

February 4, 1999

VIA FEDERAL EXPRESS

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FEB - 5 1999

Mr. Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
P. O. Box 360
Jefferson City, MO 65102

Missouri Public
Service Commission



Re: MPSC Case No. EM-96-149

Dear Mr. Roberts:

Enclosed for filing on behalf of Union Electric Company, d/b/a AmerenUE, in the above matter please find an original and fourteen (14) copies of its Reply to Staff Response to Request for Commission Guidance Or, In The Alternative, Union Electric Company's Request for an Order Establishing Further Proceedings With Respect to the Meaning of the Governing Legal Standard.

This pleading was filed on February 1, 1999, in MPSC Case No. EO-96-14. Pursuant to Commission Notice Directing Parties to File Pleadings Separately dated January 19, 1999, Union Electric Company is filing the above-referenced pleading in MPSC Case No. EM-96-149.

Kindly acknowledge receipt of this filing by stamping a copy of the enclosed letter and returning it to me in the enclosed self-addressed envelope.

Very truly yours,

A handwritten signature in black ink, appearing to read "J. Cook", is written over the typed name and title.

James J. Cook
Managing Associate General Counsel

JJC/bb
Enclosure(s)

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Missouri Public Service Commission

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of the Monitoring of the)
Experimental Alternative Regulation Plan) Case No. EM-96-149
of Union Electric Company)

**UNION ELECTRIC COMPANY'S REPLY TO
STAFF AND PUBLIC COUNSEL RESPONSE
TO REQUEST FOR COMMISSION GUIDANCE
OR, IN THE ALTERNATIVE, UNION ELECTRIC COMPANY'S
REQUEST FOR AN ORDER ESTABLISHING
FURTHER PROCEEDINGS
WITH RESPECT TO THE MEANING
OF THE GOVERNING LEGAL STANDARD**

Comes now Union Electric Company ("AmerenUE" or the "Company") in reply to the Response of the Staff of the Missouri Public Service Commission ("Staff") and of the Office of Public Counsel ("Public Counsel") to AmerenUE's Request for Commission Guidance.¹ The Company's Request had posed a narrow question of interpretation for the Commission's review: whether the word "manipulate," as found in Sections 3.f.vi. and vii. of the Stipulation and Agreement ("Stipulation") governing the Experimental Alternative Regulation Plan ("EARP"), implies a variation in the level of expenses designed to misrepresent costs and reduce the amounts to be shared with customers under the EARP. The Staff's reading of "manipulation" in its Response -- cleansing it of any nefarious intent -- defies not only common sense, but also the clear understanding of the signatories to the Stipulation. Moreover, the Staff's suggestion that it can challenge any variation in the level of expenses associated with a category of costs is foreclosed by the plain language of the Stipulation. Where the Company's accounting

¹ The Company filed its Request for Guidance on November 23, 1998. The Staff filed its response on December 3, 1998. The procedural history of the case is summarized in the Order Setting Prehearing Conference, filed by the Chief Regulatory Law Judge in Case No. EO-96-14 on December 21, 1998.

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procedures are consistent not only with past practice, but also with generally accepted accounting principles (GAAP), as is the case here, those procedures are by definition reasonable -- that is, not "manipulation" -- both as a matter of common sense and within the meaning of the Stipulation. The Staff's position is altogether without merit.

The question posed here goes to the very heart of the Stipulation; it is a threshold issue that must be addressed before the concerns raised by the Staff can sensibly be addressed. Indeed, the Stipulation expressly requires the Commission to "determine in the first instance whether a question of manipulation exists and whether that question should be heard by it." Stipulation at Section 3.f.vi. (emphasis added). The Company requests that the Commission rule that the Stipulation, on its face, does not support the strained interpretation proposed by the Staff. In the alternative, if the Commission concludes that the Stipulation is ambiguous, the Company is entitled to take discovery and develop a factual record on the fundamental question of the meaning of "manipulation." As the Stipulation expressly provides, only after the proper standard is established does it make sense for the parties to apply that standard to the other concerns raised by the Staff. The Company hopes to be able to resolve some or all of the issues by agreement with the Staff once the standard is determined, again acting consistently with the overarching design of the Stipulation that Commission proceedings be held to a minimum.

The Company is emphatically not seeking to evade its responsibilities under the Stipulation. Indeed, the Public Counsel's insinuation that the Company is seeking to insulate its earnings report from meaningful review is completely unfounded. Verification of the "accuracy" of the Company's calculation of its earnings is fully

appropriate under the Stipulation. See Public Counsel December 3 Response at 3. The question here, rather, is: What are the accounting policies and practices under which the Company's earnings are to be calculated? The Company's answer, steeped in both the text and purposes of the Stipulation, is simple: Long-established accounting policies, in conformity with past practice and GAAP, are the proper standard. Signatories to the Stipulation can -- and should -- bring any divergence from that standard, or error in any calculation, to the attention of the Company and, if necessary, the Commission.

The correctness of the Company's understanding of the standard here -- and the importance of the Commission's confirming that standard at the outset -- is underscored by the Staff's arguments. They note a change in GAAP, made effective in December 1998, to support their preferred accounting for the Company's earnings and expenses. See Staff's November 25th Motion, Attachment 1, at 2. Because GAAP is authoritative, the Company will be changing its accounting policies to conform to this change in GAAP, but GAAP was equally authoritative before this change, a logical conclusion the Staff fails to recognize. Moreover, the Staff's approval of the new GAAP methodology - - the results of which the Staff likes -- and its rejection of the prior practice under GAAP -- which they apparently do not like -- is more an example of manipulating numbers and avoiding truly neutral accounting practices than the Company's faithful application of long-standing accounting policies and practices. By ruling first on the proper standard here, the Commission will avoid such an unprincipled selection of accounting methods based on results, a manipulation that is so obviously unfair and at odds with the proper operation of the EARP.

I. The Stipulation Reflects An Up-Front Agreement as to Proper Accounting Practices.

In adopting the sharing-grid regulation plan provided for in the Stipulation, the Commission found that it was “in the public interest [because] it allows for a reduction in rates . . . and does so without the expense and delay of evidentiary proceedings.” Order in Case No. 95-411 (August 1, 1995) at 4 (emphasis added). To accomplish this goal of expeditious customer rebates, sliding-scale incentive regulation requires “up-front agreement on how earnings should be calculated for purposes of determining whether customer sharing is called for.” Transcript of Testimony Mark L. Oligschlaeger, Case No. ER-97-394 (October 1997), at 5 (emphasis added).

The Stipulation reflects precisely this concern. Sections 3.f.i. through f.v. set forth the ordinary procedures to be followed by AmerenUE in filing its sharing reports. Section 3.f.ii references a detailed “Reconciliation Procedure,” which specifies the accounting methods and adjustments to be followed in the preparation of the sharing reports. This Procedure makes repeated -- and approving -- reference to past practice and traditional policies:

“The Missouri electric allocation . . . will be calculated and applied consistent with past UE rate proceedings . . .” Section 2a. (emphasis added).

“The Company will make the following income statement adjustments which have been traditionally made in UE rate proceedings.” Section 2c. (emphasis added).

“The earnings report will utilize . . . Staff’s traditional calculation of the interest deduction for income taxes [and] Staff’s traditional calculation of income tax (refer to the income tax calculation in Case No. EC-87-114).” Section 2f. (emphases added).

It was, furthermore, clearly contemplated by the Stipulation and Reconciliation Procedure that, absent specific language to the contrary, the Company’s existing

accounting policies, which are in accordance with GAAP, prescribe the appropriate accounting methods. Section 3e. of the Stipulation identifies the financial documents that provide the basis for the annual sharing plans; these are, in most instances, documents that also form the basis of documents filed with the Securities and Exchange Commission. As this Commission is aware, such documents must be consistent with GAAP. See 210 C.F.R. § 210.4-01(a)(1) (“Financial statements filed with the Commission which are not prepared in accordance with generally accepted accounting principles will be presumed to be misleading or inaccurate, despite footnote or other disclosures, unless the Commission has otherwise reported.”); United States v. Arthur Young & Co., 465 U.S. 805, 811 n.6 (SEC regulations “require[] that the financial statements of a public corporation must be audited in accordance with ‘generally accepted accounting principles’”). Where the Stipulation contemplates a departure from the Company’s existing accounting policies and GAAP, the Reconciliation Procedure specifically so provides. See, e.g., Reconciliation Procedure at 2c. (excluding certain lobbying and advertising expenses).

The Stipulation’s default assumption that the Company’s long-established accounting policies consistent with GAAP or past practice govern, modified as necessary by a detailed Reconciliation Procedure, bespeaks the signatories’ desire to come to an “up-front agreement” as to proper accounting procedures. Consistent with this desire, section 3.f.viii. provides that the signatories can challenge “any category of cost that . . . has not been included previously in any ratemaking proceeding.” The negative inference to be drawn is that previously settled accounting practices are by definition proper.

To be sure, the Stipulation provides for the possibility that the Company might improperly depart from past practice. Sections 3.f.vi. and f.vii. are activated when, for example, there is evidence or an allegation of “manipulation.” These sections provide that in such an event, any signatory may file a “complaint” and request that the Commission launch “a full investigation.” Both sections treat allegations of manipulation as matters of such gravity that bifurcated proceeding are mandated. See 3.f.vi. (“UE shall have the right to respond to such request and present facts and argument as to why an investigation is unwarranted.”); 3.f.vii. (“An allegation of manipulation could include significant variations in the level of expenses associated with any category of cost, where no reasonable explanation has been provided. The Commission will determine in the first instance whether a question of manipulation exists and whether that question should be heard by it.”).

II. The Staff’s Interpretation of “Manipulation” Conflicts with the Plain Language of the Stipulation.

In its Response, the Staff strains to relieve the word “manipulate” of the underhanded connotations it has in common usage.² The Staff observes that one of the dictionary definitions of manipulation includes the word “artful,” which, the Staff submits, is a word lacking in sinister meaning. Staff December 3 Response at 3. The Staff also notes that an alternative definition of “manipulation” is the wholly benign, “to treat or manage with the mind or intellect.” Id. at 4. In the Staff’s view, “manipulation”

² As we noted in our November 23 Request for Commission Guidance, one of the principal dictionary definitions of “manipulate” is to “control or play upon by artful, unfair, or insidious means esp. to one’s own advantage.” Request at 2 (quoting Webster’s Ninth New Collegiate Dictionary).

is thus a value-neutral term, suggesting simply the exercise of the intellect and lacking altogether in negative overtones. See also Public Counsel December 3 Response at 3.

Let us be blunt: The Staff's interpretation of "manipulation" conflicts not only with common sense, but also with the plain language of the Stipulation.³ The procedures to be followed in filing an earnings report require a meticulous breakout of a variety of costs: If "manipulation" means nothing more than the exercise of the intellect, every earnings report would be the result of "manipulation." Moreover, the Staff's sanitized reading of "manipulation" is completely at odds with the pejorative cast the word is given in the Stipulation. The Stipulation provides that where there is a "complaint" or an "allegation" of manipulation, a "full investigation" may be needed.

Furthermore, every expense included in the Company's accounting for its operations reduces its return on equity and, consequently, the amount that can ultimately be shared with consumers. Under the Staff's contorted reasoning, any change in the level of expenses, no matter its reason, is a "manipulation" the Staff can use to trigger proceedings before the Commission. This result is at war not only with the whole purpose of the Stipulation, but with the unmistakable import of the words of Section 3.f.vi. and vii. That import is, quite clearly, that a "manipulation" is a change in the

³ The Staff's reading of "manipulation" also conflicts with the meaning of the word in a variety of legal contexts. See e.g., Santa Fe Indus. v. Green, 430 U.S. 462, 476 (1977) ("manipulation" is "virtually a term of art when used in connection with securities markets," referring to practices "intended to mislead investors by artificially affecting market activity"); Philip Morris, Inc. v. Blumenthal, 123 F.3d 103, 104 (2d Cir. 1997) ("The state alleged, inter alia, that the tobacco companies had engaged in unfair, deceptive and anti-competitive trade practices to promote the sale of their produce, including . . . the manipulation of nicotine levels."); United States v. Stanert, 762 F.2d 775, 782, as amended, 769 F.2d 1410 (9th Cir. 1985) (by "reporting less than the total story, an affiant can manipulate the inferences a magistrate will draw"); Black's Law Dictionary 963 (defining "manipulation" as "[s]eries of transactions involving the buying

method of calculating expenses undertaken solely to reduce the amount to be shared with customers.

Clutching at straws, the Staff further argues that, regardless of the meaning of the word "manipulation," it can, under the Stipulation, challenge any accounting procedure adopted by the Company, even if the Company's accounting method is consistent with past practice and in accordance with GAAP. See Staff December 3 Response at 6, 9-12 (citing Stipulation sections 3.f.vii & viii.). See also Public Counsel December 3 Response at 2-3. The Staff gestures to the fact that Section 3.f.vii. sets forth a non-exhaustive lists of events that may trigger the possibility of Commission review: "Examples include disagreements as to the mechanics of calculating the monitoring report, alleged violations of the Stipulation and Agreement, alleged manipulations of earnings reports, or requests for information not previously maintained by UE." See Staff December 3 Response at 6.

As an initial matter, it must be noted that there is no disagreement here that relates to the monitoring report or the production of documents, nor has the Staff contended that the Company has violated the terms of the Stipulation. Thus, of the examples listed in section 3.f.vii. that can trigger Commission review, the Staff actually bases its claim on only one -- that is, relating to "manipulation." Furthermore, the Staff apparently infers from the fact that the list in section 3.f.vii. is non-exhaustive the conclusion that any circumstance at all triggers Commission review. The logic here is deeply flawed. As previously demonstrated, Sections 3.e. and 3.f., especially when read in tandem with the Reconciliation Procedure, reflect the signatories' unmistakable intent that the Company's

or selling of a security for the purpose of creating a false or misleading appearance of active trading.").

traditional accounting practices and other accounting policies in accordance with GAAP are not susceptible to Staff challenge or to Commission review.

III. The Commission Should Reject the Staff's Contorted Reading of "Manipulation," or, in the Alternative, the Commission Should Allow Discovery on This Narrow Question of Interpretation.

As already indicated, the Stipulation clearly contemplates that a two-step procedure is appropriate when there is an allegation of "manipulation." Section 3.f.vii. states, "The Commission will determine in the first instance whether a question of manipulation exists and whether that question should be heard by it." See also section 3.f.vi. ("UE shall have the right to respond to such request [for an investigation into alleged manipulation] and present facts and argument as to why an investigation is unwarranted."). In the instant case, there is a question of whether manipulation exists. The answer to that question hinges on the meaning of "manipulation." In the Company's view, existing accounting policies in conformity with past practice and GAAP cannot constitute "manipulation"; in the Staff's view, any deviation in costs can give rise to an allegation of "manipulation." The correct interpretation of "manipulation" is a threshold issue that must be addressed before the other concerns raised by the Staff can be addressed.

Accordingly, the Company submits that the Stipulation requires the Commission to resolve the core dispute as to the meaning of "manipulation." The Commission can, we submit, decide this dispute by going no farther than the plain language of the Stipulation: "Manipulation," as contemplated therein, means an effort to disguise or inflate costs for no reasonable purpose other than to deprive customers of credits to which they would otherwise be entitled. Following from that, the Commission should hold that

existing accounting policies in conformity with settled practice and GAAP cannot constitute "manipulation," within the meaning of the Stipulation, and are thus not subject to Commission review.

In the alternative, if the Commission decides that the language of the Stipulation is ambiguous, the Company submits that it is entitled to take discovery and establish a factual record on this issue of interpretation. The parties have previously communicated about a procedural schedule; however, we propose the Commission order the following, which is a slight modification of the Staff proposal:

February 4	Data Requests
February 26	Responses and Production of Documents
March 8	Direct Testimony (All Parties) ⁴
March 8 - April 22	Depositions
April 23	Rebuttal Testimony (All Parties)
May 4	Surrbuttal and Cross-Rebuttal Testimony (All Parties)
May 6	Prehearing Conference
May 28	Hearing Memoranda Due
June 7 -9	Hearing

Discovery should reach only the interpretative question of the proper understanding of "manipulation" and need not extend to the parties' other disagreements. The resolution of this threshold interpretative issue will almost certainly conserve the parties' and the

⁴ In the event the Commission declines to decide the threshold issue of the meaning of "manipulation," either on the face of the Stipulation or through further development of the factual record, but instead proceeds to address the various disputes raised by the Staff, the Company respectfully argues that the simultaneous submission of direct testimony is inappropriate. As the Staff notes in its filing of this date, if the Commission orders

Commission's resources. Once the definition of "manipulation" has been clarified through adjudication, the parties will be better able, without the Commission's intervention, to resolve the other issues. Should additional proceedings be needed, the Commission could order an abbreviated schedule.

IV. Conclusion

The significance of this dispute extends well beyond the instant case. Although the EARP expired in July 1998, the rate-sharing plan now in effect for AmerenUE is governed by a Stipulation with language identical to its predecessor. See Stipulation (July 12, 1996), Section 7e. & 7f., adopted by the Commission, Report And Order, Case No. EM-96-149 (March 4, 1997). Furthermore, as the Staff noted in its Response, several other companies are currently seeking similar treatment under a similarly fashioned alternative rate-regulation plan. See Staff December 3 Response at 2. If the Staff is emboldened to challenge any accounting practice, even one observed in the past and consistent with GAAP, then each annual review of the sharing report is in jeopardy of being transformed into a full-blown ratemaking case.

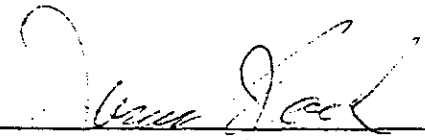
WHEREFORE, the Company respectfully submits that the Commission should decide that the Stipulation, on its face, forecloses the interpretation proposed by the Staff. The Commission should hold that "manipulation," as contemplated by the Stipulation, means an intent to disguise costs and thereby reduce the amounts to be shared with customers under the EARP. Following from that, the Commission should hold that existing accounting procedures in accordance with past practice and GAAP are not subject to Staff challenge or Commission review. In the alternative, if the Commission

proceedings as to the disputes, then the Company respectfully submits that it should be entitled to present its direct testimony first, followed by the Staff's.

finds that the text of the Stipulation is ambiguous, the Company respectfully requests that the Commission approve the procedural schedule outlined above and allow the parties to develop a factual record on the narrow question of the meaning of "manipulation," as contemplated by the Stipulation. That proceeding would not go to the other concerns that the Staff has raised, but rather would be focused on whether, under the Stipulation, existing accounting methods in accordance with past practice and GAAP are by definition reasonable and not subject to Staff challenge or Commission review.

Respectfully submitted,

UNION ELECTRIC COMPANY
d/b/a AmerenUE

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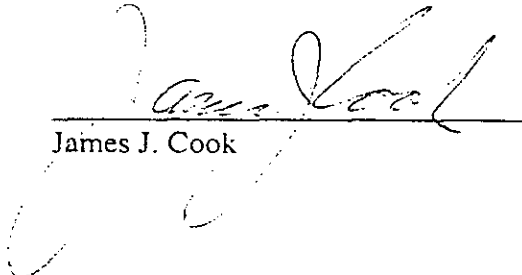
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DATED: February 1, 1999

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served via first-class, U.S. mail, postage prepaid, on this 1st day of February, 1999, to all parties on the attached service list.



James J. Cook