

**CASE NO. EX-2008-0105 STAFF COMMENTS – 1/2/08 (Attachment 1)**

The Environmental Cost Recovery Mechanism (ECRM) rules implement the environmental cost recovery provisions of Missouri Revised Statutes Section 386.266 for electrical corporations regulated by the Commission (electric utilities). This section of Missouri Statutes is often referred to as the Missouri legislation which established it, Senate Bill 179 or SB 179. The ECRM rules as proposed, with the following Staff recommendations, are structured to address the issues that face the Commission associated with implementation of the environmental cost recovery provisions, as best these evolving matters are understood at this time.

**Development of ECRM Rules**

Prior to the development of ECRM rules, the Staff conducted over fifteen roundtables/workshops with a broad group of stakeholders to develop two rules that implement the rate adjustment mechanism (RAM), i.e., the fuel and purchased power provisions, of Section 386.266. Those two rules, 4 CSR 240-3.161 and 4 CSR 240-20.090, became effective on January 30, 2007. The Staff chose to use the RAM rules as the basis for the development of ECRM rules since many of the non-consensus items resulting from the RAM roundtables/workshops apply to both the RAM and the ECRM rules. Maintaining consistency between the RAM and ECRM rules was also important for the following reasons:

- (1) Many provisions of Section 386.266 apply to both rate adjustment and environmental cost recovery mechanisms
- (2) Extensive discussions took place among stakeholders at the RAM roundtables/workshops regarding the provisions that are common to both mechanisms; and
- (3) Reduce confusion regarding the processes for establishment, modification and discontinuation and in the reporting requirements of the two types of mechanisms;

Three roundtables/workshops specific to the ECRM were held with stakeholders to receive comments and suggestions where the stakeholders worked to reach consensus on as many aspects of proposed ECRM rules as possible.

Just as in the RAM rules, in the proposed ECRM rules pursuant to Section 386.266, initially Missouri retail jurisdictional electric utilities will only be permitted to request future ECRM treatment of prudently incurred environmental costs through a general rate proceeding where all relevant expenses, revenues and rate base items are considered by the Commission. Parties to such a general rate proceeding in which an electric utility requests an ECRM can propose variations or alternative methodologies/mechanisms for the Commission to consider or can oppose the establishment of an ECRM. The Commission may approve, modify or reject any proposed ECRM. An ECRM cannot remain in effect for longer than four years without a new general rate proceeding and modification or extension of the ECRM by the Commission.

The electric utility that is allowed an ECRM is required by the proposed rules to comply with monthly and quarterly reporting requirements. (4 CSR 240-3.162(5) and (6)). Care was taken in the drafting of the reporting requirements of the proposed ECRM rules to make them consistent, as much as possible, with the reporting requirements of the RAM rules. (4 CSR 240-3.162(6)(D) and 4 CSR 240-20.091(9)(B)). As required by SB 179, and therefore consistent with the RAM rules, the proposed ECRM rules require true-ups at least every twelve months and prudence reviews at least every eighteen months. Also as required by SB 179, and therefore consistent with the RAM rules, the ECRM rules require any ECRM to be separately identified as a line item on a customer's bill.

Subsequent to the effective date of the RAM rules, the Commission revised 4 CSR 240-Chapter 2. Language regarding discovery and the treatment of confidential information is different in the ECRM rules from the RAM rules to be consistent with these recent changes. (4 CSR 240-3.162(9)-(11)). In addition, experience with implementing the first RAM in a rate case subsequent to the effective date of the RAM rules led to the adding of more descriptive language regarding the application of interest in a true-up adjustment.

The language in the ECRM rule provides for monthly application of interest, equal to the utility's average monthly short-term debt cost, to a utility's cumulative under or over-recovery of ECRM costs. (4 CSR 240-20.091(5)(A)).

There were a few changes between the RAM and ECRM rules that were necessary because of the nature of the types of costs involved. Definitions were modified, added or deleted. A detailed long-term resource plan is important to minimizing fuel and purchased power costs. Equally important to managing environmental costs is a long-term environmental compliance plan that is consistent with the electric utility's long-term resource plan. Therefore, the proposed ECRM rules do not require a long-term resource plan but do require a long-term environmental compliance plan to be filed in the general rate proceeding that establishes, modifies or continues an ECRM. (4 CSR 240-3.162(2)(N) and (3)(O)).

#### **Differences Between the FAC and ECRM Rules Due to SB 179 Provisions**

Section 386.266 includes a provision that allows the Commission to include incentives to improve efficiency and cost-effectiveness for fuel and purchased power activities for utilities which have a RAM. There is not a similar statutory provision for incentives to improve the efficiency and cost effectiveness of environmental costs. Therefore, the ECRM rules do not address incentive programs.

There is a provision of Section 386.266 that restricts the annual amount of revenue collected by an ECRM adjustment to not exceed two and one-half percent of the Missouri gross jurisdictional revenues of the electric utility. This restriction is covered in 4 CSR 240-20.091(4)(C). Section 386.266 nonetheless allows the electric utility to defer costs not recovered as a result of this restriction. The language in the rule mirrors the language in the statute. However, the Staff is concerned that different stakeholders may have different interpretations of this language. A discussion of the Staff's interpretation follows later in these comments.

### **Areas of Non-Consensus Among Stakeholders**

*The ECRM rules should not require that voltage levels be taken into account when designing the ECRM rates as the RAM rules do.*

The RAM rules contain language that requires voltage levels to be taken into account in the RAM rate design. This is because the majority of the fuel and purchased power costs that are expected to be recovered in RAMs are costs that vary with the amount of fuel used to meet the varying energy demands of the customers. Because of line losses, customers that take energy at secondary voltage require more energy to be generated to meet their needs than customers that take energy at primary or transmission voltages.

The majority of environmental costs will be large capital plant investments such as bag houses and Selective Catalytic Reduction (SCR) equipment respecting generating facilities. This equipment is required regardless of how much energy the plant generates. The requirement to add the equipment does not vary directly to the amount of energy usage of any customer or any customer class. The ECRM rules are silent on the rate design of the ECRM. Parties to the general rate case setting the ECRM can propose cost allocation methodologies and rate design proposals to the Commission. These positions may be a methodology based on energy consumption, coincident peak demand, a combination of energy and demand or whatever other type of allocation methodology a party may choose to support. The rules as proposed are not prescriptive and leave it to the Commission as to the determination of which allocation method should be used including any methods in which voltage levels are taken into account. For this reason, the Staff recommends that there be no rate design language included in the ECRM rules

*The basis for change in ECRM rates should be net increases or decreases in environmental costs.*

Adjustments to the ECRM will be largely based on large capital investments which will be depreciated over time. The proposed rules require that the ECRM reflect the net increases and decreases in an electric utility's environmental costs. (4 CSR 240-3.162(1)(D) and 4 CSR 240-20.091(1)(B)). Net increases and decreases will take into

account the depreciation of these large capital investments that accumulates as a reduction to rate base over time.

Net increases and decreases will also capture changes in environmental costs from those allowed in the general rate case that are replaced with another type of environmental cost. Consider the following for example. When an electric utility files its general rate case and requests an ECRM, it treats its coal with Chemical A and those costs are included in base rates. Prior to the next general rate case, the electric utility is required to change to the use of Chemical B from Chemical A. If only incremental changes in environmental costs are included in the ECRM, the utility could recover the cost of Chemical B in the ECRM because it is a “new” environmental cost while the cost of Chemical A, which it no longer uses, is still in base rates and is being paid for by ratepayers. Requiring the reflection of net environmental costs will result in the ECRM only collecting the difference in costs between Chemical A and Chemical B.

*Tracking all costs to calculate net increases and decreases will not be burdensome, as some electric utilities may argue.*

While accounting for net changes may be depicted as a daunting task, it is only as burdensome as the electric utility chooses to make it. The task can be manageable. An example would be an electric utility requesting an ECRM that identifies a limited number of specific environmental cost and revenue items on its books and records that would be considered in adjusting its ECRM. (4 CSR 240-3.162(2)(H)-(J) and (3)(H)-(J)) This allows the electric utility to define the scope of the accounts and records necessary to track the environmental costs included in its ECRM.

*In addition to the one mandatory ECRM adjustment at the annual true up for each ECRM, one optional adjustment between true-ups is allowed in the proposed rules.*

The rules, as proposed, allow for one optional periodic adjustment, between annual true-ups to the ECRM, in addition to an adjustment to true-up over- or under-collections that will occur at least annually. (4 CSR 240-20.091(4)(D)). Some stakeholders proposed in the roundtables/workshops, and will likely propose in their comments, to increase the

number of periodic adjustments between true-ups to three, which is the number allowed for the RAM. Again, the Staff points out that the majority of the changes in environmental costs will be due to large capital investments. These are not costs that are likely to fluctuate greatly across a short period of time as fuel and purchased power costs may. Before any of these large investments can be allowed in rates, the Commission will need to make the determination that the equipment is “fully operational and used for service.” Fewer adjustments to an ECRM will help reduce the volatility of customer bills.

*The rate adjustment limit provision of SB 179 is annual and cumulative for each year.*

There was not much discussion in the ECRM workshops regarding exactly how to apply the rate adjustment limitation provision. The Staff is concerned that there may be different interpretations of the provision. (4 CSR 240 20.091(4)(C)). The provision states “Any rate adjustment made under such rate schedules shall not exceed an annual amount equal to two and one-half percent of the electrical, gas, or water corporation’s Missouri gross jurisdictional revenues...” Section 386.266.2. The Staff’s interpretation of this provision is that an adjustment equal to two and one-half percent is allowed each year: i.e., a maximum 2½% adjustment through year 1; a possible maximum cumulative 5% adjustment through years 1 and 2 if there was the maximum 2½% adjustment in each of years 1 and 2; a possible maximum 7½% adjustment through years 1, 2 and 3, if separate maximum cumulative 2½% adjustments occur in each of years 1, 2 and 3; and a possible maximum 10% adjustment through years 1, 2, 3, and 4, if separate maximum cumulative 2½% adjustments occur in each of years 1, 2, 3 and 4. This is based on the statutory language “shall not exceed an **annual** amount” meaning that each year’s maximum ECRM amount cannot exceed 2½%. (Emphasis added).

*The Commission can determine, in the general rate proceeding, whether a cost is a fuel/purchased power or environmental cost.*

There is a concern by some stakeholders that electric utilities may chose to identify an environmental cost as a fuel or purchased power cost to enable them to collect revenues greater than the 2½% annual limit on the ECRM. While this is a valid concern, neither

the Staff nor any other stakeholder was able to suggest language for the proposed rules to address this concern that other stakeholders could agree upon. The proposed rules do state that environmental costs do not include fuel and purchased power costs as defined in the RAM rules. (4 CSR 240-3.161(1)(E)1. and 4 CSR 240-20.091(1)(C)1.). The Staff is confident that the parties to the general rate proceeding will present to the Commission their positions on which cost items in the electric utilities books and records should be collected in a RAM and which should be collected in an ECRM. Given the different parties' positions, the Commission, in the general rate proceeding, will have the opportunity to ensure that environmental costs are not improperly classified as fuel and purchased power costs to circumvent the 2½% cap.

*Further defining “federal, state, or local environmental law, regulation, or rule” in Section 386.266.2 is not necessary.*

Several stakeholders were concerned that this provision of SB 179 was too undefined. For example, some commenters may propose that a city code or ordinance that imposes a limit on the electro magnetic field (EMF) from a power line should be considered an environmental regulation and the electric utility could recover the costs of meeting an EMF requirement through the ECRM. Several attempts were made to consider what possibly could fall within the language “federal, state or local environmental law, regulation or rule” to better define what could be recovered in the ECRM. The Staff believed that each of these attempts resulted in bounds beyond the language in SB 179. Therefore, it is the Staff’s position that without any further language appearing in the rules themselves attempting to define the statutory phrase “federal, state, or local environmental law, regulation, or rule,” the Commission should determine in the general rate proceedings establishing or modifying an ECRM exactly what costs comply with any “federal, state, or local environmental law, regulation, or rule” and should be recovered in an ECRM.