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Witness: *Stephen M. Rackers*
Sponsoring Party: *MoPSC Staff*
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY
on Interim Rates

OF

STEPHEN M. RACKERS

UNION ELECTRIC COMPANY
d/b/a AmerenUE

CASE NO. ER-2010-0036

Jefferson City, Missouri
November, 2009

****Denotes Highly Confidential Information****

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REBUTTAL TESTIMONY
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OF

STEPHEN M. RACKERS

UNION ELECTRIC COMPANY
d/b/a AMERENUE

CASE NO. ER-2010-0036

Q. Please state your name and business address.

A. Stephen M. Rackers, 9900 Page Avenue, Suite 103, Overland, MO 63132.

Q. Are you the same Stephen M. Rackers who previously filed direct testimony regarding interim rates in this proceeding?

A. Yes.

Q. What is the purpose of your rebuttal testimony?

A. My rebuttal testimony will address the Direct Testimony of Union Electric Company, dba AmerenUE (UE or Company) witnesses Gary S. Weiss and Warner L. Baxter. My rebuttal testimony will also address the Direct Testimony of Laclede Gas Company (Laclede) witness Glenn W. Buck.

Q. What has Mr. Weiss presented as the basis for the amount of the interim rate increase?

A. Mr. Weiss has calculated a revenue requirement associated with the change in net plant, plant less depreciation reserve, from October 1, 2008 through May 31, 2009 as the basis for the $37.3 million interim rate request. The revenue requirement calculation made by Mr. Weiss includes return on investment, depreciation expense and income taxes based on the authorized rate of return and the income tax rate from the Company's previous rate case, Case

No. ER-2008-0318, and the depreciation rates authorized in Case No. ER-2007-0002, the Company's prior rate case.

Q. Has Mr. Weiss appropriately reflected the revenue requirement associated with the change in net plant?

A. No. Mr. Weiss has recognized the income tax expense associated with the return on net plant. However, he has failed to recognize the change in the plant-related accumulated deferred income tax (ADIT) balance as an offset to the change in net plant. Therefore, the investment on which Mr. Weiss is calculating a return is overstated. The change in the ADIT balance significantly reduces the investment, which is the basis for the return and related income tax expense components of the Company's interim revenue requirement calculation. Based on my calculation, reducing the net plant by the change in the plant related deferred income tax balance reduces the Company's interim revenue requirement of $37.3 million by approximately $5.9 million.

Q. Why is it appropriate to include the change in the ADIT balance?

A. Inclusion of the ADIT balance as a reduction to net plant is an accepted regulatory practice in determining the revenue requirement associated with return on investment. This regulatory practice of reducing net plant for the ADIT balance has been accepted by the Commission and is used by the Company in its calculation of the revenue requirement in the permanent rate case. The ADIT I have considered is generated by the change in plant as a result of the higher depreciation expense allowed for income tax purposes.

Q. Are there other calculations that should have been made by the Company to appropriately reflect the revenue requirement associated with the change in net plant?

A. Yes. Included in the change in net plant are additions related to serving new customers. Since the associated revenues, net of expenses, have not been included in the calculation, the plant should also be eliminated. Based on my calculation, eliminating the net plant additions and associated depreciation expense, related to serving new customers reduces the Company's interim rate increase request by an additional $2.7 million.

Q. Are there other reductions to revenue requirement associated with the change in net plant that should be considered?

A. Yes. Some of the change in net plant is likely related to plant additions which are intended to improve efficiency. As a result, there are cost savings related to the change in net plant. Therefore, the Company's calculation of the revenue requirement is overstated due to the fact that cost savings associated with the change in net plant have not been included. This highlights the problem with focusing on only a few components of the cost of service in an interim rate proceeding rather than considering all relevant items.

Q. Even if a company was later found to be earning in excess of its authorized return on equity in the permanent rate case, is it possible that it would be entitled to an interim rate increase according to UE's methodology?

A. Yes. UE's calculation of the interim revenue requirement is equal to the authorized return and the related income tax expense associated with the change in net plant plus depreciation expense associated with the change in gross plant. According to UE's methodology, as long as a company has a positive interim revenue requirement and a pending increase in permanent rates that is at least equal to the amount of the interim revenue requirement, it would be entitled to an interim rate increase. Therefore, a company could later be found to be earning above its authorized return on equity in the permanent rate case and still be entitled to an interim rate increase. This is due to the fact that the Company's methodology for calculating an interim rate increase focuses on the change in net plant and does not consider all relevant factors which are subject to examination during a permanent rate case audit.

Q. The Empire Electric Company (Empire) and Missouri-American Water Company (MAWC) recently filed for rate increases. According to UE's methodology would these Company's be entitled to an interim rate increase?

A. I am currently reviewing the rate case filings and information from the prior rate cases to determine if Empire and MAWC would qualify for an interim rate increase based on UE's methodology.

Q. Has there been a change in the monthly surveillance data that was used by Mr. Weiss in Tables 1 and 2 on pages 4 and 6, respectively, in his interim rates Direct Testimony?

A. Yes. Beginning in March of 2009, several additional items have been added to the rate base data that is provided in the monthly surveillance reports. The new items that are reported include cash working capital, prepayments, customer deposits and regulatory liabilities. Since all of these items, except prepayments, are reductions to rate base, the rate base reported in surveillance declined from February to March when the change occurred. This change is reflected in the decline in rate base from February to March of 2009 that appears in Mr. Weiss' tables.

Q. Do Mr. Weiss' tables fully reflect the $162 million increase in rates that the Commission authorized to commence March 1, 2009?

A. No. Mr. Weiss's earned return on equity calculations appropriately only reflect the first six months of the rate increase through August of 2009. The effect of the rate increase granted to commence March 1, 2009 will not be fully reflected in the earnings calculations until February 1, 2010, 12 months later.

Q. Does the Direct Testimony on interim rates of Mr. Buck indicate that Laclede is experiencing a problem with regulatory lag?

A. Yes. Mr. Buck's Direct Testimony on interim rates asserts that Laclede is experiencing a problem with regulatory lag which is affecting its earnings. However, according to the Staff's calculations, based on surveillance data supplied by Laclede, it earned over ** ____ ** on equity for the 12 months ending both December 31, 2007 and 2008.

Q. When was the last time Laclede filed a general rate increase case?

A. Laclede last filed a general rate increase case in December 2006.

Q. Do you agree with Mr. Baxter's characterization of the Company's earned return on equity as "consistently below the authorized return by a significant amount" on page 5 of his Direct Testimony on interim rates?

A. No. Mr. Baxter has limited his view to the earned returns beginning with the twelve months ending June 30, 2007. Prior history shows consistently high returns on equity. Beginning in 1996, as a result of Case No. ER-95-411, UE agreed to the Experimental Alternative Regulatory Plan (EARP) sharing agreement that lasted for three years. It was extended an additional three years as a result of the Stipulation And Agreement regarding UE's acquisition of CIPSCO, Inc., Case No. EM-96-149. During these sharing agreements, UE consistently paid credits to customers as a result of earning returns on equity above the 12.61% threshold established by the sharing agreements.

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In addition, according to calculations made by the Staff, based on surveillance data supplied by UE, the Company earned over ** ____ ** on equity from 2002 through 2004 and ** ______ ** in 2005.

Q. Do you have a response to Mr. Baxter's list of "key drivers of regulatory lag" that appears on page 5 of his Direct Testimony on interim rates?

A. Yes. The first driver listed by Mr. Baxter is the maximum eleven month period from the time a rate case is filed until new rates are implemented. This stands in contrast to the time it may take to process an excess earnings complaint from complaint filing to implementation of rates. On September 26, 2002 UE's rates were reduced as a result of a Stipulation and Agreement in Case No. EC-2002-1, which was filed by the Staff on July 2, 2001. Had an agreement not been reached, this 16 month proceeding would have continued much longer. In addition, the current eleven month process allows time for not only a thorough review of the Company's case, but also a true-up of historical data. In the Company's current permanent rate case, the historical test year is being trued up through January 31, 2010 to consider ten months of additional data. Any reduction in the current eleven-month time frame would only serve to shorten the period that could be included in the true-up.

Mr. Baxter's second driver attributes regulatory lag to the use of historical data in rate cases. Establishing rates based on historical cost served the Company well during the twenty years from 1986 to 2006, when UE did not file a general rate case. The Commission issued major rate reduction orders 5 times during this period, all while rates were based on historical cost.

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Mr. Baxter cites the prohibition against including construction work in progress (CWIP) in rate base as his third driver of regulatory lag in Missouri. This prohibition was enacted by voters, and, therefore, is not within the Commission's power to change. However, the eleven month rate case process and the use of a true-up mechanism facilitate the inclusion of significant plant additions in the determination of rates.

Mr. Baxter's final key driver is the lack of a mechanism to adjust rates in-between rate cases for the return, property taxes and depreciation associated with increases in net plant. The Company has the ability to address large increases in plant by properly timing its rate cases so the plant can be included in rates. Also, the Legislature has established a specific mechanism to allow for the recovery of the cost of plant additions mandated for environmental reasons, the Senate Bill 179 Environmental Cost Recovery Mechanism (ECRM), which the Company has applied for in this rate case. Although not currently available to electric companies, the Legislature has also established a mechanism to allow gas and large water company's to recover the costs associated with certain types of plant between rate cases, the Infrastructure System Replacement Surcharge (ISRS). In addition, the lack of such a rate mechanism is presumably reflected in the returns on equity authorized for the Company.

Q. How does the Company's method for calculating an interim revenue requirement differ from the ISRS mechanism that you referred to in your previous answer?

A. The ISRS mechanism only considers changes in specific types of distribution plant. For water and gas companies, the majority of the plant additions that qualify for an ISRS are related to the replacement of existing distribution mains. Other types of plant, for example production and general plant, are not eligible for consideration in the ISRS mechanism. According to UE's methodology, the entire change in plant, of all types, since the true-up cut-off date in the prior rate case, is included in the calculation of the interim revenue requirement.

The ISRS also includes the ADIT associated with the ISRS eligible plant, which reduces the associated revenue requirement. If the ISRS plant was added prior to January 1, of the current year, property taxes are also calculated on the ISRS eligible plant additions less retirements, which increase the ISRS revenue requirement. UE's methodology does not consider ADIT or property taxes.

The ISRS mechanism only reflects the accumulated depreciation reserve that is related to the ISRS eligible plant additions. However, consistent with its inclusion of the entire change in plant, UE's method reflects the entire change in the accumulated depreciation reserve since the true-up cut-off in the prior rate case.

Q. Do you agree with Mr. Baxter's statement on page 6 of his Direct Testimony on interim rates that none of the costs of the Company's investment in plant since the true-up cut-off date in the last case, September 30, 2008, have been recovered?

A. No. This statement is incorrect. Mr. Baxter's own table on page 3 of his Direct Testimony shows that UE has recovered its operating costs and earned positive returns on equity.

Q. Is there some level of earnings that will be lost to the Company as Mr. Baxter discusses on pages 6 through 8 of his Direct Testimony on interim rates?

A. Yes. However, funds were similarly lost by ratepayers to UE during the twenty years prior to 2006, when UE was not filing rate cases and there was regulatory lag in the reduction of rates.

Q. On pages 8 and 9 of his Direct Testimony on interim rates does Mr. Baxter recognize the cost control aspect of regulatory lag?

A. Yes. He recognizes that regulatory lag focuses the utility's attention on cost control. On page 15 he refers to reductions in 2009 expenditures, $1 billion in reductions after 2009 and the implementation of a voluntary separation plan as steps specifically taken to mitigate regulatory lag. It appears that these costs are discretionary, since Mr. Baxter states on page 14 that expenditures for reliability and environmental requirement will continue to be made and in his Direct Testimony in the permanent rate case at page 22, he states "we do not intend to 'tighten our belts' at the expense of providing safe, reliable service to our customers." The clear implication is that without regulatory lag, and other factors, these programs would not have been reviewed to the degree they ultimately were.

Q. On page 10 of his Direct Testimony on interim rates, Mr. Baxter refers to investments expected by customers and other key stakeholders to meet environmental and reliability requirements. Is he discussing the Power-On program?

A. Yes on July 12, 2007, UE announced its Power-On Program, which included increased spending to improve the reliability of the Company's system and install environmental equipment on its power plants. However, I am not aware of UE telling customers or other stakeholders that it intended to seek interim rates and a change in the previously accepted criteria for implementing interim rates.

Q. Does the Staff support the Company's new interim rate standard?

A. No. As I have previously discussed, the Staff finds that the Company's calculation of the amount of the interim revenue requirement is flawed. The Staff also believes the criteria for determining if a company is entitled to interim rates is of such a nature that it is potentially unrelated to regulatory lag, which is the basis of UE's request.

The Company's method of calculation ignores basic regulatory practices for calculating the revenue requirement associated with net plant. As I have previously discussed, the Company's calculation does not consider accumulated deferred income taxes, revenues for plant installed to specifically serve new customers and maintenance savings associated with plant improvements.

UE states that its request is designed to mitigate regulatory lag. However, the criteria for determining whether a company is entitled to interim rates is not based on an examination of whether regulatory lag exists or to what degree it exists. The criteria proposed by UE simply examines whether the revenue requirement associated with its calculation method produces a positive number. A company may meet the UE standard for an interim rate increase and in fact be in an over-earning's situation. Similarly, a Company may be experiencing regulatory lag, but not meet the UE standard. These last two situations are possible because the revenue requirement associated with other components of the cost of service may offset the revenue requirement associated with the change in net plant.

Q. How does UE's proposed interim rate relief standard compare with the Commission's traditional interim rate relief standard?

A. The Commission's traditional interim rate relief standard prescribes definite criteria that can be verified regarding whether a company has an immediate need for funds to continue to provide adequate service and maintain its financial integrity, which cannot be postponed and cannot be obtained through any means other than a rate increase. During the oral argument on September 14, 2009 Thomas M. Byrne, counsel for the Company admitted that UE does not meet the Commission's emergency standard: (Vol. 2, Tr.33, ln. 20 – TR.34, ln. 4; TR. 67, ls. 22-23) and as David Murray, a member of the Commission's Financial Analysis Staff states in his testimony, UE is able to access the financial markets to obtain funds and has an investment grade credit rating.

Q. On page 17 of his Direct Testimony on interim rates, Mr. Baxter says that since UE will make refunds with interest, ratepayers will not be harmed if it is later determined that the interim rates are not justified. What is your response to this statement?

A. Mr. Baxter assumes that the ratepayers cost of capital is equal to or less than the short-term interest rate. This may or may not be true. If the customer must forgo paying a credit card bill that charges a higher interest rate than UE's short-term debt rate in order to pay for the interim rate increase, the customer will be harmed if the Company has to refund any portion of the interim rate increase.

Q. Does this conclude your rebuttal testimony regarding AmerenUE's interim rate request for purposes of the December 7, 2009 evidentiary hearing in this proceeding?

A. Yes, it does.

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 Revenues for Electric Service.	))))	Case No. ER-2010-0036

AFFIDAVIT OF STEPHEN M. RACKERS

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Stephen M. Rackers, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony of Interim Rates in question and answer form, consisting of 11 pages to be presented in the above case; that the answers in the foregoing Rebuttal Testimony of Interim Rates were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Stephen M. Rackers
STEPHEN M. RACKERS

Subscribed and sworn to before me this 17th day of November, 2009.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 08, 2012
Commission Number: 08412071

D Suzie Mankin
Notary Public