John R. Ashcroft

Secretary of State
Administrative Rules Division

RULE TRANSMITTAL

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SECRETARY OF STATE
ADMINISTRATIVE RULES

Rule Number 4 CSR 240-10.085

Use a "SEPARATE" rule transmittal sheet for EACH individual rulemaking.

Name of person to call with questions about this rule:
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TYPE OF RULEMAKING ACTION TO BE TAKEN

☐Emergency Rulemaking ☐ Rule ☐ Amendment ☐ Rescission ☐ Termination
Effective Date for the Emergency _____

☐Proposed Rulemaking ☐ Rule ☐ Amendment ☐ Rescission

☐Rule Action Notice ☐ In Addition ☐ Rule Under Consideration

☐Request for Non-Substantive Change

☐Statement of Actual Cost

☒Order of Rulemaking ☐ Withdrawal ☒ Adopt ☐ Amendment ☐ Rescission
Effective Date for the Order _____

☐Statutory 30 days OR Specific date _____

Does the Order of Rulemaking contain changes to the rule text? ☐NO

☒YES—LIST THE SECTIONS WITH CHANGES, including any deleted rule text:
Section (1), (2), (3), (4), (5), (6), and (7)

Small Business Regulatory Fairness Board (DED) Stamp

JCAR Stamp

OCT 03 2018

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GOVERNOR
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September 28, 2018

Mr. Daniel Hall
Public Service Commission
200 Madison Street
PO Box 360
Jefferson City, MO 65102

RE: *Final Orders of Rulemaking*

Dear Daniel:

This office has received your Final Order of Rulemaking for 4 CSR 240-10.085 Incentives for Acquisition of Nonviable Utilities.

Executive Order 17-03 requires this office's approval before state agencies release proposed regulations for notice and comment, amend existing regulations, rescind regulations, or adopt new regulations. After our review of this rulemaking, we approve the rule's submission to the Joint Committee on Administrative Rules and the Secretary of State.

Sincerely,

Jessie Eiler
Deputy Counsel

Missouri Public Service Commission

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John Ashcroft
Secretary of State
Administrative Rules Division
600 West Main Street
Jefferson City, Missouri 65101

Re: 4 CSR 240-10.085 Incentives for Acquisition of Nonviable Utilities

Dear Secretary Ashcroft,

CERTIFICATION OF ADMINISTRATIVE RULE

I do hereby certify that the attached is an accurate and complete copy of the order of rulemaking lawfully submitted by the Missouri Public Service Commission.

Statutory Authority: section 386.040, 396.250, 393.140, and 393.146, RSMo 2016.

If there are any questions regarding the content of this order of rulemaking, please contact:

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Morris L. Woodruff
Chief Regulatory Law Judge

Enclosures

Title 4 – DEPARTMENT OF ECONOMIC DEVELOPMENT
Division 240 – Public Service Commission
Chapter 10 – Utilities

ORDER OF RULEMAKING

By the authority vested in the Public Service Commission under sections 386.040, 386.250, and 393.140 RSMo 2016, the commission adopts a rule as follows:

4 CSR 240-10.085 Incentives for Acquisition of Nonviable Utilities **is adopted**.

A notice of proposed rulemaking containing the proposed rule was published in the *Missouri Register* on July 2, 2018 (43 MoReg 1424-1425). Changes to the proposed rule are reprinted here. This proposed rule becomes effective thirty (30) days after publication in the *Code of State Regulations.*

SUMMARY OF COMMENTS: The public comment period ended August 1, 2018, and the commission held a public hearing on the proposed rule on August 7, 2018. The commission received timely written comments from Liberty Utilities (Missouri Water) LLC, Missouri-American Water Company, the Office of the Public Counsel and the staff of the commission. Jacob Westen, representing the commission's staff, Ryan Smith representing the Office of the Public Counsel, and Dean Cooper representing Missouri-American, as well as Cheryl Norton, Brian LaGrand and Jim Jenkins on behalf of Missouri-American, appeared at the hearing and offered comments.

COMMENT #1: Public Counsel questions the purpose statement of the rule, suggesting it should be clarified to make clear that the rule applies to "capable utilities" as that term is used in section 393.146 RSMo, which was cited by the commission as authority for this rulemaking.

RESPONSE: As will be discussed in response to Comment No. 24, the commission has concluded that section 393.146 RSMo is not what provides authority for this rulemaking. As a result, there is no reason to modify the purpose statement of this rule to match the language of that statute. No change will be made in response to this comment.

COMMENT #2 Public Counsel recommends the multiple definitions contained in section 10.085(1) be placed in alphabetical order for clarity.

RESPONSE AND EXPLANATION OF CHANGE: The commission agrees with the proposed clarification and will re-designate the definitions in section 10.085(1) in alphabetical order.

COMMENT #3 Missouri-American suggests an "or" be inserted between paragraphs 10.085(1)(A)1 and 2 to make it clear that a system can be found to be non-viable by meeting any one of these four items, referring to paragraphs 10.085(1)(A)1-4.

RESPONSE: Missouri-American is correct that a system can be found to be non-viable if it meets any one of the four listed criteria. However, the "or" between paragraphs 10.085(1)(A)3. and 4. is grammatically sufficient to establish that fact. No change will be made in response to this comment.

COMMENT #4 Public Counsel suggests a definition of "capable utility" be added to section 10.085(1) to better match the provisions of section 393.146 RSMo, which was cited by the commission as authority for this rulemaking.

RESPONSE: As will be discussed in response to Comment No. 24, the commission has concluded that section 393.146 RSMo is not what provides authority for this rulemaking. As a result, there is no reason to modify the definitions section of this rule to match the language of that statute. No change will be made in response to this comment.

COMMENT #5 Public Counsel suggests the definition of nonviable utility found in subsection 10.085(1)(A) be modified to limit its application to small utilities. The commission's staff concurs in that comment.

RESPONSE AND EXPLANATION OF CHANGE: The commission will modify the rule to limit the definition of nonviable utility to small utilities serving eight thousand (8,000) or fewer customers.

COMMENT #6 Paragraph 10.085(1)(A)2. of the definition of nonviable utility includes a utility that has failed to comply with any order of the department of natural resources or the commission concerning the safety and adequacy of service "within a reasonable period of time." Staff asks the commission to remove the phrase "within a reasonable period of time" from the definition. Staff believes the phrase is vague. Further, the orders with which the utility has failed to comply presumably contain their own time for compliance and there is no need to include an additional timeframe within this definition.

RESPONSE AND EXPLANATION OF CHANGE: The commission agrees with staff and will remove the phrase from the definition. The commission also notes that the definition should apply if the nonviable utility has failed to comply with the order of a federal agency. The provision will be modified accordingly.

COMMENT #7 Subsection 10.085(1)(B) defines "rate of return premiums" as an award by the commission of up to 100 basis points to a utility in recognition of the risks associated with the acquisition of a nonviable utility. Staff, Public Counsel, Missouri-American, and Liberty Utilities all express concern that the proposed definition does not make clear whether the additional 100 basis points would apply to the acquiring company's entire rate base or just the additional rate base involved in the acquisition. Staff and Public Counsel suggest the incentive be limited to just the acquired rate base. Missouri-American and Liberty Utilities point out that because the acquired rate base may be small in relation to the acquiring company's overall rate base, the incentive allowed under the rule will likely be very small and not much of an incentive.

RESPONSE AND EXPLANATION OF CHANGE: The concept of a rate of return premium is not explicitly limited by the rule to either the acquiring company's entire rate base, or to the acquired rate base. That ambiguity is an intentional feature of the rule. The commission wants to have the discretion to craft a rate of return incentive that will be effective. The details of what incentive is appropriate will be determined based on the evidence presented to the commission in a particular case. The definition will be modified to make the commission's retention of discretion more clear by referring to an adjustment to a portion or all of the acquiring utility's rate base.

COMMENT #8 Subsection 10.085(1)(B) defines rate of return premiums and indicates such an incentive can be awarded in recognition of the increased risk associated with acquisition of a nonviable utility and the "associated system improvement costs." Liberty Utilities expresses concern that the phrase "associated system improvement costs" is not clearly defined in the rule.

RESPONSE: The commission does not believe associated system improvement costs" should be rigidly defined within this rule. Rather the meaning of the term will need to be determined on a case-by-case basis, considering the evidence presented. No change will be made in response to this comment.

COMMENT #9 Missouri-American suggests the definition of "debit acquisition adjustment" contained in subsection 10.085(1)(C) be simplified to refer to all of the acquisition cost over the depreciated original cost of the acquired system rather than a "portion" of such costs.

RESPONSE: The commission wants to allow itself as much discretion as possible in crafting an appropriate incentive, including any debit acquisition adjustment. No change will be made in response to this comment.

COMMENT #10 Public Counsel argues it would be unreasonable for a utility to receive more in rate base than would be supported by the assets and is concerned that the definition does not contemplate the amount of time allowed to amortize a debit acquisition adjustment.

RESPONSE: This section just defines a term. The reasonableness and details of such an adjustment will be determined on a case-by-case basis. No change will be made in response to this comment.

COMMENT #11 Subsection 10.085(1)(D) defines "plant-in-service study." Missouri-American is concerned that nonviable acquired companies may not have sufficient books and records to allow the acquiring company to prepare a plant-in-service study. Missouri-American asks that more flexibility be built into the definition to recognize those concerns.

RESPONSE: The commission addresses concerns about unavailable records elsewhere in the rule and does not believe it is necessary to do so within this definition subsection. No changes will be made in response to this comment.

COMMENT #12 Public Counsel points to several sections of the rule that use the phrase "acquisition incentive" as a short-hand way of referring to "rate of return premiums" and "debt acquisition adjustment." It suggests that either "acquisition incentive" be defined, or that "rate of return premiums and debt acquisition adjustment, or both" be used in its place.

RESPONSE AND EXPLANATION OF CHANGE: The commission agrees that the use of the undefined term "acquisition incentive" could be misleading. A definition of "acquisitions incentive" as including the other defined terms of "rate of return premiums" and "debit acquisition adjustment" will be added as a new subsection to section 10.085(1). The definition of "acquisition incentive" will also result in changes to section 10.085(2) to incorporate that now-defined term.

COMMENT #13 Public Counsel is concerned that section 10.085(2) would allow the commission to approve an acquisition incentive in the acquisition case even though such costs would not be known and measurable and the related improvements would not be used and useful.

RESPONSE: The commission does not share Public Counsel's concerns because, as section 10.085(2) describes, an approved acquisition incentive could only be applied in a subsequent rate case, and then, only if such application will not result in unjust or unreasonable rates. No changes will be made in response to this comment.

COMMENT #14 Paragraph 10.085(3)(A)2. lists various documents and records of original costs of the nonviable utility that must be filed by the acquiring utility as part of any application for an acquisition incentive. Missouri-American and Liberty Utilities are concerned that nonviable utilities frequently do not keep good records. As a result, the acquiring company may be unable to produce some of the records required by the rule. Subsection 10.085(3)(B) provides that if those documents and records are unavailable at the time the application for acquisition incentive is filed, they can be furnished by the acquiring utility before its next rate

case. Public Counsel points out that there is no reason to believe that documents and records that were unavailable at the time the application for an acquisition incentive was filed will become available before the next rate case is filed.

RESPONSE AND EXPLANATION OF CHANGE: The commission is certainly aware that nonviable utilities may not keep good records, and recognizes that an acquiring utility cannot file documents that do not exist. That is why subsection 10.085(3)(C) allows the acquiring utility to file estimated cost-related documents so long as they also file documents supporting the reasonableness of those estimates. That provision already addresses the commenters concerns, but the first sentence of that subsection is unnecessary and may give the false impression that non-existent cost-related documents must be filed. The commission will remove that first sentence without changing the meaning of the subsection as a whole. The commission will also delete subsection 10.085(3)(B). The intent of that provision is to provide for a mechanism through which the commission would receive the information required by paragraph 10.085(3)(A)2. However, subsection 10.085(3)(C) already provides for such a mechanism, so subsection 10.085(3)(B) is unnecessary.

COMMENT #15: Public Counsel suggests the applicant for an acquisition incentive be required to certify that it is a "capable public utility" as that phrase is used in section 393.146, RSMo 2016, which was cited by the commission as authority for this rulemaking.

RESPONSE: As will be discussed in response to Comment No. 24, the commission has concluded that section 393.146 RSMo is not what provides authority for this rulemaking. As a result, there is no reason to modify the rule to match the language of that statute. No change will be made in response to this comment.

COMMENT #16: Public Counsel recommends a change in the structure of section 10.085(4) to make the statement that the acquiring utility has the burden of proof into its own subsection and then to make the list of things that must be proven paragraphs in a separate subsection.

RESPONSE: The commission does not believe the structural change proposed by Public Counsel will clarify the rule. No change will be made in response to this comment.

COMMENT #17: Public Counsel would add a provision requiring the acquiring utility to prove that it is a "capable public utility" as that phrase is used in section 393.146, RSMo 2016, which was cited by the commission as authority for this rulemaking.

RESPONSE: As will be discussed in response to Comment No. 24, the commission has concluded that section 393.146 RSMo is not what provides

authority for this rulemaking. As a result, there is no reason to modify the rule to match the language of that statute. No change will be made in response to this comment.

COMMENT #18: Public Counsel questions the provision in subsection 10.085(4)(E) that would require the acquiring utility to prove how improvements needed to make the acquired utility viable will be completed within three years. Similarly, subsection 10.085(4)(G) would require proof of how capital improvements and operational changes within the next three years will correct deficiencies. Public Counsel is concerned that an artificial three year requirement might not be sufficient to correct problems in some circumstances. Instead, it proposes a more flexible, "reasonable," timetable for the utility to work with other governmental agencies to correct problems

RESPONSE AND EXPLANATION OF CHANGE: The commission agrees with Public Counsel's concern that a three-year limitation may be unnecessarily rigid. The questioned subsections will be modified to remove the three-year limitation. In its place, the rule will require the applicant to specify an anticipated time for completion of necessary improvements.

COMMENT #19: Subsection 10.085(4)(I) requires the applicant for an acquisition incentive to prove that the acquisition would be unlikely to occur without the probability of obtaining an acquisition incentive. Liberty Utilities and Missouri-American are concerned that this "but for" requirement would be impossible to prove, meaning the acquisition incentives allowed by the rule could never be used.

RESPONSE: The commission understands the difficulty of proving that a transaction would not occur but for the chance of obtaining an acquisition incentive. Certainly, such acquisitions have taken place without the possibility of the acquisition incentive described in this rule. So, the rule should not be taken as an invitation to seek an unnecessary incentive to subsidize an acquisition that would occur without an incentive. As a result, a "but for" requirement is a necessary part of the rule. The commission cannot at this time describe exactly what would need to be proved to meet the "but for" requirement. That standard will need to be developed on a case-by-case basis depending upon the evidence presented in the particular case. No change will be made in response to this comment.

COMMENT #20: Section 10.085(5) creates a presumption that a utility that has had an acquisition incentive approved by the commission is to file a general rate case within twelve months after approval of the acquisition unless otherwise ordered by the commission. Missouri-American is concerned that it would be unreasonable, and undesirable for a large utility to be required to prematurely file a general rate case just to incorporate a small nonviable water or sewer system.

(D) Plant-in-service study. A report detailing a determination of the value of the original costs of the property of a public utility that requires the acquiring utility to accumulate the records and accounting details in order to support reasonable plant, reserve, and contributions in aid of construction balances; and

(E) Rate of return premiums. Additional rate of return basis points, up to one hundred (100) basis points, applied to either the acquiring utility's entire rate base or to the newly acquired rate base, awarded at the commission's discretion in recognition of risks involved in acquisition of nonviable utilities and the associated system improvement costs.

(2) An application for an acquisition incentive must be filed at the beginning of a case seeking authority under sections 393.190 or 393.170, RSMo. If the commission determines the request for an acquisition incentive is in the public interest, it shall grant the request. The commission may apply an acquisition incentive in the applicant's next general rate proceeding following acquisition of a nonviable utility if the commission determines it will not result in unjust or unreasonable rates.

(3) Filing Requirements—

(B) Any information not available from the seller shall be estimated by the acquiring utility, along with documentation supporting the reasonableness of the estimates developed.

(4) When submitting an application for an acquisition incentive to acquire a nonviable utility, the acquiring utility has the burden of proof and shall demonstrate the following:

(E) Any plant improvements necessary to make the utility viable will be completed within a reasonable period of time, as specified in the application, after the effective date of acquisition;

(G) How planned capital improvements and operational changes will correct deficiencies;

(5) If the acquisition incentive is approved by the commission, the utility shall file a general rate proceeding within the period of time ordered by the commission. Rate impacts of the approved incentive mechanism will go into effect upon order of the commission at the conclusion of the acquiring utility's first general rate proceeding following approval of the acquisition incentive. If the acquisition incentive is approved in a section 393.190 or 393.170, RSMo case, prior to its next general rate proceeding, the acquiring utility shall—

(A) Book contributions that were properly recorded on the books of the acquired system as CIAC. If evidence supports other CIAC that was not booked by the seller, the acquiring utility shall make an effort, supported with documentation, to determine the actual CIAC and record the contributions for ratemaking purposes, such as lot sale agreements or capitalization vs. expense of plant-in-service on tax returns;

(B) Identify all plant retirements and plant no longer used and useful, and complete the appropriate accounting entries; and

(C) If the records are not available from the acquired system to complete subsection (5)(A) or (5)(B), on a going-forward basis, create and maintain documentation of (5)(A) and (5)(B) from the date of acquisition.

(6) If a debit acquisition adjustment is requested, an acquiring utility shall either file a plant-in-service study to support the amount of its requested acquisition adjustment addition to its rate base in its next general rate proceeding, or, if it prefers to do so, the acquiring utility may file the required plant-in-service study in the section 393.170 or 393.190 application case. The acquiring utility shall reconcile and explain any discrepancies between the acquiring utility's plant-in-service study of original cost valuation and the commission's records, to the extent reasonably known and available to the acquiring utility, at the same time the supporting documentation for the study is filed. Any disputes regarding the acquiring utility's plant-in-service study will be resolved in that first subsequent general rate proceeding.

(7) Nothing in the rule precludes an acquiring utility that pays less than the depreciated original cost of the acquired system from seeking in its next general rate proceeding to include in rate base an amount up to the depreciated original cost of the acquired system.

AUTHORITY: sections 386.040, 386.250, and 393.140, RSMo 2016. Original rule filed May 30, 2018.