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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

COLLEEN M. DALE, Presiding,
CHIEF REGULATORY LAW JUDGE.

JEFF DAVIS, Chairman,
CONNIE MURRAY
ROBERT M. CLAYTON,
LINWARD "LIN" APPLING,
TERRY JARRETT
COMMISSIONERS

REPORTED BY:

KELLENE K. FEDDERSEN, CSR, RPR, CCR
MIDWEST LITIGATION SERVICES

APPEARANCES:

PAUL A. BOUDREAU, Attorney at Law
Brydon, Swearengen & England, P.C.
312 East Capitol
P.O. Box 456
Jefferson City, MO 65102-0456
(573)635-7166
paulb@brydonlaw.com

FOR: Missouri Energy Development Association (MEDA).
Aquila, Inc.

JAMES M. FISCHER, Attorney at Law
Fischer & Dority
101 Madison, Suite 400
Jefferson City, MO 65101
(573)636-6758

FOR: Kansas City Power & Light Company.

DIANA VUYLSTEKE, Attorney at Law
Bryan Cave, LLP
932 Southern Hills Court
Eureka, MO 63025
(314)259-2543
dmvuylsteke@bryancave.com

FOR: Missouri Industrial Energy Consumers.

STUART CONRAD, Attorney at Law
Finnegan, Conrad & Peterson
3100 Broadway
1209 Penntower Officer Center
Kansas City, MO 64111
(816)753-1122
stucon@fcplaw.com

FOR: Noranda Aluminum.

THOMAS BYRNE, Attorney at Law
P.O. Box 66149
1901 Chouteau Avenue
St. Louis, MO 63103
(314)554-2237

FOR: Union Electric Company, d/b/a AmerenUE.

LISA C. LANGENECKERT, Attorney at Law
The Stolar Partnership
911 Washington Avenue
St. Louis, MO 63101-1209
(314)641-5158

FOR: Missouri Energy Group.

JOHN COFFMAN, Attorney at Law
871 Tuxedo Boulevard
St. Louis, MO 63119
(573)424-6779

FOR: AARP.
Consumers Council of Missouri.

LEWIS R. MILLS, JR., Public Counsel
P.O. Box 2230
200 Madison Street, Suite 650
Jefferson City, MO 65102-2230
(573)751-4857

FOR: Office of the Public Counsel and the Public.

STEVEN DOTTHEIM, Chief Deputy General Counsel
P.O. Box 360
200 Madison Street
Jefferson City, MO 65102
(573)751-3234

FOR: Staff of the Missouri Public Service Commission.

P R O C E E D I N G S

JUDGE DALE: We are here today 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.

The first preliminary matter I would like to address before we actually take entries of appearance is to address the late-filed comments. We have two different kinds of late-filed comments. One set was filed by Noranda. It was one day late, and it was late due to unavoidable circumstances. And in light of the fact that it was only one day late, I'm going to accept those comments because I believe no party has been prejudiced in any way by them being late.

As to all other comments filed after that date, their prepared remarks, et cetera, the comment period ended on January 2nd. If you have filed late-filed comments and want to get them in the record, call a witness, have them read it into the record. At this point only testimony is permitted. No further comments are being allowed. So however you want to handle having copies distributed or just having it already filed in EFIS and having your witness read it, any of those options will work.

With that, let's go ahead with entries of

Q. Okay. Well, I will -- I certainly haven't read those comments that were filed just yesterday. And Ms. Mantle, I'm not asking for -- just generally speaking. I'm not looking -- I'm not going to -- I'm not looking to catch you in an inconsistency. I'm just trying to get a sense of where Staff stands on each of these issues. So just generally speaking, I want to ask about the annual cap as well as any potential limitations on the deferral that would go beyond that cap.

A. How we interpreted the legislation was that the first year a utility would be allowed up to two and a half percent increase; in the second year, an additional two and a half percent. Now, that would only be 5 percent if the first year there was two and a half percent and the second year there was two and a half percent. First year there was one percent, the next year there's two and a half, so it's a total of three, and so forth for all four years. So the maximum that the rates could increase would be 10 percent. The minimum of course is zero.

Q. Okay.

A. To give you -- if that answers your question on how we envision that?

Q. I think it does. That's fine. Now, on the decision of deferral, does Staff -- is Staff arguing for any restriction on the amount of the deferral, the amounts that would go beyond those percentages?

A. I'll throw that on to Greg Meyer.

MR. MEYER: No.

COMMISSIONER CLAYTON: No limitation?

MR. MEYER: The deferral, when you calculate the deferral, the deferral only kicks in after you've maxed out the two and a half percent each year.

COMMISSIONER CLAYTON: I understand.

MR. MEYER: So the deferral would carry to the next case.

COMMISSIONER CLAYTON: Okay.

MR. MEYER: Could potentially carry until the next rate case and then recovery could be sought.

COMMISSIONER CLAYTON: Right. Does Staff see any potential for that deferral being an incredibly high amount that would -- that would potentially be inappropriately high? Or, I mean, is there any circumstance where that deferral account would be an inappropriate deferral in Staff's opinion?

MR. MEYER: Well, I think the -- with the safeguards you have are, is that these expenditures that would create these large deferrals are predominantly going to be capital investments, and --

COMMISSIONER CLAYTON: That's my -- I'm going to get to that next question, so --

MR. MEYER: And that those are going to be related, or hopefully will track to an environmental compliance plan that's filed or that's shared with all the parties. So I could potentially see that, that you would have large investments between -- between rate cases. I don't -- I don't know that -- I think you'd have to look at each individual utility to determine the magnitude of the deferral that could approach -- I mean, for instance, AmerenUE has a very large revenue base and it's going to be able to sustain large amounts of investment to get to the two and a half percent where you start looking at the capital costs for additions. So it's going to be utility specific.

COMMISSIONER CLAYTON: Getting to that issue of comparison of the type of money that would go into this rate, and I suppose I'm classifying just into two groups here, your capital expense and then you'll just have your regular -- I assume there are regular expenses that would not be capitalized that could go into that?

MR. MEYER: Right.

COMMISSIONER CLAYTON: What does Staff expect in terms of a breakdown of the investments that go into these accounts? Is it -- do you see it being a 50/50 type of thing, an 80/20, 70/30? Do you see it being 100 percent capital? Does Staff have any idea what to expect?

MR. MEYER: I suspect that the largest portion of the identified environmental costs either in the rate base -- or I'm sorry, in your base rate calculation or in the future ECRM periodic costs will be driven by capital expense.

COMMISSIONER CLAYTON: So a large part, is that 51 percent, would you say, or is that 90 percent?

MR. MEYER: I don't have a percentage at this time. I think it's going to be greater than 50, capital versus expense.

COMMISSIONER CLAYTON: Does Staff have a position on whether there should be different treatment between a capital expense versus a -- just a regular one-time expense? Is there any difference that we should treat those types of investments in this rule?

MR. MEYER: Well, one-time expenses will, because you have the true-up, a one-time expense will be collected and then will be -- but that change will be reflected as a reduction on the next year.

So if you truly have a one-time expense, which I hadn't anticipated that, but that would be incurred, if it qualifies for the adjustment, would be put in the adjustment, and then the subsequent true-up periods, that expense will come out because you still have

FAC or the ECRM.

MR. MEYER: Well, I'll answer your question, but let's back up, too. Let's suggest that they go -- with your example that you're working on, that they go to a higher price coal but they don't have a fuel adjustment clause, that the -- that the Commission has found that this utility doesn't qualify for a fuel adjustment clause, and then the utility turns around and says, well, the reason I'm paying more for coal now is because I'm in compliance with a -- with an environmental rule.

I could foresee that you would be presented with a -- with an argument that would say that's not an environmental cost mechanism. That should have been -- that's more properly reflected in a fuel adjustment clause, which you found not to be appropriate for this utility.

So I mean, when you were playing the example, you were just painting off or using both mechanisms as plausible recovery mechanisms. You might actually find that a utility doesn't qualify for a fuel adjustment clause and then would have to address whether an increase in coal expense for compliance purposes should be included in the ECRM or not.

COMMISSIONER CLAYTON: Can you give me an

idea of -- does Staff have a position on these fringe issues or is it just deferring judgment until the time they come up? I mean, have you-all compiled a list of things that you'd think would be included or not included or what you anticipate the Commission should consider?

MR. MEYER: We haven't compiled a list to date, no.

COMMISSIONER CLAYTON: Does Staff believe that if we implement this rule, that there is the potential that utilities that use the rule have too good a chance to be earning beyond their authorized rate of return?

MS. MANTLE: That's a loaded question. I believe there's a potential for them to earn more than they're authorized. Now, whether this will be the cause of it or not, I don't -- but there is the potential there.

COMMISSIONER CLAYTON: Well, in your experience of auditing utilities, working with utilities, I'm assuming these expenditures are going to be quite -- it could be quite significant. Investments could be quite significant, and the surcharge potentially could be significant, relatively speaking.

Does Staff believe that the potential to earn beyond an authorized rate of return within that four-year window between rate cases, is the potential greater with an environmental clause than with a fuel adjustment clause?

MR. MEYER: I'm not sure that I can tell you which one has a greater possibility.

COMMISSIONER CLAYTON: You can tell me.

MR. MEYER: I don't know that I know the answer.

COMMISSIONER CLAYTON: Well, let's take -- take this example. You can do -- do either/or, and then I want to ask the question, if both surcharges were in place, does that change your answer?

MR. MEYER: Well, obviously any clause -- any time you have a mechanism that adjusts rates in between rate cases, the possibility that a utility can overearn is enhanced.

COMMISSIONER CLAYTON: It goes up?

MR. MEYER: Right.

COMMISSIONER CLAYTON: There's a greater chance of that going up?

MR. MEYER: Because absent the clause, the utility has to manage all of its costs and all of its revenues. You've now dissected a portion of its operations and said that it can increase its rates in between rate cases to cover those expenses. You -- you -- there's no -- there's no down side risk to that. The possibility for them to overearn, you've enhanced that possibility. That's just a given.

COMMISSIONER CLAYTON: Okay. And is that the case -- let's make this assumption, that all of the expenditures placed in the ECRM are capital expenditures, that you don't have any one-time expenses, so we avoid the issue of an expense being outside of the test year circumstance. You've got 100 percent of the expenditures are capital, and those are potentially going to go into the rate base in the next rate case, correct, if they're prudently incurred?

MR. MEYER: They go into rate base as soon as they --

COMMISSIONER CLAYTON: They go into rate base immediately?

MR. MEYER: Correct.

COMMISSIONER CLAYTON: Okay. Now, and then depreciation also kicks in at that point, and the accounting is set up to where you have the investment balance and the accumulated depreciation balance; is that right?

MR. MEYER: Right.

COMMISSIONER CLAYTON: All right. So potentially in that circumstance, ratepayers are going to get credit for that investment at some point through the reduction of rate base down the road?

MR. MEYER: Well, but it hasn't -- it hasn't been included in the revenue requirement calculation. Until it's included -- once you include it in the revenue requirement calculations, every day subsequent to that calculation that investment is -- is less value -- has less value than the day that you put it in the rates, barring no addition to the investment. I mean, they want -- after you establish rate base in a rate case, with no additions, that rate base is lower the next day, so that the earnings are over.

COMMISSIONER CLAYTON: Let me ask the question this way. I may get caught up. I tend to get easily confused in accounting issues.

But definitely you would be increasing cash flow for a utility with the addition of this surcharge regardless of what the investment is?

MR. MEYER: Correct.

COMMISSIONER CLAYTON: So the cash flow of the company is going to go up, the revenue of the company is going to go up. Do the earnings of the company also go up?

MR. MEYER: Absent not having it?

COMMISSIONER CLAYTON: Yes. But assume that it's 100 percent capital, I guess is what I'm saying.

MR. MEYER: Well, but when you have the rate mechanism, capital expenditures now equate to revenues to the company, and that will --

COMMISSIONER CLAYTON: But not necessarily earnings, okay?

MR. MEYER: Right. But -- yeah, I think your earnings will go up. I don't know that they will go up beyond -- I can't tell you that they will go up beyond what your authorized return is, because I don't know all the factors. You have to look at all the factors.

COMMISSIONER CLAYTON: But it's the earnings that you'd have to look at to determine whether they're earning greater than their authorized rate of return. It's not just revenues, I guess is my point. Revenue is one of the factors there.

MR. MEYER: You look at all the -- you look at all the operations, all the costs to operate the utility with the return on the investment and the taxes and all the operating expenses. Then you look at the revenue stream and you see if it's going to create -- if it generates the return that you put into the rate base.

COMMISSIONER CLAYTON: Does Staff believe that there should be any study of the earnings of a company either before or during the implementation of an ECRM, notwithstanding prior Commission decisions, I guess?

MR. MEYER: It's our opinion that you get the study when you have a general rate proceeding that establishes the ECRM or not. We believe we're precluded between the periods.

COMMISSIONER CLAYTON: You don't believe -- you think the law doesn't permit you to do that study; is that what you're saying?

MR. MEYER: Well, if we find that -- if we would find that we believe the utility was overearning, we'd file a complaint.

COMMISSIONER CLAYTON: How would you know unless you're doing a study?

MR. MEYER: Well, in the rules is a section on surveillance, and -- so we will have the data to track the utility to determine if we believe they're overearning.

COMMISSIONER CLAYTON: How detailed is that surveillance? How deep does it go? Is it a matter of just reviewing an SEC filing, or is it doing --

MR. MEYER: No. It's income statement, rate base and revenues. It's the same basis that we would use today to determine whether we believe the Staff should initiate a complaint against a utility. In fact, it's probably even more detailed.

COMMISSIONER CLAYTON: But how often do you conduct those studies right now? I mean, that's not something that we're necessarily aware of up on the ninth floor, I don't think.

MR. MEYER: Right.

COMMISSIONER CLAYTON: We don't know that, do we?

MR. MEYER: No.

COMMISSIONER CLAYTON: Right. I mean -- so how often does that occur, I guess?

MR. MEYER: We -- I haven't -- I didn't get a chance to visit with the person, but we have a person in the auditing department that monitors the surveillance.

COMMISSIONER CLAYTON: For each utility or is there a person for each utility?

MR. MEYER: I believe we only do the electric and gas, and I think she -- there's just one person there.

COMMISSIONER CLAYTON: One person who does all of them?

MR. MEYER: Well, it's just a matter of -- once you set up the template it's just a matter of inputting data that's provided I believe quarterly.

COMMISSIONER CLAYTON: Does Staff have a threshold that it considers whether certain actions are required, certain actions meaning a complaint to reduce rates, to instigate a rate case versus maybe something that triggers additional surveillance? Is it a certain percentage over authorized rate of return? Is it 50 basis points, 100 basis points? Is it one basis point?

MR. MEYER: It's a combination of the fact that we -- that we're -- different auditors are directly involved with different utilities and know fairly well or can at least have an idea where that utility is earning. We have to mesh that against, though, the current workload. Obviously before we would initiate complaints, we would look at the current rate case workload for the Staff to determine if it would indeed be possible to initiate a complaint.

COMMISSIONER CLAYTON: All right. So if you're not busy, then what -- what -- you know, what percentage basis points would it be?

MR. MEYER: We don't have a basis point.

COMMISSIONER CLAYTON: Okay. So what criteria do you use?

MR. DOTTHEIM: But it wouldn't be a situation where the company was, at least in our view, marginally overearning.

COMMISSIONER CLAYTON: Give me -- I'm trying to find out what's marginally mean. Give me an idea what's --

MR. DOTTHEIM: We would be observing on a -- on a regular basis the earnings of the company, and if we thought there was reason to seek even additional information, we would seek additional information. I don't know that there's any -- you know, I'll turn it back to Greg -- that there's any one particular trigger to that. It's something that depending upon the situation, would cause us to give that particular company greater scrutiny over a period of time and possibly cause us to put auditors into the field.

COMMISSIONER CLAYTON: So basically, you have one person that reviews the statements, what is it, statement of cash flows? What were the statements that you referred to earlier?

MR. MEYER: Called surveillance reports.

COMMISSIONER CLAYTON: Surveillance reports. You've got one person looking at those reports, and they make sure that the utility or that all Missouri electric and gas utilities are not earning too high over their authorized rate of return. Is it fair to say that at some point if they are earning greater than what their authorized rate of return is, at some point it triggers additional study or scrutiny, I think is what Mr. Dottheim said?

MR. DOTTHEIM: Yes.

COMMISSIONER CLAYTON: Do you believe that -- that's a more appropriate way of doing it than just 100 percent in surcharge?

MR. MEYER: I would think you'd have to just look at the circumstances of when the ECRMs are approved.

COMMISSIONER CLAYTON: I thought you were going to say that.

MS. MANTLE: I might add that with the proposed version of the rule, we ask for net increases and decreases to be looked at. That allows to take into consideration depreciation and property tax, other things that may have decreased versus other parties who have -- have other opinions on what that should be. So that netting of cost could benefit the consumer also.

COMMISSIONER CLAYTON: The netting?

MS. MANTLE: Yes, because it would take into account some of the decreases in the cost.

COMMISSIONER CLAYTON: Okay. So aside from the ROE, are there any other benefits that the customer would receive by implementation of this ECRM? Do they get a cleaner world? Do they get less of a carbon footprint, that type of thing?

MR. MEYER: I was going to say they should be --

COMMISSIONER CLAYTON: Or are those things going to happen regardless? I mean, those things may be mandated and they're going to happen regardless. That's what I'm trying to --

MR. MEYER: Right. Most of this compliance is going to be done. It's just that there has been a rate mechanism suggested that they can deal with those costs in between rate cases, you know. Except for the reduction in the return on equity, I can't think of anything else in the ratemaking concept besides the sharing, and I think it's important what Ms. Mantle brought up, the netting. I think that's very important. That's another consumer at least advantage, that I don't know that --

COMMISSIONER CLAYTON: Protection?

MR. MEYER: Protection.

COMMISSIONER CLAYTON: So I mean, this is work that's going to be done, it's an investment that's going to be done regardless of whether this rule is in place; would you agree with that statement?

MR. MEYER: That's the purpose of the rule, right.

COMMISSIONER CLAYTON: And it's not -- it's not going to change the timing of the investment necessarily, the only change is when the recovery begins?

MS. MANTLE: It may change the timing if a utility decides to install something earlier than required by the law.

COMMISSIONER CLAYTON: Earlier than mandated.

MS. MANTLE: They may be able -- when there's a deadline, say, of 2011 and every utility in the country waits until the last minute to start, then the costs to implement any of those types of measures would be greatly increased. Laborers would be harder to find, so forth. So a utility that might start earlier could perhaps have lower cost installing the technology.

COMMISSIONER CLAYTON: I'll pass to Commissioner Jarrett. Thank you.

COMMISSIONER JARRETT: Thank you. I just had one question regarding relating to the ISRS. Could you elaborate on Staff's position that procedures outlined in the ISRS rules, I guess, aren't adequate or wouldn't -- wouldn't be appropriate in the context of the environmental rules? Can you elaborate on that, on why the ISRS procedures are not adequate?

MR. MEYER: Well, the way we interpreted 179 is that it said increases and decreases in expenses and capital costs. To effectuate that, you have to -- in our opinion, you have to identify an environmental rate base that exists when you set rates in the general rate proceeding.

That language, the increases and decreases is not present in the ISRS language and in the ISRS process, all that's done is the old investment is netted against the new investment. And in this way, in order to measure the increases and decreases that have occurred, in either their capital expenses are -- or other expenses is to establish this base up front in a rate case and then to track that and use that as the -- the beginning number or the base number for which the two and a half percent can then be applied for the new environmental compliance costs.

COMMISSIONER JARRETT: Okay. Ms. Mantle, any elaboration beyond that?

MS. MANTLE: No, sir.

MR. MEYER: One other thing. ISRS just deals with capital expenditures. This legislation deals with both expenses and capital expenditures. The other argument is that to establish the environmental rate base, as I think you've read in some comments, could be burdensome, and as Ms. Mantle had said earlier, we don't believe that to be the case. We think a workable solution can be developed in the context of a general rate proceeding where an ECRM would be proposed for each company at the time they file their rate proceedings to establish what that environmental rate base should be. We're not looking for fans or pumps or drains, I'm sorry, to be included. They're not of a significant investment dollar that would require identification.

COMMISSIONER JARRETT: All right. Thank you. That's all I have, Judge.

JUDGE DALE: Thank you. Chairman?

CHAIRMAN DAVIS: All right. Mr. Meyer, without going into any -- any individual company's highly confidential information, hypothetically speaking, let's say you have a nuclear power plant like Callaway. What's rate base -- what's environmental rate base?

MR. MEYER: For the nuclear facility?

CHAIRMAN DAVIS: Uh-huh. Or you can pick a coal plant and --

MR. MEYER: I'm not that familiar with the technologies that are available to meet environmental compliance. A coal plant --

CHAIRMAN DAVIS: Okay. Use a coal plant.

MR. MEYER: One thing that jumps out at me is scrubbers. Okay. So you install scrubbers in the power plant, that would be environmental compliance.

CHAIRMAN DAVIS: Baghouses?

MR. MEYER: Baghouses, right. I'm sure there's other technologies out there. I'm just not -- I'm not up to speed on all of those at this time.

CHAIRMAN DAVIS: Okay.

MR. MEYER: Those are the types of facilities that we would be looking for to be identified.

CHAIRMAN DAVIS: Judge, I don't think I have any more questions for Mr. Meyer or Ms. Mantle.

JUDGE DALE: Thank you. Does Staff have anything else to add?

MR. MEYER: I guess there is one, and that is, there's a dispute among some of the parties about the number of filings should be made each year. The rule as developed and presented to you today suggests that there's two filings each year, one which is in context with a true-up and then another one that the utility can file at their own discretion.

It's our belief, it's the Staff's belief that those -- that is a sufficient number given the fact that we believe that the major driver of these periodic adjustments will be capital investments and that two filings within the year should be sufficient to capture those additional capital investments to meet the compliance rules.

JUDGE DALE: Thank you. It is now 12 o'clock. Let us break until 1:15, and we will come back for MEDA and Aquila. Off the record.