

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) File No. AW-2015-0282
Mechanism for Utilities)

Comments of United for Missouri, Inc.

United for Missouri, Inc. (“UFM”) appreciates the opportunity to comment on revenue decoupling mechanisms for utilities. As many commenters have already observed, the regulatory construct for utility companies has been in place in Missouri for 100+ years with very little change. And yet the governmental and economic factors that influenced the provision of utility services have dramatically changed. This is a good time for the Commission to consider these issues.

As UFM reviews the material submitted to date regarding revenue decoupling, it appears that there are two distinct mechanisms for accomplishing “decoupling.” The first is the straight-fixed variable (“SFV”) rate design. With a SFV rate design, the utility collects its distribution revenues entirely through a fixed monthly customer charge and collects commodity costs through a variable charge on a per kwh usage charge. The second is, as described by Missouri-American Water Company, a revenue stabilization mechanism (“RSM”), which “adjusts rates periodically to ensure that the amount a utility books as revenue for cost recovery is no more and no less than the amount of revenue authorized by the Commission for the utility’s cost of service.”¹ Both address to some extent or other the throughput incentive and the disincentive to encourage energy efficiency.

For the reasons outlined in these comments, UFM fully supports a greater use of SFV rate design but will, at this time, remain agnostic regarding the use of a RSM. The SFV method of

¹ *MAWC Comments Concerning Notice*, filed in File No. AW-2015-0282, at 6, (September 1, 2015).

revenue decoupling has public policy advantages with a lesser risk of legal challenge. A RSM, while having some potential benefits, has serious legal and public policy concerns. As to this latter method of decoupling, UFM will remain engaged with an open mind.

1. The Clear Advantage of SFV Rate Design.

SFV rate design has clear legal and public policy advantages over a RSM. The Court of Appeals has given clear legal approval to SFV rate design. *State ex rel. Missouri Office of Public Counsel v. Public Serv. Comm'n*, 293 S.W.3d 63 (Mo. App., 2009). The Commission itself has approved its use.²

SFV rate design also has advantages over a RSM in that it fulfills the regulatory goal of more appropriately approximating a competitive market rate. Many of the commenters have referred to the regulatory compact in their comments. That is a good context in which to discuss this issue. It is also important to note that the purpose of regulation is to stand in the stead of competition. As the Regulatory Assistance Project has pointed out in *Electricity Regulation In the US: A Guide*:

For most businesses, the prices of goods or services that are sold are determined by what the customer or market will bear. In economic terms, markets will “clear” at the point where marginal costs equal the value that consumers, in the aggregate, set for the good or service; that is at the point where supply intersects with demand. A different approach to price-setting is required for utilities, since competition and free entry into markets does not exist in natural monopolies. Regulators use a *cost of service* approach to determine a fair price for electric service, by which the aggregate cost (including a reasonable return of, and on, investment) for providing each class of service (residential, commercial, and industrial) are determined.³

The point where supply intersects demand is the most economically efficient price in a competitive marketplace. The closer the Commission can get rates to reflect true costs, the more economically efficient the marketplace will be. Transparent rates that reflect cost enable

² In re *Kansas City Power & Light Company*, File No. ER-2014-0370.

³ *Electricity Regulation In the US: A Guide*, The Regulatory Assistance Project, at 5 (March, 2011).

customers to make reasoned decisions about the true economic value and impact of their choices to use and not use utility services consistent with those values. With this, customers' decisions will more accurately represent the true demand for the service. The Commission recognized this truth in its recent *Report and Order* in Kansas City Power & Light's rate case. "Customer-related costs are generally recovered through the customer charge, which serves to prevent higher usage customers from subsidizing lower usage customers, sends all customers more accurate energy pricing signals, and provides more stable and predictable funding for utilities' fixed costs."⁴

Industries that are more competitive—the cellular telephone industry, and to a lesser extent the cable industry—have moved over time from a variable rate structure to almost exclusively a fixed charge rate structure. For these industries, much as the utility industries considered here, the lion's share of the cost of service is in fixed costs. Consequently, sellers have moved to reflect their cost structure in their pricing. And customers see these price signals, allowing them to make better economic decisions and adjust their conduct according.

UFM is aware that some may argue that various factors will impact the actual SFV rate design. Certainly, what constitutes a true measure of the fixed and variable cost is an appropriate subject of discussion. Should the variable cost reflect the long term marginal price or the short term marginal price? This is a legitimate question. However, neither creating an artificial incentive for energy efficiency nor anticipation of the Clean Power Plan are legitimate considerations in this context. State policy under MEEIA⁵ is to value energy efficiency in a manner that is equal to supply side options. To do this, the Commission shall "ensure that utility incentives are aligned with helping customers use energy more efficiently and in a manner that

⁴ File No. ER-2014-0370, at 89 (September 2, 2015).

⁵ Missouri Energy Efficiency Investment Act, §393.1075 RSMo. (2014).

sustains or enhances utility customers' incentives to use energy more efficiently." There is nothing in MEEIA which suggests artificial incentives be created, but simply to align the utility motives to serve the customers' incentives to use energy in an economically efficient manner. MEEIA makes no reference to some hypothetical climate adjustment. UFM suggests that a SFV rate design based on economic principles best achieves this goal.

2. There are Less Clear Advantages to a RSM.

Commenters have made a significant case that economic conditions are changing. These changes, declining demand, aging infrastructure, weather variability, more emphasis on providing energy efficiency programs, and others, put a utility's earning potential at risk by placing so much of the utility's revenue requirement recovery on a variable rate component. However, whether these infirmities in the existing regulatory process can be remedied by a RSM is less clear to UFM. First, the Commission's legal authority is uncertain at this point, and, second, the public policy advantages are uncertain. UFM will remain open to further discussions as to these points.

There are two potential legal challenges to a RSM: one of single issue rate making and one of retroactive ratemaking. Supporters of a RSM cite *State ex rel. Public Counsel v. Pub. Serv. Comm'n*, 397 S.W.3d 441 (Mo. App. 2013) ("OPC") as their source of Commission authority to establish a RSM against a claim of single issue ratemaking. In that case, the Western District Court of Appeals determined that the Commission could authorize the adjustment of rates outside a general rate case in order to recover the costs of demand-side investments, including lost revenues, based upon MEEIA. The case arose out of the Commission's rulemaking on MEEIA. The Office of Public Counsel challenged the Commission's rule that authorized it to permit the adjustment of rates outside of a general rate

case. The point at issue was whether MEEIA’s direction that the Commission “provide timely earnings opportunities associated with cost-effective measurable and verifiable efficiency savings,” was sufficiently clear to grant the Commission such authority. The Court found that the word “timely” clearly indicated the legislature’s belief that the interval between rate cases may not be timely. Therefore, the legislature’s intent was that the Commission should have the authority to grant a more timely remedy.

While *OPC* gives some comfort, it is less than clear whether it would apply to a RSM. It must be recognized that *OPC* was a MEEIA rulemaking for procedures to be permitted in a MEEIA case. There is a significant difference with a RSM. What the Commission will establish with a RSM are rate case procedures to be used in a general rate case and not in a MEEIA case. Since a general rate case proceeding is intended to address “all relevant factors,” it stands to reason that a court would be more reticent to permit a single issue to be interjected as a justification to modify a rate established in a rate case based on the change in one factor. It stands to reason that the rule prohibiting single issue ratemaking would still apply in the context of a rate case process designed to consider “all relevant factors” without some further direction from the legislature.

The supporters of a RSM cite *State ex rel. Noranda Aluminum, Inc. v. Pub. Serv. Comm’n*, 358 S.W.3d 293 (Mo. App. 2011) as their source of Commission authority to establish a RSM against a claim of retroactive ratemaking. In that case, Noranda challenged AmerenUE’s Fuel Adjustment Clause (“FAC”), arguing that the FAC permitted AmerenUE to recover past expenses for vegetation management. In an explanation that is somewhat less than clear to UFM, the Court declared:

Here, the question does not involve FACs and their unique statutory development. The AmerenUE expenses at issue are those incurred in complying with new Commission rules requiring vigorous protection of power lines through the control of vegetation in an attempt to avoid massive power outages in future storms. The Commission found that AmerenUE was allowed, under the rules themselves, to recover extra costs expended in complying with the new rule from the official effective date of June 30, 2008, but that it was also permissible to permit a recovery of compliance expenses incurred before the actual effective date of the rules because AmerenUE believed the rules were going to go into effect on January 1, 2008, based upon the rulemaking actions of the Commission and because it was good for the ratepayers that AmerenUE did so.⁶

At the same time, the Court recognized that the old rule still stood. Any adjustment to the cost of electricity based on electricity that had already been consumed prior to the effective date clearly constituted retroactive ratemaking.

AmerenUE cannot go back in time and adjust the rates charged to past customers to reflect increased efforts to trim plant growth and maintain electric transmission components. But because these authorized additional expenses were considered through the various procedures of the instant case for future rate payers, amortized recovery of the expenses does not constitute retroactive ratemaking. *See Midwest Gas Users' Ass'n*, 976 S.W.2d at 481 (no retroactive ratemaking where adjustments for purchased gas costs were applied to future bills, amounts charged on past bills could not be adjusted, and a review process for actual costs existed).⁷

UFM is not clear whether the distinguishing factor is whether there was a FAC previously in place that made the accounting not retroactive ratemaking or whether it was the fact that the expenses were to be incurred for the benefit of future ratepayers.

In either event, there do appear to be principled reasons to believe that a revenue tracker would be viewed in a different light. The first distinguishing factor is that it would be a revenue tracker, not an accounting or book keeping mechanism for a specific cost. As with the issue of single issue ratemaking, the purpose of the revenue tracker is to encompass a vast portion of the purpose of a rate case and not simply isolate a specific difficult to quantify expense. This is a

⁶ *State ex rel. Noranda Aluminum, Inc. v. Pub. Serv. Comm'n*, at 358 S.W3d at 319.

⁷ *Id.* at 320.

qualitative difference in scope and purpose and not merely a quantitative difference in type of expense.

The second distinguishing factor is that, in distinction to the *Noranda* case, the revenue tracker is specifically intended to recoup revenues that are not collected or return revenues that are over collected in a prior period. The *Noranda* tracker was designed to amortize expenses incurred for future customers. Referring to MAWC's definition of a RSM, it is a mechanism that "adjusts rates periodically to ensure that the amount a utility books as revenue for cost recovery is no more and no less than the amount of revenue authorized by the Commission for the utility's cost of service." It is inconceivable that such a definition could anticipate recovery of expenses incurred for future customers from those same future customers. To ensure an equivalency of revenues authorized and booked from a set of customers is a virtual impossibility unless there is a true up that allows an after the fact adjustment. UFM is not arguing that a RSM is a legal impossibility. However it does believe the legal case would be a hard one to make without a change in statute.

Finally, UFM is not sure a RSM supports the best public policy for the state. In a free market economy, market participants are constrained by the law of supply and demand. As quoted supra, "For most businesses, the prices of goods or services that are sold are determined by what the customer or market will bear. In economic terms, markets will 'clear' at the point where marginal costs equal the value that consumers, in the aggregate, set for the good or service; that is at the point where supply intersects with demand." In a competitive economy, buyers and sellers are price takers, taking prices at the clearing price. Natural monopolies, on the other hand, are price setters rather than price takers. This is something utility regulation was intended to remedy. It is intended to limit the ability of a utility to extract monopoly rents from its customers, i.e. to take away the unilateral authority to be a price setter. A RSM would reverse that policy and allow

the utility to return to the status of a price setter for the purpose of assuring it maintaining its revenue requirement.

There are certainly countervailing public policy reasons for a RSM, most particularly the recognition that utilities provide essential services and the need to keep those services viable. However, UFM is not yet of the opinion that this policy consideration outweighs the original need for rate regulation. If the Commission recognizes the risks suggesting a RSM remedy, it is more appropriate to increase the utility's rate of return on its investment, compensate shareholders for the increased risk and attract additional investment in the infrastructure.

Again, UFM appreciates the opportunity to comment on these issues and looks forward to the upcoming workshop.

Respectfully submitted,

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