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 and Sewer Service Provided in Missouri Service Areas.	)))))	**Case No. WR-2015-0301** Tariff Nos. YW-2016-0026, YW-2016-0027, YW-2016-0028, YW-2016-0029, YW-2016-0030, YW-2016-0033

STAFF'S INITIAL BRIEF

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

INTRODUCTION

In this general rate case, the Commission exercises its delegated, quasi-legislative authority to set prospective rates for Missouri-American Water Company ("MAWC"), a major public utility. This decision will affect the lives of thousands of Missourians who live and work within MAWC's various service territories. It will affect the profitability – indeed, the viability – of numerous small and large businesses and determine, in part, how much of the family budget will be available for other needs and wants. The Commission's lodestar is the "just and reasonable" rate, which is a rate that produces sufficient revenue to cover MAWC's costs of providing service, allows its shareholders a reasonable opportunity to earn a fair return on their investment, and yet is as affordable as possible for the rate-paying public.[1]

[1] Sections 393.130 and 393.140, RSMo.

The Company:

MAWC is a Missouri corporation that provides water service to more than 460,000 customers located in numerous Missouri cities and counties, including St. Louis County, Jefferson City, Joplin, Mexico, Sedalia, St. Charles, and St. Joseph.[2] MAWC provides sewer service to more than 12,000 customers located in several Missouri cities and counties.[3] MAWC has pursued an aggressive growth strategy through acquisitions large and small since 1993, when it provided only water services in St. Joseph and Joplin.[4] MAWC presently operates approximately 25 public water systems and 56 public wastewater systems in 24 Missouri counties and over 150 Missouri communities.[5] Its Missouri water service facilities include 11 water treatment plants, 29 well sites, 119 water storage tanks, and more than 6,700 miles of water mains.[6] With respect to sewer service facilities, MAWC operates 46 mechanical sewage treatment plants, 10 lagoons, and 76 miles of sewage collection system piping.[7]

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[2] MAWC provides water service to the cities and villages of Branson, Brunswick, Hollister, Houston Lake, Jefferson City, Joplin, Loma Linda, Mexico, Parkville, Platte Woods, Riverside, Reeds Spring, Sedalia, St. Charles, St. Joseph, Warrensburg, Warsaw; as well as in the following Missouri Counties: Barry, Greene, Platte, Warren, St. Louis, and Taney. *Staff's Revenue Requirement Cost of Service Report* ("*Staff's RR Report*")*,* pp. 2-4; Tr. 16:88 ("more than 460,000 water customers").

[3] MAWC provides sewer service to the cities of Arnold, Branson, Cedar Hill, Gravois Mills, Jefferson City, Laurie, Parkville, Reed Springs, Sedalia, and Warsaw, and in the following Missouri Counties: Cole, Callaway, Camden, Morgan, Taney, and Warren. *Staff's RR Report, id.;* Tr. 16:88 ("more than 12,000 wastewater customers").

[4] *Id.*

[5] Tr. 16:88.

[6] *Id.,* pp. 88-89.

[7] *Id.,* p. 89.

MAWC is a wholly-owned subsidiary of American Water Works Company, Inc. ("American Water" or "AWW"), which is the largest investor-owned water and sewer utility in the United States.[8] American Water is headquartered in Voorhees, New Jersey and provides a variety of regulated and unregulated services to approximately 15 million people in over 45 states and parts of Canada.[9] American Water provides regulated water and sewer service in 16 states including Missouri.[10] American Water also controls American Water Works Service Company, Inc. ("Service Company"), which provides various services to American Water's subsidiaries.

The Ratemaking Process:

The Commission's statutory duty is, after due consideration of all relevant factors,[11] to set "just and reasonable" rates.[12] A "just and reasonable" rate is one that balances the interests of the various stakeholders in the light of the public interest.[13] A just and reasonable rate is fair to both the utility and to its customers[14] and is no more than is necessary to "keep public utility plants in

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[8] *Staff's RR Report, supra.*

[9] *Id.*

[10] *Id.*

[11] ***State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission,*** 585 S.W.2d 41, 49 (Mo. banc 1979) ("Even under the file and suspend method, by which a utility's rates may be increased without requirement of a public hearing, the commission must of course consider all relevant factors including all operating expenses and the utility's rate of return, in determining that no hearing is required and that the filed rate should not be suspended.").

[12] Sections 393.130 and 393.140, RSMo.

[13] *See* ***State ex rel. Union Electric Co. v. Public Service Commission,*** 765 S.W.2d 618, 622 (Mo. App., W.D. 1988) ("Ratemaking is a balancing process").

[14] ***St. ex rel. Valley Sewage Co. v. Public Service Commission,*** 515 S.W.2d 845 (Mo. App., K.C.D. 1974).

proper repair for effective public service, [and] . . . to insure to the investors a reasonable return upon funds invested."[15] A just and reasonable rate is not one penny more than is required to cover the utility's necessary and prudent operation and maintenance expenses and to allow a reasonable opportunity of earning a fair profit to the shareholders.[16]

The Commission sets just and reasonable rates via a two-step process using traditional cost-of-service ratemaking.[17] The two steps are (1) the determination of the "revenue requirement," that is, the amount of income the utility needs on an annual basis going forward, and (2) the design of rates that, given the usage characteristics of the utility's customers, will produce the necessary revenue. "Under cost-of-service ratemaking, rates are designed based on a [utility's] cost of providing service including an opportunity for the [utility] to earn a reasonable return on its investment."[18] The Missouri Court of Appeals has described cost-of-service ratemaking as follows: "The Commission [considers

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[15] ***St. ex rel. Washington University et al. v. Public Service Commission,*** 308 Mo. 328, 344-45, 272 S.W. 971, 973 (banc 1925).

[16] ***State ex rel. Valley Sewage Co. v. Public Service Commission,*** 515 S.W.2d 845, 850 (Mo. App. 1974): "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. For these very reasons, the court in ***State ex rel. Missouri Water Company v. Public Service Commission,*** *supra,* recognized, if not explicitly, certainly implicitly, that rate making bodies, within the ambit of their statutory authority, are vested with considerable discretion to make such pragmatic adjustments in the rate making process as may be indicated by the particular circumstances in order to arrive at a just and reasonable rate. Consistent therewith this court believes that subsection 5 of Section 393.270, *supra,* evidences a legislative intent to imbue the Commission with authority to properly weigh all relevant factors in the sewer utility rate making process in order to achieve the ultimate goal of bilateral fairness."

[17] Also known as "rate-of-return" ratemaking. *See* L.E. Alt, ***Energy Utility Rate Setting,*** 18 (2006).

[18] FERC, ***Cost-of-Service Rates Manual,*** 1 (1999) [available electronically at www.ferc.gov].

the] expenses and revenues, to establish a rate that will allow the company to recover its cost of service from its customers."[19] Elsewhere, the court noted:

> The determination of utility rates focuses on four factors. These factors include: (1) the rate of return the utility has an opportunity to earn; (2) the rate base upon which a return may be earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating expenses. The revenue allowed a utility is the total of approved operating expenses plus a reasonable rate of return on the rate base. The rate of return is calculated by applying a rate of return to the cost of property less depreciation. The utility property upon which a rate of return can be earned must be utilized to provide service to its customers. That is, it must be used and useful. This used and useful concept provides a well-defined standard for determining what properties of a utility can be included in its rate base.[20]

This ratemaking recipe is often expressed by the following formula:

$$\mathbf{RR = C + (V - D)\,R}$$

where:	RR	=	Revenue Requirement;
	C	=	Prudent Operating Costs, including Depreciation Expense and Taxes;
	V	=	Gross Value of Utility Plant in Service;
	D	=	Accumulated Depreciation; and
	R	=	Overall Rate of Return or Weighted Average Cost of Capital (WACC).

In the present case, the parties have stipulated to a revenue requirement increase of $30.6 million. Since the Commission has approved the parties' stipulation, the task before the Commission is to determine the rate design.[21]

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[19] ***State ex rel. Laclede Gas Company v. Public Service Commission,*** 328 S.W.3d 316, 317 (Mo. App., W.D. 2010).

[20] ***Union Electric Co.,*** *supra,* 765 S.W.2d at 622.

[21] By its *Order Approving Non-Unanimous Stipulation and Agreement* of April 6, 2016, the Commission approved two non-unanimous stipulations and agreements, one concerning the revenue requirement, filed on March 16, 2016, and the other concerning the billing determinants, filed on March 24, 2016.

Rate Design:

The second half of the ratemaking process is rate design, that is, the development of rate schedules designed to produce the target revenue requirement. The steps of rate design are, first, determining the revenue requirement responsibility of each customer class, second, determining the revenue requirement responsibility of each service territory, and, third, developing the class rate schedules necessary to produce the required revenue based on the adjusted test-year billing determinants.[22] Customers, large and small, are classified based on their usage characteristics and on the cost of serving them.

Class responsibility for service costs is determined through a *Class Cost of Service Study* ("*CCOS Study*"). Both Staff and MAWC performed CCOS studies in this case.[23] The purpose of the *CCOS Study* is to establish the revenue requirement responsibility for each customer class.[24] Staff's *CCOS Study* was performed following the base-extra capacity method described in the American Water Works Association manual, *Principles of Water Rates, Fees and Charges* (AWWA, 5th ed.), and applied to MAWC's annualized and normalized test-year water service costs on a consolidated basis.[25] In the base-extra

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[22] That is, sales volumes and customer numbers.

[23] *See Staff's Class Cost of Service and Rate Design Report ("Staff's RD Report"),* pp. 2-5, 6.

[24] *Id.,* p. 2.

[25] *Id.*

capacity method, costs of service are allocated or assigned to four primary cost components: Base, Extra Capacity, Customer, and Fire Protection.[26]

Base costs are the costs that vary with the amount of water used and operation under average load conditions.[27] Base costs are allocated to customer classifications according to the amount of water consumed. Extra Capacity costs are the costs associated with meeting the requirements that are in excess of the average load conditions. The extra capacity costs include operation and maintenance expenses and capital costs for system capacity above what is required for the average rate of use. Customer costs are those costs associated with serving customers, regardless of the amount of water consumed. Those costs include customer accounting and collection expenses, meter-reading, billing, and capital costs related to meters and services. Fire Protection costs are those costs directly assigned to fire protection functions. Staff used 19 factors to allocate costs to the various customer classes.[28] Staff also made certain adjustments to remove distribution costs for certain customers connected directly to transmission mains.[29]

Staff's rate design consists of a fixed customer charge and a variable commodity charge reflecting customer usage.[30] One area of tension in this case is the Company's desire to substantially increase the customer charge

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[26] *Id.*

[27] *Id.* The remainder of this paragraph is based on the same source.

[28] *Id.,* pp. 3-4.

[29] *Id.,* p. 5.

[30] *Id.,* pp. 5-6.

component for each class in order to ensure recovery of fixed costs. Rate design may be driven by considerations additional to recovering the necessary revenue requirement in a fair and equitable manner. Learned commentators on the rate design process refer to "objectives" including fairness, simplicity, stability, avoidance of undue discrimination or preferences, efficiency, and conservation.[31] Another consideration in rate design is the avoidance of "rate shock," that is, an increase that is simply too large to be readily accepted by ratepayers.

Rates that are fair match costs to cost causers, so that similarly-situated customers will pay the same rate. Simple rates are easy to understand and administer. Stable rates will generate revenue that tracks costs, so that as costs go up, revenues will too. Discrimination and preferences are the two sides of the subsidization coin. All utility rates involve some degree of subsidization because the actual cost of serving each customer is necessarily slightly different based on unique circumstances, such as the distance of each customer from the utility plant. An important goal in rate design is keeping subsidies as limited as possible. Efficiency and conservation mean that prices send appropriate cost signals to the customers to safeguard society's scarce resources and to avoid waste.

-- Kevin A. Thompson.

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[31] Alt, *supra,* 58-60; J.C. Bonbright *et al.,* ***Principles of Public Utility Rates,*** 85-179 (PUR: Arlington, VA, 2nd ed. 1988).

ARGUMENT

1. Regulatory Policy:

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

Introduction:

First, with respect to the revenue requirement, the Commission has approved the *Non-Unanimous Revenue Requirement Stipulation and Agreement* submitted by the parties.[32] In its initial filing on July 31, 2015, MAWC sought a prospective increase of its annual base revenues of $51,028,321.[33] The parties stipulated to a revenue requirement increase of $30.6 million, divided between water ($28,544,941) and sewer ($2,055,059). Of the water service revenue requirement increase, $25,892,662 reflects the rebasing of the St. Louis County Infrastructure System Replacement Surcharge ("ISRS"), leaving a revenue requirement increase of $2,652,279.[34] Of the sewer service revenue requirement increase, $1,489,263 pertains to the newly-acquired Arnold district. Assuming that the Commission accepts the parties' stipulation, the task now before the Commission is the design of appropriate rates.

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[32] Filed on March 16, 2016; EFIS Item 227.

[33] *Staff's RR Report,* p. 1. Increased to $53,736,462 in Staff's *Reconciliation* provided to the Commission at the hearing.

[34] *Id.* The ISRS is authorized by §§ 393.1000, 393.1003 and 393.1006, RSMo., and Commission Rule 4 CSR 240-3.650. The ISRS is a surcharge that recovers the cost of certain specified capital projects between general rate cases; it is reset to zero at each general rate case and the accumulated amount of rate base investment is incorporated into base rates.

Second, with respect to rate design, the most contentious issues are district consolidation, the design of the rate structure, and whether or not MAWC should institute a pilot low-income tariff.

District Consolidation:

In the area of district consolidation, two fundamental principles of public utility regulation are at odds. Spreading the costs of the public water supply over the largest possible pool of customers allows significant improvements to be made while avoiding significant per customer rate impacts. However, equity favors requiring that those who cause additional costs, should pay them. Missouri law prohibits both discrimination and preference in utility rates.[35] However, it is also the law that ratemaking bodies are not bound to any single formula or combination of formulas and may, so far as permitted by statute, "make the pragmatic adjustments which may be called for by particular circumstances."[36]

It is the reality that some districts, generally due to fewer customers, have higher customer rates and others have lower customer rates. Customers in low-rate districts are sometimes reluctant to shoulder somewhat higher rates in order to relieve some of the burden of the customers in the high-rate districts. The opposite, of course, is also true – customers in high-rate districts are generally eager to spread costs over a larger customer base. Because MAWC operates

[35] Section 393.130, .2 and .3, RSMo.

[36] ***State ex rel. Missouri Water Co. v. PSC,*** 308 S.W.2d 704, 714 (Mo. 1957) (*quoting* ***Federal Power Comm'n v. Natural Gas Pipeline Co.,*** 315 U.S. 575, 586, 62 S.Ct. 736, 743, 86 L.Ed. 1037, ___ (1942).

numerous unconnected service areas, varying significantly in size and rates, this is a very real problem in this case.

Staff has proposed a hybrid, semi-consolidated district organization that would group service areas into three, geographically-based districts. Staff's solution serves both principles; each district would include a customer base sufficient to absorb necessary costs and yet would preserve distinct rate structures, matching costs to cost causers. None of the competing schemes is as satisfactory as the one proposed by Staff. The Company's plan, for example, would leave some small service areas exposed to intolerable rate shock; as would the *laissez faire,* "leave it the way it is," plan espoused by OPC and MIEC. The Commission has an obligation to make water and sewer service rates as affordable as possible,[37] while avoiding any undue preference or discrimination. This is what Staff's proposed district consolidation accomplishes.

The Arnold Sewer District Revenue Shortfall:

An emerging issue in this case is the fact that there is a shortfall in the recently-acquired Arnold Sewer District of approximately $700,000 between rate revenues and cost of service.[38] MAWC proposes to recover the shortfall from other customers;[39] MAWC does not intend that its shareholders will eat the shortfall.[40] The shortfall is the direct result of the rate increase cap that the

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[37] This obligation arises from the public interest. In 1935, the St. Louis Court of Appeals recognized water service as a "prime necessity of life." ***Whitsett v. City of St. Clair,*** 80 S.W.2d 696, 700 (Mo. App. 1935).

[38] Tr. 18:609.

[39] Tr. 18:609-610.

[40] Tr. 18:807.

Company agreed to with Arnold city officials when it was acquiring the Arnold system.[41] During the case in which MAWC received authority to provide service ion Arnold, there was no mention of this cap and the Commission did not approve any rate cap. There is no public policy reason why other ratepayers should cover this deficiency. Therefore, Staff proposes that it be assigned to the shareholders.

Rate Design:

Rate design is the process of actually preparing schedules of rates for water and sewer service that will collect the necessary revenue requirement over the course of a year. The necessary tools for this process are (1) a cost of service for each district to establish the relative revenue responsibility of each service territory; (2) a class-cost-of-service study that sets out the relative responsibility of each customer class for each district's cost of service, (3) billing determinants that quantify the number of customers and the amount of usage for each customer class within each district over the test year, and (4) a new, prospective annual revenue requirement. A water utility rate generally has two components, a fixed customer charge and a volumetric charge that varies depending on the individual customer's usage. Issues in rate design include balancing the customer charge against the volumetric charge. Volumetric rates are designed to recover that portion of the revenue requirement not recovered by the fixed customer charges.[42]

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[41] Tr. 18:610; 806-807.

[42] Tr. 18:535.

Some of a utility's costs of service are fixed and some are variable. MAWC contends that 90% of its costs are fixed,[43] but Staff has not conducted an in-depth study to determine whether that is true.[44] The variable costs on the system are those that vary with the amount of water produced, which include such expenses as chemicals and purchased power used to pump the water.[45] One of the Company's goals in this case is to increase its customer charge so that a smaller percentage of its fixed costs will be exposed to non-recovery.

The Customer Charge:

Staff's current customer charge proposal for a 5/8" meter is $16.46 for its proposed District 1, $14.83 for District 2, and $14.56 for District 3.[46] These charges are based on variances in billing and collection costs between the proposed districts.[47] Staff does not support a uniform, system-wide customer charge because costs of meter installation and meter reading vary between the geographic districts.[48] However, the customer charge should be uniform within each consolidated district.[49]

MAWC is seeking a state-wide customer charge of $16.90 for a 5/8" meter.[50] MAWC contends that the customer charge should include all meter

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[43] Tr. 18:613.

[44] Tr. 18:794.

[45] Tr. 18:613.

[46] Tr. 18:796. The customer charges originally proposed by Staff are no longer appropriate given the stipulated revenue requirement, Tr. 18:807-808.

[47] Tr. 18:796-97.

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

[49] Tr. 18:818.

[50] Tr. 18:625.

services, customer billing, fire costs, and an allocated portion of administrative and general costs.[51] MAWC's proposed customer charge would recover approximately 24% of its total revenue requirement.[52] MAWC contends that 24.5% of its fixed costs are customer costs.[53]

Rate Structure:

With respect to rate structure, Staff proposes to continue the existing St. Louis Metro ("SLM") rate structure for its proposed Water District 1 and to continue the existing declining block structure for all nonresidential customer rate classifications for proposed Water Districts 2 and 3.[54] Staff's method in designing the block rates was to keep the existing ratio between the currently-approved blocks constant.[55] The Company is proposing a one-block uniform volumetric charge for each customer class for each consolidated rate zone.[56]

Inclining Block Rates:

An emerging issue concerns inclining block rates, a rate structure that encourages conservation because the price per unit increases as more of the service is used. Inclining block rates are appropriate where supplies are constrained, such as in California which is suffering from a prolonged drought.[57]

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[51] Tr. 18:629..

[52] Tr. 18:534.

[53] Tr. 18:613.

[54] Tr. 18:800-801. A declining block rate structure is one in which the price per unit decreases as more of the service is used. Such a rate structure encourages consumption.

[55] *Id.*

[56] Tr. 18:535.

[57] Tr. 18:617.

Staff believes that inclining block rates would effectively encourage conservation by causing some customers to curtail usage.[58] However, it is Staff's view that the necessary level of data for designing such rates, and time for studying their impact, is not presently available.[59] In any event, Staff does not believe that inclining block rates are presently necessary in Missouri.[60]

-- 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?

Consolidation is a policy issue. While Missouri law requires the Commission to ensure that MAWC is providing safe and adequate service at just and reasonable rates,[61] there is neither guiding legal standard nor industry standard that mandates the Commission to approve district-specific pricing, single-tariff pricing, or hybrid pricing.[62] Largely, the Commission is left the discretion to discern what, if any, method of consolidation best fulfills the public interest.

One guiding principle for the Commission is cost-of-service ratemaking, which includes the concept that costs should be assigned to cost causers. Yet,

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[58] Tr. 18:818.

[59] Tr. 18:819-820.

[60] Tr. 18:820-821.

[61] Section 393.130.1, RSMo.

[62] Staff thoroughly analyzed the legal and policy implications of district-specific pricing, single-tariff pricing, and hybrid pricing in SW-2011-0103. Staff concluded that § 393.130.1, RSMo. requires safe and adequate service to be provided without undue or unreasonable prejudice or disadvantage. Staff further noted, "there exists no one controlling legal standard that can be used to evaluate what constitutes 'undue or unreasonable prejudice or disadvantage.'"

the Commission must be cognizant of the reality that ratemaking does not occur in a vacuum. There are many important public policy issues implicated in this rate case, among which include the need for Missouri residents to have access to safe and adequate drinking water, the desire to minimize -- to the extent possible -- rate shock to Missouri residents, and the unfortunate reality that there are many struggling water and sewer companies in Missouri. Simply, cost causation cannot be the only guiding principle the Commission relies upon here.

Currently, MAWC has eight water districts. The Commission in WR-2011-0337 approved the current district structure, which left the seven largest districts – St. Louis Metro (St. Louis County, St. Charles County, and Warren County), Mexico, Jefferson City, Warrensburg, St. Joseph, Platte County, and Joplin – as standalone districts and combined the remaining ten service areas into District 8.[63] The profile of MAWC has changed significantly since the last rate case with the acquisitions the water and/or wastewater systems of Saddlebrooke,[64] Emerald Pointe,[65] Tri-States,[66] Anna Meadows,[67] City of Arnold,[68] Meramec,[69] Hickory Hills,[70] and Redfield.[71] Instead of simply creating a new district for the recent acquisitions, or merely adding the new water system

[63] Busch Rate Design Rebuttal, p. 2, lines 14-19.
[64] WA-2012-0066; SA-2012-0067.
[65] WO-2014-0113; SO-2014-0116.
[66] WO-2013-0517.
[67] WA-2015-0019.
[68] SA-2015-0150.
[69] SO-2013-0260.
[70] WA-2016-0019.
[71] WA-2016-0108.

acquisitions to the existing eight districts, Staff contends that economics and public interest require the Commission to approve further consolidation of MAWC's service areas.

Staff is proposing a hybrid-district consolidation plan. In this case, Staff does not support full consolidation of all districts into one, which would result in single-tariff pricing, nor does Staff support a strict application of district-specific pricing. Staff supports combining MAWC's water service areas into three districts, and MAWC's sewer service areas into five districts.[72] Further, Staff is proposing that costs for water operations be allocated to each respective district and the fixed and commodity charges be uniform within each district for each customer class.[73] For sewer, Staff is recommending that rates remain at their current levels.[74] To accomplish that, Staff proposes that the increased revenue responsibility currently contemplated by the $30.6 million overall revenue requirement be shifted to Staff's three proposed water districts. Staff's recommendation is that 80% of the revenue responsibility be shifted to District 1, 10% to District 2, and 10% to District 3.[75]

<u>Water District Consolidation</u>

- Water District 1: St. Louis Metro, Mexico, Jefferson City, Anna Meadows, Redfield, Hickory Hills.
- Water District 2: St. Joseph, Platte County, Brunswick.

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[72] Busch Direct, p. 9, lines 7-20.

[73] Staff Report on Class Cost of Service and Rate Design.

[74] *Id.*

[75] Tr. Vol. 16, p. 405, lines 3-12.

- Water District 3: Joplin, Warrensburg, White Branch, Ozark Mountain/Lake Taneycomo Acres, Rankin Acres, Spring Valley/Lakewood Manor, Tri-States, Emerald Pointe, Maplewood/Stonebridge, Riverside Estates, and Saddlebrooke.

<u>Sewer District Consolidation</u>

- Sewer District 1: Arnold.
- Sewer District 2: Platte County.
- Sewer District 3: Cedar Hills, Warren County, Anna Meadows, Meramec.
- Sewer District 4: Jefferson City, Maplewood, Ozark Meadows.
- Sewer District 5: Stonebridge, Saddlebrooke, and Emerald Pointe.

Staff's consolidation plan supports the economic and public policy goals of cost-causation ratemaking, rate shock minimization, and providing solutions for struggling water and sewer companies. The three water districts Staff proposes are composed of service areas with similar operating characteristics and geographic locations. Grouping water districts together based on operating characteristics and geographic location makes economic sense. The service areas Staff grouped together receive their water from similar sources, and share many of the same labor and management functions.[76]

The similarity of expenses within Staff's water district consolidation plan allows costs to be allocated more clearly. A substantial portion of the Company's

[76] Busch Direct, p. 10, lines 10-12.

fixed costs is corporate costs.[77] Corporate costs originate with MAWC's parent company, American Water.[78] The costs are allocated to each state where American Water operates, and then costs are allocated to each district within those states.[79] Allocating corporate costs to small, newly-acquired companies is difficult. Small water and sewer systems do not typically share the same corporate costs of large companies such as MAWC.[80] Yet, when MAWC acquires small water and sewer systems, the small systems must pay for call centers and other MAWC corporate costs.[81] In these situations, it is difficult for Staff to find the most equitable method to allocate the corporate costs to these small systems.[82]

Many of MAWC's recent acquisitions have been small systems, with primarily residential customers.[83] Developing rates on a district-specific basis has become exceedingly difficult for Staff as MAWC continues to acquire these small, often struggling, systems.[84] Staff's hybrid-district method alleviates some of the problems of allocating costs. The additional reduction in districts allows costs to be allocated to larger service areas, and eliminates the need for Staff to conduct

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[77] *Id.*

[78] Busch Rebuttal, p. 14, lines 6-18.

[79] *Id.*

[80] *Id.*

[81] Tr. Vol. 16, pp. 478-479.

[82] *Id.*

[83] Busch Direct, p. 10, lines 10-12.

[84] Though not included in this rate case, the Commission granted MAWC approval to acquire Hickory Hills (WA-2016-0019), Jaxon Estates (WA-2016-0054), and Benton County Sewer District (SA-2015-0065). Busch Direct, p.7, lines 7-12.

the difficult task of equitably allocating cost assignments to nearly 30 separate districts.[85]

Beyond just economics, Staff's proposed consolidation plan promotes the public interest. There is a cost to providing all Missouri residents with access to safe and adequate drinking water. Many of MAWC's existing and newly acquired facilities need critical infrastructure upgrades.[86] Consolidating service areas spreads the cost of the investments over a larger population, and smooths the impact on customers' rates. Consolidation policies also encourage MAWC and other water and sewer utilities to invest in Missouri and continue to acquire struggling water and sewer systems.[87] Limiting the number of water districts creates more certainty for how newly acquired systems will fit into a utility's profile.

Notably, MAWC also recommends that the Commission consolidate MAWC's multiple water service districts into three districts. The Company has made statements lending their support to Staff's consolidation plan, even going as far to say, "The Company does not oppose Staff's water districts based on operational characteristics and geographic location. The Company believes this consolidation is an appropriate step to further reduce the number of rate areas."[88] Nonetheless, Staff and MAWC initially disagreed in filed testimony on the composition of the three consolidated districts.

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[85] Busch Direct, pp. 7-8.

[86] *Id.*

[87] Busch Direct, p. 9, lines 2-4.

[88] Herbert Rebuttal, p. 3, lines 12-15.

The Company's initial consolidation testimony requests its service areas be consolidated into three districts.[89] However, MAWC's district consolidation proposal is not proportional. The Company wishes to combine St. Louis Metro, St. Joseph, and Joplin into one district, which would result in 95% of all MAWC's customers being located in only one district, and would leave the two remaining districts with very small customer bases.[90] The Company's proposal frustrates one of the primary reasons for consolidation- the ability to spread costs over a larger customer population.

Other parties to this case have proposed a continuation of the status quo, with limited consolidation.[91] While Staff agrees that the Commission should not adopt single-tariff pricing in this case, the limited consolidation plan put forward in the *Non-Unanimous Stipulation and Agreement on Rate Design, District Consolidation and Sewer Revenue* filed on March 22, 2016, falls short. The limited consolidation plan preserves the eight-water district structure that is currently in place.[92] This plan would not alleviate cost allocation problems with the current district design, nor would it spread costs over a larger customer population in any significant way. Further, maintaining the status quo does not sufficiently support the future acquisition of struggling small water and sewer companies by other utilities. Companies seeking to acquire struggling sewer and

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[89] *See* Herbert Direct.

[90] Busch Rebuttal, p.4, lines 7-14.

[91] The Missouri Office of Public Counsel, the Missouri Industrial Energy Consumers, City of Brunswick, City of St. Joseph, and City of Joplin were signatories to a *Non-Unanimous Stipulation and Agreement on Rate Design, District Consolidation and Sewer Revenue* filed on March 22, 2016.

[92] *Id.*

water companies prefer consistency. Moving towards fewer districts, and basing the composition of the districts on clearly articulated terms, as Staff's plan does, provides consistency. Maintaining the status quo does not.

Sewer systems do not share the same regional operating characteristics that water systems do.[93] Sewer systems within the same service area may use a combination of lagoons, septic systems and mechanical treatment plants.[94] For that reason, Staff simply grouped sewer systems based on geographic location.[95] Again, this makes economic sense. The Company would likely employ the same workers to facilitate regional operations for nearby systems.[96]

Staff recognizes that there are risks in moving towards more consolidation, namely, that MAWC may have more of an incentive to over-invest. To minimize this risk, Staff is requesting the Commission to require MAWC to file a five-year capital expenditure plan yearly with the Commission by January 31 of each year after the effective date of rates in this case.[97] The capital expenditure plan would be available for every party to review and every party would have the opportunity to make recommendations on the need for investment in any particular service area.[98] Foremost, all parties retain the ability to review all of MAWC's expenditures in future rate cases and the Commission retains the right

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[93] *Id.* at lines 22-23.

[94] *Id.*

[95] *Id.* at p. 10-11.

[96] *Id.* at p. 11, lines 1-2.

[97] Busch Rebuttal, p. 11, lines 5-7.

[98] *Id.*

to disallow recovery in rates for the cost of any imprudent investments.[99] Therefore, while Staff recognizes the potential risk for over-investment, requiring the Company to submit yearly five-year expenditure plans, coupled with the Commission's authority to disallow, adequately protects customers against over-investment risks.

In short, Staff's district consolidation proposal strikes the appropriate balance between cost-of-service ratemaking and public policy concerns. Single-tariff pricing is a firm departure from the transparency of cost-of-service ratemaking, and is a move that Staff does not support in this case. Conversely, a strict application of district-specific pricing does not spread costs or provide support to struggling systems, and therefore does not promote the public interest. Staff's hybrid-consolidation plan achieves what the other plans do not -- it preserves cost-of-service ratemaking while ensuring that all Missouri residents have access to safe and adequate water and sewer service at just and reasonable rates.

-- Jamie Myers.

32. Rate Design & Customer Charge:

A. How should rates be designed?

Staff's water rate design proposal is a two-prong approach. First, Staff assigned cost responsibility to each of Staff's proposed three water districts. Second, Staff assigned cost responsibility to each customer class within each district. In designing rates, Staff performed a class cost of service study and

[99] *Id.*

utilized the base-extra capacity method.[100] This method is the generally-accepted industry standard, and MAWC utilized this same method when developing its own rate design and customer charge proposals.[101]

Staff is not proposing inclining-block rates for any of the customer classes. Certainly, there are public policy reasons for moving towards inclining-block rate structures, one of the most important being water conservation. Staff performed a *Water Utility Rate Design Analysis* ("*Analysis*"), filed on June 16, 2015. In performing this *Analysis*, Staff concluded that there was little cost justification for adopting inclining-block rates, particularly in the residential classes.[102]

Staff's method in designing block rates was to keep the existing ratio between the currently approved blocks constant.[103] In doing so, Staff proposes single-block rates for all residential customers.[104] For non-residential customers, Staff proposes the current St. Louis Metro rate structure (single-block rates) be adopted for Water District 1, and declining block structures be adopted in Water District 2 and Water District 3.[105]

B. How should the customer charge be adjusted?

Staff's current customer charge proposal for a 5/8" meter is $16.46 for its

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[100] *Staff Report on Class Cost of Service and Rate Design.*

[101] Herbert Direct, I-3.

[102] Tr. Vol 18, p. 823.

[103] *Staff Report on Class Cost of Service and Rate Design,* p.6.

[104] *Id.*

[105] *Id.*

proposed District 1, $14.83 for District 2, and $14.56 for District 3.[106] These charges are based on variances in billing and collection costs and fire protection costs between the proposed districts.[107] Staff does not support a system-wide, uniform customer charge because costs vary between the geographic districts.[108] However, the customer charge should be uniform within each consolidated district.[109]

Staff and MAWC's customer charge methods are similar. There are differences in the allocation methods of certain costs to the customer charge, but these are relatively minor and many of the differences are minor.

The major difference between Staff and MAWC's studies is public fire allocations. MAWC allocates a lower amount of costs to this class than does Staff. In turn, MAWC redistributes the costs allocated to public fire to the other classes in a way that results in recovery of those costs through the customer charge. Staff, on the other hand, allocates a larger amount of costs to the public fire class. Staff's method then redistributes those costs to the other classes and the costs are recovered through the commodity charge.

C. How should purchased power expense be allocated?

Staff has no position on this sub-issue.

-- Jamie Myers.

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[106] Tr. 18:796. The customer charges originally proposed by Staff are no longer appropriate given the stipulated revenue requirement, Tr. 18:807-808.

[107] Tr. 18:796-97.

[108] Tr. 18:808-809, 817. However, Staff did calculate one at the request of the Chairman: it is $15.33. *Response to Order Directing Filing,* filed April 7, 2016.

[109] Tr. 18:818.

34. Low-Income Tariff:

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

The Commission should not adopt the state-wide low-income tariff as proposed by MAWC in this rate case. At this time, it is Staff's opinion that implementing such a tariff on a state-wide basis would be premature without knowing how the proposal would impact all customers. While the impact of increasing water costs is an important issue, MAWC's late-filed proposal lacks the detail needed to establish a workable program in the near-term. Staff would support a limited low-income pilot program in the St. Joseph area to further study the feasibility of such a program.

During the evidentiary hearing in this case, MAWC brought forth a proposal for a state-wide low-income tariff, which had only briefly been addressed in its pre-filed surrebuttal testimony. During the live testimony, MAWC's counsel indicated that MAWC would be open to the concept of offering this as a pilot program, rather than state-wide, if the Commission found that to be appropriate.[110] This program proposes to discount the customer charge by 80% for eligible low-income customers.[111] MAWC proposes to account for the costs of such a program by including them as a regulatory asset, and deferring review until the next rate case.[112] Although facts presented at the hearing regarding the proposal seemed to indicate a minimal impact on ratepayers, there was nothing presented that would indicate exactly how such a proposal would operate and

[110] Tr. v. 18, p. 825:4-10; 851:2-4.

[111] Tr. v. 18, p. 848:1-3.

[112] Tr. v.18, p. 846:1-5.

how it would affect participating and non-participating customers. Accordingly, Staff cannot support the proposed program state-wide. However, if it were limited to the St. Joseph area as a pilot program, Staff would support a pilot low-income tariff.[113]

-- Marcella Mueth.

47. Union Issues:

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

No, Staff considers this request to be contrary to the public interest. The Unions propose to hold MAWC and all of its ratepayers hostage until unfilled bargaining unit positions are filled. However, the public interest does not require that these positions be filled. The public interest, as expressed in Missouri statutes, require safe and adequate service at just and reasonable rates.[114] It is within the discretion of the Company's officers and directors to decide how these goals shall be achieved.[115] Perhaps the Company has found a less expensive, but still adequate, labor source. Perhaps the Company has achieved operational efficiencies that allow it to function with fewer employees. So long as the result is safe and adequate service at just and reasonable rates, the public interest is satisfied. For this reason, this proposal should be denied.

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[113] Tr. v. 18, p. 865:21-23.

[114] Section 393.130.1, RSMo.

[115] ***State of Missouri ex rel. Southwestern Bell Tel. Co. v. Pub. Serv. Comm'n of Missouri*****,** 262 U.S. 276, 289, 43 S.Ct. 544, 547, 67 L.Ed. 981, ___ (1923): "It must never be forgotten that, while the state may regulate with a view to enforcing reasonable rates and charges, it is not the owner of the property of public utility companies, and is not clothed with the general power of management incident to ownership."

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 expects MAWC to undertake such valve maintenance as is necessary to ensure the continued delivery of safe and adequate service.[116] In the event that the Company should fail to do so, Staff would promptly initiate an action before the Commission to compel MAWC to undertake any necessary improvements in its facilities and methods.[117]

-- Kevin A. Thompson.

CONCLUSION

In conclusion, Staff recommends that the Commission consolidate MAWC's districts and service areas as proposed by Staff, setting customer charges and designing rates as proposed by Staff. In this way, just and reasonable rates will be set and all relevant factors considered, with due regard to the interests of the various parties and to the public interest.

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.

[116] Section 393.130.1, RSMo.

[117] Sections 393.140.2, 393.270.2, RSMo.

Respectfully submitted,

KEVIN A. THOMPSON, Mo. Bar 36288
Chief Staff Counsel

MARCELLA MUETH, Mo. Bar 66098
Assistant Staff Counsel

JAMIE MYERS, Mo. Bar 68291
Assistant Staff Counsel

Attorneys for the Staff of the
Missouri Public Service Commission.

Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102
573-751-6514 (Voice)
573-526-6969 (Fax)
kevin.thompson@psc.mo.gov

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 8th 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**