BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Union Electric Company d/b/a AmerenUE for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers In the Company's Missouri Service Area.	))))	Case No. ER-2008-0318

STAFF'S CORRECTED BRIEF

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TABLE OF CONTENTS

Introduction 3

Argument 3

1. Overview and Policy 3
2. Cost of Capital Issues 6
   a. Return on Equity 8
   b. Capital Structure 19
3. Vegetation Management and Infrastructure Inspection and Repair 20
4. January 13, 2007 Ice Storm Accounting Authority Order (AAO) 31
5. Deferred Income Taxes 36
6. Entergy Arkansas Equalization Costs in SO_2 or Other Tracker **(Settled)** 38
7. Off-system Sales **(Settled)** 38
8. Fuel Adjustment Clause **(Settled in Part)** 38
9. Callaway Unit II Combined Construction And Operating License Application (COLA) Costs 68
10. MISO Day 2 77
11. Incentive Compensation and Restricted Stock Compensation / Performance Share Unit Plans 80
12. Depreciation 91
13. Demand Side Management 93
14. Low-Income Weatherization 94
15. Pure Power Program (Voluntary Green Power Program / Renewable Energy Credits (RECs)): 99
16. Union Issues 108
17. Hot Weather Safety Program 108
18. Certain Power On and Dollar More Advertising Expense 108
19. Class Cost of Service and Rate Design 117

A Consideration of Commission Jurisdiction 127

Prayer 142

Certificate of Service 143

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COMES NOW the Staff of the Missouri Public Service Commission, by and through the Commission's General Counsel pursuant to § 386.071, RSMo, and Commission Rule 4 CSR 240-2.040(1), and for its Post-Hearing Brief, states as follows:

Introduction

AmerenUE initiated this case on April 4, 2008, by filing tariff sheets proposing a rate increase of $251 million on an annual basis, slightly more than 12% of its Missouri jurisdictional electric service revenues.[1] This increase is necessary, according to UE, because it "is continuing to face significant and continuing increases in many, probably most, of the costs that it takes to provide service to its customers,"[2] which increases, Ameren contends, "far outstrip what we might think of as normal inflation."[3]

Staff's Post-Hearing Brief follows the order of issues established for the hearing.

Argument

1. **Overview and Policy**: Overview of "cost of service," and / or what policy considerations, if any, should guide the Commission in deciding this case?

[1] Cover letter of April 4, 2008, filed by AmerenUE with the proposed tariffs that initiated this docket (EFIS Item No. 1 in docket ER-2008-0318). Staff's True-up Reconciliation, filed on January 5, 2009, shows that the Company's case is now worth $187,829,805, which is just less than 9% of UE's Missouri-jurisdictional revenues on an annual basis. (EFIS Item No. 564).

[2] Tr. 13:43-44 (Lowery, in AmerenUE's opening statement).

[3] *Id.,* at 44.

Staff's position: The Staff's cost of service for AmerenUE reflects the appropriate revenue requirement for setting rates in this case.

There is only one policy consideration that should guide the Commission in deciding this case and that is the public interest. What does the public interest require? It requires that the Commission strike an appropriate balance between the interests of UE's shareholders and the interests of UE's customers. What is that balance? It is a rate structure that produces just enough money for UE to serve the present and future interests of the citizens of Missouri and not a penny more.

That formulation may sound parsimonious, but it is not. A just and reasonable rate, after all, is sufficient to cover the Company's prudent operating and maintenance expenses and sufficient to enable it to undertake necessary improvements, to attract capital, to maintain its creditworthiness, and to access the financial markets at reasonable cost. It is enough, in short, for a healthy company.

The Commission's statutory task in this case is to set just and reasonable rates.[4] A "just and reasonable" rate is one that is fair to both the utility and its customers;[5] it is no more than is sufficient to "keep public utility plants in proper repair for effective public service, [and] . . . to insure to the investors a reasonable return upon funds invested."[6] Staff respectfully reminds the Commission that "the dominant thought and

[4] Sections 393.130, 393.140, RSMo.

[5] *St. ex rel. Valley Sewage Co. v. Public Service Comm'n,* 515 S.W.2d 845, 850 (Mo. App., K.C.D. 1974).

[6] *St. ex rel. Washington University et al. v. Public Service Comm'n,* 308 Mo. 328, 344-45, 272 S.W. 971, 973 (banc 1925).

purpose of the policy is the protection of the public . . . [and] the protection given the utility is merely incidental."[7]

Ratemaking is a two-step process. The first step is the determination of the "revenue requirement," that is, the amount of revenue the utility must receive to pay the costs of producing the utility service while yielding a reasonable rate of return to the investors.[8] The second step is the development of an equitable rate design, that is, the construction of tariffs that will collect the necessary revenue requirement from the ratepayers in a way that reflects the cost of serving each class of customer.

Revenue requirement is usually established based upon a historical test year which focuses on four factors: (1) the rate of return the utility has an opportunity to earn; (2) the rate base upon which a return may be earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating expenses.[9] The calculation of revenue requirement from these four factors is expressed in the following formula: [10]

$$RR = C + (V - D) R$$

where:

RR	=	Revenue requirement;
C	=	Cost of service including depreciation expense and taxes;
V	=	Gross value of utility plant in service;
D	=	Accumulated depreciation; and
R	=	Overall rate of return or weighted cost of capital.

Staff urges the Commission to resolve the many issues submitted to it for resolution in this case as recommended by Staff in order to achieve just and reasonable

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[7] *St. ex rel. Crown Coach Co. v. Public Service Comm'n,* 238 Mo. App. 287, ___, 179 S.W.2d 123, 126 (1944).

[8] *St. ex rel. Capital City Water Co. v. Missouri Public Service Comm'n,* 850 S.W.2d 903, 916 n. 1 (Mo. App., W.D. 1993).

[9] *Id.*

[10] *In the Matter of The Empire District Electric Company,* 13 MoPSC3d 350 (*Report & Order,* March 10, 2005).

rates that will survive scrutiny on appeal.

2. **Cost of Capital Issues:**

Introduction:

The cost-of-capital issues that the Commission faces in this case are both important and onerous. The issues are Return on Common Equity (ROE) and Capital Structure. The former represents the profit that will be returned to AmerenUE's shareholders; the latter concerns the proportions of the different sorts of capital in UE's capital structure. These issues are important because they directly determine the financial health of the Company and the costs that the ratepayers must bear. They are onerous because, in the case at least of ROE, the correct answer cannot easily be determined.

If the Commission awards an ROE that is too low, then UE "will be at a disadvantage in obtaining the capital it needs to continue to maintain and improve its infrastructure."[11] It will pay higher costs to access necessary capital,[12] and these higher costs will inevitably be passed on to ratepayers. It may have to forgo borrowing money and its ability to make desirable and necessary improvements will be compromised.[13] UE complains that "despite having completed a rate case just 19 months ago, the company has been unable to earn the ROE that was authorized by the Commission just about a year and a half ago."[14] In testimony, Ameren quantified that shortfall at 90 basis points, "on average."[15]

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[11] Voss, Rebuttal, p. 4.

[12] *Id.,* at 5.

[13] Tr. 13:48-49.

[14] *Id.,* at 47.

[15] *Id.,* at 47-48 and Voss, Rebuttal Testimony, 9-10.

On the other hand, if the Commission sets the ROE too high, the captive ratepayers will have to tighten their belts in order to provide a windfall profit to UE's investors. As Public Counsel Lewis Mills put it,

> in the event that this Commission awards too much of an increase to AmerenUE, some of those households that Mr. Thompson talked about, some of those people that are priced at the margin will no longer be in households. They won't be able to afford electricity. Some of those businesses that are at the margin will no longer be able to afford to pay for electricity and will be out of business.[16]

Other parties warn that the effect of an ROE award that is too high will be permanent damage to the state's economy in the form of failed businesses and corresponding job loss,[17] an injury that would only exacerbate the ongoing impact of the national financial crisis, which UE's CEO Mr. Voss described in this way: "Well, right now we see severe inability to get cash, which could lead to some businesses and some individuals going out of business."[18]

Capital structure is usually a straight-forward matter, based on the Company's balance sheet as of a designated day. When a capital structure issue arises in a rate case, it generally concerns the use of an actual structure versus a hypothetical one. In the present case, the capital structure issue is unique and concerns the proportion of common equity. Put bluntly, Ameren brazenly seeks to inflate the common equity component of its capital structure by improperly including retained earnings derived from unregulated subsidiaries.

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[16] Tr. 13:72 (Mills, in OPC's opening statement).

[17] Tr. 13:82-84 (Vuylsteke, opening statement for MIEC); 13:84-90 (Conrad, opening statement for Noranda Aluminum).

[18] Tr. 13:167.

ROE, on the other hand, is never a straight-forward issue. ROE always involves the conflicting testimony of expert financial analysts, all using similar methods and similar data to reach significantly different results. As UE's CEO, Tom Voss, testified, "rate of return experts . . . rely on complicated analyses, such as the discounted cash flow ("DCF") analysis and the CAPM analysis, in arriving at their recommended ROEs. . . . the results these experts reach can vary considerably, depending on the specific analyses they choose to rely on, the weight they choose to assign to each analysis, and the inputs they choose for each analysis."[19] The subjective inputs to these deceptively simple formulae leave ample scope for manipulation in any desired direction. As counsel for the State of Missouri put it, "I think you'll find that the company's expert, whenever faced with a choice between two relatively reasonable alternatives, made the choice that would increase the recommended return on equity."[20]

a. What return on equity should be used in determining revenue requirement?

Staff's position: A return on equity within the range of 9.00% to 9.75%, with a specific recommendation of 9.50%, is reasonable.

In the present case, AmerenUE seeks an ROE of 10.9% with a Fuel Adjustment Clause (FAC) or 11.15% without a FAC. Additionally, Dr. Morin, UE's expert witness, has urged the Commission to consider a 25-basis point "adder" because of the current national economic crisis. In setting UE's ROE, the Commission should be mindful that each basis point of ROE awarded represents about $500,000 of ratepayer money.[21]

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[19] *Id.,* at 4.

[20] Tr. 13:79 (Iveson, State of Missouri's opening statement).

[21] Tr. 13:271, 274-275 (LaConte).

The Commission's duty:

The Commission's duty with respect to ROE is to award a "fair and reasonable" return to investors on the value of the utility property committed to the public service.[22] Too little is an unconstitutional taking;[23] too much is an unconscionable windfall. The right amount – the "just and reasonable" amount -- is a return "equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties[.]"[24] The right amount is one that is fair to both the utility's investors and the utility's customers.[25]

What is Return on Equity?

Utility rates are designed to produce a certain amount of revenue on an annual basis, the "revenue requirement."[26] This revenue requirement has three components: First, an amount equal to the utility's prudently-incurred operating and maintenance expenses on a going-forward basis. Second, an amount sufficient to pay the utility's annual tax obligations. Third, an amount sufficient to service the capital used by the utility. Part of that capital is debt and debt is serviced by making regular payments to creditors. The other part of that capital is equity. Equity is serviced by paying dividends to the equity investors or by retaining earnings for operating purposes, resulting in greater value. It is this very last part of the revenue requirement that is the ROE. As noted

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[22] *St. ex rel. Missouri Public Service Co. v. Fraas,* 627 S.W.2d 882, 886 (Mo. App., W.D. 1981).

[23] *Bluefield Water Works & Improv. Co. v. Pub. Serv. Comm'n of West Virginia*, 262 U.S. 679, 690, 43 S.Ct. 675, 678, 67 L.Ed. 1176, 1181 (1923).

[24] *Id.,* 262 U.S. at 692-93, 43 S.Ct. at 679, 67 L.Ed. at 1182-1183.

[25] *St. ex rel. Valley Sewage Co. v. Pub. Serv. Comm'n.,*515 S.W.2d 845 (Mo. App., K.C.D. 1974).

[26] *In the Matter of The Empire District Electric Company,* 13 MoPSC3d 350, 368-69 (*Report & Order,* March 10, 2005).

above, another word for ROE is "profit." All of the rest of the utility's annual revenue will be spent on operating expenses, taxes and debt payments. Only the fraction that is left after these obligations are met will flow to the utility's owners as a return on their investment.

Calculating the Cost of Capital:

All businesses use a mixture of debt capital and equity capital; the particular percentage of each type for any given business is referred to as its "capital structure."[27] The cost of debt capital can be readily determined from the instruments in question. These costs are thus historical or "embedded." The cost of equity capital or ROE, on the other hand, cannot be so easily determined. Instead, it is a matter of expert opinion. As a starting point, it is worth noting that the Commission awarded an ROE to AmerenUE of 10.20% -- without a FAC – about 18 months ago.[28] Since that time, interest rates have declined by about 70 basis points.[29]

The Commission must sift through the conflicting opinions of the several expert witnesses who have testified in this case.[30] The chart below sets out the positions taken by six of the parties on ROE and the specific ROE recommendations offered in this case by four different experts.[31] The several recommendations extend from a low of 9.50% to

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[27] For this discussion, *see Empire, supra,* 13 MoPSC3d at 369-70.

[28] Tr. 13:295-296 (LaConte).

[29] *Id.* Interestingly, reducing the Commission's ROE award to UE in its last rate case – 10.2% -- by 70-basis points yields 9.5%, which is Staff witness Hill's recommendation in the present case.

[30] *In the Matter of The Empire District Electric Company,* 13 MoPSC3d 350, 370 and 372 (*Report & Order,* March 10, 2005).

[31] Two parties, OPC and the State of Missouri, filed positions on ROE but offered no supporting testimony. Each of these parties adopted the recommendation made by MIEC witness Michael Gorman.

a high of 11.15%; a range worth about $82 million.[32] Each of these experts, it should be noted, is eminently qualified in this field.[33] Predictably, the Company's expert offers high ROE recommendations – 10.90% with a FAC and 11.15% without a FAC. The other experts offer much lower ROE recommendations, ranging from below 9.37% with a FAC to 10.20% without a FAC.[34]

Witness	With FAC	Without FAC
UE – Morin	10.90%	11.15%
MEG -- LaConte	10.00%	10.20%
MIEC – Gorman	< 10.20%	10.20%
State of Missouri (no witness)	--	10.20%
OPC (no witness)	--	10.20%
Staff -- Hill	< 9.37%	9.50%

It is noteworthy that these experts have reached such widely differing conclusions, although their training, data and methods are much the same. The fact is that the analytical methods used by the experts only appear to be objective. These methods actually offer ample scope for manipulation in any desired direction.[35] How? By manipulation of the inputs.[36] However, as the Commission has pointed out, "it is not the method employed, but the result reached, that is important."[37]

[32] 165 basis points x $500,000 = $82,500,000. These are the *Without FAC* figures and do not include the 25-basis point "adder" recommended by Dr. Morin.

[33] Tr. 13:277 (LaConte).

[34] All of the witnesses agreed that a FAC would significantly reduce UE's business risk by about 25-basis points.

[35] Tr. 13:277-279 (LaConte).

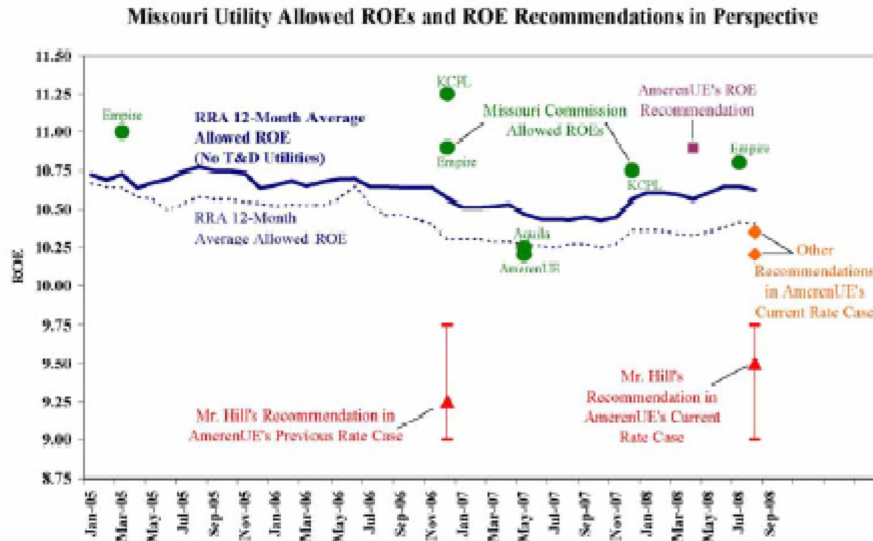
[36] Dr. Morin testified on cross examination that "the difference in all these recommendations is explained by differences in inputs." Tr. 15:390.

[37] *See Empire, supra,* 13 MoPSC3d at 372 n. 52, and collected cases there cited.

The Mainstream:

UE urges the Commission to accord it "mainstream" treatment in this case,[38] but never defines what exactly it means by the term. In the dictionary, "mainstream" is defined as "[t]he prevailing current of thought, influence or activity."[39] In fact, the word "mainstream" seems to be nothing more than a synonym for "average."

In its "Statements of Position,"[40] UE states "[a]s shown by Schedule RAM-RE9, which is reproduced below, Dr. Morin's recommendation falls squarely in the mainstream of ROEs awarded to other similar utilities."



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[38] For example, in his Surrebuttal Testimony, p. 1, UE's CEO Thomas Voss states, "Certain positions advocated by other parties in this case are significantly outside the mainstream and if adopted will undermine AmerenUE's financial stability, compromise its ability to make needed investments in infrastructure, and ultimately harm consumers." In his opening statement for UE, Jim Lowery stated:

> Taken in total, I think the evidence in this case will show three key points. First of all, AmerenUE needs recovery of its legitimate operating expenses. Second, AmerenUE needs sufficient opportunity to earn a fair mainstream return on equity. And third, AmerenUE needs a mainstream fuel adjustment clause to address volatile and uncertain and at least historically and in the near term rising fuel costs.

Tr. 13:50.

[39] *The American Heritage Dictionary of the English Language* 1084 (3rd ed., 1996).

[40] Filed November 13, 2008; EFIS Document 291.

Understanding "mainstream" to mean "average," however, it is apparent that Dr. Morin's recommendation is *not* "mainstream" at all; in fact, it is *higher* than the average ROE award of 10.51% by 39 basis points (with a FAC) and 64 basis points (without a FAC).[41] Exactly why, one wonders, should the people and businesses of this state provide a profit to UE's shareholder so significantly higher than the average? Is UE so much more risky than other utilities? Is it so much better managed?

In the past, the Commission has used the "Zone of Reasonableness" as an objective, analytical tool to assist it in parsing the recommendations of the experts and reaching a fair and reasonable result. The "Zone of Reasonableness" is defined as extending one hundred basis points – one percentage point – above and one hundred basis points below the recent national average of ROE awards in the appropriate regulated industry.[42] There has not been much reference to the Zone of Reasonableness in this case, but the national average of ROE awards to electric utilities necessarily is still a useful benchmark. Dr. Morin testified, "Allowed ROEs, although not a precise indication of a utility's cost of equity capital, are nevertheless important determinants of investor growth perceptions and investor expected returns."[43] The national average ROE award for electric utilities for the first nine months of 2008 was 10.51%.[44] The lowest awarded ROE was 9.1% to Consolidated Edison of New York in March 2008 and the highest was

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[41] Ex. 60, *Regulatory Research Associates (RRA) Regulatory Focus,* October 3, 2008; 29 decisions reported.

[42] *See Empire, supra,* 13 MoPSC3d at 375; *In the Matter of Missouri Gas Energy,* 12 MoPSC3d 581, 593 (*Report & Order,* September 21, 2004); *In the Matter of The Empire District Electric Co.,* Case No. ER-2006-0315 (*Report & Order,* issued December 21, 2005); *In the Matter of Kansas City Power & Light Co.,* Case No. ER-2006-0314 (*Report & Order,* issued December 21, 2006); *In the Matter of Union Electric Company,* Case No. ER-2007-0002 (*Report & Order,* issued May 22, 2007) at 39.

[43] Morin Rebuttal, p. 5.

[44] Ex. 60, *Regulatory Research Associates (RRA) Regulatory Focus,* October 3, 2008; 29 decisions reported.

12.12% to Virginia Electric Power, also in March 2008.[45]

Exhibit 60, which UE itself placed into the record, absolutely refutes its frequently repeated slur that Mr. Hill's recommended ROE of 9.50% is out of the mainstream. For example, Jim Lowery stated "What the company does not need and we don't think the company or its customers can afford is a far out of the mainstream and borderline ridiculous ROE like that recommended by Staff witness Hill[.]"[46] Tom Byrne, another UE lawyer, called Mr. Hill's recommendation "ridiculously low."[47] However, Mr. Hill's recommendation is not "far out of the mainstream" and is certainly not "borderline ridiculous" or "ridiculously low."[48] Mr. Hill's recommendation is 40-basis points *higher* than the lowest ROE awarded to an electric utility in 2008 and is, indeed, exactly where it should be given UE's previously-awarded ROE 0f 10.20% and the subsequent 70-basis point decline in interest rates.[49]

Analyzing the Experts' Analyses:

The several expert ROE witnesses in this case used variations of a few simple mathematical tools to reach their recommendations. In every case, the analysts employed professional judgment in selecting the precise analytical formulae employed and the

[45] *Id.* At the hearing, Chairman Davis stated to counsel for Staff, "You put on a witness who's recommending the lowest ROE in the country. You realize that?" Tr. 15:340. In fact, as Ex. 60 makes clear, Mr. Hill's recommendation in this case, if adopted, would *not* be the lowest awarded ROE in the country. Ex. 60 makes clear that the 12.12% ROE awarded to Virginia Electric Power includes an incentive of 100 basis points. If that award is excluded from consideration, the highest ROE award would be three awards of 11.70%. *See* Ex. 60.

[46] Tr. 13:54.

[47] Tr. 15:330.

[48] One wonders what the phrase "borderline ridiculous" even means. Something is "ridiculous" when it is "absurd, preposterous or silly." *The American Heritage Dictionary of the English Language* 1552 (3rd ed., 1996). "Borderline" means "verging on a given quality or condition." *Id.,* 219. Ms. LaConte, when asked whether Mr. Hill's recommendation was "outrageously low" responded, "Based on the assumptions he's made, no." Tr. 13:277.

[49] Tr. 13:295-296 (LaConte).

inputs, many of which are derived from a proxy group of regulated electric utilities.[50] Dr. Morin used two different versions of the Capital Asset Pricing Model (CAPM), two versions of the Risk Premium analysis, and four versions of the Discounted Cash Flow Model (DCM). Ms. LaConte recalculated six of Dr. Morin's eight analyses using new inputs and performed three analyses of her own: a CAPM, a Risk Premium and a DCF.[51] Mr. Gorman performed two versions of the DCF, a Risk Premium and a CAPM. Mr. Gorman also recalculated seven of Dr. Morin's eight analyses, again with new inputs. Finally, Steve Hill for Staff performed a DCF and a CAPM, as well as a Modified-Earnings-Price Ratio analysis and a Market-to-Book Ratio analysis. All of these tools were applied to one or more proxy groups, constructed on the basis of risk comparable to UE's, in order to quantify the return that investors expect from UE.[52] This approach was used because the United States Supreme Court has held that the profit due to utility investors is to be calculated on the basis of comparable risk.

Dr. Morin's professional judgment was criticized by the other expert witnesses in several respects. Ms. LaConte testified that his recommended ROE was too high because of upward adjustment for flotation costs and his use of improper proxies.[53] She explained Dr. Morin's proxies were improper because they do not share UE's business risk profile in that their percentage of revenue derived from regulated electric operations are significantly lower (UE: 83%; Constellation: 12%, Dominion: 38%, NiSource: 17%); their market capitalization is lower (Ameren: $9,100 million; Empire: $675 million,

[50] Tr. 13:277-278 (LaConte).

[51] Ms. LaConte did not recalculate two of Dr. Morin's analyses because she did not believe those analyses to be appropriate. Tr. 13:281, 282.

[52] "You're trying to find the investors' required rate of return for a given company." Tr. 15:390-391 (Morin).

[53] LaConte Direct, p. 13.

MGE: $775 million); and their credit ratings are lower (Ameren: A; Unisource: C++, CMS Energy: B).[54] Mr. Hill pointed out that Morin's Moody's proxy group is based on stale data as Moody's ceased publishing its electric index in 2002.[55]

Dr. Morin also used some inappropriate analyses. Ms. LaConte testified that he used an unusual Market Risk Premium (MRP) in his CAPM analyses.[56] Mr. Gorman characterized Dr. Morin's MRP as "unreasonably high," causing Morin's historical CAPM results to be overstated and unreasonable.[57] Mr. Hill testified that Dr. Morin violated the advice of his own textbook by ignoring the geometric mean when calculating the MRP for his historical CAPM.[58] Likewise, Gorman called Dr. Morin's MRP for his forecast CAPM "flawed and unreliable" because derived from a DCF analysis using an unreasonably high growth rate.[59] Some of Dr. Morin's calculations are just plain wrong.[60] Ms. LaConte explained that Dr. Morin's CAPM results were overstated because the β he used was too high; it was calculated from the βs of companies with more risk than UE and, necessarily, higher βs.[61] Mr. Gorman testified that utility βs have significantly declined since Dr. Morin filed his direct testimony and that the β Morin used was thus too high.[62] Mr. Hill testified that Dr. Morin's ROEs were bloated by 15 basis

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[54] LaConte Direct, p. 8.

[55] Hill Rebuttal, p. 5.

[56] LaConte Direct, p. 5.

[57] Gorman Rebuttal, p. 4.

[58] Hill Rebuttal, p. 10.

[59] *Id.,* at 6.

[60] *Id.*

[61] LaConte Direct, p. 6.

[62] Gorman Rebuttal, p. 8, *and see* Hill Rebuttal, p. 7.

points because his Risk Free Rate was overstated.[63]

Many other methodological criticisms leveled at Dr. Morin by the other ROE experts could be collected here, but they are readily available to the Commission in the rebuttal testimony of hose experts. The point is that Dr. Morin cooked his analyses in order to deliver a high ROE recommendation for his client. The point is that his recommendations should be viewed with a healthy skepticism.

The Return of the "Adder":

The "adder" is a pernicious and frequently-encountered analytical fallacy: it is an upward adjustment to ROE purportedly made to reflect some special or unique circumstance that the comparative analyses of the proxy group just couldn't catch. Oddly, it is Company witnesses who are most addicted to the use of this device, perhaps because it results in precisely the sort of bloated ROE recommendations that their clients are paying for. Dr. Morin, UE's expert ROE witness in this case, sponsored two adders.

The first of Dr. Morin's adders is the Flotation Cost Adder. Dr. Morin, systematically used an upward adjustment of 20 to 30 basis points in his analyses to reflect flotation costs.[64] Flotation costs are costs incurred in issuing stock.[65] However, UE did not issue any stock during the test year.[66] Other analysts agreed that this adder was inappropriate.[67]

[63] Hill Rebuttal, p. 6.

[64] Tr. 15:393, 401-2 (Morin); Tr. 13:283 (LaConte); Gorman Rebuttal, p. 8.

[65] Tr. 13:282.

[66] Tr. 13:160 (Voss); Tr. 13:283 (LaConte).

[67] Tr. 13:283 (LaConte); Gorman Rebuttal, p. 12. Dr. Morin admitted that, if it is true that this Commission has traditionally expensed Flotation Costs, then his Flotation Cost Adder should *not* be applied because "[i]t would be double counting." Tr. 15:393 *and see* Tr. 15:401.

The second of Dr. Morin's adders is the Financial Crisis Adder of 25-basis points.[68] It is noteworthy that, under cross-examination, Dr. Morin attempted to maintain that he had not actually recommended this second adder:

> A. . . . I did not recommend a 11.4 percent ROE. I merely stated that it would not be unreasonable for the Commission to increase the ROE in view of the ongoing financial crisis, but I am not recommending 11.4 percent.[69]

Let's look at what Dr. Morin actually said in his Surrebuttal testimony, where this second adder made its entrance. In the context of bashing Mr. Hill for not raising his recommendation in view of the current national financial crisis, Dr. Morin stated: "It would not be unreasonable to increase my ROE recommendation by at least another 25 basis points in light of the ongoing financial crisis."[70] The reality is that Dr. Morin was just being coy at the hearing.

Conclusion:

The record before the Commission supports an ROE within the range of 9.37%, with a FAC, to 11.15% -- or higher[71] – without a FAC. Any number within that range is thus defensible on appeal, assuming that the Commission adequately explains and supports its selection by referring to the evidence of record and making credibility findings as necessary. Staff believes that the recommendations offered by Mr. Hill are the best solutions, being 9.37% with a FAC and 9.50% without one, for the reasons given by Mr. Hill in his testimony. In making this decision, the Commission should be mindful that the national average is 10.51% as reported by Regulatory Research Associates and

[68] Morin Surrebuttal, p. 3.

[69] Tr. 15:383.

[70] Morin Surrebuttal, p. 3.

[71] Higher if the Commission chooses to implement Dr. Morin's Financial Crisis Adder of 25 basis points – the one he later said he hadn't recommended.

that almost all of the awards reflected in that average were to companies with FACs.[72]

b. What capital structure should be used?

Staff's position: A reasonable capital structure is 50.9% common equity, 1.8% preferred stock and 47.3% total debt.

UE's position is that the appropriate capital structure is UE's actual capital structure, which includes the undistributed earnings of certain unregulated subsidiaries previously owned by UE. The effect of including these earnings is to raise UE's common equity to 52% and, thereby, to require UE's ratepayers to dig into their pockets to provide that much more profit to UE's parent and sole shareholder, Ameren Corporation. Company witness O'Bryan contends both that UE incorrectly removed these earnings from its common equity balance when it filed its direct testimony and that it is no longer appropriate to deduct these undistributed earnings from UE's capital structure since these subsidiaries are no longer owned by UE.

UE's position is outrageous and must be rejected. The earnings in question have nothing at all to do with UE's regulated operations, so why exactly should they raise rates for ratepayers? This is nothing more than an unabashed attempt by Ameren Corporation to milk its Missouri customers for every penny of revenue it can in order to offset its disastrous operations in Illinois.[73] As Staff witness Hill made clear in his testimony, O'Bryan was right the first time – the $145 million in undistributed earnings *must* be removed from UE's capital structure.[74] When the March 2008 financials were adjusted to

[72] Ex. 60.

[73] The effect of UE's position on this point would be to raise rates by $7.6 million on an annual basis. Weiss Rebuttal, p. 16; Hill Surrebuttal, p. 9.

[74] Hill Surrebuttal, pp. 8-9.

reflect that UE no longer owned the subsidiaries and the UES Balance[75] was set to $-0-, the actual capital structure should then have equaled the adjusted capital structure used by O'Bryan in his direct testimony. In other words, by adjusting *out* the UES Balance, O'Bryan was already using a capital structure that looked like UE did not own the subsidiaries. When, in fact, UE no longer owned the subsidiaries, the actual capital structure and the ratemaking capital structure became the same.

It does not matter whether UE still owns the unregulated subsidiaries or not. The logic by which the earnings of those subsidiaries were excluded for ratemaking purposes still applies: ratepayers should pay *nothing* in rates to reflect earnings from unregulated operations because ratepayers have received no benefit from those operations. It is startling, and a matter of deep concern, that UE does not understand and accept this principle.

3. **Vegetation Management and Infrastructure and Repair**:

a. **Vegetation Management**:

i. What level of vegetation management expense is appropriate for recognition in AmerenUE's revenue requirement in this case?

Staff's position: The actual level of vegetation management expense AmerenUE incurred during the test year, as trued-up through September 30, 2008.

ii. Should AmerenUE's revenue requirement in this case include a three year amortization of vegetation management expense from January 1, 2008 to June 30, 2008 that is in excess of the $45 million annual level that was included in AmerenUE's revenue requirement for Case No. ER-2007-0002?

Staff's position: No. The Commission approved a one-way tracker in Case No. ER-2007-0002, which remains in effect until the effective date of rates in AmerenUE's current rate case. This tracker does not allow for additional recovery through

[75] Accountants refer to the undistributed earnings item as the UES or Undistributed Earnings of Subsidiaries. They were removed via a UES Adjustment. Their amount is reflected in the UES Balance.

amortizations while the tracker is in effect. In addition, the Commission's rule regarding vegetation management did not become effective until June 30, 2008.

iii. Should AmerenUE's revenue requirement in this case include a three year amortization of vegetation management expense from July 1, 2008 to September 30, 2008 that is in excess of the $45 million annual level that was included in AmerenUE's revenue requirement for Case No. ER-2007-0002?

Staff's position: No. The Commission approved a one-way tracker in Case No. ER-2007-0002, which remains in effect until the effective date of rates in AmerenUE's current rate case. This tracker does not allow for additional recovery through amortizations while the tracker is in effect.

iv. Should accounting authority be granted for vegetation management expense incurred from October 1, 2008 to February 28, 2009 in excess of the $45 million annual level that was included in AmerenUE's revenue requirement for Case No. ER-2007-0002, with this cost being deferred for treatment in AmerenUE's next rate case?

Staff's position: No. The Commission approved a one-way tracker in Case No. ER-2007-0002, which remains in effect until the effective date of rates in AmerenUE's current rate case. This tracker does not allow for additional recovery through amortizations while the tracker is in effect.

v. Should a tracker be implemented for vegetation management expense that exceeds the level of vegetation management expense the Commission recognizes in AmerenUE's revenue requirement in this case? Should such a tracker be implemented for the one-year period of March 1, 2009 to February 28, 2010?

Staff's position: Yes, the Commission should authorize AmerenUE to implement a tracker starting at the level of vegetation management expense the Commission recognizes in AmerenUE's revenue requirement in this case. The tracker should include a cap on expenses. The tracker should be implemented for the one-year period of March 1, 2009 to February 28, 2010.

b. **Infrastructure Inspection and Repair**:

i. What level of infrastructure inspection and repair expense is appropriate for recognition in AmerenUE's revenue requirement in this case?

Staff's position: The Commission should include AmerenUE's calendar year 2009 budgeted level of infrastructure inspection expense in AmerenUE's revenue requirement. The true-up level of infrastructure repair expenses should also be included in

AmerenUE's revenue requirement. This is three times the amount that AmerenUE incurred during the test year for infrastructure inspections and repairs. Additional infrastructure repair expenses should not be included since the rule specifically identifies "expenses as a result of this rule in excess of the costs included in current rates" and the Staff contends that many of the repairs would be made during AmerenUE's normal course of business.

ii. Should AmerenUE's revenue requirement in this case include a three year amortization of infrastructure inspection and repair expense from January 1, 2008 to June 30, 2008?

Staff's position: No. The Commission's rule regarding infrastructure inspection and repairs did not go into effect until June 30, 2008.

iii. Should AmerenUE's revenue requirement in this case include a three year amortization of infrastructure inspection and repair expense from July 1, 2008 to September 30, 2008?

Staff's position: No. The Staff instead proposes that the incremental cost of inspections from July 1, 2008 through September 30, 2008, in excess of the amount in the test year, be combined with subsequent amounts included in the tracker discussed in (v). As discussed in (i), the amount of infrastructure repairs should reflect the September 30, 2008 true-up level.

iv. Should accounting authority be granted for infrastructure inspection and repair expense incurred from October 1, 2008 to February 28, 2009, with these costs being deferred for treatment in AmerenUE's next rate case?

Staff's position: Yes, for infrastructure inspection expense only, the Staff proposes that the incremental amount in excess of the true-up level be included in the tracker discussed in (v). As discussed in (i), the amount of infrastructure repairs should reflect the amount should reflect the September 30, 2008 true-up level.

v. Should a tracker be implemented for infrastructure inspection and repair expense that exceeds the level of infrastructure inspection and repair expense the Commission recognizes in AmerenUE's revenue requirement in this case? Should such a tracker be implemented for the one-year period of March 1, 2009 to February 28, 2010?

Staff's position: Yes for infrastructure inspections only. Yes, the implementation period should be March 1, 2009 to February 28, 2010. This tracker should include the incremental inspection cost incurred above the true-up level. This tracker should also include the incremental inspection cost incurred above, as described in (iii) and (iv).

The Commission has stated in Rule 4 CSR 240-23.030(10) that an electric utility such as AmerenUE may seek accounting authority to defer, for possible recovery in a subsequent rate case, vegetation management costs it incurs in complying with the rule that exceed the amount of those costs included in setting its current rates, or if otherwise unidentifiable, the amount of those costs reflected in the appropriate uniform system of accounts for vegetation management on the utility's books for the test year (as updated) from the utility's last rate case. The Commission has a similar provision for infrastructure inspections and corrective actions in rule 4 CSR 240-23.020(4).

AmerenUE has not shown its expenditures on vegetation management through the effective date of new rates in this case were, or will be, made to comply with the Commission's rule. In fact, the evidence is that they were made to comply with commitments AmerenUE made ***years before*** the rule took effect on June 30, 2008, and well before the Commission opened a rulemaking case in late 2006 (Case No. EX-2006-0214) to consider a vegetation management and other rules. One of those commitments is to spend $45 million per year with a one-way tracker—required to spend on average at least $45 million per year but with no credit given in a later year for spending more than $45 million in a particular year—***until the effective date of rates in this case***. For these reasons alone, the Commission should reject AmerenUE's requests for authority to defer any of the vegetation management costs it incurred before the effective date of new rates in this case for recovery in its next rate case. Further, because AmerenUE has significantly modified its requests for the treatment of vegetation-management and infrastructure-inspection-related costs over the course of this proceeding, as well as significantly changing the amounts of the costs, last modifying them by a filing made

December 24, 2008, after the issues were heard, the Commission should have no confidence in AmerenUE's requests on these issues.[76]

It is undisputed that AmerenUE committed in late 2004 to eliminate its backlog of extended-tree-trimming cycles by December 31, 2008, to get onto a cycle of trimming at least every four years in urban areas and six years in rural areas and that it anticipated doing so would increase its tree trimming budget from $23.5 million in 2004 to at or near $30 million per year in 2005 and beyond.[77] It is also undisputed that in Case No. ER-2007-0002 AmerenUE committed to spend $45 million on vegetation management each year until new rates take effect in its next rate case—**this case**, and that if it spent less than $45 million in any given year, it would make up the difference in the following year, but if it spent over $45 million in any year, the overage would not reduce its obligation to spend at least $45 million the next year—a one-way tracker.[78] As part of this commitment to expend at least $45 million per year, AmerenUE committed to continue to move to four-year minimum urban and six-year minimum rural trim cycles, increase tree removals, and to broaden existing tree clearance practices that existed before Commission Rule 4 CSR 240-23.030 and AmerenUE's last rate case.[79]

During the test year of 2007, AmerenUE spent $45,663,000 on vegetation management.[80] AmerenUE witness Mark provided a higher amount of $50 million—the amount AmerenUE requests be included in revenue requirement in this case—possibly

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[76] Ex. 76.

[77] Zdellar Surrebuttal, Ex. 17, p. 4; Beck Surrebuttal, Ex. 218, Sch. 1; Tr. 20:1628-1631 (Zdellar).

[78] Tr. 20:1626-1627 (Zdellar); Zdellar Rebuttal, Ex. 16, p. 8; Zdellar Surrebuttal, Ex. 17. p. 4; Mark Direct, Ex. 19, p. 10.

[79] Tr. 20:1641-1642 (Zdellar).

[80] Weiss Supp. Direct, Ex. 11, p. 20; Beck Rebuttal, Ex. 217, p. 5.

by erroneously including vegetation costs incurred due to storms during the 2007 test year.[81] Originally, in April of 2008, AmerenUE asked that the Commission to include $50 million for vegetation management in its revenue requirement and grant AmerenUE accounting authority to allow it to defer until its next rate case vegetation management and infrastructure inspection related costs it incurred after January 1, 2008, through the effective date of rates in it next rate case that exceed the $45 million annual amount, and stated that it would track those costs as contemplated by Commission rule.[82] Then, in October of 2008, AmerenUE modified its request to ask for implementation of the same trackers for vegetation management and infrastructure inspection costs the Commission authorized for The Empire District Electric Company in Empire's last rate case, Case No. ER-2008-0093, *i.e.*, "set a base level of vegetation management and infrastructure inspection and repair costs in rates equal to an average of [AmerenUE]'s budgeted expenditures in those areas over the next two years" (2009 and 2010 budgeted expenditures) and track actual costs against the base level each year including the difference as a regulatory liability if AmerenUE spends less than the base level and a regulatory asset if it spends more—a two-way tracker. The resulting regulatory assets and liabilities would then be netted for inclusion in setting rates in AmerenUE's next rate case.[83]

In Empire's last rate case, Empire was authorized to defer vegetation management and infrastructure costs it incurs after the effective date of new rates in that case. The effective date of those new rates was August 23, 2008, after the June 30, 2008, effective

[81] Mark Direct, Ex. 19, p. 10; Beck Rebuttal, Ex. 217, p. 5.

[82] Weiss Direct, Ex. 10, pp. 23, 34-35; Weiss Supp. Direct, Ex. 11, pp. 20, 32-33; Mark Direct, Ex. 19, p. 10.

[83] Zdellar Rebuttal, Ex. 16, pp. 7-9.

date of the rules. If the Commission chooses to give AmerenUE the same relief it gave Empire, it should authorize AmerenUE to defer the vegetation management and infrastructure costs it incurs after the effective date of new rates in this case.[84] AmerenUE also modified its proposed base level of vegetation management costs to be set at $49 million rather than $50 million and proposed the base level of infrastructure inspection and repair costs be set at $17 million—an average of AmerenUE's budgeted amounts for 2090 and 2010.[85] AmerenUE further modified its request to ask for authority to begin amortizing over three years the amount it asserts it spent during the period of January 1, 2008, to September 30, 2008, on vegetation management, and infrastructure inspection and repair, costs that exceeded the costs for those activities that were included in its revenue requirement used to set its current rates in Case No. ER-2007-0002.[86] It also requested accounting authority to defer until its next rate case, if filed within five years, vegetation management and infrastructure inspection costs it incurs during the period October 2008 through February 28, 2009 (the anticipated effective date of new rates from this case) that exceed the costs for those activities that were included in its revenue requirement used to set its current rates in Case No. ER-2007-0002.[87] None of these amortization or cost deferral requests were made until AmerenUE filed rebuttal testimony.[88]

In November of 2008, after the end of the September 30, 2008, true-up period, AmerenUE again modified its request, not to change the type of relief requested or to

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[84] Beck Surrebuttal, Ex. 218, p. 9.

[85] Zdellar Rebuttal, Ex. 16, pp. 8-9.

[86] *Id.,* at p. 9.

[87] *Id.*

[88] Tr. 20:1639-1640 (Zdellar).

merely update cost amounts, but to add additional costs it asserts it should have included originally, namely, internal labor, annual education and pre-notification costs. With those added costs, AmerenUE asserts it incurred $50.6 million in vegetation management costs during the trued-up test year and $10.7 million in infrastructure inspection and repair costs.[89] AmerenUE also quantified the amount of vegetation management, and infrastructure inspection and repair, costs it asserts it incurred between January 1 and September 30, 2008, that exceed the cost included in the revenue requirement used for setting its rates in Case No. ER-2007-0002 that it seeks authority to defer and amortize over three years and collect in rate in this case to be $3.45 million and $8.6 million, respectively.[90] During the evidentiary hearing on December 2, 2008, AmerenUE, through its witness Zdellar, revised the $8.6 million to an "uncomfortable" $7.9 million[91] and then by a late-filed exhibit, filed on December 24, 2008, well after the week requested and without opportunity for the Commission or parties to test them, AmerenUE revised not only the $8.6 million infrastructure inspection and repair cost—to $8.0 million—it also revised the $3.45 million vegetation management cost to $2.9 million.[92]

Ultimately, AmerenUE's position is that its revenue requirement for setting rates in this case should include $54.1 million in vegetation management costs, $23.9 million in infrastructure inspection and repair costs, and respectively, $0.967 million and $2.67 million, for vegetation management and infrastructure inspection and repair for the nine-month period January 1-September 30, 2008 ($2.9 million / 3 and $8.0 million / 3).[93] It

[89] Zdellar Surrebuttal, Ex. 17, p. 12.

[90] *Id.*

[91] Tr. 20:1598-1599.

[92] Ex. 76.

[93] Zdellar Surrebuttal, Ex. 17, p. 12; Ex. 76.

also seeks authority from the Commission to accumulate and defer the costs it incurs between October 1, 2008, and February 28, 2009, that exceed the amounts in the revenue requirement upon which its current rates are based and a two-way tracker with a base of $78 million ($50.6 million + $3.5 million + $10.7 million + $13.2 million).[94]

STAFF RECOMMENDATIONS -- VEGETATION MANAGEMENT

With regard to vegetation management costs, because (1) AmerenUE increased its vegetation management expenditures due to its commitment in late 2004 to get onto a schedule of trimming vegetation along its distribution system in urban areas at least every four years and in rural areas at least every six years and (2) committed in its last rate case, Case No. ER-2007-0002, to spend at least $45 million on vegetation management each year until rates are established in this case, with a requirement that any amounts spent under the $45 million must be spent the next year and no additional recovery for any amount spent in excess of $45 million—a one-way tracker, it is the Staff's position the amounts AmerenUE has spent in excess of the $45 million for vegetation management included in the revenue requirement upon which its current rates are based are not due to any Commission rule and, therefore, AmerenUE should not recover any of this amount through an amortization or be authorized to defer any of the amount to its next rate case.[95]

While the Staff opposes recovery in rates of the difference in the $45 million included in current rates and actual costs during the period January 1, 2008, to when new rates are effective in this case, the Staff does support, with a cap, Commission authorization of a two-way tracker to flow into AmerenUE's revenue requirement in its

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[94] Zdellar Surrebuttal, Ex. 17, p.12.

[95] Beck Rebuttal, Ex. 217, pp. 4-6; Beck Surrebuttal, Ex. 218, pp. 3-6 and Schedule 1.

next rate case the difference between the vegetation management costs included in the revenue requirement upon which rates are set in this case and its actual vegetation management costs incurred during the time rates from this case are effective.[96] It is the Staff's position that for vegetation management costs, the true-up period levels for non-labor tree trimming of $49.7 million shown on the work paper of AmerenUE witness Zdellar admitted into evidence as Exhibit 240 should be included in AmerenUE's revenue requirement and also be the base for the two-way tracker.[97] That two-way tracker should include a cap of approximately 10 percent (10%), i.e., an annual ceiling of about $54.7 million.[98] AmerenUE witness Zdellar argues against a cap, asserting it would create a strong disincentive for AmerenUE to spend needed money.[99] Ironically, AmerenUE, despite a one-way tracker set at $45 million annually, has exceeded the $45 million and its own budget projections are that these costs will continue to increase.[100] Staff's valid concern is with incenting AmerenUE to most wisely manage its vegetation management costs, something an assurance of recovery does not do.[101]

STAFF RECOMMENDATIONS -- INFRASTRUCTURE INSPECTIONS

In contrast to vegetation management, AmerenUE has no relatively recent past commitments for escalating its infrastructure inspections. Therefore, the Staff's positions on the appropriate treatment of infrastructure inspection costs differ from those it takes with regard to vegetation management costs. The Staff proposes that the average of

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[96] Beck Rebuttal, Ex. 217, p. 7; Beck Surrebuttal, Ex. 218, pp. 6-10.

[97] Ex. 240; Beck Rebuttal, Ex. 217, pp. 4-5; Beck Surrebuttal, Ex. 218, pp. 4 and 10.

[98] Tr. 20:1684-1685 (Beck).

[99] Zdellar Surrebuttal, Ex. 17, p. 3.

[100] Ex. 240.

[101] Tr. 20:1668, 1702-1703 (Beck); Beck Surrebuttal, Ex. 218, p. 7.

AmerenUE's budgeted non-labor costs of $10.2 million for infrastructure inspection in 2009 should be included in AmerenUE's revenue requirement in this case and used as the base amount for a two-way tracker for infrastructure inspection costs AmerenUE actually incurs after the effective date of new rates in this case.[102] While it does not support AmerenUE's proposals, the Staff does support deferral of AmerenUE's excess infrastructure inspection costs, but not repair costs, incurred from June 30, 2008, to comply with the Commission's new rule, until the effective date of new rates in this case into a regulatory asset for recovery in AmerenUE's next rate case.[103]

As stated above, the Commission has stated in rule 4 CSR 240-23.02(4) that an electric utility such as AmerenUE may seek accounting authority to defer for possible recovery in a subsequent rate case infrastructure inspection and corrective action costs it incurs in complying with the rule that exceed the amount of those costs included in setting its current rates, or if otherwise unidentifiable, the amount of those costs reflected the appropriate uniform system of accounts for infrastructure inspection on the utility's books for the test year (as updated) from the utility's last rate case.

Because Rule 4 CSR 240-23.020 became effective June 30, 2008, the Staff proposes the Commission authorize AmerenUE to defer in a regulatory asset for potential recovery in its next rate case, the excess inspection costs it has incurred and will incur from June 30, 2008, until the effective date of new rates in this case—presumably February 28, 2009.[104] Unlike AmerenUE, the Staff does not include repair costs as costs

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[102] Ex. 240; Beck Rebuttal, Ex. 217, pp. 8-10; Beck Surrebuttal, Ex. 218, pp. 10-11.

[103] Beck Rebuttal, Ex. 217, pp. 8-9; Beck Surrebuttal, Ex. 218, pp. 10-12.

[104] Beck Rebuttal, Ex. 217, pp. 8-10; Beck Surrebuttal, Ex. 218, p. 11.

to be deferred, or amortized, for recovery because repair and maintenance costs have always been reflected in AmerenUE's rates and, until there is a showing of repair or maintenance costs attributable to the rule rather than an ongoing part of those already included in AmerenUE's rates, it should not be presumed that any excess repair or maintenance costs are incurred because of the rule.[105] During the evidentiary hearing, AmerenUE witness Zdellar admitted that it was possible that a repair cost that would have been incurred absent an inspection could be attributed to an inspection and included in AmerenUE's proposed tracker.[106]

4. **January 13, 2007 Ice Storm Accounting Authority Order (AAO)**: In Case No. EU-2008-0141, the Commission authorized AmerenUE an AAO for the extraordinary costs of the January 13, 2007 Ice Storm but deferred to this case the determination of the starting date of the five-year amortization of the deferred costs. What should be the start date of the five year amortization?

Staff's position: The five-year amortization of the $24.56 million in extraordinary costs AmerenUE incurred due to the January 13, 2007 Ice Storm should begin at or near the time AmerenUE incurred the costs. AmerenUE booked its very close estimate of the final storm costs by January 31, 2007; therefore, it is the Staff's position the amortization of these ice storm costs should begin by no later than February 1, 2007. Selecting a later date—such as the effective date of rates established in this case—has the effect of eliminating the regulatory lag associated with these extraordinary costs and providing almost certainty of recovery of more than the $24.56 million of costs incurred. The purpose of an AAO is not to eliminate the financial risk to a utility of extraordinary events, but to ameliorate the financial impacts on the utility when such an event occurs. If adopted, the Staff's position—to begin the amortization on February 1, 2007—AmerenUE will not only have the opportunity to recover the full $24.56 million of costs it incurred, it may also recover more than $24.56 million.

The Staff and AmerenUE do not dispute that AmerenUE incurred $24.56 million in costs due to a storm that it incurred on January 13, 2007 and that the $24.56 million should be evenly amortized over five years with the resulting annual amount—$4.912 million—included in AmerenUE's revenue requirement used for setting rates in this

[105] Beck Rebuttal, Ex. 217, pp. 8-9; Beck Surrebuttal, Ex. 218, pp. 11-12.

[106] Tr. 20:1643-1644 (Zdellar).

case.[107] What they disagree about is when the five-year amortization period starts. With the Staff's proposal, any rate case with the later of a test year update cut-off or true-up cut-off that does not end before January 31, 2012 (i.e., February 1, 2007 + five years) will have the $4.912 million available to include in the revenue requirement for setting rates. However, with AmerenUE's proposal, the last date will be five years from the effective date of rates in this case—about February 28, 2014 (operation of law date of March 1, 2009 + five years).[108] Thus, this dispute has no impact on AmerenUE's revenue requirement and resulting rates in this case; however, it will affect AmerenUE's opportunity to recover the entire $24.56 million in storm costs.

While the parties are not disputing the propriety of deferring the January 13, 2007, storm costs for inclusion in the revenue requirement for setting rates in this case, statements the Commission has made in the past regarding such deferrals are pertinent. In December of 1991, the Commission addressed whether and when the Commission should allow deferrals of certain costs to later periods, stating "The request to defer costs from one period to another has been characterized as a request for an Accounting Authority Order (AAO)."[109] It also stated, "The deferral of costs from one period to another period for the development of a revenue requirement violates the traditional method of setting rates."[110] And, later in that *Report and Order*, the Commission stated:

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[107] Staff witness Cassidy, Staff Report Cost of Service, Ex. 200, pp. 56-58, as corrected by Tr. 22:1849; Cassidy Surrebuttal, Ex. 226, p. 11; AmerenUE witness Barnes at Tr. 22:1842-43; Cassidy at Tr. 22:1851.

[108] Cassidy Surrebuttal, Ex. 226, p. 11; Barnes Rebuttal, Ex. 26, p. 8.

[109] *In the Matter of the Application of Missouri Public Service for the Issuance of an Accounting Order Relating to Its Electrical Operations* and *In the Matter of the Application of Missouri Public Service for the Issuance of an Accounting Authority Order Relating to Its Purchase Power Commitments*, Case Nos. EO-91-358 and EO-91-360, 1 Mo. P.S.C.3d 200, 202 (*Report & Order,* issued December 20, 1991).

[110] *Id*. at 205.

> The Commission finds that a time limitation on deferrals is reasonable since deferrals cannot be allowed to continue indefinitely. The Commission finds that a rate case must be filed within a reasonable time after the deferral period for recovery of the deferral to be considered. For purposes of this case the Commission finds that twelve months is a reasonable period. This limitation accomplishes two goals. First, it prevents the continued accumulation of deferred costs so that total disallowance would not affect the financial integrity of the company or the Commission's ability to make the disallowance; and secondly, it ensures the Commission a review of those costs within a reasonable time. If the costs are truly extraordinary, recovery in rates should not be delayed indefinitely. A utility should not be allowed to save deferrals to offset against excess earnings in some future period.[111]

The Commission ordered that Missouri Public Service was authorized to defer and record costs beginning January 1, 1992, and that it must file a rate case by December 31, 1992, to be allowed recovery of any of those costs in a rate case.[112]

In the past, the Staff has entered into agreements approved by the Commission with varying lengths of time between when the extraordinary event occurred and when the amortization of the deferred costs began. The following is a list of cases with such agreements that identifies the utility, the nature of the extraordinary event, the date of the event, and the date the amortization began:

Case No.	Utility	Event	Date of Event	Start Date of Amortization
EO-94-35	SJLP	Flood	July & Aug, 1993	11/1/93
EO-95-193	SJLP	Ice storm	12/6/94	3/1/95
EU-2002-1048[113]	KCPL	Ice storm	1/30&31/2002	9/1/2002
EU-2002-1053	Aquila	Ice storm	1/30&31, 2002	2/1/2002
ER-2008-0093	Empire	Ice storm	January 2007	February, 2007
ER-2008-0093	Empire	Ice storm	December 2007	January 2008

[111] *Id.* at 206.

[112] *Id*. at 213.

[113] 11 Mo. P.S.C. 3d 419.

In none of these cases does the time lag between the extraordinary event upon which the accounting authority is based and the start of the amortization of the deferred costs even begin to approach the more than 13 months that AmerenUE proposes here.

In deciding this issue, the Commission should keep in mind the purpose of accounting authority orders for extraordinary events, such as rare severe storms, is to shift from the utility's shareholders to its ratepaying customers the economic risk of some of the costs incurred due to those events. Some costs a utility incurs due to such extraordinary events are reimbursed from insurance or other sources. Others are not. The un-reimbursed costs may include capital costs, such as those incurred to replace damaged infrastructure. Those costs, less applicable depreciation, become a part of the utility's rate base included in determining the company's revenue requirement for ratemaking purposes. The un-reimbursed costs may also include other costs such as operation and maintenance costs that are not included in the utility's rate base and which are expensed in the year incurred. These expense costs are the costs that, when extraordinary, are the subject of Commission accounting authority orders.

With accounting authority orders, the Commission authorizes utilities to take the extraordinary costs that would otherwise be expensed in a particular year, evenly amortize them over a period of years—that is, divide the cost by a number of years—and record the resulting annual amount in each year of the allotted period of years as an amount that may be included in determining the utility's revenue requirement when setting new rates. Absent this accounting treatment, the utility does not have the opportunity to recover these costs through customer rates. This is the accounting

mechanism by which the Commission creates the opportunity for the utility to shift the risk of bearing these costs from the utility's shareholders to its regulated customers.

The Staff's proposal of an amortization period from February 1, 2007, through January 31, 2012, is based on matching the start of the agreed-upon amortization period close to the January 13, 2007, date of the extraordinary event, yet allowing sufficient time for AmerenUE to obtain a reasonable estimate of the total expense of $24.56 million being amortized.[114] As Staff witness Cassidy testified, as long as AmerenUE has rates in place for five years where the $4.912 million from the amortization is included in the revenue requirement used in setting those rates, then, from a single-issue ratemaking standpoint, AmerenUE will have fully recovered the $24.56 million.[115] Thus, assuming rates in this case are effective March 1, 2009, if the rates AmerenUE has during the period through February 28, 2014, are based on costs of service that include the annual amortization amount of $4.912 in determining the revenue requirement, AmerenUE will have fully recovered the $24.56 million, regardless of when the amortization period begins.

Under the Staff's proposal, the last such rate case could not have a final cutoff date—later of test year end date, update cutoff date or true-up cutoff date—after January 31, 2012, and still have rates that include the amortization in AmerenUE's revenue requirement. Such a rate case likely would be filed no later than sometime in late 2010 or early to mid-2011. In contrast, under AmerenUE's proposal of the effective date of rates in this case—assumed to be March 1, 2009, for purposes of discussion--AmerenUE could file a rate case with a true-up cutoff as late as February 28, 2014, and still obtain rates

[114] Cassidy Surrebuttal, Ex. 226, pp. 11-12.

[115] Cassidy Surrebuttal, Ex. 226, p. 12.

where the $4.912 was included in AmerenUE's revenue requirement for setting those rates; *i.e.*, AmerenUE, from a single issue ratemaking standpoint would over-recover the $24.56 million from its ratepaying customers. Such a result would make AmerenUE's ratepayers not only insurers, but over-insurers. Such a rate case would likely be filed by no later than sometime in late 2012 or early to mid-2013.

As Staff witness Cassidy testified, the testimony of AmerenUE witness Barnes--that the beginning of the five-year amortization period before the effective date of rates in this case will insure that AmerenUE will not fully recover its storm costs--is wrong and should be disregarded.[116] Moreover, as Staff witness Cassidy testified in response to questions from Commissioner Gunn, AmerenUE could have sought in its last rate case—Case No. ER-2007-0002—to include the January 13, 2007, storm costs in that case since the storm occurred well before the June 1, 2007, effective date of Commission's May 22, 2007, *Report and Order* issued in that case.[117]

For all the foregoing reasons, the Commission should adopt the Staff's position on this issue and set the five-year amortization period for AmerenUE's deferred January 13, 2007, storm costs for February 1, 2007, through January 31, 2012.

5. **Deferred Income Taxes**: Three items included by AmerenUE in the deferred income tax balance offset to ratebase relating to deductions taken by AmerenUE on prior tax returns may be disallowed by the IRS, but there will not likely be a final IRS ruling before 2011. Should these uncertain tax positions be included or excluded from the determination of AmerenUE's revenue requirement in this case?

Staff's position: It is the Staff's position that as long as AmerenUE continues to enjoy the benefits of prior year tax deductions—despite its concern those deductions may be disallowed by the IRS in the future—the deferred taxes associated with those deductions should continue to be an offset to AmerenUE's rate base used in the calculation of

[116] Cassidy Surrebuttal, Ex. 226, p. 12; Barnes Rebuttal , Ex. 26, p. 7.

[117] Tr. 22:1858 (Cassidy).

AmerenUE's revenue requirement. Here AmerenUE recorded three income tax deductions on prior year income tax returns that reduced the amount of income taxes it paid during those years. As a result the Company properly recorded ** [redacted] ** of associated deferred income tax reserves. Since AmerenUE has enjoyed the use of these funds it did pay in taxes due to the deductions, these deferred taxes should appropriately be used to offset rate base for ratemaking purposes. Based on the Staff's rate of return, this rate base offset reduces the revenue requirement calculation by approximately ** [redacted] million **.

AmerenUE and Staff agree that deferred taxes associated with income tax deductions should be an offset to rate base for ratemaking.[118] AmerenUE took the income tax deductions—a power plant repair deduction, a casualty loss deduction and a research cost deduction—in good faith and has not changed its position before the IRS that it is entitled to the deductions.[119]

The issue that the Commission must decide is whether ratepayers should prematurely bear the risk now of the deductions being disallowed in the future. AmerenUE would have its ratepayers bear that risk now by depriving them of the deferred income tax associated with the deductions. Presently, AmerenUE shareholders are actually realizing the benefit of the deductions.[120] Unless and until the deductions are disallowed, AmerenUE's ratepaying customers should share in that benefit by reflecting this rate base offset in rates.[121] If the IRS disallows the income tax deductions in whole or in part, the deferred income tax associated with the deductions would no longer exist and at that time appropriately would no longer be an offset to rate base.[122]

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[118] Staff witness Cassidy, Staff Report Cost of Service, Ex. 200, pp. 11-12, as corrected by Tr. 17:1083; Nelson Rebuttal, Ex. 21, p. 4; Tr. 17:1078-1080 (Nelson).

[119] Tr. 17:1078-1080 (Nelson).

[120] Tr. 17:1076-1077 (Nelson); Tr. 17:1093 (Cassidy); Cassidy Surrebuttal, Ex. 226, pp. 2-5, as corrected by Tr. 17:1084.

[121] Cassidy Surrebuttal, Ex. 226, pp. 4-5.

[122] *Id.*

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6. **Settled.**

7. **Settled.**

8. **Fuel Adjustment Clause (FAC)**:

   a. **FAC** – Should the Commission approve AmerenUE's proposed fuel adjustment clause, should the Commission approve a FAC with modifications for AmerenUE, or should the Commission reject the authorization of a FAC for AmerenUE.

Staff's position: The Commission should not authorize a FAC for AmerenUE because AmerenUE has not shown that its fuel and purchased power costs satisfy the three criteria the Commission has used in previous cases to determine whether to authorize a FAC for an electric utility that requested authority to use a FAC.

Senate Bill 179 / § 386.266.4(1) provides, in part, that the Commission, after providing opportunity for a full hearing of and considering in a general rate proceeding, including in a general rate proceeding initiated by complaint, all relevant factors which may affect the cost or overall rates and charges of the corporation, may approve rate schedules authorizing periodic rate adjustments outside of general rate proceedings to reflect increases and decreases in prudently incurred fuel and purchased power costs, if it finds that the adjustment mechanism set forth in the schedules "[i]s reasonably designed to provide the utility with a sufficient opportunity to earn a fair return on equity."

In AmerenUE's last rate increase case, Case No. ER-2007-0002, AmerenUE sought Commission authorization to utilize a fuel adjustment clause (FAC). The Staff opposed the authorization of a FAC for AmerenUE. The Commission denied AmerenUE's request and held that fuel and purchased power costs / revenues should be tracked and reflected in an FAC if they are:

1. Substantial enough to have a material impact upon revenue requirements and the financial performance of the business between rate cases;

2. Beyond the control of management, where utility management has little influence over experienced revenue or cost levels; and

3. Volatile in amount, causing significant swings in income and cash flows if not tracked.

Regarding criterion 1, the Commission held that AmerenUE's fuel and purchased power expenses are substantial and meet the first criterion.[123]

Regarding criterion 2, the Commission stated that, while AmerenUE cannot control the markets, it has more ability to influence the prices it pays for fuel and purchased power costs than do its ratepayers, who must simply pay the rates allowed by this Commission. The Commission held that, on balance, the second criterion does not provide a strong basis for either approving or denying AmerenUE's request for a fuel adjustment clause.[124]

Criterion 3 appeared to be the most problematic, drawing testimony from Michael S. Proctor, the Chief Regulatory Economist in the Commission's Energy Department, Utility Operations Department, who, among other things, is responsible for testifying before the Commission on the economic analysis of utility policy. He consults with the Staff on matters related to wholesale electricity markets and transmission expansion.[125] The Commission noted that, in addition to the fact that AmerenUE's fuel costs were rising, but not volatile, Dr. Proctor demonstrated that under some circumstances, AmerenUE's ability to sell power into the wholesale market may mitigate some of the risk resulting from rising fuel costs based on the correlation between higher fuel prices

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[123] *In the Matter of Union Electric Company,* Case No. ER-2007-0002, (*Report & Order,* 2007) p. 21.

[124] *Id.,* at 22.

[125] *Id.,* at 23; Proctor Rebuttal, Ex. 212, pp. 1-2.

for coal and natural gas and the offsetting higher spot market prices for AmerenUE electricity. The Commission stated that AmerenUE demonstrated Dr. Proctor's mitigation theory would not apply in all scenarios, and Dr. Proctor agreed his analysis did not indicate that profits from off-system sales would completely offset rising fuel costs. Nevertheless, the Commission concluded that increased profits from off-system sales tended to mitigate rising fuel costs in all likelihood, and although this mitigation effect would not be enough to eliminate the need for a fuel adjustment clause by itself, it added more weight to the balance in deciding whether a FAC was appropriate.[126]

The Commission decided that AmerenUE's fuel and purchased power costs were not volatile enough to justify the implementation of a FAC. Based on Dr. Proctor's testimony about rising off-system sales margins, the Commission determined that AmerenUE had a reasonable opportunity to earn a fair return on equity without a FAC. The Commission held that a future rate case, not a FAC, is the proper means by which AmerenUE should recover its rising fuel costs.[127]

The Staff filed in this case the rebuttal testimony of Dr. Proctor to address the direct testimony of AmerenUE witness Ajay K. Arora, which assesses the uncertainty associated with net fuel expenses. For ratemaking purposes before this Commission, net fuel expense includes the delivered cost of fuels (coal, natural gas, uranium fuel, uranium conversion, uranium enrichment, nuclear fuel assemblies fabrication, and diesel fuel) and purchased power less revenues received from sales of electricity in the wholesale electricity markets (off-system sales). AmerenUE's downside risk related to net fuel expense is the potential for significant expense increases in net fuel subsequent to a

[126] *Union Electric Company, supra,* pp. 23-24.

[127] *Id.,* at 26.

determination by the Commission of these costs in a rate case. AmerenUE asserts that the downside risk must be addressed by the Commission by authorizing it a FAC. However, if in actuality the downside risk is relatively low, then there is little need for a FAC, as provided for by § 386.266 and Rules 4 CSR 240-3.161 and 4 CSR 240-20.090.[128]

As indicated, Dr. Proctor addressed this issue in AmerenUE's last rate case. In part in his rebuttal testimony in Case No. ER-2007-0002, he stated that the fact that fuel costs are rising for AmerenUE do not necessarily imply a high downside risk in net fuel expense on a going forward basis:[129]

> Second, while changing fuel prices and wholesale electric prices impact the level of profit margins, AmerenUE has not presented any studies to show what this impact is. In essence, since there is a high level of correlation between fuel prices and spot market prices for electricity, the net impact of changing prices on profit margins could be fairly minimal, and I will present evidence to show that this is the case.

Dr. Proctor states in his rebuttal testimony in this case that while the AmerenUE study performed by Mr. Arora purportedly addresses the issue regarding the interaction between net fuel expense and electricity prices, he does not agree with the study. Dr. Proctor testified in summary as follows:[130]

> While the overall concepts that the study purportedly addresses appear to be sound, the implementation of the study is flawed in several critical respects. In this regard, the Commission has no new evidence from Case No. ER-2007-0002 on which to change its decision to deny AmerenUE's request for a FAC.

[128] Proctor Rebuttal, Ex. 212, pp. 2-3.

[129] *Id.,* at 3.

[130] *Id.,* at 4.

Dr. Proctor identified the following flaws in the AmerenUE risk assessment study for net fuel expense:[131]

1. Wrong Estimates of Uncertainty for Electricity and Natural Gas Prices:

AmerenUE's estimation of uncertainty for electricity prices and natural gas prices uses the incorrect data to estimate the uncertainty for the model which was used to calculate net fuel expense within each of the periods for which the study was performed. The result is a significant over estimation of the variability in net fuel expense.

2. Wrong Estimate of Uncertainty for Coal Prices:

AmerenUE's estimation of uncertainty for coal prices, which uses a different type of data than what was used for electricity and natural gas prices, also uses the wrong data, and fails to account for the correlation that exists between spot-market electricity prices and spot market coal prices.

3. Incorrect Analysis of Correlations Among Variables:

AmerenUE's analysis of correlation between electricity prices and coal prices used daily changes in forward prices. This analysis tests a hypothesis that, if true, may imply correlation in forecasts of the spot-market price for these two variables, but is not a necessary condition for correlation. In addition, AmerenUE presents an incorrect analysis of annual average prices of the correlation of historical levels for coal, natural gas and electricity prices. Finally, AmerenUE confuses causation with correlation in the discussion of why AmerenUE's generation facilities do not cause the electricity prices in the Midwest ISO's day-ahead energy market.

4. Results Do Not Meet A Sanity Check:

The results for AmerenUE's 250 scenarios for each period of the study indicate too high of a level of dispersion in the test year when correctly compared to historical data, and actually show declining uncertainty for the out-year periods. The uncertainty should have increased in the out-years to reflect an increasing level of forecasting uncertainty.

The Commission should consider the following facts: (1) for the most part, AmerenUE's fuel costs are ** [redacted] **;[132] (2) the fuel costs for the test

[131] *Id.*

year, the twelve months ending March 31, 2008, trued-up to September 30, 2008, do not include the increases that AmerenUE expects in its hedged fuel costs for 2009. The fact that these ** ** are not included in rates set in this case is due to the timing of AmerenUE's filing of this rate case. The fact that AmerenUE's fuel costs are for the most part ** ** means that the volatility of AmerenUE's net fuel expense for 2009 primarily depends on volatility in the prices that it may receive from its off-system sales into the MISO energy market.[133]

The impact of power prices volatility for 2009 on AmerenUE's earnings is minimal. AmerenUE has not provided the necessary evidence for its asserted case. It has not produced the requisite evidence on the impact of the volatility of power prices for 2009. The testimony of Mr. Arora is the only testimony before this Commission regarding the effect of power price volatility on AmerenUE's net fuel expense. However, the case labeled 2009 in Mr. Arora's results does not represent a case in which AmerenUE currently finds itself for 2009. Mr. Arora did not assume that fuel costs are fully hedged for 2009; instead he assumed that only a portion of AmerenUE's fuel costs are hedged, based on the percent that was hedged in February 2008:

> First, RTSim was used to model uncertainty existing at the beginning of the test year, considering AmerenUE's substantially hedged fuel positions as of that time. Second, RTSim was used to model the combined uncertainty that can be expected during the years 2009 through 2012, considering AmerenUE's hedged (or known) positions with respect to fuel purchased power, and off-system sales as of February 2008. . . .[134]

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[132] Staff Cost of Service Report, Ex. 200 (HC), p. 63 (Mantle); Mantle Surrebuttal, Ex. 224, pp Sch. 1; 439 (HC), p. 92.

[133] Staff Cost of Service Report, Ex. 200 (HC), pp. 63-64 (Mantle).

[134] Ex. 22, p.4; *and see* Tr. 26:2459-2463; 27:2464-2476 (HC); Mantle Surrebuttal, Ex. 224, Sch. 1.

In his rebuttal testimony, Dr. Proctor noted that by the time rates go into effect from the instant case most if not all of the coal scheduled for delivery in 2009 is hedged and the percent hedged for 2010 will have increased from the percentage in February 2008. Moreover, AmerenUE has a specific schedule for hedging its coal costs, and the Commission would have obtained a picture of AmerenUE's downside risk for future net fuel expense had this schedule been incorporated into AmerenUE's study on a forward looking basis. Even with this mismatch of results with what AmerenUE is actually facing for 2009, AmerenUE failed to reflect its estimates of the impact for 2009 in its surrebuttal testimony.[135]

The Test Year Case from Mr. Arora's model is the only case that presents results that show the impact on net fuel expense for the case where most fuel costs are hedged but power prices and natural gas costs are not hedged. In discussing the results from his simulation of the Test Year Case, Mr. Arora states: "the test year case takes into account the fact that AmerenUE had already hedged a significant portion of its uncertainty for the test year, and will have done so going into particular future 12 month periods."[136] **

**[137] **

[135] Proctor Rebuttal, Ex. 212, p. 24.

[136] Arora Direct, Ex. 22, p. 29.

[137] Tr. 27:2410-2411 (HC).

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**[138] Thus, the results for the Test Year Case are the only results that show the impact that is somewhat representative for 2009.

Mr. Arora's results for the Test Year Case are shown in Table 2 at page 31 of Mr. Arora's direct testimony, where the range in net fuel expense for the Average and the 75% level are shown as ** ** million and ** ** million, respectively. The difference in these two numbers represents the downside risk of revenue loss to AmerenUE of ** ** million with a probability of a higher revenue loss than ** ** million being less than 25%.[139] Comparing Mr. Arora's potential loss of ** ** million to Schedule MEB-FAC-1, attached to the Part 2: Fuel Adjustment Clause direct testimony of Maurice Brubaker, filed on September 11, 2008, for Missouri Industrial Energy Consumers (MIEC), at Line 2 Column (2) is a dollar change in cost before taxes of $36 million, which Line 2, Column (3) shows the dollar change in cost after taxes to be $22 million. Applying the same ratio to Mr. Arora's before tax ** ** million produces the after tax number ** ** million. Applying the same factor shown in footnote (3) on Schedule MEB-FAC-1 to the ** ** million of downside Test Year risk for AmerenUE results in an ** ** basis point potential change in AmerenUE's ROE.[140] However, this estimated potential loss for 2009 is significantly too high of an estimate when the results for the Test Year are compared to either the variability in power prices

[138] Tr. 27:2431 (HC); Arora Direct, Ex. 22, p. 29.

[139] Tr. 26:2436; 27:2437 (HC).

[140] AmerenUE witness Arora's testimony at the hearing supports this calculation. When asked what an ** ** million dollar swing in net fuel cost equates or translates to in terms of basis points for return on equity, Mr. Arora stated: Roughly, I think it's probably about ** ** basis points." Tr. 27:2437 (HC). One half of ** ** million is approximately ** ** million, and one half of ** ** basis points is approximately ** ** basis points.

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faced by AmerenUE over the last nine years, or more significantly to the variability calculated by Dr. Proctor as being representative of a single Test Year.[141]

Mr. Arora calculates two different measures of price volatility in his direct testimony. While Mr. Arora states that these two analyses compare favorably,[142] the results can also be used to show a much lower range of net fuel cost using the analysis with the lower uncertainty factor. ** [redacted] .[143] [redacted] .**

** [redacted] .[144] [redacted]

[141] Proctor Rebuttal, Ex. 212.

[142] Arora Direct, Ex. 22 (HC), p. 8.

[143] Tr. 27:2418-2419 (HC).

[144] *Id.,* at 2427-2428 (HC).

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Mr. Arora defines market price uncertainty as "the standard deviation of the market prices for various time periods," and notes that "[t]he standard deviation is a measure of how widely values are dispersed from the average value."[148] Mr. Arora then

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[145] ** .**

[146] ** .**

[147] According to footnote (3) on MIEC Ex. 607, Brubaker Direct, Schedule MEB-FAC-1, the after-tax basis point loss is calculated as the after-tax income loss divided by $300,000. ** **

[148] Arora Direct, Ex. 22, p. 6 and n. 1.

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calculates the uncertainty factor by dividing the standard deviation by the average price.[149] Mr. Arora uses a comparison of the Test Year uncertainty factor to the uncertainty factor calculated from AmerenUE's nine-year history, 1999 to 2007, as an empirical verification of his Test Year model's results.[150] However, in rebuttal testimony, Dr. Proctor points out that "2005 was an exceptionally high price year. This was the result of two primary drivers, the rail problems with western coal and hurricanes Katrina and Rita. If the data from 2005 is removed from the set and the uncertainty factor is recalculated, the uncertainty factor drops significantly from 22% to 18.75%."[151] Thus, while the Test Year results showed an uncertainty factor of ** **,[152] and this uncertainty factor is higher than the uncertainty factor of 22% for the nine-year history,[153] this gap between Test Year results and the nine-year history is significantly greater when the anomaly that occurred in 2005 is removed from the nine-year history. Thus, the removal of the anomalous 2005 from the nine-year history further decreases the uncertainty that should have been reflected in the results for the Test Year Case.

Dr. Proctor further points out that because of the upward trend in electricity prices that occurred from 2002 through 2007, the standard deviation estimated from the nine-year history incorporates significant shifts in supply that are unlikely to occur within a single year.[154] By eliminating this upward price trend, Dr. Proctor shows that the

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[149] *Id*. at 7.

[150] *Id*. at 8.

[151] Proctor Rebuttal, Ex. 212, p. 15.

[152] Arora Direct, Ex. 22 (HC), Sch. AKA-E1.

[153] *Id*. at Sch. AKA-E2.

[154] Proctor Rebuttal, Ex. 212, p. 15.

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standard deviation for the nine-year history is reduced from $7.44 to $1.62 and the uncertainty factor is reduced from 22% to 5.68%.[155]

While these calculations are strong indications that Mr. Arora's model of power prices for the Test Year Case significantly overstate the market price uncertainty that AmerenUE will face for 2009, Dr. Proctor concludes his analysis of the result of AmerenUE's Test Year Case by showing that the true downside risk for 2009 from lower power prices is only one fourth of what is shown in AmerenUE's modeled results.

Dr. Proctor's rebuttal testimony clearly shows that the standard deviation from AmerenUE's Test Year results is too high by a factor of 4 times.[156] This reduces AmerenUE's estimates of downside risk for the Test Year to one fourth of what is shown in Table 1 of Mr. Arora's direct testimony. The result is a before-tax downside risk of **█**million, an after-tax potential loss of **█**million, and an after-tax potential ROE impact of **█** basis points. The Staff does not believe that this level of downside risk is sufficient to warrant the Commission granting AmerenUE's request for a FAC.

AmerenUE appeared to attack Staff witness Michael S. Proctor on the basis that he does not have electric utility operational experience whereas the AmerenUE witness Ajay K. Arora, as a 10 year employee of Ameren Corporation and its affiliates, does.[157] Dr. Proctor has a Ph.D. in Economics, has taught Economics at the university level, and is Chief Regulatory Economist in the Commission's Energy Department. He is currently serving as Chairman of the Southwest Power Pool Regional State Committee's Cost

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[155] *Id*. at 16.

[156] Proctor Rebuttal, Ex. 212, p. 31; Tr. 28:2700-2701.

[157] Arora Direct, Ex. 22, pp. 1-2; Arora Surrebuttal, Ex. 24, pp. 4-12, 31-32; Tr. 28:2707.

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Allocation Working Group, Chairman of the Organization of Midwest ISO States' (OMS') Financial Transmission Rights Working Group and Co-Chairman of the OMS' Transmission Pricing Working Group.[158]

For consistency of approach purposes, the Staff would note the testimony of Richard J. Mark, AmerenUE Senior Vice President of Missouri Energy Delivery since December 2004, regarding the KEMA report. Mr. Mark has a Bachelor of Science Degree in Child Development from Iowa State University and a Master of Science in Business Administration from National Louis University. His utility career commenced in January 2002. Mr. Mark states that the purpose of his direct testimony is, among other things, to discuss AmerenUE's efforts to harden the distribution system and to improve restoration of service after a major outage due to severe weather. He sponsors and attaches to his direct testimony the 197 page report prepared by KEMA, which Mr. Mark describes as an energy consulting and technology implementation expertise firm. The KEMA report is not sworn to and it bears no author(s) identification.[159] Obviously, AmerenUE deems Mr. Mark to be eminently qualified to provide testimony on reliability of service and weather related restoration of power, but not Dr. Proctor regarding the volatility and uncertainty of fuel costs and power prices. It appears that the distinguishing factor is that AmerenUE's witnesses provide service to at least one electric company whereas the Staff's witnesses do not, regardless of their years of experience, nature and level of education or training. Mr. Mark's sponsorship of the KEMA report would have drawn objections from Counsel for GPE/KCPL in the GPE – Aquila

[158] Proctor Rebuttal, Ex. 212, pp. 1-2.

[159] Mark Direct, Ex. 19, pp. 1-2, 12-15, and Sch. RJM-E1.

acquisition case and a ruling from the Commission regarding both the limits of his expertise and the credibility of the report.

Ms. Lena M. Mantle, Energy Department Manager, Utility Operations Division, was responsible for the FAC portion of the Staff Class Cost of Service Report and filed FAC surrebuttal testimony. Ms. Mantle related the Staff's opposition to AmerenUE's request for FAC authorization in this case on the grounds that AmerenUE's fuel and purchased power costs are not volatile enough to justify the implementation of a FAC at this time and a future rate case, not a FAC, is the proper means by which AmerenUE should recover its rising fuel costs.[160] She testified that although fuel costs are volatile, fuel types vary in their degree of volatility and there are procurement measures available, such as hedging, to reduce the volatility of each fuel type. In the case of spot price of natural gas, which has been very volatile, she noted that natural gas comprises merely 1.2% of AmerenUE's total fuel costs to serve its native load.[161]

Ms. Mantle stated that, due to the emission control equipment that AmerenUE is installing on the Sioux generating units, it is likely that AmerenUE will initiate another rate increase case not long after the operation-of-law date in the pending case, i.e., shortly after rate changes resulting from Case No. ER-2008-0318 take effect.[162] At hearing, she noted that besides the Sioux scrubbers that were being installed, and the completion of which AmerenUE has indicated might be deferred, there is the rebuilding of Taum Sauk that AmerenUE will want to place in rate base. Finally, Ms. Mantle related that if AmerenUE does not file a rate case soon after the Sioux environmental upgrades are

[160] Staff Cost of Service Report, Ex. 200, p. 60 (Mantle).

[161] *Id.,* at 62-63; Mantle Surrebuttal, Ex. 224, pp. 3-4.

[162] Staff Cost of Service Report, Ex. 200, p. 62 (Mantle).

completed, that would be an indication that AmerenUE can handle the uncertainties respecting fuel costs without a FAC.[163]

The Staff's fuel model calculated that approximately 97% of AmerenUE's generation to meet its net system requirements in the test year came from coal, hydroelectric, and nuclear sources. The model estimated that AmerenUE generates approximately 70% of the energy it needed to meet its net system requirements during the test year from coal. Although the costs of AmerenUE's fuels are not within AmerenUE's control, she asserted it does have some influence over the price it pays for coal due to its fuel purchasing policies and the large quantities of fuel that it purchases.[164] AmerenUE has addressed fuel price volatility through hedging. AmerenUE has much of its costs for coal, transportation of coal, uranium, and the conversion, enrichment, and fabrication of uranium hedged ** **[165]

AmerenUE has **

[163] Tr. 11:2656-2657; Mantle Surrebuttal, Ex. 224, p. 5.

[164] Staff Cost of Service Report, Ex. 200, p. 63 (Mantle); Mantle Surrebuttal, Ex. 224, pp. 5, 6.

[165] Staff Report, *supra* (HC).

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**[166]

Ms. Mantle noted that the Commission found in the Aquila and Empire rate cases in which it authorized their use of a FAC that two components of fuel and purchased power, the cost of natural gas and spot purchased power, had fluctuated significantly in the past and were expected to be volatile in the future. AmerenUE uses a much smaller percentage of natural gas and spot purchased power to serve its retail and wholesale customers, excluding off-system sales, than either Aquila or Empire.[167] Whereas the Staff's fuel run, at the time of the filing of the Staff's direct case, estimated that less than 2% of AmerenUE's net system input requirements are met with natural gas generation and spot purchased power and comprise less than 6% of its total fuel costs. A large percentage of AmerenUE's capacity is low variable cost baseload generation from which AmerenUE makes significant off-system sales. There is little change in the percent of net system requirements met by different fuel types by AmerenUE since AmerenUE's last rate case when the Commission denied AmerenUE the use of a FAC.[168]

In contrast the Staff's final fuel run in Aquila's last general rate increase case estimated Aquila met 14.7% of its net system requirements with natural gas and spot purchased power (more than seven times that of AmerenUE) resulting in natural gas and spot purchase power costs being 44% of Aquila's total variable fuel cost (more than 8 times the percent of total cost of AmerenUE). The Staff's final fuel run in Empire's last general rate increase case estimated natural gas and spot purchased power provided

[166] *Id.;* Mantle Surrebuttal, Ex. 224, pp. 4, 12, and Sch. 1; Ex. 439 (HC), p. 92.

[167] Staff Cost of Service Report, Ex. 200, pp. 60-61 (Mantle); Mantle Surrebuttal, Ex. 224, p. 2.

[168] Staff Report, *supra,* at pp. 61, 64; Mantle Surrebuttal, Ex. 224, p.2; Tr. 26:2607-2608.

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26.4% of Empire's energy needs (more than thirteen times that of AmerenUE), which comprised 55.1% of Empire's total variable fuel and purchased power costs (more than nine times the percent of cost of AmerenUE).[169]

AmerenUE witness Mr. Aurora in his rebuttal testimony asserted Ms. Mantle's analysis and her Table LM1 are flawed for three reasons. Mr. Arora produced in his rebuttal testimony a Table AKA-R1 entitled "Comparison Of Fuel And Power Market Exposure For Aquila, Empire, And AmerenUE," which he asserts is in essence a correction of Ms. Mantle's Table LM1. He, and also AmerenUE witness Martin J. Lyons, Jr., asserted in rebuttal testimony that the first flaw in Ms. Mantle's Table LM1 is that Ms. Mantle ignored that off-system sales are included in AmerenUE's proposed FAC.[170] Ms. Mantle responded that the Staff did not ignore off-system sales and in fact discussed off-system sales in the FAC section of the Staff's Cost of Service Report. Empire and Aquila are in a very different situation than AmerenUE respecting off-system sales and to have included off-system sales in Ms. Mantle's comparison of AmerenUE, Empire, and Aquila would have been inappropriate. Ms. Mantle pointed out that AmerenUE would have a greater incentive to make off-system sales without a FAC since without a FAC, 100% of off-system sales margin above what is included in base rates could be used to offset cost increases and, if high enough, increase shareholder earnings. If AmerenUE is granted a FAC which includes off-system sales as AmerenUE proposes, AmerenUE would only retain $5 of every $100 dollars of off-system sales margin above what is in base rates to use to offset increased costs and increase shareholder earnings.[171]

[169] Mantle Surrebuttal, Ex. 224, p. 2; Tr. 26:2607-2608.

[170] Aurora Rebuttal, Ex. 23, pp. 2, 11-13; Lyons Rebuttal, Ex. 42, p. 30.

[171] Tr. 26:2671; Mantle Surrebuttal, Ex. 224, p. 9.

Ms. Mantle takes issue with Mr. Arora's Table AKA-R1 "Comparison of Fuel And Power Market Exposure For Aquila, Empire, And AmerenUE" on more than the fact that Mr. Arora includes off-system sales. Ms. Mantle notes that the percentages on line [14] Natural Gas And Net Power Exposure of Table AKA-R1 are similar for Aquila, Empire and AmerenUE because, in addition to including off-system sales, the absolute value of the difference between purchases and sales is used by Mr. Arora. Aquila and Empire are net purchasers of short-term, non-firm energy. AmerenUE sells eight to ten times the amount of short-term, non-firm energy that it purchases. Ms. Mantle listed other items in Table AKA-R1 that demonstrate differences among Aquila, Empire, and AmerenUE, which show the fallacy of attempting to use Table AKA-R1 to contend that the three utilities are similar.[172]

AmerenUE witness Mr. Arora in his rebuttal testimony asserted a second flaw in Ms. Mantle's analysis as summarized in her Table LM1 is that it implicitly assumes coal is necessarily less volatile or can be hedged better than natural gas.[173] Scott A. Glaeser, Vice President of Gas Supply and System Control at AmerenEnergy Fuels And Services Company submitted direct testimony that historically, the collective forecasting and futures trading activities of energy industry experts, traders, and physical market participants have not been able to predict and forecast natural gas prices with any degree of accuracy or certainty.[174] Mr. Arora contends that he has demonstrated that the volatility of coal prices has been similar to the volatility of natural gas prices.[175] Dr.

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[172] Mantle Surrebuttal, Ex. 224, p. 7.

[173] Arora Rebuttal, Ex. 23, p.13.

[174] Glaeser Direct, Ex. 34, pp. 8-9.

[175] Arora Rebuttal, Ex. 23, p.13.

Proctor, in particular, addressed this assertion of Mr. Arora, but it also was noted by Ms. Mantle, and will be discussed below. Not only does Mr. Arora claim that Aquila and Empire should be able to not only hedge base- and intermediate-load gas and purchased power exposure through financial instruments or long-term contracts, but to also do so easier than AmerenUE hedges the coal requirements for its baseload generation fleet.[176]

Ameren UE witnesses Messrs. Arora and Robert K. Neff addressed in their rebuttal testimonies that the spot market price for coal is volatile. Ms. Mantle did not disagree that the spot market price for coal is volatile, but she testified that the uncertainty regarding spot market price volatility is much different from the uncertainty regarding non-spot market price volatility. Also, she pointed out that most importantly, AmerenUE is not buying coal on the spot market, and has mitigated the volatility of coal prices through its use of coal contracts that define the cost of coal on terms other than daily spot market prices. Besides, the NYMEX spot market for coal is a new market with very low open interest, i.e., very few open contracts. She noted that AmerenUE has over 20 coal contracts and that the majority of the contracts are for terms of two to six years.[177]

Ms. Mantle also surrebutted Mr. Arora's rebuttal testimony that Empire can hedge natural gas and Aquila can hedge power purchases much like AmerenUE hedges coal. She testified that unlike coal where long-term contracts are the norm, long-term contracts for natural gas are not the norm. Whereas the spot market for natural gas has heavy trading and speculators can impact the cost, the spot market for coal is not mature and again most trading still occurs through long-term contracts. She explained that hedging power purchases, the output achieved by burning a fuel source, is different from hedging

[176] *Id.,* at 13-14.

[177] Mantle Surrebuttal, Ex. 224, pp. 4, 6.

coal, a fuel source used to generate electricity. She noted that unlike Aquila and Empire, the volatility of gas costs has an offsetting effect on AmerenUE's off-system sales.[178]

AmerenUE witness Mr. Arora in his rebuttal testimony asserted a third flaw in Ms. Mantle's analysis as summarized in her Table LM1 is that it implicitly suggests that AmerenUE should not receive an FAC because AmerenUE did a better job than Aquila and Empire in developing a low-cost generation mix and in hedging its base-load fuel costs.[179] Mr. Lyons equates denying AmerenUE a FAC to penalizing AmerenUE and Mr. Neff suggests that AmerenUE should consider reducing or eliminating its hedging program in order to make AmerenUE's short-term coal expense volatile.[180] Ms. Mantle responded that granting a FAC should not be a reward or a penalty to electric utilities and the Commission would not be penalizing AmerenUE for its good performance if the Commission did not grant AmerenUE a FAC because among other things AmerenUE has hedged its fuel costs. Ms. Mantle stated that the FAC is:

> . . . a tool given to the Commission by the Legislature to use at the Commission's discretion when it finds an electric utility meets the criteria of Section 386.266. I believe the Commission should deny an electric utility a FAC if it is not prudently using all of the resources available for it to reduce volatility and uncertainty. But prudent and efficient performance from an electric utility should not automatically result in the Commission granting an electric utility a FAC.[181]

Also, contrary to Mr. Arora's contentions about the Staff's analysis is the analysis of MIEC witness Maurice Brubaker. The level of net fuel cost as well as the relationship between net fuel cost and ROE is much different for AmerenUE than for Aquila and

[178] *Id.,* at 8.

[179] Arora Rebuttal, Ex. 23, pp. 14-15.

[180] Lyons Rebuttal, Ex. 42, p. 31; Neff Rebuttal, Ex. 48, p. 14.

[181] Mantle Surrebuttal, Ex. 224, p. 12.

Empire. AmerenUE's testimony does not address this matter. The September 11, 2008, Part 2: FAC direct testimony of Mr. Brubaker does address this matter.[182] Mr. Brubaker's testimony states, in part, as follows:[183]

> . . . Note that in the case of Aquila and Empire District that base fuel costs range between 35% and 49% of the common equity, whereas for AmerenUE it is only 12%. This indicates that fuel costs, and therefore changes in fuel costs, will have a substantially greater impact on Aquila and Empire than is true for AmerenUE.

Stephen G. Hill, the Staff's Return on Equity (ROE) and Capital Structure witness, testified that his ROE recommended range of 9.00% to 9.75% is based on the Staff's opposition to an FAC and that he did not make a specific quantified recommendation regarding a FAC itself. He said that because AmerenUE's common equity ratio of almost 51% is significantly higher than on average for any of the sample groups studied by Dr. Morin, Mr. Gorman, or himself, his recommended ROE would be between the low-end 9.00% and the mid-range 9.375% to reflect less financial risk and AmerenUE's ROE should be below the average for the groups if the Commission were to grant AmerenUE a FAC. He related that he agreed with Dr. Morin's quantification of the value of a FAC as approximately 25 basis points, and identified the after tax value of 25 basis points with a 51 % common equity ratio and a $5.8 billion rate base as approximately $7.5 million. Ratepayers of course pay on a pretax basis which Mr. Hill noted adds 35-40% to the $7.5 million.[184] Mr. Hill testified before the Commission in

[182] Brubaker Direct, Ex. 607.

[183] *Id.,* at 12-13.

[184] Tr. 15:485-486,.497 (Hill).

Case No. ER-2007-0002 on behalf of the Staff, when the Staff opposed AmerenUE's first request for a FAC.[185]

Mr. Hill did address in his direct testimony the fact that AmerenUE does not have a FAC:

> I have estimated the equity capital cost of the Company's electric utility operations to fall in a range of 9.00% to 9 .75%. Within that range, I estimate the equity cost of the Company's utility operations to be 9.50% above the mid-point of a reasonable range of equity costs due to the combination of AmerenUE's lower financial risk and higher risk related to its lack of a fuel adjustment clause.[186]

And further:

> That lower financial risk, alone, indicates a point-estimate cost of equity for AmerenUE below the 9.375% mid-point of a reasonable range for my sample group of electric companies.
>
> However, AmerenUE does not currently have a fuel adjustment clause and, as this Commission recognized in its recent decision in its Report and Order in the Empire District Electric Company rate proceeding (Case No. ER-2008-0093, July 30, 2008, pp. 24, 25), most electric utilities do have fuel adjustment clauses, and those clauses lower investment risk. Absent such a clause, AmerenUE would have a cost of equity capital somewhat above the average for the sample group. Therefore, an equity return of 9.50%, above the mid-point of a reasonable range of equity cost for similar-risk firms, would be reasonable for ratemaking purposes in this proceeding.[187]

Roger A. Morin, Ameren UE's Return on Equity witness, testified that rating agencies do not upgrade or downgrade utilities on the basis of a single factor such as the presence or absence of a FAC.[188] He said that he had not studied the FAC situation of utilities around the country in detail, but he looked at almost 100 utilities and 88 had

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[185] Hill Direct, Ex. 203, p. 1; *Re Union Electric Co., d/b/a AmerenUE (AmerenUE)*, Case No. ER-2007-0002, pp. 35-37, 43 (*Report & Order,* 2007).

[186] Hill Direct, Ex. 203, p. 4.

[187] *Id.,* at 44.

[188] Tr. 15:363.

FACs. He could not relate how off-system sales and capacity costs are treated, or whether generating unit outages and fuel costs are reviewed for prudence. He said that AmerenUE's proposed 95% / 5% sharing usually compares to a one-for-one in most regimes.[189]

AmerenUE had marked and received into evidence as Exhibit 61 a Standard & Poor's Ratings Direct research report entitled "Assessing U.S. Utility Regulatory Environments," and dated November 7, 2008. In an introductory section, the report on page 1 states that "[a] utility management's skill in managing regulatory risk can in many cases overcome a difficult regulatory environment."[190] In a Background section also on page 1, the report further states on this matter:[191]

> . . . the quality of regulation is at the forefront of our analysis of utility creditworthiness.
>
> * * *
>
> . . . The quality of the regulation experienced by a company is often the product of the company's management and business strategy as much as its regulators. The regulatory climate assessments only serve as a baseline of our opinion on the fundamental attitude of a jurisdiction toward the credit quality of the utilities in that state, and they are the starting point for Standard & Poor's analysis of the regulatory risk of each rated utility. . . .

In the section entitled Cash Flow Support and Stability on page 4 appears the following sentences which bring to mind the KCPL Regulation Plan with the additional amortizations facet respecting the construction of Iatan 2 and various generating facility environmental upgrades, including Iatan 1:[192]

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[189] Tr. 15:479-481.

[190] Ex. 61.

[191] *Id.*

[192] *Id.*

> Especially during upswings in the capital expenditure cycle, such as we are experiencing now, a jurisdiction's willingness to support large capital projects with cash during the construction phase is an important aspect of our analysis. This is especially true for ventures with big budgets and long lead times, such as baseload coal-fired or nuclear power plants and high-voltage transmission lines that are susceptible to construction delays. . . .

AmerenUE had marked and received into evidence as Exhibit 62, a Fitch Ratings report entitled "EEI 2008 Wrap-Up: Cost Of Capital Rising" and dated November 17, 2008. In the section entitled Investing In An Unpredictable World appears the following sentence on page 2:[193]

> . . . Meanwhile, funding costs for new debt for a 'BBB' utility, in the range of 9% and higher, are now bumping up against authorized returns on equity, which average 10.25%-10.5% for the industry, and are as low as 9.1% in New York and New Mexico. . . .

MIEC's expert witness on Return on Equity, Michael Gorman of Brubaker & Associates, Inc., testified on behalf of MIEC, that in his testimony he assumed no FAC awarded to AmerenUE as a result of the pending rate increase case. He said that if AmerenUE were granted a FAC, that would reduce AmerenUE's risk and would justify a lower ROE.[194] He stated that 25 basis points was a reasonable estimate for the value of a FAC and that Billie Sue LaConte's estimate of the value of a FAC of 20 basis points is "in the ballpark."[195] Mr. Gorman disagreed with Dr. Morin regarding the number of FACs that are 100% pass through clauses:[196]

> There are fuel adjustment mechanisms which reconcile total fuel, prudently incurred fuel costs with actual fuel cost recovery.

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[193] Ex. 62.

[194] Tr. 15:543-544.

[195] *Id.,* at 548-549.

[196] *Id*. at 588.

> But many utilities and jurisdictions have fuel adjustment mechanisms that either have band widths, have limitations on fuel cost adjustments based on an earnings test or have other restrictions on adjusting rates given the regulatory parameters that they find appropriate.

AmerenUE filed the direct testimonies of 20 separate witnesses. Of these 20 witnesses, 8 individuals filed direct testimony solely for FAC purposes. Of the 12 other witnesses, some addressed the FAC issue in addition to another issue or issues. One of the witnesses whose direct testimony was for FAC purposes alone was Kenneth Gordon, former Chairman of the Maine Commission (1988-1992) and the Massachusetts Commission (1993-1995). His Schedule KG-E1 to his direct testimony indicates that he has not submitted testimony in any proceeding after November 1, 2004, other than the instant proceeding, and he has not submitted testimony respecting regional transmission organizations or independent transmission system operators, among other subject matter. He has submitted testimony on "code of conduct" issues.[197]

In Schedule KG-SE2 to his surrebuttal testimony, Dr. Gordon quotes selectively from ratings agency reports respecting their views on FACs.[198] He quotes from May 24, 2008, and August 12, 2008, Standard & Poor's Ratings Direct reports on AmerenUE, which he notes S&P "cited the '[c]hallenging regulatory climate in Missouri and current lack of a fuel adjustment clause,' as one of AmerenUE's weaknesses."[199] Dr. Gordon acknowledged that these documents were not provided as part of his workpapers.[200] The Staff had marked and received into evidence as Staff Exhibit 243 a May 28, 2008,

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[197] Gordon Direct, Ex. 44, Sch. KG-E1.

[198] Gordon Surrebuttal, Ex. 45.

[199] *Id.,* at Sch. KG-SE2-p. 2.

[200] Tr. 24:2327.

Standard & Poor's Ratings Direct report on AmerenUE which contains the sentence cited by Dr. Gordon but also states, in part, as follows:[201]

> Major Rating Factors
>
> * * *
>
> Weaknesses:
>
> - Challenging regulatory climate in Missouri and current lack of a fuel adjustment clause;
> - Inherent operating and financial challenges of owning a nuclear unit whose performance has been mixed;
> - Escalating capital outlays for investments in infrastructure and pollution control equipment; and
> - Parent's investment in riskier unregulated generation business.
>
> Rationale
>
> The ratings on Union Electric Co. Ameren Corp.'s largest subsidiary, are based on the consolidated credit profile of the Ameren family of companies. . . . Arneren's units also consist of unregulated Ameren Energy Generating Co. (AEGC), CILCORP Inc., the intermediate holding company of CILCO, and AmerenEnergy Resources Generating Co. (AERG), CILCO's unregulated generation subsidiary. Ameren's unregulated businesses represent about 45% of net income.
>
> * * *
>
> Union Electric is in healthier financial condition on a stand-alone basis, than its parent owing to a lower debt burden. In addition, the company has a slightly better business position of 'strong', reflecting the absence of the unregulated generation businesses but encompassing many of the aforementioned attributes and weaknesses.
>
> In light of rising fuel and transportation costs, material outlays for environmental compliance and energy infrastructure to enhance reliability, the company will need to control costs, improve plant performance, finance conservatively, and secure rate relief to enhance credit quality. . . .

[201] Ex.. 243, pp. 1-2.

* * *

> Outlook
>
> Ratings stability for Union Electric mirrors that of parent Ameren and reflects the elimination of a rate-freeze threat and the manageable rate-relief package established in Illinois. The stable outlook also incorporates expectations for sufficient future rate relief in both Illinois and Missouri and management's continuing credit-supportive actions. Downside momentum would result from a weakening of consolidated financial metrics beyond current expectations or if rising power prices were again to become a high priority target of the executive and legislative branches in Illinois. In light of accelerating capital outlays, rising operating, fuel, and transportation costs, and expected slippage in the company's overall financial condition, upgrade potential in the near term is unlikely.

Mr. Gordon also relies in his surrebuttal testimony on a Standard & Poor's Ratings Direct report entitled "Fuel And Power Adjusters Underpin Post-Crisis Credit Quality of Western Utilities" dated October 14, 2004.[202] The Staff had a copy of a document containing the language which Dr. Gordon selectively quotes marked and received as Staff Ex. 244. The sections that Dr. Gordon quotes, let alone those that he chooses not to, indicate the limitations of this document for the purposes that AmerenUE is seeking to use it. One sentence that Dr. Gordon has excised from a paragraph he quotes states: "The financial distress that visited public power and investor-owned utilities (IOU) was in part attributable to the absence of fuel and purchased-power adjustment mechanisms (FPPA), coupled with a reliance on the wholesale market for significant supplies."[203] While AmerenUE has no FAC, it does not rely on the wholesale market to serve its native load.

Various AmerenUE FAC witnesses, Thomas R. Voss, Martin J. Lyons, Jr., and Robert K. Neff, relate that AmerenUE needs a FAC to deal with regulatory lag. As an

[202] Gordon Surrebuttal, Ex. 45, Sch. KG-SE2-pp.1, 2-3; Tr. 24:2329-2330.

[203] Ex. 244, p. 1.

example of this phenomenon, they testified that AmerenUE faces substantial increases in the delivered price of coal on January 1, 2009, and January 1 of subsequent years.[204] The Commission rejected this regulatory lag argument in its decision in the last AmerenUE rate increase case, Case No. ER-2007-0002:[205]

> AmerenUE was able to demonstrate that its fuel costs will be increasing in coming years. In fact, AmerenUE knows its coal costs will increase because it has already purchased a large percentage of the coal it will need for the next several years, and freight costs are largely locked in through long-term contracts as well. Thus AmerenUE's fuel costs, while certainly rising, cannot be said to be volatile.
>
> Markets in which prices are volatile tend to go up and down in an unpredictable manner. When a utility's fuel and purchased power costs are swinging in that way, the time consuming ratemaking process cannot possibly keep up with the swings. As a result, in those circumstances, a fuel adjustment clause may be needed to protect both the utility and its ratepayers from inappropriately low or high rates. Because AmerenUE's costs are simply rising, that sort of protection is not needed. . . . rising, but known, fuel costs are the worst reason to implement a fuel adjustment clause because such a fuel adjustment clause allows the utility to recover a single known rising cost while avoiding a rate case in which all its other expenses and revenue, which are changing in the background, will be examined and perhaps used to offset all or part of the rising fuel cost to avoid an unnecessary rate increase.

Ms. Mantle noted that fuel costs changed over the 20 year period that AmerenUE did not file a rate increase case.[206]

Each utility regulated by the Commission has the freedom to choose when it will file for rate relief. It is not unusual for a utility to make that decision, file its rate increase case and then fault the Staff for the consequences of that decision. The Commission should not ignore the effect of the timing of the current AmerenUE rate case in the

[204] Voss Direct, Ex. 1, p. 6; Voss Rebuttal, Ex. 2, pp. 2, 6; Lyons Rebuttal, Ex. 42, pp. 11-14; and Neff Rebuttal, Ex. 48, pp. 5-6.

[205] Case No. ER-2007-0002, *Report & Order,* pp. 22-23 (2007); footnotes omitted.

[206] Mantle Surrebuttal, Ex. 224, p. 6.

Commission's decision whether to grant AmerenUE's request for a FAC. The choice of timing for the filing of a rate case is at the discretion of the utility. Therefore, the Commission should not ignore any impacts that the timing of the filing of a rate case may have on the utility's requests. In brief, were the Commission to not take the timing into account, this would allow a utility to manipulate the potential impact on its ability to earn its authorized rate of return.

AmerenUE's claims of the effects of regulatory lag and the fuel costs it has foregone recovery of should be given some scrutiny given the timing AmerenUE chose for its case. The effective date of the Report & Order in AmerenUE's last rate increase case, Case No. ER-2007-0002, was June 1, 2007. AmerenUE filed its next rate increase case on April 4, 2008, 308 days after June 1, 2007. The effective date of the Report & Order in The Empire District Electric Company's rate increase case ER-2006-0315 was December 31, 2006. Empire did not receive authority for a FAC and Empire filed its next rate increase case, ER-2008-0093, on October 1, 2007, 274 days after December 31, 2006. The Commission issued a Report & Order Upon Reconsideration in Case No. ER-2006-0315 on March 26, 2008. KCPL, which as part of its Regulatory Plan forewent the opportunity to use the FAC provisions of S.B. 179 during the Regulatory Plan, filed a rate increase case on February 1, 2006, ER-2006-0314, and filed its next rate increase case on February 1, 2007, ER-2007-0291, 31days after the effective date of the Report & Order in its preceding rate increase case. KCPL filed its third rate increase case, ER-2009-0089, on September 5, 2009, 248 days after the effective date of the Report & Order in its preceding rate increase case. Of course, the Commission authorized Aquila to use an FAC in its Report & Order in Case No. ER-2007-0004.

Staff witness Lena M. Mantle relates in her surrebuttal testimony that AmerenUE discussed its intended early April 2008 filing date of its rate increase case with the Staff and the Staff suggested that AmerenUE file in early July 2008 instead so that the January 1, 2009, coal contract increases could be included in the true-up as in Case No. ER-2007-0002, but that AmerenUE rejected the Staff's recommendation without providing the Staff an explanation why having otherwise waited, AmerenUE would expose itself to the effect of January 1, 2009 coal price increases with a filing in April 2008.[207]

** ** [208]

[207] Mantle Surrebuttal, Ex. 224, p. 11.

[208] Ex. 433 (HC), p.17; Tr. 25:2205-2210, 2250-2255 (HC); Tr. 24:2307-2308.

NP

b. **FAC Structure** – If the Commission authorizes a FAC for AmerenUE, what are the proposals of the various parties for fuel and purchased power cost recovery pursuant to a FAC to be adopted for AmerenUE?

i. AmerenUE proposal - 95% of the difference between actual fuel and purchased power costs, net of off-system sales and the cost included in base rates

ii. MIEC proposal - 80% / 20%, with an annual limit plus or minus 50 basis points impact

iii. State proposal - 80% / 20%

iv. OPC proposal – 50% / 50%

Staff's position: The Staff has no position on this issue.

c. – h. **Settled.**

9. **Callaway Unit II Combined Construction And Operating License Application (COLA) Costs:** Should or can the costs of the combined construction and operating license application to the Nuclear Regulatory Commission for the prospective Callaway II unit be recovered in rates by AmerenUE? Can any such recovery proceed without a determination of public convenience and necessity or does AmerenUE intend to rely on the 1975 certificate?

Staff's position: *Callaway II* The Company has proposed to include in plant in service the cost of licensing Callaway II. The Staff opposes this adjustment since the process of obtaining the new license has not been completed. The application has been sent to the NRC, but a license, if granted, is not expected until 2011.

The Staff awaits AmerenUE's Brief to see if AmerenUE further develops its position on the Callaway 2 issue as AmerenUE has used the various phases of this case to develop a position on this matter. AmerenUE had two sentences of testimony in its April 4, 2008, direct case and two sentences of testimony in its June 16, 2008, supplemental direct filing.[209] The Staff filed direct testimony on this issue.[210] AmerenUE filed no rebuttal testimony in response to the Staff's direct testimony on this issue, but AmerenUE

[209] Weiss Direct, Ex. 10, p. 10, Weiss Supplemental Direct, Ex. 11, p. 8.

[210] Staff Cost of Service Report, Ex. 200, p. 6 (Rackers).

filed surrebuttal testimony in response to the OPC's rebuttal testimony.[211] The Staff also filed surrebuttal testimony on November 5, 2008.[212] Counsel for AmerenUE in his opening statement before the hearing of the Callaway 2 issue on December 1, 2008, announced new elements of AmerenUE's position, not previously revealed by AmerenUE and, as a consequence, made AmerenUE's position more complete than even was represented in AmerenUE's Statement of Positions filed on November 13, 2008:[213]

> I would note that the company spent about $45 million on the COLA application during the test year, but it's booked in the books of account as a rate base item. So the issue in the case is not a $45 million revenue requirement issue, it's a approximately $5 million revenue requirement issue.
>
> I think this is largely a legal issue that the company will address further in its brief. In short, the company believes the COLA is not part of the construction cost of a new Callaway 2 unit, and thus, does not violate Proposition 1 because a COLA may have independent value apart from the construction of a specific unit.
>
> As the Commission knows, UE has not decided whether the Callaway 2 unit would or would not be built. UE might not build it or another unit might be built as a merchant plant. In those cases, another operator might find the COLA to be valuable as it would carry with it the tax credits that I mentioned a moment ago, and it would also carry with it the fact that it's in the NRC's queue ahead of many other applications which also may have value.
>
> The company seeks recovery of these costs in this rate case because the company believes it would be appropriate -- it would be inappropriate to saddle the company's shareholders with the cost and risks associated with pursuing the COLA and the cost is pretty substantial given that the filing of the COLA when it was filed preserved these protection tax credits for the potential benefit of ratepayers.
>
> If the costs are not allowed, then the shareholders effectively will have borne all of the risks associated with what I believe may end up

[211] Kind Rebuttal, Ex. 404, pp. 11-13; Arora Surrebuttal, Ex. 24, pp. 30-31.

[212] Rackers Surrebuttal, Ex. 202, pp. 4-6.

[213] Tr. 18:1276-1278.

> being something on the order of $70 million in order to prosecute that application to completion.
>
> Finally, if a regulated Callaway Unit 2 were not built, the sums collected from customers relating to the COLA could be returned to customers with interest through an amortization in connection with a later rate case. The company believes this is the most fair ratemaking approach to this issue and it would fully protect customers while not saddling shareholders with the risks associated with pursuing the COLA when it did. Thank you very much.

Callaway 2 is not the only issue where AmerenUE has developed its position, or continued to develop its position, respecting its own case after originally filing its case, and the Staff and other parties have been required to respond as best they can as AmerenUE reveals those developments or changes its position.

AmerenUE witness Gary S. Weiss in response to cross-examination from the OPC on December 1, 2008, provided sworn testimony regarding AmerenUE's further development of AmerenUE's position on the Callaway 2 combined Construction and Operating License Application (COLA) issue. First, he testified that the COLA costs are presently recorded in the construction work in progress (CWIP) and construction overhead accounts, where they accrue allowance for funds used during construction (AFUDC). He said that he was not sure how long AmerenUE can continue to accrue AFUDC on the COLA costs in those accounts: "That's still being researched by our property accounting department."[214] Mr. Weiss then testified as follows:[215]

> Q. Now, the proposed adjustment that you have in this case moves the COLA costs into the miscellaneous and tangible plant production account; is that correct?
>
> A. That's correct.

[214] Tr. 18:1296-1298 (Weiss).

[215] Tr. 18:1298-1301 (Weiss).

Q. And is it correct that UE has a five-year depreciation rate for that account?

A. The proposal in this filing was not to start amortizing the COLA costs. Our proposal -- proposal was just to earn a return on and not a return of that investment.

Q. So in terms of depreciation, the dollars for -- for the COLA costs would be treated differently from the other items in that account; is that correct?

A. That's correct. We have various amortization periods for intangible plant.

Q. And what is your proposal for amortization of the COLA costs?

A. I would assume we would amortize the cost of the COLA over the life of the Callaway plant.

Q. Beginning when?

A. When Callaway 2 went into service.

Q. And when is the most likely day that Callaway 2 will go into service?

A. I do not know that date.

Q. Well, let's just for -- for purposes of assumption, let's say it's 2018. Can you make that assumption?

A. I can make that assumption.

Q. Okay. Between now and 2018, it's your proposal that Ameren -- AmerenUE will earn a return on the COLA costs at whatever its authorized rate of return is; is that correct?

A. That's correct.

Q. Between now and 2018, will that asset depreciate at all?

A. No, that is not in the proposal.

Q. If, for example, the Callaway 2 plant doesn't go into service until 2020, is it your proposal that you'll earn a return on those dollars until 2020?

A. That is correct.

Q. Assume with me that a decision is not made about whether or not to proceed with Callaway 2 until 2018. Is it your proposal that AmerenUE will earn a return on those dollars until such time as a decision is made?

A. That is correct.

Q. And if in -- at some time in the future, say, for example, 2018, AmerenUE decides not to proceed with the building of Callaway 2, what will happen to the returns that ratepayers have -- have paid according to your proposal between now and then?

A. I would assume those returns would be refunded to ratepayers or amortized over a period of years with interest. The ratepayers would be made whole.

Q. And why would you assume that?

A. If we decide not to build the plant and the ratepayers have paid the carrying costs of that plant, then they should receive a refund of the cost that they paid.

Q. So you're willing to commit as part of your proposal in this case that they will be returned?

A. I am.

Q. Are you authorized to make that commitment on behalf of your company?

A. I'm not sure, but I -- you know, you asked me the question and that's my opinion.

During cross-examination AmerenUE President and Chief Executive Officer, Thomas R. Voss, seemed to indicate that he equated COLA costs with the Commission's Chapter 22 electric resource planning function.[216] Mr. Weiss related that AmerenUE charges electric resource planning costs to operating expenses rather than CWIP or plant in service.[217]

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[216] Tr. 13:152-154 (Voss).

[217] Tr. 18:1314-1315.

Ameren Services Company Director of Corporate Planning, Mr. Ajay K. Arora testified that, as a consequence of filing the COLA, "AmerenUE is, in essence, able to create an asset that is potentially marketable."[218] He further testified that he did not know what the market value would be for a COLA, and not to his knowledge has there ever been a COLA sold.[219] Public Counsel's Exhibit 426 is a copy of a data request to AmerenUE which asks as follows, and shows AmerenUE's response regarding the "separate value" that AmerenUE purports the COLA has:[220]

> UE's response to Staff DR No. 0096 states that "the Operating License has a separate value whether or not the Callaway 2 plant is ever built by AmerenUE." Please provide a copy of all documents created within the last 24 months by or for UE or its affiliates that contain descriptions or analysis of the "separate value" that the "Operating License" is expected to have even if Callaway 2 is never built by AmerenUE.
>
> Response:
>
> No such document exists.

Respecting whether he reviewed the COLA, Mr. Arora stated: "I have reviewed a part of a section, I believe."[221] When asked if he performed any work on the COLA, he responded that he was asked to review portions of it: "the area that dealt with the need for power, because it was based on the AmerenUE IRP."[222]

Whatever value the COLA has, it relates to the construction of a nuclear power plant. Therefore, for an electrical corporation regulated by this Commission, § 393.135

[218] Tr. 18:1319; Ex. 22, p. 1.

[219] Tr. 18:1320.

[220] Tr. 18:1323-1324.

[221] Tr. 18:1351-1352.

[222] *Id*. at 1352.

RSMo., applies. Section 1.1.5 Requested Licenses and Authorized Uses of Part I: General Information of the AmerenUE Cola states as follows:[223]

1.1.5 REQUESTED LICENSES AND AUTHORIZED USES

> This application is for a Class 103 combined license under 10 CFR 52 (CFR, 2007b) to construct and operate a U.S. EPR nuclear power plant unit at the site of {Callaway Plant Unit 1}, located near {Reform, Missouri}. This U.S. EPR nuclear power plant unit will be used to produce electricity for sale. The period of time for which the license for the unit is requested shall begin upon the NRC's granting of the combined license for {Callaway Plant Unit 2} and shall expire 40 years from the date upon which the NRC makes a finding that acceptance criteria are met under 10 CFR 52.103(g) (CFR, 2007c) or allowing operation during an interim period under 10 CFR 52.103(c) (CFR, 2007c).
>
> In addition, this application is for the necessary licenses issued under 10 CFR 30 (CFR, 2007d), 10 CFR 40 (CFR 2007e), and 10 CFR 70 (CFR, 2007f) to receive, possess, and use byproduct, source and special nuclear material. Byproduct, source, and special nuclear material shall be in the form of sealed neutron sources for reactor startup, sealed sources for reactor instrumentation and radiation monitoring equipment calibration, and fission detectors in amounts as required. Byproduct, source, and special nuclear material in amounts as required, without restriction to chemical or physical form, shall be for sample analysis or instrument and equipment calibration or associated with radioactive apparatus or components. Special nuclear material shall be in the form of reactor fuel, in accordance with limitations for storage and amounts required for reactor operation, as described in Part 2 of this Combined License Application.
>
> The current scheduled date for the completion of construction of {Callaway Plant Unit 2 is December 2017}.

Staff auditor Stephen M. Rackers is responsible for the "Callaway II" section of the Staff's Cost of Service Report and filed surrebuttal testimony on the Callaway 2 issue. It is the Staff's position that the COLA costs are a cost of constructing Callaway 2,

[223] Ex. 411, p. 1-9.

which is not "fully operational and used for service" at this time and as a consequence of § 393.135, RSMo., is booked in construction work in progress (CWIP).[224]

Mr. Rackers testified that AmerenUE is requesting that the Commission deviate from properly accounting for these costs according to the Federal Energy Regulatory Commission (FERC) Uniform System of Accounts (USOA) and include costs related to plant that is incomplete in AmerenUE's cost of service in this case.[225] Counsel for the Staff believes that what AmerenUE is proposing is a violation of § 393.135 and so advised Mr. Rackers.[226]

From the outset the Staff wants to make it clear that it has not proposed a disallowance of costs. The Staff is proposing that the Callaway 2 COLA costs continue to be treated as CWIP and continue to accrue AFUDC.[227] AFUDC is an accounting convention used to capitalize the financing costs of a construction project until the project is recognized as being in commercial operation, mandated in Missouri for electrical corporations under § 393.135, so that ratepayers do not pay for the costs of construction until the plant is, in the terminology of § 393.135, "fully operational and used for service." Once the construction project is fully operational and used for service, the capitalized financing cost is included in rate base and the utility is allowed to earn both a return of and return on the investment.

The Western District Court of Appeals in 1982 sought to explain CWIP in a Southwestern Bell Telephone Company rate increase case on appeal to it respecting,

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[224] Staff Cost of Service Report, Ex. 200, p. 6 (Rackers); Rackers Surrebuttal, Ex. 202, pp. 4-5.

[225] Rackers Surrebuttal, Ex. 202, pp. 4-5.

[226] Staff Cost of Service Report, Ex. 200, p. 6 (Rackers); Rackers Surrebuttal, Ex. 202, p 4.

[227] AFUDC is Allowance for Funds Used During Construction.

among other things, a short-term telephone plant under construction (short-term TPUC) issue:[228]

> With respect to general CWIP, two different approaches are taken by the courts. One widely used approach is to completely exclude the present cost of CWIP from the rate base, on the ground that rate payers receive no benefit from a new plant or facility until it is placed in service. *E.g., Bell Tel. Co. v. Public Utility Com'n.,* 47 Pa.Cmwlth. 614, 408 A.2d 917, 925-26 (Pa.Commw.1979); *State ex rel. Utilities Commission v. Morgan,* 277 N.C. 255, 177 S.E.2d 405, 416-17 (N.C.1970); *Gulf States Utilities Co. v. Louisiana, etc.,* 364 So.2d 1266, 1269-71 (La.1978). To avoid working an injustice to the utility or its investors under this approach, the utility is allowed to capitalize interest accrued in the cost of capital and construction and thus recover through depreciation its capital expenditures from future rate payers once the plant is dedicated to public service. *New Eng. T. & T. Co. v. Public Utilities Commission,* 116 R.I. 356, 358 A.2d 1, 19 (R.I.1976). This approach is dictated by statute in Missouri, but only with respect to electric utilities. Section 393.135 (Initiative Proposition No. 1).

Counsel for AmerenUE asked Mr. Rackers whether the Staff is going to support cost recovery for the COLA costs incurred by AmerenUE assuming (1) Callaway 2 is not built, (2) pursuing the COLA and the cost expended on the COLA were prudently incurred costs, and (3) the decision not to build Callaway 2 was prudent. Mr. Rackers responded, "I don't know." Counsel for AmerenUE asked: "You're not willing to commit to that?" Mr. Rackers responded: "I don't know."[229] Mr. Rackers was not willing to make a commitment on the part of the Staff, even if theoretically he could have made such a commitment on behalf of the Staff.

Mr. Rackers testified that the Staff is seeking the same treatment for the cost of obtaining the construction and operating license of Callaway 2 as it did for the cost of obtaining the original construction and operating license of Callaway 1. The cost of

[228] *State ex rel. Southwestern Bell Telephone Co. v. Public Serv. Comm'n*, 645 S.W.2d 44, 52-53 (Mo. App., W.D. 1982).

[229] Tr. 18:1374.

obtaining the original construction and operating license of Callaway 1 was capitalized and remained a part of CWIP until the Callaway 1 plant went in service in Case Nos. EO-85-17 and EO-85-160 in 1985. He further testified that the cost of obtaining the original construction and operating license for the Wolf Creek Nuclear Power Plant, which is partly owned by Kansas City Power & Light Company (KCPL) was accounted for by capitalizing the cost to CWIP as part of the total construction project. The licensing cost along with the other plant construction cost was later closed to plant in service and the entire project cost was included in rates in Case Nos. EO-85-185 and EO-85-224 in 1986. Mr. Rackers identified as a more recent example of the permitting and licensing costs of a baseload generating unit being included in CWIP, along with the construction cost of the power plant, the cost of obtaining the appropriate permitting and licensing for the Iatan 2 plant. Iatan 2, which is being built by KCPL along with several partners, is being accounted for by capitalizing the permitting and licensing costs to CWIP as part of the total construction project.[230]

b. Can any such recovery proceed without a determination of public convenience and necessity or does AmerenUE intend to rely on the 1975 certificate?

The Staff believes that Commission acceptance of the Staff's answer to the preceding question will permit the Commission time to further consider this question which has been posed by Missouri Coalition For The Environment and Missourians For Safe Energy should the Commission desire to do so.

10. **MISO**[231] **Day 2**: Should AmerenUE recover in cost of service Revenue Sufficiency Guaranty resettlement costs for prior years?

[230] Rackers Surrebuttal, Ex. 202, p. 5.

[231] Midwest Independent Transmission System Operator, Inc. (MISO).

Staff's position: During the test year, the expense associated with participation in the MISO Day 2 market was increased due to RSG resettlement that ended in November. The Company adjusted the expenses to spread the cost over two years. The Staff reduced the expense level for the entire amount of the RSG resettlement that occurred in the test year. Both the Staff and the Company eliminated a meter error that caused the test year expense level to be lowered.

Respecting the Midwest Independent Transmission System Operator, Inc. (MISO or Midwest ISO), AmerenUE participates in the transmission operations often referred to as "Day 1" activities initiated prior to April 1, 2005, and in the MISO day-ahead and real-time energy markets often referred to as "Day 2" activities initiated as of April 1, 2005.[232]

As part of its participation in the MISO Day 2 market, there is a Revenue Sufficiency Guarantee (RSG) provision of MISO's tariff. AmerenUE is credited payments from MISO related to the RSG provision of MISO's tariff and AmerenUE is debited expenses related to the RSG provision of MISO's tariff. During part of the test year, AmerenUE's MISO RSG expenses were increased due to a resettlement of prior years' bills. When the MISO Day 2 market began on April 1, 2005, MISO charged market participants rates that were not in agreement with MISO's FERC tariff. By FERC Order, FERC required MISO to resettle the amounts paid by and with market participants. This resettlement cost for prior years' MISO bills is no longer in effect, and AmerenUE's MISO Day 2 expense is no longer increased due to this resettlement. This resettlement relates to events that occurred two to three years ago in 2005 and 2006 and increased AmerenUE's RSG charges only for a part of 2007. Resettlement of the expenses in question is complete and will not be in effect during the time rates set by this case will be in effect. Therefore, the Staff reduced test year expense to eliminate any recognition of the RSG resettlement costs for prior years' bills on a going-forward basis.

[232] Staff Cost of Service Report, Ex. 200, pp. 23 and 26 (Hagemeyer).

Thus, the Staff did not include in the expense level for AmerenUE any of the amount of the RSG resettlement because the resettlement of the RSG costs relates to the 2005-2006 period, is complete and nonrecurring, and was no longer in effect well before the end of the test year March 31, 2008, and the true-up period ending September 30, 2008.[233]

AmerenUE witness Gary S. Weiss testified that the $12,430,094 resettlement amount paid by AmerenUE covered the period April 1, 2005, through December 2006 and was recorded on the books of AmerenUE in April 2007.[234] Mr. Weiss's rebuttal testimony states that since the RSG tariff provisions were misapplied over a two year period, AmerenUE proposes to amortize in its revenue requirement the RSG resettlement charges over two years.[235] In his rebuttal testimony, Mr. Weiss stated that various Commission storm Accounting Authority Orders (AAOs) are examples of cases where the Commission authorized nonrecurring, extraordinary expenses to be recovered by companies. Although Mr. Weiss attempted to equate the MISO Day 2 RSG resettlement costs with the extraordinary costs of natural disasters, the Staff does not accept the analogy. As a further indication of the lack of similarity, the Staff would note that Mr. Weiss identified that in the instances of storm AAOs, Mr. Weiss believed that in most circumstances the amortization period was five years, not the two-year period that AmerenUE is asking for its proposed RSG resettlement costs amortization.[236]

Counsel for AmerenUE asked Staff witness Jeremy K. Hagemeyer whether the Staff considered shareholders bearing the cost of the $12.43 million RSG resettlement to

[233] *Id.;* Hagemeyer Surrebuttal, Ex. 222, p. 7.

[234] Tr. 16:778-779 (Weiss).

[235] Weiss Rebuttal, Ex. 12, p. 6.

[236] Tr. 16:784-85 (Weiss).

be fair and equitable. Mr. Hagemeyer responded that the Staff approached the matter from the ratemaking principle of ongoing rates reflecting a matching of revenues, expenses, and rate base which will be in effect during the time that the rates will be in effect.[237]

Mr. Hagemeyer related that the Staff's treatment of RSG resettlement costs is consistent with the Staff's and AmerenUE's treatment of the revenue requirement effects of a $1.6 million meter error that was eliminated from RSG. The $1.6 million is the quantification of an error that occurred within the test year which incorrectly decreased AmerenUE's expense level by $1.6 million. The error was corrected by adjusting AmerenUE's expense level upward to reflect that on an ongoing basis AmerenUE's expense level will be $1.6 million higher than test year level.[238]

Respecting fairness and equity, Mr. Weiss testified that AmerenUE would be seeking recovery of the RSG resettlement costs even if AmerenUE had been earning its authorized return on equity from the date the approved rates from Case No. ER-2007-0002 had been in effect.[239]

11. **Incentive Compensation and Restricted Stock Compensation / Performance Share Unit Plans**:

a. **Incentive Compensation**: AmerenUE eliminated from cost of service the Executive Incentive Plan for Officers that is awarded on the basis of earnings per share performance. Should AmerenUE recover the costs of all other incentive compensation programs?

Staff's position: Because all AmerenUE incentive compensation was based on earnings-per-share (EPS), non-specified award criteria and subjective performance measures, no incentive compensation should be included in AmerenUE's revenue requirement.

[237] Tr. 16:809-810 (Hagemeyer).

[238] Hagemeyer Surrebuttal, Ex. 222, p. 7; Ex. 228; Tr. 16:810-813.

[239] Tr. 16:785-786 (Weiss).

b. **Restricted Stock Compensation / Performance Share Unit Plans:** Should AmerenUE recover the costs of the Restricted Stock Compensation / Performance Share Unit plans?

Staff's position: Because AmerenUE's Restricted Stock Compensation / Performance Share Unit plans are based solely on shareholder return, the costs of these plans should not be included in AmerenUE's revenue requirement.

Staff's adjustments related to Incentive Compensation and Restricted Stock Compensation are not unique to this case. Staff has been recommending the disallowance of incentive compensation plans that do not provide ratepayer benefit since at least 1987.[240] It is important to note that not all of AmerenUE's expenses associated with these issues are being disallowed by Staff. Also, it must be kept in mind that Staff did not simply throw out AmerenUE's associated expenses wholesale. Staff analyzed each plan, and each Key Performance Indicator (KPI), and determined the appropriate disallowance based on the criteria of ratepayer benefit.[241] Ratepayers shouldn't be paying for incentives that don't benefit them, and particularly should not be paying to reward behavior that may inhibit the provision safe and adequate service.

The single largest category of disallowance was for incentive compensation paid when the level of performance achieved did not exceed that expected of a competent employee.[242] AmerenUE is charged with providing safe and adequate service and by operating as a public utility, AmerenUE has accepted the responsibility to hire competent personnel. Employees are expected to perform adequately and to achieve a certain level of constant improvement. In fact, AmerenUE's witness Bauer has agreed that "workers have a responsibility as part of their base compensation to continue to strive to improve

[240] *See* Case No. EC-87-114.

[241] Tr. 20:1516.

[242] Tr. 20:1490.

their performance."[243] AmerenUE has not given a compelling reason for ratepayers to pay extra to get an employee to do what they should be doing anyway; nor has AmerenUE given a compelling demonstration that the portion of payouts disallowed by Staff succeed in getting AmerenUE employees to do more than what they should be doing anyway.

AmerenUE's 2008[244] Incentive Compensation Plans consists of seven different plans, one of which it is not seeking recovery for, as payout under the Executive Incentive Plan for Officers is contingent on Earnings per Share (EPS).[245] Of the remaining plans, payouts under both available Long Term Incentive plans, and a portion of the payouts under the Executive Incentive Plan for Managers & Directors, were disallowed by Staff, as discussed in more detail below, because of the role of financial performance in determining the award.[246] Payouts under another plan, the Exceptional Performance Bonus Plan, were disallowed because the plan lacks any specific criteria.[247] The remaining payouts are made according to achievement, or partial achievement, of KPIs. In its analysis, Staff determined that 76.12% of the KPIs were not inappropriate.[248] However, Staff found AmerenUE's practice of paying out "incentive" compensation for performance that fell short of the KPI's target level of achievement to fail the test of

[243] Tr. 20:1416.

[244] AmerenUE has changed its incentive plans for 2008. Tr. 20:1417. These are the plans that will be offered going forward. However, although the Long Term Incentive Performance-Based Restricted Stock Plan (Issued 2001-2005) is no longer offered, payouts will continue to be available as awards have a seven year vesting window. Bauer Rebuttal, Ex. 25, p. 5, Table 2.

[245] Bauer Rebuttal, Ex. 25, pp. 5-6.

[246] Hagemeyer Sur., Ex. 222, pp. 4-5.

[247] Hagemeyer Sur., Ex. 222, pp 3-4.

[248] Tr. 20:1490.

providing benefit to ratepayers.[249] Staff would note that 23.88% of the KPIs related to financial metrics or other criteria that were not beneficial to ratepayers and those payouts were disallowed for that reason.[250]

Staff determined that AmerenUE has taken a step in the right direction with its short-term incentive plans, in that the majority of funding of incentive compensation is no longer tied to EPS as it was in the last case.[251] Many of the new plans are awarded based on KPIs, many of which Staff determined to not be inappropriate for recovery from ratepayers, that is to say, that achievement of the KPI would be of benefit to ratepayers. Staff did, however, disallow 23.88% of the KPIs.[252] A number of these KPIs related to financial metrics. Staff's opposition to financial metrics as a basis for incentive compensation will be discussed separately below. The remainder of the disallowed KPIs were awarded on the basis that the performance required by the KPI did not exceed the level of performance to be reasonably expected of a competent employee. For ease of reference, Staff has termed these "project-based" KPIs.[253] Staff excluded, as project-based KPIs, those KPIs which didn't improve performance over the employee's existing level, or which were structured to reward an employee for essentially doing a specific project that the employee would be expected to handle under the normal course of business anyway.[254]

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[249] Hagemeyer Sur., Ex. 222, p 3.

[250] Hagemeyer Sur., Ex. 222, p 2; Tr. 20:1490.

[251] Tr. 20:1486.

[252] Hagemeyer Sur., Ex. 222, p 2; Tr. 20:1490.

[253] Tr. 20:1515.

[254] *Id.*

Payouts made under the remaining 76.12% of the KPIs were then screened by the level of achievement of the KPI. For the acceptable KPIs, that portion of payouts that failed to provide ratepayer benefit was disallowed by Staff. Specifically, regarding the KPIs, AmerenUE has identified three benchmark levels of performance. "Maximum," or 150%; "Target," or 100%; and "Threshold," or 50%.[255] Awards are available for performance that meets Threshold, even if it falls below Target.[256] Threshold is defined by AmerenUE witness Bauer as "continuous improvement."[257] Bauer also testified that AmerenUE does not hire incompetent people.[258] She then testified that the rationale for awards for performance less than Target, but above Threshold, is that "if a group of people maybe missed a target early in the year, you wouldn't want them to just start striving - - stop striving for every bit of performance that they could achieve. You want them to keep working as hard as they can and make as much progress as they can."[259] AmerenUE would apparently then conclude that competent employees are apparently excused from "striving for every bit of performance that they could achieve," if those competent employees are not independently compensated for their efforts. Staff's disagreement with that conclusion is premised on Mr. Hagemeyer's underlying assumption that individual employees should be expected, as part of their job performance, to strive for improvement.[260] In fact, AmerenUE's witness Bauer has

[255] Tr. 20:1417-1419.

[256] Tr. 20:1421-22.

[257] Tr. 20:1425.

[258] Tr. 20:1416.

[259] Tr. 20:1425.

[260] Tr. 20:1562.

agreed that "workers have a responsibility as part of their base compensation to continue to strive to improve their performance."[261]

AmerenUE maintains that Staff's disallowance of a portion of the incentive compensation expense is inappropriate for two reasons. On the one hand, AmerenUE states that at least a portion of an employee's incentive compensation package is essentially tantamount to base salary.[262] On the other hand, AmerenUE represents that their incentive compensation is "not just for showing up" and that the KPIs are hard to achieve.[263] Staff views these rationales as antithetical. Bauer has also testified that she believes that an intelligent, hard-working individual who makes good decisions would prefer placing a portion of that employee's compensation at risk, and "look for a place where they can be rewarded for their performance."[264] Mr. Hagemeyer has explained that the group-based payout structure of AmerenUE's KPI plans compromise the effectiveness of the potential motivation of those plans. For example, Staff has testified that an individual employee's perception of the achievability of a given metric could impact the response of that employee to a financial incentive.[265] The group-based nature of these plans was explained by Bauer, "KPIs generally apply to a group of employees, not to one employee individual… …the plans are now funded based on the key performance indicator, so what – what did the team achieve…."[266] In other words, the availability of funding for the incentive compensation based on KPIs of a group of

[261] Tr. 20:1416.

[262] Tr. 20:1324.

[263] *Id.*

[264] Tr. 20:1441-49.

[265] Tr. 20:1557-1558.

[266] Tr. 20:1419-1420.

individual employees is contingent on the overall performance of that group. Absent a certain level of group performance, an individual employee is unable to earn an incentive compensation payout.

Mr. Hagemeyer has testified that if a worker perceives that their incentive pay is contingent on the performance of other individuals who may be less motivated, that individual may be faced with a disincentive for high performance.[267] As an illustration, consider the effect of a financial incentive on an otherwise high-performing employee, who is in a group of low-achieving employees. In this instance, the high-performing employee is not given an opportunity to earn a financial incentive and will see this inability to enjoy earnings commensurate with performance as a disincentive. Ms. Bauer has testified that supervisors have the ability to reduce that payout for a particular individual in light of their individual performance, but lack the ability to implement funding for a high-performing individual in a low-performing group.[268]

AmerenUE's witness Bauer has agreed that "workers have a responsibility as part of their base compensation to continue to strive to improve their performance"[269] yet, AmerenUE argues that it should be allowed to recover its incentive compensation expenses, under all but one plan, because "high performing employees want to see the opportunity to earn through incentives."[270] Ms. Bauer's rebuttal also contains a discussion of industry-wide difficulty in attracting linemen, generation technicians, and engineers.[271] Ms. Bauer's rebuttal testimony contains references to AmerenUE's "focus

[267] Tr. 20:1158.

[268] Tr. 20:1420-21.

[269] Tr. 20:1416.

[270] Tr. 20:1429.

[271] Bauer Rebuttal, Ex. 25, p 17.

on aligning both base and incentive compensation at the median of the market."[272] Under the existing plans, the role of the employee dictates the percentage of total compensation that is made up by incentive compensation. Union employees are given the ability to earn up to 3% of their total compensation from incentive compensation.[273] Most management employees have the opportunity to earn up to 6% of total compensation from incentive compensation.[274] From there, managers and directors, up through the president, Mr. Rainwater, have the opportunity for 20% - 90% of total compensation to be paid out as incentive compensation.[275] Thus, for those employees that AmerenUE has identified a critical need, the linemen, generation technician, and engineers, Staff's disallowance would place AmerenUE's salary offer, at most, 6% below median. Finally, it must be remembered that regarding that portion of total compensation placed at risk, Staff does not maintain that AmerenUE shouldn't be allowed to pay incentive compensation ever, under any circumstances.[276] Staff is simply opposing those payouts that do not benefit ratepayers.

In determining its disallowances, the Staff cited several past Commission cases as enunciating the standard that Staff used in this case for determining whether AmerenUE's incentive plans result in ratepayer benefit.[277] The first of these was derived from Case No. EC-87-114: "At a minimum, an acceptable management performance plan should contain goals that improve existing performance, and the benefits of the plan should be

[272] *Id.*

[273] Tr. 20:1441.

[274] Tr. 20:1440.

[275] Tr. 20:1438-1440.

[276] Tr. 20:1560.

[277] Tr. 20:1504-1511.

ascertainable and reasonably related to the incentive plan." The next was derived from Case No. TC-93-224: "Because the plan does not focus on Missouri-specific results and does not include service-oriented goals, the Commission concludes that it is not appropriate to include the cost of the plan in the cost of service." The third and fourth are both derived from Case No. ER-2006-0314. One, "because maximizing EPS could compromise service to ratepayers such as reducing customer service or tree trimming costs, the ratepayer should not have to bear that expense." The second states that in the case of a utility owned by a holding company, where incentive compensation is tied to the financial performance of the parent company, that recovery of that incentive compensation expense from ratepayers is inappropriate as it could incent employees to ignore ratepayers in favor of devoting resources elsewhere. The sentiment of all four of these statements is also summed up in Case No. ER-2006-0314: "[utility] management is free to offer whatever compensation package it wants. Nevertheless, if the method [the utility] chooses to compensate employees shows no tangible benefit to Missouri ratepayers, then those costs should be borne by the shareholders and not be included in the cost of service."

AmerenUE has not done a study to determine the level of cost savings, if any, derived from its offer of these incentive plans,[278] nor has AmerenUE calculated whether the benefits of the incentive plans, if any, exceed the cost of offing these incentive plans.[279] Thus, if the specific portion of payouts disallowed by Staff do have a benefit for ratepayers, AmerenUE has not shown it. Further, AmerenUE has indicated that it believes the value of its plans is rooted in focusing employee performance on the

[278] Tr. 20:1415.

[279] Tr. 20:1415-1416.

objectives desired by management.[280] AmerenUE's plans going forward have KPIs that are related to financial performance.[281] Staff also disallowed non-KPI payouts on the basis that those payouts were contingent on financial performance. AmerenUE has not shown that this specific portion of payouts disallowed by Staff has a benefit for ratepayers. In fact, as posited by the Commission in Case No. ER-2006-0314, Staff's concern with financial related incentive compensation is that focusing employee performance on financial objectives, inappropriate cost cutting may occur.[282] Staff has stated that even absent this Commission guidance, it would have examined the area of incentive compensation and likely made these same disallowances.[283]

AmerenUE provided Staff with an initial response to Staff's Data Request 50.4, as well as a supplemental response.[284] The initial response provided information on the 2008 incentive compensation plans, the plans that are currently in effect and will remain in effect going forward.[285] The supplemental response was marked as Exhibit 75 HC, and was the point of extensive questioning of Mr. Hagemeyer by Mr. Byrne, at hearing.[286] That response dealt with the discontinued compensation plans, which will not be in effect going forward.[287] The supplemental response was received by Staff on the afternoon of November 26, 2008,[288] thus Staff did not have the benefit of the information

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[280] Tr. 20:1411.

[281] Tr. 20:1561.

[282] Staff Cost of Service Report, Ex. 200, pp. 47-48.

[283] Tr. 20:1563.

[284] Tr. 20:1416-1417.

[285] Tr. 20:1441.

[286] Tr. 21:1521-1541 (HC).

[287] Tr. 20:1441.

[288] Tr. 20:1564.

contained therein for preparation of its case. Due to this constraint, Staff calculated the amount of its disallowance by ** **[289] During the questioning, Mr. Byrne seemed to imply that Staff's calculation, by relying on the data contained in the initial response, ** **[290] However, Mr. Hagemeyer stated that the ** **[291] To summarize: ** ** The KPIs that Staff examined, and based its disallowance upon, are the KPIs that AmerenUE is using going forward.[292]

AmerenUE has taken a step in the right direction with its short-term incentive plans.[293] But 23.88% of the KPIs continue to incent behavior that does not benefit

[289] Tr. 21:1531-1532 (HC). .

[290] Tr. 21:1520 (HC).

[291] *Id.*

[292] Tr. 20:1441.

[293] Tr. 20:1486. .

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ratepayers.[294] Staff opposes financial metrics as a basis for incentive compensation. Payouts under both available Long Term Incentive plans, and a portion of the payouts under the Executive Incentive Plan for Managers & Directors were disallowed by Staff, as discussed more below, because of the role of financial performance in determining the award.[295] Payouts under another plan, the Exceptional Performance Bonus Plan, were disallowed because the plan lacks any specific criteria.[296] Staff disallowed payouts which didn't require improved performance over the employee's existing level or which were structured to reward an employee for essentially doing a specific project that the employee would be expected to handle under the normal course of business anyway.[297] Staff analyzed each plan, and each Key Performance Indicator (KPI), and determined the appropriate disallowance based on the criterion of ratepayer benefit.[298] Ratepayers shouldn't be paying for incentives that don't benefit them and, particularly, should not be paying to incent behavior that may inhibit the provision of safe and adequate service.

12. **Depreciation**: Should depreciation rates for the plant accounts for the Callaway I nuclear generating station be adjusted, based on less than a full depreciation study of all plant accounts, to use the actual book accumulated depreciation reserve amounts, which adjustment would amortize an over accrual of the nuclear depreciation reserve accounts, i.e., the difference between the actual book accumulated depreciation and the theoretical accrued depreciation, on the basis that the Callaway I plant will be re-licensed for an additional 20 year term?

Staff's position: No. It is the Staff's position that changing depreciation rates based on over or under accruals of the depreciation reserve should only be made in the context of a complete depreciation study where the over or under accrual of the depreciation reserve associated with each plant account is examined, unless the over or under accrual in question is so large an adjustment should be made sooner. The over accrual of the

[294] Hagemeyer Surrebuttal, Ex. 222, p 2; Tr. 20:1490.

[295] Ex. 222 Hagemeyer Surrebuttal P 4 L 21 – P 5 L 3.

[296] Ex. 222 Hagemeyer Surrebuttal P 3 L 19 – p 4 L 6.

[297] Transcript, V 20 P 1515 l 11 – 17.

[298] Transcript, V 20 P 1516 L 13 – 16.

depreciation reserve associated with the subset of plant accounts for the Callaway I nuclear generating station is not sufficient to warrant adjusting depreciation rates without first performing a complete depreciation study involving all the plant accounts.

Public Counsel asserts that there is an over-accrual in AmerenUE's depreciation reserve for Callaway I. However, that over-accrual is so small that it is within the variability that might be expected between the studies of different depreciation experts. For this reason, Staff advocates not changing any of AmerenUE's depreciation rates without first performing a complete depreciation study of all the plant accounts.[299] Complete depreciation studies are expensive and time-consuming undertakings.[300] AmerenUE also advocates not changing any of AmerenUE's depreciation rates without first performing a complete depreciation study of all of AmerenUE's accounts.[301] To reduce customer rates now, based on a possible over-accrual for nuclear plant accounts, without first performing a complete depreciation study may increase the risk of a larger adjustment to customer rates in the future, after a complete depreciation study is performed.[302]

The depreciation rates that resulted from the last case, which were based on a complete depreciation study, have been in effect only since June 1, 2007, less than 17 months.[303] Because AmerenUE is engaged in investing hundreds of millions of dollars across its production fleet, transmission and distribution systems, the increase in depreciation accrual associated with that investment will be approximately $21.6 million annually, an adjustment (increase) nearly three times the adjustment (decrease) Public

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[299] Gilbert Rebuttal, Ex. 209; Gilbert Surrebuttal, Ex. 210, pp. 2-3; Tr. 16:861-864 (Gilbert).

[300] Tr. 16:864-65 (Gilbert).

[301] Wiedmayer Rebuttal, Ex. 13, pp. 2-3.

[302] Gilbert Rebuttal, Ex. 209, p. 3.

[303] *Id.*

Counsel seeks.[304] Absent a complete depreciation study, the Commission should not adjust depreciation rates associated with nuclear production plant accounts based on a possible over-accrual in the depreciation reserve attributable to them.

13. **Demand Side Management (DSM)**: In Case No. ER-2007-0002, AmerenUE was ordered by the Commission to book the costs of acquiring demand side management resources in a regulatory asset account. Should the Commission require netting of revenues for only demand response programs, or should netting apply to all demand side management resources?

    Staff's position: The intent of a Regulatory Asset Account (RAA) is to recover DSM costs, and a return on those costs, in rates through the rate case process. Net expenditures of for DSM programs, whether they are demand response or energy efficiency programs, which have an immediate increase in revenue to the Company should be booked as *net expenditures*.

Whenever there is an immediate, identifiable, and measurable increase in revenues that's associated with a demand response program, then netting of revenues should apply. An example of such a program is the curtailment of a large industrial customer at 5 p.m. on a hot summer day when air conditioning load is increasing. With the curtailment, AmerenUE would have additional capacity that could be sold in the off-system sales market when prices are highest. The difference between the amount paid the curtailed customer and AmerenUE's gain on the off-system sale should be netted with overall demand response program costs and should reduce the regulatory asset.

Another example of a potentially measurable, immediate and identifiable demand response program that could be used to offset revenues would be a credit or payment from MISO for implementation of certain energy efficiency programs.[305] Other demand response resources and energy efficiency programs such as weatherization and the Energy Star program reduce the overall demand on a consistent and ongoing basis, but

[304] *Id.,* at p. 4.

[305] Tr. 17: 991.

they do not have the kind of immediate and measurable effect that curtailment of a large customer at peak times would have.[306]

Staff witness Henry Warren recommended the following language in order to effectuate the netting of revenues:[307]

> The DSM Regulatory Asset [RAA] will contain all prudently incurred net incremental DSM costs. Incremental costs are defined as those costs that exceed the level of costs in existing rates for DSM programs such as the costs of low income weatherization programs that exceed the low income weatherization program costs reflected in existing rates. In addition to booking the incremental costs of implementing DSM programs in its RAA, UE shall book the reimbursement of incremental costs, in dollars, that are equal to funds from any source that the Company receives (such as payments received for bilateral sales of capacity and payments or credits from MISO [Midwest Independent System Operator] for demand response or energy efficiency programs) that are associated with its implementation of DSM programs and not otherwise credited. If a Fuel Adjustment Clause (FAC) is available to the Company, all value associated with such reimbursement of incremental costs will flow through the FAC.

The Commission will recall that Staff witness Henry Warren first raised the issue of netting of revenues in Staff's Cost of Service Report.[308] The Office of Public Counsel filed rebuttal testimony with proposed language to implement Staff's suggestion. AmerenUE failed to respond with any specific language designed to implement Staff's requirement.[309]

14. **Low-Income Weatherization Program**: Should AmerenUE provide an additional $300,000 for funding the current low-income weatherization program for the full amount directed by the Commission in Case No. ER-2007-0002 for the twelve months ended July 5, 2008? Should AmerenUE continue to fund the current low-income weatherization program for the full amount directed by the Commission in Case No. ER-2007-0002 for the twelve months ending July 5,

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[306] Tr. 17: 980.

[307] Warren Surrebuttal, p. 2.

[308] Ex. 200, Staff Cost of Service Report, p. 9.

[309] Tr. 17:957 and 966-969.

2009? In what annual amount and from what source of funds, should AmerenUE continue to fund the current low-income weatherization program beyond the Commission's Report and Order in Case No. ER-2007-0002?

Staff's position: AmerenUE should fulfill its contractual obligation to the Missouri State Environmental Improvement and Energy Resources Authority (EIERA), and pay EIERA an additional $300,000 for the twelve months beginning July 5, 2008. This program should be continued as ordered by the Commission in ER-2007-0002 with annual funding of $600,000 from ratepayers and $600,000 from the Company.

The parties at hearing agreed that this issue was purely a legal one and the parties submitted stipulated facts sufficient for the Commission to decide the issue. AmerenUE should fulfill its contractual obligation to the Missouri State Environmental Improvement and Energy Resources Authority (EIERA) and pay EIERA an additional $300,000 for the twelve months beginning July 5, 2008. This program should be continued as ordered by the Commission in Case No. ER-2007-0002 with annual funding of $600,000 from ratepayers and $600,000 from the Company. Exhibit 229 is the contract entitled Cooperation and Funding Agreement executed by DNR, the EIERA, the Commission, and AmerenUE, providing that AmerenUE would contribute $1.2 million per year for the low income weatherization program. Ameren paid only $900,000 for the current year and should therefore pay an additional $300,000.

The contract is not limited in time or by any condition or contingency and is binding upon all parties. AmerenUE, however, claims that the Commission did not have authority to order AmerenUE's shareholders to fund $600,000 of the cost in the Commission's Order in Case No. ER-2007-0002.

As to AmerenUE's argument the Commission is without authority to require AmerenUE to fund the low-income weatherization program, the Staff points out that the courts of Missouri have long recognized the broad sweep of Commission authority. In

1913, in the first case where the Missouri Supreme Court addressed the jurisdiction of the Public Service Commission under the Public Service Commission Law, the Court stated:[310]

> That act is an elaborate law bottomed on the police power. It evidences a public policy hammered out on the anvil of public discussion. It apparently recognizes certain generally recognized economic principles and conditions, to wit: That a public utility (like gas, water, car service, etc.) is in it nature a monopoly; that competition is inadequate to protect the public, and, if it exits, is likely to become and economic waste; that state regulation takes the place of and stands for competition; that such regulation, to command respect from patron or utility owner, must be in the name of the overlord, the state, and, to be effective, must possess the power of intelligent visitation and the plenary supervision of every business feature to be finally (however, invisible) reflected in rates and quality of service. It recognizes that every expenditure, every dereliction, every share of stock, or bond, or note issued as surely is finally reflected in rates and quality of service to the public, as does the moisture which arises in the atmosphere finally descend in rain upon the just and unjust willy nilly.
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> That there had been a vast increase in such utilities in the last decade or two, and that evils have grown up crying out lustily for a cure by the lawmaker, is writ larger in current history. The act, then, is a highly remedial one filling a manifest want, is worthy a hopeful future, and on well-settled legal principles is to be liberally construed to further its life and purpose by advancing the benefits in view, and regarding the mischiefs struck at—all *pro bono publico*. Beside all which the lawmaker himself has prescribed, it "shall be liberally construed with a view to the public welfare, efficient facilities and substantial justice between patrons and public utilities." Section 127.

Since this early case, the Missouri Supreme Court has continued to recognize the broad sweep of the Commission's authority and discretion, and that "many of its

[310] *State on inf. Barker ex rel. Kansas City v. Kansas City Gas Co.*, 254 Mo. 515, ___, 163 S.W. 854, 857-858 (1913).

decisions necessarily rest largely in the exercise of a sound judgment."[311] In 1934, the Missouri Supreme Court stated:[312]

> The whole purpose of the act is to protect the public. The public served by the utility is interested in the service rendered by the utility and the price charged therefore; [the] investing public is interested in the value and stability of the securities issued by the utility. In fact the act itself declares this to be the purpose. Section 5251, R. S. 1929 (Mo. St. Ann. § 5251, p. 6674), in part reads: "The provisions of this chapter shall be liberally construed with a view to the public welfare, efficient facilities and substantial justice between patrons and public utilities."

Similarly, the Missouri Court of Appeals discussed the long-standing view of Missouri's courts that the Public Service Commission Act is to be "liberally construed for the public's, *ergo* the consumer's protection," stating:[313]

> . . . "[T]he Public Service Commission Law of our own state has been uniformly held and recognized by this court to be a remedial statute, which is bottomed on, and is referable to, the police power of the state, and under well-settled legal principles, as well as by reason of the precise language of the Public Service Commission Act itself, is to be 'liberally construed with a view to the **public welfare, efficient facilities and substantial justice between patrons and public utilities.**" *State ex rel. Laundry, Inc. v. Public Service Commission*, 327 Mo. 93, 34 S.W.2d 37, 42-3(2, 3) (Mo. 1931). 'In its broadest aspects, the general purpose of such regulatory legislation is to substitute regulated monopoly for destructive competition. But the dominant thought and purpose of the policy is the **protection of the public** while the protection given the utility is merely incidental. *State ex rel. Electric Company of Missouri v. Atkinson, et al.*, 275 Mo. 325, 204 S.W. 897; *State ex rel. Pitcairn v. Public Service Commission*, 232 Mo.App. 535, 111 S.W.2d 222.' State ex rel. Crown Coach Company v. Public Service Commission, 238 Mo. App. 287, 179 S.W.2d 123, 126 (5, 6) (1944).
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> Not insignificant to the breadth of the powers and discretion legislatively granted

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[311] *State ex rel. Dyer v. Public Serv. Comm'n*, 341 S.W.2d 795, 802 (Mo. 1960), *cert. denied*, 366 U.S. 924, 81 S.Ct. 1351 (1961).

[312] *State ex rel. City of St. Louis v. Public Service Comm'n*, 335 Mo. 448, ___, 73 S.W.2d 393, 399 (banc 1934) (internal citation omitted).

[313] *De Paul Hospital School of Nursing, Inc. v. Southwestern Bell Tel. Co.*, 539 S.W.2d 542, 548 (Mo. App. 1976).

to the Commission is § 3 of the Act (codified as § 386.040, RSMo Supp. 2008) which the Missouri Supreme Court has stated confers all implied power necessary to carry out the purposes of the Act.[314] Further, § 16 of the Act (codified now as § 386.250, RSMo Supp. 2008) expressly confers implied powers with regard to utilities, including electric utilities. In addition, Section 393.140, RSMo. 2000, at subparts (2) and (5) confers upon the Commission the following authority:

> (2) Investigate and ascertain, from time to time, the quality of gas or water supplied and sewer service furnished by persons and corporations, examine or investigate the methods employed by such persons and corporations in manufacturing, distributing and supplying gas or electricity for light, heat or power and in transmitting the same, and in supplying and distributing water for any purpose whatsoever, and in furnishing a sewer system, and have power to order such reasonable improvements as will best promote the public interest, preserve the public health and protect those using such gas, electricity, water, or sewer system, and those employed in the manufacture and distribution thereof, and have power to order reasonable improvements and extensions of the works, wires, poles, pipes, lines, conduits, ducts and other reasonable devices, apparatus and property of gas corporations, electrical corporations, water corporations, and sewer corporations.
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> (5) Examine all persons and corporations under its supervision and keep informed as to the methods, practices, regulations and property employed by them in the transaction of their business. Whenever the commission shall be of the opinion, after a hearing had upon its own motion or upon complaint, that the rates or charges or the acts or regulations of any such persons or corporations are unjust, unreasonable, unjustly discriminatory or unduly preferential or in any wise in violation of any provision of law, the commission shall determine and prescribe the just and reasonable rates and charges thereafter to be in force for the service to be furnished, notwithstanding that a higher rate or charge has heretofore been authorized by statute, and the just and reasonable acts and regulations to be done and observed; and whenever the commission shall be of the opinion, after a hearing had upon its own motion or upon complaints, that the property, equipment or appliances of any such person or corporation are unsafe, insufficient or inadequate, the commission shall

[314] *State on inf. Barker ex rel. Kansas City, supra,* 163 S.W. at 858.

determine and prescribe the safe, efficient and adequate property, equipment and appliances thereafter to be used, maintained and operated for the security and accommodation of the public and in compliance with the provisions of law and of their franchises and charters.

Under the foregoing, the Legislature has given the Commission the authority to require both AmerenUE shareholders and ratepayers to each equally fund the low-income weatherization program with $600,000 annually, AmerenUE's arguments to the contrary notwithstanding.

15. **Pure Power Program (Voluntary Green Power Program / Renewable Energy Credits (RECs))**: Should the Commission authorize AmerenUE to continue its Pure Power Program / Voluntary Green Power Program, and if the Commission does so, in what form should the Commission authorize the continuation of the program?

Staff's position: The Commission should not authorize AmerenUE to continue the program. Unless AmerenUE can produce a study documenting the total costs attributed to the Program before hearing, an additional $25,895 of billing costs should be transferred below-the-line as part of this case.

However, if the Commission does authorize continuation of the program, AmerenUE should be required to provide information to participants and potential participants documenting the use of the monies contributed pursuant to the program – the percentage of total collections actually received by the producer of renewable electricity and the portions that cover activity not related to possible further green production retained by the company and by intermediaries. In addition, AmerenUE should correct misstatements on the Pure Power website in order to provide full disclosures and factual representations of the Pure Power Program to customers. If the program is allowed to continue, AmerenUE needs to be instructed to do a study to calculate implicit (unknown) administrative costs (i.e., billing and collection) and transfer the real amount of these costs below-the-line on a going forward basis.

AmerenUE's current, inefficient and misleading REC program should be discontinued. Staff's primary recommendation is that the Commission order AmerenUE to file tariffs that provide for a phasing-out of the Voluntary Green Program (program), marketed by AmerenUE as the Pure Power Program. Staff and OPC have identified numerous misrepresentations in the customer literature and marketing materials

associated with the program. In authorizing the VGP tariff in AmerenUE's last rate case, the Commission found as follows:

> The sale of RECs is not a substitute for the actual generation of power from renewable resources. But building renewable-powered generation takes time and the implementation of the plan to sell RECs can be implemented almost immediately. There is some risk of confusion among customers who are not familiar with the concept of a REC, but the program is voluntary and AmerenUE has engaged the services of an experienced company to perform customer education and marketing for the program. The Commission finds that the plan to facilitate the sale of RECs is reasonable and is unlikely to cause undue confusion among AmerenUE's customers.

AmerenUE has maintained throughout this case that customers participating in its Voluntary Green Program know what they're getting, and are happy with what they're getting. In fact, MR. Barbieri included as a schedule to his testimony letters and emails from participants.[315] Staff would agree that those customers who provided testimony letters seemed pleased with the program but does not agree that the letters show that the customers know what they are getting. In addition, the program marketing materials portray a different story regarding the effect of participation than AmerenUE acknowledges occurs. There is no dispute that customers who participate in this program are not using energy that is any "greener" than any other AmerenUE customer.[316] However, of the approximately 4,000 customers who participate in this program, 3,400 of them received a "welcome letter" that was used from program inception until recently and is replete with references to actual consumption of "green energy."[317] This letter states "Your decision to pay a charge of 1.5 cents per kilowatt hour above your standard electricity rate allows AmerenUE to purchase the energy you consume each month from

[315] *See* Ex. 9, Barbieri Rebuttal

[316] Tr. 16:734 .

[317] Tr. 16:711-714.

an emission-free wind generation facility right here in Missouri."[318] Thus, the bulk of AmerenUE's "happy" customers have been misled by their utility, under the auspices of a tariffed, Commission-sanctioned program.

Most of the letters attached to Mr. Barbieri's testimony congratulate Pure Power on its one year anniversary, thus one could safely conclude that these participants received this letter, which AmerenUE admits contained false information.[319] In short, participating customers are "happy" because the customers believe far more is being done with the monies contributed than what is actually taking place. This same welcome letter also states that "your decision to pay a charge of 1.5 cents per kilowatt hour above your standard electricity rates prevents an average of 19,500 pounds of carbon dioxide and other harmful emissions from entering the atmosphere each year."[320] Again, AmerenUE does not dispute that participating customers do not receive, as a consequence of participation, energy that is any "greener" than non-participating customers.[321]

The discontinued welcome letter is not the only promotional material that contains references to actual, electrons-flowing-through-a-wire energy. The same disconnect from reality is depicted on the updated Pure Power website[322] in what Mr. Barbieri describes as "one of the clearest [illustrations of RECs] that's out there in the industry."[323] That illustration shows what Commissioner Gunn described as appearing "that the consumer and my company, my electric company is directly benefiting from the

[318] Tr. 16:711-712.

[319] Tr. 16:714.

[320] Tr. 16:725-726.

[321] Tr. 16: 734.

[322] Ex. 69.

[323] Tr. 16:738.

renewable, from the use of renewable resources that I'm paying for through a REC."[324] AmerenUE includes this illustration on its website, despite the fact that participation in Pure Power does not result in that customer using energy generated by renewable resources.

The misinformation associated with this program is perhaps best illustrated in its slogan – "P.U.R.E. Genius – People Using Renewable Energy." Perhaps AmerenUE is optimistic that participants are motivated by a desire that some people, somewhere, will be using renewable energy. Apparently AmerenUE is also optimistic that those same participants perform enough independent research of the REC market and disregard the Pure Power materials to recognize that participation does not equate to using renewable energy. AmerenUE's opacity on this subject is best reflected in the words of their own witness, Mr. Barbieri:[325]

Q. Do participating AmerenUE customers use renewable energy?

A. Yes, they do.

Q. They do?

A. Yes, they do.

Q. Because of their participation in the Pure Power Program?

A. Well, prior to Proposition C, 4 percent of our generation came from -- comes from the hydroelectric, and the original Senate Bill 54 that approved the target allowed for hydroelectricity to be considered as a renewable resource.

Q. So if a customers elects to participate in Pure Power, then AmerenUE takes measures to ensure that the electrons delivered to their residence or business are supplied from those sources?

A. That can't happen, correct.

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[324] Tr. 16:738-739.

[325] Tr. 16:733-734.

Q. So do participating AmerenUE customers use renewable energy as a consequence of their participation?

A. What they do is they procure the REC. I'm not sure if I'm really following your question.

Q. Does participation in Pure Power cause that participating customer to use renewable energy?

A. There's no physical contract for the energy delivery, no.

Even among those customers savvy enough to realize that their participation in the Pure Power Program does not result in the addition of green energy to AmerenUE's grid, much less to their own usage, it is undisputed that AmerenUE's marketing materials do nothing to indicate what percentage of monies collected under the program actually are used to purchase RECs. AmerenUE fails to provide transparency to the Staff and its customers regarding disbursements of solicited monies and has failed to demonstrate that monies that are distributed, pursuant to the program, have any effect on increasing or encouraging the production of green energy as which is the focal point of the marketing of this program by AmerenUE. Further, AmerenUE's materials do not disclose that even the sale of a "green-e certified" REC does nothing to require the addition of a single watt of green energy to the national grid, much less to AmerenUE's grid. Out of every $15 collected pursuant to the Pure Power Program, only ** [redacted] ** makes it to a green energy producer.[326] Of the money that does make it to a producer, AmerenUE has been unable to demonstrate that the money caused or encouraged any of the following: (1) the continued production of green energy at current levels; (2) the expanded production of green energy in the future; or (3) making past production of green energy economically

[326] Ensrud Rebuttal, Ex. 220 (HC), p. 3.

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viable. AmerenUE admits that there is no means in the industry of verifying how a generator of an REC uses the money received for the sale of the REC.[327]

AmerenUE has stated that much of the money collected under the Pure Power Program that fails to make its way to green energy producers is expended on what it characterizes as customer education regarding the program.[328] However, AmerenUE has acknowledged that its tariff does not provide for customer education.[329] There is nothing in the Voluntary Green Program Tariff, or in any piece of customer literature or marketing materials that AmerenUE has provided to Staff, any indication to participating or potential customers ** ** of every solicited under the program is expended on what it characterizes as customer education.[330]

AmerenUE defends its relationship with 3 Degrees, Inc., by stating that 3 Degrees insulates AmerenUE from (1) the actual administrative expense of the program; (2) the cost of educating its customers about the program; and (3) the risk that the cost of RECs in general, and Missouri-regional RECs in particular will increase during the term of the 3 Degrees contract.[331] Staff does not find these arguments compelling for the reasons discussed below.

First, concerning AmerenUE's argument that the 3 Degrees contract insulates AmerenUE from the actual administrative expense of the program, consider the fact that administrative costs would have to be at least ** ** the current cost of a REC in order for the 3 Degrees contract to be beneficial to AmerenUE's interest in

[327] Tr. 16:764.

[328] Tr. 16: 731.

[329] Tr. 16: 731.

[330] Tr. 16: 731.

[331] Barbieri Rebuttal, Ex. 9, p. 4.

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accomplishing the purported purposes of the VGP tariff.[332] That is to say that if AmerenUE's purpose in offering the Pure Power Program is really to enable its customers to cause or encourage any of the following: (1) the continued production of green energy at current levels; (2) the expanded production of green energy in the future; or (3) making past production of green energy economically viable; then one would assume that AmerenUE's goal would be to ensure that as much of the $15 collected pursuant to the VGP tariff would ultimately be collected by a green energy producer. Instead only ** ** of the $15 collected went to green energy producers.[333]

Second, concerning AmerenUE's argument that the 3 Degrees contract insulates AmerenUE from the cost of educating its customers about the program, one need only look at the revised website to determine that they are simply promotions of the Pure Power Program, and misleading promotions at that.[334] If AmerenUE really was encountering such an overwhelming demand for a Voluntary Green Program as described in the last case, and its customers are as excited about the program as AmerenUE would lead the Commission to believe through reading the letters provided by Mr. Barbieri in his testimony, then it would follow that devoting significant sums of money to the promotion of the program would be a superfluous exercise, at best.[335]

Third, concerning AmerenUE's argument that the 3 Degrees contract insulates AmerenUE from the risk that the cost of RECs in general, and Missouri-regional RECs in particular will increase during the term of the 3 Degrees contract, consider the fact that

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[332] Ensrud Rebuttal, Ex. 220 (HC), p. 3.

[333] *Id.*

[334] Ex. 59; Tr. 16: 671.

[335] Barbieri Rebuttal, Ex. 9, pp. 2-3.

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the future cost per REC would have to ** ** in order for the 3 Degrees contract to be beneficial to AmerenUE's interest in accomplishing the purported purposes of the VGP tariff.[336] Even if the concerns about future REC prices and administrative costs are considered together, there does not seem to be much cause for concern with the current slack between the $15 collected, and the ** ** that ultimately makes its way to a green energy producer.[337]

AmerenUE also posits the argument that the 3 Degrees contract protects AmerenUE from the risk of over-acquiring RECs which might expire before they are required to be retired on behalf of a Pure Power participating customer. While this argument on its face fails for the reasons discussed above concerning administrative cost risk and the risk of REC price increases, it also poses an interesting dilemma. If AmerenUE requested the VGP tariff in response to customer desires, then a logical goal for AmerenUE would be to ensure that as much of the $15 makes it to producers as possible, even if that means RECs are purchased at a higher price, or are allowed to expire.

If the Commission does authorize continuation of the Pure Power Program, or a similar program offered pursuant to the Voluntary Green Program tariff, AmerenUE should be required to provide information to Staff, participants and potential participants documenting the use of the monies contributed pursuant to the program – the percentage of total collections actually received by the producer of renewable electricity and how the rest of the money collected is used (e.g., advertising, administrative cost of Ameren, administrative costs of a marketer). Mr. Barbieri, in clarifying his prefiled rebuttal

[336] Ensrud Rebuttal, Ex. 220 (HC), p. 3.

[337] *Id.*

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testimony, modified AmerenUE's previously stated position on disclosing to its customers the distribution of monies collected pursuant to the Pure Power program.[338] AmerenUE's position is now that it will not reveal that information to its customers, even those participating in the program, for another three to five years.[339] In addition, AmerenUE should correct misstatements on the Pure Power website and in all promotional material in order to provide full disclosures and factual representations of the Pure Power Program to customers.

In summary, Staff recommends that the Commission order AmerenUE to file tariffs that provide for a phasing-out of the Voluntary Green Program, marketed as the Pure Power Program. If the Commission does allow the continuation of this program, it should require AmerenUE to provide information to participants and potential participants documenting the use of the monies contributed pursuant to the program – the percentage of total collections actually received by the producer of renewable electricity and the portions that cover activity not related to possible further green production retained by the company and by intermediaries. In addition, AmerenUE should correct misstatements on the Pure Power website in order to provide full disclosures and factual representations of the Pure Power Program to customers. Since this is a voluntary program, ratepayers should not subsidize the program. Therefore, Staff recommends that, if the Commission allows the program to continue, it require AmerenUE to track the administrative costs of the program and document who pays for any costs above that which is collected from the participants. Staff would like to note it found there are other

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[338] Tr. 16:704.

[339] *Id.*

states allowing REC programs, and that some of these other programs undergo some sort of oversight and possible revision, albeit varying from state to state.[340] In addition, it should be noted that AmerenUE acknowledges that a customer in its service territory can purchase RECs independently of the program and that ability would survive discontinuation of the program.

16. **Union Issues**: The Unions are in support of AmerenUE's proposed rate increase but raise the following issues:

    a. Should AmerenUE be required to expend a substantial portion of the rate increase investing in its employee infrastructure, in general, including recruitment and training, if the Commission has the authority to require AmerenUE to do so;

    b. if the Commission has the authority to require AmerenUE to do so Should AmerenUE be required to fully and permanently staff itself within 3 years for its normal and sustained workload, thereby reducing the need for subcontracting and overtime, if the Commission has the authority to require AmerenUE to do so;

    c. Should AmerenUE be required to be liable for and to ensure the training and certification of its subcontractors, if the Commission has the authority to require AmerenUE to do so; and

    d. Should AmerenUE be required to make good faith efforts to hire locally, both its internal and external workforces, if the Commission has the authority to require AmerenUE to do so?

Staff's position: The Staff has no position on these issues.

17. **Hot Weather Safety Program**: Should the Hot Weather Safety Program proposed by AARP be adopted by the Commission?

Staff's position: The Staff has no position on this issue.

18. **Certain Power On and Dollar More Advertising Expense**: Should AmerenUE's advertising expense for certain Power On and Dollar More advertising be recovered in rates?

[340] Ensrud Surrebuttal, pp. 13-14.

Staff's position: The Staff has eliminated the cost of these ads because they represent institutional advertising designed to enhance the Company's image. According to the Commission's accepted criteria, such advertising expenditures should be eliminated from the cost of service.

Staff and AmerenUE have been unable to reach an agreement as to whether a number of AmerenUE's advertising expenses should be included for recovery in the Company's cost of service for ratemaking purposes. The advertisements in question account for approximately $1,366,000 of the Company's filed revenue requirement and relate specifically to AmerenUE's PowerOn Program and the Company-administered Dollar More Program.

In 1986, in case concerning Kansas City Power & Light Company, the Commission announced an approach to the recovery of advertising expenses in which each advertisement is to be evaluated and then identified as falling into one of five categories, with recovery of related expenses dependant upon the classification of the individual advertisement.[341] The five categories of advertisements, as announced in that case, are as follows:[342]

(1) General Advertising – Informational advertising that is useful in the provision of adequate service;

(2) Safety Advertising– Advertising which conveys the ways to safely use electricity and to avoid accidents;

(3) Promotional Advertising – Advertising used to encourage or promote the use of electricity;

(4) Institutional – Advertising used to improve the company's public image;

(5) Political Advertising

[341] *See Re Kansas City Power & Light Company*, Case Nos. EO-85-185 and EO-85-224, 28 Mo.P.S.C. (N.S.) 228, 269-71 (*Report & Order,* 1986).

[342] *Id.*

As to the corresponding recoverability of the expenses of the advertisements identified within each category, the Commission held in the above case that a utility's cost of service should always include the reasonable and necessary cost of general and safety advertisements (Categories 1 and 2); never include the cost of institutional or political advertisements (Categories 4 and 5); and include the cost of promotional advertisements (Category 3) only to the extent that the utility can provide cost-justification for the advertisement.[343] *Id*.

Although prior to the adoption by the Commission of the current standard, the Missouri Court of Appeals for the Western District upheld the Commission's disallowance, from recovery in rates, of costs associated with advertising identified as "goodwill" advertising.[344] The advertising expense permitted by the Commission for recovery in that case was for informative purposes related to conservation, off-peak usage and safety, or was otherwise directly related to a benefit to all ratepayers.

The *Laclede* decision was the result of Laclede's challenge of the Commission's holdings on certain issues in its rate case.[345] In that case the Commission, on the advertising issue, stated in part as follows:[346]

> Staff in making this adjustment appeared to be guided by this Commission's Report and Order in Re: Kansas City Power & Light Company, Commission Case No. 18,433, et al (April 23, 1976). At page 23 and 24 of that order the Commission held as follows on the issue of advertising:

[343] *Id.*

[344] *State ex rel. Laclede Gas Co. v. Public Serv. Comm'n,* 600 S.W.2d 222, 226-28 (Mo. App., W.D. 1980), *appeal dismissed*, 449 U.S. 1072, 101 S.Ct. 848, 66 L.Ed.2d 795 (1981) ("*Laclede*").

[345] *Re Laclede Gas Company*, Case No. GR-77-33, 21 Mo.P.S.C.(N.S.) 430 (*Report & Order,* 1977).

[346] 21 Mo.P.S.C.(N.S.) at 441-42.

> ". . . The Commission finds that the following categories of advertising are appropriate for the Company to expect to be reimbursed by its ratepayers:
>
> (1) Conservation . . .
> (2) Safety . . .
> (3) Off-Peak Load Building . . .
> (4) Information – Advertising designed to provide information of substantial benefit to the consumer in the use of the product or service sold, or in promoting customer-company relations.
>
> "Good will advertising should not be reimbursed by the Company's ratepayers."

The Staff in that case proposed before the Commission the disallowance of advertising expense it identified as "Good Will." The Staff defined "good will" as "advertising designed to promote a favorable image of the Company."[347] "Good Will" advertising was what would now be referred to as institutional advertising.

The Commission, in its Laclede decision, readopted the criteria that it had set out in 1976 in a Kansas City Power & Light Company case on the advertising issue, stating:[348]

> The Commission takes this opportunity to reaffirm its position of disallowing for ratemaking purposes expenses associated with good will type advertising. Generally speaking, this type of advertising is aimed at creating a favorable image of the Company or the Company's product in the public's view. The Commission is of the opinion, and so finds, that this type of advertising is of no direct benefit to the ratepayers and ought not to be borne by them in their rates. The Commission does recognize, however, the need to establish uniform guidelines with respect to the issue of advertising so as to put utility companies and ratepayers on specific notice as to what types of advertising will, or will not, be permitted as an allowable expense for ratemaking purposes. For purposes of this discussion, however, the criteria set out by this Commission in *Re: Kansas City Power & Light Company*, supra, is appropriate and serves as a basis from which to work until this Commission has had an opportunity to conduct a generic type proceeding on this issue.

[347] *Id*. at 442.

[348] 21 Mo.P.S.C.(N.S.) at 443.

After the introduction of the present standard by the Commission in 1986,[349] the Staff has consistently sought its application in subsequent rate proceedings and the Commission has consistently adopted it in those proceedings in which advertising expense has been a contested issue.[350]

In those cases where the 1986 *Kansas City Power & Light* standard was not explicitly adopted, the Commission certainly appears to have continued in the application of its framework.[351] It appears that only twice since the inception of the standard has the Commission expressly wavered in its adoption. In *Re St. Louis County Water* the Commission held that where the information contained in an advertisement "can be shown to be of substantial benefit to the ratepayers, the expense should not be excluded from operational expenses because the advertisements in question may result also in a

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[349] *In the Matter of Kansas City Power & Light Company*, Case Nos. EO-85-185 and EO-85-224, 28 Mo.P.S.C. (N.S.) 228, 269-71 (*Report & Order,* 1986).

[350] These contested cases include, but are not necessarily limited to the following: *The Staff of the Missouri Public Service Commission, Complainant, vs. Union Electric Company, Respondent*, Case Nos. EC-87-114 and EC-87-115, Report & Order, 29 Mo.P.S.C.(N.S.) 313, 322-23 (1987); *Re Missouri Public Service, division of UtiliCorp United Inc.*, Case No. ER-90-101, et al., Report & Order, 30 Mo.P.S.C.(N.S.) 320, 326-29 (1990); *Re Laclede Gas Company*, Case No. GR-99-315, Report & Order, 8 Mo.P.S.C.3d 436, 447-48, 454-55 (1999); *Re Laclede Gas Company,* Case No. GR-99-315, 2nd Report & Order, 10 Mo.P.S.C.3d 361 (2001); *Re Laclede Gas Company,* Case No. GR-99-315, 3rd Report & Order, 13 Mo.P.S.C.3d 215 (2005). The initial Report & Order, Order Of Clarification and Order Approving Tariffs were remanded on December 1, 2000, by the Circuit Court of Cole County to the Commission for findings of fact sufficient to support resolution of the net salvage issue. The Commission issued its 2nd Report & Order on June 28, 2001. On May 28, 2003, the Western District Court of Appeals issued its mandate to Cole County Circuit Court with directions to the Circuit Court to remand the decision. On May 30, 2003, the Circuit Court entered a docket entry stating that the case was remanded to the Commission with instructions to provide clearer, more detailed findings of fact that include the rationale for the findings and to comply with §§ 386.420 and 536.090, RSMo 2000. As a result of the remand by the Western District Court of Appeals, the Commission determined that the proceeding should be reopened to take further evidence on the issue of net salvage and depreciation. On September 22-24, 2004, a further hearing was held on the net salvage issue. The Commission issued a 3rd Report & Order on January 11, 2005.

[351] *See Re Missouri Gas Energy*, Case No. GR-96-285, *Report & Order,* 5 Mo.P.S.C.3rd 437, 453-455 (1997) (recognizing OPC's classification of certain advertisements as institutional or promotional); *Re Missouri Cities Water*, Case No. WR-91-172, *Report & Order*, 1 Mo.P.S.C.3d 119, 133-135 (1991) (acknowledging Staff's cited adherence to the "Commission's proscription against spending ratepayer dollars for purely 'image enhancing' corporate activities" as introduced in the 1986 *Kansas City Power & Light* case).

better image for the Company."[352] The Commission also found in that case, however, that the advertising to be allowed was "informational in nature, designed to allay the customers' concerns about the quality of their drinking water…in the present climate of heightened concern about water quality."[353]

The other instance of Commission divergence from the *Kansas City Power & Light* standard occurred amidst the extraordinary circumstances of the divestiture of the Southwestern Bell Telephone Company, in a case in which the Commission held that the "post-divestiture operations of a statewide telephone company require a more complicated standard for advertising costs than announced in the Union Electric and Kansas City Power & Light Company cases."[354] In the instant case, Staff witness Erin Carle presented her expert opinion that the contested advertisements constitute institutional advertising under the framework provided by the Commission in *Kansas City Power & Light,* Case No. EO-85-185, and thus that disallowance of the costs associated therewith is proper under that standard.[355] Mrs. Carle's classification of the advertisements as institutional is based upon her opinion that each disallowed PowerOn and Dollar More advertisement is designed to promote the Company's public image.[356]

At hearing, Company witness Richard Mark stated his position that. although under the framework of *Kansas City Power & Light*, the advertisements in question could

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[352] *Re St. Louis County Water*, Case No. WR-88-5, *Report & Order,* 29 Mo.P.S.C.(N.S.) 425, 445 (1988) (citing *In re: Missouri Power and Light Company*, 25 Mo.P.S.C.(N.S.) 388, 398-399 (1982)).

[353] *Id.*

[354] *The Staff of the Missouri Public Service Commission v. Southwestern Bell Telephone Company*, Case. No. TC-89-14, *Report & Order,* 29 Mo.P.S.C.(N.S.) 607, 637-639 (1989).

[355] Staff Cost of Service Report, Ex. 200, at 53, by Erin Carle.

[356] Carle Surrebuttal, Ex. 219 at 8; Tr. 17:1040 (specifically referring to PowerOn)).

probably be classified as either general or institutional,[357] that, in his opinion, such advertisements were more properly classified as general.[358] Mark also testified that the Dollar More advertisements "provide valuable information for customers," and that the PowerOn advertisements "provide important information to customers, which benefit the customers, the Company and the Commission."[359]

Mr. Mark's position however is based at least in part upon his opinion that the advertisements at issue need to be construed as a campaign rather than examined and classified on an individual basis.[360] This position is absolutely contrary to the standard established by the Commission. Prior to the introduction of the *Kansas City Power & Light* standard, the Commission utilized what was known as the "New York Rule" for allowing advertising expenses to be included in cost of service. Although the "New York Rule" was predicated on a desire to eliminate such an "ad-by-ad" review of expenses, the Commission specifically broke away from the "New York Rule" due, in part, to the fact that continued disagreements by the parties about individual ads negated the purpose of its application.[361]

Applying the appropriate standard to the facts in the present case, Staff's position is supported directly by the testimony of the Company witness himself. Mr. Mark stated at hearing that when one advertisement is taken out of the context of the campaign as a whole that it "doesn't mean anything" and may not even be understood.[362] An

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[357] Tr. 17:1020 (Mark).

[358] Tr. 17:1024 (Mark).

[359] Mark Rebuttal, Ex. 20, pp. 3, 6.

[360] Tr. 17:1024.

[361] 28 Mo.P.S.C. (N.S.) at 270.

[362] Tr. 17:1022, 1024 (Mark).

advertisement that "doesn't mean anything" surely does not "benefit the customers, the Company and the Commission," as was stated by Mr. Mark in his testimony, and more importantly is not "useful in the provision of adequate service," the traditional test for classification as a general advertisement.[363]

As Mr. Mark concedes, the advertisements do not provide much information about either the PowerOn Program or the Dollar More Program. Rather, the purpose of the advertising campaign is to get customers to "look into more information about PowerOn," information that is contained on the Company's website.[364] It is Staff's position that customers do not need and do not benefit from advertising slogans and platitudes. Customers are seeking specific information such as the location of the neighborhoods in which the Company is performing projects and when power will be restored should customers suffer an outage.[365] Customers should not have to pay millions of dollars to be "force[d]"[366] to the AmerenUE website where this information is contained, especially when the Company's website address is already displayed on a customer's bill.[367]

In the presentation of Staff witness Carle's first live testimony, a testimony in which she was admittedly nervous,[368] Mrs. Carle elected to change her position regarding the classification of certain individual advertisements. This change in position is not however dispositive of the classification of the advertisements at issue. Under § 490.065,

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[363] Mark Rebuttal, Ex. 20, p. 6.

[364] Tr. 17:1013.

[365] Tr. 17:1022, 1023.

[366] Tr. 17:1022, or "push[ed]" Tr. 17:1016.

[367] Tr. 20:1559.

[368] Tr. 17:1065.

RSMo, opinions of expert witnesses are admissible if they "will assist the tryer of fact to understand the evidence or to determine a fact in issue." As such, the determination of the facts in issue, the classification and subsequent recoverability of the advertisements, although appropriately informed by expert testimony, is left for the determination of the Commission as the tryer of fact. In reaching that determination the Commission is free to give more weight to certain pieces of testimony than to others, and in the instant case should apply the facts to the appropriate standard, as was done by Mrs. Carle in her pre-filed testimony in this action.

In that testimony, Mrs. Carle discusses the advertisements at issue, clearly states Staff's objections, and presents examples of disallowed advertisements, which clearly show that such advertisements are designed to promote the Company's image rather than provide useful information to customers as is required.[369]

In conclusion, Staff recommends the Commission accept Staff's position to disallow the portion of the PowerOn and Dollar More advertisements that constitute institutional, image-enhancing advertising. In the words of the Commission in *Kansas City Power & Light Company*, Case No. EO-85-185, "the ratepayers should not bear the cost of **institutional or good will advertising**. The Commission cannot conclude herein that institutional advertising is beneficial to the ratepayers. If the Company desires to improve its public image, that is management's business, but the costs will not be borne by the ratepayer. . ."[370]

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[369] Carle Surrebuttal, Ex. 219, at 7-9.

[370] 28 Mo.P.S.C. (N.S.) at 270; emphasis added.

19. **Class Cost of Service and Rate Design**:

a. **Class Cost of Service**: How should class revenue responsibility be determined? A number of parties have submitted class cost-of-service studies.

i Should the revenue responsibility of the various customer classes be based in part on the class cost-of-service study results?

Staff's position: Yes. An important tool and starting point in the investigation of the reasonableness of current rate levels for each customer class compared to other classes is a class cost of service study; however, other factors such as rate impact and affordability should also be considered.

ii Should there be an increase or decrease in the revenue responsibility of the various customer classes?

Staff's position: No. The Staff's Class Cost of Service study does not indicate that a realignment of class revenue responsibility is warranted at this time. Significant shifts in class revenue responsibility were made in AmerenUE's last rate case, which significantly impacted customers.

iii. If the answer to "ii" above is "yes," what basis should be used to increase or decrease the revenue responsibility of the various classes?

Staff's position: If there are shifts in class revenue responsibility, a class's revenue responsibility should not be reduced when the Staff's class cost of service study shows that class is providing revenue that yields a lower than an overall classes average rate of return; and a class's revenue responsibility should not be increased when the Staff's class cost of service study shows that class is providing revenue that yields a higher than an overall classes average rate of return.

b. **Rate Design**:

i. In respect to the class cost-of-service determination, including the class cost-of-service study determination, how should the Commission change the level of the rates of each customer class that it orders in this case?

Staff's position: Each component of each class' rate structure should be changed by an equal percentage. If the Commission varies from this procedure, it should only be to hold the Residential Customer Charge constant.

Staff recommends holding constant the relative revenue responsibility of the various customer classes. Significant shifts in class revenue responsibility were made in AmerenUE's last rate case. The Staff's Class Cost of Service study in this case does not indicate that a shift in class revenue responsibility is warranted at this time. If there are shifts in class revenue responsibility the shifts should not contradict the results of Staff's class cost of service study, i.e., a class's revenue responsibility should not be reduced when the Staff's class cost of service study shows that class is providing revenue that yields a lower than an overall classes average rate of return; and a class's revenue responsibility should not be increased when the Staff's class cost of service study shows that class is providing revenue that yields a higher than an overall classes average rate of return. Each component of each class' rate structure should be changed by an equal percentage. If the Commission varies from this procedure, it should only be to hold the Residential Customer Charge constant.

On December 3, 2008, Noranda, OPC, MIEC, and the Commercial Croup filed a Nonunanimous Stipulation and Agreement (S&A). AmerenUE was not a signatory, but did not oppose the S&A. Staff was not a signatory and opposed the S&A – thus, pursuant to 4 CSR 240-2.115(D), "[a] nonunanimous stipulation and agreement to which a timely objection has been filed shall be considered to be merely a position of the signatory parties to the stipulated position, except that no party shall be bound by it. All issues shall remain for determination after hearing." Thus, Staff retains its position supporting an equal percentage increase to all rate classes. Staff believes the quantitative evidence supports its position, and that the reduction in the Large Transmission Service (LTS) class's revenue responsibility urged by Noranda, and via the S&A, OPC, the

MIEC, and the Commercial group, lacks a quantitative basis, in that the Staff's class cost of service study shows that class is providing revenue that yields a lower than an overall classes average rate of return. If the Commission adopts the S&A, the recommended shift in LTS class' revenue responsibility would exacerbate this lower than average rate of return for the LTS class. This increases the likelihood that Noranda will be faced in the future with a greater than system average increase, if the Commission decides in the future to address the disparity from system average.

Staff does not interpret its CCoS study as supportive of any shifts in interclass revenue responsibility.[371] Staff also, in its analysis, did not find any party's CCoS study to be in support of the revenue shifts contained in the S&A.[372] Staff interprets quantitative data to provide a recommendation to the Commission based on its analysis of that quantitative data. Staff could not find any basis for support of the S&A in the quantitative data presented to the Commission in this case. Staff acknowledges in its position statement that the CCoS alone is not determinative and that "other factors such as rate impact and affordability resulting from shifting of class revenue responsibility should also be considered." However, the shifts affected by the S&A are a movement in the wrong direction, according to the evidence in this case.

If the positions contained in the S&A were adopted, the result would be that "the residential and small general service, large general service and small primary customers would have a smaller deviation from zero than they do now, and the large transmission service customer would have a larger deviation from zero, in the same direction it is

[371] Watkins Supplemental Direct, Ex 242, p. 2.

[372] Watkins Supplemental Direct, Ex 242, p. 2. Staff notes that its analysis of the company's CCoS reveals that the AmerenUE results are proper in sign for the S&A's shifts, however the magnitude of the deviations in the company's CCoS would not indicate that the shifts are necessary or appropriate.

now,"[373] for any rate increase over $80,000,000. Staff's opposition to the shifts in class revenue responsibility affected by the S&A is based on the results of its class cost-of-service study. Staff does not recommend any shifts in class revenue responsibility at this time, because as explained by Mr. Watkins:[374]

> The rule of thumb that we have used is a 5 percent band one way or the other as a first step at whose rates should be increased or decreased. In the event that, as in this example, large general service, small primary shows a decrease of more than 5 percent, the next thing we would look at is to see if there's somebody whose rates exceed 5 percent, and in the -- and our recommendation is balanced by there is really no one's rates that should be -- should definitely be increased in order to fund that rate reduction.

In other words, Staff looks to see if the difference between each class's revenue collected and costs to serve is over or under 5%. If Staff finds a number over or under 5%, Staff looks at the other classes to see whether any classes have an offsetting difference. In this case, Staff found a number slightly greater in magnitude than negative 5%, the LGS/SPS class, at -5.092%.[375] However, there was no corollary close to a positive 5%, so Staff did not recommend any revenue shifts.

But for the shift reducing the LTS class's revenue responsibility, Staff does not oppose the revenue shifts described in the S&A. Staff's study shows the LTS class to be underpaying by 4.882%, currently. If the shifts in class revenue responsibility that are described in the S&A are made, the LTS class's result would be over 5% below its cost of service which, all else being equal, Staff would consider a point of concern – particularly in recognition of the fact that the LGS/SPS class is already over 5% . Staff's failure to oppose the S&A would have denied Staff the opportunity to present this

[373] Tr. 23:2071-72.

[374] Tr. 23:2023-24.

[375] Roos Rebuttal, Ex. 214, Sch. DCR-R-1.

information to the Commission. Staff does not recommend that adjustments be made that aren't warranted, particularly when they're in the wrong direction.[376]

The S&A implements interclass revenue shifts, but requires all rate components within a given class to be increased by an equal percentage, except for the residential customer charge. The result of this arrangement is that for any increase over $80,000,000, charges that are now the same for multiple classes will be increased by different percentages from class to class. The S&A will not vary the costs that are recovered by a given charge from class to class – only the amount collected through the charge. Staff's opposition to the mechanism implementing the S&A is premised on a concern for avoiding, to the greatest extent possible, arbitrary rates. The S&A calls for different customer charges for the LPS and SPS classes.[377] Again the costs recovered by the time-of-day energy charges in the LPS and LTS classes are the same. No proponent of the S&A has identified a reason or justification for why the customer charge should vary between the LPS and SPS classes. In fact, Mr. Watkins has testified that the costs recovered under by these charges are the same for both classes.[378] No proponent of the S&A has identified a reason or justification for why the revenue responsibility of either the lighting classes, or the Metropolitan Sewer District should be altered. The S&A calls for different time of day energy charges for the LPS and LTS classes.[379] No proponent of the S&A has identified a reason or justification for why the time of day energy charge

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[376] Tr.23:2075.

[377] Tr. 23:1923.

[378] Tr. 23:2030-2031.

[379] Tr. 23:1999.

should vary between the LPS and LTS classes. Staff does not recommend that adjustments be made that aren't warranted.[380] (Transcript V23 pp. 2075, L 7 - 2076 L 6)

The rationale for Staff's opposition to the S&A was concisely explained by Mr. Watkins:[381]

> Q. What would happen if a series of unadjusted -- or a series of unwarranted adjustments were made over time?
>
> A. In the same direction? Things would get more and more distant from what should be recovered in rates.
>
> Q. And if those were made in opposite directions, would they effectively cancel each other out from case to case?
>
> A. You mean if one case you increased and the next case you decreased?
>
> Q. Yes.
>
> A. Yes.
>
> Q. What would the effect of that be over time?
>
> A. Well, if all the increases and decreases were the same, there'd be no effect, other than customer bills would go up and then they'd come down and they'd go up and then they'd come down, but they would average out.
>
> Q. So is the nature of class cost of service studies that there's a certain level of precision that you -- or certain level of imprecision that there's no need to make those marginal adjustments?
>
> A. Well, I think that it's certainly the case that it's not appropriate to make those adjustments for small deviations from the class average.

As alluded to by the Public Counsel at the hearing, the rate shifts affected by the S&A could be accomplished without destroying the rate elements noted by Mr. Watkins in his supplemental testimony.[382] Should the Commission decide for policy reasons that

[380] Tr. 23:2075-2076.

[381] Tr. 23:2075.

[382] Watkins Supplemental Direct, Ex 242, p. 2.

the rate shifts are a proper resolution of this issue, Staff urges the Commission to retain the following rate elements:[383]

> (1) The customer charges on the Small Primary Service (SPS), Large Primary Service (LPS), and Large Transmission Service (LTS) rate schedules should be the same dollar amounts.
>
> (2) The rates ($ per kW) for Rider B voltage credits should be the same under all applicable rate schedules.
>
> (3) The rate ($ per billed kVar) associated with the Reactive Charge should be the same under all applicable rate schedules.
>
> (4) The rate ($ per month) associated with the Time-of-Day meter charge should be the same under all applicable rate schedules.
>
> (5) The Time-of-Day energy charge adjustments should be the same on the LPS and LTS rate schedules.

There was much discussion during the hearing regarding who Staff was representing, or what classes Staff was representing. Pursuant to 4 CSR 240-2.010(11), the Staff is a party in all Commission cases. Staff's role in a rate case is to present a balanced review and investigation on substantive matters. Staff does not represent any specified class or group, nor does it advocate on behalf of any specified class or group. Staff does not oppose the S&A as a consequence of any obligation, or perceived obligation toward any specified class or group. Similarly, Staff does not make its recommendation for an equal percentage increase due to any particular public policy oriented motivation other than fairness and reasonableness. Quite simply, in this instance Staff views that its obligation is to indicate to the Commission the consequences of the proposals placed before the Commission – particularly the long term consequences.

[383] Watkins Supplemental Direct, Ex. 242, p. 2.

The Public Counsel represents the public.[384] But the public is not necessarily a class, it is all classes, unless the class is otherwise represented. Members of a class of customers may be represented by other than the Public Counsel, and the Director of the Department of Economic Development can select an attorney to represent a sector of the public, if the Public Counsel certifies to the Director that he, the Public Counsel, cannot represent a sector of the public without creating a conflict of interest and that sector of the public will not be protected by any party to the proceeding.[385] The Public Counsel did not invoke Section 386.710.1(3) in this case.

Much of Staff's opposition to the S&A has been framed around the results of Staff's CCoS. While Staff does not interpret any of the studies submitted in this case to provide a quantitative justification for the S&A, Staff contends the superiority of its own study based chiefly on the production capacity allocator used, and to a lesser extent, due to differences in the methodology used to calculate demand. There are basically two categories of production and transmission allocators -- Peak Responsibility methods and Capacity Utilization methods. Three variations of the Capacity Utilization method are the two Average and Peak (A&P) methods used by the Staff and the OPC, and the Time-

[384] Section 386.710(2) RSMo.

[385] Section 386.710.1(3), RSMo: The public counsel shall have the following powers and duties: He shall have discretion to represent or refrain from representing the public in any proceeding. He shall consider in exercising his discretion the importance and the extent of the public interest involved and whether that interest would be adequately represented without the action of his office. If the public counsel determines that there are conflicting public interests involved in a particular matter, he may choose to represent one such interest based upon the considerations of this section, to represent no interest in that matter, or to represent one interest and certify to the director of the department of economic development that there is a significant public interest which he cannot represent without creating a conflict of interest and which will not be protected by any party to the proceeding. The director of the department shall select an attorney, to be paid from funds appropriated for this purpose, to represent that segment of the public certified to him by the public counsel as unrepresented. Nothing in this section shall be construed to limit the right of any person, firm or corporation specified in subsection 1 of section 386.390 to petition or make complaint to the commission or otherwise intervene in proceedings or other matters before the commission.

of-Use method used by OPC. Two variations of the Peak Responsibility method are the different Average and Excess (A&E) methods used by both AmerenUE and MIEC. Each method is based on different assumptions about the reason an electric utility adds capacity and transmission. The A&P method used by Staff assumes that an electric utility adds capacity and transmission to meet the entire load of the electric utility. The A&E method assumes that an electric utility adds capacity and transmission to meet peak demands.[386] Inherent in the A&E method proposed by Mr. Brubaker for MIEC is the assumption that an electric utility adds generation capacity to meet peak demands.[387] However, that is not entirely the case. An electric utility chooses what type of generation capacity to add when doing so reduces the running costs of meeting its load requirements throughout the year by more than the cost of additional capacity.[388]

The A&E method does not take into account the fact that generation facilities are built to meet the entire load of the electric utility. The A&E method unfairly puts too great of a responsibility on the classes that have lower load factors. This happens because the demand-related piece of the allocator is determined by the difference between each class's peak demand and the class's average demand. Thus, a low load factor class would have a greater difference between its peak demand and its average demand causing an excessive amount of costs to be allocated to that class. On the other hand, the A&P method considers each class's contribution to the system's total load, as

[386] Roos Rebuttal, Ex. 214, p. 5.

[387] Brubaker, Direct, p. 21.

[388] Roos Rebuttal, Ex. 214, p. 6.

opposed to each class's excess demands at peak. This is a more reasonable approach because peak is a function of the loads of each class, not just one class.[389]

Staff's methodology is superior also because it takes into account every month of the year, not just the months with the highest peak. Including the entire year is particularly significant with regard to generating facility maintenance. Generation facilities need to be taken out of service for maintenance. This would generally occur during low demand months. The amount of capacity to meet all of the system's loads must take into account the demands in the low demand months as well as the months in which the system may be peaking. Staff's 12-NCP methodology takes this into account. Further, class peak (non-coincident peak or NCP) demand is the maximum demand of each class whenever it occurs during each month. While using coincident peak (CP or system peak) demand is theoretically appropriate, the Staff uses class peak demands because of the relative stability of class contribution to class peak demands, when compared to class contribution to coincident (system) peak demand. Each class's contribution to class peak is independent of when the system peaks; however, using coincident peaks would complicate comparisons over time.[390]

For these reasons, Staff recommends holding constant the relative revenue responsibility of the various customer classes. Any shifts in class revenue responsibility should not contradict the results of Staff's class cost of service study, and the Commission should reject reductions to the LTS class's revenue responsibility when the Staff's class cost of service study shows that class is providing revenue that yields a lower than the overall classes' average rate of return. Each component of each class's

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[389] Roos Rebuttal, Ex. 214, p. 7.

[390] Roos Rebuttal, Ex. 214, p. 8.

rate structure should be changed by an equal percentage to preserve rate design elements, regardless of whether any shifts to class revenue responsibility are made.

A Consideration of Commission Jurisdiction:

The gravamen of AmerenUE's direct, rebuttal, and surrebuttal cases is that it does not have a fuel adjustment clause (FAC) and absolutely must have one. The general approach of AmerenUE's rebuttal and surrebuttal cases is to attack the Staff's adjustments as extra-jurisdictional. The Commission's jurisdiction is wide and deep, but Great Plains Energy, Inc. (GPE) / Kansas City Power & Light Company (KCPL) have recently had some success in suggesting to the Commission otherwise and AmerenUE is pursuing that approach. The Commission should be very careful before it needlessly decides that it does not have jurisdiction. One of the areas in particular where AmerenUE appears to be attempting to move the Commission in that direction is the area of employee compensation. Reply briefs are not provided for by the procedural schedule, so the Staff to a certain extent must attempt to anticipate arguments that will be raised in this, the only round of briefs that will be filed.

Missouri appellate courts, when they reverse the Commission, seem to find instances where the Commission either abdicates its responsibility to regulate or misapplies its authority, rather than find instances where the Commission has usurped power it does not have. The Staff will identify certain instances below when the appellate courts have found a proper exercise of power. The Staff also will note the principal example of a Missouri appellate court finding that the Commission exercised power that it did not have, i.e., the Missouri Supreme Court's 1979 decision that the

Commission did not have the authority to confer upon electrical corporations the use of fuel adjustment clauses (FACs).[391]

A contrary example of a proper exercise of authority is the AmerenUE experimental alternative regulation plan (EARP) adopted by the Commission in 1995. AmerenUE contested the Commission's authority to make certain adjustments, asserting that neither the Commission's enabling statute nor any provisions of the EARP authorized the Commission to adopt the contested adjustments which AmerenUE challenged as either in direct conflict with, or unilaterally changing, the terms of the EARP. The Western District Court of Appeals held that the EARP was not a contract with the Commission and it did not impinge or restrict the Commission in the exercise of any statutory right or obligation.[392] The Court construed the EARP not as an abdication of the Commission's responsibility to regulate, but as an embodiment of it in which "[t]he EARP contemplated extensive and continuous monitoring and embraced the recognition that not all items could be anticipated and addressed and that disputes could arise" requiring Commission intervention.[393]

The Staff will cite to the Commission an area of employee compensation that the Missouri Legislature has only in recent years sought to distinctly carve out from Commission jurisdiction. In fact, it was an area that the Staff audited upon the direction of the Missouri Commissioners – utility employee compensation based on collective bargaining. This area is not at issue in this case but is cited herein for the multifaceted example that it offers regarding Commission jurisdiction.

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[391] *State ex rel. Utility Consumers Council, Inc. of Missouri v. Public Serv. Comm'n*, 585 S.W.2d 41 (Mo. banc 1979).

[392] *Union Electric Co. v. Public Serv. Comm'n*, 136 S.W.3d 146 (Mo. App., W.D. 2004).

[393] *Union Electric Co, supra,* 136 S.W.3d at 152.

In the Commission's 1982 Union Electric Company (UE) rate increase decision, in a section denoted "Miscellaneous Issues," is a subsection titled "Wage Policy."[394] In this subsection, the Commissioners expressed their concern that the Staff had not in the past audited the reasonableness of utilities' labor costs. The decision cited from the Staff's Brief a Staff witness's testimony respecting contract labor costs as follows:[395]

> The Staff does try to do some type of analysis as to where the costs are distributed and whether those costs are includable as part of the cost of service of providing electric. The overall labor costs as **contractually obligated** by the company, *the Staff has not done any type of analysis to determine whether that is reasonable or not*.

The Commission directed the Staff in its decision in Case No. ER-82-52 to prospectively address this subject area:[396]

> A situation where the appropriate level or reasonableness of Company's labor costs, whether contract or salary, or any other major costs of the Company has not been analyzed by the Staff, Office of the Public Counsel, or any other party cannot continue. The Commission itself obviously cannot do such an audit, yet it is the responsibility of the Commission to determine whether the Company's labor costs, as well as other costs, are fair and reasonable. In order to reach this conclusion, the Commission must rely upon the input provided by the parties.
>
> None of this is to say that even one dollar of the Company's labor costs in this case is not fair and reasonable. By inclusion of labor costs in its testimony concerning its need for rate increase, the Company has provided the Commission with the only evidence on labor costs. No other party introduced any contrary evidence. Thus, under the evidence in this case, the Commission has no choice but to conclude that the Company's labor costs are reasonable.
>
> In future general rate cases, the Commission will expect a company to address the issue of the reasonableness of its level of labor costs, and other major costs of its operations, and that other parties including the Staff, shall examine such issue accordingly.

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[394] *Re Union Electric Co.*, Case No. ER-82-52, 25 Mo.P.S.C.(N.S.) 194, 227 (*Report & Order,* 1982).

[395] Staff Brief, p. 98, in Case No. ER-82-52, quoting Staff testimony respecting contract labor costs; italics emphasis added in Case No. ER-82-52 *Report & Order*; bolding emphasis added in this brief.

[396] 25 Mo.P.S.C.(N.S.) at 227.

This *Report & Order* was not the work of the "Slavin Commission."[397]

In an excess earnings complaint case, the Staff, among other adjustments, proposed to disallow $5,144,000 of test year operating expense purportedly representing unwarranted or unjustified compensation concessions by Southwestern Bell Telephone Company (SWBT) in its negotiation of its 1986 labor contract with the Communications Workers of America (CWA).[398] SWBT's 1986 collective bargaining agreement covered wages for a three-year period and was the first time that SWBT negotiated with CWA on its own without AT&T since its divestiture from AT&T. The Staff did not propose any adjustment in the union wage increases granted by SWBT beyond the test year. The Commission rejected the Staff's proposed adjustment.

The Staff's proposed adjustment in the SWBT case was one of the events that resulted in the Legislature adopting, and the Governor signing in 1993, Senate Bill 289, which added a new section to be known as § 386.315, which read as follows:

> In establishing public utility rates, the commission shall not reduce or otherwise change any wage rate, benefit, working condition, or other

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[397] To place the Commission's 1982 UE rate increase case *Report & Order* in some context, the Commissioners who voted out the Case No. ER-82-252 *Report & Order* were Chairman Charles J. Fraas, Jr., and Commissioners Leah Brock McCartney, Larry W. Dority, John C. Shapleigh, and Charlotte L. Musgrave. The Commission's decision was issued after Christopher S. Bond won his second term as Governor after four years of the Joseph H. Teasdale administration. Charles J. Fraas, Jr., had originally been appointed to the Commission and named Chairman by Governor Teasdale, but Governor Teasdale a few years later named Alberta Slavin Chairman after she had served as a Commissioner for a number of years. Early in his second term, Governor Bond promoted Charles J. Fraas, Jr., to Chairman to replace Alberta C. Slavin as Chairman while she remained on the Commission. Governor Bond eventually named John H. Shapleigh to replace Commissioner Slavin, but left Charles Fraas as Chairman for a period of time before naming John Shapleigh Chairman. The Commission's *Report & Order* in *Re Union Electric Co.*, Case No. ER-82-52, 25 P.S.C.(N.S.) 194 (1982), was issued by a 5-0 vote on July 2, 1982. Commissioners Leah Brock McCartney and Larry W. Dority had been appointed by Governor Teasdale and Commissioner Musgrave had been appointed by Governor Bond after he had appointed John Shapleigh to the Commission.

[398] *The Staff of the Missouri Public Serv. Comm'n v. Southwestern Bell Telephone Co.*, Case Nos. TC-89-14 et al., 29 Mo.P.S.C.(N.S.) 607, 624 (*Report & Order,*1989).

> term or condition of employment that is the subject of a collective bargaining agreement between the public utility and a labor organization.

Section 386.315 was amended in 1994 to address, in addition to collective bargaining agreements, post-retirement employee benefits and Financial Accounting Standard 106. Other than the 1994 amendment adding unrelated provisions to the original one sentence of Section 386.315, the language of the one sentence of Senate Bill 289 remains to this day unaltered.

Not to be argumentative, but the language of Senate Bill 289 does not literally cover the adjustment proposed by the Staff in the SWBT case. The Staff in the SWBT case merely proposed disallowing recovery of certain costs relating to the terms of a collective bargaining agreement. The Staff did not propose that the Commission "change any wage rate, benefit, working condition, or other term or condition of employment that is the subject of a collective bargaining agreement between the public utility and a labor organization." Nonetheless, the Staff understands what was meant, and has not proposed a similar adjustment since the Commission's issuance of its decision in the SWBT case, even before Senate Bill 289 became law.

Not to belabor this matter, but there is an 8th Circuit decision which is instructive on the matter of this Commission's jurisdiction, rendered five years after the Commission's *Report & Order* in the Union Electric case discussed above, Case No. ER-82-52.[399] In a 1984-1985 SWBT rate increase case before the Arkansas Public Service Commission (Arkansas Commission), the Arkansas Staff proposed an adjustment decreasing SWBT's revenue requirement for wages and benefits that were unreasonable when compared with wages and benefits for similar jobs at similar companies in the

[399] *Southwestern Bell Telephone Co. v. Arkansas Public Serv. Comm'n*, 824 F.2d 674 (8th Cir. 1987).

geographic region. SWBT maintained that the Arkansas Commission was prohibited by the National Labor Relations Act (NLRA) from making adjustments to wages that were the product of collective bargaining. The Arkansas Commission rejected this argument and reduced SWBT's revenue requirement by approximately $3 million in non-management wages, benefits and payroll taxes. Of the overall $61 million rate increase that SWBT sought, the Arkansas Commission granted an overall rate increase of approximately $23 million.[400]

In addition to appealing the Arkansas Commission's decision to the Arkansas Court of Appeals,[401] SWBT filed a petition in U.S. District Court for the Eastern District of Arkansas for a declaratory judgment and a permanent injunction. The U.S. District Court held that the Arkansas Commission was preempted by the NLRA. The Arkansas Commission appealed to the U.S. Eighth Circuit Court of Appeals and the U.S. Eighth Circuit reversed the U.S. District Court, finding that the Arkansas Commission's action disallowing recovery of certain non-management wage and benefit expenses did not rise to the level of an impermissible intrusion into or control over the relationship between SWBT and the CWA:[402]

> We finally observe, as did the Ninth and First Circuits, that in any regulated industry, myriad governmental decisions, from ratesetting to the imposition of safety standards, undoubtedly will affect labor relations. Any indirect effect of the ratesetting action taken in this case, however, falls short of the kind of state interference with the labor-management relationship that Congress intended to proscribe. . . .

[400] 824 F.2d at 673.

[401] *Southwestern Bell Telephone Co. v. Arkansas Public Serv. Comm'n*, 715 S.W.2d 451 (Ark. App., banc 1986).

[402] 824 F.2d at 676.

The 8th Circuit also stated:[403]

> . . . We conclude, nonetheless, that the Commission's disallowance of what it deemed to be unreasonably high wage expenses, while perhaps indirectly affecting future bargaining strategy, does not control the terms of any particular collective bargaining agreement and does not interfere in any impermissible way with the exercise of collective bargaining rights protected by the NLRA.
>
> * * *
>
> The Commission's action and the statutory authority upon which it is based have as their only purpose and effect the setting of reasonable intrastate telephone rates in Arkansas. This does not interfere with or supplement the [National Labor Relations] Board's jurisdiction to enforce federal labor legislation or regulate industrial relations.
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> * * *
>
> Nothing in the Commission's order encroaches upon either party's ability to use economic pressure in future negotiations to gain concessions from the other. The Company remains free to resist the union's demands, and CWA may authorize a strike if its terms are not met. Furthermore, the Commission has not vetoed the wage agreement. As we have already pointed out, the Company stipulated that notwithstanding the Commission's order, it is obligated to pay the bargained-for wages. Finally, nothing in the NLRA guarantees that wages agreed upon in collective bargaining will be recovered from consumers, whether the business is regulated or not. This, therefore, is not a case where either *Machinists* or *Garmon* preemption is appropriate.

In SWBT's appeal to the Arkansas Court of Appeals, SWBT alleged that the Arkansas Commission erred respecting disallowances relating to employees covered by CWA agreements, among other adjustments. The Arkansas Court of Appeals held that a specific finding of bad faith or imprudence was not a necessary predicate to disallowance of a portion of these costs and:

> The disallowance of a portion of wage and salary expenses by the Commission carries with it the implication that these expenses, in the

[403] *Id.,* at 674-675.

> judgment of the Commission, were not reasonably necessary for providing adequate telephone service to ratepayers.[404]

After the decision of the U.S. District Court for the Eastern District of Arkansas, but prior to the decision of the U.S. Eighth Circuit Court of Appeals reversing the District Court, the Arkansas Court of Appeals rejected SWBT's argument that the Arkansas Commission was preempted by the NLRA from adopting the adjustment proposed by the Arkansas Staff:

> [W]e do not agree that the NLRA sweeps so broadly as to displace the Arkansas Commission's ability to establish reasonable utility rates. . . . We do not believe that Congress intended the NLRA to intrude into state utility regulation, and appellant has not presented us with any evidence of such congressional intent.[405]

The Arkansas Court of Appeals also significantly held that disallowance of the costs by the Arkansas Commission did not interfere with the exercise of management judgment by SWBT:

> Disallowance of some of these costs by the Commission does not interfere with the exercise of management judgment by Bell, and management remains unfettered as to how it conducts its affairs. Instead, it is the impact that conduct may have on rates with which the Commission must remain free to concern itself within the limits of its authority. It is the reasonableness of the costs, and not the attitude or wisdom with which those costs were incurred by management, as to which the Commission

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[404] *Southwestern Bell Telephone Co. v. Arkansas Public Serv. Comm'n*, 715 S.W.2d 451, 458 (Ark.App. banc 1986); *Accord State ex rel. Laclede Gas Co. v. Public Serv. Comm'n*, 600 S.W.2d 222, 228-29 (Mo.App. W.D. 1980), *appeal dismissed*, 449 U.S. 1072, 101 S.Ct. 848, 66 L.Ed.2d 795 (1981) (*Laclede*)(Commission may adopt an adjustment disallowing recovery of prudent costs that are not of benefit to ratepayers, such as advertising expense and charitable contributions); *State ex rel. Southwestern Bell Telephone Co. v. Public Serv. Comm'n*, 645 S.W.2d 44, 55-56 (Mo.App. W.D. 1982)(Commission may adopt an adjustment disallowing recovery of prudent costs that are not of benefit to ratepayers, such as allocated share of AT&T antitrust legal fees which are part of a license contract between utility and its parent). The Commission applies this criterion of denying recovery of costs not of benefit to ratepayers to all or certain categories of the following items, among other expenses: incentive compensation, advertising, charitable contributions, lobbying, rate case expense, economic development costs, transaction costs in a merger/acquisition, and community development costs, among other expenses.

[405] 715 S.W.2d at 457-58.

> must exercise its judgment. This is the true test to be applied by the Commission in scrutinizing expenses to be charged to consumers.[406]

In a decision issued soon after the Public Service Commission Act became law, the Missouri Supreme Court commented on the broad and deep scope of the jurisdiction of the Commission as follows:[407]

> That act is an elaborate law bottomed on the police power. It evidences a public policy hammered out on the anvil of public discussion. It apparently recognizes certain generally accepted economic principles and conditions, to wit: That a public utility (like gas, water, car service, etc.) is in its nature a monopoly; that competition is inadequate to protect the public, and, if it exists, is likely to become an economic waste; that state regulation takes the place of and stands for competition; that such regulation, to command respect from patron or utility owner, must be in the name of the overlord, the state, and, to be effective, must possess the power of intelligent visitation and the plenary supervision of every business feature to be finally (however invisible) reflected in rates and quality of service. It recognizes that every expenditure, every dereliction, every share of stock, or bond, or note issued as surely is finally reflected in rates and quality of service to the public, as does the moisture which arises in the atmosphere finally descend in rain upon the just and unjust willy nilly.

The Missouri Supreme Court decision in 2003 issued a decision that is instructive regarding the breadth and depth of the Commission's jurisdiction.[408] This opinion, which was handed down after the Commission authorized the UE-CIPSCO merger, decided that

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[406] *Id*. at 458; a*ccord*, *Laclede*, 600 S.W.2d at 228-29 (utility not prohibited by the Commission from engaging in certain conduct, utility merely prohibited by the Commission from recovering costs from ratepayers when there is no ratepayer benefit associated with the incurrence of the costs. The Court noted in part as follows:

> The P.S.C. is granted authority under s 393.150, RSMo 1978 to fix utility rates upon a showing that the increased rate is just and reasonable. The realm of this authority has been defined as including " . . . the power to determine what items should be included in a utility's operating expense and what items should be excluded . . . in order that the commission may arrive at a reasoned determination of the issue of 'just and reasonable' rates." *State ex rel. Hotel Continental v. Burton*, 334 S.W.2d 75, 80 (Mo.1960).

600 S.W.2d at 229.

[407] *State on inf. Barker ex rel. Kansas City v. Kansas City Gas Co.*, 254 Mo. 515, 163 S.W. 854, 857-58 (Mo. 1913).

[408] *State ex rel. Atmos Energy Corp. v. Public Serv. Comm'n*, 103 S.W.3d 753 (Mo. banc 2003).

the Commission had the authority to promulgate affiliate transaction rules, including Rule 4 CSR 240-20.015; that the promulgation of the rules satisfied all relevant rulemaking procedures, and the order of rulemaking was lawful and reasonable. The Commission promulgated these rules because, when a utility does business with an affiliate, "the safeguards provided by arms-length bargaining are absent and ever present is the danger that the utility will be charged exorbitant prices [or left with outrageous detriments] which will by inclusion in its operating costs become the predicate for excessive rates."[409]

The ability to sell property is an important incident of ownership, and the ability of a regulated utility in Missouri to transfer property to a regulated or non-regulated affiliate falls under §§ 393.190.1, 393.130, 393.150.2 and 393.140(11), and the Commission's affiliate transactions rules (4 CSR 240-20.015 for electrical corporations),[410] which is designed to address cross-subsidization issues. The Missouri Supreme Court explained the reason for this standard when it discussed the reason that such transfers are governed by the Commission:

> [Movement by public utilities from the traditional monopoly structure into non-regulated businesses] gives utilities the opportunity and incentive to shift their non-regulated costs to their regulated operations with the effect of unnecessarily increasing the rates charged to the utilities' customers. See *United States v. Western Elec. Co*., 592 F.Supp. 846, 853 (D.D.C.1984) ("As long as a [public utility] is engaged in both monopoly and competitive activities, it will have the incentive as well as the ability to 'milk' the rate-of-return regulated monopoly affiliate to subsidize its competitive ventures....") To counter this trend, the new rules--and in particular, the asymmetrical pricing standards--prohibit utilities from providing an advantage to their affiliates to the detriment of rate-paying customers. In addition, to

[409] *Id., citing United States v. Western Elec. Co., Inc.,* 592 F. Supp. 846, 853 (D.D.C. 1984).

[410] Case No. EX-99-442, Missouri Register, Proposed Rule, Vol. 24, No. 11, pp. 1340-1345 (June 1, 1999); Order of Rulemaking, Vol. 25, No. 1, pp. 55-59 (January 3, 2000).

> police compliance, the rules require the utilities to ensure that they and their affiliates maintain records of certain transactions.[411]

The Missouri Supreme Court continued with a discussion of the Commission's authority to enact and regulate such transactions:[412]

> The PSC's authority to enact these regulations is set out in chapter 393. Section 393.130.2 precludes a utility from "directly or indirectly by any special rate ... or other device or method ... [from] collect[ing] or receiv [ing] from any person or corporation ... greater or less[er] compensation" for that utility's services than it charges every other person or corporation. Section 393.140(1) states that the PSC shall have "general supervision" over all gas utilities, electric utilities, and heating utilities. Reading section 393.130.2 in conjunction with the broad supervisory power granted under section 393.140(1), the PSC's authority to require utilities to maintain records so that it may determine whether utilities are following their obligations under section 393.130.2 is firmly established.
>
> Likewise, the PSC has authority to extend the reach of the rules to a utility's affiliates. Section 393.140(12) precludes regulation of a utility's affiliate where the affiliate is "substantially kept separate and apart" from the business of the utility. However, that section also states that the PSC shall have the "right to inquire as to, and prescribe the apportionment of, capitalization, debts and expenses fairly and justly to be awarded to or borne by the ownership, operation, management or control of such gas plant, electric plant, [or heating plant]...." Sec. 393.140(12); *see State ex rel. Associated Natural Gas Co. v. Pub. Serv. Comm'n,* 706 S.W.2d 870, 880-81 (Mo.App.1985). . . .

The Missouri Supreme Court related in the *Atmos* case that the Commission had the authority to adopt by rulemaking standards respecting extending contracts or agreements to affiliates. The Court stated that the Commission promulgated rules setting asymmetrical pricing standards for the entire public utility industry; the Court held that

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[411] *State ex rel. Atmos Energy Corp. v. Public Serv. Comm'n*, 103 S.W.3d 753, 764 (Mo. banc 2003) (*Atmos*).

[412] *Id.*

the Commission had not engaged in the determination/adjudication of legal rights, duties or privileges of specific parties.[413]

In 1976, the Western District Court of Appeals stated that the Missouri Supreme Court has long held that the Commission has the power to grant interim test or experimental rates as a matter of necessary implication from practical necessity, when it has no express statutory authority.[414] The Public Service Commission Law does not expressly empower the Commission to approve interim rate increases, but the Missouri Court of Appeals held that the Commission "has power in a proper case to grant interim rate increases within the broad discretion implied from the Missouri file and suspend statutes and from the practical requirements of utility regulation."[415] The Court further stated that "[i]n its very nature, an interim rate request is merely ancillary to a permanent rate request . . ."[416]

The Staff would further note §§ 386.040 and 386.250(7), which grant to the Commission all powers necessary or proper to enable it to carry out fully and effectually all the purposes of the Public Service Commission Law:

> § 386.040. A "Public Service Commission" is hereby created and established, which said public service commission shall be vested with and possessed of the powers and duties in this chapter specified, and also all powers necessary or proper to enable it to carry out fully and effectually all the purposes of this chapter.
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> § 386.250. The jurisdiction, supervision, powers and duties of the public service commission herein created and established shall extend under this chapter:

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[413] 103 S.W.3d at 763-64.

[414] *State ex rel. Laclede Gas Co. v. Public Serv. Comm'n*, 535 S.W.2d 561, 567 n.1 (Mo. App. 1976).

[415] *Id*. at 567; *See Southwestern Bell Tel. Co. v. Brown*, 795 S.W.2d 385 (Mo. banc 1990); *State ex rel. Missouri Cable Telecomms. Assoc. v. PSC*, 929 S.W.2d 768 (Mo. App., W.D. 1996).

[416] *Id*. at 565; *State ex rel. Fischer v. Public Serv. Comm'n*, 670 S.W.2d 24 (Mo. App., W.D. 1984).

* * *

> (7) To such other and further extent, and to all such other and additional matters and things, and in such further respects as may herein appear, either expressly or impliedly.

The Staff would note one other subject area, depreciation. In addition to the Federal Communications Commission (FCC) prescribing depreciation rates for SWBT, this Commission previously prescribed depreciation rates for SWBT. The Missouri Commission in the early to mid-1980's did not join other state commissions -- ultimately 23 state commissions -- in challenging the position of the FCC that orders of the FCC in 1980 and 1981 changing the FCC's rules for depreciating telephone plant and equipment preempted inconsistent state depreciation ratemaking, or otherwise displaced state regulation, as necessary to avoid frustration of validly adopted federal policies.[417] Instead of challenging the FCC, the Missouri Commission adopted ratemaking consistent with

[417] There were three changes. The 1980 FCC order permitted telephone companies the option of grouping plant for depreciation purposes based on its estimated service life, "equal life" approach, rather than classifying and depreciating property according to its year of installation, "vintage year" method. The 1980 order also replaced "whole life" depreciation with the "remaining life" method. The 1981 FCC order required that the cost of labor and material associated with the installation of wire inside the premises of a business or residence be expensed rather than treated as a capital investment to be depreciated over time. *Louisiana Public Serv. Comm'n v. FCC*, 476 U.S. 355, ___, 106 S.Ct. 1890, 1894-95, 90 L.Ed.2d 369, ___ (1986).

NARUC petitioned the FCC for a clarification of its order respecting inside wiring. NARUC sought a declaration that that the FCC's order did not preclude state regulators from using their own accounting and depreciating procedures in computing revenue requirements and rates for intrastate services for intrastate purposes. Two Commissioners issued a dissent. A petition for reconsideration of this order was filed and the FCC reversed itself. The Court stated, in part, as follows:

> [The FCC] noted that "adequate capital recovery is important to 'make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, world-wide wire and radio communication service with adequate facilities at reasonable charges . . .' 47 U.S.C. 151," and that "[s]tate depreciation rate prescriptions that do not adequately provide for capital recovery in the competitive environment, which constitutes this Commission's policy in those markets found capable of supporting competition, would frustrate the accomplishment of that policy and are preemptable by this Commission." 92 F.C.C.2d at 876.

106 S.Ct. at 1895.

the FCC's orders challenged by other state commissions, after this Commission first rejecting expensing of station connections in.[418]

[418] *Re Southwestern Bell Telephone Co*., Case No. TR-81-208, 24 Mo.P.S.C.(N.S.) 606, 623-28 (*Report & Order,* 1981). In this case, SWBT sought ratemaking treatment from the Commission consistent with the FCC's expensing of station connections. Telephone companies were to move to expensing station connections over a four year phase in, or, with state commission approval, could choose to immediately expense such costs. The FCC directed compliance by October 1981, and permitted retroactive booking in accordance with said revision to January 1, 1981. SWBT chose expensing of station connections through a four-year phase-in to full current expensing, and a ten year amortization of embedded stations connections costs. The Staff opposed the expensing of station connections plan of SWBT and argued for the continued capitalization of station connections. Alternatively, the Staff took the position that if the Commission approved a four-year phase in that only 25% of the expense level be booked beginning October 1, 1981 be approved for ratemaking purposes.

The Commission concluded, in Case No. TR-81-208, that the proper basis for determining expensing versus capitalization should center on the nature of the expenditure which in this instance from a ratemaking standpoint are in the nature of a capital investment and in the absence of the existence of some other overriding consideration should be accorded capitalization treatment. Once that determination is made, assignment of the cost to the cost causer, if that is desired, is a matter of rate design and is distinct from expensing versus capitalization considerations.

In SWBT's next rate increase case, *Re Southwestern Bell Telephone Co*., Case No. TR-82-199, 25 Mo.P.S.C.(N.S.) 462, 510-16, (*Report & Order,* 1982), SWBT re-litigated the expensing station connections issue and the Commission reversed its prior decision. The Commission held that, based upon the facts presented by SWBT, the expensing of station connections would allow customers to pay only for those costs which they actually cause SWBT to incur and will not require customers to pay higher monthly rates in order to cover the costs associated with other customers' choices or actions concerning service connections. The Commission stated that it could no longer accept the distinction between accounting treatment of station connections and the rate design treatment to be accorded such station connections. *Id*. at 515-16.

On July 16, 1981 in response to a Staff motion, the Commission established Case No. TO-82-3, *In the Matter of the Investigation of Straight Line Equal Life Group and Remaining Life Depreciation Methods for Class A and B Missouri Jurisdictional Telephone Utilities*, Report And Order, 25 Mo.P.S.C.(N.S.) 331 (1982). SWBT proposed the use of straight line equal life group and the Staff and Public Counsel proposed the continued use of straight line vintage group method. The Commission held that straight line equal life group is reasonable and should be approved. It decided that that telephone companies that which lacked the capacity to implement straight line equal life group should be permitted to continue to utilize the vintage group procedure and the whole life technique on all accounts. SWBT and a number of other telephone companies proposed the use of straight line remaining life. The Staff and Public Counsel proposed continued use of the straight line whole life technique. The Commission stated that the most significant advantage of straight line remaining life is that it adjusts the depreciation rate to affect fuller recovery during the period when the investment is still used in providing telephone service. The Commission noted that any such adjustment is not retroactive ratemaking because the rates are prospectively recovered on investment which is still in use that has not yet been recovered. The Commission said the straight line whole life technique, underestimating service lives or making post-mortem adjustments after the investment is retired, does not fulfill the objective of return of capital in a rational and systematic manner over the investment's service life. The Commission held that straight line remaining life appears to be a reasonable solution to any capital recovery deficiency in Missouri. *Id*. at 336.

In Case No. TR-81-208, the Commission acknowledged that if it were to authorize ratemaking treatment for station connections inconsistent with the FCC, such an action would necessitate the maintenance by SWBT of substantial side-records to reflect continued capitalization treatment. The Commission stated that nonetheless such requirement should not be controlling as to the merits of the issue. The Commission noted that to do otherwise, would transfer Missouri jurisdictional ratemaking authority to the FCC:

> . . . The imposition of such record keeping obligations upon the Company should not be and is not taken lightly by the Commission. However, the fact that authorization of a particular ratemaking treatment will impose such obligations should not be controlling as to the merits of the issue. When the Commission finds, in a particular instance, that ratemaking treatment is warranted which deviates from the Uniform System of Accounts, the requirement that side-records be kept is an inevitable consequence. The Commission's rules at 4 CSR 240-30.040(3) specifically contemplate such deviations, and to foreclose the possibility that the Commission may authorize ratemaking treatment at variance with the Uniform System of Accounts would be to acquiesce in the partial transfer of Missouri jurisdictional ratemaking authority to the FCC.[419]

In 1986, in *Louisiana Public Serv. Comm'n v. FCC*, 476 U.S. 355, 106 S.Ct. 1890, 90 L.Ed.2d 369 (1986), the U.S. Supreme Court reversed the judgment of the Court of Appeals for the Fourth Circuit that the FCC depreciation orders preempted inconsistent state regulation. The U.S. Supreme Court concluded that Section 152(b) of the Communications Act of 1934 represents a bar to federal preemption of state regulation over depreciation of dual jurisdiction property for intrastate ratemaking purposes.[420] The Court noted as follows:[421]

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[419] 24 Mo.P.S.C.(N.S.) at 627.

[420] 106 S.Ct. at 1904.

[421] 106 S.Ct. at 1902.

> . . . What is really troubling respondents, of course, is their sense that state regulators will not allow them sufficient revenues. While we do not deprecate this concern, § 152(b) precludes both the FCC and this Court from providing the relief sought. As we so often admonish, only Congress can rewrite this statute.

WHEREFORE, by reason of all the foregoing, Staff prays that the Commission will resolve these issues as Staff has suggested; and grant such other and further relief as is just in the circumstances.

Respectfully submitted,

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Certificate of Service

I hereby certify that a true and correct copy of the above has been served, either electronically or by hand-delivery or by First Class United States Mail, postage prepaid, upon counsel for all parties of record on this **13th day of January, 2009.**

s/ Kevin A. Thompson___