BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the Matter of the review of Economic, legal and policy considerations of District-Specific Pricing and Single Tariff Pricing	))))	Case No. SW-2011-0103

MISSOURI-AMERICAN WATER COMPANY'S

BRIEF

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1. INTRODUCTION

On October 14, 2010, the Missouri Public Service Commission ("Commission") established the instant working docket to review the economic, legal and policy considerations of district-specific pricing and single tariff pricing. The Commission also transferred certain filings and information from two other dockets involving recent rate cases for Aqua Missouri Inc. (SR-2010-0023) and Missouri-American Water Company (WR-2010-0131). Finally, on November 9, 2010, the Commission held an on-the-record proceeding at which time the following parties appeared: the Commission's Staff ("Staff"), the Office of Public Counsel ("Public Counsel" or "OPC"), Missouri-American Water Company ("MAWC" or "Company"), Aqua Missouri, Inc., City of Joplin, and Timber Creek Sewer Company. At the conclusion of the on-the-record presentation, the Commission gave the parties an opportunity to file a brief to address the subject matter generally or to specifically address issues raised in the on-the-record proceeding.

As discussed by MAWC President, Frank Kartmann, at the on-the-record presentation, it is MAWC's position that the Commission should consider adopting a single tariff pricing structure for MAWC's water and sewer districts. The reasons for adopting single tariff pricing include the long term rate stability which results from a single tariff, the similar operating characteristics of the districts, the equivalent services offered, the principle of gradualism, the enhancement of small system viability, the promotion of regional economic development and the facilitation of compliance with Drinking Water Standards.

For purposes of this Brief, single tariff pricing is the use of a unified rate structure for multiple water or sewer utility systems that are owned and operated by a single utility, but that may or may not be contiguous systems or physically interconnected. In other words, all customers within the same customer classification (e.g., residential, commercial, industrial, etc.)

pay the same unit price for water service irrespective of geographic location. District-specific pricing would instead attempt to assign all costs (direct as well as common and joint) to individual districts and, thus, set separate prices/rates by district and then by customer classification to recover those costs.

2. HISTORY OF THE ISSUE

A brief history of the past rate cases involving MAWC is helpful in understanding the development of, as well as the debate surrounding, the issue of single tariff pricing versus district-specific pricing.[1]

As the Commission is aware, MAWC currently provides water service to the public in nine (9) districts[2] in the state of Missouri and sewer service to the public in three (3) districts[3] in the state of Missouri. Single tariff pricing, district-specific pricing, or "something in-between" have been the primary rate design methodologies that have been adopted for MAWC in these rate cases.

Beginning in 1989, in a rate case filed by Missouri Cities Water Company (a predecessor company which was subsequently acquired by MAWC in 1993), the issue of single tariff pricing vs. district-specific pricing was first raised. Since then, there have been approximately eleven (11) rate cases involving MAWC where this issue has been debated, but not definitively resolved.

From 1989 to 1997, there was a concerted movement toward a single tariff price for water service that was supported, at various times, by the Company, Staff, OPC and certain

[1] A more detailed history of these rate cases is set out in Appendix A, attached hereto.
[2] MAWC currently provides water service to the following districts: Brunswick, Jefferson City, Joplin, Mexico, Platte County, St. Joseph, St. Louis Metro (including St. Charles County), Warrensburg and Warren County.
[3] MAWC currently provides sewer service to the following districts: Cedar Hill, Platte County and Warren County.

Intervenors (such as Warrensburg and Platte County). Of significance is the fact that no intervening party during that period of time seriously opposed the movement toward single tariff pricing. In fact, in 1997, the parties to MAWC's rate case agreed, and the Commission approved, a single tariff rate for each customer class without regard to the district in which they were located.

In 2000, however, as a result of the completion of the new St. Joseph Treatment Plant (and its approximately $70 million addition to the St. Joseph District's rate base), the Commission, on a 3 to 2 vote, decided to "move away" from single tariff pricing toward district-specific pricing, primarily because of the strong, adverse public reaction in districts other than St. Joseph to paying rates that recovered costs directly attributable to a water treatment plant serving only the St. Joseph district. The Commission, however, did not adopt full district-specific pricing at that time, as it declined to reduce the rates in the Joplin district even though its district-specific cost of service would have required such a result. In fact, the Commission expressly determined that the Joplin district would contribute approximately $880,000 toward the total statewide revenue requirement, thus keeping rates in other districts lower than they would otherwise have been under a pure district-specific pricing approach.

All of the MAWC rate cases since 2000, at least with respect to the issue of rate design, have been settled by way of stipulation of the parties. While no party since 2000 has actively proposed single tariff pricing, and the cost of service studies submitted in those cases have been performed on a district-specific basis, the stipulated rates in each of those cases cannot be said to be cost based. In fact, in the 2003 case, the rate design Stipulation and Agreement specifically provided that the Brunswick District would receive a "subsidy" of $213,000 from the St. Louis County District.

The conclusion to be drawn from this twenty-plus year history is that MAWC's rates have never been based on a "pure" district-specific pricing methodology. Conversely, except for an approximate three year period (from 1997 to 2000), MAWC's rates have also not been based on a pure single tariff pricing methodology. There appears to be an implicit (or grudging) acknowledgement among the Parties to these rate cases that there are certain districts that, for one reason or another, cannot reasonably be charged rates that reflect their true cost of service. As explained by Public Counsel representative Barbara Meisenheimer at the on-the-record presentation in this docket:

> "What you have received from the parties in the way of stipulations, has elements of both single-tariff pricing. And where the costs are prohibitive, we've negotiated to allow some subsidies, some support to flow between districts . . ." (TR 46)

3. THE RATIONALE FOR SINGLE TARIFF PRICING

The reasons for using single tariff pricing in a multi-district operation, such as MAWC's, include the long-term rate stability which results from a single tariff, the similar operating characteristics of the districts, the equivalent services offered, the principle of gradualism, the promotion of regional economic development, the facilitation of compliance with drinking water standards, and the enhancement of small-system viability,.

Single tariff pricing provides long-term rate stability for the various districts served by MAWC. Utility rates are dependent on the total expenses and rate base of the utility and the amount of the commodity which the utility sells. Increases in rate base, particularly as the result of the Safe Drinking Water Act and the need to replace aging infrastructure, and changes in the quantity sold, have a significant potential for adversely impacting the rates of small or medium size utilities or rate districts within a utility.

For example, since 2000, the St. Joseph and Joplin Districts were required to replace all, or significant elements, of their treatment plants and related facilities. As a result, the capital expenditures made in those Districts were significant. The ability to absorb the costs of such projects over a larger customer base is a compelling argument in support of single tariff pricing. Capital programs will never be uniform in the various districts, even over periods of 5 to 10 years. The variances in unit costs that result from major additions are temporal and only tend to cause price instability if reflected in district-specific pricing. The cost of district-specific programs should be shared by all customers rather than burdening those of the affected districts. Rate increases will be more stable over time and large increases in rates in specific districts (i.e., rate shock) will be mitigated.

The operating characteristics of several districts also support single tariff pricing. There are many similarities in the manner in which the districts are operated. All of the district systems pump their treated water through transmission lines to distribution areas that include mains, booster pump stations and storage facilities. All of the districts provide water to individual customers through a service line and meter. All of the districts rely on a centralized work force for billing, accounting, engineering, administration, and regulatory matters. All of the districts rely on a common source of funds for financing working capital and plant construction. The only significant differences in operating characteristics are the sources of supply and treatment processes and the age of those facilities. The increasing pressure from regulators and customers related to the level of treatment will ultimately eliminate this operating characteristic difference. Thus, over the long term, the commonality of the operating characteristics support the use of single tariff pricing.

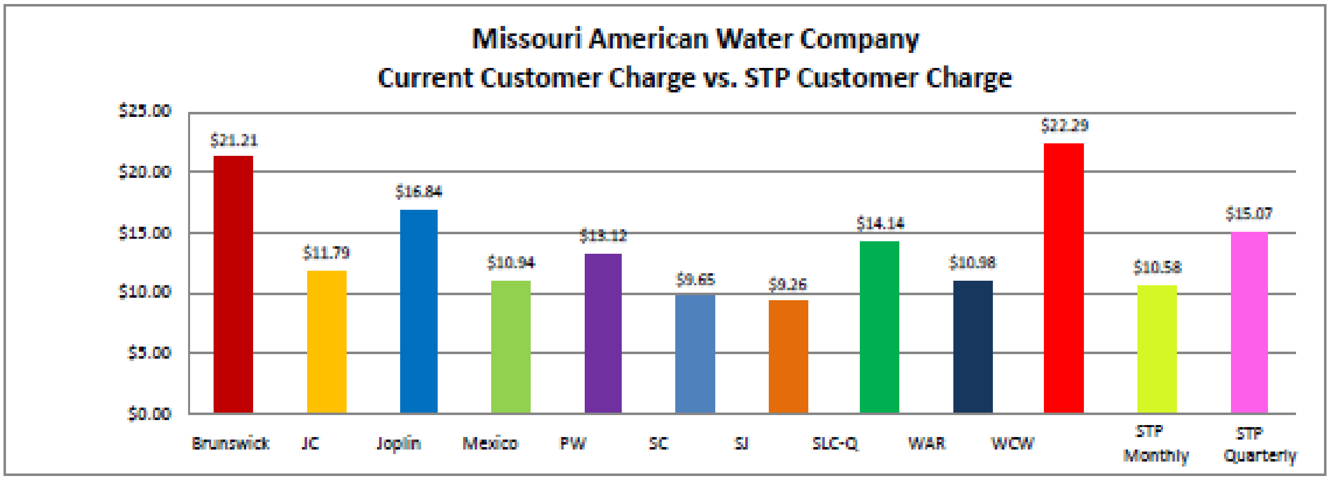
The use of single tariff pricing in a utility with noncontiguous service areas is further supported by the equivalent service rendered in each area. Although there may be considerable debate with respect to the equivalency of the service rendered to different customer classifications, there can be little argument that the service rendered to a residence in one district is the same as the service rendered to a residence in another district. Residential customers are relatively consistent in their uses of water: e.g., cooking, bathing, cleaning and other sanitary purposes, and lawn sprinkling. If customers use water for the same purposes, the service offering is the same and should be priced accordingly. Thus, from this perspective, there is no basis for charging different prices to customers in different districts.

There are other cost of service considerations that support single tariff pricing. MAWC has centralized and consolidated a significant portion of its operations. Common costs which have been assigned or allocated to each district include management fees, corporate headquarter costs, customer service costs, depreciation expense (developed on the basis of Company-wide depreciation rates) and return and income taxes based on total Company financing and tax provisions. The allocations of common costs, while reasonable, are subject to judgment and do not result in the development of district specific revenue requirements which reflect precisely the cost of serving each district, particularly if stand-alone costs are considered.

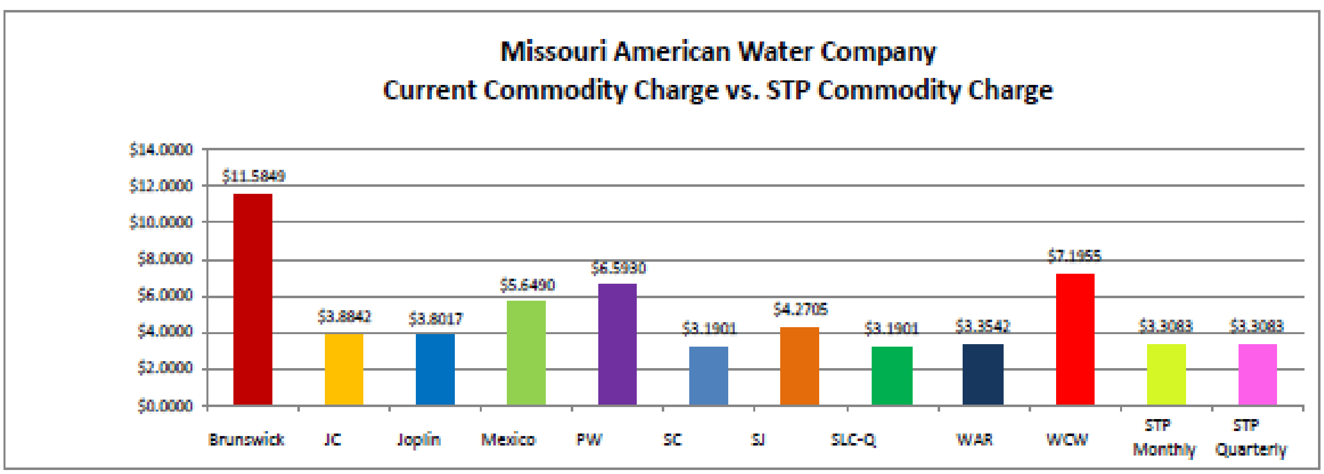
The results of assigning and allocating costs to the districts of MAWC indicate that the differences in costs between districts and, therefore, the difference between costs and single tariff pricing revenues are due to three primary factors: (1) the average age of plant; (2) the level of treatment required; and, (3) the size of the district. The first two factors are either temporal or subject to elimination resulting from customer and regulatory pressures. A policy of district-specific pricing should not be based on such factors, as it would lead to price instability.

The third factor, the size of the district, will continue to produce variances in the unit cost of serving a district. District-specific pricing that only recognizes the economies of scale in providing service in a larger district would yield higher rates for small districts and lower rates for large districts. Single tariff pricing, on the other hand, allows the small districts to participate in the cost benefits of being part of a large system. Further, the impact on the rates in the larger districts, when compared to district-specific pricing of such districts, is not significant.

For example, the Joint Report submitted by Staff, OPC and MAWC in MAWC's most recent rate case (and made a part of this docket), calculates a single tariff rate for all of MAWC's residential customers and compares it to the existing rates which are mostly district-specific. Of significance is the fact that residential customers in all districts other than the St. Louis County Metro District, would experience a reduction in both their customer charge and commodity charge. Residential customers in the St. Louis Metro District would, on average, experience an increase in their monthly rates of approximately $1.20 to $1.80, which would offset rate decreases in all other districts, with one district (Brunswick) seeing a decrease in its average monthly residential bill of nearly $40.00. This comparison is graphically shown on the two pages 2 and 3 of Attachment A to the Joint Report and are reproduced here for each of reference:



STP = Single Tariff Pricing
JC = Jefferson City
PW = Parkville Water
SC = St. Charles
SJ = St. Joseph
SLC-Q = St. Louis County Quarterly Bill
WAR = Warrensburg
WCW = Warren County Water



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Single tariff pricing also promotes regional economic development. Water is an absolutely necessary utility service to life itself, and it is essential to public safety, public health and economic opportunity. Communities and their economies are built on safe and reliable water service and, as such, it is only appropriate that water service be provided to all at a reasonable price. There shouldn't be a disparity in what customers pay for such a fundamental and basic service. (TR 14-15) For example, today customers in MAWC's Brunswick District pay about $62.00 a month for 3500 gallons of water. In contrast, customers in the St. Louis County area pay roughly half that (i.e., $31.00) for a little more than twice as much water. On a per gallon basis, Brunswick customers are paying almost four times as much as the St. Louis County customers. (TR 64) Single tariff pricing would avoid such disparities while district-specific pricing only perpetuates them.

This rate disparity created by district-specific pricing also puts smaller communities, such as Brunswick, at a distinct disadvantage in their ability to attract businesses. Businesses (and the growth they spur) are more likely to be drawn to larger communities that have the advantage of economies of scale. This only perpetuates the inequities between larger (urban) and smaller (rural) communities, and further retards the ability of small communities to complete for new business, grow their population and thus create their own economies of scale.

Single tariff pricing also addresses the viability issues that are inherent in small systems. There are over 800 wastewater collection systems in Missouri and approximately 600 of those systems serve fewer than 350 customers each. On the water side, there are over 1400 drinking water systems, and over 1000 of these systems serve fewer than 500 customers each. In other words, Missouri is a state with a large number of water and sewer systems. As the Safe Drinking

Water Act continues to become increasingly stringent, these small systems will incur significant investments and/or increased operating expenses in order to meet the Act's requirements. Single tariff pricing would serve as an incentive for companies like MAWC to acquire these systems, facilitate the needed improvements and still maintain affordable rates for the customers of these small systems. (TR 19-20)

In conclusion, single tariff pricing is an appropriate pricing strategy for multi-district water and sewer companies such as MAWC. Such pricing is supported by considerations of the benefits of sharing the impact of capital programs on a Company-wide basis; the significant costs that are common to all districts; and the equivalent service rendered. Most importantly, single tariff pricing is necessary so that all customers benefit from the economies of scale by being a part of a large system. The small systems will realize the benefits of the lower unit costs of the large systems without significantly impacting the unit costs of the total system. The best interests of all customers are served by implementing single tariff pricing.

4. ALTERNATIVES, OR A "HYBRID" APPROACH TO SINGLE TARIFF PRICING APPROACH

The Commission, of course, is charged with establishing just and reasonable rates. In that regard, the Commission has the lawful discretion to adopt single tariff pricing, district-specific pricing or an alternative or "hybrid" of the two as long as the resulting rates are not unduly discriminatory. If the Commission is uncomfortable in adopting a single tariff rate for all of MAWC's districts in the state, it may want to consider other methods of consolidating rates in order to achieve some of the previously described benefits of single tariff pricing.

For example, the Commission may want to consider a "regional consolidation" of water districts located in a certain geographic area of the state, such as Eastern (i.e., St. Louis Metro, Warren County and Cedar Hill), Central (i.e., Jefferson City, Mexico, Warrensburg and Brunswick) and Western (i.e., Joplin, Platte County and St. Joseph). This consolidation would recognize the fact that some of the Company's employees are deployed on a regional basis and therefore labor and related costs should be relatively the same among the various districts located in each of these regions.

Alternatively, the Commission may determine it is appropriate to group water districts based on their source of supply (e.g., well water vs. surface water) and sewer districts based on the nature and extent of their treatment processes. This type of grouping would recognize that the cost in treating similar sources of supply is relatively the same among those districts.

Or, the Commission may want to consider adopting a uniform customer charge, while maintaining separate volumetric charges for each of the districts. This type of partial rate uniformity recognizes that all customers, regardless of service area, have a service line and a meter. And, each customer has their meter read and a bill issued on a monthly basis (with the exception of the St. Louis Metro "quarterly" billed customers). These customer services are provided by a common workforce and are billed from a central billing function. The only cost difference that may exist among the districts is the original cost of the service lines and/or meters and some minor differences in wage rates. However, these should not prevent uniform customer charges because everyone has a meter and a service line adequate to provide service regardless of the original cost of those facilities.

These examples are not exhaustive of all of the ways in which rates may be made more uniform short of adopting "full" single tariff pricing. As a matter of fact, if the recently announced acquisition by MAWC of the Aqua Missouri properties (with its 59 sewer districts and 11 water districts) is approved by this Commission, it would appear that some sort of rate consolidation is not only appropriate, but necessary.

5. RESPONSE TO CRITICISMS OF SINGLE TARIFF PRICING

Opponents of single tariff pricing generally criticize single tariff pricing on the grounds that rates developed pursuant to single tariff pricing: 1) are not "cost based"; 2) do not create sufficient accountability or incentives (i.e. they do not promote incentives for the utility to control capital spending); and, 3) are unlawful. MAWC will address each of these criticisms.

a. Cost Based Rates

Some opponents of single tariff pricing have tried to couch the Commission's choices between district-specific pricing methodology which is "cost based" and that which they believe to be a non-cost based methodology, single tariff pricing. The truth is that in the overall picture, both methodologies are cost based. In both, the Company's revenues are based on its cost to provide service. Likewise, neither methodology places the burden of payment precisely upon the cost causer.

The difference between the two is merely that they allocate the costs over different groups of customers and, as a result, there is always going to be a certain amount of cost averaging. In single tariff pricing, rates are designed for each traditional class of customers (i.e., residential, commercial, industrial, etc.) across the entire Company and, in district-specific pricing, rates are designed for each class of customers within a district.

Neither methodology places the burden of payment directly on the cost causer. The effort to determine the cost of serving individual customers would be enormous. Factors that would affect the cost of serving an individual customer would include demand characteristics, the actual original cost of the service line and meter serving the customer, the amount of time to read meters in the vicinity of the customer, the customer's payment record, the distance from the treatment plant that water would have to travel to reach the customer, the extent to which that water would require pumping and storage, the cost of the facilities between the customer and the source of supply and the extent to which the customer used those facilities, etc. These factors would result in a cost of service for customers in different parts of the system that would be dramatically different. The Commission recognized this fact in its Report & Order on Second Remand, issued in MAWC's 2000 rate case[4], when it stated:

> In moving to a pricing system in which cost causers are cost payers, a perfect correlation will never be achieved. Any time a ratepayer pays an average rate, the correlation between cost and rates will be imperfect, because no two ratepayers are exactly similarly situated. (Order, p. 12)

Opponents of single tariff pricing argue that there is less chance for undue subsidization on a district-specific basis instead of a Company-wide basis. This is simply not true. There are numerous subsidies that remain when customers are grouped within classes within a district. Many of these subsidies may be as great as the apparent subsidies that exist on an average basis between districts. For example, it is possible that a long time residential customer in the Joplin district with moderate demands and located near the treatment plant would have a lower cost of service than a new residential customer in the same district with very high peak demands and served by a longer distribution system requiring additional pumping and storage. However, district-specific pricing proponents choose to ignore the differences of distance; costs of specific facilities between the plant and the customer (like pumping and storage); and the customer's demand characteristics and place their sole focus on the average cost differences between districts. This is a relatively arbitrary grouping of costs, given all of the other variables that affect cost. Public utility ratemaking has traditionally differentiated customers based on the

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[4] Case No. WR-2000-281, issued December 4, 2007.

nature of the customer's end-use (i.e., whether the customer is residential, commercial, industrial, etc.). This is the main differentiation that should be used for multi-district water and sewer companies.

Finally, advocates of district-specific pricing have elevated cost considerations above and to the exclusion of other factors that are equally appropriate in designing rates. Such other factors include gradualism, value of service, understandability and ease of application, social and community concerns and others. Pure district-specific pricing can lead to rate changes that are beyond the bounds of gradualism, do not recognize the value of service principle and are confusing.

b. Accountability/Incentives/Efficiency

Some opponents of single tariff pricing also criticize it for not creating sufficient accountability or incentives, claiming that it will result in investments in extravagant, unnecessary facilities, and will not permit customers a say in the investments that are to be made in their respective districts. These parties further seem to believe that the Company controls rate volatility in that it alone determines when and how much is going to be spent in any given district. These arguments ignore the impact of federal and state regulations on capital requirements, as well as the need to replace aging infrastructure and respond to the impacts of nature and customer demands. MAWC alone does not control rate volatility or how much is going to be spent. Environmental and economic regulatory agencies of the federal and state governments also have a very significant say in how much is going to be spent and, therefore, they also have control over rate volatility. Opponents of single tariff pricing also ignore the impacts of nature (e.g. flooding or droughts) and customer demands on the need for capital improvements. The Missouri River has and will experience periods of flooding and drought, as well as high levels of turbidity. Dealing with such issues while maintaining reliable, quality service that meets the demands of customers is not an inexpensive proposition.

The level of control that the Company has is the selection of a least cost alternative, not necessarily a low cost or no cost alternative. Furthermore, the selection of a least cost solution based on long term revenue requirements cannot overcome the inherent front-end loading of rate of return/rate base regulation using original costs. The suggestion that these requirements and constraints will miraculously disappear with the implementation of district-specific pricing is unrealistic. MAWC's capital spending requirements will not change with district-specific pricing, only the manner in which the related revenue requirements are recovered will change.

Cost based rates that use embedded cost can only promote economic efficiency to a point. Opponents of single tariff pricing seem to suggest that if customers are charged their specific embedded costs of water service, they would in some way respond to this price signal in order to promote economic efficiency. However, most water usage is relatively inelastic and not responsive to price signals. Some parties' concept of economic efficiency seems to suggest that the Company should take a vote of its customers on whether to build a new plant and, if so, how much should be spent to build it. This is not practical. First, public utilities have an obligation to serve and are subject to regulations as to the manner in which this service is provided. These constraints, as well as the constraints of geography and natural resources, limit the extent to which the utility can respond to its customer's desire for a low cost product. Second, a public utility plant is long lived and, for the most part, has a fixed location. The ability to modify the production inputs in response to the reaction of customers to the resultant price is either very limited or not possible. Building small increments of capacity as demand grows also is not practical.

Single tariff pricing provides more rate stability than district-specific pricing. Under single tariff pricing, new investment in a district will raise rates, but, all other things being equal, not as much as rates would have been increased under district-specific pricing. As new investments are made in other districts, rates in this district would rise even higher, and eventually approach the level that would have resulted from the investment in its area under district specific pricing. That is, the increases in rates would be smooth and more regular under single tariff pricing, rather than drastic and irregular under district-specific pricing.

c. Lawfulness of Single Tariff Pricing

Some opponents of single tariff pricing have argued that rates based on single tariff pricing run afoul of the mandates of Section 393.130 RSMo (2009 Cum. Supp.) which requires "just and reasonable" rates (Subsection 1) and prohibits any "undue or unreasonable preference or advantage" (Subsection 3). However, a thorough analysis of Missouri case law clearly reveals that this Commission has the authority to average costs and adopt system-wide, "uniform rates."

In *State ex rel. Laundry, Inc. v. Public Service Commission*, 34 S.W.2d 37 (Mo. banc. 1931), the Missouri Supreme Court discussed the concepts of undue discrimination and undue preference. The following excerpts from the Court's decision reveal that the concept of single tariff pricing is certainly appropriate.

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

Id. at 44.

* * * * *

> The common law today forbids all discrimination between two applicants who ask the same service . . . Thus the principle of equality designed to be enforced

> by legislation and judicial decision forbids any difference in charge which is not based upon differences of service. . . .

Id. at 44.

* * * * *

> . . . that principle of equality does forbid any difference in charge which is not based upon difference in service, and, even when based upon difference of service, must have some reasonable relation to the amount of difference, and cannot be so great as to produce an unjust discrimination.

Id. at 45.

There is a sameness or equivalence of the service rendered to a residence in one district as compared to the service rendered to a residence in another district. Residential customers are relatively consistent in their uses of water (e.g., cooking, bathing, cleaning and other sanitary purposes, and lawn sprinkling). If customers use water for the same purposes, the service offering is the same and should be priced accordingly. Where services provided to customers are identical as a matter of principle, they should be priced the same.

More express support for single tariff pricing can be found in later cases reviewing Commission rate decisions. In 1958, the Supreme Court of Missouri was asked to review a Commission decision authorizing a telephone company to file tariffs allowing it to add to its basic rates in each community it serves the pro rata amount of the occupational tax levied in said community. A telephone industry case is relevant to this question as its statute regarding rate and charges, Section 392.200, RSMo (2009 Cum. Supp.), contains the same key language as the statute regarding water service, section 393.130, RSMo (2009 Cum. Supp.), that is, “just and reasonable,” “undue or unreasonable preference or advantage,” and “undue or unreasonable prejudice or disadvantage.”

In *State ex rel. City of West Plains, Missouri v. Public Service Commission*, 310 S.W.2d

925 (Mo. banc. 1958), the Court discussed the “theory of ratemaking” as follows:

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

Id. at 930.

After a review of the law and the facts, the Court then concluded as follows:

> ...we may amplify our views insofar as concerns system wide ratemaking. We are able to discern no legitimate reason or basis for the view that a utility must operate exclusively either under a system wide rate structure or a local unit rate structure, or the view that an expense item under a system wide rate structure must of necessity be spread over the entire system regardless of the nature of the item involved. (emphasis added).

Id. at 933.

The *West Plains* case clearly establishes the broad discretion of the Commission to establish rates either on a “system wide basis” or on a “district-specific basis.”

The issue of the Commission’s ability to average costs and develop uniform rates was again addressed and reaffirmed in 1978 by the Missouri Court of Appeals (St. Louis Division) in *State ex rel. Cape Girardeau, Missouri vs. Public Service Commission,* 567 S.W.2d 450 (Mo.

App. E.D. 1978). In that case, the City of Cape Girardeau appealed a Commission decision establishing electric rates for the Missouri Utilities Company's Southeast Missouri Division and argued that the Commission, in establishing system-wide rates, failed to take into consideration that the cost of providing electricity within the city limits is lower than it is to provide service in the rest of the division. The City's witness contended that "the city, with approximately four times as many customers as any other division community, [was] in fact subsidizing the company's operations in the division's more diffused areas . . . ." *Id.* at 452.

Thus, Cape Girardeau contended that the only relevant factor in determining a fair utility rate is the cost of service to the user. 567 S.W.2d at 452. The Court squarely addressed the lawfulness of the Commission's decision as follows:

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

Id. at 453.

Finally, in its Report and Order on Second Remand in MAWC's 2000 rate case (Case No. WR-2000-281), the Commission justified its decision not to reduce the Joplin District's rates (even though its district-specific cost of service indicated its current rates proposed revenues approximately $880,000 in excess of its costs) as follows:

> In moving to a pricing system in which cost causers are cost payers, a perfect correlation will never be achieved. Any time a ratepayer pays an average rate, the correlation between cost and rates will be imperfect, because no two ratepayers are exactly similarly situated. The Commission attempts to remedy this disparity by grouping customers into classes that have similar costs because they have

similar usage patterns. It is an imperfect solution, as the Western District Court of Appeals notes:

> As we stated in *Associated Natural Gas*, "the Commission [can] select its methodology in determining rates and make pragmatic adjustments called for by particular circumstances." 706 SW2d at 879-80. See also *Missourians for Tax Justice Educ. Project v. Holden*, 959 SW2d 100, 104-05 (Mo. Banc 1997), cert. denied, 524 US 916, 118 S.Ct.2298, 141 L.Ed.2d 158 (1998) ("[T]he existence of another, even more mathematically precise method of achieving the constitution's purposes does not render the chosen method irrational for equal protection purposes. '[R]ational distinctions may be made with substantially less than mathematical exactitude.' *New Orleans v. Dukes*, 427 U.S. 297, 303, 96 S.Ct. 2513, 49 L.Ed.2d 511 (1976).[5] (Report and Order on Second Remand, p. 12)

These cases clearly establish that the Commission has broad discretion in the establishing of just and reasonable rates and, more specifically, that the Commission possesses the legal authority to establish system-wide or uniform rates for a utility serving more than one geographic area.

[5] *State ex rel. Midwest Gas Users Association v. Public Service Commission*, 976 S.W.2d 485, 495.

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CERTIFICATE OF SERVICE

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