BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Union Electric Company d/b/a	)	
AmerenUE's Tariffs Increasing Rates for Electric	)	**<u>Case No. ER-2007-0002</u>**
Service Provided to Customers in the Company's	)	Tariff No. YE-2007-0007
Missouri Service Area	)	

REPORT AND ORDER

Issue Date: May 22, 2007

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DEPUTY CHIEF REGULATORY LAW JUDGE: Morris L. Woodruff

REPORT AND ORDER

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Summary

This order denies AmerenUE's request for a fuel adjustment clause. It allows AmerenUE to increase the revenue it may collect from its Missouri customers by approximately $43 million. As a result, the average residential customer's monthly bill will increase by $2.33, or approximately 3.26 percent.

Procedural History

On July 7, 2006, Union Electric Company d/b/a AmerenUE filed tariff sheets designed to implement an annual general rate increase for electric service in the amount of $360,709,000. The tariff revisions carried an effective date of August 6, 2006.

On July 11, the Commission suspended AmerenUE's tariff until June 4, 2007, 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 July 31 as the deadline for submission of applications to intervene.

The State of Missouri; the Missouri Energy Group (MEG);[2] Noranda Aluminum, Inc.; the Missouri Department of Natural Resources; Aquila, Inc.; the Missouri Industrial Energy

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[1] Section 393.150, RSMo 2000.

[2] The members of MEG are Barnes-Jewish Hospital, Buzzi Unicem USA, Inc.; Holcim US, Inc.; and SSM HealthCare.

Consumers (MIEC);[3] Laclede Gas Company; AARP; the Consumers Council of Missouri; and MOKAN CCAC submitted timely applications and were allowed to intervene. Subsequently, the Missouri Association for Social Welfare; the Missouri Department of Economic Development; The Commercial Group;[4] the Missouri Retailers Association and the UE Joint Bargaining Committee filed late applications and were also allowed to intervene.

On September 12, the Commission established the test year for this case as the 12-month period ending June 30, 2006, with a further true-up period through January 1, 2007. In the same order, the Commission established a procedural schedule leading to a hearing beginning on March 12.

The Commission conducted sixteen local public hearings at which the Commission heard comments from AmerenUE's customers and the public regarding AmerenUE's request for a rate increase. Public hearings were held in St. Louis County and in the City of St. Louis on January 2, in Columbia and Rolla on January 3, in Cape Girardeau and Dexter on January 4, again in St. Louis County and the City of St. Louis on January 8, in Wentzville on January 9, in Kirksville and Hayti on January 10, in Jefferson City and Excelsior Springs on January 11, in Mexico and Moberly on January 12, and in Hillsboro on January 17.

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[3] The members of MIEC are Anheuser-Busch Companies, Inc.; Bandwidth Exchange Buildings, L.L.C.; BioKyowa, Inc.; The Boeing Company; DaimlerChrysler; Enbridge, Inc.; Ford Motor Company; GKN; General Motors Corporation; Hussman Corporation; JW Aluminum; MEMC Electronic Materials, Inc.; Monsanto; Pfizer; Precoat Metals; Proctor & Gamble Company; Nestlé Purina PetCare; Solutia; and U.S. Silica Company.

[4] The members of the Commercial Group are JCPenney Corporation, Inc.; Lowe's Home Centers, Inc., and Wal-Mart Stores East, LP.

The parties prefiled direct, rebuttal, and surrebuttal testimony. The evidentiary hearing began on March 12, and continued through March 29. Further true-up direct testimony was prefiled on April 6, but the parties agreed that no true-up hearing was needed and the true-up hearing scheduled for April 19 and 20 was canceled.

Public Counsel's Motion to Dismiss

On January 12, 2007, the Office of the Public Counsel filed a motion asking the Commission to dismiss AmerenUE from this case, for its failure to have an attorney enter an appearance at three of the multiple local public hearings held in this case. As the basis for its motion, Public Counsel points to Commission Rule 4 CSR 240-2.116(3), which provides the Commission may dismiss a party from a case for failure to comply with any order issued by the Commission, including a failure to appear at a public hearing. AmerenUE filed a response to Public Counsel's motion on January 16. Public Counsel replied on January 18. No other party has responded.

The rule cited by Public Counsel gives the Commission discretion to dismiss a party from a case for failing to comply with a Commission order to appear at a local public hearing, or other scheduled proceeding. The Commission's order scheduling fifteen local public hearings regarding AmerenUE's request for a rate increase was issued on November 3, 2006. A sixteenth local public hearing was subsequently scheduled in an order issued on January 5. Neither order explicitly requires counsel representing any party to appear at any local public hearing. Therefore, Public Counsel cannot point to any Commission order AmerenUE has violated.

The Commission schedules local public hearings to allow the public an opportunity to be heard. The sworn testimony citizen witnesses offer at the local public hearing is made a part of the record and may be relied upon by the Commission when making its decision regarding AmerenUE's request for a rate increase. For that reason, attorneys for the various parties are given an opportunity to question witnesses if they desire to do so. A party deciding not to send an attorney to a local public hearing does so at its own risk. Nevertheless, the presence of legal counsel for the parties is not essential to the local public hearing process. Therefore, if a party decides to forego the opportunity to question citizen witnesses by not sending an attorney to a local public hearing, neither the public, nor the Commission's process is harmed. In fact, many parties to this, as well as other rate cases, choose not to send an attorney to local public hearings.

The Commission certainly expects that a utility requesting a rate increase will send representatives to each local public hearing to answer questions from the public, and more importantly, to listen to the concerns and complaints of its ratepayers. AmerenUE had employees present at all of the local public hearing to fulfill that role, even though it did not have an attorney available to enter a formal appearance at some of the hearings.

There is no basis for dismissing AmerenUE from this case, and the Commission will deny Public Counsel's motion.

The Partial Stipulations and Agreements

During the course of the evidentiary hearing, various parties filed three nonunanimous partial stipulations and agreements resolving several issues that would otherwise have been the subject of testimony at the hearing. No party opposed the partial stipulations and agreements. As permitted by its regulations, the Commission treated these unopposed partial stipulations and agreements as unanimous.[5] After considering

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

each of the stipulations and agreements, the Commission approved them as a resolution of the issues addressed in those agreements.[6] The issues that were resolved therein will not be further addressed in this report and order.

Overview

AmerenUE is an investor-owned utility providing retail electric service to large portions of eastern and central Missouri, including the St. Louis metropolitan area. It is the largest electric utility in Missouri, serving approximately two million customers. AmerenUE is a subsidiary of Ameren Corporation, which is a holding company that owns electric utilities in Illinois, as well as various other unregulated subsidiaries.

AmerenUE began the rate case process when it filed its tariff on July 7, 2006. In doing so, AmerenUE asserted it was entitled to increase its rates enough to generate an additional $360,709,000 in gross electric revenues per year. AmerenUE set out its rationale for increasing its rates in the direct testimony it filed along with its tariff on July 7. 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.

Obviously, there are a multitude of matters about which the parties could disagree. Fortunately, there was no disagreement about many matters and, as a result, those potential issues were never brought before the Commission. Where the parties disagreed,

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[6] An *Order Approving Partial Stipulation and Agreement Concerning Class Cost of Service and Certain Rate Design Issues Filed on March 22, 2007* was issued on April 5, 2007; An *Order Approving Tier I Partial Stipulation and Agreement Filed on March 15, 2007*, and an *Order Approving Tier II Partial Stipulation and Agreement filed on March 26, 2007,* were issued on April 11, 2007.

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 March 7, 2007, 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. Factual matters will be addressed in the Findings of Fact section. If an issue also contains a legal aspect, that portion of the issue will be addressed in the Conclusions of Law section.

Taum Sauk

Before addressing the issues identified by the parties, there is one additional matter that needs to be mentioned because it has received a great deal of attention from the public and the press. On December 14, 2005, the upper reservoir at AmerenUE's Taum Sauk pumped storage facility in Reynolds County, Missouri ruptured, allowing 1.5 billion gallons of water to rush down the side of a mountain and through Johnson's Shut-Ins State Park. Fortunately, no one was killed in the flood, although several people were injured, but the raging waters caused extensive property and environmental damage.[7]

AmerenUE claims to accept full responsibility for the reservoir failure and the resulting damages. Consequently, its rate increase request does not include any money to pay for cleanup of the park, reimbursement of the expenses incurred by the State of

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[7] Birk Direct, Ex. 025, Page 22, lines 15-19.

Missouri, or for resolution of individual damage claims.[8] Furthermore, AmerenUE has not asked to recover the cost of fines or penalties imposed by the federal or state governments as a result of the Taum Sauk disaster.

In a rate case such as this, the Commission establishes the rates a utility may charge based in part on the expenses the utility incurs to provide service to its customers. If an expense is not allowed into the utility's cost of service, its rates will be set at a level which does not allow the company to recover that cost from its customers. Since AmerenUE will not be allowed to include the Taum Sauk expenses in its cost of service as calculated for this case, those costs will not be recovered from ratepayers and will instead have to be paid with shareholder funds.

The exclusion of the direct expenses of cleaning up the Taum Sauk mess is not the end of the matter. AmerenUE used the Taum Sauk pumped hydro power plant to provide electricity to its customers, as well as to generate power to sell off-system in the wholesale electricity market. With the Taum Sauk plant unable to generate electricity because of the failure of the reservoir, AmerenUE will have to generate electricity for its own customers using other, more expensive, power plants. Furthermore, it will be unable to sell power from the Taum Sauk plant in the profitable wholesale market. Since profits from off-system sales are used to offset AmerenUE's cost of service, and thereby reduce the rates paid by AmerenUE's customers, the loss of revenue from the Taum Sauk plant could have adverse consequences for ratepayers, aside from the direct cost of cleanup.

To avoid harming ratepayers, AmerenUE agreed that the various studies and cost models that are used to determine the company's cost of service should be based on the

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[8] Baxter Direct, Ex. 001, Page 34, Lines 14-17.

assumption the Taum Sauk plant has remained in operation throughout the test year. By using these models that assume the Taum Sauk plant is still operating, the Commission will be able to establish rates that protect ratepayers from having to pick up the bill for either the cleanup costs or the lost revenues resulting from the Taum Sauk disaster. Very late in this case, Public Counsel proposed an additional adjustment to AmerenUE's revenue requirement based on an argument that AmerenUE should account for a possible loss of opportunities to sell the regulatory capacity of the Taum Sauk Plant. The Commission deals with that question later in this order.

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.

Conclusions of Law Regarding Jurisdiction

AmerenUE is a public utility, and an electrical corporation, as those terms are defined in Section 386.020(42) and (15), RSMo Supp. 2006. 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 the proposed rate is just and reasonable.[9] AmerenUE has the burden of proving its proposed increase is just and reasonable.[10]

In determining whether the rates proposed by AmerenUE are just and reasonable, the Commission must balance the interests of the investor and the consumer.[11] 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.[12]

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[9] Section 393.150.2, RSMo 2000.

[10] Id.

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

[12] *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.[13]

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.[14]

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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[13] Id. at 692-93.

[14] *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.[15]

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.[16]

The Issues

1. The Proposed Fuel Adjustment Clause

Discussion:

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 June 30, 2006, with a true-up period running through January 1, 2007. 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 possibly incurred in the future generally are not included in the 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.

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

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

However, in 2005, the Missouri legislature passed a law allowing 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.[17] 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 rate case and has modified the details of its proposed fuel adjustment clause several times during the course of this proceeding in response to concerns expressed by various parties.[18] The details of the fuel adjustment clause AmerenUE now asks the Commission to approve are found in the surrebuttal testimony of Martin J. Lyons.[19] The fuel adjustment clause AmerenUE proposes would net 100 percent of off-system sales revenue against fuel and purchased power costs. In other words, off-system sales revenue increases would offset rising fuel and purchased power costs. The proposed fuel adjustment clause would spread recovery or return of over- or under-collections over a subsequent 12-month period. It would also contain a four percent cap and deferral mechanism applied separately to each rate class. That deferral mechanism would dampen volatility in the three fuel adjustment clause rate adjustments allowed per true-up year. Additionally, the proposed fuel adjustment clause

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[17] Section 386.266, RSMo Supp. 2006.

[18] AmerenUE's initial direct testimony, filed along with its tariff on July 7, 2006, indicated that AmerenUE was requesting a fuel adjustment clause but did not provide a detailed proposal. AmerenUE's proposed fuel adjustment clause was not described in any detail until it filed supplemental direct testimony on September 29. Several parties filed motions objecting to AmerenUE's supplemental direct testimony, arguing that AmerenUE should not be allowed to supplement its rate increase request to add a fuel adjustment clause several months after filing its initial rate increase tariff. The Commission denied those motions in an order issued on November 2, 2006, but the State of Missouri renewed its objection at the hearing (Transcript page 135) and AARP again raised the issue in its brief. Since the Commission is denying AmerenUE's request for a fuel adjustment clause, it will not need to further address those objections.

[19] Ex. 021.

would contain a sharing mechanism to provide additional incentive to the company to lower its net fuel and purchased power costs by either reducing costs or increasing off-system sales.

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,[20] 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 after giving an opportunity for a full hearing in a general rate case.[21] The statute does not, however, provide specific guidance on when a fuel adjustment clause should be approved.

A fuel adjustment clause is a powerful regulatory tool to be used with careful consideration. If a fuel adjustment clause is allowed in an inappropriate situation, the customers who pay for utility service can be forced to pay rates that are higher than they should be. In other circumstances, a fuel adjustment clause may be necessary to allow a utility an opportunity to earn a reasonable return on its investment.

A fuel adjustment clause should be used cautiously because it runs contrary to some of the basic principles of traditional utility regulation. One such principle is the matching of expenses and revenues. Over time, certain expenses incurred by the utility may go up. For example, the wages the electric utility pays its linemen may increase, or a major industrial customer may close, causing a loss of income. At the same time, perhaps the utility saves money when the interest rate it must pay to borrow money goes down, or it

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

[21] Section 386.266.4, RSMo Supp. 2006.

adds revenue by serving new customers. The increased costs or decreased income in one area may be balanced by decreased costs or increased revenue in another area.

In a traditional rate case, without a fuel adjustment clause, the Commission examines all the revenue and costs of the utility during a particular period known as a test year. The Commission then matches the revenue and costs, arriving at an amount the utility needs to recover from its ratepayers if it is to earn a reasonable return on its investment. If a fuel adjustment clause, or other tracking mechanism, is established, then the utility would be able to pass on increased costs in one area, in this case fuel and purchased power, without an examination of all the other areas in which its costs may have decreased or its revenues increased. As a result, ratepayers could be required to pay increased rates while the company enjoys increased profits.

Inclusion of a fuel adjustment clause also affects the operation of regulatory lag. Regulatory lag results because a rate case test year, at least in Missouri, is based on a historical test year, usually ending about the time the utility files for a rate increase. Since a rate case takes eleven months to complete, a utility will always be about eleven months behind. Of course, utilities do not particularly like regulatory lag when their costs are increasing, but regulatory lag can also favor the utility when their costs are decreasing. The good effect of regulatory lag is that it provides the utility with a strong incentive to maximize its income and minimize its costs. If, however, a fuel adjustment clause is in place, the utility has less financial incentive to minimize its fuel costs because those costs will be automatically recovered from ratepayers. Efforts can be made to design a fuel adjustment clause in a manner that maintains some incentive; for example, the Missouri statute authorizing a fuel adjustment clause requires the utility 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.

Based on the previous paragraphs, it might seem that a fuel adjustment clause should never be inflicted upon ratepayers. But there might be circumstances when the use of a fuel adjustment clause may be necessary 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, a fuel adjustment clause may be necessary if the company is to earn its authorized rate of return. The problem then is how to determine when a fuel adjustment clause is necessary.

Fuel adjustment clauses are common in other states. In fact, all but two of the 29 non-restructured states without retail competition, other than Missouri, allow their electric utilities to apply to recover fuel and purchased power costs through some type of fuel adjustment clause. The exceptions are Utah and Vermont.[22] Therefore, other states' experiences with fuel adjustment clauses can be instructive for this Commission in making its decision whether to grant AmerenUE's request for a fuel adjustment clause.

AmerenUE's Argument for a Fuel Adjustment Clause

While AmerenUE contends the prices it must pay for fuel are volatile, its chief argument seems to be that it must have a fuel adjustment clause because most other similarly situated electric utilities already operate under such a clause. Evidence presented by AmerenUE indicates 51 of 58 utilities in other non-restructured states are able to use a

[22] Lyons Rebuttal, Ex. 020, Page 5, Lines 17-20.

fuel adjustment clause.[23] Although it may seem trivial, AmerenUE's desire to keep up with other utilities is a legitimate cause for the Commission's concern because AmerenUE must compete with those other utilities for investment dollars.

Investors like fuel adjustment clauses because their presence tends to reduce the risk to a utility's cash flow that can result from regulatory lag in a rising cost environment.[24] Those investors may be more likely to invest in another utility that has a fuel adjustment clause rather than AmerenUE unless they can receive a higher return on their AmerenUE investment. As a result, AmerenUE's borrowing costs could increase, with a resulting increase in costs being passed on to ratepayers in a future rate case.

Findings of Fact:

Michael L. Brosch, an independent consultant who appeared as a witness for the State, testified he has appeared before public utility commissions around the country on the subject of fuel adjustment clauses.[25] He testified that a cost or revenue change should be tracked and recovered through a fuel adjustment clause only 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

[23] Lyons Surrebuttal, Ex. 020, Page 6, Lines 1-5.

[24] Transcript, Page 476, Lines 1-18.

[25] Brosch Direct (Revenue Requirement), Ex. 501, page 3, lines 1-8. *Also* Transcript, Pages 1090-1093.

3. volatile in amount, causing significant swings in income and cash flows if not tracked.[26]

Brosch based these criteria on his experience from working with expense tracking mechanisms from other proceedings.[27] The criteria proposed by Brosch appear to be well accepted in the regulatory community. AARP's expert witness, Ronald Binz, proposed similar criteria in his testimony.[28] Indeed, AmerenUE's witnesses do not challenge the validity of the criteria, although they contend AmerenUE's proposed fuel adjustment clause meets those criteria. The Commission will apply those criteria in its evaluation of AmerenUE's request for a fuel adjustment clause.

Are AmerenUE's Fuel and Purchased Power Expenses Substantial?

Brosch's first criterion is whether the expense to be tracked is substantial enough to have a significant impact on the utility. Fuel and purchased power expense is the largest item of expense AmerenUE incurs, comprising approximately 44 percent of the company's operations and maintenance expenses.[29] AmerenUE's fuel and purchased power expenses are substantial and meet the first criterion.

Does AmerenUE Have Control over Its Fuel and Purchased Power Expenses?

The second criterion is whether the utility has control over the expense that is to be tracked. The cost items that would be tracked in a fuel adjustment clause are coal, coal transportation, natural gas, oil, and nuclear fuel. AmerenUE generates 79 percent of its

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[26] Brosch Direct (FAC), Ex. 502, page 16, lines 3-11. Brosch also sets out two additional criteria for what a particular fuel adjustment clause should look like if allowed. Since the Commission has decided that AmerenUE will not be allowed to implement a fuel adjustment clause, those additional criteria need not be addressed.

[27] Transcript, Page 1123, Lines 3-5.

[28] Binz Direct, Ex. 750, Page 14, Lines 3-9.

[29] Ex. 133, Schedule 9.

electricity from coal-fired power plants,[30] with most of the rest generated by nuclear power.[31] That means the cost of coal and the cost of its transport to the power plants are the largest expenses facing the company. The price of coal and the railroad freight rates to transport coal are established by national or international markets; so AmerenUE does not have complete control over those prices. The same is true of the markets for natural gas, oil, and nuclear fuel.

Nevertheless, AmerenUE purchases and transports a large amount of coal from the Powder River Basin; so it has some ability to negotiate better rates from coal producers and railroads. It employs a staff of experts to conduct those negotiations and purchases.[32] While AmerenUE clearly cannot control the markets, it has more ability to influence the prices it pays for fuel and purchased power costs than do its ratepayers who must simply pay the rates allowed by this Commission. Removing AmerenUE's financial incentive to control its fuel costs by allowing those costs to be passed through to ratepayers will not serve the interests of those ratepayers. On balance, the second criterion does not provide a strong basis for either approving or denying AmerenUE's request for a fuel adjustment clause.

Are AmerenUE's Fuel and Purchased Power Expenses Volatile?

The third criterion described by Brosch is that the costs to be tracked are volatile. AmerenUE was able to demonstrate that its fuel costs will be increasing in coming years. In fact, AmerenUE knows its coal costs will increase because it has already purchased a

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[30] Neff Direct, Ex. 014, Page 3, Lines 14-15.

[31] Cassidy Rebuttal, Ex. 208, Page 2, Lines 4-14.

[32] Transcript, Pages 888-899. The details of AmerenUE's coal and transportation strategies are confidential and will not be described in this order.

large percentage of the coal it will need for the next several years,[33] and freight costs are largely locked in through long-term contracts as well.[34] Thus AmerenUE's fuel costs, while certainly rising, cannot be said to be volatile.

Markets in which prices are volatile tend to go up and down in an unpredictable manner. When a utility's fuel and purchased power costs are swinging in that way, the time consuming ratemaking process cannot possibly keep up with the swings. As a result, in those circumstances, a fuel adjustment clause may be needed to protect both the utility and its ratepayers from inappropriately low or high rates. Because AmerenUE's costs are simply rising, that sort of protection is not needed. As Brosch explains, rising, but known, fuel costs are the worst reason to implement a fuel adjustment clause because such a fuel adjustment clause allows the utility to recover a single known rising cost while avoiding a rate case in which all its other expenses and revenue, which are changing in the background, will be examined and perhaps used to offset all or part of the rising fuel cost to avoid an unnecessary rate increase.[35]

In addition to the fact AmerenUE's fuel costs are rising, but not volatile, Staff's witness, Dr. Michael Proctor, demonstrated that under some circumstances, AmerenUE's ability to profitably sell power into the wholesale market may mitigate some of the risk resulting from rising fuel costs. Proctor's explanation is based on the correlation between fuel prices and the price of electricity on the wholesale market. As he explains, "when fuel prices for coal and natural gas increase, the result is that spot market prices for electricity

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[33] Transcript, Page 931, Lines 8-22. The exact percentages of the needed coal that has already been bought is confidential and will not be stated in this order.

[34] Transcript, Page 902, Lines 21-25.

[35] Transcript, Page 1089, Lines 11-17.

also increase. Thus revenues from sales increase and tend to offset any large negative impacts from higher fuel costs."[36]

AmerenUE has a lot of coal-fired production capability it uses to provide the baseload or intermediate power needed under routine conditions. However, under certain circumstances, for example, a hot day in July when household air conditioners are running, the demand for electricity will peak. The demand for peak electricity is usually met by natural gas-fired peaking generators. Proctor explains that when natural gas prices go up, usually drawing up coal prices as well, the price for which AmerenUE can sell peak electricity will also tend to go up. As a result, AmerenUE's increased profits from off-system sales of electricity will tend to mitigate its increased fuels costs, and thereby reduce the need for a fuel adjustment clause.[37]

AmerenUE demonstrated Dr. Proctor's mitigation theory would not apply in all scenarios, and indeed, Dr. Proctor agreed his theory does not indicate that profits from off-system sales would completely offset rising fuel costs.[38] Nevertheless, the Commission concludes increased profits from off-system sales will tend to mitigate rising fuel costs in all likelihood. This mitigation effect would not be enough to eliminate the need for a fuel adjustment clause by itself, but it adds more weight to the balance in deciding whether a fuel adjustment clause is appropriate.

Conclusions of Law:

Section 386.266.1, RSMo Supp. 2006, the statute that allows the Commission to establish a fuel adjustment clause provides as follows:

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[36] Proctor Rebuttal, Ex. 228, Page 28, Lines 5-7.

[37] Transcript, Page 1502-1503, Lines 10-25, 1-14.

[38] Transcript, Page 1497, Lines 7-12.

> 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:

> 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 that at eighteen-month intervals, and shall require refund of any imprudently incurred costs plus interest at the utility's short-term borrowing rate.

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 rate of return in any rate proceeding, in addition to any other changes in business risk experienced by the corporation.

Finally, subsection 9 of that statute required 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 great detail the procedures for submission, approval, and implementation of a fuel adjustment clause.

Decision:

After carefully considering the evidence and arguments of the parties, and balancing the interests of ratepayers and shareholders, the Commission concludes that AmerenUE's fuel and purchased power costs are not volatile enough justify the implementation of a fuel adjustment clause at this time. Furthermore, based on Proctor's testimony about rising off-system sales margins, the Commission concludes that AmerenUE has a reasonable opportunity to earn a fair return on equity without a fuel adjustment clause. The Commission recognizes AmerenUE's fuel costs will likely rise in the next several years and to some degree be offset by rising off-system sales margins. Without a fuel adjustment clause, AmerenUE may need to file another rate case sooner rather than later. Obviously, rate cases are difficult and expensive endeavors for the Commission and intervening parties, as well as for the utility. A future rate case, not a fuel adjustment clause, is the proper means by which AmerenUE should recover its rising fuel costs.

The Commission emphasizes that its decision to deny AmerenUE's request for a fuel adjustment clause is entirely based on the evidence presented at this hearing and on the Commission's evaluation of AmerenUE's situation as it currently exists. The Commission certainly does not wish to imply that AmerenUE can never qualify for a fuel adjustment clause. If AmerenUE again wants to request a fuel adjustment clause in a future rate case, it is free to do so and the Commission shall give such a request all due consideration.

2. Off-System Sales

Discussion:

Most of the electric energy AmerenUE produces at the power plants it owns is sold to its native load customers, in other words, the people and businesses located within its service territory. However, if it can produce more energy than it needs to serve its native load, AmerenUE is able to earn extra profits by selling excess energy to off-system buyers, such as other utilities, municipalities, or cooperatives. Since the power AmerenUE is able to sell is produced by generating plants paid for by ratepayers, all parties, including AmerenUE, agree profits (revenues less incurred fuel costs) from these off-system sales should be recognized as a reduction to the company's revenue requirement.[39]

AmerenUE proposed its off-system sales be netted against its fuel costs as part of a fuel adjustment clause. However, since the Commission has rejected the proposed fuel adjustment clause, another way must be found to determine how many dollars of off-system sales should be included when calculating AmerenUE's revenue requirement.

The way it is done is to simply ascribe a certain amount of off-system sales profit to AmerenUE's revenue requirement. But it is very important for the Commission to be accurate when deciding how much profit to ascribe. If the profit level is set too high, the company will not be able to make enough profits and will not be able to earn its authorized returns. On the other hand, if the profit level is set too low, the company will earn extra profits that will not be credited to the ratepayers who made those profits possible. Of

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[39] Transcript, Page 1184-1185, Lines 23-25, 1.

course, profits from off-system sales can be exactly determined after the fact, but the rates the Commission is setting in this case will apply in the future, and will not change until the next rate case. So an incorrect estimation cannot be corrected, except through another rate case.

In most cases, an appropriate level of anticipated off-system sales could be calculated in the same way other costs are calculated, by using historical information about sales made during the test year. Unfortunately, in this case, historical information is not a good predictor of future sales. The problem is, until December 31, 2006, including the entire test year, AmerenUE operated under a Joint Dispatch Agreement (JDA) with Ameren's Illinois affiliates, AmerenCIPS and Ameren Energy Generation (AEG).[40] Under the JDA much of AmerenUE's excess power was sold to AEG at incremental cost rather than being sold on the wholesale market.[41] As a result, there is no track record for off-system sales to be used to estimate future sales.

To get around the lack of historical information, both AmerenUE and Staff ran production cost models to "simulate the dispatch of AmerenUE's generation fleet to supply existing commitments including native load and wholesale sales, while buying or selling energy economically."[42] Essentially, the experts for AmerenUE and Staff developed computer programs to simulate the exact means by which AmerenUE's generation system would be utilized throughout the year, including the specific plants used to produce electricity, the cost of fuel to produce it, and the price at which electricity could be sold.

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[40] Transcript, Page 1453, Lines 11-22.

[41] Transcript, Page 1548, Lines 6-25.

[42] Schukar Direct, Ex. 028, Page 7, Lines 3-5.

While AmerenUE and Staff developed and ran different models, the separate models essentially agreed upon the amount of energy to be sold off system.[43] The differences between the positions of AmerenUE and Staff result from disagreements about the cost of certain inputs into the computer models.

Findings of Fact:

AmerenUE's model predicts off-system sales of $202.5 million per year and the company would set the base level at that amount.[44] The model run by Staff predicts annual off-system sales of $241.3 million.[45] However, at the hearing, Staff's witness, Dr. Michael Proctor, acknowledged that his calculation mistakenly used data supplied by the company that did not include congestion and losses. When Proctor corrected his calculation to account for congestion and losses, the level of off-system sales predicted by Staff's model is reduced to $233 million. After the results of true-up were known, Staff changed that amount to $230 million.

The difference between the results of Staff's model and that of AmerenUE is attributed to different inputs relating to fuel price for natural gas and market prices for electricity.[46] On-peak prices for electricity tend to swing in correlation with natural gas prices because much on-peak electricity is generated by natural gas-fired turbines.[47] Staff's model used an input of $7.00 as the price for natural gas. Staff arrived at that amount by averaging the monthly price of natural gas over a three-year period, 2004

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[43] Transcript, Page 1452, Lines 18-23.

[44] Schukar Surrebuttal, Ex. 032, Page 7, Lines 4-7, as corrected at Transcript, Page 1174, Line 1.

[45] Proctor Surrebuttal, Ex. 229, Lines 24-27, as corrected at Transcript, Page 1018, Lines 10-12.

[46] Transcript, Page 1451, Lines 8-21.

[47] Proctor Direct, Ex. 227, Page 14, Lines 9-22. *See also*, Schukar Rebuttal, Ex. 030, Page 9, Lines 9-11.

through 2006.[48] AmerenUE's model used an average price of natural gas of $6.58, which is based on the average price of gas from January through December of 2006.[49] By using the average for that period, AmerenUE avoided including the high natural gas prices that occurred after Hurricane Katrina in 2005.

Staff's witness, Dr. Proctor, agreed the abnormally high gas prices that occurred as a result of the hurricane should be removed from the calculations when determining the level of off-system sales.[50] However, he contended he had accomplished that goal by using a three-year average including periods clearly not affected by the hurricane in 2005.

The Commission finds Dr. Proctor's use of a three-year average to calculate the cost of natural gas to be a preferable method for making that calculation. The price of natural gas goes up and down in an unpredictable manner. Using only a 12-month average, particularly an average designed to avoid a particular high-cost month, while not adjusting for unusually low-cost months, can provide a distorted result. By using a three-year average, including both low and high cost months, a more accurate picture of average costs can be developed.

AmerenUE also argues Proctor's level of off-system sales should be adjusted to account for seasonal variations in the differences between gas prices and on-peak energy prices.[51] However, Proctor demonstrated that on a month-to-month basis, spot-market electricity prices follow a cyclical monthly pattern, but fuel dispatch prices do not follow the same pattern. Therefore, these prices are not highly correlated on a month-to-month basis

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[48] Transcript, Page 1455, Lines 10-14.

[49] Schukar Rebuttal, Ex. 030, Page 21, Lines 11-13.

[50] Transcript, Page 1460, Lines 3-19.

[51] Schukar Rebuttal, Ex. 030, Page 9, Lines 9-13.

and can more accurately be correlated in the annual averages used by Staff.[52] As a result, there is no need to further adjust Staff's off-system sales base level of $230 million.

The State, joined by the Public Counsel, argue that rather than relying on the computer models run by AmerenUE and Staff, the Commission should set the off-system sales base level at the amount included for off-system sales by AmerenUE in its 2007 budget. The budgeted amount is highly confidential so it will not be stated in this order. However, it is substantially higher than the amount resulting from Staff's model. While Staff and MIEC do not directly advocate using the budgeted amount as the base level for off-system sales, they do suggest the budgeted amount is a strong indication Staff's calculation of the off-system sales levels should be treated as a minimum level and may, in fact, be too low.

It is tempting to use AmerenUE's budgeted amount for off-system sales as the base line. The person in charge of AmerenUE's budget, its Chief Financial Officer, Warner Baxter, testified that AmerenUE's budget assumptions are expected to be reasonable and achievable.[53] If AmerenUE believes it can attain the budgeted amount for off-system sales, why should it not be held to its own goal?

There are, however, a couple of flaws in that approach. First, the 2007 budgeted amount is not normalized to account for planned generation outages.[54] If fewer than normal outages are planned for 2007, as AmerenUE suggests, then the budgeted amount would not be indicative of the reasonably anticipated level of off-system sales that could be

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52 Proctor Surrebuttal, Ex. 229, Page 11, Lines 3-15.

53 Transcript, Page 157, Lines 10-18.

54 Transcript, Page 2678, Lines 14-20.

expected in a normal year. For that reason, the production models used by Staff and AmerenUE to predict a level of off-system sales may be more reliable going forward.

The second problem with using the 2007 budgeted amount to set a level for off-system sales is more fundamental. In Missouri, rates are set using a historical test year. The Commission examines the utility's revenues and expenses for that test year and uses that information to set rates to be charged in the future. The Commission does not use a forward-looking test year based on budgets and projections to set those rates. If it did, AmerenUE would no doubt appreciate an opportunity to base its rates on what it believes will be higher fuel costs in the coming years. Since the Commission uses historical expenses and revenues to set rates, it would be fundamentally unfair to reach forward to grab a single budget item to reduce AmerenUE's cost of service, while ignoring other anticipated costs that might increase that cost of service.

The level of off-system sales suggested by AmerenUE and Staff is based on sales of energy. The State and Public Counsel point out AmerenUE has recently also started to sell regulatory capacity off system. AmerenUE did not make any such capacity sales in 2006,[55] but it has started to make some capacity sales in 2007. Public Counsel and the State argue that an amount recognizing the potential to sell regulatory capacity should also be included in the base level established for off-system sales.

This argument for pulling a single item out of a future budget violates the test year and the matching principle that is the reason for using a test year, in the same way that principle would be violated by the use of the 2007 off-system sales budget to establish a base line. Furthermore, the amount of 2007 capacity sales are very small in relation to the

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[55] Transcript, Pages 1238-1239, Lines 19-25, 1-3.

established level of energy sales and would not have a significant impact on that base level.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

The Commission will establish $230 million, the result of Staff's adjusted production cost model, as the off-system sales base level.

Rate of Return Issues

The next group of issues 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. The first step toward doing that requires a determination of the appropriate mix of capital sources AmerenUE will use to obtain its needed capital. That is called a capital structure and is the next issue.

3. Capital Structure

For purposes of determining an appropriate rate of return, AmerenUE has proposed to use its actual capital structure, which is the following:

Type	Amount (Millions)	Percent of total	Cost
Long-Term Debt	$2,522	44.964%	5.473%
Short-Term Debt	$45	0.795%	5.360%
Preferred Stock	$115	2.017%	5.189%
Common Equity	$2,964	52.224%	TBD
Total	$5,675	100%	

The cost of long- and short-term debt and preferred stock is determined simply by reviewing the interest rates specified in the debt or stock instruments issued by AmerenUE. Those costs are not challenged by any party and are not an issue. Public Counsel, however, proposed a "double leverage" adjustment to account for its assertion that a portion of AmerenUE's equity is actually debt held at the parent company level.[56] Public Counsel would adjust the capital structure as follows:

Long-Term Debt	47.3%
Short-Term Debt	0.8%
Preferred Stock	2.0%
Common Equity	49.8%[57]

In his surrebuttal testimony, Public Counsel's witness continues to insist that a double leverage adjustment to the capital structure is necessary. But, while he explains how the adjustment would work, he does not explain why it is necessary, other than to explain that AmerenUE's rates will be higher if such an adjustment is not made.[58]

Findings of Fact:

Double leverage may exist if a corporate parent uses relatively low-cost debt to acquire equity in its subsidiary. Since equity is more expensive than debt, a utility is allowed a greater return on equity than it is on debt. Therefore, through double leveraging, a parent could convert low-cost debt into relatively higher cost equity, and thereby increase its returns.[59] There is no double leverage in AmerenUE's capital structure as the Commission is using it for purposes of this case. As explained by AmerenUE's witness,

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[56] King Direct, Ex. 403, Pages 4-5, Lines 20-29, 1-2.

[57] King Direct, Ex. 403, Schedule CWK-1.

[58] King Surrebuttal, Ex. 410, page 3.

[59] An explanation of the concept of double leveraging may be found in *State ex rel. Associated Natural Gas Co. v. Pub. Serv. Comm'n*, 706 S.W. 2d 870 (Mo. App. W.D. 1985).

double leverage would exist if a parent company used proceeds of a debt issuance to make an equity investment in a subsidiary, thereby turning inexpensive debt into more expensive equity. Since it was formed in 1997, Ameren has not issued debt that was contributed to the equity capital of AmerenUE. Therefore, there is no double leverage. Occasional short-term loans from Ameren to AmerenUE are reflected as debt on AmerenUE's books, not as equity.[60]

In his direct testimony, Staff's witness, Steven Hill, also proposes some adjustments to AmerenUE's capital structure.[61] Hill's proposed adjustments were not mentioned again by Staff at the hearing or in its brief, and Staff does not propose an adjustment for capital structure in its revised true-up reconciliation. As a result, it is not clear that this is a live issue, but the Commission will briefly address Hill's arguments.

Hill points out AmerenUE's proposed capital structure nets short-term debt against average construction work in progress (CWIP) balances.[62] Hill acknowledges that what AmerenUE has done is standard regulatory practice in Missouri.[63] But he points out that if the company's five-month average short-term debt in the capital structure instead would produce a capital structure that would decrease the company's allowed capital costs.[64] Hill does not, however, offer any testimony to support such a change in standard regulatory practice.

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[60] Nickloy Rebuttal, Ex. 057, page 3.

[61] Hill Direct, Ex. 214, Pages 20-24.

[62] Id. at Page 21, Line 13-15.

[63] Id. at Page 21, Lines 14-15.

[64] Id. at Page 22, Lines 3-21.

Similarly, Hill suggests AmerenUE erred when it made an adjustment to remove a negative balance of $6.5 million from its equity balance relating to the company's investment in Union Electric Development Corporation (UEDC). AmerenUE's witness, Lee Nickloy, effectively refuted Hill's suggestion in his rebuttal testimony.[65]

Staff never further pursued either suggested modification, but if Staff would contend that either adjustment to capital structure should be made, those contentions are rejected.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

The Commission rejects Public Counsel's proposed double leverage adjustment because double leverage does not exist in AmerenUE's capital structure. The following capital structure shall be used as the capital structure of AmerenUE:

Long-Term Debt	44.964%
Short-Term Debt	0.795%
Preferred Stock	2.017%
Common Equity	52.224%

4. Return on Equity

Discussion:

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,

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[65] Nickloy Rebuttal, Ex. 057, Page 2-3, Lines 7-23, 1-5.

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.

Six financial analysts offered recommendations regarding an appropriate return on equity in this case. Two analysts testified on behalf of AmerenUE. James H. Vander Weide is a professor at the Fuqua School of Business of Duke University. He holds a Ph.D. in Finance from Northwestern University. He recommends AmerenUE be allowed a return on equity of 12.2 percent. Kathleen C. McShane is a consultant from Bethesda, Maryland, who holds a Masters in Business Administration with a concentration in Finance from the University of Florida. She recommends AmerenUE be allowed a return on equity of 12.00 percent.

Four other parties offered recommendations regarding return on equity. Testifying on behalf of MIEC, Michael Gorman, a consultant from St. Louis, Missouri, who holds a Masters in Business Administration with a concentration in Finance from the University of Illinois at Springfield, recommends AmerenUE be allowed a return on equity of 9.8 percent. Charles W. King testified on behalf of the Public Counsel. Mr. King, a consultant from Washington D.C., who holds a Masters in Government Economic Policy from the George Washington University, recommends AmerenUE be allowed a return on equity of 9.65 percent. Steven G. Hill, a consultant from West Virginia, who holds a Masters in Business

Administration from Tulane University, testified on behalf of Staff. He recommends AmerenUE be allowed a 9.25 percent return on equity. Finally, J. Randall Woolridge, Professor of Finance in Business Administration at Pennsylvania State University, holder of a Ph.D. from the University of Iowa, testified on behalf of the State of Missouri. He recommends AmerenUE be allowed a return on equity of 9.00 percent. In addition, Billie S. LaConte, a consultant from St. Louis, Missouri, who holds a M.B.A. in finance from Washington University, testified on behalf of MEG. She offered analysis of the recommendations made by the other experts, but did not recommend a specific rate of return on equity.

There is one more source the Commission must consider in establishing an appropriate return on equity. In a survey of regulatory decisions from around the country, as reported by Regulatory Research Associates, the average allowed return in the electric utility industry for 2006 was 10.36 percent, with a median return of 10.25 percent.[66] That is the market in which AmerenUE will be seeking to raise capital.

The Commission does not believe it would be appropriate for its return on equity finding to unthinkingly mirror the national average. Obviously, if all commissions took that approach, returns on equity would never change, despite changing economic facts, leading to unjust results. However, the national average is a good indicator of the capital market in which AmerenUE will have to compete for the equity needed to finance its operations. The Commission has an obligation under the law and well as a matter of practical necessity, to allow AmerenUE an opportunity to earn a return that will allow it to compete in the capital market. No one, including ratepayers, benefits if AmerenUE is starved for capital.

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[66] Ex. 519.

Findings of Fact:

In recent rate cases, the Commission has used what has been described as a zone of reasonableness to assist it in evaluating the recommendations offered by return on equity experts. The zone of reasonableness has been described as a range 100 basis points above and 100 basis points below the national average allowed return on equity. If the national average is taken to be 10.36 percent, then the zone of reasonableness runs from 9.36 percent to 11.36 percent.

The zone of reasonableness is simply a tool to help the Commission evaluate the recommendations offered by various rate of return experts. It should not be taken as an absolute rule precluding consideration of recommendations falling outside that zone. However, a recommendation greatly varying from the national norm will be viewed with skepticism.

Each of the expert witnesses who offered testimony on the rate of return issue performed multiple calculations using various methods to justify their recommendations for the return on equity the Commission should use in calculating the rates AmerenUE will be allowed to charge its customers. Collectively, they devoted hundreds of pages of testimony to discrediting each others opinions. In the end, despite their best efforts to educate, the experts have managed to create a thicket of conflicting opinions. If the Commission were to attempt to force its way through the tangle, it could easily lose its way or even become ensnared.

Rather than chase the rabbit into the thicket, the Commission must pursue its prey from a greater distance. Rather than attempt to untangle each of the narrow, technical disputes between the parties, the Commission will attempt to step back and examine the problem from a broader perspective.

When the Commission steps back, the first pattern that emerges is the realization that the rate of return advocated by the experts who testified for AmerenUE is too high. James Vander Weide advocates a return on equity of 12.2 percent. Kathleen McShane, AmerenUE's other witness, is nearly as high, recommending a return on equity of 12.0 percent. Yet, Vander Weide acknowledged that, so far as he knew, if this Commission allowed AmerenUE a return on equity of 12.2 percent, or even 12.0 percent, it would be the highest return on equity allowed to any integrated electric utility in the country.[67]

In large part, the overly high return on equity recommendations put forward by AmerenUE's witnesses result from their inclusion of a large financial risk add-on premium, based on the allegedly greater financial risk resulting from the market value of common equity in AmerenUE's capital structure. The witnesses use this premium adjustment to increase McShane's return on equity recommendation by 100 basis points, and Vander Weide's by 70 basis points. But despite his advocacy of an adjustment to account for AmerenUE greater risk, Vander Weide acknowledged at the hearing that AmerenUE's risk is about average for the electric utility industry.[68]

In addition to the obvious incongruity of a large risk adjustment for a company with an average level of risk, the opposing experts convincingly explained that the proposed upward adjustment for financial risk was inappropriate for more technical reasons as well. In particular, the Commission accepts as credible the testimony of MIEC's witness, Michael Gorman, who explains that AmerenUE's proposed adjustment for financial risk is an

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[67] Transcript, Page 2880, Lines 8-14.

[68] Transcript, Page 2880, Lines 4-7.

incomplete assessment of AmerenUE's overall risk because it ignores the difference in operating risk between AmerenUE and comparable companies,[69] because it does not properly evaluate the financial risk differential between the proxy groups and AmerenUE,[70] and because it fails to recognize that a company's book value financial risk is already captured in a company's stock price.[71]

In sum, the financial risk upward adjustment proposed by AmerenUE's witnesses appears to be a transparent effort to inflate the company's proposed return on equity to obtain a better bargaining position in the hope the Commission would simply split the difference between the extreme positions. Such efforts call into question the credibility of these witnesses. Indeed, Vander Weide came close to acknowledging that his proposed return on equity was extreme when at the hearing he indicated an eleven percent return on equity, in line with the amounts that the Commission has allowed Kansas City Power & Light and The Empire District Electric Company in recent rate cases, "would be a benchmark that the financial community would look at."[72]

On the other side of the thicket, the returns on equity proposed by some of the experts are clearly too low. If the Commission were to impose the return on equity they advocate, AmerenUE would have the lowest allowed return on equity in the country. AmerenUE is an average company with an average risk. It should be allowed something close to an average return on equity.

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[69] Gorman Direct, Ex. 705, Pages 25-26, 1-12.

[70] Id, at Pages 26-27, Lines 13-25, 1-16.

[71] Id. At Pages 27-28, Lines 17-25, 1-6.

[72] Transcript, Page 2880, Lines 16-19.

In setting rates, the Commission's obligation is to reasonably balance shareholder and ratepayer interests. This is not an intellectual game designed to fatten or drive down the company's bottom line. Economic theories must be tempered by a realistic appraisal of the effect the numbers derived from those theories will have on the company and on ratepayers. For once, the Commission would like to see a rate case in which the witnesses present a balanced analysis rather than race to the extremes.

Of the witnesses who testified in this case, Michael Gorman, the witness for MIEC, does the best job of presenting the balanced analysis that the Commission seeks. His overall recommendation was for a return on equity of 9.8 percent. Gorman performed three different analyses to arrive at his overall recommendation. His Constant Growth Discounted Cash Flow (DCF)[73] analysis resulted in a recommended return on equity of 9.2 percent,[74] his Bond Yield Plus Risk Premium Model analysis results in a recommended return on equity of 10.2 percent,[75] and his Capital Asset Pricing Model (CAPM)[76] results in a recommended return on equity of 10.3 percent.[77] Gorman's overall recommendation of 9.8 percent is a blending of these three analyses.

In examining Gorman's three analyses, it seems the results of the DCF analysis are somewhat inconsistent with the results of the other two analyses. If the results of the Risk Premium and CAPM are accepted as more reasonable, Gorman's recommendation is

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[73] Gorman explains that "[t]he DCF model posits that a stock price is valued by summing the present value of expected future cash flows discounted at the investor's required rate of return (ROR) or cost of capital." Gorman Direct, Ex. 705, Page 7, Lines 3-5.

[74] Id. at Page 9, Line 17.

[75] Id. at Page 14, Lines 22-23.

[76] Gorman explains that "[t]he CAPM method of analysis is based upon the theory that the market required ROR for a security is equal to the risk-free ROR, plus a risk premium associated with the specific security." Id. at Page 15, Lines 3-5.

[77] Id. at Page 19, Lines 15-16.

pushed up into the low 10 percent area. Also, Gorman's overall recommendation of 9.8 percent should be pushed up a bit in recognition of the Commission's denial of AmerenUE's request for a fuel adjustment clause. With no fuel adjustment clause, AmerenUE takes on more risk and its return on equity should be increased to compensate.

Some of the analyses offered by other witnesses provide additional support for a return on equity in the low 10 percent area. Charles King testifying on behalf of Public Counsel offered an overall recommendation of 9.65 percent, but his classic DCF study results in an expected return on equity of 9.9 percent to the electric utility comparison group.[78] Furthermore, Steven Hill, testifying on behalf of Staff recommends a return on equity in a range going up to 9.75 percent.[79] From the other direction, James Vander Weide, testifying for AmerenUE, indicated his classic DCF analysis results in an expected return on equity of 10.61 percent for his electric utility comparison group. According to Steven Hill, if Vander Weide's DCF analysis is adjusted to eliminate very high and very low results, Vander Weide's median DCF analysis would result in an estimate of about 9.6 to 9.8 percent.[80] The Commission was not persuaded by the recommendations offered by AmerenUE's witnesses and the State's witness because they were not consistent with the recommendations of the other witnesses.

Conclusions of Law:

There are no additional conclusions of law for this issue.

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[78] King Direct, Ex. 403, Page 16, Lines 25-28.

[79] Hill Direct, Ex. 214, Page 4, Lines 6-7.

[80] Transcript, Page 3018, Lines 4-5.

Decision:

Based 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, the Commission finds that 10.2 percent is a fair and reasonable return on equity for AmerenUE that will allow it to compete in the capital market for the funds needed to maintain its financial healthy.

Some parties suggest that having established what it believes to be a fair and reasonable rate, the Commission should reduce that rate to punish AmerenUE for what they believe was a poor performance during the severe storms of 2006 and 2007. The Commission will not do so in this case. The Commission's decision regarding the return on equity that AmerenUE will be allowed is based on the evidence presented in this case. Based on that evidence, the Commission concludes AmerenUE is entitled to a below average return on equity compared to other vertically integrated utilities in the United States. No return on equity performance adjustment is necessary. The Commission will enforce service quality, reliability, and performance standards through pending rulemakings designed to establish expected performance levels for all Missouri's electric utilities.

5. Electric Energy, Inc.

Discussion:

Staff, Public Counsel, the State, The Commercial Group, and MIEC argue that the Commission should reduce AmerenUE's revenue requirement by between $63 and $75 million to account for what they believe to be the company's imprudence regarding the expiration of a low-cost power supply contract with Electric Energy, Inc. (EEInc). AmerenUE contends such an adjustment would be unnecessary, as well as illegal.

EEInc is a for-profit, Illinois corporation that is not, and has never been, subject to the jurisdiction of this Commission. It is, however, an affiliate of AmerenUE. EEInc. was formed in 1950 by a group of five electric utility companies for the purpose of building a power plant to provide electricity to the Atomic Energy Commission's uranium enrichment facility located at Paducah, Kentucky. Union Electric Company purchased 40 percent of the shares of EEInc. The other shares were purchased by Illinois Power Company – 20 percent, Central Illinois Public Service Company – 20 percent, Kentucky Utilities Company – 10 percent, and Middle South Utilities, Inc. – 10 percent.[81]

Subsequently, Middle South Utilities, Inc. sold its 10 percent share to Kentucky Utilities. In addition, Illinois Power Company and Central Illinois Public Service Company have subsequently been acquired by AmerenUE's corporate parent, Ameren. Ameren's resulting 40 percent share of EEInc. is now controlled by another subsidiary, Ameren Energy Resources Company.[82] So today, AmerenUE owns 40 percent of the stock of EEInc., its parent, Ameren, through Ameren Energy Resources, owns another 40 percent, and Kentucky Utilities owns the remaining 20 percent.

The Commission approved Union Electric's purchase of its portion of EEInc.'s stock in a report and order issued on December 8, 1950.[83] Union Electric purchased the EEInc. stock using shareholder funds,[84] and EEInc. has always remained a separate corporate entity.

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[81] Meyer Direct, Ex. 225, Page 6, Lines 8-19.

[82] Brosch Direct, Ex. 501, Page 19, lines 16-17.

[83] *In the Matter of the Application of Union Electric Company of Missouri for Authorization to Acquire Shares of the Capital Stock of Electric Energy, Inc.,* Report and Order, Case No. 12,064, Ex. 971.

[84] Transcript, Page 2709, Lines 14-17.

Shortly after it came into being, EEInc. constructed a 1,000 MW coal-fired electric power plant across the Ohio River from Paducah in Joppa, Illinois. EEInc. financed the construction of the Joppa plant with a capital structure that was composed almost entirely of debt, with only small equity infusions by the sponsoring utilities.[85] Because so much of the value of EEInc. was based on debt, the lenders required the sponsoring utilities to agree to:

> be responsible for the for the use or sale of the capacity of such generating facilities in case the Atomic Energy Commission should terminate its purchase of power from Electric Energy, Inc., in the same proportions as their respective investments in the Capital Stock of Electric Energy, Inc.[86]

Since AmerenUE owns 40 percent of EEInc.'s stock, it is responsible for 40 percent of the capacity of the Joppa plant.

Beginning in 1951, EEInc. entered into power contracts with the Atomic Energy Commission, (now the Department of Energy) and the sponsoring utilities. Any power not purchased by the federal government would be purchased by the sponsoring utilities. In keeping with its obligation to support the debt of EEInc. by taking any power not used by the federal government, the power contracts Union Electric signed with EEInc. required Union Electric and the other sponsoring utilities to purchase their share of electricity from the Joppa plant even if EEInc. was actually unable to generate that electricity.[87]

The last power supply contract Union Electric entered into with EEInc. was signed in 1987. It provided that EEInc. would sell electricity to Union Electric at cost of service,

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[85] Moehn Surrebuttal, Ex. 037, Page 5, Lines 22-24.

[86] *In the Matter of the Application of Union Electric Company of Missouri for Authorization to Acquire Shares of the Capital Stock of Electric Energy, Inc.,* Report and Order, Case No. 12,064, Ex. 971.

[87] Brosch Surrebuttal, Ex. 504, Page 33, lines 1-19.

including operating expenses, taxes and interest, plus a 15 percent return on equity capital, net of federal income tax.[88] That contract expired by its terms on December 31, 2005.[89] The agreement also provided it could be canceled by either party by giving a minimum of five years' notice.[90]

During the Joppa plant's early years, the federal uranium enrichment plant used most of the electricity produced. Overall, from 1954 to 2005, the federal government and the sponsoring utilities, other than AmerenUE, took approximately 85 percent of the output of the Joppa plant, while paying for a similar level of EEInc.'s total costs associated with producing that output.[91] However, in recent years, the federal government has not needed as much electricity so more power has been available to the sponsoring utilities under their respective cost-based power supply contracts, all of which expired on December 31, 2005.[92] The power supplied by EEInc. was inexpensive and reliable, and purchase of that power under the power supply agreement was a good deal for AmerenUE's ratepayers.

When the last power supply contracts were entered into in 1987, EEInc. had no choice but to sell its power on a cost basis. At that time, there was no transparent market for wholesale electric power. Indeed, the FERC required sales of wholesale power to occur only through bilateral cost based sales contract of the type entered into by Union Electric and EEInc.[93]

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[88] Schallenberg Rebuttal, Ex. 236, Page 6, Lines 26-30.

[89] Power Supply Agreement, Section 6.01, Ex. 130.

[90] Power Supply Agreement, Section 6.02, Ex. 130.

[91] Moehn Rebuttal, Ex. 036, Page 8, Lines 4-7.

[92] Moehn Direct, Ex. 035, Page 14, Lines 18-23.

[93] Transcript, Page 2348, Lines 18-23,

After it entered into the power supply agreement in 1987, Union Electric merged with Central Illinois Public Service and became AmerenUE. Then, during the late 1990s, a true transparent market for wholesale power began to develop. It soon became apparent EEInc. could make more money selling power into the market than it could by selling power through cost-based bilateral contracts. EEInc.'s cost of producing power is approximately $20 per MWh. Approximately $1 would be tacked onto the sale price for a 15 percent return on equity, resulting in a $21 per MWh sale price under a cost-based contract. The market price is approximately $40 per MWh for the same energy.[94] Although the cost-based contracts allow EEInc. a 15 percent return on equity, that return does not amount to much because very little equity has ever been invested in EEInc.[95] Of course, if EEInc. earns more money from power sales, its shareholders, including Ameren and AmerenUE, which between them own 80 percent of those shares, earn greater returns on their investments.

Before 2000, AmerenUE briefly considered terminating the cost-based power supply agreement under the five-year notice provision of the contract but chose not to do so because in the words of Gary Rainwater, Ameren's Chairman, President, and Chief Executive Officer, "a contract is a contract, and the right thing to do is to honor the contract."[96] At the same time, EEInc. considered canceling the contract from its end; but according to Gary Rainwater, who was also a member of the board of directors of EEInc., decided not to because at that time there was not a sufficient wholesale market to

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[94] Transcript, Page 1947, Lines 1-7.

[95] Transcript, Page 1992, Lines 17-21. About $8 million of equity is invested in EE Inc. Transcript, Page 2294, Lines 10-12.

[96] Transcript, Page 1837, Lines 20-21.

confidently make that change.[97] After 2000, it was too late for either party to cancel the contract because of the five-year notice provision, so the contract remained in effect.

During the last years of the contract, EEInc. applied for and received approval from the FERC in December 2005 to sell power at market-based rates.[98] When December 31, 2005 arrived, the power supply contract expired under its own terms and AmerenUE made no attempt to negotiate an extension of the cost-based supply contract. EEInc. now sells its power supply on the wholesale market at market-based rates. The federal government still purchases power from EEInc., but now does so at market-based rates.[99] AmerenUE no longer purchases power from EEInc., and indeed, under the terms of the Commission's affiliate transaction rule, cannot do so at market rates.[100]

After the switch to market-based rates, EEInc.'s income more than doubled from 2005 to 2006.[101] That resulted in increased earnings for EEInc.'s shareholders, including AmerenUE and ultimately the shareholders of AmerenUE. Of course, the increased payments to shareholders came, at least in part, at the expense of AmerenUE's ratepayers.

Under the expired cost-based contract, AmerenUE was able to purchase relatively inexpensive power produced at the Joppa facility. AmerenUE used that power to serve its native load. When power from the Joppa plant was no longer available, AmerenUE had to replace that power with more expensive power produced by its own combustion turbine

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[97] Transcript, Page 1835, Lines 17-22.

[98] Moehn Surrebuttal, Ex. 037, Page 7, Lines 1-5.

[99] Transcript, Pages 2289-2290, Lines 18-25, 1-13.

[100] Transcript, Page 2729, Lines 13-19.

[101] Transcript, Pages 2239-2240, Lines 24-25, 1-19. See also Brosch Surrebuttal, Ex. 504, Schedule MLB-12, Page 28 of 35.

generators.[102] In addition, when it had more power than it needed to serve its native customers, it could sell the excess into the market at a profit. Such profits would be used to offset the company's other costs and ultimately would benefit ratepayers.

Several parties contend the lost savings to ratepayers resulting from the expiration of the cost-based electricity supply from the Joppa plant should be restored to ratepayers through this case. Staff does so by imputing power from Joppa at cost in its production cost model.[103] Using that method, Staff proposed to reduce AmerenUE's revenue requirement by $65,296,469.[104]

The State of Missouri also proposes to adjust AmerenUE's revenue requirement to account for the loss of power from the Joppa plant. The State would, however, employ a different method for calculating its adjustment. The State would determine what it claims to be the excess profits of EEInc. by calculating the difference between EEInc.'s profit in 2005 (under the cost-based sales contract) and 2006 (using market-based sales). It would then impute 40 percent of those excess profits, after factoring up for tax effects, to reduce AmerenUE's revenue requirement.[105] Using this method, the State would reduce AmerenUE's revenue requirement by $73,137,000.[106]

Using Staff's calculations, but adding $9,270,000 to account for lost capacity sales revenue, Public Counsel would reduce AmerenUE's revenue requirement by

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[102] Transcript, Page 2762, Lines 23-25.

[103] Meyer Direct, Ex. 225, Page 7, Lines 8-14.

[104] Revised True-Up Reconciliation filed April 19, 2007.

[105] Brosch Direct, Ex. 501, Page 28, Lines 9-20.

[106] Revised True-Up Reconciliation, filed April 19, 2007.

$75,016,469.[107] Using a slightly different method of calculation, the Commercial Group would reduce AmerenUE's revenue requirement by $62,599,866. MIEC also supports a reduction in AmerenUE's revenue requirement but does not independently calculate the amount of such a reduction.

Findings of Fact:

The parties advance two theories to justify their proposed reduction of AmerenUE's revenue requirement. The first theory is that by purchasing power from EEInc., AmerenUE's ratepayers somehow acquired an ownership interest in the Joppa power plant. The second argument used to justify the proposed reduction in AmerenUE's revenue requirement is that AmerenUE was imprudent in not forcing EEInc. renew the cost-based power supply agreement.

a. Equitable ownership of the Joppa plant and its power

The first argument is premised on terms of the long-term purchased power contracts between AmerenUE and EEInc., together with a Union Electric guaranty of a portion of EEInc.'s debt. The contracts, by their terms, provided that the payments made for power would cover the costs of production, plus provide a reasonable return on equity. A further term required AmerenUE and the other sponsoring utilities to purchase portions of the output of the Joppa plant that were not purchased by the Federal government, even if the plant was in fact unable to produce power. The parties also point to a 1977 case in which Union Electric sought Commission authority to guaranty certain financial obligations of EEInc.. EEInc. was issuing bonds to finance the $10,000,000 cost to install air pollution control equipment at the Joppa plant, and the lender required the sponsoring utilities to

[107] Id, the entire basis of Public Counsel's argument for an additional adjustment for lost capacity sales is found in footnote (9) to the reconciliation.

guaranty the repayment of those bonds as an additional security. In a Report and Order issued in Case No. EF-77-197, the Commission granted Union Electric authorization to guaranty EEInc.'s debt.[108] The parties claim this guaranty shifted the risk associated with EEInc. to AmerenUE's ratepayers and bolsters the ratepayers claim to an equitable ownership of the power generated by the Joppa plant.[109]

Thus, according to the theory, the payment for power by ratepayers was analogous to the inclusion of the Joppa plant in AmerenUE's ratebase. In the words of Michael Brosch, witness for the State:

> equity and fairness dictates a regulatory outcome in which ratepayers who shouldered the costs and risks associated with the UE share of Joppa for many prior decades through their rates should not be denied continuing participation in the current market value of energy output of the Station.[110]

This equitable ownership theory fails because it is based upon false premises. The only money EEInc. has received, even indirectly from AmerenUE's ratepayers was for power under terms of the various power supply agreements in effect since the 1950s. The energy that EEInc. provided to AmerenUE was full consideration for the money it received under the contract. The purchase of power does not give the purchaser an ownership interest in the supplier of power any more than the purchase of a new car gives the purchaser an ownership interest in Ford Motor Company.

The other leg of this theory ignores that the guaranty given by Union Electric, now AmerenUE, was the guaranty of the company, not the guaranty of its ratepayers. Because

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[108] *In the Matter of the Application of Union Electric Company for Authority to "Guaranty" Certain Financial Obligations of Electric Energy, Inc., an Affiliate*, Report and Order, Case No. EF-77-197, June 24, 1977, Ex. 972.

[109] Brosch Surrebuttal, Ex. 504, Page 34, Lines 6-10.

[110] Brosch Direct, Ex. 501, Pages 24-25, Lines 23, 1-3.

EEInc. paid off its debts on its own no one can ever know for sure what might have happened if AmerenUE had been required to pay the debts of EEInc. But it is inconceivable that this Commission would, at any time in its history, have allowed a utility to include the cost of guarantying the debt of an unregulated affiliate in its rates and thereby pass those costs on to its ratepayers. It is equally inconceivable that this Commission would require ratepayers to pay for purchased power that was not actually delivered. If any such costs had ever been incurred, they would have been the responsibility of the company and its shareholders. Therefore, AmerenUE and its shareholders bore any risk associated with AmerenUE's ownership of the stock of EEInc. AmerenUE's ratepayers merely paid to purchase low cost power from EEInc.'s Joppa plant and did not acquire any ownership interest in EEInc. by doing so.

b. Imprudence in allowing the cost-based contract to expire

AmerenUE owns 40 percent of the shares of EEInc., with another 40 percent owned indirectly by its corporate parent Ameren. The parties argue that by combining its 40 percent ownership with the 40 percent ownership of Ameren, AmerenUE could have forced the board of directors of EEInc. to continue to sell AmerenUE power from the Joppa plant at cost-based rates. In the alternative, AmerenUE could have combined its 40 percent ownership with the 20 percent ownership of Kentucky Utilities to the same end.

Although Illinois law controls the corporate governance of EEInc., Missouri law controls the regulatory treatment afforded to transactions between a regulated utility and its unregulated affiliates. Section 393.140(12) RSMo 2000 specifically authorizes a regulated utility to conduct unregulated business. Missouri law imposes other conditions on transactions between a regulated utility and an unregulated affiliate, all of which AmerenUE appears to have observed.

Union Electric secured Commission authorization before making its initial investments in EEInc., as required by section 393.190.2. Union Electric also secured Commission authorization before pledging its credit in guaranty for EEInc, as required by section 393.180. AmerenUE has maintained the financial affairs of EEInc. separate and apart, in compliance with section 393.140(12).

The Commission's affiliate transaction rule, 4 CSR 240-20.015 prescribes the terms on which a regulated affiliate may deal with an unregulated affiliate. No party contended that the expired cost-based power contract violated those provisions. Because EEInc. now offers power at market rates and AmerenUE's cost to produce power is generally below market rates, AmerenUE has not engaged in affiliate transactions with EEInc. since the expiration of that contract in 2005. The Commission's rule does not, and cannot, require an unregulated affiliate to provide service to its regulated utility affiliate advantageous terms not available otherwise.

In support of their argument that AmerenUE was imprudent by not imposing its will on the board of directors of EEInc., the parties advocating a reduction in AmerenUE's revenue requirement cite two pieces of evidence. The first is a statement Ameren made to the FERC in connection with its application for authority to acquire Illinois Power Company. In testimony, filed on March 25, 2004, Craig D. Nelson, a Vice-President of Ameren Services Company and Central Illinois Public Service Company d/b/a AmerenCIPS, testified:

> So as to prevent any ability of Ameren, following closing of the IP Sale, to 'freeze out' KU from receiving the 20 percent of the EEInc capacity and output to which it is presently entitled, **Ameren commits to: (i) direct its representative members of the EEInc Board of Directors to take no action** which would result in decisions to restrict KU's ability to receive up to 20 percent of the capacity and output of the generation facilities owned by EEInc (if KU desires to receive such capacity and output); and (ii) direct AER and AmerenUE (the Ameren subsidiaries that are EEInc shareholders) to undertake no action at shareholder votes that would restrict KU's ability to receive up to 20 percent of the capacity and output of the generating facilities owned by EEInc. (if KU desires to receive such capacity and output. (emphasis added)[111]

The second evidentiary item is the corporate by-laws of EEInc., which provide in part:

> In the event that any holder of voting capital stock of EEInc. (including, for these purposes, such holder's Affiliates) owns in excess of 50% of the voting capital stock of EEInc., then all corporate restructuring transactions and other major corporate actions shall be decided by the vote of the holders of 75% or more of the outstanding shares of the Corporation entitled to vote. Corporate restructuring transactions and other major corporate actions shall include: (a) sale of all or substantially all of EEInc.'s stock (or other securities) or assets; (b) issuance of new securities; (c) change in the relative percentages of ownership of stock (or other securities) of EEInc held by the current owners of EEInc.; (d) any other change in the ownership or control of EEInc.; **(e) decisions to allocate the sale of the generating capacity of EEInc. among the EEInc. stockholders in a manner other than in accordance with their percentages of ownership of EEInc. stock in the event that the amount of such capacity available for sale to parties other than the U.S. Enrichment Corporation changes materially;** and (f) a material change in the business purpose or objectives of EEInc. (emphasis added)[112]

These provisions merely provide assurances that minority interests in EEInc. will not be abused by Ameren's majority position. Neither states, explicitly or implicitly, the price at which power will be offered to the sponsoring utilities. AmerenUE's ability to influence

[111] Ex. 263, Pages 10-11.

[112] By Laws of Electric Energy Inc., Article II, Section 6. Voting, Exhibit Svanda 2, attached to the deposition of David Svanda, Hearing Ex. 261.

EEInc.'s corporate governance does not, without more, require it to exercise that influence for the benefit of its ratepayers.

The Commission emphasizes the unusual nature of the facts in this case. A regulated utility made a minority investment in an unregulated affiliate fifty years ago. That affiliate had as a principal purpose the provision of service to the United States government. The utility and its affiliate conducted ancillary business during that time on conditions favorable to the utility. Such facts do not often present themselves, and readers should not read this decision expansively to apply to other affiliate transactions, or to the ability of a regulated utility to avoid its obligations to its native load customers.

Fundamentally, however, the argument that AmerenUE should have taken steps to force EEInc. to continue to sell it power at cost-based rates is based on the premise that AmerenUE had an obligation to forego shareholder profits from an unregulated affiliate to benefit ratepayers. Certainly, as a regulated utility, AmerenUE has an obligation to obtain its power supply at the lowest prudent cost. It did that by buying low cost power from EEInc. for 50 years, to the benefit of ratepayers. AmerenUE also has an obligation to engage in fair dealing with an affiliated company, and the Commission's affiliate transaction rule prohibits an action to benefit an affiliate to the detriment of its ratepayers. But, contrary to the heated rhetoric of some parties, AmerenUE did not conspire to remove EEInc. from regulation; EEInc. was never subject to regulation by this Commission and AmerenUE's Missouri ratepayers have no ownership interest in EEInc or the power produced by the Joppa plant.

Conclusions of Law:

EEInc. is an Illinois corporation that is not subject to regulation by this Commission. AmerenUE owns 40 percent of the shares of EEInc. Those shares were purchased using funds provided by AmerenUE's shareholders. As a shareholder, AmerenUE owns stock in EEInc., but it does not own the assets of EEInc. nor the power that is produced at EEInc.'s Joppa power plant.

AmerenUE's claim to a portion of power from the Joppa plant was based on contractual rights found in a series of power supply agreements dating back to the Joppa plant's inception in the 1950s. The last power supply agreement expired by its own terms on December 31, 2005, and has not been renewed.

By paying for AmerenUE's purchase of power from EEInc., AmerenUE's ratepayers paid for power and received power. They did not purchase an interest in EEInc. In the words of the United States Supreme Court:

> [c]ustomers pay for service, not for the property used to render it. … By paying bills for service they do not acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the company.[113]

Therefore, AmerenUE's ratepayers have no special claim to the power produced by EEInc.

[113] *Board of Pub. Utility Com'rs v. New York Telephone Co.,* 271 U.S. 23, 32, 46 S.Ct. 363, 70 L.Ed. 808 (1926).

Section 393.140(12) provides:

> In case any electrical corporation, gas corporation, water corporation or sewer corporation engaged in any other business than owning, operating, managing a gas plant, electric plant, water system or sewer system which other business is not otherwise subject to the jurisdiction of commission, and is so conducted that its operations are to be substantially kept separate and apart from the owning, operating, managing or controlling of such gas plant, electric plant, water system or sewer system, such corporation in respect to such other business shall not be subject to any of the provisions of this chapter and shall not be required to procure the consent or authorization of the commission to any act in such other business or to make any report in respect thereof.

Section 393.190.2 provides in pertinent part:

> No such corporation shall directly or indirectly acquire the stock or bonds of any other corporation incorporated for, or engaged in, the same or similar business .. . . unless, in either case, authorized by the commission to do so. . . .

Section 393.180 provides:

> The power of gas corporations, electrical corporations, water corporations, or sewer corporations to issue stocks, bonds, notes and other evidences of indebtedness and to create liens upon their property situated in this state is a special privilege, the right of supervision of which is and shall continue to be vested in the state, and such power shall be exercised as provided by law and under such rules and regulations as the commission may prescribe.

Commission rule 4 CSR 240-20.010 prescribes generally the terms and conditions for transactions between a regulated utility and its unregulated affiliates. *See, State ex rel. Atmos Energy Corp. v. Public Service Commission*, 103 S.W. 3d 753 (Mo. Banc 2003).

AmerenUE had no legal obligation with respect to its separate, non-regulated investment to force EEInc. to continue to sell it cost-based power after the purchased power agreement expired by its terms on December 31, 2005. Since it had no legal obligation to force EEInc. to renew the expired purchased power agreement, AmerenUE was not imprudent in not taking that action.

Decision:

While AmerenUE undoubtedly is obligated to deal fairly with its ratepayers, it has no obligation to donate what is clearly an asset of its shareholders to the benefit of its ratepayers. AmerenUE's stock in EEInc. belongs to its shareholders, not to ratepayers. For many years AmerenUE's ratepayers benefited from the ability of AmerenUE to purchase power from its affiliate. But power is the only thing ratepayers bought. They did not buy the right to own or otherwise control AmerenUE's shares of stock in EEInc. EEInc. made a rational business decision to stop selling cost-based power to AmerenUE and to instead seek much greater profits by selling power on the newly available market. As an entity subject to regulation by the FERC, and not by this Commission, EEInc. had every right to make that decision. AmerenUE had no power, and no obligation to change EEInc.'s decision. AmerenUE has not acted imprudently. No reduction in revenue requirement is warranted.

6. Inclusion of Combustion Turbine Generators in Rate Base

A. Pinckneyville and Kinmundy

Discussion:

A part of the method the Commission uses to determine the just and reasonable rates AmerenUE may charge its customers requires a determination of the value of the property the company uses to serve its customers. That property is known as the company's rate base. Two issues are presented for the Commission's decision regarding the value of property to be included in AmerenUE's rate base. Both concern the value to be placed on combustion turbine generators (CTGs) that AmerenUE has recently acquired to provide electricity to its customers.

The first issue is related to CTGs located in Pinckneyville and Kinmundy, Illinois, which AmerenUE purchased from an unregulated affiliated company, Ameren Energy Generating Company. The purchase closed on May 2, 2005.[114] The Pinckneyville generating facility consists of eight CTG units with a total capacity of 316 MW. The Kinmundy facility includes two CTG units with a total capacity of 232 MW. AmerenUE paid its affiliate the net book value of the units, which was $161.5 million for Pinckneyville and $96.4 million for Kinmundy.[115]

The price AmerenUE paid to acquire these units is important because the Commission's affiliate transaction rule requires that when a utility purchases goods or services from an affiliated company it must pay the lesser of fair market value or cost.[116] AmerenUE acquired the units at net book values, which are presumed to be cost. But Public Counsel and the State contend the fair market value at the time of purchase was less than net book value and, therefore, AmerenUE should be allowed to include only the fair market value of these units in its rate base.

Findings of Fact:

CTGs vary in the amount of energy they are capable of producing. Therefore, when comparing prices for generators, their value is expressed in terms of dollars per kW. The net book value purchase price AmerenUE paid for the Pinckneyville unit was $511 per kW

[114] Transcript, Page 3075, Lines 11-14.

[115] Brosch Direct, Ex. 501, Page 52, Lines 6-12.

[116] Commission Rule 4 CSR 240-20.015(2)(A)1.

and $416 per kW at Kinmundy.[117] The blended purchase price for the Pinckneyville and Kinmundy units was $439.50 per kW.[118]

CTGs are generally powered by natural gas, although some can also be powered by fuel oil. They are relatively inexpensive to install, but because of high fuel costs, they are expensive to operate. For that reason, they are usually operated to provide summer peaking power. CTGs are not all the same. They can be classified into three categories: (1) aero-derivatives; (2) small frame; and (3) large frame. Each type has different operational capability and cost structures and performs a specialized function. For that reason, AmerenUE needs to have a variety of CTG categories in its system.[119]

The installed cost of large frame CTGs are less per kW than the smaller aero-derivative CTGs, but the larger units offer less operating flexibility, higher operations and maintenance costs and higher start-up costs. As a result, large frame CTGs are dispatched to generate electricity less frequently. The installed cost of aero-derivative CTGs are higher, but they cost less to start and can be started more quickly. They have intraday cycling capability, meaning they can be run more than once per day, and they can count toward operating reserves.[120]

The Kinmundy site contains two large frame units with a summer peak rating of 116 MW each. The Pinckneyville site includes 4 aero-derivative units with a summer peak rating of 44 MW each, and 4 small frame units rated at 36 MW each.[121]

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[117] Brosch Direct, Ex. 501, Page 52, Lines 21-22.

[118] Voytas Rebuttal, Ex. 060, Page 4, Line 14.

[119] Voytas Rebuttal, Ex. 060, Pages 7-8, Lines 17-23, 1-2.

[120] Id. at Page 8, Lines 3-19.

[121] Id. at Pages 8-9, Lines 20-22, 1-3.

The State and Public Counsel contend AmerenUE was imprudent when it chose to pay its affiliate net book value for the Pinckneyville and Kinmundy CTG units. While AmerenUE has the overall burden to prove that the rates it is proposing are just and reasonable, a slightly different rule applies when a party alleges the utility has been imprudent in some manner. The party alleging imprudence has the burden of creating a serious doubt as to the prudence of an expenditure. If that is accomplished, then the company has the burden of proving the expenditure was in fact prudent.

The State and Public Counsel base their allegations of imprudence on their measurements of the market value of the CTGs at the time they were purchased. They allege that the market for such units was depressed at the time of the purchase and that AmerenUE overpaid for the units simply to bail out its affiliate. However, the evidence they garner to support that allegation is very thin.

Public Counsel recommends the Commission use the blended price per kW AmerenUE recently paid for CTG facilities at Audrain, Goose Creek and Raccoon Creek as the presumptive market price for the Pinckneyville and Kinmundy units. It claims the blended cost of those other CTGs was $193.80 per kW. As a secondary recommendation, Public Counsel recommends using a price of $312.50 per kW for which the Audrain plant was reputedly offered to AmerenUE in 2002.[122]

AmerenUE did recently purchase CTG facilities at Audrain, Goose Creek and Raccoon Creek, but for various reasons their purchase price is not a good measure of the market price for Pinckneyville and Kinmundy. First, the Audrain plant includes eight large

[122] Kind Direct, Ex. 404, Page 35, Lines 19-27.

frame units with a summer peak rating of 75 MW.[123] The Goose Creek facility has six large frame CTGs with a total summer capability rating of 432 MW. The Raccoon Creek facility is comprised of four large frame CTGs with a total net summer capability rating of 300 MW.[124] The Kinmundy plant can burn either oil or natural gas. Audrain, as well as Goose Creek and Raccoon Creek, are limited to natural gas. The Pinckneyville units have a lower heat rate constituting a significant improvement in efficiency.[125] All of these factors indicate the Pinckneyville and Kinmundy units have a higher market value than the Audrain plant or Goose Creek and Raccoon Creek.

More significantly, AmerenUE was able to purchase those three facilities in what was essentially a forced sale. NRG Energy, Inc., the owner of the Audrain plant, was in bankruptcy at the time the plant was sold. AmerenUE actually purchased the plant at a bargain price of $199 per kW out of the bankruptcy proceeding.[126] The purchase of the Goose Creek and Raccoon Creek plants from Aquila occurred in similar circumstances. At the time of the sale, Aquila was anxious to sell off assets to improve its financial situation.[127] A market price can be described as the price at which a willing seller, under no compulsion to sell, will sell to a willing buyer under no compulsion to buy.[128] The fact that these sales were forced sales indicates that they are not good indicators of the market value for the Pinckneyville and Kinmundy facilities.

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[123] Voytas, Rebuttal, Ex. 060, Page 9, Lines 4-6.

[124] Id. at Page 37, Lines 7-9.

[125] Id. at Pages 9-10, Lines 25-26, 1-8.

[126] Transcript, Pages 3169-3170, Lines 21-25, 1-6. also, Page 3116, Line 5.

[127] Transcript, Page 3170, Lines 7-13.

[128] *Shirley's Realty, Inc. v. Hunt,* 160 S.W.3d 804 (Mo. App. W.D. 2005)

As a secondary position, Public Counsel contends the Commission should base its determination of market value for the Pinckneyville and Kinmundy plants on a proposal letter AmerenUE received in 2002 from the owner of the Audrain plant, which offers to sell that facility to AmerenUE for $200 million.[129] According to Public Counsel's calculations, a $200 million offer for 640 MW amounts to an offer price of $312.50 per kW, and Public Counsel would use that amount as the market value of the Pinckneyville and Kinmundy plants.[130]

As previously indicated, the Audrain plant is not a good match for the Pinckneyville and Kinmundy plants and does not indicate the market value for those plants. In addition, even if the offer from NRG is accepted as a firm offer, at the time the offer was made the Audrain plant suffered from severe transmission constraints. In the view of AmerenUE, without firm transmission, the value of the Audrain plant in 2002 was no more than salvage value.[131] A possible offer to sell a plant under those circumstances cannot be used to establish the market value for the Pinckneyville and Kinmundy plants.

The State's witness, Michael Brosch, took a somewhat different approach to determining the market value of the Pinckneyville and Kinmundy plants. Brosch testified that he has not conducted a prudence investigation of the price AmerenUE paid for the Pinckneyville and Kinmundy plants. He did, however, examine comparable pricing information for transactions involving combustion turbine capacity that was compiled by AmerenUE and provided to the State in response to a data request. Based on that information, which consisted of magazine articles reporting only public information, he

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[129] The letter is attached to Voytas Rebuttal, Ex. 060 as RAV 2.

[130] Kind Direct, Ex. 404, Page 35, Lines 24-27.

[131] Voytas Rebuttal, Ex. 060, Page 14, Lines 11-17.

concluded that AmerenUE paid higher than market price for the Pinckneyville and Kinmundy plants.[132] Specifically, he averaged eight publicly reported sales between non-affiliates, found an average market transaction price of $288 per kW and re-priced the Pinckneyville and Kinmundy plants to that level.[133]

However, Brosch acknowledges that the sales that he is using for comparison include a wide variety of types of CTG units; some are large frame and some are small frame.[134] He did not know whether any of the CTG units that were sold had transmission constraint problems.[135] He also did not know whether the units he was comparing to the Pinckneyville and Kinmundy plants were of the same general size and type as those units.[136]

Brosch's inability to provide more details about his evaluation is not surprising because the information upon which he relied to make his evaluation is simply a compilation of magazine articles. The data he relied upon does not contain any information about the rating of the plants that were sold. It does not provide any specific nonpublic information about the transaction that could affect the valuation of the purchase. It does not provide any details of the fuel type used by the CTG, or their cycling capability.[137] Because of the lack of detail in his study, Brosch's price comparison cannot provide a reasonable basis for establishing the market value for the Pinckneyville and Kinmundy CTGs.

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[132] Brosch Direct, Page 56, Lines 5-11.

[133] Transcript, Page 3271, Lines 11-24.

[134] Transcript, Page 3272, Lines 12-18.

[135] Transcript, Pages 3272-3273, Lines 23-25, 1-2.

[136] Transcript, Page 3273, Lines 21-25.

[137] Transcript, Pages 3205-3206, Lines 1-25, 1-25.

Conclusions of Law:

With regard to a utility's purchase of goods and services from an affiliated company, the Commission's affiliate transaction rule for electric utilities provides as follows:

> (A) A regulated electrical corporation shall not provide a financial advantage to an affiliated entity. For purposes of this rule, a regulated electrical corporation shall be deemed to provide a financial advantage to an affiliated entity if –
>
> 1. It compensates an affiliated entity for goods or services above the lesser of –
>
> A. The fair market price; or
>
> B. The fully distributed cost to the regulated electrical corporation to provide the goods or services for itself.

The fact that the State and Public Counsel are challenging AmerenUE's prudence in paying net book cost for these CTG units brings into effect the Commission's prudence standard. The Commission established its prudence standard in a 1985 case involving the costs incurred by Union Electric Company in constructing its Callaway nuclear plant.[138] In determining how much of those costs were to be included in Union Electric's rate base, the Commission adopted a standard for determining the prudence of costs established by the United States Court of Appeals, District of Columbia, in a 1981 case.[139] The standard adopted by the Commission recognizes that a utility's costs are presumed to be prudently incurred, and that a utility need not demonstrate in its case-in-chief that all expenditures are prudent. "However, where some other participant in the proceeding creates a serious

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[138] *In the Matter of the Determination of In-Service Criteria for the Union Electric Company's Callaway Nuclear Plant and Callaway Rate Base and Related Issues. In the Matter of Union Electric Company of St. Louis, Missouri, for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Missouri Service Area of the Company,* 27 Mo. P.S.C. (N.S.) 183, 192-193 (1985).

[139] *Anaheim, Riverside, Etc. v. Fed. Energy Reg. Com'n,* 669 F.2nd 799, 809 (D.C. Cir. 1981).

doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling those doubts and proving the questioned expenditures to have been prudent."[140]

The Commission, in the Union Electric case, further established that the prudence standard was not based on hindsight, but upon a reasonableness standard. The Commission cited with approval a statement of the New York Public Service Commission that:

> . . . the company's conduct should be judged by asking whether the conduct was reasonable at the time, under all the circumstances, considering that the company had to solve its problem prospectively rather than in reliance on hindsight. In effect, our responsibility is to determine how reasonable people would have performed the tasks that confronted the company.[141]

Decision:

The State and Public Counsel have not demonstrated sufficient facts to create a serious doubt about the prudence of AmerenUE's decision to purchase the Pinckneyville and Kinmundy plants at net book value. There is no basis for an adjustment and AmerenUE's full purchase price for the Pinckneyville and Kinmundy plants shall be included in the company's rate base.

B. Peno Creek

Discussion:

The second issue regarding the inclusion of a CTG in rate base concerns a CTG facility that AmerenUE installed at Peno Creek in Pike County, Missouri. The four units at Peno Creek are aero-derivative simple cycle CTGs rated at approximately 48 MW in peak summer conditions. The units have dual fuel capability and are capable of reaching full

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[140] *Union Electric*, 27 Mo. P.S.C. (N.S.) 183, 193 (1985).

[141] *Union Electric*, at 194, quoting *Consolidated Edison Company of New York, Inc.,* 45 P.U.R. 4th 331 (1982).

output in eight minutes. As a result, the CTGs can be used to comply with the operating reserve requirements of MISO.[142]

Leon Bender, a regulatory engineer employed by the Commission, conducted a construction audit of the Peno Creek units as they were being installed. He testified that as a result of his audit, “Staff has not identified any construction costs during construction that should not be allowed in rate base.”[143] Staff recommends the full cost of construction be allowed in rate base.

Public Counsel, however, contends the gross value of the Peno Creek facility should be reduced from a value of $550 per kW to $390 per kW. Public Counsel did not do a construction audit; but its witness, Ryan Kind, argues the cost of Peno Creek was inflated because AmerenUE delayed the start of construction on needed CTGs because it hoped to be able to push a regulatory restructuring bill through the Missouri legislature. If such a bill were to be approved, needed capacity could be built more profitably through an affiliated non-regulated generation company. When restructuring did not occur in Missouri, Public Counsel says AmerenUE had to rush the construction of the facility at Peno Creek by using a type of CTG that was more expensive because it could be installed quicker. It also asserts the rush caused other increased construction costs. To correct for these increased costs, Public Counsel advocates the use of a lower cost of construction, $390 per kW, that it took from AmerenUE’s filing in an earlier case, EA-2000-37.[144]

In response to Public Counsel’s proposal, AmerenUE established that the $390 per kW cost was taken from a 1995 asset mix optimization study and represents a generic

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[142] Voytas Rebuttal, Ex. 060, Page 30, Lines 17-21.

[143] Bender Direct, Ex. 201, Page 5, Lines 3-4.

[144] Kind Direct, Ex. 404, Page 30, Lines 4-7.

installed cost for a large frame CTG based on 1995 information.[145] Furthermore, AmerenUE established it would not necessarily cost more to install a CTG on an expedited basis.[146]

Findings of Fact:

The Commission finds that a 1995 estimate of the cost to construct a large frame CTG has no relevance to the actual cost to construct an aero-derivative CTG in 2002 and is not a reasonable estimation of reasonable construction costs. Staff's engineer, who actually inspected the plant and audited its construction, testified that the full cost of the construction should be included in rate base. Against these facts, Public Counsel offers only speculations about increased costs, offered by a witness who is an economist, not an engineer, and who has no particular expertise in the design of AmerenUE's generation fleet.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

Mere speculation about political motivations and possibly increased prices does not create a serious doubt about the prudence of AmerenUE's expenditures on the Peno Creek CTG facility. There is no basis for an adjustment and AmerenUE's full construction cost for the Peno Creek plant shall be included in the company's rate base.

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[145] Voytas Rebuttal, Ex. 060, Page 30, Lines 1-4.

[146] Transcript, Page 3321, Lines 21-25.

7. SO_2 Allowance Sales

Discussion:

Sulfur Dioxide (SO_2) emissions allowances are issued by the United States Environmental Protection Agency as part of the Clean Air Act. A single allowance permits the holder of the allowance to emit one ton of SO_2. A utility holding an allowance may choose to figuratively burn that allowance along with its coal and send the remains of the allowance up its smokestack as SO_2. However, the holder of the allowance does not need to burn its allowance, it may instead buy, sell, or trade the allowance to another utility or other producer of sulfur dioxide. An active market exists for these SO_2 allowances in which companies that may not be in full compliance with the Clean Air Act can obtain needed SO_2 allowances from companies that are not producing as much SO_2.

AmerenUE tends to have more SO_2 allowances than it needs to burn,[147] largely because its power plants burn mostly low sulfur coal from the Powder River Basin in Wyoming. As a result, AmerenUE has been able to sell unneeded allowances into the market, sometimes at a considerable profit. In addition, unused allowances do not expire and can be kept by the company and banked for future use. AmerenUE has managed to accumulate a valuable bank of SO_2 allowances.[148]

The cost of SO_2 premiums and discounts must also be considered along with revenue produced from the sale of SO_2 allowances. AmerenUE pays SO_2 premiums to coal suppliers and collects discounts from them. The amount of the premium or discount is

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[147] Transcript, Page 3456, Lines 6-8.

[148] The number of allowances that AmerenUE has banked and their value is highly confidential. The number, as of November, 2006, may be found in the highly confidential testimony of Brosch Direct, Ex. 501, Page 38, Lines 4-5.

based on the difference between the sulfur content of the coal as agreed upon in the coal supply contract and the sulfur content of the coal that is actually delivered.[149]

All costs of complying with the Clean Air Act, including payment of SO_2 premiums, are included in AmerenUE's cost of service and are recovered from ratepayers. Therefore, all parties, including AmerenUE, agree that any revenue the company receives from SO_2 sales should be used to offset AmerenUE's cost of service in calculating its revenue requirement. The only question is about the best way of doing that.

Public Counsel recommends the Commission include nearly $24 million per year in AmerenUE's revenue requirement to account for a five-year average of SO_2 sales.[150] The State recommends the inclusion of approximately $20.3 million per year in AmerenUE's revenue requirement, again based on a four-year average of sales.[151]

The State also recommends, in addition to including $20.3 million per year in SO_2 sales, the Commission should establish a regulatory tracking mechanism to track variations in that amount in future years. In other words, if in a future year, AmerenUE makes sales totaling more than $20.3 million, it would accumulate a regulatory liability that could be used to reduce the company's earnings in a future rate case. If, on the other hand, the company made sales totaling less than $20.3 million, the company could be allowed to recover the shortfall in a future rate case.[152]

Staff and AmerenUE have now reached the same position regarding the treatment of SO_2 sales. In its prefiled surrebuttal testimony, AmerenUE proposed its 2006 SO_2

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[149] Transcript, Page 3464-3465, Lines 23-25, 1-7.

[150] Kind Surrebuttal, Ex 408, Page 17, lines 3-7.

[151] Brosch Direct, Ex. 501, Page 39, Line 1.

[152] Transcript, Page 3560, Lines 1-13.

allowance sales in the amount of approximately $33 million[153] be netted against approximately $34 million in operating and maintenance (O&M) expenses resulting from the 2006 severe storms in AmerenUE's service area.[154] The company would forego recovery of the remainder of its O&M storm costs in this or any other rate case.[155] In its prefiled surrebuttal testimony, Staff proposed AmerenUE's gains from the sale of SO_2 allowances be netted against the SO_2 premiums it paid with the remainder of $20.4 million to be offset against the $34 million in 2006 O&M storm costs. Staff suggested the balance of the storm costs of $13.6 million be amortized over five years and be recovered from ratepayers.[156]

At the hearing, AmerenUE's witness indicated the company was willing to accept Staff's proposal, but also stood behind its proposal to offset all 2006 O&M storm costs.[157] Staff's witness testified at the hearing that AmerenUE's proposal was "much cheaper for customers," and indicated Staff would accept the company's proposal.[158]

After offsetting the 2006 O&M storm costs, Staff and AmerenUE both propose that after January 1, 2007, all future SO_2 Premiums, net of SO_2 discounts, as well as all gains associated with SO_2 allowance sales be tracked in a regulatory liability account. The net balance in that account would then be addressed as part of the fuel expense calculation in

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[153] Transcript, Page 3505, Line 11.

[154] Transcript, Page 3406, Lines 6-8. These numbers were designated as highly confidential in the prefiled testimony but they were revealed by the company's witness at the hearing. The company indicates that numbers about past sales do not need to be protected from disclosure.

[155] Baxter Rebuttal, Ex. 002, Page 12, Lines 5-7.

[156] Meyer Surrebuttal, Ex. 226, Page 3, Lines 8-18.

[157] Transcript, Page 3442, Lines 20-24.

[158] Transcript, Page 3554, Lines 14-19.

the company's next rate case.[159] Except for the starting date, this portion of Staff and AmerenUE's proposal is the same as the tracking mechanism proposed by the State.

Findings of Fact:

Prices of emission allowances have been volatile in the recent past, as have volumes of emission sales and SO_2 premiums paid.[160] As a result, it would be difficult to project an appropriate amount of SO_2 allowance sales. If the base amount were set too low, the Company could reap undeserved profits as the result of high sales. If the base amount were set too high, the company could fall short of sales and lose the opportunity to earn an appropriate return. These costs and revenues are extraordinary because they are unpredictable and really a by-product of a process designed to protect air quality. Therefore, it is appropriate to set up a tracking mechanism to adjust for any over-recovery or shortfall. Three of the four parties filing testimony regarding SO_2 sales agree such a tracking mechanism is appropriate. The fourth, Public Counsel did not propose such an arrangement, but did not oppose it either. Therefore, the Commission will set up the requested tracking mechanism.

The real question is whether a base amount of sales should be imputed into AmerenUE's revenue requirement as part of that tracking mechanism. Under the State's proposal, AmerenUE's revenue requirement would be reduced by $20.3 million ($24 million if Public Counsel's average is used) for each year that the tracking mechanism remains in effect. However, the $34 million in 2006 O&M storm costs would be recovered from ratepayers over a five-year period, at approximately $7 million per year. Under Staff and AmerenUE's proposal, ratepayers do not have to pay the $34 million in 2006 O&M storm

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[159] Cassidy Surrebuttal, Ex. 209, Pages 12-13, Lines 21-23, 1-6

[160] Id. at Page 13, Lines 10-11.

costs, but they also do not receive the benefit of a $20.3 million per year reduction in the company's revenue requirement. Of course, ultimately, all of AmerenUE's net revenue from SO_2 sales will be given back to ratepayers through the operation of the tracking mechanism under either proposal.

In the short run, the State's proposal looks like a better deal for ratepayers. But it is important to remember SO_2 allowances were not created as a means for speculation or enrichment of the company or ratepayers. Their primary purpose is to regulate the emission of SO_2. That means AmerenUE must carefully manage its supply of allowances to ensure it remains in compliance with the nation's environmental laws. AmerenUE recognizes this fact by not including an estimation of prospective SO_2 sales in its annual budget.[161] Establishing a base amount for SO_2 sales would, in effect, give AmerenUE a strong incentive to continue making those sales each year or face a revenue shortfall, and would discourage appropriate management of its allowance bank.

If AmerenUE depletes its allowance bank, it would be forced to go into the market to buy expensive allowances from other companies, or it could be forced to accelerate the installation of scrubbers or other pollution control costs at a substantial capital cost that would be recovered from ratepayers.[162] Both results would have an adverse impact on ratepayers in the longer term. In addition, environmental regulations are tightening in the future and AmerenUE will need to use more of its allowances for compliance purposes.[163] For those reasons, the Commission finds it in the long-term best interest of ratepayers to

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[161] Transcript, Page 3428, Lines 10-14.

[162] Moore Surrebuttal, Ex. 063, Page 2, Lines 10-12.

[163] Transcript, Page 3480, Lines 1-19.

establish a regulatory tracking mechanism without including a base amount of SO_2 sales in AmerenUE's revenue requirement.

Aside from its advocacy for establishment of a base amount of SO_2 sales, the State expresses two objections to the regulatory tracking mechanism proposed by Staff and AmerenUE. First, the State argues the proposed regulatory tracking mechanism would create a perverse incentive for AmerenUE to structure its future coal supply contracts with higher SO_2 premium pricing. The tracking mechanism would only account for the SO_2 premium portion of coal costs, while the other portions of coal costs would be recovered in a future rate case through the company's base rates. That means AmerenUE could agree with a coal supplier to pay a higher SO_2 premium in order to get a lower coal price, passing the higher SO_2 premium on to ratepayers, while pocketing the benefit of the lower coal price.

The State's concerns are not persuasive. First, the tracking mechanism proposed by the State's witness would exhibit exactly the same flaw. The Commission believes the benefits associated with having a tracking mechanism would outweigh the remote risk identified by the State. Second, Staff would be able to detect any such manipulation and disallow the costs associated with such a manipulation of the system in a future rate case.[164] Furthermore, AmerenUE has already purchased most of its coal for the next several years.[165] Therefore, it would be several years before State's scenario could occur.

The State's second argument is that the tracking mechanism proposed by Staff and AmerenUE would constitute forbidden retroactive ratemaking. This argument derives from the fact Staff and AmerenUE would allow the company to begin tracking revenue from

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[164] Transcript, Page 3539, Lines 2-10.

[165] Transcript, Page 3542, Lines 6-15.

allowance sales beginning as of January 1, 2007. The rates established by this case will not go into effect until approximately five months after that date. The State contends the retroactive start of the tracking mechanism would allow AmerenUE to reach back to inappropriately capture past gains or losses. This is a legal question that will be addressed under the conclusions of law section regarding this issue.

Conclusions of Law:

The Missouri Supreme Court discussed the principle of retroactive ratemaking in the 1979 decision that declared an earlier version of a fuel adjustment clause for Missouri electric utilities to be illegal. In that decision, *State ex rel. Util. Consumers Council of Missouri, Inc.*,[166] the court addressed Public Counsel's request that the electric utilities be ordered to calculate and refund excess charges they were able to collect under the illegal fuel adjustment clauses. In denying that request, the court said:

> The commission has the authority to determine the rate to be charged. In so determining it may consider past excess recovery insofar as this is relevant to its determination of what rate is necessary to provide a just and reasonable return in the future, and so avoid further excess recovery. It may not, however, redetermine rates already established and paid without depriving the utility (or the consumer if the rates were originally too low) of his property without due process.[167]

This ruling means neither the Commission, nor the courts, can go back and redetermine utility rates to allow recovery or refund of past over or under charges. The Missouri Court of Appeals has, however, held that it is not improper to consider past costs when setting rates that will apply only in the future.[168]

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[166] 585 S.W. 2d 41 (Mo banc 1979).

[167] Id. at 58.

[168] *State ex rel. Midwest Gas Users' Ass'n v. Pub. Serv. Comm'n*, 976 S.W.2d 470, 481 (Mo. App. W.D. 1998).

Using that rationale, the Court of Appeals upheld this Commission's Emergency Cold Weather Rule establishing an accounting authority order (AAO) that allowed utilities to track, defer and recover the extra costs of complying with the cold weather rule.[169] The court explicitly found that such a deferral of expenses for consideration in a future rate case was not retroactive ratemaking.[170]

The regulatory device that Staff and AmerenUE propose to track SO_2 allowance sales in this case is analogous to an AAO, which has been found to be legal by reviewing courts. The tracking mechanism will merely defer extraordinary costs and revenue for consideration in a future case. It does not guarantee future recovery and it is not forbidden retroactive ratemaking.

Decision:

The Commission concludes that AmerenUE's 2006 storm related operating and maintenance costs shall be offset against its 2006 SO_2 allowance sales revenue. Thereafter, the company's 2006 storm related operating and maintenance costs shall not be considered in any manner in any future rate proceeding.

The Commission will establish an accounting mechanism to track AmerenUE's future SO_2 sales. Beginning on January 1, 2007, all SO_2 premiums, net of SO_2 discounts, shall be accounted for in FERC USOA Account 254, a regulatory liability account. All gains associated with SO_2 allowance sales, beginning on January 1, 2007, shall also be recorded in the same regulatory liability account. The net balance of the SO_2 premium expenses (or discounts) and corresponding gains associated with SO_2 allowance sales shall be addressed as part of the fuel expense calculation in AmerenUE's next rate proceeding.

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[169] *Missouri Gas Energy v. Pub. Serv. Comm'n*, 210 S.W.3d 330 (Mo. App. W.D. 2006).

[170] Id. at 336.

The question remains of whether a base amount of SO_2 sales should be included in that tracking mechanism.

The tracking mechanism will ensure that ultimately all income from SO_2 sales will flow back to ratepayers. But while the tracking mechanism is operating, AmerenUE will receive the cash from those sales. The ratepayers' benefits will simply accrue in a regulatory account to be considered in AmerenUE's next rate case, whenever that case might be filed. If income from SO_2 sales is simply allowed to accumulate, that regulatory account could grow to a substantial sum. That would result in intergenerational inequity as today's ratepayers would, in effect, be subsidizing tomorrow's ratepayers.

For that reason, the Commission will include an amount in the calculation of AmerenUE's revenue requirement to recognize income from SO_2 sales. From year to year, as sales fluctuate above and below the base level, the amount of money accumulating in the tracking mechanism will also go up and down.

The Commission wants to encourage AmerenUE to manage its balance of SO_2 allowances wisely and does not want to effectively force it to meet an annual quota of sales to earn its allowed rate of return. Therefore, the Commission will establish the annual base level of SO_2 sales as $5 million, which is approximately one fourth of the four-year average calculated by the State's witness.

8. Depreciation

Depreciation is the means by which a utility is able to recover the cost of its investment in its rate base by recognition of the reduction in value of that property over the useful life of the property. The parties have identified several issues regarding depreciation and they will be addressed in turn.

A. Commission Rule 4 CSR 240-10.020

Discussion:

This is a silly, almost frivolous issue, upon which the parties have lavished far too much time and attention. In his direct testimony filed at the start of this case, an AmerenUE witness, Gary Weiss, cited an obscure Commission rule that he said:

> prescribes the method that the Commission must follow in accounting for income derived by gas electric, water, telegraph, telephone and heating utilities from their investment of depreciation funds.[171]

Weiss indicated if the Commission were to follow this rule in setting rates in this case, AmerenUE would be entitled to recover twice the amount in rates that it was actually requesting. Weiss emphasized that AmerenUE was not actually asking the Commission to follow this rule in setting rates, but contended that the rule would provide additional justification for the amount of revenue AmerenUE is seeking.[172] Again, at the hearing, AmerenUE emphasized it is not proposing to implement rates that would reflect compliance with this rule.[173]

In response to Weiss' alternative hypothetical method for calculating depreciation income, Staff filed rebuttal testimony explaining that the rule in question dates back to a general order the Commission issued in 1946. It was carried unchanged into the Code of State Regulations in 1975 when the Commission made an effort to codify all of its old rules in compliance with Chapter 536, RSMo.[174] Staff concludes the Commission actually

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[171] Weiss Direct, Ex. 010, Page 29, Lines 7-9.

[172] Id. at Page 30, Lines 8-16.

[173] Transcript, Page 3604, Lines 16-19.

[174] Schallenberg Rebuttal, Ex. 236, Pages 11-12, Lines 16-23, 1-3.

abandoned the use of this rule by 1958.[175] Staff also indicated that AmerenUE – then Union Electric – has not complied with the reporting requirements of the rule since1951.[176] Nevertheless, Staff delves into the arcane requirements of the obsolete rule and determines that AmerenUE's interpretation of the rule is incorrect. If properly interpreted, Staff contends the rule would require a reduction in the company's revenue requirement of over $134 million.[177]

Findings of Fact:

The Commission does not need to determine the proper hypothetical application of this rule. It is enough to know that no party has asked the Commission to apply the rule in this case. Furthermore, the Commission finds that this rule has been obsolete since the 1950s and that no utility has attempted to follow the provisions of this rule since that time. In addition, AmerenUE has not complied with the reporting requirements of this rule since 1951. This rule is obsolete and has no application to this case.

Conclusions of Law:

Commission Rule 4 CSR 240-10.020 purports to determine the means by which depreciation is to be used in determining the reasonableness of rates charged by utilities. Subsection (5) of that rule requires affected utilities to prepare and include in their annual reports schedules showing income from investment in depreciation funds.

Decision:

No party has asked the Commission to apply the provisions of this rule in this case. In any event, the rule is obsolete and has been ignored by the Commission and the utilities

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[175] Id. at Page 13, Lines 13-15.

[176] Id. at Page 12, Lines 10-12.

[177] Id. at Page 8, Lines 9-13.

it regulates for more than 50 years. The rule has no application to this case and the Commission will not attempt to offer a hypothetical interpretation of the meaning of that rule. The Commission instructs its Staff to consider the repeal of 4 CSR 240-10.020.

B. Life Span of Fossil Fuel and Hydro Power Plants

Discussion:

AmerenUE, supported by MIEC, proposes to use a life-span method of calculating depreciation rates for categories of property that are components of its steam and hydraulic production plants. Under the life-span method, a survivor curve is used to determine the average expected useful life for the various components of the power plant. Those ages are then used to calculate the appropriate rate at which the value of those components will be depreciated. AmerenUE, however, would go one step farther. It would truncate all the survivor curves of the components at the date when it anticipates the entire power plant will be removed from service. AmerenUE reasons that when the power plant as a whole is retired, all its components must also be retired.[178] AmerenUE contends life-span treatment of power plant components is a widely accepted practice by other state commissions.[179]

In its direct testimony, for purposes of calculating depreciation, AmerenUE used a retirement date of June 30, 2026, for all its fossil fuel steam production plants. This date was chosen because it was 20 years in the future and AmerenUE's witness believed that operation of any steam plant was uncertain beyond that date.[180]

In response to criticism from other parties about the arbitrary nature of the chosen retirement date, AmerenUE's witness calculated new individual retirement dates for each

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[178] Stout Direct, Ex. 069, Page 12, Lines 7-22.

[179] Stout Rebuttal, Ex. 070, Page 8, Lines 1-5.

[180] Wiedmayer Direct, Ex. 072, Schedule jfwe1, Page II-25.

steam production plant, based on the potential for future environmental requirements, future development of new generating technologies, and the finite life of certain heavy wall components. AmerenUE's witness also considered the age and condition of each major component, the service history of each facility and the expected future service conditions, anticipated near term capital investment for each facility, and the time and resources required to permit and construct replacement base load production capacity.[181] After making this careful evaluation, the witness concluded that AmerenUE would retire all of its coal-fired steam plants as follows:

Facility	Est. Retirement Year	App. Age at Retirement
Meramec	2021	63 years
Sioux	2027	60 years
Labadie	2033	61 years
Rush Island	2037	60 years

In other words, AmerenUE estimated that all the plants would be retired when they reach approximately 60 years of age.[182] In addition, AmerenUE estimated its Osage hydro-electric plant at Bagnell dam will be retired in 2046.

In opposing AmerenUE's use of truncated survivor curves based on estimated plant retirement dates, Staff's witness, Jolie Mathis, testified that a determination of the exact timing of retirement of a particular facility can be made only relatively close to the time of retirement. Because the retirement date for steam production is not certain, it would be inappropriate to truncate the survivor curve at this time.[183]

In addition to their disagreement about the use of plant retirement dates to truncate survivor curves for components of those plants, the witnesses for Staff and AmerenUE also

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[181] Birk Rebuttal, Ex. 026, Pages 1-2, Lines 17-23, 1-9.

[182] Id. at Page 2, Lines 12-14.

[183] Mathis Direct, Ex. 222, Pages 8-9, Lines 18-22, 1-2.

disagree about the length of the survivor curves Staff's witness has utilized. AmerenUE contends that because Staff's witness used only interim retirement data and did not truncate those curves, she over-estimated the average service lives for those accounts and understated the depreciation rates.

Findings of Fact:

Staff contends the retirement date for AmerenUE's base load coal-fired electric generating plants cannot be known with any degree of certainty at this time. Based on the company's unconvincing attempts to estimate such retirement dates, the Commission must conclude that Staff is correct. In its initial direct testimony, AmerenUE simply assumed all its coal-fired production plants would be retired on the same date twenty years in the future. After hearing criticism of that arbitrary approach, AmerenUE took a closer look at the question and concluded that all of its coal-fired plants would be retired at approximately age 60 years. The second approach appears to be as arbitrary as the first.

It is very unlikely AmerenUE will actually choose to retire and replace such a large percentage of its base load generation capacity within the short span of 16 years between 2021 and 2037.[184] It is certain that AmerenUE filed an integrated resource plan in December 2005 that did not make any mention of any plan to replace base load generation capacity.[185]

AmerenUE also criticizes the length of the survivor curves Staff's witness, Jolie Mathis, chose to utilize in calculating the life span of the components of these power plants. At the hearing, Mathis was extensively cross-examined about the life spans those curves

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[184] Gilbert Rebuttal, Ex. 211, Page 4, Lines 1-4.

[185] Integrated Resource Plan, Executive Summary, Ex. 273HC.

would produce, with the implication that those expected lives were unreasonably long.[186] However, the survivor curves that Mathis used are the same curves AmerenUE's witness used, except not truncated for the speculative retirement of the plant.[187] Based on the evidence before the Commission, it appears AmerenUE's criticism of the Staff's choice of survivor curves is merely a further attempt to discredit Staff's decision not to truncate those curves to account for speculative retirement dates for AmerenUE's generating plants.[188]

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

Obviously, at some point, all of AmerenUE's electric production plants will be retired. But at this time, there is really no way to be sure when that retirement will occur. It all seems like an unimportant matter, but the truncation of survivor curves and the resultant decrease in the expected life of the components of these power plants would significantly increase the amount of money AmerenUE would be allowed to recover as depreciation expense. In turn, the calculation of depreciation expense will have a significant impact on the rates that AmerenUE will be allowed to charge its customers.[189] Without better evidence of when those plants are likely to be retired, allowing the company to increase its depreciation expenses based on what is little more than speculation about possible retirement dates would be inappropriate. Staff's use of non-truncated survivor curves is

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[186] Transcript, Pages 3736-3750.

[187] Transcript, Page 3737, lines 7-13.

[188] AmerenUE's brief at page 133 attempts to develop a more extensive argument about including both interim and final retirement data in a survivor curve. However, a party's brief is not evidence and cannot be used to support a decision of this Commission.

[189] The Revised True-Up Reconciliation filed on April 19, 2007, indicates that use of Staff's survivor curves will reduce AmerenUE's revenue requirement by $57,701,438.

appropriate and Staff's curves shall be used for calculation of AmerenUE's depreciation expense.

C. Callaway Plant Life Span

Discussion:

The Callaway Plant is a 1,292 MW nuclear plant located in Callaway County, Missouri. In 2005, the Callaway Plant was the third largest power producer on AmerenUE's system, producing 10.3 percent of AmerenUE's total generation.[190] The Callaway Plant was granted a 40-year license to operate by the Nuclear Regulatory Commission (NRC) in 1984. That license will expire in 2024. The NRC has established a process whereby license holders can apply for a 20-year license extension, which would extend the Callaway Plant's operating license until 2044.[191]

AmerenUE proposes depreciation on the Callaway Plant be calculated using a 40-year life span because the plant's current license will expire in 2024. AmerenUE indicates it has not yet decided whether to seek a 20-year license renewal.[192] It also suggests there is a possibility the NRC may refuse to extend the license, or necessary repairs at the plant may be too expensive to justify the 20-year extension of the license. Therefore, AmerenUE contends it would be more prudent to continue depreciation at its current levels by using the 2024 retirement date when calculating depreciation.[193]

Staff, Public Counsel, MIEC, and the State all contend that depreciation of the Callaway Plant should be calculated using a 2044 retirement date. They argue AmerenUE

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[190] Naslund Direct, Ex. 047, Page 3, Lines 5-8.

[191] Id. at Page 9, Lines 7-11.

[192] Id. at Page 9, Lines 13-14.

[193] Stout Direct, Ex. 069, Page 30, Lines 17-20.

is nearly certain to apply to renew the operating license for the Callaway Plant and the NRC is quite likely to grant the requested renewal. Use of a 60-year life span instead of a 40-year life span will spread the capital costs over a longer period and will have the effect of reducing AmerenUE's revenue requirement in this case by $27,919,066 according to Staff and Public Counsel.[194] MIEC's witness, James Selecky, calculates the revenue requirement reduction as $46,570,693.[195]

Findings of Fact:

The evidence overwhelmingly supports a finding that AmerenUE will apply for and receive a 20-year operating extension for the Callaway Plant. More than 90 of the 104 nuclear power plants in the United States eligible for license renewal have either sought or indicated they will seek a 20-year renewal of their operating license.[196] Although AmerenUE has not yet sought to renew the Callaway Plant's license, there is no good reason to believe it will not do so. Furthermore, the NRC has never refused to renew a commercial nuclear power reactor's initial license for the additional 20 years.[197]

AmerenUE has recently made major capital additions to replace major components of the Callaway Plant, including four new steam generators,[198] and has budgeted funds in 2013 for reactor head replacement.[199] The Callaway Plant provides a very large percentage of the power AmerenUE produces, including an even larger percentage of its

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194 The number is taken from the Revised True-Up Reconciliation filed on April 19, 2007.

195 The number is taken from the Revised True-Up Reconciliation filed on April 19, 2007. Selecky's calculations are shown in his Direct Testimony, Ex. 707, Page 26, Lines 1-11 and Schedule JTS-8.

196 Wood Surrebuttal, Ex. 247, Page 3, Lines 6-9.

197 Dunkel Direct, Ex. 400, Page 10, Lines 9-10.

198 Naslund Direct, Ex. 047, Page 4, Lines 10-20.

199 Dunkel Surrebuttal, Ex. 402, Page 4, Lines 8-13.

base load generation.[200] Quite simply, AmerenUE has too much invested in the Callaway Plant not to seek a 20-year license extension.

AmerenUE's response to those who say it is highly likely the Callaway Plant's license will be extended is simply to claim it has not yet decided to apply to extend the license and probably will not do so until 2014,[201] and something could change before 2024 to prevent such an extension. But AmerenUE is not aware of any safety or environmental issues to preclude an extension of the Callaway Plant's operating license.[202] Under the circumstances, the Commission finds the Callaway Plant's depreciation should be calculated using a retirement date of 2044.

The decision to use a retirement date of 2044 still leaves the question of which witness' depreciation schedule the Commission should accept. MIEC's proposed depreciation schedule utilizes a method of calculating net salvage the Commission has rejected in previous cases and rejects again later in Section 8-E&F of this order. Staff's calculation of net salvage uses the traditional accrual method the Commission once again approves in this order. Therefore, the depreciation schedules proposed by Staff will be accepted.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

The Commission finds it more likely than not that AmerenUE will obtain a 20-year extension of the operating license of the Callaway Nuclear Plant. Therefore, the

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[200] Transcript, Page 4220, Lines 7-15.

[201] Transcript, Page 4241, Lines 3-15.

[202] Selecky Direct, Ex. 707, Page 24, Lines 15-20.

Commission will direct that 2044 be used as the retirement date for that plant. The Commission also directs that the depreciation rates developed by Staff be used to calculate depreciation on the Callaway Plant.

D. Terminal Net Salvage and Inflation Costs Relating to Retirement of Generating Plants

Discussion:

The first portion of this issue concerns the appropriate net salvage percentages to be used for Steam and Hydraulic Plant accounts. In a non-unanimous stipulation and agreement, Staff and AmerenUE agreed that Staff's net salvage percents for Steam and Hydraulic Plant depreciation rates were to be used. MIEC and Public Counsel objected to that stipulation and agreement and demanded a hearing on the issue. As a result, the stipulation and agreement was not approved and now indicates only a change of position by the signatory parties.

The second portion of the issue concerns terminal net salvage relating to AmerenUE's Steam and Hydraulic Plant. In the objected to stipulation and agreement, AmerenUE changed its position to renounce any recovery of terminal net salvage from its ratepayers. All other parties agree that terminal net salvage should not be recovered from ratepayers.

Findings of Fact:

Staff's net salvage percentages are calculated in accordance with the traditional accrual method approved by the Commission in previous cases[203] and reaffirmed by the Commission later in Section 8-E&F of this order. The method for calculating depreciation

[203] Mathis Direct, Ex. 222, Page 7, Lines 15-25. and Schedule JLM-2

rates advocated by MIEC are rejected by the Commission in Section 8-E&F of this order. Therefore, the Commission will accept the net salvage percentages advocated by Staff.

All parties now agree terminal net salvage relating to Steam and Hydraulic Plant depreciations should not be recovered from ratepayers at this time.

Conclusions of Law:

Commission rule 4 CSR 240-2.115(D) provides:

> A nonunanimous stipulation and agreement to which a timely objection has been filed shall be considered to be merely a position of the signatory parties to the stipulated position, except that no party shall be bound by it. All issues shall remain for determination after the hearing.

Decision:

The Commission accepts the net salvage percentages advocated by Staff. Terminal net salvage relating to Steam and Hydraulic Plant depreciation shall not be recovered from ratepayers at this time.

E. Historic or Future Inflation Rates When Estimating Net Salvage

and

F. Should Net Salvage Be Based on Actual Net Salvage Expense?

Discussion:

These two sub-issues are closely connected so they will be discussed and decided together.

Salvage is the scrap value of a depleted asset that has reached the end of its useful life. Net salvage is the value remaining after the cost of removing the asset is subtracted from its salvage value. Often, net salvage is negative because the cost of removing the asset exceeds its salvage value.

In recent cases the Commission has mandated the use of the traditional accrual method for calculating a depreciation rate using the following formula:

Depreciation Rate = 100% - % Net Salvage/Average Service Life (years)

The net salvage percentage is determined by dividing the net salvage experienced for a period of time by the original cost of the property retired during the same period of time. Because net salvage costs are incurred in the future, when the asset is retired, the net salvage to be determined for the investments currently in service is called future net salvage.[204] Estimates of future net salvage are based on historical analysis of net salvage as a percent of the original cost of the facilities that are retired.[205]

As his primary position, MIEC's witness, James Selecky, recommends the Commission abandon the traditional accrual method for calculating net salvage and instead allow the company to recover only the average net salvage expense it incurs in a particular year.

As a secondary position, MIEC's witness joins with Public Counsel's witness, William Dunkel, to recommend the Commission adjust the accrual method of calculating future net salvage by substituting a projection of future inflation for the historic inflation actually experienced when conducting an analysis of net salvage.

Inflation enters into the calculation because net salvage is stated in current dollars while the original cost of the investment is stated in historic dollars. Inflation occurring during the service life of the asset thus has a major impact on the net salvage

[204] Dunkel Direct, Ex. 400, Page 19, Lines 5-10.

[205] Stout Rebuttal, Ex. 070, Page 11, Lines 11-12.

calculation.[206] Most of the plant being retired now, and which would be included in a current depreciation study to estimate future net salvage, was installed and paid for 30-50 years ago.

MIEC and Public Counsel point out that this country's economy experienced unusually high inflation rates during the 1970s and early 1980s. That high inflation rate would be reflected in the inflation experienced during the life of plant now being retired. They contend inflation in the future, during the period plant now in service will be moving toward retirement, will likely be lower. To correct for this, they propose to substitute an anticipated, hypothetical inflation rate for the historical inflation rate actually experienced by the plant now being retired.

Both MIEC and Public Counsel base their proposed future inflation rates on predictions by financial experts. MIEC relies on the Annual Energy Outlook of 2006,[207] while Public Counsel relies on a survey of professional forecasters produced by the Federal Reserve Bank of Philadelphia.[208] Relying on these projections, they recommend use of a future inflation rate of 2.5%.

In response to the proposals put forth by MIEC and Public Counsel, AmerenUE provided evidence arguing that the analysis of the other parties is flawed because it overstates the average age of historical retirements by incorrectly assuming the historical retirements occurred at an average age equal to the estimated average service life.[209]

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[206] Dunkel Rebuttal, Ex. 401, Page 11-17.

[207] Selecky Direct, Ex. 707, Page 35, Line 20.

[208] Dunkel Direct, Ex. 400, Page 24, Lines 7-9.

[209] Stout Rebuttal, Ex. 070, Page 12, Lines 5-17.

Findings of Fact:

The Commission recently addressed the question of whether the traditional accrual method should be used in calculating depreciation. In the Laclede Case, Case No. GR-99-315, the Commission found "the fundamental goal of depreciation accounting is to allocate the full cost of an asset, including its net salvage cost, over its economic or service life so that utility customers will be charged for the cost of the asset in proportion to the benefit they receive from its consumption."[210] The Commission reaffirmed that position in another 2005 rate case, this time involving The Empire District Electric Company.[211]

MIEC's proposal to abandon the accrual method of calculating depreciation would abandon what the Commission found to be a fundamental goal by once again divorcing recovery of net salvage cost from the customers who will benefit from the use of the asset during its lifetime. It would instead push those costs onto future ratepayers who would be saddled with the full cost of net salvage at the time the asset is retired. The Laclede and Empire District cases were decided properly and the Commission will not revisit those decisions.

The proposal to substitute projections of future inflation for historic rates of inflation is flawed by an overstatement of the average age of historical retirements used in the formulas for substituting projected future inflation for historic rates of inflation. As explained by AmerenUE's witness, William Stout, MIEC and Public Counsel would use average service life as the average age of future retirements. The average age of future retirements is not the average service life, but rather is the average probable life. The average

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[210] *In the Matter of Laclede Gas Company's Tariff to Revise Natural Gas Rate Schedules*, 13 Mo. P.S.C. 3d 215, 220 (2005).

[211] *In the Matter of the Tariff Filing of The Empire District Electric Company to Implement a General Rate Increase*, 13 Mo. P.S.C. 3d 350 (2005).

probable life is the same as average service life when an asset is first placed in service, but as time passes the average probable life continues to increase beyond the average service life. This is the same effect experienced in human life expectancy. At birth, a child may have a life expectancy of 70 years, but a 69 year old may still have a life expectancy of more than one year. The use of probable life would result in the inclusion of more future inflation than was recognized by MIEC and Public Counsel and would invalidate their proposed adjustments.[212]

Even more fundamentally, MIEC and Public Counsel have failed to demonstrate any reason to believe their estimates of future inflation are a more reliable predictor of future inflation than the past history used by Staff and AmerenUE in their calculations. Expert predictions of future inflation can be little more than guesswork. It is impossible to accurately predict what inflation might occur 30 or 40 years in the future. No doubt if an esteemed panel of experts had been polled in 1960 they never would have predicted the severe inflation of the 1970s and 1980s. Similarly, today's experts cannot possibly foresee whatever inflation may occur in 2023. The Commission finds past history to be a better predictor of future inflation for ratemaking purposes.

Conclusions of Law:

No additional conclusions of law are made for this issue:

Decision:

The Commission will continue to use traditional accrual accounting for calculation of net salvage. The future inflation adjustments proposed by MIEC and Public Counsel are rejected. The Commission also notes that in the Laclede case the Commission required

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[212] Stout Surrebuttal, Ex. 071, Page 7, Lines 8-16.

that company to separately accrue and account for net salvage amounts received in rates separately from other components of depreciation expense.[213] The Commission will impose the same requirement on AmerenUE.

The Commission believes this decision regarding inflation is consistent with past practices of the Commission as decided in the Laclede case. If Staff believes this decision is inconsistent with past practice, the Commission expects Staff to so advise the Commission in an application for reconsideration or clarification.

G. Is There a Difference between Actual Book Accumulated and Theoretical Accrued Depreciation?

Discussion:

In her direct testimony for Staff, Jolie Mathis indicated AmerenUE's theoretical reserve has become imbalanced with actual book accumulated depreciation. At the time Mathis filed her testimony, Staff did not recommend any adjustment to correct that imbalance, but noted the imbalance would need to be monitored in future depreciation studies.[214]

No other party responded to that statement in testimony, but in the nonunanimous stipulation and agreement regarding certain stipulation issues, AmerenUE and Staff agreed as follows:

> e. AmerenUE shall not seek to recover from its customers the difference between the book reserve balance and the theoretical reserve balance reserve for any account. AmerenUE shall transfer $82,067,828 of the accumulated depreciation reserve from the Distributed Plant accounts to the General Plant accounts.

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[213] *In the Matter of Laclede Gas Company's Tariff to Revise Natural Gas Rate Schedules*, 13 Mo. P.S.C. 3d 215, 224 (2005)

[214] Mathis Direct, Ex. 222, Pages 9-10, Lines 15-22, 1-17.

Conclusions of Law:

Although two parties objected to other aspects of the depreciation stipulation and agreement, no party objected to this provision. The provision can be taken as an expression of the positions of the signatory parties.

Findings of Fact:

This stipulated position of Staff and AmerenUE is necessary to correct an imbalance between depreciation accounts and will have no impact on depreciation rates. It is not opposed by any party.

Decision:

The stipulated position of Staff and AmerenUE is accepted.

H. Net Salvage Percentage to Be Used for Assets in Account 322

Discussion:

In her depreciation study described in her direct testimony, Staff witness, Jolie Mathis, used a net salvage percentage for assets in Account 322 of -37 percent.[215] AmerenUE's witness, John Wiedmayer, used a net salvage percentage for that account of zero percent for his depreciation study. No other party filed testimony on this issue, but MIEC indicates its supports AmerenUE's position on this question in its brief.[216]

In the objected to stipulation and agreement described several times in this order, Staff and AmerenUE agreed this issue could be resolved by adding an additional .2 percent to the depreciation rate for Account 322, and by adding an additional .1 percent to the

[215] Mathis Direct, Ex. 222, Schedule JLM-2.

[216] Missouri Industrial Energy Consumers' Post Hearing Brief, Page 49-50.

depreciation rates of the other nuclear plant accounts. At the hearing, Mathis testified that the .2 percent figure relating to Account 322 was acceptable to Staff.[217]

Findings of Fact:

There is very little evidence in the record on this question. Two experts included different numbers in their accounting schedules with no explanation offered. The parties who offered the testimony of those two experts now agree .2 percent should be added to the depreciation rate for Account 322. In the absence of any counter-evidence, the Commission will accept the position espoused by Staff and AmerenUE.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

To account for net salvage related to interim retirements, an additional .2 percent shall be added to the depreciation rate for Account 322.

As previously indicated, in the objected-to stipulation and agreement, which the Commission cannot approve, Staff and AmerenUE agree that an additional .1 percent would be added to the depreciation rates of the other nuclear plant accounts. The depreciation rates for other accounts were not identified as a separate issue and no evidence was offered on that question. The Commission has no basis for making a decision regarding those accounts.

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[217] Transcript, Page 7351, Lines 6-10.

9. Metro East

Discussion:

On February 10, 2005, the Commission issued a Report and Order on Rehearing authorizing AmerenUE to transfer its Illinois property and customers to AmerenCIPS, its sister company under the Ameren umbrella. The parties referred to this as the Metro East order. Part of that order provided as follows:

> That AmerenUE may seek recovery in a future rate proceeding (a rate increase or excess earnings complaint) of up to 6% of the unknown generation-related liabilities associated with the generation that was formerly allocated to AmerenUE's Metro East service territory, if it proves by a preponderance of the evidence that the sum of the Missouri ratepayer benefits attributable to the transfer in the applicable test year is greater than the 6% of such unknown generation-related liabilities sought to be recovered. AmerenUE will be entitled to recover that part of the 6% that is offset by benefits directly flowing from the transfer.[218]

AmerenUE sought to recover $137,986 representing the six percent of the generation-related liabilities contemplated by the Metro East order in this rate case.

AmerenUE did not address the recovery of the $137,986 in its direct testimony. Public Counsel's witness, Ryan Kind, points that fact out in his direct testimony and asserted that AmerenUE had not shown by a preponderance of the evidence that the benefits to Missouri ratepayers from the transfer outweigh the $137,986 in costs, and therefore AmerenUE should not be allowed to recover those costs.[219]

AmerenUE responded to Public Counsel's proposed adjustment in the rebuttal testimony of Gary Weiss. Weiss testified that the benefits of the transfer far outweigh the costs to Missouri's ratepayers. He indicates fuel savings to AmerenUE's Missouri

[218] Ex. 119. The Report and Order may also be found at 13 Mo. P.S.C. 3d 266 (2005).

[219] Kind Direct, Ex. 404, Page 10, Lines 22-24, 1-5.

customers as a result of the Metro East transfer amounted to $22.3 million in the test year alone.[220]

Findings of Fact:

AmerenUE's $22.3 million in fuel savings is greater than its $137,986 in generation-related liabilities.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

AmerenUE has proved by a preponderance of the evidence that the sum of the Missouri ratepayer benefits attributable to the transfer in the applicable test year is greater than the 6% of such unknown generation-related liabilities sought to be recovered. No adjustment relating to this issue shall be made to AmerenUE's revenue requirement.

10. Class Cost of Service, Rate Design, and Tariff Issues

A. Economic Development and Retention Riders

Discussion:

AmerenUE has proposed two new tariffs relating to economic development. The Economic Development and Retention Rider (EDRR) would offer a discounted rate to new or expanding industrial customers who can show they have an option to move out of AmerenUE's service territory to an area with lower electric rates.[221] AmerenUE has also proposed an Economic Redevelopment Rider (ERR) that could be used to encourage redevelopment in defined areas within the City of St. Louis. The ERR targets areas that

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[220] Weiss Rebuttal, Ex. 012, Page 18, Lines 20-21.

[221] Mill Direct, Ex. 040, Pages 5-6, lines 18-23, 1-6.

have lost industries but already contain extensive but underutilized electric infrastructure.[222] Both the EDRR and the ERR will expire on December 31, 2008, unless the term is extended by the company and approved by the Commission. Customers who have signed up by the expiration date will continue to receive the discounted rates for five years so long as they continue to meet the requirements of the tariffs.[223] AmerenUE's shareholders are paying the cost of both programs.[224]

Staff and Public Counsel support both economic development riders. The State also generally supports the riders but urges the Commission to remove the expiration dates from the tariffs. AmerenUE replies it would like to keep the expiration date to enable it to "tweak this tariff, to adjust it to the market, to the needs."[225]

Unfortunately, MIEC, which represents the large industrial customers who are most likely to be able to take advantage of the EDRR, thoroughly dislikes the new rider. It would prefer AmerenUE instead renew a previous economic development rider, known as the EDR.[226] The EDR terminated on March 31, 2006 and was not renewed by AmerenUE.[227] MIEC believes the old EDR has many features that are more attractive to customers than the newly proposed EDRR.

Findings of Fact:

Economic development is an important goal that benefits all Missourians. It is vital that AmerenUE have workable economic development tariffs that actually help to further

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[222] Id. at Page 8, Lines 8-15.

[223] Id. at Page 8, Lines 1-6.

[224] Mill Surrebuttal, Ex. 042, at Page 2, Lines 20-21.

[225] Transcript, Page 4165, Lines 16-19.

[226] The text of the EDR is Ex. 524.

[227] Transcript, Pages 4123-4124, Lines 24-25, 1-6.

that goal. But it is also important AmerenUE's tariffs not become simple giveaways to large ratepayers, leaving residential customers to pick up the slack. MIEC does not like many features of the new EDRR, but the other concerned parties, Staff, Public Counsel and the State, including the Department of Economic Development, generally support the EDRR.

The EDRR is being funded by AmerenUE's shareholders, not ratepayers, so the Commission is willing to give the company more discretion in designing what it believes to be an appropriate economic development tariff. For that reason, the Commission will approve the EDRR and will not require AmerenUE to bring back the EDR. The Commission will, however, require AmerenUE to modify the EDRR tariff to eliminate the termination date. That is a small modification that should not create an undue burden on AmerenUE but will have a positive effect on economic development. Of course, AmerenUE will be able to modify the terms of the EDRR at any time by filing a tariff revision for the Commission's approval.

No party opposes the ERR rider and it will be approved, also without a termination date.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

The Commission will approve the Economic Development and Retention Rider (EDRR) tariff and the Economic Redevelopment Rider (ERR) tariff, provided that AmerenUE remove the termination dates from the tariffs.

B. Industrial Demand Response Program

Discussion:

AmerenUE has submitted a proposed tariff to implement a new industrial demand response pilot program known as Rider IDR. The pilot program is designed to assess whether industrial process customers are able to respond to load curtailments in exchange for a lower monthly demand charge. The Rider IDR requires customers to interrupt their use of power when they are directed to do so by the company.[228] The tariff defines the occasions when a customer could be asked to interrupt but the decision to interrupt is at the discretion of AmerenUE.[229] The Rider IDR would limit the hours available for interruption to 200 per year.[230] The customer can choose the amount of curtailable load to be included in the program.[231] The availability of the program is limited to no more than five customers with a total demand response aggregated load of 100 MW and would last for three years.[232] Customers who agree to participate in the program would be paid a demand credit of $2.00 per kW per month with an additional credit of 8 cents per kWh when interrupted.[233] This is designed to be a pilot program and AmerenUE indicates it will evaluate the results of the program but has not yet designed the evaluation methods for the program.[234]

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[228] Mill Direct, Ex. 040, Page 11, Lines 10-15.

[229] Transcript, Page 3934, Lines 2-6.

[230] Mill Direct, Ex. 040, Page 11, Lines 18-19.

[231] Id. at Page 11, Lines 15-16.

[232] Id. at Page 12, Lines 2-4.

[233] LaConte Direct, Ex. 553, Page 2, Lines 2-5.

[234] Mill Direct, Ex. 040, Page 12, Lines 19-23.

Staff and the State do not oppose the proposed IDR tariff. Public Counsel is not opposed to the concept of an IDR but is concerned that AmerenUE has not yet designed a method to evaluate the success or failure of this program, despite having filed the sample tariff with its direct testimony in July 2006.[235]

The MEG, a group of industrial users who might be inclined to sign up for this pilot program, asks the Commission to approve the IDR but with modifications to make it more attractive for potential users. The MEG asks the Commission to impose the following modifications:

(a) increase the demand credit to $3.33/kW per month;

(b) modify the start date to enable customers to sign up immediately upon Commission approval of the tariff;

(c) extend the length of the pilot to at least 3 years;

(d) require any interruption of less than an hour to be counted as an hour;

(e) require the notice period for the impending interruption to be no less than 60 minutes; and

(f) require a full evaluation of the IDR pilot at the end of the pilot period.

AmerenUE objected to all of these proposed modifications except that it agreed to modify the start date of the tariff to July 1, 2007, instead of June 1 so customers can sign up this year to allow for a full two-year evaluation of the pilot program.[236] AmerenUE indicated it is willing to consider changes to the program but since the entire program is

[235] Transcript, Page 4170, Lines 9-12.

[236] Transcript, Page 4160, Lines 9-16.

being paid with shareholder funds, it is not willing to substantially expand the program unless the cost of the program is included in rates.[237]

Findings of Fact:

The Commission is very interested in promoting the development of demand response programs. It is concerned that this IDR pilot in its current form may not be attractive to the customers most likely to participate in it. But, since the IDR Pilot is being funded by AmerenUE's shareholders, not ratepayers, the Commission is hesitant to impose additional costs on the company and will give it more discretion to design an IDR Pilot it believes is appropriate.

However, the lack of a plan for evaluating the effectiveness of the pilot plan will prevent the Commission from approving the proposed tariff at this time. Such a plan is a requirement of the Commission's Electric Utility Promotional Practices rule and the Commission is not willing to waive that rule. In any event, Mr. Mill testified it would be a good idea to have an evaluation plan in place before the tariff goes into effect.[238]

Conclusions of Law:

Commission Rule 4 CSR 240-3.150(3), the Commission's Electric Utility Promotional Practices rule provides:

> The utility shall provide the following supporting information for each promotional practice:
>
> (B) For promotional practices that are designed to evaluate the cost-effectiveness of potential demand-side resources, a description of the evaluation criteria, the evaluation plan and the schedule for completing the evaluation;

[237] Transcript, Page 4286, Lines 18-25.

[238] Transcript, Page 4171, Lines 14-17.

This regulation requires AmerenUE to file the required supporting information about its plans for evaluating the success of the IDR Pilot Program before the Commission can approve such a tariff.

Decision:

The Commission will not approve the submitted tariff that would implement an IDR Pilot Program at this time because the submitted tariff does not comply with the filing requirements of the Commission's Electric Utility Promotional Practices rule. The Commission orders AmerenUE to submit a revised tariff including an evaluation plan within 30 days from the effective date of this order. In a separate order, the Commission will open a new case to consider that revised tariff. The revised tariff does not need to be submitted as part of the compliance tariffs resulting from this report and order. As it reevaluates its proposed tariff, the Commission directs AmerenUE to consult with the other parties and to give due consideration to the revisions urged by the MEG. If AmerenUE does not file a tariff that is acceptable to all other parties, the Commission may impose the revisions urged by MEG.

The Commission is interested in promoting the use of industrial demand response programs for the purpose of reducing the demand for additional generation of electricity. These issues are being discussed in the Integrated Resource Plan (IRP) filings that are periodically made by Missouri's electric utilities. AmerenUE's IRP process is currently on going and additional demand response programs may emerge from that process. But the Commission believes that more should be done. Therefore, it will open a new investigative case for the purpose of discussing demand response programs with all of Missouri's electric utilities, as well as other interested parties. The Commission will issue a separate order opening the investigative case.

C. Essential Services Rate

Discussion:

The Missouri Association for Social Welfare (MASW) proposes AmerenUE adopt what it described as an essential services rate. The essential services rate would charge a lower rate to residential customers for the number of kilowatt hours needed to provide essential service to a typical low income resident.[239] The program would be designed to be revenue neutral for AmerenUE so higher rates would need to be charged to customers who use more kilowatt hours. MASW did not do any study of AmerenUE's particular system, but indicates that national studies have put the average usage for a low-income household at approximately 680 kilowatt hours per month.[240] MASW suggests any rate increase resulting from this case be added entirely to the block of usage above the essential use dividing line with the rates for usage below that line being held steady.[241] All residential customers would receive the benefit of this essential services rate. There would be no income eligibility requirements.

Staff and AmerenUE both opposed the proposed essential services rate. AmerenUE claims four reasons to oppose such a rate. First, there is no need for an essential services rate because other programs are available to assist low-income customers.[242] Second, the program is not well targeted in that most households in

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[239] Quinn Direct, Ex. 800, Page 4, Lines 18-20.

[240] Id. at Page 4, Lines 20-23.

[241] Id. at Pages 5-6, Lines 21-22, 1-2.

[242] Hanser Rebuttal, Ex. 024, Page 7, Lines 9-14.

AmerenUE's service territory are heated with gas rather than electricity so customers would not be able to reduce their space heating bills.[243] Third, the proposed rate would subsidize all residential customers, not just those in need.[244] And fourth, an inverted block rate such as MASW proposes could hurt low-income customers in energy inefficient housing that use more than the average amount of electricity.[245]

Findings of Fact:

MASW acknowledges that the essential services rate it has proposed is more of a concept than a specific tariff proposal.[246] There simply is not enough information before the Commission to enable it to implement an essential services rate in this case. However, the Commission is interested in further evaluating MASW's proposal. Some of the criticisms of the proposal may actually reveal its strengths. For example, since it would be available to all customers without any needs test, it might provide rate relief to low-income customers without the bureaucracy and indignity fostered by a needs-based program. It might also foster energy conservation by encouraging people to reduce their usage to stay in the lower cost block. The Commission thanks MASW for bringing this concept to its attention and encourages MASW and the other parties to give this concept further consideration before the next rate case.

Conclusions of Law:

There are no additional conclusions of law for this issue.

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[243] Id. at Page 9, 10-21.

[244] Id. at Page 10, Lines 2-10.

[245] Id. at Page 11, Lines 3-19.

[246] Transcript, Page 4091, Lines 22-24.

Decision:

There is not enough information available in this case to enable the Commission to implement an essential services rate. However, the Commission believes the concept warrants further study.

D. Safety Net Proposal

Discussion:

The safety net proposal was submitted by the Consumers Council of Missouri. The Consumers Council is a party to this case but did not present any testimony at the hearing. Instead its safety net proposal was offered by its President, Alberta Slavin, at a local public hearing held at the University of Missouri-St. Louis on January 8, 2007. In her sworn testimony, Ms. Slavin indicated concern about the extensive and extended customer outages resulting from severe thunderstorms in July 2006, followed by a severe ice storm in December of that year. She urged the Commission to require AmerenUE to adopt a Safety Net Program modeled after a program implemented by Pacific Gas and Electric in California.

As an exhibit to her testimony, Ms. Slavin submitted a brochure from Pacific Gas and Electric describing its Safety Net program. The brochure indicates Pacific Gas and Electric will provide payments of $25 to $100 to residential customers who were left without power after a severe storm.[247] Neither Ms. Slavin, nor the brochure, provide any further details about the Safety Net program. The Consumers Council's attorney emphasized at the

[247] Ms. Slavin's testimony may be found at Volume 6 of the Transcript, Pages 64-74.

hearing that the funds to pay for the program should come from AmerenUE's shareholders, not its ratepayers.[248]

AmerenUE opposes the proposal, arguing that the limited record is insufficient to allow the Commission to adopt the proposal. The company also points out the proposal does not distinguish between outages caused by natural events and those that may be the fault of the company. AmerenUE contends that it should not be penalized for natural disasters that are beyond its control. AmerenUE further argues there is no evidence in the record for this case to indicate that AmerenUE's restorations efforts after the storms were inadequate.

Findings of Fact:

The Commission finds there is not sufficient evidence in the record to justify imposing a program of this sort on AmerenUE.

Conclusions of Law:

Any decision of this Commission must be supported by competent and substantial evidence on the record as a whole.[249] A pamphlet issued by a utility in California describing a program by which that utility gives money to its customers, unsupported by any other evidence, is not substantial evidence to justify the imposition of such a program on AmerenUE.

Decision:

The Commission shall not require AmerenUE to implement a Safety Net program of the type described by the Consumer Council of Missouri.

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[248] Transcript, Page 3385, Lines 5-8.

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

E. Wind Power

Discussion:

AmerenUE has committed to adding 100 MW of wind power to its generating fleet by 2010.[250] On January 31, 2007, AmerenUE issued a Request for Proposal for a minimum of 100 MW of wind generation. AmerenUE intends to bring this new generation on line by late 2009 or early 2010.[251] Staff and the Missouri Department of Natural Resources support the efforts AmerenUE has made to obtain wind generation capacity, but urge the company to do more.[252] No party has made any request for an adjustment to AmerenUE's revenue requirement relating to wind power, nor has any party requested the Commission make any sort of decision or order about this issue.

F. Demand Side Management

Discussion:

Demand Side Management is the concept of reducing the need for additional generation by reducing the demand for electricity. The Commission's integrated resource planning rules require AmerenUE to consider demand side management as part of its resource management planning process. AmerenUE is currently working with various stakeholders in preparing to file its next integrated resource plan in February 2008 and demand side management programs will be a part of that process. In order to guide AmerenUE in that process, the Department of Natural Resources proposes the Commission set demand side management targets for AmerenUE to attain through the

[250] Moehn Direct, Ex. 035, Page 17, Lines 12-13.

[251] Barbieri Surrebuttal, Ex. 043, Page 4, Lines 7-8.

[252] Wilbers Direct, Ex. 650, Pages 13-14, Lines 19-23, 1-6.

integrated resource planning process. The Department of Natural Resources suggests AmerenUE be given a goal of reducing peak demand and energy growth by:

10 percent in 2009/2010;

15 percent by 2011-2012;

20 percent by 2013/2014; and

25 percent by 2015/2016.[253]

Staff supports those goals but is concerned they may be unreasonably low. AmerenUE does not oppose the proposed goals and indicates much greater reductions may be achieved in the future.[254] Staff and the Department of Natural Resources agree these goals should be reassessed in the upcoming IRP process.

The Department of Natural Resources also proposes AmerenUE commit at least $10 million annually, rising to one percent of AmerenUE's Missouri annual sales revenue, or a minimum of $20 million by 2010, to implement energy efficiency programs.[255] AmerenUE responded by indicating it believes its final spending level should be determined through the integrated resource planning process. It did, however, commit to spending $13 million on demand side management programs, ramping up to $20 million by 2010.[256] The Department of Natural Resources was concerned that AmerenUE's spending proposal would include both demand response measures as well as energy efficiency measures, believing that its proposed amounts should be spent just on energy efficiency with additional amounts to be spent on demand response measures.

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[253] Wilbers Direct, Ex. 650, Pages 7-8, Lines 21-22, 1.

[254] Moehn Direct, Ex. 035, Page 16, Lines 12-14.

[255] Wilbers Direct, Ex. 650, Page 8, Lines 6-9.

[256] Moehn Surrebuttal, Ex. 037, Page 28, 16-20.

Staff does not believe a specific dollar amount of funding for demand response measures should be required, instead the cost-effectiveness of the programs that are implemented should be the guiding principle.[257]

Findings of Fact:

The Commission finds that demand side management programs must be a vital part of AmerenUE's resource mixture. The Commission agrees that the setting of demand side management targets for AmerenUE to attain through the integrated resource planning process is reasonable. Since no party opposes the setting of such goals, the Commission will establish them.

AmerenUE has already made a commitment to expand its spending for energy efficiency measures. The Department would like to see that funding increased still more. The Commission certainly encourages AmerenUE to increase its demand side management and energy efficiency spending; but in keeping with Staff's recommendation, it will not require AmerenUE to meet a specific goal for such spending. The Commission expects AmerenUE to comply with, and if possible, exceed the goals it has already set for itself.

Conclusions of Law:

The Policy Objectives section of the Commission's integrated resource planning rule, 4 CSR 240-22.010(2), requires a utility to:

> (A) Consider and analyze demand-side efficiency and energy management measures on an equivalent basis with supply-side alternatives in the resource planning process.

[257] Mantle Rebuttal, Ex. 221, Page 3, Lines 6-16.

Decision:

AmerenUE is given a goal of reducing peak demand and energy growth by:

10 percent in 2009/2010;

15 percent by 2011-2012;

20 percent by 2013/2014; and

25 percent by 2015/2016.

G. Low Income Programs

Discussion:

As a result of the stipulation and agreement that resolved Staff's last rate complaint against AmerenUE, the company agreed to initiate a low-income weatherization program. That program is currently funded by AmerenUE at an annual level of $1.2 million. The Department of Natural Resources recommends the program continue to be funded at that level.[258] Staff recommends AmerenUE shareholders provide $600,000 of that funding, with the other $600,000 recovered from ratepayers.[259]

AmerenUE contends it is under no obligation to continue funding the low-income weatherization program. However, it is willing to pay the $600,000 recommended by Staff as a component of its proposal for implementation of a fuel adjustment clause.[260]

Staff and the Department of Natural Resources also agree that AmerenUE should include the program in its tariff and use up to $120,000 of the program funding to do a process and impact evaluation of the weatherization program. AmerenUE accepts those recommendations.

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[258] Wilbers Direct, Ex. 650, Page 12, Lines 4-6.

[259] Mantle Rebuttal, Ex. 221, Page 4, Lines 21-23.

[260] Mark Surrebuttal, Ex. 039, Page 3, Lines 7-11.

Findings of Fact:

Richard Mark, testifying for AmerenUE, agreed the weatherization program has been successful and should continue to be supported by AmerenUE.[261] So all the parties agree the program should be continued. However, AmerenUE appeared to make its promise of future support contingent upon the Commission approving its request for a fuel adjustment clause. The Commission denies that request in this order.

Conclusions of Law:

No additional conclusions of law are made for this issue.

Decision:

AmerenUE and its customers would benefit from continuation of the low-income weatherization program. The Commission assumes that AmerenUE really did not intend to hold those low-income customers hostage to try to force this Commission to grant it a fuel adjustment clause. Therefore, the Commission directs that the low-income weatherization program continue with funding provided $600,000 by ratepayers and $600,000 by AmerenUE's shareholders. In addition, AmerenUE shall include the program in its tariff and use up to $120,000 of the program funding to do a process and impact evaluation of the weatherization program.

H. Voluntary Green Power Program

Discussion:

AmerenUE has proposed a tariff that would implement a Voluntary Green Program. This program would allow AmerenUE's customer to purchase and retire Renewable Energy Certificates (RECs). A REC is defined as the environmentally beneficial component of

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[261] Transcript, Page 1669, Lines 6-8.

renewable energy and is equivalent to 1,000 kilowatt hours.[262] The REC does not actually deliver a renewable energy commodity to the customer or to the AmerenUE system. Customers who sign up for the program will be billed an additional 1.5 cents per kilowatt hour for their total monthly usage, plus any add-on taxes.[263]

The Department of Natural Resources supports AmerenUE's proposal, but Staff objects, arguing AmerenUE should be putting its resources into actually producing renewable energy rather than providing a way for customers to buy RECs.[264] Staff is also concerned customers would be confused about what they are actually buying when they purchase a REC.[265]

Findings of Fact:

The sale of RECs is not a substitute for the actual generation of power from renewable resources. But building renewable-powered generation takes time and the implementation of the plan to sell RECs can be implemented almost immediately.[266] There is some risk of confusion among customers who are not familiar with the concept of a REC, but the program is voluntary and AmerenUE has engaged the services of an experienced company to perform customer education and marketing for the program.[267] The Commission finds that the plan to facilitate the sale of RECs is reasonable and is unlikely to cause undue confusion among AmerenUE's customers.

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[262] Mill Direct, Ex. 040, Page 13, Lines 6-8.

[263] Id. at Page 13, Lines 21-23.

[264] Mantle Rebuttal, Ex. 220, Page 1, Lines 22-29.

[265] Id. at Page 3, Lines 3-5.

[266] Barbieri Surrebuttal, Ex. 043, Page 3, Lines 3-6.

[267] Mill Direct, Ex. 040, Page 13, Lines 8-10.

Conclusions of Law:

No additional conclusions of law are made for this issue.

Decision:

AmerenUE's tariff implementing a Voluntary Green Program shall be approved.

Taum Sauk Regulatory Capacity

Discussion:

Public Counsel has attempted to raise one additional issue. In the Revised True-Up Reconciliation filed on April 19, 2007, Public Counsel for the first time proposed a $10,320,000 reduction to AmerenUE's revenue requirement for what Public Counsel called "Taum Sauk Hold Harmless – Capacity Sales. In a single paragraph at the end of its post-hearing brief, Public Counsel asserted this issue arose for the first time at the hearing, when the parties allegedly learned AmerenUE's commitment to hold ratepayers harmless with respect to the failed Taum Sauk plant did not account for the potential sale of regulatory capacity associated with that plant. The brief indicates: "Public Counsel calculated a value for that capacity using UE's value for regulatory capacity of $2.00/kw month, and a capacity value for Taum Sauk of 430 MWs."

AmerenUE filed its brief the day before on April 20, so it could not respond to Public Counsel's newly raised issue in that brief, although it did manage to insert a footnote reacting to the inclusion of new adjustment in the reconciliation. No reply briefs were scheduled; so in order to allow AmerenUE and the other parties an opportunity to respond, the Commission issued an order on May 4 directing any party wishing to offer additional arguments regarding the Taum Sauk Regulatory Capacity issue do so no later than 12:00 Noon on May 9.

AmerenUE filed a response on May 9, including a motion to strike the portions of Public Counsel's brief dealing with this matter. The State also filed a response on May 9 supporting Public Counsel's position. Public Counsel did not file any further argument on May 9, but on May 17, it filed a reply to AmerenUE's response, again arguing for an adjustment relating to the capacity question. AmerenUE responded later on May 17 with a motion to strike Public Counsel's response. Public Counsel filed a response to that motion on May 18, and AmerenUE replied to Public Counsel's response on May 18.

AmerenUE contends Public Counsel's newly proposed adjustment is far out-of-time and violates the Commission's rules and its procedural order for this case. The Commission agrees. Public Counsel's proposed adjustment regarding sales of regulatory capacity should ordinarily have been raised as part of its case in chief in its direct testimony filed in December 2006.[268] However, Public Counsel argues that it did not learn that AmerenUE is making capacity sales until the hearing.

Commission rule 4 CSR 240-2.130((8) provides in part: "A party shall not be precluded from having a reasonable opportunity to address matters not previously disclosed which arise at the hearing." But AmerenUE disputes Public Counsel's assertion that these matters first arose during the hearing, contending Public Counsel could have been aware of the facts needed to raise this issue months before the hearing.

AmerenUE also disputes the factual basis for the numbers Public Counsel uses to support the calculation of its proposed $10 million adjustment. Public Counsel's calculation assumes regulatory capacity from the Taum Sauk plant could have been sold for $2.00 per kW month, a value appropriated from the price included in AmerenUE's proposed industrial

[268] Commission Rule 4 CSR 240-2.130(7).

demand response program, the Rider IDR discussed earlier in this Report and Order. It also assumes the entire capacity of the Taum Sauk plant would have been available for sale for the entire year, another fact for which there is no supporting evidence in the record.

At this point, very late in this proceeding, it is far too late for the Commission to gather the evidence needed to make any findings of fact or conclusions of law regarding these questions. If Public Counsel had actually raised this issue at the hearing when it says it first became aware of the issue, the Commission might have been willing to allow Public Counsel, AmerenUE, and the other parties a reasonable opportunity to present additional evidence on that question, as indicated in the Commission's procedural rule. It might even have been possible to schedule an additional day of hearings to consider that issue. But instead, Public Counsel waited until it filed its brief, over 20 days after hearing ended and the evidentiary record closed, to spring this issue on the Commission and the other parties.

As the Commission indicated earlier in this order when discussing the Safety Net proposal offered by the Missouri Consumers Council, any decision by this Commission must be supported by competent and substantial evidence on the record as a whole. There is insufficient competent and substantial evidence in this record to support Public Counsel's proposed adjustment. The Commission cannot just assume that evidence into existence without giving AmerenUE and the other parties an opportunity to rebut that evidence. To do so would deny AmerenUE, and the other parties, their constitutionally protected due process rights and would likely lead a reviewing court to reverse this Report and Order. The Commission cannot make the Taum Sauk regulatory capacity adjustment proposed by Public Counsel.

AmerenUE has made a commitment to hold the public harmless from the effects of the Taum Sauk disaster, and the Commission intends to hold it to that commitment. Based on Public Counsel's allegations, it appears AmerenUE could be making additional sales of regulatory capacity if not for the loss of Taum Sauk's capacity. Unfortunately there is no way, based on the record in this case, to calculate the amount of adjustment that should be made to AmerenUE's income to account for that loss of capacity.

While the Commission cannot make that adjustment in this case because of insufficient evidence in the record, it will direct its Staff to investigate whether ratepayers are being held harmless from the Taum Sauk disaster, especially with regard to lost regulatory capacity sales. If Staff finds that such regulatory capacity sales have been lost, it shall propose an appropriate adjustment in AmerenUE's next rate case or other action as it believes appropriate.

IT IS ORDERED THAT:

1. The Motion to Dismiss filed by the Office of the Public Counsel is denied.

2. The tariff sheets filed by Union Electric Company d/b/a AmerenUE on July 7, 2006, and assigned tariff number YE-2007-0007, are rejected.

3. 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. AmerenUE shall file its compliance tariff no later than May 28, 2007.

4. Beginning on January 1, 2007, all SO_2 premiums, net of SO_2 discounts, shall be accounted for in FERC USOA Account 254, a regulatory liability account. All gains associated with SO_2 allowance sales, beginning on January 1, 2007 shall also be recorded in the same regulatory liability account. The net balance of the SO_2 premium expenses (or

discounts) and corresponding gains associated with SO_2 allowance sales shall be addressed as part of the fuel expense calculation in AmerenUE's next rate proceeding.

6. Union Electric Company d/b/a AmerenUE shall keep a separate accounting of its amounts accrued for recovery of its initial investment in plant from the amounts accrued for the cost of removal.

7. Any pending motions that the Commission has not specifically ruled upon are denied.

8. This report and order shall become effective on June 1, 2007.

BY THE COMMISSION

Colleen M. Dale
Secretary

(S E A L)

Davis, Chm., Murray, and Appling, CC., concur;
Clayton, C., concurs, concurring opinion to follow;
Gaw, C., dissents, dissenting opinion to follow;
and certify compliance with the provisions of
Section 536.080, RSMo 2000.

Dated at Jefferson City, Missouri,
on this 22nd day of May, 2007.