BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri-American	)	**Case No. WR-2015-0301**
Water Company's Request for	)	Tariff Nos. YW-2016-0026,
Authority to Implement a General Rate	)	YW-2016-0027, YW-2016-0028,
Increase for Water and Sewer Service	)	YW-2016-0029, YW-2016-0030,
Provided in Missouri Service Areas.	)	YW-2016-0033

STAFF'S REPLY BRIEF

COMES NOW the Staff of the Missouri Public Service Commission, by and through counsel, and for its *Initial Brief,* states as follows:

ARGUMENT

1. Regulatory Policy:

Staff urges the Commission to resolve all open issues in this case according to Staff's recommendations.

The Commission can use whatever methodology it likes.

The courts have said, "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 the pragmatic adjustments which may be called for by particular circumstances."[1] The Commission must, of course, consider all relevant factors during the process of ratemaking.[2] The soundness of the

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[1] ***State ex rel. Missouri Water Co. v. Public Service Commission,*** 308 S.W.2d 704, 714 (Mo. 1957), quoting ***Federal Power Commission v. Natural Gas Pipeline Co.,*** 315 U.S. 575, 586, 62 S.Ct. 736, 743, 86 L.Ed. 1037, ___ (1942). In all quotations in this brief, internal citations and punctuation have been omitted.

[2] ***State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission,*** 585 S.W.2d 41, 49 (Mo. banc 1979) (***"UCCM"***); ***State ex rel. Missouri Water Co. v. Public***

Commission's decision is measured by its final result: "It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry ... is at an end. The fact that the method employed to reach that result may contain infirmities is not then important."[3]

To summarize, the Commission may use whatever methodology it likes so long as it considers all relevant factors and the end result is "just and reasonable" rates.[4]

The end result must be "just and reasonable" rates.

What exactly are just and reasonable rates? The phrase originated in the Interstate Commerce Act of 1887.[5] Section 386.020, the lengthy definition section of the Public Service Commission Law, does not include a definition of "just and reasonable." "The primary rule of statutory interpretation is to give effect to legislative intent as reflected in the plain language of the statute."[6] The meaning of the plain language of a statute is found in the dictionary.[7] Turning to

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Service Commission, 308 S.W.2d 704, 719 (Mo. 1957), *quoting* ***State of Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission et al.,*** 262 U.S. 276, 288, 43 S.Ct. 544, 546, 67 L.Ed. 981, ___ (1922);

[3] ***State ex rel. Office of Public Counsel v. Public Service Com'n,*** 367 S.W.3d 91, 108 (Mo. App., S.D. 2012); *quoting* ***Fed. Power Comm'n v. Hope Natural Gas Co.,*** 320 U.S. 591, 602, 64 S.Ct. 281, 287-288, 88 L.Ed. 333, ___ (1944).

[4] Sections 393.130.1, 393.150.2, RSMo. All statutory references herein are to the Revised Statutes of Missouri ("RSMo."), revision of 2000, as amended and supplemented.

[5] S. Hempling, **Regulating Public Utility Performance: The Law of Market Structure, Pricing and Jurisdiction** 219 (American Bar Association, 2013).

[6] ***Gash v. Lafayette County,*** 245 S.W.3d 229, 232 (Mo. banc 2008), *quoting* ***State ex rel. Burns v. Whittington,*** 219 S.W.3d 224, 225 (Mo. banc 2007).

[7] ***Campbell v. County Commission of Franklin County,*** 453 S.W.3d 762, 768 (Mo. banc 2015).

the dictionary, "just" means "legally right; lawful; equitable."[8] "Reasonable" means "fair; proper; moderate under the circumstances."[9]

Courts have, from time-to-time, provided some commentary on the meaning of the phrase "just and reasonable" rates. In doing so, the courts have emphasized the notion of bilateral fairness and a balancing of competing interests.[10] In 1925, the Missouri Supreme Court said:

> The enactment of the Public Service Act marked a new era in the history of public utilities. Its purpose is to require the general public not only to pay rates which will keep public utility plants in proper repair for effective public service, but further to insure to the investors a reasonable return upon funds invested. The police power of the state demands as much. . . . These instrumentalities are a part of the very life blood of the state, and of its people, and a fair administration of the act is mandatory. When we say "fair," we mean fair to the public, and fair to the investors.[11]

Nearly fifty years later, the Court of Appeals said much the same thing:

> It is axiomatic that a just and reasonable utility rate is a bilateral proposition. Like a coin, it has two sides. On the one side it must be just and reasonable from the standpoint of the utility. On the other side it must be just and reasonable from the standpoint of the utility's customers. This bilateral aspect of utility rate making, although susceptible of easy expression in theory, is considerably more difficult to achieve.[12]

What is a rate that is just and reasonable from the utility's point of view? And what is a just and reasonable rate from the customers' point of view? The

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[8] ***Black's Law Dictionary*** 868 (7th ed., 1999).

[9] *Id.,* 1272.

[10] ***Federal Power Commission v. Hope Natural Gas Co.,*** 320 U.S. 591, 603, 64 S.Ct. 281, 288 (1944): "The rate-making process under the Act, i.e., the fixing of 'just and reasonable' rates, involves a balancing of the investor and the consumer interests."

[11] ***State ex rel. Washington Univ. v. Pub. Serv. Comm'n of Missouri,*** 308 Mo. 328, 344-45, 272 S.W. 971, 973 (banc 1925).

[12] ***St. ex rel. Valley Sewage Co. v. Pub. Serv. Comm'n,*** 515 S.W.2d 845 (Mo. App., K.C.D. 1974).

Missouri Supreme Court has said, "What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand, is that no more be exacted from it . . . than the services rendered by it are reasonably worth."[13] Looking more closely at the company side of the balance, the United States Supreme Court has said:

> 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. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks.That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.[14]

What about the consumers' interest? The courts have explained that the consumers' interest is that rates be no more than is sufficient to "keep public utility plants in proper repair for effective public service, [and] . . . to insure to the investors a reasonable return upon funds invested."[15] Put another way, a just and reasonable rate is "the lowest possible reasonable rate consistent with the maintenance of adequate service in the public interest."[16]

However, just and reasonable rates, the balance of investor and consumer interests with the public interest, is not a single point, but rather a range or

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[13] ***State ex rel. Missouri Water Co. v. Public Service Commission,*** 308 S.W.2d 704, 714 (Mo.1957), quoting ***Smyth v. Ames,*** 169 U.S. 466, 546-7, 18 S.Ct. 48, ___, 42 L.Ed. 819, ___ (1898).

[14] ***Hope Natural Gas,*** *supra.*

[15] ***Washington University,*** *supra,* 308 Mo. at 344-45, 272 S.W. at 973.

[16] ***Atlantic Refining Co. v. Pub. Serv. Comm'n of State of N.Y.,*** 360 U.S. 378, 388, 79 S.Ct. 1246, 1253, 3 L. Ed. 2d 1312, ___ (1959).

zone.[17] "We begin from this basic principle, well established by decades of judicial review of agency determinations of 'just and reasonable' rates: an agency may issue, and courts are without authority to invalidate, rate orders that fall within a 'zone of reasonableness,'[18] where rates are neither 'less than compensatory' nor 'excessive.'"[19] "The Commission may, within this zone, employ price functionally in order to achieve relevant regulatory purposes; it may, in particular, take fully into account the probable consequences of a given price level[.]"[20] The lower end of the zone within which the Commission may set rates is the point at which the rate becomes impermissibly confiscatory;[21] the upper end is the point at which the rate becomes impermissibly excessive.[22]

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[17] Hempling, *supra,* 220-221.

[18] This is *not* the Zone of Reasonableness, cost-of-common-equity analysis sometimes employed in cases before this Commission. That analysis was a form of benchmarking, in which the Commission somewhat arbitrarily declared that the appropriate Return on Equity ("ROE") fell within a 200-basis point range centered on the average of recently-awarded ROEs. *See, e.g.,* ***In the Matter of Union Electric Co. d/b/a AmerenUE,*** 15 Mo.P.S.C.3d 470, 492 (2007).

[19] ***Farmers Union Cent. Exch., Inc. v. F.E.R.C.,*** 734 F.2d 1486, 1502 (D.C. Cir. 1984), *quoting* ***F.E.R.C. v. Pennzoil Producing Co.,*** 439 U.S. 508, 517, 99 S. Ct. 765, 771, 58 L. Ed. 2d 773 (1979), *in turn quoting* ***In re Permian Basin Area Rate Cases,*** 390 U.S. 747, 797, 88 S. Ct. 1344, 1376, 20 L. Ed. 2d 312, ___ (1968).

[20] ***Permian Basin Area Rate Cases,*** *supra,* 390 U.S. at 797, 88 S.Ct. at 1376, 20 L. Ed. 2d at ___.

[21] "However, the Commission must at least afford the utility an opportunity to recover a reasonable return on the assets it has devoted to the public service." ***State ex rel. Utility Consumers Council, Inc. v. Pub. Serv. Comm'n,*** 585 S.W.2d 41, 49 (Mo. banc 1979) ("***UCCM***").

[22] "[T]he dominant thought and purpose of the 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 Com'n,*** 238 Mo.App. 287, ___, 179 S.W.2d 123, 126 (1944). Given that MAWC is a state-regulated monopoly and that its rates are subject to state approval, it is clear that excessive rates would violate the Due Process Clause. "[T]he Due Process Clause contains a substantive component that bars certain arbitrary, wrongful government actions regardless of the fairness of the procedures used to implement them." ***Zinermon v. Burch,*** 494 U.S. 113, 125, 110 S.Ct. 975, 983, 108 L.Ed.2d 100, ___ (1990) (internal quotation omitted).

To summarize, a just and reasonable rate is bilaterally fair in that it balances the investors' interest in a reasonable return, the consumers' interest in the lowest possible price, and the public interest. The point of balance selected by the Commission must fall somewhere in a zone that is neither so low as to be confiscatory nor so high as to be excessive, guided by the principle that the rate should be the lowest reasonable rate consistent with the provision of safe and adequate service and the investors' opportunity to earn a reasonable return.

Public policy considerations:

The Commission's work is not done, however, when it strikes the balance of investor interests against consumer interests described above. The United States Supreme Court has said:

> The Commission cannot confine its inquiries either to the computation of costs of service or to conjectures about the prospective responses of the capital market; it is instead obliged at each step of its regulatory process to assess the requirements of the broad public interests entrusted to its protection by Congress. Accordingly, the 'end result' of the Commission's orders must be measured as much by the success with which they protect those interests as by the effectiveness with which they 'maintain * * * credit and * * * attract capital.'"[23]

These considerations of public policy are particularly significant in the rate design stage of the rate case, which is the stage in which the Commission is presently engaged. This stage is directed to the development of rate schedules designed to produce the target revenue requirement. Note that the Commission is required to make "just and reasonable" *rates*, not a just and reasonable revenue

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[23] ***Permian Basin Area Rate Cases,*** *supra,* 390 U.S. at 791, 88 S.Ct. at 1372-73, 20 L. Ed. 2d at ___.

requirement.[24] A "rate" is the price that the consumers of a utility service must pay.[25] It follows that the charges appearing on the bills of utility customers must themselves be "just and reasonable." The public policy considerations that inform the rate design process include economic development, fairness, affordability, simplicity, stability, avoidance of undue discrimination or preferences, efficiency, and conservation.[26] When striking the balance of investor interests and consumer interests, the Commission must also balance these public policy interests.

Fair rates match costs and cost-causers so that similarly-situated customers will pay the same rate. Simple rates are easy to understand and administer. Stable rates vary little from year-to-year and avoid rate shock to the ratepayer. Discrimination and preferences are the two sides of the subsidization coin. All utility rates involve some degree of subsidization because the cost of serving any particular customer is necessarily slightly different than the cost of serving other customers, if only because of varying distances from the utility plant. Efficiency and conservation mean that prices signal consumers to safeguard society's scarce resources and to avoid waste.

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[24] Put another way, whether rates are just and reasonable is measured from the utility's perspective by examining the total-company revenue requirement; but they are measured from the customers' perspective by examining the bill impacts.

[25] ***Black's,*** *supra,* 1268: "An amount paid or charged for a good or service"; *see also* § 386.020(46): "'Rate', every individual or joint rate, fare, toll, charge, reconsigning charge, switching charge, rental or other compensation of any corporation, person or public utility, or any two or more such individual or joint rates, fares, tolls, charges, reconsigning charges, switching charges, rentals or other compensations of any corporation, person or public utility or any schedule or tariff thereof[.]"

[26] L.E. Alt, Jr., ***Energy Utility Rate Setting: A Practical Guide to the Retail Rate-Setting Process for Regulated Electric and Natural Gas Utilities,*** 58-60 (LULU: 2006); J.C. Bonbright *et al.,* ***Principles of Public Utility Rates,*** 85-179 (PUR: Arlington, VA, 2nd ed. 1988).

Kevin A. Thompson

31. District Consolidation/Consolidated Pricing:

Should the Commission adopt the consolidation of districts proposed by Staff, the alternative consolidation proposed by MAWC, or maintain the status quo as proposed by OPC?

Introduction:

The present case presents multiple, non-contiguous and unconnected water and sewer service territories that vary greatly in size, both geographically and in number of customers.[27] The largest water service territory, St. Louis County, has about 335,909 customers; the smallest, Redfield, has 23 customers.[28] The largest sewer service territory, Arnold, has 6,877 customers; the smallest, Ozark Meadows, has 26.[29] Necessarily, these service territories also vary significantly with respect to the local cost of service. Some of the parties seek to consolidate these territories to a greater or lesser degree in order to spread costs and achieve economies of scale.[30] Other parties oppose consolidation and seek to preserve a localized match of costs to cost-causers, a configuration that will result in higher prices – perhaps unbearable prices -- for some customers.[31]

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[27] *Staff's Cost of Service Report,* pp. 98-99; Wood Direct, pp. 4-8; Appendix A to *Non-Unanimous Partial Stipulation and Agreement,* filed March 24, 2016 (Billing Determinants).

[28] Cassidy Surrebuttal, pp. 2, 4.

[29] *Id.,* p. 3.

[30] MAWC, Staff, Riverside, Brunswick.

[31] OPC, MIEC and several cities that joined its brief: Joplin, St. Joseph, Warrensburg, and Brunswick.

What is the law?

In arguing for or against consolidation, all of the parties have had occasion to cite § 393.130, .2 and .3:

> 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.
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> 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.

Section 393.130.2 prohibits special rates and rebates that result in preferences or discrimination, that is, a greater or lesser price for the same service rendered under the same conditions. Section 393.130.3 prohibits "undue or unreasonable" preferences or discrimination with respect to (1) any person; (2) any corporation; (3) any locality; or (4) "any particular description of service." In summary, "laws designed to enforce equality of service and charges and prevent unjust discrimination, such as the Missouri act, require the same charge for doing a like and contemporaneous service (e. g., supplying water) under the same or substantially similar circumstances or conditions."[32] This principle of equality

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[32] ***State ex rel. Laundry, Inc. v. Pub. Serv. Comm'n,*** 327 Mo. 93, 109, 34 S.W.2d 37, 44 (1931).

does not mean that there cannot be different rates, for example, for different service classifications, "[b]ut 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."[33]

How do these principles apply to the consolidation issue presented by this case? Some of the parties go so far as to assert that consolidation is unlawful. MIEC, together with the cities of Joplin, St. Joseph, and Brunswick, asserts that "Missouri law requires the Commission to set water rates upon the actual cost to render water service in each district, anything less is beyond the authority of the Commission, discriminatory and unlawful."[34] Are these parties correct that consolidation is disfavored, even prohibited?

In fact, they are not correct. This conclusion is apparent from a review of the very cases cited by MIEC in support of its erroneous conclusion. The Missouri Supreme Court stated in 1958:

> We are able to discern no legitimate reason or basis for the view that a utility must operate exclusively either under a systemwide rate structure or a local unit rate structure, or the view that an expense item under a systemwide rate structure must of necessity be spread over the entire system regardless of the nature of the item involved. Experts in utility rates may well conclude that a 'hybrid system' or a 'modified system' of rate making, wherein certain expense items are passed on to certain consumers and certain items are thereby treated on a local unit basis and others on a systemwide basis, is the system which will produce the most

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[33] ***Laundry,*** *supra,* 327 Mo. at 111, 34 S.W.2d at 45, *quoting* ***Western Union Telegraph Co. v. Call Pub. Co.,*** 181 U.S. 92, 100, 21 S.Ct. 561, 564, 45 L.Ed. 765, ___ (1901).

[34] *Initial Post-Hearing Brief of the Missouri Industrial Energy Consumers, City of Joplin, City of St. Joseph, City of Warrensburg, and City of Brunswick,* p. 10 (hereinafter cited as "MIEC Brief").

> equitable rates. And it would appear to be the province and duty of the commission, in determining the questions of reasonable rates, to allocate and treat costs (including taxes) in the way in which, in the commission's judgment, the most just and sound result is reached. And it may well be that gross receipts taxes paid by a utility, while labeled 'operation expense' on the books is not a true operational expense and should be treated differently in so far as concerns the source of the money with which that 'expense' is to be paid.[35]

To summarize, rate structure is a matter within the Commission's sound discretion. The Commission may select either a systemwide rate structure (i.e., Single-Tariff Pricing or STP) or a local unit rate structure (i.e., District-Specific Pricing or DSP), or a hybrid rate structure, in order to produce "the most equitable rates" and "the most just and sound result."[36] As always, the Commission's lodestar is just and reasonable rates.

The ***West Plains*** case involved a telephone company called Western Light & Telephone ("Western"). Western operated 36 non-contiguous, but connected, exchanges in Missouri. Although the utility had a "systemwide rate structure," it sought authority to modify its rates so that license and occupation taxes imposed by some of the municipalities it operated in could be added *pro rata* to the bills of its customers who lived in those municipalities.[37] Previously, these taxes were treated as operating expenses and were paid by all of the customers under Western's systemwide rate structure.[38] The challenge on

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[35] ***State ex rel. City of West Plains v. Pub. Serv. Comm'n,*** 310 S.W.2d 925, 933 (Mo. banc 1958), *overruling in part* ***State ex rel. City of St. Louis v. Public Service Comm'n,*** 362 Mo. 977, 245 S.W.2d 851 (1952).

[36] *Id.*

[37] Municipal taxes were imposed in 25 of the 36 exchanges.

[38] ***West Plains,*** *supra,* 310 S.W.2d at 929.

appeal was "whether it was unreasonably and unjustly discriminatory as to particular telephone subscribers who, as a result of the order, paid in addition to the amount provided by the revised rates, their pro rata share of the license and occupation taxes assessed by the respective municipality in which they resided."[39] The Court concluded it was not.[40]

The importance of ***West Plains*** for the present case is the Court's instruction, quoted above, that the Commission is authorized to devise whatever rate structure it concludes will lead to the most just and reasonable result.[41] MIEC is thus clearly *wrong* in its insistence that Single Tariff Pricing ("STP") or Consolidated Tariff Pricing ("CTP") are unlawful in Missouri. In the course of its discussion, the ***West Plains*** Court said the following about a systemwide rate structure:

> It is true that the theory of rate making on a systemwide basis assumes that inequities of a sort will exist within the system and that a rough balance of such inequities will usually result, so that the discrimination remaining is not unjust discrimination. For example, as noted, the evidence in this case indicates that certain of Western's exchanges made money and others did not, and that the ones that made money may have carried the ones that did not, and that the increase in the rates was made without regard to whether a particular class of service had theretofore more than paid its way. Consequently, it is undoubtedly true that, compared to a rate for each exchange based upon the exact cost of and the amount of services rendered at each of Western's exchanges or a rate based upon the exact cost of and the amount of services furnished in each of Western's local service areas (even though each such area might encompass more than one exchange), Western's systemwide rates would not as nearly reflect the exact costs involved in rendering service at a particular exchange as

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[39] *Id.,* at 928.

[40] *Id.,* at 929.

[41] *Id.,* at 933.

> would an exchange or local service area rate. Thus, to some indefinite and variable extent (depending upon the circumstances and the locations of the service units of the particular utility) inequities in systemwide rates exist and a subscriber at exchange A may pay proportionately more for the service he receives than a subscriber at exchange B.[42]
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> We are of the view, however, that it was not necessary that the commission have before it evidence positively negativing the speculative and conjectural proposition that the result of the commission's order eliminating the unjust discrimination existing by reason of Western's prior treatment of license and occupation taxes would upset the balance of other inequities inhering in Western's systemwide rate structure to the extent of thereby causing a different unjust discrimination. It was sufficient that there was nothing before the commission to indicate that such would occur. If, by reason of the commission's order eliminating from Western's rate structure that which it reasonably found amounted to an unjust discrimination as to certain subscribers, it should occur that the balance of inequities inhering in Western's systemwide rate structure was upset to the extent that an unjust discrimination thereby has been created as to other of Western's subscribers, the entire rate structure and all questions concerning rates, including as an integral part thereof the order permitting and directing the filing of a general rule relating to the passing on of taxes, remain under the control and scrutiny of the commission and any such result is correctable.[43]

The Court stated that "the statutory power and authority which the commission has to pass upon the reasonableness and lawfulness of rates and to determine and pass upon the question of what rates are necessary to permit a utility to earn a fair and reasonable return . . . necessarily includes the power and authority to determine what items are properly includable in a utility's operating expenses and to determine and decide what treatment should be accorded such

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[42] *Id.,* at 930.

[43] *Id.,* at 930-931.

expense items."[44] As the Court said elsewhere, the Commission is authorized to "deal with an item of operating expense in a different manner than other such items as part of a pattern or design to accomplish a just and reasonable total charge to the public for [utility] service."[45]

To recapitulate, the Supreme Court in ***West Plains*** was not disturbed by the fact that, under a systemwide rate structure, "certain . . . exchanges made money and others did not, and that the ones that made money may have carried the ones that did not[.]"[46] This was acceptable because "the theory of rate making on a systemwide basis assumes that inequities of a sort will exist within the system and that a rough balance of such inequities will usually result, so that the discrimination remaining is not unjust discrimination."[47] The Court thereby authorized exactly the sort of consolidation that both MAWC and Staff have proposed in this case.

An illustration of the Commission's ratemaking discretion is found in a case from Cape Girardeau, also cited by MIEC.[48] The City contended that the Commission had unduly discriminated against electric subscribers that lived in the city because evidence showed that the cost to serve them was significantly lower.[49] The City asserted that § 393.130(3), therefore, required lower rates for

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[44] *Id.,* at 928.

[45] ***State ex rel. Hotel Continental v. Burton,*** 334 S.W.2d 75, 77 (Mo. 1960).

[46] ***West Plains,*** *supra,* 310 S.W.2d at 930.

[47] *Id.*

[48] ***State ex rel. City of Cape Girardeau v. Public Service Commission,*** 567 S.W.2d 450 (Mo. App., St.L.D., 1978).

[49] *Id.,* at 451-452.

those subscribers.[50] In affirming the Commission, the Court said:

> [W]hat the city has seemingly chosen to ignore throughout these proceedings is that § 393.130(3) forbids discrimination against persons as well as locations. The commission's order and report make it clear that it was aware of this dual obligation and in this case chose to emphasize equity to the individual user by maintaining a rate system designed on the basis of cost to a class of customer rather than to area. For this reason we view the issue as a question of reasonableness, and will treat it with more detail infra. We cannot hold as a matter of law that the city was entitled to the relief it sought merely by showing a lower cost of service to the city area as a whole.[51]

Again, the Court concluded that District-Specific Pricing ("DSP") was not required by the law, even where the evidence showed that the cost of service in one locality was lower than elsewhere.

MIEC also cites a case from Grain Valley.[52] In this case, the Court of Appeals reversed the Commission.[53] Grain Valley had complained against Southwestern Bell ("SWBT"), asserting that SWBT charged customers in Grain Valley more than it charged customers in Blue Springs for the same service.[54] The Commission found against Grain Valley, concluding that "Grain Valley customers received the same service as Blue Springs customers but that the service was not provided under the same circumstances."[55] The Court reversed the Commission, citing the principle that "a difference in rates must 'be based

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[50] *Id.*

[51] *Id.,* at 453.

[52] ***State ex rel. City of Grain Valley v. Public Service Commission,*** 778 S.W.2d 287 (Mo. App., W.D. 1989).

[53] *Id.*

[54] *Id.*

[55] *Id.,* at 288.

upon a reasonable and fair difference in conditions which equitably and logically justify a different rate....'"[56] The Court explained further that "[u]sually, different conditions are found to exist when there is a difference in the cost of furnishing the service."[57]

How can these cases be reconciled? In ***West Plains*** and ***Cape Girardeau,*** where the same service was rendered under different conditions such that the cost of service differed, the courts concluded that the law did not *require* different rates.[58] However, in ***Grain Valley,*** where the same service was provided and the cost of service did not differ, the court concluded that the law did not *permit* different rates.[59] It appears from these cases that there is a preference for uniform rates, despite differences in cost of service from locality to locality, on the presumption that "a rough balance of such inequities will usually result, so that the discrimination remaining is not unjust discrimination."[60] Where an item of cost differs to such a degree that an undue discrimination or preference can be demonstrated, the Commission is authorized to make whatever pragmatic adjustments are necessary and desirable to correct the situation.[61] As the Court said in ***West Plains:***

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[56] *Id.,* at 290, *quoting* ***State ex rel. City of St. Louis v. Public Service Commission,*** 327 Mo. 318, ___, 36 S.W.2d 947, 950 (1931).

[57] *Id.*

[58] ***West Plains,*** *supra,* 310 S.W.2d at 929; ***Cape Girardeau,*** *supra,* at 453.

[59] ***Grain Valley,*** *supra,* at 290.

[60] ***West Plains,*** *supra,* 310 S.W.2d at 930.

[61] *Id.,* at 928; ***Hotel Continental,*** *supra,* 334 S.W.2d at 77; ***Missouri Water,*** *supra,* 308 S.W.2d at 714.

> If . . . it should occur that the balance of inequities inhering in [the] systemwide rate structure was upset to the extent that an unjust discrimination thereby has been created as to other . . . subscribers, the entire rate structure and all questions concerning rates . . . remain under the control and scrutiny of the commission and any such result is correctable.[62]

Applying the law:

OPC contends that consolidation violates § 393.130 and the principle of cost-causation. An extended analysis of authoritative judicial decisions earlier in this brief has demonstrated that § 393.130 is not a bar to a consolidated or systemwide rate structure. What about cost-causation? Although this phrase did not occur in any of the judicial decisions, the courts did accord the principle significant weight. In ***West Plains,*** the court found that the Commission had reasonably concluded that it was discriminatory to charge ratepayers local taxes from which they derived no benefit.[63] In ***Grain Valley,*** the court held that differences in rates must be based upon differences in service or differences in conditions, which generally means cost of service.[64] However, in ***West Plains*** and ***Cape Girardeau,*** the courts held that local variations in cost of service, even to the extent that "certain . . . exchanges made money and others did not, and that the ones that made money may have carried the ones that did not" did not

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[62] ***West Plains,*** *supra,* 310 S.W.2d at 930-931.

[63] *Id.,* at 929-930: "The proposition, on its face, that certain nonbeneficiary subscribers have had to pay taxes for the sole benefit of other subscribers is such that from it the commission reasonably could have found that Western's former treatment of license and occupation taxes gave some of its customers an undue preference over other customers and that, therefore, the practice was unjustly discriminatory."

[64] ***Grain Valley,*** *supra,* 778 S.W.2d at 290.

constitute an undue preference or undue discrimination.[65]

The ***West Plains*** court made it clear that it is a matter of *degree:* "it was not necessary that the commission have before it evidence positively negativing the speculative and conjectural proposition that the result of the commission's order eliminating the unjust discrimination existing by reason of Western's prior treatment of license and occupation taxes would upset the balance of other inequities inhering in Western's systemwide rate structure *to the extent* of thereby causing a different unjust discrimination."[66] The phrase, "to the extent" indicates that the court considered it to be a matter of degree; that on another occasion, under different circumstances, the "balance of inherent inequities" might be upset to the point that an undue discrimination would occur.

The ***Cape Girardeau*** court, importantly, noted that § 393.130(3) prohibits undue preferences and undue discrimination directed against either localities or persons.[67] The court noted that arguably discriminatory treatment of a locality was permissible where the Commission had devised a customer class-based rate structure that was equitable to persons.[68] OPC and some other parties argue that a District-Specific ("DSP") rate structure best reflects the principle of cost-causation. However, for a member of a particular customer class to have to pay substantially more for the same service than another member of the same class who happens to live in another service territory very likely constitutes

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[65] ***West Plains,*** *supra,* 310 S.W.2d at 930; ***Cape Girardeau,*** *supra,* 567 S.W.2d at 453.

[66] ***West Plains,*** *supra,* 310 S.W.2d at 930-931 (emphasis added).

[67] ***Cape Girardeau,*** *supra,* 567 S.W.2d at 453.

[68] *Id.*

undue discrimination in violation of § 393.130(3).[69]

In the present case, Staff and MAWC have each proposed a consolidated rate structure consisting of three districts, although the proposals are not identical.

5/8" Residential Customers using 3000 G/M	**48R1** **MAWC CTP**	**49R** **Staff's CTP**	**50R1** **OPC NUSA**	**51R1** **Riverside All CTP Except Joplin & St. Jo DSP**	**53R1** **Full STP**
St. Louis Met Includes ISRS	+17.5%	+15.9%	+8.2%	+18.5%	+19.0%
Joplin	-6.4%	-11.2%	-3.3%	+0.5%	-5.2%
Mexico	+7.0%	-15.7%	+10.1%	-13.8%	-13.4%
Jeff City	+5.7%	-16.7%	-2.3%	-14.8%	-14.5%
Warrensburg	+29.4%	+22.7%	+9.6%	+30.5%	+31.1%
Platte County	-6.2%	-20.8%	-3.5%	-24.4%	-24.1%
St. Joseph	+14.6%	+21.1%	+10.7%	-1.2%	+16.1%
Brunswick	-19.6%	-43.7%	-48.5%	-46.3%	-46.1%
Spring Valley	-19.6%	-49.5%	-45.6%	-46.3%	-46.1%
Ozark Mtn	-7.7%	-42.0%	-37.5%	-38.3%	-38.1%
MRSS	-0.3%	-5.4%	+1.9%	+0.6%	+1.0%
Emerald Pointe	+120.3%	+109.0%	+123.3%	+122.3%	+123.2%
Tri-States	+73.3%	+64.4%	+77.2%	+74.8%	+75.6%

Sample Bill Impact Study:
Comparison of effect of various rate structure proposals upon customer bills, for a residential customer with a 5/8" meter using 3,000 gallons per month. The percentage represents the change from a bill using currently existing rates. Rankin and Whitebranch omitted because unaffected by any proposal.

[69] This is implied by the ***Cape Girardeau*** decision.

In its initial brief, based upon an analysis of bill impacts[70] (MAWC Ex. 53R),[71] MAWC went so far as to propose a systemwide rate structure.[72] Other parties, notably OPC and MIEC, oppose consolidation. However, their proposal results in the most adverse bill impacts.[73]

Conclusion:

As has been explained, the law allows the Commission to select whatever rate structure it concludes will result in the most equitable, just and reasonable rates. The Commission's conclusion must, of course, be based upon competent and substantial evidence of record. The selected rate structure may be purely District-Specific ("DSP"), purely Single-Tariff Pricing ("STP"), or a hybrid ("CTP"). The evidence in this case, particularly the bill impact study performed by MAWC, strongly supports consolidated pricing. The fact that some service territories cost more to serve is no bar to this rate structure as a review of the controlling cases demonstrates. Therefore, based on all the foregoing, Staff urges the Commission to adopt Staff's proposed hybrid rate structure because it will result in rates that are just and reasonable and neither unduly preferential nor unduly discriminatory.

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[70] Staff does not endorse MAWC's bill impact study.

[71] Replaced on April 19, 2016, with Ex. 53R1 due to an error.

[72] *Missouri-American Water Company's Initial Brief,* pp. 23-24.

[73] *Id.,* p. 23, MAWC Ex. 50R1. Adverse impact is measured simply by counting the number of increased rates. *Id.*

32. Rate Design & Customer Charge:

A. How should rates be designed? How should the customer charge be adjusted?

Rates for water service generally consist of a fixed customer charge and a commodity charge that varies with usage. These charges differ for each customer class and may also differ by service territory. These two charges are designed, using the billing determinants and the Class-Cost-of-Service Study, so that the revenue realized will equal the class responsibility for the revenue requirement set by the Commission.

The customer charge:

The customer charge is akin to a basic subscription charge and must be paid by every customer each period even if no water is actually used. The Company seeks a higher customer charge to move toward its contention that over 90% of its costs are fixed costs that do not vary with the amount of water sold.[74] OPC, on the other hand, argues for a low customer charge on the theory that the service will thus be more affordable for low-income customers and that conservation will thereby be enhanced due to the stronger price signals sent by the higher commodity charge.

Staff proposes a different customer charge for each of its three geographic districts, higher in each case than the customer charge proposed by OPC but not as high as that proposed by MAWC. Staff's customer charge is based on

[74] Tr. 18:613.

variances in billing and collection costs and fire protection.[75] The difference between the Company and Staff is the treatment of Public Fire, which MAWC proposes to put in the customer charge and Staff proposes to put in the commodity charge.[76] Only the immediate costs attributable to serving a customer – the meter, meter-setting, and meter-reading – should be reflected in the customer charge. The customer charges proposed by Staff vary to reflect variations in these costs by district.[77] Staff's proposal is superior in terms of affordability, stability, and fairness and should be adopted.

Rate structure:

The volumetric or commodity charge sometimes includes a block structure, whereby the price per unit either increase or decreases once a particular volume of usage is exceeded. Declining block rates encourage consumption by dropping the unit price as more is consumed; inclining block rates encourage conservation by raising the unit price as more is consumed.[78] Neither Staff nor MAWC supports inclining block rates because they are not presently necessary in Missouri.[79]

Staff proposes to continue the existing St. Louis Metro rate structure for Water District 1 and to continue the declining block structure for all nonresidential

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[75] Tr. 18:796-97.

[76] *Response to Order Directing Filing,* filed April 7, 2016, Attachment "Customer Charge Differences."

[77] Tr. 18:808-809, 817.

[78] Tr. 18:818.

[79] Tr. 18:820-821.

customer rate classifications for Water District 2 and Water District 3.[80] Staff's method in designing the block rates was to keep the existing ratio between the currently-approved blocks constant.[81]

With regard to customer classes, Staff proposes that any increase or decrease granted after consolidation should be allocated to each customer class on an equal percentage increase or decrease.[82]

C. How should purchased power expense be allocated?

Staff has no position on this sub-issue.

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34. Low-Income Tariff:

Should the Commission adopt a low-income tariff for MAWC?

Staff generally supports the concept of a Low-Income Tariff as rising costs make water service increasingly unaffordable for some, but cannot support the belated proposal submitted in this case because the necessary details are lacking.[83] Staff would prefer to see a pilot program in a smaller area in order to determine how well it works.[84]

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[80] Tr. 18:800-801.

[81] Tr. 18:801.

[82] Tr. 16:403-404.

[83] Tr. 18:864-866.

[84] Tr. 18:865.

Staff also notes that § 393.130 appears to make a Low-Income Tariff unlawful in Missouri in that it would entail a lower (or preferential) price for the same service delivered under the same cost conditions.[85]

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47. Union Issues:

A. Should the Commission condition any rate increase upon MAWC's filling unfilled bargaining unit positions?

Staff reiterates its position that the Union's request is contrary to the public interest. Nothing in the Unions' *Initial Brief* alters Staff's conclusion.

B. Should the Commission order semi-annual reporting of various items as urged by the Unions?

Staff has no position on this sub-issue.

C. Should the Commission order MAWC to comply with and implement American Water Works' valve maintenance program?

Staff reiterates its position that MAWC must do whatever it takes to provide safe and adequate service. Nothing in the Unions' *Initial Brief* leads Staff to doubt that MAWC is meeting this standard.

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WHEREFORE, on account of all the foregoing, Staff prays that the Commission will issue its findings of fact and conclusions of law, determining just and reasonable rates and charges for Missouri-American Water Company as recommended by the Staff herein; and granting such other and further relief as is just in the circumstances.

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[85] *See* discussion *supra* under District Consolidation/Consolidated Pricing, pp. 8-20.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served, either electronically or by hand delivery or by First Class United States Mail, postage prepaid, on this 22nd day of April, 2016, to the parties of record as set out on the official Service List maintained by the Data Center of the Missouri Public Service Commission for this case.

/s/ Kevin A. Thompson