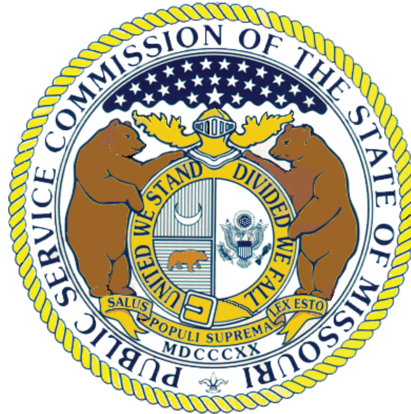
BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI



In the Matter of Union Electric Company, d/b/a	)	
AmerenUE's Tariffs to Increase Its Annual	)	**Case No. ER-2008-0318**
Revenues for Electric Service	)	Tariff Nos. YE-2008-0605

REPORT AND ORDER

Issue Date: January 27, 2009

Effective Date: February 6, 2009

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AmerenUE's Tariffs to Increase Its Annual	)	**Case No. ER-2008-0318**
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DEPUTY CHIEF REGULATORY LAW JUDGE: **Morris L. Woodruff**

REPORT AND ORDER

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The Missouri Public Service Commission, having considered all the competent and substantial evidence upon the whole record, makes the following findings of fact and conclusions of law. The positions and arguments of all of the parties have been considered by the Commission in making this decision. Failure to specifically address a piece of evidence, position, or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision.

Summary

This order allows AmerenUE to increase the revenue it may collect from its Missouri

customers by approximately $162.6 million, based on the data contained in the True-up Reconciliation filed by the Missouri Public Service Commission Staff on January 9, 2009.

Procedural History

On April 4, 2008, Union Electric Company, d/b/a AmerenUE filed tariff sheets designed to implement a general rate increase for electric service. The tariff would have increased AmerenUE's annual electric revenues by approximately $251 million. The tariff revisions carried an effective date of May 4, 2008.

By order issued on April 7, 2008, the Commission suspended AmerenUE's tariff until March 1, 2009, the maximum amount of time allowed by the controlling statute.[1] In the same order, the Commission directed that notice of AmerenUE's tariff filing be provided to interested parties and the public. The Commission also established April 28 as the deadline for submission of applications to intervene. The following parties filed applications and were allowed to intervene: Noranda Aluminum, Inc.; The State of Missouri; The International Brotherhood of Electrical Workers Locals 2, 309, 649, 702, 1439, and 1455, AFL-CIO and International Union of Operating Engineers Local 148 AFL-CIO (collectively the Unions); The Missouri Industrial Energy Consumers (MIEC);[2] The Missouri Energy Group (MEG);[3] The Missouri Department of Natural Resources; Laclede Gas Company; The Consumers Council of Missouri; AARP; The Commercial Group;[4] and Missouri

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[1] Section 393.150, RSMo 2000.

[2] The members of MIEC are Anheuser-Busch Companies, Inc.; BioKyowa, Inc.; The Boeing Company; Chrysler; Doe Run; Enbridge; Explorer Pipeline; GKN Aerospace; General Motors Corporation; Hussmann Corporation; JW Aluminum; Monsanto; Pfizer; Precoat Metals; Proctor & Gamble Company; Nestlé Purina PetCare; Solutia; and U.S. Silica Company.

[3] The members of MEG are Barnes–Jewish Hospital; Buzzi Unicem USA, Inc.; and SSM HealthCare.

[4] The members of the Commercial Group are JCPenney Corporation and Wal-Mart Stores East, LP.

Coalition for the Environment and Missouri Nuclear Weapons Education Fund, d/b/a Missourians for Safe Energy.

On May 29, 2008, the Commission established the test year for this case as the 12-month period ending March 31, 2008, with certain pro forma adjustments through September 30, 2008, trued-up as of September 30, 2008. In its May 29 order, the Commission established a procedural schedule leading to an evidentiary hearing.

In September, the Commission conducted fourteen local public hearings at various sites around AmerenUE's service area. At those hearings, the Commission heard comments from AmerenUE's customers and the public regarding AmerenUE's request for a rate increase.

In compliance with the established procedural schedule, the parties prefiled direct, rebuttal, and surrebuttal testimony. The evidentiary hearing began on November 20, and continued on November 21, 24 and 25, as well as December 1-4 and December 10-12. The parties indicated they had no contested true-up issues and Commission cancelled the true-up hearing scheduled for January 6 and 7, 2009. The parties filed post-hearing briefs on January 8. Based on the true-up reconciliation filed by Staff on January 5, 2009, AmerenUE's rate increase request has been reduced to $187,829,805. That same reconciliation indicates that each party has taken positions that will allow AmerenUE a rate increase of at least $66 million.

The Partial Stipulations and Agreements

During the course of the evidentiary hearing, various parties filed two nonunanimous partial stipulations and agreements resolving several issues that would otherwise have been the subject of testimony at the hearing. No party opposed those partial stipulations

and agreements. As permitted by its regulations, the Commission treated the unopposed partial stipulations and agreements as unanimous.[5] After considering both stipulations and agreements, the Commission approved them as a resolution of the issues addressed in those agreements.[6] The issues that were resolved in those stipulations and agreements will not be further addressed in this report and order, except as they may relate to any unresolved issues.

During the course of the hearing, the Office of the Public Counsel, Noranda, MIEC, MEG, and the Commercial Group filed a third non-unanimous stipulation and agreement that would have resolved various class cost of service and rate design issues. The Commission's Staff opposed that non-unanimous stipulation and agreement and as provided in the Commission's rules, the Commission will consider that stipulation and agreement to be merely a position of the signatory parties to which no party is bound.[7] The issues that were the subject of that stipulation and agreement shall be determined in this report and order.

Overview

AmerenUE is an investor-owned utility providing retail electric service to large portions of Missouri, including the St. Louis Metropolitan area. AmerenUE has approximately 1.2 million retail electric customers in Missouri, more than 1 million of which

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[5] Commission Rule 4 CSR 240-2.115(C).

[6] The Commission issued an *Order Approving Stipulation and Agreement as to All FAC Tariff Rate Design Issues* and an *Order Approving Stipulation and Agreement as to Off-System Sales Related Issues* on December 30, 2008.

[7] Commission Rule 4 CSR 240-2.115(2)(D).

are residential customers.[8] AmerenUE also operates a natural gas utility in Missouri but the rates it charges for natural gas are not at issue in this case.

AmerenUE began the rate case process when it filed its tariff on April 4, 2008. In doing so, AmerenUE asserted it was entitled to increase its retail rates by $250.8 million per year, an increase of approximately 12.1 percent.[9] AmerenUE set out its rationale for increasing its rates in the direct testimony it filed along with its tariff on April 4. In addition to its filed testimony, AmerenUE provided work papers and other detailed information and records to the Staff of the Commission, Public Counsel, and to the intervening parties. Those parties then had the opportunity to review AmerenUE's testimony and records to determine whether the requested rate increase was justified.

This is a complex case with many issues and it is easily understandable why the parties could, in fact, disagree on a multitude of those issues. Fortunately, the parties were able to resolve their differences on many issues. Where the parties disagreed, they prefiled written testimony for the purpose of raising those issues to the attention of the Commission. All parties were given an opportunity to prefile three rounds of testimony – direct, rebuttal, and surrebuttal. The process of filing testimony and responding to the testimony filed by other parties revealed areas of agreement that resolved some issues and areas of disagreement that revealed new issues. On November 12, the parties filed a Joint Statement of Issues listing the issues they asked the Commission to resolve.

As previously indicated, a number of the identified issues were resolved by the approved partial stipulations and agreements and will not be further addressed in this report and order. The remaining issues will be addressed in turn.

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[8] Voss Direct, Ex. 1, Page 2, Lines 21-22.

[9] Voss Direct, Ex. 1, Page 3, Lines 17-18.

Conclusions of Law Regarding Jurisdiction

AmerenUE is a public utility, and an electrical corporation, as those terms are defined in Section 386.020(43) and (15), RSMo (Supp. 2008). As such, AmerenUE is subject to the Commission's jurisdiction pursuant to Chapters 386 and 393, RSMo.

Section 393.140(11), RSMo 2000, gives the Commission authority to regulate the rates AmerenUE may charge its customers for electricity. When AmerenUE filed a tariff designed to increase its rates, the Commission exercised its authority under Section 393.150, RSMo 2000, to suspend the effective date of that tariff for 120 days beyond the effective date of the tariff, plus an additional six months.

Conclusions of Law Regarding the Determination of Just and Reasonable Rates

In determining the rates AmerenUE may charge its customers, the Commission is required to determine that the proposed rates are just and reasonable.[10] AmerenUE has the burden of proving its proposed rates are just and reasonable.[11]

In determining whether the rates proposed by AmerenUE are just and reasonable, the Commission must balance the interests of the investor and the consumer.[12] In discussing the need for a regulatory body to institute just and reasonable rates, the United States Supreme Court has held as follows:

> 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.[13]

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[10] Section 393.150.2, RSMo 2000.

[11] *Id.*

[12] *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603, (1944).

[13] *Bluefield Water Works & Improvement Co. v. Public Service Commission of the State of West Virginia*, 262 U.S. 679, 690 (1923).

In the same case, the Supreme Court provided the following guidance on what is a just and reasonable rate:

> What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. 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. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.[14]

The Supreme Court has further indicated:

> '[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 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.[15]

In undertaking the balancing required by the Constitution, the Commission is not bound to apply any particular formula or combination of formulas. Instead, the Supreme Court has said:

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[14] *Id.* at 692-93.

[15] *Federal Power Commission v. Hope Natural Gas Co.,* 320 U.S. 591, 603 (1944) (citations omitted).

> 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.[16]

Furthermore, in quoting the United States Supreme Court in *Hope Natural Gas*, the Missouri Court of Appeals said:

> [T]he Commission [is] not bound to the use of any single formula or combination of formulae in determining rates. Its rate-making function, moreover, involves the making of 'pragmatic adjustments.' … Under the statutory standard of 'just and reasonable' it is the result reached, not the method employed which is controlling. It is not theory but the impact of the rate order which counts.[17]

The Rate Making Process

The rates AmerenUE will be allowed to charge its customers are based on a determination of the company's revenue requirement. AmerenUE's revenue requirement is calculated by adding the company's operating expenses, its depreciation on plant in rate base, taxes, and its rate of return multiplied by its rate base. The revenue requirement can be expressed as the following formula:

Revenue Requirement = E + D + T + R(V-AD+A)
Where: E = Operating expense requirement
D = Depreciation on plant in rate base
T = Taxes including income tax related to return
R = Return requirement
(V-AD+A) = Rate base
For the rate base calculation:
V = Gross Plant
AD = Accumulated depreciation
A = Other rate base items

All parties accept the basic formula. Disagreements arise over the amounts that should be included in the formula.

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[16] *Federal Power Commission v. Natural Gas Pipeline Co.* 315 U.S. 575, 586 (1942).

[17] *State ex rel. Associated Natural Gas Co. v. Pub. Serv. Comm'n*, 706 S.W. 2d 870, 873 (Mo. App. W.D. 1985).

The Issues

1. Rate of Return

Introduction:

This issue concerns the rate of return AmerenUE will be authorized to earn on its rate base. Rate base includes things like generating plants, electric meters, wires and poles, and the trucks driven by AmerenUE's repair crews. In order to determine a rate of return, the Commission must determine AmerenUE's cost of obtaining the capital it needs.

a. Capital Structure

Findings of Fact:

The relative mixture of sources AmerenUE uses to obtain the capital it needs is its capital structure. All parties agree that AmerenUE's actual capital structure should be used for purposes of establishing its rates in this case. In his rebuttal testimony, AmerenUE's witness, Michael G. O'Bryan described AmerenUE's actual capital structure as of March 31, 2008 as:

Long-Term Debt	45.532%
Short-Term Debt	00.722%
Preferred Stock	01.737%
Common Equity	52.009%[18]

That structure is slightly different from the actual capital structure as of March 31, 2008 that O'Bryan described in his supplemental direct testimony. At that time, O'Bryan indicated the common equity component made up 50.928% of the structure.[19] In his rebuttal testimony, O'Bryan explained that the adjustment to common equity had occurred because he had previously adjusted the March 31 common equity balance to remove any

[18] O'Bryan Rebuttal, Ex. 8, Schedule MGO-RE1.

[19] O'Bryan Supplemental Direct, Ex. 7, Schedule MGO-E5.

earnings related to unregulated subsidiaries. AmerenUE had historically made that adjustment to remove any earnings related to unregulated subsidiaries, so that unregulated earnings would not have an impact on the company's regulated capital structure. [20] As of March 31, AmerenUE no longer owned the subsidiaries, so the adjustment was no longer necessary.[21] As a result, O'Bryan's adjustment to common equity in his rebuttal testimony was intended simply to correct a mistake in his description of the actual capital structure contained in his supplemental direct testimony.

If the retained earnings had already been removed from AmerenUE's March 31 capital structure, as they should have been since the company no longer owned the unregulated subsidiaries, O'Bryan's original adjustment to remove costs that were not there would be unnecessary, and would understate the proportion of common equity in AmerenUE's actual capital structure. O'Bryan's decision to reverse his previous adjustment would increase AmerenUE's revenue requirement by $7.6 million.[22]

In his surrebuttal testimony, Staff's witness, Stephen Hill, accused O'Bryan of improperly adding back to the capital structure the retained earnings of unregulated subsidiaries that he had previously correctly removed from the capital structure.[23] Hill and O'Bryan agree that the retained earnings of the unregulated subsidiaries do not belong in the capital structure. The real question is whether those retained earnings are in fact in AmerenUE's capital structure as of March 31, 2008.

Hill does not offer any independent evidence or calculation to show that retained

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[20] O'Bryan Rebuttal, Ex. 8, Page 8, Lines 1-6.

[21] O'Bryan Supplemental Direct, Ex. 7, Page 3, Lines 20-21.

[22] Weiss Rebuttal, Ex. 12, Page 16, Lines 8-14.

[23] Hill Surrebuttal, Ex. 205, Page 8, Lines 4-8.

earnings of unregulated subsidiaries are in the March 31, 2008 capital structure described by O'Bryan in his rebuttal testimony. Instead, he seizes on a line in O'Bryan's rebuttal testimony that says AmerenUE's UES month-end March 2008 accounts were corrected to a zero balance subsequent to the filing of O'Bryan's supplemental direct testimony.[24] Hill reasons that if the retained earnings were not removed from the account until after O'Bryan filed his supplemental direct testimony, then they must have still been in the account at the time O'Bryan originally calculated the capital structure he reported in his supplemental direct testimony. Therefore, O'Bryan would still need to make his adjustment to remove the retained earnings from the capital structure.

Considering it is worth $7.6 million, the parties paid amazingly little attention to this issue. Neither Hill nor O'Bryan were effectively cross-examined about this issue at the hearing, and neither Staff nor AmerenUE effectively addressed the issue in their briefs.

Hill's position is understandable as a matter of bare logic. However, it does not account for the likelihood that O'Bryan in fact used the corrected account balance when he reported the revised capital structure in his rebuttal testimony, even though he does not report that fact in his testimony. Given the paucity of evidence on this issue, the Commission finds O'Bryan's representations to be more credible than the theory offered by Hill. Accordingly, the Commission finds that the correct capital structure is that described by O'Bryan in his rebuttal testimony.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

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[24] O'Bryan Rebuttal, Ex. 8, Page 8, Lines 12-13.

The Commission finds that AmerenUE's actual capital structure as of March 31, 2008, is

Long-Term Debt	45.532%
Short-Term Debt	00.722%
Preferred Stock	01.737%
Common Equity	52.009%

b. Return on Equity

Introduction:

Determining an appropriate return on equity is without a doubt the most difficult part of determining a rate of return. The cost of long-term debt and the cost of preferred stock are relatively easy to determine because their rate of return is specified within the instruments that create them. In contrast, in determining a return on equity, the Commission must consider the expectations and requirements of investors when they choose to invest their money in AmerenUE rather than in some other investment opportunity. As a result, the Commission cannot simply find a rate of return on equity that is unassailably scientifically, mathematically, or legally correct. Such a "correct" rate does not exist. Instead, the Commission must use its judgment to establish a rate of return on equity attractive enough to investors to allow the utility to fairly compete for the investors' dollar in the capital market, without permitting an excessive rate of return on equity that would drive up rates for AmerenUE's ratepayers. In order to obtain guidance about the appropriate rate of return on equity, the Commission considers the testimony of expert witnesses.

Four financial analysts offered recommendations regarding an appropriate return on equity in this case. Dr. Roger A. Morin testified on behalf of AmerenUE. Dr. Morin is

Emeritus Professor of Finance at Robinson College of Business, Georgia State University, and Professor of Finance for Regulated Industry at the Center for the Study of Regulated Industry at Georgia State University. He holds a Ph.D. in Finance and Econometrics from the Wharton School of Finance, University of Pennsylvania.[25] He recommends the Commission allow AmerenUE a return on equity of 10.9 percent if AmerenUE is allowed to establish a fuel adjustment clause.[26] If AmerenUE is not allowed to establish a fuel adjustment clause, Dr. Morin recommends a return on equity of 11.15 percent.[27]

Stephen G. Hill testified on behalf of Staff. Hill is self-employed as a financial consultant, specializing in financial and economic issues in regulated industries. He has earned a Masters in Business Administration from Tulane University.[28] Hill recommends the Commission allow AmerenUE a return on equity of 9.5 percent, assuming the company is not allowed to establish a fuel adjustment clause.[29] If AmerenUE were allowed to establish a fuel adjustment clause, Hill's recommended return on equity would drop to below 9.375 percent.[30]

Michael Gorman testified on behalf of MIEC. Gorman is a consultant in the field of public utility regulation.[31] He holds a Masters in Business Administration with a concentration in Finance from the University of Illinois at Springfield.[32] Gorman

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[25] Morin Direct, Ex. 3, Page 1, Lines 8-18.
[26] Morin Direct, Ex. 3, Page 65, Lines 7-16.
[27] Morin Direct, Ex. 3, Page 71, Lines 10-13.
[28] Hill Direct, Ex. 203, Page 1, Lines 7-15.
[29] Hill Direct, Ex. 203, Page 44, Lines 10-12.
[30] Hill Direct, Ex. 203, Page 44, Lines 2-4.
[31] Gorman Direct, Ex. 600, Page 1, Line 5.
[32] Gorman Direct, Ex. 600, Appendix A, Page 1, Lines 10-12.

recommends the Commission allow AmerenUE a return on equity of 10.2 percent.[33] That rate of return is based on AmerenUE's current level of risk without a fuel adjustment clause. If AmerenUE were allowed to establish a fuel adjustment clause, Gorman would reduce his recommendation by 20 or 25 basis points, resulting in a recommended rate of return of 9.95 or 10.0 percent.[34]

Finally, Billie Sue LaConte testified on behalf of MEG. LaConte is a consultant in the field of public utility economics and regulation.[35] She holds a M.B.A. in finance from the John M. Olin School of Business at Washington University, St. Louis, Missouri. LaConte recommends the Commission allow AmerenUE a return on equity of 10.2 percent without a fuel adjustment clause, or 10.0 percent if a fuel adjustment clause is established.[36]

Findings of Fact:

A utility's cost of common equity is the return investors expect, or require, to make an investment in that company.[37] Financial analysts use variations on three generally accepted methods to estimate a company's fair rate of return on equity. The Discounted Cash Flow (DCF) method assumes the current market price of a firm's stock is equal to the discounted value of all expected future cash flows. The Risk Premium method assumes that all the investor's required return on an equity investment is equal to the interest rate on a long-term bond plus an additional equity risk premium to compensate the investor for the risks of investing in equities compared to bonds. The Capital Asset Pricing Method (CAPM) assumes the investor's required rate of return on equity is equal to a risk-free rate of

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[33] Gorman Direct, Ex. 600, Page 2, Lines 5-7.

[34] Transcript, Page 543, Lines 1-9, and Page 548, Lines 2-25.

[35] LaConte Direct, Ex. 650, Page 1, Line 4.

[36] LaConte Direct, Ex. 650, Page 2, Lines 3-4.

[37] Gorman Direct, Ex. 600, Page 10, Lines 4-5.

interest plus the product of a company-specific risk factor, beta, and the expected risk premium on the market portfolio. No one method is any more “correct” than any other method in all circumstances. Analysts balance their use of all three methods to reach a recommended return on equity. In the words of Dr. Morin, what financial analysts do is a “scientific art”, based on a solid economic foundation, but still dependent upon the analyst’s judgment.[38]

Before examining the analyst’s use of these various methods to arrive at a recommended return on equity, it is important to look at another number. For the first nine months of 2008, the average return on equity awarded to electric utilities in this country was 10.51 percent, as reported by Regulatory Research Associates. That figure was up from an average of 10.36 percent for calendar year 2007.[39] That overall average number includes all electric utilities, some of which are “wires only” utilities in restructured states that provide only distribution services and do not own generation assets. Such utilities tend to be less risky and generally receive lower authorized returns on equity. If the “wires only” utilities are eliminated from the average, the average allowed return on equity for integrated utilities, such as AmerenUE, was 10.62 percent. For Midwest integrated electric utilities[40], that average return on equity rose to 10.71%.[41]

The Commission mentions the average allowed return on equity not because the Commission should, or would slavishly follow the national average in awarding a return on

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[38] Transcript, Page 385, Lines 16-23.

[39] Ex. 60.

[40] “Integrated” or “vertically-integrated” is an industry-specific term commonly used to refer to utilities that own their own generation, transmission and distribution system. An electric utility that only owns a distribution system or possibly owns some transmission in connection with a distribution system is commonly referred to as a “wires only” company.

[41] Morin Rebuttal, Ex. 4, Page 5, Lines 5-18.

equity to AmerenUE. However, AmerenUE must compete with other utilities all over the country for the same capital. Therefore, the average allowed return on equity provides a reasonableness test for the recommendations offered by the return on equity experts.

In AmerenUE's last rate case, the Commission bemoaned the tendency of return on equity witnesses to race to extreme positions instead of offering a balanced analysis that could aid the Commission in its evaluation of the proper return on equity.[42] In this case, the experts have generally done a better job of offering a balanced analysis and the parties are to be commended. Other than Mr. Hill's recommended 9.5 percent return on equity, the recommendations of the other parties are separated by only 70 basis points, and all of those recommendations are within 50 basis points of the reported average return on equity for either vertically-integrated utilities or all utilities.

In evaluating the recommendations of the experts, the Commission will look first at the recommendation offered by Michael Gorman, the witness for MIEC. Gorman utilized a constant growth DCF model to arrive at an average return on equity of 11.86 percent.[43] He also utilized a two-stage DCF model that showed an average return on equity of 9.73 percent.[44] Gorman's use of a multi-stage DCF indicated an average return on equity of 9.89 percent.[45] Gorman also used a Risk Premium model to arrive at a return on equity in a range between 10.25 percent and 10.66 percent, with a midpoint estimate of 10.46 percent.[46] Gorman's use of a Capital Asset Pricing Model (CAPM) showed an estimated

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[42] *In the Matter of Union Electric Company d/b/a AmerenUE's Tariffs Increasing Rates for Electric Service*, Report and Order, Case No. ER-2007-0002, May 22, 2007, Page 42.

[43] Gorman Direct, Ex. 600, Page 18, Lines 9-16.

[44] Gorman Direct, Ex. 600, Page 26, Lines 8-15.

[45] Gorman Direct, Ex. 600, Page 27, Lines 16-22.

[46] Gorman Direct, Ex. 600, Page 31, Lines 1-2.

range of return on equity of 10.63 percent to 10.64 percent, with a midpoint of 10.63 percent.[47]

The results of Gorman's various methods are summarized in the following chart:

Method	Resulting Return on Equity
Constant Growth DCF	11.86%
Two-Stage Growth DCF	9.73%
Multi-Stage DCF	9.89%
Risk Premium	10.46%
CAPM	10.63%
Average of Five Methods	10.51%

However, Gorman chose to ignore the results of his constant growth DCF model in making his recommended return on equity. The results upon which he did rely are summarized in this chart:

Method	Resulting Return on Equity
Two-Stage Growth DCF	9.73%
Multi-Stage DCF	9.89%
Risk Premium	10.46%
CAPM	10.63%
Average of Four Methods	10.2%

[47] Gorman Direct, Ex 600, Page 36, Lines 6-10.

Gorman then recommended a return on equity of 10.2 percent, which is the midpoint of his estimated return on equity range of 9.81 percent to 10.55 percent.[48]

Gorman explains that he decided to ignore the results of his constant growth DCF because he found the results unreasonable and believes they represent an inflated return for AmerenUE.[49] The average 3-5 year growth rates for his three proxy groups are 6.80 percent, 7.25 percent, and 8.03 percent. He believes these growth rates are too high to be a rational estimate of the proxy groups' long-term sustainable growth, because they would exceed the growth rate of the overall US economy.[50]

For his two-stage growth DCF model, Gorman uses a published nominal 5-year and 10-year Gross Domestic Product growth rate of 5.0 percent and 4.8 percent to limit the long-term growth estimate of his proxy groups.[51] However, Gorman used these 5 and 10 year growth estimates improperly to model the historical long-term growth of the economy as a whole.[52] If instead, Gorman had used the 6.0 percent estimate of long-term US GDP growth found in Morningstar's *Stocks, Bond, Bills and Inflation 2008 Yearbook Valuation Edition*, his two-stage DCF model would have been raised by approximately 100-120 basis points, putting his estimates in the 10.7 percent to 10.9 percent range.[53] Making the same adjustment to his multi-stage DCF model would raise the results of that model into the 10.9 percent to 11.1 percent range.[54]

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[48] Gorman Direct, Ex. 600, Page 37, Lines 1-6.

[49] Gorman Direct, Ex. 600, Page 18, Lines 19-20.

[50] Gorman Direct, Ex. 600, Page 18-9, Lines 19-23, 1-13.

[51] Gorman Direct, Ex. 600, Page 25, Lines 14-22.

[52] Morin Rebuttal, Ex. 4, Page 39-40, Lines 22-23, 1-3.

[53] Morin Rebuttal, Ex 4, Page 40, Lines 11-21.

[54] Morin Rebuttal, Ex. 4, Page 41, Lines 1-5.

The Commission will not attempt to recalculate Gorman's two-stage and multi-stage DCF models using different inputs, but the problems with those models illustrate the desirability of considering his model that produces a relatively high return on equity as a balance to his DCF models that show a relatively low return on equity. In that way, the possibly unreasonable impact of one model is counterbalanced by other models. There simply is no good reason to ignore the results of Gorman's constant growth DCF.

As previously indicated, if the result of Gorman's constant growth DCF model is included with the results of his other models, the average result is 10.51 percent. That result should be further adjusted upward because the proxy groups Gorman uses are all, on average, less risky than AmerenUE in that they have average bond ratings two grades higher than the bond ratings assigned to AmerenUE by two widely-used credit rating agencies – Standard & Poor and Moody's.[55]

In the recent Empire rate case, the Commission faced the exact same scenario and noted the difference between a BBB- rating and a BBB+ rating can add between 25 and 50 basis points to a reasonable return on equity.[56] Ultimately, the Commission settled on a 25 basis point upward adjustment to Gorman's recommended return on equity to recognize the increased risk.[57]

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[55] Gorman Direct, Ex. 600, Schedule MPG-3.

[56] *In the Matter of The Empire District Electric Company's Tariffs to Increase Rates for Electric Service Provided to Customers in the Missouri Service Area of the Company*, Report and Order, Case No. ER-2008-0093 July 30, 2008, Page 20.

[57] *In the Matter of The Empire District Electric Company's Tariffs to Increase Rates for Electric Service Provided to Customers in the Missouri Service Area of the Company*, Report and Order, Case No. ER-2008-0093 July 30, 2008, Page 21.

AmerenUE is a much different utility from Empire in that AmerenUE has a higher portion of equity in its capital structure[58]. Less debt proportionately means that the utility is less risky. Accordingly, the Commission finds that in this case a 20 basis point adjustment of ROE is necessary to recognize the difference for utility bond ratings. That brings Gorman's recommended return on equity up to 10.71 percent.

One more adjustment to Gorman's recommended return on equity is appropriate. Gorman used an annualized quarterly dividend payment in calculating his DCF analyses.[59] AmerenUE as well as the overwhelming majority of traditional vertically-integrated electric utilities pay dividends quarterly, not annually. This distinction is important because the conventional DCF model does not account for the compounding of interest (earnings) investors receive and expect in the real world. So, it is more appropriate to use a quarterly DCF model.

At the hearing, Dr. Morin further explained that the use of the annual DCF model is appropriate in jurisdictions that use a forward test year to avoid being overly generous to the company. However, in a jurisdiction such as Missouri that uses a historical test year, the quarterly test year is more appropriate.[60] Morin indicated the difference between the quarterly and the annual DCF model would "definitely "add 20 basis points to a return on equity recommendation.[61] However, Morin's analysis does not contemplate the greater amount of equity in AmerenUE's capital structure referenced by the Commission earlier.

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[58] In the Empire Report and Order, the Commission found that the percentage of common equity in Empire's capital structure was 50.78 percent. *In the Matter of The Empire District Electric Company's Tariffs to Increase Rates for Electric Service Provided to Customers in the Missouri Service Area of the Company*, Report and Order, Case No. ER-2008-0093 July 30, 2008, Page 10.

[59] Gorman Direct, Ex. 600, Page 27, Lines 13-14.

[60] Transcript, Page 433-434, Lines 19-25, 1-12.

[61] Transcript, Page 435, Lines 2-6.

Therefore, the Commission finds that only a five basis point adder is appropriate in this case.

Before finishing the analysis of Mr. Gorman's testimony, the Commission takes notice that this is the second consecutive case where the Commission has made an upward adjustment for return on equity using the quarterly dividends DCF model. Since Ameren does pay quarterly dividends, it is appropriate for this Commission to require the PSC Staff to use the quarterly dividend method when calculating return on equity using the DCF model in future rate cases. Moreover, if Staff does not agree with that approach in succeeding rate cases, Staff needs to make a more compelling argument grounded in economic reality as to why the Commission should relieve them of this obligation.

The Commission finds Gorman's recommended return on equity using the DCF model as adjusted above is the most appropriate return on equity for AmerenUE. Therefore, Ameren's authorized return on equity should be 10.76 percent. However, the Commission's analysis does not end there.

That return on equity is also supported by a necessary adjustment to Gorman's bond yield plus risk premium analysis. That analysis is based on the difference between a utility's required return on common equity investments and bond yield.[62]

In his direct testimony, Gorman used a 22-year average of authorized electric return and Treasury bond yields to calculate an indicated risk premium of 5.08 percent.[63] Gorman's decision to begin his historical analysis with 1986 data is purely arbitrary and he offers no compelling reason for doing so. A careful review of this data demonstrates his

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[62] Gorman Direct, Ex. 600, Page 28, Lines 12-13.

[63] Gorman Direct, Ex. 600, Schedule MPG-14.

range and average risk premium are remarkably lower due to events that occurred 15-20 years ago.

The Commission finds that the use of more recent data when calculating a company's historical equity risk premium is helpful. The Commission makes no finding as to where that cut-off line should be, but finds the following analysis is worth noting in the context of Mr. Gorman's testimony. Using Gorman's data to calculate the average risk premium for the last ten years yields an average risk premium of 5.56 percent. Excluding 1999 data from that average yields a 5.68 percent risk premium. The averages for the most recent five-year period and three-year periods are 5.66 percent and 5.58 percent, respectively.

Further, in making these calculations, Gorman does not account for the fact that, in recent years, vertically-integrated electric utilities like AmerenUE have been awarded an average ROE substantially higher than the average for all electric utilities.

Therefore, the Commission finds the upper range of Gorman's risk premium estimates to be his most valid. If the five-year average indicated risk premium of 5.66 percent is added to the 5.1 percent 30-year Treasury bond yield used by Gorman in his Risk Premium analysis, the result is a return on equity of 10.76 percent.

As previously indicated, there is no precisely "correct" return on equity for AmerenUE. The Commission's manipulation of Gorman's recommendation is not intended to calculate a "correct" return. Rather it is intended to demonstrate the area in which a reasonable return is to be found. After a close examination, the recommendations of two of the other financial experts are also in the same range as the modified recommendation from Gorman.

Dr. Morin recommends a return on equity of 10.9 percent, which is slightly above the 10.76 percent return the Commission has found to be reasonable. However, Dr. Morin's recommendation includes an upward adjustment of approximately 30 basis points to allow for flotation costs.[64] Flotation costs are associated with stock issues. Those costs can either be expensed and recovered at the time the stock is issued, or they can be recovered over a longer period through the use of a flotation allowance, such as Morin incorporated in his return on equity recommendations.[65] However, Morin conceded that AmerenUE did not incur any flotation costs during the test year.[66] He also was unaware of whether this Commission has expensed flotation costs in the past, but concedes that if flotation costs were expensed they should not be recovered again through a flotation adjustment.[67]

AmerenUE contends flotation costs could not have been expensed in many years because before it filed its last previous rate case in 2006, it had not filed a rate case in 20 years.[68] However, the absence of a rate case does not mean AmerenUE did not recover its costs during that period, nor does it mean it should be able to reach back to retroactively recover those costs in this case. Presumably, since AmerenUE chose not to file a rate case during that 20-year period, it was recovering at least a reasonable return on equity during that time.

Since the record does not clearly indicate whether AmerenUE's flotation costs have been expensed in the past, Morin's 30 basis point flotation adjustment must be removed

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[64] Morin Direct, Ex. 3, Page 63, Lines 11-16.

[65] Transcript, Page 393, Lines 4-19.

[66] Transcript, Page 393, Lines 4-6.

[67] Transcript, Page 402, Lines 1-5.

[68] Transcript, Page 462, Lines 3-8.

from his return on equity recommendation. That reduces his return on equity recommendation to 10.6 percent, which is slightly lower than the 10.76 percent return the Commission has found to be reasonable. However, Morin also used the annual DCF model rather than the quarterly DCF model that the Commission found to be appropriate when discussing Gorman's recommendation. The Commission made only a 5 basis point adjustment to Gorman's recommendation, but Morin insisted a 20 basis point adjustment is appropriate.[69] A 20 basis point upward adjustment brings Morin's recommendation back to 10.8 percent, which is very close to the 10.76 percent the Commission has found to be reasonable.

MEG's witness, Billie Sue LaConte, utilized three methods to analyze an appropriate return on equity for AmerenUE and found that a return on equity in the range of 10.1 percent to 10.6 percent would be appropriate.[70] At the hearing, LaConte agreed that anything within her range would be a reasonable return on equity.[71] Thus, the top end of LaConte's recommendation is within 16 basis points of the rate the Commission has found to be reasonable.

Ms. LaConte frequently testifies before this Commission on rate design issues,[72] and some of her points are well taken. However, a comparison of Ms. LaConte's return on equity analysis to that offered by Dr. Morin and Mike Gorman reveals that she did not provide quite the same detailed analysis as either of those two witnesses. This limits her

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[69] Transcript, Page 435, Lines 2-6.

[70] LaConte Direct, Ex. 650, Page 14, Lines 2-4.

[71] Transcript, Page 295, Lines 22-24.

[72] Transcript, Page 285, Lines 10-13.

credibility on the issue and the Commission does not find her testimony persuasive enough to require a reduction in the rate of return the Commission has found to be reasonable.

The final return on equity expert witness is Stephen Hill for the Commission's Staff. Hill recommended a return on equity of 9.5 percent, which is 70 basis points lower than any other recommendation offered in this case, and more than 100 basis points lower than the average allowed return on equity for all electric utilities throughout the country. Hill's recommendation would give AmerenUE the lowest return on equity authorized for any integrated electric utility in the country for 2008.[73] Mr.Hill does not argue that AmerenUE is, in fact, the least risky of all those utilities.

Hill generally testifies on behalf of consumer advocates,[74] but even Public Counsel in this case did not support his extremely low recommendation. Dr. Morin's rebuttal, surrebuttal, and live testimony convincingly explain all the problems with Hill's recommendation, and the Commission will not waste its time recounting those deficiencies. It is enough to say that based on Morin's testimony, the Commission specifically finds that Hill's return on equity recommendation in this case is not credible, and the Commission will give it no further consideration.

Should the Commission adjust AmerenUE's return on equity downward in the event a fuel adjustment clause is awarded?

In this Report and Order, the Commission is authorizing AmerenUE to implement a fuel adjustment clause for the first time. Several parties contend the allowed return on equity should be adjusted downward to recognize the decreased risk AmerenUE will face because it now has a fuel adjustment clause.

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[73] Ex. 60.

[74] Transcript, Page 490, Lines 7-14.

There is no dispute that the implementation of a fuel adjustment clause will reduce the level of operating risk AmerenUE will face. The question is whether the analysts' recommendations already take that decreased risk into account.

Fuel adjustment clauses are commonly used around the country,[75] so most of the comparable companies included in the proxy groups used by the various return on equity analysts already have fuel adjustment clauses in place. Moreover, the overwhelming majority of the jurisdictions where traditional vertically-integrated utilities like AmerenUE operate (including our neighboring states of Arkansas, Kansas and Oklahoma) allow for the 100 percent pass-through of fuel and purchased power costs, which are the most significant costs AmerenUE faces. This Report and Order will not allow AmerenUE to pass-through 100 percent of those costs, meaning AmerenUE will retain more risk than most comparable companies.

AmerenUE's witness, Dr. Morin, testified that if AmerenUE did not receive a fuel adjustment clause he would have to increase his return on equity recommendation by 25 basis points to compensate AmerenUE for the higher financing costs and increased risk it would face.[76] That possible upward adjustment does not, however, mean a similar downward adjustment must be made for the presence of a fuel adjustment clause.

As indicated, most of the companies included in the proxy groups used by the analysts to estimate an appropriate return on equity for AmerenUE already operate under a fuel adjustment clause. That means the analysts are measuring and evaluating AmerenUE against companies with a level of risk that takes into account their use of a fuel adjustment clause. Therefore, while an upward adjustment may have been appropriate if a fuel

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[75] Lyons Rebuttal, Ex. 42, Schedule MJL-RE8.

[76] Morin Direct, Ex. 3, Page 68, Lines 6-14.

adjustment clause were not allowed, no corresponding reduction is necessary because a fuel adjustment clause will be in place.

Generic Return on Equity Case

Billie Sue LaConte, the witness for MEG, advised the Commission to consider opening a generic return on equity case to better deal with future rate cases. Such a case would have no effect on AmerenUE's current rate case, but it might make the Commission's task easier in future rate cases. At the same time, it would also bring some certainty to utilities and other parties as they participate in those future rate cases. The concept of a generic case was supported at the hearing by other witnesses and parties.

The Commission is interested in learning more about the concept of a generic return on equity case and plans to hold a roundtable or open a working case to consider that concept. Moreover, this Commission finds that discussion of a generic return on equity should included the quarterly DCF issue previously discussed in this Report and Order.

Conclusions of Law:

In assessing the Commission's ability to use different methodologies to determine just and reasonable rates, the Missouri Court of Appeals has said:

> Because ratemaking is not an exact science, the utilization of different formulas is sometimes necessary. … The Supreme Court of Arkansas, in dealing with this issue, stated that there is no 'judicial mandate requiring the Commission to take the same approach to every rate application or even to consecutive applications by the same utility, when the commission in its expertise, determines that its previous methods are unsound or inappropriate to the particular application' (quoting *Southwestern Bell Telephone Company v. Arkansas Public Service Commission,* 593 S.W. 2d 434 (Ark 1980).[77]

Furthermore,

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[77] *State ex rel. Assoc. Natural Gas Co. v. Public Service Commission,* 706 S.W. 2d 870, 880 (Mo. App. W.D. 1985).

> Not only can the Commission select its methodology in determining rates and make pragmatic adjustments called for by particular circumstances, but it also may adopt or reject any or all of any witnesses' testimony.[78]

In another case, the Court of Appeals recognized that the establishment of an appropriate rate of return is not a "precise science":

> While rate of return is the result of a straight forward mathematic calculation, the inputs, particularly regarding the cost of common equity, are not a matter of 'precise science,' because inferences must be made about the cost of equity, which involves an estimation of investor expectations. In other words, some amount of speculation is inherent in any ratemaking decision to the extent that it is based on capital structure, because such decisions are forward-looking and rely, in part, on the accuracy of financial and market forecasts.[79]

Section 386.266, RSMo (Supp. 2008), the statute that allows the Commission to order AmerenUE to implement a fuel adjustment clause, allows the Commission to modify a company's allowed return on equity to reflect the implementation of a fuel adjustment clause. Specifically, subsection 7 of that statute provides that the Commission may:

> take into account any change in business risk to the corporation resulting from implementation of the adjustment mechanism in setting the corporation's allowed return in any rate proceeding, in addition to any other changes in business risk experienced by the corporation.

That section does not, however, require the Commission to make any adjustment to allowed return on equity when it allows a company to implement a fuel adjustment clause.

Decision:

Based on the evidence in the record, on its analysis of the expert testimony offered by the parties, and on its balancing of the interest of the company's ratepayers and shareholders, as fully explained in its findings of fact and conclusions of law, the

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[78] *Id.*

[79] *State ex rel. Missouri Gas Energy v. Public Service Commission*, 186 S.W.3d 376, 383 (Mo App. W.D. 2005).

Commission finds that 10.76 percent is a fair and reasonable return on equity for AmerenUE. The Commission finds that this rate of return will allow AmerenUE to compete in the capital market for the funds needed to maintain its financial health. As one final check on reasonableness, the 10.76% return on equity is within 15 basis points of the national average return on equity for electric utility companies.

2. Vegetation Management and Infrastructure Inspection Expenses

Introduction:

In 2006, AmerenUE experienced extensive service outages due to severe thunderstorms in the summer and ice storms in the winter. In response to concerns that AmerenUE and other electric utilities had failed to properly maintain their electric distribution systems, the Commission promulgated new rules designed to compel Missouri's electric utilities to do a better job of maintaining their electric distribution facilities to enhance the reliability of electric service to customers. Those rules, entitled Electrical Corporation Infrastructure Standards[80] and Electrical Corporation Vegetation Management Standards and Reporting Requirements,[81] became effective on June 30, 2008.

The rules establish specific standards requiring electric utilities, including AmerenUE, to inspect and replace old and damaged infrastructure, such as poles and transformers. In addition, electric utilities are required to more aggressively trim tree branches and other vegetation that encroaches on transmission lines. In promulgating the stricter standards, the Commission anticipated utilities would have to spend more money to comply. Therefore, both rules include provisions that allow the utility a means to recover to

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[80] Commission Rule 4 CSR 240-23.020.

[81] Commission Rule 4 CSR 240-23.030.

the extra costs it incurs to comply with the requirements of the rule. In general, this issue concerns whether and how AmerenUE will be allowed to recover those costs.

This is a complicated and confusing issue that the Commission will address in pieces by answering the specific questions offered by the parties in the Statement of Issues filed before the start of the hearing. Once the specific pieces are addressed, the overall picture will come into focus.

a. Vegetation Management

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

Findings of Fact:

The determination of this number is the starting point for other decisions to follow. Staff proposes the amount be set at the company's actual expenditures during the test year, trued-up through September 30, 2008.[82] What that amount may be is not clearly revealed in the record. Initially, Staff indicated the test year level of vegetation management costs should be set at $45,666,000,[83] which is a number derived from the supplemental direct testimony of AmerenUE's witness, Gary Weiss.[84] However, since Weiss' testimony was filed on June 16, 2008, that number would not be trued-up through September 30, 2008. At the hearing, Staff's witness indicated his belief that the trued-up number might have been $49.7 million.[85]

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[82] Transcript, Page 1673, Lines 6-12.

[83] Beck Surrebuttal, Ex. 218, Page 4, Lines 8-9.

[84] Weiss Supplemental Direct, Ex. 11, Page 20, Lines 8-9.

[85] Transcript, Page 1673, Lines 13-19. That number is also found in Zdellar's workpapers entered into evidence as Ex. 240.

AmerenUE proposes the base amount for vegetation management be set at the average amounts included in AmerenUE's budgets for 2009 and 2010.[86] In Ron Zdellar's rebuttal testimony, he says that number is $49 million.[87] However, in his corrected surrebuttal testimony, the number has become $54.1 million.[88]

Whatever the exact numbers, the important determination at this point is the principle of whether an actual test year amount or a prospective budgeted amount should be used. Public Counsel, and presumably Staff, oppose the use of budgeted cost numbers, because they believe such numbers are not known and measurable.[89]

AmerenUE's expenditures on vegetation management have increased each quarter of 2008, as the company ramps up its compliance with the Commission's vegetation management rules.[90] Therefore, a projected budget amount is more likely to properly measure the company's actual expenditures in the coming years.

AmerenUE has made good progress in meeting its prior commitments and the requirements of the Commission's rule by attaining the required four and six-year tree trimming cycles as of November 14, 2008.[91] The Commission wants to encourage the company to continue making progress and allowing an amount in rates that is likely to match the company's actual expenditures is the best way to achieve that goal. Therefore, the Commission will include $54.1 million as the base amount of vegetation management costs for the calculation of rates in this case.

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[86] Transcript, Page 1610, Lines 20-24.

[87] Zdellar Rebuttal, Ex. 16, Page 9, Lines 1-2.

[88] Ex. 76.

[89] Robertson Surrebuttal, Ex. 408, Page 4, Lines 10-11.

[90] Zdellar Surrebuttal, Ex. 17, Page 3, Lines 21-22.

[91] Transcript, Page 1608, Lines 17-20.

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

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

These two questions are interrelated so the Commission will address them together.

Findings of Fact:

In answering the previous question, the Commission determined AmerenUE's rates going forward should allow the company to recover $54.1 million per year from ratepayers for vegetation management expenses. In AmerenUE's last rate case, the Commission approved a stipulation and agreement that allowed the company to recover $45 million per year, and, in fact, established a one-way tracker that required the company to spend that amount of money on vegetation management, but did not track or require future consideration of any additional spending over $45 million.[92]

The Commission's new vegetation management rule includes a provision that allows an electric utility to recover expenses it incurs to comply with the rule to the extent those costs exceed the amount allowed in the utility's existing rates.[93] Between January 1, 2008, and September 30, 2008, AmerenUE spent an additional $2.9 million for vegetation

[92] Transcript, Pages 1626-1627, Lines 18-25, 1-15.

[93] Commission Rule 4 CSR 240-23.020(4).

management, beyond what it was able to recover in its existing rates.[94] AmerenUE asks that it be allowed to amortize that amount over three years and recover it in the rates to be established in this case.

Staff opposes AmerenUE's attempt to recover these additional expenditures for two reasons: first, because the one-way tracker from the last rate case does not allow AmerenUE to track and recover expenditures above $45 million; and second, because AmerenUE's additional expenditures are related to its prior commitment to improve its vegetation management practices, and not because of the implementation of the new vegetation management rule.[95]

Staff does not identify, and the Commission does not find, anything in the one-way tracker implemented in AmerenUE's last rate case that would preclude the company from utilizing the clear provisions of the rule to recover the additional expenses it incurred to comply with the vegetation management rule. Thus, to the extent AmerenUE incurred additional costs to comply with the rule, it should be allowed to recover those costs in this case.

The question of whether AmerenUE's additional expenditures were caused by its compliance with the new rule is complicated by the fact that the new rule did not go into effect until June 30, 2008. Thus, AmerenUE's increased expenditures for the period of January 1, 2008 to June 30, 2008, undeniably occurred before the rule went into effect.

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[94] Exhibit 76, Page 12, Lines 5-6.

[95] Beck Rebuttal, Ex. 217, Page 7, Lines 1-9.

However, AmerenUE began complying with the Commission's rule on January 1, 2008, six months before the rule went into effect.[96] It did so because it anticipated that the rule would be effective on January 1, and in fact, the rule would have been effective on that date except the Commission missed the deadline for submission of its rulemaking to the secretary of state and had to restart the rulemaking process. Staff's witness, however, agreed that AmerenUE's decision to begin complying with the rule before it became effective was a good practice that benefited the company's ratepayers.[97]

The Commission finds that AmerenUE's decision to begin complying with requirements of the rule benefited the reliability of AmerenUE's electric system and thus benefited the company's ratepayers. The fact that those costs were incurred before the rule went into effect does not affect AmerenUE's ability to recover those costs under the terms of the rule.

However, that determination does not necessarily mean that AmerenUE incurred those costs because of the rule. As Staff points out, in a previous case,[98] AmerenUE made a commitment to increase its spending on vegetation management to improve the reliability of its electric system. In particular, AmerenUE agreed to implement a four-year tree-trimming cycle in urban areas and a six-year cycle in rural areas by the end of 2008.[99] Staff contends AmerenUE's extra spending was to comply with that earlier commitment and not to comply with the rule.

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[96] Zdellar Surrebuttal, Ex. 17, Page 2, Lines 6-8.

[97] Transcript, Page 1682, Lines 20-23.

[98] Commission Case No. EW-2004-0583.

[99] Zdellar Surrebuttal, Ex. 17, Page 4, Lines 8-18.

"The rule requires AmerenUE to take steps above and beyond its earlier commitment. The rule also sets a minimum clearance distance, requires mid-cycle inspections, customer education efforts, and requires notice be given before trimming. None of those requirement existed before AmerenUE began complying with the new rules and all impose additional costs on the company.[100]

Furthermore, the existence of the $45 million one-way tracker in the previous rate case actually supports AmerenUE's position. The $45 million was established in the last rate case as the amount AmerenUE would be required to spend to comply with the commitments it had made at that time. It is reasonable to assume it actually spent that amount to comply with those earlier commitments. However, after AmerenUE began complying with the rule on January 1, 2008, it spent more than the $45 million it was required to spend under the tracker. Therefore, the Commission concludes the extra $2.9 million spent above $45 million was the amount AmerenUE spent to comply with the rule. Under the terms of the rule, AmerenUE is entitled to recover that amount from ratepayers, and it may do so by amortizing $2.9 million over three years and recovering it in rates.

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

Findings of Fact:

AmerenUE is requesting an accounting authority order to allow it to accumulate and defer the additional costs of complying with the vegetation management rule it will incur

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[100] Zdellar Surrebuttal, Ex. 17, Page 4, Lines 19-23.

during the period of October 1, 2008 through February 28, 2009.[101] That period is between the end of the true-up for this case and the beginning of new rates that will go into effect at the end of this case. The Commission has just found that extra expenses incurred before October 1 can be recovered in this case. Similarly, extra expenses incurred after February 28 would be deferred for future consideration in the tracking mechanism that will be considered later in this order. However, extra expenses AmerenUE incurs during this gap could not be considered and recovered in a future rate case unless an accounting authority order is authorized.

Staff opposed granting of the requested accounting authority for the same reason it opposed allowing AmerenUE to recover the extra expenses it incurred through September 30, 2008. For the same reasons it rejected Staff's arguments regarding those costs, the Commission rejects Staff's arguments regarding the requested accounting authority order. AmerenUE is authorized to accumulate and defer the additional costs of complying with the vegetation management rule it will incur during the period from October 1, 2008, through February 28, 2009.

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

Findings of Fact:

AmerenUE asks the Commission to implement a two-way tracking mechanism for vegetation management and infrastructure inspection and repair expenses. The tracker

[101] Zdellar Surrebuttal, Ex. 17, Page 12, Lines 8-10.

would set a base level of vegetation management and infrastructure inspection and repair costs. Actual expenditures would then be tracked around that base level with the creation of a regulatory liability in any year where AmerenUE spends less than the target amount, and a regulatory asset where the company spends more than the target amount. The assets and liabilities would then be netted against each other and considered in AmerenUE's next rate case.[102]

Staff supports the idea of a two-way tracking mechanism. However, Staff would place a ten percent cap on expenditures,[103] and would limit the operation of the tracker to only one year, March 1, 2009, through February 28, 2010.[104]

The Commission finds a ten percent cap on the tracker to be appropriate. Without a cap, the tracker would essentially give AmerenUE a blank check to spend however much it wants on vegetation management with assurance that any expenditure will likely be recovered from ratepayers. Of course, any such expenditure would still be subject to a prudence review in the next rate case, but a prudence review is not a complete substitute for a good financial incentive. If AmerenUE finds it must increase its vegetation management spending to a level more than ten percent above its budgeted amount, it has the option of coming to the Commission for accounting authority to defer those costs for consideration in a future rate case.[105]

Public Counsel opposes the implementation of any tracking mechanism. Public Counsel's witness argues "the use of tracker mechanisms subvert the regulatory rate model

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[102] Zdellar Rebuttal, Ex. 16, Pages 7-8, Lines 15-22, 1-2.

[103] Transcript, Page 1684, Lines 7-22.

[104] Beck Surrebuttal, Ex. 218, Page 6, Lines 22-23.

[105] Transcript, Page 1703, Lines 14-25.

process and should be used in very limited instances."[106] Public Counsel further explains that tracker mechanisms violate the "matching principle" of regulation by moving revenues or expenses away from the time in which they were incurred, to be recovered from future ratepayers who may not have benefited from the expenditures.[107] They also reduce the utility's business risk at the expense of ratepayers, and they reduce the utility's incentive to minimize its expenses.[108]

Staff also suggests the tracker be limited to one year. Staff provided no testimony or other evidence to support such a restriction. The Commission finds that the tracker shall remain in effect until new rates are established in the next rate case.

Public Counsel's general concerns about the overuse of tracking mechanisms are valid. The Commission does not intend to allow the overuse of tracking mechanisms in this case, or in future rate cases. However, the tracker proposed by AmerenUE in this case is appropriate. This is a limited tracker that will have only a limited effect on AmerenUE's business risk. With the cap proposed by Staff, the tracker can increase AmerenUE's vegetation management costs by no more than approximately five million dollars. Furthermore, because the vegetation management rule is still very new, no one can know with any certainty how much AmerenUE will need to spend to comply with the rule's provisions. The tracker will ensure AmerenUE does not over-recover for its actual expenditures, as much as it will ensure it does not under-recover those expenditures. Thus, the risk for ratepayers, as well as for AmerenUE, is reduced by operation of the tracking mechanism.

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[106] Robertson Surrebuttal, Ex. 408, Page 10, Lines 4-5.

[107] Robertson Surrebuttal, Ex. 408, Pages 10-11, Lines 17-21, 1.

[108] Robertson Surrebuttal, Ex. 408, Page 11, Lines 1-21.

In addition, Public Counsel is concerned AmerenUE will have fewer electrical outages on its system in the future because of the work that it is doing to comply with the vegetation management rule.[109] As a result, AmerenUE will likely have fewer outage related expenses. Public Counsel points out that any reduction in outage related expenses will not be included in the tracker.[110]

Public Counsel's concerns are unwarranted. The Commission certainly hopes AmerenUE's increased spending on vegetation management will result in a reduction in outage related expenses. That will mean AmerenUE's electric system has become more reliable, a result that will certainly benefit the utility's customers. Any reduction in outage related expenses will, of course, be reflected in a reduced cost of service in AmerenUE's next rate case. In the same rate case, the Commission will consider any adjustments, up or down, that result from application of the tracking mechanism the Commission will approve in this case. Thus, balance will be maintained and ratepayers will not be harmed by operation of the tracking mechanism.

b. Infrastructure Inspection and Repair.

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

Findings of Fact:

AmerenUE proposes it be allowed to recover $23.9 million in this case for infrastructure inspection and repair costs.[111] Staff would limit AmerenUE's recovery under these provisions to the amount spent for inspections, but would eliminate expenditures for

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[109] Transcript, Page 1622, Lines 19-22.

[110] Transcript, Page 1618, Lines 3-8.

[111] Zdellar Surrebuttal, Ex. 17, Page 12, Lines 14-15.

repairs made as a result of those inspections.[112] The Commission finds that AmerenUE's rates already allow for recovery of the expenditures required to repair its electric system. The fact those repairs may occur following an inspection does not mean the repairs would not eventually have been made anyway and there is no reason to believe the repairs would be more costly simply because they were made after an inspection. Thus, to allow recovery under this provision as an increased cost of complying with the rule could result in a double recovery of those costs.[113]

AmerenUE's witness, Ron Zdellar, offered vague assurances AmerenUE would be able to separate repair costs resulting from inspections from repair costs resulting from a system failure or a customer report of problems,[114] thus avoiding the double counting problem. However, the Commission is not convinced, and finds that the risk of double recovery precludes AmerenUE's attempt to recover repair costs under this provision. Therefore, the Commission finds that AmerenUE shall recover $10.7 million as the cost of conducting infrastructure inspections. That amount is the average of AmerenUE's forecast expense for 2009 and 2010.[115]

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

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[112] Beck Surrebuttal, Ex. 218, Page 11, Lines 23-24.

[113] Beck Surrebuttal, Ex. 218, Page 11, Lines 24-28.

[114] Zdellar Surrebuttal, Ex. 17, Pages 10-11, Lines 17-21, 1-2.

[115] Exhibit 240.

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

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

Findings of Fact:

AmerenUE again proposes a three-year amortization and recovery in rates of the $8.0 million in infrastructure inspection and repair expenses it incurred to comply with the Commission's rule from January 1, 2008, through September 30, 2008.[116] For the compliance costs incurred from October 1, 2008, through February 28, 2009, AmerenUE requests an accounting authority order to defer those costs for consideration in its next rate case.

Staff again opposes recovery of the amount incurred before the rule went into effect on June 30, 2008. For the reasons previously described regarding the vegetation management rule, the Commission rejects that position.

Conclusions of Law:

For the costs AmerenUE incurred from July 1, 2008 through September 30, 2008, Staff again opposes AmerenUE's proposal to amortize and recover those costs in this case. Staff instead advises the Commission to grant AmerenUE accounting authority to defer recognition of the costs incurred from July 1, 2008 through February 28, 2009 for

[116] Exhibit 76.

consideration in AmerenUE's next rate. [117] In its brief, Staff suggests those costs simply be added to the tracking mechanism for consideration in AmerenUE's next rate case.

Staff takes that position because of its interpretation of a provision of the Commission's Infrastructure Standards Rule, 4 CSR 240-23.020.[118] Section (4) of that rule allows a utility to request an accounting authority order to recover compliance costs in its next general rate case, "filed after the effective date of this rule". AmerenUE filed this before the rule became effective, so Staff contends the costs incurred from July 1, 2008, through September 30, 2008 cannot be recovered in this case and must instead be deferred until AmerenUE's next rate case.

Staff's interpretation of the rule is overly technical and nonsensical. The intent of the rule is simply to indicate costs may be deferred until the next rate case. The Commission did not intend to limit a utility's ability to recover costs incurred within the update period of a pending rate case.

AmerenUE may amortize its infrastructure inspection costs incurred from January 1, 2008, through September 30, 2008, to comply with the Commission's Infrastructure Standards rule over three years and recover those costs in this case. Furthermore, AmerenUE is granted accounting authority to defer its infrastructure inspection costs incurred between October 1, 2008, and February 28, 2009, to comply with the Commission's Infrastructure Standards rule.

AmerenUE also proposed to recover or defer its cost of infrastructure repairs. For the reasons previously stated, the Commission finds that recovery or deferral of those repair costs is not appropriate.

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[117] Beck Surrebuttal, Ex. 218, Page 11, Lines 1-3.

[118] Beck Surrebuttal, Ex. 218, Page 11, Lines 5-19.

In his surrebuttal testimony for AmerenUE, Ron Zdellar indicated the cost of infrastructure inspection and repairs for the period of January 1, 2008, through September 30, 2008, was $8.6 million. Exhibit 240, drawn from Zdellar's work papers, breaks that down into $3.7 million for inspections and $4.9 million for repairs for the January through September period. In his corrected surrebuttal testimony, which is exhibit 76, Zdellar reduces that amount to a total of $8.0 million for infrastructure inspection and repair. Unfortunately, the record does not contain a breakdown of that total amount between repairs and inspections. Since the Commission has determined AmerenUE should not be allowed to defer and recover those repair costs, the Commission must devise a way to remove those costs from the total.

The Commission will assume Zdellar's corrected amount will retain the same ratio of repair costs to inspection costs as that in the number contained in his surrebuttal testimony. The number in the surrebuttal testimony was 43 percent inspection costs and 57 percent repair cost. Applying the same ratio to the $8.0 million number in exhibit 76 shows inspection costs of $3.44 million and repair costs of $4.56 million. Thus, the Commission will allow AmerenUE to amortize $3.44 million in inspection costs over 3 years and recover them in the rates to be established in this case.

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

Findings of Fact:

AmerenUE proposes a single tracking mechanism that would track both vegetation management expenses and infrastructure inspection expenses. The Commission has previously approved a tracker for vegetation management expenses and for the same reasons, will approve the tracking mechanism to also apply to infrastructure inspection expenses as previously described.

Conclusions of Law Regarding Vegetation Management and Infrastructure Inspection and Repair:

Commission Rule 4 CSR 240-23.020 establishes standards requiring electrical corporations, including AmerenUE, to inspect its transmission and distribution facilities as necessary to provide safe and adequate service to its customers. Specifically, 4 CSR 240-23.020(3)(A) establishes a four-year cycle for inspection of urban infrastructure and a six-year cycle for inspection of rural infrastructure.

Commission Rule 4 CSR 240-23.020(4) establishes a procedure by which an electric utility may recover expenses it incurs because of the rule. Specifically, that section states as follows:

> In the event an electrical corporation incurs expenses as a result of this rule in excess of the costs included in current rates, the corporation may submit a request to the commission for accounting authorization to defer recognition and possible recovery of these excess expenses until the effective date of rates resulting from its next general rate case, filed after the effective date of this rule, using a tracking mechanism to record the difference between the actually incurred expenses as a result of this rule and the amount included in the corporation's rates … .

Commission Rule 4 CSR 240-23.030 establishes standards requiring electrical corporations, including AmerenUE, to trim trees and otherwise manage the growth of vegetation around its transmission and distribution facilities as necessary to provide safe and adequate service to its customers. Specifically, 4 CSR 240-23.030(9) establishes a

four-year cycle for vegetation management of urban infrastructure and a six-year cycle for vegetation management of rural infrastructure. The vegetation management rule also includes a provision that would allow AmerenUE to ask the Commission for authority to accumulate and recover its cost of compliance in its next rate case.[119]

Decision:

The Commission's decision regarding vegetation management and infrastructure inspection expenses can be summarized as follows:

1. AmerenUE shall recover in its base rates $54.1 million for vegetation management costs, and $10.7 million for infrastructure inspection costs.

2. AmerenUE shall amortize over three years and recover in rates $2.9 million for vegetation management expenses beyond what it was able to recover in prior rates. AmerenUE shall amortize over three years and recover in rates $3.44 million in infrastructure inspection costs beyond what it was able to recover in prior rates.

3. AmerenUE shall establish a tracking mechanism to track future vegetation management and infrastructure inspection costs. That tracking mechanism shall include a base level of $64.8 million ($54.1 million + $10.7 million = $64.8 million). Actual expenditures shall be tracked around that base level with the creation of a regulatory liability in any year where AmerenUE spends less than the base amount and a regulatory asset in any year where AmerenUE spends more than the base amount. The assets and liabilities shall be netted against each other and shall be considered in AmerenUE's next rate case. The tracking mechanism shall contain a ten percent cap so expenditures exceeding the base level by more than 10 percent shall not be deferred under the tracking

[119] Commission Rule 4 CSR 240-23.030(10).

mechanism. If AmerenUE's vegetation management and infrastructure inspection costs exceed the ten percent cap, it may request additional accounting authority from the Commission in a separate proceeding. The tracking mechanism shall operate until new rates are established in AmerenUE's next rate case.

3. January 2007 Ice Storm AAO

Introduction:

AmerenUE experienced a severe ice storm in its service territory on January 13, 2007. Staff and AmerenUE agree AmerenUE incurred $24.56 million in storm restoration costs following that storm.[120] In an earlier case, Case No. EU-2008-0141, the Commission approved a stipulation and agreement that gave AmerenUE an accounting authority order (AAO) authorizing it to defer those storm restoration costs for consideration in this rate case.[121] The approved stipulation and agreement also determined the storm restoration costs would be amortized over a five-year period. In other words, an amount would be included in rates that would allow AmerenUE to recover one fifth of the total costs in each of five years. The only disagreement was about when that amortization period should begin. Rather than resolve that question, the stipulation and agreement in the AAO case provided the issue would be deferred for consideration in this rate case, which was already pending at the time.

Staff proposes the five-year amortization period begin on February 1, 2007, approximately two weeks after the storm.[122] AmerenUE contends the five-year

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[120] Cassidy Surrebuttal, Ex. 226, Page 11, Lines 7-9.

[121] *In the Matter of the Application of Union Electric Company, d/b/a AmerenUE for an Accounting Authority Order Regarding Accounting for the Extraordinary Costs Relating to Damage from the January 2007 Ice Storm*, Case No. EU-2008-0141, Order Approving Stipulation and Agreement, April 30, 2008.

amortization period should begin on March 1, 2009, the presumed effective date of the new rates that will be established in this case.[123]

Findings of Fact:

Staff's proposed February 1, 2007, starting date for the amortization period effectively ensures AmerenUE will be unable to recover two fifths of the storm restoration costs for which the Commission granted an AAO. When the rates established in this case go into effect, more than two of the five years of amortization would have already occurred. Those amounts amortized over the first two years would be lost to AmerenUE and likely could not be recovered. In the particular circumstances of this case, that result would be unfair to AmerenUE.

The purpose of an AAO is to give the utility an opportunity to recover extraordinary expenses. In granting AmerenUE an AAO, based on the stipulation and agreement of the parties, the Commission determined the ice storm restoration costs are extraordinary costs, and no party disputes that fact. As Staff points out, an AAO is not intended to absolutely ensure a utility recovers all those extraordinary expenses.[124] However, the utility should be given a reasonable opportunity to make that recovery.

Staff's proposed date for beginning the amortization period would not give AmerenUE a reasonable opportunity to recover those expenses because of the timing of this ice storm in relation to AmerenUE's last rate case. The ice storm occurred on January 13, 2007. That was only two weeks after the January 1, 2007, cut-off date for known and

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[122] Cassidy Surrebuttal, Ex. 226, Page 11, Lines 12-13.

[123] Barnes Rebuttal, Ex. 26, Page 8, Lines 3-5.

[124] Cassidy Surrebuttal, Ex. 226, Page 13, Lines 2-4.

measurable changes in AmerenUE's last rate case.[125] Therefore, AmerenUE incurred the expenses after the close of the test year and as a result could not recover those costs in the normal course of that rate case.

Staff suggests perhaps AmerenUE could have sought recovery of these expenses as an isolated adjustment in the last rate case.[126] However, such recovery would have been unlikely because the actual amount of the storm expenses was not known and measurable until the final invoices from contractors and other utilities were received in June 2007, after the rates from the prior rate case had gone into effect, and long after the evidentiary record in that case had closed. As a result, AmerenUE was effectively precluded from seeking recovery of those storm expenses in the last rate case.

That is important because in ordinary situations, when a utility obtains an AAO, it can control the timing of a rate case in which it will seek to recover the expenses deferred under the AAO. Thus, the utility can weigh the expenses that are being amortized under the AAO against its other expenses and revenues and decide whether it needs to come in for a rate case to try to recover the expenses that are being amortized. In some cases, the utility may conclude it does not need to increase its revenues and will decide not to file a rate case, allowing the costs deferred under the AAO to be amortized out of existence.

In this case, the extraordinary ice storm restoration expenses were incurred while AmerenUE was already in the later stages of a rate case, but too late to be recovered in that rate case. AmerenUE concluded it needed additional revenue as it failed to earn its

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[125] Barnes Rebuttal, Ex. 26, Page 8, Lines 10-12.

[126] Transcript, Page 1858, Lines 7-10.

allowed return on equity throughout 2007,[127] but as a practical matter, could not have filed a rate case much before April 2008 when it filed this case.[128] That means AmerenUE could not effectively use the option of filing a rate case to recover the costs sooner, as is frequently done in an AAO situation.

Staff contends AmerenUE would not necessarily be precluded from recovering the full amount of the expenses deferred under the AAO no matter when the five-year amortization begins. In theory, that is true, because once the annually amortized amount of expenses is included in rates, that amount of expenses will remain in rates until the Commission revises those rates in a future rate case. If the five-year amortization begins in 2007, as Staff proposes, the amortization would be complete in 2012. However, if AmerenUE chose not to file another rate case until 2014 the annually amortized amount of expenses would continue in rates for two extra years and AmerenUE would fully recover its storm restoration expenses. Indeed, if AmerenUE did not bring a rate case until 2015 or later, it could actually over-recover those expenses.

However, given the rising cost environment facing AmerenUE, it is unreasonable to believe the company will wait until 2014, or after, to file its next rate case. Indeed, the testimony presented at the hearing indicated AmerenUE will not wait nearly that long to file its next rate case.[129] Furthermore, since the Commission is authorizing AmerenUE to establish a fuel adjustment clause in this case, AmerenUE will be required to file a new rate

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[127] Barnes Rebuttal, Ex. 26, Page 9, Chart at Line 1.

[128] Transcript, Page 1847-1848, Lines 3-25, 1.

[129] Transcript, Page 2210, Lines 9-12, and Ex. 433HC, Page 17, AmerenUE's exact plan for filing future rate cases is highly confidential.

case no later than 2012, so that new rates will go into effect no later than March 1, 2013.[130] Under these circumstances, there is no risk that AmerenUE will over-recover its storm restoration expenses, and beginning the five-year amortization on the date proposed by Staff would guarantee AmerenUE would be unable to recover the full amount of expenses.

Conclusions of Law:

A fuel adjustment clause approved under Section 386.266, RSMo (Supp. 2008), the statute that give the Commission authority to approve a fuel adjustment clause for an electric utility, must contain a provision requiring the utility to "file a general rate case with the effective date of new rates to be no later than four years after the effective date of the commission order implementing the adjustment mechanism."

Decision:

Under the unique circumstances of this case, the five-year amortization period for the storm restoration costs relating to the January 2007 ice storm shall begin on March 1, 2009. This decision is dictated by these particular facts and should not be interpreted as a general rule that would require the beginning of an amortization period in a future case to coincide with the effective date of rates in a future rate case.

4. Deferred Income Taxes

Introduction:

Deferred income taxes arise from temporary differences between book and tax treatment of an item of income or expense. Under well-established regulatory principles, deferred taxes are treated as a reduction to rate base so ratepayers do not pay a return on

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[130] Section 386.266, RSMo (Supp. 2008).

funds provided to the company at no cost.[131] In that way, ratepayers are given the benefit of what is, in effect, an interest free loan from the government to the utility.[132] In other words, the benefit the company receives from being able to keep money by delaying payment to the government is passed along to ratepayers.

There is no disagreement about those principles. The issue concerns several uncertain tax positions AmerenUE has taken before the IRS. Staff wants to treat all of the money associated with those uncertain positions as deferred income taxes, and thus as a reduction to AmerenUE's rate base.[133] AmerenUE argues only the portion of the money it ultimately expects to pay to the IRS should be excluded from the deferred income tax category.[134]

Findings of Fact:

AmerenUE has taken three tax positions with the IRS about which it is uncertain. In other words, it may ultimately have to pay additional tax if the IRS rules against AmerenUE's position. At this time those taxes have not been paid.[135] The IRS audit of AmerenUE's tax positions is still in progress and AmerenUE expects to learn the results of that audit in the summer of 2009.[136]

Generally Accepted Accounting Principles (GAAP) provide rules for recording the effect of tax deferrals. Under a GAAP standard known as FIN 48, AmerenUE is required to record as deferred tax only the portion of the tax liability upon which the company expects

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[131] Staff Report – Cost of Service, Ex. 200, Page 11.

[132] Nelson Rebuttal, Ex. 21, Page 4, Lines 10-16.

[133] Staff Report – Cost of Service, Ex. 200, Page 11.

[134] Nelson Rebuttal, Ex. 21, Page 4, Lines 17-21.

[135] Transcript, Pages 1076-1077, Lines 25, 1.

[136] Transcript, Page 1079, Lines 10-11.

to prevail. The portion of that liability that the company ultimately expects to pay to the government in taxes, including interest, is treated as a "FIN 48 liability"[137]

FIN 48 requires AmerenUE to review its FIN 48 liabilities quarterly and to adjust those liabilities to take into account changes in laws and regulations and the impact those changes may have on the company's prospects of prevailing before the IRS. The company's adjustments are reviewed quarterly by external auditors.[138] AmerenUE would exclude its FIN 48 liabilities from Staff's calculations of deferred taxes for ratemaking purposes. Staff would treat the entire amount of potential tax liability as if AmerenUE will win on all positions and never have to pay the tax.[139]

If the ultimate outcome before the IRS matches the FIN 48 analysis, in other words, AmerenUE loses the uncertain tax positions, there would be no deferral of tax and no means by which AmerenUE would recover the amount that reduced rates, but was not actually realized by the company.[140]

Both ratepayers and shareholders benefit when AmerenUE takes an uncertain tax position with the IRS, because saving money on taxes benefits the company's bottom line and reduces the amount of expense the ratepayers must pay. At the hearing, Staff's witness agreed AmerenUE should pursue such positions.[141] The best way to encourage AmerenUE to continue to take uncertain tax positions is to treat the company fairly in the regulatory process.

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[137] Nelson Rebuttal, Ex. 21, Page 5, Lines 9-19.

[138] Nelson Rebuttal, Ex. 21, Page 5, Lines 21-23.

[139] Staff Report - Cost of Service, Ex. 200, Page 12.

[140] Nelson Rebuttal, Ex. 21, Page 6, Lines 6-9.

[141] Transcript, Pages 1086-1087, Lines 23-25, 1-2.

AmerenUE should not be required to recognize as deferred taxes the amount of its uncertain tax positions it ultimately expects to pay with interest to the IRS. The best means of determining that amount is by recognizing the allocation of those costs AmerenUE already makes under FIN 48. Therefore, the Commission will exclude from the deferred taxes account the amount of AmerenUE's FIN 48 liability.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

The Commission finds in favor of AmerenUE's position. AmerenUE's FIN 48 liability shall be excluded from consideration in the deferred taxes account.

5. Entergy Arkansas Equalization Costs in SO2 or other Tracker

Introduction:

This issue concerns potential refunds AmerenUE may receive as the result of ongoing litigation before the Federal Energy Regulatory Commission (FERC). The disagreement was between Staff and AmerenUE. At the hearing, Staff and AmerenUE read the following stipulation into the record as a settlement of their disagreement:

> The company shall maintain such books and records as are necessary to allow the Staff to identify the amount of refunds, if any, the company may receive in the future arising from the dispute involving the 1999 purchased power service agreement with Entergy Arkansas described in the surrebuttal testimony of Staff witness John P. Cassidy. The company shall also maintain the books and records necessary to identify any costs associated with obtaining any such refunds such as legal expenses associated with efforts to obtain refunds.[142]

Decision:

[142] Transcript, Pages 1866-1867, Lines 24-25, 1-10.

The stipulation agreed to by the parties is a reasonable resolution of their disagreement. The Commission accepts that stipulation as a resolution of this issue.

6. Off-System Sales

This issue was resolved by the Stipulation and Agreement as to Off-System Sales Related Issues, which the Commission approved in an order issued on December 30, 2008.

7. The Proposed Fuel Adjustment Clause

General Findings of Fact Regarding Fuel Adjustment Clauses:

The rates AmerenUE will be allowed to charge its customers are based on a determination of the company's revenue requirement. A revenue requirement is based on the costs and income the company experienced during a historical test year. For this case, the test year was established as the 12-month period ending on March 31, 2008, with certain pro forma adjustments through September 30, 2008, trued-up as of September 30, 2008. That means the Commission will use the expenses and revenues measured during the test year to predict the expenses the company will be allowed to recover in future rates. Expenses that may be incurred in the future generally are not included in rate calculations.

Under traditional ratemaking procedures, at the end of the rate case the Commission establishes the rates an electric utility can charge. Once rates are established, the utility cannot change those rates without filing a new rate case and restarting the review process. However, in 2005, the Missouri legislature passed a law authorizing the Commission to establish a mechanism to allow an electric utility to make periodic rate adjustments outside of general rate proceedings to reflect increases and decreases in its prudently incurred fuel

and purchased-power costs.[143] The sort of mechanism envisioned by the statute is generally known as a fuel adjustment clause. AmerenUE has requested a fuel adjustment clause in this case.

Requests from Missouri electric utilities for implementation of a fuel adjustment clause are a relatively recent development because of the recent statutory change. However, fuel adjustment clauses are frequently allowed by utility commissions in other states. A chart submitted by AmerenUE's witness indicates 87 out of 94 utilities in non-restructured states, excluding Missouri, already have a fuel adjustment clause in place. Another 3 currently have a request for a fuel adjustment clause pending. Of 27 utilities with more than 50 percent coal capacity in neighboring and other non-restructured states, 26 already have a fuel adjustment clause in place.[144] Clearly, this statute and the accompanying rules have merely transported Missouri back into the mainstream of utility regulation. That mainstream of regulation recognizes a utility must be able to recover its prudently incurred fuel costs and that it is impossible for a utility to earn its allowed return on equity in a rising cost environment without a fuel adjustment clause.

While the new statute, Section 386.266, allows the Commission to approve a fuel adjustment clause, in effect, overturning a 1979 Missouri Supreme Court decision finding fuel adjustment clauses to be contrary to Missouri law for residential customers,[145] the statute does not require the Commission to approve a fuel adjustment clause. Instead, it specifically gives the Commission authority to reject a proposed fuel adjustment clause

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[143] Section 386.266, RSMo (Supp. 2008).

[144] Lyons Rebuttal, Ex. 42, Schedule MJL-RE8.

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

after giving an opportunity for a full hearing in a general rate case.[146] The statute, while not providing specific guidance on when a fuel adjustment clause should be approved, does provide some guidance on when such a clause is appropriate. Specifically, it indicates any such fuel adjustment clause must be reasonably designed to provide the utility with a sufficient opportunity to earn a fair return on equity.[147]

There are circumstances when the use of a fuel adjustment clause may be appropriate to preserve the financial health of the utility, and no one, including ratepayers, benefits when a utility becomes financially unhealthy. In an era where fuel costs are highly volatile or rapidly rising, a fuel adjustment clause may be appropriate if the company is to earn its authorized rate of return. The problem then is how to determine when a fuel adjustment clause is appropriate.

General Conclusions of Law Regarding Fuel Adjustment Clauses:

Section 386.266.1, RSMo (Supp. 2008), the statute that allows the Commission to establish a fuel adjustment clause provides as follows:

> 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.

Subsection 4 of that statute sets out some of the provisions that must be included in a fuel adjustment clause as follows:

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[146] Section 386.266.4, RSMo (Supp. 2008).

[147] Section 386.266.4(1), RSMo (Supp. 2008)

> The commission shall have the power to approve, modify, or reject adjustment mechanisms submitted under subsections 1 to 3 of this section only after providing the opportunity for a full hearing in a general rate proceeding, including a general rate proceeding initiated by complaint. The commission may approve such rate schedule after considering all relevant factors which may affect the cost or overall rates and charges of the corporation, provided that it finds that the adjustment mechanism set forth in the schedules:
>
> *(1) Is reasonably designed to provide the utility with a sufficient opportunity to earn a fair return on equity;*
>
> (2) Includes provisions for an annual true-up which shall accurately and appropriately remedy any over- or under-collections, including interest at the utility's short-term borrowing rate, through subsequent rate adjustments or refunds;
>
> (3) In the case of an adjustment mechanism submitted under subsections 1 and 2 of this section, includes provisions requiring that the utility file a general rate case with the effective date of new rates to be no later than four years after the effective date of the commission order implementing the adjustment mechanism. …
>
> (4) In the case of an adjustment mechanism submitted under subsections 1 or 2 of this section, includes provisions for prudence reviews of the costs subject to the adjustment mechanism no less frequently than at eighteen-month intervals, and shall require refund of any imprudently incurred costs plus interest at the utility's short-term borrowing rate. (emphasis added)

Subsection 4(1) is emphasized because that is the key requirement of the statute. Any fuel adjustment clause the Commission allows AmerenUE to implement must be reasonably designed to allow the company a sufficient opportunity to earn a fair return on equity.

Subsection 7 of the fuel adjustment clause statute provides the Commission with further guidance, stating the Commission may:

> take into account any change in business risk to the corporation resulting from implementation of the adjustment mechanism in setting the corporation's allowed return in any rate proceeding, in addition to any other changes in business risk experienced by the corporation.

Finally, subsection 9 of that statute requires the Commission to promulgate rules to "govern the structure, content and operation of such rate adjustments, and the procedure for the submission, frequency, examination, hearing and approval of such rate adjustments." In

compliance with the requirements of the statute, the Commission promulgated Commission Rule 4 CSR 240-3.161, which establishes in detail the procedures for submission, approval, and implementation of a fuel adjustment clause.

Is a Fuel Adjustment Clause Appropriate?

Findings of Fact:

The Commission addressed the question of when a fuel adjustment clause is appropriate in AmerenUE's last rate case and in recent rate cases for two other Missouri electric utilities. In all cases, the Commission accepted three criteria for determining whether an electric utility should be allowed to implement a fuel adjustment clause. The Commission concluded a cost or revenue change should be tracked and recovered through a fuel adjustment clause if that cost or revenue change is:

1. Substantial enough to have a material impact upon revenue requirements and the financial performance of the business between rate cases;
2. beyond the control of management, where utility management has little influence over experienced revenue or cost levels; and
3. volatile in amount, causing significant swings in income and cash flows if not tracked.[148]

After applying those criteria in AmerenUE's last rate case, the Commission found that fuel costs for AmerenUE, which derived most of its power through its own coal or nuclear-fired generating plants, were not sufficiently volatile to justify the use of a fuel adjustment clause.[149] In addition, the Commission was influenced by the strength of Staff's witness, Mike Proctor's, testimony suggesting AmerenUE's rising fuel costs would be at least partially off-set by rising profits from off-system sales Aquila, Inc., in contrast to

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[148] *In the Matter of Union Electric Company d/b/a AmerenUE's Tariffs Increasing Rates for Electric Service*, Report and Order, Case No. ER-2007-0002, May 22, 2007, Pages 20-21.

[149] *In the Matter of Union Electric Company d/b/a AmerenUE's Tariffs Increasing Rates for Electric Service*, Report and Order, Case No. ER-2007-0002, May 22, 2007, Page 26.

AmerenUE, derived much of its power through natural gas-fired generating plants and purchased power. In those circumstances, the Commission concluded Aquila would be allowed to implement a fuel adjustment clause.[150] For similar reasons, the Commission allowed The Empire District Electric Company to implement a fuel adjustment clause.[151]

Applying that three-part test to AmerenUE, it is clear AmerenUE's fuel and purchased power cost is substantial. The approved Stipulation and Agreement as to Off-System Sales Issues established AmerenUE's total fuel and purchased power costs at $735 million for the test year, which was netted against off-system sales of $451.7 million, resulting in annual net fuel costs of $283.3 million. The cost of fuel and purchased power is AmerenUE's largest expense, comprising 25 percent of the company's operations and maintenance expense.[152] Clearly, these amounts are substantial enough to have a material impact on AmerenUE's revenue requirements and financial performance between rate cases. The first prong of the three-part test is satisfied.

The second prong of the test is whether the fuel and purchased power costs tracked in the fuel adjustment clause are largely beyond the control of AmerenUE's management. The largest portion of AmerenUE's cost to purchase fuel goes toward the purchase of Powder River Basin coal to fire its coal-fired generation plants.[153] AmerenUE buys a lot of Power River Basin coal and Staff and other parties suggest that perhaps the amount of

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[150] *In the Matter of the Tariffs of Aquila, Inc., d/b/a Aquila Networks – MPS and Aquila Networks – L&P Increasing Electric Rates,* Report and Order, Case No. ER-2007-0004, May 17, 2007, Page 37.

[151] *In the Matter of The Empire District Electric Company's Tariffs to Increase Rates for Electric Service Provided to Customers in the Missouri Service Area of the Company*, Report and Order, Case No. ER-2008-0093 July 30, 2008, Page 40.

[152] Staff Report – Cost of Service, Ex. 200, Page 60.

[153] Mantle Surrebuttal, Ex. 224, Page 2, Table LM1.

coal AmerenUE buys would enhance its ability to negotiate coal and transportation costs.[154] However, no one presented a study to actually measure any influence AmerenUE might have over those costs.[155] On the contrary, most of the costs that comprise AmerenUE's fuel costs, the costs that would be tracked in a fuel adjustment clause, are dictated by national and international markets, including competing purchases by China and India, far beyond the control of AmerenUE. Hence, no one suggests AmerenUE can control the market price it pays for coal, diesel fuel to transport that coal, natural gas, nuclear fuel, or the effect Federal carbon legislation may have on coal prices. Neither can it control the other side of its net fuel cost, the price at which it is able to sell electricity into the off-system sales market. The second prong of the three-part test is also satisfied.

The third prong of the previously established test is whether AmerenUE's net fuel cost is volatile in amount, causing significant swings in income and cash flows if not tracked. In AmerenUE's last rate case, the Commission refused to authorize a fuel adjustment clause for AmerenUE because it found the company did not satisfy this prong of the test.[156] In that decision, the Commission was heavily influenced by the fact that AmerenUE's largest fuel cost is for the purchase of coal, and those coal purchases are substantially hedged for upcoming years.

AmerenUE's coal purchase costs are still substantially hedged,[157] but the Commission's previous focus solely on coal purchase costs was misplaced. AmerenUE's net fuel cost, the amount tracked in a fuel adjustment clause, is not dependent simply on

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[154] Mantle Surrebuttal, Ex. 224, Page 5, Lines 9-11.

[155] Transcript, Page 2633, Lines 5-16.

[156] *In the Matter of Union Electric Company d/b/a AmerenUE's Tariffs Increasing Rates for Electric Service*, Report and Order, Case No. ER-2007-0002, May 22, 2007, Page 26.

[157] Neff Direct, Ex. 47, Page 16, Lines 1-9.

the purchase price of coal. Other factors, such as the market price for the sale of off-system power, which AmerenUE largely cannot hedge,[158] are very volatile. AmerenUE's witness, Shawn Schukar explained:

> The variability inherent in generation availability, native load, and market prices can cause the amount and value of off-system sales to vary significantly from one period to another, both on a short-term and long-term basis.[159]

Furthermore, through the testimony of its witness, Ajay Arora, AmerenUE was able to demonstrate that the net fuel costs AmerenUE has actually experienced over the past several years are very uncertain.[160] Considering all the costs and revenues that go into the calculation of AmerenUE's net fuel cost, it is apparent AmerenUE has satisfied the third prong of the three-part test.

In its report and order in the previous rate case, the Commission relied on the three-part test to conclude AmerenUE did not need a fuel adjustment clause at that time. As it has evaluated requests for approval of a fuel adjustment clause from other utilities in other rate cases, the Commission has found that the three-part test does not fully define the question of whether a fuel adjustment clause is needed. Thus, although the Commission has found that AmerenUE now satisfies the requirements of the three-part test, there are other, more persuasive reasons to approve AmerenUE's request for a fuel adjustment clause.

Section 386.266.4(1) RSMo (Supp. 2008) requires that any fuel adjustment charge approved by the Commission must be "reasonably designed to provide the utility with a

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[158] Lyons Rebuttal, Ex. 42, Page 19, Lines 1-3.

[159] Schukar Direct, Ex. 27, Page 14, Lines 16-18.

[160] Arora Surrebuttal, Ex. 24, Page 9, Table AKA-SR1. The numbers in the table are highly confidential.

sufficient opportunity to earn a fair return on equity". While that statutory requirement specifically applies to the design of a fuel adjustment clause rather than the need to implement such a clause, it also states a good standard by which the Commission can measure the need for such a clause. In a sense, the need to provide a utility with a sufficient opportunity to earn a fair return on equity is just a summation of the end goal of the previously described three-part test. The question then becomes, does AmerenUE have a reasonable opportunity to earn a fair return on equity without a fuel adjustment clause?

An examination of recent history indicates the answer is no. AmerenUE is faced with a rising cost environment and consequently is hit hard by regulatory lag. Regulatory lag is simply the time between when the company incurs an increased cost and the time it can recover that increased cost from its customers through a rate increase. As costs rise, AmerenUE inevitably experiences a delay in being able to recover those costs. In other words, the company must run faster toward a goal that keeps moving away.

For example, AmerenUE's cost of delivered coal increased by 12 percent from the amount used to set rates in the last rate case to the amount that will be used to set rates in this case.[161] Delivered coal costs for the next several years, much of which has already been locked in under long-term contracts, will experience similar cost increases in future years.[162] By the time the rates approved in this case go into effect, AmerenUE will have under-recovered $114 million in coal costs since January 1, 2007.[163]

Since fuel costs are the largest expense item for AmerenUE, rising fuel costs have a

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[161] Neff Direct, Ex. 47, Page 4, Lines 1-5.

[162] Neff Direct, Ex. 47, Page 4, Lines 7-13. The precise numbers are highly confidential.

[163] Lyons Rebuttal, Ex. 42, Page 2, Lines 18-20. The number in the testimony is declared to be highly confidential, but it is repeated as public information in AmerenUE's brief at page 32.

large effect on the company's bottom line. As a result, in recent years, AmerenUE has been unable to earn its allowed rate of return. For the period following the implementation of new rates following AmerenUE's last rate case in May 2007, through August 2008, AmerenUE was able to earn an actual return on equity of only 9.31 percent, far below its authorized return of 10.2 percent.[164]

In its Report and Order in AmerenUE's last rate case, the Commission said, "a future rate case, not a fuel adjustment clause, is the proper means by which AmerenUE should recover its rising fuel costs."[165] However, simply filing more frequent rate cases cannot solve the regulatory lag problem for AmerenUE. In Missouri, rate cases generally last 11 months from the time the company files tariffs to increase rates until the Commission issues a decision about that rate increase request. So, for example, this rate case, filed in April 2008, is able to incorporate the substantial January 1, 2008 coal cost increase in AmerenUE's cost of service for consideration in this order. Those coal cost increases will be included in the rates that go into effect at the conclusion of this case on March 1, 2009. However, that means AmerenUE will not recover approximately 14 months of those increased costs. If, following the conclusion of this case, AmerenUE wants to recover its January 1, 2009 coal cost increase, it could perhaps file for its next rate increase in July 2009. Those rates would likely not go into effect until June 2010. By that time, AmerenUE would have lost 17 or 18 months of the 2009 cost increase, as well as 5 or 6 months of the 2010 increase, assuming the 2010 increase could be brought within the test year for that

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[164] Voss Rebuttal, Ex. 2, Page 10, Chart at line 3.

[165] *In the Matter of Union Electric Company d/b/a AmerenUE's Tariffs Increasing Rates for Electric Service*, Report and Order, Case No. ER-2007-0002, May 22, 2007, Page 26.

rate case.[166]

When costs are steadily rising, regulatory lag clearly has a significant impact on AmerenUE's opportunity to earn a fair return on its investment. In its Report and Order in AmerenUE's last rate case, the Commission said "rising, but known fuel costs are the worst reason to implement a fuel adjustment clause…."[167] That statement did not take into account the fact that regulatory lag in a rising cost environment will deprive AmerenUE of an opportunity to earn a fair return on its investment. As a result, the statement is, simply, wrong.

Regulatory lag's pernicious effect on AmerenUE's ability to earn a fair return not surprisingly has an effect on the company's ability to attract investors. For all the reasons previously indicated, fuel adjustment clauses have become extremely common for regulated utilities in this country.[168] As a result, investors expect to see those fuel adjustment clauses in operation. The lack of a fuel adjustment clause puts AmerenUE a step behind the utilities against which it must compete for investment capital.

The credit rating agencies that evaluate AmerenUE have taken note of the company's lack of a fuel adjustment clause. In downgrading AmerenUE's investment grade in May 2008, Moody's Investor Services said:

> The downgrade also reflects the challenging regulatory environment for electric utilities operating in the state of Missouri, as Union Electric is one of the relatively few utilities in the country operating without fuel, purchased power, and environmental cost recovery mechanisms. This lack of automatic cost recovery provisions creates uncertainty regarding the timely recovery of

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[166] Lyons Direct, Ex. 41, Page 11, Lines 4-14.

[167] *In the Matter of Union Electric Company d/b/a AmerenUE's Tariffs Increasing Rates for Electric Service*, Report and Order, Case No. ER-2007-0002, May 22, 2007, Page 23.

[168] Lyons Rebuttal, Ex. 42, Schedule MJL-RE8.

> the higher costs and investments being incurred and leads to significant regulatory lag.[169]

In issuing a credit opinion on Union Electric Corporation in August 2008, Moody's reaffirmed that opinion, stating:

> A combination of higher operating costs, limited rate relief, and the lack of cost recovery mechanism in place has resulted in a steady decline in Union Electric's financial metrics and ratings over the last several years.
>
> What Could Change the Rating - Up
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> An increase in the supportiveness of the regulatory environment for electric utilities in Missouri; the implementation of fuel, purchased power, and/or environmental cost mechanisms…
>
> What Could Change the Rating – Down
>
> An adverse outcome of its pending rate case, including the inability to implement a fuel adjustment clause…[170]

Gary M Rygh, a Senior Vice President at Barclays Capital Inc., the investment banking division of Barclays Bank PLC, [171] testifying on behalf of AmerenUE, convincingly described the problem as follows:

> [T]he majority of utilities with which AmerenUE has to compete for capital benefit from the inclusion of an FAC in their ratemaking process. As I addressed earlier, that competition for capital now and in for the foreseeable future will be difficult and intense, and will be even more difficult for AmerenUE if it must compete for capital without the benefit of an FAC.
>
> Indeed, investors, credit rating agencies and others will likely penalize AmerenUE for the risk associated with the inability to better manage the burden associated with procuring fuel for customers unless an FAC is approved for AmerenUE. In a good environment these penalties would be visible, in the current environment and the environment we expect for the foreseeable future, they could be severe. This will likely cause an increase in the cost of capital which will create a longer term and greater cost for customers. The lack of inclusion of a reasonable FAC will continue to keep

[169] Rygh Rebuttal, Ex. 46, Page 25, Lines 9-21.

[170] Gordon Surrebuttal, Ex. 45, Schedule KG-SE2.

[171] Rygh Rebuttal, Ex. 46, Page 1, Lines 7-13.

AmerenUE in the minority of its peers who have these procedures in place and will also be going to market to raise capital.[172]

It would be easy to join with Public Counsel in criticizing the credit rating agencies as "greedy and focused on short-term profits".[173] However, while Public Counsel's witness, Ryan Kind, may not "take a whole lot of stock in what they say as a group,"[174] a whole lot more investors care about what Moody's and the other rating agencies say about AmerenUE than care about Ryan Kind's opinion.

Right or wrong, the opinions of credit rating agencies do matter. And they matter to AmerenUE's ratepayers as well as its investors. A further investment rating downgrade of AmerenUE would increase the company's cost to borrow the capital it needs to meet the electricity needs of its customers. Those increased borrowing costs will ultimately be passed along to ratepayers in a future rate case.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

The Commission finds that AmerenUE meets the previously described three-part test for approval of a fuel adjustment mechanism. Further, the Commission finds that the company needs a fuel adjustment clause to have a sufficient opportunity to earn a fair return on equity. Finally, the Commission finds that AmerenUE needs a fuel adjustment clause to be able to compete for capital with other utilities that already have a fuel

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[172] Rygh Rebuttal, Ex. 46, Page 24, Lines 1-17.

[173] Public Counsel's Post Hearing Brief, Page 15.

[174] Transcript, Page 2740, Lines 3-5.

adjustment clause. Based on those findings, the Commission authorizes AmerenUE to implement a fuel adjustment clause.

Appropriate Incentive Mechanism

Introduction:

The Commission has authorized AmerenUE to implement a fuel adjustment clause. The Commission now must define an appropriate incentive mechanism to include in AmerenUE's fuel adjustment clause. The statute that authorizes the Commission to establish a fuel adjustment clause for AmerenUE already includes features designed to give the company an incentive to maximize its income from off-system sales and minimize its costs. Specifically, the statute requires a utility operating under a fuel adjustment clause to file a new rate case every four years, and requires the Commission to review the prudence of the company's purchasing decisions every 18 months. But regulatory reviews are only a partial substitute for the direct incentives that can result from a utility's quest for profit. Therefore, the statute allows the Commission to include features "designed to provide the electrical corporation with incentives to improve the efficiency and cost-effectiveness of its fuel and purchased-power procurement activities."[175]

AmerenUE proposed the Commission use the same incentive mechanism it used when it established fuel adjustment clauses for Aquila and Empire in those companies' recent rate cases.[176] The fuel adjustment clause would include a 95 percent pass-through provision. That means only 95 percent of any over or under recovery balance, measured against a base level, would be passed to customers under the fuel adjustment clause. The other 5 percent would be absorbed by AmerenUE's shareholders.

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[175] Section 386.266.1, RSMo (Supp. 2008).

[176] Lyons Direct, Ex. 41, Page 3, Lines 6-14.

Maurice Brubaker, witness for MIEC, proposed an 80 percent pass-through provision. Under his proposal, the other 20 percent of any fuel cost increase would be absorbed by AmerenUE's shareholders. Of course, shareholders would also retain 20 percent of any fuel cost decreases.[177] To protect shareholders and ratepayers from truly dramatic cost variations, Brubaker's proposal would also place a 50 basis point cap on the amount of cost changes that would be absorbed by AmerenUE's shareholders.[178]

Testifying on behalf of the State, Martin Cohen also recommended an 80 percent pass through provision. Alternatively, Cohen proposed an asymmetrical provision that would give AmerenUE's shareholders an 85 percent pass through of any cost increases above the base, while giving ratepayers a 95 percent pass through of any cost decreases below the base.[179]

Public Counsel, through its witness, Ryan Kind, proposed a 50 percent pass through mechanism.[180] AARP and the Consumers Council of Missouri did not offer any testimony on a sharing mechanism, but supported Public Counsel's proposed 50 percent pass through mechanism.[181] Noranda also did not offer testimony on a sharing mechanism, but suggested a pass through sharing mechanism of between 75 and 90 percent.[182] Staff took no position on an appropriate sharing mechanism.[183]

The goal of all these pass-through plans is to ensure AmerenUE retains sufficient

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[177] Brubaker Direct, Ex. 607, Page 9, Lines 2-6.

[178] Brubaker Direct, Ex. 607, Page 9, Lines 12-23.

[179] Cohen Direct, Ex. 500, Pages 23-24, Lines 20-21, 1-5.

[180] Kind Rebuttal, Ex. 404, Page 6, Lines 21-23.

[181] Transcript, Page 2139, Lines 21-25.

[182] Post-Hearing Brief of Noranda Aluminum, Inc., Page 33.

[183] Transcript, Page 2616, Lines 1-6.

financial incentive to make a strong effort to reduce its fuel and purchased power costs. The statute that allows the Commission to approve a fuel adjustment clause contains some protections to ensure the electric utility acts prudently to control its costs. Notably, it requires the Commission to undertake periodic prudence reviews of the company's incurred costs.[184] However, an after-the-fact prudence review is not a substitute for an appropriate financial incentive, nor is an incentive provision intended to be a penalty against the company. Rather, a financial incentive recognizes that fuel and purchased power activities are very complex and there are actions AmerenUE can take that will affect the cost-effectiveness of those activities.

Findings of Fact:

The Commission finds that the 50 percent pass through proposed by Public Counsel is inappropriate because it would largely negate the effect of the fuel adjustment clause. For example, consider the $114 million in increased coal costs that AmerenUE was unable to recover from January 1, 2007 through the March 1, 2009 presumed effective date of rates established in this case.[185] Under Public Counsel's proposal, AmerenUE would be able to pass through to ratepayers only half of those increased costs, and shareholders would be required to absorb the other $57 million in increased costs. No matter how efficiently it operated, there is no evidence to suggest AmerenUE could find cost savings sufficient to balance a cost increase of that magnitude. Therefore, a 50 percent pass through operates not as an incentive, but rather as a means to blunt the desired effect of the approved fuel adjustment clause.

The 80 percent pass through proposals offered by Brubaker and Cohen are more

[184] Section 386.266.4(4), RSMo (Supp. 2008).

[185] Lyons Rebuttal, Ex. 42, Page 2, Lines 18-20.

reasonable attempts to devise an incentive mechanism. However, those proposals would still impose more costs on AmerenUE than is necessary to provide an appropriate incentive. If AmerenUE's coal costs increased by $137 million in 2009 and 2010 as anticipated, Brubaker's mechanism would still force AmerenUE's shareholders to absorb approximately $25 million in coal costs alone in 2010.[186]

A 95 percent pass through provides AmerenUE sufficient incentive to operate at optimal efficiency because the company already has several incentives in place that encourage it to minimize net fuel costs. First, AmerenUE's largest fuel cost is for the purchase of Powder River Basin coal to fire its power plants.[187] The coal AmerenUE uses is purchased by an affiliated company, AmerenEnergy Fuels and Service Company, which also purchases coal for the unregulated Ameren merchant generating companies operating in Illinois. As a result, AmerenUE pays the same price for coal as the unregulated affiliates.[188] Presumably, Ameren has a strong incentive to minimize costs for its unregulated operations, so AmerenUE would benefit from those same incentives.

Second, AmerenUE's key employees responsible for managing the company's net fuel costs all have personal financial performance incentives related to things like generation levels, generation availability, and cost of generation.[189] Thus, individual employees have a financial incentive to minimize the company's fuel costs.[190]

Third, adjustments under the fuel adjustment clause are based on historical rather projected costs. Hence, AmerenUE will not entirely escape the incentive effects of the

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[186] Lyons Rebuttal, Ex. 42, Page 24, Lines 13-16, as corrected at Transcript, Page 2141.

[187] Mantle Surrebuttal, Ex. 224, Page 2, Table LM1.

[188] Lyons Rebuttal, Ex. 42, Page 21, Lines 3-9.

[189] Transcript, Pages 2179-2180, Lines 23-25, 1-5.

[190] Lyons Rebuttal, Ex. 42, Page 23, Lines 9-17.

regulatory lag between the incurrence of its fuel costs and the recovery of those increased fuel costs from ratepayers under the fuel adjustment clause. Therefore, the company has an incentive to minimize net fuel costs to mitigate that remaining regulatory lag.[191]

Fourth, as required by the Commission's rules, AmerenUE's fuel adjustment clause includes a detailed heat rate/efficiency testing plan that will allow the Commission to guard against imprudent operation and maintenance of the company's generating units, thus controlling net fuel costs.

Fifth, AmerenUE will need to come back to the Commission in its next rate case to have its fuel adjustment clause renewed. As the Commission has previously indicated, "a fuel adjustment clause is a privilege, not a right, which can be taken away if the company does not act prudently."[192] If AmerenUE does not efficiently control its net fuel costs, the Commission could reconsider the fuel adjustment clause.

There is one additional consideration that supports the implementation of a 95 percent pass through provision in AmerenUE's fuel adjustment clause. That is the likely impact the pass through provision will have on AmerenUE credit worthiness in the eyes of Wall Street. The Commission has recently allowed two other Missouri electric utilities, Aquila and Empire, to implement a fuel adjustment clause including a 95 percent pass through provision. To now impose a less favorable pass through provision on AmerenUE would signal investors that AmerenUE was less well regarded by this regulatory agency.[193] When asked specifically about the 80 percent pass through proposal offered by MIEC,

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[191] Lyons Rebuttal, Ex. 42, Page 22, Lines 3-15.

[192] *In the Matter of The Empire District Electric Company's Tariffs to Increase Rates for Electric Service Provided to Customers in the Missouri Service Area of the Company*, Report and Order, Case No. ER-2008-0093 July 30, 2008, Pages 45-46.

[193] Transcript, Pages 2370-2371, Lines 23-25, 1-8. Also, Transcript, Pages 2384-2385, Lines 14-25, 1-7.

AmerenUE's witness, Wall Street investment banker, Gary Rygh, said he would not be comfortable with that proposal because "the markets are looking for bad news … that would be a fairly tough thing for them to swallow."[194]

The key from the perspective of investors and the rating agencies is that AmerenUE's fuel adjustment clause must be in the mainstream of regulation. Most fuel adjustment clauses in use around the county provide for a 100 percent pass through of costs.[195] To allow substantially less than a 100 percent pass through would push AmerenUE's fuel adjustment clause out of the mainstream and hurt the company's efforts to compete for needed capital.

Some parties argue rating agencies and investors simply look to see whether a fuel adjustment clause is in place and do not concern themselves with the operational details of the clause. In support of this idea they offer the testimony of AmerenUE's rate of return witness, Dr. Roger Morin, who, when asked whether rating agencies essentially view fuel adjustment clauses as either present or not present, replied in the affirmative and indicated such agencies typically do not get into the details of the clause.[196]

However, Dr. Morin's response must be read in the context of earlier questioning regarding rating agencies concern or lack of concern about the technical details of fuel adjustment clauses such as timing and duration of accumulation and recovery periods.[197] As a result, Dr. Morin's comment should not be interpreted as suggesting something as significant as a pass through percentage would not be considered by the rating agencies.

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[194] Transcript, Page 2374, Lines 18-21.

[195] Transcript, Page 2369, Lines 22-23.

[196] Transcript, Pages 382-383, Lines 20-25, 1-2.

[197] Transcript, Pages 362-365.

Indeed, Dr. Morin also testified that the terms of a fuel adjustment clause are important to the credit rating agencies, saying, "I think they would be concerned with a marked deviation from the conventional practice of one to one (pass through of all fuel costs). They would look at the terms of the adjustment clause."[198] MIEC's rate of return witness, Michael Gorman, also testified that in his opinion, "rating agencies are capable of understanding a fuel adjustment clause and understanding the – the effect of that clause in allowing a utility to produce the cash flows necessary to support financial obligations."[199]

Conclusions of Law:

The Commission rule that requires AmerenUE to submit a heat rate/efficiency testing plan as part of its proposed fuel adjustment clause is 4 CSR 240-3.161(2)(P).

Decision:

AmerenUE's fuel adjustment charge shall include an incentive clause providing that 95 percent of any deviation in fuel and purchased power costs from the base level shall be passed to customers and 5 percent shall be retained by AmerenUE. This incentive clause will give AmerenUE a sufficient opportunity to earn a fair return on equity as required by Section 386.266 and the Hope and Bluefield decisions. At the same time, it will protect AmerenUE's customers by giving the company an incentive to be prudent in its decisions by not allowing all costs to simply be passed through to customers.

Rate Design of the Fuel Adjustment Clause:

The details of the tariff that will actually implement AmerenUE's fuel adjustment clause are established through the Stipulation and Agreement as to All FAC Tariff Rate Design Issues, which the Commission approved in an order issued on December 30, 2008.

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[198] Transcript, Page 459, Lines 14-21.

[199] Transcript, Page 545, lines 15-19.

8. Callaway 2 COLA Costs

Introduction:

During the test year, AmerenUE spent $45,987,000 to prepare and file a Construction and Operating License Application (COLA) with the Nuclear Regulatory Commission, seeking approval to construct a second nuclear reactor at the company's Callaway Nuclear Plant.[200] AmerenUE proposes to adjust its accounts to move that approximately $46 million into its plant in service account.

That means the COLA cost would be moved into the company's rate base so that AmerenUE would earn a return on that investment.[201] That $46 million would not be subject to depreciation until the Callaway 2 plant is actually in operation, so AmerenUE would not immediately receive a return of its investment.[202] As a result, if AmerenUE's proposed adjustment is accepted, the inclusion of the $46 million in the company's rate base would have the effect of increasing AmerenUE's cost of service by approximately $5 million per year, the exact amount depending upon the rate of return the Commission authorizes in this case. Several parties oppose AmerenUE's proposal to move the $46 million into rate base as a violation of section 393.135, RSMo, frequently known as the anti-CWIP initiative.

Findings of Fact:

AmerenUE is currently accounting for the Callaway 2 COLA costs as Construction Work in Progress, generally known by the acronym CWIP, just as it would any other capital

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[200] Weiss Supplemental Direct, Ex. 11, Page 8, Lines 6-7.

[201] Transcript, Page 1300, Lines 6-10.

[202] Transcript, Page 1300, Lines 11-24.

project that is not yet complete.[203] A utility does not earn a return on investments held as CWIP until the project for which the investment is made is actually placed in service.[204] However, AmerenUE is allowed to calculate AFUDC (allowance for funds used during construction) on the project until it is complete.[205] AFUDC represents the financing cost associated with construction projects, and when the project is complete, the company will earn a return on the cost of the project, including AFUDC.[206]

For purposes of this rate case, AmerenUE's senior management, presumably AmerenUE's President and Chief Executive Officer, Thomas R. Voss, decided that it would be appropriate to include the Callaway 2 COLA costs in rate base and instructed the company's accountants to make a pro forma adjustment to accomplish that change.[207]

The costs associated with the Callaway 2 COLA are properly accounted for as CWIP, as a necessary construction related cost to operate the Callaway 2 reactor.[208] This is the same accounting treatment the Commission afforded AmerenUE's cost to obtain the operating permit to build the Callaway 1 plant in the 1970s and 1980s.[209]

Missouri's statutes include a provision that explicitly prohibits the inclusion of cost of construction work in progress in rates before the project is fully operational and used for service.[210] AmerenUE attempts to avoid the statute's prohibition on the inclusion of CWIP in rates by arguing that the Callaway 2 COLA costs are not CWIP because the NRC's

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[203] Rackers Surrebuttal, Ex. 202, Page 4, Lines 20-22.
[204] Transcript, Page 1297, Lines 9-24.
[205] Transcript, Page 1298, Lines 3-7.
[206] Rackers Surrebuttal, Ex. 202, Page 3, Lines 17-18.
[207] Transcript, Page 1298, Lines 12-24.
[208] Rackers Surrebuttal, Ex. 202, Pages 4-5, Lines 21-23, 1-2.
[209] Rackers Surrebuttal, Ex. 202, Page 5, Lines 5-10.
[210] Section 393.135, RSMo 2000.

permit to build Callaway 2 might have some independent value apart from the permission to construct the nuclear reactor. In that regard, Thomas Voss, AmerenUE's president and chief executive officer, compared the Callaway 2 COLA to real estate that would be purchased in advance and held for later development.[211]

The supposed independent value of the COLA is based on the eligibility for certain federal tax credits afforded by the filing of the COLA in 2008. The federal Energy Policy Act (EPAct) creates potential tax savings that could save AmerenUE and its ratepayers a total of $500 million over eight years if the Callaway 2 unit is ultimately built. Since EPAct required a COLA be filed and docketed with the NRC on or before December 31, 2008, to be eligible to receive those tax credits, AmerenUE's COLA might have an independent value if AmerenUE later decided to sell the right to build Callaway 2 as a merchant plant.[212]

However, any independent value of the COLA is highly speculative since, so far as AmerenUE's witness was aware, no COLA has ever been sold.[213] In any event, even if the COLA was treated as an asset to be held for future use, that does not allow that asset to be put into rate base, until its is actually in use. That is particularly true where, as here, AmerenUE has no definite plan to either build Callaway 2 or attempt to sell the COLA to a merchant plant operator.[214]

Even if the COLA has some independent value, it is no different from a turbine that AmerenUE might purchase in anticipation of ultimately installing it as part of Callaway 2 or for some other project, or even for eventual resale to some other utility. That turbine would

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[211] Transcript, Page 128, Lines 20-23.

[212] Transcript, Page 129, Lines 1-5.

[213] Transcript, Page 1320, Lines 19-21.

[214] Transcript, Page 1309, Lines 5-23.

not be included in rate base until it was actually used to generate electricity, despite its undeniable independent value.[215] If that turbine could not be included in rate base, AmerenUE did not make a convincing argument that the COLA should be included in rate base at this point in time.

Conclusions of Law:

In 1976, Missouri's voters passed an initiative that was codified as Section 393.135, RSMo 2000. That section provides as follows:

> Any charge made or demanded by an electrical corporation for service, or in connection therewith, which is based on the costs of construction in progress upon any existing or new facility of the electrical corporation, or any other cost associated with owning, operating, maintaining, or financing any property before it is fully operational and used for service, is unjust and unreasonable, and is prohibited.

That statute clearly and explicitly forbids the inclusion of CWIP in an electric utility's rates until the construction work is complete and the project is fully operational and used in service.

Decision:

AmerenUE contends the inclusion of the Callaway 2 COLA costs in rate base is simply a means by which ratepayers should be required to bear their fair share of the cost and risk associated with the COLA. Whatever the merits of that proposition, AmerenUE's argument is unconvincing because when Missouri's voters passed the initiative that became Section 393.135, RSMo, they determined a utility would have to wait until a plant was completed and in service before it could recover the cost of its investment. The costs associated with AmerenUE's preparation and filing of the Callaway 2 COLA are properly treated as CWIP and as such they may not be included in AmerenUE's rate base until the

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[215] Transcript, Page 253, Lines 1-7.

Callaway 2 plant is fully operational and used for service.

9. MISO Day 2 Charges

Introduction:

AmerenUE participates in the Midwest ISO, which is a regional transmission organization that jointly operates the transmission systems of its member utilities. Midwest ISO also operates a day-ahead and real-time energy market, referred to as MISO Day 2. In operating that market, Midwest ISO sometimes has to dispatch a utility's generation assets in a manner required to meet the reliability needs of the system while not actually selling any power. In those circumstances, Midwest ISO compensates the affected utilities by making Revenue Sufficiency Guarantee (RSG) payments to the utilities for the use of the assets, and collecting RSG charges from the other member utilities to cover those payments.[216]

Midwest ISO began operating its Day 2 market on April 1, 2005. Subsequently, the Federal Energy Regulatory Commission (FERC) ruled Midwest ISO had not properly followed its tariff when it charged its members for RSG, and ordered the Midwest ISO to resettle those RSG transactions. As a result of that resettlement, in 2007, Midwest ISO billed, and AmerenUE paid, $12,430,094 for additional RSG charges relating to the period of 2005 and 2006.[217]

AmerenUE proposes to amortize these resettlement RSG charges over two years and recover them in rates at approximately $6.1 million per year.[218] Staff opposes the recovery of these charges because the expenses relate to charges incurred in the two

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[216] Staff Report – Cost of Service, Ex. 200, Page 23.

[217] Weiss Rebuttal, Ex. 12, Page 6, Lines 8-15.

[218] Weiss Rebuttal, Ex. 12, Page 6, Lines 18-20.

years prior to the test year and because the charges are not recurring and thus will not cause expenses to be higher in future years.[219]

Findings of Fact:

There is very little dispute about the fact regarding this issue. The $12.4 million resettlement imposed on AmerenUE by Midwest ISO covered the period of April 1, 2005, through December 2006.[220] AmerenUE actually paid that resettlement amount to Midwest ISO in April 2007,[221] which was within the test year for this case.[222] Furthermore, although Midwest ISO frequently imposes smaller resettlements, there is no indication AmerenUE will be required to make a resettlement payment of this magnitude in the future.[223]

It is also clear that the Commission has approved AmerenUE's participation in the Midwest ISO, and no one has questioned the prudence of that participation.[224] AmerenUE was required to make the resettlement RSG payment by the terms of the Midwest ISO tariff.[225] The resettlement was necessary because Midwest ISO did not properly follow its tariff in 2005 and 2006, not because AmerenUE did anything wrong.[226]

If Midwest ISO had properly followed its tariff and charged AmerenUE the correct amount in 2005 and 2006, an additional $6.2 million would have been included in AmerenUE's annual revenue requirement in its last rate case and would have been

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[219] Hagemeyer Surrebuttal, Ex. 222, Page 7, Lines 1-10.

[220] Transcript, Page 778, Lines 18-19.

[221] Transcript, Page 779, Lines 4-5.

[222] Transcript, Page 801, Lines 16-18.

[223] Transcript, Page 790, Lines 2-12.

[224] Transcript, Page 809, Lines 7-18.

[225] Transcript, Page 801, Lines 19-22.

[226] Transcript, Pages 801-802, Lines 23-25, 1-6.

recovered from ratepayers during the last two years.[227] If Staff's position is adopted, AmerenUE would be precluded from recovering the $12.4 million resettlement cost and the company's shareholders would be required to absorb that entire cost.[228] A $12 million expense that cannot be recovered from ratepayers would reduce AmerenUE's actual return on equity by approximately 24 basis points.[229] Staff agrees such an impact on AmerenUE's earnings would be significant.[230]

Staff's reason for excluding the cost is that the resettlement cost is non-recurring.[231] That means if the larger amount is included in rates, there is a possibility AmerenUE will be able to over-recover its costs, to the detriment of ratepayers.[232] However, that over-recovery is only possible if AmerenUE waits more than two year to file its next rate case. As has been noted elsewhere in this order, given the rising cost environment facing AmerenUE, it is unlikely the Company will wait more than two years to file its next rate case.[233]

Conclusions of Law:

Since AmerenUE paid the Midwest ISO resettlement charge during the test year, it does not need to obtain an accounting authority order to bring this expense into the rate case. As a result, the accounting standards used to consider the granting of an accounting authority order do not apply. Because this is a test year expense, the Commission has a

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[227] Transcript, Page 803, Lines 20-25.

[228] Transcript, Page 807, Lines 18-25.

[229] Transcript, Page 796, Lines 9-15.

[230] Transcript, Page 809, Lines 4-6.

[231] Transcript, Pages 816-817, Lines 25, 1-3.

[232] Transcript, Page 792, Lines 5-16.

[233] Transcript, Page 791, Lines 17-23.

great deal of discretion when deciding whether to include this expense when setting AmerenUE's revenue requirements for ratemaking purposes.

Decision:

Under the circumstances of this case, fundamental fairness requires that AmerenUE be allowed an opportunity to recover the $12.4 million RSG resettlement cost, which was incurred in the test year and was necessitated by the failure of the Midwest ISO to follow its tariff. AmerenUE's proposal to amortize that amount over two years is a reasonable means to allow that recovery to take place, and that proposal is approved.

10. Incentive Compensation

Introduction:

AmerenUE chooses to pay a portion of its employee compensation as incentive pay. That is, the employees receive that portion of their compensation only if they, or the company, meet certain goals. The compensation in question is, for the most part, not a bonus program restricted to top executives, but rather is a portion of the market-based pay for ordinary employees. AmerenUE offers a total rewards package to its employees, which includes both base pay and incentive pay programs, to attract talent and remain competitive with other employers.[234]

AmerenUE offers several different incentive pay plans, divided into the general categories of long-term compensation, short-term compensation, and an exceptional performance bonus program.[235] Staff would entirely disallow the cost of the long-term compensation program and the exceptional performance bonus program, but would allow a

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[234] Bauer Rebuttal, Ex. 25, Page 8, Lines 7-9.

[235] Bauer Rebuttal, Ex. 25.

small portion of the short-term compensation program.[236] The Commission will separately consider the three categories of incentive compensation.

Findings of Fact:

Long-Term Compensation:

AmerenUE's long-term compensation plans are offered to members of the Ameren Leadership Team, which includes Officers, Directors, and Managers.[237] AmerenUE's witness indicated, "the purpose of a long-term incentive plan is to ensure that the Company's leaders are focused not only on the short-term success of the organization, but also on the long-term success of the organization."[238] The long-term compensation programs attempt to meet that goal by offering stock options, or other means by which executives are given an equity stake in the business.[239]

Ameren offered a restricted stock plan from 2001 through 2005, and replaced that program with the Performance Share Unit Program in 2006. The restricted stock program gave participants annual grants of stock that vested over a 7-year period based on earnings performance. The Performance Share Unit Program gives participants annual performance share units, which allows them to receive stock if certain performance criteria are met.[240] Eligibility for both long-term incentive programs are based on measures of earnings per share or of total shareholder return.[241]

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[236] Hagemeyer Surrebuttal, Ex. 222.

[237] Bauer Rebuttal, Ex 25, Page 5, Chart at Line 3.

[238] Bauer Rebuttal, Ex. 25, Page 19, Lines 4-6.

[239] Bauer Rebuttal, Ex. 25, Page 19, Lines 6-7.

[240] Bauer Rebuttal, Ex. 25, Page 20, Lines 1-4.

[241] Bauer Rebuttal, Ex. 25, Page 5, Chart at Line 3.

The Commission has frequently disallowed costs relating to incentive programs that are based on measures of the financial return achieved by the utility. It has done so because such measures are based on the level of profits the utility can achieve. At best, a utility's level of profitability has little or no benefit for ratepayers. At worst, an increase in the utility's profitability may be harmful to ratepayers if that profitability is obtained by cutting customer service or system maintenance to cut costs and thereby increase earnings per share. Because eligibility for AmerenUE's long-term compensation plans are based on measures of the financial return achieved by the utility, the cost of those plans should fall on the shareholders who will primarily benefit from the company's increased financial return.

Short-Term Incentive Plans:

AmerenUE offers several short-term incentive plans for various groups of employees. One, the Executive Incentive Plan for Officers, is entirely funded by a measure of earnings per share. AmerenUE is not seeking to recover the cost of that program through rates.[242] The other short-term incentive programs are the Executive Incentive Plan for Managers and Directors (EIP-M), the Ameren Management Incentive Plan (AMIP), the Ameren Marketing, Trading and Commodities Plan (AMTC) and the Ameren Incentive Plan (AIP).[243] Except for the EIP-M for members of the Ameren Leadership Team below the Officer level, which is 25 percent funded by earnings per share, these short-term compensation plans are not measured by the company's earnings per share. Rather, they

[242] Bauer Rebuttal, Ex. 25, Page 15, Lines 11-22.

[243] Bauer Rebuttal, Ex. 25, Page 5, Chart at Line 1.

are funded based on the employee's achievement of pre-defined Key Performance Indicators (KPIs).[244]

The KPIs are part of a system AmerenUE has developed to communicate specific goals to its employees and to drive the performance of those employees.[245] The KPIs focus on four critical areas: financial management of the business, process improvement, the customer, and employees.[246] Each functional group within AmerenUE develops a scorecard of KPIs that will contribute to the overall performance of AmerenUE.[247] Every individual employee receives a scorecard containing from 4 to 6 KPIs.[248] Individual KPIs are designed to focus the employee's attention on such things as increased reliability, customer satisfaction, safety, or operational performance.[249]

Each KPI includes three levels of performance. The first level of performance is called "threshold," and it represents the "minimum acceptable level of goal achievement for any given KPI."[250] At the hearing, AmerenUE's witness clarified that the "threshold" level of performance represents "a continuous improvement toward a goal", not just the minimum an employee must do to keep their job.[251] Beyond the "threshold" level, an employee's performance can reach the "target" level, which is a stretch goal that employees are striving

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[244] Bauer Rebuttal, Ex. 25, Page 5, Chart at Line 1.

[245] Bauer Rebuttal, Ex. 25, Page 4, Lines 13-14.

[246] Bauer Rebuttal, Ex. 25, Page 10, Lines 4-6.

[247] Bauer Rebuttal, Ex. 25, Page 10, Lines 7-10.

[248] Transcript, page 1422, Lines 11-13.

[249] Bauer Rebuttal, Pages 11-14.

[250] Bauer Rebuttal, Ex. 25, Page 10, Lines 11-12.

[251] Transcript, Page 1416, Lines 12-17.

to achieve.[252] Finally, if an employee does very well, they might reach the "maximum" level, which represents a level of performance that is very difficult to achieve.[253] As an employee, or a team of employees moves up in level of performance their incentive compensation will increase.[254]

Staff does not entirely oppose the KPI concept and the short-term compensation program, but for various reasons would disallow most of the costs related to that program.[255] Specifically, Staff would disallow payments made under certain KPIs because they were based on what Staff called financial metrics or what Staff described as project based metrics. In addition, Staff would disallow incentive payments made for performance that reached the "threshold" level, but did not reach the "target" level[256]

Before examining Staff's reasons for disallowing part of the cost of the short-term compensation program, it is important to look at the qualifications of the witnesses presented by Staff and AmerenUE. AmerenUE's witness was Krista Bauer. Ms. Bauer is employed by Ameren Services Company as Manager, Compensation and Performance.[257] She holds a Masters Degree in Industrial/Organizational Psychology from Southern Illinois University in Edwardsville, and she will complete her MBA from Webster University in October of 2009. She has eleven years of human resources experience and has served as

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[252] Bauer Rebuttal, Ex. 25, Page 10, Line 13.

[253] Bauer Rebuttal, Ex. 25, Page 10, Lines 14-15.

[254] Transcript, Page 1425, Lines 9-15.

[255] Staff would allow less than $527,000 into rates, approximately 2 percent of AmerenUE's total incentive compensation costs. Transcript, Page 1501, Lines 1-10.

[256] Transcript, Page 1510, Lines 2-19.

[257] Bauer Rebuttal, Ex. 25, Page 1, Lines 10-11.

adjunct faculty at St. Louis University between 2000 and 2005, where she taught courses in Industrial Psychology.[258]

Staff's witness was Jeremy Hagemeyer. He has been a Utility Regulatory Auditor within the Auditing Department of the Commission's Staff since 2002. He has a Bachelor of Science degree in Accounting and German from Southwest Missouri State University, and an MBA from Fontbonne University.[259] Although Mr. Hagemeyer was a bright and articulate witness for Staff on several issues in this case, he has no real expertise in evaluating or designing a compensation plan for a major utility.[260]

Yet, Mr. Hagemeyer offered testimony suggesting that payments made under specific KPIs, which are part of the overall compensation plan designed by AmerenUE, should, or should not be recovered through rates. Not surprisingly, his standards for deciding what should be recovered and what should be disallowed were rather vague and do not provide the Commission with any real basis to judge the plan. Furthermore, his proposal to disallow all payments for performance that met only the threshold level of the plan clearly misunderstood the intent of the plan. As Ms. Bauer explained, "threshold" is a description of the level of improvement at which incentive compensation is earned. It does not represent the minimum an employee must do to keep their job.

Staff should not be in the business of trying to design a compensation plan for AmerenUE. Staff is not qualified to do so and its attempts to manage the affairs of AmerenUE are inappropriate. That does not mean that anything goes for the company. Staff certainly must evaluate AmerenUE's incentive compensation plans. However, it must

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[258] Bauer Rebuttal, Ex. 25, Page 2, Lines 8-16.

[259] Staff Report – Cost of Service, Ex. 200, Background, Education and Credentials, Page 18.

[260] Transcript, Pages 1468-1471.

do so at a higher level and not get bogged down in the details. AmerenUE's incentive programs must stand or fall as a program. If the overall program is appropriate, AmerenUE should be able to recover the costs of that program through rates. If the overall program is unacceptable, then the entire program will be excluded from rates. The Commission will not attempt to manage the details of those programs.

Looking at the short-term compensation programs as a whole, the Commission finds them to be appropriate for recovery through rates. Incentive compensation programs are very common in business in general and in the utility industry in particular. Among AmerenUE's peer utility companies, 36 out of 37 offer short-term incentive plans for their executives.[261] Thus, AmerenUE needs to offer similar plans to compete for employees with other utilities.

For example, if AmerenUE's research determines that the market rate for a certain position is $60,000 per year, it will evaluate the appropriate base-level of compensation and determine an appropriate amount that should be offered through incentive compensation.[262] It is clear that if AmerenUE simply abandoned its incentive plan and offered market rates as base pay, it would have no difficulty in recovering all those costs through rates.[263] However, AmerenUE has chosen to implement an incentive compensation plan so that it has the ability to reward its employees for achieving the performance goals set by the company. So long as the overall program does not contain incentives that could be harmful to ratepayers, such as the purely financial incentives that

[261] Bauer Rebuttal, Ex. 25, Page 6, Lines 11-14.

[262] Bauer Rebuttal, Ex. 25, Page 8, Lines 9-15.

[263] Transcript, Page 1546, Lines 11-15.

caused the Commission to disallow recovery of AmerenUE's long-term compensation plan, AmerenUE should be able to recover the costs of incentive compensation through rates.

The Commission finds that the overall KPI system described in the testimony is likely to bring improvements in employee performance that will benefit AmerenUE's ratepayers as well as the company's shareholder. The Commission will allow AmerenUE to recover the cost of those short-term incentive compensation programs through rates.

The Exceptional Performance Bonus Plan:

The final program within AmerenUE's incentive compensation package is known as the Exceptional Performance Bonus Plan. That program applies to 868 management employees below the level of the Ameren Leadership team.[264] The program allows a supervisor to recommend an employee receive a bonus for exhibiting superior performance above and beyond what is expected of them. The supervisor's recommendation is reviewed by senior leadership for review and approval. Awards under the plan generally range from $500 to $3,000.[265] Many of the rewards are given for exceptional performance that directly benefits AmerenUE's customers, such as exceptional performance at restoring power after an ice storm.[266] Staff opposes AmerenUE's recovery of the cost of this program because the program lacks specific criteria by which awards are to be given.[267]

The lack of specific criteria for the program is actually the point of the program. It exists so that unusual and unanticipated exceptional effort can be rewarded. The program could certainly encourage outstanding customer service and exceptional performance that

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[264] Bauer Rebuttal, Ex. 25, Page 17, Lines 17-23.

[265] Bauer Rebuttal, Ex. 25, Pages 17-18, Lines 23, 1-3.

[266] Bauer Rebuttal, Ex. 25, Page 18, Lines 3-18.

[267] Hagemeyer Surrebuttal, Ex. 222, Page 3, Lines 21-22.

would benefit ratepayers and the company as a whole. However, if not run properly, the program could degenerate into a means by which extra money is funneled to management favorites, without any benefit to the company or to ratepayers. The Commission will allow the program to be included in rates, but will direct AmerenUE to maintain proper records of payments made under the program so that Staff can review it in AmerenUE's next rate case.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

The Commission finds that AmerenUE shall recover in rates the cost of its short-term incentive compensation programs and the cost of its Exceptional Performance Bonus Plan. Taken as a whole, those programs are likely to benefit AmerenUE's ratepayers as well as its shareholders. However, AmerenUE shall not recover in rates the cost of its long-term compensation plan, which the Commission finds will primarily benefit shareholders and not ratepayers.

11. Depreciation

Introduction:

Depreciation is the means by which a utility is able to recover the cost of its investment in its rate base by recognizing the reduction in value of that property over the estimated useful life of the property. AmerenUE's current depreciation rates were established by the Commission in AmerenUE's last rate case, Case Number ER-2007-0002. Public Counsel contends the Commission should adjust downward the established

depreciation rates for five specific accounts for the Callaway Nuclear Production Plant.[268] Staff and AmerenUE agree the Commission should not "cherry pick" a few isolated accounts to adjust outside the context of a complete depreciation study, which was not conducted for this case.

Findings of Fact:

A complete depreciation study requires an actuarial analysis of the complete mortality records of all plant account assets owned by the company.[269] Such a depreciation study was performed in AmerenUE's last rate case, ER-2007-0002, and the depreciation rates that resulted from that case have only been in effect since June 1, 2007.[270]

Not surprisingly, complete depreciation studies are expensive and time consuming. Such a study may involve site visits, interviews, data and actuarial analysis, and the production of reports and testimony.[271] That is one of the reasons, the Commission's rules require such depreciation studies to be done only periodically, and not necessarily for every rate case.[272] AmerenUE submitted a complete depreciation study in July 2006, as part of its last rate case, covering the period through December 31, 2005. As a result, AmerenUE's next complete depreciation study would be due in July 2011, unless it files a

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[268] Dunkel Direct, Ex. 400, Schedule WWD-1. The affected accounts are 321 Structures and Improvements, 322 Reactor Plant Equipment, 323 Turbogenerator Units, 324 Accessory Electrical Equipment, and 325 Miscellaneous Power Plant Equipment.

[269] Gilbert Rebuttal, Ex. 209, Page 3, Lines 13-14.

[270] Gilbert Rebuttal, Ex. 209, Page 3, Lines 14-16.

[271] Transcript, Pages 864-865, Lines 18-25, 1.

[272] Transcript, Page 865, Lines 14-18.

new rate case after July 2009, in which case a new depreciation study would have to be filed with the rate case.[273] AmerenUE did not submit a depreciation study in this case.

Public Counsel also did not submit a complete depreciation study in this case. However, through the testimony of its witness, William Dunkel, Public Counsel asks the Commission to order changes to five particular depreciation accounts. Dunkel contends there is a mismatch in these accounts because the approved depreciation rates are calculated using a theoretical reserve instead of actual book reserve.[274]

Dunkel explains that since the Callaway plant was built, depreciation rates have been based on an assumption that the nuclear plant would have a life of 40 years, which was the length of its license from the NRC. However, in the last rate case, the Commission ordered the depreciation rates regarding the Callaway plant be calculated based on a 60-year life span, assuming that AmerenUE would seek and receive a 20-year license extension from the NRC. The actual book reserve, which is based on past depreciation that assumed a 40 year life, is now higher than theoretical reserve, which is based on an assumed 60 year life.[275] Dunkel argues the theoretical reserve and the book reserve should be brought back into balance by adjusting the depreciation rates for the five

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[273] Weidmayer Rebuttal, Ex. 13, Page 5, Lines 8-14. .

[274] Dunkel Direct, Ex. 400, Page 5, Lines 9-11.

[275] Dunkel Direct, Ex. 400, Page 14, Lines 1-16. AmerenUE's witness describes "theoretical reserve" and "book reserve" as follows:

> The theoretical reserve, also known as the calculated accrued depreciation, is as its name implies a calculated amount or reserve and is a function of the age of the electric plant in service and the depreciation parameters selected. The theoretical reserve is commonly used in industry practice as a benchmark to assess the adequacy of a company's book reserve. The theoretical reserve is a calculated amount made at a particular point in time. The Company's accumulated depreciation or "book reserve" is the sum of actual monthly charges that have been recorded by the Company throughout its history to accumulated depreciation for items such as depreciation accruals, salvage, cost of retiring, retirements, etc.

Wiedmayer Rebuttal, Ex. 13, Page 13, Lines 5-12.

specified accounts and reducing AmerenUE's depreciation expense by approximately $7.1 million per year.[276]

Staff and AmerenUE contend no adjustment should be made at this time without the benefit of a full depreciation study. The Commission finds that Staff and AmerenUE are correct in their concern about making an isolated adjustment to a few depreciation accounts outside the context of a full depreciation study. Such an isolated adjustment is closely analogous to the larger concept of single-issue ratemaking. Just as it would be inappropriate to adjust a utility's rates based on a change to a single item without considering changes in all other items that may off-set that single item, it would be inappropriate to adjust a few depreciation rates without looking at all depreciation rates in a complete study. In a complete study, depreciation rates for some accounts may increase, while others decrease. The balance of the increases and decreases is what is important in establishing depreciation rates for the company.

The Commission did look at a complete depreciation study in the last rate case. Furthermore, the parties to that case were aware of the difference between theoretical reserve and book reserve. A Staff witness brought that imbalance to the Commission's attention, but at that time, Staff advised the Commission to simply monitor the imbalance for possible correction in a future depreciation study. No party, including Public Counsel, proposed any adjustment regarding that imbalance in that case.[277]

Public Counsel's witness claims an adjustment should be made in this case because of a "major change" since the last rate case. The "major change" he describes is

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[276] Dunkel Direct, Ex. 400, Page 17, Lines 7-11.

[277] Dunkel Direct, Ex. 400, Page 6, Lines 1-33, quoting *In the Matter of Union Electric Company d/b/a AmerenUE's Tariffs Increasing Rates for Electric Service*, Report and Order, Case No. ER-2007-0002, May 22, 2007, Page 94.

AmerenUE's announcement that it will, indeed, be filing an application to extend the Callaway plant's NRC license by another 20 years.[278] However, AmerenUE's filing of the application to extend the license of the Callaway plant is not a "major change" from the last rate case. It is not a change at all. The question of whether Callaway's service life should be extended for 20 years for depreciation purposes was certainly an issue in the last rate case, and the Commission emphatically ordered that the plant's service life should be extended.[279] Therefore, the 60-year life-span assumption for the Callaway plant was already in place when rates were set in the last case. AmerenUE's decision to actually apply for a license extension changes nothing.

Public Counsel's witness also claims that an immediate change to the depreciation rate for these five accounts is necessary because the imbalance between the actual and theoretical reserve has "grown drastically" since the last case.[280] However, Dunkel actually testified that the actual Callaway book reserve in 2005, measured at Commission approved depreciation rates, was $219 million above the theoretical reserve. By December 31, 2007, he testified that difference had grown to $250 million.[281] While the difference has grown, it is hardly the "drastic growth" that might justify an isolated change to the depreciation rates for just five accounts.

Public Counsel's witness attempts to justify his proposed isolated adjustment by claiming the balancing of possibly increasing and decreasing rates that would take place in

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[278] Dunkel Direct, Ex. 400, Page 3, Lines 7-20.

[279] *In the Matter of Union Electric Company d/b/a AmerenUE's Tariffs Increasing Rates for Electric Service*, Report and Order, Case No. ER-2007-0002, May 22, 2007, Pages 87-88.

[280] Dunkel Direct, Ex. 400, Page 8, Lines 17-19.

[281] Dunkel Direct, Ex. 400, Page 8, Lines 19-24, as corrected at Transcript, Page 824.

a complete depreciation study is not necessary because if his adjustment were applied to all accounts, not just the five he proposes to adjust, the result would be a much larger reduction.[282] However, his calculation are based on 2005 data, which likely would not be accurate for 2008.[283] Furthermore, his proposed adjustment would still be based on just a single factor, albeit spread over a wider range of accounts. It would not eliminate the single-issue ratemaking objection to his proposal to adjust the depreciation rates for a few accounts outside of a complete depreciation study.

When the Commission last looked at this issue in the 2007 rate case, it accepted Staff's suggestion to continue to monitor the imbalance between theoretical reserve and actual book accumulated depreciation. The Commission will continue to monitor that imbalance and if Public Counsel wants to raise this issue again in AmerenUE's next rate case in the context of a complete depreciation study, it is free to do so.

In his surrebuttal testimony, Dunkel requested that if the Commission decided not to make his proposed adjustments in this case, it should order AmerenUE to include certain information in its next depreciation study to aid in the review of the imbalance.[284] That request is reasonable and was not opposed by any party. The Commission will order AmerenUE to include the requested information in its next depreciation study.

Conclusions of Law:

Commission Rule 4 CSR 240-3.160 requires any electric utility that submits a general rate increase to submit a complete depreciation study, unless the utility has

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[282] Dunkel Surrebuttal, Ex. 401, Page 6, Lines 10-11.

[283] Transcript, Page 894, Lines 6-9.

[284] Dunkel Surrebuttal, Ex. 401, Pages 10-11, Lines 16-20, 1-4.

previously submitted such a study to the Commission's Staff within the three years before filing the rate case.

Commission Rule 4 CSR 240-3.175 requires an electric utility to submit a complete depreciation study at least once every five years even if it has not filed a rate case within that time.

Decision:

The Commission will not make any changes to AmerenUE's depreciation rates without consideration of a complete depreciation study. When it prepares its next depreciation study, AmerenUE shall provide for each account (1) the book reserve amount, (2) the theoretical reserve amount, (3) the remaining life years, and (4) the whole life depreciation rate with the reserve variance amortized over the average remaining life.

12. Demand Side Management

Introduction:

In AmerenUE's last rate case, the Commission approved a stipulation and agreement that established a regulatory asset that allows AmerenUE to treat demand side management expenditures as a depreciable asset, thus diminishing any advantage AmerenUE might perceive in investing in new generation rather than in demand-side resources.[285] Staff asked the Commission to clarify its previous order by directing that net expenditures were to be included in the regulatory asset account, so that income resulting from demand-side expenditures would be netted against those expenditures.[286] In his rebuttal testimony, Public Counsel's witness, Ryan Kind proposed language to accomplish

[285] Staff Report – Cost of Service, Ex. 200, Page 9.

[286] Staff Report – Cost of Service, Ex. 200, Page 9.

that netting.[287] AmerenUE did not object to the concept of netting, but objected to Kind's language as overly broad.[288]

Findings of Fact:

At the hearing, Kind acknowledged his original language could be difficult to administer. As a result, he offered the following substitute language:

> In addition to booking the incremental costs of implementing DSM programs in its regulatory asset account, UE shall book the reimbursement of incremental costs, in dollars, that are equal to capacity related revenues from any source that the Company receives that are associated with its implementation of DSM programs and not otherwise credited.[289]

At the time of the hearing, Voytas expressed general satisfaction with the change offered by Kind, but indicated he would have to examine the language in more detail before he could accept it.[290] In its brief, AmerenUE offered the following language as a substitute for that offered by Kind:

> DSM should be booked as net expenditures when DSM has a transactionable, identifiable and measurable increase in revenue to the Company. Transactionable refers to tradable products with an identifiable counter-party which provides a value. Identifiable refers to the linkage whereby specific revenue streams can be tied to specific programs. Measurable means that there is a protocol established as the basis for cash settlement.

It appears this issue is moot since the Commission allows AmerenUE to implement a fuel adjustment clause. The netting that would be the result of the language proposed by both AmerenUE and Public Counsel would occur through the fuel adjustment clause.[291] However, to the extent this issue is not moot, the Commission finds that the language

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[287] Kind Rebuttal, Ex. 404, Page 14, Lines 21-25.

[288] Voytas Surrebuttal, Ex. 18, Page 4, Lines 8-14.

[289] Transcript, Page 929, Lines 3-9.

[290] Transcript, Page 948, Lines 15-19.

[291] Transcript, Page 942, Lines 8-25.

proposed by AmerenUE is preferable because it is more narrowly tailored to meet the need identified by the parties.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

The Commission finds that if this issue is not moot, the language proposed by AmerenUE shall be adopted.

13. Low-Income Weatherization Program

Introduction:

In the Commission's Report and Order resolving AmerenUE's last rate case, ER-2007-0002, the Commission ordered AmerenUE to fund a low-income weatherization program. That order directed $600,000 of that funding be included in AmerenUE's cost of service to be collected from ratepayers. The Commission directed the other $600,000 be paid by AmerenUE using shareholder funds.[292] In response to the 2007 order, AmerenUE entered into a contract with the Missouri Department of Natural Resources, the State Environmental Improvement and Energy Resources Authority (EIERA), and the Public Service Commission, whereby it agreed to pay $1,200,000 to the low-income weatherization fund administered by EIERA on July 5 of each year.[293] AmerenUE made the entire required payment in 2007, but on June 26, 2008, it paid only $900,000 to the fund.

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[292] *In the Matter of Union Electric Company d/b/a AmerenUE's Tariffs Increasing Rates for Electric Service*, Report and Order, Case No. ER-2007-0002, May 22, 2007, Pages 112-113.

[293] A copy of that contract is attached to Wolfe Direct, Ex. 550, as Attachment LW-2.

The Department of Natural Resources asks the Commission to order AmerenUE to pay the $300,000 it withheld in July, and asks the Commission to order AmerenUE to continue funding the program in the future.

Findings of Fact:

At the hearing, the parties agreed there was no dispute about the facts and agreed this issue could be resolved on stipulated facts and as a matter of law. To that end, they agreed to stipulate to the following three facts:

> 1. In the Commission's Report and Order issued in ER-2007-0002, the Commission ordered that: "the Commission directs that the low income weatherization program continue with funding provided $600,000 by ratepayers and $600,000 by AmerenUE shareholders."
> 2. A contract was entered into among the parties and a true and correct copy of that contract is attached to the direct testimony of DNR witness Wolfe, marked as Exhibit LW-2.
> 3. AmerenUE paid $900,000 on or around June 26, 2008, toward that obligation.[294]

The parties also agreed the prefiled testimony of all witnesses relating to this issue could be admitted into evidence without cross-examination.[295]

AmerenUE withheld $300,000 from the July 2008 payment required by the contract because it believed new rates would be going into effect on March 1, 2009 at the conclusion of this case and it was unsure whether this Commission would require it to continue to make the payment under the new rates. Therefore, it withheld payment for the last three months of the fiscal year.[296]

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[294] Transcript, Page 1001, Lines 9-23.

[295] Transcript, Page 1002, Lines 5-9.

[296] Wolfe Direct, Ex. 550, Page 12-18.

As explained in its conclusions of law, the Commission has no authority to require AmerenUE's shareholders to make what is in essence a charitable contribution to the low-income weatherization fund. Therefore, it cannot require AmerenUE's shareholders to continue to contribute $600,000 to the fund. However, there is a continuing need for the low-income weatherization fund. The Commission finds that low-income residential customers face great hardships as they face high energy expenses on a small household income. Weatherization provides long-term benefits to customers by helping reduce energy demand, thereby reducing energy bills.[297] Therefore, the Commission will order AmerenUE to continue to pay $1.2 million per year into the fund, with all funds being recovered through rates. Since the program is continuing at full funding, AmerenUE shall immediately pay into the fund the $300,000 it withheld in June 2008.

There is one other matter that needs to be addressed. The Department of Natural Resources is concerned about disruptions in payment to the EIERA fund every time AmerenUE files a new rate case and thus brings the continued funding of the program into question. AmerenUE concedes the EIERA needs to have a stable source of funding, but is unwilling to commit to making payments that it may not recover in a future rate case.[298] AmerenUE may have an obligation to make those payments under its contract with EIERA, the Department of Natural Resources, and this Commission. However, as indicated in the conclusions of law for this issue, the Commission has no authority to enforce that contract. The Commission, will, however, encourage AmerenUE to continue its stable funding of the program. While this Commission cannot bind a future Commission to make a particular

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[297] Wolfe Direct, Ex. 550, Page 6, Lines 4-9.

[298] Mark Rebuttal, Ex. 20, Pages 7-8, Lines 18-23, 1-7.

decision in a future rate case, the Commission believes that AmerenUE will be treated fairly in any future rate case.

Conclusions of Law:

The Commission has broad authority under the law to regulate public utilities. It does not, however, have unlimited power. The case cited by AmerenUE, *City of Joplin v. Wheeler*,[299] although an old case, actually predating the creation of this Commission, establishes the principle that a regulatory body "can no more compel a public service corporation to do or abstain from doing anything not pertaining to the public service itself than it can compel a private individual; for, outside of its public functions, the corporation is a private corporation."[300] By ordering AmerenUE to fund part of the low-income weatherization program the Commission would be requiring the shareholders to make a charitable contribution. Such a contribution has nothing to do with AmerenUE's obligation to provide service to the public and is beyond the Commission's authority.

AmerenUE has entered into a contract that requires the company to pay $1.2 million each July to EIERA. AmerenUE did not make the full required payment in July 2008. In refusing to make that payment, AmerenUE may have violated that contract, but the Commission has no authority to make such a determination. "The PSC is an administrative body created by statute and has only such powers as are expressly conferred by statute and reasonably incidental thereto."[301] The Commission is not a court, and the legislature

[299] 173 Mo. App. 590, 158 S.W. 924 (Mo. App. 1913).

[300] *City of Joplin*, at 928.

[301] *State ex rel. AG Processing v. Thompson*, 100 S.W. 3d 915, 919 (Mo. App. W.D. 2003)

has not given it authority to enforce a contract.[302] Therefore, if any party want to enforce that contract, it will need to proceed to circuit court.

Decision:

The Commission finds that AmerenUE shall continue to pay $1.2 million per year into the low-income weatherization fund administered by EIERA. AmerenUE's payments to the fund shall be included in the company's revenue requirement to be recovered through rates.

14. Pure Power Program

Introduction:

In AmerenUE's last rate case, the Commission approved AmerenUE's proposal to begin offering a voluntary green energy program.[303] The voluntary program AmerenUE now offers is called Pure Power. Staff opposed the proposed green energy program in the last rate case and now asks the Commission to require AmerenUE to discontinue the program.

Findings of Fact.

The Pure Power program is a voluntary program whereby participating AmerenUE customers agree to pay an additional amount on their monthly bill to purchase a Renewable Energy Credit, known as a REC. The RECs are purchased from a third party, 3 Degrees, which purchases the RECs from the green power producer.[304]

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[302] *Kansas City Power & Light v. Midland Realty*, 338 Mo 1141, 93 S.W.2d 954 (Mo. 1936).

[303] *In the Matter of Union Electric Company d/b/a AmerenUE's Tariffs Increasing Rates for Electric Service*, Report and Order, Case No. ER-2007-0002, May 22, 2007, Page 115.

[304] Barbieri Rebuttal, Ex. 9, Page 3, Lines 8-14.

AmerenUE has entered into a five-year contract with 3 Degrees that fixes the price AmerenUE customers pay for a REC at fifteen dollars.[305] One dollar of that fifteen is kept by AmerenUE as an administrative fee, with the remaining fourteen going to 3 Degrees. 3 Degrees uses that money to buy the REC and keeps any money left over to pay its own expenses, and as profit.

3 Degrees is obligated under the contract to market and administer the Pure Power program and to educate AmerenUE's customers about the program.[306] One half of the RECs 3 Degrees purchases for AmerenUE's customers must come from green power generators located in Missouri or Illinois, with the rest coming from generators located within the MISO region.[307] The Pure Power program is Green-e certified and 3 Degrees pays for an annual Green-e audit through the Center for Resource Solutions.[308]

The Pure Power program has been operating since October 2007.[309] Approximately 4000 AmerenUE customers have chosen to participate in the program during that first year.[310]

Staff is concerned the sale of RECs is not an effective means of producing green power to supplant fossil fuel power. RECs are for the purchase of power generated in the past, and Staff is concerned the sale of RECs will do nothing to encourage the future generation of green power.[311] This is the same concern Staff expressed in the last rate

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[305] Barbieri Rebuttal, Ex. 9, Page 4, Lines 9-10.

[306] Barbieri Rebuttal, Ex. 9, Page 4, Lines 11-13.

[307] Barbieri Rebuttal, Ex. 9, Page 4, Lines 15-20.

[308] Barbieri Rebuttal, Ex. 9, Page 4, Lines 21-23.

[309] Transcript, Page 662, Lines 12-17.

[310] Transcript, Page 713, Lines 7-10.

[311] Staff Report – Class Cost of Service & Rate Design, Ex. 206, Page 19-20.

case. However, other governmental organizations do not share Staff's concern. The National Renewable Energy Lab and the Federal Department of Energy state programs such as Pure Power have assisted in bringing more than 1,000 MWs of new renewable projects online.[312]

A REC is not produced until actual renewable energy is produced. Even though those electrons have already been produced and used, the sale and purchase of a REC stimulates demand for additional renewable energy by sending a market signal to green power producers to develop additional sources of renewable energy.[313] Staff's witness may not believe RECs are effective, but he concedes that millions of RECs are sold each year.[314] He also concedes the Missouri Department of Natural Resources, and the Environmental Protection Agency support the concept of RECs.[315] In fact, he concedes RECs are widely accepted throughout the nation as contributing to the expansion of green generation, although he describes that acceptance as "an unsubstantiated belief, widely accepted."[316]

Staff is also concerned that customers are confused about what they are actually receiving when the purchase a REC. Staff seems to believe customers think they are buying actual electrons generated by a green generation source, when they buy a REC. The concept of a REC and the purchase of the environmental attributes associated with

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[312] Barbieri Rebuttal, Ex. 9, Page 7, Lines 9-11.

[313] Transcript, Page 724, Lines 14-21.

[314] Transcript, Page 629, Lines 16-22.

[315] Transcript, Page 637, Liens 13-18.

[316] Transcript, Pages 641-642, Lines 22-25, 1-4.

green production versus fossil fuel production is difficult to understand.[317] AmerenUE concedes it is difficult to explain to customers that they are purchasing a REC and not electricity. Some of the initial marketing materials sent out by 3 Degrees did not do enough to avoid that confusion, but AmerenUE and 3 Degrees have continued to improve those marketing materials, including major revisions to the Pure Power website. In the end, the desire to improve the marketing materials does not justify terminating the program after only one year of existence.

Aside from its concerns about the effectiveness and the marketing of the Pure Power program, Staff is also concerned the contract between AmerenUE and 3 Degrees does not pass enough money through to actual green energy producers. As previously indicated fourteen of the fifteen dollars AmerenUE collects from participating customers is passed to 3 Degrees for the purchase of RECs. Not surprisingly, not all the money that goes to 3 Degrees is used to purchase RECs. 3 Degrees keeps some to pay for marketing and administration and profit.[318] Staff believes the contract is overly generous to 3 Degrees. However, 3 Degrees assumed the risk that the market price for RECs may rise in the next five years, thus reducing its profit margin. A rise in the market price for RECs is possible as demand for RECs rises because of the imposition of renewable portfolio standards such as the recently enacted Proposition C in Missouri.[319]

Finally, Staff is concerned non-participating AmerenUE customers may be subsidizing AmerenUE's administrative costs associated with the Pure Power program

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[317] Transcript, Page 628, Lines 6-14.

[318] The highly confidential numbers are found at Ensrud Surrebuttal, Ex. 220, Page 11, Line 18.

[319] Transcript, Page 748, Lines 11-19.

because AmerenUE is not doing enough to separately track those costs.[320] AmerenUE agrees that non-participating customers should not be subsidizing the program and indicates all administrative costs, as well as revenues generated by the program, are accounted for below the line.[321] Staff is concerned, for example, that the cost of billing customers who participate in the Pure Power program is not segregated from the cost of billing all other customers.[322] However, the maximum potential cost identified by Staff is not substantial and does not justify any immediate accounting change.[323]

The Commission finds that the Pure Power program is a voluntary program that seems to be popular with some of AmerenUE's customers. No customer is forced to participate in the program and if they are unhappy with the program, they can leave at any time. The program is nationally respected and has been awarded the 2008 New Green Power Program of the year award by the U.S. Department of Energy, in conjunction with the U.S. Environmental Protection Agency and the Center for Resource Solutions.[324] Most importantly, the program has only been in operation for one year. It is too soon to properly assess the program and it is certainly too soon to kill the program.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

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[320] Staff Report – Class Cost of Service & Rate Design, Ex. 206, Pages 21-22.

[321] Barbieri Rebuttal, Ex. 9, Page 9, Lines 5-22.

[322] Transcript, Page 696, Lines 4-10.

[323] Staff Report – Class Cost of Service & Rate Design, Ex. 206, Page 22. The precise number is highly confidential.

[324] Barbieri Rebuttal, Ex. 9, Page 11, Lines 1-5, and Transcript, Page 703-704, Lines 20-25, 1.

The Commission authorizes AmerenUE to continue to offer the voluntary Pure Power program to its customers.

15. Union Issues

Introduction:

The various unions that represent AmerenUE's employees appeared at the hearing to generally support the company's request for a rate increase. However, they asked the Commission to order AmerenUE to spend more money on employee training and to take specific steps to increase its internal workforce so it will use fewer outside contractors. AmerenUE contends it is currently providing safe and adequate service and argues the Commission has no authority to manage the day-to-day affairs of the company.

Findings of Fact:

David Desmond is the business manager of International Brotherhood of Electrical Workers Local 2, AFL-CIO.[325] He testified that too much of AmerenUE's daily workload is performed by less trained subcontractors rather than by AmerenUE's internal workforce.[326] He asked the Commission to require AmerenUE to invest in its employee infrastructure and require subcontractors to meet the standards of training and certification similar to those required of AmerenUE's internal workforce.[327]

Donald Giljum is the Business Manager for the International Union of Operating Engineers Local Union No. 148.[328] He testified AmerenUE has curtailed its training

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[325] Desmond Direct, Ex. 901, Page 1, Lines 2-3.

[326] Desmond Direct, Ex. 901, Page 2, Lines 14-22.

[327] Desmond Direct, Ex. 901, Page 3, Lines 13-19.

[328] Giljum Direct, Ex. 903, Page 1.

activities and allowed internal staffing level to decline to the point it must rely on outside contractors to perform some of the work at its power plants.[329]

Michael Walter is the Business Manager of International Brotherhood of Electrical Workers Local 1439, AFL-CIO.[330] He testified AmerenUE has not spent enough on training new workers and as a result has over-relied on outside contractors to perform normal and sustained work.[331] He asks the Commission to require AmerenUE to spend its rate increase to improve training and increase the portion of the workload performed by its internal workforce.[332]

Michael Datillo is the Business Manager and Financial Secretary of International Brotherhood of Electrical Workers Local 1455, AFL-CIO.[333] Datillo also complained AmerenUE relied too heavily on outside contractors. In particular, he objected to the outsourcing of call center work to a company operating out of North Carolina.[334]

AmerenUE denied its use of outside contractors has diminished the efficiency or safety of the company's operations. AmerenUE demonstrated that measures of power plant reliability have significantly improved over the last 10 years. Since 1998, the equivalent availability[335] of AmerenUE's coal plants has improved from 79.91 percent in

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[329] Giljum Direct, Ex. 903, Page 2.

[330] Walter Direct, Ex. 902, Page 1, Lines 2-3.

[331] Walter Direct, Ex. 902, Pages 2-4.

[332] Walter Direct, Ex. 902, Page 6, Lines 8-23.

[333] Datillo Direct, Ex. 900, Page 1, Lines 2-4.

[334] Datillo Direct, Ex. 900, Page 2, Lines 18-20.

[335] Equivalent availability is the total actual megawatt hours a unit is available after all outages and derates have been subtracted, divided by the total maximum megawatt hours a full unit capacity. Birk Rebuttal, Ex. 15, Pages 6-7, Lines 22-23, 1.

1998, to 90.73 percent in 2008. In the same period of time, the net capacity factor[336] for those plants has improved from 61.92 percent to 79.26 percent.[337] Furthermore, the OSHA incident rate for generation employees has declined over the last ten years from 9.0 in 1998 to 1.9 in 2008,[338] which is near the top quartile rate for generating plants around the country.[339]

AmerenUE acknowledges it is facing an industry-wide shortage of trained linemen, and must, therefore, rely on outside contractor. However, AmerenUE is trying to find more workers that are qualified and is offering a $15,000 bonus for persons who qualify as a journeyman lineman.[340] In addition to a general shortage of linemen, the average age of AmerenUE's work force is getting older. For example, in one union bargaining unit the average age is 49 and one half, with an average retirement age of 55 or 56.[341] As more employees approach retirement, there is a need for increased training to bring new workers in to replace those who are retiring.

In response to those concerns, Commissioner Davis asked the AmerenUE witnesses how the company would spend an extra $3 million on training if provided with additional funds as a result of this case.[342] In response to Commissioner Davis' question,

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[336] Net capacity factor is a ratio of how much power was actually produced by the plants, divided by the capacity of the plants. Birk Rebuttal, Ex. 15, Page 7, Lines 2-3.

[337] Birk Rebuttal, Ex 15, Page 7, Chart at Line 4.

[338] Birk Rebuttal, Ex. 15, Page 8, Chart at Line 1.

[339] Transcript, Page 1810, Lines 22-25.

[340] Zdellar Rebuttal, Ex. 16, Page 11, Lines 12-13.

[341] Transcript, Page 1766, Lines 17-25.

[342] Transcript, Page 1820-1821, Lines 23-25, 1-19.

AmerenUE subsequently filed an exhibit detailing how it would spend extra money on training.[343]

The Commission finds that the evidence presented by the union witnesses does not demonstrate that AmerenUE has failed to supply safe and adequate service to the public. Furthermore, for reasons fully explained in its Conclusions of Law, the Commission does not have the authority to dictate the manner in which AmerenUE conducts its business. Therefore, the Commission will not attempt to dictate to the company regarding its use of outside contractors.

However, the union witnesses and AmerenUE agree there is a need for improved training to replace skilled workers nearing retirement age. Therefore, the Commission will add $1,410,000 to AmerenUE's cost of service to fund increased training staff. The Commission will also allow AmerenUE an additional $1,800,000 for additional training equipment and materials, and external costs, to be amortized over five years and recovered in rates. That would increase AmerenUE's cost of service by an additional $360,000 per year, for a total increase of $1,770,000.

Conclusions of Law:

The Commission has the authority to regulate AmerenUE, including the authority to ensure the utility provides safe and adequate service. However, the Commission does not have authority to manage the company. In the words of the Missouri Court of Appeals,

> The powers of regulation delegated to the Commission are comprehensive and extend to every conceivable source of corporate malfeasance. Those powers do not, however, clothe the Commission with the general power of management incident to ownership. The utility retains the lawful right to manage its own affairs and conduct its business as it may choose, as long as

[343] Ex. 78.

> it performs its legal duty, complies with lawful regulation, and does no harm to public welfare.[344]

Therefore, the Commission does not have the authority to dictate to the company whether it must use its internal workforce rather than outside contractors to perform the work of the company.

Decision:

The evidence presented by the union witnesses does not demonstrate that AmerenUE has failed to provide safe and adequate service and the Commission will not dictate to the company whether it must use its internal workforce or outside contractors to perform the company's work. However, the Commission will add $1,410,000 to AmerenUE's cost of service to fund increased training staff. The Commission will also allow AmerenUE an additional $1,800,000 for additional training equipment and materials, and external costs, to be amortized over five years and recovered in rates. That increases AmerenUE's cost of service in this case by $1,770,000 per year.

16. Hot Weather Safety Program

Introduction:

AARP asks the Commission to order AmerenUE to instigate a limited experimental pilot program designed to encourage low-income seniors to turn on their air conditioners during hot weather by offering them a bill credit during the summer. AmerenUE opposes the pilot program as poorly thought out and unlikely to be effective.

Findings of Fact:

AARP cites studies showing that some seniors refuse to turn on their air conditioners even in very hot weather, in part because of concerns about the high cost of operating an

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[344] *State ex rel. Harline v. Public Serv. Com'n*, 343 S.W.2d 177, 182 (Mo. App. 1960)

air conditioner.[345] As a result, those seniors are at a greater risk of dying from heat related illness.[346] AARP's proposed pilot program attempts to address that problem by offering low-income seniors a small bill credit on their bills to encourage them to use their air conditioning when it is hot.

AARP initially proposed to make the hot weather credit available to all low-income seniors in the AmerenUE's service territory at a cost of nearly $1.5 million.[347] However, by the time of the hearing, AARP had reduced its proposal to an experimental pilot program that would provide bill credits of $5 per day for 9.5 extreme heat days during the summer months, for 2,400 participating households. The cost of providing the bill credits would be $114,000, which AmerenUE would be allowed to recover in rates.[348]

The Commission is concerned about the health of the elderly citizens of AmerenUE's service territory, but AARP's proposed pilot program is not well thought out and there is no indication that a bill credit of $5.00 per day will actually prompt an at-risk elderly person to turn on their air conditioning. This sort of program has never been tried anywhere else and AARP admits it does not really know how it will work.[349] A heat alert warning from the Missouri Department of Health, attached to AARP's testimony, indicates for some at-risk elderly persons, "even encouragement from relatives and friends could not convince them to use their air conditioner."[350] In those circumstances, it is hard to see how a slightly

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[345] Howat Direct, Ex. 850, Pages 6-7, Lines 17-23, 1-5.
[346] Howat Direct, Ex. 850, Page 8, Lines 1-20.
[347] Howat Direct, Ex. 850, Page 12, Lines 7-8.
[348] Transcript, Page 1130, Lines 7-12.
[349] Transcript, Pages 1165-1166, Lines 20-25, 1-2.
[350] Howat Direct, Ex. 850, Attachment AARP-JH-3.

reduced utility bill at the end of the month would convince an at-risk person to turn on their air conditioning.

Of course, in terms of this multi-million dollar rate case, the $114,000 it would cost to implement AARP's pilot program is not significant. However, implementation of an ill-conceived pilot program could distract AmerenUE and other interested parties from more effective actions to help the elderly poor. In fact, that was the conclusion of the collaborative group to which AARP presented its proposal last spring.[351] Instead, that collaborative group decided to move forward with other plans to educate the elderly about the dangers of extreme heat.[352]

The Commission finds that AARP's proposed hot weather safety pilot program, while well intentioned, would not be an effective use of AmerenUE's resources and the financial resources of AmerenUE's ratepayers.

Conclusions of Law:

There are no additional conclusions of law on this issue.

Decision:

AARP's proposed hot weather safety pilot program is rejected.

17. Certain Power On and Dollar More Advertising Expense

Introduction:

Staff seeks to disallow approximately $1.36 million in advertising expenses incurred by AmerenUE in promoting its Power On program and its Dollar More program.[353]

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[351] Transcript, Page 1228, Lines 8-14.

[352] Transcript, Page 1231, Lines 5-9.

[353] Transcript, Page 1008, Lines 10-12.

AmerenUE replied that the advertisements challenged by Staff were appropriate for inclusion in rates and their cost should be recovered from ratepayers.

Findings of Fact:

Staff bases its proposal to disallow the cost of certain advertisements on a decision made by the Commission in a 1986 KCPL rate case. In that decision, the Commission defined five categories of advertisements.

1. General: Informational advertising that is useful in the provision of adequate service;
2. Safety: Advertising that conveys the ways to safely use electricity and to avoid accidents;
3. Promotional: Advertising used to encourage or promote the use of electricity;
4. Institutional: Advertising used to improve the company's public image; and
5. Political: Advertising associated with political issues.

In that case, the Commission found the cost of General and Safety advertising could be recovered from ratepayers, while the cost of Institutional and Political advertising should not be recovered. The Commission in that case found promotional advertising could be recovered if it was shown to be cost justified.[354] The Commission finds that categorization of advertising to be useful and will use the same categories in considering this issue.

Staff's witness, Erin Carle, examined hundreds of individual print, radio, television and billboard advertisements, the cost of which AmerenUE seeks to recover in rates. Staff disallowed recovery for many of those advertisements as institutional advertising designed

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[354] *In the Matter of Kansas City Power & Light Company's Tariffs Increasing Rates for Electric Service,* 28 Mo. P.S.C. (N.S.) 228, 270 (1986).

to promote the image of the utility.[355] AmerenUE contend the challenged ads are properly categorized as General, meaning they are informational advertising that is useful in the provisioning of adequate service.

AmerenUE's Power On program is a billion dollar initiative AmerenUE has undertaken to improve the reliability of its electric network. Under Power On, AmerenUE will spend approximately $500 million in mandated environmental expenditures, $300 million in undergrounding work, and $150 million to more aggressively trim trees.[356] Staff conceded that some advertising for Power On should be categorized as General advertising because it conveyed useful information to the public about the specifics of the program. However, Staff claimed the cost of other Power On ads should be excluded because the advertisements did not convey enough useful information to the public.[357]

Erin Carle examined each of AmerenUE's Power On advertisements and offered an opinion on whether each advertisement conveyed enough useful information to the public. The problem with that approach is Erin Carle is an accountant, and is working on her MBA.[358] Although she claims to be an advertising expert for ratemaking purposes,[359] she has no training in the field of advertising, aside from looking at old cases at the Commission.[360]

Not surprisingly, given her lack of expertise and the vague standard by which she was attempting to judge the individual advertisements, Carle's testimony fell apart on cross-

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[355] Carle Surrebuttal, Ex. 219, Page 7, Lines 16-19.

[356] Mark Rebuttal, Ex. 20, Page 6, Lines 7-10.

[357] Transcript, Page 1040, Lines 17-20.

[358] Transcript, Page 1030, Lines 12-20.

[359] Transcript, Page 1038, Lines 19-25.

[360] Transcript, Page 1039, Lines 6-16.

examination and it became clear that her categorization of particular Power On advertisements as either General and thus recoverable, or Institutional, and thus excludable, was essentially arbitrary.

The fault was not with Ms. Carle, but rather with Staff's attempt to individually categorize each and every advertisement produced by AmerenUE. As Mr. Mark testified for AmerenUE, it makes more sense to look at an advertising campaign as a whole.[361] Thus, a simple billboard advertisement that by its nature cannot convey a great deal of information to a motorist rushing by at 70 miles per hour, may motivate and direct that customer to seek out more detailed information from another source.

In the future, Staff would do well to examine advertisements on a campaign basis rather than becoming ensnared in the effort to evaluate individual ads within a larger campaign. If on balance a campaign is acceptable then the cost of individual advertisements within that campaign should be recoverable in rates. If the campaign as a whole is unacceptable under the Commission's standards, then the cost of all advertisements within that larger campaign should be disallowed.

The same finding must be made in relation to the challenged Dollar More advertisement, which was a print advertisement that appeared in the game day program for the St. Louis Rams and urged Rams fans to go to the company website to learn more about the Dollar More program.[362] The overall campaign to promote the Dollar More program is acceptable, so the individual advertisements within that larger campaign shall not be disallowed.

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[361] Transcript, Page 1024, Lines 7-11.

[362] The ads in question are attached to Mark Rebuttal, Ex. 20, Schedules RJM-RE2-9 and RE2-10.

For purposes of this case, Staff's proposal to disallow the cost of certain Power On and Dollar More advertisements is rejected.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

Staff's proposal to disallow the cost of certain Power On and Dollar More advertisements is rejected.

18. Rate Design

Introduction:

After the Commission determines the amount of rate increase that is necessary, it must decide how that rate increase will be spread among AmerenUE's customer classes. The basic principle guiding that decision is that the customer class causing a cost should pay that cost. During the course of the hearing, Public Counsel, MIEC, MEG, the Commercial Group, and Noranda filed a nonunanimous stipulation and agreement that reached an agreement on how the rate increase should be allocated to the customer classes. AmerenUE did not sign the stipulation and agreement but did not oppose the compromise agreement. Staff, however, does oppose that agreement. Therefore, the Commission cannot approve the stipulation and agreement. Nevertheless, the compromise described in the stipulation and agreement remains the position of the signatory parties and the Commission can consider that position as it decides this issue.

Findings of Fact:

AmerenUE has five customer classes.[363] The Residential class is comprised of residential households. The Small General Service and Large General Service classes are comprised of commercial operations of various sizes. The first three classes receive electric service at a low secondary voltage level. The Small Primary Service and the Large Primary Service are larger industrial operations that receive their electric service at a high voltage level. The final class is Large Transmission Service. There is only one member of that class, Noranda. Noranda operates an aluminum smelter in Southeast Missouri and receives massive amounts of electricity at a transmission voltage level.[364]

To evaluate how best to allocate costs among these customer classes, four parties prepared and presented class cost of service studies. The studies presented by AmerenUE and MIEC used versions of the Average and Excess Demand Allocation method. An Average and Excess Demand Allocation method recognizes that peak demand, the amount of energy that must be produced and delivered during the periods of highest demand, and average class energy consumption, determine how the generation and distribution systems must be structured. The Average and Excess Demand Allocation method gives weight to both of those considerations by evaluating both average class demands and the excess non-coincident peak demands of each class.[365]

Staff and Public Counsel also presented class cost of service studies, but they used a different allocation method known as a Peak and Average Demand Allocation method. Staff's allocation method is based on each class' contribution to the 12 monthly non-

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[363] The Lighting class, which includes street lights, is a sixth class but because of its unique load pattern, it is not treated as a separate class for the class cost of service studies. Staff Report - Class Cost of Service & Rate Design, Ex. 206, Page 9.

[364] Cooper, Direct, Ex. 39, Page 4, Lines 7-11.

[365] Cooper Direct, Ex. 39, Page 13, Lines 7-21.

coincident class peak demands and applies a monthly weighting factor for capacity utilization prior to calculating the class contribution to demand.[366] Public Counsel also presented a second study using a time of use method.

The following chart compares the results of each of the class cost of service studies, indicating the percent change in class revenues required to equalize class rates of return. A negative number means the class is paying more than its indicated share of costs. A positive number means that class is paying less than its indicated share.

Study	Residential	Small General Service	Large General Service	Primary Service	Large Transmission Service
Staff	3.160%	-3.063%	-5.092%	2.901%	4.882%
AmerenUE	6.820%	-6.626%	-7.561%	3.536%	-2.641%
OPC (TOU)	-1.850%	-9.900%	-2.130%	14.470%	23.010%
OPC (A&P)	0.060%	-7.080%	-2.550%	10.480%	11.630%
MIEC	12.300%	-5.800%	-11.000%	-3.800%	-16.200%

The completion of a class cost of service study does not end the rate the design process. The Commission is not required to precisely set rates to match the indicated class cost of service. Instead, the Commission has a great deal of discretion to set just and reasonable rates, and can take into account other factors, such as public acceptance, rate stability and revenue stability in setting rates[367]

AmerenUE and Staff proposed that because their class cost of service studies did not show any large variations from appropriate class contributions, any rate increase should be allotted equally to each customer class. In other words, each class would receive the system average percentage increase. Several other parties advocated various adjustments to benefit the customer classes they represent.

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[366] Staff Report – Class Cost of Service & Rate Design, Ex. 206, Page 11.

[367] Cooper Direct, Ex. 39, Attachment A-2.

The objected-to stipulation and agreement represents a compromise among the various customer classes. It would divide any rate increase into three tiers, as follows:

Tier 1: For any increase up to $80 million, all classes will receive the system average percentage increase.

Tier 2: The Tier 2 spread operates on any approved increase equal to or above $80 million and up to $150 million. Within Tier 2, there are several interrelated adjustments.

> Step 1. The increment directed to the Large Transmission Service class will be one-half of the system average percentage increase.
>
> Step 2. The amount of the increase not directed to the Large Transmission Service class will be spread among the remaining customer classes in proportion to the true-up level of rate revenues of these classes.
>
> Step 3. The residential increase will be adjusted to be equal to the system average percentage increase plus 0.3 percent. For example, a 7 percent system average increase would result in a residential increase of 7.3 percent.
>
> Step 4. The additional revenue generated by the Step 3 adjustment to residential class revenues will be spread among the Small General Services, Large General Services and Small Primary Service rate classes in proportion to the true-up revenues form those rate classes.

Tier 3. Tier 3 applies to the increase amount, if any, in excess of $150 million. Under that Tier, all classes will receive the system average percentage increase.

In other words, the first $80 million of rate increase will be spread equally over all classes as Staff and AmerenUE suggested. It is only for the increment between $80 million and $150 million that any adjustments would be made among the classes.

At the hearing, after the compromise was filed, witness after witness took the stand to testify that the compromise is supported by the studies and would be a reasonable exercise of the Commission's authority to set reasonable rates. Maurice Brubaker, the witness for MIEC, a collection of large industrial customers, testified that the compromise is consistent with the class cost of services studies. He pointed out that the deviations from system average were minor, with no disruptive increases for any customer class.[368] Donald Johnstone testified in support of the compromise on behalf of Noranda, the only member of the Large Transmission Service class.[369] Richard Baudino, testifying on behalf of the Commercial Group, a group of large retailers, described the compromise as reasonable and resulting in "just and reasonable rates the Commission can rely on."[370] Finally, Barbara Meisenheimer and Ryan Kind testified on behalf of Public Counsel. Both Meisenheimer[371] and Kind[372] supported the compromise position.

The only witness who opposed the compromise position was James Watkins representing Staff. He indicated Staff opposed the compromise because it would result in a reduction for the Large Transmission Service, which Staff's study shows is already paying

[368] Transcript, Page 1916, Lines 1-16.

[369] Transcript, Page 1952-1953, Lines 24-25, 1-7.

[370] Transcript, Page 1965, Lines 4-8.

[371] Transcript, Page 1974, Lines 18-25.

[372] Transcript, Pages 1976-1977, Lines 14-25, 1-13.

less than its indicated share of costs.[373] Staff acknowledged its study also showed that the Small General Service, Large General Service, and Small Primary Services classes should receive a smaller than system average increase, as they would under the compromise position, but not under the across the board increase demanded by Staff.[374] Staff also conceded that only $2.9 million is being redistributed between classes compared to the equal percentage distribution demanded by Staff.[375] That $2.9 million would represent only 0.14 percent of AmerenUE current total revenues.[376] Nevertheless, Staff dogmatically insisted it would oppose the compromise position even if only $1 was redistributed for the benefit of the Large Transmission Service class.[377]

Staff claims its position is justified because its cost of service study shows the Large Transmission Service class should be given a larger than system average increase rather than a decrease. The cost of service studies presented by AmerenUE and MIEC both indicate the Large Transmission Service class should receive a lower than average increase, but Staff believes only its cost of service study, and perhaps that of Public Counsel, is valid.[378]

However, the method Staff uses in its study, the Capacity Utilization method, is a method of Staff's own invention, having been designed by Dr. Michael Proctor in 1982.[379] Staff has used this method since that time, but the method has never been accepted by this

[373] Transcript, Page 1991, Lines 22-25.
[374] Transcript, Page 1995, Lines 10-15.
[375] Transcript, Page 2017, Lines 11-14.
[376] Transcript, Page 2018, Lines 1-4.
[377] Transcript, Page 2015, Lines 6-10.
[378] Transcript, Page 2025, Lines 10-17.
[379] Staff Report – Class Cost of Service & Rate Design, Ex. 206, Page 12.

or any other Commission in the country.[380] Indeed, the Peak and Average Demand allocation method used by Staff is inherently flawed as it double counts the average demand of customer classes, resulting in customers with higher load factor, in other words industrials, being allocated an inequitable share of production plant investment.[381]

The Commission finds that the compromise position advocated by parties representing all of the customer classes is supported by the class cost of service studies submitted by AmerenUE and MIEC. The class cost of service study offered by Staff is inherently flawed and unreliable, but even that study does not preclude the slight redistribution between classes that will result from the compromise position. The Commission find that the compromise position will result in just and reasonable rates, and the Commission will adopt that position.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

The Commission adopts the compromise position advocated by Public Counsel, MIEC, MEG, the Commercial Group, and Noranda. That position is described as follows:

Tier 1: For any increase up to $80 million, all classes will receive the system average percentage increase.

Tier 2: The Tier 2 spread operates on any approved increase equal to or above $80 million and up to $150 million. Within Tier 2, there are several interrelated adjustments.

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[380] Transcript, Page 2066, Lines 15-18.

[381] Cooper Rebuttal, Ex. 40, Pages, 4-5, Lines 17-23, 1-4.

Step 1. The increment directed to the Large Transmission Service class will be one-half of the system average percentage increase.

Step 2. The amount of the increase not directed to the Large Transmission Service class will be spread among the remaining customer classes in proportion to the true-up level of rate revenues of these classes.

Step 3. The residential increase will be adjusted to be equal to the system average percentage increase plus 0.3 percent. For example, a 7 percent system average increase would result in a residential increase of 7.3 percent.

Step 4. The additional revenue generated by the Step 3 adjustment to residential class revenues will be spread among the Small General Services, Large General Services and Small Primary Service rate classes in proportion to the true-up revenues form those rate classes.

Tier 3. Tier 3 applies to the increase amount, if any, in excess of $150 million. Under that Tier, all classes will receive the system average percentage increase.

19. FERC 7-Factor Test

Introduction:

This final issue is not contested by any party. Nonetheless, AmerenUE asks the Commission to make a factual determination to satisfy the requirements of its agreement with the Midwest Independent Transmission System Operator, Inc. (Midwest ISO), and Midwest ISO's FERC electric tariff.

Findings of Fact:

The Agreement of Transmission Facilities Owners to Organize the Midwest Independent Transmission System Operator, Inc., a Delaware Non-Stock Corporation

requires its member utilities to request a determination by their state regulatory commission that the utility has classified its energy delivery facilities in accordance with the 7-Factor Test prescribed by the Federal Energy Regulatory Commission (FERC).[382] AmerenUE is a party to that agreement by virtue of its membership in the Midwest ISO.

The FERC 7-Factor Test is a test used to determine whether an energy delivery facility should be classified as either local distribution or transmission.[383] As a participant in the Midwest ISO, AmerenUE has transferred operational control of its electrical transmission facilities to the Midwest ISO. AmerenUE retains control over its local distribution facilities. Thus, the purpose of the determination required by the Midwest ISO agreement is to ensure that the participating utility has properly classified the facilities it has transferred to the control of the Midwest ISO.

AmerenUE's witness, Edward Pfeiffer, testified that AmerenUE has applied the 7-Factor Test in classifying its energy delivery facilities between distribution and

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[382] Pfeiffer Direct, Ex. 53, Page 2, Lines 15-14.

[383] The 7 factors in FERC's test are as follows:

1. Local distribution facilities are normally in close proximity to retail customers.
2. Local distribution facilities are primarily radial in character.
3. Power flows into local distribution systems; it rarely, if ever, flows out.
4. When power enters a local distribution system, it is not reconsigned or transported on to some other market.
5. Power entering a local distribution system is consumed in a comparatively restricted geographical area.
6. Meters are based at the transmission/local distribution interface to measure flows into the local distribution system.
7. Local distribution systems will be of reduced voltage.

Pfeiffer Direct, Ex. 53, Page 3, Lines 1-11.

transmission.[384] He also attached a list of the energy delivery facilities AmerenUE classified as transmission and transferred to Midwest ISO for operations.[385]

Staff's witness, Daniel Beck, testified that the list of transmission facilities identified by AmerenUE "appears to be reasonable". However, Beck indicated he had not reviewed the list and application of the FERC 7-Factor test on a line-by-line basis.[386] Beck also explained that Midwest ISO's FERC electric tariff, which incorporates the requirements of the Midwest ISO agreement referenced by AmerenUE, requires the company to request a determination from the Commission. It does not require that the Commission approve that request. Thus, AmerenUE met the requirement of the Midwest ISO's tariff when it requested the determination, and the Commission does not actually need to approve the requested determination.[387]

Beck testified that if the Commission chooses to make the determination requested by AmerenUE, it should note that its determination does not have any ratemaking impact, and does not modify the terms of AmerenUE's participation in the Midwest ISO.

Conclusions of Law:

Midwest ISO's FERC Electric Tariff provides as follows:

> Prior to the end of the fourth (4th) year of the Transition Period, each Owner shall file a request with the appropriate regulatory authority or authorities (unless a proceeding has already been initiated or completed) for a determination of which of its facilities are transmission facilities or which are distribution in accordance with the seven (7) factor test set forth in FERC Order No. 888, 61 Fed. Reg. 21,540, 21,620 (1996) or any applicable successor test. Each Owner shall use its best effort to cause these determinations to be made before the end of the Transition Period. Owners

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[384] Pfeiffer Direct, Ex. 53, Page 3, Lines 22-23.

[385] Pfeiffer Direct, Ex. 53, Schedule ECP-E1.

[386] Beck Rebuttal, Ex. 217, Page 3, Lines 12-14.

[387] Beck Rebuttal, Ex. 217, Page 2, Lines 25-28.

that are not subject to regulation by a regulatory authority shall apply to the Midwest ISO for such a determination.[388]

Decision:

Based on the uncontested testimony of Edward Pfeiffer, the Commission determines that AmerenUE has classified its energy delivery facilities in accordance with the 7-Factor Test prescribed by the FERC. This determination does not have any ratemaking impact, and does not modify the terms of AmerenUE's participation in the Midwest ISO.

IT IS ORDERED THAT:

1. The tariff sheets filed by Union Electric Company, d/b/a AmerenUE on April 4, 2008, and assigned tariff number YE-2008-0605, are rejected.

2. Union Electric Company, d/b/a AmerenUE is authorized to file a tariff sufficient to recover revenues as determined by the Commission in this order.

[388] Midwest ISO FERC Electric Tariff, First Revised Rate Schedule No. 1, Substitute First Revised Sheet No. 125. Beck Rebuttal, Ex. 217, Appendix C.

3. This report and order shall become effective on February 6, 2009.

BY THE COMMISSION

(S E A L)

Colleen M. Dale
Secretary

Murray and Jarrett CC, concur;
Davis, C, concurs, with separate concurring opinion to follow;
Clayton, Chm, dissents;
and Gunn, dissents, with separate dissenting opinion to follow;
and certify compliance with the provisions
of Section 536.080, RSMo.

Dated at Jefferson City, Missouri,
on this 27th day of January, 2009.