

STATE OF IOWA  
DEPARTMENT OF COMMERCE  
BEFORE THE IOWA UTILITIES BOARD

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IN RE: :  
 : DOCKET NO. RPU-2009-0004  
IOWA-AMERICAN WATER COMPANY :  
APPLICATION FOR REVISION OF RATES :  
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**IOWA-AMERICAN WATER COMPANY COMMENTS  
CONCERNING RATE EQUALIZATION**

COMES NOW Iowa-American Water Company (“Iowa-American” or the “Company”), pursuant to the Board’s “Order Setting Temporary Rates, Approving Corporate Undertaking, and Requiring Additional Information” (“Interim Rate Order”), issued July 27, 2009, and files these comments regarding rate equalization.

1. The Board’s Interim Rate Order raises the question whether Iowa-American’s rates should be equalized between the Clinton District and the Quad Cities Districts. Currently, separate rates are set for each district based on the results of class cost-of-service studies for each district.

2. The Board’s Interim Rate Order asks the Company and the Office of Consumer Advocate (“OCA”) to submit comments addressing the following issues:

- a) whether or not rate equalization should be required;
- b) the pros and cons of rate equalization for Iowa-American's customers in each district;
- c) might Iowa-American's separate systems be significantly different from the separate distribution systems of a gas utility and if so , in what way;
- d) how might rate equalization best proceed, such as immediately in the current rate proceeding or phased-in over time;
- e) what methods might be used to equalize Iowa-American's rates, including the method described in the Interim Order or other alternative methods.

Iowa-American's comments on each identified issue follow.

Should Rate Equalization be Required?

3. Iowa-American believes that rate equalization can be of benefit to its customers. Single district pricing would be more comprehensible to customers, would present a consistent message to customers, would be easier for the Company to apply, would eliminate the need for separate cost of service studies for each of the districts and would therefore be less costly. The primary reason that the Company has separate rates for each district is that the sources of supply for the two districts are different; Clinton's water comes from aquifers and Quad Cities' water comes from the Mississippi River. The difference in source of supply leads to differences in, for example:

- a) The facilities required to pump and treat the water;
- b) The chemicals required to treat the water;
- c) The cost of power to pump and treat water.

These differences are reflected in the different costs to serve each district. Separate rates insure that the customers in Quad Cities District pay only for the actual costs incurred by Iowa-American to provide water service to them, including capital improvements, operating expenses and a return on the actual assets used to provide service to Quad Cities customers. Similarly, separate rates insure that the customers in Clinton District pay only for the actual costs incurred by the Company in providing water service to them, including capital improvements, operating expenses and a return on the actual assets dedicated to providing service to Clinton customers. So, for example, Quad Cities water treatment plant was constructed in 1873 and has had numerous additions and improvements over the years through 2007. It is used only to provide service to Quad Cities customers. Under the Company's separate rate structure, only Quad Cities customer rates included costs associated with the water treatment facility. In the current case, the Clinton radium treatment facility is used only to treat water from certain wells in Clinton used solely to provide water service

to Clinton customers. Thus, cost of service principles would provide that only the rates of Clinton customers should include costs associated with the radium removal facility. Such might seem to be the only fair result.

However, a single rate structure, which spreads all costs over the entirety of the two districts might be judged to be more equitable in that it would spread the cost of large projects over more customers, thereby eliminating very large rate increases. Exhibit 1 attached to these comments shows how the rate increase that is the subject of the proposed settlement in this case would be spread to the districts under an across-the-board basis, on a single district pricing basis and on the separate tariff basis as proposed in the Iowa-American's original filing in this case. The exhibit shows that the differences in the rate increase to the two districts lessens the impact of the large capital addition in Clinton on Clinton customers, while at the same time not significantly increasing the rates of the Quad Cities Customers, even under single district pricing. For this reason, Iowa-American believes that rate equalization is in the best interests of the customers.

#### The Pros and Cons of Rate Equalization

4. The positives associated with rate equalization are several. A single set of tariffs would lessen confusion on the part of consumers, who continually question why the rates for the two districts are so different. Single district pricing would be perceived by the customers as more fair because rate changes would be applied on a consistent basis. As discussed above, single district pricing is easier to administer than is multiple district pricing and it could be expected that there would be a reduction in administrative and rate case costs, due to the elimination of the necessity for two cost of service studies.

On the downside, customers might perceive that rates are not cost-based. However, rates are never exactly cost-based for each individual customer; rather, they are cost-based only on a district and class basis. It is a matter of where the line is drawn in the attempt to bill according to the specific

costs incurred. In determining whether rates should be equalized, the ultimate question to be answered is whether the underlying costs (among districts, or classes or individual users) are significantly different to justify the additional effort and cost necessary to create a separate and distinct tariff?

Iowa-American believes that in its case, the overall, long-term costs of providing service to the two districts are not sufficiently disparate to justify continuation of multiple district pricing.

Iowa-American's distribution system(s) versus gas utility distribution system(s)

5. The question whether and to what extent Iowa-American's water distribution system is different from a natural gas utility distribution utility, such that it would be inappropriate to require single district pricing for Iowa-American, is largely dependent upon the individual characteristics of Iowa-American and the particular natural gas utility being compared. In general, the gas supply source can be loosely equated to the production facilities of a water company, and gas transmission facilities (i.e., pipelines) used to get gas from the source of supply to the city gate or the gas utility's storage facilities can be generally equated to the transmission facilities (i.e., water mains) used by a water utility to get water from the source of supply to the water utility's storage facilities or distribution lines. Distribution facilities of both gas and water utilities are utilized to transfer the commodity (gas or water) to the end user. Beyond these generalities, however, a realistic comparison of Iowa-American's system to that of a gas utility requires consideration of a number of other factors. For example, are the utilities supplied from a single source or multiple sources? If there are multiple sources of supply, can they be moved interchangeably within the system to supply customers? To what extent can the supply from multiple sources be intermixed within the system? Are the transmission and distribution systems of the respective utilities urban or rural (that is, how many customers are there per mile of pipe)? Do

any special conditions exist that distinguish distribution systems one from another, such as terrain, geology, local regulations, etc.)?)

#### The Appropriate Rate Equalization Process

6. If the Board adopts single district pricing, as recommended by the Company in paragraph 7 below, the Company recommends that the conversion should be undertaken and completed in the current proceeding, subject to paragraph 8 below. As shown by Exhibit 1, an across-the-board rate increase, as was utilized to develop interim rates, will not result in significantly different rates than would application of single district pricing. Thus, there is no reason to convert to the new pricing regime over a period of years.

#### The Appropriate Rate Equalization Methodology

7. Iowa-American's current rates in the Clinton District are not substantially different than those in the Quad Cities District, and for that reason, Iowa-American believes that single district pricing by customer class, with no differences between districts, is the appropriate rate equalization methodology to use.

#### **Caveat: Rate Refund Issues**

8. Because the Board ordered an across-the-board interim rate increase, approval of the settlement proposed in this case will result in lower final rates for Quad Cities District customers and higher final rates for Clinton District customers. The Board's precedent is to look to total revenues to determine refund liability, i.e., so long as the finally-approved revenues across both districts are not less than the approved interim revenues, no refunds are ordered. Such should be the result here. However, if the Board were to look at interim versus final revenues on a district-by-district basis to determine refund liability, the result here would be that Quad Cities customers would receive refunds and the Company would not be able to collect the difference in interim revenues allowed from Clinton District customers. Such a result would not only be unfair, but

unlawful as a taking of Iowa-American's property. This was clearly not the intent of the Board in ordering an across-the-board interim rate increase. The Board specifically stated in its interim rate discussions and order that the methodology chosen for interim rates would and should have no effect on Iowa-American's overall allowed interim revenues. If the Board adopts single district pricing, but does not intend to abide by its intention that rate equalization not have an effect on the overall interim rates allowed by the Company, then rate equalization should await the Company's next rate case.

Respectfully submitted,

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