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MISSOURI PUBLIC SERVICE COMMISSION

COMMISSION STAFF

**RATE DESIGN
REBUTTAL TESTIMONY**

OF

JAMES A. BUSCH

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2015-0301

*Jefferson City, Missouri
February 2016*

Staff Ex 11

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**RATE DESIGN
REBUTTAL TESTIMONY**

OF

JAMES A. BUSCH

MISSOURI-AMERICAN WATER COMPANY

CASE NO. WR-2015-0301

Q. Please state your name and business address.

A. My name is James A. Busch and my business address is P. O. Box 360,
Jefferson City, Missouri 65102.

Q. By whom are you employed and in what capacity?

A. I am the Regulatory Manager of the Water and Sewer Department,
Commission Staff Division of the Missouri Public Service Commission (Commission).

Q. Are you the same James A. Busch that has already filed testimony in this
proceeding?

A. Yes, I am.

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

A. The purpose of my rate design rebuttal testimony is to respond to the
testimony of Missouri-American Water Company (MAWC) witnesses Paul Herbert and
Jeanne Tinsley, Office of the Public Counsel (Public Counsel) witnesses Geoff Marke
and Ralph Smith, and MIEC witness Brian Collins. Furthermore, I will be responding to
the supplemental testimony filed by MAWC witnesses Herbert and Roach.

District Consolidation - Water

Q. What is the major difference among the parties with regard to rate design?

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1 A. The major difference between the parties is whether or not the
2 Commission should order further consolidation of rate districts or should keep the current
3 structure in place.

4 Q. What parties have filed testimony regarding this issue?

5 A. Staff, MAWC, Public Counsel, and MIEC have filed testimony on this
6 issue.

7 Q. What are the different proposals concerning water district consolidation?

8 A. Staff and MAWC have proposed to further consolidate MAWC's various
9 water districts. Both Staff and MAWC have proposed to consolidate the water districts
10 into three distinct districts or zones. However, Staff and MAWC differ on the makeup of
11 the districts. Public Counsel proposed to keep the current structure in place at this time.
12 MIEC seems to recommend district-specific pricing.

13 Q. What is the current structure?

14 A. The current structure, as agreed to by the parties in MAWC's last general
15 rate case and approved by the Commission (WR-2011-0337), left the seven largest
16 districts (St. Louis Metro -- which consists of St. Louis County, St. Charles County, and
17 Warren County -- Mexico, Jefferson City, Warrensburg, St. Joseph, Platte County, and
18 Joplin) as stand-alone entities and combined the remaining districts into one district,
19 called District 8.

20 Q. How is District 8 constructed?

21 A. District 8 consists of ten separate districts. Those ten districts were
22 grouped into four distinct sub-districts. One group, consisting of the Warsaw and Rankin
23 Acres territories are charged a flat, monthly rate only. The other three groups have both a

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1 customer charge and a commodity rate. The customer charge is the same among these
2 three groups. However, the commodity rate is different among the three groups. The
3 districts are grouped as follows: Brunswick, Spring Valley, and Lakewood Manor; Ozark
4 Mountain and Lake Taneycomo Acres; and, Maplewood/Lake Carmel, Riverside Estates,
5 and Stonebridge (Roark).

6 Q. Has MAWC added new water districts since its last rate case?

7 A. Yes. MAWC has added Saddlebrooke, Emerald Pointe, and Tri-States, all
8 in and around the Branson area; Anna Meadows in Lincoln County near its St. Louis
9 Metro district; and Redfield near Jefferson City.

10 Q. Please describe the difference between MAWC's position and Staff's
11 position.

12 A. According to the testimony of MAWC witness Herbert (Herbert Direct,
13 page 13, lines 17 - 24), MAWC divides the water districts into three zones. The zones
14 were designed to combine districts that had similar current rates. Thus, Zone 1 contains:
15 St. Louis Metro, St. Joseph, Joplin, Warrensburg, Maplewood, Stonebridge,
16 Saddlebrooke, Emerald Pointe, Anna Meadows, and Tri-States. Zone 2 contains:
17 Mexico, Jefferson City, and Platte County. Zone 3 contains: Brunswick, Ozark
18 Mountain, Lake Taneycomo, Rankin Acres, White Branch, Spring Valley, and Lakewood
19 Manor.

20 Staff's proposal combines districts based more on geographical location and
21 operating characteristics. Staff's District 1 contains the water districts in the east-central
22 portion of the state (St. Louis Metro, Anna Meadows, Jefferson City, Redfield, and
23 Mexico). District 2 contains the districts located in the northwest portion of the state (St.

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1 Joseph, Brunswick, and Platte County). District 3 contains those districts in the
2 southwest part of the state (Joplin and Branson area), including Sedalia area systems and
3 Warrensburg.

4 Q. Does Staff agree with MAWC's proposed consolidated districts?

5 A. No.

6 Q. Why not?

7 A. By combining St. Louis Metro with St. Joseph, Joplin, and others, MAWC
8 has created a district with over 95% of the company's customers. One of the major
9 benefits of district consolidation is to spread out the rate impact of future capital costs to
10 a larger customer base. By putting the vast majority of customers in one district or zone,
11 but excluding others, MAWC defeats this goal. In fact, a review of MAWC's proposed
12 Zone 3 shows that this district is made up entirely of very small water districts, with a
13 combined customer base of approximately 1,200. Any benefits associated with
14 consolidation or zonal pricing are negated by the lack of size of all the districts in this
15 zone.

16 Q. Since the St. Louis Metro district contains a majority of MAWC's water
17 customers, isn't any zone or district containing that district going to have the vast
18 majority of MAWC's water customers?

19 A. Yes.

20 Q. So why is Staff's proposed rate design more reasonable than MAWC's?

21 A. Although Staff's District 1 also has a larger percentage of MAWC's water
22 customers, it is not as disproportionate as MAWC's proposal. Further, each of Staff's
23 proposed districts has at least one larger district as an anchor (St. Louis Metro -- ~350,000

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1 customers, St. Joseph - ~30,000 customers, and Joplin - ~21,000 customers). This creates
2 a more balanced grouping of districts which leads to a greater benefit of spreading costs
3 to a larger customer base. Also, Staff's proposal makes geographic sense.

4 Q. Why is it important that the consolidated districts make geographic sense?

5 A. In MAWC's case, many of the districts are managed by an area manager.
6 For example, Matt Barnhart is the operations manager for Joplin and southwest
7 operations, the Branson area districts, and Warrensburg. Staff's proposal combines all of
8 those districts into District 3. Therefore, there is some cost justification to Staff's
9 proposal that does not exist in MAWC's proposal.

10 Q. Have you read the direct testimony of MIEC witness Collins?

11 A. Yes, I have.

12 Q. What is Mr. Collins' recommendation?

13 A. Mr. Collins, on page 8, lines 6 – 10, recommends that district-specific
14 pricing be continued.

15 Q. Is there a problem with this recommendation?

16 A. Yes.

17 Q. What is that problem?

18 A. As noted above, the current structure contains seven independent districts
19 and all other districts are combined into a different, separate district. Since the last rate
20 case, MAWC has purchased additional systems. It is not clear what Mr. Collins intends
21 to do with these additional systems. Mr. Collins' schedule BCC-1, attached to his direct
22 testimony, includes the seven larger districts, but also separates Brunswick into its own
23 district, separate from District 8. The schedule also seems to combine the other districts

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1 into one district. Thus, it is unclear if Mr. Collins is recommending complete district-
2 specific rates, recommending the current rate design, or proposing some other
3 combination.

4 Q. Why is this lack of clarity an issue?

5 A. Brunswick is a relatively small district. Some of the districts that MAWC
6 has purchased are actually bigger than Brunswick (~350 customers), i.e. Tri-States
7 (~3,000). In fact, Tri-States by itself is more similar to established districts like Platte
8 County, Warrensburg, and Mexico than to the any district in District 8. Thus, it does not
9 make sense to separate Brunswick, but combine a bigger service district with the other
10 small districts. Another issue is that, as described above, the systems in District 8 are
11 further grouped together by commodity rate. Mr. Collins does not seem to address if
12 those groupings should remain together or if they should be separated or if they should be
13 just consolidated into one rate. If Mr. Collins suggests keeping the groupings the same,
14 he does not have a recommendation for the newly acquired systems. Thus, Mr. Collins'
15 recommendation is incomplete at this time.

16 Q. Have you read the testimony of Public Counsel witnesses Marke and
17 Smith?

18 A. Yes.

19 Q. What is Public Counsel's recommendation?

20 A. According to Dr. Marke's testimony on page 4, lines 3 – 6, he states that
21 further consolidation is not warranted at this time.

22 Q. Does Public Counsel's proposal have the same deficiency as MIEC's
23 proposal?

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1 A. Yes. Public Counsel does not specifically indicate what should happen
2 with MAWC's newly acquired districts. Public Counsel does not indicate if those new
3 districts should remain independent like the seven largest districts or if they should be
4 combined within District 8. Thus, Public Counsel's recommendation is incomplete at
5 this time as well.

6 Q. Do MIEC and Public Counsel make similar arguments for their collective
7 disagreement with consolidation of rate districts?

8 A. Yes. Both parties discuss the concepts of cost causation and the potential
9 for over-investment as significant factors in opposing further consolidation of rate
10 districts.

11 Q. Does Staff agree with those arguments?

12 A. Fundamentally, yes.

13 Q. If Staff fundamentally agrees with those arguments, why is it proposing
14 further consolidation at this time?

15 A. It is a very complex issue. In a perfect, simplistic world, district-specific
16 pricing is the most reasonable approach to determining rates. The economic concept of
17 cost causation, that those who cause the cost should pay, is efficient and equitable.
18 However, we do not live in a perfect, simplistic world. Water is the one utility product
19 that customers actually ingest. Water is the basic building block of life and the ability to
20 access safe supplies of water is essential to the health and safety of all of Missouri's
21 citizens as well as being a necessary infrastructure for economic growth. As water and
22 sewer systems continue to fail and/or require significant investment to avoid further
23 degradation and failure, different strategies must be considered to address this situation.

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1 Unfortunately, there are not many entities that are willing and able to purchase failing
2 systems and make the appropriate investment in them in Missouri, or throughout the
3 nation.

4 Q. Please continue.

5 A. MAWC is one of only a small handful of companies willing and able to
6 take the risk associated with these types of systems in Missouri. Unfortunately, when a
7 company like MAWC purchases a distressed system, investment is generally needed
8 immediately or in the very near future. Once that investment is made, the cost of
9 providing service to the system, especially if it has a small customer base, becomes
10 prohibitive. Consolidating rates helps to spread out those costs to a much larger customer
11 base, which means that all MAWC customers and more Missouri citizens will have
12 access to safe and adequate water at just and reasonable rates. This extremely important
13 public policy determination has to take precedence over the very valid concerns of cost
14 causation.

15 Q. Both MIEC and Public Counsel state that over-investment is a concern of
16 further consolidation. What is Staff's position regarding the potential of over-
17 investment?

18 A. Staff agrees that when service territories are consolidated, the company
19 has an opportunity to over-invest in any particular district.

20 Q. Please explain.

21 A. Under a more district-specific structure, any investment is going to have to
22 be paid for by those customers living within that district. Thus if a large capital
23 investment is required, it can cause a substantial amount of rate shock that will impact the

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1 ratepayers within that district. Once districts are combined, those costs are spread over a
2 larger customer base. Thus, the rates will not rise as dramatically. This means that the
3 utility could, in theory, overbuild facilities and rates would not be as objectionable to
4 customers or regulators.

5 Q. Is there any incident that supports this theory?

6 A. Yes. During the Flood of 1993, MAWC's water treatment facility in its
7 St. Joseph service territory, which was already in need of major rehabilitation, was out of
8 service for a week because it was severely damaged due to flooding. After a study of
9 various alternatives for rehabilitation and for new reliability concerns, MAWC decided
10 the best course of action was to replace the facility with a new plant at a different
11 location. Part of MAWC's selling points to the customers in the St. Joseph service area
12 was that the costs of the new facility would be spread to all MAWC customers through
13 single-tariff pricing (STP), another name for consolidation. In the rate case that was filed
14 to include the St. Joseph plant into rates and further the move toward single-tariff pricing
15 (WR-2000-281), Staff, Public Counsel, and others not only argued against STP, but also
16 argued for a prudence disallowance to certain aspects of the new facility.

17 Q. What was the Commission's decision in that proceeding?

18 A. The Commission ruled against moving towards STP and went back to
19 district-specific pricing. Further, the Commission ruled that some of the costs of the
20 treatment facility were not prudently incurred and disallowed a portion of those costs.

21 Q. Is MAWC the same company today as it was then?

22 A. No.

23 Q. Please explain.

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1 A. At the time of WR-2000-281, MAWC had seven districts. Those districts
2 were St. Charles, Mexico, Brunswick, St. Joseph, Platte County, Warrensburg, and
3 Joplin. Today, MAWC has included St. Louis County, Jefferson City, as well as many
4 other small water systems, not to mention its sewer operations.

5 Q. Why is the change in composition of MAWC important?

6 A. The change in composition of MAWC is important because it no longer
7 only operates in a limited number of districts of relatively similar size. It is a water utility
8 that provides service to a single, large area with over 350,000 customers, as well as to a
9 single, small area with only 15 customers. It has expanded to take systems that were
10 failing and it has grown its operations. Therefore, the manner in which it is regulated
11 through its rate design needs to evolve to address this new reality.

12 Q. What are some potential consequences of maintaining the status quo
13 regarding district consolidation?

14 A. The major consequence that could occur from maintaining the status quo,
15 in Staff's opinion, is that MAWC may decide that further acquisition of failing systems is
16 no longer justifiable. If that occurs, the State of Missouri will lose an important player in
17 addressing the continued provision of safe and adequate service to its citizens. Both Staff
18 of the Commission as well as the Department of Natural Resources (DNR) reach out to
19 MAWC, as well as other entities, when there is a failing system that needs immediate
20 repair. MAWC's potential refusal to continue to participate in "bailing out" failing
21 systems could be detrimental to the State of Missouri.

22 Q. Has anyone at MAWC indicated to you that it plans on ceasing its current
23 strategy of purchasing troubled water and sewer systems?

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1 A. Absolutely not. However, it is Staff's fear of what may happen in the
2 future.

3 Q. Due to the issues of potential over-investment if further district
4 consolidation is approved, does Staff have a proposal to combat that threat?

5 A. Yes. Staff would suggest that MAWC be required to file a five-year
6 capital expenditure plan with the Commission for review by January 31 of each year after
7 the effective date of rates in this case. Every party to this case would then have the
8 ability to review MAWC's plans and make recommendations regarding investment and
9 the need to make investments in any service area. All expenditures will still be subject to
10 full review in MAWC's future rate cases.

11 Q. On page 6, lines 15 – 21, of his direct testimony, Mr. Collins posits that
12 consolidated pricing reduces MAWC's incentive to perform due diligence when
13 acquiring new systems and this may impact the price MAWC is willing to pay. Do you
14 have a comment on his statement?

15 A. Yes. Staff has been involved with MAWC, and others, in the potential
16 acquisition of various water and sewer utilities. Due diligence is something that all
17 potential purchasers take very seriously. Secondly, MAWC and other potential
18 purchasers understand that Staff does not recognize acquisition premiums for purchased
19 systems and that the Commission has generally not granted any acquisition premium.
20 Thus, systems are usually purchased based on the selling utility's rate base valuation,
21 which is a generally accepted regulatory philosophy. This philosophy has worked
22 extremely well in Missouri, keeps purchase prices in line, and avoids undue costs being
23 borne by ratepayers.

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1 Q. On page 20, lines 8 and 9, Dr. Marke states that consolidated pricing
2 would clearly give MAWC a competitive advantage in the market place for future
3 municipal acquisitions. Does Staff agree with Dr. Marke's assertion?

4 A. No. As noted earlier, MAWC is one of only a small number of utilities
5 that is willing and able to purchase struggling water and/or sewer utilities. Thus there is
6 not a lot of competition for water/sewer systems. Further, if another entity was more
7 active in purchasing distressed utilities and was as diverse as MAWC, the Commission
8 could also provide a consolidated rate structure for that entity. Moving to a consolidated
9 rate design for MAWC does not preclude other entities from requesting similar treatment.

10 Q. Please explain Staff's assertion that MAWC is one of a very small number
11 of entities willing and able to purchase water and/or sewer utilities in Missouri.

12 A. First, Staff keeps a list of entities that it has personal knowledge of that
13 have expressed an interest in expanding its operations. The list is small and Staff is
14 always looking to add companies to this list. Second, a water/sewer utility in
15 receivership recently was ordered by a Circuit Court Judge to solicit bids for the transfer
16 of its assets. This was a decent-sized system with decent revenues as far as small systems
17 are concerned. MAWC was one of four entities to place a bid.

18 Q. Starting on page 4 of his direct testimony, Mr. Collins argues against
19 consolidated pricing stating that there is no common or economic cost structure across
20 MAWC's districts. How does Staff's proposal address this argument?

21 A. Staff's proposal addresses this argument by consolidating districts by
22 geographic location and operating characteristics. Staff agrees that water treated in St.
23 Louis does not go to customers in Joplin as argued by Mr. Collins and Public Counsel

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1 witnesses Marke and Smith. However, certain operational functions are spread over
2 certain geographic areas within MAWC. Staff's proposal matches those operational
3 functions with its consolidated districts. Thus, Staff's proposal takes into account those
4 micro-cost structures.

5 Q. Did you participate in any of the local public hearings (LPHs) held by the
6 Commission for this rate case?

7 A. Yes. I presented Staff's position on rate design at 10 of the 12 ordered
8 LPHs. I did not attend the LPH held in Warsaw, mainly a sewer area, or the LPH held in
9 Joplin.

10 Q. At the ten LPHs that you did attend, was the consolidated district proposal
11 discussed?

12 A. Yes. The consolidated pricing issue was discussed in both the question
13 and answer sessions held prior to the LPH and during the on-the-record portion of the
14 LPH as well.

15 Q. What was the customer reaction to the proposed consolidation?

16 A. The reaction, not surprisingly, was mixed. In areas where rates were
17 proposed to be lower, customers were okay with consolidation. In areas where rates were
18 proposed to be higher, customers did not like consolidation. The main argument against
19 consolidation was the concept of cost causation. The main argument for consolidation
20 was why do customers in one area pay more for the same commodity than customers in
21 different area.

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1 Q. In Mr. Collins' testimony, he argues that under consolidated pricing, some
2 districts would be providing subsidies to other districts (page 7, lines 1 -13). Do you
3 agree with his argument?

4 A. No.

5 Q. Why not?

6 A. Subsidization means that someone is paying above costs so that someone
7 else can pay below costs. In the case of MAWC, many of the costs of providing service
8 are not directly allocated. Costs for MAWC's ratepayers come from corporate
9 allocations from its parent company, American Water, in New Jersey. These costs are
10 allocated to each state that American Water operates. Further, MAWC's own Missouri-
11 specific corporate overhead costs are also allocated to each district. There are various
12 methods of allocating costs to any given district and all parties, including Staff, do a
13 reasonable job of allocating them. However, since many of those costs are allocated, it
14 makes it difficult to fully determine what it actually costs to provide service to say
15 St. Louis County compared to what it actually costs to provide service to Spring Valley.
16 Thus, the idea of subsidization is difficult to fully accept. And due to this, consolidation
17 of rates does not really mean that one district is "subsidizing" another district since any
18 given allocation method could allocate more or less costs to any given district.

19 Q. Does Staff agree that when districts are combined, some districts will have
20 rates that increase and others will have rates that decrease absent any increase in revenue
21 requirement?

22 A. Yes. Staff acknowledges that some customers will see a reduction in rates
23 while others will see an increase in rates. However, Staff's proposal will lead to just and

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1 reasonable rates throughout MAWC's service territory and will provide long-lasting
2 benefits to consumers and the public interest going forward.

3 Q. With Staff's movement to three districts or zones, does Staff foresee
4 further consolidation in the future?

5 A. Not at this time. Staff's proposal is one that could settle the issue of
6 consolidation for the foreseeable future. It is a fair and balanced approach to the issue of
7 district pricing and addresses many of the concerns of all parties.

8 **District Consolidation – Wastewater**

9 Q. Is there a similar argument for and against district consolidation of
10 MAWC's wastewater districts as there is on the water side?

11 A. No.

12 Q. Please explain.

13 A. MAWC proposes to combine all sewer districts into a consolidated rate
14 district, except for the newly acquired Arnold system. Staff proposed to combine the
15 sewer districts into five districts. However, based on Staff's cost of service
16 recommendation, Staff has proposed maintaining the sewer rates at current levels. Public
17 Counsel, in Mr. Smith's testimony starting on page 60, indicates that it prefers to keep the
18 wastewater districts as is, but it believes Staff's proposal has some merit, with slight
19 modifications.

20 Q. What is Staff's main concern with sewer rates and district consolidation?

21 A. Staff's main concern is that many of MAWC's wastewater customers
22 already pay \$65.22 per month for sewer service. Staff is concerned with magnitude of
23 this rate and will support a rate design that does not impact this rate too much. At this
24 time, Staff's revenue requirement allows for all wastewater rates in all districts to remain

1 unchanged. However, if revenue requirement increases, Staff will move toward its
2 proposed district consolidation and may ultimately support further consolidation as
3 proposed by MAWC if necessary.

4 **Revenue Stabilization Mechanism and Customer Charges**

5 Q. Is MAWC proposing a revenue stabilization mechanism (RSM) in this
6 proceeding?

7 A. Yes.

8 Q. What is a RSM?

9 A. A RSM can be designed in many ways, but in this case, the RSM is a
10 mechanism that will provide MAWC with a much greater probability that MAWC will
11 receive the revenue requirement granted by the Commission in this rate case.

12 Q. Does MAWC agree that its revenues will be more certain under a RSM?

13 A. Yes. MAWC witness Tinsley states on page 27, line 13 – 15, that a RSM
14 "... will help ensure that the Company would receive the authorized revenue, no more
15 and no less, and customers would pay the appropriate price for water service in their
16 monthly bills..." (emphasis added).

17 Q. Is it the Commission's role or responsibility to provide any guarantee that
18 a utility has the right to earn its "authorized revenue?"

19 A. No. The Commission does not guarantee that the utility will actually earn
20 its authorized revenue. The Commission does give the utility an opportunity to earn its
21 authorized revenue.

22 Q. What is the Commission's role then if not to guarantee authorized
23 revenues?

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1 A. The Commission's role is to approve a revenue requirement during the
2 course of the rate case that is equivalent to the utility's cost of providing service. Rates
3 are then developed that will allow the utility to charge its customers in order to collect
4 revenues. In a perfect world, the utility would collect those revenues and the utility's
5 actual cost will not change, so that revenues will equal cost and a fair return will be
6 earned by shareholders. However, in the real world, usage will be greater or lesser than
7 the level used in the rate case to create rates; costs will be lower or higher than the
8 normalized costs used to develop the revenue requirement; or any combination of those
9 and many other factors will occur causing revenues to be higher or lower. This is why
10 the shareholders are allowed to earn a return on their investment - to compensate them for
11 the risk that costs and revenues will be higher or lower after rates are established. There
12 is no guarantee that the revenues will be consistent nor any guarantee that costs will be
13 consistent.

14 Q. In Ms. Tinsley's statement, she also states that the RSM would allow the
15 customers to pay the "appropriate price" for water service. Does Staff agree with this
16 statement?

17 A. No. The appropriate price for water service is established at the time rates
18 are set in the rate case. Under the RSM, rates will be adjusted between rate cases. Thus,
19 the rate that the customer will pay will either be greater or lesser than the appropriate rate
20 that the Commission established as a just and reasonable rate in the rate case.

21 Q. How would MAWC's proposed RSM work?

22 A. At this time, it is very unclear as to how MAWC's proposal will work.

23 Q. Please explain.

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1 A. In Ms. Tinsley's testimony, beginning on page 28, Ms. Tinsley goes into a
2 little detail about the mechanism. But, she starts her discussion off with, "Please
3 **generally** describe the components..." (emphasis added). She then provides some
4 characteristics that would be included in the RSM. However, on page 27, lines 16 – 17,
5 she states, "Depending on how the RSM is designed..." So, it seems that MAWC has
6 not provided a concrete example or methodology of how the RSM would actually work.

7 Q. Did MAWC provide a sample tariff sheet for review to provide the parties
8 and the Commission an opportunity to see how the RSM would operate?

9 A. No, it did not. The Commission, Staff, and the other parties are left to the
10 vague description within Ms. Tinsley's testimony to determine how the RSM would
11 work.

12 Q. Ms. Tinsley's testimony does go through some description of MAWC's
13 proposed mechanism. Why does Staff think it is vague?

14 A. In Staff's opinion, a request to consider establishing any sort of change to
15 the regulatory process as consequential as what MAWC is proposing requires a full
16 description with examples and tariff sheets for review, critique, and proposed changes.
17 What MAWC has proposed is a shell for the mechanism, without the details needed for
18 proper consideration.

19 Q. On page 18, lines 14 – 22, Ms. Tinsley states that revenue is decreasing.
20 Does Staff agree with this statement?

21 A. No. Revenues have not been decreasing. Public Counsel witness
22 Hyneman in his revenue requirement rebuttal testimony provided revenues for MAWC

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1 since 2011 as reported in MAWC's Annual Report. Starting in 2011, revenues were
2 \$241 million, \$276 million, \$261 million, and \$266 million, respectively.

3 Q. On page 18, lines 14 – 22, Ms. Tinsley states that the reduction in water
4 sales has been a source of fiscal stress for MAWC. Does Staff agree with this statement?

5 A. No. Staff disagrees with the statement that MAWC has been under fiscal
6 stress. If a utility is under fiscal stress, it should file for rate relief. MAWC waited
7 almost as long as it was statutorily allowed to wait before it filed this rate increase case.
8 Further, MAWC made approximately \$436 million in capital investments, plus purchased
9 a handful of new systems, including the City of Arnold's wastewater treatment assets.
10 Such activity does not indicate that a company is in financial stress.

11 Q. Please explain the statement that MAWC waited for almost as long as it
12 was statutorily allowed before it filed for this rate increase.

13 A. MAWC utilizes the Infrastructure System Replacement Surcharge (ISRS).
14 By statute, when MAWC establishes an ISRS, it must file a general rate case to reset the
15 ISRS rate to zero within three years of that establishment. Thus, MAWC was required to
16 file a rate case no later than September of this year. MAWC filed this rate case on
17 July 31.

18 Q. On page 20, lines 6 and 7, Ms. Tinsley states that MAWC's proposed
19 RSM will advance the Commission's goals. Does Staff agree with this statement?

20 A. No. Staff is not aware of what Commission goals are being referenced.

21 Q. On page 27, lines 1 – 7, Ms. Tinsley argues that the traditional ratemaking
22 model clearly fails to achieve its goal if sales volumes do not exactly match the projected

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1 pro forma volumes used to establish rates (emphasis added). Does Staff agree with this
2 statement?

3 A. No. The traditional, cost-of-service ratemaking model has been
4 successfully used for decades. Within that model, sales volumes will not exactly match
5 those used in a given rate case. They can be higher or lower. Just like explained above,
6 any cost or any component used in the traditional ratemaking process can be higher or
7 lower. It is because of this variability that investors require a certain level of
8 compensation so that they can have the opportunity to earn a fair return on their
9 investment.

10 Q. Do consumers benefit from the traditional ratemaking model?

11 A. Yes. Consumers benefit from the traditional ratemaking model by having
12 stable rates once those rates become effective in a rate proceeding. These rates are set
13 appropriately after a thorough review of all the utilities books and records are reviewed.
14 The RSM proposed by MAWC will allow for that rate to change without an appropriate
15 review of all of the utility's costs and revenues. The proposed RSM as described by Ms.
16 Tinsley shifts the risk of variability from the utility to the consumer, without any
17 proposed reduction in risk payment to the utility or benefits accrued to the customer.

18 Q. On page 31, lines 8 - 10, Ms. Tinsley states that MAWC's proposed RSM
19 encourages and rewards customers for using water more efficiently, because reduced
20 consumption translates into a reduced bill and increased consumption results in a higher
21 bill. Does Staff agree with this statement in the context of MAWC's proposed RSM?

22 A. No. Throughout her discussion regarding the RSM, Ms. Tinsley cites the
23 Company's belief that declining usage is causing revenues to be less and thus an

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1 alternative mechanism, such as the RSM, is needed to offset that proposition. On page
2 24, line 17, she states, "The current ratemaking structure is simply not well adapted to a
3 declining usage...." Then on the other hand (page 31), MAWC is arguing that a RSM is
4 needed to encourage customers to use less water. If the rate a customer pays for water
5 increases in the future because the customer used less today, then the customer is not
6 encouraged or rewarded for conserving its usage.

7 Q. Does any other party agree with Staff's assessment?

8 A. Yes. Public Counsel witness Gorman in his direct testimony, on page 5,
9 lines 5 – 17, discusses how MAWC's proposed RSM will discourage conservation
10 efforts.

11 Q. On page 31, line 15, Ms. Tinsley states that a RSM will reduce the
12 frequency of rate cases. Does Staff agree with that statement?

13 A. No. As was mentioned earlier, MAWC is required to file a rate case
14 within a defined period due to its use of the ISRS statute. If MAWC continues its use of
15 the ISRS statute, there is no basis for assuming the frequency of rate cases will change.

16 Q. The ISRS mechanism was mentioned earlier in this testimony. How does
17 the ISRS mechanism impact MAWC's concerns about the alleged declining revenues?

18 A. The ISRS is a mechanism that allows MAWC to recover the costs of
19 certain types of capital expenditures it makes for the replacement of aging infrastructure.
20 The ISRS allows MAWC to collect additional revenues of up to 10% of the revenue
21 requirement approved by the Commission in MAWC's last rate case. So even if MAWC
22 is experiencing declining revenues, the ISRS allows additional revenue to be collected by
23 the Company outside the need for a rate request. If MAWC is granted a RSM, with an

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1 ISRS in place, MAWC will likely be guaranteed to collect more revenues between rate
2 cases than what the Commission approved.

3 Q. On pages 25 and 26 of her direct testimony, Ms. Tinsley discusses how the
4 RSM could produce both refunds and surcharges. On page 26, she includes a graph from
5 Ms. Pamela Morgan's paper, *A Decade of Decoupling for U.S. Energy Industries*, that
6 shows rate impacts of other decoupling measures in the U.S. What does this graph show?

7 A. What this graph shows is that the impacts of providing a surcharge or a
8 refund to customers are virtually identical and that the frequency and impact are similar
9 for either a surcharge or refund. This graph, to Staff, indicates that the current
10 ratemaking model works. Some years, the utility may see revenues increase and some
11 years, the utility may see revenues decrease. This graph shows that a RSM is not
12 necessary.

13 Q. Does any other party agree with Staff's interpretation of this graph?

14 A. Yes. On page 6, lines 1 – 15, Mr. Gorman also discusses the relative
15 balance of the traditional ratemaking without an RSM.

16 Q. What is Staff's recommendation for MAWC's proposed RSM?

17 A. Staff recommends that the Commission not approve MAWC's RSM as
18 proposed.

19 Q. Is Staff against all revenues stabilizations mechanisms?

20 A. Not necessarily. Staff might be able to support a properly designed
21 mechanism that would provide benefits to both customers and shareholders. However, at
22 this time, Staff does not have a recommendation on how to design such a mechanism.

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1 Q. Are there alternative methods to address some of the concerns raised by
2 MAWC?

3 A. Yes.

4 Q. Please explain.

5 A. As pointed out in Mr. Herbert's direct testimony, moving toward a rate
6 structure more closely aligned with the concepts of straight fixed variable pricing (SFV)
7 is an alternative to the RSM proposed by MAWC. According to Mr. Herbert's
8 testimony, in question 39 (some of the page numbers are missing in Mr. Herbert's filed
9 testimony), MAWC could have a customer charge of about \$56 if it was designed to
10 collect 90% of MAWC's fixed costs.

11 Q. Did Staff propose an increase to MAWC's customer charge?

12 A. No, Staff's proposed customer charge varies by district, and is generally
13 lower than the Company's proposed \$17.40 system-wide customer charge.

14 Q. Is Staff taking an inconsistent position by arguing against MAWC's
15 proposed RSM, proposing an alternative mechanism similar to SFV, and supporting a
16 lower customer charge?

17 A. No. Staff proposed customer charge is a just and reasonable rate for
18 MAWC's customers. Staff does not recommend the Commission approve MAWC's
19 RSM proposal. However, Staff recognizes that an alternative may be considered and
20 would support a higher customer charge rather than the RSM as proposed by MAWC.

21 **MAWC's supplemental testimony**

22 Q. Has Staff reviewed the supplemental testimony filed by MAWC?

23 A. Yes.

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1 Q. Is there any other Staff witness filing testimony in response to MAWC's
2 supplemental testimony?

3 A. Yes. Staff expert David Murray will address MAWC witness Rungren's
4 supplemental testimony.

5 Q. On page 4, lines 5 and 6 of his supplemental testimony, Mr. Herbert states
6 that he believes Staff, by its statements in its Analysis, has accepted that water companies
7 have fixed costs of up to 75-80%. Does Staff agree with this assertion?

8 A. No. In its Analysis, Staff stated, "it has been claimed by some utilities
9 that approximately 75-80% of all costs of providing water service is fixed." This is by no
10 means Staff's acceptance of the claim.

11 Q. On page 5, lines 17 – 24 of his supplemental testimony, Mr. Herbert, in his
12 discussion regarding inclining block rates argues for a three-block structure instead of the
13 two-block structure suggested by Staff. Does Staff agree with this suggestion?

14 A. Mr. Herbert, later in his testimony on page 6, lines 6 – 10, indicates that he
15 does not believe an inclining block rate structure is necessary. Staff agrees with this
16 statement, that an inclining block rate structure is not necessary. Thus, the difference
17 between a two-block vs. three-block structure is moot at this point.

18 Q. What is Staff's position if an inclining block rate structure is requested?

19 A. In that case, Staff agrees with Public Counsel witness Marke's direct
20 testimony that a rate design/class cost of service docket be open for MAWC to fully vet
21 all of these potential changes. To further this point, if the Commission is interested in a
22 revenue stabilization mechanism, Staff would recommend including that discussion in the
23 docket as well. This way, all factors that go into the creation of rates and rate structures

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1 can be addressed and the potential impacts can be explored prior to any actual change in
2 regulatory practice takes place.

3 Q. Did you read the supplemental testimony of Mr. Roach?

4 A. Yes.

5 Q. Does Staff have any comments to his supplemental testimony?

6 A. No. Most of Mr. Roach's supplemental testimony is similar to the debate
7 being held between MAWC and Staff/Public Counsel regarding declining customer
8 usage.

9 **Special Contracts**

10 Q. Does Staff propose any change to the Triumph Food contract rates?

11 A. Not at this time.

12 Q. Does Staff have any recommendation at this time regarding the contract
13 rates that Triumph Foods is currently operating under?

14 A. Yes, it does.

15 Q. What is Staff's recommendation concerning Triumph Foods special
16 contract and rates?

17 A. Staff recommends that a review of the contract between MAWC and
18 Triumph Foods be conducted for consideration during MAWC's next general rate
19 increase. In MAWC's rate case, WR-2010-0131, the contract was amended and a new
20 commodity charge was established based upon a variable cost component and a margin
21 component. Further, in the Stipulation and Agreement that was filed in the case and
22 approved by the Commission, Highly Confidential Appendix D stated, among other
23 provisions, that the Signatories agree not to request a review of the Triumph Foods
24 contract until after December 31, 2015. As this current case was filed in July of 2015,

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1 Staff did not request a review at that time. However, since it is now past December 31,
2 2015, Staff is requesting a review of the contract be conducted and any changes deemed
3 appropriate will be addressed in MAWC's next general rate proceeding.

4 Q. Does MAWC have any other special contracts?

5 A. Yes.

6 Q. Does Staff have any recommended changes or requests regarding those
7 contracts?

8 A. No. Those contracts are slightly different than the Triumph contract and
9 thus are not subject to the same treatment.

10 Q. Please explain.

11 A. The other two contracts have been approved under a different section of
12 the Economic Development Rider tariff provision and also have a different term than the
13 Triumph contract. Due to those specific differences, the rate and review that is allowed
14 of the Triumph contract does not apply to the other contracts.

15 **Updates**

16 Q. Was there an error in Staff's water District 2 information?

17 A. Yes. There was an error in calculating total usage in the industrial class.

18 Q. Did Staff update its District 2 CCOS?

19 A. Yes. The summary of Staff's new District 2 CCOS is attached to this
20 testimony.

21 Q. Please summarize Staff's revised District 2 CCOS.

22 A. Based on correcting the error and other minor updates, the results show
23 the following: instead of substantial percentage decreases to the residential, commercial,
24 and other public authority (OPA) classes and a large increase to the industrial class, the

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1 residential and OPA classes will receive increases, the commercial class will receive a
2 slight decrease, and the industrial class will receive a substantial decrease. Sale for resale
3 and the fire classes were not impacted to the same degree as the other classes.

4 **Summary**

5 Q. Please summarize your testimony.

6 A. Staff's proposal for rate consolidation is the most reasonable approach to
7 designing rates. It takes some of the best arguments for district-specific pricing and
8 single-tariff pricing and combines them into a fair and equitable rate design. Staff is
9 opposed to MAWC's proposed revenue stabilization mechanism as proposed in its direct
10 case. With that said, Staff would not be opposed to increasing the customer charge if a
11 RSM is not approved by the Commission in this case, but the Commission is interested in
12 providing more stability to MAWC.

13 Staff is not proposing to change any of the rates approved through the special
14 contracts MAWC has with various industrial customers in the St. Joseph service area.
15 However, Staff is requesting a review of the rates and the contract between MAWC and
16 Triumph to be conducted in MAWC's next general rate request.

17 Q. Does this conclude your rebuttal testimony?

18 A. Yes.

Missouri American Water Company
Water District 2
PSC Staff Study

Comparison of Cost of Service with Revenues under Present and Proposed Rates
For Test Year Ending December 31, 2014

Customer Classification	Revenues Present Rates		Revenues Proposed Rates		Proposed Change	
	Amount	Percent	Amount	Percent	Amount	Percent
Residential	\$ 16,121,798	52.74%	\$ 16,916,493	59.85%	\$ 794,695	4.93%
Commercial	\$ 5,485,901	17.95%	\$ 5,348,237	18.92%	\$ (137,664)	-2.51%
Industrial	\$ 4,941,434	16.17%	\$ 2,703,125	9.56%	\$ (2,238,309)	-45.30%
Other Public Authority	\$ 922,100	3.02%	\$ 1,039,300	3.68%	\$ 117,200	12.71%
Sale for Resale	\$ 2,552,301	8.27%	\$ 2,046,999	7.24%	\$ (505,302)	-19.80%
Public and Private Fire	\$ 545,174	1.78%	\$ 208,739	0.74%	\$ (336,435)	-61.71%
Total	\$ 30,568,708	100%	\$ 28,262,893	100%		
Other Revenues	\$ 286,237		\$ 286,237			
Total	\$ 30,854,945		\$ 28,549,130		\$ (2,305,815)	-7.47%