

additional electric appliances, and perhaps most significantly the widespread use of air conditioning continued to fuel reliable load growth year after year. Finally, in the 1980's and 1990's, the introduction of electronic devices and big screen TVs resulted in continued load growth.

However, in recent years, the electric industry has experienced a sea change. Electric utilities now operate in an environment with little or no load growth, persistent moderate inflation, the need to replace and modernize aging infrastructure, increasing customer expectations and rapidly-evolving technology that could materially change the landscape for vertically-integrated utilities.

The rules that worked in 1913 are no longer sufficient to facilitate optimal service for customers and allow utilities to ramp up needed investments and at the same time protect their financial integrity over the long run. In short, there is no question that the existing regulatory framework needs to be updated to address these modern challenges and opportunities if Missouri is to keep up with other states.

Ameren Missouri looks forward to actively participating in this proceeding and engaging with other stakeholders in workshops in an effort to address these issues. We are interested in presenting our positions, but equally interested in hearing the positions of others. Our belief is that the current system of regulation benefits no one over the long term, and we are hopeful that some consensus can be reached to take steps to modernize Missouri's regulatory framework for the benefit of all.

The Fundamental Problem

From Ameren Missouri's perspective, the fundamental problem with Missouri's existing regulatory framework is simple: Missouri sets rates for future periods based on historical data. Specifically, Missouri uses costs and revenues from an historical test year, with some updates through a true-up period, to set future rates. But in most cases, the test year ends more than a year before new rates take effect, and even the true-up period ends at least five or six months before the effective date of new rates. As discussed further below, utilization of a true-up period, even if it is within five or six months of the effective date of new rates, still means that there will be tremendous regulatory lag associated with capital investments in the electric utility's system, often spanning a period of years, not months.

The impact of this process may be obvious, but it is worth stating. If the electric utility experiences inflation, particularly with flat or declining load growth, setting rates based on historical expenses will cause the utility's rates to be inadequate to cover its future expenses. Such a shortfall can never be made up. It is a permanent loss to the utility.

With regard to capital investments, the impact of utilizing historical data to set future rates creates an even bigger problem for electric utilities. Electric utilities are permitted to accrue an Allowance for Funds Used During Construction (AFUDC), which compensates them for their investment during the period that a capital item is being constructed. But once construction is complete and the capital item is placed "in-service," all compensation for the cost

of the capital ceases until the next rate case is completed and the item can be reflected in rates, often years later. Even worse, upon being placed “in-service,” capital items immediately begin to depreciate, generating depreciation expense not reflected in the utility’s rates and that reduces the utility’s earnings dollar-for-dollar. Consequently, the electric utility is not compensated for the cost of this depreciation between rate cases, and ultimately only the depreciated portion of the cost of the capital item is included in rates. In effect, customers receive a new capital asset but they only pay the cost of a used capital asset. Again, this under-recovery of cost is never made up.

As stated, these losses incurred between rate cases were previously offset by increases in revenues due to load growth between rate cases. But in the electric industry of today and, we believe, of tomorrow, with little or no load growth, the playing field is tilted sharply and inappropriately against the ability of electric utilities to recover their costs.

This framework also provides electric utilities with a powerful financial incentive to constantly cut expenses and capital investment. This does provide a good incentive to manage costs, but it is not sustainable over the long run. It does not facilitate the replacement of aging infrastructure or ramping up of investment to enhance service or offer the benefits of improved technology to existing customers, particularly when the limited pool of capital is also required to be spent to meet increasing environmental and other mandates. In the long run, the existing regulatory framework will not serve the interests of utilities, customers or the state of Missouri as we grapple with the many issues we are facing now and in the future.

One Problem, Many Possible Solutions

Missouri is not alone in facing the problem of having to address modern-day issues with a century-old regulatory structure. Many state public service commissions were created in the same era, and most had similar enabling statutes which set rates based on a backward look at costs and revenues. But for the most part, other states have taken concrete steps to modernize their regulatory frameworks. Some of the methods other states have used are as follows:

- **Allowing Construction Accounting/Plant-in-Service Accounting** — Allows the electric utility to defer the return and depreciation associated with a capital asset from the time it is placed in-service until it can be reflected in rates so that the permanent losses discussed earlier are eliminated. Missouri has occasionally allowed construction accounting on an ad hoc basis for unusually expensive capital items, such as a generating plant or a coal plant scrubber. The Commission has thus far rejected proposals to apply plant-in-service accounting more broadly.
- **Trackers/Riders** — Some jurisdictions have allowed frequent use of trackers and riders to address infrastructure investment and/or specifically identified expenses. The Commission has allowed limited use of trackers, primarily to address changes in pension expenses and the cost of complying with new safety regulations. Riders are limited to those expressly allowed by statute, currently limited to the Fuel Adjustment Clause (FAC), energy efficiency costs and a few other costs.

- Projected/Partially-Projected Test Year — Many states set rates based on a projected or partially-projected test year, to align rates more closely with the costs that are actually being incurred during the period when the rates apply. Missouri is prohibited by statute from setting rates based on plant investment before the plant is “fully operational and used for service.” There is no statutory prohibition against utilizing projected expenses to set rates, but so far the Commission has not done so.
- Interim Rates — Many states and the Federal Energy Regulatory Commission (FERC) reduce regulatory lag by regularly allowing interim rates to recover the cost of capital investments, or other costs, in rates during the pendency of a rate case. The Commission has historically utilized a standard for considering interim rates that is so stringent that, in practice, interim rates have simply not been available.
- Including CWIP in Rate Base — Construction Work in Progress, or CWIP, is the money that is spent on capital items until the capital item is placed in-service. Many states and the FERC allow CWIP to be included in rate base, which reduces the financial penalty for capital investment. Current Missouri statutes prohibit the Commission from including the cost of electric plant in rate base until it is fully operational and used for service, which effectively prevents CWIP from being included in rate base.

Almost every state uses at least one of these mechanisms. In fact, the map attached hereto shows that Missouri is one of only a few states that does not allow CWIP in rate base, or have a projected (or partially-projected) test year, or have an electric infrastructure system replacement surcharge.

Missouri has already taken some steps to address regulatory lag for water and gas utilities. Both types of utilities have been authorized by statute to implement Infrastructure System Replacement Surcharges—riders that allow them to change rates in between rate cases to reflect the cost of certain types of infrastructure improvements. In addition, gas utilities have been permitted to implement a rate design that collects most fixed costs in the customer charge and the first block of usage, which has much the same impact as decoupling. But these measures have not been authorized for Missouri electric utilities.

In the 2016 Missouri legislative session, Ameren Missouri and the other electric utilities in the state supported a more comprehensive approach through legislation that would have enabled the use of performance-based rates (PBR) for a 10-year period, similar to PBR programs enacted in several other states, including Illinois and Arkansas. PBR would not only have solved the problem utilities face in making investments due to regulatory lag, but also would have provided significant benefits to customers. Among other things, the bill provided for:

- Annual and multi-year average revenue caps;
- Earnings caps for the utility, with a timely return of any over-earnings to customers;
- Performance metrics;
- Transparency in capital spending for utilities; and

- Annual review of rates by the Commission.

If enacted, this legislation would have enabled electric utilities to make significant investments in their infrastructure in the current low interest rate environment, enhance the reliability of their systems, replace aging infrastructure, create and retain thousands of jobs in the state and position Missouri for economic development in the future. Although the bill achieved wide support among many groups, it ultimately was not passed. Ameren Missouri continues to support this type of comprehensive approach as one solution to the issues that we face, but we are also open to other solutions that may address the problem.

Chairman Hall's Proposed Solution

Chairman Hall has been engaged and helpful in trying to find a path forward in this area. As part of this working docket, Chairman Hall filed a thoughtful proposal for workshop participants to consider. Under this proposal, electric utilities would file a “full-scale” rate case every three years and, subject to Commission approval, could file annual 7-month Rate Case Adjustment cases in the years in between. The shorter cases would not adjust rate of return, capital structure or ROE. There would be 3-5% rate adjustment caps for each rate class, the Commission would be permitted to establish performance incentives and disincentives, and the utilities would be required to present capital investment plans for the next 1, 5 and 10 years.

We appreciate Chairman Hall's willingness to think outside the box (of existing regulation) in putting together this proposal, but we are concerned that it does not address the underlying problem of regulatory lag. Since there would be no true-up in the 7-month Rate Case Adjustment cases, we do not believe that regulatory lag would be ameliorated by that proposal. Specific numbers help illustrate this issue. In the shorter 7-month rate case process, cost data from at least three months prior to the filing would have to be used to set rates. That cost data would be 10 months stale by the time the new rates took effect. That would be the shortest amount of regulatory lag that could be experienced under this proposal for the 7-month, mini-rate cases. But, the full period of regulatory lag would extend back to the cut-off date for data used to set rates in the previous rate case—in the case of annual 7-month rate cases, 12 months prior to that. So the full period of regulatory lag under Chairman Hall's proposal would be from 10 months to 22 months (prior to the effective date of new rates), or an average of 16 months.

In contrast, consider the regulatory lag experienced by an electric utility filing rate cases under the current regulations (with a true-up) every 15 months, which has been the average time between rate cases filed by Ameren Missouri over the last decade or so. With a true-up, a traditional rate case permits cost data within 5 months of the effective date of rates to be used. Five months is the shortest amount of regulatory lag that is experienced under that model. The longest amount of regulatory lag that could be experienced is back to the true-up date for the previous rate case. Assuming a rate case is filed every 15 months, that true-up date would be 20 months prior to the effective date of rates in the next case. The full period of regulatory lag under these assumptions would be from 5 months to 20 months, or an average of 12.5 months—less than the average regulatory lag under Chairman Hall's proposal.

Ameren Missouri is also concerned about the imposition of hard caps on rates, with no exceptions, that would potentially require electric utilities to absorb prudently-incurred costs that might be completely outside their control as the price for reducing regulatory lag so that other prudently-incurred costs can be recovered.

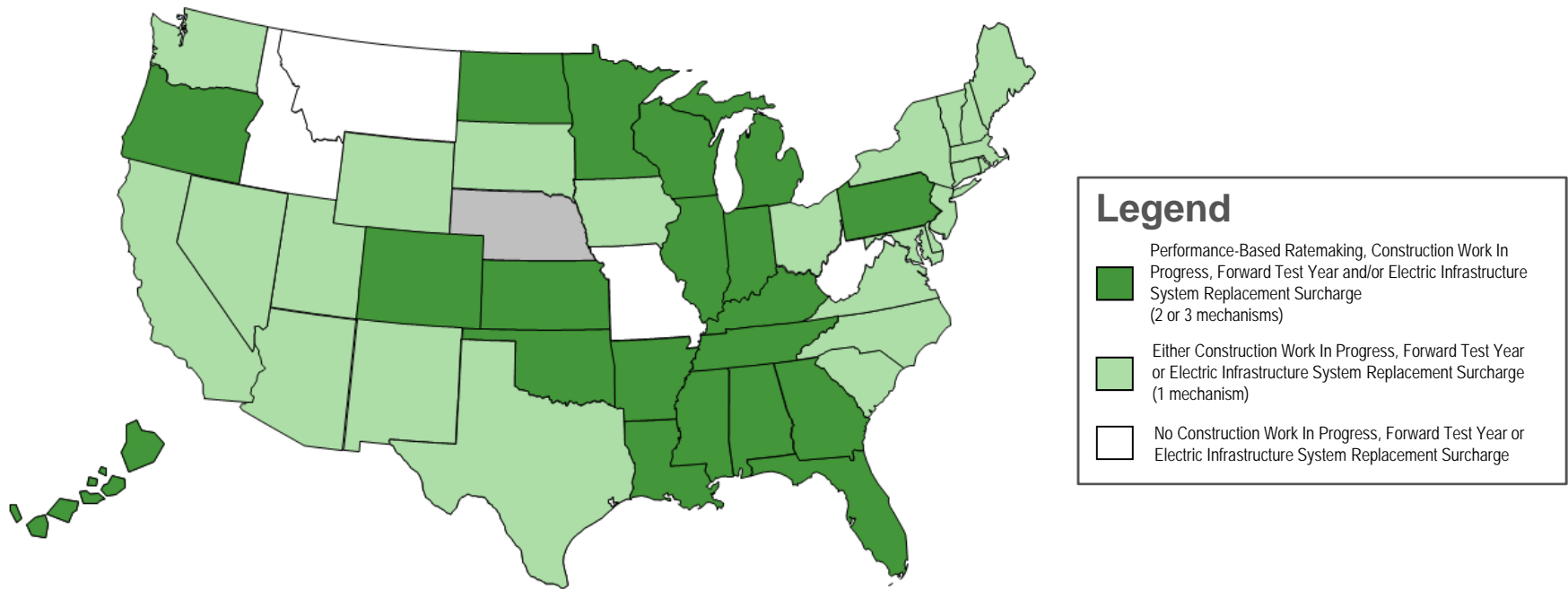
Chairman Hall's proposal provides a valuable tool to help aid the discussion about regulatory lag and possible solutions. A shortened rate case process for some rate cases with limited issues certainly could be part of the solution. Multi-year rate plans have been successfully adopted in other states, including, most recently, Minnesota. Commission-approved performance incentives and disincentives, and transparency about capital investments, which are included in Chairman Hall's proposal, also appear to be promising components. Even rate caps, properly qualified, could be a reasonable part of any regulatory reform. We look forward to discussing this proposal, and other proposals that may be put forward by workshop participants.

In summary, Ameren Missouri is eager to actively participate in the workshops that the Commission has scheduled. We believe that this is a timely opportunity to address emerging issues that are critical to regulators, customers and utilities, and that impact the long-term economic viability of the state. We are optimistic that stakeholders, working together in good faith, can make progress to improve the regulatory framework in Missouri to the ultimate benefit of all.

Respectfully submitted,

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State Comparison of Electric Utility Mechanisms for Infrastructure Investments



Source: Edison Electric Institute, Pacific Economics Group Research and Ameren analysis.

