BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the Matter of Union Electric Company, d/b/a Ameren Missouri's Tariffs to Increase Its Annual Revenues for Electric Service.	))))	**Case No. ER-2012-0166** Tariff No. YE-2012-0370

Staff's Initial Brief

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STAFF'S POST-HEARING BRIEF

COMES NOW the Staff of the Missouri Public Service Commission, by and through counsel, and for *Staff's Post-Hearing Brief,* states as follows:

INTRODUCTION

In this general rate case, the Commission exercises its delegated, quasi-legislative authority to set prospective rates for Ameren Missouri, a major public utility. This decision will affect the lives of thousands of Missourians who live and work within Ameren Missouri's service area. It will affect the profitability – indeed, the viability – of numerous businesses and determine, in part, how much of the family budget will be available for other needs and wants; it will determine whether or not St. Louis will attract new business enterprises. The Commission's lodestar is the "just and reasonable" rate, which is one that covers Ameren Missouri's costs in providing electric service, allows its shareholders a reasonable opportunity to earn a fair return on their investment, and yet is as affordable as possible for the rate-paying public.

The Company:

Ameren Missouri is a traditional, integrated electric utility serving approximately

1.2 million customers, over 1 million of which are residential customers.[1] Ameren Missouri's service territory includes 61 Missouri counties and over 500 towns and cities.[2] To serve its customers, Ameren Missouri owns and operates four large, base-load, coal-fired generating plants with a combined capacity of approximately 5,500 megawatts ("MW"); one nuclear-fueled generating plant with a capacity of 1,200 MW; 44 oil-fired or natural-gas-fired combustion turbine generating units ("CTGs") with a combined capacity of about 3,000 MW; and three hydroelectric generating plants with a combined capacity of about 810 MW.[3] Ameren Missouri operates and maintains 33,000 miles of distribution lines, 650 distribution substations, and 2,900 miles of transmission lines.[4] The Company employs over 4,000 persons.[5] Ameren Missouri is a wholly-owned subsidiary of Ameren Corporation, a publicly-traded, public utility holding company headquartered in St. Louis, Missouri.

The Commission:

The Commission's statutory duty is to set "just and reasonable" rates.[6] A "just and reasonable" rate is one that balances the interests of the various stakeholders in the light of the public interest.[7] A just and reasonable rate is fair to both the utility and to

[1] Exs. 201 & 202 HC, *Staff Revenue Requirement Cost-of-Service Report ("RR Report"),* p. 1; Ex. 1, *Baxter Dir.,* p. 5.

[2] *RR Report,* p. 2 n. 1; *Baxter Dir.,* p. 5.

[3] *Baxter Dir.,* p. 4.

[4] *Baxter Dir.,* p. 5.

[5] *Id.*

[6] Sections 393.130 and 393.140, RSMo.

[7] *See* ***State ex rel. Union Electric Co. v. Public Service Commission,*** 765 S.W.2d 618, 622 (Mo. App., W.D. 1988) ("Ratemaking is a balancing process").

its customers[8] and is no more than is necessary to "keep public utility plants in proper repair for effective public service, [and] . . . to insure to the investors a reasonable return upon funds invested."[9] A just and reasonable rate is not one penny more than is required to cover the utility's necessary and prudent operation and maintenance expenses and to allow a reasonable opportunity of earning a fair profit to the shareholders.

The Commission sets just and reasonable rates via a two-step process using traditional cost-of-service ratemaking.[10] The two steps are (1) the determination of the "revenue requirement," that is, the amount of income the utility needs on an annual basis, and (2) the design of rates that, given the usage characteristics of the utility's customers, will produce the necessary revenue. "Under cost-of-service ratemaking, rates are designed based on a [utility's] cost of providing service including an opportunity for the [utility] to earn a reasonable return on its investment."[11] The Missouri Court of Appeals has described cost-of-service ratemaking as follows: "The Commission [considers the] expenses and revenues, to establish a rate that will allow the company to recover its cost of service from its customers."[12] Elsewhere, the court noted:

> The determination of utility rates focuses on four factors. These

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

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

[10] Also known as "rate-of-return" ratemaking. *See* L.E. Alt, ***Energy Utility Rate Setting,*** 18 (2006).

[11] FERC, ***Cost-of-Service Rates Manual,*** 1 (1999) [available electronically at www.ferc.gov].

[12] ***State ex rel. Laclede Gas Company v. Public Service Commission,*** 328 S.W.3d 316, 317 (Mo. App., W.D. 2010).

> factors include: (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. The revenue allowed a utility is the total of approved operating expenses plus a reasonable rate of return on the rate base. The rate of return is calculated by applying a rate of return to the cost of property less depreciation. The utility property upon which a rate of return can be earned must be utilized to provide service to its customers. That is, it must be used and useful. This used and useful concept provides a well-defined standard for determining what properties of a utility can be included in its rate base.[13]
>
> This ratemaking recipe is often expressed by the following formula:

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

where:	RR	=	Revenue Requirement;
	C	=	Prudent Operating Costs, including Depreciation Expense and Taxes;
	V	=	Gross Value of Utility Plant in Service;
	D	=	Accumulated Depreciation; and
	R	=	Overall Rate of Return or Weighted Average Cost of Capital (WACC).

To summarize, cost-of-service ratemaking establishes the utility's cost of providing service on an annual basis based upon annualized and normalized test year expenses and adds to that amount a reasonable allowance for a profit to the shareholders on the value of their investment. The profit allowance, in turn, is calculated by multiplying the value of the utility's plant-in-service less accumulated depreciation by a rate of return. This sum is the revenue requirement, that is, the amount of money the company must earn annually to cover its cost of service and provide a reasonable return to its investors. Determining the revenue requirement is the first half of the ratemaking process.

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[13] ***Union Electric Co.,*** *supra,* 765 S.W.2d at 622.

In considering the Company's test year expenditures, the Commission should consider whether they are reasonable, necessary and beneficial to ratepayers. Unreasonable and unnecessary expenditures should be excluded from rates and charged to the shareholders. An expenditure is reasonable if the value received is commensurate to the amount paid. An expenditure is necessary if, without it, the utility's ability to provide safe and adequate services to its customers would be impaired. Likewise, expenditures that provide no benefits to the ratepayers should be excluded from rates and charged to the shareholders.

The second half of the ratemaking process is rate design, that is, the development of rate schedules designed to produce the target revenue requirement. The two steps of rate design are, first, determining the revenue requirement responsibility of each customer class and, second, adjusting or designing the class rate schedules to produce the necessary revenue requirement. Customers, large and small, are classified based on their usage characteristics and on the cost of serving them.

Rate design may be driven by considerations in addition to recovering the necessary revenue requirement in a fair and equitable manner. Learned commentators on the rate design process refer to "objectives" including fairness, simplicity, stability, avoidance of undue discrimination or preferences, efficiency, and conservation.[14]

Fair rates match costs and cost causers, so that similarly-situated customers will pay the same rate. Simple rates are easy to understand and administer. Stable rates will generate revenue that tracks costs, so that as costs go up, revenues will too.

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[14] Alt, *supra,* 58-60; J.C. Bonbright *et al.,* ***Principles of Public Utility Rates,*** 85-179 (PUR: Arlington, VA, 2nd ed. 1988).

Discrimination and preferences are the two sides of the subsidization coin. All utility rates involve some degree of subsidization because the actual cost of serving each customer is necessarily slightly different based on unique circumstances, such as the distance of each customer from the utility plant. An important goal in rate design is keeping these subsidies as limited as possible. Efficiency and conservation mean that prices send appropriate cost signals to the customers to safeguard society's scarce resources and to avoid waste.

In summary, Staff urges the Commission to set just and reasonable rates for Ameren Missouri, after due consideration of all relevant factors, by adopting Staff's recommendations as further discussed herein.

ARGUMENT

1. Regulatory Policy and Economic Considerations:

This case began on February 3, 2012, when Ameren Missouri filed proposed tariff sheets, direct testimony, accounting schedules, and other documents calling for a general rate increase of approximately $375.6 million on an annual basis, a 14.6% increase.[15] Based on its thorough audit of the Company's books, Staff's position is that a rate increase is indeed warranted, but certainly not of the magnitude requested by the Company. Staff has determined that a rate increase of $202 million is appropriate.[16]

The National Economy and Financial Markets:

The nation's economy is recovering at a slow pace from the collapse of 2008,

[15] *RR Report,* pp. 1, 3.

[16] *Id.;* and see Ex. 409, *Staff Reconciliation;* using Staff's 9.0% Return on Equity ("ROE") recommendation.

unlike the rapid pace of previous economic recoveries.[17] Observers consequently remain concerned about the long-term outlook for the U.S. and global economies.[18] Most economists expect that ongoing domestic economic growth will be lower than those achieved between the end of World War II and the Great Recession of 2008.[19] Many economists expect the long-term nominal GDP growth rate to be in the range of 4% to 5%, based on an expected annual inflation rate of 2%.[20]

In an ongoing effort to stimulate further economic recovery, the Federal Reserve Bank has maintained the Federal Funds Rate at historic low levels between 0.00% and 0.25% and has extended its bond buy-back program in an effort to maintain, or even further reduce, low long-term interest rates.[21] Nonetheless, the Federal Reserve Bank has also lowered its projections of near-term economic growth to between 1.9% and 2.4% this year and under 3% next year.[22] Market expectations of inflation are low; the 2012 monthly spread between 30-year Treasury Inflation Protected Securities ("TIPS") and non-inflation protected Treasury bonds indicates that investors are requiring only an additional 2.25% to 2.40% return for potential inflation.[23] In summary, the price of money has never been lower.

Utilities have been reaping the benefit of the present low cost of capital. It is now

[17] *Id.,* p. 16.

[18] *Id.,* pp. 16-17.

[19] *Id.,* p. 17.

[20] *Id*.

[21] *Id*.

[22] *Id*.

[23] *Id*., at pp. 17-18.

common for utilities to issue 10-year to 15-year bonds at coupons in the 3% range.[24] The Empire District Electric Company issued $88 million worth of 15-year secured debt at a coupon of 3.58% in April 2012.[25] Long-term interest rates, as measured by 30-year Treasury bonds ("T-bonds"), decreased to the high 2% to 3% range for the period August 2011 through May 2012.[26] Long-term utility bond yields have closely tracked the changes in 30-year T-bond yields; the current spread between utility bond yields and 30-year Treasury yields at 1.91% is slightly above the average of 1.55% since 1980, the absolute yield on utility bonds recently fell below 5% for the first time.[27]

The low cost of debt reflected by bond yields has produced a "spectacular couple of years for electric utility stock returns."[28] "Regulated" utilities' total returns in 2010 and 2011 were 38.05% over the two years, a far superior performance to the markets in general.[29] For the twelve months ending December 31, 2011, the total return on the Dow Jones Industrial Average was 8.38%, the total return on the Standard & Poor's 500 ("S&P 500") was 2.11%, and the total return on the Edison Electric Institute ("EEI") Index of electric utilities was 19.99%.[30] More specifically, on a non-market capitalization weighted basis, the total return for the twelve months ending December 31, 2011, was 22.30% for EEI "Regulated" electric utilities, 19.52% for EEI "Mostly Regulated" electric utilities and 21.36% for "Diversified" electric utilities. This strong performance in the

[24] *Id*., at p. 18.

[25] *Id*.

[26] *Id*., and see Schedules 4-2 and 4-3.

[27] *Id*., and see Schedules 4-1 and 4-3.

[28] *Id*., at p. 19.

[29] *Id*. 2010: 15.75%; 2011: 22.30%.

[30] *Id.,* p. 19.

regulated utility equity sector has evidently been driven by the continued decline in bond yields because there is no evidence that investors expect high growth in that projected 5-year earnings-per-share ("EPS") forecasted growth rates have actually declined.[31] This clear indication that investors are willing to pay more for regulated utility shares is unmistakable evidence that the cost of equity for regulated electric utilities has declined.[32] As Staff's expert financial analyst David Murray testified:[33]

> The current macroeconomic environment is clearly favorable to utilities in terms of a lower cost of capital for debt and equity instruments. Staff believes these lower capital costs should be shared with ratepayers through lower authorized returns on common equity ("ROEs").

Economic Conditions in Ameren Missouri's Service Area:

Following the collapse of the United States economy in 2008,[34] Missouri's economic recovery has been weak compared to the nation as a whole.[35] As of March 2012, Missouri was at only 89.7% of its pre-recession level, while the nation as a whole was at 97%.[36] Missouri's Gross Domestic Product ("GDP") growth has been behind that of the nation as a whole.[37] Personal income and household income are lower in Ameren Missouri's service area than in the nation generally.[38]

Ameren Missouri's rates are lower than the national average; however, 47% of Ameren Missouri's customers receive a weekly wage below the national average

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[31] *Id.*

[32] *Id.*

[33] *Id.,* at p. 20.

[34] *Id.,* at p. 16.

[35] *Id.,* p. 4.

[36] *Id.,* p. 5.

[37] *Id.,* and Chart 3.

[38] *Id.,* p. 7.

weekly wage.[39] Over half of Ameren Missouri's customers enjoy less personal income than the national average per capita personal income and unemployment rates are above 2007 pre-recession unemployment rates for all 61 counties where Ameren Missouri provides service.[40]

Staff advises the Commission that, since 2007, Ameren Missouri's rates have increased by 30.09% while average wages in its service area have only increased by 11.09%.[41] Staff does note that Ameren Missouri has experienced inflationary pressure as evidenced by the 19.66% increase in the Producer Price Index ("PPI") for Industrial Commodities over the same period.[42] While Ameren Missouri's rates are below the national average, the cost of living utility index for Missouri of 103.1 indicates that general utility expenses constitute a higher percentage of a Missouri resident’s living expenses than the average U.S. resident.[43]

Regulatory Policy:

Although there has been some erosion, Missouri continues to make utility rates using traditional cost-of-service ratemaking.[44] Under this paradigm, the Commission balances the interests of the various stakeholders during a general rate case, including setting a risk-reflective rate of return intended to pay the shareholders for the use of their money. Thereafter, rates cannot change until they are once again put into play by

[39] *Id.,* p. 11.

[40] *Id*.

[41] *Id.,* pp. 2-3 and Chart 1.

[42] *Id.,* p. 3 and Chart 1.

[43] *Id.,* p. 4.

[44] Erosion of the traditional coast-of-service ratemaking paradigm may be found in the adjustment mechanisms authorized by SB 179 as well as the increasing use of accounting authority orders ("AAOs") and trackers.

the commencement of a new general rate case.[45] During the interval between rate cases, the Company's shareholders bear the risk that costs will increase and eat into their profits; and the ratepayers bear the risk that costs will decrease and that they will pay a handsome profit to the shareholders for the utility service they receive. The imposition of these complementary risks upon the parties to the regulatory compact is fair, and fairness is a necessary characteristic of just and reasonable rates.

At the hearing and in its prefiled testimony, Ameren Missouri has sought to persuade the Commission to adopt a number of risk-reducing mechanisms in order to mitigate what the Company has described as "chronic regulatory lag" and "earnings attrition." These proposed risk-reducing mechanisms, each of which sounds reasonable in isolation, represent further erosion of the cost-of-service regulatory paradigm. Each mechanism reduces to some degree the business risk inherent in the public utility line of business.[46] One such risk, for example, is that fuel will cost more than expected, resulting in fuel expense in excess of the budgeted amount. The implementation of a Fuel Adjustment Clause ("FAC") for Ameren Missouri pursuant to statutory authorization has now effectively moved that risk from the utility to its customers. However, that very significant reduction of the risk born by the shareholders has never been reflected by a corresponding reduction in Ameren Missouri's rate of return.

Now Ameren Missouri seeks additional risk-reducing mechanisms, but the

[45] A general rate case may be initiated via one of three means: (1) the filing by the Company of proposed tariffs calling for a general rate increase, followed by the suspension of those tariffs by the Commission; (2) the filing of a complaint by the Staff or some other party in interest; or (3) by the Commission on its own motion. § 393.150.1, RSMo.

[46] A line of business already far less risky than most given that public utilities are monopolies and purveyors of life's necessities.

Company is not characterizing them as such. Ameren Missouri's CEO Warner Baxter testified, "the Company is proposing some additional regulatory mechanisms that will provide it with a better opportunity to obtain full and timely recovery of the costs it incurs to provide safe and reliable service to its customers, and help reduce the barriers to investment that currently exist."[47] These mechanisms include Plant-in-Service Accounting, a Two-Way Storm Restoration Costs Tracker and the Transmission Cost and Revenue Tracker proposed in the Sur-Surrebuttal Testimony of Jaime Haro.[48] The theme of the Company's presentation is that "the regulatory framework in Missouri is not balanced and does not provide our Company with a reasonable opportunity to earn a fair return on our investments."[49] In support of this theme, Ameren Missouri offered a number of charts purporting to show that the Company, despite its best efforts, the Commission's past allowance of a plethora of non-traditional ratemaking mechanisms such as the Fuel Adjustment Clause ("FAC") and trackers, and frequent rate increases by this Commission, has nonetheless consistently been unable to earn its authorized return on equity ("ROE").[50]

Is that picture even true?[51] Staff raised a question about the accuracy of Mr. Baxter's charts by introducing a surveillance report filed by Ameren Missouri for the 12 months ended June 30, 2012, which showed that the Company had actually earned in

[47] *Baxter Dir.,* p. 6.

[48] *Baxter Dir.,* p. 6; Ex. , *Haro Sur-Surrebuttal,* pp 23-27.

[49] Ex. 2, *Baxter Surr.,* p. 2.

[50] Schedules WLB-ES1 through WLB-ES4, attached to *Baxter Surr.*

[51] Tr. 19:801 (Brosch): "a theme in my testimony is that we shouldn't be focused on historical results at all. The more important consideration is whether the company's made a showing prospectively that there's an earning attrition issue to be addressed, and I maintain they have not."

excess of its authorized ROE.[52] A great deal of hearing time was devoted to this point and to the Company's efforts to explain it away. Time was devoted to understanding what was and what was not included in each set of numbers.[53]

What cannot be explained away is the fact that further erosion of the regulatory compact in favor of the Company would be bad regulatory policy. Why? Because it would be unfair to push more of the risk onto the captive ratepayers, who cannot seek an alternate source of supply at a better price. One of this Commission's most important roles is to serve as a proxy for competition. Business enterprises that are subject to competition are efficient; they are lean and they are focused. Members of management are accountable to the shareholders and directors for every penny of expense and may well be removed if earnings per share are not as expected. Every risk-reducing mechanism granted to Ameren Missouri by the Commission reduces the risk that it will not recover its costs and necessarily reduces the incentive for the Company to become efficient. It is risk that keeps the Company efficient and the Commission will do the ratepayers a serious disservice if the Company's risk is reduced too much. As OPC expert witness Ted Robertson testified, "Economic theory predicts

[52] Ex. 237; reported ROE: 10.53%; authorized ROE: 10.20%.

[53] Ex. 237, the surveillance report, is not weather-normalized, which means that it reflects the increased electric sales caused by the unusually hot spring and summer weather. It also does not reflect the tax impact of the Commission's disallowance of the Taum Sauk rebuild costs, which would make it *higher*. It includes the one-time Entergy Refund of $36 million, the removal of which would make it *lower*. Quite a few other factors would have to be adjusted in order to make the surveillance report figure truly comparable to the Commission-awarded ROE, including EPS-based incentive compensation, Callaway refueling, institutional advertising, and similar below-the-line items. *See* Tr. 19:627-656, 670-80, 690-98, 701-717, 721-732 (Barnes), 741, 747-754, 758-763, 765-768 (Cassidy); 24:1444-1466, 1469-1476 (Weiss). As a measure of Ameren Missouri's actual operational performance, the surveillance report should ***NOT*** be weather-normalized; that is an adjustment undertaken for predictive purposes and it is inappropriate to so adjust performance data viewed for historical purposes. Likewise, since Mr. Baxter's charts reflect the *payment* of the Entergy charges later refunded, it is inappropriate to remove the *refund* of those charges. With these considerations in mind, the surveillance report is an accurate measure of Ameren Missouri's performance as measured against its authorized ROE.

that the longer the regulatory lag, the more incentive a utility has to control its costs."[54] In fact, there is evidence in the present case that Ameren Missouri is inefficient and has failed to control its costs as stated by Mr. Brosch:

> I think that, as I said, you look at Mr. Weiss' calculations and rate base is relatively stable but for the Sioux scrubber addition. What you see is volatility in the income statement that suggests that an inability to contain expenses at the same rate of growth that revenues are growing is really the root cause of the historical earnings problem. But as I said, the more important issue is prospectively do we have a problem that's crying out for a solution.[55]

Staff suggests that the answer to Mr. Brosch's perceptive question is "no." Contrary to the frequently-repeated assertions of Ameren Missouri, there is no problem that is crying out for a solution. Cost-of-service ratemaking in Missouri is not broken.

Kevin A. Thompson

2. Cash Working Capital ("CWC"):

A. Should the collection lag be calculated using the CURST 246 Report for the 12-month period ending October 31, 2010, or the Accounts Receivable Breakdown Report?

Cash Working Capital ("CWC") is a rate base issue and it also has revenue requirement implications.[56] CWC is the amount of ready cash that Ameren Missouri must have on hand so that it can pay its bills while waiting for its customers to pay their electric bills.[57] It is "the amount of cash and other liquid funds necessary to cover day-

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[54] Ex. 408, *Robertson Surr.,* p. 3.

[55] Tr. 19:803 (Brosch).

[56] The revenue requirement effect is the return that ratepayers must pay on the CWC asset. Thus, MIEC expert witness Greg Meyer noted that his recommendation, if adopted, would "reduce the CWC requirement included in rate base by approximately $52.3 million and the revenue requirement by approximately $5.6 million." Ex. 510, *Meyer Dir.,* p. 22.

[57] Alt, ***Energy Utility Rate Setting***, 36: "Cash working capital is the money a utility needs to pay its operating expenses necessary to provide service until the revenues from that service are received."

to-day expenses."[58] The amount is calculated via a Lead-Lag Study[59] and this sub-issue involves the calculation of the collection lag, that is, the average interval between billing and collection.[60]

Staff relied on Ameren Missouri's CURST 246 report for the twelve months ending October 31, 2010, to develop a collection lag of 21.11 days.[61] Ameren Missouri, on the other hand, calculated a collection lag of 28.75 days, based on its Accounts Receivable Breakdown Report ("ARBR").[62] The longer the lag period, the more money that must be available to Ameren Missouri for CWC and the larger the return that the ratepayers must pay on it; thus, the crux of the dispute on this issue is that Ameren Missouri seeks a larger revenue requirement than Staff thinks is appropriate.

The CURST 246 report was prepared by Ameren Missouri for 25 years for the sole purpose of calculating collection lag for CWC in rate cases.[63] The ARBR, on the other hand, is a report that Ameren Missouri prepares for use in the ordinary course of business.[64] In January 2011, Ameren Missouri stopped preparing the CURST 246 report, which explains why Staff and MIEC relied on the report for the twelve months

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[58] ***Union Electric Co. dba Ameren UE v. Public Service Comm'n of the State of Missouri,*** 136 S.W.3d 146, 157 (Mo. App., W.D. 2004).

[59] Alt, *supra:* "A lead-lag study computes the number of days between when revenues for utility services rendered are received and when the costs of providing those services are paid. The number of days so calculated, times the average daily operating expenses, produces the cash working capital required for operations. A lag occurs when the revenue is received after the expenses are paid."

[60] Ex. 510, *Meyer Direct,* p. 20: "The collection lag represents the amount of time, on average, customers take to make payment following the receipt of their utility bills."

[61] *RR Report,* p. 59; Ex. , Ex. 231, *Boateng Surr.,* p. 2.

[62] Tr. 18:452.

[63] *RR Report,* p. 59; *Boateng Surr.,* 3; *Meyer Dir.,* 20.

[64] *Id*.

ending October 31, 2010 -- there is no later vintage report available.[65] Nonetheless, Staff continues to believe that the CURST 246 report produces a more accurate and reliable collection lag than the ARBR because of the very different bases on which the two reports were prepared.[66]

The focus of the CURST 246 report is the actual payments received by Ameren Missouri from customers, which is exactly the behavior that the collection lag is intended to express.[67] The ARBR, in contrast, focuses on how much money is owed to Ameren Missouri by customers in 30-day increments.[68] While this data is necessarily related to payment behavior, since it is the receipt of payments that reduces the total of outstanding accounts receivable, it is really not the same thing at all.[69] It is this difference in focus, as well as the ordering of customers in 30-day cadres, which explains the different results produced by the parties' analyses.[70]

Several flaws render the ARBR unreliable for collection lag calculations. One such flaw is its inclusion of customers that never pay at all, resulting in an overlong collection lag.[71] Staff used the CURST 246 report and proposed the same collection lag for Ameren Missouri's last rate case; that calculation is still appropriate because Ameren

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[65] *Boateng Surr.,* p. 2; Tr. 18:455.

[66] *Id*.

[67] *Boateng Surr.,* p. 2.

[68] *Id.,* at 4.

[69] *Meyer Dir.,* 21. "The Company is now using an aged accounts receivable report as a reflection of the collection lag. **However, this method does not rely on actual customer payment behavior**" (emphasis added).

[70] The difference between the collection lag calculated by Staff and that calculated by the MIEC, both of whom relied on the CURST 246 report, is explained by the different use each party made of that data set. Staff used the 12 months ending October 31, 2010, while MIEC used the 12 months ending March 30, 2010. *See Meyer Dir.,* p. 21; *Boateng Surr.,* p. 9.

[71] *Boateng Surr.,* 5, 6-7; Tr. 18:457-458; Tr. 18:492.

Missouri has not changed its billing and collections policies or procedures.[72] Another is the fact that Ameren Missouri's reliance on the ARBR results in a collection lag that exceeds the 21 days allowed to customers to pay their bills.[73] In other words, Ameren Missouri's position is that all of its customers pay late, despite the resulting impact on their credit profiles and the imposition of a late payment fee.[74] Additionally, Ameren Missouri's calculations are demonstrably incorrect because they do not employ dollar-weighting, a flaw that also results in a longer collection lag.[75] Another flaw is Ameren Missouri's misunderstanding of the role that bad debts play in the collection lag calculation.[76] Yet another flaw is that the ARBR does not measure the actual payment habits of Ameren Missouri's customers.[77] For example, it does not reflect at all those customers who pay early.[78] The effect of each of these flaws is to overstate the collection lag.[79]

In conclusion, Staff advises the Commission to reject Ameren Missouri's proposed collection lag based upon the ARBR. Instead, the Commission should adopt Staff's proposed collection lag, based on the CURST 246 report, as it has done repeatedly in prior Union Electric rate cases. Otherwise, because of the flaws inherent

[72] *Id*., p. 59; *Boateng Surr.,* p. 7.

[73] *Meyer Dir.,* p. 22.

[74] *Id.* In fact, Ameren Missouri's own witness testified that only 30%-36% of customers pay late. Tr. 18:489.

[75] Ex's 511 & 512 HC, *Meyer Surr.,* p. 20.

[76] *Id.* That role is "none," contrary to the position taken by Ameren Missouri's expert. *See also Boateng Surr.,* at 4-5.

[77] *Boateng Surr.,* 5.

[78] *Boateng Surr.,* 5-6.

[79] Tr. 18:498.

in Ameren Missouri's attempt to calculate a collection lag based on the ARBR, the revenue requirement will be overstated to the detriment of the ratepayers.[80] The Commission should also order Ameren Missouri to resume preparation of the CURST 246 report.

B. Should the income tax calculation be removed from Ameren Missouri’s cash working capital requirement?

Staff agrees with Ameren Missouri on Issue 2.B.

C. What is the proper calculation of the expense lag for Gross Receipts tax?

Staff agrees with Ameren Missouri on Issue 2.C.

Kevin A. Thompson

3. Plant-in-Service Accounting ("PISA")

Should the Commission grant Ameren Missouri accounting authority to accrue a return on invested capital and to defer depreciation for non-revenue-producing plant additions in a regulatory asset during the period between the date when those plant additions begin serving customers until the date they are reflected in rate base in a later rate case?

Ameren Missouri's Plant-in-Service Accounting ("PISA") proposal is an attempt to extend construction accounting beyond the in-service date when it traditionally stops to the "in-rates" date.[81] Company witness Lynn Barnes testified that the return lost to the Company between the in-service date and the "in-rates" date on plant additions was a major cause of the Company's purported chronic failure to earn its authorized ROE.[82]

[80] With respect to the Company's attempt to impeach Mr. Boateng because he evidently used the prior testimony of Staff witness Lisa Ferguson as a template, Staff notes that Company witness Lynn Barnes admitted under cross-examination to doing exactly the same thing. Tr. 19:610-611.

[81] The in-service date is the date upon which a plant addition is fully operational and used-and-useful in the provision of utility service. The "in-rates" date, by analogy, would be the effective date of rates including a new plant addition.

[82] Tr. 19:613 (Barnes). As of the true-up date of July 31, 2012, the amount lost since the last rate case is some $37 million. Tr. 19:607 (Barnes).

Staff opposes Ameren Missouri's PISA proposal because it is an unjustified departure from traditional cost-of-service ratemaking principles.[83] The effect of implementing PISA would be to shift a substantial portion of Ameren Missouri's business risk to ratepayers with no corresponding reduction in Ameren Missouri's authorized Return on Equity ("ROE").[84] Its effect would be to make rates less fair, less reasonable and less just.

Construction accounting is the treatment accorded utility plant under construction.[85] Carrying costs are capitalized as AFUDC and deferred for later recovery.[86] Traditionally, this treatment ends when the plant goes on line.[87] At that point, the utility plant begins depreciating. Now, the Company seeks accounting authority to accrue for return and deferral of depreciation expense for all non-revenue producing plant additions in a regulatory asset during the period between the in-service date and the "in-rates" date. In each future rate case, the Company would include these deferred amounts in its revenue requirement to be amortized over the lives of the underlying assets. As explained by Ameren Missouri witness Lynn Barnes:

> With respect to Plant-in-Service Accounting, the existing regulatory framework reflects an inherent (and inherently unfair) disincentive for the Company to invest in the system due to the regulatory lag caused by the

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[83] *Cassidy Rebuttal,* p. 5: "Traditional ratemaking practice requires that rates be set based upon a historical test year that uniformly captures all of the changes in a utility's revenues, expenses and investment levels and also maintains this proper relationship through a matching all these variables." Ex. 234, *Cassidy Surr.,* pp. 2-3.

[84] Ex. 234, *Cassidy Surr.,* p. 2.

[85] Alt, *supra,* 37-38.

[86] *Id.,* at p. 38: : "When CWIP is not included in rate base, normally the financing or interest cost of the investments made during the construction phase is accumulated and included (capitalized) as part of the total plant cost." *See* Tr. 19:795 (Brosch): "The AFUDC return is allowed on CWIP investment because CWIP investment is not eligible for rate case inclusion particularly in Missouri by act of law."

[87] Tr. 19:740-1 (Cassidy); 19:796 (Brosch).

> complete loss of depreciation expense and return on these investments during the period between when these assets are placed in service and when they ultimately are included in rate base and reflected in rates in a future rate case. To mitigate this disincentive, the Company is requesting the ability to accrue the lost return on its net investment and to defer depreciation expense during this interim period.[88]

Staff does not support Ameren Missouri's proposed extension of construction accounting. Staff's expert witness, John Cassidy, testified that Staff has five primary concerns with the Company's proposal.[89] First, this proposed regulatory mechanism represents unjustifiable single-issue ratemaking.[90] Construction accounting is only justifiable in extraordinary circumstances, such as when a company has undertaken an unusually large financial risk inherent in building a major new plant.[91] The Company's PISA proposal is not associated with a major construction project or any other extraordinary circumstance.[92] In fact, the Company seeks extended construction accounting treatment for **all** non-revenue producing investment -- which means infrastructure replacements and improvements.[93] Ameren Missouri seeks thereby to make extraordinary accounting treatment commonplace.

Second, the PISA proposal fails to accurately measure the change in Ameren Missouri's costs between rate cases.[94] The proposal is single-issue ratemaking, that is,

[88] *Barnes Dir.,* p. 5.

[89] Ex. 208, *Cassidy Rebuttal,* pp. 2-7.

[90] *Cassidy Rebuttal,* p. 2.

[91] *Cassidy Rebuttal,* p. 3.

[92] *Id.*

[93] *Id.* Management has advised investors that there are no substantial rate base additions on the horizon. Tr. 19:614 (Barnes: "our infrastructure is needing to be replaced").

[94] *Cassidy Rebuttal,* p. 2.

a focus on the changes in one cost factor to the exclusion of all others.[95] Ratemaking is based upon the consideration of **all** relevant factors, matched to one another within the same temporal period under the "matching principal."[96] The reality is that all cost and revenue factors are constantly changing, some to the Company's detriment and some to its advantage.[97] Ameren Missouri unfairly seeks to focus on a single, disadvantageous change, and to collect additional revenues on its account to the detriment of the ratepayers. As MIEC expert witness Michael Brosch testified:[98]

> So the general ratemaking framework says for assets that are completed and in service they are eligible to be considered along with the rest of rate base whenever the utility elects to bring a rate case. The importance of that election is when the utility brings a rate case, they have to make accounting for everything that changed. They have to update the billing determinants, the sales volumes and revenues. They have to tell you about how many employees they have today, what the labor and non-labor costs are today. They have to update the full gamut of what touches the revenue requirement, and that achieves the matching that's important.
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> * * *
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> The elegance of the traditional model is, we provide an opportunity, indeed an obligation to quantify and update all of those things instead of looking in isolation at this one known increase in costs and picking it out for preferential or extraordinary rate treatment, and that's why it's objectionable.

Third, the proposal weakens management’s incentive to efficiently control costs.[99] Staff witness John Cassidy testified, "traditional historical test year regulation creates a necessary and beneficial regulatory lag incentive to management that encourages efficient controls over capital budgeting as well as actual capital

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[95] *Cassidy Rebuttal,* pp. 4-5.

[96] *Id*.

[97] *Id*.

[98] Tr. 19:796, 797 (Brosch).

[99] *Id.*

expenditures."[100] He went on to explain that:

> Ameren Missouri's plant-in-service proposal defeats these built-in incentives to efficiently manage costs that arise from regulatory lag because it would result in an almost automatic future recovery of whatever amounts Ameren Missouri chose to spend on non-revenue producing capital improvements. Furthermore, the Company's proposal shifts the cost responsibility and risk to its customers who are least able to influence cost levels associated with much of the Company's non-revenue producing investment decisions.[101]

For this reason, Staff considers Ameren Missouri's PISA proposal to be bad regulatory policy.

Fourth, the Company's proposal fails to take into consideration reduced maintenance costs that may result from having replaced older and less reliable investment, in addition to other cost savings that may occur related to new plant additions.[102] Failure to recognize such changes would create an overstatement of revenue requirement in the context of future rate cases.[103] The reality is that Ameren Missouri is not adding new customers. Expected load growth is modest.[104] At the same time, Ameren Missouri faces a significant and increasing need to replace worn-out infrastructure that serves existing customers.[105] This is what the Company means when it refers to "non-revenue producing plant."[106] However, Ameren Missouri has ignored

[100] *Cassidy Rebuttal,* p. 5; Tr. 19:765 (Cassidy).

[101] *Id.*

[102] *Cassidy Rebuttal,* pp. 2-3.

[103] *Id*.

[104] *Id.*

[105] *Id.,* p. 6.

[106] *Id.*

the very substantial avoided costs implicit in new infrastructure.[107] It will realize savings because it won't have to repair the new infrastructure.[108]

Fifth, the proposal is not consistent in its treatment of non-revenue producing investment placed in service between rate cases because it fails to address the associated accumulated deferred incomes taxes ("ADIT") that are related to that investment.[109] This failure to address ADIT would also result in a significant overstatement of future revenue requirement determinations.[110] Put another way, Ameren Missouri's PISA proposal addresses items that are rate base ***additions,*** while ignoring associated rate base ***deductions.***[111] Such an approach is inherently unfair and can only result in rates that are unjust and unreasonable. As Staff witness John Cassidy testified, "The result will be a flawed and biased result for ratemaking purposes that will not accurately reflect Ameren's true rate base value or true cost of service at any point in time."[112] ADIT is one such associated rate base deduction.[113] Cassidy further testified, "Excluding the impact of these ADIT changes as an offset within the context of the Company's plant-in-service accounting proposal would result in a significant and unfair overstatement of future revenue requirement."[114]

For all of these reasons, Staff urges the Commission to reject Ameren Missouri's

[107] *Id.*

[108] *Id.*

[109] *Cassidy Rebuttal,* p. 3.

[110] *Id.*

[111] *Id.*, pp. 6-7.

[112] *Id.,* at pp. 6-7.

[113] *Id.,* at p. 6.

[114] *Id.,* at p. 7.

one-sided and unjustified PISA proposal. It is an out-of-the-mainstream proposal, unlike anything ever authorized by any public utility commission.[115]

ROE Reduction if PISA is Granted:

Several witnesses testified that, if the Commission does grant Ameren Missouri's PISA proposal, it should ***reduce*** the Company's awarded ROE to reflect the substantial resulting reduction in business risk.[116] None of these witnesses quantified by how much the ROE should be reduced.[117] However, in view of Company witness Barnes' testimony that the amount lost since the last rate case, which PISA would have preserved for recovery in this rate case, amounts to $37 million,[118] and Staff expert witness John Cassidy's testimony that each basis point is worth $540,000,[119] it can be calculated that PISA on the facts of this case is worth nearly 70 basis points.[120] Given the approximately 18 months between Ameren Missouri's rate cases, if PISA is awarded, the Commission should reduce Ameren Missouri's authorized ROE by 45 basis points.[121]

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[115] Tr. 19:580-581; 617 (Barnes).

[116] Tr. 19:608 (Barnes); 19:742, 757 (Cassidy); 19:773, 776 (Robertson); 19:793-795, 799 (Brosch); 26:1687-1688 (Gorman)..

[117] Mr. Gorman did advise the Commission to stay within his recommended ROE range, presumably moving to the low end (9.3%). Tr. 26:1688.

[118] Tr. 19:607 (Barnes): As of the true-up date of July 31, 2012, the amount lost since the last rate case is some $37 million.

[119] Tr. 19:763 (Cassidy).

[120] $37,000,000 / $540,000 = 68.516.

[121] (68/18) x 12 = 45.

4. Income Tax, Accumulated Deferred Income Taxes ("ADIT") and Net Operating Loss ("NOL"):

A. Should a portion of the $2.8 Million income tax benefit realized on dividends paid on Ameren Corporation shares held in Employee Stock Ownership Plan ("ESOP") accounts be a reduction to Ameren Missouri's revenue requirement?

An Employee Stock Ownership Plan ("ESOP") is an employee benefit plan which permits employees of a company to become owners of stock in that company.[122] Such a plan provides tax advantages to both the company and to the participating employees.[123] A tax deduction is available for dividends paid on stock held in the ESOP; in 2011, this deduction amounted to $9.3 million.[124] Because Ameren Corporation now administers the ESOP, it has retained all of the tax benefits, although 56.01% of the participating employees are employees of Ameren Missouri.[125] It is Staff's position that 56.01% of the tax benefits generated by the ESOP should be allocated to Ameren Missouri as a reduction to revenue requirement.[126]

The dividends in question are paid by Ameren Corporation from funds received from Ameren Missouri and ultimately originating with Missouri ratepayers.[127] Ameren Missouri proposes to deny any benefit of the ESOP-related tax benefit to Missouri ratepayers under the mistaken theory that this benefit is unrelated to the cost of service.[128] MIEC's witness Michael Brosch testified, "Ameren Missouri has not shown

[122] Ex. 234, *Cassidy Surr.,* p. 8.

[123] *Id.*

[124] *Id.,* p. 9, 10.

[125] *Id.,* p. 10.

[126] *Id.*

[127] *Brosch Dir.,* p. 27.

[128] *Brosch Dir.,* p. 28.

that any ESOP program expenses have been incurred and not been allowed in its revenue requirement, so there is no basis to allow the Company to retain these income tax savings as a windfall for shareholders."[129]

The contrary arguments raised by Ameren Missouri's witness James Warren should be disregarded.[130] Ameren Missouri is a wholly-owned subsidiary of Ameren Corporation, its only shareholder. However, Ameren Missouri is the chief source of income for Ameren Corporation and its thousands of shareholders.[131] "It is disingenuous to suggest that the equity investors in Ameren Corporation, who are paid dividends on common stock, are somehow distinct from the equity investors who are compensated by Ameren Missouri ratepayers through the authorized return on equity."[132] As MIEC witness Mike Brosch points out, rigid application of "the legal entity distinction between Ameren Corporation and Ameren Missouri/UE that is advanced by Mr. Warren, [leaves us] with an absurd result through which the Commission could find that Ameren Missouri/UE is not a taxpayer at all and owes no income taxes, since Ameren Corporation actually files the returns and is liable for the Company's income tax liability."[133]

The Commission should not allow Ameren Missouri to ignore or assert the distinction between itself and its corporate parent only when it is beneficial to do so. For these reasons, the Commission should include an appropriate share of the ESOP

[129] *Brosch Dir.,* pp. 28-29.

[130] Ex. 10, *Warren Rebuttal*.

[131] *Brosch Surr.,* p. 18.

[132] *Brosch Surr.,* pp. 16-17.

[133] *Brosch Surr.,* p. 17.

deduction in Ameren Missouri's revenue requirement as an offset.

B. Should CWIP-related ADIT balances be included as an offset to rate base?

In Ameren Missouri's previous rate case, both the Company and the Staff reduced rate base for amounts pertaining to CWIP-related Accumulated Deferred Income Tax ("ADIT") balances.[134] However, in the present case, Ameren Missouri is proposing a new treatment for this item and is not reflecting a rate base offset.[135] Staff supports the testimony of MIEC witness Brosch that a rate base offset for CWIP-related ADIT deferred tax balances is appropriate.[136]

This issue arises from an unjustifiable change in position by Ameren Missouri that is intended to improve its financial situation at the expense of ratepayers. Differences between Generally Accepted Accounting Principles ("GAAP") and the Internal Revenue Code ("IRC") with respect to such items as depreciation result in significant cost-free cash flows for Ameren Missouri because the Company collects money from ratepayers now for taxes that it will not actually pay until sometime in the future.[137] Some of these cash flows result from on-going capital projects and are thus CWIP-related; it is these cash flows that are at issue here.[138] GAAP requires that such cash flows be accounted for as ADIT assets or liabilities.[139] Traditionally, such assets are subtracted from rate base because they do not represent funds contributed by the

[134] *Id.,* p. 11. "CWIP" is "Construction Work in Progress."

[135] *Id.*

[136] *Id.,* p. 12.

[137] Ex's 500, 501HC, *Brosch Dir.,* pp. 30-42; Ex. 502, *Brosch Surr.,* pp. 24-32.

[138] *See* Sch's MLB-3, MLB-4 and MLB-5 attached to *Brosch Direct.* This issue also includes ADIT related to the Sioux Scrubbers and ADIT related to the Taum Sauk costs previously disallowed by the Commission. *See Brosch Dir.,* pp.; 40-41.

[139] *Brosch Dir.,* p. 30.

shareholders;[140] in fact, they are funds contributed by the ratepayers that the Company is able to use for capital projects temporarily because of tax-timing rules.[141]

Ameren Missouri's position is that “CWIP-related ADIT should be treated in the same manner as CWIP plant. Since CWIP is excluded from rate base, CWIP-related ADIT should be excluded as well.”[142] Although CWIP is excluded from rates by statute in Missouri,[143] ratepayers still pay the carrying costs on the capital project financing, termed Allowance for Funds Used During Construction ("AFUDC").[144] Thus, Ameren Missouri's argument that ratepayers should not benefit from CWIP-related ADIT is without merit. MIEC's expert witness Michael Brosch testified:

> The AFUDC return is fully compensatory to Ameren Missouri and obligates ratepayers to repay in cash the full amount of all AFUDC that is reasonably recorded. If the Company’s new proposal to exclude CWIP-related ADIT balances from rate base is implemented, Ameren Missouri’s AFUDC accounting will be excessive and will over-compensate for the Company’s actual investment in newly constructed plant assets. This will occur because AFUDC calculations apply a carrying charge rate to the gross investment in such construction with no accounting for CWIP-related ADIT benefits that tend to reduce such investment. This fact was acknowledged by Ameren Missouri in its response to MIEC Data Request10.19(f) where the Company admits that, “CWIP investment that is used for the calculation of AFUDC is not reduced for CWIP-related ADIT.”[145]

Ameren Missouri also argues (1) that current customers are not burdened by CWIP investments; (2) that current customers should not enjoy a rate decrease for

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[140] *Brosch Dir.,* p. 32.

[141] *Id.* The amount of these funds is considerable; Ameren Missouri witness Gary Weiss has estimated that they will amount to over $2 billion as of July 31, 2012. *Id.*

[142] *Id.,* p. 35; *quoting* Ameren Missouri's response to MIEC DR 10.19.

[143] Section 393.135, RSMo.

[144] *Brosch Dir.,* p. 36; *Brosch Surr.,* pp. 25-26; Tr. 19:755 (Cassidy).

[145] *Brosch Dir.,* pp. 36-37.

costs that will be borne by future customers; and that (3) current customers' rates should be the same with or without CWIP.[146]

First, most of Ameren Missouri's present customers will likely still be customers at the time of its next rate case, by which time nearly all of its current CWIP investment will be in service.[147] Any rate decrease enjoyed now will be matched by rate increases that these very same customers will pay following Ameren Missouri's next rate case, likely only about a year and a half away.[148] There is no intergenerational inequity as Mr. Warren would have the Commission believe. Ameren Missouri's current customers "are burdened with the responsibility to pay higher returns and depreciation expense to fully repay the accrued AFUDC balances on today's CWIP investment."[149] MIEC's witness Brosch testified that the Company's goal that current customers' rate should be exactly the same with or without CWIP "has never been a reasonable goal."[150] This is yet another expression of Ameren Missouri's intellectually-bankrupt intergenerational equity argument. As Mr. Brosch explained:

> Under Mr. Warren's approach, rate base would be overstated now by ignoring CWIP-related ADIT and rate base would be overstated again in the future because the FERC rules governing AFUDC calculations allow a full return on CWIP balances that have not been reduced by ADIT.[151]

For these reasons, the Commission should require that the ADIT balances set out on Schedules MLB-3, MLB-4 and MLB-5 attached to Michael Brosch's *Direct*

[146] Ex. 10, *Warren Rebuttal.*

[147] *Brosch Surr.,* p. 26.

[148] *Hanneken Surr.,* p. 7.

[149] *Brosch Surr.,* p. 27.

[150] *Brosch Surr.,* p. 32.

[151] *Id.*.

Testimony be included in rate base as an offset.

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5. Rate Case Expense:

> *What is the appropriate amount to include in Ameren Missouri's revenue requirement for Rate Case Expense?*

It is Staff's position that a $1,500,000 total rate case expense level, normalized over an 18-month period, resulting in an annual expense of $1,000,000, is the appropriate amount of rate case expense to include in Ameren Missouri's revenue requirement.[152] Staff's position is based on an analysis of historical data obtained from Ameren Missouri and the Company's own projections as to the timing of its next rate case filing.[153] It is not, as the Company would have it, a number picked "out of the air."[154]

Ameren Missouri seeks an annual allowance for rate case expense of $1.538 million.[155] Staff believes this amount is too high, based on the following considerations:

- Ameren Missouri estimates it will spend $1.922 million on this rate case.[156]
- Historically, there is a downward trend in Ameren Missouri's rate case expenditures.[157] Additionally, Ameren Missouri historically tends to overestimate its rate case expense by about 20%.[158]

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[152] *RR Report,* p. 110; Tr. 19:880 (Hanneken).

[153] Ex. 236, *Hanneken Surr.,* pp. 7-8.

[154] Tr. 19:865 (Barnes).

[155] Ex. 12 HC, *Barnes Rebuttal,* p. 30.

[156] *Hanneken Surr.,* p. 8.

[157] *Id.,* at p. 7 Tr. 19:912 (Hanneken).

[158] *Id.,* at p. 8; Tr. 19:912 (Hanneken).

- Based on historical data, the rates set in this case will only be in effect for 18 months. Thus, recovery of all rate case expense over 18 months will make the Company whole.[159]

Unlike the Office of the Public Counsel, Staff has not proposed that any amount of Ameren Missouri's rate case expense be disallowed.[160] Staff's concern is that a realistic estimation of these expenses be collected over a realistic time frame.[161] In that regard, Staff compared Ameren Missouri's actual rate case expenditures -- to the extent invoices were available -- to those of other Missouri utilities only as a check on reasonableness and not as a way to estimate magnitude.[162] As Staff witness Lisa Hanneken testified, "I looked at what they spent their money on, not how much."[163]

The Company seeks to recover a normalized level of rate case expense based on the actual amount expended over the last few cases.[164] That approach ignores the observable downward trend seen in the data and Ameren Missouri's habit of over-estimating, points concerning which the Company has taken a cavalier attitude: "[S] so we may over-collect on rate case expense, then we under-collect on labor or we under-collect on something else, and at the end of the day it all sort of comes out in the wash."[165]

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[159] *Id.,* at p. 7.

[160] Tr. 19:912-13 (Hanneken).

[161] An estimation must be used as the final actual total of rate case expense will not be known by the time rates become effective. Tr. 19:862-63 (Barnes).

[162] *Id.,* at p. 9; Tr. 19:900, 901 (Hanneken). Staff reviewed every available invoice to determine whether the expenditures were reasonable, prudent and necessary. Tr. 19:896 (Hanneken).

[163] Tr. 19:897.

[164] *Barnes Rebuttal,* pp. 30-31.

[165] Tr. 19:852 (Barnes).

Missouri's ratepayers cannot afford to hope that it will all somehow come out in the wash. Staff urges the Commission to include $1.0 million, and no more, in annual revenue requirement for rate case expense, which will permit Ameren Missouri to recover 100% of its actual expenditures on this rate case by the time the rates set in its next rate case become effective.

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6. Property Tax Refund:

> *What portion, if any, of the $2.9 Million property tax refund received by Ameren Missouri should be credited to ratepayers. If an amount should be credited, over what period should the credit be amortized?*

Ameren Missouri appealed its $28.9 million 2010 property tax assessment.[166] The appeal was settled and the Company was awarded a refund of approximately $2.9 million, which it received between August 30, 2011, through February 13, 2012, during the test year and true-up period for this case.[167] Because ratepayers paid this money to Ameren Missouri in rates, it is Staff's position that the ratepayers should receive the $2.9 million property tax refund, amortized over two years.[168] Ameren Missouri's assessment appeal was pending during Case No. ER-2011-0028 and the disposition of any refund was an issue in that case.[169] The Commission declined to determine the issue at that time, concluding that it was not ripe, but stated:[170]

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[166] Ex. 6, *Weiss Rebuttal,* p. 27.

[167] *Id.; RR Report,* p. 117; Ex. 218, *Carle Surr.,* p. 6; Ex. 510, *Meyer Dir.,* p. 16.

[168] *RR Report, supra; Carle Surr., supra.*

[169] *Id.,* Tr. 21:973 (Weiss).

[170] *Id., quoting **In the Matter of Union Electric Company doing business as Ameren Missouri,*** Case No. ER-2011-0028 (***Report & Order,*** issued July 13, 2011) pp. 111-112 (*"2011 Report & Order"*); *see Carle Surr.* at p. 7.

> If Ameren Missouri does receive a tax refund, then the Commission would certainly expect that the company would return that refund to its customers who are ultimately paying the tax bill. It is hard to imagine a circumstance in which such a refund would not be ordered. However, such an order must wait until a future rate case in which that decision will be presented to the Commission.

This is the future rate case in which that decision is before the Commission.

Ameren Missouri's position is that the refund belongs to the Company and that the ratepayers have no claim on it:

> When a revenue requirement was established in the Company's last case the assumption was that the revenue requirement would cover the Company's costs once rates took effect. From that time (July 31, 2011) customers have paid for *service* from the Company, but they have not paid any specific cost, except for fuel costs, which are tracked dollar-for-dollar through the fuel adjustment clause (subject to the 95%/5% sharing). Once rates are set, due to regulatory lag a utility may receive revenues that are more than assumed, or less. If a particular item of expense turns out to be less than assumed, the Company benefits, just as if a certain item of expense turns out to be more than assumed the Company bears the higher cost. The reason we are here is that the test year (as trued-up) level of revenues is not sufficient to allow the Company to recover its costs and earn what the Commission determined just one year ago was a fair return. It is inappropriate to add to that problem by in effect confiscating revenues derived from a single cost item, while ignoring the much greater increases in other cost items. While the Company received this $2.9 million refund, there were many operating expenses where the Company spent more than was assumed when rates were last set (e.g., labor $28 million more; employee benefits $28 million more). Moreover, from July 2011 through June 2012, the Company did not consistently earn its allowed ROE, meaning that even if one engaged in the fiction that customers "pay costs" the customers have failed to pay all of the Company's costs.[171]

The revenue requirement approved by the Commission in Case No. ER-2011-0028 included $28.9 million for property tax expense, the amount of Ameren Missouri's

[171] *Weiss Rebuttal,* p. 28.

2010 property tax assessment, and ratepayers paid that amount through rates.[172] The Company has had the use of the excess money in the interim. Now, it being finally determined that the basis of the revenue requirement approved in Case No. ER-2011-0028 was in error in that it overstated property tax expense by $2.9 million, it is right and proper to return that money to the ratepayers from whom it was unfairly exacted.

Staff notes the inconsistency in Ameren Missouri's attitude toward revenue requirement mismatches such as this one.[173] The Company's PISA proposal, for example, as well as its numerous presently-established and hoped-for-future trackers, all represent mechanisms intended to correct such mismatches when deleterious to the Company and the Company has argued strenuously in their favor.[174] Yet the Company argues just as strenuously against correcting this mismatch to the benefit of the ratepayers. This refund represents an extraordinary, one-of-a-kind revenue item, similar in kind to the extraordinary expense items whose recovery the Company routinely seeks through Accounting Authority Orders ("AAOs").[175] The Commission should follow-up on its statement in the ER-2011-0028 *Report & Order* and return the property tax refund to the ratepayers.

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7. Property Taxes:

> *What property tax rates should be used in calculating the allowance for property tax expense to include in Ameren Missouri's revenue requirement?*

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[172] Ex. 218, *Carle Surr.,* p. 6.

[173] *Carle Surr.,* pp. 7-8.

[174] Tr. 21: 975 (Weiss): "The revenue requirement is set, and any increases or decreases between rate cases is *[sic]* not recovered, unless it is recovered in a tracker or rider." *See Meyer Surr.,* 18.

[175] Tr. 21:980 (Weiss).

Staff's position is that the actual amount of property tax expense paid in December 2011 is the appropriate annualized ongoing value to include in Ameren Missouri's revenue requirement for property tax expense.[176] Based upon this approach, Staff has included $127.2 million as the appropriate level for inclusion in the cost of service calculation.[177] This is the latest known and measureable figure for this expense item.

Ameren Missouri originally sought about $139.9 million for property tax expense.[178] However, in the *Rebuttal Testimony* of its expert witness Chris L. Cudney,[179] the Company proposed a new figure based upon a projection of its anticipated 2012 property expense:

> Ms. Cudney proposes a normalized tax rate increase based upon the actual history of increases in property tax rates that Ameren Missouri has experienced over the past three years and recommends applying this proposed normalized increase against the January 1, 2012 assessed value that was provided by the Missouri State Tax Commission's on June 28, 2012. Ms. Cudney's calculations produce a normalized level of approximately $130.4 million for Ameren Missouri's 2012 property tax expense.[180]

Staff is unable to accept the results of the forecasting methodology proposed by Ms. Cudney because it violates the cost-of-service ratemaking paradigm used in Missouri, which depends upon a historical test year, annualized and normalized and updated for known and measureable changes occurring prior to a designated true-up

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[176] *RR Report,* p. 116.

[177] *Carle Surr.,* p. 8.

[178] Ex. 510, *Meyer Dir.,* p. 14; *Carle Surr.,* p. 9: " Company witness Weiss proposed that $140.0 million was the appropriate level of property tax expense to include in the cost of service[.]"

[179] Ex. 14.

[180] *Carle Surr.,* p. 9.

deadline.[181] Tax rates may or may not increase for 2012 and the magnitude and direction of any change cannot be predicted in advance.[182] Past tax rate changes are not predictive of future tax rate changes.[183] As Staff witness Erin Carle pointed out in her *Surrebuttal Testimony,* the Commission has previously rejected a proposal almost identical to that advanced here by Ameren Missouri, saying: " Staff's proposal to use a known amount (the last amount actually paid), while probably not a perfectly accurate representation of the property taxes that will be paid in the future, at least avoids the speculation inherent in Company's proposal."[184]

As this issue goes to hearing before the Commission on October 2, 2012, the assessed valuation of Ameren Missouri's property is known,[185] but many of the tax rates have not yet been set and the tax bills have not yet been rendered.[186] The bills will not arrive until November or December and Ameren Missouri will not actually pay its property taxes until December 2012.[187]

Based on all the foregoing, Staff urges the Commission to include a reasonable allowance in revenue requirement for property tax expense, based upon the most

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[181] *Carle Surr.,* p. 10; *Meyer Surr.,* p. 16; Tr. 21:1024 (Carle).

[182] *Carle Surr.,* p. 10; *Meyer Dir.,* p. 15; *Meyer Surr.,* p. 15.

[183] *Carle Surr.,* p. 10; *Meyer Surr.,* p. 15.

[184] *Carle Surr.,* p. 10, *quoting* ***In the Matter of St. Louis County Water Company,*** 10 Mo.P.S.C.3d 255, 268 (2001).

[185] *Cudney Rebuttal,* p. 3: "The Tax Commission certified its results on June 28, 2012, for access by Ameren Missouri and the taxing jurisdictions within the Company's service area."

[186] *Staff RR Report,* p. 116; *Cudney Rebuttal,* p. 3: "After their budgets are completed, the various taxing jurisdictions file their respective tax rates for Tax Year 2012 with the State Auditor's office any time between September and December 2012." Tr. 21:1012-1013 (Cudney). Ameren Missouri will receive 66 or 67 separate property tax bills and has not yet received any of them. Tr. 21:1024-1025 (Carle).

[187] Tr. 21:1012 (Cudney).

recent known and measureable figure for that expense, which is the amount the Company paid in December 2011.

Kevin A. Thompson

8. Renewable Energy Standard ("RES") Costs:

A. Should the Commission order Ameren Missouri to include a base level of RES costs in permanent rates? If so, what is the base amount to include in permanent rates and should the level included in permanent rates in this case be netted against any future deferred expenditures that occur beyond the July 31, 2012, true-up date?

Yes, the Commission should order Ameren Missouri to include a base level of RES costs in permanent rates in the amount of $4.7 million, with the base level netted against any future deferred expenditures that occur beyond the July 31, 2012, true-up date.

Proposition C, also known as the Renewable Energy Standard ("RES"), is codified at Sections 393.1020, 393.1025 and 393.1030, RSMo (Supp. 2010), and became effective November 4, 2008. The RES requires electric utilities to purchase or generate a certain percentage of its electricity sales from renewable energy resources. Of particular importance to this discussion is Section 393.1030.2 (4) RSMo (Supp. 2010), which provides that the Commission shall establish rules that include "[p]rovisions for recovery **outside the context of a regular rate case of prudently incurred costs** and the pass-through of benefits to customers of any savings achieved by an electrical corporation in meeting the requirements of this section."[188] The Commission's RES rule, found at 4 CSR 240-20.100 and effective September 30, 2010, allows a Company to recover certain costs incurred to comply with the RES. Rule 4

[188] Section 393.1030.2 (4) (emphasis added).

CSR 240-20.100 (1)(N) defines RES compliance costs as "…prudently incurred costs, both capital and expense, directly related to compliance with the [RES]." Ameren Missouri has incurred RES compliance costs and it remains the Staff's position that the Commission should order Ameren Missouri to include $4.7 million as a base level of RES costs in permanent rates, with the base level netted against any future deferred expenditures that occur beyond the July 31, 2012, true-up date.[189]

It is well established that the Commission has the authority to interpret the meaning of one of its own rules. "The rule-making power of the Commission is not questioned. The power to make rules includes the power to alter them, and to determine any reasonable policy of interpretation and application of said rules."[190] Additionally, the courts "…defer to an agency's interpretation of its own regulation as long as such interpretation does not expand upon, narrow or result in an interpretation that is inconsistent with the plain and ordinary meaning of the words used in the regulation." [191] It is true that 4 CSR 240-20.100 (6) allows two alternatives from base rates to recover costs or pass-through benefits as a result of compliance with the RES requirements, those being to file outside or as part of a general rate case for a Renewable Energy Standard Rate Adjustment Mechanism (RESRAM) or an Accounting Authority Order (AAO).[192] However, nothing in the RES rule absolves the Commission from its

[189] Staff Ex. 202, p.133, ll. 27-28; Surrebuttal Testimony of John P. Cassidy, p. 6, ll. 21-22, p. 7, ll. 16-19.

[190] ***State ex rel. Dail v. Public Service Com'n*****,** 203 S.W.2d 491, 497 (Mo. App. 1947).

[191] ***State ex rel. Office of Public Counsel v. Missouri Public Service Com'n*****,** 301 S.W.3d 556, 566 (Mo. App. W.D., 2009).

[192] Staff Ex. 202, p. 132, ll. 21-28, p.133, ll. 1- 12.

obligation in a general rate case to set a company's base rates after considering all relevant factors of the case.

Sections 393.150 and 393.270, RSMo (2000), allow the Commission after hearing to fix the lawful rate an electric company may charge for service.

> …[I]n order to carry out its statutory duties and effectuate the legislative policy objectives embodied therein, the commission must supervise, regulate and control the public utilities within its jurisdiction It can do so, under the statutes, either by 'approval of rate schedules filed with it or by order after investigation or hearing.' The ultimate purpose of such action is to fix a rate which is just and reasonable both to the utility and to its customers."[193]

"First and foremost is that in a rate case the Commission must consider 'all relevant factors.'"[194] Section 393.270.4 states that "[i]n determining the price to be charged for…electricity…the commission may consider all facts which in its judgment have any bearing upon a proper determination of the question although not set forth in the complaint and not within the allegations contained therein…" "Although the quoted section of the statute refers to 'complaints', the requirement that all relevant factors be considered is of course applicable under the file and suspend method also."[195] Thus, the Commission must consider 'all relevant factors' in determining the rates to establish from this rate case.

Ameren Missouri has incurred costs to comply with the RES statute and rule.[196]

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[193] ***State ex rel. Utility Consumers' Council of Missouri, Inc. v. Public Service Commission*****,** 585 S.W.2d 41, 48-49 (Mo. banc, 1979) ("***UCCM***") (internal citations omitted).

[194] ***State ex rel. Missouri Gas Energy v. Public Service Com'n*****,** 210 S.W.3d 330, 336 (Mo. App. W.D., 2006).

[195] ***UCCM,*** 585 S.W.2d at 56.

[196] Tr. 21:1043, ll. 24-25; Staff Ex. 202, p. 133, ll. 27-28.

Further, these costs are continuing to increase.[197] The test year RES expense level incurred by Ameren Missouri for the provision of service is a relevant factor in determining the price a utility should charge for electricity. Therefore, the Commission should include the true-up level of RES costs in Ameren Missouri's cost of service established in this case.[198]

B. Over what period of years should the Commission order Ameren Missouri to amortize the deferred RES costs incurred from January 1, 2010, through July 31, 2012?

Staff recommends the Commission order Ameren Missouri to amortize the deferred expenditures from January 1, 2010, through July 31, 2012, over three years. However, Staff alternatively recommends that six years would also be an acceptable amortization period if the Company is afforded rate base inclusion for the unamortized RES deferred regulatory asset balance from January 1, 2010, through July 31, 2012.[199]

C. Should the Commission order Ameren Missouri to include the unamortized RES deferred regulatory asset balance from January 1, 2010, through July 31, 2012, in rate base?

No, the Commission should not order Ameren Missouri to include the unamortized RES deferred regulatory asset balance in rate base if it accepts Staff's recommendation of a three-year amortization period for the unamortized RES deferred regulatory asset balance incurred between January 1, 2010, through July 31, 2012. [200] However, if the Commission authorizes a six-year amortization period, then Staff

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[197] Tr. 21:1047, ll. 14-16.

[198] Ex. 235, p. 6, ll. 21-22; Tr. 21:1069, ll.23-25; 21:1070, ll.1-7; 21:1073, ll. 4-8.

[199] Ex. 202, p. 133, ll. 28-32; Ex. 235, p. 7, ll. 7-12.

[200] *Id.*

recommends inclusion of the unamortized balance in rate base. [201]

Staff urges the Commission to consider the question of rate base treatment in this way: Is a RES expense the same as a power plant that the Commission has historically allowed companies to place in rate base and earn a return on? Currently, solar rebates are the majority of RES costs incurred by Ameren Missouri.[202] Unlike a power plant, which is owned and operated by Ameren Missouri, the solar equipment that Ameren Missouri pays the rebate for is owned and operated by the customers and for the primary benefit of the customers.[203] RES costs are simply an expense Ameren Missouri incurs to comply with the RES statute.[204]

The expenses in Ameren Missouri's RES accounts are not capital items in nature.[205] Why then should the Ameren Missouri receive the return of and a return on an expense that is not capital in nature and that it does not own or maintain? All else remaining equal, customers of Ameren Missouri will pay more in rates if the Commission allows rate base treatment for the RES expenses incurred.[206] Therefore, the Commission should not order Ameren Missouri to include the unamortized RES deferred regulatory asset balance in rate base.

Jennifer Hernandez

[201] *Id.*

[202] Tr. 21:1042, ll. 23-25; 21:1043, ll. 1-3.

[203] Tr. 21:1043, ll. 4-13.

[204] Tr. 21:1043, ll. 21-25; §§ 393.1020, 393.1025 and 393.1030, RSMo (Supp. 2010).

[205] Tr. 21:1047, ll. 4-10.

[206] Tr. 21:1045, ll.10-18.

9. Fuel Adjustment Clause ("FAC"):

Should the sharing percentage in Ameren Missouri's fuel adjustment clause be changed to 85%/15%?

Staff's position is that Ameren Missouri's Fuel Adjustment Clause ("FAC") should be continued, but modified.[207] Staff recommends that the sharing percentage should be changed from 95%/5% to 85%/15%.[208]

Not unexpectedly, fuel costs are Ameren Missouri's largest single cost item.[209] According to Ameren Missouri's witness Lynn Barnes, "these costs . . . continue to be quite volatile."[210] Prior to the enactment of SB 179[211] in 2005, FACs were unlawful in Missouri.[212] The Commission first granted Ameren Missouri a FAC in 2009 in Case No. ER-2008-0318;[213] the tariffs became effective on March 1, 2009.[214] The Commission has reauthorized Ameren Missouri's FAC in two subsequent rate cases.[215] Ameren

[207] Ex. 224, *Mantle Surr.,* p. 17: "Staff is merely proposing changes that, short of taking away the privilege, would provide Ameren Missouri more incentive to manage its net fuel cost efficiently and cost-effectively." AARP and Consumers' Council of Missouri recommend that the Commission discontinue Ameren Missouri's FAC. Tr. 22:1135.

[208] Staff makes this recommendation, despite the fact that the Commission denied it in Ameren Missouri's last rate case, because Staff considers it to be the right decision from a public policy perspective.

[209] Ex. 11, *Barnes Dir.,* p. 8. Fuel costs amounted to $941 million in the test year, comprising 47% of Ameren Missouri's annual Operating and Maintenance ("O&M") expense. *Id.*

[210] *Barnes Dir.,* p. 8. Ms. Barnes testified that natural gas costs, while volatile, have been falling and OSS revenues have been declining. Coal is purchased under long-term contracts designed to reduce volatility; also dampening volatility are hedging strategies. Tr. 22:1149-1150; *and see Barnes Rebuttal,* p. 7. Mr. Neff testified that Ameren Missouri typically burns between 21 and 22 million tons of coal per year. Tr. 22:1161. Staff does not contend that Ameren Missouri has not done a good job of managing its F&PP costs. Tr. 22:1233 (Mantle).

[211] Codified at § 386.266, RSMo.

[212] *RR Report,* p. 158; ***St. ex rel. Utility Consumers' Council v. Public Service Commission of Missouri et al.,*** 585 S.W.2d 41, 53-4 (Mo. banc 1979).

[213] After denying its request in Case No. ER-2007-0002.

[214] *RR Report,* at 159; Ex. 11, *Barnes Dir.,* p. 6.

[215] Case No. ER-2010-0036 and Case No. ER-2011-0028.

Missouri now seeks the third reauthorization of its FAC. The authorization of a FAC is by statute conditioned on a prudence review at intervals no greater than 18 months.[216] In 2011, the Commission determined Ameren Missouri's first FAC prudence review and disallowed approximately $18 million and required its return to the ratepayers.[217] Ameren Missouri's second FAC prudence review, Case No. EO-2012-0074, is pending now.[218] SB 179 also requires an annual FAC true-up.[219] Ameren Missouri filed its first FAC true-up on December 1, 2010.[220]

Ameren Missouri's FAC has always included a sharing mechanism set at 95%/5% as an incentive to the Company to efficiently manage its fuel and purchased power ("F&PP") costs and to pursue opportunities for off-system sales ("OSS").[221] Such incentives are expressly authorized by SB 179:

> Subject to the requirements of this section, any electrical corporation may make an application to the commission to approve rate schedules authorizing an interim energy charge, or periodic rate adjustments outside of general rate proceedings to reflect increases and decreases in its prudently incurred fuel and purchased-power costs, including transportation. **The commission may, in accordance with existing law, include in such rate schedules features designed to provide the electrical corporation with incentives to improve the efficiency and cost-effectiveness of its fuel and purchased-power procurement activities.**[222]

The sharing percentage requires the Company to pass through to its ratepayers

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[216] § 386.266.4(4), RSMo.

[217] *RR Report,* at 160.

[218] Fully briefed and awaiting decision as of August 24, 2012.

[219] § 386.266.4(2), RSMo.

[220] *RR Report,* at 160.

[221] *2011 Report & Order,* at pp. 74-75; Ex. 12, *Barnes Rebuttal,* pp. 3-4.

[222] § 386.266.1, RSMo; emphasis added.

95% of any upward or downward deviation of F&PP costs from the base level, and to retain or absorb the other 5%.[223] In the present case, as in Ameren Missouri's last general rate case, Staff recommends that the Commission adjust the sharing ratio to 85%/15%, citing a number of reasons:[224]

- First, a comparison of the actual fuel costs that Ameren Missouri did not collect under the 95%/5% sharing mechanism with what Ameren Missouri would not have collected with an 85%/15% sharing mechanism and with what Ameren Missouri would not have collected if Ameren Missouri did not have a FAC at all during accumulation periods 2 through 9, suggests that 85%/15% may be the optimum sharing percentage. Why? Because the change from 95%/5% to 85%/15% would require Ameren Missouri to absorb only a minimal amount of additional net F&PP costs; from 1.1% to 3.3%, an increase of only 2.2%.[225] This amount is trivial compared to the additional $306 million in net F&PP costs that Ameren Missouri would have had to absorb had it not had an FAC at all in accumulation periods 2 through 9.[226]
- Second, also passing through Ameren Missouri's FAC, as an offset to F&PP costs, are OSS margins.[227] Ameren Missouri's OSS margins are more

[223] *2011 Report & Order,* p. 75.

[224] *RR Report,* p. 163. The Commission rejected Staff's recommended modification of the sharing ratio in Case No. ER-2011-0028, *2011 Report & Order,* p. 86.

[225] *Id.,* at p. 164. Ameren Missouri's total net F&PP costs for accumulation periods 2 through 9 was $1.4 billion; 2.2% of that is about $30.8 million.

[226] *Id.* $306 million is 21.8% of Ameren Missouri's total net F&PP costs for the period.

[227] *Id.,* at pp. 164-165. "OSS margins" are profits on off-system sales. OSS amounts to approximately $360 million per year. *Barnes Dir.,* p. 8.

variable than its F&PP costs.[228] At the 85%/15% sharing ratio, Ameren Missouri would keep three times as much of the OSS margins than it does at the current sharing mechanism of 95%/5%.[229] Staff expert witness Lena Mantle urged the Commission to look at each component of Ameren Missouri's net F&PP costs and to understand "how volatile each component actually is."[230]

- Third, an 85%/15% sharing mechanism would provide greater incentive to Ameren Missouri to reduce its F&PP costs and to increase its OSS because the Company would keep more of any F&PP savings and more of any OSS margins.[231] In particular, it would give Ameren Missouri more incentive to search out and find additional OSS opportunities.[232] Ameren Missouri would also keep more of any savings generated by its nascent energy efficiency programs.[233] While Ameren Missouri complains that having to absorb 5% of its net F&PP costs is a "heavy burden," the burden of absorbing 95% is even greater for the Company's customers.[234]
- A sharing mechanism of 85%/15% would provide Ameren Missouri with more incentive to accurately estimate the net base energy cost factors in general

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[228] *Id.,* at p. 165; *Barnes Rebuttal,* p. 7: "Yes, it is true that OSS margins have been more volatile."

[229] *Id.;* Tr. 22:1148 (Barnes).

[230] Ex. 224, *Mantle Surr.,* p. 17.

[231] *Id.,* at p. 165. *See Mantle Surr.,* p. 15: "if Ameren Missouri is responsible for more of the increase in fuel costs it will take great care to keep that increase as small as possible."

[232] *RR Report,* p. 165.

[233] *Id.*

[234] *Mantle Surr.,* p. 16; *Barnes Rebuttal,* p. 7.

rate cases.[235] Historically, net actual energy costs have been higher than the estimated net base energy costs.[236] One possible cause of this mismatch is estimation error.[237]

- Fifth and finally, Ameren Missouri used the FAC process in its second FAC prudence review case, Case No. EO-2012-0074, to create regulatory lag that may benefit Ameren Missouri and its shareholders to the detriment of its customers.[238] Should the Commission again find that Ameren Missouri acted unlawfully and must flow the AEP and Wabash revenues back to its customers through its FAC, then there will be considerable regulatory lag for the ratepayers.[239] In fact, Ameren Missouri's customers will have waited longer to get their money back than Ameren Missouri must wait in a rate case to receive increased revenues.[240]

Contrary to the Company's representations, the 85%/15% is not proposed as a penalty.[241] Being able to bill its customers for 85% of any increase in its F&PP costs met of OSS is a benefit, not a penalty.[242] A simple analogy is that Ameren Missouri is

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[235] *RR Report,* at p. 166; *Mantle Surr.,* p. 8. Since the FAC was implemented, Ameren Missouri has consistently under-recovered its net-fuel costs and has required upward adjustments to fuel costs recovered through the FAC. *Barnes Rebuttal,* p. 12.

[236] *Id.*

[237] *Id.*

[238] *Id.*

[239] *Id.* In other words, they could have had their money sooner.

[240] *Id.*

[241] *See* Ex. 18, *Neff Rebuttal,* p. 6; *and see Mantle Surr.,* p. 13: "Q. Is the proposed 15% sharing a "penalty" for Ameren Missouri for proactively complying with the CSAPR regulations? A. No, it is not."

[242] *Mantle Surr.,* p. 13.

asserting that it is being penalized because its "cup" is only 85% full when in the not-too-distant past, it has been completely empty.

SB 179 expressly authorizes the Commission to include an incentive mechanism as part of the FAC. While we know how well the 95%/5% ratio works, and we know how well the 100%/0% ratio works, we have no data on the 85%/15%.[243] In particular, as long as Ameren Missouri has a FAC, it must file rate cases at least every four years.[244] Mr. Neff revised his calculations at the beginning of his live testimony, but only after Staff expert witness Lena Mantle filed surrebuttal testimony pointing out that his calculations were misleading. Mr. Neff also seeks to lead the Commission into error by violating the matching principle and including in this case coal contract cost increases that will not occur until after the true-up cut-off date.[245] The Commission should disregard Mr. Neff's testimony.

Company witness Lynn Barnes emphasizes the volatility and unpredictable nature of the F&PP and OSS markets. In fact, these points are all the more reason that the Company should have "more skin in the game" via an adjusted sharing ratio.[246] Staff expert witness Mantle testified, "With no stake or very little, such as the current 5%, the impact on Ameren Missouri of less efficient or cost-effective fuel procurement activities is minimal while it could be very great on Ameren Missouri's customers."[247]

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[243] *Mantle Surr.,* p. 18; Tr. 22:1217 (Mantle).

[244] *Id.*

[245] *Id.,* as does Lynn Barnes. *See Mantle Surr.,* pp. 17-18.

[246] *Mantle Surr.,* pp. 15-16.

[247] *Id.*

10. FAC Tariff, including the Transmission Tracker:

A. Should the MISO schedule costs that are allowed to flow through the FAC be listed on the FAC tariff sheets?

The parties have resolved this issue by *Stipulation and Agreement.*[248]

B. Should the definition of Factor PP in Ameren Missouri's FAC tariff be modified to state, "Only transmission costs incurred for the purchase or sale of electricity shall be included"?

The parties have resolved this issue by *Stipulation and Agreement.*

C. Apart from transmission costs addressed in Item B, should Ameren Missouri be permitted to flow through the FAC MISO transmission charges, including charges reflecting the cost of building transmission facilities, and associated transmission revenues?

No. By statute, amounts flowing through the FAC are limited to "prudently incurred fuel and purchased-power costs, including transportation."[249] Staff considers the word "transportation" to indicate the cost of delivering coal to a power plant by rail and to exclude transmission costs. Additionally, costs related to nonoperational property of electric corporations may not be charged to ratepayers under Missouri law.[250]

This issue arose when Staff proposed that certain clarifying language be added to Ameren Missouri's FAC tariff.[251] Staff expert witness Lena Mantle testified, "Only after the Staff Report was filed did Staff learn that Ameren Missouri was stating on its website regarding the Lutesville to Heritage Transmission line that Ameren Missouri

[248] Tr. 22:1087-1088.

[249] Section 386.266.1, RSMo.

[250] Section 393.135, RSMo.

[251] *Mantle Surr.,* p. 2; *RR Report,* p. 158, 170. "Ameren Missouri's FAC tariff sheets should be revised to clarify that the only transmission costs that are included in it are those that Ameren Missouri incurs for purchased power and off-system sales ("OSS")." *Id.,* p. 158. *See Oligschlaeger Res.,* p. 2.

intended to pass its costs of building the Lutesville to Heritage transmission line through the FAC."[252]

Company witness Jaime Haro responded in opposition to Staff's proposal.[253] Mr. Haro testified that Ameren Missouri incurred certain MISO transmission charges both because of its membership in the MISO and because of its need to use third-party transmission facilities to serve a portion of its native load;[254] he further testified that it is fair to pass these charges on to the ratepayers because they are enjoying benefits from Ameren Missouri's MISO participation.[255] As a MISO member, Ameren Missouri sells all of its generation into the MISO system and buys back what it needs to serve its native load.[256] Ameren Missouri is a "net seller," meaning that it sells more power to MISO than it takes.[257]

Ameren Missouri's MISO-participation-based arguments are disingenuous. The biggest part of the MISO transmission charges in dispute in this case are Schedule 26A charges.[258] Schedule 26A charges are MISO's method of recovering capital investment in transmission projects.[259] These charges started in January 2012 and amount to $25.9 million for the calendar year.[260] Ameren Missouri never specifically notified Staff

[252] *Mantle Surr.,* pp. 2-3.

[253] *Haro Rebuttal,* pp. 19-24.

[254] *Id.,* pp. 20-21. The load in question is located in the Bootheel and must be served using Entergy transmission resources. *Id.,* p. 21.

[255] *Id.,* pp. 21, 23.

[256] *Id.,* p. 22.

[257] *Id.*

[258] Tr. 22:1174 (Haro).

[259] Tr. 22:1173 (Haro).

[260] Tr. 22:1173-1174, 1182-1183, 1184-1185 (Haro).

that these charges had begun and were now being run through the FAC; they were included in a monthly report to the Staff, but not separately stated or identified.[261] Staff expert witness Lena Mantle testified that, in fact, Ameren Missouri violated a rule requiring it to give Staff "notice of any significant changes in expense or revenues."[262] Ameren Missouri has been including these charges in FAC Factor CPP, which is defined as follows:

> Costs of purchased power reflected in FERC Account Numbers 555, 565, and 575, excluding MISO administrative fees arising under MISO Schedules 10, 16, 17, and 24, and excluding capacity charges for contracts with terms in excess of one (1) year, incurred to support sales to all Missouri retail customers and Off-System Sales allocated to Missouri retail electric operations. Also included in factor "CPP" are insurance premiums in FERC Account Number 924 for replacement power insurance to the extent those premiums are not reflected in base rates. Changes in replacement power insurance premiums from the level reflected in base rates shall increase or decrease purchased power costs. Additionally, costs of purchased power will be reduced by expected replacement power insurance recoveries qualifying as assets under Generally Accepted Accounting Principles.[263]

The MISO transmission charges in question are not, in fact, purchased power costs. Nor are they charges incurred in transmitting purchased power.[264] They are capital construction costs, incurred in the process of constructing transmission assets such as the Lutesville to Heritage Transmission Line.[265] While they are recoverable costs, they may not be recovered through the FAC. Missouri law forbids the recovery of these

[261] Tr. 22: 1174, 1187, 1190-1194, 1213-1215; *and see* Ex. 239 HC. MISO Sch. 26A costs were lumped in with MISO Sch. 26 costs. Tr. 22:1256 (Mantle). A complicating issue is the difficulty of extracting meaningful information from the utility. *See* Tr. 22:1265-1267 (Mantle).

[262] Tr. 22:1216-1217 (Mantle).

[263] *Mantle Surr.,* p. 3, *quoting* Ameren Missouri's current FAC tariff.

[264] Ex. 527, *Dauphinais Sur-Surr.,* pp. 2-3.

[265] Tr. 22:1173 (Haro); *Dauphinais Sur-Surr.,* p. 7.

charges through the FAC.

There are two statutes that, when considered *in pari materia,* prohibit the recovery of Schedule 26A capital construction costs through the FAC. SB 179, which authorizes the FAC, limits amounts flowing through the FAC to "prudently incurred fuel and purchased-power costs, including transportation."[266] Whatever the word "transportation" means, it certainly does ***NOT*** mean the ongoing capital construction costs of building transmission facilities, particularly in view of Missouri's Anti-CWIP statute, which forbids charging costs related to nonoperational property of electric corporations to ratepayers.[267] It is Staff's position that the Commission may not lawfully authorize Ameren Missouri to pass these costs to ratepayers through the FAC.

Nor would it be appropriate to pass these costs through the FAC even if it were lawful to do so. As Staff expert witness Lena Mantle testified, "Just because a cost is incurred to deliver energy to Ameren Missouri customers, does not mean the cost should flow through the FAC."[268] She characterized the inclusion of these charges in the FAC as bad public policy.[269] Construction costs, and related costs such as easement and real estate costs, are simply not the kind of costs that the FAC was intended to recover.[270] The purpose of the FAC is to protect the utility from uncontrollable volatility in the F&PP and OSS markets. Changes in transmission

[266] SB 179 is codified at § 386.266.1, RSMo.

[267] Section 393.135, RSMo.

[268] *Mantle Surr.,* p. 4.

[269] Tr. 22:1208-1209 (Mantle).

[270] *Mantle Surr.,* pp. 4-5; Tr. 22:1244-1245 (Mantle).

construction costs are neither uncontrollable nor volatile nor, in this case, of significant magnitude.[271]

D. Should Ameren Missouri be permitted to flow through the FAC transmission charges associated with transmission service in a term in excess of one year?

Staff supports the position of the MIEC on Issue 10.D.

E. If the Commission determines that the MISO transmission charges and revenues addressed in Item C should not be flowed through the FAC should they be deferred in a transmission cost and revenue tracker using the trued-up test year sum for those charges and revenues as the base against which changes will be tracked, with sums above the base to be booked to a regulatory asset and sums below the base to be booked to a regulatory liability? If so, how should the amortization of the regulatory asset or regulatory liability be handled?

Staff opposes Ameren Missouri's proposed Transmission Tracker, but if the Commission nonetheless grants one, it should be subject to the conditions set out in the testimony of Staff witness Mark Oligschlaeger.

Company witness Jaime Haro has proposed that the MISO transmission costs that are the subject of dispute between the Company and the Staff with respect to their recovery through the FAC, together with MISO transmission revenues, should be tracked via a Transmission Cost and Revenue Tracker. A tracker is a device that records a specific unrecovered item of cost and preserves it for possible future recovery in a general rate case.[272] Mr. Haro's proposal is an alternative to flowing MISO transmission costs through Ameren Missouri's FAC; Ameren Missouri's preferred resolution is to leave things as they are and include MISO transmission revenues in the FAC.[273] Staff and other parties oppose leaving things as they are, even if MISO

[271] Tr. 22:1209 (Mantle).

[272] Ex. 240, *Oligschlaeger Res.,* pp. 3-4.

[273] *Id.,* p. 3.

transmission revenues are included in the FAC, and also oppose the Transmission Cost and Revenue Tracker.[274]

At the present time, MISO revenues and MISO transmission charges are roughly equal in amount.[275] The revenues are included in base rates and the charges, which are at issue here, have been flowing through the FAC.[276] However, to justify its proposed tracker, Ameren Missouri asserts that the MISO transmission charges are expected to increase in the future, while the revenues are expected to remain the same.[277]

No one has yet established the reasonableness of Ameren Missouri's projection of increased MISO transmission expenses. The Company did not provide its most recent estimates of the escalation in transmission expenses to Staff and the other parties until shortly before this issue was litigated. Staff's expert witness Mark Oligschlaeger testified that he had not yet been able to review these estimates in any meaningful way.[278] In 2013, Ameren Missouri claims the MISO transmission charges will exceed the revenues by one or two million dollars.[279] The following year, the difference is projected by Ameren Missouri to be as much as $10 million.[280] Thus, by the time Ameren Missouri files its next rate case, the proposed Transmission Tracker

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[274] *Oligschlaeger Res.,* p. 2.

[275] Tr. 22:1166 (Haro); *Oligschlaeger Res.,* p. 7.

[276] Tr. 22:1168, 1172 (Haro); *Oligschlaeger Res.,* pp. 3, 5.

[277] Tr. 22:1166, 1176 (Haro).

[278] Tr. 22:1298 (Oligschlaeger).

[279] Tr. 22:1166, 1167 (Haro).

[280] Tr. 22:1167 (Haro).

will only track about $12 million in increased net MISO transmission charges, if the Company's projections are accurate.[281]

MISO revenues will increase only if Ameren Missouri builds additional transmission.[282] Ameren Missouri currently has no plans to build Multi-Value Transmission Projects,[283] the allocated costs of which are primary drivers of the projected MISO transmission expenses. Transmission built by Ameren Corporation or by one of its unregulated subsidiaries would not result in revenue benefits for Ameren Missouri's ratepayers, although they would bear a portion of the construction costs if MISO determines that the transmission projects are Multi-Value Projects.[284] Revenues, by contrast, would inure solely to the benefit of whoever built the transmission facility.[285]

Staff opposes the Transmission Tracker proposed by Mr. Haro on behalf of the Company.[286] A tracker shifts risk from the Company to its customers.[287] As explained earlier in Staff's *Initial Brief,* each such mechanism further erodes the balance of risk and opportunity that traditional cost-of-service ratemaking strikes between the utility and its customers.[288] Ameren Missouri seeks to justify these "regulatory ratchets" by insisting that regulatory lag -- and Missouri's supposedly old-fashioned, "broken"

[281] Tr. 22:1168 (Haro).

[282] Tr. 22:1168-1169, 1173 (Haro).

[283] Tr. 22:1169 (Haro).

[284] Tr. 22:1169-1170, 1171, 1172 (Haro): "Whoever gets the benefit from the usage of the transmission pays for the costs."

[285] Tr. 22:1171-1172 (Haro).

[286] As does the MIEC. Ex. 527, *Dauphinais Sur-Surrebuttal,* p. 2.

[287] *Oligschlaeger Res.,* p. 4.

[288] *Supra,* pp. 10-14.

regulatory paradigm -- are unfairly condemning it to a chronic inability to earn its authorized rate of return.[289]

The reality, however, is that Ameren Missouri is a mature utility serving a long-established and fully-developed service area. The halcyon days of enormous cash flows from new customers and new uses of electricity are over, perhaps forever. The suburbs are built. There will be very few new developments with hundreds of new homes.

Ameren Missouri faces a future characterized by nearly flat load growth, energy-efficient end-uses, and escalating costs from increasingly strict environmental mandates and the ongoing need to maintain its aging infrastructure.[290] This situation does not call for a revision of Missouri's cost-of-service ratemaking paradigm; however, it calls for a revision of the expectations of Ameren Missouri's shareholders. The answer is not, as the Company urges, to create risk-shifting mechanisms to artificially maintain a level of profit characteristic of an earlier phase in the Company's development, but to find a "steady state" reflective of a mature utility serving a populous but full-developed service area. Risk-shifting mechanisms should be reserved for the expected areas of escalating costs, particularly (1) environmental mandates and (2) infrastructure replacement. That is what good public policy looks like.

Staff further opposes the Transmission Tracker because it "singles out an individual rate element for possible special rate treatment without examination of other,

[289] Public Counsel Lewis Mills colorfully, and accurately, described such risk-mitigation devices as "regulatory ratchets" because they change the balance of the regulatory compact and they never go away.

[290] Tr. 26:1589 (Hevert). Ameren Missouri's *Integrated Resource Plan* ("IRP") shows that expected load growth over the next twenty years is 0.75%.

potentially offsetting, changes in a utility's revenue requirement caused by fluctuations in its rate base, expenses, required rate of return and revenues."[291] It is an unjustified departure from the "all relevant factors" ratemaking required by Missouri law.[292] It will ensure Ameren Missouri's recovery of one item of cost, to the certain detriment of the Company's ratepayers, because the Company will no longer have any incentive to minimize these costs.[293]

Staff also opposes the Transmission Tracker because Ameren Missouri does not meet the three criteria that led Staff to support such a transmission tracker in a prior case.[294] Those criteria are:[295]

> (1) The historical growth and current high level of transmission expenses;
>
> (2) The uncertainty in the levels of future transmission expenses; and
>
> (3) The lack of Company control over the level of transmission expenses compared to the level of Company control over most of its other expenses.

As Mr. Haro testified, Ameren Missouri's MISO transmission costs net of MISO revenues are not presently high at all;[296] there is no uncertainty as to future net MISO

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[291] *Oligschlaeger Res.,* p. 4.

[292] Indeed, all trackers may well be unlawful under the rule announced in ***St. ex rel. Utility Consumers' Council v. Public Service Commission of Missouri et al.,*** 585 S.W.2d 41, 56-58 (Mo. banc 1979) "***UCCM***"). SB 179, which authorized the FAC and certain other "adjustment mechanisms," does not provide for a transmission tracker such as is proposed here and which is objectionable for the same reason as the FAC disallowed by the Missouri Supreme Court in ***UCCM***.

[293] *Dauphinais Sur-Surr.,* p. 4.

[294] The case, or more properly, cases were ***In the Matter of Kansas City Power & Light Company,*** Case No. ER-2010-0355, and ***In the Matter of KCPL Greater Missouri Operations Company,*** Case No. ER-2010-0356. Tr. 22:1345-1346 (Oligschlaeger).

[295] Ex. 26, *Haro Sur-Surrebuttal,* p. 23; *Oligschlaeger Res.,* p. 5; *Dauphinais Sur-Surr.,* p. 5. *See* Commission Rule 4 CSR 240-20.090(2)(C).

[296] Tr. 22:1166 (Haro).

transmission cost levels, rather, the evidence is that they are expected to increase by about $2 million next year and $10 million the year after that;[297] and Ameren Missouri is represented on the MISO board.[298] Ameren Missouri does not meet these three criteria and simply does not qualify for a tracker.[299] As Staff expert witness Oligschlaeger testified, "Staff asserts that Ameren Missouri has failed to demonstrate that it has met the first and second tests laid out in the KCPL and GMO 2010 rate cases; i.e., that its current level of net transmission expense is high and that its future level of net expenses is uncertain and likely to increase significantly."[300]

MIEC expert witness Dauphinais testified, "A $3.4 million increase in transmission expenses by the end of 2013 and another $6.6 million by the end of 2014 is miniscule in comparison to the total revenue requirement increase the Company has requested in this proceeding . . . These anticipated changes do not rise to a magnitude that justifies them being tracked through a Transmission Tracker."[301] Mr. Oligschlaeger agreed, stating, "Even considered in isolation, however, the expected annual increases in transmission expenses shown in Mr. Haro's testimony are not of a sufficient magnitude to suggest that use of extraordinary ratemaking measures, such as a tracker, is justified in this instance."[302] Mr. Oligschlaeger further testified that this Commission has never authorized a tracker, AAO or other such device on the basis of *projected*

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[297] Tr. 22:1166-1167, 1176 (Haro). Expected increases in a cost are not volatility. Tr. 22:1153 (Barnes). Staff notes that it does not concede that the cost increases projected by Ameren Missouri are certain.

[298] Tr. 22:1177-1178 (Haro).

[299] *Oligschlaeger Res.,* p. 6; *Dauphinais Sur-Surr.,* p. 5.

[300] *Oligschlaeger Res.,* p. 6.

[301] *Dauphinais Sur-Surr.,* p. 6.

[302] *Oligschlaeger Res.,* at p. 8.

future revenue requirement increases, but has done so only based upon a demonstration of presently increasing costs.[303] As of right now, as the Commission decides this issue, Ameren Missouri has not shown that its MISO transmission costs are increasing.

Should the Commission nonetheless authorize a Transmission Costs and Revenues Tracker for Ameren Missouri, then the ratepayers should be protected by the imposition of certain conditions, as described by Staff expert witness Mark Oligschlaeger.[304] In summary, those conditions are:[305]

(1) The tracker should include MISO revenues as well as MISO costs;

(2) The Company should provide reports to Staff and all other parties to this case, including:

- Monthly billings from MISO for all MISO rate schedules that contain charges and revenues that will be included in the tracker and will report, per its general ledger, all expenses and revenues included in the tracker by FERC USOA account and Ameren Missouri minor account;

- Quarterly internal reports used to manage ongoing transmission costs and revenues;

- Notification of any reporting changes.

(3) Ratemaking treatment, including a review of prudence, to be reserved to the next general rate case;

(4) Imputation into the tracker of MISO transmission revenues earned by ATX, ATXI, and any other unregulated Ameren Missouri affiliate from facilities in Ameren Missouri's service area;

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[303] Tr. 22:1345-1346 (Oligschlaeger).

[304] *Id.,* at pp. 9-11.

[305] *Id.*

(5) No superseding or modifying effect on previous Commission orders or agreements concerning Ameren Missouri's involvement in MISO or treatment of MISO transmission revenues and expenses and the provisions of sections 10.c, "Incentive Adders" and 10.j, "Rate Treatment – Affiliate Owned Transmission" within the *Non-Unanimous Stipulation and Agreement* filed in Case No. EO-2012-0128 shall be extended through Ameren Missouri's next general rate proceeding.[306]

(6) Deferrals of under-collections into the tracker cease when, and for as long as, Ameren Missouri's reported return on equity ("ROE') exceeds its authorized ROE on an overall basis; and, likewise, deferrals of over-collections into the tracker cease when, and for as long as, Ameren Missouri's reported ROE is below its authorized ROE on an overall basis.

In summation, Staff urges the Commission to deny Ameren Missouri's request for a Transmission Cost and Revenue Tracker in the event that the Commission chooses to exclude MISO transmission charges from the FAC; however, if the Commission nonetheless grants the requested tracker, then it should impose upon it conditions designed to protect the ratepayers as described in the testimony of Mark Oligschlaeger and summarized above.

F. Should hedging gains and losses be excluded from Ameren Missouri's FAC except for hedging gains and losses associated with mitigating volatility in its fuel costs and allowances for SO2 and NOx emissions?

The parties have resolved this issue by *Stipulation and Agreement.*

G. What other changes should be made to Ameren Missouri's FAC tariff?[307]

The parties have resolved this issue by *Stipulation and Agreement.*

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[306] Filed on November 17, 2011 and approved by the Commission on April 19, 2012.

[307] Also erroneously designated "F" on the *Joint Revised Hearing Schedule* filed by Staff.

11. Coal Inventory, including Coal in Transit:[308]

Should the value of Ameren Missouri's coal inventory include the value of coal in transit?

Ameren Missouri contends that, at any given moment, it owns a significant amount of coal that is in transit by rail to its facilities and that the value of this coal should be included in its inventory in rate base.[309] Staff's position is that coal in transit has never been included in rate base in Missouri[310] and should not now be included in rate base because, as it has not yet been paid for by Ameren Missouri,[311] it does not represent any amount of shareholder investment.

Staff determined the amount of coal-on-hand to include in Ameren Missouri's cost-of-service by a 13-month average of coal inventory through April 30, 2012, adjusted to reflect inventory levels and coal prices that will be in effect as of July 31, 2012.[312] This is the method Staff has always used for this item. Although Company witness Robert Neff asserted otherwise,[313] the truth is that coal-in-transit has never been included in the value of rate base or in the revenue requirement.[314] Additionally, inclusion of coal-in-transit would increase Ameren Missouri's inventories above the

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[308] The *force majeure* coal inventory issue has been resolved by the parties. Tr. 25:1388.

[309] *Neff Rebuttal,* p. 5. The value, which is HC, is under $10 million. *Id.; Meyer Surr.,* p. 28.

[310] Ex. , *Hanneken Surr.,* p. 3.

[311] Tr. 24:1408, 1410, 1414, 1421; Tr. 25:1400-1401 HC (Neff). The fact that the coal is not paid for until two-weeks after delivery is not Highly Confidential.

[312] *RR Report,* p. 62.

[313] *Neff Rebuttal,* p. 5; Tr. 24:1409 (Neff).

[314] *Hanneken Surr.,* p. 3; Tr. 24:1436 (Hanneken). Mr. Neff asserted that he had examined Ameren Missouri's last five rate cases and found that coal-in-transit was included in rate base in one case and excluded in the other four. Tr. 24:1412 (Neff). However, the case in which coal-in-transit was purportedly included was resolved via a black-box settlement, so it is not known what was actually included. Tr. 24:1415-1416 (Neff).

levels specified by its own policies.[315] This consideration also weighs against including coal-in-transit.[316] An additional reason to deny the Company's request, which was disclosed at the hearing, is that $53 million is included in Cash Working Capital for coal, including coal-in-transit, so granting the Company's request would permit Ameren Missouri a double recovery on this item.[317]

For all of these reasons, Staff urges the Commission to exclude coal-in-transit from Ameren Missouri's cost-of-service.

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12. Return on Common Equity ("ROE"):

In consideration of all relevant factors, what is the appropriate value for Return on Equity ("ROE") that the Commission should use in setting Ameren Missouri's Rate of Return?

Introduction

Staff has determined, based upon its expert analysis of market-driven data using traditional analytical tools, that Ameren Missouri's cost of common equity is within the range of 8.00% to 9.00%, mid-point 8.50%, which should be combined with Ameren Missouri's August 31, 2012, capital structure, cost of debt and cost of preferred stock to arrive at the allowed rate of return ("ROR") in this case. Staff recommends that, based on a consideration of all relevant factors, the Commission authorize a return on common equity ("ROE") in the range of 9.0, Mr. Murray's recommendation, and the third

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[315] *Hanneken Surr.,* pp. 3-4; *Meyer Surr.,* pp. 27-28.

[316] *Hanneken Surr.,* p. 4.

[317] Tr. 24:1423-1424, 1437-1438, 1439-1440 (Hanneken) and Sch. GSW-E5.

quarter national average of awarded ROEs of 9.9,[318] mid-point 9.45, which is within Mr. Gorman's recommended range of 9.3 to 9.5 and almost identical to his recommended ROE of 9.4.of 9.00%.

What is the significance of this Issue?

Cost of capital is the largest single issue in this case – the difference between Staff's position and the Company's is worth over $83 million.[319] Cost of capital is always a large issue in terms of the amount of revenue requirement and also a contentious issue in a general rate case; this case is no exception. The term "cost of capital" refers to the cost of each component of the capital structure, typically long-term debt, preferred equity and common equity.[320] The cost of both long-term debt and preferred equity is historic or "embedded" and can be readily determined from the controlling instruments.[321] The cost of common equity, on the other hand, is driven by the market and must be estimated through expert analysis and judgment. Three expert financial analysts testified before the Commission in this case and offered recommendations to the Commission for the cost of common equity as set out below.[322] Each of the expert witnesses testified that he recognized the others as experts.[323] Each of the expert witnesses testified that an authorized ROE anywhere within his

[318] Tr. 26:1650 (Hevert).

[319] Ex. 409, *Staff's True-up Reconciliation.*

[320] Short-term debt, that is, debt payable in less than one year, is typically excluded.

[321] For example, the interest rate on a corporate bond can be determined by examining the indenture.

[322] Mr. Hevert, Mr. Gorman and Mr. Murray all have MBAs and are Chartered Financial Analysts. Tr. 26:1573-1574 (Hevert).

[323] Tr. 26:1618 (Hevert); 26:1763-1764 (Gorman); 30:2014-2015 (Murray).

recommended range would be appropriate.[324]

SUMMARY OF ROE RECOMMENDATIONS:		
Hevert	Company	10.25 to 11.00, **10.50**[325]
Gorman	MIEC	9.20 to 9.40, **9.30**[326]
Murray	Staff	8.00 to 9.00, **9.00**[327]

Table 1.

Additionally, the Office of the Public Counsel, while not sponsoring an expert cost-of-capital witness, has urged the Commission to set Ameren Missouri's allowed ROE at the low end of Staff expert witness David Murray's range, 8.00%.[328]

In addition to the Company's prudent operating and maintenance expenses, revenue requirement includes both a return "of" and a return "on" the net current value of the shareholders' investment. The former is provided by depreciation expense; the latter by the rate of return. The rate of return is a multiplier which, applied to the net current rate base, results in the return or "profit" allowed to the investors in return for the use of their private property in serving the public.[329] The Due Process Clause requires that the shareholders be allowed an opportunity to earn a reasonable return on their investment.[330] Pursuant to financial theory, a fair rate of return is an amount sufficient to meet the utility's capital costs. For this reason, the rate of return is considered to be equivalent to the Weighted Average Cost of Capital ("WACC"). The WACC is computed

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[324] Tr. 26:1630 (Hevert); 26:1697-1698, 1711 (Gorman); 30:1971 (Murray).

[325] Ex. , *Hevert Rebuttal,* p. 112; Tr. 26:1575, 1629 (Hevert).

[326] Ex. , *Gorman Dir.,* p. 2; Tr. 26:1697-1698 (Gorman).

[327] *RR Report,* p. 13; Tr. 30:1978-1979 (Murray).

[328] Tr. 26:1501-1502 (Opening Statement of Ms. Christina Baker).

[329] *RR Report,* p. 14.

[330] ***UCCM,*** *supra,* 585 S.W.2d at 49.

by multiplying a ratio reflecting the proportion that each capital component constitutes of the whole by its cost and summing the results. The Commission does not set the rate of return directly, but sets the ROE which is a component of the rate of return. In this way, the Commission indirectly sets the rate of return.

Determination of the Cost of Common Equity

The cost of common equity capital must be estimated. This is a difficult task, as academic commentators have recognized.[331] It is said that this "is an area of ratemaking in which agencies welcome expert testimony and yet must often make difficult choices between conflicting testimony."[332] The evaluation of expert testimony is left to the Commission, which “may adopt or reject any or all of any witness’s [sic] testimony.”[333]

A matter of terminology arises at the outset. Staff maintains that the cost of equity ("COE") is distinct from the return on equity ("ROE"); a position in which neither Mr. Hevert or Mr. Gorman concur. Nonetheless, the truth of Staff's position is readily apparent. The COE is the return necessary to induce investors to invest in the utility's common stock; it is a market-driven value that must be discerned by the experts through analysis and judgment. The ROE is the figure set by the Commission. The ROE has often been referred to in this case as the "allowed ROE" or "authorized ROE"

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[331] C.F. Phillips, Jr., ***The Regulation of Public Utilities: Theory & Practice*** 394 (PUR: Arlington, VA, 1993); L.S. Goodman, 1 ***The Process of Ratemaking***, 606 (PUR: Vienna, VA, 1998).

[332] Goodman, *supra,* 606.

[333] ***State ex rel. GS Technologies Operating Company, Inc. v. Public Service Commission of Missouri,*** 116 S.W.3d 680, 690 (Mo. App., W.D. 2003); ***State ex rel. Associated Natural Gas Company v. Public Service Commission,*** 37 S.W.3d 287, 294 (Mo. App., W.D. 2000) (quoting ***State ex rel. Associated Natural Gas Company v. Public Service Commission,*** 706 S.W.2d 870, 880 (Mo. App., W.D. 1985)).

in contradistinction to the "earned ROE," which is a measure of the utility's actual financial performance over some past period of time. The COE and ROE may be the same number, but they don't have to be. The experts all recognized that the Commission in its discretion can set the ROE at, above or below the COE, with various consequences.

The COE is the return necessary to induce investors to invest in the utility's common stock, or, put slightly differently, "[a] utility's cost of common equity is the return investors require on an investment in the utility."[334] According to Mr. Hevert, "the key consideration in determining the Cost of Equity is to ensure that the methodologies employed reasonably reflect investors' view of the financial markets in general, and the subject company (in the context of the proxy group) in particular."[335] Mr. Hevert testified:

> When you look at the methods that we use, which is that -- we look at data from thousands of investors in the process that they use to form prices. And we infer from that the return that they require. . . . a lot of this cost of equity information is based upon the notion of opportunity cost, meaning the return you would get on one investment is the [return] that you forgo by not investing somewhere else as a similar risk.[336]

Constitutional Parameters:

The United States Supreme Court, in two frequently-cited decisions, has established the constitutional parameters that must be met in setting the cost of

[334] *Gorman Dir.,* p. 11.

[335] *Hevert Dir.,* p. 18.

[336] Tr. 26:1619-1620 (Hevert).

common equity.[337] Each of the experts has affirmed that he conducted his studies and made his recommendations with these parameters in mind. In the earlier of these two cases, ***Bluefield Water Works***, the Court stated that:

> Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.[338]

In the same case, the Court provided the following guidance as to the return due to equity owners:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public 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; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.[339]

The Court restated these principles in ***Hope Natural Gas Company***, the later of the two cases:

> '[R]egulation does not insure that the business shall produce net revenues.' But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the

[337] ***Federal Power Commission v. Hope Natural Gas Company***, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); ***Bluefield Water Works & Improvement Company v. Public Service Commission of West Virginia***, 262 U.S. 679, *43 S.Ct. 675, 67 L.Ed. 1176* (1923).

[338] ***Bluefield***, *supra,* 262 U.S. at 690, 43 S.Ct. at 678, 67 L.Ed. at 1181.

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

> debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.[340]

From these two decisions, three guiding principles can be discerned:

(1) An adequate return is commensurate to the returns realized from other businesses with similar risks. This is the principle of the commensurate return.

(2) An adequate return is sufficient to assure confidence in the financial integrity of the utility and to maintain the utility's credit rating. This is the principle of financial integrity.

(3) An adequate return is sufficient to enable the utility to obtain necessary capital. This is the principle of capital attraction.

The first of these principles is based on risk and requires a comparative process. The return on common equity set by the PSC must be about as much as investors would realize from other investments with similar risks. What entities are those? Other public utilities. Financial analysts and investors recognize that every line of business is, by its very nature, subject to a set of unique risks. Consequently, the business entities that face corresponding risks and uncertainties to the utility under consideration are necessarily other utilities engaged in delivering the same service under similar conditions. Therefore, the Commission must look to the returns realized by a proxy group of comparable companies in setting the utility's return on common equity.

The second principle, simply stated, refers to the effect of the PSC's decision on the utility's credit rating. If the Commission's decision will not cause it to drop, then the

[340] ***Hope***, *supra,* 320 U.S. at 603, 64 S.Ct. 288, 88 L.Ed. 345 (citations omitted).

utility's credit is maintained and confidence that the utility will continue in business in the future, meeting its obligations as they come due, providing safe and adequate service to its customers, and yielding a fair return to its shareholders is unimpaired.

The third principle refers to the utility's ability to compete in the market place for necessary capital. Ameren Missouri competes for capital with other utilities and utilities likewise compete with unregulated businesses.[341]

Methodology for Determining the Cost of Equity:

Two principal methods have emerged for determining the cost of common equity: these are the "market-determined" approach and the "comparable earnings" approach.[342] The market-determined approach relies upon stock market transactions and estimates of investor expectations.[343] Examples of market-determined methods are the Discounted Cash Flow method ("DCF") and the Capital Asset Pricing Model ("CAPM").[344] The comparative earnings approach is a comparative method and relies upon the concept of "opportunity cost," that is, the return the investment would have earned in the next best alternative use.[345] The comparative earnings approach requires a comparative study of earnings on common equity in both regulated and unregulated enterprises of similar risk.[346] Another frequently-encountered method that does not fall within the boundaries of either of the principal approaches referred to above is the Risk

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[341] Tr. 26:1711-1712, 1759 (Gorman).

[342] Phillips, *supra,* 394.

[343] *Id.*

[344] *Id.*

[345] *Id.,* at 397.

[346] *Id.,* at 397-98.

Premium method ("RP"). This method is "relatively straightforward" and requires that the analyst "(1) determine the historic spread between the return on debt and the return on common equity, and (2) add this risk premium to the current debt yield to derive an approximation of current equity return requirements."[347]

In the final analysis, the method employed to estimate the cost of common equity is unimportant, as long as the result that is reached satisfies the constitutional requirements.[348] "If the total effect of the rate order cannot be said to be unjust or unreasonable, judicial inquiry is at an end."[349] "It is the impact of the rate order which counts; the methodology is not significant."[350] Within a wide range of discretion, the PSC may select the methodology.[351] The Commission may select its methodology in determining rates and make pragmatic adjustments called for by particular circumstances.[352] It may employ a combination of methodologies and vary its approach from case-to-case and from company-to-company.[353] "No methodology being statutorily prescribed, and ratemaking being an inexact science, requiring use of different

[347] *Id.,* at 399.

[348] ***State ex rel. Arkansas Power & Light Company v. Missouri Public Service Commission,*** 736 S.W.2d 457, 462 (Mo. App., W.D. 1987); ***State ex rel. Associated Natural Gas Company v. Public Service Commission of Missouri,*** 706 S.W.2d 870, 879 (Mo. App., W.D. 1985).

[349] ***Hope***, *supra,* 320 U.S. at 602, 64 S.Ct. at 287, 88 L.Ed. 345 at ___ .

[350] ***State ex rel. GTE North, Inc. v. Public Serv. Commission,*** 835 S.W.2d 356, 361, 371 (Mo. App., W.D. 1992).

[351] ***Missouri Gas Energy v. Public Service Commission***, 978 S.W.2d 434 (Mo. App., W.D. 1998), *rehearing and/or transfer denied*; ***State ex rel. Associated Natural Gas Company v. Public Service Commission***, 706 S.W.2d 870, 880, 882 (Mo. App., W.D. 1985); ***State ex rel. Missouri Public Service Company v. Fraas***, 627 S.W.2d 882, 888 (Mo. App., W.D. 1981).

[352] ***State ex rel. Associated Natural Gas Company v. Public Service Commission of Missouri,*** 706 S.W.2d 870, 880 (Mo. App., W.D. 1985).

[353] ***State ex rel. City of Lake Lotawana v. Public Service Commission***, 732 S.W.2d 191, 194 (Mo. App., W.D. 1987).

formulas, the Commission may use different approaches in different cases."[354] The Constitution "does not bind ratemaking bodies to the service of any single formula or combination of formulas."[355] "Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances."[356]

The Proxy Groups:

Guided by the principle of the commensurate return, and because Ameren Missouri's stock is not publicly traded, each analyst employed a proxy group of publicly-traded companies selected to reflect the investment risk characteristics of Ameren Missouri.[357]

Company witness Robert Hevert assembled a proxy group of companies that he asserted "all possess a set of operating and risk characteristics that are substantially comparable to Ameren Missouri‟s electric utility operations, and thus provide a reasonable basis for the derivation and assessment of ROE estimates."[358] In his rebuttal testimony, Mr. Hevert revised his recommendation based on performing all of

[354] ***Arkansas Power & Light,*** *supra,* 736 S.W.2d at 462.

[355] ***Federal Power Commission v. Natural Gas Pipeline Company***, 315 U.S. 575, 586, *62 S.Ct. 736, 743, 86 L.Ed. 1037, 1049-50* (1942).

[356] *Id.*

[357] And to mitigate the biasing effects of transitory, anomalous events. *Hevert Dir.,* p. 14. Mr. Hevert testified, "By necessity, you have to use proxy groups because you cannot rely -- for the reasons we talked about a minute ago, you can't rely on a single company. There could be all sorts of the anomalies that would be in the data that could significantly skew your result. And you also have the issue of opportunity cost and comparable risk, comparable return standards. So it's important to use proxy groups in developing the cost of equity." Tr. 26:1651 (Hevert).

[358] *Hevert Dir.,* p. 14; "The whole point of constructing a proxy group is to put together a group of enterprises that are of similar risk." Tr. 26:1620. Mr. Hevert's original proxy group of eleven companies included American Electric Power, Cleco Corp., Edison International, Great Plains Energy, IDACORP, Integrys Energy Group, Otter Tail Corporation, Pinnacle West Capital, Portland General Electric, Southern Company, and Westar Energy. *Hevert Dir.,* p. 17.

his analyses again, this time on two proxy groups: one being his original proxy group with the addition of The Empire District Electric Company; the other being a combination of his revised proxy group and David Murray's proxy group.

Staff witness David Murray selected a proxy group of ten companies.[359] Seven companies appeared both in Mr. Hevert's original proxy group and in Mr. Murray's proxy group.[360] Mr. Gorman used Mr. Hevert's original proxy group.[361] All of the proxy groups include only companies classified as "electric utilities" by Value Line, that are not in the process of merging, that consistently pay dividends, that are at least investment grade, and that derive the majority of their revenues from vertically-integrated, regulated electric utility operations.[362] Mr. Murray criticized Hevert's proxy group and stated that Edison International, Otter Tail and Integrys were inappropriate choices for various reasons.[363] Specifically, Edison International's credit ratings have been directly impacted by its non-regulated merchant generation subsidiary, Edison Mission Group, which is the same risk posed on Ameren by its non-regulated merchant subsidiary, Ameren Generating Company. Ratepayers of regulated utilities should not be charged a higher cost of capital due to the regulated utilities affiliation with these higher-risk affiliates.[364]

[359] Alliant Energy, American Electric Power, Cleco Corp., Great Plains Energy, IDACORP, Pinnacle West Capital, Southern Company, Westar Energy, Wisconsin Energy, and Xcel Energy. *RR Report,* App. 2, Sch. 8.

[360] American Electric Power, Cleco Corp., Great Plains Energy, IDACORP, Pinnacle West Capital, Southern Company, and Westar Energy.

[361] *Gorman Dir.,* p. 12.

[362] *Hevert Dir.,* pp. 16-17;

[363] *Murray Rebuttal,* pp. 6-11.

[364] *Murray Rebuttal,* pp. 6-9.

The Experts' Analytical Methods:

The analysts all used variants of the same analytical methods, relying on market-based data to quantify investor expectations regarding required equity returns.[365] Each analyst used the DCF method, the CAPM and the RP method. In its simplest, "constant growth" form, the DCF is simply the sum of the dividend yield and a growth rate.[366] The dividend yield is calculated by dividing the annualized dividend by the current stock price.[367] Each analyst also performed one or more multi-stage DCFs, in which a different growth rate is specified for each of several stages.[368] Staff expert witness Murray testified, "The ability of a multi-stage DCF analysis to reliably estimate the cost of common equity is primarily driven by the analyst using a reasonable growth rate for the final stage because this rate is assumed to last in perpetuity."[369]

The CAPM's inputs are the risk-free rate, the market-risk premium, and beta, a coefficient unique to each company that expresses its risk compared to that of the market as a whole. Regulated electric utilities are generally less risky than the market as a whole and thus have betas less than one, as Mr. Hevert testified:

> I don't think there's any disagreement among anyone here that utilities are less risky and that the market utilities typically have beta coefficients of less than one. And beta coefficients, of course, are a measure of the relative volatility of a stock. And when I say relative, I mean relative to the broader market. So in that sense, we all agree that utility stocks are less volatile than the overall market and, therefore, are less risky than the overall market.[370]

[365] *Hevert Dir.,* p. 18.

[366] *Gorman Dir.,* pp. 13-14; *Hevert Dir.,* p. 21; *RR Report,* p. 27.

[367] *See Hevert Dir.,* Sch. RBH-E1.

[368] *Hevert Dir.,* p. 25.

[369] *RR Report,* p. 30.

[370] Tr. 26:1577 (Hevert).

The Expert's Analytical Results:

Company witness Hevert performed constant growth DCF analyses and two multi-stage DCF analyses and based his recommendation primarily on the results of those studies.[371] He also performed CAPM studies, and a Bond Yield Plus Risk Premium approach to support his recommended return for Ameren Missouri.[372] For his three constant growth DCFs, Mr. Hevert used mean growth rates of 5.06, 4.86 and 5.05; the average of which is 5.07, and median growth rates of 4.80, 5.00 and 5.50, the average of which is also 5.07.[373] His results ranged from 8.79 to 11.07.[374] For his two multi-stage DCFs, Hevert used a growth rate of 5.07 for Stage 1, a linear transition for Stage 2, and 5.67 for the terminal stage.[375] His results ranged from 7.90 to 12.67.[376] Mr. Hevert also performed a CAPM and a RP analysis as checks on reasonableness.[377] Mr. Hevert's CAPM results are based on two different forward-looking equity risk premium estimates.[378] The first is based on his application of the DCF to the S&P 500 to determine an expected market return.[379] The second is based on a novel approach that involves analyzing excess returns as compared to option volatility (Sharpe/Vix

[371] *Hevert Dir.,* p. 18; *Murray Rebuttal,* p. 2; Tr. 26:1581, 1583 (Hevert).

[372] *Gorman Dir.,* p. 40.

[373] *Hevert Rebuttal,* Sch. RBH-ER10.

[374] *Hevert Rebuttal,* p. 108, Table 17.

[375] *Hevert Rebuttal,* p. 108; Tr. 26:1583-1586 (Hevert).

[376] *Hevert Rebuttal,* p. 110, Table 18.

[377] *Murray Rebuttal,* p. 2.

[378] *Id.*

[379] *Id.*

ratio).[380] Mr. Hevert's updated CAPM results ranged from 8.48 to 10.76.[381] Mr. Hevert's RP is based on the spread of Commission-allowed ROEs as they compare to 30-year Treasury bond yields over an historical period.[382] His updated RP results range from 9.96 to 10.94, mean 10.35.[383]

Staff witness David Murray determined Ameren Missouri's COE through a comparable company cost-of-equity analysis of a proxy group of ten companies using the DCF method.[384] Additionally, Mr. Murray used a CAPM analysis and a survey of other indicators as a check of the reasonableness of his recommendations.[385] For his constant growth DCF, Mr. Murray used a growth rate of 5.0 to 5.5 based on equity analysts' 5-year EPS growth forecasts; his results were 9.1 to 9.6.[386] However, Mr. Murray does not believe that his constant growth DCF produced reliable results and therefore placed primary emphasis on his multi-stage DCF.[387] Mr. Murray used a three-stage DCF and used the analysts' 5-year EPS growth forecasts for his Stage 1 growth rate, average of 5.4, transitioning through Stage 2 to his Stage 3 growth rate, 3.0 – 4.0; his results ranged from 7.8 to 8.6.[388] Mr. Murray emphasizes that it is not reasonable to assume that electric utilities can grow at the same rate as nominal Gross Domestic

[380] *Id.*

[381] *Hevert Rebuttal,* p. 111.

[382] *Murray Rebuttal,* p. 2.

[383] *Hevert Rebuttal,* p. 111.

[384] *RR Report,* p. 25.

[385] *Id.*

[386] *RR Report,* pp. 28-29.

[387] *RR Report,* pp. 29-30.

[388] *RR Report,* p. 30.

Product ("GDP") in perpetuity,[389] an opinion firmly supported by Staff's historical studies showing that Central Region electric utilities grew at less than half of GDP between 1968 and 1999.[390] Mr. Murray's CAPM results were 7.06 and 5.96.[391] Mr. Murray also performed a "Rule of Thumb" analysis, in which a risk premium is added to the yield-to-maturity of the subject company's long-term debt.[392] His results ranged from 7.92 to 9.52.[393]

MIEC witness Michael Gorman performed three versions of the DCF, a CAPM and a RP analysis, using Hevert's original proxy group.[394] Mr. Gorman performed a constant-growth DCF using equity analysts' growth rates, a constant-growth DCF using sustainable growth rates, and a multi-stage DCF analysis.[395] The average of the analysts' growth rates he used in his constant growth DCF was 4.84 and his results ranged from 9.3 to 9.9.[396] In his sustainable growth DCF, Mr. Gorman used an average growth rate of 4.20 and his results ranged from 8.47 to 8.63.[397] For his multi-stage DCF, Mr. Gorman used analyst growth rates for Stage 1, transitioning through Stage 2

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[389] *RR Report,* p. 32.

[390] *RR Report,* p. 33. Staff provided a thorough and un-rebutted analysis of the trends in the growth of utilities and GDP since 1947. The data from the Bureau of Economic Analysis shows that the utility industry's contribution to GDP has been declining since the late 1990s, which refutes the assumption that utilities would be expected to maintain the same growth as GDP in perpetuity. While Mr. Murray did find that there was some correlation of electric utility growth to GDP growth, Mr. Murray found that this aggregate growth was diluted by 50% due to electric utilities issuance of additional common equity because of high dividend payout ratios. Consequently, if aggregate GDP growth rates were to be used as proxy for electric utility growth, it would need to be cut in half to take into consideration this dilution.

[391] *RR Report,* p. 47.

[392] *RR Report,* p. 47.

[393] *RR Report,* p. 48.

[394] *Gorman Dir.,* p. 3, 11-12; *Murray Rebuttal,* pp. 2-3.

[395] *Murray Rebuttal,* pp. 2-3.

[396] *Gorman Dir.,* p. 16.

[397] *Gorman Dir.,* p. 17.

to the consensus analysts' projected U.S. nominal GDP growth rate of 4.9 for Stage 3.[398] His result was 9.4.[399] It is noteworthy that Mr. Gorman used nominal GDP for his Stage 3 growth rate despite acknowledging that, in reality, utility sales grow at a slower rate than does the GDP.[400] The average of all of Gorman's DCF results was 9.11.[401] Mr. Gorman also performed two different RP analyses; his results for the first were 8.11 to 9.83; his results for the second were 8.04 to 9.63.[402] Mr. Gorman's final RP results were 9.1 to 9.3, midpoint 9.2.[403] Mr. Gorman also performed a CAPM.[404] His result was 8.65 (rounded to 8.7), based on a risk-free rate of 3.7, a beta of 0.75, and a market-risk premium of 6.6.[405] For his final recommendation, Mr. Gorman relied on his DCF and RP results.[406]

Analytical Flaws and Errors:

Each of the three expert witnesses criticized the work product and recommendations of the other two. Nonetheless, it is noteworthy that both Mr. Hevert and Mr. Gorman refused to characterize Murray's recommendation as confiscatory.[407] Mr. Hevert testified, "An ROE set at the edge of legal confiscation would be too low to

[398] *Gorman Dir.,* p. 22, 24-25; consisting of real GDP growth of 2.5 to 2.8 and inflation of 2.1 to 2.2. *Id.*

[399] *Gorman Dir.,* p. 26.

[400] *Gorman Dir.,* p. 23.

[401] *Gorman Dir.,* p. 26.

[402] *Gorman Dir.,* pp. 26-30. Gorman assigned a weight of 2/3 to his high end result, 9.83, and 1/3 to his low end result, 8.11. *Id.,* at 28.

[403] *Gorman Dir.,* p. 30.

[404] *Gorman Dir.,* pp. 31-36.

[405] *Gorman Dir.,* p. 36.

[406] *Id.*

[407] Tr. 26:1618-1619 (Hevert); 26:1763-1764 (Gorman).

be considered."[408]

SUMMARY OF ANALYTICAL METHODS, CRITICAL INPUTS AND RESULTS		
HEVERT		
Method	**Growth Rates**	**Results**
Constant-growth DCFs	Mean: 5.06, 4.86, 5.05 (5.07) Median: 4.80, 5.00, 5.50 (5.07)	8.79-11.07
Multi-stage DCFs	Stage 1: 5.07 Stage 3: 5.67	7.90-12.67
CAPMs	Equity-risk premium: 5.55-5.61 Equity risk premium: 8.42 Equity-risk premium: 10.25	8.48-10.76
Bond Yield Plus RP	--	9.96-10.94
MURRAY		
Constant-growth DCF	5.0-5.5	9.10-9.60
Multi-stage DCF	Stage 1: 5.4 Stage 3: 3.0-4.0	7.80-8.60
CAPM	4.10-5.70	5.96-7.06
Rule of Thumb	--	7.92-9.52
GORMAN		
Constant-growth DCF	4.84	9.30-9.90
Sustainable-growth DCF	4.20	8.47-8.63
Multi-stage DCF	Stage 1: 4.84 Stage 3: 4.90	9.40
CAPM	Market-risk premium: 6.6	8.65-8.70
RPs	--	8.11-9.83 8.04-9.63

Table 2

Mr. Gorman criticized Mr. Hevert's refusal to recognize that capital market costs have declined.[409] In fact, Mr. Hevert's stubborn effort to group utility stocks with the broader volatility of the S&P 500 collapsed under cross-examination and he admitted

[408] Tr. 26:1655-1656 (Hevert).

[409] *Gorman Surr.*, p. 2.

that the cost of capital has declined since Ameren Missouri's last rate case.[410] Gorman and Hevert also disagreed that the market views electric utilities as safe, low risk investments.[411] Mr. Murray attached reports to his testimony from investment analysts that support Mr. Gorman's position.[412] In fact, Ameren itself understands that investors buy electric utility stocks for the safety of the dividend.[413] As Mr. Gorman noted, the current situation of low utility bond yields and high utility share prices indicates that investors view utilities as safe investments.[414]

Mr. Gorman characterized Mr. Hevert's results as "overstated" and suggested that they be disregarded.[415] Mr. Gorman testified that he was not surprised that Hevert got the highest results, considering the inputs he chose.[416] Mr. Gorman stated:[417]

> Mr. Hevert's analyses produce excessive results for various reasons: (1) his constant and multi-stage growth DCF results are based on excessive, unsustainable growth rates, (2) his multi-stage growth DCF model does not appropriately reflect the timing of the dividend payments and includes an unreasonable transition stage dividend growth rate created by the imbalance assumption that dividend payout ratios will increase to historical levels while earning growth exceeds historical levels, (3) his CAPM is based on inflated market risk premiums and beta estimates, and (4) his Bond Yield Plus Risk Premium is based on inflated utility equity risk premiums.

Mr. Gorman described Mr. Hevert's Constant Growth DCF results as "overstated" and as "inflated and unreasonable" due to Hevert's reliance on "unsustainably high

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[410] Tr. 26:1548, 1563, 1565 (Hevert).

[411] *Gorman Surr.,* pp. 3-4.

[412] *Murray Surr.,* Sch. 1.

[413] *Murray Surr.,* p. 6.

[414] *Gorman Surr.,* p. 4.

[415] *Gorman Dir.,* p. 40.

[416] Tr. 26:1695 (Gorman).

[417] *Gorman Dir.,* pp. 40-41.

short-term (five-year) growth rate estimates."[418] Gorman also criticized Hevert's multi-stage DCF as "flawed for at least three reasons."[419] He went on to say:

> First, he relied on a long-term GDP growth rate of 5.61% as a long-term sustainable growth. Mr. Hevert's GDP growth rate is based on a nominal GDP growth rate that is considerably higher than the market GDP growth outlooks as reflected in the consensus analysts' projections. Second, Mr. Hevert's multi-stage DCF study is flawed because he reflects four quarters of dividend payments in the first two quarters after the stock is purchased. This misstatement of dividend receipts overstates the DCF return estimate. Finally, he makes an inconsistent assumption on his long-term steady-state growth rate, in combination with his long-term steady-state dividend payout ratio. The assumptions underlying these two growth outlooks are contradictory and produce an implausible transitional stage dividend growth rate outlook.[420]

In particular, Mr. Gorman singled out Hevert's use of an unsustainably high GDP growth rate and described it as "out of line and out of touch."[421] Mr. Gorman also criticized Hevert's CAPM, concluding that "his market risk premium estimates are inflated."[422] Again, he pointed out that the problem lies with Hevert's use of an irrationally high growth rate.[423] Mr. Gorman also found Hevert's Bond Yield Plus Risk Premium Study to be unreliable.[424]

Mr. Gorman also responded to Mr. Hevert's criticisms of his own analyses and his purported "adjustments" to them. He asserted that Mr. Hevert had "mischaracterized" his analyses and that Hevert had manipulated his purported

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[418] *Gorman Dir.,* p. 43.

[419] *Gorman Dir.,* p. 45.

[420] *Gorman Dir.,* pp. 45-46.

[421] *Gorman Dir.,* pp. 46-47.

[422] *Gorman Dir.,* p. 50.

[423] *Gorman Dir.,* p. 51.

[424] *Gorman Dir.,* pp. 51-55.

adjustment to Gorman's DCF in order to get higher results.[425] Mr. Gorman brushed aside Hevert's criticism of his sustainable growth DCF and noted that it "largely repudiates the construct of his own multi-stage growth DCF model," which is fundamentally a version of the sustainable growth DCF.[426] Hevert and Gorman criticized each others' multi-stage DCF analyses.[427] In particular, Mr. Gorman noted that Hevert inflated his DCF results by improper quarterly-dividend compounding.[428] Gorman noted that Hevert's purported "adjustments" to his multi-stage DCF analysis were "inappropriate" and, contrary to Hevert, actually reflected an ROE for Ameren Missouri of 9.4 to 9.6.[429] Gorman dismissed other "adjustments" by Hevert as "self-serving" and "not based on widely accepted industry data."[430] Mr. Gorman also made "adjustments" to Mr. Hevert's analyses and achieved results that supported Gorman's recommendations: "With reasonable adjustments to his proxy group's DCF, CAPM and Risk Premium return estimates, Mr. Hevert's own studies show my recommended return on equity (as described above) is reasonable for Ameren Missouri."[431]

Staff expert witness Murray also criticized Mr. Hevert's recommendation and methodology. Mr. Murray pointed out that both Hevert and Gorman performed a constant-growth DCF using equity analysts' 5-year EPS forecasts as their assumed

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[425] *Gorman Surr.,* pp. 4-6.

[426] *Gorman Surr.,* p.p. 6-9

[427] *Gorman Surr.,* pp. 9-10.

[428] *Gorman Surr.,* p. 10.

[429] *Gorman Surr.,* p. 13.

[430] *Gorman Surr.,* p. 14.

[431] *Gorman Dir.,* p. 41 and Table 6, Column 2, on p. 42.

constant growth rate.[432] Murray criticized the underlying assumption that dividends per share ("DPS") can grow in perpetuity at the same rate as equity analysts' 5-year EPS projections.[433] Murray noted that the primary reason for the wide discrepancy between his COE estimate and Mr. Hevert's COE estimate was "[g]rowth rate assumptions with the perpetual growth rate having the largest overall impact."[434]

Reviewing Hevert's multi-stage DCF results, Murray concluded that most of the difference between his results and Hevert's results was due to their different growth rates, 4.0 for Murray versus 5.61 for Hevert.[435] In particular, Murray criticized Hevert's assumption that electric utilities can grow at the same rate as the GDP in perpetuity.[436] Ameren's own internal dividend policy discussions with JP Morgan confirmed that investors would discount any growth projections above historically achieved levels of 2-3%.[437] Mr. Hevert's assumption that investors believe that electric utilities can grow at 2 to 3 times the rates achieved historically is not confirmed by Ameren's own investment considerations. Mr. Murray points out that Hevert's CAPM is fatally skewed through is use of ridiculously high equity risk premia.[438] Murray testified, "These equity risk premium estimates are far above what most investors expect as a total return for the total market, much less an additional return over the risk-free rate."[439]

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[432] *Murray Rebuttal,* pp. 2-3.

[433] *Id.*

[434] *Murray Rebuttal,* p. 5.

[435] *Murray Rebuttal,* p. 12.

[436] *Murray Rebuttal,* pp. 16-18.

[437] *Murray Surr.,* p. 8.

[438] *Murray Rebuttal,* p. 19.

[439] *Id.*

Inflated results through the use of high growth rates and unsupported high equity risk premia seems to be the theme of Mr. Hevert's work: "Mr. Hevert's inclination to inflate his equity risk premiums well above rational estimates should cause concern about Mr. Hevert's tendency to use higher estimates regardless of the cost of equity methodology employed."[440] For example, Hevert estimated a return of 12.91% for the S&P 500, when the first Quarter 2012 *Survey of Professional Forecasters* projected a return of 6.80% on the S&P 500 and Burton Malkiel projected approximately 7.0%.[441] Subtracting Hevert's risk-free rate of 3% from these returns reveals that the equity risk premium is actually about 4%, not the 10.68% used by Mr. Hevert.[442] Mr. Murray went on to say:

> As Staff explained at length in the Staff's Report, regulated electric utility companies are currently trading at a premium (in terms of price-to-earnings ratios) to the S&P 500 even though, on average, they historically have traded at a discount. While I agree with Mr. Hevert that the S&P 500 has been more volatile in the recent past, this does not translate into a higher COE for regulated utility companies. As Staff explained in the Staff Report, regulated electric utility stocks have had a cumulative total return of 38.05% over the last two years, while the S&P 500 has had a cumulative total return of 17.17%, or less than half of that of EEI's regulated electric utility index.[443]

Given the fact that 5-year EPS forecasts for Hevert's proxy group average 5.71, compared to 10.68 for the S&P 500, the observably better performance of utility stocks can only be explained by a decrease in regulated utility required ROEs, due to the very

[440] *Murray Rebuttal,* p. 20.

[441] *Murray Rebuttal,* p. 21.

[442] *Murray Rebuttal,* pp. 20-21.

[443] *Murray Rebuttal,* pp. 21-22.

low interest rate environment and investors' flight to quality, such as relatively safe electric utility stocks.[444] Mr. Hevert recognized the flight to quality, testifying:

> [I]f you recognize that in large measure part of the reason for the decline in Treasury yields has been investors looking to preserve capital, to avoid the risk of equity loss, so they buy Treasury yield -- excuse me -- buy Treasury securities for the relative safety. And as they buy securities, of course, the yield goes down. You can't say that the resulting lower yield is a function of people being less risk averse. In fact, they're more risk averse.[445]

Mr. Gorman also recognized this flight to quality, stating: "I think there's a very, very profound flight to quality in the existing marketplace and low risk securities like Treasuries and like utility securities are being sold at a premium."[446]

Evaluating the Experts:

Mr. Hevert pointed out that the Commission's difficulty is in evaluating the credibility of the inputs used by the various experts.[447] It is these inputs, after all, that drive the differences between the various experts' results and recommendations. All of the experts, as has already been shown, use much the same methods and data and their varying results are driven by their varying assumptions and inputs.[448] There is not a single right answer; rather, there is a range or spectrum of answers within which the Commission is free to choose the value that meets its regulatory goals.

A useful and entirely relevant benchmark for the Commission to consider is the

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[444] *Murray Rebuttal,* p. 22. In his updated analyses presented in his rebuttal testimony, Mr. Hevert used a growth rate of 5.07%. Tr. 26:1581 (Hevert).

[445] Tr. 26:1566-1567 (Hevert).

[446] Tr. 26:1723 (Gorman).

[447] Tr. 26:1626 (Hevert).

[448] Table, *supra,* p. ___.

trend manifest in the ROEs authorized by other state commissions.[449] That trend over the past six months is downward.[450] Mr. Gorman testified, "The cost of capital has been on a declining trend over the last few years. I think more recently in the last six months or so, it has -- has had a very noticeable drop and declined quite a bit throughout 2012."[451] For the twelve months ending June 30, 2012, the national average was 10.15.[452] For 2011, the national average was 10.22.[453] For the first quarter of 2012, the average spiked, to 10.84; but for the second quarter, the average was 9.92.[454] For the third quarter, it was 9.9.[455]

Another helpful approach is found in the cost-of-common-equity jurisprudence of the United States Supreme Court, whose ***Bluefield*** and ***Hope*** decisions have already been cited as the source of the controlling constitutional parameters: the principles of the commensurate return, financial integrity and capital attraction.[456] The Supreme Court's ratemaking cases describe a two-step return-setting paradigm that could be used to make the Commission's task somewhat easier. In ***Bluefield***, the Court said:

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[449] Tr. 26:1700 (Gorman).

[450] Tr. 26:1604 (Hevert). Hevert testified, "just as a factual matter as we've been noticing today, the numbers have been drifting downward. And if there were sort of a self-perpetuating cycle, you would imagine that there would be no such drift over time. But we have seen the numbers come down. And as I've said, even based on my analyses, I've suggested somewhat of a downward drift. And I think those two things are consistent." Tr. 26:1651.

[451] Tr. 26:1691 (Gorman).

[452] Tr. 26:1609-1610 (Hevert).

[453] Tr. 26:1609-1610, 1648 (Hevert).

[454] Tr. 26:1609-1610 (Hevert).

[455] Tr. 26:1650 (Hevert).

[456] ***Federal Power Commission v. Hope Natural Gas Company***, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); ***Bluefield Water Works & Improvement Company v. Public Service Commission of West Virginia***, 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923).

> Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.[457]

Here, the Court unmistakably described one limit on the Commission's decision: a return that is ***too low*** is tantamount to confiscation and is thus unconstitutional. In the same case, the Court also delineated a second limit on the Commission's rate decision: "A public utility . . . has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures."[458] This language describes the upper limit of the rate decision. A return that is **too high** is one that produces the sort of profits realized from "highly profitable enterprises or speculative ventures."[459]

Between these limits is a "zone of reasonableness" within which the Commission is free to set the rate of return. The Supreme Court has stated, "[w]e have emphasized that courts are without authority to set aside any rate adopted by the Commission which is within a 'zone of reasonableness.'"[460] This is not, however, the analytical tool of the same name that this Commission has frequently used over the past few years. That tool is an exercise in benchmarking in which the recommendations of the experts are compared to the average of recently-allowed ROEs. While useful, that analysis is

[457] ***Bluefield***, *supra,* 262 U.S. at 690, 43 S.Ct. at 678, 67 L.Ed. at 1181.

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

[459] *Id.* An ROE that is too high would likely also be unconstitutional by virtue of taking unjustifiable advantage of the captive ratepayers.

[460] ***In re Permian Basin Area Rate Cases,*** 390 U.S. 747, 797-798, 88 S.Ct. 1344, 1376, 20 L.Ed.2d 312, ___ (1968).

flawed. First, it inevitably pulls the ROE in any case toward the average; and second, its range of 100 basis points either side of the average is entirely arbitrary. [461]

The first step is to define the limits of the zone of reasonableness. At the bottom is what the Court calls the "lowest reasonable rate," that is, the ***lowest*** rate that is not confiscatory and, consequently, is constitutionally permissible. "By long standing usage in the field of regulation the 'lowest reasonable rate' is one which is not confiscatory in the constitutional sense."[462] By keying the Commission's return-setting analysis off the ***lowest reasonable rate*** rather than the average of recently-awarded returns, the flaws noted above are avoided.

The second step is to set the ROE by reference to the lowest reasonable rate. The Commission is free to set the return on equity anywhere within the zone of reasonableness, guided by its consideration of all the evidence in the light of the public interest. As the Court has said, rate-setting agencies "are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances."[463] The Court has also said, "[t]he Commission may, within this zone [i.e., the zone of reasonableness], employ price functionally in order to

[461] Staff notes that the Commission's Zone of Reasonableness analysis has been upheld in the face of every challenge by zealous counsel. ***State ex rel. Praxair, Inc. v. Public Service Commission,*** 328 S.W.2d 329, 340-41 (Mo. App., W.D. 2010); ***State ex rel. Public Counsel v. Public Service Commission,*** 274 S.W.3d 569, 574 (Mo. App., W.D. 2009).

[462] ***Federal Power Commission,*** *supra,* 315 U.S. at 585, 62 S.Ct. at 742, 86 L.Ed. at ___. The Court went on to say: "Assuming that there is a zone of reasonableness within which the Commission is free to fix a rate varying in amount and higher than a confiscatory rate, the Commission is also free . . . to decrease any rate which is not the 'lowest reasonable rate.'" *Id.* (internal citations omitted).

[463] ***Federal Power Commission v. Natural Gas Pipeline of America,*** 315 U.S. 575, 585-586, 62 S.Ct. 736, 742-743, 86 L.Ed. 1037, ___ (1942).

achieve relevant regulatory purposes; it may, in particular, take fully into account the probable consequences of a given price level for future programs[.]"[464]

Staff's expert witness David Murray has identified Ameren Missouri's COE and, in his ROE recommendation, identified the lowest reasonable rate. He testified that he did not expect the Commission to adopt his ROE recommendation and that his intention was to accurately report Ameren Missouri's COE.[465] Above Staff's recommendation is the zone of reasonableness within which the Commission is free to set the return.[466] As Missouri courts have stated repeatedly, "[i]t is not the theory or methodology, but the impact of the rate order which counts."[467] Nonetheless, the Commission must articulate its reasons for setting the return at a particular point within the allowable zone.[468] These reasons extend to all "relevant regulatory purposes" including a consideration of the likely impacts of the rate order.[469] Among the principles that should guide the Commission's choice of a particular point within the zone of reasonableness are those articulated in ***Hope*** and ***Bluefield,*** including the principles of the commensurate return, capital attraction and financial integrity.[470]

Expert testimony affirmed that the ROE set by the Commission is important, not

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[464] ***Permian Basin Area Rate Cases,*** *supra,* 390 U.S. at 797-798, 88 S.Ct. at 1376, 20 L.Ed.2d at ___.

[465] Tr. 30:1981 (Murray).

[466] Mr. Murray's studies show that the point of confiscation is below the low end of his recommended range at 8.0. *Murray Surr.,* p. 10.

[467] ***Praxair,*** *supra,* 328 S.W.3d at 339, *citing* ***State ex rel. Missouri Water Co. v. Public Service Commission,*** 308 S.W.2d 704, 714 (Mo.1957).

[468] Otherwise, judicial review is frustrated.

[469] ***Permian Basin Area Rate Cases,*** *supra,* 390 U.S. at 797-798, 88 S.Ct. at 1376, 20 L.Ed.2d at ___.

[470] ***Bluefield,*** *supra,* 262 U.S. at 692-93, 43 S.Ct. at 679, 67 L.Ed. at 1182-1183; ***Hope,*** *supra,* 320 U.S. at 603, 64 S.Ct. 288, 88 L.Ed. 345 (citations omitted).

only for the purpose of providing a compensatory return to shareholders, but also for the purpose of maintaining the company's financial integrity and enabling its access to the capital markets.[471] Capital attraction, after the events of 2008, is a very important criterion.[472] The 2007 through 2009 time period was one of the worst periods of financial crisis this country has ever experienced.[473] Some utility companies came close to defaulting on their financial obligations because short-term borrowing facilities were shut down.[474] The cost of borrowing for some companies sky-rocketed.[475] For example, Ameren Illinois, during the 2008/2009 time period, had to issue mortgage bonds at an interest rate of over 10 percent.[476]

Mr. Murray testified that, if the Commission actually adopted his ROE recommendation, Ameren Missouri would have one of the lowest authorized ROEs of any electric utility in the country and would experience downward pressure on its stock price.[477] Mr. Gorman testified that he was uncomfortable recommending a return on equity as low as Mr. Murray recommended because some caution is necessary in awarding a ROE for an electric utility company since dropping that authorized ROE too fast can create financial trouble, even if the return on equity reflects fair compensation in the marketplace.[478] He went on to say that a utility needs time to modify its financial

[471] Tr. 26:1656 (Hevert).

[472] Tr. 26:1571 (Hevert).

[473] Tr. 26:1772-1773 (Gorman).

[474] *Id.*

[475] *Id.*

[476] *Id.*

[477] Tr. 30:2024-2025, 2030-2032 (Murray).

[478] Tr. 26:1774 (Gorman).

housekeeping in order to maintain its financial integrity while receiving a very low authorized return on equity, even if it is consistent with current market costs.[479]

Conclusion

Based on all of the foregoing, Staff recommends that the Commission authorize an ROE for Ameren Missouri somewhere in the range of 9.0, Mr. Murray's recommendation, and the third quarter national average of awarded ROEs of 9.9.[480] The mid-point of the recommended range is 9.45, which is well-within Mr. Gorman's recommended range of 9.3 to 9.5 and almost identical to his recommended ROE of 9.4. As Staff has demonstrated herein, the United States Supreme Court has held that there is a zone of reasonableness within which the Commission has discretion to set the cost of common equity in order to achieve appropriate regulatory goals. These goals include those traditional ***Hope*** and ***Bluefield*** goals of assuring the utility's financial integrity and its ability to attract capital at a reasonable cost, but also encompass and extend to broader regulatory and public policy objectives. These objectives include consideration of the likely impact of the Commission's order.

Staff urges the Commission to find that Mr. Murray's recommended ROE of 9.0 is the lowest reasonable rate and thus the bottom of the zone of reasonableness within which the Commission has discretion to set Ameren Missouri's ROE.[481] Staff further urges the Commission to find that the top of the zone of reasonableness is found in the 3rd quarter national average of awarded ROEs of 9.9. The evidence presented

[479] Tr. 26:1775 (Gorman).

[480] Tr. 26:1650 (Hevert).

[481] Staff's position

suggests that a higher award would be contrary to the observable recent trend of ROE awards and would take unfair advantage of the Company's captive ratepayers.

Kevin A. Thompson

13. Severance Costs and VS-11:

> *Should Ameren Missouri be authorized to amortize to rates over three years the approximately $25.8 Million in costs incurred in its VS-11 voluntary employee separation program?*

As part of its continuing efforts to improve profitability, Ameren Missouri implemented a voluntary separation program, VS-11, to reduce payroll and other employee-related costs.[482] The program was successful and some 340 employees voluntarily separated.[483] Staff disallowed the costs of the VS-11 program because Ameren Missouri will have already recovered from payroll, payroll tax and benefits, and other employee-related savings, an amount in excess of the costs it incurred in the VS-11 voluntary employee separation program by the time that rates in this case become effective.[484] Therefore, there is no justification for including any of these costs in prospective rates.[485] Staff has included the costs of at least one of Ameren Missouri's prior voluntary separation program in rates, but that was because those costs would not have otherwise been recovered.[486] Here, they will have been recovered. The VS-11

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[482] *RR Report,* p. 101.

[483] Tr. 26:1665 (admission by Mr. Lowery).

[484] *Id.* The disallowed costs amounted to $25.8 million. *Id.;* Tr. 26:1659-1660 (Ferguson). Savings expected by January 2, 2013, are $26 million, viewed conservatively. Tr. 26:1660-1661 (Ferguson) and Ex. 242.

[485] As the Commission concluded when the same issue was presented in a MGE rate case some years ago, ***In the Matter of Missouri Gas Energy, a division of Southern Union Company,*** Case No. GR-96-285, 5 Mo.P.S.C.3d 437, 453 (Missouri Public Service Commission, January 22, 1997) ("***MGE***"); *see Ferguson Surr.,* pp. 11-12.

[486] Ex. 232, *Ferguson Surr.,* p. 10.

program has thus paid for itself.

The Company complains that Staff has denied it the benefit of positive regulatory lag.[487] Not so; regulatory lag only lasts until rates are reset in the next rate case, which in this instance was filed at a time selected by the Company. Ameren Missouri could have increased the benefits of lag in this instance by simply delaying its rate case filing.[488] By choosing to file when it did, Ameren Missouri chose to forego future positive regulatory lag from the VS-11 program. And, in the future, Ameren Missouri will continue to avoid the costs represented by the severed employees.[489]

The Company also complains that it will have no incentive to pursue such cost reductions in the future.[490] MIEC's expert witness Steve Carver explained that there was actually no disincentive.[491] The laws of corporate governance create sufficient incentive for the officers and the board of Ameren Missouri to reduce supernumerary employees to increase profitability.[492] As Staff's expert witness Lisa Ferguson testified, "It is a matter of concern to Staff that a Vice President of Business Planning and Controller would testify that there is no incentive for the Company to reduce costs."[493]

Staff expert witness Lisa Ferguson also testified that granting the Company's request on this issue would result in an unjustifiable double recovery.[494] As the

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[487] *Barnes Rebuttal,* pp. 15-16.

[488] *See Ferguson Surr.,* p. 11.

[489] Tr. 26:1663 (Ferguson).

[490] *Barnes Rebuttal,* p. 16.

[491] Tr. 28:1813-1814 (Carver).

[492] *Id.*

[493] *Ferguson Surr.,* p. 9.

[494] *Ferguson Surr.,* p. 10; Tr. 26:1659 (Ferguson).

Commission stated in 1997, "The Commission will not allow [the Company] to charge ratepayers the costs associated with employee severances where [the Company] has already recovered those costs."[495] Staff urges the Commission to decide for Staff, and against Ameren Missouri, on this issue.

Kevin A. Thompson

14. Storm Costs Tracker:

> *Should the Commission establish a two-way storm restoration cost tracker whereby storm-related non-labor operations and maintenance ("O&M") expenses for major storms would be tracked against the base amount with expenditures below the base creating a regulatory liability and expenditures above the base creating a regulatory asset, in each case along with interest at the Company's AFUDC[496] rate?*

No, the Commission should not establish a two-way storm restoration costs tracker because existing procedures are adequate for all storm events. "Normal" storm costs are addressed by including a multi-year average level of historical costs in rates. "Extraordinary" storm costs have been addressed -- and will continue to be addressed -- by the Company's application when appropriate for an Accounting Authority Order ("AAO") allowing it to defer extraordinary non-labor-related storm restoration costs to the utility's balance sheet for possible recovery in its next general rate case. These two methods have successfully addressed all significant storm events recently experienced by Ameren Missouri.

In its direct case, Ameren Missouri proposed a two way storm tracker in which each year its actual non-labor O&M storm restoration expense would be compared to

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[495] ***MGE,*** *supra,* 5 Mo.P.S.C.3d at 453.

[496] "AFUDC" is Allowance for Funds Used During Construction, i.e., the carrying costs for capital used for construction.

the storm expenses included in rates from its previous rate case proceeding.[497] The difference between the actual expense and the base level included in rates would then be captured and booked as a regulatory asset or liability.[498] If actual storm damage expenses during the calendar year were more than the expense included in rates, Ameren Missouri would record the difference as a regulatory asset. If the actual storm costs were less than the cost levels included in rates, the difference would be recorded as a regulatory liability.[499] The resulting regulatory asset or liability would be included in the calculation of rate base and the balance amortized to expense in the Company's next rate case.[500] Staff opposes Ameren Missouri's request for a storm cost tracker for three reasons: (1) the current regulatory scheme is adequate to allow Ameren Missouri to cover its costs; (2) allowing a storm cost tracker would shift the burden of production from the company to the Commission Staff; and (3) allowing such a tracker would shift an inordinate amount of risk to the ratepayer

First, Ameren Missouri has failed to show the necessity of its proposed two-way storm restoration costs tracker. Normal storms that occur during a test year can be dealt with using standard ratemaking practices.[501] A certain number of storm events will occur each year in any electric utility's service territory and the repair and restoration costs associated with these events should be considered as part of normal and ongoing expense for an electric utility, and included in the utility rates at a normal and ongoing

[497] *Barnes Dir.,* p. 14.

[498] *Id*.

[499] *Boateng Rebuttal,* pp. 2-3.

[500] *Boateng Rebuttal,* p. 2.

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

level.[502] Test year storm costs that exceed the normal level are generally addressed with 5 year amortizations.[503] Alternatively, if an extraordinary storm event occurs between rate cases, the Company has the option to request an Accounting Authority Order ("AAO") to capture the cost and defer it for possible rate treatment in a future rate case.[504] These methods have all been employed with Ameren Missouri in the past. In fact, the process currently in place has worked well for Ameren Missouri. The evidence demonstrates that, from March 1, 2009, through the July 31, 2012, Ameren Missouri collected approximately $8.2 million more in rates than the actual costs it incurred to restore service.[505]

Secondly, the Company is asking the Commission to shift the burden of proving the nature of the storm expense from itself to the Commission Staff. The Company's requested storm cost tracker would do away with the requirement, necessary to an AAO, for the Company to "prove up" the extraordinary nature of the storm and its related restoration expenses, but would instead turn the onus onto Staff, during the course of a general rate case. In other words, the Company is attempting to switch to a default where everything (as noted below, a lot more of everything) is automatically included as an expense unless the Commission Staff can discern the level of spending out of pocket, over the amount already baked into rates. Requiring Staff to prove that storm expense is not excessive would create an extraordinarily heavy burden for Staff to meet long after the storms and during the course of a general rate case. The burden

[502] *Id*.

[503] *Id.,* at p. 3.

[504] *Id*.

[505] *Meyer Surr.,* p. 12, lines 16-21.

is so heavy that the trackers may effectively become automatic rate adjustments.[506] Furthermore, Staff supports the use of AAOs as needed over a storm tracker because the analysis Staff auditors conduct for an AAO is more stringent than when a number goes into a tracker that is already established. A tracker gives a preapproval of expenditures, whereas an AAO requires a review of all relevant factors. The more appropriate regulatory approach to dealing with extraordinary storms is an AAO, in which all relevant factors are considered.

In addition, Company witness Barnes complains that the AAO creates "unwarranted negative regulatory lag."[507] However, regulatory lag is inevitable with either an AAO or tracker. Rates do not change outside of a rate case simply because a utility has a tracker. With either an AAO or a tracker, capital costs associated with extraordinary storm costs will not be included in rate base and any recognition of the storm costs incurred through an amortization of the deferred amounts will not be included in the utility's cost of service until the resolution of the next rate case.

Third, Staff believes that allowing a two-way storm tracker would shift an inordinate amount of risk to the ratepayer absent any reduction in the ROE. This is because embedded within the Company's request for a two-way storm tracker is the corresponding request, as mentioned above, to forego the use of normalized levels of storm costs, AAOs and amortizations for extraordinary storm costs. Currently, a certain level of normalized storm costs are built into rates. If costs exceed the level built into rates, the Commission views it as part of the risk of being a regulated utility. If costs are

[506] *Id.*

[507] *Barnes Dir.,* p. 15.

lower than the level built into rates, the Company is allowed to pocket the difference as additional profit.

In the past, extraordinary storms costs[508] have been addressed by various AAOs, which allow the Company to defer extraordinary non-labor-related storm restoration costs to the utility's balance sheet for recovery in the Company's next general rate case. In the next rate case, the Commission may allow the amounts to be recovered through amortizations. Ameren Missouri requests that the Commission adopt the IEEE 1366 method[509] of determining "major storm events" instead of tracking extraordinary costs. Those events classified as "major storm events" PLUS preparation for "major storm events" that don't materialize (which cost above 1.5 million) PLUS the corresponding interest would be tracked via the tracker mechanism until the next rate case.[510] During the next rate case, those costs above the base level, would be evaluated by Staff for prudency and put into rates also via an amortization.[511] Staff opposes this approach because it seeks extraordinary treatment and recovery for all non-labor-related storm restoration costs, irrespective of whether or not they are extraordinary in nature, and effectively shifts the normal risks associated with being a regulated utility onto the

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[508] Those storms costs which Staff witness Boateng describes as featuring large numbers of customers being out of service and massive repair and restoration efforts. *Boateng Surr.,* p.12. Generally, Staff has considered a storm event to be extraordinary if restoration costs equal or exceed 5% of the Company's net income. Tr. 29:1917.

[509] The IEEE 1366 method looks at the magnitude of an outage event by examining customer minutes out per customer on a daily basis, and it compares them to the "normal" range of customer outage minutes based on 5 years of historical daily customer outage minutes, including days with storms. If the customer minutes of interruption per customer on a given day are outside of the "normal" range, the day is classified as a Major Event Day under the IEEE standard, and presuming the cause was a weather event, this event would be classified as a major storm. *Wakeman Dir.*, p. 13, lines 10-16.

[510] *Id,* p. 13.

[511] *Wakeman Surr.,* p. 3.

ratepayers.

In summation, the currently available ratemaking methods of normalization, amortizations and accounting authority orders are sufficient to allow the Company to recover both its ordinary and extraordinary storm costs, and Staff urges the Commission to deny Ameren Missouri's request for a storm cost tracker.

Meghan E. McClowry

15. Storm Restoration Costs:

A. If the Commission does not establish a two-way storm restoration costs tracker, then what is the appropriate amount to include in revenue requirement for major storm restoration costs?

Staff recommends including in revenue requirement approximately $6.8 million for a normalized level of non-labor storm preparation and restoration costs based on a 60-month average ending July 31, 2012. At hearing, Company witness Ms. Lynn Barnes testified that this normalized test year level for non-labor related storm restoration costs would be sufficient.[512]

B. If the Commission does establish a two-way storm restoration costs tracker, then what is the appropriate base level of major storm restoration Operations and Maintenance ("O&M") costs to include in Ameren Missouri's revenue requirement?

The Commission should not establish a two-way storm restoration costs tracker because existing procedures are adequate for all storm events. However, in the event the Commission does establish a two-way storm tracker, Staff recommends that the base level should be set at $6.8 million.

Meghan E. McClowry

[512] Tr. 29:25 (Barnes).

16. Storm Assistance Revenues:

A. If the Commission authorizes a two-way storm restoration cost tracker for Ameren Missouri, should storm assistance revenues received from other utilities be included in the tracker or annualized and normalized and included as an offset in revenue requirement?

Storm assistance revenues received from other utilities should be annualized and normalized and included as an offset in revenue requirement. Expense associated with providing storm assistance to other utilities should be similarly addressed by including these costs as a component of the revenue requirement. These storm assistance revenues and expenses are more appropriately accounted for through traditional annualization and normalization methods.

B. What amount of storm assistance revenue should be included in the cost of service?

The Commission should include $581,189 of storm assistance revenue in the cost of service calculation based upon a five-year normalization of storm assistance revenues received by the Company during the sixty months ending July 31, 2012.

From time to time, Ameren Missouri provides storm restoration assistance to other utilities.[513] These utilities pay Ameren Missouri for labor charges associated with the Ameren Missouri crews that provide assistance.[514] Staff recommends including $581,189 normalized level of storm assistance revenues to be included in the cost of service based upon a 5-year normalization of storm assistance revenues received by the Company during the 60 months ending July 31 2012.[515] Staff's position is that these

[513] *RR Report,* p.

[514] *Id*.

[515] *Id*.

types of ongoing revenues and expenses are best accounted for through traditional annualization and normalization methods.[516]

The Company argues that because it may not earn these revenues every year, these amounts should not be included in the revenue requirement.[517] At hearing, the Company attempted to show that because the 5-year amortization period chosen by Staff resulted in a number larger than the Company had received in storm restoration revenues in 2007, 2008, 2009, and 2010, it would be unfair to put any amount in revenue requirement for storm assistance revenues, let alone the $581,189 recommended by Staff.

Ameren Missouri's argument is without merit. The Company has provided storm restoration assistance 11 times since 2006.[518] Staff accounts for recurring costs and revenues by "baking" normalized levels of such costs/revenues into rates.[519] Failing to include these revenues in rates would be unfair to the ratepayers who provide the skilled labor and equipment used by the Company to earn the storm assistance revenues. The Commission should order that a normalized level of storm assistance revenues be included in the cost of service based upon a 5-year normalization of storm assistance revenues received by the Company during the 60 months ending July 31, 2012. That amount is $581,189 on an annual basis.

Meghan E. McClowry

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[516] *Cassidy Surr.,* p.

[517] *Wakeman Rebuttal,*, p. 6.

[518] Tr. 29:1911.

[519] *Cassidy Surr.,* p. 8.

17. Vegetation Management and Infrastructure Inspection Tracker:

A. Should the unamortized balance for the regulatory asset associated with the Vegetation Management and Infrastructure Inspection Tracker be adjusted for all amortization through December 31, 2012, and amortized over two years?

No. The Commission should amortize the net under-collection for these costs as of the true-up ending July 31, 2012, over three years in order to avoid over-collection.[520] This approach is consistent with how Staff and the Commission have amortized similar expenditures in past cases,[521] and there is no evidence or testimony on the record indicating these trackers should be treated differently. Also, any unamortized balance from the previous related tracker should be rolled into the amortization established in this proceeding so that only one tracker remains.[522]

B. Should the vegetation management and infrastructure inspection trackers be continued?

Yes. The Commission first approved the vegetation management and infrastructure inspection trackers for Ameren Missouri in Case No. ER-2008-0318[523] and again authorized the use of these trackers in Ameren Missouri's subsequent general rate case, Case No. ER-2010-0036.[524] In the instant case, the Commission should authorize the continuation of the vegetation management and infrastructure inspection trackers at least through the end of the Company's first trimming cycle. The Company has completed its first urban trimming cycle but has not yet completed its first

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[520] Ex. 202, pg. 115, lines 22-24.

[521] *Id.*

[522] *Id.,* at lines 29-31.

[523] *Id.* at p. 113, lines 26-27, and p. 114, lines 1-2.

[524] *Id.* at p. 115, lines 7-10.

rural trimming cycle.[525] These trackers were created to allow the Company to monitor the expense of complying with new Commission rules,[526] establishing a foundation for predicting those costs in the future. This purpose has not yet been accomplished. The costs of the vegetation management and infrastructure inspection programs have not yet stabilized in such a way that the Company can reliably predict them.[527] It is reasonable and appropriate to allow the Company to observe its costs for these programs for at least one full cycle of operation in the hopes that data on a full cycle would accomplish the purpose for which the Commission originally ordered the trackers. After a full cycle is complete, if the Company's costs appear to have stabilized, it would then be appropriate to reexamine whether the trackers should continue at that time.

Amy E. Moore

18. Class Cost of Service and Rate Design:

> *A. What methodology should the Commission use to allocate generation fixed costs among customer classes?*

Staff was a signatory to the *Revised Non-Unanimous Stipulation and Agreement* ("*Stipulation*") that was filed on October 10, 2012, which purports to settle allocation of any revenue increase in the event the Commission finds that Ameren Missouri's rates should be increased, as well as certain other tariff issues. No interested party opposed the *Stipulation*. The only issues litigated were related to the customer charge, Issue 18.D.

[525] Tr. 29:1952, line 11-14.

[526] Ex. 202, p. 113, lines 26-27, and p. 114, lines 1-2.

[527] Tr. 29:1952, lines 11-21.

B. How should the non-fuel, non-labor components of production, operation and maintenance expense be classified and allocated?

This issue was resolved by the *Stipulation* of the parties.

C. How should any rate increase be collected from the several customer classes?

This issue was resolved by the *Stipulation* of the parties.

D. What should the Residential Class customer charge be?

Staff recommends increasing Ameren Missouri's residential customer charge by $1, from $8 to $9 after considering and taking into account the potential for rate shock.[528]

E. What should the Small General Service Class customer charge be (single-phase and three-phase)?

The Small General Service ("SGS") Class customer charge (single-phase and three-phase) increase should be the same percent increase that is not associated with the Energy Efficiency ("EE") revenue requirement percentage as outlined in paragraph 1.c. of the *Revised Non-Unanimous Stipulation and Agreement* to settle allocation of any revenue increase in the event the Commission finds that Ameren Missouri's rates should be increased.

F. Should the Commission address declining block rate design either by opening a separate docket on rate design or by ordering Ameren to address the rate design in its next general rate case?

This issue was resolved by the *Stipulation* of the parties.

Meghan E. McClowry

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[528] *Staff's Rate Design and Class Cost-of-Service Report ("RD Report")*, p.

19. Energy Independence and Security Act of 2007 ("EISA"):

Pursuant to the Energy Independence and Security Act of 2007 ("EISA"), the Commission is required to determine whether or not it is appropriate to implement each of the standards for electric utilities found in the Public Utility Regulatory Policies Act of 1978 ("PURPA"), § 111(d), not later than December 19, 2009, or in the first general rate case for each individual electric utility, commenced after December 19, 2010. This is not at contested issue.

The Staff addressed in its Cost Of Service Revenue Requirement Report (Ex. 201, pp. 176-184), in sections sponsored by Staff witnesses Natelle Dietrich (Ex. 201, pp. 176-182) and Randy S. Gross (Ex. 201, pp. 182-184), the four "new" Public Utility Regulatory Policies Act of 1978 ("PURPA") Section 111(d) standards for electric utilities established by Congress through the Energy Independence and Security Act of 2007 ("EISA"). The Commission is required to consider and determine whether it is appropriate to implement each of the new standards so as to carry out the purposes of PURPA, which are to encourage: (1) conservation of electric energy, (2) efficiency in the use of facilities and resources by electric utilities, and (3) equitable rates to consumers of electricity.[529] Should the Commission decline to implement a PURPA standard for which it determines the standard is appropriate to carry out the above-noted purposes, the Commission is directed to state in writing its reasons.[530] The Commission is to complete its consideration and determination of each standard no later than December 19, 2009, two years after enactment of EISA. Absent such determination, the Commission is to consider in the first general rate case for each individual electric utility,

[529] PURPA Section 101.

[530] PURPA Section 111(b)(2)(c)(2).

commenced after December 19, 2010, whether or not it is appropriate to implement such standard to carry out the above noted purposes.[531]

The Commission established three files for the four EISA standards:

1) File No. EW-2009-0290: In the Matter of the Consideration of Adoption of the PURPA Section 111(d)(16) Integrated Resource Planning Standard as Required by Section 532 of the Energy Independence and Security Act of 2007. ("IRP Docket");

2) File No. EW-2009-0291: In the Matter of the Consideration of Adoption of the PURPA Section 111(d)(17) Rate Design Modifications to Promote Energy Efficiency Investments Standard as Required by Section 532 of the Energy Independence and Security Act of 2007. ("Rate Design Docket"); and

3) File No. EW-2009-0292: In the Matter of the Consideration of Adoption of the PURPA Section 111(d)(18), Smart Grid Investments Standard, and the PURPA Section 111(d)(19), Smart Grid Information Standard, as Required by Section 1307 of the Energy Independence and Security Act of 2007. ("Smart Grid Docket").[532]

The Commission, on November 23, 2009, issued its *Order Finding Consideration / Implementation of New Federal Standards Through Workshop and Rulemaking Procedures Is Required* in File Nos. EW-2009-0290, EW-2009-0291, and EW-2009-0292, in which it stated at page 5:

> The Commission has satisfied the requirements for consideration of the new EISA standards, and on the basis of the quasi-legislative record created in these workshops, the Commission determines that no comparable standards have been considered that would constitute prior

[531] PURPA Section 112(c).

[532] Congress mis-numbered the four new EISA standards, but corrected the mis-numbering in Section 408, Technical Corrections, enacted as part of the American Recovery and Reinvestment Act of 2009. Pub. L. No. 110-140, 121 Stat. 1492 (2007), amended by Section 408 of The American Recovery and Reinvestment Act of 2009 (the EISA, prior to this amendment, is codified at 16 USCS 2621 and 2622 (Cum. Supp. 2008)). PURPA is codified generally in 16 USCS 2601 et seq., but various provisions appear elsewhere in the United States Code.

> state action and prohibit the Commission from taking any further action in relation to the new EISA standards. . . .

Ms. Dietrich recommended in the Staff's *Cost of Service Revenue Requirement Report* the Commission consider each standard and make its determination with respect to Ameren Missouri in the File No. ER-2012-0166 rate case based on the discussion in the Staff's *Cost of Service Revenue Requirement Report*.[533] No party filed any responsive testimony to Ms. Dietrich's or Mr. Gross' testimony on the four EISA / PURPA standards.

PURPA Section 111(d)(16), Integrated Resource Planning Standard as required by Section 532 of EISA, requires state commission consideration of whether to implement the following:

> (A) integrate energy efficiency resources into utility, State, and regional plans; and
>
> (B) adopt policies establishing cost-effective energy efficiency as a priority resource.

The Commission's promulgation of a rulemaking revising Chapter 22 Electric Resource Planning Rules in File No. EX-2010-0254, *In the Matter of a Proposed Rulemaking Regarding Revision of the Commission's Chapter 22 Electric Utility Resource Planning Rules* became effective on June 30, 2011. Ms. Dietrich noted that the Commission has a workshop docket, Case No. EW-2010-0187, open to investigate how to achieve its statutory responsibilities under the Missouri Energy Efficiency Investment Act ("MEEIA"), Section 393.1075, RSMo., among other things, within the background of FERC policies that eliminate barriers to demand response and that direct the Midwest Independent Transmission System Operator ("MISO") and the Southwest

[533] *RR Report,* Ex. 201, p. 178.

Power Pool ("SPP") to accommodate state policy regarding retail customer demand-side activity.[534]

While not specifically making a determination to implement PURPA Section 111(d)(16), the Commission has promulgated rulemakings to address the principles of that section; therefore, Staff suggests there is nothing that remains for the Commission to determine in response to PURPA Section 111(d)(16), and recommends the Commission make such a finding in this rate case for Ameren Missouri.[535]

PURPA Section 111(d)(17), Rate Design Modifications to Promote Energy Efficiency Investments Standard as required by Section 532 of EISA, requires state commissions to consider whether to implement: (1) removing the throughput incentive and disincentives to energy efficiency; (2) providing utility incentives for successful management of energy efficiency programs; (3) including the impact of energy efficiency as one of the goals of retail rate design; (4) adopting rate designs that encourage energy efficiency; (5) allowing timely recovery of energy efficiency related costs; and (6) offering energy audits, demand-response programs, publicizing the benefits of home energy efficiency improvements and educating homeowners about Federal and State incentives. In 2009, Governor Nixon signed Senate Bill 376, the "Missouri Energy Efficiency Investment Act" ("MEEIA"), with a stated policy to "value demand-side investments equal to traditional investments in supply and delivery

[534] *RR Report,* Ex. 201, p. 179.

[535] *RR Report,* Ex. 201, p. 178.

infrastructure and allow recovery of all reasonable and prudent costs of delivering cost-effective demand-side programs."[536]

The Commission promulgated a rulemaking in File No. EX-2010-0368, *In the Matter of the Consideration and Implementation of Section 393.1075, The Missouri Energy Efficiency Investment Act*. The rules became effective on May 30, 2011 – Rules 4 CSR 240-20.093, 20.094, 3.163, and 3.164. Ameren Missouri submitted its MEEIA application on January 20, 2012, in Case No. EO-2012-0142 *In the Matter of Union Electric Company d/b/a Ameren Missouri's Filing to Implement Regulatory Changes in Furtherance of Energy Efficiency as Allowed by MEEIA*. A *Unanimous Stipulation and Agreement Resolving Ameren Missouri's MEEIA Filing* was filed in that case on July 5, 2012, one day before the Staff's *Cost of Service Revenue Requirement Report* was filed in this case. On August 1, 2012, the Commission approved the *Unanimous Stipulation And Agreement Resolving Ameren Missouri's MEEIA Filing* in File No. EO-2012-0142.

Staff recommends that the Commission, in this case, make a finding that no further determination is needed in response to PURPA Section 111(d)(17) for Ameren Missouri.[537]

In response to PURPA Section 111(d)(18), Smart Grid Investments Standard, and PURPA Section 111(d)(19), Smart Grid Information Standard, as required by Section 1307 of EISA, the Commission, on December 29, 2010, issued an order to open File No. EW-2011-0175 as a repository for information concerning the Smart Grid in Missouri. Ms. Dietrich addresses the Smart Grid in general in her section on EISA

[536] Section 393.1075.3, RSMo.

[537] *RR Report,* Ex. 201, p. 181.

and Mr. Gross addresses specifically the status of Ameren Missouri's Smart Grid deployment in his section in the Staff's *Cost of Service Revenue Requirement Report*.[538] Mr. Gross' Schedule RSG-1 in Appendix 3 to Ex. 201 is a summary description of the Smart Grid technology presently deployed by Ameren Missouri.

PURPA Section 111(d)(18), the Smart Grid Investments Standard, requires the Commission to consider and determine whether the following is appropriate to implement to carry out the purposes of PURPA:

> (A) IN GENERAL – Each State shall consider requiring that, prior to undertaking investments in nonadvanced grid technologies, an electric utility of the State demonstrate to the State that the electric utility considered an investment in a qualified smart grid system based on appropriate factors, including --
>
> (i) total costs;
> (ii) cost-effectiveness;
> (iii) improved reliability;
> (iv) security;
> (v) system performance; and
> (vi) societal benefit.
>
> (B) RATE RECOVERY – Each State shall consider authorizing each electric utility of the State to recover from ratepayers any capital, operating expenditure, or other costs of the electric utility relating to the deployment of a qualified smart grid system, including a reasonable rate of return on the capital expenditures of the electric utility for the deployment of the qualified smart grid system.
>
> (C) OBSOLETE EQUIPMENT – Each State shall consider authorizing any electric utility or other party of the State to deploy a qualified smart grid system to recover in a timely manner the remaining book-value costs of any equipment rendered obsolete by the deployment of the qualified smart grid system, based on the remaining depreciable life of the obsolete equipment.

[538] *RR Report,* Ex. 201.

PURPA Section 111(d)(19), the Smart Grid Information Standard, requires the Commission to consider and determine whether it is appropriate that all electricity purchasers and other interested parties should be provided access to information from their electricity provider related to, among other things, time-based prices, usage, and sources of power and type of generation, with associated greenhouse gas emissions for each type of generation, to the extent such information is available on a cost-effective basis, so as to carry out the purposes of PURPA.[539] The standard appears in EISA as follows:

> (A) STANDARD. – All electricity purchasers shall be provided direct access, in written or machine-readable form as appropriate, to information from their electricity provider as provided in subparagraph (B).
>
> (B) INFORMATION. – Information provided under this section, to the extent practicable, shall include:
>
> > (i) PRICES. – Purchasers and other interested persons shall be provided with information on –
> >
> > > (I) time-based electricity process in the wholesale electricity market; and
> > > (II) time-based electricity retail prices or rates that are available to the purchasers.
> >
> > (ii) USAGE. – Purchasers shall be provided with the number of electricity units, expressed in kwh, purchased by them.
> >
> > (iii) INTERVALS AND PROJECTIONS – Updates of information on prices and usage shall be offered on not less than a daily basis, shall include hourly price and use information, where available, and shall include a day-ahead projection of such price information to the extent available.
> >
> > (iv) SOURCES – Purchasers and other interested persons shall be provided annually with written information on the sources of the power provided by the utility, to the extent it can be determined, by

[539] *RR Report,* Ex. 201, p. 182.

> type of generation, including greenhouse gas emissions associated with each type of generation, for intervals during which such information is available on a cost-effective basis.
>
> (C) ACCESS – Purchasers shall be able to access their own information at any time through the internet and on other means of communication elected by that utility for Smart Grid applications. Other interested persons shall be able to access information not specific to any purchaser through the Internet. Information specific to any purchaser shall be provided solely to that purchaser.

Ms. Dietrich relates in the Staff's *Cost of Service Revenue Requirement Report* that the Staff, on January 13, 2011, filed the *Missouri Smart Grid Report* in File No. EW-2011-0175. Among other things, the *Missouri Smart Grid Report* presents issues and concerns and identifies key issues requiring further emphasis, including Smart Grid deployment, planning, implementation, cost recovery, cyber security and data privacy, customer acceptance and involvement, and customer savings and benefits. It recommends the Commission hold a Smart Grid workshop every six months for information exchange and sharing of best practices and educational opportunities; and also recommends the Commission open a docket to address cost recovery issues. The Commission has held Smart Grid conferences on June 28, 2010, and November 29, 2011, and the Smart Grid was also the most recent subject of the *PSConnection*, a publication of the Commission.[540]

Staff recommends the Commission make a determination in this case that it has established the appropriate avenues for monitoring Smart Grid activities and no greater ongoing activity is needed in response to PURPA Section 111(d)(18) and PURPA

[540] *RR Report,* Ex. 201, p. 181-182.

Section 111(d)(19) in the context of Ameren Missouri.[541]

Steven Dottheim

CONCLUSION

In conclusion, Staff recommends that the Commission grant Ameren Missouri a general rate increase amounting to approximately $202 million, resolving each contested issue as Staff has recommended. In this way, just and reasonable rates will be set and all relevant factors considered, with due regard to the interests of the various parties and to the public interest.

WHEREFORE, on account of all the foregoing, Staff prays that the Commission will issue its findings of fact and conclusions of law, determining just and reasonable rates and charges for Ameren Missouri as recommended by Staff herein; and granting such other and further relief as are just in the circumstances.

Respectfully submitted,

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[541] *RR Report,* Ex. 201, p. 182.

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Certificate of Service

I hereby certify that a true and correct copy of the foregoing was served, either electronically or by hand delivery or by First Class United States Mail, postage prepaid, on this **5th day of November, 2012,** to the parties of record as set out on the official Service List maintained by the Data Center of the Missouri Public Service Commission for this case.

s/ Kevin A. Thompson