

COMPLETE REVIEW

During rate case proceedings, the PSC Staff thoroughly reviews the books and records of the company, including the general ledger, invoices, actuarial reports, independent audit reports, Board of Director materials, financial statements, income statements, balance sheets, and other documents.

By Kim Bolin

Utility services and infrastructure are essential to the economy of Missouri. They provide heating and cooling during extreme temperatures. They offer access to emergency services and vital information systems. They provide safe drinking water and assure the environmentally sound disposal of wastewater. Virtually every Missouri citizen receives some form of utility service from a company regulated by the Missouri Public Service Commission (Commission or PSC).

The Commission has the statutory responsibility of ensuring that consumers receive “safe and adequate” service at rates that are “just and reasonable.” According to the law, those rates must be set at a level which will provide the companies’ shareholders with an opportunity to earn a reasonable return on their investment. It is important to note that shareholders must be given an opportunity, not a guarantee, to earn a reasonable return on their investment to maintain market viability. Rates should also be set at a level to allow a utility to recover its ongoing

level of prudently incurred expenses that are necessarily incurred in order to provide utility services.

General rate cases are complex and can, at times, draw much public attention. The five Commissioners will ultimately decide the case. That decision will be based upon a thorough review of the evidence in the case submitted by all participating parties in the proceeding.

The Public Service Commission Staff (PSC Staff) plays a key role in the development of

that evidence through its audit of the books and records of the company seeking a rate increase.

The PSC Staff is not a consumer advocate. The PSC Staff is a neutral party separate from the Commissioners for purposes of a rate case proceeding.

The PSC Staff's job is to present a position that it believes will be the best balance between the needs of the utility and the needs of the public. The PSC Staff has worked hard to

Those Likely To Participate In A Rate Case Before The PSC

- **Public Service Commissioners** -- Five members of the Public Service Commission (Commission) who decide all cases brought before the agency. Commissioners are appointed by the governor with the advice and consent of the Missouri Senate. In cases before it, Commissioners issue a ruling based on a thorough review of all of the evidence presented.
- **Public Service Commission Staff (PSC Staff)** -- A group of professionals that includes specialists in the fields of engineering, accounting, law, finance, management, economics and customer services. The PSC Staff is separate from the Commissioners who decide cases brought before it. The PSC Staff is a party in all cases before the Commission. When the PSC Staff makes a recommendation to the Commission, it is NOT an official position of the Commission. The PSC Staff recommendation carries the same weight, no more no less, as all other testimony filed in a case. The PSC Staff **is not** the consumer advocate. The PSC Staff proposes a position that, in its opinion, is the best balance between the utility and the general public.
- **Office of the Public Counsel (OPC)** --The consumer advocate. The Office of the Public Counsel is a separate state agency representing the general public (typically residential and small business customers) before the Public Service Commission.
- **Intervenors** -- Someone who files to participate in a case before the Public Service Commission. Intervenors are typically large business customers, governmental agencies or representatives of a customer group with a particular interest in a case, an interest that is different from that of the general public.
- **General Public** -- In addition to being represented by the Office of the Public Counsel, the general public can also submit comments in cases before the Commission. They are also invited to comment on the rate request or any service related issues when the Commission holds local public hearings in the company's service territory. Comments received during the formal local public hearing process are recorded by a court reporter and become a part of the official record in the case.



The Commission holds local public hearings.

present that position for more than 100 years of utility regulation in Missouri.

So what does the PSC Staff do when a rate case is filed with the Commission?

In developing its recommendations as to the amount of an increase, if any, that should be granted, the PSC Staff will spend several months conducting their audit. They will examine all of the company's costs of providing safe and adequate service to its customers.

The PSC Staff will thoroughly review the books and records of the company, including the general ledger, invoices, actuarial reports, independent audit reports, Board of Director materials, financial statements, income statements, balance sheets, and other internal documents. When reviewing these items, the PSC Staff looks for trends among the company's historical costs, increases and decreases in the company's test-year expenses and any abnormal levels of specific costs.

All rate case audits are based upon a selected "test year." In a rate case, the test year is a 12 month operating period used to evaluate the cost of service to customers and the adequacy of the rates a utility is charging or proposes to charge.

As part of its review, the PSC Staff also tours and inspects various utility facilities; interviews company personnel; and sends numerous data requests to obtain information and documents from the company. The PSC Staff will also examine all of the testimony and other filings

made by the company and every other party ("intervenors") in the rate case.

When the rate case is filed with the Commission, the utility will file "testimony" from various utility representatives and consultants that summarize and describe the utility's reasoning for seeking an increase in its customer rate levels. Similarly, at the conclusion of its audit process, the Commission Staff and other parties will also file testimony or reports that summarize their audit findings, conclusions and recommendations.

In rate cases, the Commission will hold local public hearings to give consumers the opportunity to comment on the rate increase request or any service related problems. At those hearings, there are several issues that often are of interest to the general public. Let's take a moment to discuss two of those issues: utility company employee compensation expense, and dues and donations.

Employee Incentive Compensation Expense: When a company files for a rate increase, one of the items reviewed is employee compensation. One part of employee compensation may be incentive compensation, or bonuses or awards, paid to company employees. The PSC Staff may perform a multi-year analysis of bonuses and awards as part of its audit in determining what it will recommend as just and reasonable rates.

The PSC Staff will examine the criteria for future bonuses and awards and what employees are eligible for those bonuses or awards. Based upon this examination, the PSC Staff will determine if the bonuses and awards are based on measurable results that provide a benefit to ratepayers.

Determining if bonuses and awards should be included can be a complicated and time-consuming analysis. For example, the performance standard may be based on certain financial results of the company, such as the earning per share or rates of return on equity or investment. PSC Staff usually recommends disallowance of these awards because they primarily benefit the utility and its shareholders.

In contrast, a performance standard based on customer service criteria is of benefit to the customer and may be allowed to be recovered by the utility company in customer rates. For instance, an incentive compensation program tied to improving the quality of service a utility customer receives, such as faster responses to

customer inquiries received at a utility “call center,” will usually be a cost recommended by the PSC Staff to be included in rates. Performance standards intended to improve employee safety are also generally recommended for rate recovery.

Dues and Donations: During local public hearings in a rate case, customers often ask questions such as: “Am I paying, in my monthly utility bill, the costs of the company to have a luxury box or to advertise at a major sporting event?”

The PSC Staff auditor(s) assigned to the dues and donations area will ask the company for a list of all dues and donations made by the utility company during the rate case test year. The Staff will also seek information on the nature and purpose of all dues and donations and how the utility company believes its ratepayers benefited from the expense.

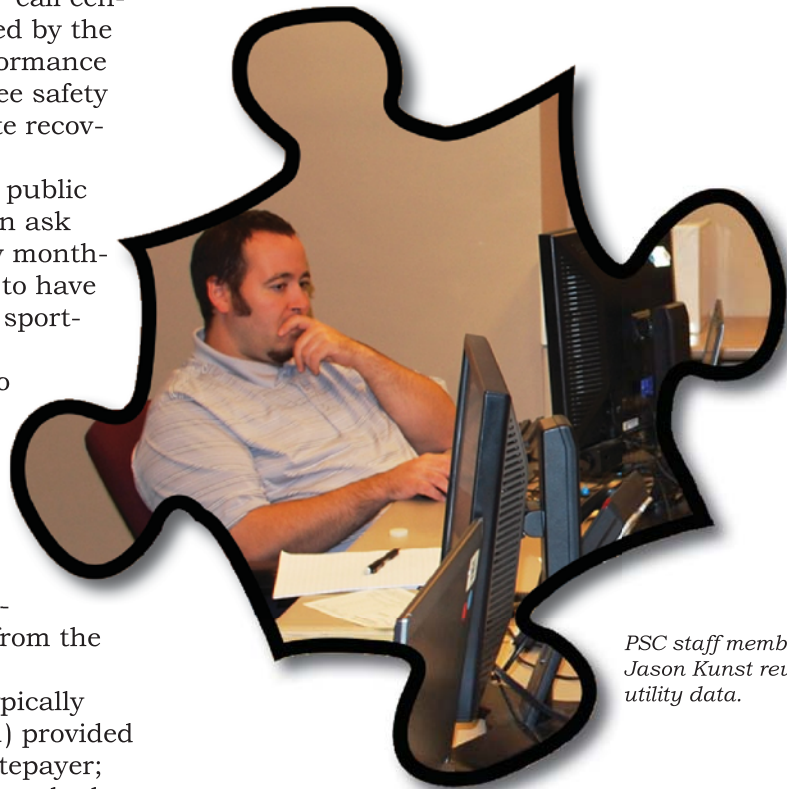
In the past, the Commission has typically not allowed dues and donations that: 1) provided no direct, quantifiable benefit to the ratepayer; 2) were not necessary in providing safe and adequate service to the ratepayer; or 3) represented an involuntary contribution on the part of the ratepayer to an organization.

Those costs associated with charitable donations are routinely disallowed in the PSC Staff recommendation in a rate case on the general grounds that utility ratepayers should not be placed in the position of being “involuntary” donors to a charity or cause supported by the utility company. Also, any dues or donations associated with political advocacy or “lobbying” activities have not been allowed to be recovered in rates.

That is not to say that any dues and donations are allowed to be recouped in rates. For example, the Commission does recognize dues and donations to some economic and civic organizations (such as Chambers of Commerce), business, industry and professional organizations.

What other types of issues are commonly examined by Commission Staff and other parties as part of the rate case process?

Besides reviewing expenses incurred by the company during a rate case, the PSC Staff also reviews other items and provides recommendations on subjects such as: rate of return, low income weatherization, depreciation and rate design.



*PSC staff member
Jason Kunst reviews
utility data.*

Rate of Return

An analysis must be performed to determine the return (or “profit”) a company will be allowed to earn on investments used in providing utility service to its customers. This profit level is usually referred to as the “rate of return.” The rate of return calculation takes into account both the necessary return the utility should earn on its equity investment, as well as the interest required to be paid to the company’s debtholders. The PSC Staff provides its own analysis in each rate case before the Commission as to the appropriate level of rate of return for that utility. As part of this analysis, the PSC Staff uses various financial models and comparisons of other utilities within the state as well as other national utilities’ financial earnings to determine a reasonable rate.

Low Income Weatherization

The Commission has approved programs designed to help low-income customers with energy conservation efforts. The Low Income Weatherization Assistance Program (LIWAP) is administered by the Missouri Division of Energy

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using federal, state, and utility funding. It is administered locally by Community Action Agencies or other local agencies. The LIWAP provides money to help low-income consumers purchase home weatherization repairs (insulation, etc.) and energy-efficient appliances. As part of the rate case, the PSC Staff reviews the weatherization programs in the utility’s service territory to determine if the programs are effective and what level of funding should be included in rates.

Depreciation

Depreciation is the return of the Company’s investment in utility assets over the life of its property used to provide service to its customers. The depreciation rate for each classification of property is designed to recover, over the life of the asset, the cost of the investment plus any cost to remove it (net of salvage proceeds) when it is no longer being used to provide utility service. The PSC Staff reviews the history of the Company’s investments, such as how long the equipment has been in service and what the industry expects the life to be, in order to determine an estimated life span of the investment on which the recommended depreciation rate will be based.

Rate Design

After reviewing all utility costs, the PSC Staff recommends which and how much of those costs should be recovered in customer rates (the total amount of costs is commonly referred to as the “revenue requirement”) and also how that revenue requirement should be recouped from the various classes of customers (such as residential, commercial and industrial).

Rate design recommendations are normally based upon a “class cost of service study.” This type of study also provides information useful in formulating recommendations on the amount of the “customer charge” (a monthly fixed rate charge on the customer bill) and the amount of the commodity charge (variable charge on the



PSC staff auditors Lisa Ferguson and Jason Kunst confer during a work session.

bill based upon the customers actual usage of the utility service for a month). The process of determining how much of a utility’s overall revenue requirement should be recovered from each customer class is commonly referred to as “rate design.”

How Are Rate Cases Resolved?

Rate cases may be resolved through negotiation of the parties (rate case settlements), or by submission of issues to the Commission through the hearing process.

Settlement and Negotiations

Not every rate case results in a hearing before the Commission. In every rate case, parties meet to see if they can come to an agreement on the amount of the rate increase, rate design and other issues pending in the case. This process usually begins after the PSC Staff has filed its direct testimony in the case outlining the results of its audit.

If the parties can reach an agreement, the



The Commission holds weekly Agenda meetings to discuss cases and issue decisions.

agreement will be filed for Commission consideration. However, in some cases, all parties do not agree on all issues presented in the case. When this happens a partial agreement is filed and the Commission will then hear all of the remaining issues in the rate case.

Litigated Hearings

For rate cases that go to hearing, the Commission will hear evidence for each individual issue in dispute among the parties.

All witnesses supporting a position in the case must take the witness stand and undergo cross-examination by opposing parties, as well as questioning from the Commissioners.

Based upon the evidence presented to it in both written testimony and in the hearing room, the Commission will decide each issue based upon which party it believes has submitted the most persuasive evidence on the matter.

The Commission's decisions on all litigated issues are outlined in a document called a "Report and Order."

Kim Bolin works in the Audits, Accounting & Financial Analysis Department of the PSC.

How To Watch Rate Case Hearings

The PSC regularly webcasts rate case hearings and other events on its website (www.psc.mo.gov).

To view a live webcast, click on the "Events Now Streaming" link on the top left corner of the homepage. If a webcast is in progress, you will see the title of the event.

If you click on the title (i.e. Hearing or Agenda), you will be able to view the live webcast. If no events are streaming, the box will say "No Events Active."

Past webcasts can also be viewed. Those events can be found by clicking on the link "Archived Videos" toward the bottom of the homepage.