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Missouri Public
Service Commission

Ms. Colleen Dale
Secretary and Chief Regulatory Law Judge
Missouri Public Service Commission
P.O. Box 360
Jefferson City, Missouri 65102

Re: EX- 2006-0472

Dear Ms. Dale:

Accompanying this letter for filing are the comments of the Missouri Attorney General with respect to proposed rule 4 CSR 240-20.090 and 4 CSR 240-3.161.

Thank you for your assistance with this filing. If you have any questions please do not hesitate to contact me.

Sincerely,

JEREMIAH W. (JAY) NIXON
Attorney General

Douglas E. Micheel
Assistant Attorney General

Enclosures

BEFORE THE PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI

In re proposed rule 4 CSR 240-20.090	)	
Electric Utility Fuel and Purchased Power	)	**Case No. EX-2006-0472**
Cost Recovery Mechanisms.	)	

Comments of the Missouri Attorney General

Comes now Missouri Attorney General Jeremiah W. (Jay) Nixon and pursuant to the notice of proposed rules published in the Missouri Register on July 17, 2006 provides the following comments for the Commission's consideration regarding the proposed rule 4 CSR 240-20.090 Electric Utility Fuel and Purchased Power Cost Recovery Mechanisms:

As a matter of public and regulatory policy the Attorney General continues to believe that use of a fuel adjustment clause or any other rate adjustment mechanism is inappropriate and unfairly tilts the playing field in favor of the electric utilities. The Attorney General did not actively participate in the roundtable discussions hosted by the Commission on this topic because the Attorney General remains opposed to isolating fuel costs for recovery from consumers without reviewing all costs as the practice has been since the Public Service Act was enacted in 1913.

After a review of the proposed rules it is clear that those roundtables failed to produce any meaningful consumer protections. According to John Coffman the former Public Counsel and current attorney for AARP: "Despite the many meetings with utilities we have made no progress, the rule proposed by the Public Service Commission

contains absolutely no consumer protections." *St. Louis Post-Dispatch* August 22, 2006 p. B-4.

These proposed rules stem from the passage of Senate Bill 179 last session. Senate Bill 179 marks a sea change in utility regulation by allowing electric utilities, for the first time, to shift some or all of the risk of fluctuating fuel prices from the utility to its customers. Senate Bill 179 leaves it up to the Public Service Commission to determine what consumer protections should be put in place. Specifically, Section 386.266.9 grants the Commission the authority to impose whatever restrictions are necessary to "...the structure, content and operation..." of rate adjustments in order to ensure the appropriate balance between consumer and utility interests are achieved. As proposed, these rules shift 100% of the risk of fuel price changes from the utility to the consumers. In determining the final rules the Commission should be cognizant of the fact that its principal interest is to serve and protect ratepayers. *State ex rel Capital City Water v. Public Service Commission,* 850 S.W.2d 903, 911 (Mo. App. 1993).

The proposed rules are devoid of any meaningful consumer protections and if adopted by the Commission will unfairly shift risk away from electric utilities and result in higher costs to Missouri consumers. The Commission will have failed in its principal interest to serve and protect ratepayers. Instead it will be primarily serving and protecting the interests of the electric utilities.

Proposed Consumer Protections

To better balance the consumer and electric utility interests the Commission should insert the following consumer protections into the proposed rules:

Rate Adjustment Mechanism (RAM) Threshold Test: "Prior to gaining the ability to utilize any of the RAM mechanisms authorized by Section 386.266 the electric utility shall be required to demonstrate to the Commission and the Commission must find after hearing that without the ability to use the RAM mechanisms authorized by Section 386.266 the electric utility would be unable to have an opportunity to achieve its Commission authorized rate of return."

The electric utilities in pressing for this legislation claimed that because of fuel costs they were unable to achieve their authorized return on equity. Subsection 4(1) of Section 386.266 notes that any RAM authorized by the Commission must be "reasonably designed to provide the utility with a sufficient opportunity to earn a fair return on equity." If an electric utility already has a sufficient opportunity to earn a fair return on equity, it does not need a RAM.

The Attorney General's proposed language would require that the electric utility demonstrate that it does not already have a sufficient opportunity to earn a fair return on equity. Obviously electric utilities under the old regulatory regime have had a sufficient opportunity to earn a fair rate of return. Union Electric recently filed its first general rate increase case in twenty years. The Attorney General believes that it would fundamentally subvert the historic utility regulatory structure to allow an electric utility that already has a

sufficient opportunity to earn a fair rate of return to shift the risk of fuel price increases on to the back of the consumer.

Earnings Review: "After the Commission has authorized any of the rate adjustment mechanisms authorized by this rule, the electric utility shall provide the Staff, Public Counsel and other authorized parties access to the surveillance reports that detail the electric utility's earnings. If after hearing the Commission determines that a electric utility's earnings exceed its authorized rate of return the Commission shall adjust the RAM surcharge to prevent windfall profits."

The RAMs authorized by this proposed rule are single issue surcharges. If an electric utility's overall costs drop the single issue surcharge could result in an excessive return to the electric utility. The Attorney General's proposal for an earnings review while the RAMs are in effect would serve as a check to ensure that that does not occur. Certainly the legislature did not intend that the adjustment clauses authorized by Section 386.266 would allow an electric utility to earn in excess of its authorized return. Such a result would be the antithesis of utility regulation.

Amount of Fuel and Purchase Power Cost Subject to Rate Adjustment Mechanism (RAM): "The Commission shall in a general rate case set the percentage of fuel and purchased power costs the electric utility will be allowed to recover pursuant to a RAM, if any."

The Attorney General's proposed language would allow the Commission to determine the appropriate balance of fuel and purchased power costs that would be

subject to the RAM. This language would give the Commission the authority to balance the risk of fuel and purchased power cost increases between the electric utility and the consumer based upon the unique facts relating to each electric utility. By allowing all or some of fuel and purchased power costs to remain in base rates the commission will have a tool that it can use to ensure that the electric utility keeps its fuel and purchased power costs as low as possible. Moreover, this flexibility will allow the Commission to increase or decrease the percentage of fuel and purchased power costs subject to a RAM as the facts and circumstances of each case dictate.

4 CSR 240-20.090 (1)(B): This section of the proposed rule provides the definition of fuel and purchased power costs. According to the draft rule these costs are "prudently incurred and used fuel and purchased power costs, including transportation costs." The Attorney General believes that this definition is too broad and could allow increased fuel costs caused by inappropriate acts or omissions of the electric utility to be included in the rate adjustment mechanism. For example, an electric utility could construct a combined cycle gas plant and place it on line without having obtained the appropriate zoning authority from the county in which the plant was constructed or the needed certificate from the Commission to operate the plant. The plant could be idled because the electric utility lacked the appropriate authority to operate the plant and the utility would have to purchase power to replace the capacity taken off line. In such a situation it would be prudent for the utility to purchase power to replace the idled capacity. The Commission's

proposed rule would allow the electric utility to include the increased purchased power costs in the RAM even though those costs were the direct result of the utility managements failure to comply with the law.

Of course, this situation is not an abstract example. As the Commission is aware Aquila operated its South Harper plant under just circumstances. The Attorney General is aware of at least three other situations with electric utilities where management actions or inactions may have resulted in increased purchase power costs: Union Electric's Taum Sauk dam failure; the explosion, fire and disabling of the former St. Joseph Light & Power Company's Lake Road 3 generator and the explosion and disabling of one of the generators at KCP&L's Hawthorn power plant.

Although nowhere delineated in the proposed rules, the Attorney General assumes that the Commission will be applying the long standing prudence standard set out in *In re Union Electric,* 27 Mo. PSC (N.S.) 183, 194 (1985):

> "[T]he company's conduct should be judged by asking whether the conduct was reasonable at the time, under all the circumstances, considering that the company had to solve its problem prospectively rather than in reliance on hindsight. In effect, our responsibility is to determine how reasonable people would have performed the tasks that confronted the company."

The proposed rules can be read to allow an electric utility to meet the Commission's long standing prudence standard not withstanding the fact that it was the electric utility's actions or inactions that caused the increased fuel or purchased power costs.

To close this loophole the Attorney General recommends that the following sentence be added to the definition of fuel and purchased power costs: "Any and all increased fuel and purchased power costs caused by an electric utility's failure to appropriately operate its generating facilities shall not be included in any rate adjustment mechanism authorized by Section 386.266." If this loophole is not closed the electric utility will be allowed to foist increased fuel and purchase power costs upon consumers caused by its inappropriate, perhaps unlawful actions or inactions.

4 CSR 240-20.090 (1)(C): For all of the reasons contained in the comment to subsection (1)(B) above, the Attorney General recommends that the following sentence be inserted between the first and second sentence of proposed subsection (1)(C): "Any and all increased fuel and purchased power costs caused by an electric utility's failure to appropriately operate its generating facilities shall not be included in any FAC authorized by the Commission pursuant to Section 386.266."

4 CSR 240-20.090 (1)(D): This portion of the proposed rule sets out the definition of "General rate proceeding." The Attorney General recommends that the phrase "initiated by the file and suspend method be inserted into the definition of general rate proceeding so that the definition reads: " General rate proceeding means a general rate increase proceeding *initiated by the file and suspend method* or complaint proceeding..." This definition accurately describes the two methods authorized by statute by which a general rate case proceeding can be initiated. See: *State ex rel. Jackson County v. Public Service*

Commission, 532 S.W.2d 20, 28-29 (Mo banc 1975) *cert. denied,* 429 U.S. 822, 97 S. Ct. 73, 50 L. Ed.2d 84 (1976).

4 CSR 240-20.090 (1)(F): For all of the reasons contained in the comment to subsection (1)(B) above, the Attorney General recommends that the following sentence be inserted between the first and second sentence of proposed subsection (1)(F): "Any and all increased fuel and purchased power costs caused by an electric utility's failure to appropriately operate its generating facilities shall not be included in any IEC authorized by the Commission pursuant to Section 386.266."

4 CSR 240-20.090 (2)(E): This proposed rule states in pertinent part: " Where a utility proposes to establish a RAM and an alternative base rate recovery mechanism..." Nowhere in the proposed rule is the term *alternative base rate recovery mechanism* defined and the Attorney General does not know what the Commission means when it use that term. The Attorney General recommends that the Commission provide an appropriate definition of the term "alternative base rate recovery mechanism."

Nor does the proposed rule provide any definition of the term "...base rate recovery mechanism..." The Attorney General recommends that the Commission provide an appropriate definition of the term "base rate recovery mechanism."

The proposed rule also appears to give the electric utility unilateral veto power over the Commission's determination as to what RAM is appropriate for use by the electric utility. The proposed rule provides in pertinent part: "...if the commission modifies the electric utility's 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 will be included in base rate recovery mechanism if the commission authorizes the utility to do so." This provision in the proposed rule will cause both practical and legal problems for the Commission.

If this section of the proposed rule is not deleted, the Staff, Public Counsel and other interveners will be required to file both a case with respect to the electric utility's proposed RAM and a case for placing the components that would have been included in the proposed RAM in the "base rate recovery" mechanism, whatever that mechanism may be. This will result in unneeded duplication of work and unnecessary complication of general rate case proceedings.

It is also unclear under the proposed rule when the Commission would be required to issue its order regarding a RAM and how long the utility would have to notify the Commission whether it will accept the Commission ordered RAM. If the Commission issues its rate case order rejecting a RAM three weeks before the operation of law date and parties have ten days to seek rehearing, does this mean that the issue of fuel costs must be tried in two weeks prior to the effective date of the order? Does this mean that both the proposed RAM and the "other base rate recovery" mechanism must be litigated in every general rate case? The Commission's proposed rule raises but does not answer these questions.

Moreover, the proposed rule seems to indicate that the Commission could deny the electric utility recovery of the costs related to the "base rate recovery mechanism." Does this mean that the electric utility will not get an opportunity to recover its fuel costs?

Allowing the electric utility unilateral veto power over the Commission's RAM decision as apparently authorized by this provision of the proposed rule calls into question the legality of this portion of the rule. It is well settled law that a public utility may by filing schedules suggest to the commission rates and classifications which it believes are just and reasonable. If the commission accepts them, they are authorized rates, but the commission alone can determine that question and set lawful rates. *May Department Stores Co. v. Union Electric Light & Power Co.,* 107 S.W.2d 41, 50 (Mo. 1937). Under this portion of the proposed rule, the Commission appears to unlawfully cede its ratemaking authority to the electric utility. This Commission has exclusive jurisdiction to set rates and a public utility has no right to fix its own rate. *Id.* at 57. If allowed to stand the proposed rule would allow electric utilities to determine their own rates in direct contravention of the regulatory scheme established by the Missouri legislature in Chapter 393.

This Commission has no power except that granted by the legislature. The Commission cannot adopt a rule which results in nullifying the express will of the legislature, and it cannot under the theory of construction of a statute proceed in a manner contrary to the plain terms of statute. *State ex rel. Springfield Warehouse & Transfer Co. v. Public Service Commission,* 225 S.W.2d 792,794 (Mo. App. 1949). This proposed

provision would nullify the will of the legislature as expressed in Sections 393.140 RSMo and 393.150 RSMo for the Commission to set utility rates.

4 CSR 240-20-090 (7): This portion of the proposed rule sets out that a RAM adopted by the Commission will be subject to a "prudence review" but it fails to articulate what will be included in the "prudence review" and what standard, if any, this Commission will utilize to determine whether an electric utility acted in a "prudent" manner in procuring its fuel and/or purchase power. The Attorney General believes that the Commission should articulate some prudence standard in its proposed rule so that parties are on notice of the standard the Commission will use to review prudence. Or, if the Commission intends to use the current prudence standard that it uses in natural gas actual cost adjustment cases it should make that clear.

4 CSR 240-20-090 (11): This portion of the proposed rule allows the electric utility or any other party to recommend incentive or performance based programs. The Attorney General believe that a new section (D) should be added that states the following:

> "(D) Disclosure on Customers' Bills of incentive or performance based portion of the RAM. Consistent with Subsection (8) of these rules, the amount of the incentive RAM charge authorized by this section shall be set out separately on the disclosure required by Subsection (8)."

The Attorney General believes that consumers should be made fully aware of what portion of the approved incentive RAM is being returned to the electric utility as profit so that the consumer can be aware of the actual fuel and purchased power costs being incurred by the utility. If the electric utility is allowed an incentive RAM consumers'

electric bills will be higher than they otherwise would be because instead of passing fuel costs through to consumers dollar for dollar the electric utility would be allowed to earn a profit on the fuel costs over and above its return authorized in a general rate case proceeding. This disclosure is particularly important given the fact that Section 386.266.5 and subsection 11(C) of the proposed rule require that any incentive mechanism "shall be binding on the on the commission for the entire term of the plan."

Finally, the Attorney General questions whether or not the legislature can authorize and the Commission can promulgate a rule that will bind the Commission to accept an incentive plan for the entire term regardless of the plan's consequences. The Missouri Supreme Court in *State ex rel. Chicago, R.I. & P.RR Co. v. Public Service Commission*, 312 S.W.2d 791,796 (Mo. 1958) stated:

> "It's [Commission'] supervision of the public utilities of this state is a continuing one and its orders and directives with regard to any phase of the operation of any utility are always subject to change to meet changing conditions, as the commission, in its discretion may deem to be in the public interest."

This proposed rule subsection (11) (C) and Section 386.266.5 are directly contrary to the spirit of the Public Service Act, one of the primary purposes of which was to set up the machinery for continuous regulation of utilities as changes in conditions require. *State ex rel. Jackson County v. Public Service Commission,* 532 S.W.2d 20, 29 (Mo. banc 1975) *cert. denied* 429 U.S. 822, 97 S.Ct. 73, 50 L.Ed.2d 84 (1976). This legislation and the proposed rule in subsection (11) (C) bind the Commission to a certain decision even though circumstances can change over time. Subsection 5 of 386.266 and subsection (11)

(C) of this proposed rule could potentially prevent the alteration of rates that are unreasonable to consumers and conflict with the Commission's statutory authority found in Section 386.490.3 to change or abrogate any of its orders. This portion of Section 386.266 and the proposed rule also conflicts with the continuous ratemaking scheme set up by the legislature in Chapter 393 for electric utilities.

4 CSR 240-20-090 (13): This proposed section of the rule notes that "nothing in this rule shall preclude a complaint from being filed, as provided by law, on the ground that a utility is earning more than a fair return on equity..." This portion of the proposed rule appears to be the only portion of the rule that can even be said to be a "consumer protection." However, it does not provide ratepayers with any more consumer protections than are already available to them under the current statutory scheme. The rule requires the Commission to "...issue a procedural schedule that includes a clear delineation of the case timeline no later than sixty (60) days from the date the complaint is filed." But this is not an additional consumer protection because the commission has authority now to delineate a clear timeline for any complaint case. The proposed rule fails to set any time frame in which the Commission must ultimately rule on any complaint. Contrast this with the requirement that an electric utility's rate increase request must by law be processed in eleven (11) months.

Moreover, there is an apparent conflict between this section of the proposed rule and subsection (11) of the proposed rule. What will the Commission do if as a result of an incentive RAM mechanism an electric utility is earning more than a fair rate of return?

According to this proposed rule and subsection 5 of 386.266 the Commission is powerless to remedy such a situation; consumers must pay unreasonable rates until the incentive RAM approved by the Commission expires. This is simply one more example of how Senate Bill 179 and these proposed rules further tilt the playing field in favor of the electric utility.

4 CSR 240-20-090 (16): This section of the proposed rule provides in pertinent part as follows: "If the electric utility files a general rate proceeding thirty (30) days or more after the commission issues a notice of proposed rulemaking respecting initial RAM rules, the provisions of this section shall apply..." This proposed section of the rule states that even though these rules are **proposed** rules any electric utility that files a general rate proceeding thirty days or more after the Commission issued this notice of proposed rulemaking must follow the proposed requirements of subsection (16). This Commission has no authority to require parties to comply with proposed rules. To do so would be contrary to the requirements of Section 536.021 RSMo 2000 which sets forth the notice and comment procedures for rulemaking. In *St. Louis Christian Home v. Missouri Comm'n on Human Rights,* 634 S.W.2d 508, 515 (Mo. App. 1982), the court observed:

> The very purpose of the notice procedure for a proposed rule is to allow opportunity for comment by supporters or opponents of the measure, and so to induce a modification...To neglect the notice...or to give effect to a *proposed* rule before the time for comment has run...undermines the integrity of the procedure. (emphasis in original)

cited with approval in *NME Hospital v. Dept. of Social Serv.* 850 S.W.2d 71, 74 (Mo. banc 1993). By noting in this subsection that "...the provisions of this rule shall apply..." to electric utilities even though the rules are not yet final the Commission has prematurely given effect to the **proposed** rule. Such action is in clear violation of Section 536.021, undermines the integrity of this procedure and calls into to question the propriety of any rule that ultimately emerges from this process or any action taken under the proposed rule. A rule adopted in violation of Section 536.021 is void. *NME Hospital* at 74.

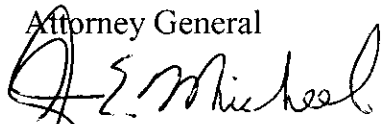
As a matter of policy the Attorney General objects to use of these "transitional" rules. Not only does such a requirement subvert the rulemaking requirements legislated by the general assembly, it poses too great a risk of wasting the limited resources of the Commission and the other parties to the case because the rules may change. Simply put, proposed rules are a moving target.

The better course of action is to reject any tariffs filed by the electric utilities respecting these RAMs until this Commission has duly promulgated valid rules for the RAMs operation. Clearly section 386.266 gives the Commission such authority. Subsection 9 of 386.266 merely gives the utility the ability to "apply" for any adjustment mechanism, it does not and cannot require this Commission to grant the request. See: *May Department Stores v. Union Electric Light & Power Co.,* 107 S.W.2d 41 (Mo. 1937). In fact, this course of action would be more consistent with the requirements of Section 386.266.12 that the Commission not issue an order authorizing any of the rate adjustments

allowed by SB 179 until it has promulgated rules to implement the application process for the proposed rate adjustment mechanism.

Respectfully Submitted,

JEREMIAH W. (JAY) NIXON
Attorney General



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