BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of a Proposed Rule Regarding Electric Utility Fuel and Purchased Power Cost Recover Mechanism	)))	Case No. EX-2006-0472

PUBLIC COUNSEL COMMENTS ON PROPOSED CHANGES TO
4 CSR 240-3.161 AND 4 CSR 240-20.090

The Office of the Public Counsel (OPC) believes the proposed rules as filed with the Secretary of State do not contain adequate consumer protections nor do the proposed rules provide adequate assurance that utilities will minimize fuel, transportation, and purchased power costs. Senate Bill 179 authorized Rate Adjustment Mechanisms (RAM) which include Fuel Adjustment Clauses (FAC) and Interim Energy Charges. FACs provide electric utilities with protection from the adverse effect on earnings that can result from volatility in fuel and purchased power prices 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 generate electricity in the most economic manner, to operate those facilities reasonably, and to procure purchased power appropriately. Regulatory procedures should be put in place to ensure the ratepayers are protected. Finally, implementation timelines set out in the proposed rule should not place parties at a disadvantage in the regulatory process, thereby impinging on their due process rights.

Public Counsel will also suggest at the end of our comments some changes to the proposed rule that ensure definitions are consistent between Chapter 3 and Chapter 20.

There can be no dispute that a Fuel Adjustment Clause shifts the risk of volatile and escalating fuel prices 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 fuel and related transportation services along with purchased power decisions. This is a major change in the regulatory paradigm in Missouri that has fostered some of the lowest rates in the nation and while maintaining reasonable returns for investors. Public Counsel believes that adequate consumer protections must exist in the proposed rule to compensate ratepayers for the additional risk they are assuming under the proposed rule. 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 a FAC by the Commission mandatory (RSMo. 386.266 (4)), however the proposed rules do not provide any guidance for making this determination of whether a FAC 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 a FAC 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 and assessment of whether a FAC could allow a utility to earn in excess of its authorized rate of return. In order for non-utility parties to evaluate a proposed RAM, the utility must be required to submit adequate financial data (that only the utility processes) as part of its application.

Earnings in excess of its authorized rate of return also relate to the consumer protection referred to as an "earnings test". Any FAC that would allow increases in fuel costs 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 240-20.090 (3) (A) require the Commission to find that a RAM provides the utility the opportunity to earn a fair rate of return on equity if the Commission determines to continue or modify a RAM when the utility has requested to discontinue the RAM. While it is clear a review of the effect of a RAM on earnings of a utility is appropriate to determine if a RAM should be continued or modified, it is just as clear that this determination is necessary when determining whether or not

to implement a RAM 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 a RAM versus the legal basis for consumers to challenge a Commission decision to modify or continue a RAM.

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 FAC 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.

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 a FAC is a critical consumer protection. The ability to pass through 100 percent of the expenses incurred 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 expense of electric generation in a prudent manner and to implement resource plans 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.

A utility's ability to pass through all or even a portion of the annual expense associated with the production or acquisition of electricity also creates a disincentive to manage its long-term resource planning process in a prudent manner where prudence is measured by providing service to ratepayers at just and reasonable rates. A perverse incentive that exists with a FAC is that Missouri electric utilities could choose not to invest in the infrastructure necessary to generate electricity but simply take a short-run view of earnings and risk and use purchased power contracts to supply the needs of Missourians. The proposed rule does not provide any regulatory oversight to ensure this does not occur. Absent a robust Integrated Resource Planning process in conjunction with a FAC that recovers 100 percent or even a significant majority of operating expenses associated with the generation/acquisition of electricity, a utility has no reason to undertake the efforts necessary to plan for or assume the risk associated with meeting base load capacity needs with capital intensive projects that take several years to complete. A utility would be able to rely on either low capital cost gas-fired generation or market based purchased power capacity/energy contracts to satisfy its electric supply obligations. All the utility would have to do 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.

In stark contrast to the lack of consumer protections in the proposed rule, the proposed rule provides that the utility has the ability to protect its interests by effectively vetoing a FAC that is designed to provide just and reasonable rates by simply withdrawing its request for a FAC (proposed 4 CSR 240-20.090 (2) (E) ("if the commission modifies the electric utility's proposed RAM in a manner unacceptable to the electric utility, the utility may withdraw its request for a RAM"). This creates an obvious imbalance in the regulatory process and effectively turns the regulatory decision process over to the very entity that is being regulated. It results in a complete abandonment by the Commission of its statutory obligations. This portion of the proposed rule cannot be supported or justified by any language found in SB 179.

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 a RAM 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. Customers would bear not only the risk of increasing and volatile fuel prices but also not receive any consideration for providing other revenues which resulted in excess earnings for the utility in addition to the FAC 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 the staff from filing an earnings complaint or to even have the ability to pursue the investigation necessary to make a determination on 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, get the complaint filed, or timely prosecuted to a final result.

The Transitional Period for the proposed rules provided for in proposed 4 CSR 240-20.090 ((16) provides that a utility may amend its filing requesting a RAM as part of a general rate proceeding up to 165 days after the initial filing. This could allow a significant change in the rate case five and one-half months into the eleven month process. This would allow the utility to present a significant change in the rate case more than five months after its start and would not allow the parties' sufficient time during the rate case to address the changes, thus denying other parties due process.

The following two paragraphs address definitions contained in proposed 4 CSR 240-3.161 and proposed 4 CSR 240-20.090 that define the same term but with slightly different language.

Public Counsel would recommend that proposed paragraphs 4 CSR 240-3.161 (1) (A) and 4 CSR 240-240.090 (1) (B) be consistent and that proposed 4 CSR 240-3.161 (1) (A) is the appropriate paragraph to use. This paragraph defines fuel and purchased power costs and the definition should be the same for each proposed rule with no ambiguity in the language.

Public Counsel would recommend that proposed paragraphs 4 CSR 240-3.161 (1) (E) and 4 CSR 240-20.090 (1) (G) be consistent and that proposed 4 CSR 240-20.090 (1) (G) is the appropriate paragraph to use. This paragraph defines Rate Adjustment Mechanism and the definition should be the same for each proposed rule with no ambiguity in the language.

Attached to these comments are a red line strikeout / blue underline insertion of edits to the proposed rules to implement a RAM under the authority of SB 179 that Public Counsel believes are necessary to properly balance the interests of ratepayers and utility investors. This source document used by Public Counsel was provided by Commission staff member Warren Wood in an email to all parties on Wednesday, August 9, 2006. In the email, Mr. Wood states. "For you use, the versions of the rules sent to the SOS for publication in the MO register (case no. EX-2006-0472)". Public Counsel was unable to verify that these are the exact documents published by the Secretary of State.

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 7th day of September 2006:

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