

FILED
December 03, 2008
Data Center
Missouri Public
Service Commission

Exhibit No.: 062
Issue(s): Policy
Witness: Thomas R. Voss
Sponsoring Party: Union Electric Company
Type of Exhibit: Rebuttal Testimony
Case No.: ER-2008-0318
Date Testimony Prepared: October 14, 2008

MISSOURI PUBLIC SERVICE COMMISSION

Case No. ER-2008-0318

REBUTTAL TESTIMONY

OF

THOMAS R. VOSS

ON

BEHALF OF

**UNION ELECTRIC COMPANY
d/b/a AmerenUE**

**St. Louis, Missouri
October, 2008**

UE Exhibit No. 2
Case No(s) ER-2008-0318
Date 11-20-08 Rptr XF

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- Approval of a reasonable return on equity (“ROE”), commensurate with the ROEs authorized for other integrated electric utilities in this state and throughout the country is critical to maintaining AmerenUE’s financial stability.
- Permitting the Company to utilize a reasonable fuel adjustment clause (“FAC”) as proposed by the Company and without an unusual cost sharing mechanism, is necessary to address the chronic problem the Company has faced and will continue to face in receiving full and timely recovery of its fuel costs. Approval of such an FAC is absolutely critical to the Company’s ability to compete for the capital it needs with the vast majority of other electric utilities that are permitted to recover their fuel costs on a timely basis.
- The Company has listened to the concerns expressed by the Commission and its customers relating to improving the reliability of its system. The Company took a leadership role in the development of the Commission’s new vegetation management, infrastructure inspection and repair, and reliability rules. The Company is complying with those rules, and should be permitted to use the trackers contemplated by the Commission’s rules and recently authorized for The Empire District Electric Company (“Empire”) to allow the Company to recover its compliance costs, while also protecting customers from any variation in the level of those costs.

1 • The Company has also listened to the Commission respecting the
2 structure of its incentive compensation programs, which are important
3 components of compensating and motivating its employees, and which
4 provide direct benefits to customers. Those programs have been
5 largely disconnected from Company earnings, and meet the
6 Commission's criteria for inclusion in rates. Consequently, the
7 Company's incentive compensation costs should be allowed in rates.

8 **Q. In your direct testimony, you cited rising costs, the need for AmerenUE to**
9 **invest in infrastructure, and regulatory lag as challenges that the Company faces. Do**
10 **the positions reflected in the Staff's Report and other direct testimonies filed in this case**
11 **adequately address those challenges?**

12 A. No they do not. Many of the positions in other parties' direct cases reflect
13 recommendations that are significantly outside of the mainstream. If adopted by the
14 Commission, these recommendations would undermine AmerenUE's financial stability,
15 compromise its ability to make needed investments in infrastructure, and ultimately hurt
16 customers in the long run. For example, Staff's 9.5% return on equity ("ROE")
17 recommended for AmerenUE is materially below the ROEs authorized by this Commission
18 for other electric utilities in recent cases. Very recently the Commission authorized a 10.8%
19 ROE for Empire, and in the recent past ROEs of 10.25% and 10.75% were authorized for
20 Aquila, Inc. ("Aquila") and Kansas City Power & Light Company, respectively. The return
21 recommended by the Staff is also materially lower than the average ROE (10.62%)
22 authorized for integrated utilities throughout the country over the 12 months ending August,

1 2008 as reported by Regulatory Research Associates (now SNL), the data base used by the
2 Commission in previous cases in determining a reasonable ROE.

3 **Q. Are you a rate of return expert?**

4 A. No I am not, but the Company's ROE expert, Dr. Roger Morin, addresses this
5 issue in detail. I understand that rate of return experts, including Dr. Morin, rely on
6 complicated analyses, such as the discounted cash flow ("Dcf") analysis and the CAPM
7 analysis, in arriving at their recommended ROEs. I also understand that the results these
8 experts reach can vary considerably, depending on the specific analyses they choose to rely
9 on, the weight they choose to assign to each analysis, and the inputs they choose for each
10 analysis. Having said that, although I am not qualified to critique the details of these experts'
11 analyses, it is clear to me from my position as President and CEO of the Company that the
12 final ROE adopted by the Commission must be in the mainstream of ROEs approved for
13 similar utilities in Missouri and other states.

14 **Q. Why is it clear to you that adoption of a reasonable ROE that is in the**
15 **mainstream is important?**

16 A. AmerenUE must compete for capital with other utilities. If its authorized
17 ROE is materially below the ROEs awarded to other similar utilities it will be at a
18 disadvantage in obtaining the capital it needs to continue to maintain and improve its
19 infrastructure. This is a particularly important consideration in the current environment
20 where AmerenUE needs to invest significantly in its system. We have budgeted capital
21 expenditures of approximately \$1 billion per year for 2008 and 2009, and other electric
22 utilities with whom we compete for capital are undertaking similar capital programs. See
23 Schedule TRV-E3-1, attached to my direct testimony. Moreover, in the not-too-distant

1 future, AmerenUE is likely to need access to capital to build additional baseload generation.
2 If the Company is to be able to access the capital it needs at a reasonable cost, it must be
3 provided fair regulatory treatment, similar to that provided to other utilities. A 9.5% return
4 on equity does not come close to meeting this standard.

5 **Q. Does the turmoil that is currently affecting capital markets make it more**
6 **difficult for AmerenUE to access capital on reasonable terms?**

7 A. Absolutely. As explained in detail in the rebuttal testimonies of AmerenUE
8 witnesses Michael G. O'Bryan and Gary M. Rygh, the current turmoil in the capital markets
9 is detrimentally impacting access to capital for many companies, particularly those like
10 AmerenUE with large capital needs and credit ratings that have already been eroded.
11 AmerenUE is currently unable to issue commercial paper, and has experienced difficulty in
12 accessing credit from other sources. These problems in accessing capital are very real for
13 AmerenUE.

14 **Q. The Staff, Office of the Public Counsel and two other intervenors oppose**
15 **the Company's proposed FAC. Do you have any response to their testimony on this**
16 **issue?**

17 A. Yes. As AmerenUE witness Martin J. Lyons, Jr.'s testimonies show, again
18 these parties have taken a position that is detrimental to AmerenUE, and outside the
19 mainstream of regulation in this state and other states. In Missouri, both of the other electric
20 utilities that are eligible to seek an FAC have been granted one similar to the FAC
21 AmerenUE has requested. In other states, most utilities have either been restructured and
22 allowed to flow through their cost of power, or remained integrated and been permitted to use
23 an FAC. As shown in Schedule MJL-RE8 attached to Mr. Lyons' rebuttal testimony, 85 of

1 94 non-restructured electric utilities in the U.S. are currently using an FAC. Even for coal-
2 dependent utilities in the Midwest, the use of FACs has become almost universal practice.

3 **Q. What is the harm in not permitting AmerenUE to use a fuel adjustment**
4 **clause, like the other electric utilities?**

5 A. As explained in Mr. Lyons' direct testimony, AmerenUE's fuel costs are
6 increasing significantly from year to year. Because of the delays inherent in the rate case
7 process, which the Commission itself has recognized to be time-consuming, AmerenUE has
8 literally no opportunity to recover its actual fuel costs without an FAC. Our last rate case
9 provides a good example of this problem. In that case, AmerenUE filed for increased rates in
10 July, 2006. Due to contractual increases in coal and transportation costs, AmerenUE's
11 overall fuel costs increased effective January 1, 2007. However, rates reflecting this step-up
12 in costs did not take effect until June, 2007. As a consequence, for the period from January,
13 2007 through June, 2007 AmerenUE had no way to recover this material cost increase. The
14 under-recoveries related to rate case timing issues and the impact of these under-recoveries
15 on the Company's earnings are significant, as outlined in Mr. Lyons' rebuttal testimony. As
16 Mr. Lyons also points out, this is a continuing problem, which has and will result in large
17 under-recoveries of fuel costs in 2008 and in part of 2009, and even larger under-recoveries
18 in 2010, even if the Company files rate case after rate case. Because under the traditional
19 rate case process this delay is unavoidable, an FAC is necessary so that the Company and its
20 customers can be sure that the actual costs of fuel will be reflected in rates—no more and no
21 less.

22 The harm AmerenUE suffers from not having this commonly used rate
23 mechanism is again that its financial position is compromised, and it has more difficulty than

1 other utilities in accessing capital as explained in the rebuttal testimony of Messrs. O'Bryan
2 and Rygh.

3 **Q. Noranda witness Donald Johnstone suggests that if there are concerns**
4 **about AmerenUE's financial position, those should be addressed in some separate**
5 **proceeding and that an FAC is not needed to address them. Do you agree?**

6 A. No, I do not. The financial challenges facing the Company today, and over
7 the next few years, relate to the chronic problem we have faced and will continue to face
8 without an FAC in receiving full and timely recovery of our fuel costs, timely recovery of the
9 investments we are making in our system, and the general challenge regulatory lag is posing
10 for us and other electric utilities in the rising cost environment in which we are operating
11 today. Fair and reasonable regulatory treatment, including granting a reasonable ROE, an
12 FAC, and otherwise addressing regulatory lag when deciding rate cases, will go a long way
13 toward addressing the financial challenges the Company faces today and in the next few
14 years. We don't need a separate proceeding – we need fair treatment in this rate case,
15 including the receipt of permission to use an FAC, as has been given to Empire and Aquila.

16 **Q. The Missouri Industrial Energy Consumers (MIEC) have endorsed an**
17 **FAC with an 80%/20% cost sharing mechanism. Would this type of FAC be**
18 **acceptable?**

19 A. No it would not. The premise of MIEC's proposal is that AmerenUE needs to
20 have sufficient "skin in the game" to ensure that it operates its system efficiently and
21 minimizes overall costs for customers. As explained in Mr. Lyons' testimony, in addition to
22 the potential for cost disallowances during prudence reviews, AmerenUE already has
23 significant incentives to keep its fuel costs low. These incentives include substantial delays

1 in recovering costs through the FAC (costs must be recovered over 12 months), the operation
2 of the Company's coal pool (which requires regulated and non-regulated generation to pay
3 equivalent cost for coal), and salary incentives for the individual employees involved in
4 acquiring fuel, operating generating units and making off-system sales. In addition, because
5 the Commission ordered a 95%/5% sharing of fuel cost changes as part of the FACs for
6 Aquila and Empire, AmerenUE also incorporated this additional incentive into its FAC. But
7 most jurisdictions do not have any cost sharing mechanism of this type, and an 80%/20%
8 sharing mechanism is once again far out of the mainstream of the sharing mechanisms that
9 do exist.

10 **Q. Would the 80%/20% sharing mechanism proposed by MIEC operate**
11 **symmetrically for AmerenUE and its customers?**

12 A. No it would not. Unfortunately, in the current rising cost environment, the
13 proposed 80%/20% split would simply require AmerenUE to absorb 20% of all fuel cost
14 increases. This would not provide the Company with a reasonable opportunity to earn its
15 authorized return.

16 **Q. Do you agree that it is necessary for AmerenUE to have some "skin in the**
17 **game" in order to properly manage its fuel costs?**

18 A. No, I do not. AmerenUE has consistently done a good job in minimizing fuel
19 costs for its customers for many years, and our commitment to proper management of these
20 costs would not diminish, whether an FAC is granted or not. AmerenUE has been a well-
21 recognized leader in properly managing gas costs, even though the Commission's purchased
22 gas adjustment mechanism, which has been in effect for approximately forty years, requires
23 no "skin in the game." Nonetheless, the Company's proposed 95%/5% sharing mechanism,

1 the delays in cost recovery under the Commission's rules, the operation of the Company's
2 coal pool, the financial incentives provided to Company employees and, of course the
3 prudence reviews of the Commission should leave no doubt in anyone's mind that
4 AmerenUE will have adequate incentives to continue managing its fuel costs properly.

5 **Q. Aside from fuel cost recovery, are there other noteworthy examples of the**
6 **impact of regulatory lag on the Company's ability to earn a fair return that you wish to**
7 **address in light of the other parties' positions in this case?**

8 A. Yes. As I discussed in my direct testimony, the Company has very large
9 capital expenditure needs this year and in the years to come. The Company's rate base is
10 growing rapidly and under the historic test year ratemaking traditionally employed by the
11 Commission, the Company will face significant lag in recovering its capital investments. For
12 example, a return on and of the costs of investments placed in service through the true-up
13 date in this case (September 30, 2008) will not begin until five months later when rates set in
14 this case take effect. Even worse, return on and of investments placed in service just after
15 the true-up date, in October of 2008, will not begin until the conclusion of the Company's
16 next rate case, some time in the first half of 2010 at the earliest. These material lags in cost
17 recovery make it very difficult for the Company to earn its authorized return.

18 **Q. Does the very low revenue requirement recommendation of the Staff**
19 **make sense to you given the Company's earnings since new rates took effect on June 4,**
20 **2007?**

21 A. No, the Staff's recommendation makes no sense to me at all. As Mr. Weiss
22 outlined in his direct testimony, the Company's earned regulatory returns since the last rate
23 case through the filing of the Company's case in April were nearly 100 basis points below

1 that authorized by the Commission in May, 2007. For the period through August of this
2 year, as reflected in Mr. Weiss' updated table, which I have reproduced below, the Company
3 has consistently failed to earn its authorized return.

<u>Month</u>	<u>Mo. Electric Rate Base</u>	<u>Mo. Electric Operating Income</u>	<u>Return on Rate Base</u>	<u>Return on Equity</u>
June	\$5,894,787,447	\$ 409,836,625	6.95%	8.14%
July	5,857,606,784	413,787,801	7.06%	8.36%
August	5,852,708,753	434,074,853	7.42%	9.06%
September	5,832,533,516	454,226,385	7.79%	9.78%
October	5,843,612,754	438,158,731	7.50%	9.22%
November	5,850,240,664	429,010,087	7.33%	8.89%
December	5,815,927,377	433,537,872	7.45%	9.13%
January	5,814,605,545	440,938,071	7.58%	9.38%
February	5,856,834,745	433,006,825	7.39%	9.01%
March	5,832,160,085	444,541,129	7.62%	9.46%
April	5,849,549,828	482,114,278	8.24%	10.68%
May	5,869,432,908	467,424,494	7.96%	10.13%
June	5,874,810,247	457,787,345	7.79%	9.79%
July	5,877,435,787	454,545,693	7.73%	9.68%
August	5,890,259,653	433,445,576	7.36%	8.94%
Average				<u>9.31%</u>

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5 Although actual results in any particular month can be influenced by unusual weather,
6 changes in power prices or other factors that are normalized in the ratemaking process,
7 AmerenUE's consistent inability to earn its authorized return on equity month after month
8 suggests that it does not have a fair opportunity to do so. Not only has AmerenUE been

1 unable to earn its authorized return from its last rate case, but it is earning far less than its
2 true cost of equity – 10.9% with an FAC – as outlined in Dr. Morin’s testimony in this case.
3 Costs throughout the Company’s business are continuing to escalate, and will be higher by
4 the time new rates take effect from this case than they are today. The kind of rate relief
5 recommended by the Staff, among others, is simply inadequate to give the Company a
6 reasonable opportunity to earn a fair ROE.

7 **Q. Are there any other significant issues that you believe merit rebuttal?**

8 A. Yes. The Commission is being asked to address at least two other very
9 important policy matters in this case: providing for the recovery of vegetation management,
10 infrastructure inspection and repair, and reliability costs necessary to ensure system
11 reliability and to comply with the Commission’s new rules in these areas (*See* the rebuttal
12 testimony of Ronald C. Zdellar), and fair treatment of an important component of employee
13 compensation – incentive compensation payments to employees (*See* the rebuttal testimony
14 of Krista G. Bauer).

15 **Q. Why is the Commission’s treatment of vegetation management,
16 infrastructure inspection and repair, and reliability costs important?**

17 A. As Mr. Zdellar explains in detail in his rebuttal testimony, in recent years, the
18 Company has heard much from both the Commission and its customers about the need to
19 improve the reliability of its system. While customers have long enjoyed the lowest rates in
20 the state, and some of the lowest in the entire country, what we have heard is that we must
21 invest the sums necessary to improve system reliability even if that means rates must go up to
22 pay for those improvements. In response to these messages, the Company is doing just what
23 was asked of it. The Company took a leadership role in working with the Commission to

1 develop and implement aggressive and workable vegetation management, infrastructure
2 inspection and repair, and reliability rules, and has taken steps to fully comply with those
3 rules. The Company also initiated its Power On project, which includes investing hundreds
4 of millions of dollars in its system to improve reliability through undergrounding circuits
5 experiencing significant reliability problems. These programs are having a positive impact
6 on reliability, as was demonstrated by the testimony in the local public hearings the
7 Commission held in this case. At those hearings only a handful of customers (among
8 AmerenUE's 1.2 million customers) raised reliability issues in their testimony, and those few
9 issues are being addressed by the Company, as explained in the rebuttal testimony of Mr.
10 Zdellar.

11 **Q. You noted that the Company has the lowest rates in the state and has**
12 **very low rates compared to rates elsewhere in the country. Please explain.**

13 A. I have attached Schedule TMV-RE7 to this testimony, which shows that
14 AmerenUE's average retail rates are substantially lower than those of all other Missouri
15 investor-owned utilities. This would remain true if the full rate increase requested by the
16 Company was approved in this case. Our rates are also approximately 40% below the
17 national average, as shown in Schedule TMV-RE8. Finally, St. Louis enjoys some of the
18 lowest electric rates among major metropolitan areas, as shown on Schedule TMV-RE9.

19 **Q. How has the Staff responded to the Company's initiatives to improve**
20 **reliability?**

21 A. Instead of supporting full rate recovery of the costs the Company must incur
22 to comply with the Commission's rules, and to otherwise improve reliability, the Staff has
23 completely failed to consider the fact that test year levels of these kinds of expenditures

1 simply do not reflect the level of expenditures the Company will have to incur when rates
2 from this case are in effect, since the programs are being ramped up. To address this issue,
3 AmerenUE has proposed a tracking mechanism to help it recover the incremental cost of
4 complying with the Commission's rules regarding vegetation management, infrastructure
5 inspection and reliability, but the Staff has not supported this tracker. I believe such a cost
6 tracking mechanism is fully justified.

7 **Q. Why is a tracking mechanism necessary to recover these costs?**

8 A. As Mr. Zdellar explains, like other utilities, AmerenUE must ramp-up the
9 implementation of these programs. As more employees are hired and trained, more money is
10 spent each year until full implementation is achieved. Inclusion of the test year level of
11 expenses for these projects is not sufficient to permit the recovery of the full cost of
12 compliance.

13 The Commission's rules specifically provide for the establishment of
14 mechanisms relating to the recovery of incremental costs of compliance that are incurred
15 between rate cases. Moreover, the Commission has already approved a tracking mechanism
16 for Empire that is essentially identical to the mechanism that is being proposed by
17 AmerenUE in this case. (*See* the rebuttal testimony of Mr. Zdellar.) Again we feel we are
18 only asking for recovery of legitimate costs that the Company has incurred and will incur to
19 improve reliability, just as our customers and the Commission demanded in the last rate case.
20 We are seeking to implement a rate recovery mechanism that is specifically contemplated by
21 the rule, and one that was previously ordered by the Commission in the *Empire* case.

22 **Q. Why is the Commission's treatment of incentive compensation an**
23 **important issue?**

1 A. As explained in detail in the rebuttal testimony of Ms. Bauer, the Company's
2 compensation system is specifically designed to put a portion of an employee's market-based
3 pay at risk each year in order to create a greater incentive for the employee to produce value
4 for customers and shareholders. Moreover, in response to criticisms from the Staff about the
5 design of the Company's prior incentive compensation programs (which tied much of the
6 incentives to Company earnings), the Company completely redesigned its incentive
7 compensation programs to substantially decouple the incentives from Company earnings.
8 The incentives are now primarily driven by Key Performance Indicators, or KPIs, tied to
9 metrics which measure improvements in areas such as reliability of service, safety and
10 customer satisfaction.

11 As Ms. Bauer explains, it is well understood by human resource and
12 management professionals that incentive compensation is an important component of overall
13 employee compensation, and it is necessary to attract, retain and motivate skilled employees.
14 The Company believes that its redesigned program indeed meets the criteria the Commission
15 has outlined in the past that supports recovery of incentive compensation in rates, and that
16 therefore there should be no question about the recoverability of incentive compensation in
17 this case. Given that the Company has listened to Commission concerns on this issue, and
18 redesigned its program as I note above, it is important that the Commission include the
19 Company's incentive compensation costs in rates.

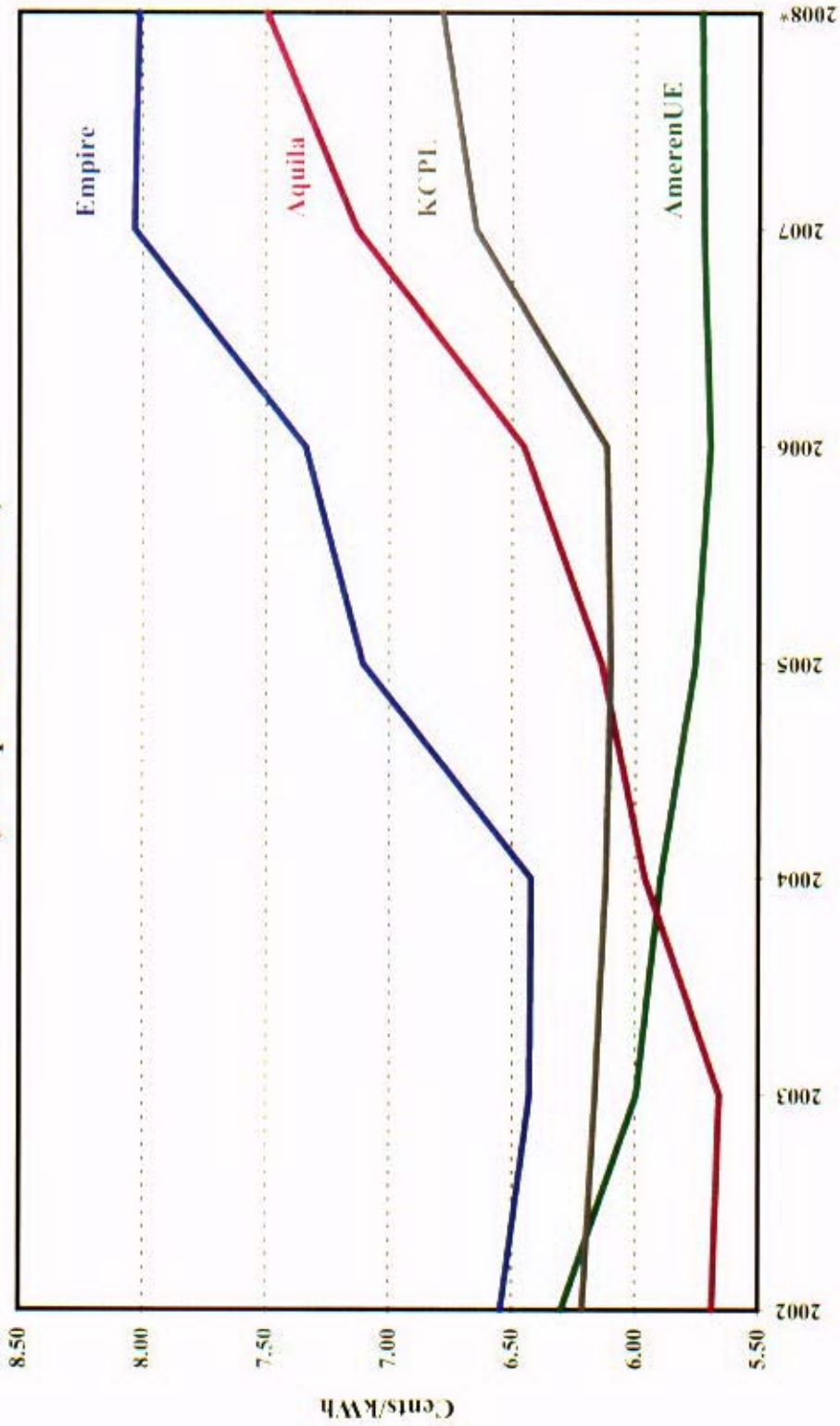
20 **Q. Why shouldn't the Commission just "split the difference" between the**
21 **costs that are included in the Company's cost of service and those recommended by the**
22 **Staff in this case?**

1 A. The Company has made a sincere effort not to propose in this rate case the
2 inclusion of costs or the establishment of cost recovery mechanisms that are unusual or
3 beyond the mainstream of what is normally allowed for electric utilities in this state and
4 around the country. If we are not given mainstream regulatory treatment by (a) being
5 permitted to earn a reasonable ROE, (b) being authorized to use a mainstream FAC, and (c)
6 being permitted to recover our other legitimate expenses needed to enhance the reliability of
7 our system and pay our employees, our financial condition will deteriorate further and our
8 access to capital will be further impaired. These are not speculative outcomes, but they are
9 very real, very immediate problems we are facing right now, as explained in detail in the
10 testimony of Messrs. Rygh and O'Bryan. I would urge the Commission to carefully consider
11 our testimony on these matters, and issue an order that helps preserve AmerenUE's financial
12 stability, its access to capital at a reasonable cost, and its opportunity to earn a fair return
13 commensurate with those authorized for other similarly situated utilities.

14 **Q. Does this conclude your rebuttal testimony?**

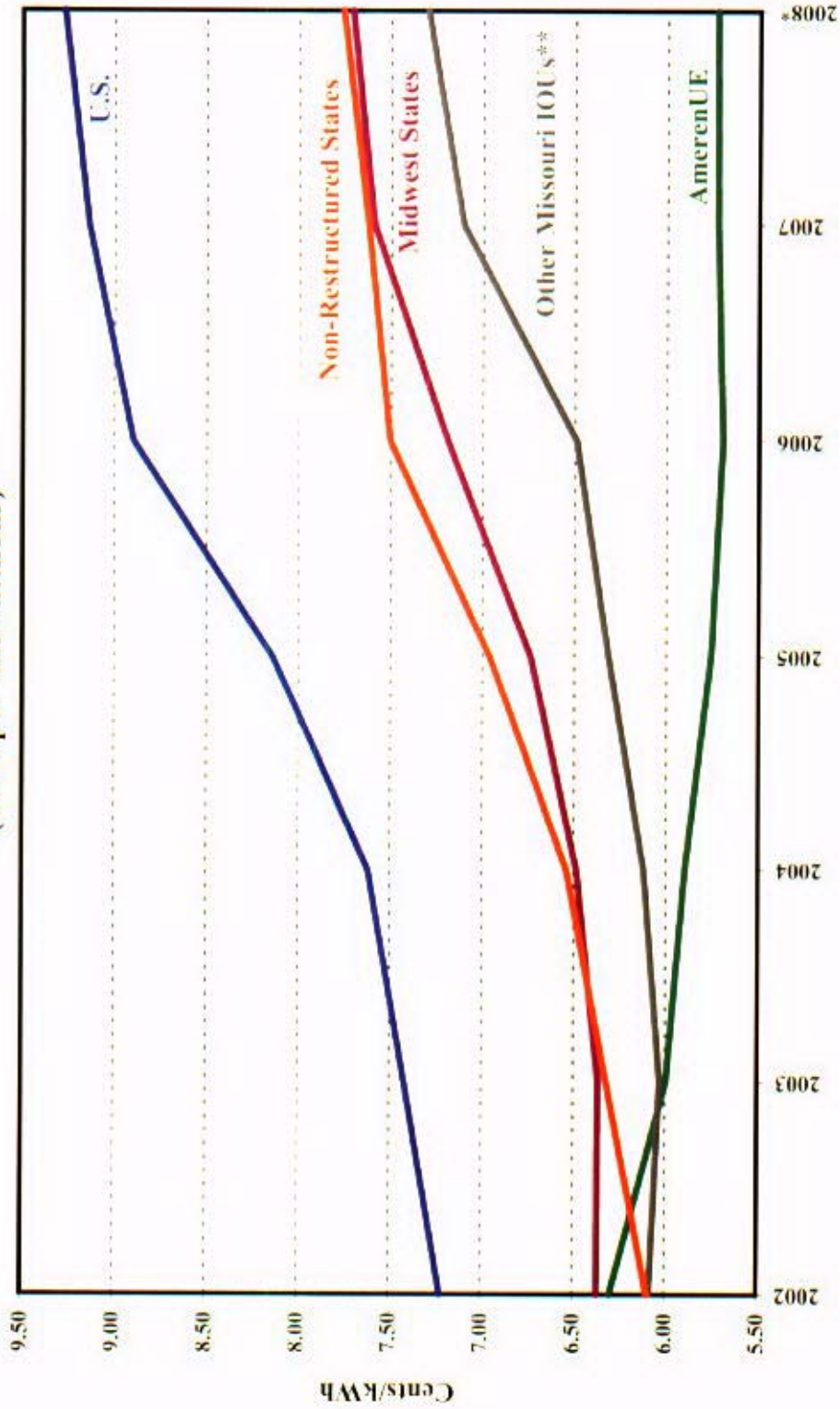
15 A. Yes, it does.

**Comparison of Average Retail Rates in Missouri
(cents per kilowatthour)**



Source: DOE/EIA. Retail customers include residential, commercial, and industrial customers.
*2008 rates are calculated using 12 months ending in May 2008.

**Comparison of AmerenUE-Missouri Average Retail Rates
(cents per kilowatt-hour)**



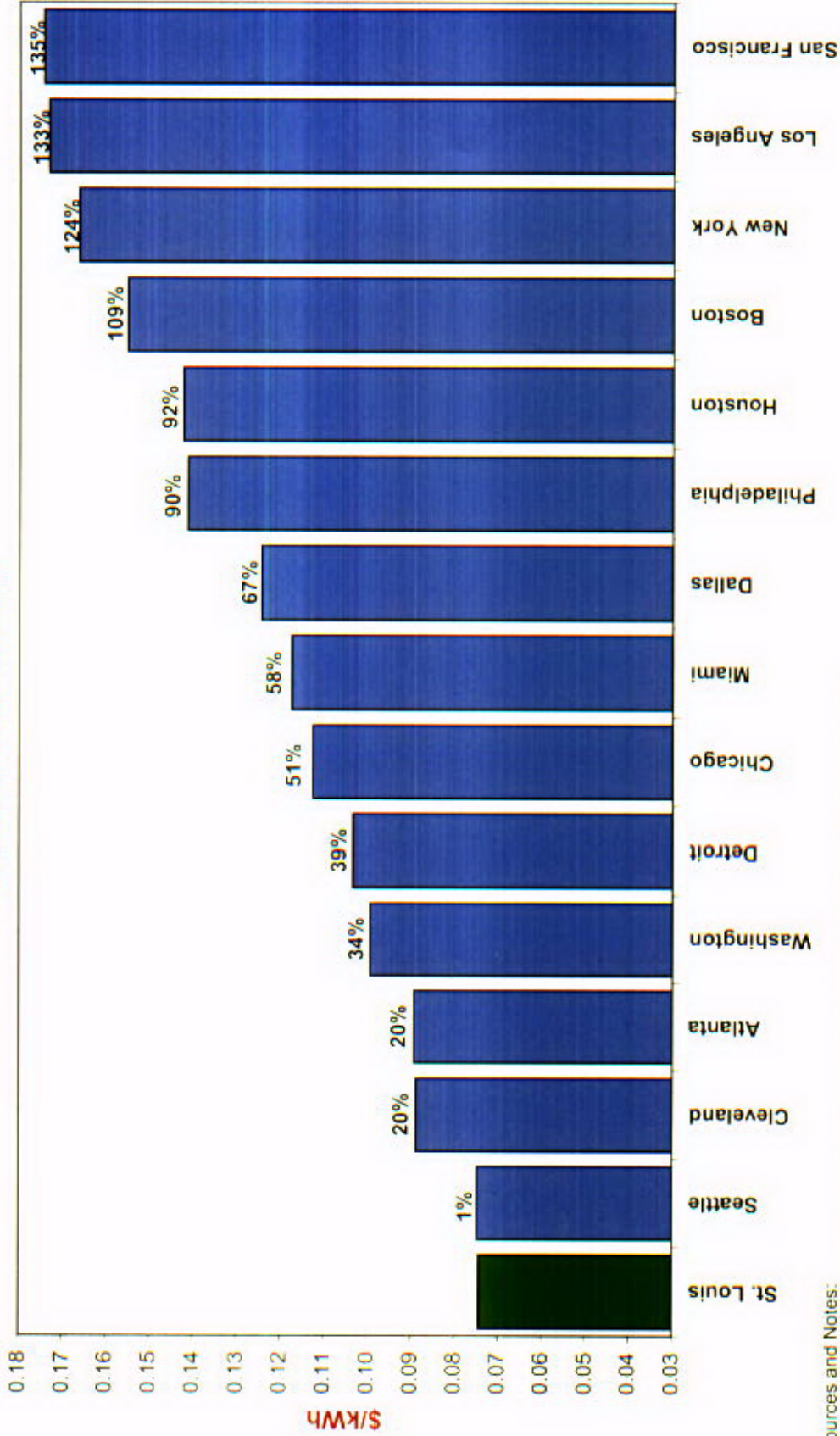
Source: DOE/EIA.

* 2008 rates are calculated using 12 months ending in May 2008.

** Other Missouri IOUs are Aquila, Empire District Electric, and Kansas City Power & Light.

Non-restructured states are those states that have not deregulated the generation of electricity, similar to Missouri. Midwest states based on Census Region definitions. Retail customers include residential, commercial, and industrial customers.

Average Consumer Electricity Prices (2007) for All Major Metropolitan Areas Reported by the Bureau of Labor Statistics



Sources and Notes:
 BLS data based on monthly surveys of 10 residential electricity bills per metropolitan area.
 Rates do not include seasonal discounts.
 Source: www.bls.gov/data.
 Percentages indicate extent to which each city's rates are higher than rates in St. Louis.