BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Proposed Rules	**)**	
4 CSR 240-3.162 and	**)**	
4 CSR 240-20.091, Environmental	**)**	**Case No. EX-2008-0105**
Cost Recovery Mechanisms	**)**	

COMMENTS OF UNION ELECTRIC COMPANY d/b/a AMERENUE

COMES NOW Union Electric Company d/b/a AmerenUE, and for its Comments in response to the Notice of Proposed Rulemaking published in the *Missouri Register* on December 3, 2007, states as follows:

INTRODUCTION

The proposed Environmental Cost Recovery Mechanism (ECRM) rules under consideration in this docket are the product of a series of technical workshops moderated by the Commission's Staff. Those workshops produced a proposed rule which in many respects is similar to the fuel adjustment clause (FAC) rules adopted by the Commission in 2006. AmerenUE was an active participant in the workshop process and, with one important exception, is supportive of most of the provisions in the proposed rules Staff developed from that process.

That one exception deals with a proposal originally made by the Office of the Public Counsel (OPC) for the handling of capital costs in the ECRM. This proposal, if adopted, would treat capital costs in the ECRM in a manner different than capital costs are handled in Commission-approved Infrastructure System Replacement Surcharges (ISRS) and in a manner that is contrary to the purpose the Legislature sought to accomplish when it enacted Senate Bill 179 (SB 179). Tese Comments center upon AmerenUE's concerns with this aspect of the rules, as proposed.

SPECIFIC COMMENTS

1. OPC's proposal, embodied in Staff's "environmental revenue requirement" concept in the proposed rules, has previously been rejected, and contravenes the purpose of SB 179.

The version of the rules prepared by Staff (and now proposed by the Commission) reflects a second attempt by rate adjustment mechanism opponents to substantially limit or even eliminate the effectiveness of a rate adjustment mechanism, in this case, a rate adjustment mechanism that is designed to provide utilities with more timely recovery of costs mandated by federal and state laws over which utilities have little or no control. The first such attempt occurred in the 2003 rulemaking proceeding for the gas ISRS rules, which of course also provide for more timely recovery of pipeline relocations and safety-related gas infrastructure replacements that are mandated by law. The current attempt, in the context of the proposed ECRM rules, like the first one, would require the Commission to engage in the complicated task of figuring out, and tracking, depreciation and deferred taxes on a hypothetical "environmental rate base" that is unrelated to the hundreds of millions of dollars of new scrubbers and other environmental control technology that Missouri utilities will soon be required by law to install. The Commission should reject attempts to treat capital costs in the ECRM context differently than they are currently treated in the ISRS context. The treatment of capital costs in the ISRS has worked well, and there is no good reason to depart from that treatment in the handling of mandated environmental capital expenditures. Indeed, a departure from that treatment may very well thwart one of the benefits of the environmental provisions of SB

179; that is, to encourage more timely installation of environmental control equipment which would lead to faster improvements in the State's environmental stewardship.[1]

The attempt to treat capital costs differently is embodied in the "environmental revenue requirement" concept which the proposed rules define in subsection (1)(D) of proposed rule 4 CSR 240-20.091. *See also* subsection (4)(B) of proposed rule 4 CSR 240-20.091. For several reasons, this "environmental revenue requirement" concept (which essentially requires the development of an "environmental rate base") is contrary to the purpose of SB 179, and is extremely difficult if not arguably impossible to apply.

2. <u>The "environmental rate base" concept is impractical and would be extremely difficult if not impossible to implement.</u>

The "environmental rate base" concept would be extremely difficult if not impossible to implement. Calculating an "environmental rate base" would require the separate identification of existing "environmental" facilities or portions of facilities on the utility's books and records. Expanding the scope of the ECRM from new environmental investments to all existing and new environmental investments would almost certainly lead to protracted and contentious disputes respecting which existing capital items installed over many decades were or were not "environmental" in nature. Not only would this be extremely difficult to decide for many individual capital investments made over many decades, but there would also likely be difficult and contentious issues relating to the allocation of the costs of existing capital items which serve a dual purpose – both an environmental and operational purpose.[2] Effectively, every single item of a utility's rate base (assembled over decades) would have to be

[1] *See* Concurring Opinion of Commissioner Jeff Davis, at p. 4, filed in this docket.
[2] For example, what portion of a control system is "environmental" versus "operational" if part of the system was necessary to control emissions, but where control of the emissions is part and parcel of operating the plant and generating electricity?

reviewed and categorized, such as every pump, fan, duct, drain, smokestack, control system, etc – this list is, indeed endless. The enormity of this task and the difficulties (and inevitable disagreements that would undoubtedly arise) create a very real and perhaps insurmountable impediment to establishing the "environmental rate base" that the proposed rule contemplates, thus effectively devaluing or perhaps disabling use of an ECRM entirely. Similar concerns were expressed and heard by the Commission in the ISRS rulemaking, and the Commission rejected the approach to capital costs embodied in the proposed rules at that time.

3. <u>Mandated environmental costs do not produce revenues; indeed, they may reduce revenues or increase related costs that are unlikely to be offset by other cost decreases or revenue increases.</u>

While others (such as OPC) may argue that an ECRM addresses problems of regulatory lag for the utility and thus an "environmental rate base" ought to be included to address a potential regulatory lag for customers, the proposed "environmental rate base" fails to recognize that even with an ECRM, a utility will still experience significant regulatory lag for huge costs that are very unlikely to somehow be "offset" by other cost decreases or revenue increases. Not only do ECRM-qualifying investments not produce revenues, but they may in fact reduce revenues or increase related costs. This is because they often consume generating resources (e.g., the energy needed to run a new scrubber), thus reducing megawatt hours available to serve retail load or to sell into the off-system sales market. Moreover, there is substantial evidence that utility operating costs, in general, are increasing as demonstrated by the rate increases this Commission itself (as well as Commission's across the Country) have recently granted.

4. **<u>The "environmental rate base" concept ignores the terms of SB 179.</u>**

The proposed rules ignore the terms of SB 179. SB 179, unlike virtually all rate adjustment mechanisms in other states, requires utilities to come back and file another rate case within 37 months (which will be completed within four years) after the ECRM is established. Moreover, the proposed rule, like the FAC rules, completely preserves the ability to file an over-earnings complaint case if utilities are indeed over-earning over time. Just as the FAC rules do, the proposed ECRM rules require extensive and regular surveillance reporting which would enable others to identify the need to pursue such an over-earnings complaint case, if warranted. The obvious point of the every-four-year rate case requirement is to allow the Commission to re-evaluate all of the utility's costs and revenues no less frequently than every four years, but in the interim, to provide timely and full recovery of these mandated environmental costs without examining other cost or revenue changes in the utility's business.

5. **The "environmental rate base" concept is contrary to the treatment of capital costs used by other state utility commissions that have approved environmental cost recovery mechanisms.**

If adopted, the proposed treatment of capital costs would be contrary to the treatment afforded to capital costs for environmental compliance in the other states that utilize similar rate adjustment mechanisms. Indeed, of the eight other states of which AmerenUE is aware that have similar environmental cost recovery mechanisms,[3] not a single one of them calculates the environmental adjustment in the manner proposed by Staff. In fact, each of them looks at the capital costs associated with an environmental project(s) being implemented after the utility's last rate case and then allows a surcharge to existing base rates for the cost of capital (return) and depreciation associated with those projects, without reducing the amount of that surcharge by accumulated

[3] Alabama, Arkansas, Colorado, Florida, Indiana, Kentucky, Minnesota, and Mississippi.

depreciation on capital investments already in rate base at the time of that last rate case. In other words, each of those eight states recognizes that an environmental surcharge mechanism is a single issue mechanism designed to address non-revenue producing costs mandated by legal requirements over which the utility essentially has no control. Each of those eight states recognize that it makes no sense to go back and piecemeal try to pull certain discrete cost items out of the prior rate case's revenue requirement analysis without looking at other cost items that may (and almost certainly have) changed. To do so would, effectively, require rate cases between rate cases – a sort-of "earnings test" – which the Commission has already rejected in the context of adopting the FAC rules.

6. **Foregone costs due to significant regulatory lag even with an ECRM also demonstrate the inappropriateness of the "environmental rate base" concept.**

The proposed rule's treatment of environmental capital costs ignores the very significant regulatory lag that will *remain* a critical issue for the utilities who will soon be investing billions of dollars in environmental capital expenditures over just the next few years, even with an ECRM. This is particularly true since the proposed rules would allow just two ECRM adjustments per year. The same circumstance exists with respect to the ISRS, but unlike Staff's proposal here, the ISRS rules do not require an offset for depreciation on some hypothetical "ISRS qualifying rate base" from the last rate case. However, if Staff's proposal were adopted here, while also limiting ECRM adjustments to just two per year, the regulatory lag problem SB 179 was intended to improve will be exacerbated, leading to a substantial impairment of the effectiveness of SB 179 respecting the recovery of environmentally-mandated capital costs.

Given the proposed rules' limitation of ECRM adjustments to just two per year, a utility could permanently forego tens of millions of dollars of costs (depreciation, return, and taxes) on in-service environmental investments (such as a new scrubber, which could cost $500 million or more) between the time the new investment went into service and the date an ECRM adjustment can actually be made. To now add to that loss by offsetting new, governmentally-mandated capital investments with accumulated depreciation for old investments having nothing to do with the new investments exacerbates this problem, all while ignoring increasing wage, pension, medical, material, and other costs, plus operating and maintenance costs associated with the new capital investments, which would also significantly and negatively impact earnings.

7. **The Commission should follow the ISRS approach.**

At bottom, the Legislature, when it enacted SB 179, decided that single-issue ratemaking mechanisms for fuel and purchased power costs and for environmental costs should be available to the Commission. The Commission has experience with a single issue ratemaking mechanism that deals with capital costs – the ISRS – and properly decided to allow recovery of the full cost of ISRS-qualifying investments without reaching back to consider accumulated depreciation on unrelated, existing rate base, but with the trade off that utilities could not recover carrying costs on those investments between their in-service dates and the date of the adjustment, even though only two adjustments per year are allowed. The Commission should do the same thing in this rulemaking, consistent with the Legislature's desire to provide more timely recovery of these huge, governmentally-mandated environmental costs.

8. **AmerenUE endorses and adopts the edits suggested by MEDA President Warren Wood.**

The corrections to the proposed rules needed to eliminate the unworkable and unwise "environmental rate base" concept are not difficult, and are outlined in the Comments filed in this docket by MEDA President Warren Wood. AmerenUE endorses and adopts those corrections, a copy of which are attached hereto and incorporated herein by this reference as Exhibit A.

CONCLUSION

The environmental provisions of SB 179, in particular as they relate to capital investments in environmental controls that are mandated by law, were designed to provide utilities with much more timely recovery of the huge capital expenditures Missouri utilities will face in the coming years. Those capital expenditures are well documented by MEDA President Warren Wood's testimony, and in the case of the Company, have been widely disclosed in filings made by the Company with this Comission and with the United States Securities and Exchange Commission. It would be extremely difficult, if not impossible, and unwise (given the purpose of SB 179) to establish a so-called "environmental rate base." The Commission faced this issue in the gas ISRS rulemaking, and rejected a similar concept, and for good reason, as discussed in these Comments. AmerenUE urges the Commission to reject that concept here, and to adopt a set of rules that will create an ECRM mechanism that is, indeed, useful to utilities, and that will, indeed, encourage these investments, provide for timely cost recovery, and ultimately, improve the environmental performance and stewardship of utility plants across the State.

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Respectfully submitted,

SMITH LEWIS, LLP

By: **/s/ James B. Lowery**
James B. Lowery, #40503
Suite 200, City Centre Building
111 South Ninth Street
P.O. Box 918
Columbia, MO 65205-0918
Phone (573) 443-3141
Facsimile (573) 442-6686
lowery@smithlewis.com

ATTORNEYS FOR UNION ELECTRIC COMPANY d/b/a AMERENUE

UNION ELECTRIC COMPANY, d/b/a AmerenUE

Steven R. Sullivan, #33102
Sr. Vice President, General Counsel & Secretary
Thomas M. Byrne, #33340
Managing Associate General Counsel
1901 Chouteau Avenue, MC-1310
P.O. Box 66149, MC-131
St. Louis, Missouri 63101-6149
(314) 554-2514 (Telephone)
(314) 554-4014 (Facsimile)
tbyrne@ameren.com

Exhibit A to AmerenUE Proposed ECRM Rule Comments
Corrections to Proposed Rules

4 CSR 240-3.162 Electric Utility Environmental Cost Recovery Mechanisms Filing and Submission Requirements

Sections (1)(D) & New (1)(F) – Existing (1)(F) & (1)(G) Become (1)(G) & (1)(H):
(D) Environmental Cost Recovery Mechanism (ECRM) means a mechanism established in a general rate proceeding that allows periodic rate adjustments, outside a general rate proceeding, to reflect the net increases or decreases in an electric utility's environmental costs **as compared to the electric utility's base environmental expenses**;
(F) Base environmental expenses means the non-capital environmental costs identified in the general rate proceeding and included in base rates which form the base for future periodic adjustments in the ECRM.

Reasons: These are definitional changes necessary to ensure that the unwieldy and unreasonable exercise of determining an "environmental" and a "non-environmental" rate base is not required. For further discussion, see the reasons listed under (2)(I) and (2)(L), below.

Sections (2)(I) & (2)(L):
(I) A complete explanation of all of the **base environmental expenses**~~, both capital and expense,~~ incurred to comply with any current federal, state, or local environmental law, regulation or rule that the electric utility is proposing be included in base rates and the specific account used for each **base environmental expense** item on the electric utility's books and records;
(L) For each of the major categories of costs**, both capital and expense,** that the electric utility seeks to recover through its proposed ECRM, a complete explanation of the specific rate class cost allocations and rate design used to calculate the ~~proposed base amount of environmental costs in permanent rates and any subsequent~~ ECRM rate adjustments during the term of the proposed ECRM;

Reasons: These provisions fall under the reporting requirements of electric utilities filing to establish an ECRM in a general rate proceeding. Section (2)(I) contemplates a segmentation of all rate base into "environmental" and "non-environmental," which as noted, is an extremely unwieldy and unreasonable exercise. As written this would require that all the portions of plant control systems, electrical systems, instrumentation, pumps, fans, piping, and structures installed over many decades and that in any way are necessary to comply environmental requirements would need to be specifically identified

in the utility's books and records. It could even be argued that this provision would require that electric utility building water treatment and sewage system cost that were incurred in compliance with environmental requirements would need to be separately tracked and reported.

The buildings and major equipment owned and operated by electric utilities include many items that are necessary, more or less, to comply with environmental regulations at the federal, state or local level. They range in size from the flue gas desulphurization system on a coal-fired power plant that may cost several hundred million dollars to the small backflow prevention valve on a building's drinking water system that costs less than one hundred dollars. Another complication is the fact that many electric utility plant systems comply with several different requirements. What this means is that some pumps, piping, fans, ducts, structures and electrical instrumentation and control systems are required in order for the plant to operate and to comply with environmental requirements. Calculating what percentages of all of the systems operated by an electric utility are "environmental" and "non-environmental" would quickly become an extremely unwieldy, contentious, and unreasonable exercise.

Section (2)(H) requires a complete explanation of all the costs that shall be considered for recovery under the proposed ECRM and the specific account used for each cost item on the electric utility's books and records. The language in section (2)(L) comes back to the idea that all environmental cost must be separately identified by an electric utility seeking an ECRM. The language in section (2)(L) that would remain after MEDA's suggested deletion provides, with the other reporting requirements in section (2), the level of detail that parties will need in a general rate proceeding.

Sections (3)(I) & (3)(L):

(I) A complete explanation of all of the **base environmental expenses**~~, both capital and expense,~~ incurred to comply with any current federal, state, or local environmental law, regulation or rule that the electric utility is proposing be included in base rates and the specific account used for each **base environmental expenses** item on the electric utility's books and records;

(L) For each of the major categories of costs**, both capital and expense,** that the electric utility seeks to recover through its proposed ECRM, a complete explanation of the specific rate class cost allocations and rate design used to calculate the ~~proposed base amount of environmental costs in permanent rates and any subsequent~~ ECRM rate adjustments during the term of the proposed ECRM;

Reasons: These provisions fall under the reporting requirements of electric utilities filing to continue or modify an ECRM established in a general rate proceeding. Because the

suggested changes to sections (3)(I) and (3)(L) are identical to the suggested changes to sections (2)(I) and (2)(L), see the reasons given for sections (2)(I) and (2)(L) above.

Section (5)(C) – Original Section (5)(C) is eliminated; remaining Sections of (5) become (5)(C), (D), (E) and (F):
~~(C) The electric utility's actual environmental compliance costs and revenues allocated by rate class and voltage level, as applicable, consistent with the most recent commission approved allocation methods and rate design;~~

Reasons: Original Section 5 C is duplicative of the reporting in original Section 5 E and therefore is unnecessary.

Sections (7)(A)2. & (7)(A)3.:
2. The level of **base** environmental expenses in the base rate revenue requirement from the prior general rate proceeding;
3. The levels of **base** environmental expenses in the base rate revenue requirement from the prior general rate proceeding as adjusted for the proposed date of the periodic adjustment;

Reasons: These provisions fall under the filing requirements of a utility seeking to adjust an ECRM rate between general rate proceedings. As previously noted in the reasons for changing sections (2)(I) and (2)(L), identification of an "environmental" versus a "non-environmental" rate base is not reasonably achievable.

4 CSR 240-20.091 Electric Utility Environmental Cost Recovery Mechanisms

Section (1)(B):
(B) Environmental Cost Recovery Mechanism (ECRM) means a mechanism established in a general rate proceeding that allows periodic rate adjustments, outside a general rate proceeding, to reflect the net increases or decreases in an electric utility's incurred environmental costs **as compared to the electric utility's base environmental expenses**;

Reasons: This is a definitional change necessary to ensure that the unwieldy and unreasonable exercise of determining an "environmental" and a "non-environmental" rate base is not required. For further discussion, see the reasons listed under (2)(I) and (2)(L) in the Chapter 3 rule, above.

Section (1)(D) – the rest of the Sections in (1) become (1)(D), (E), (F) and (G):

~~(D) Environmental revenue requirement means the base environmental expenses identified in the general rate proceeding which forms the base for future periodic adjustments of the ECRM;~~

Reasons: This provision falls under the definitions. As previously noted in the reasons for changing sections (2)(I) and (2)(L) of rule 4 CSR 240-3.162, identification of an "environmental" versus a "non-environmental" rate base is not reasonably achievable.

Section (2) (G):
(G) If an ECRM is approved, the commission shall determine a level of base environmental expenses included in the utility's overall revenue requirement.

Reasons: As noted earlier, this change is necessary to eliminate the unwieldy and unreasonable exercise of determining and "environmental" and "non-environmental" rate base.

Sections (4)(A) & (4)(B):
(A) ~~The periodic adjustment shall be based on environmental costs incurred since the prior general rate proceeding.~~
~~(B)~~ The first periodic adjustment following the electric utility's general rate proceeding in which the ECRM mechanism was established shall consist of **capital environmental costs to be included in the ECRM and any increases or decreases in environmental expenses, the sum of which will be compared to the base environmental expenses established in the electric utility's general rate proceeding in which the ECRM mechanism was established, less any decreases in costs directly related to the environmental costs included in the periodic adjustment. Subsequent periodic adjustments shall consist of any increases in capital environmental costs and any increases or decreases in environmental expenses as compared to the base environmental expenses established in the electric utility's general rate proceeding in which the ECRM mechanism was established, less (a) any decreases in costs directly related to the environmental costs included in the periodic adjustment and (b) any change in the accumulated depreciation reserve and related depreciation expense and property taxes for capital items whose costs are being recovered through the ECRM. The return applied to all capital environmental costs shall be the weighted cost of capital, including the return on common equity, established in the electric utility's general rate proceeding in which the ECRM mechanism was established.** ~~a comprehensive measurement of both increases and decreases to the environmental revenue requirement established in the prior general rate proceeding plus the additional environmental costs~~.

Reasons: These provisions fall under the filing requirements of a utility seeking to adjust an ECRM rate between general rate proceedings. As previously noted in the reasons for changing sections (2)(I) and (2)(L) of rule 4 CSR 240-3.162, identification of all environmental costs in base rates is not reasonably achievable. The language suggested by MEDA would identify environmental cost increases since the last rate proceeding less decreases in costs directly related to the environmental items identified in a previous ECRM adjustment and the less accumulated depreciation reserve, related depreciation expense and property taxes for capital items whose costs are being recovered through the ECRM. This approach provides for depreciation and property tax offsets similar to those adopted by the PSC in their Infrastructure System Replacement Surcharge (ISRS) rule. This approach will provide for a reasonable depreciation and tax offset and will be reasonably easy to administer. The language suggested by MEDA in the last sentence of section (4)(B) clarifies what return shall be applied to capital environmental costs.

Section (12):

(12) Rule Review. The commission shall review the effectiveness of this rule by no later than ~~June~~ **December 31**~~30~~, 2011, and may, if it deems necessary, initiate rulemaking proceedings to revise this rule.

Reasons: December 31, 2011 is consistent with the similar provision in section 17 of rule 3.162. The rule review provision for these rules should reflect the same date.