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Service Commission**

Exhibit No.: 852
Issues: Fuel Adjustment Clause
Witness: Kevin C. Higgins
Sponsoring Party: The Commercial Group
Type of Exhibit: Direct Testimony
Case No.: ER-2007-0002
Date Testimony: December 29, 2006
Prepared:

BEFORE
THE MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. ER-2007-0002

Direct Testimony of Kevin C. Higgins

on behalf of

The Commercial Group

FAC

December 29, 2006

Commercial
Group Exhibit No. 852
Date 3-21-07 Case No. ER-2007-
Reporter KR 0002

1 **DIRECT TESTIMONY OF KEVIN C. HIGGINS**

2

3 **Introduction**

4 **Q. Please state your name and business address.**

5 A. Kevin C. Higgins, 215 South State Street, Suite 200, Salt Lake City, Utah,
6 84111.

7 **Q. By whom are you employed and in what capacity?**

8 A. I am a Principal in the firm of Energy Strategies, LLC. Energy Strategies
9 is a private consulting firm specializing in economic and policy analysis
10 applicable to energy production, transportation, and consumption.

11 **Q. On whose behalf are you testifying in this proceeding?**

12 A. My testimony is being sponsored by The Commercial Group. The
13 Commercial Group is comprised of the Missouri locations of Lowe's Home
14 Centers, Inc.; Wal-Mart Stores East, LP; and J.C. Penney Corporation, Inc.
15 Collectively, the members of The Commercial Group purchase more than 236
16 million kWh annually from AmerenUE in Missouri, primarily on rate schedules
17 LGS and SPS.

18 **Q. Are you the same Kevin C. Higgins who pre-filed direct testimony in the**
19 **Revenue Requirement phase of this proceeding?**

20 A. Yes, I am.

21 **Q. What is the purpose of your testimony in this phase of the proceeding?**

1 A. My testimony addresses the possible implementation of a Fuel Adjustment
2 Clause ("FAC") and the need to include in the calculation any fuel and purchased
3 power disallowances from the revenue requirements phase of this proceeding.
4

5 **The Calculation of the FAC with Disallowances**

6 **Q. In your direct testimony filed in the Revenue Requirements phase of this**
7 **proceeding, you indicated that any imprudence adjustment to base rates**
8 **associated with fuel and purchased power expense would also require a**
9 **corresponding adjustment to any FAC calculation. Please explain.**

10 A. As I stated in my previously-filed testimony, if an FAC is adopted, and if
11 base fuel and purchased power expense is determined by the Commission to be
12 too high as a result of imprudence, then the imprudence adjustment made to base
13 rates must also be made to the FAC calculation. Otherwise any base rate
14 disallowance will be overridden in the calculation of the Fuel and Purchased
15 Power Adjustment and imprudent costs will be inadvertently recovered through
16 the FAC.

17 **Q. Can you provide a simple example of this point?**

18 A. Yes. Assume that Base Fuel Costs prior to an imprudence disallowance
19 are 1.341 cents/kWh. Assume further that the Commission orders a Base Fuel
20 Cost disallowance of .156 cent/kWh¹ in this proceeding, reducing the allowed
21 Base Fuel Cost recovery to 1.185 cents/kWh. Now further assume that actual fuel
22 and purchased power costs prudently increase by .259 cent/kWh during a

¹ This is the approximate disallowance I am recommending in my testimony filed in the Revenue Requirements phase of this proceeding.

1 subsequent Accumulation Period. Actual costs thus turn out to be 1.6 cents/kWh
2 (i.e., $1.341 + .259 = 1.6$. For simplicity, we will ignore any true-up and/or interest
3 costs.) Absent any explicit treatment of the .156 cent/kWh disallowance going
4 forward, the FAC would simply calculate the difference between the actual fuel
5 and purchased power costs during the Accumulation Period (1.6 cents/kWh) and
6 the allowed base fuel rate of 1.185 cents/kWh. The resulting Fuel and Purchased
7 Power Adjustment would recover this full differential of .415 cent/kWh – instead
8 of just .259 cent/kWh – completely negating the effect of the .156 cent/kWh
9 disallowance. The effective fuel cost paid by customers under this inadvertent
10 result would be the full 1.6 cents/kWh being experienced by the Company,
11 whereas the appropriate effective rate would have been 1.444 cents/kWh.² For
12 this reason, any base fuel cost disallowance must be carried forward into the FAC
13 calculation.

14 **Q. Should a base fuel cost disallowance that is carried forward into the FAC**
15 **calculation remain a constant amount or should it change over time?**

16 A. The answer depends on the Commission's intent in making the original
17 disallowance. If the Commission intends that base rates be reduced by a constant
18 amount going forward, then the disallowance applied to the FAC calculation
19 should remain constant – at least until the next general rate case. Alternatively, if
20 the disallowed costs are subject to change, and if the Commission intends that
21 these changes be reflected going forward, then the disallowance in the FAC can
22 be allowed to vary as the disallowed costs change over time. For example, this

² Allowed Base Fuel Cost of 1.185 cents/kWh plus the increase in prudent costs of .259 cent/kWh = 1.444 cents/kWh.

1 approach can be applied to the EEInc.-related disallowance recommended in my
2 Revenue Requirements testimony.

3 **Q. How would any base rate disallowance that is carried forward into the FAC**
4 **calculation be incorporated into the proposed tariff?**

5 A. As described in the proposed tariff language attached to the supplemental
6 direct testimony of Martin J. Lyons, Jr., AmerenUE is proposing to use the
7 following formulation for the FAC:

$$8 \quad \text{FPA} = [\text{CF} + \text{CPP} + \text{SMS} + \text{R} + \text{I}] / \text{S} - \text{BFC}$$

9 Where FPA = Fuel and Purchased Power Adjustment

10 CF = Allowable fuel cost

11 CPP = Cost of purchased power [as defined in the tariff]

12 SMS = Shares of off-system sales margins, if applicable

13 R = Under/Over recovery from prior Recovery Period, and modifications ordered
14 as a result of required prudence reviews

15 I = Interest

16 S = Applicable Recovery period kwh, at the generation level

17 BFC = Base Fuel Cost

18
19 As indicated in the Company's proposed definitions above, R may
20 incorporate the effects of disallowances from required prudence reviews. This
21 term may also be the appropriate component for incorporating imprudence
22 disallowances applicable to base rates that are carried forward from a previous
23 general rate proceeding. Alternatively, this latter type of disallowance could be
24 reflected in its own variable. The formulation above could be modified to read:

$$25 \quad \text{FPA} = [\text{CF} + \text{CPP} + \text{SMS} + \text{R} + \text{I} - \text{D}] / \text{S} - \text{BFC}$$

26 Where D = Any base rate disallowance ordered in the prior general rate
27 proceeding.
28

1 **Q. Aside from any Commission-ordered disallowances, are there other potential**
2 **applications for your proposed variable, "D"?**

3 A. Yes. In this proceeding, AmerenUE has calculated base rates by assuming
4 that the failed Taum Sauk Plant had remained in operation throughout the test
5 year. The Company's stated intent is to shield customers from any increased
6 power costs the Company is incurring to replace energy lost due to the
7 unavailability of the plant.³ For this intent to be carried forward, the increased
8 actual costs associated with the unavailability of the Taum Sauk plant would have
9 to be incorporated into the FAC calculation. Otherwise, the Fuel and Purchased
10 Power Adjustment would inadvertently recover these increased costs. This
11 adjustment can be made in my suggested variable, "D".

12 **Q. In your direct testimony filed in the Revenue Requirements phase of this**
13 **proceeding, you indicated that an alternative approach to implementing a**
14 **fuel-related disallowance would be to apply it directly to the FAC calculation**
15 **without applying it base rates. Please explain.**

16 A. I mention this alternative simply for the sake of offering a complete
17 discussion of the options. If an FAC is approved, then it is possible to implement
18 a fuel-related disallowance through the FAC calculation, without changing Base
19 Fuel Cost. Using the example discussed previously, if the Commission disallowed
20 fuel costs of .156 cent/kW, but opted to implement this disallowance solely
21 through the FAC calculation, then the Base Fuel Cost in rates would remain 1.341
22 cents/kWh and the disallowance of .156 cent/kWh would be applied to the
23 calculation of the Fuel and Purchased Power Adjustment (i.e., 1.6 cents/kWh -

1 .156 cent/kWh - 1.341 cents/kWh = .103 cent/kWh). The effective rate paid by
2 customers would then be 1.444 cents/kwh,⁴ which as discussed above, is the
3 appropriate outcome for this example.

4 Although this approach produces a correct outcome, it has the
5 disadvantage of delaying the implementation of the disallowance until the Fuel
6 and Purchased Power Adjustment is in force.

7 **Q. What is recommendation to the Commission on this issue?**

8 A. If an FAC is approved, I recommend that the Commission require that the
9 FAC be designed to ensure that the calculation of the Fuel and Purchased Power
10 Adjustment carries forward any fuel and purchased power disallowances that
11 may be determined in the preceding general rate case, as discussed in my
12 testimony.

13 **Q. Does this conclude your direct testimony?**

14 A. Yes, it does.

³ Direct testimony of Warner L. Baxter, pp. 34-35.

⁴ Base rate of 1.341 cents/kWh plus the Fuel and Purchased Power Adjustment of .103 cent/kWh = 1.444 cents/kWh.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Union Electric Company)
d/b/a AmerenUE for Authority to File)
Tariffs Increasing Rates for Electric) Case No. ER-2007-0002
Service Provided to Customers in the)
Company's Missouri Service Area.)

AFFIDAVIT OF KEVIN C. HIGGINS

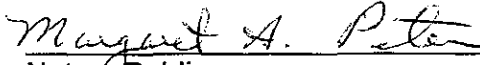
STATE OF UTAH)
COUNTY OF SALT LAKE)

Kevin C. Higgins, being first duly sworn, deposes and states that:

1. He is a Principal with Energy Strategies, L.L.C., in Salt Lake City, Utah;
2. He is the witness who sponsors the accompanying testimony entitled
"Direct Testimony of Kevin C. Higgins;"
3. Said testimony was prepared by him and under his direction and
supervision;
4. If inquiries were made as to the facts and schedules in said testimony he
would respond as therein set forth; and
5. The aforesaid testimony and schedules are true and correct to the best of
his knowledge, information and belief.


Kevin C. Higgins

Subscribed and sworn to or affirmed before me this ____ day of December, 2006,
by Kevin C. Higgins.


Notary Public

My Commission No.: 134523
My Commission Expires: 02-28-08
(SEAL)

