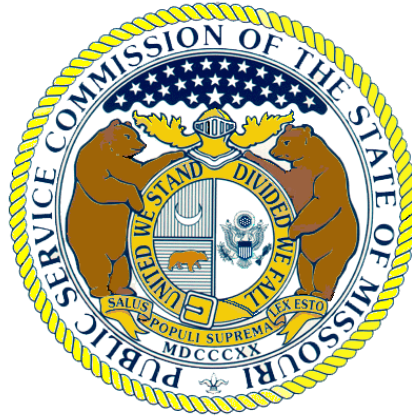


**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**



In the Matter of Missouri-American Water Company's)
Request for Authority to Implement a)
General Rate Increase for Water Service)
Provided in Missouri Service Areas)

File No. WR-2010-0131
Tracking No. YW-2010-0310

REPORT AND ORDER

Issue Date: June 16, 2010

Effective Date: June 18, 2010

BEFORE THE PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI

In the Matter of Missouri-American Water Company's)
Request for Authority to Implement a) **File No. WR-2010-0131**
General Rate Increase for Water Service) Tracking No. YW-2010-0310
Provided in Missouri Service Areas)

REPORT AND ORDER

The Missouri Public Service Commission is determining the terms of, and charges for, the water and sewer services of Missouri American Water Company (“MAWC”) as set forth in the *Stipulation and Agreement* (“settlement”) that the parties filed on May 25, 2010. Such terms include a revenue increase of approximately \$ 28 million. The Commission is rejecting the pending tariff assigned Tracking No. YW-2010-0310, and ordering MAWC to file a new tariff in compliance with this *Report and Order*. The Commission makes each ruling on consideration of all allegations and arguments of each party, and the substantial and competent evidence upon the whole record, but does not specifically address matters that are not dispositive. The Commission’s findings reflect its determinations of credibility. On those grounds, the Commission independently finds and concludes as follows.

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I. Appearances

Dean L. Cooper and **R. W. England**, Attorneys at Law with Brydon, Swearengen & England, PC, 312 East Capitol, P.O. Box 456, Jefferson City, MO 65102; and **John J Reichart**, Corporate Counsel, American Water Company, 727 Craig Road, St. Louis, MO 63141; for Missouri-American Water Company.

Jennifer Hernandez, Legal Counsel with the Office of Staff Counsel, 200 Madison Street, Suite 800, P.O. Box 360, Jefferson City, MO 65102, for the Staff of the Missouri Public Service Commission.

Christina Baker, Senior Public Counsel with the Office of the Public Counsel, 200 Madison Street, Suite 650 P.O. Box 2230, Jefferson City, MO 65102, for the Office of the Public Counsel.

Sherrie A. Schroder and **Michael A. Evans**, Attorneys at Law with Hammond & Shinnors, 7730 Carondelet Ave., Ste 200, St. Louis, MO 63105, for the Utility Workers Union of America Local 335.

Stuart Conrad and **David Woodsmall**, Attorneys at Law with Finnegan, Conrad & Peterson, LC, 3100 Broadway, Suite 1209, Kansas City, MO 64111, for AG Processing, Inc.

Leland B. Curtis, Attorney at Law with Curtis, Heinsz, Garrett & O'Keefe, PC, 130 S. Bemiston, Suite 200, St. Louis, MO 63105, for City of Warrensburg.¹

Terry C. Allen, Attorney at Law with Allen Law Offices, LLC, 612 E. Capitol Ave, P.O. Box 1702, Jefferson City, MO 65102, for the St. Louis Fire Sprinkler Association.

Stephanie S. Bell, **Marc H. Ellinger** and **Thomas R. Schwarz**, Attorneys at Law with Blitz, Bardgett & Deutsch, LC, 308 E. High Street, Ste. 301, Jefferson City, MO 65101 for City of Joplin.

Lisa C. Langeneckert, Attorney at Law with Sandberg, Phoenix & von Gontard PC, One City Centre, Suite 1500, 515 North Sixth Street, St. Louis, MO 63101, for Missouri Energy Group.²

James M. Fischer and **Larry W. Dority**, Attorneys at Law with Fischer & Dority, PC, 101 Madison Street, Suite 400, Jefferson City, MO 65101, for Public Water Supply District No. 1 of Andrew County, Public Water Supply District No. 1 of DeKalb County, and Public Water Supply District No. 2 of Andrew County.

¹ All cities, counties and districts are in Missouri.

² Missouri Energy Group is an association of the following entities: Barnes-Jewish Hospital and SSM HealthCare.

Byron E. Francis and **J. Kent Lowry**, Attorneys at Law with Armstrong Teasdale LLP, One Metropolitan Square, Ste. 2600, St. Louis, MO 63102-2740 for Metropolitan St. Louis Sewer District.

Joseph P. Bednar, Jr., Attorney at Law with Spencer Fane, Britt Browne LLP, 308 E High St Suite 222, Jefferson City, MO 65101, for City of Riverside.

Lisa Robertson, City Attorney with the City of St. Joseph, City Hall, Room 307, 1100 Frederick Ave. St. Joseph, MO 64501; and **William D. Steinmeier**, Attorney at Law with William D Steinmeier, PC, 2031 Tower Dr., P.O. Box 104595, Jefferson City, MO 65110-4595; for City of St. Joseph.

Karl Zobrist and **Roger W. Steiner**, Attorneys at Law with Sonnenschein, Nath & Rosenthal LLP, 4520 Main Street, Suite 1100, Kansas City, MO 64111, for Triumph Foods, LLC.

Mark W. Comley, Attorney at Law with Newman, Comley & Ruth, PC, 601 Monroe Street., Suite 301, P.O. Box 537, Jefferson City, MO 65102-0537; and **Nathan Nickolaus**, City Counselor with City of Jefferson, City Hall, 320 East McCarty Street, Jefferson City, MO 65101, for the City of Jefferson.

Diana M. Vuylsteke, Attorney at Law with Bryan Cave, LLP 211 N. Broadway, Suite 3600, St. Louis, Missouri 63102, for Missouri Industrial Energy Consumers.³

Daniel Jordan, Regulatory Law Judge.

II. Procedural History

MAWC filed tariffs on October 30, 2009. On November 20, 2009, MAWC filed additional tariffs. The tariffs proposed uniform terms of service among MAWC's territories and a general rate increase of approximately \$ 48.5 million. The tariffs bore an effective date of November 29, 2009.

By orders dated November 18, 2009, and November 23, 2009, the Commission suspended the tariffs and the additional tariffs, respectively, until September 29, 2010, the maximum time allowed by statute.⁴ The suspension of the tariffs initiated a contested case.⁵

³ Missouri Industrial Energy Consumers is an association of the following entities: The Boeing Company, Hussmann Refrigeration, and Monsanto.

⁴ Section 393.150, RSMo 2000.

⁵ Section 393.150.1, RSMo 2000; and Section 536.010(4), RSMo Supp. 2009.

A contested case is a formal hearing procedure, but it allows for waiver of procedural formalities⁶ and a decision without a hearing,⁷ including by stipulation and agreement.⁸

In the November 18, 2009 order, the Commission directed that notice of this action be provided to the public and to certain parties and set a deadline for filing applications to intervene. At the early pre-hearing conference, the Commission granted applications to intervene from all persons filing them:

- Utility Workers Union of America Local 335
- AG Processing, Inc.
- City of Warrensburg
- St. Louis Fire Sprinkler Association
- City of Joplin
- Missouri Energy Group⁹
- Public Water Supply District No. 1 of Andrew County;
- Public Water Supply District No. 1 of DeKalb County; and
- Public Water Supply District No. 2 of Andrew County
- Metropolitan St. Louis Sewer District
- City of Riverside
- City of St. Joseph
- Triumph Foods, LLC
- City of Jefferson and

⁶ Sections 536.060(3) and 536.063(3), RSMo 2000.

⁷ Sections 536.060, RSMo 2000.

⁸ *Id.* and 4 CSR 240-2.115.

⁹ Missouri Energy Group is an association of the following entities: Barnes-Jewish Hospital and SSM HealthCare.

- Missouri Industrial Energy Consumers.¹⁰

Also at the early pre-hearing conference, the Commission consolidated the sewer action with the water action. Further, the Commission established the test year relevant to MAWC's rates. The Commission memorialized those ruling by notice dated December 14, 2009.

By order dated January 13, 2010, the Commission ruled on which known and measurable changes were relevant to update the test year. In that same order, the Commission established a procedural schedule. In March and April, 2010, the Commission conducted nine local public hearings in MAWC's service territories to take comments from MAWC's customers and the public regarding this action. By order dated April 12, 2010, the Commission established the true-up period and accounts for other significant items relevant to MAWC's rates. By May 6, 2010, the parties pre-filed all direct, rebuttal, and sur-rebuttal testimony, except as to the true-up period. On May 11, 2010, the parties filed a Joint Statement of Issues. On May 15, 2010, the Commission had received all position statements filed.

The Commission scheduled a hearing for May 17-21 and May 24-28, 2010. On May 17, 2010, the Commission convened an evidentiary hearing as scheduled. On that date, MAWC moved to suspend the hearing to discuss settlement.

The parties filed a comprehensive *Stipulation and Agreement* ("settlement") on May 25, 2010. The settlement supersedes an earlier partial stipulation and agreement and resolves all issues between the signatory parties, which includes all parties except the following non-signatory parties:

¹⁰ Missouri Industrial Energy Consumers is an association of the following entities: The Boeing Company, Hussmann Refrigeration, and Monsanto.

- City of Warrensburg,
- City of Jefferson,
- City of Joplin, and
- Utility Workers of America Local 335.

The signatory parties represented that the non-signatory parties do not object to the settlement. No party filed any opposition to the settlement by the seven-day deadline that the Commission's regulations set,¹¹ so the Commission will deem the settlement to be unanimous.¹²

On June 11, 2010, Staff filed Exhibit No. 227, a synopsis comparing the settlement's proposed rate changes with the record. No party objected within the time set.¹³ Therefore, the Commission will enter Exhibit No. 227 into the record.

III. Settlement

The settlement provides that the parties will either separately reach agreement, or seek this Commission's decision, at a later date as to certain matters ("deferred matters").

Deferred matters appear in the settlement at paragraphs:

14. City of Riverside.
15. Triumph Foods, LLC.
16. Consolidation of Tariff.
17. Main Extensions.
18. Residential Fire Sprinkler Service.

This *Report and Order* includes no determination on the deferred matters in those paragraphs.

¹¹ 4 CSR 240-2.115(2)(B).

¹² 4 CSR 240-2.115(2)(C).

¹³ Order dated June 2, 2010.

As to matters settled in those and other paragraphs, the Commission granted the parties' request to enter all pre-filed testimony into the record. The record thus contains substantial and competent evidence weighing in favor of the settlement's provisions.

The settlement waives procedural requirements that would otherwise be necessary before final decision,¹⁴ including each commissioner's duty to either hear all the evidence or read the full record.¹⁵ Also, because the settlement disposes of this action, the Commission need not separately state its findings of fact.¹⁶ Therefore, the Commission incorporates the terms of the settlement into this *Report and Order*.

This *Report and Order* would be unnecessary altogether if MAWC dismissed its action, or if the Commission allowed the tariff to take effect by operation of law alone.¹⁷ But that is not the outcome that the parties seek. The parties do not waive final decision.¹⁸ On the contrary, the parties expressly ask for an "Order approving all of the specific terms and conditions of"¹⁹ the settlement. The settlement's terms include terms²⁰ and rates²¹ for water and sewer service. The order must include a report of the Commission's conclusions.²²

Therefore, the Commission independently finds and concludes as follows.

¹⁴ Section 536.060, RSMo 2000.

¹⁵ Section 536.080.2, RSMo 2000.

¹⁶ Section 536.090, RSMo 2000.

¹⁷ Section 393.150, RSMo 2000.

¹⁸ Nor can they. *Weber v. Firemen's Retirement System*, 872 S.W.2d 477, 480 (Mo. banc, 1994).

¹⁹ Settlement, page 10 last paragraph to page 11.

²⁰ Settlement, pages 4-5, paragraphs 7-10.

²¹ Settlement, page 2, paragraph 3.

²² Section 386.420.2, RSMo 2000.

IV. Jurisdiction

Because the Commission is a creature of statute, the statutes determine the Commission's jurisdiction, and the Commission should explain its jurisdiction in every case.²³

The Commission's jurisdiction generally includes every public utility:

The jurisdiction, supervision, powers and duties of the public service commission herein created and established shall extend under this chapter:

* * *

(5) To all public utility corporations and persons whatsoever subject to the provisions of this chapter [386, RSMo] as herein defined [²⁴]

Chapter 386, RSMo, defines public utility corporations to include:

(43) . . . every . . . water corporation . . . and sewer corporation, as these terms are defined in this section [²⁵]

That section provides the following definitions:

(49) "Sewer corporation" includes every corporation . . . owning, operating, controlling or managing any sewer system, plant or property, for the collection, carriage, treatment, or disposal of sewage anywhere within the state for gain . . . ;

* * *

(59) "Water corporation" includes every corporation owning, operating, controlling or managing any plant or property, dam or water supply, canal, or power station, distributing or selling for distribution, or selling or supplying for gain any water[²⁶]

²³ **Greene County Nursing & Care Center v. Department of Social Servs.**, 807 S.W.2d 117, 118-19 (Mo. App., W.D. 1991).

²⁴ Section 386.250, RSMo 2000.

²⁵ Section 386.020, RSMo Supp. 2009.

²⁶ *Id.*

Also:

The commission shall:

(1) Have general supervision of all . . . water corporations and sewer corporations [. ²⁷]

Those provisions include MAWC because MAWC provides sewer service to customers in three territories, and water service to customers in 12 territories, across Missouri.

Regulating MAWC's services and rates is specifically within the Commission's jurisdiction:

The commission shall:

* * *

(11) Have power to require every . . . water corporation, and sewer corporation to file with the commission . . . schedules showing . . . and all rules and regulations relating to rates, charges or service [.]

* * *

No corporation shall charge . . . different compensation for any service . . . than the rates and charges applicable to such services as specified in its schedule filed and in effect at the time [. ²⁸]

Such schedules—or “tariffs”—and are subject to the Commission's decision:

Whenever there shall be filed with the commission by any [utility] any [tariff], the commission [may] enter upon a hearing concerning the propriety of such [tariff], upon its own initiative[. ²⁹]

This action began with the filing with the Commission of tariffs proposing changes in terms and rates for sewer service³⁰ and water service.³¹

²⁷ Section 393.140, RSMo 2000.

²⁸ *Id.*

²⁹ Section 393.150.1, RSMo 2000.

³⁰ File No. SR-2010-0135.

V. Service

The standard for service is as follows:

[E]very water corporation, and every sewer corporation shall furnish and provide such service instrumentalities and facilities as shall be safe and adequate [. ³²]

Upon review of the record and the settlement, the Commission independently finds and concludes that the settlement's proposed terms support safe and adequate service. Without further discussion, the Commission incorporates such provisions, as if fully set forth, into this *Report and Order*.

VI. Rates

The standard for rates is "just and reasonable,"³³ a standard founded on constitutional provisions, as the United States Supreme Court has explained:

Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.³⁴

But the Commission must also consider the customers:

The rate-making process . . . i.e., the fixing of 'just and reasonable' rates, involves a balancing of the investor and the consumer interests.³⁵

Further, that balancing has no single formula:

The Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas. Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make

³¹ File No. WR-2010-0131.

³² Section 393.130.1, RSMo Supp. 2009.

³³ *Id.* and Section 393.150.2, RSMo 2000.

³⁴ ***Bluefield Water Works & Improvement Co. v. Public Serv. Com'n of the State of West Virginia***, 262 U.S. 679, 690 (1923).

³⁵ ***Federal Power Com'n v. Hope Natural Gas Co.***, 320 U.S. 591, 603 (1944).

the pragmatic adjustments which may be called for by particular circumstances.³⁶

Moreover, making such pragmatic adjustments is part of the Commission's duty:

What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts.³⁷

And:

[T]he Commission [is] not bound to the use of any single formula or combination of formulae in determining rates. Its rate-making function, moreover, involves the making of 'pragmatic adjustments.'³⁸

Thus, the law requires a just and reasonable end, but does not specify a means:

Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling. It is not theory but the impact of the rate order which counts.³⁹

The means employed in the settlement consists of "rate case usage parameters [⁴⁰]" which is a system of policy decisions and accountancy conventions as follows.

a. Rate Adjustment

Determining whether a rate adjustment is necessary requires comparing MAWC's current net income to MAWC's revenue requirement. Revenue requirement is the amount of money that a utility may collect per year, which depends on the requirements for providing safe and effective service at a profit. Those requirements are tangible and intangible:

³⁶ *Federal Power Com'n v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942).

³⁷ *Bluefield*, 262 U.S. at 692.

³⁸ *State ex rel. Associated Natural Gas Co. v. Public. Serv. Com'n*, 706 S.W.2d 870, 873 (Mo. App., W.D. 1985) (citing *Hope Natural Gas Co.*, 320 U.S. at 602-03).

³⁹ *Id.*

⁴⁰ *Stipulation and Agreement*, page 2, paragraph 3.

From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock.⁴¹

That and similar holdings have led to a conventional analysis of the resources devoted to service, from which the Commission determines revenue requirement as follows.

To provide service, a utility devotes resources, which accounting conventions classify as either expense or investment. Expenses include operation, replacement of capital items as they depreciate (“current depreciation”), and taxes on the return. Investment is the basis (“rate base”) on which the utility seeks profit (“return”). Return is therefore a percentage (“rate of return”) of rate base. Rate base includes capital assets (“gross plant”), less historic deterioration of such assets (“accumulated depreciation”), plus other items.

Those components relate to each other in the following formula:

$$\begin{aligned} \text{Revenue Requirement} &= \text{Expenses} + \text{Return on Rate Base} \\ & \qquad \qquad \qquad \text{Rate of Return} \times \text{Rate Base} \\ & \qquad \qquad \qquad \text{Cost of Capital} \times \text{Capital Invested} \end{aligned}$$

where:

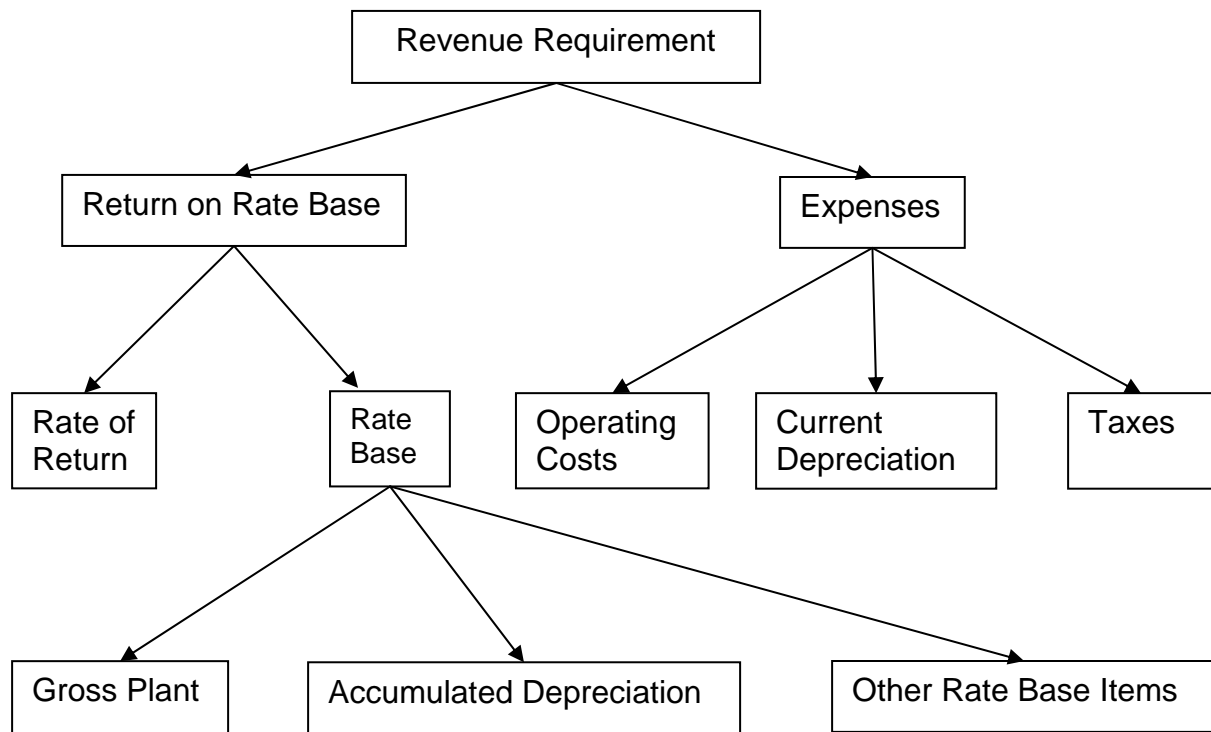
$$\text{Capital Invested} = \text{Gross Plant} - \text{Accumulated Depreciation on Plant} + \text{Other Items}$$

and:

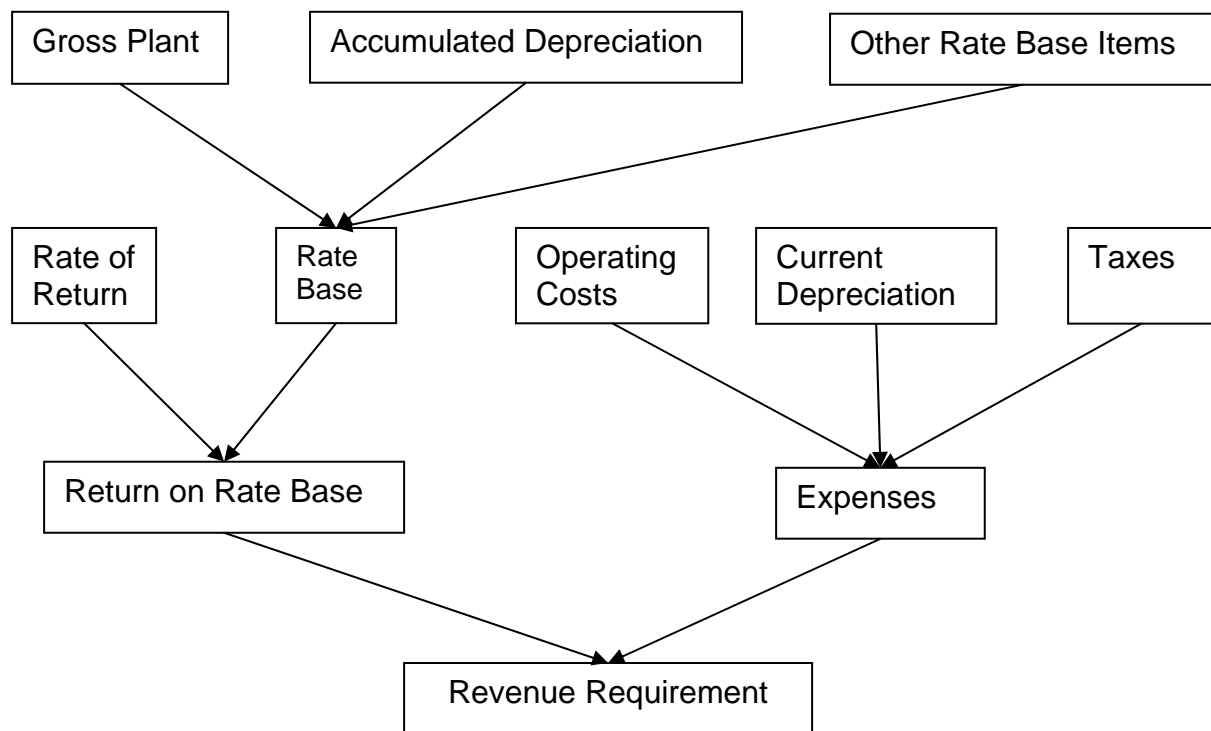
$$\text{Expenses} = \text{Operating Costs} + \text{Current Depreciation} + \text{Taxes}$$

Thus, the revenue requirement breaks down into its elements as follows.

⁴¹ *Hope Natural Gas Co.*, 320 U.S. at 603 (1944).



Conversely, determining the revenue requirement means putting those elements together.



But determining that amount does not end the analysis, because the utility must collect that amount from its customers, and all customers need not receive identical treatment.

b. Rate Design

Rate design is how a utility distributes its revenue requirement among its various classes of customer. Customers vary as to the costs attributable to their service. Accordingly, their rates should reflect their costs, respectively. Just and reasonable rates may account for such differences among customers.

c. Rates Proposed in the Settlement

A utility has the burden of proving that increased rates are just and reasonable⁴² by a preponderance of the evidence.⁴³ The Commission has compared the substantial and competent evidence on the whole record with the settlement as to both rate adjustment and rate design. The Commission independently finds and concludes that the rates proposed in the settlement are just and reasonable rates. Therefore, the Commission incorporates such provisions, as if fully set forth, into this *Report and Order* without further discussion.

VII. Expedited Dates

For those reasons, the Commission will reject the tariff and order the filing of new tariff sheets in compliance with this *Report and Order* (“compliance tariffs”). The parties request approval of such compliance tariffs for services provided on and after July 1, 2010. To accommodate that request, the Commission will order an expedited effective date for this *Report and Order*,⁴⁴ and expedited dates for the filing of compliance tariffs, the effective date of compliance tariffs,⁴⁵ and the filing of Staff’s recommendation on the compliance tariffs.

⁴² Section 393.150.2, RSMo 2000.

⁴³ ***State Board of Nursing v. Berry***, 32 S.W.3d 638, 641 (Mo. App., W.D. 2000).

⁴⁴ Section 386.490.3, RSMo 2000.

⁴⁵ Section 393.140(11), RSMo 2000.

VIII. Additional Report

In addition, the Commission notes that the settlement's effect on the average residential customer varies widely among MAWC's service territories, as Exhibit 227, Attachment A shows. While the record contains substantial and competent evidence weighing in favor of the settlement's provisions, it does not describe the facts that lead to such disparity of rates. Therefore, the Commission will order a report as follows.

Staff, MAWC, and the Office of the Public Counsel shall jointly file a report setting forth, for each service in each service territory, the underlying facts that support each territory's cost of service. Such details may include, but are not limited to, variations in infrastructure requirements, age of each system, number of customers, or differences in water treatment to make water potable. Also, the report will show Exhibit 227, Attachment A with a sixth column that will estimate a single-tariff rate based on comparable usage for the average residential customer. The report will be drafted in a manner such that a layperson will be able to understand the differences in rates.

THE COMMISSION ORDERS THAT:

1. Exhibit No. 227 is entered into the record.
2. The tariff sheets filed by Missouri-American Water Company, to which the Commission assigned tariff number YW-2010-0310, are rejected.
3. Missouri-American Water Company shall file a new tariff consistent with this *Report and Order* no later than June 18, 2010.
4. As to the tariff described in ordered paragraph 3, the Commission's staff shall file its recommendation no later than June 21, 2010.

5. Staff, Missouri-American Water Company, and the Office of the Public Counsel shall file the report described in the body of this *Report and Order* no later than October 15, 2010.

6. The Commission makes no determination as to the deferred matters described in the body of this *Report and Order*.

7. This *Report and Order* shall become effective on June 18, 2010.

BY THE COMMISSION

(S E A L)



Steven C. Reed
Secretary

Jarrett, Gunn, and Kenney, CC., concur.
Clayton, Chm., concurs with separate concurring opinion attached;
and Davis, C., concurs with separate concurring opinion to follow;
and certify compliance with the provisions of
Section 536.080, RSMo.

Dated at Jefferson City, Missouri,
on this 16th day of June, 2010.