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,	)	Case No. EX-2009-0252
Environmental Cost Recovery Mechanisms	)	

COMMENTS OF
THE MISSOURI INDUSTRIAL ENERGY CONSUMERS

Come now the Missouri Industrial Energy Consumers (MIEC) and submits the following comments on the Commission's proposed rules 4 CSR 240-3.162 and 4 CSR 240-20.091 concerning environmental cost recovery mechanisms (ECRMs).

MIEC member companies are among the largest employers in the state of Missouri, and contribute significantly to the economic base of the state. Because the MIEC companies operate in competitive markets (in contrast to the price regulated markets in which utilities operate), they are keenly concerned about controlling all aspects of their costs. For this reason, the MIEC has actively participated in all proceedings leading to promulgation of the proposed ECRM rules.

Legislative Intent

Section 386.322 provides the authority for the Commission to promulgate regulations to implement, and that are consistent with, that section. That section, under certain circumstances, grants the Commission discretion to allow utilities to implement an ECRM, but the statute does not encourage or require the Commission to do so. The Legislature could have authorized utilities to implement an ECRM on their own, but rejected that approach in favor of granting the Commission discretion, under carefully defined parameters, to determine whether or not to authorize an ECRM. Section 386.322 reflects the Legislature's far from unfettered deference to the Commission regarding a controversial and technical regulatory issue.

The Legislature heard arguments and testimony by several utilities asserting that ECRMs were needed for them to maintain financial integrity. The Legislature also heard testimony from consumers that some of the state's most profitable utilities clearly did not need an ECRM, and performed better in the absence of an ECRM. In consideration of these arguments, the Legislature struck a balance. On the one hand, section 386.266 does in fact authorize the Commission to grant ECRMs that will automatically adjust rates outside of rate case. At the same time, the Legislature wisely inserted consumer protections in the statute. Section 386.266 is replete with examples of those protections:

> (1) the environmental costs must be "prudently incurred" (section 386.266.2);
> (2) the annual increase in rates may not exceed 2.5% (section 386.266.2);
> (3) the Commission must consider all costs and revenues in a general rate case (section 386.266.4);
> (4) the Commission must find that the ECRM is designed to "provide the utility with a sufficient opportunity to earn a fair return" (section 386.266.2(1));
> (5) the Commission must allow for an annual true-up to "remedy any over- or under-collections" (section 386.266.2(2));
> (6) the ECRM must be reviewed in a general rate case at least every 4 years (section 386.266.2(3));
> (7) the Commission must conduct regular "prudence reviews" of costs (section 386.266.2(4)); and
> (8) the Commission may consider changes in risk associated with the ECRM in determining an allowed rate of return (section 386.266.2.7).

The Commission's regulations must be faithful to these consumer protections; the Legislature recognized that a court challenge could render such an ECRM unlawful (section 386.266.2(3)).

Need for Consumer Protections to Be Addressed in Rules

It is crucial that essential consumer protections be included in these rules, rather than being left for later decision in individual rate cases. Development of regulations for potential ECRMs is a major change in state policy. This requires that key principles governing the

mechanism be included in rules of general applicability and not through a piecemeal approach. *See NME Hospitals v. Dept. of Social Services,* 850 S.W.2d 71 at 75 (Mo. Banc 1993)(changes in statewide policy are rules within the meaning of the Administrative Procedure Act). Industrial consumers must plan for the potential impact of ECRMs, and therefore must know the principles governing this major change in regulation. Section 386.266 requires fundamental consumer protections in the rules. Moreover, providing those protections in the rules ensures predictability for consumers and utilities alike, and lead to fair application of the rules. A piecemeal approach would fail to serve these policies.

Need for Protection Against Utility Over-Earnings

Absent some mechanism for adjusting rates in the event earnings increase above the amounts found appropriate in the most recent general rate proceeding, there is a strong potential that utilities will over-earn and that rates will be too high.

Section 386.266 requires that an ECRM be "reasonably designed to provide the utility with a sufficient opportunity to earn a fair return on equity." Section 386.266 does not provide that utilities "earn at least a fair return on equity." Had that been the intent of the Legislature, it would have used those words. Moreover, the Commission's statutory obligation under 393.130 RSMo is to establish "just and reasonable rates." Consistent with other statutes governing the Commission, section 386.266 requires that the ECRM adjustment allow the utility a sufficient opportunity to achieve a fair, not excessive or above a fair, return on equity.

After rates are set in a rate proceeding, numerous elements of the revenue requirement equation will change. For example, existing assets will depreciate, resulting in a reduction in rate base; utilities achieve efficiencies in work processes and in operations that result in reduced costs; sales volumes increase; and contracts are renegotiated. Also, the utility may make new

investment, expand or contract its work force, or experiences changes in other costs. The combined effect of these changes determines whether the utility's return on equity increases or decreases.

When rates are set, examined, and monitored in rate proceedings, the utility has maximum incentive to manage its costs. To the extent that particular cost items are singled out for separate recovery outside of general rate proceedings, such as the case with the ECRM, there is a high likelihood that the utility will over-earn because increases in environmental compliance costs may be passed through up to the two and one-half percent of the utility' gross jurisdictional revenues, regardless of any offsetting decreases in other costs. Accordingly, it is imperative that a mechanism that reviews the utility's earnings, which mechanism will provide the Commission with the ability to protect consumers by limiting the pass through of costs in the ECRM if the utility is experiencing countervailing decreases in other cost elements. The Legislature understood this and that is why section 386.266 in general, and section 386.266.4(1) in particular, read as they do.

Indeed, at least two of Missouri's major electric utilities have been in this position in recent years. Both of these utilities have, for various reasons, earned returns in excess of what would be considered reasonable, and as a result have made refunds to customers and reduced customers' rates. Undoubtedly, utilities will argue that this was a thing of the past, and that with large new construction programs, it is not likely to be repeated. If that is the case, the utilities should be unconcerned with the MIEC's proposals herein. But the MIEC believes that the potential for over-earnings still exists and that consumers are still entitled to the protections that the Legislature envisioned. This is especially true in the event that new adjustment clauses (fuel and purchase power and ECRM) are added to the tariffs. These mechanisms, if left unchecked,

will allow the utilities to recover costs on an isolated basis, without considering all other cost and revenue factors. Even if contemplated future construction programs are not anticipated to produce excessive rates of return, the inevitable winding down of major construction programs will result in an environment where capital additions have significantly increased the rates, rates have been set to cover the full costs, but then depreciation starts to accrue, the rate base declines, other efficiencies are incorporated in utility operations, and returns on equity increase.

To guard against this, MIEC believes that there should be language in the proposed rule to prevent or remedy any increase in rates under an ECRM where such an increase would cause or has caused the utility to earn above its authorized return on equity.

To address this situation, and to comply with Subsection 4(1) of 386.266 and 393.130, MIEC proposes to add the following language to the proposed rules as 4 CSR 240-20.091(2)(K):

> In establishing, continuing or modifying the ECRM, the Commission shall consider whether the presence of the ECRM is likely to allow the utility to earn in excess of its authorized return on equity. If the Commission finds this to be the case, it may include in the ECRM procedures designed to periodically examine the utility's earnings (on a regulatory basis), and appropriately limit the collection of costs under the ECRM to the extent necessary to prevent the utility from earning in excess of its authorized return on equity as a result of revenues received through the ECRM.

This language is found in the attached red-line of suggested changes at 4 CSR 240-20.091(2)(K).

Limitation on Deferrals of ECRM Costs

Ratepayers may need protection against large deferrals of ECRM costs as contemplated under the proposed rules. Such deferrals may be excessive and result in unreasonable rates and undue harm to ratepayers. The proposed rules should be modified to recognize the Commission's authority to limit deferrals as needed to protect ratepayers. This protection could be accomplished by specifying that any deferred costs cannot be subsequently recovered when the utility has earned in excess of its authorized return on equity during the period when the

deferred costs were incurred; and that any costs passing this test be collected over the life of the capital addition that gave rise to the cost deferral.

Suggested Changes to the Proposed ECRM Regulations

The MIEC respectfully submits, and incorporates herein, a red-line copy of the proposed ECRM regulations in which the MIEC has suggested changes that will conform the regulations consistent with the comments made herein and consistent with sections 386.266 and 393.130. These suggested changes are largely those offered by the Office of Public Counsel during the last iteration of ECRM rulemaking.

Respectfully submitted,

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