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Missouri Energy Development Association Testimony at Missouri Public Service Commission Rulemaking Hearing on Environmental Cost Recovery Mechanisms

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By Warren Wood

Chairman and Commissioners, may it please the Commission.

My comments today are on behalf of the Missouri Energy Development Association, also known as MEDA. The purpose of MEDA is to develop, organize and promote measures that will advance the ability of investor-owned utilities to build, maintain, protect and provide the utility infrastructure and services that are critical to the economic well being of Missouri business and the health and safety of Missouri citizens

Missouri's electric utilities, along with electric utilities across the country, are at the beginning of a major infrastructure building period. This infrastructure is necessary to provide the increasing amounts of energy customers are demanding and to meet stricter environmental requirements mandated by state and federal law. The increasing costs of this infrastructure and the increasing expenses of utility operations have already caused electric utility rates to increase and will cause additional increases in the short- and long-term.

The factors causing these rate increases are well known by many groups other than MEDA. Policy makers interested in researching this topic are referred to:

A June 2006 Report prepared by *The Brattle Group* for *The Edison Foundation* titled "**Why Are Electricity Prices Increasing – An Industry Wide Perspective**"; and

The following *Edison Electric Institute* publications:

- "**Straight Answers About Rising Electricity Prices**", July 2006;
- "**Rising Electricity Costs: A Challenge For Consumers, Regulators, And Utilities**", May 2006; and
- "**Behind the Rise in Prices - Electricity Price Increases Are Occurring Across the Country Among All Types of Electricity Providers. Why?**" July/August 2006

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Also, regulatory proceedings in other states illustrate these factors. Connecticut Light and Power and United Illuminating, two utilities that went before their Connecticut Energy Advisory Board with their joint integrated resource plan last week noted that their rates are likely to remain high because of external forces that the utilities have no control over, namely natural gas prices, upcoming carbon emission restrictions and economic growth.

A new report by the State Utility Forecasting Group, based at Purdue University projects a 22% increase in rates for Indiana's residential customers by 2012. The report notes a perfect storm of tightened federal regulations and escalating costs of raw materials and fuel is producing a somber price outlook for consumers. Douglas Gotham, director of the State Utility Forecasting Group said "a lot has to do with the combination of steel prices and fuel prices and certainly the federal mandates" to reduce air pollution. Mr. Gotham went on to say "the price trajectory on fossil fuels peaks out at the same time we see the biggest hit from pollution controls. We've never seen anything like this before, and we've been doing reports for 20 years. This last time we saw price increases like this was in the 1970s with the energy crisis."

These factors are causing rates to go up for Missouri's and the nation's cooperative electric customers as well. The reasons I have given are well documented in The Association of Missouri Electric Cooperatives' monthly *Rural Missouri* magazines over the last year.

Over the next 10 years Missouri's investor-owned and cooperative utilities are expected to spend approximately $8 billion on new generation plants and $4 billion to comply with environmental requirements. These Missouri-specific numbers were calculated in late 2006 and have certainly increased since then.

Senate Bill 179 provides a reasonable, but by no means easy, mechanism to address a portion of the environmental compliance expenditure aspect of this situation. The provisions in these rules are extensive and complicated and many of them are designed to protect customers while providing electric utilities a means to seek more timely recovery of prudently incurred environmental compliance costs.

SB 179 includes the following customer protections:

- The Commission has discretion to accept, reject or modify utility ECRM proposals.
- Rate adjustments under an ECRM shall not generate annually more than a 2 ½ % increase in revenues.
- An ECRM cannot be in effect for more than 4 years without a general rate case.
- Prudence reviews are required no less often than every 18 months.
- Annual true-up of actual ECRM charges vs. authorized revenues.
- Customer line-item bill disclosure of ECRM charge.

In addition to these protections, the Commission Staff and parties that participated in the rulemaking workshops added the following customer protections:

- Submittal of long-range environmental compliance plan.
- Extensive application requirements to establish, continue, or modify an ECRM.
- Extensive surveillance monitoring reporting to parties.
- Extensive monthly reporting requirements.
- Rules also include a number of consumer protections that protect party's rights to intervene, participate, submit and receive updates to discovery, and file a complaint case if over-earnings are suspected.
- Finally, these rules require that the Commission review the effectiveness of these rules in 2011 and may, if necessary, initiate rulemaking proceedings to revise these rules.

I will now address the major issues that some parties have commented on regarding these rules.

<u>Assertion: An Earnings Test Must Be Added</u>

In support of this suggested change some parties have suggested that these rules, if they do not include an earning test, will result in a strong likelihood of utility over-earnings. As I've already testified in some detail, utility costs of operations are increasing at a significant pace which makes such a situation very unlikely. Also, as I've already testified, the customer protections in SB 179 and these rules are extensive. The "earnings test" that some have commented on is simply unreasonable. The customer protection mechanisms present here are specifically crafted to protect customers from the very risk that are inherent in a recovery mechanism like the ECRM. The earnings test would effectively be a rate case between each general rate case – completely undermining the purpose of SB 179 and these rules.

The arguments presented by parties in support of an earnings test in this rulemaking match the arguments proposed by parties attempting to implement an earnings test in the recently promulgated fuel adjustment clause rules. In that rulemaking the Commission correctly decided not to implement an earnings test on top of the other customer protection provisions in these rules. In fact, in that rulemaking (EX-2006-0472, 4 CSR 240-20.090, Issued September 21, 2006) the Commission's response to parties' comments suggesting the fuel adjustment clause rules include an earning test was as follows:

> The Commission notes that the rule includes the following: "(13) Nothing in this rule shall preclude a complaint case from being filed, as provided by law, on the grounds that a utility is earning more than a fair return on equity, nor shall an electric utility be permitted to use the existences of its RAM as a defense to a complaint case based upon an allegation that it is earning more than a fair return on equity. If a complaint is filed on the grounds that a utility is earning more than a fair return on equity, the commission shall issue a procedural schedule that includes a clear delineation of the case timeline no later that sixty (60) days from the date the complaint is filed." The Commission finds that the safeguards established in the rule appear to be sufficient at this time. Therefore, no change will be made. As we have previously noted, we will watch carefully to determine whether additional safeguards need to be included in this rule.

As with the fuel adjustment clause rules, these ECRM rules include an identical complaint case provision at 4 CSR 240-20.091 Section (11).

<u>Assertion: Prudence Review Provisions Are Insufficient</u>

Some parties have cast doubt on the effectiveness of prudence reviews. This is an argument that is irrelevant to these ECRM discussions. Under the current pre-ECRM regime if a utility invest in a major infrastructure item such as a new scrubber for an existing power plant the PSC has the opportunity to assess the prudence of this expenditure and the infrastructure's operation prior to recommending it be permitted to be placed in rate base. Under the ECRM the PSC still has that opportunity and in fact has more opportunities, no less often than every 18 months vs. only during the general rate case. Also, under the ECRM rules as proposed, the utility will be required to file a long-range environmental compliance plan, a new regulatory requirement that will certainly help with assessing upcoming environmental compliance requirements and anticipated expenditures.

Assertion: These ECRM Rules are a Simple "Automatic Pass-Through"

Some parties have referred to the ECRM as an "automatic pass-through" of cost. Before any policy-maker accepts this assertion I ask them to look over 1) the filing requirements to request a change in the ECRM amount, 2) the provisions to true-up ECRM revenues to approved recovery levels and 3) the prudence provisions. I also ask them to consider this assertion in reviewing the filing provisions in order to even seek an ECRM in a general rate proceeding.

Assertion: These ECRM Rules Do Not Include Sufficient Customer Protections

As I have previously testified in some detail, these rules include extensive customer protections. SB 179 included significant customer protection provisions and the Commission's proposed ECRM rules include a number of additional customer protections.

Assertion: Commission Should Limit Deferrals Over 2 ½ % Annual ECRM Cap

Some have suggested that the Commission should not allow recovery of prudently incurred environmental expenditures that exceed the 2 ½ % annual cap or only allow recovery over a period of many years.

Regarding the concept of not permitting recovery of prudently incurred environmental costs in excess of the 2 ½ % annual cap, SB 179 includes the following (RSMo 386.266.2):

> Any costs not recovered as a result of the annual two and one-half percent limitation on rate adjustments may be deferred, at a carrying cost each month equal to the utilities net of tax cost of capitol, for recovery in a subsequent year or in the corporation's next general rate case or complaint proceeding.

It is simply not reasonable for a utility, despite spending 10s or 100s of millions of dollars to comply with a federal or state environmental mandates, had these expenditures reviewed for prudence, had the revenues from its ECRM audited to confirm they match actual expenditures, anticipate denial of recovery because the expenditure level exceeds a 2 ½% per year cap. No provision exist in these state or federal mandates to limit compliance to what would cost 2 ½ % per year and no such provision should now be attempted when the cost of compliance with these mandates is sought.

Regarding the concept of permitting recovery of prudently incurred environmental costs in excess of the 2 ½ % annual cap over a period of years: if this refers to return on capital investments as is presently the treatment of other capital investments that is reasonable. If this however refers to recovery of prudently incurred expenses over a period of many years, the life of an asset for instance, MEDA is not in support of deferring the recovery of these expenses over a period of more than a few years.

I should note that MEDA agrees with the Commission Staff's testimony regarding how the 2 ½ % ECRM cap should be calculated.

Assertion: These ECRM Rules Should Only Permit Recovery of the Costs of Compliance of New Environmental Rules

Earlier in my testimony I provided some detail regarding the environmental compliance cost of electric utilities in Missouri and referenced a number of publications that illustrate that this situation is national in scope. Much of the investment now being planned that results in the expenditures I described is driven by currently-effective emission regulations. The reason these compliance projects have not already been completed is that these regulations have deadlines for compliance that are in the future, as is the case with many emission regulations. The fact that a regulation is already in existence and being planned for does not mean that it should somehow be exempted from these ECRM rules or that future expenditures are only associated with yet-to-be-determined future regulations.

Also, regarding efforts to deny recovery of prudently incurred environmental cost from existing regulations, SB 179 includes the following (RSMo 386.266.2):

> Subject to the requirements of this section, any electrical, gas, or water corporation may make an application to the commission to approve rate schedules authorizing periodic rate adjustments outside of general rate proceedings to reflect increases and decreases in its prudently incurred costs, whether capital or expense, to comply with any federal, state, or local environmental law, regulation, or rule.

The enabling statute for these rules does not include any requirement that applicable federal, state, or local environmental laws, regulations or rules must be new regulations and addition of this requirement would conflict with and greatly undermine the purpose of SB 179.

Assertion: Environmental Cost Recovery Should be Divided Between Base Rates & ECRM Charges as an Incentive for Utilities to Control Cost and That 4 CSR 240-20.091 Section (2)(D) Allows This

Rule 4 CSR 240-20.091 Section (2)(D), States:

> The Commission may, in its discretion, determine what portion of prudently incurred environmental costs may be recovered in an ECRM and what portion shall be recovered in base rates.

SB 179 (RSMo 386.266.2), In Part, States:

> Subject to the requirements of this section, any electrical, gas, or water corporation may make an application to the commission to approve rate schedules authorizing periodic rate adjustments outside of general rate proceedings to reflect increases and decreases in its prudently incurred costs, whether capital or expense, to comply with any federal, state, or local environmental law, regulation, or rule.

Commission Staff included the following in its comments regarding these rules:

> Section 386.266 includes a provision that allows the Commission to include incentives to improve efficiency and cost-effectiveness for fuel and purchased power activities for utilities which have a RAM. There is not a similar statutory provision for incentives to improve the efficiency and cost effectiveness of environmental costs. Therefore, the ECRM rules do not address incentive programs.

Earlier in my testimony I provided some details regarding the level and timing of environmental expenditures to comply with state and federal mandates. MEDA is opposed to a sharing provision as some parties have suggested since environmental infrastructure cost are much more likely to increase versus decrease. This is because new environmental infrastructure will either be replacing older, highly depreciated infrastructure or will simply be new without any replacement of existing infrastructure. A sharing mechanism with a 90% ECRM recovery and 10% base recovery provision of environmental expenditures is certainly not balanced or reasonable if infrastructure costs are simply anticipated to increase. Effectively all the Commission will have achieved is denying recovery of a portion of prudently incurred environmental compliance cost.

In some respects the ECRM is similar to the Infrastructure System Replacement Surcharge (ISRS). The ISRS provides recovery of non-revenue producing gas safety-related replacements and mandated infrastructure relocations. Similarly, the ECRM is structured to provide for recovery of cost incurred to comply with federal and state mandates and is largely infrastructure related. The ISRS does not include any provisions structured to deny recovery of prudently incurred cost and the ECRM should not be structured to do so. MEDA believes any recovery structure that systematically denies recovery of prudently incurred environmental cost conflicts with the cost recovery provisions of SB 179.

Assertion: Establishing an "Environmental Rate Base" for all Rate Base that is Environmental in Scope is Unworkable

This was MEDA's assertion in its initial comments filed on January 2, 2008. In reviewing the Commission Staff's rulemaking comments MEDA notes the following comments:

> Net increases and decreases will take into account the depreciation of these large capital investments and accumulates as a reduction to rate base over time.

Commission Staff also stated:

> While accounting for net changes may be depicted as a daunting task, it is only as burdensome as the electric utility chooses to make it. The task can be manageable. An example would be an electric utility requesting an ECRM that identifies a limited number of specific environmental cost and revenue items on its books and records that would be considered in adjusting its ECRM. (4 CSR 240-3.162(2)(H)-(J) and (3)(H)-(J) This allows the electric utility to define the scope of the accounts and records necessary to track the environmental costs included in its ECRM.

If Commission Staff is suggesting that electric utilities could propose in their rate case filing a defined subset of environmental infrastructure for the purpose of calculating depreciation offsets and parties could propose well-defined changes to that infrastructure MEDA believes this option may be workable. This is a significantly more burdensome provision than exist in the other states that have ECRM like recovery provisions and while MEDA is not in support of this modification to the rules this does appear to be workable. A critical aspect to the workability of this option is the delineation of applicable infrastructure – it must be well-defined and reasonably separable from other rate base items. Examples of this type of infrastructure might include an electro-static precipitator, fabric filter, selective catalytic reduction, and flue-gas desulphurization.

That concludes my prepared testimony at this rulemaking hearing. I thank you for your time and welcome any questions the Commission may have.