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

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

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**STAFF'S INITIAL BRIEF**

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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. The Commission’s lodestar is the “just and reasonable” standard, which creates a rate that produces sufficient revenue to cover MAWC’s cost of providing service, that includes a reasonable opportunity for its shareholders to earn a fair return on their investment, and yet is just and reasonable for the rate-paying public.<sup>1</sup>

***The Company and Customers:***

MAWC is a Missouri corporation that is a wholly-owned subsidiary of American Water Works Company, Inc. (“American Water” or “AWC”), which is the largest investor-owned water and sewer utility in the United States.<sup>2</sup> American Water is headquartered in Voorhees, New Jersey and provides a variety of regulated and unregulated services to approximately 15 million people in 47 states and parts of Canada.<sup>3</sup> American Water provides

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<sup>1</sup> Sections 393.130 and 393.140, RSMo (2016). All references to the 2016 Missouri Revised Statutes.

<sup>2</sup> Ex. 101, *Staff’s Cost of Service Report* (“*Staff’s COS Report*”), 2: 11-14, 21-22.

<sup>3</sup> *Id.*, 2:14-16.

regulated water and sewer service in 16 states including Missouri.<sup>4</sup> American Water also controls American Water Works Service Company, Inc. (“Service Company”), which provides various services to American Water’s subsidiaries.<sup>5</sup>

MAWC provides water service to more than 460,000 customers located in numerous service areas in and around Missouri cities and counties, including, but not limited to, St. Louis County, Jefferson City, Joplin, Mexico, Warrensburg, St. Charles, St. Joseph, and Riverside.<sup>6</sup> MAWC provides sewer service to more than 12,000 customers located in several Missouri cities and counties.<sup>7</sup> Since its last rate case, Case no. WR-2015-0301 filed in June 2015, MAWC has acquired several water and wastewater systems.<sup>8</sup>

MAWC’s customers are divided into 3 general rate classes: Rate A, Rate B, and Rate J.<sup>9</sup> Rate A generally includes three customer classes: residential, commercial, and other public authorities, Rate B is sale for resale, and Rate J is industrial.<sup>10</sup>

***Ratemaking:***

The Commission’s statutory duty is, after due consideration of all relevant factors,<sup>11</sup> to set “just and reasonable” rates.<sup>12</sup> The United States Supreme Court has said that:

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<sup>4</sup> Ex. 101, *Staff’s COS Report*, 2:20-30.

<sup>5</sup> *Id.*, 2:16-18.

<sup>6</sup> 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, St. Louis metropolitan area, Warrensburg, Warsaw; as well as other areas in the following Missouri Counties: Barry, Greene, Platte, Warren, St. Louis, and Taney. Ex. 101, *Staff’s COS Report*, 2:20-30.

<sup>7</sup> 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. *Id.*, 2:20-30.

<sup>8</sup> *Id.*, 3:1-26.

<sup>9</sup> Ex. 104, *Staff’s Staff’s CCOS & RD Report* (“*Staff’s CCOS & RD Report*”), 6:5-11.

<sup>10</sup> Ex. 104, *Staff’s CCOS & RD Report*, 6:5-11.

<sup>11</sup> *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

Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.<sup>13</sup>

The Supreme Court has further explained that “[t]he rate-making process ... i.e., the fixing of ‘just and reasonable’ rates, involves a balancing of the investor and the consumer interests.”<sup>14</sup>

Missouri Courts have reiterated that balance, stating a “just and reasonable” rate is one that balances the interests of the various stakeholders in the light of the public interest.<sup>15</sup> A just and reasonable rate is fair to both the utility and to its customers<sup>16</sup> and is no more than is necessary to “keep public utility plants in proper repair for effective public service, [and] . . . to insure to the investors a reasonable return upon funds invested.”<sup>17</sup>

The Commission sets just and reasonable rates via a two-step process using traditional cost-of-service ratemaking.<sup>18</sup> 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. The Missouri Court of Appeals has described cost-of-service

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expenses and the utility's rate of return, in determining that no hearing is required and that the filed rate should not be suspended.”).

<sup>12</sup> Sections 393.130 and 393.140, RSMo.

<sup>13</sup> *Bluefield Water Works and Improvement Co. v. Pub. Serv. Com’n of the State of West Virginia*, 262 U.S. 679, 690 (1923).

<sup>14</sup> *Fed. Power Comm’n v. Hope Nat. Gas Co.*, 320 U.S. 591, 603 (1944).

<sup>15</sup> 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”).

<sup>16</sup> *St. ex rel. Valley Sewage Co. v. Public Service Commission*, 515 S.W.2d 845 (Mo. App., K.C.D. 1974).

<sup>17</sup> *St. ex rel. Washington University et al. v. Public Service Commission*, 308 Mo. 328, 344-45, 272 S.W. 971, 973 (banc 1925).

<sup>18</sup> Also known as “rate-of-return” ratemaking. See L.E. Alt, *Energy Utility Rate Setting*, 18 (2006).

ratemaking as follows: “The Commission [considers the] expenses and revenues, to establish a rate that will allow the company to recover its cost of service from its customers.”<sup>19</sup>

In the present case, the parties negotiated and unanimously stipulated to a total revenue requirement for MAWC of \$318 million, an approximate \$24 million increase over revenues authorized in the previous case.<sup>20</sup> Should the Commission approve that Stipulation and Agreement, the remaining revenue requirement issue the Commission must decide is whether to allow MAWC to recover the deferred cost of MAWC’s lead service line replacement program.<sup>21</sup> See below, *Argument*, Section I, Lead Service Line Replacement Program.

***Rate Design:***

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

Class responsibility for service costs is evaluated and presented through a *Class Cost of Service and Rate Design Report*. Both Staff and MAWC performed Class Cost of Service

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

<sup>20</sup> See, Case No. WR-2017-0285, EFIS Item 261, *Stipulation and Agreement*, filed March 1, 2018.

<sup>21</sup> The Commission previously approved that MAWC could book (read: account for) the costs of the lead service line replacement program for consideration for future recovery via this case, in the AAO case heard in November 2017. See, Ex. 135, *Transcript, September 27, 2017 Hearing, Case No. WU-2017-0296*.

<sup>22</sup> That is, sales volumes and customer numbers.

(“CCOS”) studies in this case.<sup>23</sup> The purpose of Staff’s Cost of Service and Rate Design Report (“*Staff CCOS & RD Report*”) is to establish the revenue requirement responsibility for each customer class.<sup>24</sup> Staff’s *CCOS & RD Report* followed the base-extra capacity method described in the American Water Works Association manual, *Principles of Water Rates, Fees and Charges* (AWWA, 7<sup>th</sup> ed.), and applied to MAWC’s annualized and normalized test-year water service costs on a consolidated basis.<sup>25</sup> In the base-extra capacity method, costs of service are allocated or assigned to four primary cost components: Base, Extra Capacity, Customer, and Fire Protection.<sup>26</sup>

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.<sup>27</sup> 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.

While the Stipulation and Agreement filed by the parties resolved some Rate Design considerations, such as to use the *Staff CCOS & RD Report*, to establish customer classifications, two substantial considerations remain for the Commission to determine: (1) whether to maintain the current three-district rate structure, adopt a single rate for each of the customer classes for all service areas—also known as “single tariff pricing” (STP) or consolidated tariff pricing (CTP),

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<sup>23</sup> Ex. 15, *Heppenstall Direct*, CEH-1; Ex. 104, *Staff’s CCOS & RD Report*.

<sup>24</sup> Ex. 104, *Staff’s CCOS & RD Report*, p. 2.

<sup>25</sup> Ex. 104, p. 2

<sup>26</sup> Ex. 104, p. 2

<sup>27</sup> Alt, *supra*, 58-60; J.C. Bonbright *et al.*, *Principles of Public Utility Rates*, 85-179 (PUR: Arlington, VA, 2<sup>nd</sup> ed. 1988).

or return to the eight water districts; and (2) what should be the appropriate customer charge and commodity charge. See below, *Argument*, Section II, Single Tariff Pricing; and Section III, Customer Charge / Commodity Charge.

***Settled and Non-contested Issues:***

The parties to the above-captioned matter reached several Stipulation and Agreements resolving a majority of the issues prior to hearing. On February 28, 2018, MAWC and Jefferson City filed a Stipulation and Agreement resolving the following issues:<sup>28</sup>

- Coordination with local Municipalities for Water Main Replacement (Issue 33 and related sub-issues)
- Private Fire Service Rates (Issue 31 sub-issue)
- Cedar City / Jefferson City Airport and Fire Protection (Issue 34)

On March 1, 2018, the parties filed a Unanimous Stipulation and Agreement, resolving nearly all revenue requirement issues, and some Rate Design issues.<sup>29</sup> These settled issues are as follows:

- Future Test Year (Issue 1)
- Rate of Return (Issue 2)
  - Return on Common Equity (Issue 2a)
  - Capital Structure (Issue 2b)
  - Debt/Preferred Stock Rates/Costs (Issue 2c)
- Usage Normalization (Issue 3)
- Water Utility Revenues (Issue 4)
- Sewer Utility Revenues (Issue 5)
- System Delivery (Issue 6)
- Production Costs (Issue 7)
- Uncollectible Expense (Issue 8)
- Payroll (Issue 9)
  - Lobbying (Issue 9 sub-issue)
  - Capitalization Ratio (Issue 9 sub-issue)
  - Incentive Compensation (Issue 9 sub-issue)
  - Employee Benefits (ESPP) (Issue 9 sub-issue)
- Pension & OPEBs (Issue 10)
- Insurance Other than Group (Issue 11)

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<sup>28</sup> Issue numbering based upon the February 15, 2018, *List of Issues, Order of Witnesses, Order of Cross-Examination and Order of Opening Statements* (“*Issues List*”), filed in the docket of this case.

<sup>29</sup> As identified on the *Issues List* filed February 15, 2018.



- Rate Case Expense (Issue 12)
- Property Taxes (Issue 13)
- Main Break Expense (Issue 14)
- Tank Painting Expense (Issue 15)
- Hydrant Painting (Issue 16)
- Maintenance Expense (Issue 17)
- Miscellaneous Expenses (Issue 18)
  - Advertising Expenses (Issue 18 sub-issue)
  - Postage (Issue 18 sub-issue)
  - Management Expense Charges (Issue 18 sub-issue)
- Engage2Excel Awards (Issue 19)
- Affiliate Transactions (Issue 21)
- Depreciation Expense (Issue 23)
- Depreciation Reserves
- Rate Base (Issue 24)
  - AFUDC regulatory amortization (Issue 24 sub-issue)
  - Capitalized Depreciation (Issue 24 sub-issue)
  - Cash Working Capital (Issue 24 sub-issue)
- Tax Cut and Job Act of 2017 (Issue 25)
  - Corporate Tax Rate Adjustment (Issue 25a)
  - ADIT Treatment Going Forward (Issue 25b)
  - Other TCJA Impacts (Issue 25c, 25d)
- AMI Implementation (Issue 26)
- Cloud Computing (Issue 27)
- Continuation of the Low-Income Pilot Program (Issue 28)
- Inclining Block Rates (Issue 29)
- Revenue Stabilization Mechanism (RSM) (Issue 30)
- Water Rate Design
  - Class Cost of Service (Issue 31 sub-issue)
  - Miscellaneous Service Charges (Issue 31 sub-issue)

On March 6, 2018, the parties filed a Stipulation and Agreement Regarding Rate Design, resolving the following issues:

- Corporate Allocations between Water and Sewer Districts (Issue 20)
- Customer Classifications (Issue 31 sub-issue)
- Sewer Rate Design (Issue 32)

Finally, on March 8, 2018, during hearing, the parties filed a fourth “Stipulation and Agreement Regarding Inclining Block Pilot Program.”

*- Jacob Westen*

## ARGUMENT

### **I. *Lead Service Line Replacement Program***

#### **a. Should MAWC Continue to replace the customer-owned portion of lead service lines (LSL)<sup>30</sup> while performing water main repairs and replacements?**

Yes, MAWC should continue to replace the customer-owned portion of LSLs while performing water main repairs and replacements. This issue was discussed at length throughout the precursor accounting authority order case.<sup>31</sup> In the Commission's *Report and Order* in WU-2017-0296, issued on November 30, 2017, the conclusion was made that "...public policy related to lead in drinking water and its adverse health effects is particularly persuasive in this case."<sup>32</sup> In Staff's view, the Company's replacement of customer-owned portions of LSL was sufficiently argued and ultimately deemed to be good policy in WU-2017-0296,<sup>33</sup> and, thus, will make its argument on this issue brief.

The information backing the public policy of full LSL replacement and the dangers of LSL in general is extensive and well-established:

- When LSL are disturbed, particularly in a partial LSL replacement, lead particles can leach into the water.<sup>34</sup>
- After a LSL is disturbed, it takes times, though the research is unclear on how long, for the line to become "stable" and the presence of lead to dissipate.<sup>35</sup>
- Increased flow volume can cause lead to come loose in a LSL.<sup>36</sup>

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<sup>30</sup> Lead service lines and replacements are discussed throughout this brief. The authors use the following shorthand: LSLs for lead service lines, LSLRs for lead service line replacements. The authors use variations of the short and long form for clarity or readability.

<sup>31</sup> Ex. 135, *Transcript of WU-2017-0296*.

<sup>32</sup> Case No. WU-2017-0296, *Report and Order*, p. 9.

<sup>33</sup> *Id.*

<sup>34</sup> Hrg. Tr. Vol. 15, 309:12-17; 338:20-22.

<sup>35</sup> Hrg. Tr. Vol. 15, 322:7-20.

<sup>36</sup> Hrg. Tr. Vol. 15, 341:9-16.

- Full LSL replacement completely removes a source of potential lead exposure.<sup>37</sup>
- Water filters are not a long-term solution.<sup>38</sup>
- Replacement of customer-owned LSLs during main replacements and other projects is efficient.<sup>39</sup>
- MAWC is focusing on LSL, as opposed to pipes constructed of other materials, because they are a known health risk.<sup>40</sup>
- Past compliance with the Lead and Copper Rule is not a guarantee of future compliance and does not eliminate inherent risks associated with LSL.<sup>41</sup>
- Any reduction in sources of lead is beneficial, as there is no safe blood lead level for children.<sup>42</sup>
- Offering low interest loans to customers to finance LSL replacement is not a reasonable solution for low income households.<sup>43</sup>
- Encountering a LSL and leaving it may not be considered safe and adequate service, something the Company is required to provide.<sup>44</sup>
- MAWC, a water utility, can only reasonably control one source of potential lead contamination.<sup>45</sup>

For the reasons stated above, and as argued in Case No. WU-2017-0296, Staff fully supports the continued replacement of LSL.

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<sup>37</sup> Hrg. Tr. Vol. 15, 356:9-12; 398:1-11.

<sup>38</sup> Hrg. Tr. Vol. 15, 358:2-20; 401:17-24.

<sup>39</sup> Hrg. Tr. Vol. 15, 380:7-12.

<sup>40</sup> Hrg. Tr. Vol. 15, 384:14-20.

<sup>41</sup> Hrg. Tr. Vol. 15, 407:10-21.

<sup>42</sup> Hrg. Tr. Vol 16, 46:12-17.

<sup>43</sup> Hrg. Tr. Vol. 16, 472:1-8.

<sup>44</sup> Hrg. Tr. Vol. 16, 479:1-9.

<sup>45</sup> Hrg. Tr. Vol. 16, 493:8-15.

**b. Should the Commission order the implementation of OPC's Proposed LSL Pilot Program?**

No. Staff renews its argument, originally made in Case No. WU-20107-0296, that OPC's Proposed LSL Pilot Program is unnecessary and outside of the purview of MAWC's control. This is a position taken by other parties in both cases, as well.

In case No. WU-2017-0296, expert witness for MAWC, Mr. Naumick testified that OPC's pilot program is largely redundant in scale and therefore not a best use of MAWC ratepayer money.<sup>46</sup> Similarly, Division of Energy witness Martin Hyman expressed concerns about MAWC ratepayers funding a study that, one, would not be limited to MAWC's service territory, and, two, would consider lead-related issues that are unrelated to the water system and outside of MAWC's control, which is "lead in the water."<sup>47</sup>

In the evidentiary hearing in *this* case, Mr. Naumick once again testified as to the redundancy of OPC's Proposed Pilot Program. When asked by counsel for OPC, "After reviewing all of the testimony, do you still believe that OPC's pilot proposal would be either duplicative or inconsistent with the lead service line replacement collaborative?," Mr. Naumick responded, "Yes."<sup>48</sup> Mr. Naumick goes on to state that the Company has already taken some of the steps suggested by OPC in its Proposed Pilot Program, such as working with local groups and state agencies.<sup>49</sup> OPC's Proposed Pilot Program seems to envision a LSLR plan in its infancy and perhaps earlier; it fails to account for the fact that MAWC began this process before the filing of Case No. WU-2017-0296 and that it has continued through the present day.

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<sup>46</sup> Ex. 135, *Transcript of WU-2017-0296*, 116:7-19.

<sup>47</sup> Ex. 135, *Transcript of WU-2017-0296*, 231:8-16.

<sup>48</sup> Hrg. Tr. Vol. 15, 326:14-18.

<sup>49</sup> Hrg. Tr. Vol 15, 328:7-13; 329:7-13.

It also fails to accept the fact that “The reason for complete removal is that today’s accepted best practice is to undertake ‘full LSL replacement’ as opposed to ‘partial LSL replacement.’”<sup>50</sup>

Furthermore, in prefiled testimony, Dr. Marke, when discussing OPC’s Pilot Program says that “...OPC has designed an alternative path forward that would...ensure prudent expenditures and utilize attempt to minimize the seemingly many unintended consequences that are associated with removing a hazardous material on a customer’s premise.”<sup>51</sup> OPC’s concerns contemplate a lack of information being provided by the company as part of its LSLR practices. This concern is unfounded based on the Company’s agreement to a Staff recommendation to provide annual information “regarding its planned main replacement projects expected to include lead service lines, including the footage of main, number of customer connections, and estimated number and cost of customer-owned lead service lines for that year.”<sup>52</sup> This information can be used to periodically evaluate the prudence of MAWC’s costs and address them in a timely manner if issues are identified.

As part of its argument for the implementation of its Proposed Pilot Program and the general policy matters surrounding LSL, counsel for OPC asked Staff witness Merciel if he knew of any parties that had presented “witnesses with a medical background that could explain the extent of any benefit of removal of the lead service line.”<sup>53</sup> Mr. Merciel admitted that there had been no such witnesses.<sup>54</sup> OPC later asked DE witness Hyman if he had any medical background, and Mr. Hyman respond that he did not.<sup>55</sup> However, when Staff asked OPC witness

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<sup>50</sup> Ex. 108, Merciel Rebuttal, 6:2-4.

<sup>51</sup> Ex. 207, Marke Surrebuttal, 11:20-24.

<sup>52</sup> Ex. 3, Aiton Surrebuttal, 7:14-17.

<sup>53</sup> Hrg. Tr. Vol. 15, 407:23-25.

<sup>54</sup> Hrg. Tr. Vol. 15, 408:1-2.

<sup>55</sup> Hrg. Tr. Vol. 16, 468:18-19.

Marke if he had any medical background he also responded that he did not.<sup>56</sup> OPC's questions of witness express concern that the proper professionals and experts have yet to weigh in on this case, necessitating a Pilot Program, but OPC itself has not presented any medical experts to counter the argument that full LSL replacement is the most beneficial option.

Perhaps the most problematic issue with OPC's Proposed Pilot Program is its focus on a cost on a cost/benefit analysis of lead service line replacement. OPC asked Mr. Hyman if, while keeping in mind that that safest level of lead is zero, if Mr. Hyman had a "cost ceiling" in mind when discussing LSL removal.<sup>57</sup> Mr. Hyman responded that this question "kind of misses the point of reducing public health risks."<sup>58</sup> OPC's Proposed Pilot Program places a limit on the amount of money that the Company can spend on LSLRs, suggesting that once funds were exhausted, OPC would prefer LSLs to remain in use by customers regardless of corresponding main repair and replacement. When asked about whether OPC's preference would be for the LSL to remain in service, without a pilot program or consideration of cost recovery to MAWC, OPC witness Marke was unable to answer a yes or no question by Commissioner Kenney.<sup>59</sup>

Also troubling is OPC's concerns regarding the legality of MAWC's LSL replacement practices. In his prefiled testimony, Dr. Marke states that "OPC maintains its initial position that MAWC's current practice is unlawful and not properly designed. OPC believes that this is an issue beyond the purview of the Commission and more appropriate for the

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<sup>56</sup> Hrg. Tr. Vol. 16, 493:5-7.

<sup>57</sup> Hrg. Tr. Vol. 16, 469:18-21.

<sup>58</sup> Hrg. Tr. Vol. 16, 469:25-470:1.

<sup>59</sup> Hrg. Tr. Vol. 16, 507:15 – 21:

(Question by Comm'r Kenney: "My question is, though, should it be replaced or not? What's your thought? It's just a simple question, yes or no. Regardless of how much is replaced or how much it is.")

Answer by Dr. Marke. "So I don't think it's a simple question, and I guess that's where I'm struggling with this.");

*See*, 502:15 - 508:12 (Full exchange).

Missouri Legislature.”<sup>60</sup> OPC’s concern is not limited, though, to one piece of prefiled testimony, as Dr. Marke makes multiple references to this issue.<sup>61</sup> However, at the evidentiary hearing, and after admitting references to the legality of LSL replacement by the Company were contained in his prefiled testimony, counsel for OPC objected to questions to Dr. Marke asking him about his testimony’s assertion of illegality, and the legality associated with OPC’s Proposed Pilot Program.<sup>62</sup> Staff is confused as to how Dr. Marke is able to speak to the potential illegality of the Company’s actions when he is unable to speak to the potential legality of a program detailed in his own testimony in both this case and Case No. WU-2017-0296. This same circumstance arose in Case No. WU-2017-0296 when Dr. Marke was unable to answer similar questions posed by Staff in response to OPC’s position that MAWC’s tariff does not permit the company to replace customer-owned service lines.

Nowhere in OPC’s testimony is there proposed tariff language that, following their own argument, would make their program “legal.” The entire proposal outlines responsibilities for MAWC in minutia, including request for proposals, potential job creation, soil abatement, proposals for addressing the costs of garbage days, trees, and finished basement, as well as literature review surrounding toys. If OPC believed that tariff language was absolutely necessary, it is startling that OPC would neglect to propose new tariff language to address the legality of their own proposal, or even to recommend that MAWC be responsible for proposing changes. Even more befuddling is that the witness that designed the pilot proposal and spent three rounds of testimony and dozens of pages of testimony describing and defending it, cannot answer if his proposal is a tariff violation or not. A review of his attached case participation history

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<sup>60</sup> Ex. 206, Marke Rebuttal, 8:11-13.

<sup>61</sup> Ex. 203, Marke Direct, 11:20-21; Ex. 201, Marke Direct, 14:3; Ex. 207, Marke Surrebuttal, 11:19-20.

<sup>62</sup> Hrg. Tr. Vol. 16, 487:8-24.

shows Dr. Marke has worked on numerous cases in which he has proposed tariff language, a recent example being the KCPL rate case, Case No. ER-2016-0285, where he proposed customer disclaimer language regarding rooftop solar. In that case, he was able to testify to appropriate tariff language. Dr. Marke also seemed to still have the ability to write testimony regarding tariffs, including alleged violations in his prefiled testimony. Only in this hearing was the witness unable to testify about tariffs and alleged violations, or whether OPC's proposed pilot program was a violation. OPC has not made a showing that MAWC's lead service line replacements are a violation of their tariff.

OPC cannot have it both ways—either its witness who argues legality should be able to identify whether or not its own program is legal—or not. Because Counsel for OPC objected to questions of the witness on this topic at hearing, any filed testimony of Dr. Marke discussing legality ought to be given no weight by the Commission as to any point regarding legality.

Finally, while Staff does oppose the implementation of OPC's proposed program, Staff would not be opposed to taking part in a working group on LSL replacements if so ordered by the Commission.

**c. What recovery approach, if found prudent by the Commission, should be adopted for the AAO amount from WU-2017-0296?**

The appropriate recovery approach adopted for the AAO amount from Case No. WU-2017-0296 should be the unamortized balance of \$1,668,796<sup>63</sup> to be included in rate base and amortized over ten years.<sup>64</sup> These costs are associated with property MAWC will

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<sup>63</sup> See, WR-2017-0285, *Stipulation of Fact Related to True-Up and Motion to Suspend True-Up Procedural Schedule*, Exhibit A.

<sup>64</sup> Ex. 107, McMellen Rebuttal, 3:10-13.



neither own nor maintain and therefore should continue to be recorded in NARUC Account 186.<sup>65</sup>

Staff has proposed a ten year recovery period, shorter than that 65 year recovery period proposed by the Company, because they are extraordinary costs, as determined in WU-2017-0296, but should not be booked in an account associated with plant in service.<sup>66</sup> Staff notes that a ten year recovery period is still longer than that typically associated with AAO costs, but MAWC LSL replacement practice is a larger undertaking than those usually seen in AAO cases.<sup>67</sup> Furthermore, Staff finds the Company's proposal of a 65 year recovery period inappropriate, because LSLs are not a true asset, as they are customer-owned, and should be amortized and not depreciated.<sup>68</sup>

Staff's position also allows the Company to accrue costs on the deferral balance until the point in which the unamortized balance is included in rate base.<sup>69</sup> Staff recommends the carrying charge be calculated using the short-term debt rate.<sup>70</sup>

While OPC takes that position that LSL replacement costs should not be recovered at all, OPC witness Roth stated at the evidentiary hearing that she agrees with Staff that the costs should not be booked in Account 345. Ms. Roth also stated that, in the event the Commission was to approve recovery of LSL replacement costs, those costs should be put into Account 186.<sup>71</sup> OPC recognizes that there is no situation in which booking LSL replacement costs into Account 345 would be appropriate.

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<sup>65</sup> Ex. 124, McMellen Surrebuttal, 2:13-22.

<sup>66</sup> Hrg. Tr. Vol. 16, 440:10-16.

<sup>67</sup> Hrg. Tr. Vol 16, 448:2-6.

<sup>68</sup> Hrg. Tr. Vol. 16, 454:18-22.

<sup>69</sup> Hrg. Tr. Vol. 16, 455:3-9.

<sup>70</sup> Hrg. Tr. Vol. 16, 439: 19-20.

<sup>71</sup> Hrg. Tr. Vol. 16, 481:11-482:2.

Staff also supports a return of and on the unamortized balance stated above be included in rates. According to Staff witness McMellen, “Typically with AAOs where the Commission and the Staff agree it’s a project the company needs to do, we typically include that in rate base and give them the carrying costs and the return on.”<sup>72</sup> Essentially this decision bleeds into the policy issue associated with LSL discussed above: where the Commission has indicated that a Company action is good policy, Staff grants ratemaking treatment for the costs associated with that action treatment that is more favorable than they might otherwise. MAWC has admitted that, without recovery of a return on their LSL associated costs, they would try to avoid encounters with LSL.<sup>73</sup>

Because MAWC does not and will not own the LSL being replaced, Staff recommends that the costs should be included in rate base and not plant in service. To clarify, rate base is the total of net investor funded or supplied plant and other investments (such as materials and supplies, cash working capital, prepaid pension assets, AAO deferrals, etc.) used by the utility in providing service to its customers.<sup>74</sup> Rate of return is then applied to all the investments to arrive at the net operating income requirement. Plant in service represents structures and improvements owned and used by the Company to provide services to ratepayers which are depreciated over time. Although plant in service is a significant part of rate base, there are other investments included in total rate base as stated above. While this is technically just a difference in accounting treatment, Ms. McMellen stated at the evidentiary hearing that plant in service is “an asset that is property that is owned either by person or company that provides a future benefit

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<sup>72</sup> Hrg. Tr. Vol. 16, 444:6-10.

<sup>73</sup> Hrg. Tr. Vol. 15, 301:7-15; 396:10-20.

<sup>74</sup> Hrg. Tr. Vol. 16, 452: 7-25.

to the owner.”<sup>75</sup> The LSL assets will never be owned by the Company and therefore will not provide any future benefit to the Company. To book the costs into Account 186 is the only reasonable way to account for these costs.<sup>76</sup> However, if the Commission were to decide that LSL replacement costs should be placed in Account 345, as proposed by MAWC, Staff would propose that the costs be placed in a subaccount with a different depreciation rate than other costs in Account 345.<sup>77</sup>

MAWC’s argument in support of LSL replacement costs being placed in Account 345 is tenuous at best. MAWC witness Jenkins argues that replacing customer-owned LSL is akin to “installation costs,” including disturbed pavement, sidewalks, and other costs relating to restoring a site to a prior of safe condition.<sup>78</sup> The major flaw in this reasoning is that a customer-owned service line that provides drinking water from the main to the residence is not alike in either purpose or function like curbs or sidewalks. Lines are necessary for utility service. Curbs are not. Such an argument, taken to its logical conclusion, opens the door for MAWC to deem other costs “incidental” that have not been considered so in the past. While Staff supports the replacement of LSLs, they are not incidental to main replacement; MAWC is taking affirmative steps to remove a health risk, not merely restoring damaged customer property. Mr. Jenkins himself admits that, following a LSL replacement, “The resulting replaced portions of the service line owned by the Company will belong to the Company, and the portions owned by the customer will still belong to the customer. Ongoing responsibility for repairs and maintenance of the customer owned portion of the line remains with the customer.”<sup>79</sup>

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<sup>75</sup> Hrg. Tr. Vol. 16, 445:5-8.

<sup>76</sup> Hrg. Tr. Vol. 16, 449:4-7.

<sup>77</sup> Hrg. Tr. Vol. 16, 455:20-24.

<sup>78</sup> Ex. 21, Jenkins Surrebuttal, 46:17-23.

<sup>79</sup> Ex. 19, Jenkins Rebuttal, 39:1-4.

This logic is negated by the fact that MAWC requested an AAO from the Commission, indicating that the costs associated with customer-owned LSL replacement are extraordinary and non-recurring; incidental costs would not meet that standard.

**d. What should the Commission authorize for the recovery of future LSL replacement activity?**

For future recovery of LSL replacement activity, the Commission should authorize MAWC to record any future activity with the same accounting treatment discussed in the previous section and approved in the Report and Order in Case No. WU-2017-0296.<sup>80</sup> MAWC and OPC, restate the same positions on this issue that they take on the previous issue as well: MAWC argues for LSL replacement costs to be booked in Account 345 and OPC argues for no recovery at all. Without belaboring the point, Staff states that, for the policy and accounting principles detailed above, MAWC should continue to book LSL replacement costs in Account 186 and evaluated in future rate cases.<sup>81</sup>

- *Casi Aslin*

**II. *Single Tariff Pricing – Should the Commission keep the current water district structure, adopt single tariff pricing for the water customers, or return to eight water districts?***

The Commission should keep the current three (3) district structure when deciding the method to allocate costs to the various water systems “for the purpose of developing the rates that the customers served by those systems must pay” because a hybrid method like the consolidated current structure is the best way to achieve the most just and sound result.<sup>82</sup> “[W]hen ratemaking, the Commission has the statutory authority to decide whether to employ a

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<sup>80</sup> Ex. 107, McMellen Rebuttal, 3:16-22.

<sup>81</sup> Ex. 107, McMellen Rebuttal, 3:16-22.

<sup>82</sup> *Missouri-Am. Water Co.'s Request for Auth. to Implement a Gen. Rate Increase for Water & Sewer Serv. Provided in Missouri Serv. Areas v. Office of Pub. Counsel*, 526 S.W.3d 253, 257 (Mo. App. W.D. 2017).

single-tariff pricing system,<sup>83</sup> a district-specific pricing system,<sup>84</sup> or a hybrid of the two<sup>85</sup> in order to achieve the most just and sound result.”<sup>86</sup>

While the general purpose of rate design is to develop rates for each customer class based upon an allocation of MAWC’s cost of service, rate design in this case is multifaceted and rates must also be developed based upon the allocation of MAWC’s cost of service to its various districts.<sup>87</sup> This is so because some costs can be directly assigned to a particular district (e.g., treatment facility or distribution system), but other costs, such as corporate costs, must be allocated to all of the districts.<sup>88</sup> Recognizing these important considerations, and in addressing the crux of this policy decision, Staff’s position is to maintain the current consolidated or hybrid structure,<sup>89</sup> as it reaches the most just and reasonable result in setting rates for the customers of MAWC.

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<sup>83</sup> With single tariff pricing, “all costs from the utility are combined and rates are developed on a utility-wide basis so that all customers pay the same rate based on the combined service costs of all water systems.” *Missouri-Am.*, 526 S.W.3d at 257; Ex. 104, Busch, *Staff’s CCOS & RD Report*, 11: 4-6. “Under single-tariff pricing, every customer in every water system operated by a particular water utility pays the same rate.” *Missouri-Am.*, 526 S.W.3d at 257; Ex. 104, Busch, *Staff’s CCOS & RD Report*, 11: 6-8.

<sup>84</sup> District specific pricing “takes all of the costs of providing service to each individual water system and develops rates based upon that water system’s cost of service.” Ex.104, Busch, *Staff’s CCOS & RD Report*, 10: 20-21; *Missouri-Am.*, 526 S.W.3d at 257. “Under district-specific pricing, the customers in each water system pay a rate based only on the costs associated with providing service to that water system.” *Missouri-Am.*, 526 S.W.3d at 257; Ex.104, Busch, *Staff’s CCOS & RD Report*, 10: 21-22.

<sup>85</sup> “A third method for allocating costs is consolidated tariff pricing, in which several water systems are consolidated into a larger district for the purpose of allocating costs and determining rates.” *Missouri-Am.*, 526 S.W.3d at 257; Ex. 104, Busch, *Staff’s CCOS & RD Report*, 11: 16-20. “Under consolidated tariff pricing, all customers within a consolidated district pay the same rate based on the combined service costs of the water systems within that consolidated district.” *Missouri-Am.*, 526 S.W.3d at 257. “Effectively, consolidated tariff pricing implements single-tariff pricing amongst consolidated subsets of water systems operated by a particular water utility.” *Missouri-Am.*, 526 S.W.3d at 257-58.

<sup>86</sup> *Missouri-Am.*, 526 S.W.3d at 265.

<sup>87</sup> Ex.104, *Staff’s CCOS & RD Report*, 10: 2-6.

<sup>88</sup> Ex.104, *Staff’s CCOS & RD Report*, 10: 8-11.

<sup>89</sup> Ex. 104, *Staff’s CCOS & RD Report*, 10: 1-2.

**a. Benefits and Detriments of District Specific Pricing and Single Tariff Pricing**

A primary benefit of district specific pricing is that the cost-causers pay for their own costs, a concept which is sometimes referred to as “cost causation”.<sup>90</sup> However, for small service areas of a few customers, any large necessary investment in rate base can create immediate and long-lasting affordability concerns where a pure cost causation method is followed in designing rates.<sup>91</sup> Alternatively, a primary benefit of consolidated tariff pricing is that it spreads out the costs to a larger customer base, which helps to mitigate the impact of large capital expenditures that need to be made in any particular district.<sup>92</sup> A main detriment of single tariff pricing is that pooling all costs completely requires all customers to pay a portion of all costs, regardless of the cost causer, and the pooling of costs could lead the utility to spending more money than necessary since the overall increase would be spread to all customers.<sup>93</sup>

While district specific pricing and single tariff pricing are the two extremes on the rate design spectrum, a “consolidated” or “hybrid” method is a reasonable alternative to use to develop rates appropriate to collect the revenues needed by MAWC to cover its cost of service.<sup>94</sup> It is this hybrid of the two extremes that the Commission approved in the prior rate case<sup>95</sup> by consolidating the service areas into three distinct districts for purposes of designing rates. This hybrid of the two extremes should likewise be approved in this case because it supports the economic and public policy goals of cost-causation ratemaking, rate shock minimization, and providing solutions for struggling water and sewer companies.

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<sup>90</sup> Ex. 104, *Staff’s CCOS & RD Report*, 10: 27-30.

<sup>91</sup> Ex. 104, *Staff’s CCOS & RD Report*, 10: 30 – 11:2.

<sup>92</sup> Ex.104, *Staff’s CCOS & RD Report*, 11:10-12.

<sup>93</sup> Ex. 104, *Staff’s CCOS & RD Report*, 11:12-15.

<sup>94</sup> Ex. 104, *Staff’s CCOS & RD Report*, 11:16-20; see also *Missouri-Am.*, 526 S.W.3d at 265.

<sup>95</sup> Case No. WR-2015-0301.

**b. The Commission should keep the current water district structure, which consists of three (3) districts**

Staff recommends that the Commission maintain the current three (3) water district structure because altering the structure in this case is not in the best interest of rate payers.<sup>96</sup> Rather, a hybrid method like the current consolidated structure is the best way to achieve the most just and reasonable result. The current consolidated structure of three districts reaches a just and reasonable result for at least four reasons.

First, the current structure has the benefits of both the district specific pricing and single tariff pricing approaches.<sup>97</sup> For example, the districts are large enough to absorb large, necessary rate base investments without extreme customer rate impact.<sup>98</sup> Further, the costs which the customers pay are more aligned with each district in that operating characteristics of the individual systems in each district generally exhibit similar operating characteristics determined by the source of supply and by geographic location.<sup>99</sup>

Second, the current size of the districts is more manageable from an operations and regulatory perspective.<sup>100</sup> This kind of manageability has allowed MAWC to continue to invest in small systems without causing rates to increase too dramatically.<sup>101</sup> Additionally, by maintaining three districts, there is still some restraint on the company from overspending on any

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<sup>96</sup> Ex. 104, *Staff's CCOS & RD Report*, 11:22-24.

<sup>97</sup> Ex. 104, *Staff's CCOS & RD Report*, 11:25.

<sup>98</sup> Ex. 104, *Staff's CCOS & RD Report*, 11:26-27.

<sup>99</sup> Ex. 104, *Staff's CCOS & RD Report*, 11:27-30.

<sup>100</sup> Ex. 104, *Staff's CCOS & RD Report*, 12:1-2.

<sup>101</sup> Ex. 104, *Staff's CCOS & RD Report*, 12:2-3. Since approximately 2012, MAWC has acquired on average two-and-a-half systems per year. Hrg. Tr. Vol. 17 627:24 – 628:5. MAWC has acquired four (4) systems since its last rate case. Ex. 104, *Staff's CCOS & RD Report*, 12:20-25.

given project because the spread of the costs associated with any increases to a specific district are limited to the customer base in that district.<sup>102</sup>

Third, corporate costs are a substantial portion of the cost of service for MAWC – it is difficult to allocate corporate costs to each separate service territory on a district-specific basis.<sup>103</sup> More specifically, trying to determine the most equitable manner to allocate those costs to each service territory, especially the very small service territories, is difficult when attempting to determine the true cost of service to those service territories.<sup>104</sup> Combining service territories through three-district consolidation alleviates that difficulty as corporate costs are allocated to a larger grouping of service territories via the district in which they are assigned.<sup>105</sup>

Fourth, MAWC continues to increase its number of service territories.<sup>106</sup> Investment in these small systems is or will be needed in order to keep these small systems in order so they can continue to provide safe, adequate and reliable service to customers.<sup>107</sup> When the improvements are made, the higher cost of upgrades must be spread over the smaller customer base, which may cause rates to increase dramatically.<sup>108</sup> The dramatic increase may result in rate shock to the customers.<sup>109</sup>

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<sup>102</sup> Ex. 104, *Staff's CCOS & RD Report*, 12:3-6. Staff counsel generally agrees with Mr. Mills' response to Chairman Hall's question at hearing, and Mr. Mills' understanding of the importance of early review of expenditures. Hrg. Tr. Vol. 17 576: 7-24.

<sup>103</sup> Ex. 104, *Staff's CCOS & RD Report*, 12:7-9.

<sup>104</sup> Ex. 104, *Staff's CCOS & RD Report*, 12:9-11.

<sup>105</sup> Ex. 104, *Staff's CCOS & RD Report*, 12:11-13.

<sup>106</sup> Ex. 104, *Staff's CCOS & RD Report*, 12:14-15. *See also* note 101, *supra*.

<sup>107</sup> Ex. 104, *Staff's CCOS & RD Report*, 12:15-17.

<sup>108</sup> Ex. 104, *Staff's CCOS & RD Report*, 12:17-19.

<sup>109</sup> Ex. 104, *Staff's CCOS & RD Report*, 12:19-20.



For these reasons, the Commission should maintain the current consolidated structure consisting of three districts, with the districts being made up of service territories described in Exhibit 104, Staff's CCOS & Rate Design Report, 12:26-13:4.

**c. Why Staff has not recommended Single Tariff Pricing at this time**

The Commission should not adopt single tariff pricing for at least four reasons. First, the Commission just approved consolidation in the previous rate case and those rates have not even been in effect for two years.<sup>110</sup> With a major change in rate design, it makes sense to allow time for the effects of that change to flow through and allow for customers to become accustomed to the new structure.<sup>111</sup> One of the basic principles of rate design is stability; constantly changing rate design does not allow for stability and could lead to greater customer confusion and dissatisfaction.<sup>112</sup>

Second, one concern with consolidated pricing is the potential for the company to increase capital expenditures; to try and avoid that potential problem, the Commission adopted Staff's proposal in the last rate case that MAWC provide its five-year capital planning reports.<sup>113</sup> The first of these five-year plans was submitted in early 2017 and Staff, and the Office of the Public Counsel reviewed that plan.<sup>114</sup> While MAWC has filed its second of the five-year plan in 2018 and review is pending,<sup>115</sup> no conclusions can be drawn from the 2017 plan that over-investment concerns are not still valid.<sup>116</sup>

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<sup>110</sup> Ex. 116, Busch Rebuttal, 13:4-6.

<sup>111</sup> Ex. 116, Busch Rebuttal, 13:6-8.

<sup>112</sup> Ex. 116, Busch Rebuttal, 13:8-10.

<sup>113</sup> Ex. 116, Busch Rebuttal, 13:11-15.

<sup>114</sup> Ex. 116, Busch Rebuttal, 13:17-19.

<sup>115</sup> Hrg. Tr. Vol. 17, 661: 18-22.

<sup>116</sup> Ex. 116, Busch Rebuttal, 13:17-20; Hrg. Tr. Vol. 17, 661: 18-22.

Third, the operating characteristics of the company do not support further consolidation from three districts to one overarching district for the entire state of Missouri.<sup>117</sup> While there are certain similarities in operating characteristics supporting the current structure, a further leap that because all systems have transmission and distribution systems with mains and booster pumps and storage facilities cannot be appropriately made to support the proposition that based on those “all system similarities” all customers face similar costs of service.<sup>118</sup> Thus, the overall operating characteristics are similar enough to support the three-district consolidation, but not so similar as to support single tariff pricing.

Fourth, the additional potential benefits of further consolidation, which in effect would be pure single tariff pricing, proposed by MAWC are not persuasive enough to justify such a change.<sup>119</sup> For example, MAWC witness James Jenkins states that consolidated tariff pricing (CTP) provides better incentives for standard water quality.<sup>120</sup> However, Staff is unaware that MAWC has not met standard water quality in all of its systems and would be shocked to find out MAWC’s standards would deteriorate without further consolidation.<sup>121</sup> Additionally, Mr. Jenkins stated that CTP provides better incentives to purchase small, under-performing utilities.<sup>122</sup> Staff cannot disagree that spreading the costs of necessary upgrades to a larger customer base is beneficial, but this benefit has been achieved already with the current consolidated three districts and it is not anticipated that adopting single tariff pricing would alter

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<sup>117</sup> Ex. 116, Busch Rebuttal, 14:3-7.

<sup>118</sup> Ex. 116, Busch Rebuttal, 14:3-19.

<sup>119</sup> Ex. 116, Busch Rebuttal, 14: 20 – 15:1.

<sup>120</sup> Ex.116, Busch Rebuttal, 15: 2-3.

<sup>121</sup> Ex. 116, Busch Rebuttal, 15: 2-6.

<sup>122</sup> Ex. 116, Busch Rebuttal, 15: 7-8.

MAWC's growing footprint in the state.<sup>123</sup> Mr. Jenkins also posited that CTP promotes state economic development goals, but even without CTP, economic development riders have been utilized to help entice certain large customers to MAWC's service territories.<sup>124</sup> At bottom, the mechanisms in place work and will continue to work.<sup>125</sup>

For the reasons above, the Commission should maintain the current consolidated structure consisting of three districts, and should not adopt single tariff pricing.

**d. Why Staff has not recommended eight districts**

The Commission should not return to eight districts as suggested by the Coalition Cities. The Coalition Cities' witness, Mr. Michael McGarry, suggests reversion back to the largest seven districts having their own rate, plus all the other districts combined into a consolidated district.<sup>126</sup> Unfortunately, no further recommendation was made as to how the rates for those other districts in the consolidated district should be determined.<sup>127</sup> More to the point, and prior to the last case, District 8 was made up of various small districts; there was a common customer charge, but districts within District 8 were combined into three tiers.<sup>128</sup> Since that time, MAWC has acquired additional districts that have been included in one of the three existing districts based on the acquired system's relative geographic location.<sup>129</sup> The Coalition Cities witness' recommendation is silent on the proper way to set rates for those remaining districts to be consolidated into District 8.<sup>130</sup> Based on the foregoing, and with the party advocating

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<sup>123</sup> Ex. 116, Busch Rebuttal, 15: 8-11.

<sup>124</sup> Ex. 116, Busch Rebuttal, 15: 12-14.

<sup>125</sup> Ex. 116, Busch Rebuttal, 15: 14.

<sup>126</sup> Ex. 121, Busch Surrebuttal, 6: 12-14.

<sup>127</sup> Ex. 121, Busch Surrebuttal, 6: 14-15.

<sup>128</sup> Ex. 121, Busch Surrebuttal, 6: 16-17.

<sup>129</sup> Ex. 121, Busch Surrebuttal, 6: 18-19.

<sup>130</sup> Ex. 121, Busch Surrebuttal, 6: 20-21.

eight districts making no suggestion as to the setting of rates for those districts, the Commission should not return to eight districts.

- e. **Offset Mechanism – If the Commission orders consolidated tariffs for water service, should it also order the implementation of the Coalition City Offset Mechanism to allow certain service areas to avoid paying certain capital investment costs?**

**Impacts of Pricing Districts on cities/service areas – If the Commission adopts either MAWC’s or Staff’s rate district proposal, should the Commission establish a working group or collaborative process to determine a rate offset for cities/service areas that have borne the costs of their own system upgrades since 2000?**

Staff had not taken a position on the offset mechanism issue at the time of hearing, except to recommend keeping the current three district rate design without any additional costs except those currently included in MAWC’s cost of service.<sup>131</sup> Coalition Cities’ witness Mr. McGarry suggested the offset mechanism and noted in his surrebuttal testimony that although he prepared a conceptual example, “there are many nuances with respect to timing, cost allocation, and rate design that need to be worked out.”<sup>132</sup> Because these nuances have not yet been worked out, Mr. McGarry recommended a working group or collaborative process to establish the details of the offset mechanism and to report back to the Commission.<sup>133</sup>

If the Commission were to order a working group or collaborative process, then a threshold matter for the working group or collaborative process would be to determine the legality of the offset mechanism. More specifically, the very first question is whether the offset mechanism would involve issues of retroactive ratemaking.<sup>134</sup> Another major legal

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<sup>131</sup> Ex. 104, *Staff’s CCOS & RD Report*, p. 9-13; Ex. 116, Busch, Rebuttal, p. 12-17; Ex. 121, Busch, Surrebuttal, p. 5-6.

<sup>132</sup> Ex. 331, McGarry Surrebuttal 7:1-2.

<sup>133</sup> Ex. 331, McGarry Surrebuttal 7: 3-7.

<sup>134</sup> “The Commission fixes rates prospectively and not retroactively.” *Lightfoot v. City of Springfield*, 236 S.W.2d 348, 353 (Mo.1951). “The commission has the authority to determine the rate to be charged.” *State ex rel. Util. Consumers’ Council of Missouri, Inc. v. Pub. Serv. Comm’n*, 585 S.W.2d 41, 58 (Mo. 1979) (citation

question involves issues of undue discrimination or undue preference,<sup>135</sup> as Mr. McGarry has not identified why only those specific Coalition Cities (St. Joseph, Jefferson City, and Warrensburg)<sup>136</sup> should solely qualify for the offset instead of all service areas, where there is no difference in service.<sup>137</sup> These legal questions are undoubtedly far too great to be considered and implemented outside the rate case through simply submitting a report to the Commission at a later date. Finally, if the intent is for all service areas to receive offset treatment, then the offset mechanism is merely a way to undercut and defeat Commission-ordered single tariff or consolidated pricing.<sup>138</sup>

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omitted). “In so determining it may consider past excess recovery insofar as this is relevant to its determination of what rate is necessary to provide a just and reasonable return in the future, and so avoid further excess recovery.” *Id.* (citation omitted). “It may not, however, redetermine rates already established and paid without depriving the utility (or the consumer if the rates were originally too low) of his property without due process.” *Id.* (citation omitted). “The utilities take the risk that rates filed by them will be inadequate, or excessive, each time they seek rate approval.” *Util. Consumers’ Council*, 585 S.W.2d at 59. “To permit them to collect additional amounts simply because they had additional past expenses not covered by either clause is retroactive rate making, i.e., the setting of rates which permit a utility to recover past losses or which require it to refund past excess profits collected under a rate that did not perfectly match expenses plus rate-of-return with the rate actually established.” *Id.* (citations omitted). “Past expenses are used as a basis for determining what rate is reasonable to be charged in the future in order to avoid further excess profits or future losses, but under the prospective language of the statutes, §§ 393.270(3) and 393.140(5), they cannot be used to set future rates to recover for past losses due to imperfect matching of rates with expenses.” *Id.* (citations omitted).

<sup>135</sup> *State ex rel. Laundry, Inc. v. Public Service Com'n*, provides:

All individuals have equal rights both in respect to service and charges. Of course, such equality of right does not prevent differences in the modes and kinds of service and different charges based thereon. There is no cast iron line of uniformity which prevents a charge from being above or below a particular sum, or requires that the service shall be exactly along the same lines. But that principle of equality does forbid any difference in charge which is not based upon difference in service, and, even when based upon difference of service, must have some reasonable relation to the amount of difference, and cannot be so great as to produce an unjust discrimination.

34 S.W.2d 37, 45 (Mo. 1931).

<sup>136</sup> Ex. 331, McGarry Surrebuttal 1: 8-10.

<sup>137</sup> Ex. 17, Heppenstall Surrebuttal 5: 6-11; *see also* note 135, *supra* and accompanying text.

<sup>138</sup> Hrg. Tr. Vol. 17, 613:19-23.

**f. Impacts of Pricing Districts on cities/service areas – If the Commission adopts either MAWC’s or Staff’s rate district proposal, should the Commission establish a working group or collaborative process to explore capital expenditure tracking mechanisms?**

If the Commission orders consolidated tariffs for water service, a working group or collaborative practice to explore capital expenditure tracking mechanisms should not also be ordered. Instead, MAWC should continue to file its yearly five-year capital expenditure budget that was ordered in WR-2015-0301.<sup>139</sup> By continuing with the filing of the yearly five-year capital expenditure budget, the parties are allowed an opportunity to review the budget and expenditures plan, to examine changes from year to year, and to better address or protect against any potential overinvestment that can occur under a consolidated pricing approach.<sup>140</sup>

**g. Conclusion with respect to Single Tariff Pricing / District Specific Pricing**

Based on the foregoing, the Commission should keep the current consolidated three (3) district structure because a hybrid method like the current consolidated structure is the best way to achieve the most just and reasonable ratemaking result. The Commission should keep the current three district rate design without any additional costs except those currently included in MAWC’s cost of service. Moreover, while a working group is not necessary, should the Commission establish such a process to evaluate rate offsets for certain cities, the group should first determine whether the proposed offset mechanism is allowable as a matter of law. The Commission should not order a working group or collaborative process for the purpose of exploring a capital expenditure tracking mechanism, but MAWC should continue to file its yearly five-year capital expenditure budget that was ordered in WR-2015-0301.

*- Alexandra Klaus*

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<sup>139</sup> Ex. 116, Busch Rebuttal, 13:17-14:2; Hrg. Tr. Vol. 17, 661:16.

<sup>140</sup> Hrg. Tr. Vol. 17, 661: 1-8.

### III. *Customer Charge / Commodity Charge*

- a. **Customer Charge – What is the appropriate customer charge for each customer classification?**
- b. **Commodity Charge – What is the appropriate commodity charge for each customer classification?**

The Commission in each general rate case approves a revenue requirement, equivalent to the utility's cost of providing service.<sup>141</sup> Rates are developed to permit the utility to collect that revenue requirement determined by the Commission.<sup>142</sup> The customer charge is the fixed portion of customer rates, which is charged to every active customer regardless of the customer's usage, and the commodity or usage charge is the portion that varies with a customer's water usage.<sup>143</sup> A customer charge is essentially a flat monthly rate that recovers certain fixed costs caused by all customers regardless of the amount of service used. Fixed costs of service include, in part, items like the costs of meters and service lines. The volumetric charge is based on the amount or volume of service used by the customer, and allows a utility to recover costs that vary with customer demand.<sup>144</sup> In the case of all utilities it is possible to send price signals to customers when setting the volumetric and fixed customer charges. "For example, we know we can expect a different response to a high customer charge and a low volumetric charge than from a low customer charge and a high volumetric charge, even if the two are designed to produce equal revenues in the short run."<sup>145</sup>

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<sup>141</sup> Ex. 116, Busch Rebuttal, 3:17-22.

<sup>142</sup> Ex. 116, Busch Rebuttal, 3:17-22.

<sup>143</sup> Ex. 104 *Staff's CCOS & RD Report*, p. 6:20-24.

<sup>144</sup> *State ex rel. Public Counsel v. Missouri Public Service Com'n*, 289 S.W.3d 240, 243-244 (Mo. App. 2009). While this particular case involves the provision of natural gas service, the Court's description of a customer charge and commodity charge are applicable to this matter. *See also*, Ex. 104, *Staff's CCOS & RD Report*, 3:3-5

<sup>145</sup> Ex. 203, Marke Direct Rate Design, 7:20-23.

Staff has recommended that the current rate structure and customer charges set for MAWC in its last rate case, Case No. WR-2015-0301, remain in effect based on the results of Staff's class cost of service report filed in this case.<sup>146</sup> One of the basic principles of rate design is stability;<sup>147</sup> keeping the current rate structure creates familiarity with the rate structure for most of MAWC's customers.<sup>148</sup> The current customer rates are consistent with the results of Staff's CCOS study conducted in this proceeding and reflect proper allocation of the cost to provide service to MAWC's rate classes.<sup>149</sup> The Commission itself in the Report and Order filed in WR-2015-0301 stated that it attempted "to set a charge that will be fair to both the company and its customers."<sup>150</sup>

The Commission previously approved the current customer charge in the last rate case, stating about the charges that, "[a]nything else is unfair to not only the company but also to customers who use higher amounts of water and thus are disadvantaged by the higher volumetric rates that must accompany a lower customer charge."<sup>151</sup> OPC and CCM have expressed their support for Staff's position, which also exemplifies that Staff's recommendation is fair to MAWC's customers; and DE stated that without moving quarterly customers to monthly billing; it also supported leaving the customer charges in place.<sup>152</sup>

MAWC has also proposed, as part of this request for a rate increase, to move its quarterly billed customers to a monthly billing cycle as AMI meters are installed throughout its

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<sup>146</sup> Ex. 104 *Staff's CCOS & RD Report*.

<sup>147</sup> Ex. 116, Busch Rebuttal, 13:8-9.

<sup>148</sup> Ex. 104, *Staff's CCOS & RD Report*.

<sup>149</sup> Ex. 104, *Staff's CCOS & RD Report* 6:5-12.

<sup>150</sup> Case No. WR-2015-0301, *Report and Order Case*, p. 42.

<sup>151</sup> Case No. WR-2015-0301, *Report and Order Case*, p. 43.

<sup>152</sup> Hrg. Tr. Vol. 18, 872:15-19.



territory.<sup>153</sup> This would only affect MAWC's St. Louis County customers, as quarterly billing is only in effect in that service area.<sup>154</sup> In conjunction with moving the quarterly customers, MAWC proposes to charge its quarterly customers a fixed charge of \$30, more than the current \$22.35, and proposes to lower the customer charge to monthly-billed customers to \$10.<sup>155</sup> MAWC witness LaGrand acknowledges that the proposed quarterly charge is three times the amount of the proposed monthly charge<sup>156</sup> and DE witness Hyman notes that this increases the overall amount collected from current quarterly billed customers by \$7.65 every three months.<sup>157</sup> <sup>158</sup> MAWC testified that it has approximately 370,000 quarterly customers, all in its St. Louis County area.<sup>159</sup> Staff has concerns first of all that not all customers will receive AMI meters for two years from the effective date of rates in this matter<sup>160</sup>, and second, that if the quarterly billed customers are moved to a \$30 customer charge from the current \$22.35 and then shifted to monthly billing, that the customers will experience an increase in the customer charge.<sup>161</sup> In addition to this increase, due to billing and collecting matters, it is cheaper overall to bill customers quarterly as is the current practice so customers may see a rise in future billing costs with a move towards monthly billing.<sup>162</sup> Staff recommends MAWC wait to adjust its customer charge and move its quarterly-billed customers to a monthly billing cycle until its next

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<sup>153</sup> Ex. 22 LaGrand Direct, 18:18-19:8.

<sup>154</sup> Ex. 116, Busch Rebuttal, 12:10-11.

<sup>155</sup> Ex. 22 LaGrand Direct 19:9-13.

<sup>156</sup> Ex. 22 LaGrand Direct 18:19-20.

<sup>157</sup> Ex. 603 Hyman Surrebuttal, 8:18-9:3.

<sup>158</sup> Ex. 22 LaGrand Direct, 18:18-19:8.

<sup>159</sup> Hrg. Tr. Vol. 18, 819:15-25.

<sup>160</sup> Ex. 121, Busch Surrebuttal, 7:18-21.

<sup>161</sup> Hrg. Tr. Vol. 18, 848:21 – 849:7.

<sup>162</sup> Hrg. Tr. Vol. 18, 868:10-18.

rate case, following full installation of AMI meters for these customers and better consideration of its capital expenditures.<sup>163</sup>

The commodity charge was not previously agreed to by the parties to this matter; however, the parties agreed at hearing that it is a calculation that must be derived from the ultimate determination of the rate design, particularly the customer charge, and there is no dispute as to how that calculation is performed.<sup>164</sup> Therefore, Staff believes that from its recommended rate design and customer charge, an appropriate commodity charge will be calculated following the Commission's decision in its report and order to be filed in this matter.

- Whitney Payne

**IV. Scenario Proposed at Hearing – Policy and legal perspectives that the Commission ought to consider.**

At hearing, the Commission asked the parties to brief, for its consideration, legal and policy perspectives of the following cohesive scenario: (1) the recovery of the lead service line AAO costs (2) over a five year amortization period (3), where those costs are currently booked and future costs will continue to be booked into account 186 and (4) those costs will receive rate base treatment when recovered and carrying costs at MAWC's long term debt rate until they are recovered; and, (5) adopting single tariff pricing with a (6) customer charge of eight or nine dollars, where (7) the lead service line replacement costs were spread across customers.<sup>165</sup>

Ratemaking is wholly within the discretion of the Commission so long as the ultimate rates are just and reasonable.<sup>166</sup> Setting rates that encompass the above scenario would be well

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<sup>163</sup> Ex. 121, Busch Surrebuttal, 7:1-8:3.

<sup>164</sup> Hrg. Tr. Vol. 18, 796:1-6; 801:7-16.

<sup>165</sup> Hrg. Tr. Vol. 18, 927:12 – 929:6.

<sup>166</sup> Section 393.130, RSMo (2016); *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 (1942); citing *Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591, 602 (1944) (“It is not theory but the impact

within the authority of the Commission.<sup>167</sup> Nevertheless, while the Commission has broad statutory authority to set rates, Commission decisions must be based upon competent, substantial evidence on the record.<sup>168</sup> Thus, any decision the Commission reaches in regards to the proposed scenario must be based on evidence in the record.

At the invitation of the Commission, Staff presents the following law and policy perspectives for the Commission to consider when deciding whether to order the implementation of the proposed hypothetical.

**a. Can the LSLR costs be allocated (either through direct assignment or formula) to all subclasses within Rate A within a STP scenario?**

First, the Western District recently upheld the prior court finding that “the Commission [has] the statutory authority to spread the costs of service to all of the [utility]’s customers.”<sup>169</sup>

Notably, that court cited to *State ex rel. City of West Plains v. Pub. Serv. Comm’n.* decision:

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 system-wide basis, ***is the system which will produce the most 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.<sup>170</sup>

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of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end.”)

<sup>167</sup> *Id.*

<sup>168</sup> *Missouri-Am. Water Co.’s Request for Auth. to Implement a Gen. Rate Increase for Water & Sewer Serv. Provided in Missouri Serv. Areas v. Office of Pub. Counsel*, 526 S.W.3d 253, 260–61 (Mo.App. W.D. 2017)(The Commission’s order is determined to be reasonable when the order is supported by substantial, competent evidence on the whole record; the decision is not arbitrary or capricious; or where the Commission has not abused its discretion)(internal quotations and notations omitted).

<sup>169</sup> *Missouri-Am. Water Co.’s Request for Auth. to Implement a Gen. Rate Increase for Water & Sewer Serv. Provided in Missouri Serv. Areas v. Office of Pub. Counsel*, 526 S.W.3d 253, 264 (Mo.App. W.D. 2017), *reh’g and/or transfer denied* (June 29, 2017), *transfer denied* (Oct. 5, 2017).

<sup>170</sup> *State ex rel. City of West Plains v. Pub. Serv. Comm’n.*, 310 S.W.2d 925, 933 (Mo. 1958).

(Emphasis added). The Commission, therefore, has the statutory authority to assign particular, given costs to particular, given customers, to the extent the assignment of those costs are equitable.

Direct assignment of costs, to the extent they are knowable, is generally better.<sup>171</sup> However, if costs are not knowable to a particular customer class, then assignment via factor is appropriate. MIEC Witness Mr. Collins testified that direct assignment of lead service line replacement costs is possible based upon MAWC work orders.<sup>172</sup> Nevertheless, regardless of use of direct assignment or allocation via factor, the question remains whether or not the Commission, as a matter of policy *ought* to “allocate and treat costs . . . in the way in which, in the Commission's judgment, the most just and sound result is reached.”<sup>173</sup>

This therefore becomes a policy question for the Commission to decide. The Commission is not bound by *stare decisis*, as the Commission must independently weigh the best course of public policy to apply to reach just and reasonable rates.<sup>174</sup> As long as there is sufficient fact supporting the policy the Commission wishes to implement, and the Commission is authorized by statute to act, the Commission may do so.

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<sup>171</sup> Hrg. Tr. Vol. 17, 650:11 – 651:16 (Heppenstall at 651:12-13, “If it’s possible to directly assign, it’s better. . .”).

<sup>172</sup> See, Hrg. Tr. Vol. 18, 892:10 – 894:2.

<sup>173</sup> *City of West Plains*, 310 S.W.2d 925, at 933.

<sup>174</sup> See, *State Ex rel. Praxair, Inc. v. Pub. Serv. Comm'n of the State of Missouri*, 328 S.W.3d 329, 340 (Mo.App. W.D. 2010)(The PSC “is not bound by *stare decisis* ” based on prior administrative decisions, so long as its current decision is not otherwise unreasonable or unlawful), quoting, *State ex rel. AG Processing, Inc. v. Pub. Serv. Comm'n*, 120 S.W.3d 732, 736 (Mo. banc 2003). See also, *State Ex rel. Praxair, Inc.*, 328 S.W.3d 329, 340 (The Commission has considerable discretion in rate setting due to the inherent complexities involved in the rate setting process. It is not the theory or methodology, but the impact of the rate order which counts); citing, *State ex rel. Associated Natural Gas Co. v. Public Serv. Comm'n*, 706 S.W.2d 870 (Mo.App.1985).

Staff understands Rate A customers to be the source of the LSLR costs currently recorded in account 186.<sup>175</sup> Under the single tariff pricing scenario, class costs would be spread among all customers of the same class. Moreover, in case WU-2017-0296 that authorized the accounting authority order to defer costs related to the LSLR program, the Commission identified that:

The public policy related to lead in drinking water and its adverse health effects is particularly persuasive in this case. MAWC'S LSLR Program adheres to the recommended method of lead removal and eliminates the risk of lead containment that exists with partial lead pipe replacements.<sup>176</sup>

To the extent the Commission views that this public policy consideration outweighs concerns of tying costs to cost-causers, the Commission may decide to set rates that spread the LSLR program costs to all customers within Rate A.

**b. Can the LSLR costs be spread to all customer classes, not just Rate A, under a STP scenario?**

Following the same logic above, the question becomes whether the same analysis extends to the Commission ordering that all LSLR program costs be applied in rates to *all* customer classes, not just the subclasses within Rate A. Generally, the same analysis applies, although the facts in this case are less supportive. Upon review of the available record, there are no facts in the record that suggest whether any members of Rate B or Rate J may have lead service lines.<sup>177</sup> If any industrial or sale for resale customers in Rate B or Rate J have LSLs, then despite difference in costs of replacement from Rate A or Rate J, there would be a basic underlying fact shared among the classes. Without that fact, to place sharing of some of the LSLR costs upon Rate B and Rate J customers, the Commission would need to determine that the public policy

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<sup>175</sup> Ex. 135, *Transcript of WU-2017-0296*, 248:16 – 17. During the WU-2017-0296 case, in responding to a question whether his review of MAWC LSLR invoices showed whether any customers were vulnerable, Mr. Merciel replied regarding the invoices “Well, it’s my understanding that all of – all of those are residential.”

<sup>176</sup> Case No. WU-2017-0296, *Report and Order*, p. 9.

<sup>177</sup> Ex. 135, *Transcript of WU-2017-0296*, 248:16 – 17

implications greatly outweighed any counter-considerations. Without sufficient fact, the support for that policy decision is problematic.

**c. If authorized, would recovery of LSLR costs properly go into the customer charge or the commodity charge?**

As discussed above in Section III, the customer charge is a flat rate intended to capture the fixed costs of a utility. In determining fixed costs, the Staff and MAWC have used in the past and in the current case, the “American Water Works Association Manual of Water supply Practices, Principles of Water Rates, Fees, and Charges, Seventh Edition” (“AWWA M1”).<sup>178</sup> Fixed costs included in Customer Charge are customer costs, which “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 certain capital costs related to meters and services.”<sup>179</sup>

However, LSLR costs are different from the above costs for a couple reasons. First, MAWC would normally not recover any costs associated with customer-owned LSLRs,<sup>180</sup> because the lines being replaced by MAWC are *customer-owned* fixtures, and MAWC would not traditionally replace customer-owned materials. Recovery may be authorized for the Commission, only because of the “particularly persuasive” public policy in favor of replacing LSLs.<sup>181</sup>

Second, the *type of work* itself does not constitute costs that traditionally fall into Customer Costs as according to the AWWA M1. Lead service line replacements occur at the

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<sup>178</sup> Ex. 104, *Staff’s CCOS & RD Report*, 2:14 – 23.

<sup>179</sup> Ex. 104, *Staff’s CCOS & RD Report*, 3:3 – 5.

<sup>180</sup> Hrg. Tr. Vol. 15, 405: 14 – 21; Ex. 135, *Transcript of WU-2017-0296*, WU-2017-0296 *Exhibit 4 Direct Testimony of Brian LaGrand*, 5:20 – 22.

<sup>181</sup> Case No. WU-2017-0296, *Report and Order*, p. 9.

time that MAWC is performing water main repair and replacement.<sup>182</sup> The replacement of water mains is associated with different service costs. These types of costs are generally built into commodity charge rates, not the customer charge. As a result, even if LSLR costs could be recovered without approval from the Commission, they are not appropriate for inclusion in the customer charge.

**d. Does a reduction in customer charge alleviate additional LSLR costs?**

One final perspective worth addressing is whether or not lowering the customer charge to the propose \$8 or \$9 would mitigate concerns raised by including additional LSLR costs. From a theoretical perspective, to the extent that a lowered customer charge would lower that portion of a customer's bill to the extent it offsets any increase incurred from LSLR program cost, the answer is yes. However, from a technical perspective following the above argument, recovery of LSLR costs is not the type of cost to be recovered in a customer charge but instead in the commodity charge, and therefore there is no "mitigation" of the LSLR costs within the customer charge itself. Because an \$8 or \$9 customer charge is below the customer charge in the CCOS results of both the Staff and MAWC,<sup>183</sup> any costs not captured within the customer charge must necessarily be pushed into the commodity charge, increasing that rate. As LSLR recovery costs are likely to be recovered in the commodity rate, and a lower customer charge increases the commodity rate, arguing that a lower customer charge mitigates LSLR costs may only be philosophical.

- *Jacob Westen*

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<sup>182</sup> Hrg. Tr. Vol. 15, 393:3 – 15;

(Question by Chairman Hall: "My understanding is that the customer-owned lead service line replacement is essentially a by-product of the main replacement plan wherever -- wherever -- I'm sorry. Is that a "yes"?"

Answer by MAWC Witness Bruce Aiton: "I would say yes.")

<sup>183</sup> Ex. 104, *Staff's CCOS & RD Report*, CCOS Schedule 2 (\$15,33); Ex. 15, Heppenstall Direct, 12:15-17 (\$18.68).

## **CONCLUSION**

**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 Staff herein; and granting such other and further relief as is just in the circumstances.

Respectfully submitted,

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## **CERTIFICATE OF SERVICE**

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile, or electronically mailed to all parties and or their counsel of record on this 30th day of March, 2018.

**/s/ Jacob T. Westen**