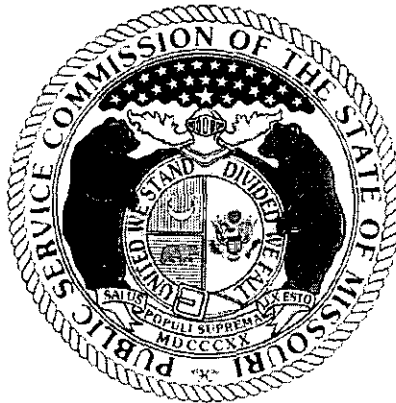


**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

Filed
May 19, 2011
Data Center
Missouri Public
Service Commission



In the Matter of Union Electric Company, d/b/a)
AmerenUE's Tariffs to Increase Its Annual)
Revenues for Electric Service)

Case No. ER-2008-0318
Tariff Nos. YE-2008-0605

REPORT AND ORDER

Issue Date: January 27, 2009

Effective Date: February 6, 2009

OPC Exhibit No. 309
Date 5-4-11 Reporter TU
File No. ER-2011-0028

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 than projected costs. Hence, AmerenUE will not entirely escape the incentive effects of the

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,

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 country 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.

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.

¹⁹⁸ Transcript, Page 459, Lines 14-21.

¹⁹⁹ Transcript, Page 545, lines 15-19.