BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Proposed Rules 4 CSR240-3.162	)	
and 4 CSR 240-20.091, Environmental Cost	)	Case No. EX-2008-0105
Recovery Mechanisms	)	

PUBLIC COUNSEL COMMENTS ON PROPOSED CHANGES TO
4 CSR 240-3.162 AND 4 CSR 240-20.091

The Office of the Public Counsel (OPC) believes the proposed rules as filed with the Secretary of State do not contain adequate consumer protections, effectively authorizes a electric utility to achieve excess earnings above its authorized rate of return, and the proposed rules do not provide adequate assurance that utilities will act in a prudent manner with respect to expenditures related to environmental costs as defined by the rules. Senate Bill 179 authorized Rate Adjustment Mechanisms (RAM) which include Environmental Cost Recovery Mechanisms (ECRM). ECRMs provide electric utilities with the ability to seek Commission approval of an ECRM that would reflect some or all of the net increases or decreases in an electric utility's incurred environmental costs and potentially defer the recognition of expenditures for environmental regulation compliance costs between general rate cases. It is reasonable to assume the Legislature would not grant this protection for utilities without believing the Missouri Public Service Commission (MPSC or Commission) would enact rules implementing SB 179 that have corresponding protections for ratepayers. The following cites support this assumption.

> The Act establishing the Public Service Commission is indicative of a policy to protect the public. The protection given the utility is incidental.
> State ex rel. Dail v. Public Service Com., 240 Mo. App. 250 (Mo. Ct. App. 1947)

> [T]he guiding star of the public service commission law and the dominating purpose to be accomplished by such regulation is the promotion and conservation of the interests and convenience of the public.
> State ex rel. Crown Coach Co. v. Public Service Com., 238 Mo. App. 287, 298 (Mo. Ct. App. 1944)

> The Commission's principal interest is to serve and protect ratepayers
> State ex rel. Capital City Water Co. v. Missouri Pub. Servs. Comm'n, 850 S.W.2d 903, 911 (Mo. Ct. App. 1993)

Despite the hard work by the Commission's staff and comments by all the parties provided in the public workshops, this proposed rule does not provide adequate ratepayer protections.

Public Counsel believes these protections must take several forms. First, regulatory procedures must address the needs of both ratepayers and utilities (safe and adequate service at just and reasonable rates that provide a utility an opportunity to earn a fair rate of return). The proposed rule should also provide the utility with proper incentives to make the necessary investments in facilities to comply with environmental rules in the most economic manner and to operate those facilities reasonably. Regulatory procedures should be put in place to ensure the ratepayers are protected. Finally, timelines should be set out in the proposed rule to ensure ratepayers are not adversely impacted by large rate increases.

Attached to these comments are a strikeout/underline deletion/insertion of recommended changes to the proposed rules to implement an ECRM under the authority of SB 179 that Public Counsel believes will better balance the interests of ratepayers and utility investors.

There can be no dispute that a Environmental Cost Recovery Mechanism shifts the risk of changes in costs associated with compliance with environmental rules from the utility to its customers. As a direct result, this shift of risk removes most of the incentives for utilities to exercise due diligence and make prudent decisions regarding environmental compliance strategies and decisions related to the ongoing implementation of those strategies. This is a major change in the regulatory paradigm in Missouri that has fostered some of the lowest rates in the nation while maintaining reasonable returns for investors. Public Counsel believes that adequate consumer protections must be added to the proposed rules to compensate ratepayers for the additional risk they are assuming under the proposed rule and properly balance the interests of consumers and shareholders. In fact, in order for the Commission to perform its statutory obligation to ensure electric rates are just and reasonable, adequate consumer protections must exist.

SB 179 does not make the authorization of an ECRM by the Commission mandatory (RSMo. 386.266 (4)), however the proposed rules do not provide any guidance for making this determination of whether an ECRM is appropriate for a utility that requests one. A basic consumer protection should be included in the proposed rule that addresses this inadequacy. A “threshold test” based on the utility’s need to have an ECRM in order to have an opportunity to earn its authorized rate of return is fundamental to this determination and is consistent with the Commission’s obligation to ensure ratepayers have just and reasonable rates. Such a test would include an assessment of whether an ECRM could allow a utility to earn in excess of its authorized rate of return. In order for non-utility parties to evaluate a proposed ECRM and make recommendations to the Commission, the utility must be required to submit adequate financial data (that only the utility processes) as part of its application.

Public Counsel has proposed several changes in the attached rule to address the threshold concern of whether or not a utility even requires an ECRM. Specifically, the attached rules contain a specific changes in language to add the word “necessary” in 4 CSR 240-20.091 (2)(a) or the phrase “but not in excess of a fair return on equity” in 4 CSR 240.3.162 (2)(E) and (4)(C). Public Counsel has also recommends that additional information be filed by the utility in order to perform the required analysis, 4 CSR 240-03.162 (2)(new P and Q) and 4 CSR 240-03.162. (3)(new P).

Earnings in excess of its authorized rate of return also relate to the consumer protection referred to as an "earnings test." Any ECRM that would allow increases in environmental cost compliance to be passed through to ratepayers during a time of excess earnings would cause the Commission to abrogate its obligation to ratepayers. This clearly cannot be the intent of the Legislature which passed SB 179 and the Governor who signed the bill into law. It should be noted that proposed 4 CSR 240-20.091 (2) (A) requires the Commission to find that an ECRM provides the utility the opportunity to earn a fair rate of return on equity if the Commission determines to continue or modify an ECRM when the utility has requested to discontinue the ECRM. While it is clear that a review of the effect of an ECRM on earnings of a utility is appropriate to determine if an ECRM should be continued or modified, it is just as clear that this determination is necessary when determining whether or not to implement an ECRM in the first place. Absent such, an inconsistency exists between the legal basis for ratepayers or other parties to challenge the Commission decision to implement an ECRM versus the legal basis for consumers to challenge a Commission decision to modify or continue an ECRM.

Public Counsel has proposed several changes in the attached rule to reduce the utility's ability to manage its earnings to earn in excess of its authorized return on equity. Specifically the attached rules contain new sections which set out the standard to determine whether deferred costs can be included in either an ECRM or rate case proceeding, 4 CSR 240.20-091 (4)(C)(4).

Risk provides the opportunity for financial gain or loss and thus provides a powerful incentive to a utility to plan and operate its system in the most prudent manner. The opportunity for financial gain, (increase in earnings) provides an immediate and tangible result from operational decisions and processes that are effective. The operational decisions and processes must be done in real time. In contrast, regulatory oversight required under a ECRM provides for an after-the-fact review in which the regulatory analyst and ultimately the Commission must often recreate the situation and put themselves in the position of a “reasonable person” to determine if what the utility did two or more years prior was in fact reasonable. It must be pointed out that the majority of the information and data necessary to make this evaluation is under the control of the utility and thus not always available to the analyst or MPSC.

The Commission recognized the shortcomings of after-the-fact prudence reviews in the portion of its Report and Order in Case No. ER-2007-0004 where it addressed Aquila’s request for approval of a Fuel Adjustment Mechanism (FAC). At page 53 of that order, the Commission stated:

> While the Commission believes Aquila should be given the opportunity to recover its prudently incurred fuel costs, it also agrees with Mr. Johnstone and Ms. Brockway that: 1) after-the-fact prudence reviews alone are insufficient to assure Aquila will continue to take reasonable steps to keep its fuel and purchased power costs down; and 2) the easiest way to ensure a utility retains the incentive to keep fuel and purchased power costs down is to allow less than 100% pass through of those costs. Accordingly, it is not appropriate to allow Aquila to pass 100% of its fuel and purchased power costs, above those included in its base rates, through its fuel adjustment clause. [Footnote omitted]

SB 179 provides for incentive mechanisms as part of the regulatory process, RSMo 386.266 (8). Public Counsel believes that maintaining a financial incentive (gains or losses) as part of an ECRM is a critical consumer protection. The ability to pass through 100 percent of the cost eliminates any financial incentive absent regulatory review and resulting disallowances which could take up to 2 years. Absent the protection afforded by keeping some of the utility’s “skin in the game,” a utility has significantly diminished incentive to manage the annual cost associated with environmental rules compliance in a prudent manner and to implement environmental compliance strategies that minimize long-run costs. The regulatory analyst and the Commission do not have the ability to review all transactions in real time, know all options available to control costs or find viable alternative sources, or analyze all the other information available to the utility on a 24 by 7 by 365 basis.

All the utility would have to do in order to justify recovery of environmental compliance costs is present its case well enough in a prudence review that would occur several years subsequent to the actions supported by information available during the period in question. Such information may not be even available at the time of the regulatory review for a variety of reasons. A regulatory model should not be developed in a piece-meal fashion. The electric industry is a complex field with its different components and constituencies being inter-related and inter-dependent. A "fix" in one area has implications that can cascade through the rest of the system. A regulatory model that does not recognize this fact is doomed to provide inferior outcomes for consumers.

Public Counsel has proposed several changes in the attached rule to address this concern. As example, Public Counsel has included the phrase "some or all" in several sections to explicitly recognize the Commission's discretion to approve an ECRM that permits of only a portion of the changes in costs allowable to be included and recovered in the ECRM. In addition, Public Counsel has inserted a new section entitled "Incentive Mechanism or Performance-Based Program". This section is consistent with 4 CSR 240-20.090 (11).

Also in Case No ER-2007-0004, the Commission adopted three criteria to be used to evaluate whether utility costs should be part of a cost adjustment mechanism:

> 1. They represent a significant portion of a utility's costs;
> 2. they fluctuate significantly; and
> 3. the costs are outside the utility's control.
> (Report and Order, Case No. ER-2007-0004, page 34).

As drafted, the Commission's proposed rule did not adequately address the question of volatility. Public Counsel proposes an addition to 4 CSR 240-20.091(2)(C) to include volatility as a criteria in the evaluation of whether a particular cost should be included in an ECRM.

Absent the Commission enacting rules to implement SB 179 which include consumer protections, the only way consumer interests can be protected under the new paradigm of electric regulations created by this proposed rule is the filing of a complaint – a protection that already exists. There are many shortcomings of this protection as a remedy for the changes brought about by the passage of SB 179. The financial short-coming of the complaint process is that the utility will keep all excess earnings created by an ECRM until such time as the complaint is fully processed. It is also critical to realize that there is not a statutory time limit on the Commission to decide a complaint case. Utilities have a real financial incentive to take advantage of this fact and delay the final decision in a complaint by whatever means available to it. For utilities with an ECRM in place, customers would bear not only the risk of increasing and volatile environmental compliance costs but also receive no consideration for providing other revenues which resulted in excess earnings for the utility in addition to the ECRM revenues.

A significant legal short-coming of the complaint process is that the field of potential complainants is limited by statute. A practical short-coming is that complainants face a hugely resource-intensive undertaking and must begin that process with minimal information to determine whether or not the efforts will be justified. In fact, the only single entity in the state that realistically has current resources to mount a full-fledged earnings complaint against a major electric utility is the Commission's staff. And as recent events have highlighted, workload considerations can effectively prevent or substantially delay the staff from filing an earnings complaint and limit its ability to even pursue the investigation necessary to make an initial assessment of utility earnings. The surveillance provisions in the proposed rule will help interested entities determine when a complaint may be justified, but they will not provide the data necessary to support a complaint, or the resources necessary to get the complaint filed or timely prosecuted to a final result.

Public Counsel believes that the legislative enactment of SB 179 that permitted the Commission to develop and implement rules prior to considering the utilization of single issue cost recovery mechanisms in Missouri clearly contemplated that the Commission would fulfill its obligation to protect consumers if SB 179-related rules are promulgated. Public Counsel finds that SB 179 provides for regulatory mechanisms that enhance a utility's ability to increase revenues and thus provide a significantly greater probability that the utility will earn its authorized rate of return. SB 179 does not eliminate or even change the underlying concept of Rate of Return Regulation. Therefore Public Counsel believes that the rules implementing SB 179 must contain provisions that protect ratepayers from excess earnings that may result due to the use of SB 179 provisions to adjust rates.

In stark contrast to the lack of consumer protections in the proposed rule, the proposed rule provides the utility with the ability to protect and even enhance its interests by deferring costs during a period of over-earnings until a subsequent period when rates would be adjusted to recover those deferred costs. Absent any recognition of what the overall earnings of the utility's regulated operations were, the proposed rules as written would allow utilities to manipulate their earnings to the detriment of the public. The utility controls the timing of rate cases, the timing of filings under SB179, the timing of investments being placed in service, and how and when many of its other costs are incurred. This control provides the utility with ample opportunity to "manage" its earnings. SB 179 did not eliminate the basic method of regulation in this state which is Rate of Return Regulation. The proposed rules' failure to reflect that fact and failure to incorporate safeguards into the process will result in a detriment to the public and a transfer of wealth from ratepayers to utilities without any cost of service justification.

Ratepayers still have a right to just and reasonable rates. Therefore Public Counsel has proposed several new sections to provide the Commission with necessary tools to incorporate deferred costs into an ECRM or general rate case proceeding consistent with this goal and past Commission precedents in general ratemaking proceedings, These sections are 4 CSR 240.20.091 (4)(C)(new 5,6,7, and 8).

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, emailed or hand-delivered to the following this 2nd day of January 2008:

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