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Missouri Public
Service Commission

Mr. Dale H. Roberts
Secretary/Chief Regulatory Law Judge
Public Service Commission
P. O. Box 360
Jefferson City, MO 65102

RE: Union Electric Company,
Case No. EM-96-149

Dear Mr. Roberts:

Enclosed for filing in the above-referenced case please find the original and eight copies of **Public Counsel's Report Regarding The Experimental Alternative Regulation Plan II.** I have on this date mailed, faxed, and/or hand-delivered the appropriate number of copies to all counsel of record. Please "file" stamp the extra enclosed copy and return it to this office.

Thank you for your attention to this matter.

Sincerely,

John B. Coffman
Deputy Public Counsel

JBC:jb

cc: Counsel of Record

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of Union Electric Company for an Order Authorizing: (1) Certain Merger Transactions Involving Union Electric Company; (2) the Transfer of Certain Assets, Real Estate, Leased Property, Easements and Contractual Agreements to Central Illinois Public Service Company; and (3) in Connection therewith, Certain Other Related Transactions.	)	Case No. EM-96-149

PUBLIC COUNSEL'S REPORT/REGARDING THE EXPERIMENTAL ALTERNATIVE REGULATION PLAN II

COMES NOW, the Office of the Public Counsel (Public Counsel) and for its Report Regarding the Experimental Alternative Regulation Plan II (EARP II) provides the following observations and recommendations regarding this experiment as required by Paragraph 7.g. of the Stipulation and Agreement approved in this case by the Public Service Commission (Commission) on February 21, 1997.

A. The experiment with alternative regulation for AmerenUE over the past few years should not be continued.

Public Counsel has been disappointed in the results generated from the Experimental Alternative Regulation Plan (EARP I) and EARP II. Although significant rate reductions and rate credits have been ordered during the past five and one-half years, and some important regulatory lessons have been learned, it is Public Counsel's firm belief that this experiment should not be continued when the EARP II expires on June 30, 2001.

The following is a short description of some of the more important factors that have led Public Counsel to make this recommendation. These recommendations are based upon Public Counsel's experiences over the past few years and numerous discussions with AmerenUE and other parties regarding the EARP II.

1. One of the benefits that was expected to occur during EARP I and EARP II was that credits would be granted to consumers more quickly than rate reductions could typically be ordered through the process of a rate complaint case filing. Unfortunately, consumers have been denied prompt credits. Litigation regarding the proper interpretation of the EARP's, controversies among the parties regarding the proper amount of sharing credits, and other delays, have resulted in a lags much longer than Public Counsel had hoped.

The EARP I and EARP II anticipated that the final report on each period's sharing credits would be issued 105 days following each annual test period (approximately October 13 of each year). The truly final decisions on sharing credits, after all issues have been resolved by the Commission have come much later. The actual results were as follows:

TEST PERIOD	MILLION $ CREDITED	DATE CREDITS WERE ORDERED	LAG
EARP I, Year 1 (ended June 1996)	$43.6M	December 20, 1996	37 days
EARP I, Year 2 (ended June 1997)	$18M	July 8, 1998	268 days
EARP I, Year 3 (ended June 1998)	$26M	December 23, 1999*	436 days
EARP II, Year 1 (ended June 1999)	$20.2M	October 30, 2000	382 days
EARP II, Year 2 (ended June 2000)	Still contested. Hearings anticipated on May 22-24, 2001.	----------	----------
EARP II, Year 3 (ends June 2001)	----------	----------	----------

(Also delayed the EARP 3rd year rate reduction which had been anticipated to become effective September 1, 1998.)

2. The sharing grids agreed upon by the parties contain rate of returns that have become too high and which permit AmerenUE to retain an unreasonably high percentage of excess earnings in the lower "bands".

On this matter, AmerenUE, quite simply, got the better end of a bargain made with Public Counsel, the Staff of the Commission (Staff), and other parties. (It is important to realize that the bargain made for EARP I and II also involved stipulated rate reductions and that the bargain for EARP II was part of the larger resolution of significant merger issues.) However, it would have

been more fair to start the "sharing" at lower levels and to allow consumers to receive a larger share of earnings at lower levels. Conversely, AmerenUE could be allowed a larger share of earnings at upper levels, actually creating a better incentive to be efficient.

3. The alternative regulation plan experiment was allowed to continue for an unreasonably long period without the opportunity for analysis and reconsideration.

By their very nature, Public Counsel believes that any EARP-type plan is unlikely to function smoothly beyond two or three years. As all parties have learned, such alternative regulation plans, especially when they control the disposition of several millions of dollars, are naturally more prone to disagreement and litigation as time passes. Such controversy defeats the benefit of timely credits to consumers which that was the primary benefit that Public Counsel anticipated from the EARP (discussed in paragraph 1 above). Any such alternative regulation plans should be revisited on a frequent basis by the Commission to hopefully minimize confusion about the operation and intent of the plans.

4. In Public Counsel's opinion, the lessened scrutiny of AmerenUE's operations and expenditures during the pendency of EARP I and II has not served the public interest.

At various times during these "experiments", Public Counsel has encountered increased resistance and delays to discovery requests. It is Public Counsel's fear that there has been inadequate scrutiny of fundamental decisions that have been made in AmerenUE's regulated business during this time. Among Public Counsel's suspicions are that AmerenUE has strategically timed certain expenditures to "manage" its earnings and that AmerenUE has expended considerable money to develop systems that will primarily benefit non-regulated activities with funds that should have been used primarily for the benefit of regulated consumers.

In a more traditional rate case setting, these matters could have been resolved in manner that was fair to consumers and shareholders.

5. In retrospect, Public Counsel believes that the type of alternative regulation plan instituted with EARP I and II has actually set up perverse incentives regarding the way that AmerenUE manages its regulated business.

The plans "sharing grid" which determines annual credits sets up an incentive for AmerenUE to manage its earnings instead of providing an incentive to efficiently manage its business. The natural incentive is to make large one-time outlays of expense or increases to rate base during a test period of excess earnings, or risk having to give those funds to consumers under the EARP II.

6. It is not accurate to state that the EARP I and II is designed in such a way as to promote "competitive practices" nor is it accurate to call these plans "performance-based regulation."

Rate of return regulation is designed to be a surrogate for competition and one of the ways that it fulfills this goal is by creating a very real cash incentive to reduce expenses and manage a utility more efficiently between rate cases. Competitive markets, like traditional regulation, are based on rate of return. Investors place their money's in the firms that earn returns commensurate with the investor's risk profile. The incentives created under the current alternative regulation plan are different from the incentives to run a more efficient utility that are inherent to regulatory lag.

7. Pending litigation and legislation should preclude any alternative regulation for AmerenUE at this time.

There are several pending matters that could affect AmerenUE operations and should be resolved before any alternative regulation is considered again for this utility, including:

a. Case No. EM-2001-233, which involves a request to increase the Missouri jurisdictional allocation factors.

b. Cole County Circuit Court Case No. 00CV323273 et al., which is an appeal of the third year "sharing credits" decision by the Commission for EARP I. If the courts alter the understanding of EARP concepts held by Public Counsel and the Commission as a result of this appeal, then no such agreement should be considered in the future.

c. AmerenUE is supporting legislation that would restructure the generation of electricity and it would not be in the public interest to enter into another EARP during a time that this matter is being considered.

B. If the Commission decides to proceed with any further alternative regulation plan similar to the EARP II, Public Counsel recommends several conditions that would mitigate harm to the public.

1. Any alternative regulation plan approved for AmerenUE should be preceded by a full audit and general rate case or rate complaint case to "rebase" electric rates before the plan commences. Only then can a benchmark be set to compare any efficiencies achieved during a future alternative regulation scheme.

2. Any EARP-type alternative regulation plan should have a duration of no longer than two to three years.

3. There should be no incentive for AmerenUE to cause delays in the ordering of sharing credits in any alternative regulation plan established for AmerenUE in the future. While the current EARP II does not require interest to accrue on any disputed or undisputed sharing credit amounts, Public Counsel recommends that any alternative regulation plan established in the future contain a provision that AmerenUE must pay an appropriate level of interest on top of any sharing credit amounts deemed reasonable by the Commission, calculated from the last day of the test period. Interest should be calculated at AmerenUE's equity return.

Such a provision should encourage prompt award of sharing credits to consumers and discourage any litigation that would serve merely to delay or prolong credits. Furthermore, any future EARP should contain a provision requiring all *undisputed* "sharing credits" to be issued to consumers immediately following each Final Report filing by AmerenUE.

4. The statutory discovery rights of Staff and Public Counsel, along with the discovery rights of other parties should not be limited in any way by the adoption of any future alternative regulation plan for AmerenUE.

Respectfully submitted,

OFFICE OF THE PUBLIC COUNSEL

By: _____

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed or hand-delivered to the following this 1st day of February 2001:

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