**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 WAL-MART STORES EAST, LP AND SAM’S EAST, INC.**

Wal-Mart Stores East, LP and Sam’s East, Inc. (collectively, “Walmart”), hereby provide their comments in response to the Commission’s Notice of Workshop and Requesting Responses issued August 5, 2015 in the above captioned docket.

Walmart is an international retailer with 154 retail stores and four distribution centers in the state of Missouri. Walmart is a large customer of most of the electric, natural gas, water, and sewer utilities regulated by the Commission, as detailed below.

Walmart takes service from the following electric utilities regulated by the Commission:

1. Ameren Missouri (“Ameren”);
2. Empire District Electric Company (“EDE”);
3. Kansas City Power & Light (“KCP&L”); and
4. KCP&L Greater Missouri Operations Company (“GMO”).

Walmart takes service from the following natural gas utilities regulated by the Commission:

1. Ameren;
2. Empire District Gas;
3. Laclede Gas Company;
4. Liberty Utilities;
5. Missouri Gas Energy; and
6. Summit Natural Gas.

Walmart takes service from the following water and sewer utilities regulated by the Commission:

1. EDE;
2. Liberty Utilities; and
3. Missouri-American Water Company.

The Commission’s notice requested responses to a number of questions regarding the legality and implementation of decoupling for the utilities regulated by the Commission, and Walmart’s comments will focus on the second question:

Please comment on your interests and preferences for any of the various aspects related to revenue regulation and decoupling contained in “Revenue Regulation and Decoupling: A Guide to Theory and Application, June 2011, The Regulatory Assistance Project.” (“RAP Report”)

It should be noted that Walmart takes no position on the structure and applicability of a decoupling mechanism as it relates to the rates of residential or other non-demand-metered customers, assuming that demand-metered customer classes would be excluded from the mechanism. The comments below will focus on the structure and applicability of any decoupling mechanism on demand-metered customers. Additionally, because electricity is Walmart’s largest utility cost in Missouri, the comments will focus on decoupling as it would be applied to electric utilities.

Decoupling mechanisms are regulatory risk management tools employed by a Commission to encourage a utility to promote energy efficiency when doing so may have the potential to compromise the utility’s ability to earn an authorized rate of return on investments. Utility-implemented measures to improve energy efficiency, mandated through legislation or the regulatory process, if effective, reduce energy consumption and thus reduce energy sales, all other factors being equal, potentially lowering a utility’s revenues and earnings. If the Commission determines this sort of risk management tool is appropriate for one or more of the utilities in the state, it is important for the Commission to not lose sight of the fact that the principles underlying sound ratemaking do not change and should continue to be followed. All of the factors considered in the ratemaking process continue to matter, as discussed below. Implementation of decoupling should not divert the Commission from addressing serious existing issues in utility rates, such as inter- and intra-class subsidies contained in rates. Additionally, implementation of decoupling should not be done in such a manner that existing issues are exacerbated or new issues are created.

Walmart prefers that, if the Commission determines that implementation of decoupling is appropriate for a utility, decoupling be done separately for each customer class, and for demand-metered customer classes be implemented via changes to the tariffed rate designs as opposed to an “approved vs. actual” mechanism. Additionally, the Commission should determine the extent to which implementation of the decoupling mechanism reduces that utility’s business risk and should be reflected in the Company’s cost of capital.

1. **Price Matters**

Walmart advocates that a utility’s rates charged to customers – or prices – reflect the utility’s underlying cost of service. This produces equitable rates that reflect cost causation, sends proper price signals, and minimizes price distortions. According to the Oxford Dictionary of Economics:

“The price mechanism refers to the role of prices in organizing the production and distribution of goods and services in an economy; the prices people are willing to pay convey information about the valuation they put on different goods and services, and the prices charged by suppliers convey information on how they value the effort and inputs needed for production.”[[1]](#footnote-1)

For better or worse, a utility’s ability to collect its approved revenue requirement is inextricably intertwined with pricing. Likewise, a customer’s ability to efficiently deploy limited resources to operate its facilities and manage its energy usage relies on a utility’s rates transparently and reliably communicating the value of the costs underlying those rates. The RAP Report seems to suggest that bills, as opposed to prices, should be the focus of a consumer advocate.[[2]](#footnote-2) However, a bill ultimately shows total cost to the customer, which is a sum of all unit prices multiplied by their respective billing units, and is not a price itself. Failure by a utility or regulator to correctly price service or failure by a customer to correctly account for prices can result in economically inefficient outcomes and inefficient use of utility and customer resources. The Commission should ensure that, regardless of whether or how it chooses to implement decoupling, a utility’s rates – or prices – reflect the utility’s underlying costs.

1. **Cost of Service Matters**

Class cost of service and the allocation of revenue requirement among customer classes have been significant issues in recent general rate cases adjudicated by the Commission. The Commission has recognized this issue and worked to move customer classes towards cost of service, however more movement is required before rates for each of customer classes of each of the electric utilities will be set at their respective costs to serve.[[3]](#footnote-3)

Decoupling, if applied incorrectly, can continue or exacerbate existing cost of service and revenue allocation issues or even create new issues. For example, some utilities have implemented a total company decoupling mechanism that uses an “approved vs. actual” accounting and deferral mechanism, in which the utility’s approved revenues and actual revenues for a given period are reconciled and the difference is credited or charged to all customers on a single $/kWh rate.[[4]](#footnote-4) As a result, total company “approved vs. actual” mechanisms can lock in the over-collection of revenues from customer classes that are paying more than their cost of service in base rates, and, by extension, paying more towards the utility’s fixed costs than customers who are paying less than their cost of service. These mechanisms can also expose those customers to additional increases if the Company, in total, under-recovers its allowed fixed cost recovery. Customers who are already over-paying should not be exposed to the possibility of additional over-payment through a decoupling mechanism.

1. **Rate Design Matters**

Electric utility costs are classified in three primary cost classifications. The first classification is customer-related costs, which are costs, such as meters, that are directly related to the number of customers served. The second classification is demand-related costs, which are costs, such as generation plant, transmission, and distribution, that vary with the kW demand imposed by customers. Customer-related and demand-related costs are fixed costs, which are defined as costs that do not vary with the level of output and must be paid even if there is no output.[[5]](#footnote-5) The final classification is energy-related costs, which are costs that vary with the energy or kWh that the utility provides.[[6]](#footnote-6)

For electric utilities, decoupling via rate design is the process of setting the $/month customer charge, the $/kW demand charge (or charges), and the $/kWh energy charge (or charges) at their full cost levels, such that each charge collects the full amount of the costs assigned to the respective classification. As such, the customer charge will collect all costs classified as customer-related, the demand charge(s) will collect all costs classified as demand-related, and the energy charge(s) will collect all costs classified as energy-related. No fixed costs are recovered via the per-kWh energy charge(s).

Decoupling via rate design has two key advantages to an approved vs. actual mechanism. First, the rate design approach allows the Company to create rates that reflect cost of service and correctly account for cost causation. This minimizes inter-class and intra-class subsidies and sends correct price signals to customers in addition to decoupling the relationship between earnings and energy sales.

The second key advantage is that rate design is an *ex ante* process – that is, the price for service is set in advance of customer’s activities. With *ex ante* ratemaking, customers have the benefit of complete information related to the bill impacts of their energy efficiency efforts at the time the decision to act is being made. An approved vs. actual rate adjustment mechanism is an *ex post* adjustment – that is, the price for service is set after the customer’s change in usage occurs and the revenue and usage impacts to the utility are determined. The impacts of energy efficiency efforts cannot be known to a customer at the time the decision to act is being made and, unlike fuel, where a customer could follow the commodity markets and predict general movements in what the future fuel cost might be, the customer has no way to predict what the future decoupling rate will be, as that rate is wholly dependent on utility billing, collections, and accounting and other customers’ usage.

The current rate designs of the four Missouri electric utilities for large commercial and industrial demand-metered customers are largely deficient in the collection of fixed costs through customer and demand charges. Each utility currently employs a version of an “hours-use” rate design for large customers.[[7]](#footnote-7) These rate designs employ a $/month customer charge, a $/kW demand charge, and a three-tier hours-use energy charge, which sets the billing kWh for each block based on the kWh used for each kW of billing demand, or load factor for the billing month. One rate is charged for the first X kWh used per kW of billing demand, a second lower rate is charged for the next Y kWh used per kW of billing demand, and all additional kWh are charged the lowest third block rate. Hours-use rate designs purposefully under-recover demand-related costs through the demand charge and spread recovery of those costs among the energy charges. In essence, if a rate class with an hours-use rate design is under-recovering its fixed cost – for any reason – it is doing so on purpose.

If the Commission were to apply an approved vs. actual mechanism on top of the hours-use rate, it would essentially be rewarding the purposeful under-recovery of fixed costs. This is not cost-based ratemaking nor appropriate public policy.

Walmart advocated extensively on hours-use rate design in the most recent Ameren rate case and continues to encourage the Commission to examine whether the hours-use rate design continues to be an appropriate rate design for Missouri electric utilities to use.

1. **Risk Matters**

The overarching premise of the regulation of public utilities is that regulation serves as a substitute for the pricing and operational discipline that comes from exposure to forces in a competitive market. Decoupling, if implemented as an actual vs. approved mechanism, has no competitive market analogue – if a business loses a customer to another business, the business cannot apply a charge to that customer to account for lost contribution to fixed costs, and any potential price increases to remaining or future customers is tempered by competitive forces. A business in a competitive market is wholly responsible for its fixed cost recovery and has no guarantee of consistent revenues year to year.

Decoupling, as stated above, is a risk management tool, and if implemented, the risk reducing effects of the implemented mechanism should be considered in the determination of the appropriate cost of capital for a utility. The RAP Report addresses this issue in detail and suggests that the risk mitigation of decoupling could be reflected in either the capital structure or return on equity of the utility.[[8]](#footnote-8)

Other Commissions have recognized that decoupling can reduce business risk. For example, the Connecticut Public Utility Regulatory Authority, which has authorized actual vs. approved mechanisms for both United Illuminating and Connecticut Light & Power, has stated:

“In this case, the Authority will not make an explicit downward adjustment to ROE, but notes that financial theory indicates a decoupling mechanism, which virtually guarantees the Company’s ability to achieve its allowed revenues, eliminates some business risk that UI would otherwise face. Therefore, the Authority finds that an allowed return selected from low to midpoint of the range of reasonableness is appropriate and supported by the record evidence and financial theory.“ *See* Docket No. 13-01-19, Decision, August 14, 2013, page 126.

In summary, it is vital that the Commission consider any implemented decoupling mechanism in its consideration of a utility’s cost of capital.

\* \* \* \*

WHEREFORE, Walmart respectfully submits these comments to the Commission for its consideration.

DATED this 1st day of September, 2015.

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1. Black, John. *Oxford Dictionary of Economics*. New York: Oxford University Press, 1997. Page 362 to page 363. [↑](#footnote-ref-1)
2. RAP Report, page 2. [↑](#footnote-ref-2)
3. For example, see the Commission’s Report and Order in the most recent Ameren rate case, File No. ER-2014-0258, page 74, and the Commission’s Report and Order in the most recent EDE rate case, File No. ER-2014-0351, page 20. [↑](#footnote-ref-3)
4. For example, see Connecticut Light & Power’s Revenue Decoupling Mechanism Rider (<https://www.eversource.com/Content/docs/default-source/rates-tariffs/rider-rdm.pdf?sfvrsn=0>) or the generic example in the RAP Report. [↑](#footnote-ref-4)
5. Pindyck, Robert S. and Daniel L. Rubinfeld. *Microeconomics, 5th ed.* New Jersey: Prentice Hall, 2001. Page 206. [↑](#footnote-ref-5)
6. National Association of Regulatory Utility Commissioners. *Electric Utility Cost Allocation Manual*. Washington D.C.: NARUC, 1992. Page 20. [↑](#footnote-ref-6)
7. See for example, EDE’s General Power Service Schedule (<https://www.empiredistrict.com/DocHandler.ashx?id=3048>), KCP&L’s Large General Service Schedule (<http://www.kcpl.com/~/media/Files/My%20Bill/MO%20Detailed%20Tariffs/82014%20updates/11LargeGeneralService.pdf>), and Ameren’s Large General Service Schedule (<https://www.ameren.com/-/media/missouri-site/Files/Rates/UECSheet56Rate3MLGS.pdf>). [↑](#footnote-ref-7)
8. Rap Report, page 37 to 38. [↑](#footnote-ref-8)