BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Review of Economic, Legal and Policy Considerations of District-Specific Pricing and Single Tariff Pricing	))))	**SW-2011-0103**

COMMENTS AND BRIEF
OF AG PROCESSING INC A COOPERATIVE

I. INTRODUCTION.

First, Ag Processing Inc a Cooperative (AGP) would like to thank the Commission for considering this question. As this brief will make clear, we do not agree that single-tariff pricing should be re-adopted, but we nevertheless appreciate the opportunity to comment on the suggestion.

Second, AGP is a large industrial customer in St. Joseph, Missouri and uses significant quantities of water supplied by Missouri-American Water Company (MAWC). AGP has participated in numerous MAWC rate cases and, in particular, participated in the 2000 rate case (WR-2000-281) that concerned the inclusion of the large new water plant to serve St. Joseph.

There, along with other industrials, AGP argued that, even though single-tariff pricing (STP) might save on the level of rates in St. Joseph as compared to district specific pricing (DSP), STP was incorrect as an approach and would lead to greater problems in the future if it continued to be followed. We urged a careful look at whether MAWC's construction of the new water plant was justified and prudent.

In that case the Commission determined to move away from STP toward DSP and, as a result, charged the value of the new St. Joseph plant to the St. Joseph district.[1/] That plant continues to be paid for by the St. Joseph customers and, based on our understanding, no others.

Having paid and continuing to pay for the new St. Joseph plant, AGP understands that in this proceeding the Commission is taking another look at STP as against the DSP approach. Although it might conceivably reduce AGP's water costs to some degree, STP remains no less incorrect now than it did ten years ago. AGP respectfully recommends to the Commission that the existing approach - district specific pricing -- be retained.

II. ARGUMENT.

A. STP Remains As Wrong Now As It Was 10 Years Ago.

The STP proposal is nothing more complicated than taking the costs of a utility's districts, combining them, then developing essentially uniform tariffs that recover those costs across the separate districts. This mechanism, of course, disregards costs that are specific to each district, especially the district specific capital costs necessary to supply service to each separate district.

[1/] There was, as we recall, a small disallowance for excess capacity. We are uncertain as to the current status of this disallowance.

Instead of directly charging each district for its unique costs, STP simply "averages" those costs and distributes them to all the districts with the result being that company customers in any of the districts only accidentally pay the actual costs that the company incurs to provide them with service. While this may be more convenient and expedient for the Company in preparing rate cases, the Courts of this state have often cited an axiom that aptly fits this situation:

> [N]either convenience, expediency or necessity are proper matters for consideration in the determination of whether or not an act of the commission is authorized by the statute.

See, *State ex rel. Kansas City v. Public Service Commission*,[2]; *State ex rel. Util. Consumers Council v. Public Service Commission*,[3]; *State ex rel. Missouri Cable Telecommunications Ass'n v. Public Service Commission*,[4].

AGP respectfully encourages the Commission to keep this guiding principle in mind as it re-evaluates STP as compared to the more appropriate DSP approach.

B. Rate Discrimination Generally.

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[2] 257 S.W. 462 (Mo. *en banc* 1923).

[3] 585 S.W. 41, 49 (Mo. *en banc* 1979).

[4] 929 S.W. 2d 768, 772 (Mo. App. W.D. 1996).

The legal requirement is that the rate approved by the Commission must be lawful, reasonable, nondiscriminatory and non-preferential.[5/]

1. The General Assembly Has Circumscribed the Commission's Ability to Create Subsidized Rates.

The Commission's jurisdiction is determined by the General Assembly's statutory delegation of regulatory power to the Commission. Section 393.130 RSMo 2000[6/] limits the Commission's power in this particular case. Single Tariff Pricing (STP) violates Section 393.130, which provides in pertinent part:

> 1. . . . . ***All charges*** made or demanded by any . . . water corporation . . . ***for water . . . service rendered or to be rendered shall be just and reasonable*** . . . . ***Every unjust or unreasonable charge made or demanded for . . . water . . . service***, or in connection therewith . . . ***is prohibited***.

The previously commenting parties appear to have focused on this provision in the statute. But they overlook a later portion of the same statute.

> 3. ***No . . . water corporation*** . . . ***shall make or grant any undue or unreasonable preference or advantage to any . . . locality***, or to any particular description of service in any respect whatsoever, or ***subject any . . . locality*** or any particular description of service ***to any undue or unreasonable preju-***

[5/] Most of the discussion on this topic has focused on the lack of "undue" discrimination. Section 393.130 has, however, a broader scope which does not appear to have been addressed.

[6/] All statutory citations are to RSMo 2000.

dice or disadvantage in any respect whatsoever. [Emphasis Added]

Subsection 1 requires rates to be just and reasonable for the "***water . . . service rendered***." The setting of rates for service in a district, which are higher than the reasonable cost to render the water service in such district violates this subsection. When none of the utility districts are interconnected, and none of the customers in any one of the districts is provided service by any of the other districts, any attempt to impute or include in the rates of one district, the costs of providing service to another district, is prohibited by Subsections 1 and 3 of Section 393.130.

Subsection 3 expands on the anti-discrimination and anti-preference provision of the law relating to water companies. The General Assembly added this provision and, we believe, went beyond the "undue discrimination" prescriptions contained in subsection 1 by adding additional language directed to "localities." This provision is written in the disjunctive: not only is it unlawful to subject a ***locality*** to "any undue or unreasonable prejudice or disadvantage in any respect whatsoever"; it is equally unlawful to grant a ***locality*** "any undue or unreasonable preference or advantage . . . in any respect whatsoever." *See*, *Alexander v. Chicago, M. & St. P. R. Co.*[7/], interpreting what is now Section 387.110, which includes virtually identical language pertaining to common carriers.

[7/] 147 S.W. 217 (Mo. 1912).

2. The Legislature's Choices Should Be Respected.

The legislature's choice of wording has significance. We do not believe that the General Assembly acted precipitously nor do we believe that the words that were chosen were mere surplusage. Instead they draw a distinction between (a) prohibiting "undue" discrimination between ***individual*** customers by putting them into a class with other ***individual*** customers sharing common load and usage characteristics, and (b) prohibiting an undue or unreasonable "preference or advantage" or an undue or unreasonable "prejudice or disadvantage" "in ***any*** respect whatsoever" to a ***locality***. These language choices deserve respect, and they highlight a distinction.

A utility could not rationally set a rate for each individual customer, but must group customers by common load and usage characteristics. Doing so is not "undue discrimination." But to attempt to unify physically separate and unconnected districts by averaging their rates violates introduces "undue" discrimination and an "undue" preference or disadvantage.

In the case of Single Tariff Pricing for non-interconnected districts with substantially different district specific costs of service, both prohibitions in Section 3 are broken. Not only does STP violate the law by granting undue or unreasonable preference or advantage to those localities (districts), whose resulting rates are lower than the cost of rendering such districts with water service, but STP also violates the law by subjecting other localities (districts) to undue or unreasonable

prejudice or disadvantage, by requiring them to pay higher rates than justified by the cost of rendering those districts with water service. Under STP, it is only happenstance and chance that the rates in any one locality (district) recover no more or no less than the cost of rendering such district's water service.

3. The General Assembly Is Presumed to Know Existing Judicial Construction.

Legislative selection of terms such as "undue preference" and "unreasonable discrimination" as limitations on a utility's authority were intentional. They are declarative of the common law rule, founded on public policy requiring one engaged in a public calling to charge a reasonable rate without discrimination. *State ex rel. Laundry, Inc. v. Public Service Commission*.[8/] Use of these terms sets clear limits on the grant of authority to the Commission. The terms "discrimination" and "preference," qualified with the additional terms "undue" and "unreasonable" have been construed by our courts to foreclose

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[8/] 34 S.W. 2d 37 (Mo. 1931). The *Laundry* case should be required reading for anyone interested in understanding the anti-discrimination provisions of Section 393.130.2 and 3. There is a very scholarly discussion of the purpose of the law prohibiting undue discrimination and undue preference found there. In *Laundry*, the Court determined that there was undue and unlawful discrimination for failure to give the same rate to all who used water under the same or substantially similar circumstances. In that case the company had a manufacturers rate and refused to give it to laundries, who were not manufacturers but used water the same as manufacturers. Quite obviously, the converse, where one locality is charged the same rate as another locality but the costs to serve each locality are substantially different, is also discrimination.

severance of the close relationship between cost-causers and cost-payers.

The parties heretofore have commented that there appears to be no precedent one way or the other on this issue. We think they may have overlooked several of the important cases in addition to *Laundry, supra*. For example:

In *State ex rel. City of Cape Girardeau v. Public Service Commission*,[9/] the court confirmed rejection of a rate proposal that would have "pass[ed] on to all residential customers within the city the benefits derived from the consumption of one user; it would [have] establish[ed] residential rates which would not reflect the true cost to those individual customers.

In *State ex rel. City of West Plains v. Public Service Commission*,[10/] the Supreme Court noted that a telephone utility's prior tariffs that passed through several individual municipal franchise taxes to ratepayers in other communities that did not impose such taxes was an "unjust discrimination" and upheld tariffs that limited charges for municipal taxes ***only*** to the utility customers ***living within those municipalities***.

And, in *State ex rel. City of Grain Valley v. Public Service Commission*,[11/] the Missouri Court of Appeals held that Southwestern Bell was in violation of Section 392.200, the anti-discrimination statute applicable to telephone companies, for

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[9/] 567 S.W.2d 450, 454 (Mo.App., 1978).

[10/] 310 S.W.2d 925 (Mo. en banc 1958).

[11/] 778 S.W.2d 287 (Mo. App. W.D. 1989)

providing the same service under the same conditions to two localities but charging one locality a different rate than the other locality. This, of course, is the converse to STP, which is the providing of a different service under different conditions to differing localities but charging all localities the ***same*** rates, thereby subjecting some utility service territories (localities) to undue or unreasonable prejudice or disadvantage while granting undue or unreasonable preference or advantage to the other utility service territories (localities) in violation of Subsection 3 of Section 393.130.

C. Operationally Separate Service Districts Have Different Costs.

Most of the water and sewer districts, existing and proposed, are operationally separate. There is no physical connection between these districts. For example, there is no possibility that the water treatment plant, mains or distribution facilities in St. Joseph may be used by the ratepayers in St. Charles, nor can the wells that provide a source of supply in Joplin provide service to customers in Warrensburg. The separate districts are discrete operating entities that have their own unique treatment plants, and their own ***unique*** sources of supply. Costs that are imposed by the provision of service to customers in one district simply do not benefit customers in another district. Utility plant that is used and useful in providing service to customers in St. Charles is not used and useful in providing service to customers in Joplin.

Staff has referenced the cost of water processing as being different. St. Joseph draws supplies from a Rainey well situated alongside the Missouri River (essentially as it did from its old plant although benefiting from the alluvial filtration of the Rainey well).

Joplin draws from wells as does Warrensburg but even those sources differ. Competent hydrogeologists would inform the Commission of the differences in well water from wells that are in the Ozark mountains than from those just south of the Missouri River, with the southern wells drawing water that is far less brackish and requiring less treatment to eliminate sulphur odors. There are other problems with surface water, and each separate district and source requires analysis and different treatment options -- and costs -- to bring the raw water to a finished state. The difference results, among other things, from the extent of glaciation during the most recent ice age.

The touchstone of public utility rate regulation is the rule that one group or class of consumers shall not be burdened with costs created by another group or class. *Coffelt v. Ark. Power & Light Co.*[12]; *Utilities Comm. v. Consumers Council*[13], *Jones v. Kansas Gas & Elect. Co.*[14]

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[12] 248 Ark. 313, 451 S.W. 2d 881 (1970).

[13] 18 N.C. App. 717, 198 S.E. 2d 98 (1973).

[14] 222 Kan. 390, 401, 565 P.2d 597, 606 (1977).

D. When Cost Are Shifted From Cost-Causers, Discrimination Results.

Under Section 393.130.3, an undue or unreasonable preference or advantage is given some districts while other districts are subjected to undue or unreasonable prejudice or disadvantage when the cost recovery is separated from cost causation. Transferring a significant portion of the cost responsibility caused by the use of a physically discrete utility plant and necessitated and caused by the usage of one group of customers in the served to another group of customers in different localities who have or derive no benefit whatever from that utility plant violates Section 393.013.3. Under STP, depending upon the district in which they are located, utility customers are either being subjected to an undue or unreasonable prejudice or disadvantage or are given an undue preference or advantage.

At its most basic, the justification for ignoring these undisputed cost differences is that it will allow the utility Company to spread the costs of its operations over more customers. Just as obviously, those who would otherwise have to pay the costs are given an unreasonable preference; those who have to pay costs that they did not cause are unduly prejudiced.

Spreading one district's discrete costs to the other districts unquestionably will reduce the rate impact on the customer in the ***benefited*** district. Both the common law and Section 393.130 are barriers to discrimination between cost-causers and cost-payers.

There is a useful (though imperfect) analogy in the electric field. Several years ago, the citizens of the State of Missouri, through an initiative Proposition, amended the Public Service Commission statutes to deny the Commission the authority to pass through costs associated with electric plant that was not used and useful. *See*, Section 393.135. Although applicable explicitly only to electric utilities, the section, and the fact that it was passed by an initiative, strongly hints that public sentiment would preclude the use of regulatory devices to charge ratepayers costs that are associated with utility investment that is not used and useful to them.

E. Single Tariff Pricing Is Poor Public Policy and Inconsistent With Objectives of Regulation.

We have noted above the inappropriate nature of STP based on its preferential treatment for some districts and its prejudicial treatment against other districts via its complete and undisputed departure from district by district cost of service. STP is also unreasonable on the same basis. Approaching the question from this perspective reveals an entirely different analysis.

As held in the *Jones* case, *supra*, the relationship between costs and rates is the essence of public utility regulation. Consider for a moment how this relationship came to be recognized.

Public utility regulation was established because the people, through their elected representatives, recognized that

public utility operations were capital intensive and that duplication of competing facilities within a geographical territory was economically inefficient. Accordingly, public utilities were permitted to have a monopoly in a given service territory. Recognizing, however, that monopoly powers were destined to result in abuses, the legislature established a regulatory commission to counterbalance what would otherwise be the unrestrained exercise of monopoly power. The regulatory commission was established as the substitute for competition and was intended to establish, through regulation, a close approximation of the pricing structure that would result if competition were permitted. Thus the *quid pro quo* for the monopolistic rights granted the utility was its submission to regulation and its commitment to safe, adequate and non-discriminatory service to all requesting that service within its monopoly territory.

One of the typical abuses of monopoly power that the regulators were to prevent was the monopolist's ability to enhance or protect its market dominance by overcharging customers for services as to which there was no effective competition, while using the excess monopoly rents gained thereby to subsidize below-cost operations in other areas. Thus was born the companion principle that each separate utility service should, to the maximum extent possible, be priced based on its cost including an approximately equal rate of return for the utility on the value of its investment used to provide that service. To say it in another way, the question was posed: What rate would likely

result if robust competition were permitted? The answer is that no service would be provided at much above or much below cost, because, in either case, and in a competitive environment, either the below-cost supplier would be forced out of business, or competitors would undercut the prices of the above-cost supplier. In all cases, after several iterations, rates that represented a return of the cost to provide the particular service, including a reasonable rate of return on the needed investment, would develop.

Thus approached, the concept of "cost of service" is not limited to the aggregate revenue requirement of the utility, but extends to cover the appropriate pricing of service to customers and groups of customers that are reasonably related as to cost and usage characteristics. Regulation that does not achieve this objective is failing its basic mission and purpose. Regulation that achieves control only of the **aggregate** level of utility revenues is doing an incomplete job. After all, regulation does not exist to benefit the monopoly utility; it exists to protect the public from the abuses of monopoly.

This case demonstrates the effect of abandoning these basic principles of public utility regulation. Cost differences between physically discrete service districts are acknowledged as present, but then dismissed or ignored under STP.

There are other practical reasons behind cost-based rates, including:

- ***Cost based DSP rates send proper price signals to utility customers***. They permit appropriate evaluation

of alternatives such as housing insulation, electric appliances, selection of manufacturing equipment on efficiencies, and (in this case) the evaluation of the cost of the use of scarce resources such as water, whether to install more efficient plumbing fixtures or engage in "zero-scaping" to reduce lawn-watering. They promote wise use of resources and meaningful comparison of available alternatives. In some instances, they may even cause previously unexplored alternatives to become economic.

- ***Cost based DSP rates provide appropriate public feedback for the utility regarding its investment and encourage prudence in making that investment***. If rates do not track costs, or if ratepayers are over-charged or under-charged, customer reaction to the costs associated with utility investment will be misdirected and inappropriate. Excessive investment will be inhibited by the fear of public scrutiny and wrath.

  There is an example of this available in Missouri-American's construction of the new St. Joseph plant. Well-documented in the record of the WR-2000-281 case, MAWC urged community support of the construction, arguing that St. Joseph would only bear one-third of the new plant's cost, with the remainder spread to other districts. When a 80%-250% increase in rates arrived (depending on the meter size), there was much outcry. Assurance of district specific pricing would prevent a recurrence and avoid overbuilding when district service parameters do not support the size of a construction project.

- ***Cost based DSP rates do not mask the true costs of an acquisition by one utility of another district.*** A utility business plan to acquire another service district (or several) should be similar to that involved in a main extension question: Does the additional business justify the investment? An up-front loss may be required in order to earn future returns.[15/]

- ***Cost based DSP rates provide earnings stability for the utility***. When customer usage patterns shift, utility revenues will shift. If rates are tied to costs, costs will also shift in synchrony with changes in usage patterns; utility earnings will remain stable. Conversely, if rates and costs are not related, customer

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[15/] It is occasionally forgotten that utilities are only guaranteed an ***opportunity*** to earn a reasonable return. Prudent management is still required.

> usage shifts will still change revenues, but underlying costs may not change with resultant instability and unpredictability in utility earnings.

In *In re Gas Service Company*,[16/] this Commission ruled:

> Above all, in the opinion of the Commission, *the **touchstone** of rate design is that the rates must and should reflect the cost to serve that particular customer or group of customers*. To depart from this basic principle will place the regulator in a never-never land wherein he can design rates to suit his own particular whim or caprice, or satisfy his own preconceived ideas of how society should be charged for services. [Emphasis added].

III. CONCLUSION.

The Commission of today should recognize the validity of these well-established principles. By promoting STP, utilities seek to ignore costs, how costs are incurred, and for whose benefit costs are incurred. STP should not enjoy a resurgence.

AGP has listened to several arguments that attempt to justify socialization of utility costs. But AGP picked up and continues to pick up its tab for the new St. Joseph plant. We did not ask for a subsidy from another MAWC district. Though more costly, we advocated DSP because that was the proper approach. Having once paid its dues, AGP does now not wish to pay those of another. We respectfully urge that DSP be retained and that STP be rejected.

Respectfully submitted,

[16/] 21 Mo. P.S.C. (N.S.) 262 (1976).

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SERVICE CERTIFICATE

I certify that I have caused a true copy of the foregoing pleading to be provided to parties of record in this proceeding through electronic service upon the addresses provided by the EFIS.

December 22, 2010

An attorney for Ag Processing Inc a Cooperative