COMMITTEE ON LEGISLATIVE RESEARCH
OVERSIGHT DIVISION

FISCAL NOTE

L.R. No.: 4103-02
Bill No.: SB 1124
Subject: Public Service Commission; Utilities
Type: Original
Date: February 9, 2004

FISCAL SUMMARY

ESTIMATED NET EFFECT ON GENERAL REVENUE FUND			
FUND AFFECTED	FY 2005	FY 2006	FY 2007
General Revenue	($554,571)	($521,618)	($206,564)
Total Estimated Net Effect on General Revenue Fund	**($554,571)**	**($521,618)**	**($206,564)**

ESTIMATED NET EFFECT ON STATE FUNDS			
FUND AFFECTED	FY 2005	FY 2006	FY 2007
Public Service Commission Fund*	$0	$0	$0
Total Estimated Net Effect on All State Funds	**$0**	**$0**	**$0**

*Assumes costs to the Fund of $420,347, $470,275, and $482,179 and offsetting increases in assessments against regulated utilities in the next three fiscal years.

Numbers within parentheses: ( ) indicate costs or losses.
This fiscal note contains 12 pages.

ESTIMATED NET EFFECT ON FEDERAL FUNDS			
FUND AFFECTED	FY 2005	FY 2006	FY 2007
Total Estimated Net Effect on All Federal Funds	**$0**	**$0**	**$0**

ESTIMATED NET EFFECT ON LOCAL FUNDS			
FUND AFFECTED	FY 2005	FY 2006	FY 2007
Local Government	**$0**	**$0**	**$0**

FISCAL ANALYSIS

ASSUMPTION

Officials of the **Department of Economic Development - Public Service Commission (PSC)** state this proposal would implement an electric fuel and purchased power adjustment clause for the regulated electric utilities in the state of Missouri if the PSC finds them to be in the public interest. This would result in additional filings, audits, prudency reviews and associated proceedings.

In reviewing this draft legislation's different provisions and assessing their impacts to the PSC, a number of assumptions regarding how the number of Full Time Equivalents (FTE) was arrived at are important to understand. PSC assumes the utilities that have the option to utilize the provisions of this legislation will do so if they believe that an increase in revenues may result from this effort. In fact, it is their fiduciary responsibility to do so if they believe that revenues will be enhanced. The provisions of this legislation may result in increased revenues, through increased rates, for the regulated electric utilities in Missouri.

These increases in rates would impact Missouri's industries, business owners and residential customers. In cases before the PSC one of the issues that must be considered is the need to balance rate increases that help Missouri's utilities versus how these higher rates result in it being more expensive to do business in Missouri and live in Missouri. Missouri's current rates are below national averages but so is Missouri's average income.

ASSUMPTION (continued)

In looking at the needed PSC staff to perform the tasks required by this legislation, it is important to consider the existing regulatory environment. Surcharges that cover certain portions of utility expenses and ignore others create incentives to shift costs to areas where they can be assessed through surcharges for increased revenues. Given the range of costs defined in this legislation, PSC believes that efforts to shift costs to surcharges will take place. In fact, PSC regularly deals with efforts by parties to broaden the definition of what costs can be passed through the current natural gas utility purchased gas adjustment surcharge.

Also, the first Infrastructure System Replacement Surcharge petition to the PSC, as newly permitted by HB 208 from the last session, had costs included in it that were not allowed by the legislature. These inappropriate costs were detected by the PSC during its audit and litigated. The surcharges in this legislation will require significant effort to evaluate, monitor and review if they are to work as the legislation intends.

When assessing the potential for fraudulent behavior, PSC typically starts its review by looking for two things: 1) the opportunity to abuse and 2) the incentives to abuse. The language in this legislation provides for opportunities for abuse that will take significant PSC staff resources to regulate. Some of Missouri's utilities are having difficulty getting unsecured debt at this time due to unregulated operations losses, low equity due to company policies outside of regulation and a tighter capital market, and this legislation will provide them an opportunity to acquire money from their ratepayers through another mechanism at a favorable interest rate if the provisions of this legislation are not properly implemented and regulated.

Even if PSC determines that the decisions of a utility were not prudent and the PSC issues an order requiring refunds, the utility can appeal that decision. Based on how the natural gas purchased gas adjustment clause is operating, it is clear that these appeals can, and often do, take years to work through the courts. Since the utilities have full time counsel, they have incentives to pursue this course of action to possibly overturn the decision, or at the very least, extend the date on which such penalties actually have to be paid. While this litigation continues, it costs more to live and do business in Missouri.

PSC assumes when assessing the impact of this legislation, it may be helpful to be aware of the following statistics. Based on 2000 census information, the State of Missouri has approximately 2.2 million households with an average number of people per household of 2.48. The median household annual income is approximately $37,900. In 2000 about 70% of the households in Missouri (over 3.8 million people) were dependant upon a regulated electric utility for service. In 2000 the average Missouri residential customer paid over $870 for electric service (before

ASSUMPTION (continued)

taxes). This legislation could result in new surcharges that can regularly change on electric bills for a significant majority of the state's population. All customers of regulated electric utilities (residential, commercial, and industrial) could feel these impacts. Some of these customers can barely afford to maintain their current financial burdens.

In looking at the potential number of additional filings and FTE that this legislation could result in, it is necessary to look at the different provisions that the legislation contains separately while keeping in mind potential synergies between new and existing PSC staff in evaluating needed FTE. A summary of the staffing additions associated with this legislation is provided below and described in more detail in the sections that follow. PSC notes that even though this analysis provides for the addition of 7 FTE, the effective number of staff that would be added would be significantly less than 7 due to the proposed redirection of several FTE to support the Public

Service Commission Advisory Staff contemplated in Section 386.135. A number of these redirected positions of the PSC staff represent senior position vacancies due to retirements. Also, PSC is currently losing positions to retirements under recent legislative incentives that permit only 25% of the vacancies to be filled.

PSC assumes several provisions of this legislation amount to short-cuts to current regulations. These short-cuts will result in PSC reviews of actual costs and prudence of utility management decisions that do not regularly take place under current regulations. The number of cases filed with the PSC has increased far out of proportion to the increases in PSC staff over the last 17 years. Unfortunately the provisions of this legislation do not appear to provide for any significant counterbalancing reductions in any current areas of PSC staff responsibility. Detailed descriptions of how the numbers below were arrived at are provided in the sections that follow.

Additional FTE associated with this legislation:
3 Auditors
1 Rate & Tariff Examiner
1 Engineer
1 General Counsel
1 Judge
Total = 7 FTE, but actual increase in PSC staff working on these cases is significantly fewer than 7 FTE due to potential redirection of existing FTE to PSC Advisory Staff and inability to fill all vacancies due to retirements. Seven FTE represent a 3% increase in PSC staff. In the last 17 years, PSC staff has grown 7% to address a 244% increase in cases.
ASSUMPTION (continued)

Additional filings associated with provisions of legislation:

Provisions	Assumed # of Filings
Electric Fuel & PP Clause	18 Filings

The analysis of this legislation has been broken out below based on each of the provisions in the legislation.

Electric Fuel & Purchased Power Adjustment Clause

Fiscal Note Impact: Additional Workload
New quarterly electric surcharge filings (assumed 3 of the possible 5 utility districts would be permitted to implement) that will include operations audits, fuel and purchased power price reviews and PSC staff recommendations for each PSC decision.

New annual true-up audits of all incurred fuel expenses and revenues – will result in annual cases before the PSC to determine ACA balances.

New annual prudence audits of all fuel and purchased power decisions – will result in cases before the PSC to address any prudence issues each year.

Increase in level of consumer inquires and complaints.

May result in a reduction in rate cases. Although this is certainly not a foregone conclusion, new power plants, significant changes in interest rates, significant changes in corporate structure and/or mergers and acquisitions, and PSC or OPC complaint cases can all trigger rate cases. PSC notes that in his dissenting opinion in a case related to the electric fuel adjustment clause that existed prior to the MO Supreme court decision in 1979, Commissioner Fain noted that the FAC had not appeared to reduce the number of rate cases being brought before the PSC.

Lengthy true-up and prudence assessments with highly litigious process for recovery of imprudent expenditures. Utilities often appeal prudence decisions in a process (outside of the PSC) that takes years to resolve.

Additional Number of Filings Estimate:
Assumed that 3 of the possible 5 utility districts will file quarterly electric fuel adjustment clauses. This adds up to 12 fuel adjustment filings per year.

ASSUMPTION (continued)

Each of these three utilities will be subject to true-up audits. This adds up to 3 true-up audits per year.

Each of these 3 utilities will be subject to prudency audits each year. PSC strongly recommends avoiding tri-annual prudence reviews as the availability of information and knowledgeable personnel to assess these very complicated transactions will be extremely difficult to manage on a three-year review cycle. The annual prudence review would take place during the annual true-up audit. This adds up to 3 prudency audits per year.

Total Number of Filings Used for FN Estimate = 18 per year (12 + 3 +3)

Requested FTE:
Requesting 6 FTE for non-adjudication divisions. This is based on current resources to address natural gas PGA/ACA process that this legislation would create for the electric utilities – even though electricity procurement and prudence assessment is more complicated and the opportunities for abuse are greater while more difficult to detect.* Adjudication impacts are described below in the section titled "Adjudication Division Analysis of Fiscal Note Impact."

1 Manager – Responsible for organizing department cases and assigning of staff. Will act as expert witness in some cases with new or difficult to understand issues. Responsible for administrative functions of PSC. Responsible for developing training programs for existing staff to be in a position to perform the activities relied upon to reduce the number of requested FTE.

1 Engineer – Responsible for modeling of generation options available to each utility with an objective of optimizing operation of the utility for least costs.

2 Auditors – Responsible for conducting the annual true-up and prudency audits of the expenses and revenues associated with the energy adjustment surcharges.

1 Rate & Tariff Examiner – Responsible for reviewing and responding to quarterly energy adjustment filings.

1 Senior General Counsel – Responsible for coordinating cases before the PSC with involved staff and representing staff in hearings before the PSC.

*Natural gas procurement and delivery involves gas supply basins and contracts, transportation pipelines and contracts, storage fields and contracts, appropriate planning, hedging and reliable service. Electric generation and delivery is fundamentally different. Electric utilities do not typically purchase fuel for direct delivery. Fuel is used by electric utilities to generate electricity, and they have options as to which fuels to use, when to use them, where to buy them, which units to operate, which units to take down for maintenance, when to perform maintenance, what hedging strategies to pursue, what excess power they can sell, and which power purchase contracts to execute as well as many other management decisions. All of these decisions have direct impacts on fuel and purchased power cost.

2 Auditors – Assumed that existing auditors will be at least partially available to assist in true-up and prudency audits during times when numerous cases with significant surcharge increases occur at the same time. Also assumed reduced rate case load (primarily Aquila and Empire) may provide for available auditors to check filing numbers and assist in true-up audits.

1 Consumer Services Specialist - Assumed that existing consumer service staff would be able to address the increase in consumer calls on the fuel adjustment surcharges on their bills.

Oversight has, for fiscal note purposes only, changed the starting salary for the requested 7 FTE to correspond to the second step above minimum for comparable positions in the state's merit system pay grid. This decision reflects a study of actual starting salaries for new state employees for a six month period and the policy of the Oversight Subcommittee of the Joint Committee on Legislative Research.

Officials of the **Department of Economic Development - Office of the Public Counsel (OPC)** state this proposed legislation would significantly increase the work load associated with fuel expenses for electric utilities. Currently, fuel is primarily addressed only during rate cases which have a frequency of once every 2-3 years per electric utility. This legislation would increase those reviews to four times per year for each utility (4 major electric utilities, one of which has 2 separate divisions).

In addition, the bill provides for an annual true-up mechanism for each utility's fuel clause which would require annual audits of actual revenues received and actual costs incurred. Further, the bill provides for a "full prudence review" of the utility's affairs regarding fuel on a historic basis once every three years, at a minimum. These prudence audits would require the opportunity for litigated proceedings and would be in addition to the fuel annualization processes in rate cases (which are forward looking and not historic in nature).

OPC believes that implementation of electric fuel cost prudence reviews would in practice be similar in frequency to the reviews of natural gas utilities purchase gas practices which occur annually as part of the true-up process. However, the complexity of fuel cost reviews for electric corporations would be much greater than PGA gas reviews and require the review of many more fuel source options and other variable inputs.

The Office of the Public Counsel would require an engineer or an economist, an accountant, an attorney, and an additional support staff person to handle the annual duties created by this bill. This bill would also require OPC to purchase an economic electric dispatch model software which would cost approximately $40,000. (This is the amount the Public Service Commission paid for its software.) The annual license for the Fuel Model would run in the neighborhood of $4,000. (Price previously quoted from the Public Service Commission's existing annual license cost.) It is projected that the FY 2005 cost for the license fee would be due September, 2004 (FY 2005).

The bill requires a rate case prior to implementation by any company, except in limited circumstances. A rate case for each company would have been required nonetheless to determine specific fuel costs in order to prevent the FAC from providing double compensation from ratepayers. OPC would need to hire fuel consultants for the rate case necessitated by this bill, for each electric company, at $40,000 per audit. Furthermore, for each necessary rate case, the OPC would need to hire outside experts in each of the following disciplines: outside auditors (estimated at $80,000 per case); financial analysts ($20,000); and rate design experts ($20,000) totaling $160,000 per case for outside consultants.

The expenses described above are one time expenses associated with each company filing a rate case in order to determine base fuel costs (2 cases in FY05; 2 cases in FY06). OPC assumes that two cases will occur immediately and two cases will follow in the subsequent fiscal year.

As to space and accommodations for 4 new employees within the Office of Public Counsel, current workspace would have to be reorganized. Cubicles and furnishing would need to be furnished for new technical personnel. Two cubicles areas could easily be modified to accommodate two of the positions, however, two full systems would be needed. Also, necessary equipment would include four computers, an additional printer, and copy machine.

The Public Utility Engineer/Economist would be needed to perform economic electric dispatch modeling and resulting fuel and purchased capacity costs of each utility to determine the accuracy of each company's request to recover these costs, and to investigate purchased capacity

ASSUMPTION (continued)

and energy costs to determine whether the utility performed in a prudent and reasonable manner in purchasing capacity and energy. These duties would be performed on an annual basis.

OPC would need one additional Public Utility Accountant I to collect and correlate the additional data associated with fuel and purchase power. Also, this accountant would have to perform audits on the fuel purchasing decisions of the company. This includes the potential four filings made per year per company, plus a true-up audit to determine the actual purchasing activities.

OPC does not currently have a sufficient number of attorneys to represent utility customers in any additional proceedings. The additional 30 FAC proceedings per year would require an attorney to present the witnesses and legal arguments on contested issues to the Public Service Commission regarding prudent and reasonable energy cost purchasing, as well as handle the many issues relating to the complex interplay between the various FAC cases will have with each electric utility's general rate cases.

OPC already experiences a low support staff/professional ratio. With the addition of two full-time technical positions and an attorney, OPC's current two support positions would be extremely burdened with the additional duties this would incur. An additional support staff position will be within the best interests of the OPC in order to maintain the level of support required to existing and requested professional/technical personnel. This would be a Senior Office Support Assistant (clerical) position.

Oversight has, for fiscal note purposes only, changed the starting salary for the requested 4 FTE to correspond to the second step above minimum for comparable positions in the state's merit system pay grid. This decision reflects a study of actual starting salaries for new state employees for a six month period and the policy of the Oversight Subcommittee of the Joint Committee on Legislative Research.

Oversight assumes the Public Service Commission would adjust assessments against regulated utilities to offset increased costs due to this proposal; however, the amount of assessment against regulated utilities is limited to one-forth of 1 percent (.0025) of gross intrastate operating revenues of all utilities under PSC jurisdiction. If assessments are insufficient to cover PSC costs, then the PSC would have to seek an increase in the amount which may be assessed or seek funding for the PSC from different sources.

FISCAL IMPACT - State Government	FY 2005 (10 Mo.)	FY 2006	FY 2007

GENERAL REVENUE FUND

Cost - Office of Public Counsel			
Personal Service (4 FTE)	($112,914)	($138,884)	($142,356)
Fringe Benefits	($46,746)	($57,498)	($58,935)
Expense and Equipment	($394,911)	($325,236)	($5,273)
Total Cost - OPC	($554,571)	($521,618)	($206,564)
ESTIMATED NET EFFECT ON GENERAL REVENUE FUND	**($554,571)**	**($521,618)**	**($206,564)**
PUBLIC SERVICE COMMISSION FUND			
Income - Increased Assessments on Regulated Utilities	$420,347	$470,275	$482,179
Cost - Public Service Commission			
Personal Service (7 FTE)	($253,349)	($311,620)	($319,410)
Fringe Benefits	($104,886)	($129,011)	($132,236)
Expense & Equipment	($62,112)	($29,644)	($30,533)
Total Cost - PSC	($420,347)	($470,275)	($482,179)
ESTIMATED NET EFFECT ON PUBLIC SERVICE COMMISSION FUND	**$0**	**$0**	**$0**

FISCAL IMPACT - Local Government	FY 2005 (10 Mo.)	FY 2006	FY 2007
	$0	**$0**	**$0**

FISCAL IMPACT - Small Business

Small businesses would be impacted as a result of this proposal only to the degree that electric utility rates are impacted.

KS:LR:OD (12/02)

DESCRIPTION

This proposal allows electrical companies to recover all reasonable and prudent costs incurred for fuel delivery and variable cost components of purchased electrical energy through energy cost adjustment schedules. Companies can pursue this option either through filing a proposed schedule with the Public Service Commission (PSC) as part of a general rate proceeding or in cases where the PSC has explicitly permitted the option in another contested proceeding.

Under this proposal, the PSC shall establish and implement a true-up mechanism, which will remedy any over or under collections from previous adjustment periods through inclusion of such over or under recoveries in subsequent cost adjustments.

The PSC shall allow modification of energy adjustment schedules every ninety days to reflect varying fuel and purchased energy costs reflected in the permanent base rates filed with the PSC.

Electrical corporations are not allowed under this act to collect energy cost adjustments for a period exceeding three years unless it has been explicitly permitted to do so by the PSC. Once the corporation has begun collecting costs under such an agreement, the corporation shall not discontinue the use of an energy adjustment clause unless it has been explicitly permitted to do so by the PSC.

Nothing in this proposal allows corporations to avoid any rate freeze, moratorium, or other commitments made in connection with a prior proceeding settlement. Nothing shall be construed as limiting the authority of the PSC to review and consider fuel and purchased energy costs.

The PSC may take into account any reduction in business risk to an electrical corporation resulting from the energy adjustment clause in setting the electrical corporation's allowed return in any rate proceeding.

This proposal provides the PSC with the authority to implement mechanisms designed to provide the electrical corporation with incentives for performance in the acquisition of fuel and purchased power.

DESCRIPTION (continued)

The proposal directs that any corporation adopting an energy adjustment clause conduct its affairs in a reasonable and prudent manner, with its actions being subject to prudence review at least once every thirty-six months. Every corporation operating under an energy adjustment clause shall reconcile its differences between the revenues resulting from such adjustment and the appropriate pretax revenues found by the PSC during that time; such a reconciliation shall occur every twelve months and be subject to review by the PSC.

This legislation is not federally mandated, would not duplicate any other program and would not require additional capital improvements or rental space.

SOURCES OF INFORMATION

Department of Economic Development
Public Service Commission
Office of the Public Counsel

Mickey Wilson

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February 9, 2004