BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Union Electric Company d/b/a AmerenUE for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area.	)))))	**Case No. ER-2008-0318**

POST-HEARING BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL

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TABLE OF CONTENTS

I. INTRODUCTION

This brief will address the five main contested issues on which Public Counsel provided testimony, plus the Return on Equity issue. These six issues are addressed in this brief in the same order that they appear in the List of Issues: Return on Equity, Vegetation Management, Fuel Adjustment Clause, COLA Costs, Depreciation and Demand-side Management Netting.

II. RETURN ON EQUITY

Public Counsel endorses Missouri Industrial Energy Consumers (MIEC) expert witness Mike Gorman's opinion that the just and reasonable rate of return on common equity for AmerenUE is 10.2%, the median value of his estimated range of 9.81% to 10.55% with an overall rate of return of 8.00%. (Exhibit 600, Gorman Direct, p. 2) Gorman's suggested range for rate of return meets the elementary legal requirements that it is supported by the competent and substantial evidence in the whole record and by his opinion as a qualified expert in utility finances using data deemed reliable by such financial experts. Section 490.065, RSMo 2000. It also meets the constitutional requirement for utility rates of return in Bluefield Water Works and Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679. 43 S.Ct. 675, 67 L.Ed. 1176 (1923).

A fair cost of common equity for a regulated utility is defined in Bluefield and Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944). These decisions identify the general standards that must be considered in a regulator's determination of the cost of common equity and authorized return: (1) be sufficient to maintain financial integrity; (2) attract capital under reasonable terms; and (3) be commensurate with returns investors could earn by investing in other enterprises of comparable risk.

His recommended rate of return is supported by competent and substantial evidence that it will permit AmerenUE to earn a return on its investment that equals that generally made by other businesses that have corresponding risks and uncertainties. It is supported by competent and substantial evidence that shows that the return is reasonably sufficient to assure confidence in the financial soundness of AmerenUE and to support its credit status to allow it to raise the necessary funds for its operations and capital investments. Bluefield, *supra.*

Mr. Gorman's recommendations on rate of return stand above the recommendations of Morin, Hill and LaConte because of the depth of his investigation and his reasonable, straightforward analysis that meets the relevant factors head on. Mr. Gorman's qualifications to conduct the investigation, to make the rate of return analysis, and to offer a competent and persuasive opinion on the appropriate return are clear and undisputed. His investigation into the relevant and recognized financial and credit markets and his analysis of that data is well documented and reflects the appropriate methodology. The basis of his opinions and conclusions are defined by specific data set out in his testimony and tested by cross-examination. His evidence, conclusions, and recommendations are sound, reasonable and creditable and merit the Commission's strong consideration and adoption.

Mike Gorman is a consultant and a managing principal with Brubaker & Associates, Inc., an energy, economic, and regulatory public utility consulting firm. He has testified before many state regulatory commissions and is recognized as a qualified expert witness before the Missouri Public Service Commission. Section 490.065.1 RSMo 2000. AmerenUE and its witness Dr. Morin respect Mr. Gorman as a rate of return analyst, find him experienced, competent and admit that he "has conducted a series of thorough and complete analyses." (TR. 331).

Mr. Gorman's expert opinion is supported by competent and substantial evidence in the record, employing data inputs relied upon by experts in the financial analysis field, and tested with proper methodology properly applied. Section 490.065.3 RSMo. His recommended return on equity is based on his evaluation of the relevant data using the recognized approaches of a Discounted Cash Flow (DCF), a Risk Premium (RP), and a Capital Asset Pricing Model (CAPM). (Exhibit 600, Gorman Direct, page 1)

His approach and recommendation was in keeping with the long recognized judicial mandate in Bluefield, *supra*, that rates must be reasonable for both the ratepayer and the utility and the constitutional mandate that the company must have a fair opportunity to earn a reasonable return on the investment. Mr. Gorman testified:

> …that my recommended return on equity and proposed capital structure for AmerenUE will provide AmerenUE with an opportunity to realize cash flow financial coverages and balance sheet strength that conservatively supports AmerenUE's current bond rating. Consequently, my recommended return on equity represents fair compensation for AmerenUE's investment risk, and it will preserve AmerenUE's financial integrity and credit standing.
> (Exhibit 600, Gorman Direct, page 2)

MIEC witness Gorman investigated the relevant facts that financial experts rely on to compile the evidence that generated his conclusions and recommendation. He compared his estimated range of market return on equity for AmerenUE to the industry average authorized return on equity for electric utility companies over the last five years. He also reviewed the credit rating history and stock investment returns for the industry over that same period (Exhibit 600, Gorman Direct, pages 2-3)

His findings gave clear "market validation that the market cost of equity for AmerenUE should be consistent with the recent industry average." (Exhibit 600, Gorman Direct, page3). His investigation into the industry returns found:

> Industry authorized returns on equity have averaged approximately 10.3% from 2006 to date, and have averaged approximately 10.5% over the last 5 to 6 years.

> These authorized returns on equity have supported improvement to the credit standing of the electric utility industry and have resulted in quite robust stock price performance over this time period. Indeed, electric utility stock price performance has outperformed the overall marketplace during this time period. This market evidence indicates that commission-authorized returns on equity in the range of approximately 10.0% have supported stock price and credit standing of utility companies.
> (Exhibit 600, Gorman Direct, pages 2-3)

His factual findings show that his range and his midpoint recommendations are equal to other business undertakings with corresponding risk and uncertainties. His rate of return recommendation maintains and supports AmerenUE's credit status. Bluefield, *supra.* His findings on the electric industry's credit standing were confirmed by comments from The Edison Electric Institute (EEI), an electric utility industry trade organization: "The industry's general credit quality has actually improved steadily over the last three years, with upgrades outnumbering downgrades in ten of the prior 12 quarters and in each of the last three calendar years." (Exhibit 600, Gorman Direct, pages 3-4). Standard & Poor's concurs with this positive outlook: "The U.S. utility industry demonstrated stable credit quality in the fourth quarter of 2006, and should continue to do so in 2007 despite increasing capital spending needs related to reliability enhancements and environmental requirements." (Exhibit 600, Gorman Direct, page 5)

AmerenUE would not appear to suffer from an inability "to raise the money necessary for the proper discharge of its public duties." Bluefield, *supra*. Mr. Gorman notes that for electric utilities and all utilities:

> the market is providing capital to the industry for significant capital improvements, and the market is attracted to the safe investment characteristics of regulated utility companies, which generally receive supportive regulatory treatment in terms of cost recovery of prudent and reasonable expenses. This is providing a vehicle for strong growth over at least the next 3 to 5 years.
> (Exhibit 600, Gorman Direct, pages 6-7)

Stock earnings of electric companies have not suffered from recent returns on equity approved by regulators. "Electric Utility Stock Index has outperformed the market in every year over the last 6 years. Again, this strong stock performance indicates commission-authorized returns on equity over the last several years have been positively received by the market." (Exhibit 600, Gorman Direct, page7)

Witness Gorman provided competent and substantial evidence of the specific credit standing of AmerenUE to give context to the industry trends. His analysis of the credit opinions of Standard & Poor's and Moody's demonstrated that any negative operating risk assessment of AmerenUE can be linked to its higher risk parent company and utility affiliates in Illinois while in Missouri the concern was recovery of fuel costs and construction risk. (Exhibit 600, Gorman Direct, page 8)

In summary, Mr. Gorman reached the following conclusion on the characteristics of AmerenUE that dovetailed into his analysis:

> The bottom line: AmerenUE has investment risk characteristics typical of an integrated electric utility company. In order to maintain the competitive position of AmerenUE, it is important to estimate a return on equity that is risk compensatory to its investors, and no higher than necessary in order to achieve that objective. An unreasonably high authorized return on equity will unreasonably increase its retail rates, and unnecessarily contribute to the erosion of AmerenUE's competitive position. A noncompetitive utility would be an impediment to the attraction and retention of businesses in AmerenUE's service territory, and will also negatively impact AmerenUE's credit standing and ability to attract capital."
> (Exhibit 600, Gorman Direct, page 8)

Mr. Gorman used several models based on financial theory to estimate AmerenUE's cost of common equity: (1) a constant growth Discounted Cash Flow (DCF) model; (2) a two-stage growth DCF model; (3) a multi-stage DCF model; (4) a Risk Premium model; and (5) a Capital Asset Pricing Model (CAPM) (TR. 557-563). Based on his analyses, he estimated AmerenUE's current market cost of equity to be 10.18%, rounded up to 10.2%. His recommended return on equity of 10.2% is at the midpoint of his estimated return on equity range for AmerenUE of 9.81% to 10.55%. The high end of the estimated range of 10.55% is based on the average of CAPM, 10.63%, and his risk premium analysis, 10.46% ((10.63% +10.46%) ÷ 2). The low end of the estimated range of 9.81% is based on the average of his two-stage growth DCF analysis, 9.73%, and his multi stage growth DCF analysis, 9.89% (9.73% + 9.89%) ÷ 2). (Exhibit 600, Gorman Direct, page 37).

AmerenUE witness Morin testified that he recommended 10.9 if the Commission authorized AmerenUE to use a fuel adjustment clause and 11.15% if it did not allow the clause. (TR. 383-384). Dr. Morin admitted that rating agencies view FAC as either present or not without getting into the details (TR. 382-383) Dr. Morin said that he only used bond ratings for comparable sample companies to be sure they are investment grade. (TR. 423-424) This would indicate that a FAC may not have any measurable significance impact on bond ratings unless it lowered a bond rating from investment grade. Dr. Morin's differential in ROE for a FAC or its absence does not seem valid if the added risk is not reflected as a significant factor to consider in the bond rating. (TR. 423-424)

During cross-examination, Mr. Gorman testified that the details of a FAC had not had any effect on the bond rating or caused a change in the bond rating to his knowledge. (TR. 543-545, 546-547)

MEG witness LaConte's analysis and recommendations support Mr. Gorman's recommended range and 10.2 rate of return on equity.

The search for the just and reasonable and most appropriate rate of return has been described in prior rate proceedings as a "tangled thicket of conflicting opinions." Yet the approaches used by the experts here are essentially the same four with some variations. The real difference lies with the inputs. Dr. Morin points this out. But he also notes that even on inputs he has little disagreement with Gorman. (TR. 386, 390)

Reliable and accurate data is the hallmark of Gorman's investigation, analysis and testimony. He did not fall back on his academic position and his textbook authorship as a substitute for expert investigation and disclosure of the relevant facts. Although he may have criticism of the other experts, he did not resort to making snide remarks like "I smell a rat basically." (TR. 386) Mr. Gorman's approach and his recommendations are sound and should be accepted.

III. VEGETATION MANAGEMENT

A. Introduction

AmerenUE has proposed not one, not two, but three extraordinary ratemaking treatments for vegetation management expenses. AmerenUE described them in its opening statement on this issue:

> AmerenUE is asking for three recovery mechanisms. First, the company asked to be able to amortize the increased O&M expenditures incurred between January 1st of 2008 through September 30th of 2008. Second, the company requests an accounting authority mechanism to capture the incremental O&M incurred from October 1st through the end of this rate case, approximately February 28th of 2009. Those costs would be held and dealt with in our next rate case. Finally, the company requests a two-way tracker based on the average of its budgeted expenditures for vegetation management and infrastructure inspection and repairs for 2009 and 2010.
> (TR. 1593-1594)

Public Counsel opposes each of these extraordinary accounting treatment requests.

B. The use of post-test year budgeted amounts is not appropriate

It is well-settled law that post-test year changes in expenses should be included in rates only in extraordinary circumstances, and even then, only if they are known and measurable. In a case involving GTE North, the Commission adopted Staff's position on separation factors because the Commission found that "the Staff's method of determining separations is more reasonable than the Company's which includes projected data."[1] The Western District Court of Appeals upheld the Commission decision, and listed the "known and measurable" requirement first in explaining when post-test year changes in expenses should be included in rates:

> "The accepted way in which to establish future rates is to select a test year upon the basis of which past costs and revenues can be ascertained as a starting point for future projection." State ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm'n, 645 S.W.2d 44, 53 (Mo. App. 1982). A test year is a tool used to find the relationship between investment, revenues, and expenses. Certain adjustments are made to the test year figures; "normalization" adjustments used to eliminate non-recurring items of expenses or revenues and "annualization" adjustments used to reflect the end-of-period level of investment, expenses and revenues. Adjustments are also made for events occurring outside the test year. The criteria used to determine whether a post-year event should be included in the analysis of the test year is whether the proposed adjustment is (1) "known and measurable," (2) promotes the proper relationship of investment, revenues and expenses, and (3) is representative of the conditions anticipated during the time the rates will be in effect. (*Ibid.*, at 368).

C. Broad estimates of future costs should not be included in current rates

Public Counsel opposes the use of budgeted cost numbers in the tracker mechanism that AmerenUE proposes for the estimated cost of compliance with the recently-promulgated vegetation management rules. As Public Counsel witness Robertson stated in his Surrebuttal Testimony:

> First, it is obvious to me that the Company is expending a level of vegetation management expense that is approximately equal to the amount authorized for base rates in AmerenUE, Case No. ER-2007-0002. Second, I believe that the ramp-up in vegetation management expenditures in recent years should help to yield lower storm related expenses in future years; however, because the ramp-up in expense has only recently occurred I do not think we have seen all the benefits it should yield. Finally, the historical annualized expense recommended by Staff is reasonable because it appears that no matter what level of expense the

[1] State ex rel. GTE North, Inc. v. Missouri Public Service Com., 835 S.W.2d 356, 371 (Mo. Ct. App. 1992).

> Commission authorizes for base rates the Company will find a way to spend the monies. I do not believe that just "throwing" money at the Company is a prudent way to address the situation. A more plausible method would be to let the current increase that is already included in base rates effectuate the changes needed while closely monitoring the Company's progress. I believe that Staff's reliance on the current historical expense level moves the Company in that direction at a reasonable pace.
> (Exhibit 508, Robertson Surrebuttal, pages 9-10).

<u>D. The proposed tracker mechanism is inconsistent with the new rules and would be very bad ratemaking practice</u>

Public Counsel witness Robertson explained in his testimony why AmerenUE's proposed tracker is not appropriate:

> Tracker mechanisms, if used at all, should be utilized on a limited basis because they have the effect of either increasing or decreasing a utility's earnings for a prior period by increasing or decreasing revenues in future periods. The process violates the accounting and regulatory ratemaking "matching principle" by distorting the comparison of revenues, rate base return and expenses for each accounting period subject to the terms of the tracker. They also have the effect of inappropriately manipulating a utility's business risk. In instances where costs are carried over for recovery in future years business risk is reduced without any offsetting compensation mechanism that recognizes the reduced business risk and vice versa for the reciprocal position. However, most important of all is that fact that a tracker mechanism guarantees a utility that all costs incurred will eventually be included in its cost of service and base rates. This subversion of the regulatory ratemaking model has at least two major detrimental effects. First, to one degree or another, it relieves the utility's management of some responsibility to appropriately manage the costs it incurs. Of course, a utility's management will promise and profess their undying fidelity to ratepayers and financial responsibilities to shareholders to gain the benefits a tracker provides, but in the end a guarantee of including the deferred expense in base rates versus the normal regulatory ratemaking process of subjecting all expenses to ongoing prudence reviews can have a sobering impact on actual management actions. Secondly, the regulatory ratemaking process in this State is a surrogate competitive process for monopoly utilities. The guarantee of base rate recovery that a tracker provides inappropriately shortcuts the "competitive" actions that the regulations and rules of the regulatory ratemaking process were setup to provide. In a normal situation, a utility has the burden of proof to convince the Commission to authorize revenues sufficient to provide for all costs in each and every general rate increase case. If the costs under review are authorized for base rate inclusion, the utility is then allowed the "opportunity," but not the "guarantee" to earn a return on equity after paying all other costs (which are impacted by the future actions of its management and operations). Trackers eliminate a real incentive to manage costs

> in real time and are not consistent with a competitive market. In essence, trackers circumvent the regulatory competition supplied by the normal ratemaking process by eliminating the utility's burden to "prove," in every general rate increase case, the costs for which it seeks recovery.
> (Exhibit 508, Robertson Surrebuttal, pages 11-12).

Furthermore, both AmerenUE witness Zdellar and Staff witness Beck conceded that the proposed tracker mechanism would eliminate all risk of under-recovering or over-recovering vegetation management expenses. (TR. 1609 {Zdellar}, 1668 {Beck}) There is no corresponding return on equity adjustment proposal to account for the elimination of this risk. AmerenUE also concedes that it will likely have fewer outages in the future because of the work it is doing to comply with the vegetation management rules (TR. 1622), but AmerenUE also concedes that the tracker mechanism that it has proposed does not account for these decreased costs. (TR. 1618).

E. The proposed amortization and accounting authorization are also inappropriate

Staff witness Beck explained in his surrebuttal testimony why the proposed amortization should be rejected:

> As AmerenUE witness Zdellar states, "In its last rate case AmerenUE agreed to a one-way tracking mechanism to operate until a new rate case is concluded." [Zdellar, Rebuttal, page 8, lines 6-7]. It is my understanding that this one-way tracker began July 1, 2007 and will end on the operation of law date in this case, March 1, 2009. If the Commission were to grant AmerenUE an amortization of expenditures between January 1, 2008 and September 30, 2008, the previously agreed to one-way tracker would end on January 1, 2008, not March 1, 2009.
> (Exhibit 218, Beck Surrebuttal, page 8)

Mr. Beck also explains why the proposed accounting authorization should be rejected:

> The Staff maintains that the current tracker will track the costs until February 29, 2009 and the new tracker should begin when the rates for the current rate case go into effect. No accounting authorization should be given for the time prior to that date. This would be consistent with what was granted to Empire in Case No. ER-2008-0093. As stated previously, since AmerenUE has already ramped up its vegetation management efforts and has base rates in effect from AmerenUE's last rate case which reflect that, I do not believe that the accounting authorization for

> the five (5) month period of October 2008 through February 28, 2009 is a reasonable request.
> (Exhibit 218, Beck Surrebuttal, page 9)

Public Counsel witness Robertson agrees that these other two requests for extraordinary ratemaking treatment should be denied:

> Essentially, the two items he describes in the request represent an attempt on Company's part to obtain recovery authorization of costs that may exceed the annualized cost included in current rates during the period January 1, 2008 through the effective law date of this general rate increase case. His request masks the real financial impact of the proposal which is to recover from future ratepayers earnings that may have not been realized in the past due to changes in cost levels. Public Counsel does not believe that the request for recovery (or future recovery) of such costs is reasonable or appropriate.
> (Exhibit 508, Robertson Surrebuttal, pages 13-14).

IV. FUEL ADJUSTMENT CLAUSE

A. The Commission's three-part test

The key to this issue is whether the Commission will stick to the standards that it has used in past cases to evaluate FAC requests. If it does so, the Commission will find that AmerenUE has failed to meet those standards just as it did in its last request. The Commission has, since the passage of Senate Bill 179, used a three-part test to evaluate requests for FACs. It most recently annunciated that test in the last Empire District Electric rate case, Case No. ER-2008-0093, where it stated 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
> 3. volatile in amount, causing significant swings in income and cash flows if not tracked.[2]

[2]Case No. ER-2008-0093, Report and Order, page 37.

In its opening statement on this issue, AmerenUE suggested that the Commission should add other criteria from Senate Bill 179. AmerenUE fails to recognize that the Commission's three criteria are explicitly designed to accomplish the goals of senate Bill 179. AmerenUE suggested that the Commission should employ a "fourth standard," which would be "the impact of the costs and the revenues that are going to be tracked in that FAC on the utility's opportunity to earn a fair return on equity." (TR. 2114-2115). The Commission's three criteria already address this concept quite thoroughly; there is no need in this case, the fourth recent case to consider a FAC request, to add another duplicative criteria.

AmerenUE proposes to distort the Commission's well-reasoned three criteria in still another way: it attempts to focus the inquiry on the volatility of market prices rather than the volatility of the costs and revenue changes to AmerenUE. Thus, while AmerenUE witnesses Neff and Glaeser testified about scary swings in the futures markets for coal and natural gas, the important consideration – as the Commission has repeatedly recognized – is the volatility (or lack thereof) in the prices that AmerenUE actually pays. With the hedging programs AmerenUE has in place and the buying power it has in the Powder River Basin coal market, AmerenUE has been able to, and will continue to be able to, effectively dampen those swings. AmerenUE CEO Tom Voss, when asked by Commissioner Gunn about "the most volatile fuel cost," chose to reply in reference to market prices, not AmerenUE's costs. (TR. 184-185)

Exhibit 438, an AmerenUE press release issued at the beginning of this case, touted cost recovery "without the time and expense required for a full rate case" as a benefit to consumers. No evidence was produced in this case to show that fewer rate cases would be filed if a FAC is approved. In fact, AmerenUE concedes that, at least in the near term, having a FAC will not necessarily reduce the frequency of rate case filings. (TR. 2235-2236).

In AmerenUE's last rate case, Case No. ER-2007-0002, the Commission used the same three criteria, and concluded:

> 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.[3]
>
> The Commission also concluded in that case:
>
> 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 [State of Missouri witness] 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.[4]

B. The misplaced emphasis on credit rating agencies

Another criteria that AmerenUE suggests that the Commission add to the three that it has consistently used is: "Whatever will Moody's think of us if we don't get a FAC?" In its opening statement on this issue, AmerenUE asserted that the opinion of credit rating agencies "is becoming increasingly important." (TR. 2119-2120). Far from becoming increasingly important, the credit rating agencies have very likely marginalized themselves through their greed, their focus on short-term profits, and their having been co-opted by the companies that they are supposed to objectively analyze.

The Commission should not be influenced by the supposed "hypersensitivity" of investors (TR. 2384) to the question of whether AmerenUE should or should not be allowed to

[3]Case No. E-2007-0002, Report and Order, page 60.
[4] *Ibid*., page 23; emphasis added.

use a FAC. Whether or not credit rating agencies or investors are expecting a FAC should not determine the Commission's decision in this case. The Commission was given the discretion – and the corresponding obligation – by the legislature to analyze whether a FAC is necessary. If the Commission buys into the "regulate with one eye on the utility and one on the rating agencies" theory, then it will have effectively conceded its discretion and abandoned its obligation. Even if it is true that rating agencies will immediately conclude that there is something wrong with AmerenUE if the Commission does not award it a FAC like Empire and Aquila, the Commission should still stick to its principles and make a determination based upon its stated three criteria. Moreover, by not authorizing AmerenUE to use a FAC, the Commission is really sending the opposite message; it is in effect saying, "AmerenUE is so well positioned and so well managed that it can continue to operate effectively and remain financially healthy without a FAC."

Public Counsel witness Kind explained why it would be a mistake for the Commission to weight too heavily the possibility that credit ratings agencies might see denial of AmerenUE's FAC request as a major disaster:

> I do know a fair amount about what credit rating agencies do and their basis for rating things. I've spoken with people from the rating agencies about what they look for in terms of regulatory climate in terms of incentives, and I know from those conversations that they tend not to look at any one factor, and they tend to look at the overall climate which can be, you know, a matter of -- can include things such as what sort of constructive engagement is taking place amongst regulators and stakeholders with a certain utility and how does that lead to, you know, outcomes in the regulatory process that -- that lead to, you know, good ability to be able to maintain certain financial ratios and to be able to maintain access to -- to capital markets.
>
> That said, I've also witnessed really the dismal performance of a lot of credit rating agencies and investment banks with respect to their views about the marketplace and their views of, you know, what -- what a viable firm is and what a viable firm isn't, and their views of whether or not fundamentals exist for, you know, things like housing bubbles to persist forever, and I frankly don't take a whole lot of stock in what they say as a group.

> I think there's certain individuals that -- at rating agencies and investment banks that would have some credibility with me, but as a group, I don't place a whole lot of stock in what they say. And I don't think that the Commission's exercise of its discretion in regulating utilities should rely a whole lot on the views of these types of entities.
> (TR. 2739-2740)

The press has recognized the huge problems created by over-reliance on credit rating agencies that are paid by the targets that the agencies are supposed to be objectively analyzing. In a recent series of articles and opinion pieces (primarily dealing with the financial crisis), the New York Times has put the spotlight on credit rating agencies:

> Members of Congress have grilled the agencies, asking their executives to answer accusations of incompetence and to say whether they assigned glowing ratings to keep clients happy and expand their business.
>
> State and federal officials are also making inquiries. Moody's recently disclosed in its regulatory filings that it had received subpoenas from state attorneys general and other authorities pertaining to its role in the credit crisis.
>
> …
>
> Moody's current woes, former executives say, were set in motion a decade or so ago when top management started pushing the company to be more profit-oriented and friendly to issuers of debt. Along the way, the firm, whose objectivity once derived from the fact that its revenue came from investors who bought Moody's research and analysis, ended up working closely with the companies it rated, and being paid by them.[5]

A pair of opinion pieces published a few weeks later reached the same conclusions:

> Everyone now knows that Moody's and Standard & Poor's botched their analyses of bonds backed by home mortgages. But their most costly mistake — one that deserves a lot more attention than it has received — lies in their area of putative expertise: measuring corporate risk. [6]
>
> **End the official status of the rating agencies.** Given their performance it's hard to believe credit rating agencies are still around. There's no question that the world is worse off for the existence of companies like Moody's and Standard & Poor's. There should be a rule against issuers paying for ratings. Either

[5] December 6, 2008, "Debt Watchdogs: Tamed or Caught Napping?" By Gretchen Morgenson http://www.nytimes.com/2008/12/07/business/07rating.html?scp=3&sq=moody's&st=cse.

[6] January 4, 2009, "The End of the Financial World as We Know It," By Michael Lewis and David Einhorn. http://www.nytimes.com/2009/01/04/opinion/04lewiseinhorn.html?scp=1&sq=einhorn&st=cse.

investors should pay for them privately or, if public ratings are deemed essential, they should be publicly provided.[7]

C. A FAC reduces the incentive to manage fuel costs

In the Report and Order in AmerenUE's last rate case, Case No. ER-2007-0002, the Commission noted its concern with the effect a FAC has on a utility's incentives to effectively manage its fuel costs:

> 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.[8]

The question of incentives still merits the utmost consideration by the Commission. The State of Missouri's witness on this issue, Martin Cohen, in response to a question from the bench, stated: "we need to retain as much as possible the incentives inherent to traditional rate of return regulation in designing a fuel clause mechanism." (TR. 2593) The power of these incentives is so great that Mr. Cohen concludes – as do Staff and Public Counsel witnesses – that that best course is to not authorize a FAC at all in this case. (TR. 2593). Mr. Cohen's exchange with Chairman Davis developed this point more fully:

> Q. And are you familiar -- and obviously, you know, the Staff here at the Missouri Public Service Commission reminds me at every opportunity that we had fuel adjustment in this state up until 1979, and then when it went away, miraculously the electric utilities in this state grew much more efficient. Think that's a pretty solid assumption?
> A. That's exactly what I've seen in Illinois, when fuel adjustment clauses were eliminated and we saw powerful improvement in the efficiency of the companies, to their benefit, as well as customers.
> Q. And I don't know if you saw this in Illinois, but did you -- did you ever get the impression that the electric utilities that were relying on gas, which obviously your state's a lot heavier nuclear, so you may not have that much, but that the

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7 January 4, 2009, "How to Repair a Broken Financial World," By Michael Lewis and David Einhorn. http://www.nytimes.com/2009/01/04/opinion/04lewiseinhornb.html?pagewanted=3&ref=opinion; emphasis in original

8 Case No. E-2007-0002, Report and Order, page 18.

actual hedging practices of the electric utilities that were purchasing gas in your state were much more sophisticated than those of the gas LDCs that were just buying gas and passing it through with a PGA?
A. I believe that's true, yes.
(TR. 2594).

This exchange prompts the obvious question: "Do the benefits to be gained from authorizing a FAC outweigh all the efficiency that will be lost?" For ratepayers, no. For AmerenUE in the long run, no. For AmerenUE's short-run profit margin, maybe.

AmerenUE looks at this question from a curious perspective. It posited that Callaway has an availability factor of 99%, and then asked whether there is much room for improvement. (TR. 2603). No party, not even AmerenUE, has suggested that authorizing a FAC will lead to an **increase** in AmerenUE plants' availability factors. A more pertinent question is whether there is a lot of room for degradation. Indeed there is! It is difficult to imagine, given the incentive structures, that AmerenUE will manage to improve the availability factors of Callaway and its other plants if a FAC is authorized. It is not difficult to imagine that the availability factors will decline.

This is particularly true given State witness Cohen's uncontroverted testimony that one Illinois utility's nuclear fleet went from an abysmal 47% availability factor to a very respectable 95% availability factor shortly after the proper incentives were restored. (TR. 2596-2597). While it is unthinkable that this Commission and AmerenUE would allow Callaway to sink as low as a 47% availability factor, it is certainly not unthinkable that the stellar 99% availability factor that AmerenUE posited could slip significantly once the strong incentives to maintain it are removed.

AmerenUE CEO Tom Voss acknowledged the power of proper incentives:

Q. So are you suggesting that AmerenUE employees would produce the same value for customers and shareholders if these incentive pays did not exist?

> A. I would say if incentive pays were not there, they would not produce the same values that they are now.
> Q. So your testimony then with respect to that incentive is that establishing an incentive does, in fact, encourage them to produce value for customers and shareholders that otherwise would not exist, correct?
> A. I would agree with that.
> (TR.110-111)

And Mr. Voss agreed that there is certainly a stronger incentive as the percentage in the incentive structure rises. (TR. 113-114).

D. The question of volatility

Perhaps one of the most outlandish claims that AmerenUE makes in its arguments on this issue is its contention that variations in fuel usage due to weather variations constitute "volatility." (TR. 2483, 2626). There is no indication that the legislature ever intended that the Commission use FACs to eliminate weather risk for electric utilities. Furthermore, there is a direct correlation – as far as weather is concerned – between increased fuel used and increased sales. If there is an extremely hot summer and AmerenUE has to buy more fuel (even though it has 100% of a "normal burn" locked in), its revenues will be much higher than normal. There is no evidence in the record that such a situation would lead to cost or revenue changes that are substantial enough to have a material impact and volatile in amount, causing significant swings in income and cash flows if not tracked.

Throughout the case, AmerenUE has tried to blur the distinction between uncertainty and volatility. State witness Martin Cohen testified in his surrebuttal testimony that:

> The company continues to conflate the two concepts [volatility and uncertainty], but they are far from identical and "uncertainty" does not appear among the FAC standards articulated by the Commission. A significant degree of uncertainty about future conditions always exists, and as Staff witness Proctor explains, it is a "fact that uncertainty is greater the farther away the forecast is from real time." The meaning of volatility is expressed in the standard as "causing significant swings in income and cash flows if not tracked."
> (Exhibit 501, Cohen Surrebuttal, pages 4-5)

One factor that allows AmerenUE to significantly reduce the volatility of the prices it pays (as opposed to volatility in spot markets or futures prices) is buying power. Both Public Counsel witness Kind (TR. 2632-2633) and Staff witness Proctor (TR. 2705-2706) testified that AmerenUE is able to exert buying power when it comes to buying Powder River Basin coal. Perhaps the most persuasive piece of evidence about the extent of AmerenUE's buying power comes from AmerenUE's own analysis. Exhibit 1001HC, slide 10, clearly shows how significant this power really is.

One piece of evidence on which AmerenUE sought to rely for a demonstration of volatility, Exhibit 79, was thoroughly discredited. That exhibit was admitted for the sole purpose of showing one particular definition, and Staff witness Proctor testified that the way volatility was defined in Exhibit 79 has no bearing on the Commission's determination of volatility in this case:

> That definition deals with the concept of volatility in forward market prices. Okay. And it's very specific. That whole document deals with volatility in forward market prices. And I don't believe -- I think the Commission is more concerned with actual volatility that occurs in fuel costs, volatility that occurs in prices that AmerenUE actually faces on a day-to-day basis when they sell electricity and not the volatility that occurs in forward markets. And forward markets tend to be very volatile because -- particularly as you get close to the time of settlement, you have a lot of speculators in those forward markets. I'll use that word. They have to settle out. They're not taking delivery. So they have to -- they have to balance their books at the end of the period. They can't get stuck with either having to deliver or taking the delivery. So you tend to get a lot more volatility in those forward markets than you actually see in the spot markets.
> Q. And, in fact, are the prices that UE, the costs that UE actually incurs for fuels as volatile as either the forward markets or the spot markets?
> A. Well, for fuels. Okay.
> Q. Let's talk about coal in particular.
> A. In terms of coal, no, they're not, but the forward markets do -- obviously do play a role in terms of what they can hedge in -- there's been a lot of testimony on their hedging programs, but do you -- do you see that kind of volatility in the final cost that they contract for that you will see in the coal markets on a daily basis? And the answer is no.

(TR. 2704-2705)

Another argument that AmerenUE raises with respect to volatility is that its margins from off-system sales are volatile. But even that argument is suspect. The following exchange highlights both the ongoing efforts by AmerenUE to equate uncertainty with volatility and disagreement over just how uncertain off-system sales margins really are:

> Q. And we don't know what the volumes of off-system sales are going to be next year either, do we?
> A. Not for certain. We have a pretty good idea of what they'll be, but we don't know for certain.
> (TR. 2708)

E. If a FAC is authorized, no more than 50% of changes in fuel costs should be passed through it

Public Counsel is firmly convinced that the record in this case does not support AmerenUE's request for a fuel adjustment clause. But if the Commission disagrees, any such clause should limit the periodic adjustments to no more than 50% of the change in fuel and purchased power costs. In his Rebuttal testimony (Exhibit 404), Public Counsel witness Kind explained why only 50% of the variation in AmerenUE's fuel and purchased power costs should be included in periodic adjustments:

> Public Counsel believes that if an FAC is approved for UE, only 50% of the variation in UE's fuel costs from the baseline cost level established in this rate case should be passed on to ratepayers through periodic adjustments. This lower pass through would recognize (1) the lower dependence of UE on volatile purchased power and volatile fuels like natural gas relative to other Missouri utilities and (2) the extent to which UE has been able to hedge the prices of the coal and nuclear fuel that is used in its baseload units.
> (Exhibit 404, Kind Rebuttal, pages 6-7).

V. COLA COSTS

Section 393.135 RSMo 2000 provides:

> Any charge made or demanded by an electrical corporation for service, or in connection therewith, which is based on the costs of construction in progress

> upon any existing or new facility of the electrical corporation, or any other cost associated with owning, operating, maintaining, or financing any property before it is fully operational and used for service, is unjust and unreasonable, and is prohibited.

Although this section is sometimes referred to as the "anti-CWIP"[9] law, it is broader than just CWIP. It precludes entirely, with no exceptions, charges that are based on any property before it is fully operational and used for service. By no stretch of the imagination can the COLA be considered "fully operational and used for service;" it had not even been accepted by the Nuclear Regulatory Commission for docketing at the time of the evidentiary hearing in this case.

In AmerenUE's opening statement on the COLA issue, AmerenUE complained: "If the costs are not allowed, then the shareholders effectively will have borne all of the risks associated with what I believe may end up being something on the order of $70 million in order to prosecute that application to completion." (TR. 1277). The shareholders are supposed to bear such risks and are well compensated to do so. In State ex rel. Union Electric Co. v. Public Service Com., 765 S.W.2d 618, 622-623 (Mo. Ct. App. 1988), the court summarized this point:

> The Commission concluded that the initial risk of cancellation, in this case, should be borne by the investor-stockholder. If this was not true and a stockholder could be assured a return of his investment whether the plant was canceled or not, it would make the investment practically risk-free. The circumstances under which Union Electric obtained financing for its Callaway plants indicates that the investors did not consider the investment risk-free. In fact, Union Electric's witness, Jerre Birdsong, testified that the relationship between risk and return is undoubtedly recognized by all investors, whether or not they are familiar with more sophisticated theories of investment analysis.

In this case, investors should bear the initial risk that AmerenUE may decide – once again – not to proceed with Callaway 2 and the risk that the supposed market for an operating license may not develop. Bearing the initial risk does not mean that investors will necessarily ultimately get stuck holding the bag, it just means that there has been no valid reason shown to shift any of that

[9] CWIP is the commonly-used acronym for construction work in progress.

risk – or any costs – to ratepayers in this case. AmerenUE CEO Tom Voss acknowledged that recovery of the COLA costs could be accomplished in a later case even if the Commission does not accept the company's position in this case:

> Q. Now, with respect to the recovery of COLA costs, is it your understanding that if those costs that you've accumulated to date are not recovered in this case, that they will never be recovered?
> A. That's not my opinion.
> Q. So even if the Commission doesn't allow you to recover them as a return on them in rate base in this case, you can continue to accumulate those costs and ask for recovery later; is that true?
> A. Well, yes. Hopefully you at least get to recover those costs when it went in service at some point in time if not before, you know. no, I wouldn't say these costs would never be recovered.
> (TR. 253)

Even if the Commission decides that AmerenUE is not prohibited by Section 393.135 from earning a return on the money spent to date on the COLA, the Commission should still not allow recovery in this case. Section 393.135 does not appear to allow exceptions for plant that has inherent value or for plant that will soon be used and useful, but even if it did, there has been no credible showing that the COLA costs at issue here fit under either exception. In his testimony on the "Overview and Policy" issues, AmerenUE CEO Tom Voss testified that the license "could be similar to real estate that you would buy ahead of time before you actually develop it." (TR. 128). Public Counsel agrees that the real estate analogy that Mr. Voss offered is a good one. The traditional regulatory model for real property held for future use (and the required treatment pursuant to Section 393.135) is that a utility is not allowed to include it in rates. Such should be the Commission's treatment of the COLA costs at issue here.

One of the two AmerenUE witnesses on the COLA issue, Mr. Gary Weiss, testified that the Commission had, sometime in the 1970s or 1980s, allowed recovery of a return on plant held for future use. He could not identify any particular pieces of plant that were afforded such extraordinary treatment, nor could he cite any specific cases. But he did give his understanding of the criteria that the Commission used to allow this type of extraordinary treatment: “projects with plants to be used within five years have been allowed, and those without a foreseeable use have not been allowed.” (TR. 1307). Mr. Weiss then opined that even that criteria could be stretched for a nuclear plant operating license: “there could be a longer term [than] five years applied to that situation because [the operating license] does have a definite use in plan.” (TR. 1307-1308). However, Mr. Weiss's definite use in plan is simply two “ifs” and a “maybe.” Mr. Weiss testified that the definite use was “if UE doesn't build the plant and the license has a value, we may be able to sell that license to another company.” (TR. 1308). Under any plausible standard for allowing exceptions to the concept of used and useful, such a remote possibility does not make the grade.

Mr. Weiss also was unaware that AmerenUE has taken the position that the operating license might have some inherent value. Nevertheless, when asked questions in which that possibility was an assumption, witness Weiss had no problem in quickly testifying that AmerenUE would take any profit from the sale of the license even if ratepayers had borne the costs of the application for a decade:

> Q. Well, can you assume with me that there is -- that there is at least some testimony in this case that the COLA may have a value in and of itself? Can you just make that assumption?
> A. Yes, I can.
> Q. Okay. And assume further that -- that that turns out to be the case and that in, say, 2018, AmerenUE actually does sell the COLA. What is your proposal for returning the returns that the ratepayers have paid in the interim between now and 2018 under those circumstances?
> A. It would be my same proposal, that the ratepayers would receive a refund of the returns they have paid to an amortization with interest.
> Q. Okay. And further assume with me that it turns out that the COLA is really, truly valuable and it is sold for more money than the ratepayers have contributed over the years. Who would -- who would get the excess in those circumstances?
> A. Under my proposal, AmerenUE would get the excess.

(TR. 1302-1303).

AmerenUE's other witness on the COLA issue, Ajay Arora, admitted that the market value of a COLA – if any – was completely unknown:

> Q. I'm Todd Iveson for the State of Missouri. Just a couple of questions. What is the market value for a COLA?
> A. At this time I don't know what the market value would be for a COLA.
> Q. Has there ever been a COLA sold, to your knowledge?
> A. Not to my knowledge.
> (TR. 1320).

Indeed, witness Arora admitted that AmerenUE had not even done any analysis to try to determine a value for the operating license. (TR. 1323-1324)

Before AmerenUE could build the second Callaway unit, the Nuclear Regulatory Commission must accept AmerenUE's COLA. While one would think that after having spent almost $50 million on the application, simply getting a regulatory body to accept it would be a slam dunk, but apparently not. Several applications submitted after AmerenUE's have already been accepted, but (at least as of the evidentiary hearing), the NRC still had issues with the completeness of AmerenUE's. (TR. 1349-1359).

In addition to getting the NRC to docket its application, AmerenUE must get the NRC to approve the design for the type of reactor AmerenUE proposes to build. While the NRC has approved reactor designs, it has not approved the design for the evolutionary pressurized reactor that AmerenUE proposes to build. (TR. 1359-1360). Only after these two preliminary steps will the NRC even begin to consider the merits of AmerenUE's COLA.

AmerenUE claims that one of its reasons for submitting its COLA when it did is to get in line for certain tax credits. Even these benefits are speculative. The plant must actually get built and start providing service for any tax credits to be allowed. (TR. 1329) AmerenUE insists that it has not even decided whether it will proceed with building the plant. Furthermore, the level of tax credits for any one unit depends on the number of new nuclear units built. (TR. 1329-1330)

The prospects of a second unit at Callaway actually becoming used and useful, or of the operating license being sold for an appreciable sum, are remote. It is possible that one of these outcomes may come about years from now, but it is also possible that neither ever comes about. For other purposes, AmerenUE has made a big deal out of the fact that it has not made a final decision to even build the plant, yet for purposes of recovering the COLA costs, it asserts that there is a "definite use in plan" for the license. This is not a situation that is amenable to having it both ways. AmerenUE witness Weiss conceded that the only argument for earning a return on a plant that is not "used and useful" is if that the particular plant is "about to be used and useful." Such is clearly not the case here.

Staff witness Rackers explained the proper accounting for these costs, and the way in which AmerenUE wants to deviate from proper accounting, in his surrebuttal testimony (Exhibit 202):

> The Company is accounting for these costs like any other capital project that is not yet complete. In accordance with the FERC's USOA, these costs are currently booked in CWIP. The Company is asking the Commission to deviate from properly accounting for these costs according to the FERC USOA and including costs related to plant that is incomplete in the cost of service in this case. This license application is a necessary construction related cost to operate Callaway II. (pages 4-5)

VI. DEPRECIATION

A. Depreciation Rates for Callaway are Excessive

For the Callaway nuclear plant there has been a major change of circumstance since the 2007 AmerenUE proceedings (Case No. ER-2007-0002). In that 2007 case, AmerenUE proposed Callaway depreciation rates that were calculated using a 40 year life-to-final-retirement for Callaway. The Nuclear Regulatory Commission (NRC) initially licenses commercial nuclear reactors for 40 years, and companies can file for a 20 year extension of the license. NRC has never refused to renew a commercial nuclear power reactor's license for the additional twenty years. Whether or not AmerenUE would file for a 20 year Callaway license extension was the major area of disagreement in the prior case pertaining to Callaway depreciation. The Commission Order in the 2007 case essentially straddled the fence. A 60 year life was ordered, but the excess in the depreciation reserve, which had been built up assuming a 40 year life, was not amortized or considered in the depreciation rate calculations. However, since that prior case, AmerenUE has announced that it will be filing for the 20 year extension of the Callaway plant's nuclear operating license, to the year 2044. (Exhibit 401, Dunkel Direct, pages 3, 4, 8).

It is necessary to know how much has already been collected from customers in the past in order to determine how much remains to be collected in future depreciation rates. Both Staff witness Gilbert and AmerenUE witness Wiedmayer agreed that this is true (TR. 874 {Gilbert}; TR. 833 {Wiedmayer}). The book reserve shows the net accumulated amount that has already been collected from the customers in past depreciation rates (Exhibit 400, Dunkel Surrebuttal, page 2; TR. 874).

However, the actual book reserve amount that has already been collected from customers in the past was <u>not</u> used in the calculation of the Callaway depreciation rates, as both Mr. Gilbert and Mr. Wiedmayer acknowledge (TR. 870 {Gilbert}; TR. 835 {Wiedmayer}). Failing to consider the amount already collected from the customers, and now held by AmerenUE in the book reserve, results in excessive depreciation rates. At the end of 2007, the Company held $1,182 million in the Callaway "book" depreciation reserves, but the "book" depreciation reserve amounts were not considered in the depreciation calculations. Instead a lower "theoretical" reserve amount of $930 million is effectively incorporated into the Callaway depreciation rates.

Ignoring the $252 million over-accrual ($1,182 million - $930 million = $252 million) that has already been collected, means this $252 million will be collected again from the customers in future depreciation rates, which is an overcharge. This overcharge works out to $7.4 million per year. (Exhibit 401, Dunkel Direct, page 15-16, Schedule WWD-6 page 2 of 3). In the 2007 case, the Callaway book reserve was $1,051 million and "theoretical" reserve amount was $831 million. At that time the Callaway over-accrual that was ignored in the calculation of the Callaway depreciation rates was $220 million ($1,051 million - $831 million = $220 million (Exhibit 400, Dunkel Surrebuttal, Schedule WWD-SR8 page 1). Thus the over-accrual continues to mount; it has increased by over $30 million just since the last case. Such over collecting violates USOA requirements (Exhibit 401, Dunkel Direct, pages 11-12).

Public Counsel proposes that the $252 million over-accrual in the Callaway accounts be amortized over the remaining life of those accounts. This produces a $7,424,133 annual amortization amount, which is a reduction of expense as compared to the AmerenUE proposal. This will result in properly depreciating the Callaway investments over their life (Exhibit 401, Dunkel Direct, Schedule WWD-3 page 2).

<u>B. Both Mr. Wiedmayer and Mr. Gilbert have proposed similar amortizations in other cases.</u>

AmerenUE witness Wiedmayer and Staff witness Gilbert oppose amortizing the Callaway over-accrual in this case, but both of them have recommended similar reserve variance amortizations in other proceedings. As Mr. Wiedmayer stated on page 855 of the transcript

> A. Sure. The methodology that I've presented in the previous case ER-2007-0002, I proposed whole life rates used in conjunction or plus an amortization of the reserve variance. That amortization of the reserve variance was to be trued up over the remaining life of the plant accounts. Mr. Dunkel has also used the same method in this proceeding.
> (TR. 855)

In fact, in ten out of his last ten cases, Mr. Wiedmayer has recommended depreciation rates that included the book reserve amounts in the calculation of his recommended depreciation rates. (Exhibit 400, Dunkel Surrebuttal, Schedule WWD-SR7; TR. 832). The Callaway depreciation rates that AmerenUE is using in this case exclude the book reserve amounts in the calculation of depreciation rates. Mr. Dunkel's recommendation effectively includes book reserve amounts in the calculation of depreciation rates, similar to what Mr. Wiedmayer has done in ten out of his last ten cases.

Although he initially testified that he had never seen an adjustment in individual accounts outside of a depreciation study (TR. 864), when confronted with his own testimony in Case GR-2006-0387, a case involving Atmos Energy Corporation, Mr. Gilbert conceded that he proposed an amortization to true up some reserve over-accrual in that case in the absence of a full depreciation study. Mr. Gilbert acknowledged there was no difference between the reserve over-accrual amortization that Mr. Dunkel is proposing in this case, and the reserve over-accrual amortization Mr. Gilbert had proposed in the Atmos Case:

> A. I believe Mr. Dunkel is calling for a change in the depreciation rate.
> Q. Based upon what?
> A. His observance of an over-accrual in the reserve.
> Q. And what would the nature of his change be, an amortization of that difference?
> A. I'd -- I'd have to look. I think so.
> Q. And can you explain to me how that is different from what you proposed in the Atmos case?
> A. I can't.
> (TR. 888-889)

<u>C. There is no valid reason to overcharge customers for the Callaway depreciation.</u>

No party has provided a valid reason for overcharging for Callaway depreciation. Mr. Wiedmayer stated the over-accrual was being monitored. But he admitted the book reserve was not used in setting the depreciation rates (TR. 834-835). "Monitoring" in this context effectively means watching while the customers are overcharged, and doing nothing about it.

AmerenUE and the Staff contend that the amortization of the Callaway over-accrual cannot be adopted with out a full depreciation study of all accounts, because they claim the other accounts might "counteract" or "offset" the amortization of the over-accrual Callaway accounts. (TR. 822, 846, 874). But including the book reserve in the calculation of the depreciation rate for the other accounts would **add** to the expense reduction, **not offset** it. Mr. Gilbert supervised the preparation of Exhibit 420, which is a Staff Schedule from Case No. ER-2007-0002. That Staff document shows that, at the depreciation rates Staff proposed in the 2007 case, the Callaway accounts were over-accrued by $144 million, but when all accounts were included the over-accrual was $766 million. Mr. Gilbert agreed this Staff exhibit showed that "if you were to take into account all the other accounts, they would not counteract the over-accrual in nuclear accounts but instead would add to the over-accrual." (TR. 884, 880, and Exhibit 420).

Schedule WWD-SR8 to Public Counsel witness Dunkel's surrebuttal testimony (Exhibit 400) is a similar analysis except it uses the depreciation rates the Commission approved in the Case No. ER-2007-0002. Using the Commission approved rates, the over accrual is $219 million for the Callaway accounts, but when all accounts were included the over-accrual was $822 million. Mr. Gilbert agreed this document shows that including all accounts would not counteract the effect of using the book reserve in the Callaway accounts, but in fact it would add to the effect (TR. 887-888).

Neither Mr. Gilbert nor Mr. Wiedmayer had done any analysis, or had any evidence, to support their speculation that including the book reserve for the other accounts would offset or counteract the impact of including the book reserve in the calculation of the Callaway depreciation rates (TR. 846, 875; Exhibit 418).

In addition, as previously discussed, Mr. Gilbert in Case GR-2006-0387, a case involving Atmos Energy Corporation did call for an amortization to true up some reserve over-accrual in that case in the absence of a full depreciation study. Mr. Gilbert confessed that what he proposed in that Atmos case is just like what Mr. Dunkel proposes in this case. (TR. 888-889). Therefore an amortization of a reserve over-accrual can be adopted in a case that does not include a full depreciation study of all accounts.

Of course, the previous AmerenUE case, ER-2007-0002, did include a full depreciation study of all accounts, but the Callaway depreciation rates that fail to include an amortization of the Callaway over-accrual, resulted from that case. Clearly waiting for another full depreciation study does not insure a timely correction of this over-accrual.

In addition, the excessive Callaway depreciation rates should be corrected before increasing the prices charged to customers, not after increasing the prices (Exhibit 400, Dunkel Surrebuttal, page 4). If the Callaway depreciation rates are not corrected in this case, then the prices in this case will be over $7 million per year higher that they should be. Mr. Gilbert indicated that AmerenUE will have to file a full depreciation study in the year 2009 (TR. 866). If that full depreciation study in the year 2009 is outside a rate case, it is not clear that customer prices would quickly be reduced based on the resulting depreciation rates. (TR. 869).

Mr. Gilbert discussed AmerenUE's capital program. He appears to contend that the existence of this capital program makes overcharging for Callaway depreciation acceptable (TR. 863-864). However on cross examination Mr. Gilbert indicated he was not clear about the fact that the depreciation rates automatically apply to new investments (TR. 867-868).

In summary, there is no dispute that it is necessary to know how much has already been collected from customers in the past, called the "book reserve," in order to determine how much remains to be collected in future depreciation rates. There is no dispute that the book reserve amount was not used in the calculation of the Callaway depreciation rates. Because the book reserve amount (currently $252 million) was ignored in the calculation of the depreciation rates, the over-accrual in that book reserve will be collected from the customers again in the future depreciation rates, unless the Commission prevents this over charge. The reserve excess of $252 million should be amortized over the remaining life of the Callaway investments, which is an amortization of $7.4 million per year. This amortization will result in fully depreciating the investments over their lives, which is consistent with the USOA requirements. In other cases, both Mr. Wiedmayer and Mr. Gilbert have proposed similar amortizations of the reserve excess, including Mr. Gilbert's reserve excess amortization recommendation in a case that did not include a full depreciation study (the Atmos case). The evidence strongly supports the OPC recommendation that the Callaway reserve excess of $252 million be amortized over the remaining life of the Callaway investments.

VII. DEMAND-SIDE MANAGEMENT NETTING

The issue of whether UE should book gross or net DSM expenditures to the DSM regulatory asset account approved in Case No. ER-2007-0002 has arisen in this case as UE has booked expenditures to this account and seeks to have the return on and of those expenditures reflected in its rates. As noted in the direct testimony of Staff witness Henry Warren, the issue of netting DSM expenditures also arose previously in Case No. ET-2007-0459 in which: "the Commission approved a stipulation and agreement where AmerenUE agreed to a pilot IDR program for which it would only book its net expenditures on the IDR pilot to the DSM regulatory asset account." (Staff Report - Cost of Service, page 9)

Staff witness Henry Warren's direct testimony explained the importance of crediting off-system sales revenues to the regulatory asset account to avoid a situation where "AmerenUE's ratepayers would be paying AmerenUE's expenditures to recruit and compensate AmerenUE customers for reducing usage as participants in AmerenUE's demand response program, while AmerenUE's shareholders reap the benefits AmerenUE receives from the increased off-system sales revenues. Mr. Kind made a similar point in his rebuttal testimony where he stated that the netting of DSM costs that are booked to the regulatory asset account is necessary "to protect UE's customers from being overcharged for DSM expenditures." (Exhibit , Kind rebuttal p. 14, lines 19-20) Public Counsel's proposal for how this netting should occur as set forth in Mr. Kind's rebuttal testimony (page 14) was:

> In addition to booking the incremental costs of implementing DSM programs in its regulatory asset account, UE shall book the reimbursement of incremental costs, in dollars, that are equal to funds from any source that the Company receives that are associated with the its implementation of DSM programs and not otherwise credited.

After reviewing the surrebuttal testimony of AmerenUE witness Voytas and Staff witness Warren, Mr. Kind determined that this proposal should be modified in order to make it more workable. Mr. Kind's modified proposal, as he explained at the hearing is:

> In addition to booking the incremental costs of implementing DSM programs in its regulatory asset account, UE shall book the reimbursement of incremental costs, in dollars, that are equal to capacity related revenues from any source that the Company receives that are associated with its implementation of DSM programs and not otherwise credited.
> (TR. 927)

Staff also made a proposal for how this netting should occur in the portion of the Staff Report sponsored by Staff witness Henry Warren (Exhibit 200, Staff Report - Cost of Service, pages 9-10) and subsequently revised this proposal in Mr. Warren's Surrebuttal testimony (Exhibit 225, Warren Surrebuttal, page 2). Mr. Warren's proposal was as follows:

> The DSM Regulatory Asset will contain all prudently incurred net incremental

> DSM costs. Incremental costs are defined as those costs that exceed the level of costs in existing rates for DSM programs such as the costs of low income weatherization programs that exceed the low income weatherization program costs reflected in existing rates. In addition to booking the incremental costs of implementing DSM programs in its RAA [Regulatory Asset Account], UE shall book the reimbursement of incremental costs, in dollars, that are equal to funds from any source that the Company receives (such as payments received for bilateral sales of capacity and payments or credits from MISO [Midwest Independent Transmission System Operator] for demand response or energy efficiency programs) that are associated with its implementation of DSM programs and not otherwise credited. If a Fuel Adjustment Clause (FAC) is available to the Company, all value associated with such reimbursement of incremental costs will flow through the FAC.
> (Exhibit 225, Warren Surrebuttal, page 2)

Mr. Voytas admitted at the hearing that AmerenUE has not made any proposals in this case to limit the amounts booked to the regulatory asset account to the net expenditures that UE makes as it implements DSM programs. (TR. 968)

Both Staff and UE witnesses expressed their views of the revised Public Counsel proposal for netting DSM expenditures made by Mr. Kind at the hearing. Mr. Voytas's response on behalf of AmerenUE was that the new Public Counsel proposal "is an improvement definitely to the DSM netting concept that's been expressed in testimony." (TR. 947). Later in his cross-examination, Mr. Voytas described UE's view of the revised proposal by Public Counsel by stating "I think we are getting close." (TR. 969). Mr. Warren expressed Staff's response to the revised Public Counsel proposal at the hearing. Mr. Warren agreed that the revised Public Counsel proposal "generally speaking…captures the position that Staff took in the position statement in this case, subject to some details." (TR. 976)

In this case, the Commission is in the position of having to choose between Staff's proposal and Public Counsel's. AmerenUE, although it believes improvements can be made to the DSM cost recovery process, has not – in this case or any other – actually proposed any cost recovery mechanism. (TR. 957) Public Counsel submits that its proposal, as modified at the evidentiary hearing, is the most straightforward way of dealing with DSM cost and revenue netting.

WHEREFORE, Public Counsel respectfully offers this Post-hearing Brief and prays that the Commission conform its decision in this case to the arguments contained herein.

Respectfully submitted,

OFFICE OF THE Public Counsel

/s/ Lewis R. Mills, Jr.

By:______________________________

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been emailed to all parties this 8th day of January 2009.

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