Senate Bill 179, RSMo Section 386.266 Rulemaking
Electric Fuel Adjustment Clause Provisions
Case No. EX-2006-0472

Testimony of Warren Wood
September 7, 2006

Education & Work Experience Background for Warren Wood

In December 1987, I received a Bachelor of Science degree in Civil Engineering from the University of Missouri at Columbia, Missouri. Upon graduation, I accepted employment with Black & Veatch Engineers – Architects and worked in the Energy and Environmental divisions of this consulting firm for a little over ten years.

While at Black & Veatch I designed a wide range of power generation and water treatment associated facilities, acted as an engineering liaison between our design office and joint venture partner offices, developed specifications, drafted engineering drawings, designed mechanical equipment supports and wrote custom computer programs to assist in solving many types of engineering problems. My work while at Black & Veatch focused on new and retrofit work on coal, combustion turbine, and nuclear power plant projects. I worked for Questec Engineering in Columbia, Missouri in 1997 and 1998. While at Questec I was a project manager in charge of site development and completion of numerous types of engineering projects for industrial, commercial and residential customers.

I have worked for the Commission for about seven years. Initially I was hired as a Regulatory Engineer in the Procurement Analysis Department of the Commission. While working in the Procurement Analysis Department I investigated the natural gas purchasing practices of Missouri's natural gas utilities and filed testimony in procurement analysis and actual cost adjustment audit cases. Later, I was employed as the Natural Gas Department Manager, promoted to the newly created Energy Department

Manager position and was recently promoted to Utility Operations Division Director. As the Natural Gas Department Manager I oversaw the regular tariff filings at the Commission of the natural gas utilities in the state, the Commission's activities in interstate natural gas pipeline cases at that Federal Energy Regulatory Commission (FERC) and the activities of the Commission's natural gas safety section. As the Energy Department Manager I oversaw the activities of the natural gas department sections listed above in addition to the activities of the engineering and economic analysis sections, which deal primarily with electric utilities in the state. In addition to overseeing the day-to-day activities of the Operations Division in my current position, I also regularly participate in presentations to stakeholder groups, legislative committees, conduct roundtables and facilitate rulemaking workshops.

I am a registered Professional Engineer in the State of Missouri and hold a certificate of registration from the National Council of Examiners for Engineering and Surveying. I am a member of Tau Beta Pi, an honorary engineering society and Chi Epsilon, an honorary civil engineering society.

I have previously filed testimony before this Commission in Ozark Natural Gas Co., Inc., Case No. GA-96-264, Laclede Gas Company, Case No. GR-96-193, Missouri Gas Energy, Case No. GR-96-285, Empire District Electric Company, Case No. ER-97-81, Missouri Public Service, Case No. GR-95-273, Missouri Gas Energy, Case No. GO-97-409, Associated Natural Gas Company, Case No. GR-97-272 and United Cities Gas Company, Case No. GO-97-410. I have also recently provided oral testimony in Kansas City Power & Light Company (KCPL), Case No. EO-2005-0329, Aquila, Inc. electric divisions MPS and L&P, Case No. EO-2005-0293 and Empire District Electric Company, Case No. EO-2005-0263, on their generation plant resource planning, in the experimental regulatory plan cases they filed with the Commission associated with the construction and their joint ownership of Iatan II.

EX-2006-0472 Rulemaking Testimony

Good morning and may it please the Commission, Staff offers its comments in support of rules 4 CSR 240-3.161 and 4 CSR 240-20.090 implementing the electric fuel and purchased power costs recovery provisions of Missouri Revised Statutes Section 386.266. This section of Missouri Statutes is often referred to as Senate Bill 179 or SB 179. Although Staff did not take a position on SB 179, Section 386.266 is the law and Staff is committed to making this law work in keeping with Staff's understanding of it and the rest of the laws of Missouri. Staff believes these rules are well structured to address the issues that face the Commission associated with implementation of the electric utility fuel and purchased power costs recovery portions of 386.266.

Staff has conducted over fifteen roundtables with a broad group of stakeholders to develop rules to implement the provisions of SB 179. The rulemaking that is the subject of today's hearing is the first of the rules to implement the provisions of SB 179 to make it to this phase of rulemaking.

As described in these proposed rules, pursuant to Section 386.266, electric utilities would be permitted to establish future rate adjustment mechanism treatment of permissible costs and revenues through a general rate proceeding where all other relevant costs, revenues and rate base items are reviewed. Parties to a general rate proceeding in which a rate adjustment mechanism has been proposed can offer alternative mechanisms, including incentive programs, for Commission consideration or simply oppose the proposed mechanism. The Commission may approve, modify or reject any proposed rate adjustment mechanism.

If approved in some form by the Commission, any rate adjustment mechanism charges, or credits, must be identified as a line item on the customer's bill. If the rate adjustment mechanism is in the form of a fuel adjustment clause, rates will be able to go up or down with actual changes in

fuel and purchased power costs and possibly go up or down based on changes in off-system sales revenues. If the rate adjustment mechanism is in the form of an interim energy charge, then only refunds will be possible. Under Section 386.266, a rate adjustment mechanism cannot be in effect for longer than four years without an earnings review and modification or extension by the Commission.

While a rate adjustment mechanism is in effect, the utility is required to comply with monthly and quarterly reporting requirements to the parties of the rate proceeding in which the rate adjustment mechanism was established, continued or modified. Prudence audits will be conducted no less often than every 18 months. Current proposed rules anticipate annual changes to the rate adjustment mechanism in order to true-up over- or under-collections. The rate adjustment mechanism charge, or credit, will be permitted to change up to four times per year.

In their current form, these rules provide flexibility as to what costs and revenues will be considered in calculating the rate adjustment mechanism. Generally fuel and purchased power costs, including transportation, will be included in the rate adjustment mechanism. It is anticipated that off-system sales will also be considered in many of the proposed rate adjustment mechanisms. Off-system sales sharing mechanisms as a form of incentives were discussed extensively in stakeholder meetings and will likely be part of any future rate adjustment mechanism implementation discussions. Current proposed rules only permit recovery of actual costs; no projected or forecasted numbers are permissible. The Staff continues to support this approach.

Some stakeholders have represented that absolutely no customer protections exist in these rules. In actuality these rules have extensive customer protections. While it may be possible to point to another state and say it has this protection or that protection, Staff is not aware of another state that has

all the consumer protections these rules offer and still has a rate adjustment mechanism.

In summary, these proposed rules include the following consumer-oriented provisions:

- Establishment of a rate adjustment mechanism or discontinuation, modification or extension of an existing rate adjustment mechanism can only take place in a rate proceeding where all other relevant costs, revenues and rate base items are reviewed.

- The Commission has broad discretion to approve, modify or reject any rate adjustment mechanisms, and incentive mechanisms, proposed by parties in a rate proceeding.

- No rate adjustment mechanism can be in place for more than four years without having been permitted to continue in affect, with or without modification, through another general rate proceeding and Commission approval.

- All money collected or credited through a rate adjustment mechanism will be subject to annual true-up with any over- or under-collections being returned to, or collected from, customers with interest.

- All expenditures associated with a rate adjustment mechanism will be subject to a prudence audit no less often then every eighteen months.

- Any electric utility authorized by the Commission to have a rate adjustment mechanism will be required to file monthly and quarterly reports regarding its revenues, expenses, fuel and purchased power costs, off-system sales, plant operating characteristics, rate base quantifications, capitalization quantifications, income statement, operating revenues, operating and maintenance expenses,

jurisdictional allocation factors, financial data and budgeting information.

- In rate proceedings where a utility is requesting a rate adjustment mechanism, parties may propose for the Commission's consideration alternate rate adjustment mechanisms and/or incentive or performance based programs to improve the efficiency and cost-effectiveness of the electric utility's fuel and purchased power procurement activities.

- These rules are unprecedented in the extent of their discovery provisions for parties to the rate proceeding in which a rate adjustment mechanism is established, continued, discontinued or modified.

- Any amounts approved for recovery by the Commission through a rate adjustment mechanism are required to be disclosed as a line-item on customer bills.

- These rules do nothing to limit any party's ability to request that the Commission establish a complaint case if a party believes over earnings are occurring as a result of the rate adjustment mechanism or otherwise and in fact require that a procedural schedule delineating the case timeline be issued not later than 60 days from the date of the filing of a complaint.

- Finally, these proposed rules include a provision that requires the Commission to review the effectiveness of these rules by no later than 12/31/10 and, if the Commission deems it necessary, initiate a rulemaking proceeding to revise these rules accordingly.

Throughout this process of over a year, Staff has carefully reviewed the concerns expressed by stakeholders and Staff has offered serious responses in an effort to respond to the issues they identified. Staff now offers the following responses to each of the primary concerns expressed throughout these roundtables and public hearings:

Concern: *Some stakeholders believe these rules should, and some stakeholders believe these rules should not, include an "earnings" or "threshold need" test. Some of these stakeholders are not satisfied that the ability to file a complaint case is the only means to address electric utility over-earnings.*

Staff Response: Proposed rule 20.090, Section (13) clearly protects the rights of parties to file a complaint case on the grounds that a utility is earning more than a fair or reasonable return. Further, this rule requires that if such a complaint is filed the Commission will issue a procedural schedule that includes a clear delineation of the case timeline no later than 60 days from the date the complaint is filed. In addition to these provisions, Staff notes that these rules include provisions that limit the time a rate adjustment mechanism can be in place without another rate proceeding, require annual true-ups, require prudence audits, require extensive monthly and quarterly reporting, include significant data sharing with other parties, only allow recovery of actually incurred costs versus projected or forecasted costs, and provide for Commission ordered incentive or performance based programs designed to improve the efficiency and cost-effectiveness of the electric utility's fuel and purchased power procurement activities. In summary, Staff believes that these rules provide for sufficient opportunities for the parties to develop reasonable rate adjustment mechanisms, monitor the performance of these mechanisms and revise these mechanisms if necessary.

Concern: *Some stakeholders believe these rules should, and others believe these rules should not, include a requirement that the utility have an approved Chapter 22 resource plan in place prior to approval of any rate adjustment mechanism.*

Staff Response: Staff believes that these rules should include requirements to report (i) on all supply- and demand-side resources, (ii) the dispatch of supply side resources, (iii) the efficiency of supply side resources and (iv) information showing the utility has a functioning resource planning process,

important objectives of which are to minimize overall delivered energy costs and provide reliable service. These concerns prompted the drafting of proposed rule 3.161, Section (2), Paragraphs (O) through (Q) and Section (3), Paragraphs (P) through (R). While Staff believes the idea of having an "approved" resource plan as a prerequisite to having a rate adjustment mechanism may have some merit, everything considered, Staff does not believe this to be reasonable as the resource planning rules do not contemplate "approval" for these purposes, resource planning is not necessarily tied to current fuel and purchased power prudency, and the resource planning rules will likely be changed as a result of upcoming rulemaking efforts. Also, Staff believes the information being requested in the current proposed rules, along with additional discovery if needed, will provide parties with sufficient information to argue a utility does not have an adequate planning process in place, if in fact the utility does not.

Concern: *Some stakeholders believe these rules must be written such that the utility continues to have "skin in the game" in order to assure some level of prudence in utility practices with a rate adjustment mechanism and these incentives should be structured to align the interest of shareholders and ratepayers. Further, some stakeholders believe that rate volatility mitigation and/or cap provisions should be added to these rules. Some stakeholders however believe the proposed rules go beyond the intent of Section 386.266.1 and would allow the Commission to impose a broad array of incentive and performance based programs.*

Staff Response: Staff agrees that the rules that implement this portion of SB 179 should include provisions for incentive and performance based programs. Proposed rule 20.090, Section (11), consistent with Section 386.266, provides that the Commission may implement incentive mechanisms and performance based programs to improve the efficiency and cost-effectiveness of the electric utility's fuel and purchased power procurement activities. Proposed rule 20.090, Section (11), Paragraph (B) specifies important objectives and criteria for establishment of incentive

plans such as "aligning the interests of the electric utility's customers and shareholders" and "the overall anticipated benefits of the electric utility's customers from the incentive or performance based program shall exceed the anticipated costs of the mechanism or program to the electric utility's customers".

Concern: Some stakeholders believe that these rules need clear definitions of what is permissible in the rate adjustment mechanism.

Staff Response: Staff agrees that whatever costs are to be included in, or excluded from, a rate adjustment mechanism must be clearly defined. This prompted the specific accounting information language in proposed rule 3.161 for all costs and revenues to be considered in the determination of any amounts eligible for recovery under the rate adjustment mechanism. Beyond the requirement to specify which costs and revenues are being proposed for consideration and the specific accounts they are to be recorded in on the electric utility's books and records, Staff believes these rules should preserve flexibility in which costs and revenues may be considered, consistent with Section 386.266, as parties may wish to consider different costs and revenues when dealing with different electric utilities.

Concern: Some stakeholders believe that minimum equipment performance standards are needed in these rules.

Staff Response: Staff agrees that equipment performance standards should be a part of these rules and has included in the proposed rules requirements to develop generating unit efficiency testing and monitoring procedures. Staff will, as a result of receiving this data, have the ability to monitor each electric utilities' power plants in terms of their capability to efficiently convert fuel to electricity. Any observed reductions over time may be an indication of the utility's need to implement programs to improve efficiency. Staff views this as a very important and necessary detail since the efficiency

of each electric utility's power plants directly relates to each electric utility's fuel and purchased power costs.

Concern: *Some stakeholders believe that less prescriptive rules that simply set out the application process should be adopted versus the detailed rules that have been proposed. Some stakeholders also believe that the current level of complexity and requiring "complete" versus "reasonable" explanations associated with data requirements could cause potential delays in rate adjustments. Some stakeholders further believe that the extensive monthly and quarterly reporting requirements in these rules are unduly burdensome and of limited benefit.*

Staff Response: A careful and close review of the proposed rules shows that the requirements for the provision of detailed information is narrowly, not indiscriminately, drafted; only certain portions of the rules apply to certain types of filings. For example, in order to establish a rate adjustment mechanism only a portion of 3.161 applies. Future proceedings to true-up the rate adjustment mechanism or to propose changes to the rate adjustment mechanism are addressed in separate sections of 3.161. This approach to drafting the rules does result in some provisions being repeated in different sections of the rules, and adds to the length of the rules, but it is much more convenient for the reader to have the rule sectionalized in this manner. Regarding the explanations required in the rule, Staff does not agree that 3.161 should not require a "complete" explanation of the data provided. Regarding the amount of data to be provided in monthly and quarterly reporting, Staff participated in the meetings where these data descriptions were developed and believes that the data requested is of value and will be used by the parties in their monitoring of rate adjustment mechanism operation, rate adjustment mechanism credits and charges, true-up account monitoring, prudence audits and monitoring of utility earnings.

Concern: *Some stakeholders, electric utilities, believe these rules should be clarified to reflect that they believe that under the provisions of the statute,*

Section 386.266, only utilities can propose to establish or continue a rate adjustment mechanism and that parties should only be able to propose alternatives if the utility proposes to establish or continue in the first place. These stakeholders also believe that these rules should not allow parties to force an undesirable rate adjustment mechanism to stay in place for perpetuity.

Staff Response: Staff believes that the current provisions of Section 386.266 and these rules allow only electric utilities to propose establishment of a rate adjustment mechanism. After the electric utility has a rate adjustment mechanism in place, future rate proceeding filings to extend, modify or discontinue the rate adjustment mechanism will be subject to alternative proposals of other parties and the Commission's power to approve, modify or reject any of these proposals. Proposed rule 20.090, Section (3), Paragraph (A) clearly states that parties can "oppose the discontinuation of a RAM on the grounds that the utility is opportunistically discontinuing the RAM due to declining fuel or purchased power costs and/or increasing off-system sales revenues". Staff believes that the final rules should include such a provision. Staff notes however that it does believe that it is appropriate that proposed rule 20.090, Section (2), Paragraph (E) provide the ability for a utility to request a rate adjustment mechanism or recovery of these costs through base rates as part of a rate proceeding in which a rate adjustment mechanism is proposed.

Concern: Some stakeholders believe that the current rules' limits on costs not to be passed through due to costs being an insured loss, or subject to reduction due to litigation are not appropriate as they appear to be structured to prevent inclusion of costs in rate adjustment mechanisms even if no insurance proceeds have been received and even if no prudence disallowance has been determined.

Staff Response: Proposed rule 3.161, Section (7), Paragraph (F) is a utility reporting requirement and reads "Extraordinary costs not to be passed

through, if any, due to such costs being an insured loss, or subject to reduction due to litigation or for any other reason;" Staff views this language as appropriate in that it requires the utility to identify any costs subject to insured loss or litigation and further that it puts the utility on notice that such costs may not be recoverable as long as they are subject to these issues. This is viewed by Staff as an appropriate incentive to the utility to use all means necessary to pursue these appropriate additional funds versus receiving these funds up-front from ratepayers.

Concern: Some stakeholders believe these rules should not include a requirement that the rules be reviewed in the future by the Commission for their effectiveness.

Staff Response: The proposed rules include a December 31, 2010, review requirement; they do not require that a new rulemaking be initiated, just that the rules be reviewed for their effectiveness. Staff views this as a reasonable requirement in these rules given their content and the potential for lessons to be learned in the next few years through the rate adjustment mechanisms that may be approved by the Commission.

After these rules were sent to the Secretary of State for publishing in the Missouri Register, Staff discovered other appropriate changes and received additional suggested changes from stakeholders to these rules. Staff has considered each of these additional suggested changes and is filing the following suggested changes:

Rule 4 CSR 240-3.161

Section (1), Paragraph (E) – To clarify that a RAM is either a fuel adjustment clause or interim energy charge:
Rate adjustment mechanism (RAM) ~~means~~ refers to either a fuel adjustment clause or interim energy charge;

Section (2), Paragraph (F) – To clarify that an IEC only has a refundable portion and is not the same as an FAC :

A complete explanation of how the proposed FAC~~RAM~~ shall be trued-up to reflect over- or under-collections, or the refundable portion of the proposed IEC shall be trued-up, on at least an annual basis;

Section (3), Paragraph (F) – To clarify that an IEC only has a refundable portion and is not the same as an FAC:
A complete explanation of how the proposed FAC~~RAM~~ shall be trued-up to reflect over- or under-collections, or the refundable portion of the proposed IEC shall be trued-up, on at least an annual basis;

Section (3), Paragraph (O) – To remove unnecessary 'and':
A description of how responses to subsections (B) through (N) differs from responses to subsections (B) through (N) for the currently approved RAM; ~~and,~~

Section (4) – To correct reference to appropriate 20.090 section:
When an electric utility files a general rate proceeding following the general rate proceeding that established its RAM as described in 4 CSR 240-20.090(~~3~~2) in which it requests that its RAM be discontinued, the electric utility shall file with the commission and serve parties as provided in sections (9) through (11) in this rule, the following supporting information as part of, or in addition to, its direct testimony:

Section (4), Paragraph (A) – To correct reference to appropriate 20.090 subsection:
An example of the notice to be provided to customers as required by 4 CSR 240-20.090(3)(~~D~~C);

Section (4), Paragraph (B) – To clarify that an IEC only has a refundable portion and is not the same as an FAC:
A complete explanation of how the refundable portion of~~over-collection~~ the IEC or the over- or under-collections under the FAC~~of the RAM~~ that the electric utility is proposing to discontinue shall be handled;

New Section (17) – To make proposed rule 3.161 consistent with review requirements in proposed rule 20.090:
(17) Rule Review. The commission shall review the effectiveness of this rule by no later than December 31, 2010, and may, if it deems necessary, initiate rulemaking proceedings to revise this rule.

Rule 4 CSR 240-20.090

Section (1), Paragraph (B) – To make definition in proposed rule 20.090 consistent with definition in proposed rule 3.161 and remove unnecessary 'and used':
Fuel and purchased power costs means prudently incurred ~~and used~~ fuel and purchased power costs, including transportation costs. If not inconsistent with a commission

approved incentive plan, fuel and purchased power costs also include prudently incurred actual costs of ~~including any~~ net cash payments or receipts associated with hedging instruments tied to specific volumes of fuel and associated transportation cost;

Section (2), Paragraph (E), second sentence – To change proposed rule language so that utilities can request a rate adjustment mechanism or base rate recovery in establishment of a RAM but can only choose to receive recovery in base rates versus recovery through a RAM if the Commission authorizes the utility to select this option in its order. Staff believes this is a reasonable approach to deal with the 'veto' power concerns some stakeholders have expressed, given the matters addressed in the Staff's cover pleading:
Any party to the general rate proceeding may oppose the establishment, continuation or modification of a RAM and/or may propose alternative RAMs for the commission's consideration including but not limited to modifications to the electric utility's proposed RAM. Where a utility proposes to establish a RAM and, ~~an~~ alternatively to recover the components that would have been treated in the RAM in base rates ~~base rate recovery mechanism~~, versus proposing continuance or modification of a RAM, 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 and the components that would have been treated in the RAM may~~will~~ be included in base rates ~~recovery mechanism~~ if base rate recovery is authorized in the commission order ~~if the commission~~ authorizing~~es~~ the utility to recover these components. ~~do so~~.

Section (3), Paragraph (A), second to last sentence – To clarify language regarding the rate schedules that implement the RAM:
Any party to the general rate proceeding may oppose the discontinuation of a RAM on the grounds that the utility is opportunistically discontinuing the RAM due to declining fuel or purchased power costs and/or increasing off-system sales revenues. If the commission finds that the utility is opportunistically seeking to discontinue the RAM for any of these reasons, the commission shall not allow the RAM to be discontinued, and shall order its continuation or modification. To continue or modify the RAM under such circumstances, the commission must find that it provides the electric utility with a sufficient opportunity to earn a fair rate of return on equity and the rate schedules that~~filed to~~ implement the RAM ~~must~~ conform to the RAM approved by the commission. Any RAM shall be based on historical fuel and purchased power costs.

Section (4), Paragraph (A), second sentence – To correct number of potential filings as current language would appear to require two filings where the intent was that only one filing is mandatory:
An electric utility with a FAC shall file one (1) mandatory adjustment to its FAC in each true-up year coinciding with the true-up of its FAC. It may also file up to ~~one (1) to~~ three (3) additional adjustments to its FAC within a true-up year with the timing and number of such additional filings to be determined in the general rate proceeding establishing the FAC and in general rate proceedings thereafter.

Section (11), Paragraph (B), second sentence – To clarify that rule would permit an incentive or performance based program with symmetrical cost sharing:

Any incentive mechanism or performance based program shall be structured to align the interests of the electric utility's customers and shareholders. Unless the incentive mechanism or performance based program proposes a symmetrical cost sharing, t~~T~~he anticipated overall benefits to the electric utility's customers from the incentive or performance based program shall exceed the anticipated costs of the mechanism or program to the electric utility's customers. For this purpose, the cost of an incentive mechanism or performance based program shall include any increase in expense or reduction in revenue credit that increases rates to customers in any time period above what they would be without the incentive mechanism or performance based programs.