BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of a Working Case to Consider	**)**	
Proposals to Create a Revenue Decoupling	**)**	**Case No. AW-2015-0282**
Mechanism for Utilities	**)**	

Initial Comments of the Missouri Energy Development Association

I. Introduction

At the request of its Staff, the Missouri Public Service Commission ("Commission") on July 22, 2015, issued an order[1] in the captioned case. The Order was in response to a petition for rulemaking filed by Missouri-American Water Company ("MAWC") in February requesting that the Commission authorize the use of a revenue decoupling mechanism ("RDM") to set rates for service. The Commission invited interested stakeholders to submit comments by September 1, 2015. The Missouri Energy Development Association ("MEDA")[2] appreciates the opportunity to make its preliminary views concerning this important topic known to the Commission and it looks forward to continued involvement in the workshop dialogue. MEDA's comments will provide some preliminary information concerning the use of RDMs in the regulation of the natural gas, electric, water and wastewater utility industries nationwide and the legal basis for utilizing an RDM as proposed by MAWC in Missouri.

II. The Current Use of RDMs to Regulate Utility Rates

The Commission's Order notes that MAWC's proposed rate decoupling mechanism "would allow utilities to seek a Commission order that would allow them to track actual revenues between rate cases and to true-up actual revenues against the authorized revenue requirement in a future rate case." This approach is referred to as "decoupling" in the sense that

[1] Order Opening A Working Case To Consider Proposals To Implement A Revenue Decoupling Mechanism For Missouri's Utilities (hereinafter, the "Order").

[2] MEDA is a trade association comprised of the largest investor-owned public utilities doing business in the State of Missouri. MEDA's members serve a combined total of over 3.8 million customers in Missouri. MEDA's member companies all are regulated by the Commission as to rates and terms and conditions of service.

it breaks the link between dollars collected and unit sales of water. Instead, it looks to the objective of collecting the revenue requirement as determined by the Commission to be fair and reasonable.

As will be discussed below, RDMs have been employed by regulators in many states as an alternative to traditional rate base, rate of return regulation which uses an historical test year as a starting point. There are a number of reasons for employing a new regulatory model, but the principal drivers have been (1) the modernization and replacement of aging utility plant that is not revenue-producing, (2) declining usage, or minimal growth in usage, driven by conservation efforts, higher-efficiency customer appliances/fixtures/equipment and better construction techniques, (3) slower population and economic growth, (4) the use of volumetric rate designs to recover fixed costs and (5) an inability to predict the weather and its effect on customer usage, particularly when volumetric rate design is employed. In some cases, these trends have broken the historical link between investment in utility plant and continuous revenue growth, but all of them have the effect of misaligning the interests of shareholders and consumers. RDMs are being used to address the difficulty that utilities have experienced under the traditional regulatory model of collecting their revenue requirement needed to ensure that they can meet their public obligations and, in doing so, to have the opportunity to earn a reasonable return on private capital deployed in service to the public.

The use of RDMs has been most widely used in the regulation of natural gas utilities. This has been in recognition of the fact that many such utilities have actually been experiencing *declining* use of energy. RDMs have been employed to break, or lessen the link between, volumes of gas sold and the recovery of fixed delivery costs.[3] According to study undertaken by

[3] *See*, **New Regulatory Frameworks for Electric Infrastructure Investment** published by the Edison Electric Institute ("EEI") attached hereto as **Appendix A**.

Graceful Systems LLC published in 2013, as many as twenty-one (21) states have adopted some form of gas decoupling.[4] In Missouri, the Commission has approved the use of a straight fixed variable (SFV) rate design for several of its natural gas utilities which often is referred to as a "revenue decoupling" rate design.[5] This approach to designing rates is distinguishable from the revenue tracking proposal submitted by MAWC in File No. WX-2015-0209, but the principle behind SFV rate design (i.e., separating a utility's revenues from its unit sales volumes) is fully in accord with the objective of a revenue tracking mechanism.

RDMs also have been employed in the case of electric utilities. According to a 2013 EEI survey,[6] approximately ten (10) states have employed "decoupling true-up plans" generally along the lines of what MAWC has proposed. The Graceful Systems Survey puts the number of states that have adopted electric decoupling at fifteen (15). The impetus for this according to the EEI Survey is slower growth in energy use per customer failing to adequately fund needed new investment. Citing information from Standard & Poors rating agency, the EEI Survey observes that bond ratings for investor-owned electric utilities ("IOUs") have dropped significantly since 1970.[7] While RDMs are increasingly being authorized by utility regulatory commissions to address this fundamental deficiency in the traditional regulatory model for electric utilities, Missouri has not done so.

RDMs also have been employed in connection with the regulation of water and wastewater utility rates. A report of the National Association of Water Companies ("NAWC") observes the similarities of water utilities to that of natural gas utilities, that is, declining *per*

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[4] **A Decade of Decoupling for US Energy Utilities: Rate Impacts, Designs and Observations** (the "Graceful Systems Survey") attached hereto as **Appendix B**.
[5] This innovation has been found to be a lawful exercise of the Commission's regulatory authority. *State ex rel. Office of the Public Counsel v. Public Service Commission*, 367 S.W. 3d 91 (Mo. App. S.D. 2012); *State ex rel. Office of the Public Counsel, et al. v. Public Service Commission*, 293 S.W.3d 63 (Mo. App. S.D. 2009).
[6] **Alternative Regulation for Evolving Utility Challenges** (the "EEI Survey") attached hereto as **Appendix C**.
[7] While over 50% of electric IOUs were AA rated in 1970, only about 1% currently have that rating.

capita water consumption.[8] The NAWC Report identifies five (5) states, not including Missouri, which have employed general decoupling with periodic true-up for water utilities.

Unlike several of Missouri's gas utilities, electric, water and wastewater utilities in this state are still heavily reliant on collecting their revenue through volumetric-based rates in which recovery of fixed costs are tied to sales. Consequently, the declining usage trend results in the collection of less revenue at a time when those industries are increasing their investment in non-revenue producing items like replacement of aging infrastructure and environmental compliance.

To summarize, RDMs are increasingly being used by regulators nationwide to address current trends and challenges that make it unlikely that utilities will achieve their revenue requirements using the traditional, outdated ratemaking model. RDMs are increasingly being used by regulators to address successfully the problems inherent in traditional ratemaking, including declining *per capita* use of energy and water by customers and increasing utility investment in non-revenue producing infrastructure replacements or additions. It is time that the Commission took a careful, considered look at setting rates based by adjusting them to ensure that a utility's actual revenue matches up with the levels determined by it to be just and reasonable.

III. Question Concerning Legal Authority

One of the items Staff requested that the Commission direct workshop participants to address is the "legality of decoupling in Missouri."[9] A clear understanding of the legal framework within which a RDM would take place is essential and, consequently, Staff's

[8] **Alternative Regulation and Ratemaking Approaches for Water Companies**, September 2013 (the "NAWC Report") attached hereto as **Appendix D**.

[9] Motion to Direct Interested Stakeholders to Respond to Question Presented by Commission Staff and Notice of Workshop, July 30, 2015.

question is directly pertinent to the topic of this workshop. As it turns out, the legal basis for the revenue decoupling mechanism proposed by MAWC is apparent.

An RDM that has as its principal operating feature a tracker to account for revenues is lawful under §393.140.4 RSMo., 2000. A similar mechanism, an expense tracker, that was put in place in the wake of the Commission's new vegetation management and infrastructure inspection rules was determined to be a lawful exercise of the Commission's authority to direct how utilities may keep their accounts. *State ex rel. Noranda Aluminum, Inc., v. Public Service Commission*, 356 S.W.3d 293, 320 (Mo. App. S.D. 2011). MAWC has proposed a mechanism to track revenues that operates in the same manner as an expense tracker. There is no principled reason to believe that a revenue tracker would be viewed in a different light. In either case, it is merely an accounting convention authorized by the Commission. Consequently, MEDA believes the tracker proposed by MAWC in Case No. WX-2015-0209 if approved by the Commission would be a lawful exercise of its power to regulate utility rates in this state.[10]

IV. Conclusion

The current Missouri ratemaking model has been in use continuously since the Public Service Commission law was enacted in 1913, over one hundred years ago. President William Howard Taft was replaced by Woodrow Wilson that year. The 16th Amendment to the Constitution (authorizing the income tax) was ratified and the 17th Amendment (requiring direct election of Senators) was passed. Ford Motor Company introduced the first moving assembly line for the production of automobiles and R.J. Reynolds introduced Camels, the first packaged cigarettes. That the nation has changed fundamentally since that time cannot be seriously doubted. Familiarity with ways of doing things can cause complacency. It is time to look with

[10] This is so even in the case of electric utilities because the anti-CWIP law prohibits the setting of rates on plant not yet in service whereas the revenue decoupling mechanism under discussion would provide for adjustments to match actual to authorized revenues without regard to costs accruing in specific plant accounts.

fresh eyes and open minds at utility ratemaking in light of current economic and regulatory circumstances.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the above and foregoing document was delivered by first class mail, electronic mail or hand delivery, on the 1st day of September, 2015, to the following:

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