

**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI**

In the Matter of Missouri-American	)	<b><u>Case No. WR-2007-0216</u></b>
Water Company's Request for Authority	)	Tariff File Nos. YW-2007-0407, YW-2007-
to Implement a General Rate Increase	)	0409, YW-2007-0410, YW-2007-0411,
for Water Service Provided in Missouri	)	YW-2007-0412, and YW-2007-0413
Service Areas	)	

**POST HEARING BRIEF**

**COMES NOW** Intervenor City of Joplin and for its Post Hearing Brief states as follows:

**I.**

**INTRODUCTION**

Missouri American Water Company ("MAWC," hereinafter) filed its initial rate case before this Commission seeking slightly less than a 25 percent across-the-board rate increase. After the rate case ran its full course but prior to hearing, the Public Service Commission Staff ("Staff," hereinafter) and the Office of Public Counsel ("OPC," hereinafter), a number of other intervening parties, and MAWC reached a Stipulation and Agreement among themselves. That Agreement, in the form of a non-unanimous Stipulation and Agreement, was filed with this Commission. Intervenor City of Joplin has objected to the Stipulation and Agreement, making that Stipulation and Agreement a Joint Recommendation of the parties.

As a Joint Recommendation, the positions filed in that Joint Recommendation are given no special benefit and the traditional burdens remain before this Commission. It is the role of this Commission to establish an appropriate rate, including all the supporting calculations therein, for MAWC's operations across the State of Missouri. Under Section 393.140(5), RSMo, the rates must not be "unjust, unreasonable, unjustly discriminatory or unduly preferential" and must be "just and reasonable." Section 393.140(5), RSMo 2000.

There are multiple districts in MAWC's system, and this Commission has adopted, appropriately, the theory of district-specific pricing ("DSP," hereinafter). The proper calculation of revenue requirements for each district is amongst the most important issues that this Commission is faced with in any rate case, under DSP.

Originally the City of Joplin filed a List of Disputed Issues consisting of three primary categories in which there was a dispute between Joplin and the parties supporting the Joint Recommendation. Those three disputed areas consisted of: 1) the proper normalized chemical expense for the City of Joplin; 2) the corporate allocation of expenses to the Joplin District; and 3) the proper calculation of payroll and payroll taxes in the course of annualizing expenses.

#### **CHEMICAL EXPENSE RESOLVED**

On August 14, 2007, a hearing was held before this Commission at which time a statement was made by the Company and the Company's witness, Mr. Ed Grubb, that a mistake had been made regarding the chemical adjustment for the Joplin District. (Tr., Vol. 14, 150:10-25.) The effect of the Company's correction is to reduce the revenue requirement to the Joplin District by \$236,416.00. (Tr., Vol. 14, 150:25.) The change to the chemical expense and the resulting revenue requirement is endorsed by the Company (Tr., Vol. 14, 151:10-13), the Office of Public Counsel (Tr., Vol. 14, 125:22-126:3), the Staff of the Public Service Commission (Tr., Vol. 15, 208:4-8) and by the City of Joplin.

No party has objected to the recalculation of the revenue requirement for the Joplin District of MAWC through the chemical expense adjustment proposed by the Company. In light of the unanimity with respect to the chemical adjustment for the Joplin District, and lack of any opposition thereto, this Commission should adopt the change and reduce the revenue requirement to the City of Joplin by \$236,416.00. Based upon the position of the parties with

respect to this matter, the City of Joplin no longer believes that chemical expense is a disputed issue in this case before this Commission. That leaves two disputed issues before this Commission which have not been resolved through the hearing or in any action subsequent thereto.<sup>1</sup>

This Commission should reject the Joint Recommendation<sup>2</sup> with respect to the remaining disputed issues (allocation of corporate expenses and payroll annualization) and enter its Report and Order in accordance with this Post-Hearing Brief and the Proposed Findings of Fact and Conclusions of Law submitted concurrent hereto.

## **II.**

### **ALLOCATION OF CORPORATE EXPENSES**

The revenue requirements for the Joplin District of MAWC include the direct costs incurred by the District and the corporate expenses allocated to the Joplin District. In the course of allocating such corporate expenses, the Joint Recommendation unjustly discriminates against the City of Joplin by using improper allocation factors effectively shifting revenue costs away from ratepayers in St. Louis County and St. Charles County, and shifting them to ratepayers in

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<sup>1</sup> All other issues addressed in the Non-Unanimous Stipulation and Agreement, except the two remaining issues, are unobjected to by Joplin and thus unopposed. Some issues have already been determined by this Commission and are not addressed in the Non-Unanimous Stipulation. For example, the remedy for the 2000 case for the Joplin District has been excluded from this case by Commission action. On March 29, 2007, Joplin filed a Motion to Consolidate the 2000 case into the current case. That motion was denied by the Commission on May 15, 2007. A Motion for Rehearing or Reconsideration was filed on May 16, 2007, and has never been ruled upon. As a result, the 2000 case and any remedy thereto is not before the Commission in this case. Joplin does NOT waive any rights or defenses regarding the 2000 MAWC case (No. WR-2000-0281) in the current case.

<sup>2</sup> This Commission must have competent and substantial evidence to support its Report and Order. See, *State ex rel. U.S. Water/Lexington v. Missouri Public Service Commission*, 795 S.W.2d 593, 595 (Mo. App. W.D. 1990). That the Stipulation came about as a “compromise” does NOT represent competent and substantial evidence. Any determination of any disputed issue must be based upon such competent and substantial evidence. The Western District ejected the concept of adopting a negotiated rate simply due to it being negotiated. “The Commission is not bound to accept whatever cost of debt is ‘negotiated’ and presented to it.” *Id.* at 597. The parties to the Joint Recommendation seem to believe that since the Joint Recommendation was negotiated and the parties to it compromised, that it should be adopted, regardless of any evidence to support it.

the Joplin District.<sup>3</sup> The use of the proper allocation factors to allocate corporate customer account expense, administrative and general expenses, depreciation expense, and other tax expenses results in a fair and appropriate revenue requirement for the various districts, including the Joplin District, unlike that in the Joint Recommendation.<sup>4</sup> It is the

province and duty of the Commission, in determining reasonable rates, to allocate and treat costs (including taxes) in the way in which, in the Commission's judgment, the most just and sound result is rendered.

*State ex rel. City of West Plains v. Public Service Commission*, 310 S.W.2d 925, 933 (Mo. banc 1958) (emphasis supplied).

For these reasons, the allocation factors proposed by the City of Joplin's witness, Leslie Jones, in her testimony should be adopted by this Commission as being the appropriate allocation factors for the various costs referenced herein.<sup>5</sup> Witness Jones is the only witness who testified to having experience in allocating costs in her normal course of work, outside of rate cases. (Tr., Vol. 15, 356:8-14.) The calculation of rates and revenue impacts in Exhibit JOP-2, Spreadsheet E, should therefore be adopted by this Commission.

#### A.

#### **Customer Account Corporate Expense**

The current Joint Recommendation allocates customer accounts expense, an expense generated by the corporate department of MAWC, based upon payroll expense of the company.

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<sup>3</sup> Witnessed by the fact that St. Louis and St. Charles ratepayers see only a fraction of the rate increase of Joplin ratepayers. Much, if not most, of that disparity is a result of such corporate allocations.

<sup>4</sup> The Staff witness who created the allocations in the Joint Recommendation, Steve Rackers, admitted that he had never taken any classes or continuing education on the proper method of allocating corporate expenses. Tr. Vol. 15, 317:12-19 and 318:8-12.

<sup>5</sup> Joplin is not challenging every corporate cost allocation, only those which do not rationally relate to their allocation basis. The allocations of MAWC and the PSC Staff, of corporate costs, as a sum are not relevant to the issues before the Commission. Instead, it is only those specific costs referenced herein.

There is no rational relationship between the customer account expense and payroll of any given district. Customer account expense is driven solely and entirely upon various customer accounts within MAWC. To be consistent, such customer account expense should be allocated from MAWC's corporate to the various districts based upon the number of customers in each district, vis-a-vis the total number of customers in MAWC across all its districts.

The use of payroll expense, a position advocated by the Staff, results in allocating **customer** expenses based upon **employees** of MAWC. That allocation method offers no consistency or any logical connection. Moreover, no factual support for that allocation was presented to the Commission. To allocate **customer** expenses based upon payroll, and not upon number of customers, is arbitrary and without any competent or substantial evidence in support. Where a corporate allocation is made based upon a factor that has no rational connection to the expense to be allocated, that allocation factor should be rejected by this Commission.

The payroll allocation factor should be rejected by this Commission, for the allocation of customer accounts, and the logically connected and supported allocation of customer account expense to the various districts based upon customer numbers should be adopted by this Commission. The cumulative effect of the corporate allocation based upon customer numbers to the customer account is documented in Exhibit JOP-2, Spreadsheet A, required by this Commission to be filed on August 22, 2007. These are the appropriate allocations and this Commission should adopt the same.

## **B.**

### **Administrative and General Corporate Expenses**

Administrative and general expenses of MAWC have been allocated to the various districts, primarily based upon the Staff's use of the payroll allocation factor.<sup>6</sup>

The other administrative and general expenses of MAWC corporate have been improperly allocated by the Staff in the Joint Recommendation and the proposed allocation methods of Leslie Jones should be adopted by this Commission as they are the rational and supported means of allocating such expenses.

## **i.**

### **Call Center Expenses**

One significant corporate expense which has been improperly allocated by the staff based upon payroll is the call center expense of MAWC. The position of MAWC in their initial filing is that the call center expense should be allocated based upon customer numbers. (Tr., Vol. 14, 156:11-19.) The testimony of Mr. Ed Grubb, from MAWC, referenced above, clearly delineates that customer number is the proper method of allocating the call center expense. Further, the call center expense is allocated from American Water's corporate headquarters to MAWC. The basis of that allocation from the national corporation to MAWC is based upon number of customers. (Tr., Vol. 14, 162:9-13.)

It is important that costs be consistently allocated based upon a rational basis. Clearly a call center is a completely customer-driven expense. Customers initiate calls to the call center and the call center assists customers in resolving their problems. *See* Tr., Vol. 15, 284:22-285:6.

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<sup>6</sup> The Belleville Lab's expense was not allocated based upon the payroll allocation factor and that particular allocation is not in dispute in this matter. Nor are the allocations of worker's compensation, OPEBs, pension, and injuries and damages expenses. These four categories of administrative and general expenses have been allocated based upon payroll and there is no dispute that that is the proper allocation method for those employee-related expenses of Missouri American Water corporate.

The Staff's position is to use payroll to allocate the call center cost. (Tr., Vol. 15, 283:19-21.) However, the Staff position is internally inconsistent in that the corporate allocation of the call center cost to MAWC is based upon customer numbers and the Staff allocation from MAWC to districts is not based upon customer numbers. *See* Tr., Vol. 15, 295:5-9.<sup>7</sup> Staff witness Rackers admitted he had never conducted any inquiry or study to determine a relationship between payroll and call center expenses. (Tr., Vol. 15, 287:1-8.) In fact, Rackers admitted that he has never looked to determine what generates expense at a call center. (Tr., Vol. 15, 289:22-25 – 290:1-2.)

The inconsistency of Staff's allocation method versus the rational consistency of using the customer allocation factor and the compelling fact that call center costs are generated to serve customers and to respond to customer complaints mandates that this Commission should allocate call center costs based upon the number of customers allocation factor.

## **ii.**

### **Shared Services**

Similarly, shared services are allocated from corporate headquarters to MAWC headquarters based upon the number of customers. The Company's rationale for that allocation of shared services is compelling as MAWC's witness, Grubb, noted:

“What generates, and what, you know, we're here to serve is the customers. The customers is the main allocator and that's the company's position. The customers are the main focus of providing service to them, you know, the cost to provide that service.”

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<sup>7</sup> Staff's only possible support for using payroll is that payroll follows customers. However, when the primary basis is available for allocation, there can be no good reason why a secondary basis would be used. The customer numbers are available and should be controlling.

Tr., Vol. 14, 166:6-11. The Staff never even attempted to reallocate the corporate allocations to Missouri. (Tr., Vol. 15, 293:18-23.) Yet the Staff used a totally different allocation factor inside Missouri. (Tr., Vol. 15, 294:5-9.) Facts that illuminate the inconsistency of their approach.

Those shared service costs, a component of administrative and general expenses, should be allocated based upon the number of customers just as the corporate allocations from the national corporation to MAWC were made. Again, consistency is important. By allocating national expenses to MAWC, then allocating from MAWC to the various districts, using the same method, consistency is maintained. Accordingly, the shared services should be allocated based upon customer numbers.

### **iii.**

#### **Remaining Administrative and General Expenses**

The remaining administrative and general expenses should be allocated based upon customer numbers, with the exception of those noted in Footnote 6 above. As MAWC's witness, Grubb, noted, the purpose of these administrative costs is to serve the customers. (Tr., Vol. 14, 166:6-11.) The number of customers is the most appropriate basis for allocating corporate administrative and general expenses to the districts. These expenses, with the exceptions noted previously, all relate to providing service to customers and not to benefits for the employees (as is the case with the exceptions in Footnote 6). The testimony of Leslie Jones clearly indicates that where expenses are related to employees, such as worker's compensation or pensions, they should be allocated based upon payroll. Conversely, where expenses are based upon customer service or response, such as call center or shared services, the corporate costs should be allocated based upon number of customers. This is the most rational method of allocation, a method supported by Company's expert, Grubb, and by Joplin's witness, Jones.



Staff's witness, Rackers, disagreed with that allocation factor; however, he offered no basis for his allocation. Consistently, witness Rackers only referred to payroll as the appropriate method, with no support for that position. In fact, he testified that of 30 administrative and general expense categories only one was not allocated by payroll. (Tr., Vol. 15, 311:19-25 and 312:1-2.) As witness Grubb noted, payroll actually follows customers. (Tr., Vol. 14, 166:14-16.) Customer number is the better method of allocating administrative and general costs, the only one which is supported by any facts or any logical basis, and should be so adopted by this Commission.

#### **iv.**

#### **Depreciation Expense**

Depreciation expense relates to the equipment owned by corporate headquarters and used by those corporate assets. This expense has been allocated to the districts based upon utility plant and service pursuant to MAWC's proposed allocation method. (Tr., Vol. 14, 166:22-23.) Staff, however, has chosen, explicably, to allocate depreciation expense based upon payroll expense. This indefensible position has been incorporated into the Joint Recommendation. Payroll expense has no rational relationship to depreciation expense. Depreciation expense is based upon assets and their age. (Tr., Vol. 14, 167:3-7.) Payroll expense has no connection to either assets or age of assets.

Joplin witness Jones proposed using length of mains as the appropriate allocation factor. This factor is rationally related to the depreciation expense.<sup>8</sup> Since assets produce the depreciation expense, it should be allocated by assets also. (Tr., Vol. 14, 167:14-17.) The proper method of allocation should always be the focus of the Commission and length of mains is the

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<sup>8</sup> In fact the allocation factor length of mains for depreciation actually results in a slightly larger amount of depreciation expense being allocated to Joplin.

appropriate method for depreciation. Undoubtedly, payroll expenses is not the best method of depreciation allocation and should not be adopted by this Commission.

**v.**

**Other Taxes**

“Other taxes” have also been inappropriately allocated by the Joint Recommendation based upon the Staff’s allocation methods. “Other taxes” should, in fact, be allocated based upon number of customers. (Tr., Vol. 15, 354:3-5.) The current allocation method is net plant, however, the “other taxes” relate more specifically to customers than to the plant values and should be allocated thereon. This is a more rational process since it is the method by which such taxes are allocated from the corporate to the MAWC accounts. To maintain consistency it should be allocated similarly to the various districts. For that reason, the other taxes should be allocated based upon number of customers.

**vi.**

**Summary of Allocations**

These allocation methods are most appropriate and result in consistency and reasonableness in direct correlation to the cost drivers generating the allocated expenses. The effect of such changes is contained in the spreadsheets attached to Joplin’s filing, pursuant to this Commission’s order, admitted as Exhibit JOP-2. These allocations should be adopted, the changes to the Joint Recommendation ordered by this Commission, and such other relief as this Commission deems appropriate should be granted.

### **III.**

#### **PAYROLL ANNUALIZATION**

The payroll annualization from corporate to the various districts is incorrectly done and should not be confirmed by this Commission. The creation of the massive annualization of payroll attributed to the Joplin District has no merit or substance. Accordingly, this Commission should not accept that annualization and should strip it in its entirety from Joplin's rate base in the Joint Recommendation.

### **IV**

#### **CONCLUSION**

The allocation methods used by the Staff, and incorporated in the Joint Recommendation, are unfair, unsupported by any rational basis, and are discriminatory against Joplin ratepayers. The net effect of those allocations is to take a \$4 million profit and erase it through corporate allocation. That a district, such as Joplin, has low operating costs and has good water should not be a reason for the Staff of the Public Service Commission to eliminate the profitability of the District via discriminatory corporate allocations.

Corporate allocations should have a rational basis to the costs that are being allocated. For example, call centers should be allocated based upon customers: the driver for the call center. The Staff has chosen to allocate based upon payroll, a basis that makes no rational sense and should not be entertained by this Commission.

Ultimately this Commission should adopt the allocations proposed by Joplin as the most rational and best methods to allocate corporate costs. See, *e.g. State ex rel City of West Plains v. Public Service Commission*, 310 S.W.2d 925, 933 (Mo. banc 1958). The effects of such allocations do not eliminate rate increases or, for that matter, significant rate increases for Joplin

ratepayers; however, they do establish a rational method by which corporate costs should be allocated.

Just as Joplin advocated district-specific pricing years ago, based upon the law and good sense of that policy, Joplin now advocates allocation of corporate costs upon sensible rational basis, looking at cost drivers, as good policy of this Commission. The alternative is blanket allocation with no support or analysis for such allocation. The effect of these issues in dispute is to place an additional revenue requirement on Joplin ratepayers of \$462,599.00 per year (after taking out the \$236,416.00 in chemical expense errantly included.) Exhibit JOP-2, Spreadsheet E and Non-Unanimous Stipulation, Appendix A-1-1.

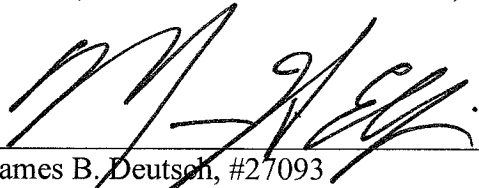
Accordingly, Joplin urges this Commission to accept its allocations, to implement the resulting rates, and modify the rates submitted in the Joint Recommendation as reflected in Joplin's Exhibit, JOP-2, Spreadsheet E. This will result in fair allocations, which should ultimately be the goal of this Commission.

**WHEREFORE**, Intervenor City of Joplin prays that this Commission enter its Report and Order in conformance with the positions of the City of Joplin, for the reasons stated in this Post-Hearing Brief, and for such other relief as this Commission deems appropriate.

Respectfully submitted,

BLITZ, BARDGETT & DEUTSCH, L.C.

By:

A handwritten signature in black ink, appearing to read 'J. B. Deutsch', is written over a horizontal line.

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### Certificate of Service

I hereby certify that a true and accurate copy of the foregoing Post-Hearing Brief was served by electronic transmission this 7<sup>th</sup> day of September, 2007, on:

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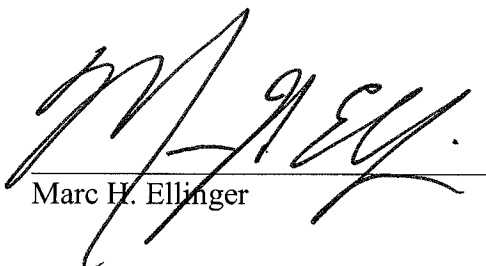
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