

STATE OF IOWA
DEPARTMENT OF COMMERCE
UTILITIES BOARD

IN RE: IOWA-AMERICAN WATER COMPANY	DOCKET NO. RPU-2009-0004
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ORDER APPROVING SETTLEMENT AND REQUIRING FILINGS

(Issued October 8, 2009)

I. INTRODUCTION

On April 30, 2009, Iowa-American Water Company (Iowa-American) filed with the Utilities Board (Board) a proposal for a general increase in temporary and final water rates. Iowa-American proposed a temporary increase that would produce additional annual revenue for Iowa-American of approximately \$7.9 million and a permanent increase that would produce additional annual revenue of approximately \$9.4 million, or 34.8 percent more than the existing rates. On May 18, 2009, the Board docketed the proposed increases for further investigation and set a procedural schedule. The proceeding was identified as Docket No. RPU-2009-0004.

Iowa-American serves customers in two districts, the Quad Cities district (50,600 customers) and the Clinton district (10,100 customers). The Board held consumer comment hearings in the Clinton district on June 4, 2009, and the Quad Cities district on June 11, 2009.

On July 27, 2009, the Board issued an order allowing Iowa-American to increase its total revenue on a temporary basis by \$6,817,952, or 25.2 percent.

Rather than applying temporary rates as proposed by Iowa-American, which would have resulted in a 20.1 percent increase for the Quad Cities district and a 50.3 percent increase for the Clinton district, the Board in its order applied previously-established regulatory principles first articulated in Docket No. RPU-95-8 and levelized the rate impact between the two districts. This resulted in an increase for the Clinton district of about 25 percent and an increase in Quad Cities rates of about 24 percent. In the temporary rate order, the Board also asked Iowa-American and the Consumer Advocate Division of the Department of Justice (Consumer Advocate) to submit comments on whether rate equalization should be required for Iowa-American's two districts, including the pros and cons for customers in each district, and how Iowa-American's separate Clinton and Quad Cities districts might be different from the separate distribution systems of a gas utility.

On August 21, 2009, Iowa-American and Consumer Advocate filed a unanimous proposed settlement agreement (Settlement Agreement) that would resolve all outstanding issues. The Settlement Agreement allows the Board to consider equalizing rates between Iowa-American's two districts and Iowa-American and Consumer Advocate each submitted comments on August 28, 2009, on rate equalization pursuant to the Board's July 27, 2009, order. Consumer Advocate filed reply comments on September 16, 2009. Iowa-American filed additional information concerning rate design on September 17, 2009.

II. SUMMARY OF SETTLEMENT AGREEMENT

The Board has the authority to resolve contested cases by settlement. In evaluating a proposed settlement, the Board examines whether the settlement is reasonable in light of the whole record, consistent with law, and in the public interest. Iowa Code § 17A.12(5) (2009); 199 IAC 7.18(6).

The Settlement Agreement provided that Iowa-American would increase its total annual revenue by \$6,060,000, which is \$757,952 less than is being collected in temporary rates. While the Settlement Agreement assumes that Iowa-American's current rate design is based on separate revenue requirements and rate structures for its two districts, the Settlement Agreement allows for redesign of the rates included in the Settlement Agreement if the Board orders rate equalization between the two districts and states that final rates shall be designed in accordance with any such Board order.

While the Settlement Agreement does not provide sufficient detail to determine a specific return on equity, because the Settlement Agreement is for less than is included in temporary rates, it is reasonable to assume that the parties used a figure that approximates the 10.5 percent return on equity allowed in temporary rates. The Settlement Agreement authorizes some specific rate design revisions, including increasing the returned check charge, increasing the service charge, and increasing the turn-on charge. The Settlement Agreement stipulates that existing depreciation rates shall remain in effect.

The Settlement Agreement also addresses the method Iowa-American uses to account for costs related to a Mississippi River floodwall project being built to protect its Davenport water plant. Under the agreement with the U.S. Army Corps of Engineers (USACE), USACE pays for 75 percent of the project's costs and the city of Davenport pays 25 percent. Iowa-American reimburses the city's contribution. However, due to federal regulations, Iowa-American cannot take title to the floodwall; the city must hold the title. The Settlement Agreement allows Iowa-American to book floodwall-related costs as construction work in progress, so that Iowa-American does not have to write-off floodwall costs as an expense. This continues the practice authorized by the Board in an order issued January 15, 2009, approving an amendment to the previous rate case settlement between Iowa-American and Consumer Advocate in Docket No. RPU-07-3. The Settlement Agreement specifically provides that the previous rate case settlement amendment remains in effect.

Finally, the Settlement Agreement provides that Consumer Advocate and Iowa-American agree, for purposes of this proceeding, that the Settlement Agreement specifically reflects an annual \$200,000 amortization of the pension regulatory asset "associated with and attributable to the transition from Employee Retirement Income Security Act to Federal Accounting Standard 87 for rate recovery purposes" and that the balance of the pension regulatory asset as of December 20, 2007, is \$1,673,698.

The Board, after examining the complete record of this proceeding, finds the proposed unanimous settlement is reasonable, consistent with law, and in the public interest. The settlement will be approved and rate equalization will be addressed separately in Section III. Iowa-American will be required to file compliance tariffs consistent with the settlement within 20 days of the date of this order. Because final rates are less than temporary rates, Iowa-American will also be required to file a refund plan, which will be discussed in greater detail in the Board's discussion of rate design.

III. RATE DESIGN

The Settlement Agreement assumes Iowa-American's current rate design is based on separate revenue requirements and rate structures for the Clinton and Quad Cities districts. However, the Settlement Agreement allows for re-design of the settlement rates if the Board orders Iowa-American to equalize its Clinton and Quad Cities rates. The Settlement Agreement provides that the final rates shall be designed in accordance with any such Board order. Iowa-American and Consumer Advocate each filed comments on rate equalization on August 28, 2009. Consumer Advocate filed reply comments on September 16, 2009. Iowa-American filed additional information on rate design on September 17, 2009.

Iowa-American Position

Iowa-American argues that rate equalization is in the best interests of its customers. Iowa-American explains that the main reason separate rate structures

have been maintained is that the water supply sources for each district are different. Iowa-American states that the Clinton district is supplied by aquifers and wells, whereas the Quad Cities district is supplied by the Mississippi River. Iowa-American notes that this difference results in different costs for serving each district and separate rates ensure that the customers in each district pay only for the costs of serving their district. For example, in the current proceeding, Clinton rates include the cost of the Clinton radium treatment facility, which is used only to treat well water in the Clinton district. However, Iowa-American points out that rates are never precisely cost-based for each individual customer; instead, they are aggregated by larger customer groups such as districts and customer classes.

Iowa-American maintains that the boundary lines that separate the different customer groups should be based on whether the cost of serving each group is sufficiently different to justify the additional effort and administrative expense necessary to maintain them as separate groups. Iowa-American believes the long-term costs of serving the Clinton and Quad Cities districts are not sufficiently different to justify their continuation as separately-priced districts. Iowa-American notes the additional expense of administering separate cost and rate structures for each district and the additional rate case expense of preparing and presenting two separate class cost-of-service studies.

Iowa-American believes that a single rate structure would be more understandable and viewed as more fair by customers, who frequently question why

rates are so different between the two districts. Iowa-American also believes that reducing the rate impact of new plant additions by spreading the costs over a broader customer base would be more acceptable to customers.

Regarding questions about how rate equalization should proceed, Iowa-American believes it can be completed in the current proceeding with minimal adverse rate impacts. Iowa-American calculates the percentage increases under the Settlement Agreement and its rate equalization proposal as follows:

	<u>Clinton</u>	<u>Quad Cities</u>
Residential	21.5%	26.1%
Commercial	21.7%	18.7%
Industrial	21.8%	8.8%
Other Public Authorities	21.8%	20.3%
Private Fire	0.0%	36.1%

Alternatively, if general metered service rates were equalized in this proceeding and private fire rates were set at levels originally proposed for final rates, increases under the Settlement Agreement would be as follows:

	<u>Clinton</u>	<u>Quad Cities</u>
Residential	21.9%	26.5%
Commercial	22.1%	19.1%
Industrial	22.2%	9.1%
Other Public Authorities	22.2%	20.7%
Private Fire	7.5%	20.0%

Iowa-American asks that the Board determine its refund liability based on the company as a whole rather than by district. Iowa-American argues that if the refund liability were determined by district and the final Settlement rates were higher than temporary rates in one district, but lower than temporary rates in the second district,

the refund obligation in the first district could not be offset by the under-collections in the second (and the under-collections could not be recouped from second district customers retroactively), which would unfairly make the total refund liability greater than it would have been if determined for the company as a whole.

Regarding the Board's question about how Iowa-American's separate water distribution systems might be different from the separate distribution systems of a gas utility, Iowa-American responds that it largely depends on the characteristics of the gas utility being compared with Iowa-American. Iowa-American's water supply sources can be broadly analogous to a gas utility's gas supply sources and Iowa-American's water main distribution systems can be broadly analogous to a gas utility's pipeline distribution systems. Beyond this, however, Iowa-American points out that a number of factors might be different. For example, one set of factors might be whether the distribution systems are served by a single source or multiple sources of supply, and, if there are multiple sources, whether they can be intermixed or moved interchangeably. Another set of factors might be whether the distribution systems serve different customer densities (e.g., urban versus rural) or traverse different geographical terrains.

Consumer Advocate Position

Consumer Advocate does not make a specific recommendation on whether to equalize Iowa-American's rates, but recommends caution. Consumer Advocate notes that in the gas rate case cited by the Board as precedent for its temporary rate

design decision (Docket No. RPU-95-8), the Board later postponed the decision of whether to equalize rates in its final decision, citing cost differences between the two gas districts. Consumer Advocate notes that the Clinton and Quad Cities distribution systems are not interconnected and are 18 miles apart at their closest point.

Consumer Advocate acknowledges that gas utilities also have separate distribution systems, but notes that the largest part of a gas customer's bill is the cost of natural gas. Consumer Advocate points out that natural gas is supplied to local gas utilities by one or more interstate pipelines, which obtain all or part of their supply from the same natural gas fields. Consumer Advocate states that Iowa gas utilities have consolidated their purchased gas adjustment (PGA) clauses for recovering natural gas costs.

Consumer Advocate notes that the Board, in its July 27, 2009, order, stated its long-standing policy had been to eliminate geographic rate differences within a utility's service territory, so that similarly-situated customers would pay the same rates for the same service regardless of their location in the utility's service territory. Consumer Advocate states the essential question is whether customers in the Clinton and Quad Cities districts are similarly situated. Consumer Advocate points out that they are not similarly situated in terms of their sources of water supply because Clinton's water comes from wells and the Quad Cities' water comes from the Mississippi River. However, Consumer Advocate states that they are similarly situated in their allocation of common overhead costs.

As the Board has recognized, Consumer Advocate agrees that equalization would eliminate situations where the Clinton district receives significantly higher increases than the Quad Cities district; but later, if Quad Cities costs are the source of a large increase, Clinton customers would share in it. Consumer Advocate notes that this would have happened in 1990, when Quad Cities' costs indicated a 65 percent increase, but Clinton's stand-alone costs indicated a much smaller increase. Consumer Advocate points out that the Board, in its July 27, 2009, order, indicated that Iowa-American's future construction plans might be relevant in determining whether to equalize rates. Consumer Advocate notes that substantial construction is scheduled for both districts in the next five years and that the Quad Cities district has 83 percent of Iowa American's customers and the Clinton district has 17 percent.

Consumer Advocate recommends the Board carefully consider the applicability of its cost-based rate rule (199 IAC 20.10) in deciding whether to equalize Iowa-American's rates. Consumer Advocate states that the rule clearly requires recognition of material differences in costs when setting rates for different customer groups and customers served from wells in Clinton have cost characteristics very different from customers in the Quad Cities served from the Mississippi River.

In its reply comments, Consumer Advocate addressed Iowa-American's refund liability. Consumer Advocate notes that generally it advocates that refunds be

determined by district and by rate schedule. However, given the difference between rate changes proposed in this case, which were separate and by district, and the Board's decision in temporary rates to levelize the separate district increases in temporary rates, Consumer Advocate believes a levelized refund for both districts might be appropriate, especially if the Board decides to equalize and levelize rates in the two districts for final rate purposes.

Board Discussion

The Board has a long-standing policy of eliminating geographic rate differences within the service territories of Iowa gas and electric utilities, so that similarly-situated customers pay the same rates for the same service, regardless of their location within the utility's Iowa service territory. Application of this policy has included gas utilities with separate distribution systems and separate class cost-of-service studies. Examples of the Board's implementation of this policy on the electric side include the former Interstate Power Company (Docket No. RPU-92-10) and its successor, Interstate Power and Light Company (Docket Nos. RPU-02-3, RPU-02-8, RPU-04-1, RPU-05-3, RPU-06-1, RPU-07-4, and RPU-08-5). Examples on the gas side include Interstate Power and Light Company (Docket No. RPU-02-7) and MidAmerican Energy Company (Docket Nos. RPU-98-5, RPU-02-2).

Consumer Advocate points out differences between the separate water districts of Iowa-American and the separate districts of a gas utility. However, Iowa-American suggests that in terms of costs, the Clinton and Quad Cities districts are

not sufficiently different over the long term to justify the continuation of separate rate structures. Iowa-American adds that a single equalized rate structure would be easier to administer and more understandable and acceptable to customers.

For Iowa-American, rate equalization would eliminate situations where the Clinton district receives significantly higher rate increases than the Quad Cities district. Because of their disproportionate sizes, large cost increases in the smaller Clinton district can be spread to the much larger Quad Cities district, with significant mitigating effects for Clinton rates and relatively moderate increases for Quad Cities rates. However, if the situation is reversed and the large cost increases are in the Quad Cities district, much of the rate impact will also be experienced in the Clinton district with little mitigation. Over the last five Iowa-American rate cases (Docket Nos. RPU-93-5, RPU-95-2, RPU-98-3, RPU-04-1, and RPU-07-3), the Clinton and Quad Cities increases have been roughly similar, averaging 12.5 percent per case for the Clinton district and 11.3 percent for the Quad Cities district.

However, there has been an Iowa-American rate proceeding that demonstrates what could happen if there are large cost increases associated with the Quad Cities district and rates are equalized. In Docket No. RPU-90-10, the Quad Cities district received an increase of more than 50 percent, while the Clinton district received an increase of 11.5 percent. That would have been 41.5 percent for both districts if rates had been equalized.

The Board believes now is the time to equalize most of Iowa-American's rates; the different costs of serving each district do not appear to be significant enough in the long term to justify the additional effort and administrative expense necessary to maintain them as separate groups. Because of Iowa-American's relatively small size, as rate-regulated utilities go, the additional expense of administering separate cost and rate structures for each district and the additional rate case expense of preparing and presenting two separate class cost-of-service studies are not justified by the identified cost differences and the rate impact of future plant additions can be spread over a broader customer base. For example, Iowa-American in Docket No. RPU-07-3 indicated that class cost-of-service studies for its two districts would increase rate case expense by about \$50,000. Allowing Iowa-American to file a single class-cost-of-service study in future cases, where warranted, will result in rate case expense being less than it would have been if two studies were required.

It is important to spread the impact of future plant additions over a broader customer base in order to provide customers with greater rate stability and lessen the impact of major construction projects on customers in a particular district. The most current information provided to the Board by Iowa-American indicates that capital projects projected for the Quad Cities district are not proportionately greater than those projected for the Clinton district over the next 3-5 years, meaning that rate equalization will provide greater rate stability for customers than if the districts remained separate. Also, a single rate structure would be more understandable to

customers. Iowa-American reports that its customers frequently question why rates are different between the two districts.

The Clinton and Quad Cities rates could be fully equalized in this proceeding, with the resulting Clinton and Quad Cities Settlement Agreement rates generally being less than the final rates originally proposed by Iowa-American. However, this would result in one group of customers, Quad Cities private fire service, receiving a larger increase than originally proposed for final rates. The Board will proceed cautiously to minimize the impact on any customer group and implement equalization for general metered service and require Iowa-American to file a proposal for completing the equalization of private fire service rates in its next rate case. It is reasonable to postpone final equalization for private fire service because in its current and previous rate cases, Iowa-American has been reducing private fire rate differentials between the two districts. In the current case, private fire rates would be increased by a uniform 7.5 percent in the Clinton district and by a uniform 20 percent in the Quad Cities district (that is, the increases implemented in temporary rates).

The Board will adopt Iowa-American's approach to equalization of general metered service rates, which applies the Clinton district Settlement Agreement rates to the Quad Cities district and then reduces both sets of rates by a uniform percentage until they produce the combined final Settlement Agreement increase for general metered service. This approach ensures that no customer class in either district will receive an increase greater than 26.6 percent:

	<u>Clinton</u>	<u>Quad Cities</u>
Residential	21.9%	26.6%
Commercial	21.9%	19.0%
Industrial	21.9%	8.9%
Other Public Authorities	21.9%	20.5%

Under this approach, all customer classes except Quad Cities residential would receive final increases lower than their 26 percent temporary increase. The Quad Cities residential increase would be only slightly higher, 26.6 percent, and is less than what was originally proposed by Iowa-American. The percentage increase may vary for individual residential customers in the Quad Cities district because customer charges are being increased by a greater percentage than volumetric charges. This means that low-usage customers with relatively small total monthly bills will experience larger percentage increases. Iowa-American's Exhibit B to its September 17, 2009, additional rate design information filing uses this approach, such that total company revenue is no greater than the amount agreed to in the settlement. All other rates, including the private fire service increases of 7.5 percent in the Clinton district and 20 percent in the Quad Cities district (as well as the increases for the Service Activation Charge, NSF Check Charge, and Reconnection Charge) will remain at the levels set in temporary rates.

Iowa-American and Consumer Advocate both commented on the appropriate refund methodology. Previous Board policy has been to determine the utility's refund liability for the utility as a whole, rather than determining separate refund liabilities for each district or customer group. While Consumer Advocate generally does not

support this approach, it believes an exception is warranted for this proceeding. Iowa-American will be required to submit a refund plan with its total refund liability based on the company as a whole, rather than by district or customer class.

IV. FINDINGS OF FACT

Based on a thorough review of the entire record in these proceedings, the Board makes the following findings of fact:

1. The Settlement Agreement entered into between Iowa-American and Consumer Advocate is reasonable, consistent with law, and in the public interest.
2. It is reasonable for purposes of this proceeding that the Settlement Agreement specifically reflects an annual \$200,000 amortization of the pension regulatory asset "associated with and attributable to the transition from Employee Retirement Income Security Act to Federal Accounting Standard 87 for rate recovery purposes" and that the balance of the pension regulatory asset as of December 20, 2007, is \$1,673,698.
3. It is reasonable to equalize general metered service rates between the Clinton and Quad Cities districts in this proceeding, as shown in Iowa-American's Exhibit B attached to its additional rate design information filed on September 17, 2009.
4. It is not reasonable to equalize private service fire rates in this proceeding.

V. CONCLUSIONS OF LAW

The Board has jurisdiction of the parties and the subject matter in this proceeding, pursuant to Iowa Code chapter 476 (2007).

VI. ORDERING CLAUSES

IT IS THEREFORE ORDERED:

1. The proposed tariffs filed by Iowa-American Water Company on April 30, 2009, identified as TF-2009-0082 and TF-2009-0083, and made subject to investigation as part of this proceeding, are declared to be unjust, unreasonable, and unlawful.
2. The unanimous settlement agreement filed by Iowa-American Water Company and the Consumer Advocate Division of the Department of Justice on August 21, 2009, is approved.
3. General metered service rates shall be equalized, with all other rates remaining at temporary rate levels, as shown in Exhibit B attached to Iowa-American Water Company's additional rate design information filed on September 17, 2009.
4. Iowa-American Water Company shall file tariffs in compliance with the settlement and this order within 20 days from the date of this order, reflecting rates that produce additional revenues of no more than \$6,060,000.
5. Iowa-American Water Company shall file a refund plan consistent with the settlement and this order within 30 days from the date of this order.

6. Iowa-American Water Company shall include in its next rate case filing a proposal to equalize private fire service rates between the Clinton and Quad Cities districts.

7. This order constitutes the final decision of the Utilities Board in Docket No. RPU-2009-0004.

UTILITIES BOARD

/s/ Robert B. Berntsen

/s/ Krista K. Tanner

ATTEST:

/s/ Judi K. Cooper
Executive Secretary

/s/ Darrell Hanson

Dated at Des Moines, Iowa, this 8th day of October, 2009.