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Mechanism
Witness: James A. Busch
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MISSOURI PUBLIC SERVICE COMMISSION

INDUSTRY ANALYSIS DIVISION

**REBUTTAL TESTIMONY
Class Cost of Service/Rate Design**

OF

JAMES A. BUSCH

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2022-0303

Jefferson City, Missouri
January 2023

1 A. Yes. The cases in which I have filed testimony before the Commission are listed
2 on Schedule JAB-r1 attached to this testimony.

3 Q. What is the purpose of your rate design rebuttal testimony?

4 A. The purpose of my rate design rebuttal testimony is to respond to the direct
5 testimonies of Missouri-American Water Company (“MAWC” or “Company”) witnesses
6 John M. Watkins and Charles B. Rea regarding MAWC’s proposed Revenue Stabilization
7 Mechanism.

8 **REVENUE STABILIZATION MECHANISM**

9 Q. Is MAWC proposing a Revenue Stabilization Mechanism (“RSM”) in this
10 proceeding?

11 A. Yes.

12 Q. Briefly describe the RSM that MAWC is proposing.

13 A. MAWC witness John M. Watkins describes the proposed mechanism in detail
14 on pages 10-14 of his direct testimony. But briefly, the proposed RSM would work in the
15 following manner.

16 First, it will only impact the residential, commercial, other public
17 authorities (“OPA”), and sale for resale (“SFR”) classes. The industrial class would
18 be excluded.

19 Second, the Commission-approved revenue requirement would be set for each class,
20 as well as production costs (consisting of power, chemicals, purchased water, and waste
21 disposal).

22 Third, these “authorized” revenues and costs for each above mentioned class would
23 be compared to actual revenues and costs for those same classes on a monthly basis.

1 Fourth, each month, either a regulatory asset (if actuals are less than “authorized”)
2 or a regulatory liability (if actuals are greater than “authorized”) will be booked by
3 the Company.

4 Fifth, at the end of each calendar year, MAWC will make an annual reconciliation
5 to determine if there is a net asset to be recovered from the consumers or a net liability to
6 be returned to the customers. If there will be a recovery from the consumers, a per unit
7 surcharge will be calculated that will be included on the consumers’ bills for the months of
8 April – December. If the company owes money to the customers, a one-time bill credit is
9 the proposed mechanism to give that money back.

10 Q. Does MAWC’s proposal to include a RSM guarantee that it will receive its
11 Commission-ordered revenue requirement?

12 A. Yes. It means that once the Commission sets the appropriate revenue
13 requirement for the Company, the Company will be assured of a guaranteed amount of revenue.

14 Q. Does Staff agree with MAWC’s proposed RSM?

15 A. No. Staff recommends that the Commission reject MAWC’s proposal in
16 this proceeding.

17 Q. In MAWC witness Rea’s direct testimony, beginning on page 54 of his
18 direct testimony, he states that the Company is having problems collecting its Commission
19 “authorized” revenues due to “volatility” in water usage. Is it the Commission’s role to
20 guarantee that any utility collects its “authorized” revenue?

21 A. No. The Commission does not guarantee a utility will earn its
22 authorized revenue. However, the Commission does give a utility an opportunity to earn its
23 authorized revenue.

1 Q. What is the Commission's role in a general rate case?

2 A. The Commission's role is to approve a revenue requirement during the course
3 of the rate case. This revenue requirement is equivalent to the utilities' cost of providing
4 service. Rates are then developed based on the revenue requirement that will allow the utility
5 to charge its customers in order to collect revenues. In a perfect world, a utility would collect
6 those revenues and the utilities' actual cost would not change during the period the rates are in
7 effect, such that revenues will equal costs, and a fair return will be earned by shareholders.

8 However, in the real world, customer usage can be greater than or less than the level
9 used in the rate case to develop rates; costs will be lower or higher than the normalized costs
10 used to develop the revenue requirement; or any combination of these factors as well as many
11 other factors will occur, causing revenues or costs to be higher or lower. This is why the
12 shareholders are allowed to earn a return on their investment - to compensate them for the risk
13 that costs and revenues will be higher or lower after rates are established. There is no guarantee
14 that the revenues will be consistent nor any guarantee that costs will be consistent.

15 Q. On page 59, lines 2 – 9, MAWC witness Rea discusses how an RSM will
16 eliminate the throughput incentive. What is a "throughput incentive?"

17 A. A throughput incentive is a concept that states that utilities are disincentivized
18 to promote the efficient use of their product (water, electricity, gas) because they make more
19 money when they sell more units.

20 Q. Is MAWC encouraging conservation now, without a RSM?

21 A. Yes. In fact, the Company has several examples of promoting conservation and
22 efficiency—without the use of an RSM. MAWC witness Rea broadly discusses these efforts
23 on page 59, lines 10 – 16 of his direct testimony.

1 Q. Does the fact that the Company is already encouraging efficiency and
2 conservation *support* its need for an RSM?

3 A. No. There is no data to suggest that the declining customer use is related to
4 MAWC's encouraging conservation. One argument used by utilities seeking an RSM is that an
5 RSM mitigates the throughput incentive, and thus allows the utility to promote conservation
6 efforts, which in turn will reduce the need for future investment in high cost generation
7 facilities. MAWC is already encouraging conservation without the need of an RSM.
8 Moreover, the RSM proposed will not prevent future capital expenditures. In fact, MAWC
9 argues that the RSM will allow the Company to continue making investments in its systems.¹

10 Q. On pages 53 and 54 of his direct testimony, MAWC witness Rea claims that
11 MAWC's revenue is volatile due to the relative fixed nature of its cost while the majority of its
12 revenues are collected through a commodity charge. How does Staff respond to that argument?

13 A. Staff would like to point out a couple of items about MAWC witness
14 Rea's statements.

15 First, MAWC witness Rea claims that only 19.4% of revenues are fixed
16 (customer charge) while most of the remaining 80.6% of revenues are variable due to the
17 volumetric rate (commodity charge). This is not an accurate picture. Included in that
18 nearly 80% amount of variable revenue is all the revenue from the industrial class' volumetric
19 rate. Although this amount comes from a "variable" rate, these dollars are practically fixed. It
20 is one of the reasons why the industrial class is exempt from the RSM because the revenues
21 that the Company collects from that class are already stable.

¹ Rea Direct Testimony, page 58, lines 19 – 23.

1 Second, even though there is a seasonality to water usage, there is also a base amount
2 of usage that all customers use throughout the year. Generally speaking, the average MAWC
3 customer usages at least 4,000 gallons per month, regardless of the month. This means that
4 although this amount is charged a variable usage rate, for all intents and purposes, this is a fixed
5 revenue for the Company. The same will be true for the commercial, OPA, and especially the
6 high level of usage of the SFR class.

7 When these considerations are taken into account, the 19.4% amount of fixed revenues
8 jumps to approximately to 55%.

9 Q. On page 54, lines 3 through 15 of his direct testimony, MAWC witness Rea
10 claims that MAWC is significantly concerned about revenue volatility. MAWC witness Rea
11 also discusses, on page 57, lines 1 through 11 of his direct testimony that it is not in MAWC
12 customers' best interests for revenue to decline. Is there any indication that MAWC's revenues
13 are decreasing?

14 A. No. Staff reviewed MAWC's PSC Annual Reports since 2012. Below are the
15 yearly total revenues MAWC collected:

16

<u>Calendar Yr</u>	<u>Yearly Revenues</u>
2021	\$349,429,411
2020	\$345,995,302
2019	\$324,614,677
2018	\$319,007,901
2017	\$289,427,008
2016	\$287,591,368
2015	\$268,845,673
2014	\$270,159,539
2013	\$266,465,171
2012	\$279,467,684

17 As can be seen, revenues have trended up over the past ten years. Considering
18 MAWC has been very aggressive over the past few years in acquiring new water and

1 sewer systems, Staff is skeptical that MAWC will be experiencing decreasing revenues
2 anytime in the near future.

3 Q. On pages 58 and 59 of his direct testimony, MAWC witness Rea gives
4 some reasons why MAWC believes that an RSM will provide benefits to customers. Does
5 Staff agree?

6 A. No. MAWC witness Rea's main argument is that customers will benefit
7 from having an RSM, if 1) the Company can recover its revenue requirement; and,
8 2) that conservation of water resources can only be achieved by eliminating the
9 "throughput incentive."

10 As I discussed above, MAWC has capably increased its revenue requirement over the
11 last ten years without an RSM and while implementing current conservation practices.

12 Q. Is it Staff's opinion that implementation of a RSM does not help
13 MAWC's customers, and in fact may harm them?

14 A. Yes. The only factor that customers can control of their water service is their usage.
15 The pricing of water sends a price signal to the customer. Each customer can then determine
16 how vigilant they need to be to control their usage, and thus their bill. Under an RSM, that
17 control is taken away. The RSM does not reward the customer who is trying to control their
18 usage to lower their bills.

19 In fact, an RSM could actually cause harm to the customer. Please consider this
20 scenario. Assume that in year one, MAWC's actual revenues are less than those authorized by
21 the Commission. If the RSM is in place, a surcharge would be included on residential
22 customers' bills between April and December in year two. Now, let's assume that year two is

1 hotter and drier than normal. Generally, this means that usage and bills may increase, compared
2 to years when the weather is more normal. So, even though a consumer is trying to conserve,
3 usage goes up, and thus bills increase. But if there is an RSM, the bills would be even higher
4 due to the surcharge from the prior year being included on the customers' bills. Thus, the
5 customer is paying more for year two, plus the additions from year one.

6 Now, the counter could be that in year three, if actual revenues were in fact greater in
7 year two than the authorized revenues, the customer may get a refund in year three. However,
8 that refund does not help pay the higher bills from year two. Nor is there any guarantee that
9 the overall yearly revenues would be higher than the authorized revenues.

10 Q. Can the RSM also cause intra-class subsidization?

11 A. Yes. If a customer has already undertaken conservation efforts, it has already
12 reduced their usage. If other users then lower their usage, the Company will not meet its
13 "authorized" revenues and according to MAWC's proposed RSM, a surcharge will be placed
14 on all customers' future bills. Thus, the first customers who have undertaken conservation
15 efforts or who cannot lower usage for other reasons, will pay a surcharge to help offset the
16 lower revenue amount caused by later customers who finally undertook some conservation
17 methods. The same argument holds for low volume residential users versus high volume
18 residential users. Basically, the RSM will cause intra-class shifts of responsibility, while the
19 Company is made whole.

20 Q. Does an RSM shift risk to customers?

21 A. Yes.

22 Q. Do customers benefit from risk being shifted from the Company to ratepayers?

23 A. No.

1 Q. Please explain why an RSM shifts all of the risk onto the customers.

2 A. Under normal regulatory structures, there is a risk that the utility may earn
3 more or less in any given year. However, this is no different than in competitive industries.
4 Therefore, investors demand a premium on their investment to cover this risk. Under a RSM,
5 one of major factors in determining if a utility is earning its authorized return is being fixed.
6 The utility will earn its revenues regardless. However, the inherent risk does not disappear, it
7 is simply shifted to the ratepayers.

8 In general, if consumers take action to lower their usage, in order to conserve water,
9 or lower their bills, the RSM will place a surcharge on future bills, which means that
10 consumers' conservation efforts will not benefit them. Consumers understand that if they
11 use more, they will pay more. Because consumers can control their usage to control their
12 bill, this leads to one of the biggest detriments to consumers under MAWC's proposed
13 RSM-all of the risk that the company is compensated for is shifted onto the customers, who
14 do not enjoy compensation for this increased risk.

15 Q. The Company will have the benefit of stability in its revenues and has
16 shifted the risk to its customers. Has the Company thus included any type of reduction in
17 its return on equity ("ROE") as part of its proposal?

18 A. No. Although the business risk of the company will be lower since
19 revenues will no longer be variable, the Company has not included any type of reduction
20 in ROE or cost of debt in its proposal.

21 Q. Do you have evidence that the Company's business risk will be lower if its RSM
22 proposal is adopted?

1 A. First, it just makes sense. Any company’s ability to earn profit is dependent on
2 two basic factors, dollars in and dollars out. All businesses face risk that their revenues will
3 not be as robust as forecasted, and thus investors require a risk reward for that uncertainty. If
4 revenues are all but guaranteed, uncertainty fades and risk is reduced. Second, the Regulatory
5 Assistance Program (“RAP”), acknowledges that decoupling (another name for an RSM), tends
6 to reduce utility risk by providing revenue stability.²

7 Q. Should MAWC have included a reduced level of business risk in its ROE as a
8 part of its proposed RSM?

9 A. Yes.

10 Q. On page 58, lines 1 – 6 of his direct testimony, MAWC witness Rea gives his
11 opinion of what he believes the General Assembly’s purpose was in passing the statute that
12 authorizes the possibility of an RSM type mechanism. Do you have a comment on his opinion?

13 A. Yes. First, in the section that MAWC witness Rea quotes, he left out the initial
14 portion Section 386.266.4, RSMo that states, “... a water corporation...MAY make an
15 application to the Commission...”

16 He does not then mention 386.266.5, RSMo, that states, “The Commission shall have
17 the power to approve, modify, or reject adjustment mechanisms.....”

18 Based on the plain reading of those two sections of 386.266, RSMo, it appears that the
19 Legislature was giving the Commission a tool to put in its toolbox, but was definitely making
20 sure that the Commission had the ultimate authority to deny any such requests unless proven
21 necessary. In this case, MAWC has not proven that an RSM is necessary.

² Migden-Ostrander, Janine, & Sedano, Rich (2016) *Decoupling Design: Customizing Revenue Regulation to Your State’s Priorities*, Montpelier, VT: The Regulatory Assistance Project, available at <http://www.raponline.org/knowledge-center/decoupling-design-customizing-revenue-regulation-state-priorities>.

Rebuttal Testimony of
James A. Busch

1 Q. Does Staff have any recommendations to the Commission if the Commission
2 decides to implement an RSM?

3 A. If the Commission does decide to approve an RSM, Staff recommends that
4 the Commission acknowledge the reduced business risk that the Company will face with an
5 RSM in place. There are two ways that the Commission can make this acknowledgement.

6 First, the Commission, after making its ROE findings, can then lower that ROE by an
7 amount the Commission believes reflects the reduction in business risk.

8 Second, if the Commission is wary of lowering ROE, the Commission can adjust the
9 capital structure that it found reasonable to be weighted more heavily on the debt side due to
10 the lower cost of debt. Either method can be used to achieve a similar result and is discussed
11 in the RAP paper described earlier in this testimony.

12 Q. Please summarize your rebuttal testimony.

13 A. In summary, Staff does not agree that an RSM should be approved for
14 MAWC in this proceeding. MAWC's proposed RSM is a guarantee of revenues without a
15 corresponding reduction in ROE. RSMs shift risk from the utility to the customers and
16 removes the customers' ability to control their own bill. MAWC is already encouraging
17 conservation without the need of an RSM. However, if the Commission does approve an
18 RSM for the water system, an acknowledgement of the lower business risk to the
19 Company must be included.

20 Q. Does this conclude your rebuttal testimony?

21 A. Yes.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

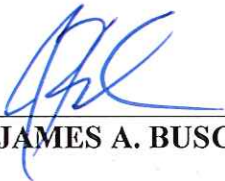
In the Matter of Missouri-American Water)
Company's Request for Authority to) Case No. WR-2022-0303
Implement General Rate Increase for Water)
and Sewer Service Provided in Missouri)
Service Areas)

AFFIDAVIT OF JAMES A. BUSCH

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

COMES NOW JAMES A. BUSCH and on his oath declares that he is of sound mind and lawful age; that he contributed to the foregoing *Rebuttal Testimony of James A. Busch*; and that the same is true and correct according to his best knowledge and belief.

Further the Affiant sayeth not.



JAMES A. BUSCH

JURAT

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 20th day of January 2023.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: April 04, 2025
Commission Number: 12412070



Notary Public

**Cases of Filed Testimony
James A. Busch**

<u>Company</u>	<u>Case No.</u>
Union Electric Company	GR-97-393
Missouri Gas Energy	GR-98-140
Laclede Gas Company	GO-98-484
Laclede Gas Company	GR-98-374
St. Joseph Light & Power	GR-99-246
Laclede Gas Company	GT-99-303
Laclede Gas Company	GR-99-315
Fiber Four Corporation	TA-2000-23; et al
Missouri-American Water Company	WR-2000-281/SR-2000-282
Union Electric Company d/b/a AmerenUE	GR-2000-512
St. Louis County Water	WR-2000-844
Empire District Electric Company	ER-2001-299
Missouri Gas Energy	GR-2001-292
Laclede Gas Company	GT-2001-329
Laclede Gas Company	GO-2000-394
Laclede Gas Company	GR-2001-629
UtiliCorp United, Inc.	ER-2001-672
Union Electric Company d/b/a AmerenUE	EC-2001-1
Laclede Gas Company	GR-2002-356
Empire District Electric Company	ER-2002-424
Southern Union Company	GM-2003-0238
Aquila, Inc.	EF-2003-0465
Missouri-American Water Company	WR-2003-0500
Union Electric Company d/b/a AmerenUE	GR-2003-0517
Aquila, Inc.	ER-2004-0034
Aquila, Inc.	GR-2004-0072
Missouri Gas Energy	GR-2004-0209
Empire District Electric Company	ER-2004-0570
Aquila, Inc.	EO-2002-0384
Aquila, Inc.	ER-2005-0436
Empire District Electric Company	ER-2006-0315
Kansas City Power & Light	ER-2006-0314
Union Electric Company d/b/a AmerenUE	ER-2007-0002
Aquila, Inc.	EO-2007-0395
Missouri-American Water Company (Live)	WC-2009-0277
Missouri-American Water Company	WR-2010-0131
Review of Economic, Legal and Policy Considerations Of District Specific Pricing and Single Tariff Pricing (Live)	SW-2011-0103
Timber Creek Sewer Company	SR-2011-0320
Missouri-American Water Company	WR-2011-0337
Emerald Pointe Utility Company	SR-2013-0016

City of Pevely and CPWSD C-1 of Jefferson County	WC-2014-0018
Hickory Hills Water and Sewer Company, Inc	SR-2014-0166/WR-2014-0167
Peaceful Valley Service Company (Live)	SR-2014-0153/WR-2014-0154
Central Rivers Wastewater Utility	SR-2014-0247
Missouri-American Water Company	WR-2015-0301
Ridge Creek Water, LLC	WO-2017-0236
Missouri-American Water Company	WO-2018-0059
Missouri-American Water Company	WR-2017-0285
Liberty Utilities (Missouri Water), LLC and Ozark	WM-2018-0023
Liberty Utilities (Missouri Water), LLC	WR-2018-0170
Osage Utility Operating Company (Live)	WA-2019-0185
Confluence Rivers Operating Company	WA-2019-0299
Elm Hills Operating Company	WR-2020-0275
Missouri-American Water Company	WR-2020-0344