BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of a Proposed Rule Regarding Electric Utility Fuel and Purchased Power Cost Recovery Mechanisms.	))))	**EX-2006-0472**

PREPARED COMMENTS OF NORANDA ALUMINUM, INC.
REGARDING SELECTED ISSUES IN PROPOSED RULE

I. INTRODUCTION.

Following final enactment of Senate Bill 179 ("SB179"), now codified as Section 286.266 RSMo, the Commission initiated a series of informal workshops to elicit comment from stakeholders and other interested persons and entities regarding the contours of the implementing rules which the General Assembly tasked the Commission to design. Throughout that extended process, Noranda Aluminum, Inc. ("Noranda"), through its representatives, actively participated in these many meetings and discussions.

Noranda operates an aluminum reduction facility near New Madrid, Missouri. It presents a unique load to its serving utility, AmerenUE.[1/] Operating at virtually a 100% load factor, Noranda's demand is measured at roughly 475 mW. For purposes of

[1/] The particulars of this load and Noranda's requirements for reliable and economical power supplies were detailed to the Commission in Case No. EA-2005-0180 in which AmerenUE applied and was granted an amendment to its certificate of public convenience and necessity to provide service to Noranda.

comparison only, Noranda's load is greater than the total of the entire Large Industrial Class served by AmerenUE.

Noranda's need for reliable and economical power is no secret and is well known to the Commission. Competing in a national and international market, where product prices are set in a worldwide market, costs for electricity are the largest component of Noranda's production costs. It is critical that rules implementing any fuel adjustment be carefully and correctly designed.

Through the earlier workshop meetings, Noranda has intentionally focused its attention on four issues:

- ***Mandatory recognition of losses*** as a significant part of proper rate design and thus the design of an appropriate fuel adjustment clause ("FAC");
- ***A limitation on rate volatility*** in the form of a properly designed Rate Cap;
- ***Appropriate and robust surveillance*** of the affected utilities' operations; and
- ***Alignment of the interest of the utility in making a profit with the interest of the ratepayer in lower rates*** so that the mechanism retains some measure of cost control; a concept we have called "Alignment of Interest."

Given the magnitude of Noranda's load and the large effect that even small missteps or errors can have on Noranda's power costs, our comments will focus on improvements to the proposed rule to remedy the possibilities of a manifest rate

design inequity. Noranda will not address all of its points here but will leave some of the other important issues for others to address.

II. SUBSTANTIVE COMMENTS ON THE PROPOSED RULE.

A. Any Final Rule Should Properly Address the Issue of Rate Design.

A cost-based rate for services is the essence of regulation. Assuming for our present purposes electric service that is in all respects adequate and reliable, then attention next must fall to the rates for the services rendered. Among the important rate design considerations are the "losses" that occur on the electric system between the generation of electricity at power plants and delivery to any customers. A closely related issue is the separation of FAC costs into demand and energy related components.

In the context of fuel costs and a FAC,[2/] the differences in losses among customer classes constitute an essential issue that will properly differentiate rates among the customer classes. If the FAC expands and is allowed to include costs and credits other than fuel -- a distinct possibility based on the scope of the proposed rule -- then a separation of costs into demand and energy components will also become necessary. Alternatively, demand related costs must not be collected through a FAC.

[2/] The proposed rules refer to the mechanism of SB179 as a Rate Adjustment Mechanism or "RAM."

1. Proposed Modification To the Proposed Rule Language.

To address this concern, Noranda would respectfully encourage Commission consideration of the following language change to the indicated provision of the proposed rule ("Change One"):[3/]

4 CSR 240-20.090

. . . . .

(9) Rate design of the RAM. The design of the RAM rates *shall reflect an allocation method or methods for costs based on the principle of cost causation and shall not be designed in a manner that will allocate costs or revenues among customers or customer classes in a manner that is inconsistent with the principle of cost causation. The allocation method or methods shall* ~~may~~ reflect differences in losses incurred in the delivery of electricity at different voltage levels for the electric utility's different rate classes. Therefore, the electric utility shall conduct a Missouri jurisdictional system loss study within twenty-four (24) months prior to the general rate proceeding in which it requests its initial RAM. The electric utility shall conduct a Missouri jurisdictional loss study no less often than every four (4) years thereafter, on a schedule that permits the study to be used in the general rate proceeding necessary for the electric utility to continue to utilize a RAM.

B. Proper Rate Design Must Consider the Division Between Demand for Capacity and the Energy Generated By That Capacity.

There can be no reasonable debate. Fuel costs are energy related. All that is needed for a proper rate design of the energy rates is for the fuel costs to properly account for

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[3/] Deleted text is marked as strikeout, ~~thus~~. Added text is italicized, *thus*.

losses. However, items to be passed through under the proposed rule are subject to a definition that goes beyond the coal, natural gas, and other fuels that are used to drive the generators. For example, some of the costs for purchased power may well include a demand component. As such it may become necessary to develop a rate design that separately addresses demand and energy charges. This is a straightforward matter that is addressed in Change One, *supra*, at p. 4 of these comments. In the absence of an appropriate allocation of any demand related costs, the remedy must be to exclude the demand related costs from recovery as a part of any fuel rate adjustment mechanism.

1. Proposed Modification to Language of the Proposed Rule.

The suggestion made above, identified as Change One, is believed adequate to address this issue.

C. The Final Rule Should Properly Address the Proper Recognition of Losses.

1. Losses Are A Necessary Component of the Transformation and Transmission of Electrical Energy.

Electricity generated at a power plant must be transformed from the generation voltage level to the much higher voltage level of the "high tension" transmission lines. Transformers, which are just large electrical machines, are employed to "transform" the electricity from one voltage level to the other. The transmission lines allow the electricity to travel over the transmission grid to load centers where transformers are

again needed to reduce the electricity to primary and secondary distribution voltages.

But there is no free lunch! It takes power to transmit or transform power. Each transformer and all of the transmission and distribution lines consume some portion of the electrical energy in order to perform their respective functions. The electricity consumed in the transformations up and down among the various voltage levels and in the movement of the electricity over the transmission and distribution lines is termed "losses." In a technical sense, the energy is not "lost," but rather is a necessary component of and is consumed in the transportation/transmission process from the many generators to the many loads. It may be dissipated as radiant heat energy, overcoming the resistance and impedance of the transmission wires and the coils in the transformer. It is only "lost" in the sense that a portion of the energy generated is necessarily consumed by a utility's electrical system in the process of transformation, transmission and distribution, but it is, therefore not available for service to customers. These are physical principles and are not optional. Losses cannot be avoided by wishing them away.

Just last year as a part of docket EA-2005-0180[4/] both the contract between Noranda and AmerenUE and rate schedule LTS (Large Transmission Service) received detailed and extensive

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[4/] The Commission's Report and Order was entered March 10, 2005 and the necessary compliance tariffs were approved by the Commission on May 20, 2005. Service to Noranda began under those tariffs on June 1, 2005.

scrutiny. Certainly parties asked about the losses and charges for losses. But throughout the proceedings there was never a suggestion by any party that losses could be optionally ignored -- and for good reason: Proper losses are a *bona fide* cost of providing electrical service to any customer.

Losses represent the energy consumed in the delivery of electricity. Noranda is aware of no rate case in memory of its counsel or advisors in which there was a class cost-of-service study that ignored losses. The existence of losses is simply a physical reality that is beyond debate.

2. The Final Rule Should Require that Losses Be Recognized and Not Leave Their Recognition As An Option.

The proposed rule specifies that losses "may" be considered in designing a fuel clause. This injects uncertainty and potential debate into a long-established process that is already complex. The Commission should not propose a rule that would burden the already-complex rate case process by opening a debate of whether losses "may" be considered. Rather, Noranda recommends that the recognition of losses continue to be a required part of rate design -- the present "may" should become a "shall." The focus should be on the real issues, the level of fuel costs and the other costs that drive rates up.

3. Inclusion of "May" In the Proposed Rule is Puzzling.

In the context of the discussions leading to the proposed rule, Noranda has listened carefully, but remains puzzled as to why several parties proposed FAC rule language suggesting that appropriate rate design, by the permissive provision for losses, "may" ***ignore reality***. Yet this optional language has crept into the text of the rule as proposed. The motivations and implications must now be explored and revealed in the light of the public record.

These parties have suggested that the Commission should have the "flexibility" to account for losses -- or not -- as a part of the FAC. The sole justification we have heard is "flexibility." Flexibility to what end? The losses incurred in providing service to Noranda are unavoidable and will neither increase nor decrease if there is a FAC. The amount of fuel used to generate electricity for Noranda includes fuel for the energy consumed in transmitting and delivering that energy.

It was documented in Case No. EA-2005-0180 that the AmerenUE rate for Noranda properly provides for the losses on the AmerenUE system and that Noranda also compensates Associated Electric Cooperative, Inc. ("AECI") for the losses on the AECI system. Moreover, it is beyond debate that losses are incurred for every other customer. AmerenUE cannot deliver electricity without the use of its transformers, transmission lines, and distribution lines. Fuel costs will include the cost of the fuel

necessary to operate those same transformers, transmission and distribution lines. Why then a call for flexibility?

We sense the matter reduces to economics. We sense that representatives of customers at the end of the distribution system are seeking to muddy the water and open an opportunity to reverse long standing Commission practice. They simply want to make an argument to shift fuel costs: To have others, *i.e.*, Noranda, pick up some of the fuel costs incurred to serve their clients. We see no other rational explanation.

But their view is mistaken. The FAC as proposed would not operate like a rate case where there can often be extensive testimony, settlement discussions, and compromises of multiple complex issues in the context of settlement stipulations. Rather, once a FAC is approved by the Commission, the rates will move up (and perhaps rarely down) through rate filings that doubtless will not be the subject of testimony and hearings and settlement discussions. For a fuel mechanism to work with reasonable efficiency the costs and the rates, practically by definition, cannot be subjected to a new rate design debate with each filing.

A call for flexibility on this issue is misplaced. What has been slipped into the proposed rule under the guise of "flexibility" is simply an effort to shift costs from smaller customers to larger customers. The benefits sought by these parties cannot occur because there are not and cannot be facts

that can counter the physical principles of losses incurred in transmission, transformation and distribution.

4. Needless Disputes Will Deflect the Commission From Consideration and Investigation of Critical Issues.

Although the Commission cannot ignore losses, it can avoid relitigating this well established fact of transmission operations in every FAC it considers. For the sake of efficiency in litigation before the Commission, for the sake of maintaining established equity among customers, for the sake of respect for the body of work that has come before this Commission over many years, the flexibility to ignore losses must be removed from the rule.

5. Proposed Modification of Language of Proposed Rule.

Noranda believes that the language that has been proposed above as "Change One" concerning rate design is adequate to address this issue. The Commission's attention is respectfully drawn to the deletion of the word "may" and its replacement by the word "shall" to require that losses be considered and not ignored.

D. The Final Rule Should Permit Consideration of a Correctly Designed Volatility Mitigation Mechanism or "Rate Cap."

The traditional approach to electric rates in Missouri has provided consumers with the beneficial stability of base rates. But a fuel rider for the electric industry will inevita-

bly destabilize rates and thereby create problems for customers. Indeed, were utility fuel costs not volatile, there would be no need in the first instance for a FAC at all. A rate cap offers a simple approach that will limit rate volatility for consumers in way that every customer can understand. Noranda recommends a rule provision that will provide for the consideration of a rate cap. It should be applied on the same percentage basis to all customers with any allowed fuel cost amounts in excess of the cap to be deferred for later collection. Appropriate interest provisions will protect the value of the monies later collected.

Two types of rate caps have been discussed. *First*, there is a "hard" cap that establishes a finite "not to exceed" limit. Any excess over the level of the cap is simply lost to the utility and, under the general principles of ratemaking undisturbed by SB179, may not be recovered. *Second*, a "soft" cap, which is really a deferral mechanism, has the effect of smoothing an otherwise "spike" increase over a longer period of time. A soft cap permits the utility to defer costs that are above the cap, spreading them to a later period while accommodating carrying charges. Noranda recommends a "soft" cap.

The history of Missouri regulation offers conceptual support for a rate cap. When an infrequent extraordinary electric rate increase has arisen, there has been a phase-in of the large increase. Phase-in plans were adopted for the Union Electric Company for costs associated with the Callaway Plant, for the Kansas City Power & Light Company regarding the Wolf

Creek Plant, and for the Arkansas Power & Light Company regarding the Grand Gulf Plant (AmerenUE has since acquired the Missouri service territory of Arkansas Power & Light). These are examples of rate phase-in (a series of "rate caps") to mitigate an extraordinary increase. As a consequence, the disruptive rate volatility arising from large cost increases has been reduced. These are positive examples of mechanisms to reduce volatility. A negative example may be drawn from the unpleasant volatility caused by the operation of the unlimited and uncapped PGA mechanism. The rule at a minimum must provide the Commission with an effective mechanism to control unmitigated rate volatility.

Less volatility will be helpful to all. The benefit to Noranda is assurance that a sharp or extraordinary rate increase will not cause a permanent reduction in operations. Were such to occur, the impact on Noranda operations might be so severe as to result in a shutdown. Even if, at a later time, some mitigation were implemented through a refund, that would not work for Noranda. The nature of Noranda's operations are such that, were a corporate decision made to shut down Noranda's smelter, the capital costs associated with resuming production could be prohibitive.

Also, as the Commission is well aware, there is ample evidence of the pain caused by large unexpected increases to all manner of customers. That pain is unnecessary and avoidable. Instead, it is a relatively simple matter to provide for the

possibility of a rate cap in the rule. The language set forth in Change Two, *infra*, should be incorporated into the rule.

One of the challenges of the workshop process on this issue was the difference in size of the involved utility. What was acceptable for a large utility was not acceptable for a smaller one. The way around this obstacle is simple: Noranda's suggestion is that the final rule authorize a party to propose such a rate volatility mitigation mechanism in a rate case in which a FAC is being considered. That will permit the issue to be addressed in a manner that can accommodate the size differences between utilities. In this case, one size does not fit all.

1. Proposed Modification to Language of Proposed Rule.

To address this concern, Noranda would respectfully suggest consideration of the following additional language to the proposed rule ("Change Two"):

4 CSR 240-20.090(2)

. . . .

(H) Any party to the general rate proceeding may propose a non-discriminatory rate cap or other mechanism that is reasonably designed to smooth or otherwise mitigate volatility or sharp or extraordinary increases in fuel costs that are reflected in the RAM and takes into account the size and generation mix of the applicant utility.

E. The Provisions of the Proposed Rule Regarding Surveillance Appear to Be Adequate and Should Not Be Diluted or Weakened.

Ratepayers enjoy some protection in the rate case process through the thorough audit, potential challenge, and Commission review of claimed expenses and revenues. Another protection is the matching process that assures that expenses are properly related to revenues. The operation of the proposed FAC removes most of these protections for ratepayers. Therefore a robust surveillance program coupled with adequate data is critically important. The rule should reflect the philosophy voiced by a United States President in another context: "Trust, but verify."

Noranda gratefully acknowledges that much work by the Commission Staff, Office of the Public Counsel, and others, has gone into the surveillance provisions of the proposed rule. Ideally, Noranda would prefer that surveillance be sufficiently specific to enable an interested party to readily identify any inappropriate fuel costs and excess earnings. While the proposed surveillance provisions may fall short of this ideal, Noranda is satisfied that the proposed surveillance provisions are reasonable so long as they are not weakened by additional modifications.

F. The Intentional Alignment of Interests of Shareholders and Ratepayers Continues In Its Importance, But Will Be Addressed By Others.

Noranda will leave debate on this important point to others. First and foremost, Noranda is exposed to direct and substantial harm if the rate design and loss recognition provisions of the proposed rule are not repaired in the final rule. Those provisions have therefore become the priority for Noranda.

III. SUMMARY AND CONCLUSION.

The only suggestion in support of potentially ignoring the physical fact of losses has been an unexplained desire to maintain "flexibility." This desire is misplaced, ignores physical facts, and may mask other lurking agendas. The Commission should not be drawn into this needless controversy and instead must close down the issue in the final rule. The amount of losses may still remain open as those parameters will vary by utility and installation and the required loss studies will inform the necessary decision.

Losses represent the energy consumed in the delivery of electricity. Unalterable principles of physics are involved. Losses are a physical reality and their existence should be beyond debate. To ignore them injects needless controversy.

The final rule should authorize rate case parties to recommend a rate cap as a means of mitigating volatility and other sharp, extraordinary increases. The rule should, however, leave the specifics of that rate cap open so that the parties to

the rate case may propose a mechanism that is specific to the size and generation fleet of the utility involved.

Noranda is satisfied that reasonable surveillance will be possible under the rule as proposed. Those provisions should be continued into the final rule without dilution or weakening.

Respectfully submitted,

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