

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

In the Matter of the Application and Petition of)
Missouri-American Water Company Requesting the) **Case No. WX-2015-0209**
Commission Promulgate a Revenue Decoupling)
Mechanism for the Water and Sewer Industry.)

STAFF'S COMMENTS AND RECOMMENDATION

COMES NOW the Staff of the Missouri Public Service Commission, by and through counsel, and hereby tenders its attached *Comments and Recommendation* to the Commission for its consideration as ordered by the Commission on March 2, 2015. Staff notes that its recommendation in the attached *Comments and Recommendation* is that the Commission NOT proceed with the proposed rule because it would establish a mechanism that is unlawful under Missouri law.

Respectfully submitted,

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Certificate of Service

I hereby certify that a true and correct copy of the foregoing was served, either electronically or by hand delivery or by First Class United States Mail, postage prepaid, on this **1st day of April, 2015**, to all counsel of record as set out on the official Service List maintained by the Data Center of the Missouri Public Service Commission for this case.

/s/ Kevin A. Thompson

COMMENTS AND RECOMMENDATION

TO: Missouri Public Service Commission, Case No. WX-2015-0209.

FROM: Jim Busch, Water & Sewer Department; Kevin A. Thompson,
Staff Counsel's Office

/s/ Jim Busch 04/01/2015 /s/ Kevin A. Thompson 04/01/2015
Project Coordinator / Date Staff Counsel's Office / Date

SUBJECT: Staff Recommendation as to proceeding with rulemaking initiated by Missouri-American Water Company, Inc., to establish a Revenue Stabilization Mechanism for water and sewer utilities.

DATE: April 1, 2009

On February 27, 2015, Missouri-American Water Company (MAWC or Company) filed an *Application and Petition for Promulgation of Rule*. On March 2, 2015, the Commission ordered its Staff to investigate the Company's petition and to recommend to the Commission prior to April 1, 2015, whether or not the Commission should proceed with a rulemaking. This report shows the results of Staff's investigation and recommends that the Commission not proceed with a rulemaking at this time.

Introduction

In its *Petition*, MAWC requests that the Commission promulgate a rule to institute a Revenue Stabilization Mechanism ("RSM") for water and sewer corporations. According to the *Petition*, the proposed RSM will allow water and sewer corporations to establish a tracker in a rate case that will track actual revenues compared to the authorized revenue requirement approved by the Commission in its previous rate case. This tracker will track the difference in the period between rate cases.

The proposed RSM is intended to account for both under-collection and over-collection of a utility's Commission-authorized rate revenues. The differences in collections shall be netted against each other for recovery or refund in a future rate case.

In its *Petition*, MAWC included the proposed rule as Appendix A. The proposed rule establishes how a water or sewer corporation would file an application for a RSM during a general rate proceeding. If a RSM is ultimately approved by the Commission, the RSM would permit the corporation to track on a monthly basis actual revenues against the Commission-authorized revenue requirement during the period between general rate cases.

Further, the proposed rule indicates that in the rate case where the RSM is first proposed, the corporation shall include a description of how the RSM would operate. It

also specifies that any RSM will not impact industrial customers. The application will spell out how the rest of the customer classifications will be impacted.

Next, the RSM will account for under-collections and over-collections of revenues as well as production costs, which for MAWC includes power, chemicals, purchased water, and waste disposal. These items will be netted against each other to determine if a recovery or refund will be due during the next rate case.

Any over-collections by the corporation will be divided equally by the number of customers in the rate classifications and refunded. Any under-collections will be charged proportionally based on volumetric billed amounts for each customer by rate classification.

The last portion of the proposed rule discusses any proposed application for discontinuation.

Legal Analysis

The law requires that “[a]ll charges made or demanded by any . . . water corporation or sewer corporation for . . . water, sewer or any service rendered or to be rendered shall be just and reasonable and not more than allowed by law or by order or decision of the commission.”¹ The law further provides that “[e]very unjust or unreasonable charge made or demanded for . . . water, sewer, or any such service, or in connection therewith, or in excess of that allowed by law or by order or decision of the commission is prohibited.”² Finally, the law specifies what the Commission must do if, after investigation and hearing, it determines that the rates of the subject utility are not “just and reasonable”:

Whenever the commission shall be of the opinion, after a hearing had upon its own motion or upon complaint, that the rates or charges or the acts or regulations of any such persons or corporations are unjust, unreasonable, unjustly discriminatory or unduly preferential or in any wise in violation of any provision of law, the commission shall determine and prescribe the just and reasonable rates and charges thereafter to be in force for the service to be furnished, notwithstanding that a higher rate or charge has heretofore been authorized by statute, and the just and reasonable acts and regulations to be done and observed[.]³

What is a “just and reasonable” rate? It is a rate that balances the interests of the various stakeholders in the light of the public interest.⁴ A just and reasonable rate is fair

¹ Section 393.130.1, RSMo.

² *Id.*

³ Section 393.140(5), RSMo.

⁴ See ***State ex rel. Union Electric Co. v. Public Service Commission***, 765 S.W.2d 618, 622 (Mo. App., W.D. 1988) (“Ratemaking is a balancing process”).

to both the utility and to its customers⁵ and is no more than is necessary to “keep public utility plants in proper repair for effective public service, [and] . . . to insure to the investors a reasonable return upon funds invested.”⁶ In 1925, the Missouri Supreme Court stated:

The enactment of the Public Service Act marked a new era in the history of public utilities. Its purpose is to require the general public not only to pay rates which will keep public utility plants in proper repair for effective public service, but further to insure to the investors a reasonable return upon funds invested. The police power of the state demands as much. We can never have efficient service, unless there is a reasonable guaranty of fair returns for capital invested. * * * These instrumentalities are a part of the very life blood of the state, and of its people, and a fair administration of the act is mandatory. When we say "fair," we mean fair to the public, and fair to the investors.⁷

In striking the balance between the utility and its customers, the Commission must be particularly solicitous of the latter: “the dominant thought and purpose of the policy is the protection of the public . . . [and] the protection given the utility is merely incidental.”⁸ However, the Commission must at least afford the utility an opportunity to recover a reasonable return on the assets it has devoted to the public service.⁹

One aspect of just and reasonable rates is that they are neither unduly preferential nor unduly discriminatory with respect to any customer or class of customers.¹⁰ The Commission has no authority to approve discriminatory rates.¹¹ Discriminatory and preferential rates are specifically forbidden:

No gas corporation, electrical corporation, water corporation or sewer corporation shall make or grant any undue or unreasonable preference or advantage to any person, corporation or locality, or to any particular description of service in any respect whatsoever, or subject any particular person, corporation or locality or any particular description of service to

⁵ **St. ex rel. Valley Sewage Co. v. Public Service Commission**, 515 S.W.2d 845 (Mo. App., K.C.D. 1974).

⁶ **St. ex rel. Washington University et al. v. Public Service Commission**, 308 Mo. 328, 344-45, 272 S.W. 971, 973 (banc 1925).

⁷ *Id.*

⁸ **St. ex rel. Crown Coach Co. v. Pub. Serv. Comm'n**, 238 Mo. App. 287, ___, 179 S.W.2d 123, 126 (1944).

⁹ **St. ex rel. Utility Consumers Council, Inc. v. Pub. Serv. Comm'n**, 585 S.W.2d 41, 49 (Mo. banc 1979) (“**UCCM**”).

¹⁰ Section 393.130.3, RSMo.; see **State ex rel. City of Joplin v. Public Service Com'n of State of Mo.**, 186 S.W.3d 290, 296 (Mo. App., W.D. 2005).

¹¹ **City of Joplin**, *supra*, 186 S.W.3d at 296.

any undue or unreasonable prejudice or disadvantage in any respect whatsoever.¹²

Turning to the RSM proposed by MAWC, as an initial comment, Staff notes that the proposed advantageous treatment granted to industrial customers is unlawful. Under the proposed RSM, industrial customers are exempt from its provisions; such customers will not pay a proportionate share of any under-collection. This exemption constitutes an unlawful preference. Any difference in the treatment of the various rate classes must be based upon tangible differences in the services they receive; MAWC has identified no such factors that support the preferential treatment of industrial customers in the proposed RSM.

Second, the RSM is generally unlawful because it is unfair in that it shifts all business risk from the utility to its customers.

It is axiomatic that a just and reasonable utility rate is a bilateral proposition. Like a coin, it has two sides. On the one side it must be just and reasonable from the standpoint of the utility. On the other side it must be just and reasonable from the standpoint of the utility's customers. This bilateral aspect of utility rate making, although susceptible of easy expression in theory, is considerably more difficult to achieve. For these very reasons, the court in ***State ex rel. Missouri Water Company v. Public Service Commission***, [308 S.W.2d 704 (Mo. 1957)], recognized, if not explicitly, certainly implicitly, that rate making bodies, within the ambit of their statutory authority, are vested with considerable discretion to make such pragmatic adjustments in the rate making process as may be indicated by the particular circumstances in order to arrive at a just and reasonable rate. Consistent therewith this court believes that subsection 5 of Section 393.270, *supra*, evidences a legislative intent to imbue the Commission with authority to properly weigh all relevant factors in the sewer utility rate making process in order to achieve the ultimate goal of bilateral fairness.¹³

The fixing of just and reasonable rates involves a balancing of the investor and the consumer interests and the making of pragmatic adjustments as necessary to achieve just and reasonable rates. The proposed RSM describes a scheme that is prohibited:

The utilities take the risk that rates filed by them will be inadequate, or excessive, each time they seek rate approval. To permit them to collect additional amounts simply because they had additional past expenses not covered by either clause is retroactive rate making, i.e., the setting of rates which permit a utility to recover past losses or which require it to refund

¹² Section 393.130.3, RSMo.

¹³ ***State ex rel. Valley Sewage Co. v. Public Service Commission***, 515 S.W.2d 845, 850 (Mo. App. 1974).

past excess profits collected under a rate that did not perfectly match expenses plus rate-of-return with the rate actually established[.]¹⁴

Retroactive ratemaking would be the norm under the proposed RSM. But the cost-of-serve ratemaking system created by Missouri's General Assembly forbids retroactive ratemaking.¹⁵ The Commission has no authority to "change the rate making scheme set up by the legislature."¹⁶ Additionally, the proposed RSM is founded upon an unconstitutional exercise of governmental authority. The Missouri Supreme Court has said that the Commission "may not . . . redetermine rates already established and paid without depriving the utility (or the consumer if the rates were originally too low) of his property without due process."¹⁷

Discussion

Staff has reviewed MAWC's *Petition*. It is Staff's opinion that a RSM, as designed by MAWC, is not allowable under Missouri law. Therefore, the Commission should not proceed with this rulemaking.

The proposed RSM is based upon decoupling, that is, a severing of the fundamental nexus between a customer's usage habits and the customer's bill for services. Decoupling is a regulatory tool that is appropriate in certain situations. However, Staff suggests that decoupling is not suitable in this situation because it would send the wrong signal to consumers. By diminishing or eliminating the financial reward of conservation, consumers may be encouraged to carelessly waste water. Based on the vague nature of the proposed language, it is unclear how this proposal would impact any individual customer and whether or not any particular customer would benefit or be harmed by the rule. What can be discerned from the language is that the water or sewer corporation will benefit in any scenario. For that reason, Staff suggests that the public interest does not support the proposed

During the course of Staff's investigation, Staff became aware of House Bill 1335. HB 1335 was introduced on March 12, 2015, and proposes changes to RSMo 386.266. The proposed changes include language that would add water and sewer corporations to the types of utilities allowed to file for periodic rate changes outside of a general rate case. The periodic rate changes would be to ensure that revenues collected are neither more nor less than those authorized by the Commission. This proposal is essentially the same as the RSM rule filed by MAWC, except that MAWC's proposed rule does not contemplate rate adjustments outside of a general rate case. As with the Fuel Adjustment Clause ("FAC") discussed in the Legal Analysis section, above, only the legislature can authorize a RSM.

¹⁴ *UCCM*, p. 59.

¹⁵ *Id.*

¹⁶ *Id.*, p. 56.

¹⁷ *Id.*, p. 58.

Recommendation

Based upon the above reasoning, it is Staff's recommendation that the Commission NOT proceed with a rulemaking at this time because a RSM is not authorized by Missouri law. The General Assembly may enact a new state law that specifically deals with this type of mechanism.