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 PRAXAIR, INC.,
AG PROCESSING INC A COOPERATIVE, AND
SEDALIA INDUSTRIAL ENERGY USERS' ASSOCIATION
REGARDING SELECTED RULEMAKING ISSUES

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 with this the General Assembly tasked the Commission to design. Throughout that extended process, Praxair Inc., ("Praxair"), Ag Processing Inc a Cooperative ("AGP"), and Sedalia Industrial Energy Users' Association ("SIEUA"), through their representative, actively participated in the many meetings and discussions. For convenience of reference, and unless the context requires otherwise, we will hereafter refer to this group of companies as "Multiple Industries."

Praxair Inc. ("Praxair") is a major air liquefaction process operator, producing industrial and commercial processing gasses for other manufacturers, retail users including hospitals and other consumers. Praxair operates manufacturing facilities

in the service territories of Empire District Electric Company and Kansas City Power & Light Company. AGP operates a soybean processing facility in St. Joseph, Missouri in the service territory of Aquila. SIEUA is a group of industrial companies operating in and near Sedalia, Missouri in the service territory of Aquila. All are industrial users operating their facilities with high load factors and for all, the cost of electrical energy is a major cost of their production and operations in Missouri. Each is a major source of employment for Missourians at these facilities and provides important economic benefits in their respective communities.

II. SUBSTANTIVE COMMENTS ON THE PROPOSED RULE.

A. Endorsement of Portions of Comments Submitted by Noranda Aluminum, Inc.

Throughout the workshop process, Multiple Industries have paralleled their efforts (and employed the same counsel) with Noranda Aluminum, Inc. in supporting appropriate provisions in the proposed fuel adjustment clause ("FAC") rule. Recognizing that the Commission will have much material to review in the continuing process of rulemaking, Multiple Industries are seeking to present their collective comments on an individual basis on issues of concern to them while still generally endorsing the separate comments provided by Noranda Aluminum, Inc.

B. The Final Rule Should Not Include a Provision That Permits Utility Veto Of a Commission Decision on a FAC.

Somewhere between the version of the proposed rule that was last considered in the workshops and the proposal that was sent to the Secretary of State, an unusual provision was inserted. This provision appears to give the utility an ability to "veto" a FAC proposal that the Commission has ordered if a final result is not "acceptable" to the utility. This could even occur, and indeed would likely occur, after the case has been fully litigated. The proposed rule provides:

> 4 CSR 240-20.090(2)
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> . . . .
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> (E) Any party to the general rate proceeding may oppose the establishment, continuation or modification of a RAM and/or may propose alternative RAMs for the commission's consideration including but not limited to modifications to the electric utility's proposed RAM. Where a utility proposes to establish a RAM and, alternatively to recover the components that would have been treated in the RAM in base rates, versus proposing continuance or modification of a RAM, ***if the commission modifies the electric utility's proposed RAM in a manner unacceptable to the electric utility, the utility may withdraw its request for a RAM and the components that would have been treated in the RAM will be included in base rates*** as reflected in the commission order authorizing the utility to recover these components if a record respecting this alternative is fully developed before the commission during the course of the case. (Emphasis added)

Multiple Industries question the purpose of parties proposing alternatives to the Commission through experts, exhibits and other evidence of record is the Commission decision can

simply be set aside by the utility. If they persuade the Commission that a better alternative exists, but the utility disagrees, under this language it can veto the decision of the Commission based on the record. Who is the regulator? Who is the regulated?

1. SB179 Did Not Repeal Existing Missouri Utility Law.

It was our understanding that the Commission was empowered by the legislature to regulate public utilities in this state and to make decisions, with the force of law (provided they are lawful and supported by competent and substantial evidence on the whole record) as to what constitutes reasonable terms and conditions for the offering of public utility services. That principle remains following enactment of SB179. SB179 did not repeal public utility law in this state. Indeed, SB179 states that "Chapter 386, RSMo, is amended by ***adding*** thereto one new section . . . ." (emphasis added). The General Assembly did not repeal existing law, nor even change existing law; it added "one new section." Further, Section 10 of SB179 states:

> Nothing contained in this section shall be construed as affecting any existing adjustment mechanism, rate schedule, tariff, incentive plan, or other ratemaking mechanism currently approved and in effect.

Given this, the proposed rule provision is patently offensive and plainly absurd. It is plainly one-sided and should form no part of any final rule.

2. Utilities Should Not Be Permitted To Veto The Results Of Their Own Actions.

If the utility finds that it is too risky to propose a FAC, defend its proposal and then find that the Commission agreed with the proponents of another approach, then the utility should simply not initiate the process by filing a FAC. However, if the utility enters the arena and subjects its FAC proposal to the crucible of public scrutiny, audit and due process, it should be deemed to have also accepted the result of such submission, even if it does not agree with it. Doing otherwise would be analogous to allowing a plaintiff to avoid a judgment on a counter-claim by simply dismissing their original action. If the utility is not willing to accept that risk, cost recovery is not denied; the utility can always simply file for base rate treatment for its fuel costs.

3. The Proposed Provision Violates The Express Terms of SB179.

This proposed provision finds no support in SB179 in any event. As such it is *ultra vires*. In fact, Section 5 of SB179 provides:

> Once such an adjustment mechanism is approved by the commission under this section it shall remain in effect until such time as the commission authorizes the modification, extension, or discontinuance of the mechanism in a general rate case or complaint proceeding.

The proposed provision in the rule, however, would provide that when the commission approves an adjustment mechanism, the utility can withdraw it ***after*** the commission's approv-

al. The proposed rule provision directly contradicts the provisions of SB179 and must therefore not be retained.

C. Alignment of Interest Between Utility and Ratepayer Should Be Preserved and Enhanced.

1. Incentives Are Better At Enforcing Aggressive Purchasing Practices Than After-The-Fact Prudence Reviews.

For roughly 25 years following the Missouri Supreme Court's decision in the *UCCM* case,[1/] Missouri electric utilities have been highly motivated to keep their purchased power and fuel costs low and to drive those costs even lower between rate cases. Despite predictions of impending doom following the Supreme Court's 1979 decision, they discovered that in an era when fuel prices generally declined, utilities with fixed rates could increase their profits by reducing costs below the level on which their then-current rates were built. Although this well served the interest of utilities, and some profited significantly from these conditions, it was occasionally necessary for complaints to be threatened or brought to force utilities to reduce their rates to reflect the declining costs and to pass some of those savings through to ratepayers. Indeed, by invalidating the fuel adjustment clause for the state, our Supreme Court coincidentally established a strong incentive for electric utilities to reduce and control their fuel and purchased power costs.

[1/] *State ex rel. Utility Consumers Council of Missouri, Inc., v. Public Service Commission of Missouri*, 585 S.W.2d 41; 1979 Mo. LEXIS 292; 33 P.U.R.4th 273 (Mo. 1979).

In stark contrast stand Missouri's natural gas distribution utilities. They were permitted to continue with their purchased gas adjustment ("PGA") regime. Challenges to the PGA were deflected on the basis that there was no "change in form" of the methane molecules and concerns that an adverse decision would also bankrupt these utilities.[2/] Of course the same cry had not deflected the prescient *UCCM* court. But the dollar-for-dollar pass-through of purchased gas costs eviscerated any incentive for those major gas purchasers to aggressively control their purchased gas costs. Local distribution companies ("LDCs") became subject only to after-the-fact prudence reviews. Those reviews were often hotly contested and litigated through the courts, further delaying any relief to captive ratepayers. Instead of building expertise in the deployment of the new tools that FERC Orders 436, 500, 528 and 636 and "open access" brought to natural gas transportation, including hedging tools and storage, the LDCs developed expertise in demonstrating and building documentary databases to demonstrate prudence.

In this contrast between non-fuel adjustment-equipped electric utilities and PGA-enhanced gas distributors, the power of a profit incentive as a firm and observant policeman is brightly highlighted. Certainly one of the major defects of the PGA process was its severance of purchasing activity from financial responsibility for purchases.

[2/] *State ex rel. Midwest Gas Users' Association v. Public Service Commission*, 976 S.W.2d 470; 1998 Mo. App. LEXIS 1020 (Mo. App. 1998).

More recently, fuel prices have risen, in some instances, dramatically. While electric utilities were satisfied with the *UCCM* decision for over two decades while prices declined, they seized upon political changes and were quick to launch a massive lobbying effort with the 2005 General Assembly for a "PGA-like" approach when fuel prices increased. The result, as we know, was SB179.

2. Incentives Should Be Preserved Or Maintained.

It is important that as much of the financial incentive for prudent purchasing decisions be maintained, even with the advent of SB179. To be clear, we hope to profitably manufacture and sell our respective "widgets." We are not repulsed by similar expectations on the part of our servant utility. Because, few of our plants and facilities are built on railroad cars, our interests are best served by a financially lean, trim and healthy utility that has the resources needed to provide safe, adequate and reliable service at rates that provide a reasonable but not excessive return on utility shareholder's investment.

3. The Final Rule Should Preserve the Relationship Between Purchasing and Financial Responsibility.

Preservation of the strong connection between financial responsibility for purchases and the responsibility of making those purchases is an essential control mechanism. History shows that such preservation will make a much more effective policeman

of responsible financial behavior than the threat of after-the-fact prudence reviews.[3/] We would rather not pay the excessive costs in the first place as opposed to paying them now and hoping for a refund in some far-removed universe. Accordingly, a FAC mechanism that aligns the expected profit-maximizing activities of the public utility with the interests of the ratepayers in lowest reasonable cost service makes good common sense.

4. The Utilities Recognized the Power of Incentives When Their Abandoned Effort To Increase Their Share of Off-System Sales Margins.

Lest the point be lost, at an early stage in the preceding public rule workshops, representatives of MEDA suggested a mechanism that would allow the utility to retain 25% of the margin from off-system sales of power. The justification for this proposal was that it would create an "incentive" for the utility to maximize its off-system sales. Alas, MEDA's enthusiasm for even its own proposal was short-lived, for when a remarkably similar proposal was suggested by customers with respect to overall fuel and purchased power costs, the utilities' affection for their "incentive" proposal vanished. Apparently they see themselves as better at selling excess energy from the generators their ratepayers are supporting than they do as fuel and power purchasers with some of their shareholder's monies. Regardless,

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[3/] We do not mean in any sense to derogate the dedication of the Staff members who scrutinize the purchasing practices and records of the gas utilities. Their perseverance is the only effective barrier between the customers and abuse by their purported public utility.

the utilities' proposal demonstrates the power of the profit incentive and the need to retain a strong relationship between purchasing decisions and the financial responsibility for them.

5. Incentives In the Proposed Rule Should Be Enhanced In the Final Rule.

The proposed rule contains much that should be retained. But some improvements can still be made. Our suggestion for such an improvement to a portion of the proposed rule follows:[4/] As we would recommend, proposed 4 CSR 240-20.090(11)(B) would provide:

> (B) Any incentive mechanism or performance based program shall be structured to align the interests of the electric utility's customers and shareholders. *Unless the incentive mechanism or performance based program proposes a symmetrical cost sharing,* ~~t~~*t*he anticipated benefits to the electric utility's customers from the incentive or performance based program shall exceed the anticipated costs of the mechanism or program to the electric utility's customers. For this purpose, the cost of an incentive mechanism or performance based program shall include any increase in expense or reduction in revenue credit that increases rates to customers in any time period above what they would be without the incentive mechanism or performance based program.

The purpose of this suggested change should be obvious: Symmetrical sharing (50/50) will preserve the strong relationship between decision making and financial responsibility for those decisions will be preserved. Purchasing decisions that save

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[4/] Deletions from the proposed language are shown ~~thus~~; added language is shown in *italics*.

money for the ratepayers will create profit for the utility. Conversely, imprudent or unwise actions that result in unnecessarily increased costs for the ratepayers will result in the utility sharing in those costs through a reduction in its profits. Ratepayers and utility alike will share in the gains of cost reductions and in the pains of cost increases.

In the workshop discussions, we encouraged consideration of an approach that was variously called "incentive by design" or "interest alignment." The key foundation of this approach is that increases and decreases in these costs should be shared. After the periodic comparison of actual cost to the base cost established in the enabling general rate proceeding, the utility should receive base rate treatment for a percentage of the fuel cost reduction when its expenses fall below the base rate fuel cost level. As expenses rise above the base rate cost, the adjustment mechanism should likewise reflect a corresponding percentage in base rates. The utility and customers alike will then share an aligned financial interest in good utility performance and lower costs.

6. Equipment Performance Standards Are Needed To Prevent Gaming and Pass-Through of Indemnified or Controllable Costs.

Minimum equipment performance standards are needed to encourage efficient operations and maintenance and avoid the automatic pass through of extraordinary insured or controllable

costs (such costs are not caused by fuel price changes in any event).

7. Alignment of Interests Will Save Staff Auditing Time and Other Public Resources.

An important consequence of interest alignment is that less Staff time will be consumed in often fruitless after-the-fact reviews. That Staff time can then be redirected to other more significant needs and objectives. If well designed, and coupled with robust surveillance requirements, the system could prove to be virtually self-policing. Rates will be lower in the first place, and administrative efficiency will be enhanced both for Staff and the utilities by reducing the pressure for intensive after-the-fact reviews.

8. Interest Alignment Works As Demonstrated By the Recent Aquila Steam Case in St. Joseph.

A useful example is the recent Commission approval of the fuel rider for Aquila's Steam division in Case No. HR-2006-0024. The fuel cost rider that the Commission approved in that proceeding has many of these features and was proffered through a settlement. The initial quarterly adjustment was filed recently and resulted in a statement that the key indicators had been subject to a basic review and found to be consistent with the tariff provision. Although an annual review and true-up is still called for in the tariff, the investment of Staff time was apparently small.

9. Three Illustrations Of an Alignment of Interest Methodology Are Attached To These Comments.

We have attached three illustrations of the Interest Alignment or Incentive by Design concept dealing with three different scenarios. Again, the fundamental concept is the retention of an significant share of the incentives inherent in base rate regulation while accommodating a sharing by the utility and ratepayers of a significant portion of the cost and risk of variations in prudently incurred fuel and purchased power costs, thereby aligning the utility interest in low and stable costs with the interests of customers in low and stable rates. In the attached illustrations the percentage of fuel costs established in base rates and the percentage established in the FAC are 40% and 60%, respectively, but this is not intended to suggest those levels. This difference is provided in the examples so that the respective shares may be distinguished and the analysis tracked. Net proceeds from off-system sales are not separated in the illustrations and are assumed to receive the same treatment. A FAC could proceed from various structures and the alignment concept is not intended to prejudge other aspects of structure.

Illustration 1 assumes that an initial rate case will determine the amount of prudently incurred fuel and purchased power costs to be included in the revenue requirement and that the amount so determined will be included in base rates. At the first FAC adjustment the variation of total fuel and purchased power costs from the base rate amount would be separated accord-

ing to the Incentive by Design mechanism into the portion in base rates and the portion in the FAC.

Illustration 2 assumes that an initial rate case will determine the amount of prudently incurred fuel and purchased power costs to be included in the revenue requirement and that the amount so determined is separated according to the Incentive by Design mechanism into a portion included in base rates and a portion included in the FAC. Pursuant to the base rate case decision, base rates would go down by the amount of the costs afforded FAC treatment and the FAC charge would collect the same amount with no net effect on rates. At such time as there is the first FAC adjustment the total fuel and purchased power costs would be separated according to the Incentive by Design mechanism into the portion afforded base rate treatment and the portion afforded FAC treatment. A new FAC charge would be computed to reflect the FAC fuel and purchased power costs so determined.

Illustration 3 assumes that an initial rate case will determine the amount of prudently incurred fuel and purchased power costs to be included the revenue requirement and that the amount so determined will be stated as an amount per kWh. Base rates reflect all of the costs so determined. At the time of the first adjustment, the fuel and purchased power costs are computed according to a structure defined in the IEC/FAC mechanism and the variation per kWh would then be subject to the Incentive by Design mechanism. There have been IEC mechanisms that operated on the cost per kWh and this illustration is meant to illustrate

that Incentive by Design also works effectively in a structure that operates on costs per kWh however determined – pursuant to either an IEC or FAC mechanism.

D. The Proposed Transitional Provisions Should Be Rejected As They Represent An Attempt To Subvert Established Rulemaking Statutes and Procedures.

The transitional provisions of the proposed rule (4 CSR 240-20.090(17)) present serious concerns. By definition, a rule cannot have effect prior to its adoption by the proposing agency. The transition provisions, while understandable, are an attempt to make a rule effective before it has been approved and or has even been through the rulemaking process. There is a process, called an "emergency rulemaking" which the Commission could have employed, but chose not use, presumably because the test associated with that standard could not be met. Any attempt to achieve a result that imposes the requirements of a rule before the rule has been approved and issued as final is in violation of the rulemaking procedures established by statute and is, at one level, meaningless.

Moreover, once a final rule is adopted, the need for a transitional rule disappears. This analysis demonstrates that their purpose was to attempt to reach beyond the established rulemaking procedure to give a proposed rule final effect. Thus seen, there is simply no reason for the proposed transitional rules and they may, in fact, cause the invalidation of the entire rulemaking process. A complicated structure and process of

multiple sequential waivers is no longer needed. Pure and simple, this transitional rule was an attempt to enact a rule with immediate effect but without following the statutory procedure.

Further, such "transitional" provisions are not even necessary. When the proposed rules were sent to the Secretary and State and published, all affected utilities in the state were given notice of the scope and requirements of the proposed rule. Any subsequent filing could comply with those requirements, but at the risk of the utility. Should the final rule differ from the rule proposed, the utility can modify its filing or, if necessary, seek a waiver from the requirement. Of course, the utility might have to demonstrate that the change needed would not prejudice any party in the rate case and would have to run that risk. The attempted mechanism for implementing the rule before it is finally promulgated runs afoul of the procedures for making a rule under the Administrative Procedure Act.

Beyond those comments, the procedures established in the transitional proposal are unduly complex and provide the utility with multiple attempts to repair a defective filing. Simply walking through the procedures specified in the transitional provision will make this clear. First a waiver is required. If this fails, the utility can make a curative filing. Then if the curative filing is deficient, another waiver can be sought, and so on. All the while the suspension period clock ticks away. The result is that the utility interested in "gam-

ing" this system can end up denying parties the right even of notice of what is being filed until the last possible moment and their effective ability to review and analyze the proposal has vanished. This is not a fair procedure in any event and denies due process. That a procedure creates a structure that denies due process is objectionable. It does not matter that in a particular case the party may have had some level of notice. The rule is not "no harm, no foul." Rather, if the procedure is not fair on its face, it is unlawful.[5/]

III. CONCLUSION.

While we appreciate the opportunity to present these views to the Commission, there are several needed revisions to the proposed rule. The provision allowing for utility "veto" of a Commission decision has no place in the rule and is unsupported by the enabling legislation. Incentives should be preserved and interests aligned as a means of encouraging mutual benefit from desirable activities in purchasing fuel and purchased power. Transitional provisions are unnecessary, prejudicial and essentially a subversion of the statutory rulemaking process. They

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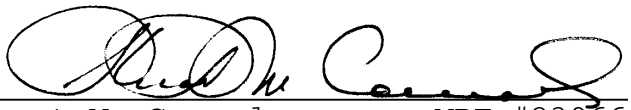
[5/] *Fischer v. Public Service Commission*, 670 S.W.2d 24; 1984 Mo. App. LEXIS 3613 (Mo. App. 1984).

may have already contaminated the rulemaking process and should be rejected.

Respectfully submitted,

FINNEGAN, CONRAD & PETERSON, L.C.



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September 7, 2006

INCENTIVE BY DESIGN
ILLUSTRATIONS FOR DISCUSSION
October 25, 2005

Line	**Assumptions**	
1	Unit sales (million kWh)	5,000
2	Fuel cost determined appropriately in base rate case to start process (million)	$100
3	Fuel cost per kwh (ignoring losses for illustration)	$0.02000
4	Incentive by Design - base rate percent	40%
5	Incentive by Design - FAC percent	60%
6	Period 1 fuel cost (million)	$120
7	Period 1 fuel cost per kwh (ignoring losses for illustration)	$0.02400
8	Average total bill to hypothetical customer, per kWh (post rate case, before period 1 fuel adjustment)	$0.05000

INCENTIVE BY DESIGN
ILLUSTRATIONS FOR DISCUSSION
October 25, 2005

Line	**Illustration 1**	
9	Fuel cost as determined in the initial rate case (million)	$100
10	Fuel cost in base rates (million)	$100
11	Period 1 fuel annualized cost (million)	$120
12	Period 1 fuel percent increase	20%
	FAC recovery computation	
13	Fuel Cost variance (million)	$20
14	Variance reflected in FAC (million)	$12.00
15	FAC amount per kwh (ignoring losses for illustration)	$0.00240
	Hypothetical Bill before Period 1 FAC, per kWh	
16	Base rate component of bill	$0.05000
17	FAC component of bill (ignoring losses for illustration)	$0.00000
18	Total bill	$0.05000
	Hypothetical Bill with Period 1 FAC, per kWh	
19	Base rate component of total bill	$0.05000
20	FAC component of bill (ignoring losses for illustration)	$0.00240
21	Total bill	$0.05240
22	Customer increase percent	5%

INCENTIVE BY DESIGN
ILLUSTRATIONS FOR DISCUSSION
October 25, 2005

Line **Illustration 2**

Line		
23	Fuel cost as determined in the initial rate case (million)	$100
24	Fuel in base rates (million)	$40
25	Fuel tracked in FAC (million)	$60
26	Fuel tracked in FAC, per kWh (ignoring losses for illustration)	$0.01200
27	Period 1 fuel annualized cost (million)	$120
28	Period 1 fuel with base rate treatment (million)	$48.00
29	Period 1 fuel with FAC treatment (million)	$72.00
30	Period 1 fuel with FAC treatment, per kWh (ignoring losses for illustration)	$0.01440
31	Variation in fuel reflected in FAC	$12.00
Line	Hypothetical Bill before Period 1 FAC, per kWh	
32	Base rate component of bill	$0.03800
33	FAC component of bill (ignoring losses for illustration)	$0.01200
34	Total bill	$0.05000
Line	Hypothetical Bill with Period 1 FAC, per kWh	
35	Base rate component of bill	$0.03800
36	FAC component of bill (ignoring losses for illustration)	$0.01440
37	Total bill	$0.05240
38	Customer increase percent	5%

INCENTIVE BY DESIGN
ILLUSTRATIONS FOR DISCUSSION
October 25, 2005

Line	**Illustration 3**	
39	Unit fuel cost as determined in the initial rate case, per kWh (ignoring losses for illustration)	$0.02000
40	Unit fuel cost in base rates, per kWh (ignoring losses for illustration)	$0.02000
41	Period 1 unit fuel cost, per kWh (ignoring losses for illustration)	$0.02400
	FAC recovery computation	
42	Fuel Cost variance, per kWh (ignoring losses for illustration)	$0.00400
43	FAC amount per kwh (ignoring losses for illustration)	$0.00240
	Hypothetical Bill before Period 1 FAC, per kWh	
44	Base rate component of bill	$0.05000
45	FAC component of bill (ignoring losses for illustration)	$0.00000
46	Total bill	$0.05000
	Hypothetical Bill with Period 1 FAC, per kWh	
47	Base rate component of total bill	$0.05000
48	FAC component of bill (ignoring losses for illustration)	$0.00240
49	Total bill	$0.05240
50	Customer increase percent	5%