

**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-2015-0301
General Rate Increase for Water and Sewer) Case No. SR-2015-0302
Service Provided in Missouri Service Areas.)

**MISSOURI-AMERICAN WATER COMPANY'S
INITIAL BRIEF**

COMES NOW, Missouri-American Water Company (MAWC or Company), and, as its Initial Brief in this matter, states as follows to the Missouri Public Service Commission (Commission).

TABLE OF CONTENTS

1. Regulatory Policy	2
2. Water District Consolidation/Consolidated Pricing	5
A. Positions of the Parties.....	5
B. The Case for Consolidation	8
C. Response to Criticisms of Consolidated Pricing.....	12
D. Lawfulness of Consolidated Tariff Pricing.....	17
E. Bill Impact Analysis of Various Consolidation and Rate Design Proposals	20
F. Consolidation of Sewer Districts and the Proposed Revenue Contribution from Water to Sewer.....	24
3. Rate Design.....	27
A. How Should Rates be Designed?.....	27
B. How Should the Customer Charge be Designed?.....	29
C. How Should the Volumetric Rate be Designed?	33
D. How Should Purchase Power Expense Be Allocated?	34
4. Low-Income Tariff	36
5. Union Issues	40

The following sections will address those issues described in the *Second Amended List of Issues, List and Order of Witnesses, Order of Opening Statements, and Order of Cross-Examination* (filed March 18, 2016).

1. Regulatory Policy

MAWC operates water and wastewater systems throughout the State of Missouri. The Company provides safe and reliable service to more than 460,000 water customers and 12,000 wastewater customers through around 25 public water systems and 56 public wastewater systems in 24 counties and more than 150 communities. (MAWC Exh. 11; Kartmann Cor. Dir., p. 5)

The water facilities include approximately 11 water treatment plants and 29 well sites, 119 water storage tanks, and over 6,700 miles of water mains. (*Id.*) On the wastewater side there are approximately 46 mechanical wastewater treatment plants, and 10 wastewater lagoons, and 76 miles of wastewater collection system piping. (*Id.*)

MAWC has not been before this Commission for a general rate case since the current base rates became effective in 2012. (MAWC Exh. 11; Kartmann Cor. Dir., p. 8) Since the last general rate case:

- 1) MAWC has brought additional efficiencies to its systems - Missouri-American's O&M expenses have *decreased* as compared to the amounts recognized in the last general rate case. (MAWC Exh. 11; Kartmann Cor. Dir., p. 11) Total O&M expenses as of the true-up ending January 31, 2016, were about \$6.74 million *less* than they were in the last general rate case test year (after eliminating the \$4.898M of new O&M costs related to systems added since the last rate case). (MAWC Exh. 39; Watkins Sur., pp. 27-28, Sch. JMW-3) The savings in O&M costs offsets some of the revenue requirement associated

with capital additions in this case. If that savings is CPI adjusted, it can be said that the annual expense reduction was more than \$13.5 million. (*Id.*)

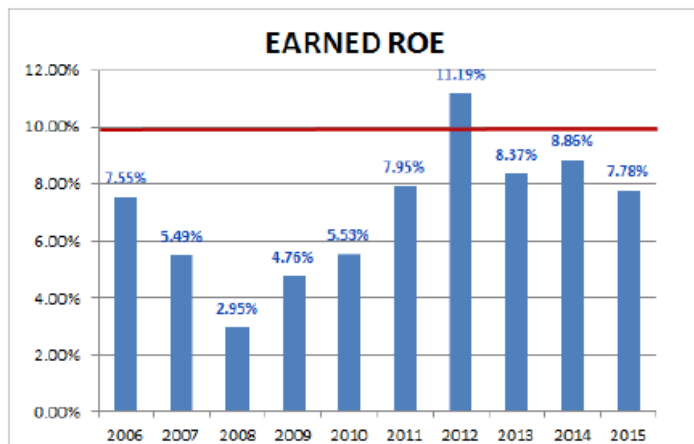
- 2) Since the last general rate case, MAWC has added 6 water systems and 6 wastewater systems. Most of these systems are small, and some of them were in dire condition – such as Tri-States Utility, Inc., which came to the Company from a federal bankruptcy proceeding (File No. WO-2013-0517); and the Hickory Hills Water & Sewer Co., Inc., which was transferred to the Company from a long pending Commission receivership proceeding (File No. WA-20016-0019/SA-2016-0020).
- 3) Finally, since the last general rate case, MAWC has made substantial investment in the State of Missouri - As of January 31, 2016, the Company had invested nearly \$500 million in capital improvements since the last rate case. (Staff Exh. 4) These investments provide improved systems, dependability, and jobs.

The Company, however, continues to face significant challenges. First, water and wastewater utilities are capital intensive (MAWC Exh. 11; Kartmann Cor. Dir., pp. 12-13) – Compared with other utilities, water and wastewater utilities are the most capital intensive utilities. The water industry is three times more capital intensive than the gas industry and nearly twice as capital intensive as electric utilities. (*Id.*)

The Company is also faced with declining use per customer. Today, with little growth in numbers of customers in existing systems and declining per customer consumption and revenue due to conservation largely driven by nationwide efficiency standards, the economic and environmental policy landscape is driving the need for adjustments to the traditional regulation that was developed in a growth environment. (MAWC Exh. 11; Kartmann Cor. Dir., p. 15)

People still buy new appliances and fixtures, but due to federal mandates, those new appliances and fixtures now use less energy and water than those they replace. (*Id.*)

The Company also faces significant challenges in attempting to recover its fixed costs through a variable rate structure. Most of a water utility's costs are fixed, including wages and salaries, taxes and recovering investments in pipes, treatment plants and other equipment, while most of its water revenue is variable, collected through volumetric rates charged on a per-gallon basis. Ninety-one percent (91%) of MAWC's costs are fixed, while only twenty-three percent (23%) of its revenues come from fixed charges. (MAWC Exh. 35; Tinsley Dir., p. 17) Thus, year in and year out MAWC is relying on its variable (or volumetric) revenues to recover over 2/3rds of its fixed costs. This has contributed to the Company's inability to earn its authorized return. The following chart illustrates that, over the last ten (10) years, MAWC's return on equity only exceeded 9% in 2012 – one of the hottest, driest summers on record:



Lastly, on a local level, the recent Infrastructure System Replacement Surcharge (ISRS) decision will have an impact – If the recent Missouri Court of Appeals' decision concerning MAWC's ISRS stands, it will certainly change the investments that MAWC is able to make in

St. Louis County. One need only look to the discussions and circumstances surrounding St. Louis County Water Company prior to the enactment of ISRS to get an idea how negatively things may change.

Since the last general rate case, MAWC has invested an additional \$221M in this infrastructure replacement through its ISRS investments. Of concern, however, the great majority of the necessary investment remains yet to be made. *See In the Matter of the Consideration of an Accounting Authority Order Designed to Accrue Infrastructure Replacement Costs for St. Louis County Water Company*, 2001 Mo.PSC LEXIS 515; 10 Mo. P.S.C. 3d 56 (MoPSC 2001).

Although the use of an historic test year relying on volumetric sales (as Staff and OPC suggest) might have been appropriate when the growth in usage and customers helped to offset the growth in investment, this situation no longer exists. (MAWC Exh. 11; Kartmann Cor. Dir., p. 15) Today, we see increasing investment requirements alongside falling per customer revenue. (*Id.*)

The best way to ensure that appropriate levels of capital investment are consistently and appropriately funded is through predictable and timely recovery of investments, meaningful recognition of revenue trends, and the return on the capital devoted to serving customers' needs. (MAWC Exh. 11; Kartmann Cor. Dir., p. 14) In the future, there will need to be a willingness to think beyond what has been described as the “traditional” ratemaking techniques if MAWC is going to continue to provide safe and adequate service at just and reasonable rates.

2. Water District Consolidation/Consolidated Pricing

A. Positions of the Parties

In this case, the Company is proposing to consolidate its (19) existing water districts into three (3) zones, as follows:

<u>Zone 1</u>	<u>Zone 2</u>	<u>Zone 3</u>
St. Louis Metro	Mexico	Brunswick
Joplin	Platte County	Spring Valley/Lakewood
St. Joseph	Jefferson City	Ozark Mountain/LTA
Warrensburg		Rankin Acres/Whitebranch
Maplewood/Riverside/ Stonebridge/Saddlebrooke/ Emerald Pointe Water Tri-States		

(MAWC Exh. 9, Sch. PRH 6, p. 1 of 2)

The basis for the Company's proposed consolidation was to group existing water districts based on their level of present rates in order to mitigate the rate impact on the districts as a result of consolidation. Accordingly, Zone 1 contained districts with the lowest present rates; Zone 3 contained those districts with the highest present rates; and Zone 2 contained those districts with rates in between Zones 1 and 3 (Tr. 388).

Staff also proposed to consolidate the Company's existing water districts into three (3) districts, as follows:

<u>Water District 1</u>	<u>Water District 2</u>	<u>Water District 3</u>
St. Louis Metro	St. Joseph	Joplin
Mexico	Platte County	Warrensburg
Jefferson City	Brunswick	Maplewood/Riverside/ Stonebridge/Saddlebrooke/ Emerald Pointe Water Tri-States Spring Valley/Lakewood Ozark Mountain/LTA Rankin Acres/Whitebranch

(MAWC Exh. 9, Sch. PRH 6, p. 2 of 2)

Staff's proposed consolidation was primarily based on geographic location/proximity and the similar operating characteristics of the districts. (Staff Exh. 9; Busch Dir., p. 10).

In contract, Public Counsel initially proposed to maintain the status quo by maintaining the seven (7) “large” stand-alone districts, and consolidating Brunswick and the other, smaller water districts into a District 8. However, at the time of hearing, Public Counsel expressed its preference for the partial consolidation advocate in the Non-Unanimous Stipulation and Agreement on Rate Design, District Consolidation and Sewer Revenue (“Non-Unanimous Stipulation on Rate Design”) signed by Public Counsel, MIEC, Brunswick, St. Joseph and Joplin. (Tr. 708-709)

MIEC, which prefers district specific pricing, is a signatory to the Non-Unanimous Stipulation on Rate Design, which does propose some consolidation of water districts and a revenue contribution from water to the sewer. (Tr. 718)

Intervenor Cities Riverside and Brunswick support some level of consolidation. (Riverside’s Statement of Position on the Issues, p. 2; Brunswick’s Statement of Position on the Issues, p. 1)

Intervenor Cities Joplin and St. Joseph support maintaining the status quo, but have also signed the Non-Unanimous Stipulation on Rate Design, which provides for some additional level of consolidation. (Joplin’s State of Position, p. 1; St. Joseph’s Statement of Position, p. 1) Moreover, Joplin’s witness Haase indicated that as long as Joplin’s rates were based on District Specific Pricing, she had no objections to the consolidation of other districts. (Tr. 291, 298)

Intervenor City Warrensburg inconsistently supports Staff’s proposed consolidation into three (3) districts, but also supports for the Non-Unanimous Stipulation on Rate Design. (Warrensburg’s Position Statement, Tr. 561, Warrensburg’s Joinder in Non-Unanimous Stipulation on Rate Design, District Consolidation and Sewer Revenue)

B. The Case for Consolidation

In 2000, this Commission addressed the debate of Single Tariff Pricing (STP) versus District Specific Pricing (DSP), finding that “Single Tariff Pricing” is a rate design theory under which all customers of a system with multiple service areas, whether interconnected or not, pay the same rate, regardless of differences in the actual cost of providing the service to the various customers. DSP, on the other hand, sets different rates for each of the service areas, based upon the discreet cost of service in each District. (Report and Order, Case No. WR-2000-281, p. 57-58, issued August 31, 2000). Consolidated Tariff Pricing (CTP), as proposed in this case, is a form of STP, but on a smaller scale than statewide uniform rates.

To be clear, no party to this case is advocating for strict District Specific Pricing, as all proposals (including the Non-Unanimous Stipulation on Rate Design, District Consolidation and Sewer Revenue) employ some amount of district consolidation. Thus, the question is not whether to consolidate, but rather to what degree should the Commission consolidate existing water districts. As Company witness Karl McDermott states, consolidated pricing “provides significant public policy benefits to customers, MAWC and to the Missouri Public Service Commission . . . and MAWC’s further movement toward CTP should be approved.” (MAWC Exh. 12; McDermott Dir., p. 3) Dr. McDermott further states, “One of the primary concerns of regulators has been the ability to assure that the essential services provided by public utilities are as widely-available at reasonable prices to as many members of society as possible at rates that compensate the utility for the total cost incurred inclusive of a fair return.” (MAWC Exh. 12; McDermott Dir., p. 10) CTP promotes a simple and understandable tariff that meets this regulatory goal of “universal service.”

Consolidated pricing also promotes long-term rate stability. Utility rates are dependent on the total expenses and rate base of the utility and the amount of the commodity which the utility sells. Changes in rate base, particularly as a result of the Safe Drinking Water Act, have a significant potential to create undue rate disparities for certain districts within a water utility. The ability to absorb the cost of such necessary projects over a larger customer base is a compelling argument in support of rate consolidation and relative stability. Capital programs will never be uniform in the various operating districts, even over periods of five to ten (5-10) years. The cost of specific programs should be shared by all customers, rather than selectively burdening those of the affected districts. Rate increases will be more stable and major increases in specific tariff groups (i.e., rate shock) will be avoided. (MAWC Exh. 7; Herbert Dir., p. 16)

Consolidated pricing is further supported by the many similarities in the manner in which the various districts are operated. All of the water systems pump their treated water through transmission lines to distribution areas that include mains, booster pump stations, and storage facilities. All of the districts provide water to individual customers through a service line and meter. All of the districts rely on a centralized workforce for billing, accounting, engineering, administration and regulatory matters. All of the districts rely on a common source of funds for financing, working capital and plant construction. Inasmuch as the costs of operation are related to functions in which the operating characteristics are the same, the use of uniform rates is supported. (MAWC Exh, 7; Herbert Dir., p. 17)

Consolidated pricing is further supported by the fact that equivalent services are rendered in each district. For example, the water service rendered to a residence in one area is the same as the water service rendered to a residence in another area. Residential customers are relatively consistent in their uses of water: cooking, bathing, cleaning and other sanitary purposes, and

lawn-sprinkling. If customers use water for the same purposes, the service offering is the same and services at the same company should be priced accordingly. (MAWC Exh. 7; Herbert Dir., p. 17-18) Similarly, the “value of service” is the same, and further supports the case for consolidated pricing. Public Counsel witness Smith indicates that the concept of value of service is one factor that should be considered in setting rates. (OPC Exh. 15; Smith Rate Design Dir., p. 7) The Company agrees. Value of service pricing leads to the pricing of a service based on the customer’s perceived value of that service rather than the exact cost. So, if customers perceive that the value of water service is the same, then the pricing should be the same. (MAWC Exh. 9; Herbert Reb., p. 10-11)

Consolidated pricing also results in lower administrative and regulatory costs. Simplifying rate structures leads to lower administrative costs, as utilities can more easily help customers who have questions, lower the cost of billing and collection, and reduce the regulatory costs of filing separate rate proceedings, or at least separate filings within a single rate proceeding. (MAWC Exh, 12; McDermott Dir., p. 16) Staff witness Busch also recognizes the significant administrative and regulatory costs savings resulting from consolidation:

Second, because of an agreement in the last rate case that required Staff to perform separate cost of service studies for each district, many Staff hours were devoted in this proceeding to the allocation and direct assignment of costs to the nearly 30 separate districts where MAWC provides service. While Staff was able to adequately perform such a task in this case, Staff will be able to more efficiently allocate its resources to the overall audit and investigation of the Company’s books and records, rather than separating and allocating each cost to the separate districts if the Commission approves Staff’s proposed rate design. Staff’s recommended approach may benefit the customers through reduced rate case expense, as it is likely that the Company will not have to allocate as many resources to future rate cases.

(Staff Exh. 9; Busch Rate Design Dir., p. 8)

Another significant benefit of consolidated pricing is the incentive for larger utilities to acquire and merge with other systems. The water industry experiences many inefficiencies because of the fragmentation of the market and the existence of smaller, less efficient systems. These smaller systems have struggled to keep up with the burdens imposed by various regulatory agencies. The viability of small systems becomes increasingly difficult as the Federal government has imposed more stringent environmental regulations (e.g., the Clean Water Act, the Safe Drinking Water Act, EPA regulations, etc.). These regulations, albeit targeted to public health and safety, have come with increased costs of compliance that small companies and their customers find hard to afford. Further, the water industry is extremely capital- and cost-intensive (as noted earlier, more so than the gas and electrical industries). The water industry also faces a more acute problem of an aging infrastructure. These costs cannot be reduced in the short-run, which further burdens these small companies. Finally, these smaller companies struggle to keep up with the administrative burdens, such as timely rate filings, which means they are not able to accurately and timely recover their cost of service. The inefficiencies associated with the fragmentation of the water industry provide the opportunity for consolidation and provide an incentive for larger water companies to purchase small, underperforming water companies. This promotes a more ubiquitous water infrastructure investment in the state and brings cost-effective, higher quality water services to a larger number of citizens. (MAWC Exh. 12; McDermott Dir., p. 14-15)

All of these benefits have contributed to the trend among State Commissions across the country to move toward consolidation of serving areas and consolidated pricing. The surveys of state regulatory commissions attached to Company witness McDermott's testimony show that more state commissions are moving toward consolidated pricing. (MAWC Exh. 12; McDermott

Dir., p. 18-21, Sch. KAM-2 and KAM-3) This was confirmed by Company witness Herbert who indicated in response to a question from the bench that, based on his experience, State Commissions are moving more to consolidated pricing for water and wastewater utilities. (Tr. 391-392) Regulators appear to be recognizing that factors other than simply cost are important to this pricing decision and have been more receptive to consolidated pricing. These factors include removing disparate pricing across the State, providing incentives for larger water companies to consolidate smaller companies, mitigating rate shock, and providing a standard regulatory approach to pricing. (MAWC Exh. 12; McDermott Dir., p. 18-19)

The Company believes that the benefits of consolidated pricing far outweigh the arguments in favor of DSP. Moreover, this case presents a unique opportunity for the Commission to implement consolidated pricing without a great deal of disruption to the customers of all of the districts. (Tr. 170, 178) In the present case, nearly \$26 million or 91% percent of the total water revenue deficiency of \$28,544,941 is already being recovered through the Company's Infrastructure System Replacement Surcharge (ISRS). (MAWC Exh. 52) Thus, the "net" increase in water revenues as a result of this case is \$2,652,279 or just 1.15% percent. Pushing the decision regarding consolidated pricing off to a future rate case where significant increases may be required in one or more districts will only make consolidated pricing more difficult to achieve. (Staff Exh. 12; Busch Sur., p. 11-12)

C. Response to Criticisms of Consolidated Pricing

The criticisms raised by parties who oppose Consolidated Tariff Pricing generally fall into the following categories:

- Consolidated Tariff Pricing is inappropriate for water utilities because water service is inherently local in nature, unlike other utility services such as electricity and natural gas.

- Consolidated Pricing is not sufficiently cost justified.
- Consolidated Pricing sends an inappropriate price signal to customers.
- Consolidated Pricing could lead to an over-investment in infrastructure.

Critics of Consolidated Tariff Pricing point to the fact that, in many instances, the various water districts of the Company are not interconnected. For example, Public Counsel witness Marke argues that water is local and the cost of providing this service and, consequently, its usage, varies considerably based on its location. (OPC Exh. 9; Marke Dir., p. 5) The lack of interconnection among the districts, however, is not a reason to reject Consolidated Tariff Pricing. In fact, the fragmentation of the water industry is a significant problem, not a virtue, and is, itself, a compelling a reason for consolidation. As explained by Company witness McDermott, the water industry experiences many inefficiencies because of fragmentation resulting in the existence of disparate, smaller systems. The inefficiency associated with this fragmentation actually provides a justification for consolidation. When water companies expand their customer base, they are able to reduce inefficiencies associated with smaller water companies. As a result, larger water companies have begun to acquire these smaller, inefficient systems and smaller systems have begun to merge in order to take advantage of economies of scale. These larger water systems are better able to conform to regulatory burdens and deal with the significant capital costs associated with upgrading infrastructure by spreading the capital costs over a larger customer base. The concentration and consolidation of companies in the water industry results in increased efficiency and this increase in efficiency allows for lower costs to serve customers, as well as improved service. (MAWC Exh. 12; McDermott Dir., p. 8-9)

Company witness Herbert further discounts the importance of interconnection. The critical point to remember is that all customers require water to be treated. All customers require

water to be pumped, and all customers require water to be delivered through a distribution system. But the end product that is delivered to the customers is the same – water that meets the quality standards delivered at a minimum pressure. While the costs of production and treatment may be different among districts, that doesn't mean the price shouldn't be the same. Furthermore, while Dr. Marke and critics of CTP are concerned with costs being different among districts, they are unconcerned about costs that differ within districts. For example, it is widely acknowledged that a customer who resides near the treatment plant requires far lower distribution costs compared to a customer who resides many miles away. Also, certain customers can be served directly from high service pumping at the treatment facility, while others require additional booster pumping and storage facilities in order to receive service at higher elevations. Yet, these significant cost differences within a district are universally ignored in a district specific Rate Design. (MAWC Exh. 10; Herbert Sur., p. 2-3; Tr. 372-373)

To take Dr. Marke's (and other critics) reasoning to its logical conclusion, each customer would have to have rates designed individually to reflect his or her specific costs. Not only would this be nearly impossible to determine and an administrative nightmare to implement, it would directly contravene the notion of a "public" utility providing universal service. Finally, Public Counsel and those critical of consolidated pricing, nevertheless seem to recognize that some consolidation is not only warranted, but appropriate, as evidenced by the Non-Unanimous Stipulation on Rate Design. (Tr. 679, 688, 709)¹

¹ A related criticism of Consolidated Pricing is that it is not sufficiently cost based and, therefore, sends poor price signals to the consumer, as well as leads to inefficiencies in production and consumption. Such arguments are based on embedded cost of service studies but it is simply not possible to draw conclusions regarding efficient pricing based on embedded cost of service studies. An embedded cost of service study is a static engineering study of the accounting costs of providing water service. (MAWC Exh. 13, McDermott Reb., p. 4) Furthermore, economics has only one view of costs as they relate to consumption and production efficiency: prices should be based on marginal opportunity costs which provides the correct price signal for firms to produce in an efficient manner and customers to consume in an efficient manner. Any other measure of costs does not tell the regulator anything about the efficient production and consumption patterns. (MAWC Exh, 13, McDermott Reb., p. 3)

Opponents of Consolidated Tariff Pricing also claim that customers in low-cost districts “subsidize” customers in high-cost districts basing that conclusion on embedded cost studies. However, in economic terms, a subsidy exists only if the price is less than the marginal cost or exceeds the stand-alone costs of serving a particular district. (MAWC Exh. 13; McDermott Reb., p. 3) In the present case, no one has attempted to estimate the marginal cost or the stand-alone costs of providing service in the Company’s water districts. (MAWC Exh. 13; McDermott Reb., p. 3-4)²

Finally, critics of consolidated pricing claim that it creates an incentive to over-invest in the system. To the contrary, as Dr. McDermott explains, the incentive to over-invest results from a regulatory commission setting the allowed return on capital higher than the market return. When this occurs, capital that would have been directed to other uses could be allocated by the market to utilities because the return is higher than the opportunity cost of capital. Consolidated pricing does nothing to change the cost of capital applied to utility assets. The cost of capital is set by the Commission in each rate proceeding based, typically, on market data and well-known finance and economic models that are designed to obtain a market-based cost of capital. This has nothing to do with whether CTP has been put in place or not. (MAWC Exh. 13; McDermott Reb., p. 15)

² Staff witness Busch also cautions about drawing any conclusions regarding subsidies from an embedded cost study:

There are various methods of allocating costs to any given district and all parties, including Staff, do a reasonable job of allocating them. However, since many of those costs are allocated, it makes it difficult to fully determine what it actually costs to provide service to say St. Louis County compared to what it actually costs to provide service to Spring Valley. Thus, the idea of subsidization is difficult to fully accept. And due to this, consolidation of rates does not really mean that one district is “subsidizing” another district since any given allocation method could allocate more or less costs to any given district.

(Staff Exh. 11; Busch Rate Design Reb., p. 14)

Moreover, as explained by Company witness Dunn, MAWC undertakes a rigorous planning process to determine the capital needs of each service area. This process includes a review of the condition of both above-ground and below-ground infrastructure to determine replacement projects, review of projected customer consumption to determine new utility plant requirements, review of regulatory environmental requirements to determine new utility plant requirements, and review of efficiency projects that reduce operating/maintenance expenses or improve safety. Projects are determined for the needs of the service area and these projects are then prioritized. A five-year capital plan is created by reviewing the prioritization of the needs, along with regulatory compliance date and available Company funding. (MAWC Exh. 4; Dunn Dir., p. 3) Nevertheless, to meet this illusory objection, Staff proposes to address the potential of over-investment by having MAWC file a five-year capital expenditure plan with the Commission each year. Parties would then have the ability review MAWC's plans and make recommendations regarding investment and the need to make investment in any service area. (Staff Exh. 11; Busch Rate Design Reb., p. 11) MAWC does not have an objection to providing its five-year plan to Staff, Public Counsel and interested parties. However, because MAWC is part of American Water Works Company, Inc., which is a publicly traded company, this information regarding future investments may be considered highly confidential and may need to be protected from public disclosure under the Commission's Confidential Information Rules (4 CSR 240-2.135).

There was also a concern regarding the potential incentive CTP might give to potential purchasers of small, troubled systems to pay more than is necessary to acquire these systems. Staff witness Busch dismissed this fear by noting that Staff does not recognize acquisition premiums for purchased systems and, more importantly, the Commission has generally not

granted an acquisition premium in the setting of rates. Thus, these smaller systems are usually purchased based on the selling utilities' rate base valuation, which is a generally accepted regulatory philosophy. This philosophy, as noted by Mr. Busch, has worked extremely well in Missouri, keeps purchase prices in line, and avoids undue costs being born by ratepayers. (Staff Exh. 11; Busch Rate Design Reb., p. 11)

D. Lawfulness of Consolidated Tariff Pricing

An issue raised at the hearing is whether the Commission has the authority to adopt consolidated or single tariff pricing for MAWC's water and sewer districts. An analysis of Missouri case law reveals that this Commission has the authority to average costs and adopt single tariff or consolidated pricing, as part of the requirement of setting just and reasonable rates, and avoiding "any undue or unreasonable preference or advantage." (Section 393.130.1 and 3, RSMo.)

In *State ex rel. Laundry, Inc. v. Public Service Commission*, 34 S.W.2d 37 (Mo. banc. 1931), the Missouri Supreme Court discussed the concepts of undue discrimination and preference. The following excerpts from the Court's decision reveal that the adoption of single tariff pricing is certainly appropriate, if not required in some circumstances.

. . . laws designed to enforce equality of service and charges and prevent unjust discrimination, such as the Missouri act, *require the same charge for doing a like and contemporaneous service (e.g., supplying water) under the same or substantially similar circumstances or conditions.*

* * *

The common law today forbids all discrimination between two applicants who ask the same service . . . Thus the principle of equality designed to be enforced by legislation and judicial decision *forbids any difference in charge which is not based upon differences of service.* . . .

* * *

. . . 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.

Id. at 44-45 (emphasis added).

Support for the Commission's authority to adopt single tariff pricing can be found in various appellate decisions reviewing Commission rate orders. In 1958, the Supreme Court of Missouri was asked to review a Commission decision authorizing a telephone company to file tariffs allowing it to add to its basic rates in each community it serves the pro rata amount of the occupational tax levied in said community. This telephone industry case is relevant, as the telephone service statute regarding rates and charges, (i.e., §392.200, subsections 1.2 and 3, RSMo.) contains essentially the same key language as the statute regarding water service, (i.e., §393.130, subsections 1, 2 and 3). In *State ex rel. City of West Plains, Missouri v. Public Service Commission*, 310 S.W.2d 925, 933 (Mo. banc. 1958), the Court concluded that there is "no legitimate reason or basis for the view that a utility must operate exclusively either under a system wide rate structure or a local unit rate structure."

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

upon the circumstances and the locations of the service units of the particular utility) inequities in system wide rates exist and a subscriber at exchange A may pay proportionately more for the service he receives than a subscriber in exchange B.

Id. at 930 (emphasis added). The *West Plains* case illustrates the discretion afforded the Commission in establishing rates either on a “system wide” or “district-specific” basis, depending on the facts and arguments then before the Commission.

The issue of the Commission’s ability to average costs and develop uniform rates was again addressed and reaffirmed in *State ex rel. Cape Girardeau, Missouri vs. Public Service Commission*, 567 S.W.2d 450 (Mo.App. E.D. 1978). In that case, the City of Cape Girardeau appealed a Commission decision establishing electric rates for the Missouri Utilities Company’s Southeast Missouri Division, arguing that the Commission, in establishing system-wide rates, failed to take into consideration that the cost of providing electricity within the city limits is lower than it is to provide service in the rest of the division. The City’s witness contended that “the city, with approximately four times as many customers as any other division community, [was] in fact subsidizing the company’s operations in the division’s more diffused areas”

Id. at 452. The Court squarely addressed the lawfulness of the Commission’s decision as follows:

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

Id. at 453.

In 2007, the Commission exercised its authority to authorize a uniform rate for a utility providing water and sewer service to multiple districts. *In the Matter of the Tariff Filing of Algonquin Water Resources of Missouri, LLC*, Case No. WR-2006-0425, Report and Order issued March 13, 2007. In fact, in the Algonquin case, the Commission held it was required to average costs and approve a unified rate for two districts. “The Commission concludes that just and reasonable rates require a unified rate for water service to Algonquin's service to the Ozark Mountain and Holiday Hills service territories.” *Id.* at 57.

Finally, Section 393.320 RSMo., enacted in 2010, evidences a legislative preference, if not intent, for consolidating smaller water systems when acquired by a large water utility. (Tr. 498-499)

As illustrated by the Missouri case and statutory law discussed above, the Commission, in fulfilling its duty to establish just and reasonable rates, possesses the legal authority to approve single tariff pricing, or uniform rates, for a utility serving more than one geographic area. Further, given the record now before the Commission, the establishment of just and reasonable rates requires the adoption of consolidated or single tariff rates for MAWC's water and sewer districts.

E. Bill Impact Analysis of Various Consolidation and Rate Design Proposals

The purpose of a bill impact analysis, as explained by Division of Energy (DE) witness Hyman, is to determine the changes to customer bills as a result of changes in rates. Mr. Hyman, therefore, recommended that the Commission request scenarios illustrating the bill impacts of the district consolidation proposals in this case under common revenue requirement and billing unit assumptions. (DE Exh, 5; Hyman Rate Design Reb., p. 23) The Company agrees with Mr. Hyman's recommendation and, at the time of hearing, submitted five (5) exhibits which

attempted to display the bill impacts on residential and non-residential customers for all water districts based on a common revenue requirement of \$30.6 million using billing determinants as agreed to by the parties in the Non-Unanimous Partial Stipulation and Agreement filed March 24, 2016. After the close of the hearing, Company made several modifications and/or corrections to those exhibits as a result of questions and/or suggestions by the parties or the bench during the hearing and submitted revised bill impact analyses designated MAWC Exhibits Nos. 48R, 49R1, 50R, 51R and 53R. The scenarios represented by those bill impact analyses are as follows:

MAWC Exhibit No. 48R represents the Company's CTP proposal, as well as its proposed rate design for customer and volumetric charges.

MAWC Exhibit No. 49R represents Staff's CTP proposal, including its proposed rate design for customer and volumetric charges.

MAWC Exhibit No. 50R1 represents the impact of the Non-Unanimous Stipulation on Rate Design, including the proposed rate design for customer and volumetric charges, and \$565,000 revenue contribution from the Joplin and St. Louis Metro Districts to the Company's sewer districts other than Arnold.

MAWC Exhibit No. 51R1 represents a proposal by the City of Riverside to consolidate all districts except Joplin and St. Joseph, who would remain on District Specific Pricing (DSP). In addition, the rate design represented in that exhibit proposes a uniform customer and volumetric rate for the districts being consolidated and district specific customer and volumetric charges for Joplin and St. Joseph based on their current rate structure.

MAWC Exhibit No. 53R represents full CTP (or STP) for all water districts, as requested by Commissioner Rupp. In this exhibit, the Company used a uniform customer and volumetric charge for all water districts served by the Company.

To Company's knowledge, it is the only party that has performed any bill impact analyses based upon the agreed-to revenue requirement and billing determinants. The Company agrees with the Division of Energy witness Hyman that this type of analysis is critical to any decision the Commission makes in this case regarding the consolidation of districts and structuring of rates.

After reviewing the various exhibits, it is clear that the consolidation proposals shown in MAWC Exh. 51R (CTP for all districts, except Joplin and St. Joseph) and MAWC Exh. 53R (STP for all districts) achieve the greatest amount of consolidation and have the least amount of adverse impact (i.e., number of increased rates) on residential customers of the five proposals. MAWC Exhibit 51R, which is CTP for all districts, except Joplin and St. Joseph, shows that only residential customers in the St. Louis Metro and Warrensburg districts will receive an increase in their rates. With respect to any increase in the St. Louis Metro district, it should be remembered that approximately ten percent (10%) of any increase is already being paid by St. Louis County customers as a result of the Infrastructure System Replacement Surcharge (ISRS). So, for example, a St. Louis County Rate A 5/8" meter customer, using 5,000 gallons a month, will really experience a net increase of 8.5%, as they are already paying the ISRS. (Tr. 394) While the percentage increase in residential customer rates in Warrensburg would appear to be significant (i.e., 30.5% at 3,000 gallons a month; 26.9% at 5,000 gallons a month; and 23.9% at 8,000 gallons a month), the actual rates for those levels of consumption are still well below what customers in Platte County and Brunswick are currently paying for the same amount of usage and essentially the same service. This is because Warrensburg's current residential bills are the lowest of any of the "large" districts served by the Company. As Public Counsel witness Marke acknowledged, it is not necessarily the percentage of increase that is important, but the amount of resulting bill. (Tr. 706-707) Accordingly, the resulting rates for service to the customers in the St. Louis Metro and Warrensburg districts are not unreasonable or unduly discriminatory despite their percentage increases.

The next proposal with the least amount of adverse impact on existing residential customer rates is full CTP or STP for all districts (MAWC Exh. 53R). In this case, St. Louis

Metro and Warrensburg district residential customers will see an increase in their existing bills, as well as St. Joseph residential customers using 3,000 and 5,000 gallons a month. It should be noted that the St. Joseph residential customers are currently paying the second-lowest amount for water service of the Company's large districts and well below what residential customers in Platte County and Brunswick are paying for the same amount of usage and essentially the same service. Again, the resulting rates for service are not unreasonable or unduly discriminatory.

In contrast, the proposal that appears to have the most adverse impact (i.e., number of rate increases) on residential customers is the Non-Unanimous Stipulation on Rate Design (MAWC Exh. 50R1). And, if not for the proposal in that Stipulation to provide Riverside's residential customers with a five percent (5%) decrease in their revenue requirement, all residential customers in the Platte County district would have experienced a rate increase as well. Not surprisingly, the Non-Unanimous Stipulation on Rate Design also achieves the least amount of consolidation. Further, looking at the Non-Unanimous Stipulation and the impact on large users in the St. Louis Metro district (i.e., the MIEC members), the proposed increases are the smallest among all the consolidation proposals, with Rate J – 6" meter customers experiencing only a 2.6% increase at 45,000 gallons a month; a 6.1% increase at 2,000,000 gallons a month; and a 6.2% increase at 4,000,000 gallons a month. This seems hardly fair when the overall increase to the St. Louis Metro District is 14.87% (MAWC Exh. 50R1, p. 4 of 7).

Given the bill impacts of the various proposals, it is clear that the proposals achieving the greatest consolidation (i.e., MAWC Exh. 51R and 53R) are also the ones that have the fewest increased rates for residential customers and are the most just and reasonable for water service provided by the Company. Accordingly, the Company would urge the Commission to adopt

either the proposal for CTP for all districts except Joplin and St. Joseph (MAWC Exh. 51R), or the proposal for full statewide CTP or STP (MAWC Exh. 53R).

F. Consolidation of Sewer Districts and the Proposed Revenue Contribution from Water to Sewer

All of the reasons for consolidating water districts applies as well to consolidating the Company's sewer districts. In this case, the Company is proposing to consolidate its 13 existing sewer districts into two rate zones – one for Arnold and a consolidated tariff for all the remaining districts. Company's proposed rates for Arnold reflect a 25.35% increase to their existing minimum and volumetric charges, as well as their flat rate charge. The rate structure for the remaining districts includes a \$40.00 per month minimum charge for customers with 5/8" water meters, increasing for larger size meters, and a volumetric charge of \$0.5900 per hundred gallons. The flat rate charge of \$69.50 per month reflects an average monthly usage of 5,000 gallons priced out at the proposed volumetric rates. (MAWC Exh. 7; Herbert Dir., p. 21)

Staff initially proposed to combine the sewer districts into five districts, with Arnold being a stand-alone district and the remaining four districts being combined based on geography. (Staff Exh. 9; Busch Dir., p. 10-11; Staff Exh. 11; Busch Rate Design Reb., p. 15) However, in its direct filing given Staff's revenue requirement before true-up and other adjustments, Staff determined that the total sewer revenue deficiency was only \$39,345.00. Therefore, Staff recommended leaving all sewer rates at their current levels and transferring \$39,345.00 from its proposed water District 2 to cover this deficiency. (Staff Exh. 9; Busch Dir., p. 11) As a result of the Non-Unanimous Stipulation regarding Revenue Requirement, the sewer districts are now experiencing a total revenue deficiency of \$2,055,059.00. (MAWC Exh. 52) Nevertheless, Staff is proposing: 1) not to consolidate the sewer districts; 2) to keep rates for sewer service in all

districts, except Arnold, at their current levels; and 3) to transfer approximately \$565,000.00 in revenue from all water districts to cover this revenue deficiency. (Tr. 453-455) The problem with Staff's proposal is that it leaves Arnold with a deficiency of nearly \$1,500,000.00, which would require existing rates for Arnold customers be increased by over 44%. (MAWC Exh. 52)

The Company proposed to deal with the sewer revenue deficiency for all districts by limiting the amount of Administrative and General (A&G) costs allocated to each district to \$20 per customer. (MAWC Exh. 35; Tinsley Dir., p. 14) By limiting the amount of A&G costs allocated to the various sewer districts, the Company was able to mitigate the cost of service assigned to these districts. Because of the small size of the sewer districts and because the smaller districts do not require the same level of service as the larger districts, the Company felt it would not make sense to utilize the traditional cost allocation factors that would allocate significantly more costs to the smaller districts, thus burdening those customers with higher cost of service and rates. If the Company utilized the traditional allocation factors, the average cost per customer for the smaller districts would be in the range of \$150 per customer to over \$300 per customer compared to less than \$130 per customer for the larger districts. (MAWC Exh. 36; Tinsley Reb., p. 27)

Staff, however, disagreed with the Company's proposal and instead allocated the full amount of A&G expenses to these districts in accordance with the district allocation procedures for the water districts. (Staff Exh. 7; Bolin Reb., p. 1) Staff's refusal to limit the amount of A&G costs allocated to the sewer districts appears to be inconsistent with its own witness Busch's testimony at hearing in which he opined that he didn't believe that these small sewer districts were causing the same level of corporate costs as the larger districts. (Tr. 478-480) Nevertheless, Staff rejected the Company's proposal to cap the allocation of A&G costs to the

smaller sewer districts and, as a result, Staff is now faced with the dilemma of needing to recover a revenue deficiency for the sewer districts that, in most cases, would produce significant rate increases. For example, given the agreed to sewer revenue deficiency of \$2,055,059, the following sewer districts would require substantial increases to cover their respective costs of service:

Anna Meadows	31.74%
Arnold	44.16%
Jefferson City	38.32%
Meramec	79.24%
Ozark Meadows	44.53%
Platte County	47.22%
Warren County	78.06%

(MAWC Exh. 52)

Staff is willing to erase these deficiencies for all districts except Arnold, through a revenue contribution from the water districts. It is unwilling to do so in the case of Arnold because of a “commitment” the Company made when it acquired the Arnold system not to increase rates in that district beyond \$33.58 during the first four (4) years of MAWC’s ownership. (Tr. 446; Staff Exh. 32) If the Company keeps its commitment to Arnold and raises rates to \$33.58, there is still a revenue deficiency in the Arnold district of approximately \$700,000. (Tr. 609) Company, therefore, proposes that in addition to the revenue contribution Staff and signatories to the Non-Unanimous Stipulation on Rate Design have proposed of \$565,000, an amount of \$700,000 be contributed to recover the shortfall in the Arnold District. If Staff is truly concerned about MAWC’s (and other water and wastewater utilities) willingness to acquire small wastewater systems, it certainly sends the wrong signal to require MAWC to raise rates in its Arnold district by more than 40% or ask MAWC’s shareholders to absorb a \$700,000 revenue deficiency above an increase in rates to \$33.58. Staff also fails to explain why

it's unwilling to raise rates in any other sewer district that have a revenue deficiency, yet it appears to have no qualms with Arnold customers absorbing a 40+% increase in their sewer rates. Staff's understandably concerned with raising existing sewer rates that are already at a \$65 level, but not all sewer rates are at that level and Staff is not proposing any increase in those existing rates that are below \$65. (Tr. 454-455) So it is particularly troubling that Staff is unwilling to do anything for the Arnold customers when it appears to be holding all other sewer customers harmless. The more reasonable and equitable approach is for the Commission to set the revenue contribution from the water districts at \$1.3 million, instead of the \$565,000 contribution recommended by Staff and the signatories to the Non-Unanimous Stipulation on Rate Design.

3. Rate Design

A. How Should Rates be Designed?

Rates should be designed to recover the agreed-to revenue requirement in this case, with the rates for each customer class (i.e., customer charges and volumetric rates) designed to recover the costs assigned to those various customer classes. In this proceeding, Company and Staff are the only parties who have performed a full Class Cost of Service Study (CCOSS). The Company performed a CCOSS for each water district, as well as a statewide cost of service study which is the sum of the proforma cost of operations for all the water districts. (MAWC Exh. 7; Herbert Dir., p. 4, Sch. PRH-1) In its statewide CCOSS, the Company allocated the aggregated cost of water service to the following customer classifications: Rate A, consisting of residential, commercial, small industrial and Other Public Authority (OPA) customers; Rate B, consisting of Sale for Resale customers; Rate J, consisting of large users; and Rate F, private fire protection

customers. The cost of service associated with public fire protection was identified and reallocated back to the Rate A and Rate J customer classifications. (MAWC Exh. 7; Herbert Dir., p. 4) The Company's CCOSS study was performed in accordance with generally accepted principles and procedures and results in the relative cost responsibilities of each class of customers. In performing his study, Company witness Herbert followed the base-extra capacity method of cost allocation as described in the 2012 and prior Water Rates Manuals published by the American Water Works Association. The base-extra capacity method is a recognized method for allocating the cost of providing water service to customer classifications in proportion to the classifications' use of the commodity, facilities, and services. The base-extra capacity method is generally accepted throughout the water industry as a sound method of allocating the cost of water service and has been used by the Company in previous cases. (MAWC Exh. 7; Herbert Dir., p. 4-5)

In determining an appropriate rate structure, the Commission should consider the results of the Class Cost of Service Study, as well as the impact of changes from the present rate structure, the understandability and ease of application of the rate structure, the community and social influences, and the value of service. In the present case, Company witness Herbert also followed the following guidelines in designing rates:

- Develop rate schedules for three rate zones as a step toward a Consolidated Tariff Pricing rate schedule applicable to all water customers statewide;
- Propose uniform customer charges that recover the applicable customer costs by meter size;
- Design volumetric rates for Rate A and Rate J for each rate zone and for Rate B for two rate zones so that the proposed revenues by customer classification move toward or approximate their indicated cost of service;
- Design private fire and private hydrant rates for two rate zones to recover the indicated cost of service; and
- Develop consolidated tariff rates for all wastewater (i.e., sewer) service areas except for Arnold, which has its own rate schedule. (MAWC Exh. 7; Herbert Dir., p. 13)

B. How Should the Customer Charge be Designed?

In its initial case, the Company proposed a customer charge for a 5/8” meter of \$17.40 a month (and \$31.00 for quarterly-billed customers). These rates were based on proforma customer costs as determined by Company witness Herbert in his Class Cost of Service Study. Increases to the larger size meters (i.e., 3/4” through 12” meters) were based on the existing meter ratios by size to the 5/8” charge. (MAWC Exh. 7; Herbert Dir., p. 14) Based on the agreed-to additional revenue requirement of \$30.6 million, Mr. Herbert recalculated a customer charge of \$16.90 for a 5/8” meter, as well as customer charges for meters 3/4” through 12”. (Tr. 570, 625; MAWC Exh. 48R, p. 4 of 7) The Company also proposed that its customer charges be uniform throughout the state, as the fixed costs related to serving a customer (i.e., the meter, meter reading, billing and collection) do not vary significantly. (Tr. 621)

Staff initially proposed customer charges for a 5/8” meter that were uniform among each of its proposed rate districts. For example, in its Report on Class Cost of Service and Rate Design, Staff proposed customer charges for 5/8” meter of \$11.06 for District No. 1, \$10.57 for District No. 2, and \$9.32 for District 3. (Staff Report, Sch. 2-1, 2-2 and 2-3) However, Staff updated its proposed customer charges based upon the stipulated revenue requirement of \$30.6 million and calculated updated meter charges for 5/8” meter of \$16.50 for District 1, \$14.80 for District 2, and \$14.50 for District 3. (Tr. 796; MAWC Exh. 49R)

Parties to the Non-Unanimous Stipulation on Rate Design proposed a uniform customer charge of \$14.42 for a 5/8” meter, which is based on the existing meter charges in the St. Louis Metro District. (Stipulation, ¶ 1) The Division of Energy supports a “low” customer charge in order to encourage efficient consumption. (DE Exh. 6; Hyman Sur., p. 18) While it appears that

the parties supporting the Non-Unanimous Stipulation on Rate Design nor the Division of Energy oppose uniform statewide customer charges, the level of customer charges they propose are deficient and not supported by a full Cost of Service Study. (Tr. 756, 770)

The primary issue to be determined regarding the customer charges is the level of the charges. In this case, Company believes that its Class Cost of Service Study has appropriately captured all of the fixed costs related to serving the customer and a charge of \$16.90 for 5/8" meter is necessary in order to move toward a proper recovery of those costs. Staff's initial Class Cost of Service Study contained several deficiencies in its calculation of a customer charge. At hearing, Staff corrected most of these deficiencies so the only significance between its study and the Company's study was the manner in which they treated Public Fire costs. (See Staff's Response to Order Directing Filing Regarding Customer Charge Differences filed April 7, 2016)

The Company does not have public fire hydrant rates, so the costs associated with public fire must be recovered from other classes. Since public fire costs are fixed costs and do not vary at all with water usage, these costs must be recovered through customer charges. Mr. Herbert's study allocated public fire costs based on meter size so that customers with larger meters will pay more for public fire and also recognizes that customers with larger meters generally have higher property values. (MAWC Exh. 9; Herbert Reb., p. 4)

Staff, on the other hand, allocates a larger amount of the costs to the public fire class, then redistributes those costs to the other customer classes to be recovered through their volumetric rates. By placing recovery of these costs on the volumetric charge, large users will pay a disproportionately greater amount of these costs. The Company believes it is more equitable to all customers to recover public fire costs through the customer charge. Customers

with larger meters will still pay a greater amount than small use customers, but not nearly as much as they would if these costs were recovered through the volumetric rate.

Division of Energy witness Hyman argues for much lower customer charges, which shifts even more cost recovery to the volumetric charge. He believes this is appropriate in order to encourage efficient use of water, including conservation. (DE Exh. 3; Hyman Dir., p. 5; DE Exh. 6; Hyman Sur., p. 18) This is a fallacy, however, because Mr. Hyman fails to recover the appropriate fixed customer related costs in his customer charge. For example, Mr. Hyman believes that uncollectible expense should not be included in customer charges. However, uncollectible accounts do not vary with usage; they vary with the number of customers. By using an allocation factor based on the number of customers to allocate uncollectible accounts, the result is more closely aligned with the write-offs by class, as shown by the table below.

	<u>Write-offs</u>	<u>Percent</u>
Residential	\$3,945,329	94.36%
Commercial	230,248	5.51%
Industrial/Other	1,005	0.02%
Fire Service	4,448	0.11%
TOTAL	\$4,181,070	100.00%

(MAWC Exh. 9, Herbert Reb., p. 9)

The table above clearly shows that the residential class is primarily responsible for uncollectible accounts and are properly allocated to customer costs based on the number of customers. Allocating uncollectible accounts to volumetric rates, as Mr. Hyman suggests, would be inequitable, since large users would pay a disproportionate share of those costs. (MAWC Exh. 9; Herbert Reb., p. 9) Finally, in addition to lacking appropriate cost support, Mr. Hyman has not updated his proposed customer charge to reflect the agreed-to additional revenue requirement of \$30.6 million.

The Non-Unanimous Stipulation on Rate Design's proposed customer charge of \$14.42 for a 5/8" meter also suffers from lack of cost support and produces approximately \$1.6 million less revenue than Company's existing customer charges. (MAWC Exh. 50R1, p. 3 of 7) This result is counterintuitive when one considers that the parties have agreed to an increase in present revenues of \$30.6 million. Clearly, a portion of that increase is attributable to an increase in customer costs but the Non-Unanimous Stipulation fails to account for this increase.

Thus, the only customer charges in this case that are supported by an appropriate Class Cost of Service Study and properly recovers the fixed costs associated with serving the customer are those proposed by the Company. Concerns from other parties that the Company's proposed customer charge is "too high" are belied by the facts that even at the Company proposed rate levels, its customer charges only recover approximately 24.5% of its total revenue requirement. By comparison, existing customer charges only recover approximately 21.5% of existing revenues. (Tr. 395, 612) Given the fact that the Company's fixed costs are over 90% of its total costs, and the fact that it has withdrawn its request to establish a Revenue Stabilization Mechanism (RSM) in this case, it is critical that its customer charge, at a minimum, recover its true customer costs. If the customer charges do not recover the true customer costs, those costs will have to be recovered through the volumetric rates. This results in customers with larger usage volumes to be over-charged for customer-related costs and subsidize low use customers who would not be paying their fair share of the fixed customer costs required to serve them. (MAWC Exh. 8; Herbert Sup., p. 3-4) In addition, putting more of the cost recovery on the volumetric charge jeopardizes the Company's ability to recover its revenue requirement where the Company is subject to declining residential use and a RSM has not been established. Staff witness Busch recognizes this dilemma and states in his rebuttal testimony:

“Staff does not recommend the Commission approve MAWC’s RSM proposal. However, Staff recognizes that an alternative may be considered and would support a higher customer charge rather than the RSM as proposed by MAWC.”

(Staff Exh. 11; Busch Rate Design Reb., p. 23)

C. How Should the Volumetric Rate be Designed?

In this case, the Company proposed a one-block, uniform volumetric rate for its Rate Zones 1, 2 and 3 and for each of the customer class within those rate zones. These volumetric rates are designed to recover as closely as possible the indicated customer class costs as shown by the Company’s Class Cost of Service Study. (MAWC Exh. 7; Herbert Dir., p. 14)

Staff proposes a one-block, uniform volumetric rate for all customer classes in its rate District 1 (St. Louis Metro, et al.). Staff also proposes to keep a single block rate for residential customers in its Rate Districts 2 and 3, but keep the declining rate block structure for the volumetric rates in the non-residential classes in those districts. (Tr. 800-801)

The Division of Energy proposes a one-block rate for volumetric rates, as uniform volumetric rates can encourage efficient consumption through a relatively simple and equitable design. In addition, uniform volumetric rates provide a more gradual transition toward inclining block rates. (DE Exh. 3; Hyman Rate Design Dir., p. 14) However, Division of Energy does not recommend implementation of inclining block rates for residential customers in this case. (MAWC Exh. 3; Hyman Rate Design Dir., p. 6)

Public Water Supply District’s Andrew County supports Staff’s continuation of declining block rates for the non-residential customer classes in the St. Joseph District. (Tr. 564)

The parties to the Non-Unanimous Stipulation on Rate Design propose that after establishing the appropriate customer charges “(A)ll other remaining increases/decreases will be

applied on an equal percentage basis to all other rate elements for all classes in each District.” (Stipulation, ¶ 1) However, it is not clear whether they propose to keep the declining block structure for non-residential classes or propose a single volumetric rate for all customer classes.

Presently, the Company has a single-block volumetric rate structure for all residential customers in all districts. In addition, it has a single-block, volumetric rate for non-residential customers in the St. Louis Metro District. In this case, it is proposing to adopt a single-block volumetric rate for other non-residential customer classes in all districts/rate zones, which not only achieves simplicity in the design of rates, but also provides customers with enough of an incentive to conserve if they choose to do so. (MAWC Exh. 8; Herbert Sup., p. 6) Essentially, the Company is proposing in this case to utilize its St. Louis Metro rate structure for all three of its rate zones. This rate structure has been in effect for many years. Rate A has a single volumetric rate applicable to residential, and the smaller commercial, industrial and public authority classes. Rate J has a single volumetric rate applicable to large customers, such as large commercial and industrial customers. Rate B has a single volumetric rate applicable to Sales for Resale customers. This rate structure also acknowledges the better load factor for large users with a lower rate under the Rate J classification. (MAWC Exh. 8; Herbert Sup., p. 7) Depending on the way in which the Commission chooses to consolidate various districts in this case, the Company would urge it to apply the St. Louis Metro rate structure for the volumetric rates to whatever consolidated grouping of districts the Commission determines is appropriate.

D. How Should Purchase Power Expense Be Allocated?

In this case, the Company allocated purchase power expense to each class of customer consistent with the demand portion of power costs allocated to extra capacity costs to the degree that it varies with the demand-pumping requirements. This is referred to as Allocation Factor 1

in the cost study. This is the manner in which the Company has allocated power costs in its Class Cost of Service Study in prior cases and is consistent with the AWWA Rates Manual. (MAWC Exh. 9; Herbert Reb., p. 7-8) Missouri Industrial Energy Consumer (MIEC) witness Collins generally agrees with Company witness Herbert's Class Cost of Service Study, but proposes a modification to the way in which power costs are allocated among customer classes in the St. Louis Metro District. Mr. Collins suggests that since power bills include a demand charge that varies with the Company's peak demands, Allocation Factor 3 would be a more appropriate factor for allocating power costs. (MIEC Exh. 5; Collins Dir., p. 9-11)

In response to MIEC's proposed allocation factor, Mr. Herbert analyzed a sample of the Company's power bills in the St. Louis Metro District and determined that the bills include a monthly demand charge regardless of the level of service. Generally, electric rates are structured with the customer charge, a demand charge, and commodity charges. Depending on the rate structure, there will be a monthly demand charge every month even when power is at its lowest demand. The amount of the demand charge that fluctuates from month to month would be considered the extra capacity portion of the Company's power purchases, not the total demand charges. In Mr. Herbert's analysis of power bills, the difference between the minimum demand charge for the lowest demand month and the demand charges for the remaining months results in approximately 4.5% of the total purchase power expense attributable to extra demand. Consequently, Mr. Herbert could support a refinement to his cost study that would allocate 4.5% of purchase power costs to the extra capacity function, but this refinement would result in only a very minor revision to his study. (MAWC Exh. 9; Herbert Reb., p. 7) Furthermore, Public Counsel witness Smith also objects to MIEC witness Collins' proposed power allocation factor. Public Counsel witness Smith states that Allocation Factor 3 does not have a cost causative

relationship to power costs for pumping and that Factor 1, as used by Mr. Herbert, allocates costs which vary with the amount of water consumed. Mr. Smith concludes that Factor 1 is the most appropriate for the allocation of power costs. He also criticizes Mr. Collins for “cherry-picking” one isolated factor from MAWC’s Class Cost of Service Study stating that Mr. Collins’ recommendation “would inappropriately reallocate a single selected category of water utility cost away from his clients (Rate J customers) and place additional cost burdens on the other customer classes.” (OPC Exh. 16; Smith Reb., p. 5-6) Public Counsel witness Smith, therefore, recommends that Mr. Collins’ recommendation be rejected. MAWC concurs.

4. Low-Income Tariff

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

Proposal

MAWC previously proposed a low income tariff in its general rate case WR-2010-0131. Because of the opposition it received at that time, MAWC did not propose such a tariff in its 2011/2012 rate case or, initially, in this case. Later, however, concerns were raised in rebuttal testimony about affordability of new rates in this case for low income residential users.

To address any concerns the Commission may have that the rates resulting from this case could create an affordability problem, MAWC proposed a low-income tariff in its surrebuttal testimony. (MAWC Exh. 37; Tinsley Sur., pp. 4-6; Sur. Sch. JMT1)

The Company’s proposed low-income customer rate would provide eligible low-income customers with an 80 percent (80%) discount on the customer charge for a residential, 5/8-inch meter. (MAWC Exh. 37; Tinsley Sur., pp. 4-6, Sur. Sch. JMT1) The volumetric charge would not change under this proposal, therefore continuing to encourage the efficient use of water.

(MAWC Exh. 37; Tinsley Sur., p. 6)

Customers would establish eligibility by contacting the local community action agency and establishing that they would qualify for the Missouri Low Income Home Energy Assistance Program (LIHEAP), whether or not they actually participate in LIHEAP. (Tr. 841, 847; MAWC Exh. 37; Tinsley Sur., pp. 5-6). Customers would be required to reestablish eligibility on an annual basis. (*Id.*)

The best method for funding, given the newness of this program, is a deferral of the discounts given, along with any third party administrative costs. (Tr. 845-846) The known administrative costs include the charges from community action agencies providing the qualification process. (Tr. 854-855) MAWC currently pays a fee to those agencies in conjunction with its H2O Help program. (*Id.*) The Company recommends the following language be added to any Commission order implementing a low income program:

MAWC will be authorized to record on its books a regulatory asset, which represents the actual discounts provided to those customers participating in a Low Income Program along with any third party administration costs. MAWC shall maintain this regulatory asset on its books until the effective date of rates resulting from MAWC's next general rate proceeding. The amortization period for the deferred regulatory asset associated with a Low Income Program will be determined in the next MAWC rate proceeding.

As proposed, the tariff would apply state-wide. Provided that there is a deferral mechanism for the funding of costs, MAWC is open to variations of the proposed program. For example, something less than a state-wide program – a pilot program – offered in a limited geographic area, may be appropriate for the purpose of experimenting with the costs, administrative requirements, delivery systems, marketing, and participation rates. Such an experimental program might provide a basis to assess the possible connection between a low-income tariff and a reduction in bad debt expense. (Tr. 849-850, 851-852)

To that end, a pilot program utilizing the St. Joseph service area, in conjunction with a deferral of the costs, may be appropriate. St. Joseph had a number of persons at its local public hearing express affordability concerns. (Tr. 851) St. Joseph is further a large enough district to have both urban and rural customers and a number of persons that may be eligible for the program, without the possibility that the costs of the program will get uncomfortably large before some of the above questions are answered. As an alternative, a pilot program might be made applicable to a geographic area with higher customer charges or counties with the highest poverty rates. (Tr. 851) Staff witness Busch indicated that if there was a pilot program, he would like to see it utilize a smaller area to determine how well it works in practice. (Tr. 865)

Legality

In the past, low-income rate proposals have drawn objections based upon Section 393.130, RSMo. Section 393.130.2 states as follows:

No . . . water corporation . . . shall directly or indirectly by any special rate, rebate, drawback or other device or method, charge, demand, collect or receive from any person or corporation a greater or less compensation for . . . water . . . or for any service rendered or to be rendered or in connection therewith, except as authorized in this chapter, than it charges, demands, collects or receives from any other person or corporation for doing a like and contemporaneous service with respect thereto under the same or substantially similar circumstances or conditions.

Section 393.130.3 further states as follows:

No . . . water corporation . . . shall make or grant any undue or unreasonable preference or advantage to any person, corporation or locality, or to any particular description of service in any respect whatsoever, or subject any particular person, corporation or locality or any particular description of service to any undue or unreasonable prejudice or disadvantage in any respect whatsoever.

There are many examples of discrimination in rates among MAWC's customers that are generally thought to not violate these provisions. Residential, commercial, industrial, other public authorities, sale for resale, and other categories of customers all pay different rates for a

gallon of water. Those differences are based on allocations of costs. These allocations can be based on a variety of things, to include, customer characteristics such as average consumption and maximum hour extra demand relative cost responsibilities.

The question here is whether a low income rate (i.e. the differentiation of customers based on income level, household size, and other related factors) would establish different “circumstances or conditions” or an “undue or unreasonable preference or advantage.” This is a question that has not been addressed by the Courts in Missouri.

The safest path to a low-income rate would be specific statutory authorization. In a prior working docket, the Staff’s Reply Comments, *In the Matter of a Working Case to Consider the Establishment of a Low-Income Customer Class, et al.*, File No. WW-2013-0047 (filed September 24, 2012) (p. 6), quoted “A National Study of Ratepayer-Funded Low-Income Energy Programs,” which indicated as follows:

Our research found that states have frequently mandated the creation of low-income affordability programs by statute, thus rendering moot the question of whether the state utility commission has the authority to pursue such programs.

The Missouri General Assembly did something similar in the Missouri Energy Efficiency Investment Act (MEEIA), by specifically authorizing a low-income subclass in that particular situation -- “The commission may reduce or exempt allocation of demand-side expenditures to low-income classes, as defined in an appropriate rate proceeding, as a subclass of residential service.” Section 393.1075.6, RSMo. The General Assembly has not done so in regard to water corporation rates. While this is not determinative, it will be something raised by those that are opposed to low-income rates.

As an alternative to a state-wide rate, a low-income rate pilot program may be defensible under the Commission’s authority to implement “experimental rates.” The Commission has

described this power as follows:

Furthermore, the authority of this Commission to approve an experimental rate plan is well within its powers.³ Indeed, the Court of Appeals has characterized the Union Electric experimental alternative regulation plan "not as an abdication of the Commission's responsibility to regulate, but as embodiment of it. It was an attempt to streamline the rate monitoring process and provided a means to resolve issues in lieu of the formal complaint process."

In the Matter of a Proposed Regulatory Plan of Kansas City Power & Light Company, 242 P.U.R.4th 492, Case No. EO-2005-0329 (Mo.PSC 2005); *See also State ex rel. Laclede Gas Co. v. PSC*, 535 S.W.2d at 567, n.1 (noting the Missouri Supreme Court "has long held" that the Commission has the power to grant interim test or experimental rates "as a matter of necessary implication from practical necessity").

5. Union Issues

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

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

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

General Response

Section 393.130.1, RSMo, requires every water corporation to "furnish and provide such service instrumentalities and facilities as shall be safe and adequate and in all respects just and reasonable." Section 393.140(1) gives this Commission general supervisory authority over all water corporations.

Although the Commission has authority to regulate MAWC to ensure it provides safe and adequate service, the Commission does not have authority to manage the company. The Missouri Court of Appeals has stated:

³ *See Union Electric Co. v. PSC*, 136 S.W.3d 146, 149, 152 (Mo. App. W.D. 2004).

The powers of regulation delegated to the Commission are comprehensive and extend to every conceivable source of corporate malfeasance. Those powers do not, however, clothe the Commission with the general power of management incident to ownership. The utility retains the lawful right to manage its own affairs and conduct its business as it may choose, as long as it performs its legal duty, complies with lawful regulation, and does no harm to public welfare.

State ex rel Harline v. Public Service Commission, 343 S.W.2d 177, 182 (Mo.App. 1960).

Therefore, except as necessary to ensure the provision of safe and adequate service, the Commission does not have the authority to dictate to the Company specific matters such as how many employees it must hire, what positions it must fill, or what valves it must exercise. *See In the Matter of Union Electric Company*, Report and Order, Case No. ER-2014-0258 (April 29, 2015); and *In the Matter of Union Electric Company*, Report and Order, ER-2011-0028 (July 13, 2011). The Commission should not have any wish to intrude into this area of company discretion, especially at the behest of a party with a clearly vested interest

MAWC is providing safe and adequate service, meets the high standards required by the Missouri Department of Natural Resources, and the Partnership for Safe Water. (MAWC Exh. 43, pp. 10-11) Accordingly, the Commission should decline the Union's invitation to intrude into management's clear right and authority to manage the day-to-day affairs of the Company.

Unfilled Positions

The Utility Workers of America, Local 335 (UWUA Local 335) suggests that there are a significant number of individuals in St. Louis County who are currently eligible for retirement or will be eligible for retirement in the near future. Its proposed solution is that this Commission order MAWC to fill certain positions as they become vacant.

As stated above, there is no justification for the Commission to insert itself in this management of the Company. MAWC has worked diligently to review staffing opportunities resulting from attrition and to continually evaluate the needs and priorities of its business.

MAWC continually evaluates its business to identify costs savings and efficiencies. (MAWC Exh. 43, p. 10) Reductions in workforce may occur when it is determined there is a more efficient way to perform operations, for example, replacing obsolete equipment and automating processes. (*Id.*) This is a process that has worked over the last few years to decrease the operation and maintenance expenses experienced by the Company and borne by its customers.

Given the lack of any allegation that MAWC has failed to provide safe and adequate service in St. Louis County, there is certainly no evidence to require the Commission to condition any rate increase upon the filling of unfilled bargaining unit positions, particularly when there has been no provision for such positions in the Company's cost of service in this case.

Reporting

UWUA Local 335 suggests that the Commission order MAWC to provide semi-annual reporting of certain items related to its valve maintenance.

First, as described below, a formal valve maintenance program is neither necessary nor cost beneficial for MAWC or its customers. Moreover, the Staff of the Commission already has access to MAWC's books and records. Information may be obtained regarding valve maintenance without the necessity of additional reporting requirements. *See In the Matter of Union Electric Company*, Report and Order, Case No. ER-2014-0258 (April 29, 2015) ("The Commission finds there is no need to impose a new reporting requirement on Ameren Missouri as Staff can already obtain whatever information it needs from Ameren Missouri"); and *In the Matter of Union Electric Company*, Report and Order, ER-2011-0028 (July 13, 2011) ("The Commission's Staff is able to obtain any information it may want or need from the company without the need and expense of creating any additional reporting requirements.").

Valve Maintenance Program

UWUA Local 335 suggests that the Commission order MAWC to comply with and implement a valve maintenance program that was developed by MAWC's parent, American Water Works Company, Inc. (AWWC).

While AWWC does have a recommended practice for valve exercising, it is not mandatory and each subsidiary is free to adopt all or part of the practice if the benefits exceed the cost of such a program. (MAWC Exh. 43, p. 11) In MAWC's case, there is no need to adopt the American Water Works valve maintenance program because nearly 10,000 valves are operated annually in response to main breaks that occur in St. Louis County. (*Id.* at p. 11) MAWC also assigns valve maintenance work (repairing known broken valves) as fill-in work for crews when main breaks are at low levels. (*Id.*)

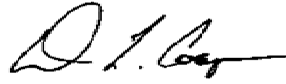
The cost of a formal program is not warranted at this time. A business case concerning the benefits and costs of implementing a systemic valve maintenance program was completed in October of 2012. (MAWC Exh. 43, p. 12) This evaluation indicated that a program would require 10 distribution field workers and 2 management employees and 7 vehicles, and a significant cost to the customers. (*Id.*) The program was thought to have questionable measureable benefits, when the Company's primary strategy has been focused on investment to replace aging water mains and distribution system equipment. (*Id.*)

It is neither necessary nor appropriate to require MAWC to adopt the American Water Works' valve maintenance program recommended by UWUA Local 335.

WHEREFORE, MAWC respectfully requests that the Commission consider this Initial

Brief and, thereafter, issue such order as it shall find to be reasonable and just.

Respectfully submitted,



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CERTIFICATE OF SERVICE

The undersigned certifies that a true and correct copy of the foregoing document was sent by electronic mail, on April 8, 2016, to the parties.

