ELECTRIC RESTRUCTURING PLAN FOR THE COMPETITIVE SUPPLY OF GENERATION IN MISSOURI

BY

THE MISSOURI PUBLIC SERVICE COMMISSION STAFF

TASK FORCE ON RETAIL COMPETITION
OF THE MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. EW-97-245

JUNE 12, 1998

ELECTRIC RESTRUCTURING PLAN FOR THE COMPETITIVE SUPPLY OF GENERATION IN MISSOURI

BY

THE MISSOURI PUBLIC SERVICE COMMISSION STAFF

TASK FORCE ON RETAIL COMPETITION
OF THE MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. EW-97-245

JUNE 12, 1998

TABLE OF CONTENTS

CHAPTER 1
ELECTRIC RESTRUCTURING PLAN

INTRODUCTION

One of the primary reasons for the creation of Missouri Public Service Commission's (Commission's) Task Force on Retail Electric Competition was to compile a comprehensive plan for implementation of retail electric competition in the State of Missouri in the event legislation is enacted which authorizes or mandates the competitive supply of generation to retail electric consumers. The Task Force Report provides the information necessary for developing such a comprehensive plan but a comprehensive plan could not be developed which would have obtained a consensus of the Task Force. The Task Force Report addresses many of the solutions and options for resolving issues but does not provide a specific approach to implementing restructuring. The Working Groups' Reports also provide a thorough discussion of the issues that need to be addressed and contain recommendations. The Working Groups' Reports though do not provide a single comprehensive plan.

The Staff of the Commission (Staff) having participated fully in the Working Groups and the Task Force will take this opportunity to present a comprehensive plan for restructuring in Missouri based upon the information currently available.[1] This plan adopts the same assumption of the Task Force that electric restructuring will be mandated. This plan will provide some general policy direction and will make proposals for implementation of retail competition.

[1]If circumstances change or information currently available to the Staff changes, the Staff reserves the right to modify this plan.

Two models, gas and telecommunications, exist under current state and federal law from which to draw some lessons. Some states also have moved toward retail competition by enacting legislation. These states have had to develop solutions for many of the problems identified by the Task Force. Staff believes three major public policy issues must be addressed by any legislation establishing retail competition. First the issue of replacing revenues from taxes, franchise fees and payments in lieu of taxes (PILOTs) must be addressed before the market is opened to competition. In the most recently concluded legislative session, the Missouri Legislature passed Senate Bill No. 627, which addresses business license taxes, franchise fees and PILOTs, which is less than all of the relevant "taxes" identified by the Tax Subcommittee of the Legal Committee of the Task Force. Senate Bill No. 627 purports to:

(1) Maintain a fair and equitable tax structure and preserve the local tax base by requiring all persons who provide electricity or gas service to pay an equitable share;

(2) Equalize the amount of business taxes, franchise fees and payments in lieu of taxes on competing suppliers of electricity and gas service;

(3) Restore to political subdivisions revenue sources that existed prior to any previously implemented gas industry restructuring; and

(4) Remove disparities in the liability of natural gas suppliers for business taxes, franchise fees, and payments in lieu of taxes, which disparities have arisen as a result of any previously implemented gas industry restructuring.

The State of Oklahoma has enacted electric restructuring legislation that conditions the commencement of retail competition on the establishment of tax laws to provide similar levels of state and local revenues that otherwise would be lost through restructuring. The Staff agrees with this approach.

Second, legislation should recognize the physical constraints that exist in the delivery of electricity to consumers. Safe, reliable and adequate facilities must be available to carry the power and these facilities must be maintained. Current statutes and regulatory framework support a system that has served our state and citizens very well for many years. Any legislation opening the retail electric market to competition should maintain as much of this structure as possible. The Staff recommends that existing providers maintain the distribution system and that these providers which are now regulated continue to be subject to regulation by the Missouri Public Service Commission. Conclusions 1, 2 and 5 set out by the Reliability Working Group establish the fundamental policy that should guide any legislation. These are:

> Consumers may be allowed to risk price changes or unreliability of a supplier but a consumer should not be given the choice to choose service that is less safe or which could interfere with another customer's reliability or safety.
>
> Emergency response, metering, and building of new distribution facilities should remain with current providers. Territorial agreement statutes and "anti flip flop" statutes should be modified to allow for different suppliers of the product but only one provider of the distribution delivery facility.
>
> Current statutes, although not perfect, are gradually allowing for the establishment of distinct service territories for regulated utilities, cooperatives and municipalities. This process should be allowed to continue. Current law and regulatory framework were created to prevent duplication of physical facilities and this is still good public policy.

The third general policy consideration is the need to ensure that competition does not return Missouri to the days before rural electrification. High cost customers, remote locations and high risk customers must be kept on the system where reasonably possible. We achieved the lifestyle and economic stability we have today by ensuring all citizens could receive the basic necessities in a modern society. Electricity was a fundamental necessity to bring all consumers to a certain standard

of life. Any legislation establishing competition for retail electric service should maintain this public policy goal.

To meet this policy goal, the Staff recommends that the current providers of electric power be made providers of last resort for their current customers and that they be required to extend service to new customers within their current and any future service territory. Provisions should be made for the current providers to provide service to those who do not wish to choose a competitive provider and those who have no choice because of payment history or geographic location.

With these three public policy considerations as our guide, the Staff will address other issues that it determines need a resolution to achieve retail competition. The Staff's basic view is that the electric market should more closely resemble the current gas market rather than the telecommunications market. End-use electricity customers should be free to buy from the supplier of their choice. Marketers, resellers and generation owners should be required to obtain certificates of service authority to enter the competitive market in Missouri. Their certificates should be granted by the Commission under certain minimum conditions.[2] Current providers of electricity should be required

[2]In addition to the information regarding Senate Bill No. 627 which was previously noted above, certain other facets of Senate Bill No. 627 are relevant to the Staff's proposed electric restructuring plan, including the Staff's position that marketers, resellers and generation owners should be required to obtain certificates of service authority. Senate Bill 627 defines "distributors" and "sellers" as follows:

> 393.298(3) "Distributor", an electrical or gas corporation as defined by section 386,020, RSMo, which is authorized by the commission under chapter 393, to provide or distribute energy services
>
> 393.298(10) "Seller", any person who uses, leases, or controls the distribution system of a distributor or a political subdivision or any part thereof to sell energy services at retail within the political subdivision other than a distributor or a political subdivision which uses its own distribution system

to functionally separate their generation facilities from their other facility operations or divest these facilities. A state-wide power pool should be established through which the regulated utility companies can obtain power at market-based prices to meet their obligation to serve as providers of last resort.

SUMMARY OF THE RESTRUCTURING PLAN

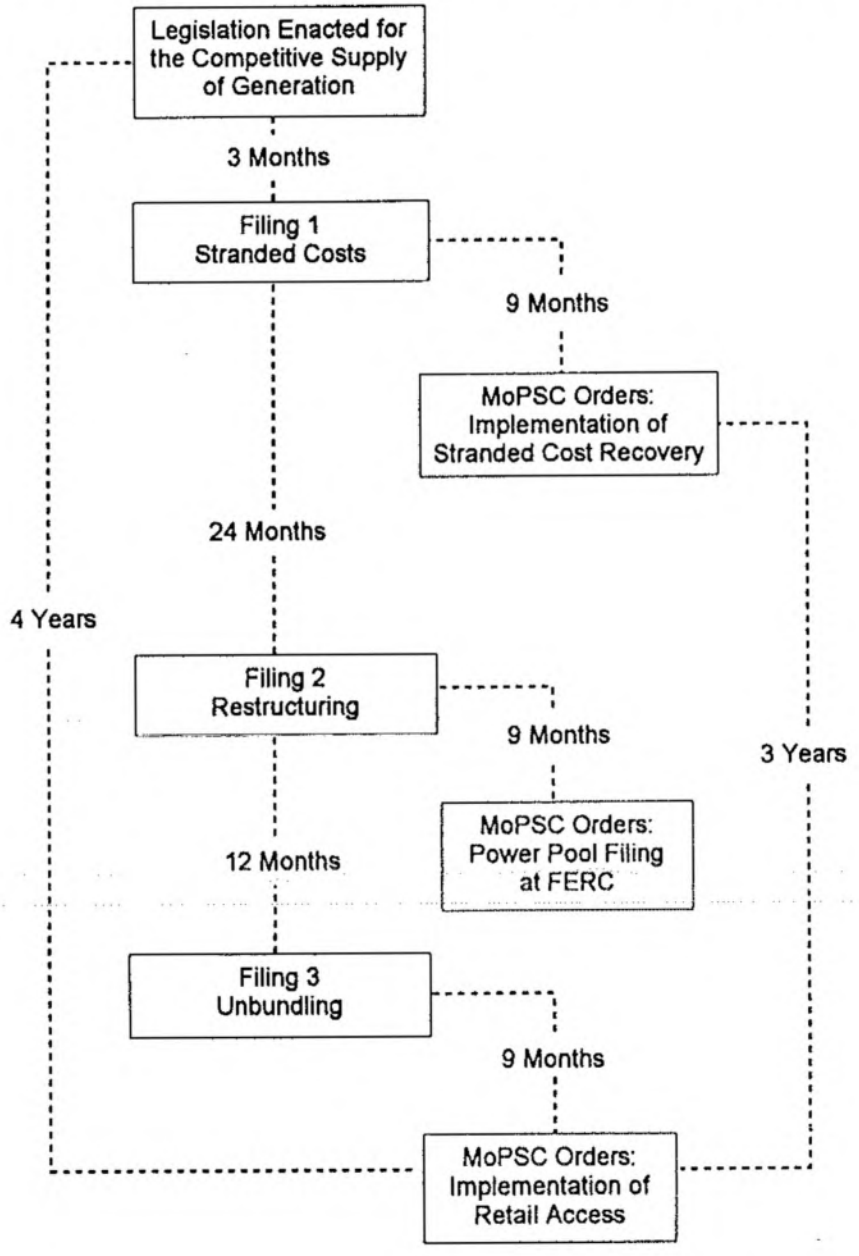
In response to the Task Force on Retail Competition, the Staff of the Missouri Public Service Commission is setting forth its position on a restructuring plan for the competitive supply of generation in Missouri. Due to the investor-owned utilities being regulated by the Commission, this plan focuses on these utilities. From the effective date which the State of Missouri or United States Congress enacts legislation that mandates the competitive provision of generation to retail, end-use consumers, the Staff's plan has a **transition period of four (4) years**. In the first year, utilities may submit proposals for reduction of expected positive levels of stranded costs. The Commission will determine whether to approve each utility's proposal or whether to direct changes to these proposals. Over the subsequent three years, retail rates for all end-use consumers will be fixed to allow for mitigation and partial or total recovery of stranded costs. Only after this initial transition period of four years will all retail electric load be opened to competitive supply of generation. During this

---

Under Senate Bill No. 627, Sections 393.299.1 and 393.299.2 provide for the certification of "sellers" by the Commission, and Section 393.299.4 provides that the Commission shall establish procedures for certification pursuant to Chapter 536, RSMo. Section 393.299.8 states that no "seller" may provide energy services unless it does so in accordance with all applicable laws and the applicable rules of the Commission. Finally, Section 393.301.2 provides that should the provisions of Section 393.299 be declared void or invalid by final judgment of a proper court, no energy services should be permitted except upon a finding of public convenience and necessity and compliance with all provisions pursuant to Chapter 393, regulations adopted pursuant thereto and Commission Orders.

transition period, the investor-owned utilities will make three filings with the Commission (see the time line presented in Figure 1). Each of these filings is described in detail in the next chapter of this report.

FIGURE 1
STAFF'S IMPLEMENTATION FILINGS AND TIME LINE FOR THE COMPETITIVE SUPPLY OF GENERATION FOR RETAIL CONSUMERS



The first filing is on stranded cost recovery and will occur three months after legislation on the competitive supply of generation is passed and becomes law. The Commission will have nine months for hearings and to write orders for each utility. Thus, one year after legislation is enacted into law, companies will begin recovering stranded costs through fixed rates over the next three years. If at the end of this three year period, the utility believes that it has not fully recovered its stranded costs, it will have the opportunity to request a wires charge for the recovery of a portion of any remaining positive levels of stranded costs. This wires charge should not extend beyond an additional three years, and it is the hope of the Staff that such a wires charge would not be required.

Even before legislation is enacted, the Staff's plan calls for establishing dockets to investigate the stranded cost potential for each investor-owned utility. This immediate action plan is presented in the first section of the third chapter of this report, and represents a proactive approach to prevent a regulatory log jam with respect to these initial stranded cost recovery filings.

The second filing is on restructuring and will occur 24 months after the initial filing. From the date of the second filings, the Commission will have nine months for hearings and to write orders for each utility. The restructuring filing would include both how the utility proposes to restructure its company, separating regulated from non-regulated business, as well as an electric utility industry proposal for a state-wide power pool to supply power to the providers of last resort. In addition, if any investor-owned electric utility has not yet joined an independent system operator (ISO), this filing would include a proposal for joining an ISO and a request for permission from the Commission for the utility to turn the planning, operations and pricing of transmission over to an ISO. If the utility plans to have a Retail Electric Provider (REP) function, this filing will indicate compliance with both

the affiliated transaction rule and code of conduct yet to be established by the Commission. Finally, this filing will define the metering and data management responsibilities of the Local Distribution Utility (LDU), as well as the billing responsibilities of the REPs and LDUs.

The third filing is on unbundling and will occur 12 months after the restructuring filing. The Commission will have nine months for hearings and to write orders respecting each utility's simultaneous filing. The unbundling filing would include a request for Commission authorization of proposed unbundled rates for the LDU, proposed rates to collect the cost of providing electricity from the state-wide power pool and supporting public benefits programs and any proposals for performance based ratemaking that might be put into effect at the time of full retail access to competitive generation. In addition, this filing would include any requests by the investor-owned utilities for further recovery of stranded costs by means of an additional wires charge.

While not included as a part of the time line in Figure 1, during the four year transition period the Commission will need to conduct rulemakings regarding (1) the certification of REPs, (2) a code of conduct and other regulations respecting affiliated transactions and (3) the revision of present consumer protection rules. Each of these rulemakings are also discussed in greater detail in the next chapter of this report.

CHAPTER 2
RESTRUCTURING FILINGS

FILING 1: STRANDED COST RECOVERY

This filing should be made three months after legislation which allows for competitive supply of the generation of electricity to all retail, end-use consumers becomes law. At that time, each Missouri investor-owned electric utility would file with the Commission information concerning its current cost of service (including its embedded generation costs), projections of future stranded cost exposure under competitive conditions, projections and proposals for mitigation of stranded costs and how it expects to reduce or eliminate positive levels of stranded costs over a three year period commencing in nine months. Based on the evidence provided and after making any appropriate rate changes,[3] the Commission could approve a three-year rate freeze for the utilities. Rates would not be reduced if the impact of the rate change would be to make recovery by the utility of its projected stranded costs unlikely within the three-year period. Utilities could opt out of this filing and the rate freeze, but only by foregoing all rights to future stranded cost recovery from the Commission.

During the three year rate freeze, utilities will be able to apply the benefits of any expense reduction effort they undertake or of any other type of stranded cost mitigation measure they employ to offset their stranded costs. These measures should allow the electric utilities the opportunity to increase earnings during the interim three-year period, before the implementation of retail access, and apply this increase in earnings to write down the book values of plant assets that may be potentially

[3]For example, if a utility is over earning, a reduction in rates or a sharing plan could be found to be appropriate along with reducing possible positive levels of stranded costs.

stranded. If, during this three year period, a utility chooses to divest some portion of its generating assets, any proceeds received that are greater than the book value of the assets divested would likewise be used to write down the values of other potentially stranded assets.

If the three-year rate freeze is not sufficient for the utility to fully recover its recoverable stranded cost totals, then the company would have the option of making a filing nine months prior to the implementation of retail competition (concurrent with the "unbundling" filing) to (1) present updated estimates of stranded cost exposure and mitigation, and (2) propose a non-bypassable wires charge for recovery of any residual stranded cost. For this second round of residual stranded cost recovery, the Staff recommends that the portion recovered from utility customers be less than one hundred percent.[4] The proportion of residual stranded costs allowed to be recovered from customers by the Commission would be dependent upon the method used to quantify the stranded costs. If administrative methods[5] are proposed by the utility for this purpose, recovery by the utility should be limited to fifty percent (50%). If a market method such as future divestiture is used to quantify the stranded costs, a higher proportion of recovery by the utility would be warranted (perhaps 67% or 75%). If adequately justified by the utility, the Commission would approve such a non-bypassable wires charge for a length of time sufficient to recover the customers' portion of the recoverable stranded cost total, but with a maximum duration of three years. In addition, stranded cost recovery

[4]One possible exception to not allowing full recovery of positive levels of residual stranded costs might be where the utility has divested a major portion of its generation assets, has been able to significantly write down the book value of those assets but still has a large level of positive stranded costs.

[5]An example of an administrative cost method is one which estimates the market price for electricity over the life of a generation asset and compares it to that asset's book value.

based on administrative quantifications should be trued-up not more than 18 months after the wires charge goes into effect, with market price assumptions for electricity to be corrected, at a minimum.

RATIONALE

The "rate freeze" approach to mitigating stranded costs before competition is reasonable in that such a device gives the utilities an incentive to mitigate their stranded costs as much as possible or face a substantial disallowance after retail access begins, without unduly delaying potential customer benefit from restructuring. This approach will also minimize the market distorting impact of substantial stranded cost recovery by incumbent utilities. Nonetheless, the initial three years may not be sufficient to allow all utilities a reasonable opportunity to recover stranded costs, so an option for a stranded cost charge after retail competition begins should be offered. Only in the case where the utility has made significant divestiture of its generation assets should these subsequent charges be set at levels necessary to allow 100% of the remaining utility stranded costs to be recovered. Otherwise, the utility will have no incentive to maximize mitigation of stranded costs during the earlier three-year rate freeze. Incentives should be provided as part of the recovery process to encourage use of accurate, one-time-only quantifications of stranded costs through market methods of calculation.

FILING 2: RESTRUCTURING

This filing should be made 27 months after legislation is enacted and becomes law, which allows for competitive supply of the generation of electricity to all retail, end-use consumers.

A. THE NEW ELECTRIC INDUSTRY STRUCTURE

Under the Staff's proposal, the new electric utility structure is one in which the vertically integrated utility company is separated into distinct service components. The restructuring filing is meant to specify how the utility plans to organize and manage those components. Restructuring of the utility would occur by separation of the various business units through either:

1) Divestiture (sale of generation and/or transmission assets to other entities);
2) Separate affiliate companies (holding company structure); or
3) Separate divisions within the same company.

Generation should be separated from the other components of the electric utility business because the physical production of electricity will be sold in a competitive market at unregulated prices. In the restructuring filing, investor-owned utilities must address which method or combination of methods it is proposing to apply in the separation of its generation business. The Staff believes that divestiture of generation by utilities will more quickly promote vigorous competition in the generation markets and raise fewer questions and concerns regarding independence of operation of the generation assets. If generation is divested, different units should be transferred to different entities; i.e., one separate entity should not be permitted to purchase all generating units of a previously vertically integrated electric utility.

Transmission should also be separated from the other components of the electric utility business, but for a different reason. Unlike generation, transmission will remain a monopoly provided service that will be entirely regulated with respect to operations, planning and pricing of transmission by the Federal Energy Regulatory Commission (FERC) through ISOs, among other possible entities. The

Commission should encourage the formation of ISOs rather than other transmission entities, such as transmission companies (TRANSCOs). If the formation or selection of an ISO by each of investor-owned electric utility has not occurred by the time of the restructuring filing, the restructuring filing must address this lack of formation or selection of an ISO by each investor-owned electric utility. Each electric utility must seek approval by the Commission to turn the operation of its transmission facilities over to an ISO. In either case, the utility restructuring filing should include the application of the FERC seven factor test to specify the separation of assets and associated expenses between the transmission and distribution functions.

Distribution should be a separate utility business that is operated by the Local Distribution Utility (LDU), and is regulated by the Commission. The LDU would maintain the function of meter reading and data management. The restructuring filing must address the basic metering requirements, as well as the products and processes required for the LDU's data management function, including the security of information required to maintain individual consumer privacy.

Retail Electric Providers (REPs) would be a separate competitive business, and if the utility wants to be in this business, it must set up a separate affiliate company. The restructuring filing must indicate compliance with the Commission's affiliate transaction rules and code of conduct to be promulgated by the Commission.

The LDU would be the **provider of last resort** that would supply the electricity requirements for end-use consumers that have not entered into arrangements for competitive electricity supply from a REP.

Billing would be performed by the REPs for their customers and by the LDU for the consumers which it serves. REPs would be billed by the LDU for the distribution services which it is providing to the REPs' customers, and it would be the REPs' responsibility to recover these costs from its own customers. The LDU would provide basic metered data to the REP, and if the REP has special metering requirements, it must arrange that metering with the LDU and the customer. The restructuring filing must address the metering and billing arrangements.

B. THE PROVIDER OF LAST RESORT

The LDU will be the provider of last resort. The Staff recommends that there be a state-wide power pool from which each LDU can purchase electricity to meet its obligation as provider of last resort.

The use of a power pool allows for a consolidation of the purchased power function into a single entity that is regulated by the FERC[6]. In essence, there would be a single, independent staff that would operate by the rules and code of conduct set out under the power pool structure. In addition to operations, the state-wide power pool would be governed by an independent, non-stakeholder board of directors, and the power pool would have specific provisions for planning and pricing. After initial approval by the Missouri Commission, the power pool structure would then be filed with the FERC for final approval.

[6]If the LDU were to purchase power to meet its obligation as provider of last resort, then each LDU would have to maintain a staff to decide which contracts to enter into, as well as what purchases to make on an hourly basis in the spot market for electricity. Each year the prudence of those decisions would need to be reviewed by the Commission. When compared to having a single entity (state-wide power pool) carry out this purchasing function, the approach of placing the responsibility on each LDU appears to be a much less efficient method for having the LDU meet its obligation to serve as the provider of last resort.

The LDU would provide the load forecast for the entire load for which it provides distribution services. Each REP would provide the LDU with the list of its customers, and the LDU would estimate the load requirements for the REPs' customers. The state-wide power pool would then contract to purchase electricity for the difference between the total LDU load and the REP load, including transmission to the distribution substations of each LDU. The Commission would set the rates that allow the LDU to collect from end-use consumers the power pool charges to the LDU. This may involve a purchased electricity adjustment mechanism, with an annual true-up for differences in what was collected from end-use consumers compared to what was charged to the LDU by the power pool.

C. MARKET POWER MITIGATION

The restructuring filing must also include studies which measure the potential horizontal market power of the incumbent vertically integrated investor-owned electric utility within its current service territory. These studies must take into account the limitations on transmission import capability into the service territory and load pockets within the service territory. In addition, each study must determine the amount of local, must-run generation required to meet reliable service criteria.

Based on the results of its market power studies, each utility must propose methods for mitigation of its market power. While the Staff supports divestiture as the most straight forward method for horizontal market power mitigation, utilities should be allowed to submit proposals for other mitigation options. For example, the utility could structure its generation function into several separate generation business units with rules and codes of conduct aimed at requiring these generation business units to compete with one another for sales, i.e., a utility's generating units would not be

divested to, or organized as, one entity. Other possible mitigations could require a portion of generation to (1) be sold into the state-wide power pool at regulated prices, or (2) require that generation used to serve a local area to be sold at market prices which are determined without bids from that generation. The Staff's concern with these options is that they extend the regulation of generation into the future and require an ongoing review to determine the generation involved.

The Staff sees a state-wide power pool as the entity which would be best situated to monitor ongoing or developing market power problems and, if need be, implement market power mitigations. However, in the absence of a state-wide power pool, the monitoring and, if needed, implementation of market power mitigations could come under the purview of ISOs. Since both the power pool and the ISO involve wholesale power transactions, the ultimate regulatory authority for dealing with potential ongoing or developing market power problems would be the FERC.

The Staff believes that because of potential vertical market power problems, ISOs must be in place and each utility must be required to join a properly established and operating ISO before any retail load is allowed to be served generation on a non-regulated basis. Missouri appears to be located at the boundaries of at least three ISOs, thus, it is critical that boundary issues be resolved among the ISOs, including the elimination of pancaked rates among ISOs.

FILING 3: UNBUNDLING

This filing should be made 39 months after legislation is enacted and becomes law which allows for the competitive supply of the generation of electricity to all retail, end-use consumers.

A. UNBUNDLED RATES

The unbundling filing should include the unbundled rates for the LDU, the rates to collect the cost of providing electricity from the state-wide pool, the wires charge to recover any remaining recoverable stranded costs and the wires charge to fund public interest programs.

The filing would include both the unbundling of costs and the rates designed to recover them. Costs would be unbundled into at least the following categories:

- The anticipated cost of energy delivered to the LDU including both the separately determined cost of energy purchased from the power pool and the separately determined cost of transmission to the LDU's distribution system.
- The cost of delivering energy to the end-use consumer through the LDU's distribution system determined on the basis of the customer's delivery voltage. Also included would be the costs for basic metering, meter reading, and data management.
- The costs of billing and collections.
- The costs for optional metering and/or meter reading.
- The costs of funding public interest programs.
- Recoverable stranded costs.

Rates will be designed to recover costs for each of the following categories:

- LDU wire charges to all consumers (non-bypassable) for:
  - distribution and basic metering costs
  - public interest programs
  - recoverable stranded costs
- Electricity delivered to the LDU as provider of last resort.
- Billing and collecting for consumers served by the LDU as provider of last resort.
- Optional metering and/or meter reading.

B. RATEMAKING PROCEDURES FOR THE RECOVERY OF PURCHASED ELECTRICITY COSTS

The unbundling filing would also include procedures, by which the purchased electricity costs which the LDU incurs in its obligation to serve as the provider of last resort, are recovered on a timely basis. Such a mechanism is currently in place for the recovery of natural gas costs incurred by the local gas distribution companies. This mechanism has an adjustment component and a true-up component. The rates for purchased electricity costs would be set out on tariffs that are approved by the Commission. If these rates are either under- or over-recovering costs, the LDU would be allowed to adjust them to more correctly price the electricity. At the end of an annual period, the revenues collected would be compared to the costs incurred, and an adjustment would be made for differences. This actual cost adjustment would then be collected/credited on bills rendered during the next annual period. Something on the order of this ratemaking procedure would need to be implemented for the LDUs.

C. MAINTAINING QUALITY OF SERVICE

1. Quality of Service

Consumers must be assured that the quality and reliability of service is, at the very least, maintained at existing levels during the transition and after the implementation of restructuring. The introduction of competition will provide utilities with powerful incentives to cut costs. Cost savings measures may be implemented in attempts to generate funds that can then be invested in competitive unregulated ventures. Knowledgeable utility management personnel may be transferred to focus their talents on the unregulated business. Such actions could easily have negative impacts on the quality of service received by the customer from the LDU. Total separation of regulated and unregulated

businesses (e.g., divestiture of generation assets) would result in fewer incentives for utilities to cut their quality of service. Therefore, the Staff believes it is necessary to establish a system of service standards to ensure an ongoing level of service quality.

The Commission has the clear authority to set quality of service performance standards, related to service interruption, trouble reports, response to customer inquiries, and other standards that will permit the Commission to measure any denigration of service. This information should be maintained at the Commission and be available to the public upon request.

2. Performance Based Ratemaking

An application of having measured and monitored service quality standards is in performance based ratemaking (PBR). PBR provides for the development of a series of standards and indices covering a wide range of services provided by the LDU. Earnings sharing between the LDU's shareholders and customers is based on how well the LDU performs relative to the quality of service standards.

D. CONSUMER PROTECTION RULES

Under the present system, the Commission has exercised its authority over electric utility price and services and has developed a comprehensive framework of consumer protection, regulations and policies. The Commission has promulgated rules addressing: quality standards; safety standards; billing and payment standards; meter reading standards; deposit, credit and late payment standards; discontinuance of service standards; restriction on service disconnection during cold weather restrictions and procedures; dispute resolution requirements and consumer complaint procedures.

The challenge of consumer protection under competition will require a reexamination of the present rules to determine their ongoing applicability. Present rules should be evaluated and strengthened where necessary to maintain consumer protection in a restructured environment. For example, billing and disconnect responsibilities will need to be clarified within these revised rules. This effort should be completed before the introduction of retail competition in order to educate consumers and service providers as to their rights and responsibilities.

E. PUBLIC BENEFITS

Public benefits are defined as items that will not be produced and delivered by the competitive market, but nonetheless deliver a desirable commodity and a value to society at large. Utility customers have historically funded a number of different public-benefit programs such as energy efficiency, weatherization and low-income assistance programs through the rates they pay. Within a regulated utility environment, the utilities managed and administered these programs with the oversight of the Commission. However, some of these programs will become vulnerable under a competitive marketplace as companies focus on cost reduction. For example, low-income programs have historically been funded by a mix of federal aid and rate supported utility contributions. It is widely expected that the level of federal aid is going to be substantially decreased. Generally, the ongoing provision of many of these programs must be assured.

Various states have implemented, or are considering, a non-bypassable system benefits charge based upon kWh sales that is assessed and collected through the LDU. These funds could be

allocated to various public benefit programs that are deemed to be critical.[7] The Staff supports the concept and application of a public benefits charge to fund those low income, energy efficiency and environmental services deemed to be necessary for the public good. However, legislative decisions must be made first as to the specific programs which should be supported, the appropriate levels of funding and the administration of such programs.

ADDITIONAL PUBLIC SERVICE COMMISSION RELATED ACTIVITIES

1. Rulemaking for REP Certification and Code of Conduct

During the four-year transition period, the Commission will need to establish rules which set out the criteria that must be met in order to be certified to do business as a REP[8] within the state of Missouri. These criteria would primarily focus on both the physical and financial ability of a REP to provide what it claims to be able to provide to end-use consumers. Some states require the supplier to post a bond or other type of security approved by the public service commission. The posting of security can be used to provide a recourse to customers if service does not meet promised levels, if codes of conduct are violated or if there is fraud in marketing. The posting of security may also be utilized to screen suppliers with financial situations that appear unstable.

---

[7] For example, California and Wisconsin are funding both energy management programs and low-income assistance plans out of a "public goods" charge based on kWh sales via the distribution companies. Massachusetts is funding its programs through a general access charge.

[8] REPs are companies that enter into financial contracts to purchase electricity at a wholesale level and resell that electricity at a retail level. REPs are distinct from aggregators who act as a representative for a group of end-use consumers in the purchase of electricity from one or more certified REPs at the retail level. Moreover, if an aggregator becomes involved in directly contracting to purchase electricity from a generator, then that aggregator is acting as a REP and will need to be certified as such.

In addition to certification requirements, the rulemaking should establish a code of conduct by which certified REPs agree to function. The code of conduct would deal with what representations REPs can fairly make to end-use consumers and what practices are considered unethical, such as "slamming." For example, a code of conduct can require the REPs provide complete, standardized information to customers on pricing, terms and conditions of service. Codes of conduct can address requirements that the suppliers agree to abide by any rules for billing and payment and a commitment to truth in advertising. If a REP violated this code of conduct, then the Commission could remove its certification to operate within the state. Removal of certification would require an evidentiary hearing before the Commission.

2. Dispute Resolution/Enforcement

The consumer must be assured that there is a neutral, effective forum for addressing and resolving consumer complaints against REPs. The Commission should have the clear and unambiguous authority from the legislature to expeditiously investigate and enforce compliance with consumer protection rules. To ensure adequate enforcement of Commission rules, the Commission should have the ability to hold a hearing and upon making its findings, have the ability to impose fines and other sanctions and ultimately revoke certificates when such action is required to help protect the public.

CHAPTER 3
IMPLEMENTATION DURING THE TRANSITION

COMMISSION AND UTILITY ACTIVITY BETWEEN NOW AND THE DATE WHEN RESTRUCTURING LEGISLATION BECOMES LAW

1. Preliminary Investigatory Dockets

Although it is assumed that electric restructuring in the form of retail access will occur in Missouri, it is not known at this time whether that will actually happen. If such electric restructuring does occur, there is no certainty when the Legislature and the Governor will, respectively, pass and sign into law such legislation. Since the time between such legislation becoming law and the commencement of the implementation of the substance of such law is likely to be shorter than what would be desired by those who will be charged with the implementation of the law, it is imperative that the Commission constructively utilize the time between now and the date when restructuring legislation commences implementation.

The Commission can constructively utilize this time by establishing separate investigatory dockets on stranded costs for each investor-owned electric utility having a service territory in Missouri. The purpose of each of these company specific dockets would be to determine, among other things, what information exists and what information may need to be developed for the Commission to make the determination whether these utilities have positive, negative or no stranded costs under the likely restructured electric regime. An important result of these investigations will be the determination of whether or not restructuring is likely to lower rates for the customers of the investor-owned utilities.

In these investigatory dockets, the Staff will give serious consideration to going forward with proposals for writing down the value of generation assets that are subject to stranded cost liability (e.g., proposals for accelerating the depreciation of these assets), even prior to and irrespective of enactment of legislation on retail competition.[9] These investigations will entail three elements that are not found in a typical rate case or earnings complaint proceeding:

(1) the unbundling of costs;

(2) the determination of the likelihood of positive, negative or no stranded costs; and

(3) the application of utility earnings to reduce the utility's stranded cost, if they are positive.

Some, if not all, of these companies are themselves in the process of reviewing data, quantifying and developing positions on stranded costs. Since the earliest date by which electric restructuring legislation would likely become law is approximately September 1, 1999, under the Staff's proposal and the chronology identified in the Staff's plan, the investor owned electric utilities would file their stranded cost filings on approximately December 1, 2000. The Commission would have until approximately September 1, 2000, to hold hearings, issue Reports And Orders and start to implement the three year period of stranded cost recovery for all five of the electric utilities under the Commission's jurisdiction. To the extent that the investigatory dockets would culminate in ratemaking involving the reduction of positive stranded costs, it is anticipated that these dockets would be completed by September 1, 2000.

[9]If other dockets already exist involving ratemaking for investor-owned, electric utilities, the Staff will address writing down positive stranded costs in those dockets.

2. Working Groups

The Staff sees the need for three Commission working groups to deal with the issues raised in its plan. The purpose of these three working groups is to provide a forum in which input is provided to the Staff related specifically to areas in which the Commission will be making decisions. The first two areas involve rulemakings on consumer protections and REP certification, and the third area involves the state-wide power pool.

The consumer protections working group would examine the current Commission rules that address:

(1) quality standards;

(2) safety standards;

(3) billing and payment standards;

(4) meter reading standards;

(5) deposit, credit and late payment standards;

(6) discontinuance of service standards;

(7) cold weather restrictions on service discontinuance;

(8) consumer complaint procedures; and

(9) dispute resolution requirements.

This working group would make recommendations to the Commission regarding how existing rules should be amended to meet the challenges of the competitive supply of generation.

The certification requirements for REPs working group would review requirements being instituted in other states and make recommendations for Missouri. The Staff supports the concern

expressed in the report of the Market Power working group that certification requirements not be so stringent as to become a barrier to entry for reliable electricity providers, yet be rigorous enough to screen out those who are unlikely to meet their obligations to provide reliable electric service to consumers. In addition, this working group would be responsible for developing a REP code of conduct relating to representations which REPs can make to end-use consumers, unethical practices and standardization of information on pricing, terms and conditions of service.

The Staff has not recommended that a working group be set up to consider affiliate transactions and associated codes of conduct because the Commission has already directed rulemakings on this matter. These rulemakings should be comprehensive and will address the existence of generation and REP functions as competitive business units within the incumbent utilities, which will also provide transmission, distribution and customer services on a regulated basis.

Only after legislation in enacted into law that mandates competitive supply of generation which has adopted the Staff recommendation of a state-wide power pool would the third working group be established. This working group would investigate and make recommendations on the structure, financing, governance and operating rules for a state-wide power pool.

RETAIL WHEELING EXPERIMENTS

The Staff recommends that the Commission actively seek the introduction, enactment and signing into law of legislation which allows the Commission to approve retail wheeling experiments during the four year transition period. These experiments would be filed with the Commission, which should

act in a timely fashion to allow any reasonable experiment. The purpose of these experiments is to encourage REPs to begin operations in each service territory prior to the date of full implementation of retail direct access legislation. During this period, retail rates will be bundled, but with the filing of an experiment, the utility would propose avoided cost credits to the end-use consumer's bill for generation and transmission. Thus, during the transition period, an end-use consumer would consider the cost charged by the REP compared to the credit received from the utility. If the utility can avoid capacity costs (either generation or transmission) by having a portion of its load served by an alternative provider that is willing to supply capacity on a firm basis, then the credit should include these avoided capacity costs.[10] The extent or size of these experiments may in part be determined by the investor-owned utilities' need for new or replacement generation capacity during the four year transition period. In effect, the Staff is proposing that competitive supply of new generation take place during the transition period.

The timing of the filings of these experiments, in part, will depend on each utilities' need for new generation capacity, its plans regarding replacing purchased power contracts, its plans for renewing leases on generation capacity or its plans to sell any of its existing generation capacity. The legislation on retail wheeling experiments which the Staff proposes that the Commission seek, would permit filings for retail wheeling experiments at the earliest possible date, even before the Legislature passes laws allowing for the full competitive supply of generation in Missouri.

[10]Several investor-owned utilities have purchased power contracts that expire within this four year period, and all of the investor-owned utilities have need to add capacity due to load growth. Thus, the Staff would expect all of the investor-owned utilities to have positive avoided capacity costs.

1. Replacing Expired Purchase Power Contracts and Capacity Leases

Several of the investor-owned utilities in Missouri are faced with expiration of purchased power contracts and/or leases on generation capacity which will occur before the earliest possible open access date under the Staff's proposed plan. The pending issue is what should investor-owned utilities do regarding replacement of the capacity that will be required to serve retail customers only during the four year transition period.

For at least some of these new purchased power contracts, it is possible that the new contract price will be higher than the old price for two reasons. First, the old contracts were for periods of time that are longer than the new contracts are likely to cover. The utility will not want to commit to new contracts over long time periods when such a contract term might result in stranded costs at the time that direct access is implemented. Second, the old contracts were negotiated at a time when there was excess generation capacity in the region. This excess in generation capacity has diminished over time as electric loads have grown, and this has resulted in an increase in the market price for generation capacity. Thus, if these utilities negotiate new contracts, the result will be higher costs and either lower stranded cost recovery during the transition period or higher retail rates to achieve the same level of stranded cost recovery.

Clearly, one way to mitigate stranded cost recovery or achieve the same level of stranded cost recovery at lower retail rates during the transition is to allow alternative energy suppliers access to retail customers up to the amount of load that would otherwise be served by the new contracts. The Staff recommends that the investor-owned utilities in Missouri propose such plans as a part of their stranded cost filings. If necessitated by the timing for replacing existing contracts, the Staff would

look favorably on filings made prior to the scheduled date for the stranded cost filings, so long as the necessary legislation on retail wheeling experiments is in place.

2. Addition of Generation Capacity to Meet Load Growth

In addition to replacing existing generation capacity, all of the investor-owned utilities will need to add additional capacity to meet their growth in native load (wholesale under contract and retail). It is anticipated that much of this new generation capacity will be acquired through short-term purchased power contracts rather than from the addition of new generation capacity. Whatever the source of the new generation capacity, some of the investor-owned utilities will be in a situation where the cost of the new generation capacity will be above the embedded (average) cost of their existing generation capacity. This situation is analogous to the one just described regarding the replacement of existing contracts, and Staff recommends that the investor-owned utilities propose competitive provision of this generation by giving alternative suppliers access to retail customers in amounts equal to the load corresponding to their needs for new generation capacity to meet load growth. Again, Staff's recommendation is based on there being in place the necessary legislation respecting retail wheeling experiments.

In the situation where the new generation capacity required to meed load growth is less costly than the utility's embedded cost of generation, the Staff believes that the experience gained by their being end-use consumers with alternative REPs will result in overall benefits. Thus, if the only way to encourage experiments is to allow alternative suppliers to serve load growth by having avoided generation credits for end-use consumer bills during the transition, the Staff would support such proposals.

SALE OF GENERATION ASSETS

The Staff fully supports the concept of separation of generation through the divesture of generation assets. The sale of generation assets results in an immediate market determination of the levels of stranded costs, if there are any. In addition, if the utility does not divest a significant portion of its generation, it should be required to explain how retaining those assets will not result in it having undue horizontal market power in its service territory. In order to facilitate the most accurate determination of stranded costs and the elimination of undue horizontal market power by incumbent utilities, the Staff recommends that utilities sell a significant portion of their generating units to different companies (i.e., a utility's portfolio of generating units should not be sold to a single company or a single consortium of companies).

During the transition period, the sale of a generation asset may require the utility to enter into a purchased power contract with the company purchasing the asset in order for the utility to meet its obligation to serve load, or the date of the sale may be set for the end of the four year transition period. If in its stranded cost recovery filing, the utility plans to divest some, or all, of its generation assets, it should also include the plan for meeting its obligation to serve during the transition period. If a company does not plan to divest its generation assets, then that company needs to explain in its filing how retaining these assets will result in maximizing the mitigation of its stranded costs. It is also important to note that divestiture of generation assets can create avoided capacity costs which would then be included in the utility's experimental retail wheeling programs.

CHAPTER 4
NECESSARY LEGISLATION

As previously indicated, one of the Committees of the Retail Competition Task Force was a Legal Committee. Among other things, the Legal Committee sought to:

(1) Identify state and local tax issues[11], the collection of which is potentially affected by the restructuring of the electric industry in Missouri, and address franchise fees that some utilities pay to municipalities, counties and villages (municipalities) and payments in lieu of taxes (PILOTs), which are paid by government-owned utilities which are passed through to customers;

(2) Identify and address legal issues that relate directly to the alternative market structures for retail competition considered by the Market Structure and Market Power working group;

(3) Identify existing legal impediments to the implementation of retail electric competition in Missouri; and

(4) Survey and summarize legal authority and precedent concerning the identification and recovery of stranded costs.

TAX RELATED ISSUES

At page 2 above, the Staff noted: (1) its position that the reduction or loss of tax, franchise fee and PILOT revenues due to restructuring must be addressed by any legislation establishing retail competition; and (2) Senate Bill No. 627 passed in the just concluded Legislative Session purports to address business license taxes, franchise fees and PILOTs, which is less than all of the relevant taxes identified by the Tax Subcommittee of the Legal Committee of the Task Force. In addition, at pages 2 and 3 above, the Staff states its view that any legislation that opens the retail market to

[11]Municipal business license taxes, property taxes, sales/use taxes on purchase of electricity by end-use customer, state and local sales/use taxes on purchase of electricity by electricity provider, state corporate income tax and state corporate franchise tax.

competition must assure that safe, reliable and adequate distribution facilities exist to carry power to the end-use consumers and that high cost customers, remote locations and high risk customers must be kept on the system where reasonably possible.

Although the Legal Committee members were not able to reach unanimous agreement on the desirability of the following tax reform principles, the Task Force Report states that the Task Force supports the application of the following tax reform principles to the extent feasible. The Staff supports the Task Force's tax reform principles set out below:

- Level Playing Field: the General Assembly should seek equal tax treatment of competing energy suppliers in a restructured electricity market.
- Revenue Neutrality: the General Assembly should seek to maintain revenue opportunities for state and local governments so they are not harmed by electricity restructuring.
- Customer Tax Burdens: any modifications to the tax laws should be structured to minimize the shifting of tax burdens among customer classes or among customers within a particular class.
- Collectibility: any modification the tax laws should be structured to maximize the ability of state and local governments to collect them.
- Interstate Competitiveness: the state and local tax system should be structured to enhance the competitiveness of Missouri businesses.
- Avoidance of Litigation: the General Assembly should seek to design tax legislation that is unlikely to be subject to court challenges in order to avoid potentially significant tax refunds and delays in obtaining certainty in tax treatment.

ANTI-FLIP/FLOP STATUTES

The Legal Committee of the Task Force clearly identified one legal impediment to effectuating retail electric competition in Missouri, the anti-flip/flop statutory provision. In a recent proceeding, Case No. EO-97-491, In the Matter of the Consideration of a Competitive Market Research Project and Pilot Open Access Program for the Empire District Electric Company, the Empire District Electric Company (EDE) filed two proposed tariffs. One of the proposed tariffs, the pilot open access transmission tariff, was jointly developed by EDE and two of its large customers ICI/Praxair, and provided that these two customers would remain on the EDE distribution system but purchase their power competitively. The Commission noted that ICI/Praxair argued that the proposed pilot open access transmission tariff did not provide for a change of suppliers in violation of Section 393.106 in that EDE would remain the sole source of distribution of electrical energy for all customers. The Commission found that the proposed tariff violated Section 393.106 stating as follows:

> The statute was intended to prevent a utility from investing capital to provide permanent service only to lose the customer to a competing utility. . . .While EDE will be reimbursed, at least theoretically, for its capital investment in distribution facilities and will remain as the distribution company, EDE will not be reimbursed for its generation facilities and cannot compete for generation for at least four years. . . .
>
> . . . The Empire District Electric Company is the lawful supplier of retail electric energy to ICI and Praxair through permanent service facilities and, therefore, other suppliers of electrical energy are expressly denied the right to provide such service in the form of sale of electrical power directly to these customers.

Based upon that ruling, section 393.106 must be addressed by any legislation seeking to establish retail competition. Most immediately, there is a need for legislation which would address the

Commission's holding in the above noted EDE case, and specifically permit experiments regarding proposals that go beyond sale for resale transactions.

The purpose of this document is to provide the Staff's position on retail electric restructuring as it relates to investor-owned utilities. Thus, the Staff will address Section 393.106 RSMo 1994, which is in the chapter of Missouri statutes that addresses the power of electrical corporations and their regulation by the Commission. The Staff will not address Section 394.315 RSMo 1994, which is in the rural electric cooperative Law chapter of Missouri Statutes, nor will the Staff address Section 91.025 which is in the municipally owned utilities chapter of Missouri statutes. Sections 394.315 and 91.025 are, respectively, the rural electric cooperative and municipally owned utility counterparts to Section 393.106.

SUMMARY

Generally, the Staff will not seek to replicate herein legal issue subject matter contained in the Task Force Report. The Staff believes that the Task Force Report is comprehensive in its discussion of this subject area, and if the Commission does not already possess the necessary authority, either expressly or implicitly, to effectuate the recommendations contained herein, then the Missouri Legislature may confer that authority upon the Commission. The Staff would note that the lack of a specific statutory grant of authority is not necessarily an indication that the Commission does not have the requisite authority. New legislation expressly granting power to the Commission may be intended only to clarify and particularize existing law.