BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Missouri-American Water Company's Request for Authority to Implement General Rate Increase for Water and Sewer Service Provided in Missouri Service Areas.	))))	**Case No. WR-2020-0344**

MECG STATEMENT OF POSITIONS

COMES NOW, the Midwest Energy Consumers Group ("MECG") and for its Statement of Position provides the following. MECG has provided positions on certain issues and based upon the testimony that has been filed to date. That said, however, MECG reserves the right to take positions or supplement its positions in the context of briefs based upon evidence elicited during the evidentiary hearing.

OVERVIEW

It is well established the one of the purposes of a rate case is to assure the "financial integrity" of the utility.

> The rate-making process under the Act, i.e., the fixing of "just and reasonable" rates, involves a balancing of the investor and the consumer interests. [T]he investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated.[1]

Thus, the Commission's review of the issues in this rate case should be considered against a backdrop of the financial integrity of the utility.

In the case at hand, all of the evidence indicates that Missouri American Water Company ("MAWC") and its parent company American Water Works are extremely healthy. For instance, over the course of the past 10 years MAWC has seen its earnings in Missouri triple from $22.0 million to $62.7 million.[2] The rapid increase in earnings is the fundamental reason that MAWC continues to invest in Missouri. As Staff witness Busch points out, MAWC has invested $850 million in Missouri over the last 5 years. Furthermore, MAWC anticipates that it will invest $1 billion in just the next three years.[3] Moreover, unlike Arizona, Texas, New Mexico, Ohio and New York,[4] where American Water Works has sold its operations because they did not deliver adequate shareholder returns, MAWC has purchased dozens of small systems in Missouri.[5]

Given the financial performance of MAWC and its parent company, the rate of investment in Missouri and the rapid purchase of small water systems, the Commission should be comfortable

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[1] *Federal Power Commission v. Hope Natural Gas Company,* 320 U.S. 591, 603 (1944).
[2] Meyer Direct (Rate Design), page 4.
[3] Busch Rebuttal, page 12.
[4] *Id.* at page 16.
[5] *Id.* at page 12.

in knowing that the current regulatory paradigm assures the financial integrity of this utility. As such, mechanisms such as future test year, revenue stabilization mechanisms, tracker mechanisms, all mechanisms that the Commission has previously labeled as "unique shareholder-focused ratemaking tools . . . to insulate shareholders from risk"[6] are entirely unnecessary.

ISSUES

1. **Test Year** – What is the appropriate test year (historic or future test year), update, true-up period and discrete adjustments, if any, that the Commission should employ for purposes of determining MAWC's cost of service in this case?

Overview: The Commission establishes rates by taking a financial snapshot of a utility's financial picture at a common point in time. By looking at the utility's investment, costs and revenues as of a single date, the Commission can get an accurate picture of a utility's profitability and its need for a rate increase. Traditionally, this snapshot was taken based upon a historic test year. In the past couple decades, the Commission has significantly reduced regulatory lag for the utility through the utilization of a true-up period.

The benefits of a historic test year / true-up period is that it allows for a recent financial snapshot of the utility's profitability while still being faithful to the ratemaking doctrines that expenses and revenues should be "known and measure" and investments should be "used and useful". Any departure from these ratemaking doctrines cast doubts on the accuracy of the financial snapshot and introduces error into the ratemaking process.

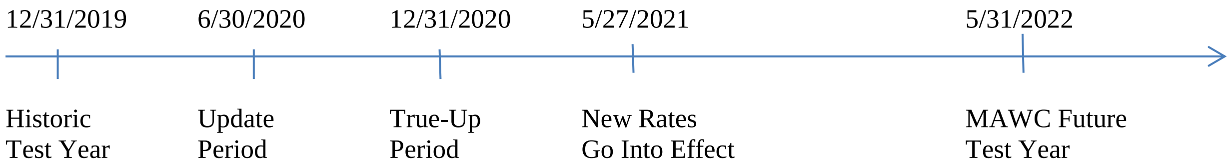
After decades of applying a historic test year / true-up period, MAWC asks that the Commission employ a future test year in this case. Specifically, while the operation of law date (the date on which rates will go into effect) in this case is May 27, 2021,[7] MAWC asks that the Commission project expenses, revenues and investment through May 31, 2022.[8] As discussed in more detail, *infra*, the reason that MAWC proposes a future test year is obvious, it leads to immediate overearnings and eliminates any pressure to minimize costs going forward.

MAWC's future test year request was opposed by all remaining parties to this case in a response dated July 27, 2020.[9] Ultimately, these parties asked that the Commission employ a historical test year consisting of: (1) a historic test year consisting of the 12 months ending December 31, 2019; (2) an update period through June 30, 2020; and (3) a true-up ending December 31, 2020.

In its Order dated August 26, 2020, the Commission agreed with these parties and ordered a historic test year.[10] That said, however, the Commission left the door open for MAWC to argue at hearing for the inclusion of future test year adjustments. "Additionally, the parties may make specific (discreet) adjustments to the June 30, 2020, known and measurable revenue requirement

[6] *Id.* at page 49.
[7] *Notice of Contested Case and Order Suspending Tariff and Delegating Authority*, issued July 8, 2020, at page 2.
[8] See, *Motion to Establish Future Test Year*, filed June 30, 2020.
[9] *Response to MAWC Motion for Future Test Year*, filed July 27, 2020.
[10] *Order Setting Test Year and Adopting Procedural Schedule*, issued August 26, 2020, at pages 2 and 4 ("After reviewing the filings and arguments made by the parties, the Commission concludes that the historic test year with adjustments should be adopted as recommended in the August 13, 2020, proposed procedural recommendation as filed by all the parties, except Missouri-American.").

calculation."[11] Imposed on a timeline, the various proposals can then be graphically viewed as follows:



►**<u>General Concerns</u>**: The problems associated with a future test year are well established within the ratemaking community and significantly undermine the accuracy of the ratemaking process. These problems were discussed in detail in the July 27, 2020 Response filed by Staff, OPC, MIEC, MECG, Consumers Council of Missouri, the City of Riverside, the City of St. Joseph, and the Municipal League of Metro St. Louis.

(1) <u>Immediate Over-Earnings</u>: The use of a future test year creates a situation of immediate over-earnings. As mentioned, MAWC seeks to earn a return on projected investment through May 31, 2022.[12] This creates a situation in which MAWC will immediately over-earn if new rates are based on future rate base investment. Specifically, on May 27, 2021, when rates go into effect, MAWC will be collecting a return on investment that is not projected to be in-service for as much as 12 months in the future. As such, for several months, MAWC will collect rates on investment that it has not yet made, and may not ever make. This collection of rates on "phantom plant" creates a situation of immediate over-earnings.

This inequitable outcome is compounded by the fact that MAWC has repeatedly made clear that its capital expenditures are never certain. For example, in a prior MAWC rate case, Case No. WR-2015-0301, the Company was ordered to submit a 5-year capital investment plan. The Highly Confidential plan[13] submitted in EFIS included language on the first page stating "Projects/budgets are subject to change based on changes in circumstances and/or the Company's periodic review of projects and priorities."[14]

In another case, the Company reiterated the uncertainty surrounding its capital investment by threatening to "re-examine the prioritization of projects" and deploy capital elsewhere if its request is not granted.[15] Clearly, MAWC's projections of capital expenditures are far from certain. To set rates based on the Company's assertions would not result in rates "based on capital actually expended" but, instead, would allow the Company to earn a return on speculative "phantom plant".

(2) <u>Contrary to Statute</u>: Missouri statutes appear to require the use of a historical test year.[16] Section 393.270.4 provides that in setting rates, the Commission shall consider all relevant

[11] *Id.* at page 4.
[12] See, LaGrand Direct, page 23.
[13] MAWC designated the spreadsheet provided Highly Confidential because it "includes market-specific information relating to goods or services purchased or acquired for use in providing services to customers, as well as information relating to future contract negotiations." No Highly Confidential information is quoted in this pleading.
[14] Case No. WR-2015-0301, EFIS Document No. 467.
[15] *See* MAWC response to Staff DR0010 in Case No. WU-2017-0296.
[16] It should be pointed out that, at least with regards to electric utilities, the use of future test years and the inclusion of future plant growth have been expressly declared unlawful. See, Section 393.135.

factors including "a reasonable average return upon capital ***actually expended***."[17] In its future test year approach, MAWC asks that it be permitted to earn a return on capital applied to a 13-month average of forecasted plant in service through May 31, 2022. As such, MAWC does not seek to earn a return on capital "actually expended" as provided by Section 393.270.4. Instead, MAWC seeks to earn a return on capital that **may** be expended, at some indefinite point in the future.

(3) Abandonment of Used and Useful Standard: In July 2013, the National Regulatory Research Institute ("NRRI")[18] published a briefing paper entitled Future Test Years: Challenges Posed for State Utility Commissions.[19] In that paper, NRRI found that the use of future test years is inherently problematic for several different reasons. For instance, NRRI pointed out that the use of a future / forecasted test year necessarily involves the abandonment of the "used and useful" standard. The "used and useful" standard has been the bedrock of Missouri ratemaking for decades.[20] The future test year proposed by MAWC abandons this basic principle and customers end up paying for facilities that may never become operational.

> As previously described, MAWC's future test year contains adjustments to include a 13-month average rate based ending May 31, 2022. Rates in the current case will go into effect sometime around May 31, 2021. Thus, under MAWC's future test year proposal, rates will include investment that is not "used and useful" or providing service to customers. As indicated, it has been the long-standing policy of this Commission to only include in customer rates, investment that is used and useful. The Commission would have to abandon this principle if it adopted MAWC's future test year.[21]

(4) Abandonment of Known and Measureable Standard: In addition to the abandonment of the "used and useful" standard, the rejection of a historical test year in favor of the flawed future test year also necessarily results in the elimination of the "known and measureable" standard. This standard is based on fundamental accounting principles that require that rates be based on known and measurable costs. Most assets, liabilities, gains and losses and revenues and expenses of U.S. business entities are recorded at historical cost. The Financial Accounting Standards Board ("FASB") and the Accounting profession has determined that historical-cost accounting is more reliable than other forms of accounting, such as fair value accounting, or what MAWC proposes as "estimated future costs." The FASB has retained historical cost accounting as the basis of U.S. generally accepted accounting principles ("GAAP"). GAAP are the Accounting standards that all U.S. companies, including MAWC, must comply with in the preparation of financial

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[17] Emphasis added.

[18] As reflected on its webpage, NRRI serves as a research arm to NARUC and its members, the utility regulatory commissions of the fifty states and the District of Columbia in the United States. NRRI's primary mission is to produce and disseminate relevant and applicable research related to the utility sector - natural gas, electricity, water and telecommunications

[19] The NRRI briefing paper is attached as Exhibit 1. ("NRRI Report")

[20] The "used and useful" standard has been viewed favorably by Missouri Courts. "The property upon which a rate of return can be earned must be utilized to provide service to its customers. That is, it must be used and useful. This used and useful concept provides a well-defined standard for determining what properties of a utility can be included in rate base." (See, *State ex rel. Union Electric v. Public Service Commission*, 765 S.W.2d 618 (Mo.App. 1988)). Through its request to utilize a future test year, MAWC asks that the Commission abandon this well-defined "used and useful" standard.

[21] Meyer Direct (Revenue Requirement), page 13.

records. As a result, significantly all accounting for business operations, both regulated and nonregulated, are based on historical costs. Like the "used and useful" standard, the "known and measureable" standard has been viewed favorably by Missouri Courts.[22]

> The "known and measureable" standard requires that an event actually has occurred or is known. In addition, the cost implications of that known event must be capable of being measured with certainty. Given that future events cannot be known and that the cost implications cannot be measureable, the known and measureable standard necessarily does not contemplate the use of forecasts and inflation factors as proposed by MAWC.[23]

(5) <u>Informational Assymetry</u>: The use of a future test year places the utility at an informational advantage to other rate case parties.[24] As NRRI pointed out:

> The core problem with FTYs [future test years] for commissions is information asymmetry. Commissions are at a distinct disadvantage relative to the utility in interpreting and evaluating the utility's performance. Commissions generally lack the knowledge, for example, to detect when the utility is efficient or inefficient, and the opportunities for utilities to minimize costs. As part of their duties, they need to evaluate whether the utility's projected costs reflect competent utility management, or imprudent management.[25]

(6) <u>More Time Intensive</u>: A general rate case utilizing a historic test year already involves an intense review process by all parties involved, and under normal circumstances, can be an extremely time-intensive process. However, as the NRRI paper points out, given the complexities of future test year rate cases, these cases must necessarily involve even *more* time.[26]

> Utilities have a distinct "resource" advantage over other parties that they can better exploit under an FTY rate filing. Given the limited time for rate cases and the complexity of evaluating forecasts, parties may have insufficient time to thoroughly assess a utility's forecasts.[27]

(7) <u>Operational Inefficiency</u>: Finally, future test years reduce or eliminate a utility's incentive to minimize costs and operate efficiently. The NRRI paper notes that "FTYs can have a negative effect on cost efficiency." For instance, NRRI notes that a utility would have a "weaker incentive" to control a cost where that cost has already been imputed into rates through a future

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[22] See, *KCPL's Request v. Public Service Commission*, 509 S.W.3d 757 (Mo.App. 2016). See also, *State ex rel. Missouri Public Service Co. v. Fraas*, 627 S.W.2d 882, 888 (Mo.App. 1981).

[23] Meyer Direct (Revenue Requirement), pages 8-9.

[24] The notion of "information asymmetry" is not simply theoretical. In a recent rate case, Case No. WR-2015-0301, MAWC failed to disclose problems with usage data resulting from faulty meters. Only after testimony was filed was this problem disclosed. Then, the MAWC individual responsible for disclosing this information was suddenly discharged by MAWC. Clearly then, the notion of "information asymmetry" is very real as it applies to MAWC.

[25] NRRI Report at page 19.

[26] The Signatories would note, in addition to the clear policy concerns outlined in this pleading, this proceeding will not take place under "normal circumstances." The COVID-19 pandemic currently gripping this country has forced parties before this Commission to utilize alternative working arrangements not necessarily conducive to the litigation of a major rate case. Drastic changes to the rate making process would serve to further complicate this proceeding.

[27] NRRI Report at page 23.

test year. As such, NRRI concludes that "an FTY would seem to score poorly in achieving cost efficiency."[28]

►**Specific Concerns**: The problems with MAWC's future test year proposal goes beyond simply general problems with future test years. Rather, there are numerous specific problems associated with MAWC's financial condition and application of the future test year that mandate the rejection of MAWC's proposal. Of utmost concern, MAWC's projection of O&M increases and usage decreases are inflated. Not surprisingly, both projections inflate the rate increase in this case.

(1) Financial Condition: As indicated (pages 1-2), MAWC, and its parent company American Water Works, are both incredibly healthy. Currently, American Water Works is A-rated by S&P. Over the past 10 years, MAWC has seen its earnings in Missouri triple from $22.0 million to $62.7 million.[29] This financial health is also reflected in the stock performance of its parent company. "While American Water Works' stock price has appreciated by 525% in the last ten years, the Dow Jones Industrial Average has only increased by 165%."[30] Finally, in addition to stock appreciation, shareholders have benefitted from the profitability of its operating subsidiaries like MAWC in the form of dividends. Specifically, in the last 10 years, the dividend has increased from 22¢ / share to 55¢ / share.[31] Therefore, the rejection of the historical test year and the implementation of the novel future test year is not needed to ensure the financial integrity of the utility. Therefore, the future test year is simply designed to inflate customer rates and shareholder profits.

(2) O&M Cost Projections are Inflated: In its future test year proposal, MAWC blindly applies an inflation factor to its various O&M costs. The problem with this approach is that MAWC has seen very little O&M increase over the past 10 years. MAWC's president admits this fact.

> Mr. Evitts and Ms. Bowen demonstrate that we have been very successful in implementing efficiency improvement initiatives that have allowed us to maintain relatively flat O&M expense levels for the past 10 years. . . Our ability to maintain O&M cost demonstrates the effectiveness of our efforts and the resulting cost benefit to our customers.[32]

In fact, after looking at O&M spending for the past 10 years, Mr. Meyer points out that that O&M costs have increased from $119.5 million in 2010 to $123.8 million in 2019. Thus, O&M costs have increased 3.6% over 10 years . . . 0.4% per year.[33] Despite such minimal increases, MAWC asserts that, by the date of the future test year, O&M costs will increase by 14.0% over 2019 levels. Clearly then, MAWC's proposal to apply a blanket inflation adjustment to O&M costs that have only increased 0.4% over the past 10 years is misplaced.

[28] *Id.* at page 26.
[29] Meyer Direct (Rate Design), page 4.
[30] *Id.* at page 6.
[31] *Id.* at page 5.
[32] Dewey Direct, page 13.
[33] Meyer Direct (Revenue Requirement), page 10.

(3) Not Needed to Encourage Investment: Throughout this case, MAWC has asserted that various mechanisms (future test year, district consolidation, RSM, trackers, etc.) are necessary to encourage investment in Missouri. The evidence, however, indicates that the current regulatory paradigm, which excludes these mechanisms, provides tremendous incentives for American Water Works to invest in Missouri.

Currently, American Water Works has operations in 16 states. In states in which American Water Works does not perceive adequate shareholder support, it simply sells the operations. Over the past 10 years, American Water Works has sold the entirety of its operations in Arizona, Texas, New Mexico and Ohio.[34] Furthermore, American Water Works is currently attempting to close on the sale of the New York operations. Missouri is at the opposite end of the spectrum. Over the past decade, American Water Works has purchased dozens of small systems in Missouri.[35]

Staff provides additional evidence on this point. As Mr. Busch points out MAWC has invested $850 million in Missouri over the last 5 years. Furthermore, MAWC anticipates that it will invest $1 billion in just the next three years.[36] Certainly, the rapid purchase of water systems in a state and the planned investment of $1 billion is not symptomatic of a regulatory paradigm that does not provide adequate shareholder support.

(4) Usage Projections are Problematic: In its future test year proposal, MAWC projects significant decrease in water usage. The data indicates that MAWC's projections may be opportunistic in that they fail to recognize that 2019 usage was an aberration. For the period of 2019 – 2019, water usage varied from a high of 58,857,510 k-gallons in 2017 to a low of 55,658,516 k-gallons in 2017. Thus, over the course of 10 years, usage only fluctuated by 5.4%.[37] In 2019, however, usage declined dramatically as a result of warmer weather and rainfall.[38] In fact, usage in 2020 appears to be back in line with usage in 2017 and 2018.[39] Nevertheless, largely based upon 2019 data, MAWC projects usage to decline by 9.2% under its future test year proposal.[40] Clearly it is inappropriate to consider the irregular nature of 2019 usage and use that aberration as justification for a future test year.

(5) Will Not Result in Less Rate Cases: At various times, MAWC has asserted that the use of a future test year will reduce the number of rate cases going forward. This argument is misplaced. First, the cost of a rate case for MAWC amounts to only 0.67% of operating expenses.[41] Next, the General Assembly, in the context of the fuel adjustment clause and ISRS legislation, has recognized the importance of regular rate case.[42] Thus, because of the existence of the water ISRS, MAWC is required to file a rate case every 3-4 years. Recognizing that MAWC is filing

[34] *Id.* at page 16.
[35] *Id.* at page 12.
[36] Busch Rebuttal, page 12.
[37] Meyer Direct (Revenue Requirement), page 14.
[38] *Id.* at page 15.
[39] *Id.*
[40] *Id.*
[41] Meyer Direct (Revenue Requirement), page 17.
[42] See, Section 386.266.5(3); Section 393.1003.3; Section 393.1012.3.

rate cases approximately every 3 years currently,[43] the implementation of a future test year cannot result in fewer rate cases.

(6) Does Not Anticipate Reduction in Return on Equity: It is well established that many of the mechanisms requested by MAWC (future test year, RSM, property tax tracker) will lead to reduced risk. In fact, in the most recent Spire case, the Commission pointed out that each of these mechanisms are "unique shareholder-focused ratemaking tool . . . to insulate shareholders from risk".[44] The General Assembly has previously pointed out that the Commission should consider the impact on return on equity associated with mechanisms that change the business risk of the utility.[45] Nevertheless, MAWC made no effort to reflect such decreased risk in its return on equity recommendation.

> MAWC's future test year filing significantly favors shareholders' interests. For instance, the recognition of depressed level of water usage, as proposed by MAWC, would shield the utility from the risk of future declines in water usage. Similarly, the recognition of an inflated level of O&M costs, as suggested by MAWC, would shield the utility from cost pressures that may exist in the future from O&M cost increases. These reductions in operating risks should logically include a reduction in the utility's proposed return on equity. In this case, MAWC has not proposed a reduction in its recommended return on equity in the event that the Commission accepts its future test year. Instead, MAWC takes a "have out cake and eat it too position in that it wants to have the inflated return on equity that comes with the use of a historical test year as well as the decreased risk associated with its proposed future test year.[46]

3. **Rate Base**

f. ADIT –

i. Should MAWC's booked Accumulated Deferred Income Tax (ADIT) include a reduction for net operating loss?

ii. If so, would there be an effect on the level of excess ADIT to be flowed back to rate payers?

Position: MECG takes no position on whether ADIT should include a reduction for net operating losses. That said, however, it is important to recognize that the Commission's decision on whether ADIT should include a reduction for net operating losses will have a significant effect on the quantification of excess Accumulated Deferred Income Tax to be returned to ratepayers pursuant to the decision in the next issue. As reflected in MIEC witness Meyer's direct testimony, net operating losses are a subset of Excess Accumulated Deferred Income Taxes (EADIT).[47] In fact, while a portion of net operating losses is treated as a protected EADIT and must be amortized over the ARAM period, the remainder is considered an unprotected EADIT

[43] Meyer Direct (Revenue Requirement), page 17.
[44] *Id.* at page 49.
[45] See, Section 386.266.8.
[46] Meyer Direct (Revenue Requirement), pages 18-19.
[47] Meyer Direct (Revenue Requirement), page 26.

and may be returned to customers pursuant to the Commission's discretion.[48] The entire focus of MECG's position on this issue is to alert the Commission to the fact that the determination of the proper treatment of net operating losses will have an effect on the quantification of the EADIT balance that is to be amortized pursuant to the Commission's decision on the following issue.

4. **Excess ADIT** – What is the appropriate treatment for the flow back of unprotected excess ADIT to rate payers?

Position: Utility companies are allowed certain deductions that are not reflected for ratemaking purposes. For instance, a utility is allowed to deduct accelerated depreciation for purposes of calculating taxes. That said, however, instead of using accelerated depreciation for ratemaking purposes, rates are based upon straight-line depreciation. This treatment of depreciation creates a timing difference.[49] Thus, a utility collects a greater amount of taxes from ratepayers than it actually submits to the government. Eventually, however, after accelerated depreciation eats away the entirety of the utility investment, the taxes paid by the utility will be higher than the taxes collected in rates.[50] For this reason, the taxes collected from ratepayers, but not payable to the government until sometime in the future are known as "deferred taxes."[51] As these deferred taxes build up over time they become known as Accumulated Deferred Income Taxes ("ADIT").

In 2017, the Tax Cut and Jobs Act ("TCJA") reduced the federal corporate income tax from 35% to 21%. Relevant to the issue of excess ADIT, this means that deferred taxes, that were quantified to be payable in the future at 35%, were reduced by the implementation of the 21% tax rate. The difference in deferred income taxes caused by the reduction in the tax rate from 35% to 21% became known as Excess Accumulated Deferred Income Taxes ("EADIT").[52]

The importance of this issue is that the EADIT previously paid by ratepayers under the belief that they would be payable to the government at a 35% tax rate can now be returned back to ratepayers. After all, the utility only needs to retain that level necessary for it to pay the deferred tax at 21%. Amounts collected at 35% and not deemed to be excessive should be returned back to ratepayers. No party disputes that such taxes should be returned back to ratepayers. The entirety of this issue surrounds how quickly MAWC should be required to return this money back to ratepayers. In other words, should MAWC be allowed to retain funds that indisputably belong to ratepayers simply because it appreciates having this free money.

EADIT consists of two different types: (1) protected and (2) unprotected. The IRS has dictated that protected EADIT be returned to ratepayers over the life of the assets to which accelerated depreciation was applied – a period of time known as ARAM.[53] That said, however, the IRS left

[48] While EADIT is a positive number, the net operating loss balance is a negative number. Therefore, if the Commission treats net operating losses as an offset to ADIT, then the EADIT balance will be lower than if the Commission rejects such treatment.
[49] Tax timing differences are created for a multitude of reasons other than simply depreciation.
[50] Given that utilities are generally an increasing rate base industry, the timing change (in which the utility pays more in taxes than they receive from the ratepayer) never occurs. For this reason, deferred taxes for a utility never actually goes to zero.
[51] Meyer Direct, page 24.
[52] *Id.*
[53] *Id.* ("The IRS specified in the TCJA the time period for the flow-back of Protected EADIT.").

to the Commission's discretion the period of time over which it would amortize and return unprotected EADIT back to ratepayers.[54]

In this case, MAWC seeks to keep these ratepayer funds (unprotected EADIT) for an extended period of time. Specifically, MAWC seeks to return the unprotected EADIT balances over the same time period as the protected balances. Using the proposed ARAM period, MAWC seeks to keep these balanced for as long as 30-40 years.

> It is not surprising that MAWC would want to use an extended time period over which it must repay the EADIT to ratepayers. Using the ARAM method, as proposed by MAWC, will unnecessarily delay return of ratepayer provided funds for approximately 30 years. This is simply too long of a period to return monies owed to ratepayers from MAWC.[55]

In contrast, MECG suggests that these unprotected EADIT funds be returned to ratepayers in an expeditious period. Here, MECG suggests that three years is an appropriate period.[56] There are several reasons that a 3 year amortization period for the return of the unprotected EADIT balances is appropriate.

First, MAWC, and its parent company (American Water Works) is financially strong. Currently American Water Works is an A-rated corporation. Over the past 10 years, American Water Works has seen its stock price appreciate by 525% in the last 10 years. Additionally, American Water Works has raised its dividend 10 times in just the last 10 years – from 22¢ / share to 55¢ / share.[57] Moreover, as reflected in its 10Q filing with the SEC, American Water Works currently sits on $560 million of cash. In fact, instead of returning cash balances to ratepayers, American Water Works has instead increased its dividends to shareholders. Clearly then, providing for an expedited return of these ratepayer funds will not result in any financial harm to Missouri American or American Water Works.

Second, the expeditious return of these ratepayer funds is dictated by the doctrine of intergenerational equity. The notion of intergenerational equity dictates that customers that receive the benefit of utility service should be the ones to pay the costs of that service. In the case at hand, MAWC charged past customers for these deferred taxes as a portion of the utility that those customers have received over the past several decades. Now, we realize that the amounts that were charged have turned out to be significantly more than was necessary. Intergenerational equity then dictates that these funds be returned back as expeditiously as possible so that it is more likely that the individuals that paid those funds will actually be the individuals that see those funds returned. In contrast, MAWC seeks to return those funds over the next 40 years. Certainly, by the time that those funds are returned, all of the individuals that were responsible for paying these overages will either be moved or dead. Certainly, allowing MAWC to extend the period for the return of these funds violates all notions of intergenerational equity.[58]

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[54] *Id.* ("The IRS . . . allowed regulators to determine the appropriate time period for the flow-back of Unprotected EADIT.").
[55] Meyer Direct, page 28.
[56] *Id.*
[57] *Id.* at page 5.
[58] Meyer Surrebuttal, page 29.

Third, as the Commission is well aware, much of MAWC's customer base is suffering from the economic impacts of the Covid-19 pandemic. The expeditious return of the unprotected EADIT balance will mitigate the magnitude of any rate increase in this case. On the other hand, MAWC's proposal, to return the unprotected EADIT balances over 40 years, would lead to a significantly higher rate increase in this case and further exacerbate the economic hardship of the pandemic. As Mr. Meyer points out, "this is an optimal time to accelerate the distribution of EADIT back to ratepayers. People and businesses can use this reduction in their water bills over the three years to pay off debts, invest in businesses, and reopen businesses – the opportunities are numerous."[59] Given this, the expeditious return of these funds to ratepayers can be viewed as an opportunity to stimulate the Missouri economy instead of allowing MAWC to simply sit on those funds.

MECG's proposal to amortize these unprotected balances over a three year period is not unreasonable. In fact, in a recent rate case, Empire District Electric voluntarily agreed to return these funds to ratepayers over three years. "Empire proposes returning the unprotected portion to customers amortized over three years."[60] Certainly recognizing the lingering impact of the pandemic it is justifiable, especially since it has failed to provide any valid reason for keeping these funds for up to 40 years, that MAWC be ordered to amortize the unprotected EADIT over a three year period.

4. **Usage Normalization** – What is the appropriate level of normalized annual usage that the Commission should adopt for calculating normalized revenues for each rate class and service territory?

Position:

5. **Water Utility Revenues** – What are the appropriate revenues to use to determine the increase or decrease in water service revenue requirement?
    a. Residential Revenue – What is the appropriate number of meters for fixed or customer charge to be used for revenues?
        i. Non-Residential Revenues – What is the appropriate annualized number of meters level for each revenue class?

Position: For those classes in which meters have shown a steady increase over the course of several years, then the end of period number of meters should be used. For those classes in which the number of meters has fluctuated, then an average across multiple years should be used. Therefore, since the residential class has shown growth over time, it is appropriate to use the number of meters as of the true-up date. Similarly, the commercial class in the non-St. Louis County district has also demonstrated steady growth and the end of period number of meters should be used. Other classes demonstrate different characteristics.

> The Commercial and Industrial Classes for St. Louis County and the Industrial Class for the Other Water District do not show consistent growth, and thus would require a different methodology for annualizing revenues. For the Commercial and Industrial class, customer counts fluctuate from year to year. Therefore,

[59] Meyer Direct, page 29.
[60] *Report and Order*, Case No. ER-2019-0374, issued July 23, 2020, at page 104.

much like my recommendation for tank painting expense normalization, this fluctuating number should be averaged.[61]

8. **Rate of Return/Capital Structure**

a. Return on Common Equity – What is the appropriate return on common equity to be used to determine the rate of return?

Position: MECG agrees with the positions advanced by OPC witness Murray. Therefore, the Commission should authorize a return on equity of 9.25% applied to a capital structure of either a common equity ratio of 41.1% or 39.18% (depending on the Commission's decision on AFUDC).[62] Mr. Murray's recommendation is based upon a discounted cash flow and capital asset pricing approach. Moreover, the 9.25% recommendation is consistent with the return on equity authorized by the Commission just last year for Empire District Electric. Finally, the 9.25% return on equity is higher than the average ROE that Mr. Murray observed for water utilities in 2020 of 8.82%.

b. Capital Structure – What capital structure should be used to determine the rate of return?

Position: MECG supports the consolidated capital structure of American Water Works as reflected in the testimony of OPC witness Murray. Specifically, the ratemaking capital structure for this case should reflect: 41.10% equity and 58.9% long-term debt, if the Commission also order MAWC to use short-term debt for its Allowance for Funds Used During Construction (AFUDC) rate. Alternatively, if the Commission does not order MAWC to use short-term debt for its AFUDC rate, Murray recommends a capital structure of 39.18% common equity, 56.16% long-term debt, and 4.66% short-term debt.

c. Debt/Preferred Stock Rates/Costs – What Debt / Preferred Stock Rates/Costs should be used to determine the rate of return?

Position: Recognizing that MECG's proposed capital structure does not include any preferred stock.

14. **Tank Painting Expense** –

a. Tank Painting Expense – What is the appropriate amount for tank painting expense to be included in the cost of service calculation?

Position: Data indicates that tank painting expenses have historically fluctuated.

Historic Tank Painting Expenses	
Year	**Amount**
2015	$1,213,954
2016	$684,011

[61] Meyer Surrebuttal, pages 20-22.
[62] Murray Direct, pages 3-5.

2017	$1,243,536
2018	$1,841,772
2019	$2,151,825
2020	$1,186,064

Source: Meyer Surrebuttal, page 16

Given the extreme fluctuations in tank painting expenses, it would be inappropriate to use a single year for inclusion in rates. For this reason, MECG supports a five year average in tank painting expenses as proposed by both Staff and MIEC.[63]

b. Capitalization – Should tank painting expense be capitalized going forward?

Position: In ratemaking it is important to understand the significance between labeling a particular item as an expense versus classifying that item as investment. While expenses are recovered through rates on a dollar for dollar basis, investment is included in rate base. The utility would then be allowed to recover a return of the investment (depreciation / amortization); a return on the investment (return on equity) as well as increased income taxes on the profit realized.

> In general, expenses are included in cost of service. Therefore, if handled correctly in the ratemaking formula, expenses are recovered dollar for dollar. For every dollar incurred, the utility will recover a dollar of expense. Historically, tank painting maintenance expenses are handled in this manner for ratemaking purposes. In its direct testimony, however, MAWC asks that tank painting expenses be capitalized. In this way, MAWC asks that the expense be included in rate base. This would allow MAWC to not only recover the amortization, but also to earn a return on these tank painting maintenance costs. In other words, MAWC is attempting to change tank painting expense into tank painting investment so that they can earn a profit on these dollars.[64]

MAWC attempts to justify its attempt to extract profits out of routine maintenance expense by claiming that the maintenance (painting) of water tanks will "extend" the lift of the water tank. MAWC's logic is flawed however. The water tanks have a certain life assuming this level of preventative maintenance. The painting of water tanks does not extend the life, that maintenance is necessary for the tank to reach its life. In this light, the failure to maintain the tanks would keep the tank from reaching its useful life. If adopted, MAWC's proposal would effectively turn all maintenance expense into an investment for which the utility would earn and return.

In this regard, tank painting is akin to preventative maintenance on a car.

> When you buy a car you expect it to last at least ten years, if not more. However, one must recognize to achieve that life, ordinary maintenance must be performed on the car. For example, the oil must be changed, the timing will need to be replaced and other maintenance items addressed. If those items are not

[63] Staff Cost of Service Report, page 55; Meyer Surrebuttal, page 16
[64] Meyer Surrebuttal, page 17.

performed, the car will not last ten years. Proper maintenance on the car did not extend the expected life of the car beyond your expectations, but allowed you to drive the car for its expected life.[65]

15. **Income Tax Gross Up Factor** – Should the income tax gross-up factor include consideration of uncollectibles and PSC assessment?

Position: The Commission routinely employs an income tax gross-up factor. As described, the income tax gross-up factor is designed to reflect the fact that a portion of the utility's revenue requirement increase will be subject to income taxes. "In order for the utility to recover the appropriate revenue requirement, the revenue requirement must be grossed up to account for the income taxes that will be payable. . . . By grossing up the net income required to operate the utility, the utility will receive the proper level of revenues to cover all of its expenses."[66]

Here, however, MAWC seeks to expand the gross-up factor to include not only the effects of income taxes, but also the alleged effects of uncollectibles. Noticeably, while MAWC proposed the adjustment (CAS-1) to reflect the inclusion of uncollectibles in the gross-up factor, MAWC failed to provide any evidentiary support for the inclusion of uncollectibles in the gross-up factor. "MAWC has not provide any evidence that shows that an increased revenue requirement will automatically translate into higher uncollectibles."[67] In fact, even after MIEC filed testimony opposing this adjustment, MAWC failed to provide any rebuttal refuting MIEC's positions.

As MIEC witness Meyer points out, "while it may seem intuitively logical that a rate increase will lead to a higher level of uncollectible expense, it has been my experience that uncollectibles are not directly related to the level of rate increase. In fact, I have seen situations in which uncollectible expense has decreased even though rates have increased."[68] Given that uncollectibles are entirely unrelated to the level of rate increase authorized in this case, it is inappropriate to include uncollectible expense in the income tax gross-up factor.

16. **Service Company Costs** –

a. Sale of New York American – Should service company costs be increased to account for the sale of New York American by American Water Works?

Position: American Water Works has water and sewer operations in 16 states including a subsidiary in New York. American Water Works provides certain support functions to these subsidiaries through a service company. The service company charges are then allocated to each of the subsidiaries.[69]

In November 2019, American Water Works agreed to sell its New York operations (126,000 customers). To date, over 15 months later, that sale has yet to be approved by the New York Public Service Commission. Nevertheless, MAWC suggests that, because of the potential sale of the New York operations, there will be a smaller number of customers over which to allocate

[65] Meyer Direct (Revenue Requirement), pages 32-33.
[66] Meyer Direct, page 42.
[67] *Id.* at page 43.
[68] *Id.*
[69] Meyer Rebuttal, page 7.

these service company charges. As such, MAWC suggests that the level of service company charges included in rates consist of not only the test year level, but also an additional $1.4 million attributable to the sale of the New York operations and its 126,000 customers.

While MECG does not dispute the test year level of service company charges, MECG asserts that the inclusion of an additional $1.4 million of service company charges alleged resulting from the sale of the New York operations is inappropriate for several reasons.

First, the sale of the New York operations is not known and measureable. It is well established that "the known and measureable principle requires that an event must have occurred (i.e., "known") and that the impact must be quantifiable (i.e., "measureable")."[70] While the sale of the New York operations has been announced, the closing of that transaction is certainly not known. Rather, it is apparent that the approval by the New York Public Service Commission has become contentious. In fact, recent newspaper accounts suggest that the transaction is facing extreme criticism. "Two weeks after Gov. Andrew M. Cuomo announced legislation that would require the state Department of Public Service study the prospect of municipalizing the system, customers in the virtual public hearing by the Public Service Commission overwhelmingly called on the agency to reject the $607 million sale."[71] Certainly then, the closing of this transaction cannot be considered to be known and the financial implications cannot be considered to be measureable.

Second, while seeking to recognize the loss of customers resulting from the sale of the New York operations, MAWC fails to recognize the historical growth in customers that occurs as a result of organic growth in its service areas or from new system acquisitions. The following table shows the historic growth that American Water Works has seen in its customer base.

American Water Works' Customer Counts		
Year	**Customer Count**	**Increase**
2015	3,252,691	
2016	3,312,304	59,613
2017	3,353,877	41,573
2018	3,381,695	27,818
2019	3,434,025	52,330

Source: Meyer Rebuttal, page 9.

Given that MAWC seeks to recognize the customer reductions from the speculative sale of the New York operations, while simultaneous ignoring the growth in customers that occurs throughout the company, its adjustment is "one-sided".[72]

In fact, over the last four years, the average annual increase in customers has been approximately 45,300 customers. Assuming the historical three year period in between rate cases, American Water Works will experience organic growth of approximately 136,000 customers in this 3 year period. This exceeds the 126,000 customers potentially lost if the New York transaction occurs.

[70] Meyer Surrebuttal, page 10.
[71] https://www.newsday.com/business/nyaw-liberty-utilities-1.50062565
[72] Meyer Rebuttal, page 8.

Third, MAWC's proposed adjustment effectively treats the service company charges as fixed costs in that they do not vary with a change in customer counts. That said, however, the service company charges consist primarily of labor expenses.[73] Labor costs are variable in nature and should fluctuate with the number of customers served by American Water Works. "MAWC has failed to make any provisions for the possible reduction in the labor force at the service company in response to the sale of the New York utility."[74] In fact, as MIEC witness Meyer recognizes, MAWC's failure to account for the potential reduction in service company labor charges is likely a reflection of the fact "that American Water Works will continue to grow and needs those employees to provide those services."[75]

Given the fact that the sale of the New York operations is not known and measureable and given the one-sided nature of the MAWC adjustment, the Commission should reject MAWC's attempt to inflate service company charges by $1.4 million.

17. **Property Tax** –

a. Property Tax Expense - What is the appropriate level of property tax to be included in rates?

Position: As reflected in the testimony of MIEC witness Meyer, the Commission should include a level of property taxes consistent with the amount paid by MAWC as of the true-up date. In this case, that would include the level of property taxes just recently paid by MAWC as of December 31, 2020. In contrast, MAWC proposes that the Commission should include property taxes based upon the level of investment that it projects will be in place in the future test year (May 31, 2022). Not only is the investment that MAWC claims in the future year deemed speculative and unreliable, the property taxes on the speculative level of investment is uncertain. Again, this demonstrates the fact that the future test year will immediately lead to a level of earning since MAWC will be allowed to charge customers for property taxes that it won't have to pay to the taxing authority until December 31, 2022.[76]

b. Property Tax Tracker - Should the Commission implement a property tax tracker?

Position: It is well established that the Commission's authority to utilize deferral accounting (the deferral of costs from the one period for recovery in a subsequent period is limited.

> Under historical test year ratemaking, costs are rarely considered from earlier than the test year to determine what is a reasonable revenue requirement for the future. Deferral of costs from one period to a subsequent rate case causes this consideration and should be allowed only on a limited basis. ***This limited basis is when events occur during a period which are extraordinary, unusual and unique, and not recurring***.[77]

Given this directive from the Courts, the Commission has steadfastly applied the "extraordinary" standard. Recently, when considering the retirement of the Sibley AAO, the Commission held

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[73] *Id.* at page 9.
[74] *Id.*
[75] *Id.*
[76] Meyer Direct (Revenue Requirement), pages 19-21.
[77] *Report and Order*, Case No. EO-91-358, issued December 20, 1991, 1 Mo.P.S.C. 3d, 200, 205 (emphasis added).

that "the question before the Commission is whether GMO's decision to close the Sibley units is 'extraordinary, unusual and unique, and not recurring.'"[78]

The Commission has already considered whether to allow deferral accounting for property taxes. Given this steadfast application of the "extraordinary" standard, the Commission has previously rejected an AAO tracker for MAWC property taxes.[79]

> The issue is whether the increase in MAWC's property taxes to the Counties for 2017 and the beginning of 2018 resulted from an event that would be considered "unusual" or "extraordinary" under NARUC USOA. That is to say, did the Counties' implementation of a different standard for assessing MAWC's property taxes cause an unusual, unique and nonrecurring event worthy of exceptional treatment? For the following reasons, the Commission finds they do not. There is nothing unusual or extraordinary about paying property taxes to warrant an AAO. It is a recurring expense.[80]

Similarly, the Commission has rejected a property tax tracker for KCPL on the basis that property taxes are not extraordinary. Instead, property taxes are "ordinary and typical, not an abnormal and significant different" from the normal activities of the Company.[81]

Recognizing that property taxes are not extraordinary, MECG urges the Commission to reject MAWC's proposed property tax tracker.

29. **Rate Case Expense** –

a. <u>Sharing of Cost</u> – Should rate case expense be shared?
b. <u>Expense</u> - What amount of rate case expense should be borne by the ratepayers?
c. <u>Normalization Period</u> – What is the appropriate normalization period for recovering rate case expense?

<u>Position</u>: MECG supports Staff's position on rate case expense levels and the appropriate normalization period. Furthermore, MECG asserts that rate case expense should be shared between ratepayers and shareholders. In this regard, the Commission's 2017 finding in the Spire case is particularly information. There, the Commission held that the sharing of rate case expense was particularly appropriate since Spire pursued "more new, unique shareholder-focused ratemaking tools in this case to insulate shareholders from risk, such as three new tracking mechanisms (environmental expense tracker, cyber security tracker, and major capital projects tracker) and a revenue stabilization mechanism."

The current case reflects a similar situation. Here, MAWC has proposed a revenue stabilization mechanism, the implementation of a property tax tracker, the capitalization of tank painting expenses, and the consolidation of rate districts all over the objections of consumers and Staff.

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[78] *Report and Order*, Case No. EC-2019-0200, issued October 17, 2019, pages 12-13.
[79] There is no practical difference here between deferral accounting as utilized in the context of a tracker and deferral accounting within the meaning of an Accounting Authority Order. As the Western District Court of Appeal pointed out, "[t]he request by KCPL for the "tracking" accounting mechanism is the same as a request for an AAO, as it seeks to book a particular cost, normally charged as an expense on a utility's income statement in the current period, to the utility's balance sheet as a regulatory asset or regulatory liability." *Kansas City Power & Light*, 509 S.W.3d 757 (Mo. App. 2016).
[80] *Report and Order*, Case No. WU-2017-0351, issued December 20, 2017, at page 15.
[81] *Report and Order*, Case No. ER-2014-0370, issued September 2, 2015, page 53

These proposals, as in the Spire case, are all “new, unique shareholder-focused ratemaking tools in this case to insulate shareholders from risk.”

The Courts, in recent years, have twice held that the sharing of rate case expense is appropriate. In 2016, the Western District Court of Appeals considered the Commission’s decision to share rate case expense between KCPL shareholders and ratepayers. There, the Court affirmed the Commission’s decision saying “[w]e find that the remedy crafted by the PSC was a reasonable exercise of the PSC's discretion and expertise in determining just and reasonable expenses to be borne by ratepayers."[82]

Just two weeks ago, the Supreme Court upheld the Commission’s decision to share rate case expense in the aforementioned Spire case. There the Supreme Court held:

> To be sure, the PSC’s decision to exclude 50 percent of Spire’s remaining rate case expenses (after allowing full recovery of the cost of notices and the depreciation study) was not the result of a decision to include or exclude expenses on an item-by-item basis. This is not to say, however, that the PSC’s decision was unsupported by competent and substantial evidence on the whole record, and it was far from the sort or irrational or unconsidered approach properly characterized as arbitrary, capricious, or an abuse of discretion.
>
> The PSC expressly identified those issues (and related expenses) Spire pursued that benefitted only its shareholders and not its ratepayers, and the PSC decided what proportion of the total case (and expenses) they represented. Nothing in the PSC’s authorizing statutes or this Court’s precedents requires the PSC to conduct an item-by-item analysis when the issue is the degree to which a utility’s case expenses should be included in calculating “just and reasonable” rates rather than rejecting a particular expense as imprudent. Accordingly, the PSC did not err in excluding a portion of Spire’s rate case expenses.[83]

Recognizing that, as with the Spire case, MAWC has proposed a number of “new, unique shareholder-focused ratemaking tools in this case to insulate shareholders from risk”, the Commission should require a 50 / 50 sharing of rate case expense between ratepayers and shareholders.

37. **COVID-19 Accounting Authority Order** –

a. <u>Recovery</u> – How much, if any, of MAWC’s COVID-19 AAO should the Commission approve for recovery in MAWC’s rates?
b. <u>Interest Expense</u> – Should interest expense be recoverable in rates as part of the COVID-19 AAO agreed to in Case No. WU-2020-0417?
c. <u>Amortization</u> – Over what period should the COVID-19 AAO be amortized?

<u>Position</u>: On March 20, 2020, American Water Corporation executed a term loan facility for up to $750 million. That loan provided for an initial borrowing of $500 million with the option to borrow an additional $250 million on June 19, 2020. As alleged by MAWC, that loan was executed to address liquidity concerns at the beginning of the pandemic.

[82] *State ex rel. Kansas City Power & Light Company*, 509 S.W.3d 757 (Mo.App. 2016).
[83] Supreme Court Case No. SC97834, decision issued February 9, 2020.

On October 28, 2020, the Commission approved a stipulation in Case No. WU-2020-0417 which provided for the issuance of an Accounting Authority Order ("AAO") related to MAWC response to the Covid pandemic. Importantly, that settlement provides that the issuance of the AAO does not guarantee recovery of the deferred amounts.

> Future Recovery: The Parties agree that the ability to track and defer costs into a regulatory asset is for accounting purposes only. All questions regarding potential ratemaking treatment of the deferred costs and the materiality thereof are reserved for the Company's pending base rate proceeding (WR-2020-0344) and a subsequent rate case for deferred items not considered for recovery in WR-2020-0344. The Parties reserve the right to review the Company's deferral of COVID-19 costs and recommend adjustments in the Company's applicable general rate case.[84]

One provision of the AAO allowed MAWC to defer the interest expenses associated with its portion of a loan executed by American Water Works in response to the Covid pandemic.[85] In its testimony, MAWC seeks to recover the deferred interest expense on this loan. While MECG does not object to the recovery of a portion of the deferred interest expense, it recommends that a significant portion of the interest expense be disallowed for several reasons.

First, the loan proceeds were never used for any utility purposes. Rather, based upon a review of the 10-Q filings of American Water Works, the entirety of the $500 million in proceeds was retained in cash. As such, the proceeds never provided any utility benefits, but instead simply stayed on the parent company's balance sheet.[86]

Second, the liquidity concerns which form the entire justification for the loan never materialized. In fact, on June 19, 2020, American Water Works did not exercise the additional $250 million of borrowing capacity under the loan agreement. "Moreover, in data request responses, American Water Works has indicated that it does not intend to seek replacement financing when this loan becomes payable in March 2021.[87]

Third, on June 2, 2020, American Water Works increased its dividend by 5¢ / share per quarter. As Mr. Meyer points out, "[d]ividend increases are not symptomatic of a utility that has concerns with liquidity. Instead liquidity concerns should drive a utility to preserve cash. Obviously, if American Water Works can increase its dividend during the pandemic, the necessity for a pandemic-related loan and incurrence of interest on that loan must be questioned."[88]

Fourth, the loan provides for no penalty for prepayment. Recognizing that American Water Works increased its dividend on June 2 and no longer had any liquidity concerns, it should have used the cash proceeds that remained on its balance sheet to pay off the loan early and terminate any further interest expenses. As Mr. Meyer concludes, "[r]atepayers rates should not be increased to recover interest expense that has been used for no purpose."[89]

[84] See, *Order Approving Non-Unanimous Stipulation and Agreement*, Case No. WU-2020-0417, issued October 28, 2020, Appendix A, paragraph 14.
[85] *Id.* at page 3.
[86] Meyer Rebuttal, page 3.
[87] *Id.*
[88] *Id.* at pages 3-4.
[89] *Id.* at page 4.

Given that the liquidity concerns that provided the initial justification for the pandemic loan never materialized, that the loan proceeds were never used for utility purposes, that there was no penalty for prepayment, and that American Water Works signaled its lack of concern with liquidity when it increased its stock dividend, MECG recommends that the Commission disallow a portion of the interest expense on the loan.

Specifically, MECG recommends that, while the Commission allow the recovery of the interest expense through June 2, 2020 (the date that American Water Works increased its dividend), the Commission should disallow all interest expense incurred after that date. As Mr. Meyer points out:

> I cannot question American Water Works' initial decision as being imprudent when securing the loan on March 20, 2020. . . However, recognizing that the loan provides for no penalty for prepayment, American Water Works should have constantly evaluated the continued need for the funds to determine whether the loan should have been retired early. Clearly, on June 2, when American Water Works increased its dividend, it has determined that continued liquidity concerns no longer existed. At that date, American Water Works should have paid off the loan instead of incurring interest expense for cash that was not being utilized.[90]

MECG's position in allowing recovery of a portion of the interest expense is eminently reasonable. In a recent case involving Kentucky American Water, a subsidiary of MAWC, the Kentucky Commission disallowed recovery of all of the interest expense associated with the pandemic loan.

> Term-Loan Interest Expense.
> Given the uncertainty of the financial markets at the onset of the COVID-19 pandemic, the Commission notes that AWCC's decision to obtain a $500 million draw on its 364-day term loan credit facility might have been a reasonable action. However, as the pandemic progressed, the $19.6 million dollars allocated to Kentucky-American were not used and remain in Kentucky-American's cash reserves. Kentucky-American did not adequately explain why the $19.6 million debt allocation was not returned to AWCC within the first few months once Kentucky-American realized that the pandemic's impact on the financial markets had not materialized, particularly as there is no prepayment penalty.
>
> For the reasons discussed above regarding materiality, Kentucky-American failed to establish that the Term-Loan Interest expense is material to its financial position and warrants deferral accounting. Kentucky-American's requested Term-Loan Interest expense of $186,620 represents only 1.42 percent of the Interest expense Kentucky-American reported in the calendar year ending December 31, 2019, of $13,165,898. Additionally, Kentucky-American did not demonstrate that the allocation of the AWCC loan was necessary given that the loan proceeds remain in a cash reserve account untouched and that the associated interest expense is not material. ***<u>For these reasons the Commission finds that Kentucky-American's request to establish a regulatory asset for the recovery of its Term-Loan Interest expense should be denied</u>***.[91]

[90] *Id.*
[91] *Id.* at page 6 (citing to Kentucky Public Service Commission Case No. 2020-00257, Order issued December 30,

Recognizing that the interest expense associated with the pandemic loan did not provide any ratepayer benefits and that American Water Works should have paid off the loan early rather than continue to incur interest expense, MECG recommends that the Commission disallow all interest expense incurred after June 2, 2020 – the date on which American Water Works signaled a lack of any liquidity concerns by increasing its dividend.

38. **System Delivery** – c. Main Break Audit – Should MAWC conduct annual audits regarding its water main breaks?

Position: Yes. MAWC should submit to the Staff, OPC and any other interested party an annual report that details main breaks and lost and unaccounted for water by major service area. This report would allow the Staff and others to monitor the operations of MAWC as it relates to the deliverability of water.[92]

43. **Revenue Stabilization Mechanism (RSM)** –

a. Should the Commission approve a Revenue Stabilization Mechanism for MAWC? And if so, how should the RSM be structured in terms of revenue requirement, included customer classes, the calculation of refunds, the inclusion of production costs, or other factors?
b. If so, is there a change in business risk that may be taken into account in setting MAWC's authorized return on equity?

The Commission Should Reject the RSM: In 2018, the Commission considered Spire Missouri's request to implement a revenue stabilization mechanism ("RSM"). Under its proposed RSM, Spire would be permitted to "make adjustments for all variations in average usage per customer (such as, fuel switching, rate class switching, new customers with non-average usage, and economic factors)".[93] Ultimately, the Commission noted that the RSM was a "unique shareholder-focused ratemaking tool . . . to insulate shareholders from risk".[94] Additionally, the Commission found that "[a] RSM is not needed by Spire Missouri due to difficulty meeting its revenue requirement without a RSM."[95]

In the case at hand, MAWC also asks that the Commission implement its proposed RSM in order to insulate shareholders from risk. As designed, "the RSM would compare the Authorized Revenues to actual billed revenues for the residential, commercial, other public authorities (OPA) customer classes and Sale for Resale, and defer/accrue the difference, less the applicable change in production costs, on a monthly basis."[96]

2020, at pages 19-20).

[92] Meyer Rebuttal, pages 10-12.

[93] *Amended Report and Order*, Case No. GR-2017-0215, issued March 7, 2018, page 83.

[94] *Id.* at page 49.

[95] *Id.* at page 79.

[96] Watkins Direct, page 16.

On a general level, the Commission should be aware that it has addressed these type of special ratemaking mechanisms in the past. Repeatedly, the Commission has said that such mechanisms "should be used sparingly."[97]

On a more specific basis, the RSM faces opposition from Staff,[98] OPC,[99] MECG and MIEC.[100] The reasons for the opposition are many and undermine each of the rationales provided by MAWC in support of the proposed RSM.

First, as the Commission recognized with the proposed Spire RSM, the RSM in this case is not needed for MAWC to recover its costs. As Mr. Meyer points out, over the past 10 years, MAWC has realized an increasing level of net income. Recognizing that MAWC has net income, it is clear that MAWC is able to pay all of "its operating and maintenance expenses, depreciation expenses, property taxes, other taxes, income taxes and interest expense."[101] Mr. Meyer then points out that "[t]he only component left after paying all of these costs is the level of profits recognized by MAWC."[102] For this reason, "the sole advantage of an RSM is to guarantee a certain level of profits for MAWC."[103]

The evidence regarding the financial health further accentuates the notion that the Commission should not take steps to guarantee a level of profits to MAWC. Over the past 10 years, MAWC earnings have tripled from $22.0 million to $62.7 million.[104] This financial health is also reflected in the stock performance of its parent company. "While American Water Works' stock price has appreciated by 525% in the last ten years, the Dow Jones Industrial Average has only increased by 165%."[105] Finally, in addition to stock appreciation, shareholders have benefitted from the profitability of its operating subsidiaries like MAWC in the form of dividends. Specifically, in the last 10 years, the dividend has increased from 22¢ / share to 55¢ / share.[106] Clearly then, the Commission should not institute mechanisms, like the proposed RSM, to simply guarantee MAWC profits when shareholders are clearly recognizing sufficient profits.

Second, like the Spire mechanism which was rejected because it tracked changes in customer usage regardless of the reason, the proposed RSM in this case is similarly faulty. Specifically, much as the Commission observed in the Spire case, the MAWC mechanism would allow MAWC to make adjustments that result from economic factors and virtually any other factor. More egregious, the RSM would have allowed MAWC to make adjustments to reflect declines in usage that resulted from the pandemic or other Acts of God.

> If the Commission had allowed MAWC to implement an RSM as MAWC proposed in its last rate case, MAWC would have been be allowed to collect any

[97] *Report and Order*, Case No. ER-2014-0258, issued April 29, 2015, page 50.
[98] See, Busch Rebuttal, page 3 ("Staff recommends that the Commission reject MAWC's proposal in this proceeding.").
[99] See, Mantle Rebuttal, page 13 ("I recommend that the Commission reject the RSM proposed by MAWC.").
[100] See, Meyer Direct, page 3 ("MIEC is opposed to the implementation of an RSM in this rate case.").
[101] Meyer Direct (Rate Design), page 4.
[102] *Id.*
[103] *Id.*
[104] Meyer Direct (Rate Design), page 4.
[105] *Id.* at page 6.
[106] *Id.* at page 5.

> shortfall in revenues resulting from the pandemic. Similarly, an RSM would allow revenue recovery for any major storms or other incidents where service may be disrupted. A recent example that comes to mind would be the Joplin tornado. If an RSM was in effect, the lost revenues from the tornado or pandemic would be restored without any Commission review. Noticeably, this recovery of lost revenues would occur despite the fact that MAWC and the Commission have determined that a utility should not recover lost revenues associated with an extraordinary event. If an RSM is approved, there should be a provision limiting the RSM to weather and/or conservation, but not allowing revenue recovery for extraordinary events such as Acts of God.[107]

Third, as Staff correctly points out, the role of regulation is to "simulate a competitive environment in a non-competitive market."[108] It is important then to recognize competitive firms are not given any guarantees. "Firms are not guaranteed to receive a certain annual amount of revenues, they are not guaranteed a rate of return on their investment, and they are generally not guaranteed survival. Firms in the competitive market also are not granted a captive group of customers, unlike rate regulated utilities that are given certificated areas by state authority."[109]

Against this background, one should recognize that "[a]n RSM is a mechanism that enables utilities to essentially guarantee recovery of a certain level of revenues, which significantly enhances the likelihood that they will meet or exceed their authorized rate of return."[110] Given this, Staff properly concludes that "an RSM is not a symmetrical mechanism that is in the best interests of all stakeholders."[111]

Fourth, contrary to various assertions, MAWC has not experienced declining revenues. Rather, as Staff witness Busch points out, MAWC's revenues have been increasing over the past 5 years.

Year	Total Annual Revenues
2015	$268,845,673
2016	$287,591,368
2017	$289,427,008
2018	$319,007,901
2019	$324,614,677

Source: Busch Rebuttal, page 6.

Not only are revenues increasing, but Staff also points out that MAWC has comfortably collected its authorized level of revenues. As Mr. Busch points out, in July of 2016, MAWC was authorized a revenue requirement of $285,680,272. Noticeably, in 2017 and 2018, MAWC collected revenues that exceeded this authorized revenue requirement. Still again, in May 2018, the Commission authorized a revenue requirement of $318,000,000. As before, MAWC realized

[107] Meyer Surrebuttal, page 8.
[108] Busch Rebuttal, page 4.
[109] *Id.* at page 5.
[110] *Id.*
[111] *Id.*

revenues in both 2018 and 2019 that exceeded the authorized revenue requirement.[112] Clearly then, even without its treasured RSM, MAWC was "able to exceed its authorized revenues in each of the past four years."[113]

Fifth, MAWC's argument that an RSM is necessary to recover fixed costs is highly questionable. Specifically, after claiming that 92.53% of its revenue requirement is associated with fixed costs, MAWC suggests that only 20.77% of its revenues are considered "fixed" revenues collected through a customer charge.[114] As Staff points out, however, MAWC's focus solely on revenues collected through the customer charge is misleading. Instead, a significant portion of MAWC's usage is considered non-discretionary and not affected by factors such as the variability of weather.[115] In fact, over half of MAWC's usage is virtually certain of collection. Therefore, MAWC is virtually assured of collecting a significant level of fixed costs through this non-variable portion of customer usage. For this reason, it is misleading for MAWC to claim that only 20.77% of its revenues are considered fixed.

Moreover, it is disingenuous for MAWC to complain about the level of revenues that are collected through the customer charge. In 2015, the residential customer charge was set at $15.33. In the next case, however, MAWC proposed a residential customer charge of $10.00 "even though its class cost of service study supported a customer charge of $18.68."[116] In this regard, the level of revenues collected through the customer charge is a self-inflicted wound and MAWC should not be allowed to use this self-inflicted wound as support for its anti-consumer RSM.

Sixth, the implementation of an RSM is not necessary to provide MAWC with an incentive to invest in Missouri operations. As MIEC witness Meyer points out, MAWC acquired 16 water systems in the last 10 years despite the fact that it did not have an RSM.[117] Moreover, Staff points out that, despite not having an RSM in place, MAWC has invested $850 million in Missouri over the last 5 years. Furthermore, MAWC anticipates that it will invest $1 billion in just the next three years.[118] Clearly, given its past investment without an RSM in place, there is already adequate incentive for MAWC to invest.

Structure: Putting aside the numerous reasons why the Commission should reject the notion of implementing any RSM for MAWC, the Commission should also reject the RSM structure proposed by RSM. Typically, an RSM is designed to guarantee that MAWC collects the level of revenues authorized by the Commission in this case. MAWC, however, not only proposes to use the RSM to reflect shortfalls in revenues, it also seeks to extend the reach of the RSM to also reflect increases in the production cost of water.

> The MAWC's proposed RSM will not only ensure a certain level of revenues (profit restoration), but will also allow MAWC to collect any changes in water

[112] *Id.* at page 7.
[113] *Id.*
[114] Watkins Direct, page 13.
[115] Busch Rebuttal, page 9.
[116] *Id.* at page 8.
[117] Meyer Direct (Revenue Requirement), page 12.
[118] Busch Rebuttal, page 12.

> production costs. Essentially, what MAWC is proposing is a revenue surcharge mechanism (tracker) and a water production surcharge mechanism (tracker) all rolled into an RSM.[119]

An RSM that is intended to simply allow for the collection of revenues would multiply any shortfall in usage by the cost of production <u>resulting from this case</u>. MAWC, however, cleverly extends the reach of the proposed RSM by multiplying any shortfall in usage by the <u>future</u> cost of production when the shortfall is realized. Given this, MAWC seeks to not only collect shortfalls in revenues, but also increases in its cost of production.[120] The surreptitious expansion of the RSM to include increases in costs of production has the practical effect of making MAWC less concerned with minimizing the cost of production.[121]

In order to avoid the expansion of the RSM to include any consideration of increases in cost of production, MIEC witness Meyer suggests that the Commission, in the event that it approves an RSM, should calculate an RSM factor. This RSM factor would simply be the total cost of production divided by the annualized level of water sold. This would then represent the cost for MAWC to calculate a gallon of water.[122] It should be this RSM factor (the cost of production as calculated in this case) that should be multiplied by any shortfall in usage, not the future cost of production.

Next, the MAWC proposed RSM is faulty in the manner in which it treats any revenue shortfall versus the manner in which it treats any revenue credit. Specifically, MAWC suggests that, while any shortfall in revenues should be addressed by adjusting customer rates on a volumetric basis, any increased revenues due to heightened usage should be returned through a customer bill credit.[123] As Mr. Meyer points out, this disparate treatment between revenue shortfalls and revenue excesses is not appropriate. Instead, Mr. Meyer suggests that "all RSM adjustments be based on volumetric changes, whether revenues are above or below the level authorized by the Commission. This would align the revenues with the consumption of water for all customers."[124]

<u>**Business Risk**</u>: Finally, it is beyond dispute that the implementation of an RSM would cause a change in business risk that should be reflected in the return on equity authorized in this case. Section 386.266.4 provides the statutory authorization for the Commission to implement a water RSM. Section 386.266.8 directs the Commission to "take into account any change in business risk to the corporation resulting from implementation of the adjustment mechanism in setting the corporation's allowed return in any rate proceeding."

It is indisputable that the implementation of an RSM reduces MAWC's business risk. When considering a similar RSM for Spire, the Commission found that an RSM is a "unique shareholder-focused ratemaking tool . . . to insulate shareholders from risk".[125] Staff agrees:

[119] Meyer Direct (Revenue Requirement), page 10.
[120] Meyer Surrebuttal, page 5.
[121] *Id.*
[122] *Id.* at page 6.
[123] Meyer Direct, page 13.
[124] *Id.*
[125] Meyer Surrebuttal, page 49.

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

A. First, it just makes sense. Any company's ability to earn profit is dependent on two basic factors, dollars in and dollars out. All businesses face risk the revenues will not be as robust as is forecasted, and thus investors require a risk reward for that uncertainty. If revenues are all but guaranteed, uncertainty fades and risk is reduced. Second, RAP, the Regulatory Assistance Program, acknowledges that decoupling (another name for an RSM), tends to reduce utility risk by providing revenue stability.[126]

Given the numerous problems associated with MAWC's proposed RSM, MECG urges the Commission to reject that mechanism.

44. **Water Rate Design**

a. <u>Single Tariff Pricing / District Specific Pricing</u> – Should the Commission keep the current water district structure, or adopt single tariff pricing for the water customers?

<u>Position</u>: There is virtual unanimity on this issue. Staff, OPC, MECG and MIEC all agree that the Commission should keep the current water district structure which reflects a district for the service areas which are charged an ISRS (St. Louis County) and a consolidated district for the remaining service areas that are not charged an ISRS (non-St. Louis County).

In 2018, the Commission considered the issue presented here. There, the Commission considered a MAWC proposal to consolidate from 3 districts into a single district with single tariff pricing. In its decision, the Commission made several findings that are still equally applicable today.

> St. Louis County's unique circumstance makes it inappropriate to consolidate all three water districts at this time. St. Louis County is subject to the ISRS, which is a surcharge not recovered from other customers of MAWC, which can increase a customer's bill by as much as ten percent of the Company-wide revenues. By combining all three districts, customers in St. Louis County would be disadvantaged by being the only area paying the additional surcharge until costs can be included in rate base, while still contributing to improvements in other areas.[127]

As in 2017, MAWC is still only authorized to impose an ISRS in St. Louis County. While MAWC has supported legislation to change this, to date only St. Louis County is charged the ISRS.

In its testimony, MAWC provides several misplaced reasons for the creation of a single statewide water district. ***<u>First</u>***, MAWC suggests that the adoption of single tariff pricing (a

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[126] Busch Rebuttal, page 17 (citing to Migden-Ostrander, Janine, & Sedano, Rich (2016) *Decoupling Design: Customizing Revenue Regulation to Your State's Priorities*, Montpelier, VT: The Regulatory Assistance Project, available at http://www.raponline.org/knowledge-center/decoupling-design-customizing-revenue-regulation-state-priorities).

[127] *Report and Order*, Case No. WR-2017-0283, issued May 2, 2018, page 30.

single statewide district) will encourage the "purchase of small, under-performing water companies." Noticeably, however, the Commission has already rejected the notion that the adoption of single tariff pricing is necessary to provide such an incentive. Instead, the Commission has already found that the purchase of "small struggling systems" is already encouraged through the Commission's action in the last case in "combining Districts 2 and 3" into a single non-St. Louis County district.[128] In fact, the evidence demonstrates that MAWC acquired 16 water systems in the last 10 years despite the fact that it did not have consolidated rates.[129] Clearly then, consolidated pricing is not necessary to provide an incentive to acquire these small systems.

Staff agrees. "MAWC has been very active in acquiring small systems under the current rate structure. . . Staff sees no reason why further consolidation would add additional incentive to MAWC to purchase more systems."[130]

Second, MAWC suggests that the adoption of a single tariff pricing would "improve affordability for all customers." In the last case, however, the Commission rejected this rationale. Instead, the Commission found that the use of single tariff pricing actually provides a perverse incentive for increased spending because such increases would not be readily detectable since the increased costs would be spread across more customers.

> A concern with STP is that by pooling all costs, all customers must pay a portion of all costs, regardless of cost causation. This could lead to a utility spending more money than necessary, sometimes referred to as "gold plating," since the overall increase would be spread to all customers, which would lower the impact.[131]

The primary problem underlying district consolidation for a water utility, which is not physically interconnected like an electric system, is that each system has entirely different costs and quality of service. As mentioned previously, the St. Louis County district is assessed an ISRS surcharge. On the other hand, there is no statutory authority for the imposition of an ISRS in the non-St. Louis County district. The cost differences go much further than simply a consideration of the geographic limitations of ISRS. As MIEC witness York points out, "the proposal for CTP ignores the principle of cost-causation. A particular water district's rates should be based on the costs that MAWC incurs to provide that district with service. . . Consolidated pricing is inconsistent with traditional cost of service principles and ignores the concept of cost-causation. In essence, consolidated pricing results in price subsidies to customers in a high-cost district at great cost to customers in a low-cost district."[132]

This difference in cost between the districts is apparent when one reviews the impact of consolidation on the two current districts.

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[128] *Id.* at page 31.
[129] Meyer Direct (Revenue Requirement), page 12.
[130] Barnes Rebuttal, page 7.
[131] *Id.* at page 27. Interestingly, when asked for any studies supporting the claim that consolidated pricing would improve affordability, MAWC was unable to provide "any quantitative analysis or evidentiary basis for such claims." (York Direct, page 3).
[132] York Direct, pages 7-8.

	St. Louis County	Non-St. Louis County
Rate A (Residential)	43.1%	17.4%
Rate A (Non-Residential)	46.6%	16.4%
Rate J	84.8%	22.6%

Source: York Direct, page 23.

Staff agrees:

> Based on the current rate structure, St. Louis County rates are lower than the rates for the rest of the state. Even with the large number of customers in the St. Louis area, if consolidation were to occur, the rates in St. Louis County would necessarily increase to absorb the costs of service for the other areas. Thus, the St. Louis County customers, the majority of MAWC's customers, would actually see less affordable rates.[133]

Clearly, given the magnitude of the rate impacts resulting from consolidation, there are differences in cost between St. Louis County and non-St. Louis County. As Ms. York concludes, these cost differences are covered up by consolidation of the two districts.

There are not only differences in cost between the two current districts, there are also differences in quality of service. As Ms. York concludes, based upon data request responses from MAWC, "quality of water service does vary between the various districts."

> [I]n response to MECG DR 7-001, MAWC discusses the prevalence of water main breaks in the St. Louis County district and in the non-St. Louis County district. There MAWC points out that, while it has tracked water main leaks in St. Louis County for over a decade, it did not even track water main breaks in the non-St. Louis County district prior to 2019. "Prior to 2019 the number of water main breaks were not tracked outside of St. Louis County." Given the fact that MAWC was tracking water main breaks in St. Louis County and ignoring the frequency of main breaks outside of the County tends to indicate that main breaks are a much bigger problem in St. Louis County. Therefore, contrary to Mr. Rea's assertion, quality of service does vary between the St. Louis County district and the non-St. Louis County district.[134]

Given the vast difference in cost and quality of service between the St. Louis County and the non-St. Louis County districts, as well as the presence of the ISRS in one district, it would be inappropriate to consolidate the two remaining districts.

Third, MAWC suggests that the implementation of single tariff pricing may "promote state economic development goals."[135] MAWC's claim is baffling. As Staff points out:

> Even without full consolidation, Missouri's Economic Development Riders ("EDR") have been utilized to help entice certain large customers to MAWC's

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[133] Barnes Rebuttal, page 6.
[134] York Surrebuttal, pages 5-6.
[135] Rea Direct, page 25.

> service territories. The current large customers that have utilized Missouri's EDR's in MAWC service area are Triumph Foods and Liberty Utilities (Missouri Water) d/b/a Liberty Utilities or Liberty. STP is not necessary for these mechanisms to work towards promoting state economic development goals. The EDRs have worked with many different rate district structures in the past, and will continue to work.[136]

Finally, the claimed industry movement towards consolidation is apparently not as prevalent as some may believe. Currently, American Water Works has operations in 16 states. To date, the consolidation that has occurred appears to have taken place in states with the smaller number of customers.

> According to its most recent 10-K filing with the Securities Exchange Commission, American Water Works operates in 16 states. Therefore, while American Water Works may have CTP in four states [Iowa, Kentucky, Maryland, and West Virginia], it does not have CTP in 12 other states (New Jersey, Pennsylvania, Missouri, Illinois, California, Indiana, Georgia, Hawaii, Michigan, New York, Tennessee, and Virginia). Importantly, American Water Works' six largest states, which represent over 80% of its customers do not have CTP. Therefore, while consolidation may have occurred in four of its states, that consolidation clearly involved much fewer customers than it would in the larger states. As such, consolidation was a more simple undertaking involving very few customers. If approved, Missouri would be the largest state (with approximately 470,000 customers), of the 16 states in which American Water Works operates, to have approved a consolidated rate.

Given the numerous problems and the limited, if any, benefits surrounding the adoption of single tariff pricing, MECG urges the Commission to reject MAWC's proposal and maintain the current structure with St. Louis County as a single ISRS-assessed district and all the other service areas combined into a non-St. Louis County district.

b. <u>Industrial Class</u> – Should MAWC create an industrial customer class (Rate L)? Should the Commission eliminate Rate J and begin the migration of customers that do not qualify for a new Rate L to Rate A?

<u>Position</u>: Currently, large MAWC customers are served on Rate J. In general, the threshold for service on Rate J is 450,000 gallons / month. As part of its proposal, MAWC seeks to create a new Rate L, to be used by customers with usage in excess of 3,000,000 gallons / month. All current Rate J customers that do not meet the 3,000,000 gallons / month threshold to be on Rate L would be migrated to Rate A to be served under the same rate as residential customers.[137]

MECG does not object to the creation of a Rate L large industrial customer class. That said, however, MECG objects to MAWC's proposal to eliminate Rate J and serve those customers off of Rate A.

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[136] Barnes Rebuttal, pages 7-8.

[137] There are currently 140 customers served off of Rate J. Of these, 47 would qualify for Rate L. Thus, 93 current Rate J customers would be migrated to Rate A.

First, MAWC's proposal to eliminate Rate J and have customers that do not qualify for Rate L served off of Rate A fails to recognize the tremendous disparities in usage characteristics between Rate A customers and these former Rate J customers. As MIEC witness York points out, "[t]hese Rate J non-residential customers have different load and service characteristics from current Rate A non-residential customers, and to combine them as proposed by MAWC violates cost-causation principles."[138]

As Ms. York demonstrates, the Rate J customers that do not qualify for Rate L have much different usage characteristics from Rate A customers.

> Rate J customers have historically had lower maximum day and maximum hour demands relative to their average day and average hour demands, than Rate A customers. Specifically, this historical data shows that Rate A customers have a maximum daily usage that is 2.0 – 2.3 times its average daily usage. In contrast, Rate J customers have a maximum daily usage that is only 1.4 times its average daily usage. This contrast also exists when the analysis focuses on maximum hourly usage. This indicates that Rate J loads are less "peaky" than Rate A, and more efficiently utilize the capacity installed on MAWC's system to serve them.[139]

Second, MAWC's proposal imposes mammoth rate increases on these former Rate J customers. As MIEC witness York points out, "[f]or Rate J customers that do not qualify for Rate L, the impacts of moving directly to Rate A are extreme – well over 100%."[140] Even while MAWC proposes to mitigate this impact by only moving halfway to Rate A, the impacts are still significant. "[T]he Company's proposal would result in approximately an 85% increase for Rate J customers in St. Louis County, and about a 23% increase for Rate J customers outside of St. Louis County. The impact to the Rate J class on a consolidated basis is an increase of 67%."[141]

Clearly then, the Rate J customers that do not qualify for Rate L demonstrate radically different usage characteristics from the Rate A customers with whom MAWC wants to lump them. Given this, and the tremendous impacts associated with MAWC's proposal, it is apparent that this proposal is not well reasoned and should be rejected.

c. Class Costs –
   i. What is the appropriate cost of service for each customer class?
   ii. What is the appropriate methodology for conducting the class cost of service study

Position: MAWC's class cost of service study is faulty for several reasons.

MAWC provided a single, statewide class cost of service study that reflects its proposals: (1) to consolidate districts, (2) to phase out Rate J by transitioning many Rate J customers to Rate A, and (3) to implement a new large user tariff known as Rate L. This is unreasonable and inaccurate for several reasons.

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[138] York Direct, page 16.
[139] *Id.* at page 17.
[140] *Id.* page 13.
[141] *Id.*

First, MAWC's COSS disregards the Commission's finding in the prior case that the St. Louis County district must remain separate from MAWC's remaining service territory because of the existence of the ISRS.

Second, MAWC combined current non-residential Rate A and Rate J customers that would not otherwise qualify for Rate L into a Non-Residential class in its COSS. These Rate J non-residential customers have different load and service characteristics from current Rate A non-residential customers, and to combine them as proposed by MAWC violates cost-causation principles. As a result, MAWC's COSS provides no insight into the cost of providing service to these Rate J customers, despite that this class currently exists, and will continue to exist for the foreseeable future.

Third, MAWC has inexplicably oversimplified its COSS in this case, by ignoring numerous cost-causing differences among customers that should be recognized. This is a change from the detailed COSS models that were provided in prior cases. It is difficult to reconcile MAWC's study in this case with the model provided in the last case to confirm that costs have been functionalized, classified and allocated consistently, and in accordance with the Base-Extra Capacity method.

d. Customer Charge – What is the appropriate customer charge for each customer classification?

Position: The Commission should reject Staff's proposal to reduce the customer charge in the event that a rate decrease is ordered. The evidence demonstrates that, while the vast majority of MAWC's costs are fixed in nature, it collects approximately 77% of its revenue requirement through commodity charges.

> MAWC stated that 94% of its total cost of providing service is fixed, yet only 23% of MAWC's proposed revenue requirement would be recovered through fixed charges. Reducing monthly fixed charges would create an even greater misalignment between rates and the nature of the underlying costs they should recover.[142]

[142] York Rebuttal, pages 3-4.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that the foregoing pleading has been served by electronic means on all parties of record as reflected in the records maintained by the Secretary of the Commission through the EFIS system.

_____/s/_David Woodsmall____________
David Woodsmall

Dated: February 18, 2021