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REBUTTAL TESTIMONY

OF

LENA M. MANTLE

Submitted on Behalf of the Office of the Public Counsel

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2022-0303

January 18, 2023

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REBUTTAL TESTIMONY

OF

LENA M. MANTLE, P.E.

MISSOURI AMERICAN WATER COMPANY

CASE NO. WR-2022-0303

1 **Q. What is your name?**

2 A. Lena M. Mantle.

3 **Q. Are you the same Lena M. Mantle who filed direct testimony in this case?**

4 A. Yes, I am.

5 **Q. Why are you filing rebuttal testimony?**

6 A. In this testimony I will respond to the direct testimonies of Missouri American
7 Water Company (“MAWC”) witnesses Brian W. LaGrand, Charles B. Rea, John
8 M. Watkins, and Ann E. Bulkley in which they argue the Commission should
9 approve a revenue stabilization mechanism (“RSM”) in general and, in particular,
10 the RSM proposed by MAWC. In my testimony, I include references to the direct
11 testimony of MAWC witness Thomas O’Drain in which he describes the volatility
12 of the costs of chemicals used by MAWC.

13 In addition, I explain why the Commission should not approve the production cost
14 tracker requested by MAWC witness Brian W. LaGrand.

15 **Q. What are your recommendations to the Commission?**

16 A. I have two recommendations for the Commission.

- 17 1. The Commission should not approve a RSM for MAWC; and
18 2. The Commission should not approve a tracker for MAWC’s production
19 costs.

1 **THE COMMISSION SHOULD NOT APPROVE A REVENUE STABILIZATION**
2 **MECHANISM FOR MAWC**

3 **Q. What MAWC witnesses provided testimony describing MAWC’s proposed**
4 **RSM?**

5 A. Two MAWC witnesses provided testimony regarding MAWC’s proposed RSM.
6 First, Charles B. Rea provided testimony on MAWC’s policy reasons supporting
7 the proposed RSM.¹ Second, John M. Watkins provided testimony on the
8 mechanics of MAWC’s proposed RSM.²

9 **Q. What is a Revenue Stabilization Mechanism?**

10 A. A RSM is a mechanism that moves the risk of revenue collection from the utility to
11 its customers. It allows for interim rate changes between general rate cases to
12 ensure that the utility receives the full amount of revenue requirement established
13 by the Commission in the most recent general rate case. A RSM assures the utility
14 that it will receive the normalized revenues set in the rate case regardless of changes
15 in the number of customers, customer usage, or changes in costs, *i.e.* the revenues
16 billed by the utility are assured regardless of customers’ usage, without a review to
17 determine if the utility has prudently incurred its costs to serve the customers.³

18 **Q. Does a Missouri statute allow MAWC to have a RSM?**

19 A. Yes, but only if approved by the Commission. As Mr. Rea notes in his direct
20 testimony,⁴ section 386.266.4 RSMo. allows MAWC to request that the
21 Commission grant it a RSM that would allow for rate adjustments between general
22 rate cases to ensure that MAWC bills the revenues equal to the revenue requirement
23 set in MAWC’s most recent general rate case, such as this case, or a complaint case.

¹ Direct testimony of Charles B. Rea, page 4.

² Direct testimony of John M. Watkins, page 3.

³ [Microsoft Word - BRATTLE NAWC REPORT MON 23 Sept 2013.docx](#), page 2. Also attached as Schedule LMM-R-1.

⁴ Direct testimony of Charles B. Rea, page 57.

1 **Q. What is revenue requirement?**

2 A. A utility’s revenue requirement represents the total amount of revenue a utility must
3 collect from customers to pay all the utility’s costs including a reasonable return on
4 investment. The Commission determines this amount in a general rate case after it
5 examines all expenses and costs. The Commission then approves rates designed
6 rates in a manner to give the utility an opportunity to earn this amount.

7 **Q. Does § 386.266.4 RSMo require the Commission to grant a RSM if MAWC**
8 **makes an application for one?**

9 A. No. While I am not an attorney, my understanding is that section 386.266.5 RSMo.
10 gives the Commission the power to approve, modify, or reject MAWC’s request
11 for a RSM only after providing the opportunity for a full hearing in a general rate
12 case. Based on this language, it is my understanding that the Missouri legislature
13 did not regard granting a RSM as a default option.

14 It is my understanding that Section 386.266.5 also requires that the Commission
15 approve a RSM only “after considering all relevant factors which may affect the
16 costs or overall rates and charges of the corporation . . .” It is my opinion that in
17 making this a requirement, the legislature clearly realized that there needed to be a
18 careful review of the design and impact of a RSM on not only MAWC but also on
19 MAWC’s customers.

20 **Q. What relevant factors should the Commission consider in deciding whether to**
21 **approve MAWC’s request for a RSM in this case?**

22 A. A RSM should not be considered a default option for MAWC. It is a special
23 treatment of revenue collection that should only be approved if it is necessary for
24 MAWC to provide safe and adequate service and earn a return on its investment
25 and it provides benefits to customers that surpass the transfer of risk to customers.

1 Therefore, there are two critical factors for the Commission to consider when
2 determining whether it approves, modifies, or rejects MAWC’s request for a RSM:

3 1) Has the lack of a RSM resulted in MAWC having insufficient funds to
4 provide safe and adequate service and earn a sufficient rate of return
5 (“ROR”); and

6 2) Would an RSM provide benefits to MAWC’s customers that are greater
7 than the increase in risks that they are being asked to assume?

8 MAWC did not show that a RSM was necessary for it to earn a sufficient nor that
9 there were benefits to the customers that outweighed the shift of risks to them.

10 **Q. Is an RSM necessary for MAWC to be able to earn a sufficient return on its**
11 **investments?**

12 A. No. Testimony provided by MAWC witnesses John Watkins and Brian LaGrand
13 show that MAWC has been able to earn a sufficient return without a RSM.

14 **Q. Would a RSM benefit customers?**

15 Q. No. A RSM moves the risk of revenue recovery from MAWC to MAWC’s
16 customers with no corresponding reduction in revenue requirement to compensate
17 customers for the shift in risk.

18 *A RSM IS NOT NECESSARY FOR MAWC TO EARN A SUFFICIENT RETURN*

19 **Q. Did any of MAWC’s witnesses provide testimony that a RSM was necessary**
20 **for MAWC to earn a return on its investments?**

21 A. No. MAWC’s return on equity (“ROE”) witness Anne E. Bulkley testifies that:

22 Since a substantial portion of the Company’s fixed costs are
23 recovered on a variable basis, MAWC is likely to experience
24 significant volatility in annual cost recovery. As a result, MAWC is
25 proposing a revenue stabilization mechanism (“RSM”) that would
26 reconcile actual revenue with the revenue the Commission

1 authorizes (i.e., “Authorized Revenues”) the Company to collect in
2 rates.⁵

3 As I understand Ms. Bulkley’s testimony, it is her position that the Commission
4 should approve the RSM because MAWC is *likely* to experience significant
5 volatility. Later in my testimony here, I show the Commission the small amount
6 of volatility in the revenues from the classes to which MAWC’s RSM would apply.

7 In addition, MAWC witness Brian W. LaGrand states that MAWC is proposing a
8 RSM to address what he labels as “shortfalls” in MAWC’s ability to earn the ROE⁶
9 that he claims was “contemplated” in Stipulation and Agreements in MAWC’s last
10 four general rate cases.⁷ However, this argument is also flawed.

11 **Q. What is Mr. LaGrand referring to as a “shortfall” in MAWC’s ability to earn**
12 **the ROE it contemplated in the past four cases?**

13 A. Mr. LaGrand compared MAWC’s actual return on equity for the last ten years to
14 the ROE range that he opines the Commission “has held” but was not ordered in
15 those four cases. He defines shortfall as the difference between the ROE MAWC
16 achieved and what he believes was the ROE that the Commission would have
17 ordered had MAWC and the Parties to those cases not settled the issue.⁸

18 **Q. What ROE has MAWC earned over the last ten years?**

19 A. Mr. LaGrand provides testimony that MAWC has earned an average ROE of 8.52%
20 over the ten years of 2012 through 2021.⁹ He also gives his calculation of MAWCs
21 earnings for each of those ten years that ranges from 7.46% to 11.19%.¹⁰

⁵ Direct testimony, page 64.

⁶ As OPC witness David Murray explains in his direct testimony in this case, both the ROE and the capital structure impact the rate of return (“ROR”) on MAWC’s investment.

⁷ Page 10.

⁸ LaGrand Direct, pages 9 – 10.

⁹ Page 10.

¹⁰ *Id.*

1 **Q. How does the 8.52% compare to the ROEs set by the Commission during this**
2 **time period?**

3 A. As Mr. LaGrand pointed out, the Commission did not set a ROE for MAWC during
4 this time period.¹¹ Rather, MAWC entered into settlement agreements in which
5 MAWC, along with other parties to the cases,¹² agreed to, among other items, a
6 normalized revenue requirement for MAWC. In agreeing to a revenue requirement,
7 in each of these cases MAWC agreed that the Stipulation allowed it an opportunity
8 to earn a sufficient ROR.

9 **Q. Do you agree that there has been a “shortfall” in the ROE earned by MAWC?**

10 A. No. Since MAWC’s cases have been black box settlements that did not include a
11 designated ROE, it is impossible to say whether MAWC has obtained the ROE that
12 it thought was included in the settled revenue requirement.

13 **Q. If the Commission set a ROE for MAWC, is MAWC guaranteed to earn that**
14 **ROE?**

15 A. No. The Commission sets rates in a manner that gives MAWC *an opportunity* to
16 earn the ROE included in revenue requirement. The ROE MAWC actually earns
17 is based on the revenues MAWC collects and the actions taken by MAWC in its
18 spending.

19 **Q. What does Mr. LaGrand point to as the reasons that MAWC did not have**
20 **higher ROE’s during this time period?**

21 A. Mr. LaGrand pointed to two broad categories: (1) regulatory lag and (2) differences
22 between the billing determinants used to set rates and the actual billing
23 determinants experienced.¹³

¹¹ Page 8.

¹² Pages 8 – 9.

¹³ *Id.*

1 **Q. What are billing determinants?**

2 A. Billing determinants are the units used, along with revenue requirement, to
3 determine rates. For MAWC, billing determinants are usage and the size of the
4 customer's meters.

5 **Q. Who determined the billing determinants in the last two MAWC general rate
6 cases?**

7 A. MAWC and other parties in MAWC's last two general rate increases agreed to
8 billing determinants in those cases. I have attached the agreed too billing
9 determinants from WR-2017-0285 and WR-2020-0344 as Schedules LMM-R-2
10 and LMM-R-3.¹⁴

11 **Q. Will a RSM resolve the differences between the billing determinants used and
12 the billing determinants realized?**

13 A. No. A RSM compares the *revenue* requirement and actual billed *revenue* not the
14 billing determinants and then bills/credits customers the *revenue* difference. A
15 RSM would assure MAWC that it will receive the *revenues* set in the rate case
16 regardless of fluctuations in billing determinants due to weather, number of
17 customers, and conservation efforts. A RSM will not change billing determinants.

18 **Q. Would a RSM increase the possibility of a higher ROE for MAWC?**

19 A. Not necessarily. There are numerous components in the determination of ROE. A
20 RSM would only guarantee that MAWC would be able to bill the revenues set in
21 the last rate case. All else being equal, if the actual billed revenues are greater than
22 the revenue requirement, then having a RSM would result in a lower ROE because
23 MAWC would be required to return revenue to customers. If the actual billed

¹⁴ Attachment A of the *Stipulation and Agreement* in WR-2017-0285 and Attachment A of the *Stipulation and Agreement* in WR-2020-0344 attached to this testimony as Schedules LMM-R-2 and LMM-R-3 respectively.

1 revenues were less than revenue requirement, then the RSM would allow MAWC
2 to bill for more revenue thus increasing its ROE.

3 **Q. How is ROE calculated?**

4 A. According to Investopedia, ROE is calculated as:¹⁵

5
$$\text{Return on Equity} = \frac{\text{Net Income}}{\text{Average Shareholders' Equity}}$$

6 Net Income is further defined as “the amount of income, net expenses, and taxes
7 that a company generates for a given period.” With a RSM, only gross income is
8 set. Net expenses and taxes are not.

9 **Q. In the last five years, all other things being equal, would MAWC’s ROE have
10 been higher if it had a RSM?**

11 A. No. In fact, all other things being equal, MAWC’s ROE would have been lower if
12 it had a RSM.

13 **Q. Would you explain?**

14 A. MAWC witness Watkins shows, in his Schedule JMW-1 attached to his testimony
15 that of the five years of 2017 through 2021, the revenues collected in three years
16 were greater than the revenues set in the previous rate case.¹⁶ If MAWC had a
17 RSM during those five years, it would have returned a portion of the revenues (the
18 difference between the revenues set in the most recent general rate case and the
19 actual revenues due) to its customers, which would have reduced MAWC’s income
20 and decreased its earned ROE.

¹⁵ [Return on Equity \(ROE\) Calculation and What It Means \(investopedia.com\)](https://www.investopedia.com/terms/r/return-on-equity-roe-calculation-and-what-it-means/).

¹⁶ In his schedule JMW-1, Mr. Watkins calls the revenues allocated to the RSM classes in previous rate cases “Authorized Revenues” and the production costs included in the determination of revenue requirement as “Authorized Production Costs.” The Commission did not “authorize” the billing of any revenues or the recovery of any production costs in the last ten years. Revenue requirement and rate design was a black box settlement without agreed to “authorized” revenues or production costs for the RSM classes.

1 **Q. If a RSM would not have resulted in a higher ROE, why is MAWC requesting**
2 **a RSM?**

3 A. A RSM would lower MAWC’s risk by removing uncertainty regarding the revenue
4 MAWC bills its customers. This piece of the ROE equation would be set. With a
5 RSM, MAWC would receive a set amount of revenue regardless of the weather.
6 MAWC would receive a set amount of revenue regardless of a drop in the number
7 of customers. And MAWC would receive a set amount of revenue regardless of
8 any reduction in its customers’ usage and reduce MAWC’s incentive to control and
9 reduce costs.

10 **Q. Should MAWC’s ROE be adjusted if the Commission approves its request for**
11 **a RSM?**

12 A. Not necessarily. Please see OPC witness David Murray’s rebuttal testimony for
13 recommended approaches to consider the lower business risk associated with an
14 RSM. As Mr. Murray’s testimony explains, lower business risk allows for the use
15 of more debt in a capital structure. The ability to utilize more debt reduces the ROR
16 charged to customers even if the ROE is held constant. However, if MAWC’s
17 capital structure is not adjusted to include more debt, then the Commission should
18 reduce the authorized ROE. Again, see Mr. Murray’s testimony for more detail on
19 the appropriate consideration for the lower business risk if an RSM is approved.

THE VOLATILITY OF MAWC'S BILLED REVENUES HAS NOT BEEN
EXCESSIVE

Q. In their direct testimony, both Mr. Rea¹⁷ and Ms. Bulkley¹⁸ express their concerns regarding revenue volatility and how the RSM will reduce this volatility. Do you have a measure of the revenue volatility that would have been avoided had a RSM been in effect for the time period of 2017 through 2021?

A. Yes. Using the information provided in Mr. Watkins's Schedule JMW-1, I calculated the following variances from the normalized revenue requirement for the classes that the RSM would apply to.

Table 1
Revenue Variances

	Rate Case Revenue	Billed Revenue	Variance	% Diff
2017	\$258,553,015	\$259,688,901	\$1,135,886	0.44%
2018	\$274,074,840	\$286,326,807	\$12,251,967	4.47%
2019	\$281,650,968	\$276,050,243	(\$5,600,725)	-1.99%
2020	\$281,650,968	\$284,651,761	\$3,000,793	1.07%
2021	\$299,556,421	\$296,546,416	(\$3,010,005)	-1.00%
Total	\$1,395,486,212	\$1,403,264,128	\$7,777,916	0.56%

What this table shows is that the difference between the actual revenues billed and the rate case normalized revenues ranged from 4.47% (meaning MAWC collected 4.47% more revenues in that year than the normalized rate case revenues) and -1.99% (meaning the revenues MAWC billed were just 1.99% less than the normalized rate revenues.) For the total five years, MAWC billed for 0.56% more revenue than the rate case normalized revenues from these rate classes.

¹⁷ Pages 54 – 56 and 62.

¹⁸ Pages 64 - 65.

1 These variances are just the difference between the revenue requirement and the
2 billed revenues for the classes that MAWC is requesting be included in its proposed
3 RSM. If the variances were compared to MAWC’s total revenues which would
4 include the industrial class and other revenues,¹⁹ the variance percentages would be
5 even smaller.

6 **Q. If MAWC collected more than the revenues set in its rate cases over the past**
7 **five years, why would MAWC want a RSM?**

8 A. A RSM would reduce MAWC’s *risk* regarding revenue billing.

9 **Q. To summarize this section of your testimony, has MAWC’s financial condition**
10 **suffered in the last ten years because it did not have a RSM?**

11 A. No. According to the testimony of MAWC witness Mr. LaGrand,²⁰ over the ten
12 years of 2012 through 2021, MAWC’s net income increased by approximately 43%
13 and its average equity increased 114%. Its annual ROE ranged from 11.19%
14 through 7.46% with an average of 8.52%. While MAWC may not have earned the
15 ROE it contemplated it was agreeing to, this fluctuation in ROE is consistent with
16 the purpose of awarding an equity risk premium. A RSM would not assure MAWC
17 of no volatility in its earned ROE.

18 IMPACTS OF A RSM ON CUSTOMERS

19 **Q. Moving to the second factor that the Commission should consider: how would**
20 **a RSM impact MAWC’s customers?**

21 A. A RSM will introduce uncertainty to customers. Customers would be faced with
22 weather risks, the risks of revenue reductions due to customers leaving MAWC,
23 and the risks that their bills will be higher because their neighbors are using less

¹⁹ MAWC workpapers show that these industrial, private fire and miscellaneous revenues were 5.56% of total revenues for the 12 months ending June 30, 2022.

²⁰ Page 10.

1 water. Customers would lose the predictability of how their actions affect their
2 bills if the Commission approves a RSM for MAWC.

3 **Q. Are there any benefits to MAWC's customers from MAWC receiving a RSM?**

4 A. In the event that MAWC bills for more revenue than the revenue requirement set
5 in the rate case, MAWC's customers will get a credit on their bills. Mr. Rea touts
6 this as a customer benefit,²¹ but he also provides testimony that he expects water
7 consumption per customer to decline.²² This means, everything else being the
8 same, MAWC's revenues will decrease without a RSM. Taking this as true,²³ it is
9 unlikely that the RSM would provide a credit back to customers.

10 **Q. Mr. Rea states that MAWC has no control over the weather as a reason that**
11 **MAWC should be granted a RSM.²⁴ Do customers have control over the**
12 **weather?**

13 A. No.

14 **Q. Mr. Rea states that MAWC does not have control of the drivers that result in**
15 **declining usage as a reason that MAWC should be granted a RSM.²⁵ Do**
16 **MAWC's customers have control over these drivers?**

17 A. No. Mr. Rea explains in his testimony:

18 Water-efficient fixtures and other drivers such as conservation
19 education and government-mandated standards will continue to
20 drive further efficiency into residential and nonresidential usage per
21 customer.²⁶

²¹ Direct testimony of Charles B. Rea, page 53.

²² Page 55.

²³ MAWC made this same assertion in its last two rate cases. However, the fact that MAWC billed for more revenues than the revenue requirement in three of the last five years gives some doubt about MAWC's assertion that its revenues will decline due to declining usage per customer.

²⁴ Page 55.

²⁵ *Id.*

²⁶ Page 42.

1 Just as MAWC does not have control over these drivers, MAWC’s customers do
2 not have control over the efficiencies of the fixtures that are available or
3 government-mandated standards.

4 **Q. Is MAWC acting in any manner that may contribute to a decline in usage?**

5 A. Mr. Rea states that MAWC “is committed to helping customers use water
6 efficiently.”²⁷

7 This commitment to help customers use less water, contributes to the decline in
8 customers’ water usage.

9 **Q. Did MAWC provide any other ways a RSM would benefit MAWC’s**
10 **customers?**

11 A. Mr. Rea provided the following as the benefit of a RSM to MAWC’s customers:

12 As I explain below, the Company's ability to reliably recover its
13 revenue requirement over the long term through rates is an important
14 part of the Company's ability to properly operate, maintain, and
15 invest in the water system at a reasonable cost. This ability to
16 prudently manage the systems at a reasonable cost is in the long-
17 term best interests of our customers.²⁸

18 **Q. Will a RSM guarantee customers that MAWC will properly operate, maintain,**
19 **and invest in the water system?**

20 A. No. It only guarantees that MAWC will recover a set amount of revenues.

21 **Q. Will a RSM guarantee customers that MAWC will prudently manage its water**
22 **system?**

23 A. No. It only guarantees that MAWC will recover a set amount of revenues.

²⁷ Page 57.

²⁸ Page 57.

1 **Q. Are these the only benefits to customers mentioned by Mr. Rea?**

2 A. No. Mr. Rea also points out that a RSM would eliminate MAWC’s financial
3 incentive to sell more water.²⁹

4 **Q. How is this a benefit to customers according to Mr. Rea?**

5 A. Mr. Rea states that:

6 Improving water efficiency is a “win/win/win” providing a wide range of
7 benefits for consumers, utilities, businesses, and for communities as a
8 whole. Approving an RSM opens the path to achieving that winning
9 combination.³⁰

10 **Q. Do you agree that a RSM opens the path to improving water efficiency?**

11 A. No. A RSM will send mixed signals to customers. If all customers improve their
12 water efficiency equally, their bills will not change because the RSM charge will
13 increase to assure MAWC gets a set revenue. If their bill does not reflect monetary
14 savings, then customers will be less likely to implement water saving measures.

15 **Q. Would you explain how the bills of customers with declining usage would
16 change if the Commission approves a RSM?**

17 A. With a RSM, the revenues billed are constant regardless of customers’ usage.
18 Therefore, customers can use less and their bill could be higher if weather was
19 wetter than normal and/or if their neighbors used considerably less than they did
20 the previous year. This is so because a RSM will require MAWC’s customers to
21 replace the revenues not billed because of reduced usage.

22 In addition, customers can only reduce their usage so much without impacting their
23 quality of life. All else being equal, when a customer meets this point, their bill
24 will increase even though they have minimized their usage until all the other
25 customers have also reached this point.

²⁹ Page 59.

³⁰ *Id.*

1 **Q. Is Mr. Watkins wrong when he says in his testimony “No matter what happens**
2 **with sales, customers who use less will pay less”?**³¹

3 A. Technically no. If a customer reduces their usage, then their bill will be lower than
4 it would have been when they were using more. This is so because the bill is the
5 amount of water used multiplied by the applicable rate. No matter the rate, the less
6 the customer uses the lower his or her bill will be.

7 However, what Mr. Watkins leaves out is that if the Commission approves an RSM,
8 customers can use less and their bill can be higher. The portion of their bills that is
9 directly tied to usage, which is the price signal to the customer, will change every
10 year. Therefore, a customer’s bill can increase even if their usage decreases due to
11 changes in the volumetric rate charged.

12 **Q. In conclusion, is the RSM necessary for MAWC and its parent company**
13 **American Water Works to remain financially stable?**

14 A. No. A cursory review of American Water Works stock price shows that it and its
15 affiliates have done remarkably well over the last four years. The graph below,
16 obtained from searching for American Water Works stock on Google’s search
17 engine,³² shows that its stock price has almost doubled over the past five years.

³¹ Page 12.

³² [american water works stock price - Google Search](#) on January 9, 2023.



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This Commission’s previous orders without a RSM have not placed American Water Works and MAWC in financial jeopardy.

Q. Should the Commission approve a RSM for MAWC?

A. No. MAWC does not need a RSM to remain financially viable and, as I explained above, a RSM provides improper price signals to customers. The Commission should not approve a RSM of any kind for MAWC.

THE RSM PROPOSED BY MAWC HAS MANY ISSUES

Q. What are the problems of the RSM proposed by MAWC?

- A. The RSM proposed by MAWC has at least the following issues:
- 1) It improperly includes a mechanism to collect increases in production costs between rate cases;
 - 2) The RSM rate is the same for all rate classes;

- 1 3) Revenue shortfalls are treated differently than revenue excesses; and
2 4) MAWC’s proposed tariff sheets do not match the RSM proposed by the direct
3 testimony of MAWC’s witnesses.

4 **Q. Would you explain your understanding of how MAWC’s RSM rate is**
5 **calculated?**

6 A. Mr. Watkins provides the calculation of the RSM rate as a monthly comparison of
7 revenue requirement³³ to actual billed revenues for the residential, commercial,
8 other public authorities (“OPA”) customer classes and Sale for Resale (“SFR”)
9 customers.³⁴ Any differences between these two amounts accrue interest at
10 MAWC’s short-term interest rate and are accumulated over the calendar year.

11 Mr. Watkins then states that in each month the actual production costs will be
12 compared to the production costs included in the revenue requirement in the last
13 rate case allocated to the months.³⁵ This difference, positive or negative, is added
14 to the difference between the actual revenues billed and the revenue requirement.

15 If these two differences combined are positive, then a RSM rate is calculated and
16 charged to the customers of these four customer classes the next year in the April
17 through December billing months.

³³ Mr. Watkins proposes on page 10 of his direct testimony that a monthly proration of annual rate revenues to months be set using data from the last two years of system delivery. He did not provide the allocation percentages resulting from his proposal.

³⁴ According to Section 386.266.4 RSMo., a RSM cannot apply to the industrial class.

³⁵ Mr. Watkins proposes on page 10 of his direct testimony that a monthly proration of annual rate revenues to months be set using data from the last two years of system delivery. He did not provide the data or the allocation percentages resulting from his proposal.

1 PRODUCTION COSTS CANNOT BE INCLUDED IN A RSM

2 **Q. Why is MAWC including production costs in the RSM?**

3 A. MAWC witness Rea states that “excluding the incremental production costs would
4 reduce the Company’s opportunity to earn a fair return on Equity.”³⁶

5 **Q. In your opinion, does Section 386.266.4 allow for recovery of production costs
6 in a RSM?**

7 A. No. It is my understanding that Section 386.266.4 RSMo. only allows MAWC to
8 request an interim rate mechanism that insures that its revenues billed equal the
9 revenue requirement set in the last rate case for the residential, commercial, public
10 authority, and sale for resale customer classes. It does not include provisions for
11 any costs incurred by MAWC.

12 By including the production costs in this calculation, MAWC is essentially asking
13 the Commission to approve two interim rate mechanism rolled together – one that
14 guarantees that it recover the revenue requirement set in this case (as allowed by
15 statute) and one that guarantees that it recover its production cost expense (that has
16 not been authorized by statute).

17 **Q. How is this interim rate mechanism that MAWC is requesting different from
18 a tracker for production costs?**

19 A. With a tracker, the difference between the cost incurred and the costs used to
20 determine revenue requirement is tracked between cases. Interim rates are not
21 charged between rate cases to recover these costs. In the next rate case, parties
22 review the prudence of MAWC incurring those costs. Based on this review,
23 testimony is provided to the Commission regarding how much, if any, of the tracked
24 costs MAWC should be allowed to recover in the revenue requirement of that future
25 case.

³⁶ Page 53.

1 By including these production costs in the RSM, MAWC will recover the
2 production costs between rate cases with no prudence review of these costs.

3 **Q. If actual production costs were less than the production cost “authorized” in**
4 **the last rate case, would the mechanism proposed by MAWC give that cost**
5 **savings back to the customers?**

6 A. Yes. However, there are two factors that lead me to believe that MAWC does not
7 expect the production cost to be less than what it has historically been. First, the
8 direct testimony of MAWC witness Thomas O’Drain leads me to believe that
9 MAWC is very uncertain regarding its estimate of production costs included in its
10 proposed revenue requirement for this case. Mr. O’Drain, in his direct testimony
11 summarizes the volatility of chemical prices, which are included in “production
12 costs” to be tracked in the RSM, as follows:³⁷

13 Material price increases in 2022 have been driven by external
14 factors, outside of the control of the Company and in many cases
15 outside of the control of many of the Company’s suppliers. These
16 factors will continue to impact pricing beyond current contracts,
17 based on ongoing discussions with suppliers. Although contract
18 timelines have been adjusted in an effort to hedge future price risk,
19 the Company will see continued growth in bids and agreed-upon
20 prices effective July 1, 2022, and for calendar year 2023. In short,
21 historical trends in chemical prices are not determinative of future
22 chemical costs.

23 **Q. Is there any other indications that it is unlikely that production cost will be**
24 **greater than what is included in revenue requirement in this case?**

25 A. Yes. MAWC would not ask for a tracker if it thought there was a good probability
26 that actual costs would be less than what would be included in revenue requirement.

³⁷ Page 17 – 18.

1 **Q. Why is that?**

2 A. Without a tracker, if MAWC was able to acquire the products at a cost less than
 3 what was included in revenue requirement, MAWC keeps those savings. The
 4 amount included in revenue requirement would not be changed until the next rate
 5 case. The savings between rate cases would be positive regulatory lag for MAWC.
 6 This induces efficiencies between rate cases.

7 **Q. Is there a circumstance where an increase in production costs could lead to a**
 8 **RSM charge when billed revenues were greater than revenue requirement set**
 9 **in this case?**

10 A. Yes. If chemical costs increase, as Mr. O’Drain’s testimony suggests is likely,
 11 when the difference between the actual billed revenue was greater than the revenue
 12 requirement set in the RSM but less than the increase in the cost of chemicals, the
 13 RSM would appear as an increase on MAWC’s customers’ bills. Table 2 below
 14 give some examples of how increases in production costs would affect the RSM if
 15 production costs were included in the RSM as proposed by MAWC.

16 Table 2
 17 RSM with Production Costs Examples

	Scenario	A	B	C	D
Revenues	Rev Req	\$400	\$400	\$400	\$400
	Actual	\$405	\$405	\$395	\$395
	<i>Diff</i>	(\$5)	(\$5)	\$5	\$5
Production Costs	Rev Req	\$10	\$10	\$10	\$10
	Actual	\$18	\$8	\$18	\$8
	<i>Diff</i>	\$8	(\$2)	\$8	(\$2)
RSM Amount		\$3	(\$7)	\$13	(\$3)

18 In Scenario A, MAWC billed customers \$5 more than revenue requirement. Absent
 19 the inclusion of production costs, MAWC would return that \$5 to its customers.
 20 However, production costs were \$18 which was \$8 more than what was included
 21 in revenue requirement. The inclusion of the production costs resulted in a RSM

1 amount of \$3. So even though customers paid \$5 more than the revenue
2 requirement, they will be charged an extra \$3 because of the increase in production
3 costs.

4 In Scenario B, MAWC again billed its customers \$5 more than revenue
5 requirement. Absent the inclusion of production costs, this \$5 would be returned
6 to the customers. However, in this scenario, production costs decreased by \$2 so
7 by including production costs in the RSM, MAWC would return \$7 to its
8 customers.

9 In Scenario C, MAWC billed customers \$5 less than the revenue requirement. In
10 this scenario, absent the production costs, MAWC would recover the \$5 through
11 the RSM. However, production costs increased by \$8 meaning that MAWC would
12 collect \$13 through the RSM.

13 In the final scenario, MAWC billed customers \$5 less than the revenue requirement.
14 A RSM without the production costs would result in MAWC billing customers the
15 extra \$5. In this scenario, the production costs went down \$2, so if production costs
16 are included, customers only pay \$3.

17 **Q. What conclusions can you draw from these scenarios?**

18 A. These scenarios, while just examples, show how the RSM that MAWC is proposing
19 is actually two different mechanisms; one mechanism to collect/return the
20 difference between the revenues billed and revenue requirement and the other
21 mechanism to collect/return differences in the production costs included in the rate
22 case and the actual production costs.

1 **Q. Do you disagree with Mr. Watkins’s testimony that production costs vary with**
2 **sales volume and therefore should be included in a RSM?**³⁸

3 A. It makes sense that production costs would vary with the amount of usage.
4 However, after reading Mr. O’Drain’s testimony, I believe that substantial
5 increases in the cost of chemicals is likely regardless of the sales volume.

6 Regardless of whether or not a cost varies with usage, Section 386.266.4 RSMo. is
7 very specific that the Commission can only authorize a mechanism that assures
8 MAWC recovers its revenue requirement. This section does not allow for recovery
9 of costs.

10 *MAWC’S RSM ASSUMES ITS CUSTOMERS ARE HOMOGENOUS*

11 **Q. Would you explain why having the same RSM rate for all rate classes is a**
12 **shortcoming of MAWC’s proposed RSM?**

13 A. MAWC is requesting the RSM apply to all the customer classes that Section
14 386.266.4 allows. Its proposed RSM treats each customer as if they were the same.
15 The mechanism assumes that each class is equally weather sensitive, *i.e.* a St. Louis
16 County residential customer reacts the same to a change in weather as an Other
17 Public Authority customer from St. Louis County.

18 It also assumes that the impact of a customer leaving the system is the same
19 regardless of what class the customer was in before leaving, *i.e.* the impact on the
20 revenue requirement of a residential customer leaving the system is the same as the
21 revenues from a Sale for Resale customer leaving the system.

22 **Q. Why are these not valid assumptions?**

23 A. In his direct testimony, Mr. Rea provides the results of his modeling the residential,
24 commercial and OPA classes. He developed a model for each class that shows the

³⁸ Page 10.

1 weather sensitivity for each class is different.³⁹ The table below provides the result
2 of his modeling of with respect to each class' sensitivity to changes in temperatures
3 in the summer.⁴⁰

4 Table 3
5 Class Differences in Weather Sensitivity

		Temperature Sensitivity	t-Stat
Residential	St. Louis County	0.0017	1.0271
	Other	0.0064	5.8139
Commercial	St. Louis County	0.0430	3.9349
	Other	0.0234	4.3045
OPA	St. Louis County	0.1287	3.7572
	Other	0.0325	1.7095

6 **Q. Would you explain how this information shows that these classes have**
7 **different sensitivities to changes in temperature?**

8 A. The larger the number in the column labeled "Temperature Sensitivity" the greater
9 the sensitivity to changes in temperature.⁴¹ The St. Louis County Other Public
10 Authority class is the most weather sensitive with a value of 0.1287. The St. Louis
11 County Residential class is the least sensitive to changes in temperature with a value
12 of 0.0017. This indicates that the usage of a St. Louis Other Public Authorities
13 customer is much more reactive to a change in weather than a St. Louis Residential
14 customer's usage.

15 As Mr. Rea testified, the t-Stat number indicates the explanatory power of the
16 variable.⁴² The higher the t-Stat the more meaningful temperature sensitivity is in
17 explaining how the class uses water. Any t-Stat value of less than 2 has little
18 explanatory power. In Mr. Rea's model's temperature sensitivity is a very

³⁹ Mr. Rea states that he did not develop a model for normalizing the Sale for Resale class (page 36).

⁴⁰ Pages 38 - 39.

⁴¹ This is the coefficient for cooling degree days (or CDD) from Mr. Rea's analysis.

⁴² Page 32.

1 significant explanatory variable for usages of the Residential Other class even
2 though the response to weather is much smaller than the response of the St. Louis
3 OPA customers. St. Louis County residential class temperature sensitivity variable
4 has a t-Stat of 1.03 which is less than 2. This result means that the temperature
5 sensitivity variable does not explain the usage of the class well.

6 Based on this, Mr. Rea’s own modeling show a significant difference in these
7 classes.

8 **Q. Would the impact of a Sale for Resale customer leaving the system have the**
9 **same impact as a residential customer leaving MAWC’s system?**

10 A. No. Table 4 shows another fallacy of the assumption that all customers are
11 similar.⁴³

12 Table 4
13 Customer Numbers & Average Use

	# of Customers in Dec. 2021	Average 2021 Monthly Use/Customer (Gallons)
Residential	435,076	5,714
Commercial	26,244	33,493
Other Public Authorities	1,919	50,371
Sale for Resale	27	16,683,452
Total	463,266	8,973

14 While the bulk of MAWC’s customers are residential, the average usage of a Sale
15 for Resale customer is about 3,000 times greater than the average residential
16 customer.

⁴³ The information in this table is from MAWC workpaper “CAS 11 and CAS 12 Support – Water Customer Count & Usage”.

1 **Q. If the Commission approves MAWC’s RSM as requested, what would be the**
2 **impact of a Sale for Resale customer leaving the system?**

3 A. The bills of all the other customers would increase to assure MAWC is still
4 receiving the revenue that it would have billed that Sale for Resale customer that
5 used approximately 16.7 million gallons per month.

6 **Q. If the Commission approves MAWC’s RSM as requested, what would be the**
7 **impact of a residential customer leaving the system?**

8 A. All other customers would have increased bills to assure MAWC is still receiving
9 the revenue that it would have billed that Residential customer. However, as is
10 significantly different from the Sale for Resale customer, on average, MAWC’s
11 residential customers use approximately 5,714 gallons per month. Therefore, this
12 difference may not show up in the RSM rate due to rounding of the RSM rate to
13 the nearest 0.00001 per 100 gallons.

14 **Q. How are RSM shortfalls⁴⁴ treated in MAWC’s proposed RSM?**

15 A. If there is a RSM shortfall, meaning the customers to which the proposed RSM
16 would apply need to pay to assure MAWC gets full recovery of the revenue
17 requirement set in the last rate case, the shortfall amount is divided by the expected
18 water usage of the customers in the RSM classes to determine the RSM rate. This
19 same rate is applied to the usage of *all* non-industrial customers.

20 **Q. How does MAWC propose to return RSM excesses to customers?**

21 A. A credit would be determined based on the number of customers at the time the
22 credit is issued.

⁴⁴ Changes in revenues and production costs that are greater than revenue requirement and production costs set in MAWC’s most recent general rate case.

1 **Q. Why does this matter?**

2 A. Each customer would receive the same refund, i.e. the SFR customer with an
3 average usage of 16,683,452 gallons would get the exact same refund as a
4 residential customer with an average usage of 5,714 gallons. MAWC witness Mr.
5 Watkins, states that in 2012, when there would have been \$11.2 million credited to
6 customers, each customer, regardless of how much they had paid MAWC over the
7 year, would have gotten a credit of \$24.17.⁴⁵ This means each residential,
8 commercial, OPA, and SFR customer would have received a credit of \$24.17
9 regardless of how much each had overpaid in the accumulation period.

10 *IMPACT OF PROPOSED RSM ON CUSTOMERS THAT CONSERVE WATER*

11 **Q. Mr. Watkins testifies that this would reward customers who conserve water at
12 a higher percentage than those that use more water.⁴⁶ Do you agree?**

13 A. Mathematically he is correct. However, MAWC’s proposed method to return an
14 over-collection “rewards” every customer, whether they conserved or not, exactly
15 the same amount. The purpose of the RSM is not to promote conservation by
16 customers. It is to make sure that MAWC collects the same amount of revenues
17 despite its customers’ efforts to conserve water. If MAWC wants to incent its
18 customers to conserve water, there are other, more direct methods that provide
19 incentives to only to those customers who actually conserve water.

20 This methodology for “crediting” customers really is just customers with large
21 usage subsidizing low-usage customers.

⁴⁵ Page 12.

⁴⁶ Pages 11 - 12.

1 **Q. With MAWC’s RSM design, Mr. Watkins testifies that customers that**
2 **conserve are rewarded through the RSM when there are excess revenues.⁴⁷**
3 **What is the impact on these customers when there is an under-collection of**
4 **revenues?**

5 A. Despite their best conservation efforts to reduce their bills, customers’ bills could
6 increase because the previous summer was cool and rainy. Or their bills could
7 increase because many of the other customers are conserving due to a recession.
8 Customers’ bills may also increase because customers are leaving the system. This
9 is the asymmetry of the RSM. This certainly is not an appropriate “reward” for
10 customers that conserve.

11 **Q. Then is the RSM proposed by MAWC symmetrical as Mr. Watkins testifies?⁴⁸**

12 A. It is symmetrical for MAWC in that it is guaranteed a set level of revenues. If
13 actual revenue billed is lower than revenue requirement, customers make up the
14 difference and if actual revenue billed are higher than revenue requirement, MAWC
15 returns the excess to the customers. However, it is not symmetrical to MAWC’s
16 customers. If there is a shortfall, customers make up the difference according to
17 their usage and if there is excess the same amount is credited to each customer
18 regardless of their usage.

⁴⁷ Direct testimony of John Watkins, Page 18.

⁴⁸ Page 13.

1 A RSM SHOULD NOT BE USED TO “CORRECT” ERRORS IN THE
2 NORMALIZATION OF USAGE USED TO DETERMINE REVENUE
3 REQUIRMENT

4 **Q. In his testimony regarding the RSM, MAWC witness Mr. Watkins, makes the**
5 **statement that “If the Commission approves both the RSM and the declining**
6 **usage adjustment, and the Company projects too great a decline in usage, the**
7 **Company will credit the over-collection of the revenues to customers through**
8 **the RSM.”⁴⁹ Is an advantage of a RSM that it will correct any errors in the**
9 **normalization of usage?**

10 **A.** No. There are at least two reasons why the Commission should be vigilant in the
11 determination of normalized usage.

12 First of all, in the situation provided by Mr. Watkins in which MAWC over-collects
13 because normalized usage was set too low, MAWC is allowed to use that over-
14 collection until it is returned to customers. I have already discussed the inequalities
15 with MAWC’s proposed method to return an over-collection to the customers
16 above. In addition to these concerns, new customers will get the same credit as
17 customers that were on the system for the whole year. Customer that have left the
18 system after they overpaid do not receive a credit. For many customers, it does all
19 work out the same in the end.

20 Second, the lower the normalized usage, the greater the increase in revenue
21 requirement which in turn results in a higher volumetric rate. The volumetric rate
22 is the price signal sent to the customers. Theoretically, the higher the rate, the more
23 incentive to conserve and the more likely usage is going to decline. That pattern
24 makes MAWC’s forecast of declining usage a self-fulfilling prophecy. Again, for
25 the customers, it does not work out the same in the end.

⁴⁹ Direct testimony of John Watkins, Page 13.

1 The Commission should choose the usage per customer that best normalizes usage
2 in the test year to provide the proper efficiency incentives to MAWC and proper
3 price signals to the customers. The availability of a RSM should not be used to
4 reduce the accurateness of normalized revenues the Commission sets in this case.
5 A laissez-faire attitude towards the determination of normalized revenues will not
6 harm MAWC if the Commission approves a RSM because MAWC would have a
7 guaranteed revenue requirement but it could harm MAWC's customers.

8 PROPOSED RSM IS INCONSISTENT WITH FILED TARIFF SHEETS

9 **Q. Finally, what problems have you identified with MAWC's proposed RSM**
10 **tariff sheets?**

11 A. I will provide details on the inconsistencies I found with MAWC's proposed RSM
12 tariff sheet in CCOS/Rate Design rebuttal testimony to be filed on January 25, 2023.

13 THE COMMISSION SHOULD NOT APPROVE A PRODUCTION COST
14 TRACKER

15 **Q. Which MAWC witness provided direct testimony requesting a tracker for**
16 **production costs and why is MAWC requesting a tracker for production**
17 **costs?**

18 A. Mr. LaGrand requests the Commission approve a tracker for production costs. He
19 states the following as the reason for his request.⁵⁰

20 Similar to the Company's Pension & OPEB trackers that have been
21 in place for nearly 15 years, the production cost tracker primarily
22 consists of costs that are outside the Company's control. These are
23 among the most critical costs incurred because they are critical for
24 providing safe, clean drinking water to our customers and their
25 families. This is not a discretionary expense the Company can
26 choose to incur or not incur.⁵¹

⁵⁰ Page 18.

1 **Q. Are production costs new to MAWC?**

2 A. No, they are not.

3 **Q. Is the fact that the costs are outside of the control of MAWC a reason for a**
4 **tracker?**

5 A. No.

6 **Q. Would you explain?**

7 A. First, I would like to point out that, the testimony of MAWC witness Mr. O'Drain
8 describes different ways MAWC has sourced procurement of chemicals showing
9 that MAWC does have some control over costs.

10 Second, most of the costs MAWC incurs are out of its control. For example,
11 MAWC does not have complete control over how much postage costs or the cost
12 of health insurance for its employees. Yet it does what it can, emailing instead of
13 snail mail and shopping for health insurance, to minimize these costs just as it
14 currently does to minimize production costs.

15 Finally, MAWC receives a return on its investment for the risk that it is taking. The
16 risk of fluctuations in production costs is one of the risks it gets compensated for.

17 **Q. Does Mr. LaGrand give specific costs that he is proposing be placed in this**
18 **tracker?**

19 A. No. He gives the following general definition of the costs that would be included.

20 These costs are related to Fuel & Power, Chemicals, Waste
21 Disposal, and Purchased Water. This would include things such as
22 the costs of electricity at water treatment plants, the costs of
23 chemicals to treat and clean the water before it is delivered to
24 customers, sludge removal costs at a wastewater lagoon, and water
25 purchased from a neighboring community to supplement our
26 production capacity.⁵²

⁵² Page 17.

1 **Q. Is there a problem with having a general definition?**

2 A. Yes. It would be nearly impossible to audit whether or not the costs that MAWC
3 includes in the tracker are actually production costs increasing the likelihood of
4 future disagreements on how to interpret what is a “cost related to” a production
5 cost.

6 **Q. Did MAWC show that absent a production cost tracker, there will be a strong
7 likelihood that it will have problems earning its authorized ROE?**

8 A. No. Mr. LaGrand filed very limited testimony on why MAWC should be granted
9 a tracker for these costs.

10 **CONCLUSION**

11 **Q. In conclusion, why should the Commission reject MAWC’s request for a RSM
12 and a production cost tracker?**

13 A. A RSM, like trackers, changes the balance of risk and responsibility that has served
14 customers of regulated utilities in Missouri well for over a century. A utility comes
15 to the Commission and proves to the Commission the revenue requirement it needs
16 to pay its bills and to earn a return on the capital expenditures it invests in to serve
17 its captive customers. The return included in the utility’s revenue requirement is
18 based on the risks the utility is taking in providing service to its customers. Risks
19 that include rising costs and fluctuations in the revenues it collects.

20 After being granted rates that are designed to collect the revenue requirement
21 determined by the Commission, the utility determines how to spend the revenue
22 that it collects from its customers. If the utility can find ways to efficiently meet its
23 customers’ needs at lower costs, it keeps those savings even as expenses covered
24 by rates fall. This relationship drives efficiency in the utility’s expenditures.

25 If, between rate cases, revenues increase due to increased customer usage, the utility
26 keeps the revenue above what the Commission determined appropriate in the last

1 rate case. If the revenues decrease, then the utility must either find ways to reduce
2 its costs or file a general rate increase case with the Commission. This risk-reward
3 relationship has worked well for MAWC and its customers.

4 On the customers' side, under the current framework, they have stability in their
5 rates. They are assured that their rates will not change without a thorough review
6 by the Commission of all of the utility's costs and revenues. Changes in customers'
7 bills are a result of their action or inaction. Because customers have an
8 understanding of the impact of a change in their behavior, they can decide to reduce
9 their bills by reducing their usage or, knowing the impact on their bill, choose to
10 water their lawn for an additional hour or two, thus increasing their bill. Under the
11 current framework, customers have information available to them on which to make
12 these types of decisions.

13 **Q. Does this conclude your rebuttal testimony?**

14 **A.** Yes, it does.

