BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Consideration and Implementation of Section 393.1075, the Missouri Energy Efficiency Investment Act	)))	**Case No. EX-2010-0368**

PUBLIC COUNSEL'S BRIEF ON LEGAL ISSUES

COMES NOW the Office of the Public Counsel for its Brief on Legal Issues states as follows:

1. The DSIM rate adjustment constitutes single-issue ratemaking, and SB376 did not give the Commission authority to implement a single-issue ratemaking mechanism.

This brief will address this question in two parts: A) Does the DSIM (Demand-Side Programs Investment Mechanism) rate adjustment in the draft rules, which would change rates outside of a general rate case, constitute single-issue ratemaking; and B) Did the legislature in SB376 authorize the Commission to allow single-issue ratemaking for these costs?

A. The proposed DSIM rate adjustment mechanism is unlawful single-issue ratemaking.

The two most relevant cases to start a discussion of single-issue ratemaking are Hotel Continental and UCCM.[1] Hotel Continental concerned a Tax Adjustment Clause (TAC), and UCCM concerned a Fuel Adjustment Clause (FAC); the TAC was found not to be unlawful

[1] Hotel Continental v. Burton, 334 S.W.2d 75 (Mo. 1960) and State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission, 585 S.W.2d 41, 56-58 (Mo. banc 1979)

single-issue ratemaking, but the FAC was found unlawful. The Court in UCCM did a very thorough job[2] of recapitulating the Hotel Continental analysis:

> In [Hotel Continental], this court affirmed an order of the circuit court affirming the commission's power in a rate case to permit the Kansas City Power & Light Co. to include in its rate schedule a tax adjustment clause (TAC) which permitted the company to state separately on each customer's bill a charge equal to any part of a license, occupation, or other similar fee or tax applicable to service by the utility to that customer and imposed by local taxing authorities on the basis of gross receipts. This court concluded that the TAC was a rule or practice relating to a rate, pursuant to§ 393.150, RSMo, and that it could become a part of a rate schedule approved by the commission pursuant to the latter's power to set just and reasonable rates, inasmuch as that power included the power to treat one item of operating expense differently than another. It also permitted the amount of gross receipts tax imposed to be increased or decreased. Respondents assert that the same reasoning which supported the commission's authority to allow a TAC would support its authority under the statutes to permit a fuel adjustment clause. We cannot agree.
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> The court was very careful in Hotel Continental to limit its holding to the specific type of clause before it, a TAC. In describing the power of the commission to carry out its duty to set just and reasonable rates, we concluded, as respondents note, that the commission has the power to treat one item of operating expense differently than another, and, further, that it can determine which items should be included in operating expenses and which items should not be included. There is no doubt that this is a valid statement, insofar as the commission does not breach other facets of the relevant statutes in exercising this general power in a particular case. It is to this latter point, the particular exercise of this power, that the court addressed itself in the rest of the opinion. It continued: "Appellants say further that the commission's order is unlawful because its approval of the tax adjustment clause is contrary to statutory mandate in that it permits the company to increase or decrease its rates without filing new rate schedules and thereby denies interested parties an opportunity to be heard as to the propriety of the changed rates."
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> In considering the automatic adjustment of the tax clause itself, however, the court did not speak as broadly. It noted that the amount of the tax was a valid expense item which no one questioned the utility had a right to collect; that "the amount of an expense item represented by the amount of a valid tax is not affected by economy of operation in other respects or by greater volume of sales or by variations in the amounts of any other expense items", … and that the sole

[2] Indeed, the Supreme Court's analysis in UCCM is so thorough and so clearly applicable to the current proposal to allow single-issue ratemaking for DSM costs that this brief quotes the decision at great length.

purpose of the TAC was to recover the exact amount of an increase or decrease in the gross receipts tax. It concluded that:

> "The commission does not lose supervisory control over company's operation because of the automatic tax adjustment clause contained in the present order. The company's rates are still subject to the commission's supervision. *Those rates, however, are not and cannot be affected one iota by the amount of, or any change in the amount of, the money company must collect with which to pay its gross receipts tax, except in the exact amount by which that tax is increased or decreased."* (emphasis added).

That is to say the tax was a *direct* charge, exactly proportioned to the customer's bill, the amount of which was directly determined by the amount of that bill. Effectively, the tax was imposed on the amount of the customer's bill, and hence its amount was governed by the other amounts charged the customer. Any change in other cost factors could not change this direct relationship, and thus any change in the tax rate could properly be taken into consideration under the TAC without regard to changes in other costs and without disturbing the statutory scheme that changes in rates of return not occur without considering all cost factors and without public awareness and understanding of rates proposed to be charged.

In this context, the court concluded that the TAC was lawful, despite the fact that no new hearing would be held before each adjustment made pursuant to the TAC in response to a change in the gross receipts tax itself, because at the hearing below in the ratemaking case in which the TAC was approved:

> "the commission took into consideration the circumstance that the tax might be increased or decreased and provided that the company would gain or lose revenue in an amount exactly equal to the increased or decreased amount necessary to pay the tax item. *Consequently, the order operates so that the approved rate of return of necessity remains the same*, provided, of course that the *only* substantial change in the company's operation is the gross receipts tax rate . . ." (emphasis added, except in final clause).

The distinction between the gross receipts tax and other items of cost to the utility was further underscored by the court in discussing the reasonableness of the commission's order, wherein it noted that the evidence showed:

> "*that the only items of operating expense which are directly related to the company's gross revenues are the gross receipts tax and the state sales tax; that those two items fall into a separate category*; that the company collects for the state the sales tax which is paid by the customers as a separate item added to the bills; that under the order proposed the gross receipts tax would be separately itemized on the bill

> but the amount of tax due would be a part of the customer's total cost, *i.e., the customer cost is the same whether the gross receipts tax is shown as a separate item or is included in the steam rate as such*; that the gross receipts tax is an expense item which well may be dealt with as an item segregated from other expense items; *that other tax items (other than sales tax) do not lend themselves to such segregated handling*; that the gross receipts tax is *subject to change at any time by the city council."* (emphasis added).

The court concluded that the evidence justified the commission's order and that the TAC was lawful.[3]

The Missouri Supreme Court then addressed the salient differences between a TAC and a FAC. It found that the Hotel Continental single-issue ratemaking exception for a TAC was carefully and narrowly drawn. The Court found that, not only would the exception not extend to a FAC, it would not even apply to other kinds of taxes. Indeed, there is no hint in UCCM of a category of costs that the Court would consider to be similar enough to a gross receipts tax to qualify for an exception. The Court held:

> In contrast, a fuel adjustment clause would not be of such limited scope. While it could nominally be considered a "rule relating to a rate", as was the tax adjustment clause, the commission does not thereby gain power to permit its use if this would in effect initiate a new method of granting rate increases. As noted in Hotel Continental, non-tax operating costs (such as fuel) fall into a wholly separate category than does the tax cost at issue in that case. Although in their brief respondents attempt to distinguish a fuel adjustment clause from an adjustment clause for labor, supplies, construction and so forth on the basis that fuel is the largest single expense item, in oral argument they admitted that the rationale behind authorization of a fuel adjustment clause could be used to justify adjustment clauses covering these other items of operating expense. To permit all such costs to be automatically adjusted would create a third method of approval of rates not within the contemplation of the authorizing statutes.
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> Unlike the tax adjustment clause approved in Hotel Continental, a charge under a fuel adjustment clause is not a direct charge. A tax adjustment charge is figured by determining the amount of gross receipts tax applicable to the amount of the customer's bill. The fuel adjustment charge is figured by estimating the amount of sales which will be made in a given month and allocating to each kilowatt-hour sale a percentage of the increase in fuel costs incurred during a

[3] UCCM, *supra*, at 51-52; citations omitted.

> prior month. Thus, if higher costs are incurred in January, the amount of these costs each customer will pay in March will depend in part not only on the amount of electricity he uses but on the total amount of electricity used. If fewer sales are made, his proportionate charge will be greater than if more sales are made.
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> Additionally, the fuel adjustment charge will be affected by a utility's management decisions such as choice of fuel, choice of generating unit, the efficiency of that unit and similar operational matters. The average cost per kilowatt-hour will also be affected by overall use of energy during peak hours, when less efficient generators may have to be added to supply all necessary power, even though the individual consumer may in fact use electricity primarily during non-peak hours. Further, since in our mobile society customers move in and out of the territory of any particular utility as they change jobs or careers, new customers in, for example, October will be charged for an actual increase in fuel costs incurred in August when different customers were using electricity for air conditioning, etc. We do not mean to imply that the method of allocation approved by the commission is not a good or reasonable one, if authorized, but simply to state that given these factors fuel costs are not directly assignable to the fuel use of the customer and thus that they cannot be put in the same category as a gross receipts tax cost, which enters the picture only once the service relationship of the company and consumer is over, at least for that month, and is simply added as a charge to the bill in the month the bill is paid.
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> Finally, we note that adjustment of a TAC cannot affect the rate of return of the utility, since economies of operation cannot be used to increase or decrease it directly. While fuel costs are to a large extent dependent on general market conditions and periodically fixed contract costs, the utility does exercise control over its fuel costs when it negotiates fuel contracts or chooses what fuel to buy or burn in what generating unit. It also is possible to offset fuel costs with savings from efficiencies in other areas of operation, such as salaries, wages, taxes, depreciation and materials and supplies other than fuel.[4]

If DSM costs are very much like gross receipts taxes, then the Commission could allow a single-issue ratemaking exception for them without explicit statutory authority. If, on the other hand, they are more like costs for fuel, "labor, supplies, construction and so forth," then the Commission would need explicit statutory authority. The Court's analysis of the differences between a TAC and FAC clearly point out that DSM costs are much more like fuel costs than gross receipts taxes. The Commission's "powers are limited to those conferred by statute, either

[4] UCCM, *supra*, at 53-54.

expressly, or by clear implication, as necessary to carry out the powers specifically granted."[5] Thus the Commission can only allow single-issue ratemaking for DSM costs if the legislature explicitly granted the Commission such authority.

B. The legislature in SB376 did not authorize the Commission to allow single-issue ratemaking for DSIM rate adjustment mechanisms.

The statute authorizing FACs and Environmental Cost Recovery Mechanisms[6] is detailed, runs several pages, and **explicitly** allows single-issue ratemaking. The statute authorizing Infrastructure Recovery Surcharges[7] is even more detailed,also runs several pages, and also **explicitly** allows single-issue ratemaking. Even the oldest of the statutorily-created single-issue ratemaking exceptions (for nuclear decommissioning costs[8]) while considerably shorter than the other two, also **explicitly** allows single-issue ratemaking:

> Notwithstanding any other provision of law to the contrary, **the public service commission shall have the power, pursuant to regulations, to review and authorize changes to the rates** and charges contained in the schedules of an electric corporation as a result of a change in the level or annual accrual of funding necessary for its nuclear power plant decommissioning trust fund only after a full hearing and after considering all facts relevant to such funding level or accrual rate. The commission shall also have the authority to adopt regulations to govern the procedure for submission, examination, hearing and approval of such tariff changes and to ensure that the amounts collected from ratepayers and paid into such trust funds will be neither greater nor lesser than the amounts necessary to carry out the purposes of the trusts.[9]

In contrast to the explicit way in which the legislature has created every other single-issue ratemaking exception, proponents of the DSIM adjustment mechanism argue that the

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5 Utilicorp United Inc. v. Platte-Clay Elec. Co-op., Inc., 799 S.W.2d 108, 109 (Mo. App. W.D. 1990)

6 Section 393.1000, *et seq*. RSMo Cum. Supp. 2006.

7 Section 386.266 RSMo Cum. Supp. 2008.

8 Section 393.292 RSMo 2000.

9 *Ibid*. Emphasis added.

legislature's use of the single word "timely" in two sentences creates a single-issue ratemaking exception. While this would be an exceedingly weak argument in any event, it is completely undercut by the fact that the legislature considered an **explicit** grant of authority to allow single-issue ratemaking in SB376, **but then deliberately took it out**.

SB376, as introduced, explicitly provided that the Commission could use cost recovery mechanisms including "a cost adjustment clause for collection of costs associated with energy efficiency programs."[10] When the full Senate voted on SB376, that phrase was completely removed, and the statute as enacted also omits it. It is simply not plausible to assert that – in contrast to the explicit language of other single-issue ratemaking exceptions and in contrast to the explicit language in early versions of SB376 itself – the legislature meant to create an exception to one of the core principles of utility law by using the single word "timely."

2. SB376 did not give the Commission authority to implement a mechanism that allows for recovery of lost revenues.

As the Missouri Supreme Court noted in UCCM[11], there are only two permissible ways to raise rates in Missouri: the complaint method and the file-and-suspend method.[12] There is no authority in Missouri law for a third method of raising rates to account for revenues that might have been realized, all else being equal, if a utility had not taken certain actions. The

[10] SB376, Introduced, Section 393.1124.3. Later drafts, including the draft that became the Senate Committee Substitute, had the same phrase in Section 393.1124.5 rather than Section 393.1124.3.

[11] UCCM, *supra*, at 53.

[12] Since UCCM was decided in 1979, the Missouri Legislature has created several other mechanisms, but the premise of UCCM (that rates can be raised only by these two methods unless an explicit statutorily-created mechanism exists) is still valid.

Commission's "powers are limited to those conferred by statute, either expressly, or by clear implication, as necessary to carry out the powers specifically granted."[13]

Much like the provision in early versions of SB376 that authorized the DSIM adjustment mechanism, there was a provision in the first, introduced version of SB376 that authorized the recovery of lost revenues. And like the single-issue ratemaking provision, the provision that authorized the recovery of lost revenues **was deliberately taken out**. SB376, as introduced, explicitly authorized the Commission to "allow[] the utility a fixed investment recovery mechanism to recover lost margins...."[14] The legislature, recognizing how controversial this provision would be, and how much opposition it would draw, wisely decided to remove it, and it did not even survive through the first committee vote in the Senate Committee on Commerce, Consumer Protection, Energy and the Environment. Since the legislature considered giving the Commission the authority to implement a lost revenue mechanism, but then deliberately declined to do so, it would be clearly beyond the Commission's authority to implement such a mechanism.

WHEREFORE, Public Counsel respectfully submits its Brief on Legal Issues.

Respectfully submitted,

OFFICE OF THE PUBLIC COUNSEL

/s/ Lewis R. Mills, Jr.

By:_____

Lewis R. Mills, Jr. (#35275)
Public Counsel
P O Box 2230
Jefferson City, MO 65102
(573) 751-1304

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13 Utilicorp United, *supra*, at 109.

14 SB376, Introduced, Section 393.1124.3.

(573) 751-5562 FAX
lewis.mills@ded.mo.gov

I hereby certify that a copy of the foregoing has been emailed this 14th day of September 2010 to:

Nathan Williams
Missouri Public Service Commission
P.O. Box 360
200 Madison Street, Suite 800
Jefferson City MO 65102
Nathan.Williams@psc.mo.gov

/s/ Lewis R. Mills, Jr.