BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Proposed Rules 4 CSR 240-3.162 and 4 CSR 240-20.091, Environmental Cost Recovery Mechanisms.	)))))	**Case No. EX-2008-0105**

DISSENTING OPINION OF COMISSIONER ROBERT M. CLAYTON III

This Commissioner dissents from the Final Order of Rulemaking for the rule known as the Environmental Cost Recovery Mechanism (ECRM) or surcharge. This is the second surcharge authorized by SB179 to impact Missouri customers and it has, by far, the greatest potential for significant rate increases. The first surcharge stemming from SB179 was the Fuel Adjustment Mechanism rule promulgated in 2007. In the present rulemaking, the majority rejected all of this Commissioner's amendments that were designed to protect customers from rate increases over and above the utility's authorized rate of return. The public should be prepared for new rate cases in which electric utilities will be permitted to seek not one, but two new surcharges on consumer bills.

First and foremost, surcharges, riders or modifiable trackers are rate designs that permit rate adjustments outside of a general rate case where normally "all relevant factors" are taken into consideration in establishing rates that are "just and reasonable." To determine how much revenue the company should receive to provide service, all expenses, revenues, capital plans and expenditures, labor decisions, fuel estimates and

infrastructure retirements are fully evaluated. Base rates are designed from the comprehensive audit and review by staff in identifying the revenue requirement. The surcharges, however, can be adjusted upward without a full evaluation of "all relevant factors." Over or under collections for non-environmental costs are not evaluated or considered in the appropriateness of the surcharge. If the utility is over-collecting or over-earning after a review of "all relevant factors," it would still be able to collect additional funds through the surcharge enabling it to earn over and above its authorized rate of return or profit. If the utility is under-collecting or under-earning, then the surcharge can elevate the utility to its authorized return level. In either case, the utility receives a benefit while the customer pays more than he or she would have without the surcharge.

Missouri's first surcharge authorizing rate increases without reviewing "all relevant factors" was created in HB208 in 2003 for gas and water utilities known as the Infrastructure System Replacement Surcharge (ISRS). In 2005, SB179 authorized the creation of a Fuel Adjustment Mechanism or clause (FAC), which has since been codified in 4 CSR 240-20.090 and implemented in one electric utility's latest rate case. The ECRM, like the FAC, is applicable to electric utilities. Each surcharge has the potential to enable inappropriate utility returns.

Electric utilities now have two separate mechanisms that may be authorized by the Commission and can easily lead to examples of utility over-earning. During the rulemaking hearing, staff witnesses affirmatively stated that for the utility, "there's no down side risk. . . The possibility for them to overearn, you've enhanced that possibility.

That's just a given."[1] This Commissioner recommended that language proposed by the Public Counsel be included in the rule to protect customers from paying rates over and above the utility's authorized rate of return. This amended language was offered in 4 CSR 240-3.162 for subsections 2(E), 3(E) and 4(C), and in 4 CSR 240.20.091 for subsections 2(A), 4(C)(4-8). The language simply allows the utility to use the surcharge to reach its Commission approved rate of return as authorized by statute, but not to exceed it. Some have argued that this language is unnecessary because such analysis is implicit in what the Commission does. However, including the proposed language only restates current statute and makes the Commission's purpose clear. Clarity only improves this rule.

Over-earning can also be affected by deferrals of cost increases. The proponents of the rule argue that consumers are protected because of a two and one-half per cent (2½ %) cap on annual adjustments to the surcharge. While on the surface, customers do receive some comfort of a limitation on the increase, one should be concerned with the amounts that exceed the cap and are deferred for collection in future rate cases. There is no limit to the amount of such a deferral. Capital investments would most likely be added to rate base anyway, but expenses incurred outside the test year would not be added. The greatest inequity with the unlimited deferrals is those expenses deferred for collection in the next case during a time when the company may be over-earning. For example, if the utility defers $10 million in investments or expenses that exceed the two and one-half per cent (2½ %) cap during a year in which it is earning 200 basis points above its authorized rate of return, the utility gets to keep the over collections and then would be entitled to collect the additional deferrals in base rates in the next rate case. In

[1] Tr. at 31-32.

the past, without using surcharges, the staff would fully evaluate the occurrences of both over and under-earning to find a revenue requirement that was "just and reasonable."

This Commissioner offered for consideration language suggested by Public Counsel and supported by AARP for evaluating this circumstance. In 4 CSR 240-20.091, subsection 4(C) (4-8) was offered to contemplate an occasion for unlimited deferrals when the company is also over-earning. The majority rejected this language. During examination at the hearing, this Commissioner inquired as to staff's intentions during periodic adjustments to the ECRM in light of company earnings. Staff advised that it currently has the power and authority to investigate and possibly file a complaint to reduce rates at times of over-earning. This is supposedly a consumer protection in the rule, however, one person on staff has the responsibility to review all electric and gas utilities' income statements and revenue calculations outside of a rate case which may require several years in analysis. Staff is entirely dependent on the utility to supply accurate and sufficient data to conduct such an analysis. One year's calculation may not be sufficient to trigger a complaint. There are simply insufficient protections in the rule to address the potential for over-earning with pending deferrals.

Lastly, the testimony highlights the great potential for significant amounts of costs to be processed or collected through this surcharge.[2] It is not clear what may be included in the surcharge calculation which is certainly defined to include capital and expense costs. Staff suggests that many of these details should wait for consideration during general rate increases. With possible Congressional mandates on the horizon, the potential for new taxes or fees on certain types of generation and the pursuit of more costly renewable sources of energy, there is no limit on what can be argued by a party to

[2] Tr. at 120.

be eligible for inclusion in the surcharge. This Commissioner recommended adding language that would require costs to be "directly" associated with environmental compliance, yet this language was also rejected by the majority.

Other concepts were suggested to offer guidance to future Commissions. In 4 CSR 240-20.091(11), this Commissioner offered language proposed by some of the consumer advocates that would authorize incentive mechanisms to balance or align the interests of ratepayers and shareholders to encourage prudent decisions. Language was suggested in 4 CSR 240.3-162, subsection 2(P-Q) and 3(P-Q), to require five years worth of study on pending environmental investments and cost incurring decisions with how the surcharge would effect the utility's rate of return. This Commissioner offered another amendment that would have authorized the Commission the flexibility to include "some or all" of the environmental costs as part of the surcharge in 4 CSR 240.20.091(1) (B) if fairness or reasonableness required it. The majority rejected each of these amendments that would have offered a layer of protection for consumers.

In conclusion, the most striking testimony admitted into the record related to the alleged underlying purpose of the rule. It has been argued that this rule is important for Missouri's compliance with environmental rules and that this rule will enable a cleaner Missouri environment. The testimony by industry representatives reflected that this rule does not encourage environmental investment;[3] there was further testimony that environmental projects would not necessarily be accelerated because of this rule;[4] and, the industry comments reflected that this rule will not cause any new environmental

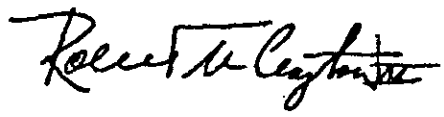
[3] Tr. at 66.
[4] Tr. at 67.

improvement that would not already be required under the law.[5] One surcharge currently in place, the ISRS, which allows for earlier recovery of infrastructure investment has not led to additional or accelerated utility investment.[6]

There is no question that the utility stands to benefit from the acceleration of cost recovery and the shift in risk to consumers. The General Assembly intended for this Commission to promulgate a rule to implement this surcharge. However, consumers, legislators and the public expect that the Commission will use its expertise to implement the rule in a fair and reasonable manner to make sure all parties have a share of the alleged benefits. The Final Order of Rulemaking fails to balance those interests and may very well lead to inappropriate rate increases.

For the foregoing reasons, this Commissioner dissents.

Respectfully submitted,



Robert M. Clayton III
Commissioner

Dated at Jefferson City, Missouri,
on this 28th day of February 2008.

[5] Tr. at 67-68.
[6] Tr. at 68-69.