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 AMERENUE

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INTRODUCTION

AmerenUE is seeking a substantial rate increase in this case, and unfortunately the Company is in a situation where that rate increase is badly needed. As the testimony in this case has demonstrated, AmerenUE is facing sharply rising costs in almost every area of its business—from the costs of new construction, to labor and materials required to maintain the system, to the cost of fuel needed to run its generating plants. These cost increases are not unique to AmerenUE; they are being experienced throughout the electric utility industry. But the problem is more acute for AmerenUE because, at the behest of our customers and the Commission, we have embarked on a massive construction program to storm harden our system, improve reliability, and comply with the Commission's new rules addressing vegetation management and infrastructure inspection and repair. These investments in our system have already resulted in measurable improvements in reliability to customers and they promise to improve reliability further in the future. However, they come at a cost that must be recovered through rates.

The Company is also confronted with some severe financial challenges which must be addressed in this case. We face unusually significant regulatory lag in recovering our costs due to our inability to utilize a fuel adjustment clause, Missouri's reliance on an historic test year, and the statutory prohibition against including construction work in progress in rate base. Largely as a consequence of this regulatory lag, the Company's financial condition has materially deteriorated in recent years. Our bond credit rating now sits at just 1-2 notches above

junk status, we are currently unable to issue commercial paper (an important source of short-term debt), and our access to long-term debt is limited. Moreover, we have consistently been unable to earn even the allowed return on equity (ROE) approved in our last rate case, and certainly are unable to earn our current cost of equity. To address these issues, it is critically important that the Company be permitted to recover the costs that it prudently incurs to provide service to its customers on a timely basis. This will permit the Company to restore its financial health, and insure our access (at reasonable cost) to the capital that we need to maintain our system, improve reliability, and meet the future needs of our customers.

Although the relief that we seek in this case is necessarily significant, we have made a conscious effort to ensure that our requests are not excessive. We are simply seeking mainstream regulatory treatment in almost every area. Mainstream treatment is critically important because it has a great effect on how debt and equity investors – and those they rely upon for investment information – perceive the risk of providing capital to the Company. That perception of risk in turn affects both the Company's access to capital and the cost of that capital. In an era when the Company is investing huge sums in its system, capital access and cost issues are more important than perhaps they have ever been.

An example of the mainstream treatment we seek is found in our requested ROE of 10.9%, which is quite close to the national average for integrated electric utilities and the ROEs recently awarded in Missouri to other electric utilities. In contrast, the ROE recommendations of our opponents (particularly the 9.5% ROE recommended by the Commission Staff) are very far below the ROEs that are typically awarded, and if adopted would further damage the Company's financial health.

This pattern plays out in the other issues in this case. The fuel adjustment clause (FAC) that we are seeking is similar to those used by the overwhelming majority of integrated electric utilities throughout the country, and patterned after the FACs recently approved by the Commission. Our opponents' positions that either (a) no fuel adjustment clause should be approved at all, or (b) an FAC with a punitive sharing mechanism should be approved, are far outside the mainstream of regulation. If adopted they would also fail to place AmerenUE on the same footing as other integrated utilities with whom it must compete for capital.

Other examples of this phenomenon involve the vegetation management/infrastructure tracker and incentive compensation issues, where the Staff is proposing regulatory treatment that would effectively require AmerenUE to absorb demonstrably prudent costs of improving reliability and paying its employees market-based compensation. In fact, with regard to most of the revenue requirement issues in this case, the Company is simply proposing to recover the costs that it has actually incurred to provide service to its customers, and the Staff is proposing disallowance or Company absorption of those costs based on one theory or another.

In this case, the Company has requested only (a) a mainstream FAC and ROE, and (b) recovery of its prudently incurred, actual costs of providing service to its customers. This relief is absolutely necessary if AmerenUE is to be able to restore its financial health, access capital at a reasonable cost, and be in a position to meet the needs of its customers now and in the future.

CONTESTED ISSUES

I. RETURN ON EQUITY.

ROE is the highest dollar value issue in this rate case, accounting for approximately $65.4 million in revenue requirement between the lowest and highest recommendations. There are four expert witnesses who use a variety of technical analyses to support various

recommended ROEs for the Company: Staff witness Stephen Hill supports by far the lowest recommended ROE of 9.5%. The Missouri Energy Group (MEG) witness, Billie Sue LaConte, and the Missouri Industrial Energy Consumers (MIEC) witness, Michael Gorman, both support a 10.2% ROE. Finally, Company witness Dr. Roger Morin supports a 10.9% ROE, assuming AmerenUE's fuel adjustment clause is approved.[1] The range of ROEs each expert is recommending is set forth in the table below.

Expert	Party	Recommended Range	Recommended ROE
Hill	Staff	9.0%-9.75%	9.5%
LaConte	MEG	10.1%-10.6%	10.2%
Gorman	MIEC	9.81%-10.55%	10.2%
Morin	AmerenUE	10.3%-11.4%	10.9%

Of the four recommendations, Dr. Morin's is based on the most credible analyses, is most consistent with mainstream ROEs approved for other integrated electric utilities throughout the country and in this state, and is most consistent with the legal standards applicable to the determination of an appropriate ROE. As a consequence, Dr. Morin's recommended ROE should be adopted. A discussion of each expert's recommendation follows.

A. **Mr. Hill's Recommended ROE of 9.5% Should be Given No Consideration Whatsoever.**

In AmerenUE's last rate case, Case No. ER-2007-0002, the Commission was confronted with sharply divergent recommendations for AmerenUE's ROE. At one end of the spectrum, AmerenUE's witnesses (Dr. Vander Weide and Ms. McShane) recommended ROEs of 12% and

[1] If the proposed FAC is not approved, Dr. Morin recommends that the Company's ROE be increased to 11.15%. The other experts have testified that their recommended ROEs should be decreased if an FAC is approved. However, this makes no sense. Since almost all integrated electric utilities operating in non-restructured states have FACs (*See* Ex. 41 (Lyons Direct), Sch. MJL-E6 for a complete listing) and since restructured states permit the periodic recovery of fuel costs, the companies in the sample groups used by all of the experts predominantly already have FACs. As a consequence, their recommended ROEs derived from their analyses of these sample groups should instead be *increased* if no FAC is approved.

12.2% respectively.[2] At the other end of the spectrum, the State of Missouri expert recommended an ROE of 9.0%, and Staff witness Stephen Hill recommended an ROE of 9.25%. At the time the average ROE for all (including less risky "wires only") electric utilities reported by Regulatory Research Associates for the immediately preceding calendar year (2006) was 10.36%.[3]

In that case, the Commission found that AmerenUE was an electric utility facing an average level of risk that should be allowed something close to the average return on equity. The Commission expressed serious concerns about the recommendations at both ends of the spectrum, both far above and far below the average. The Commission stated:

> In sum, the financial risk upward adjustment proposed by AmerenUE's witnesses appears to be a transparent effort to inflate the company's proposed return on equity to obtain a better bargaining position in the hope the Commission would simply split the difference between the extreme positions. Such efforts call into question the credibility of these witnesses. Indeed, Vander Weide came close to acknowledging that his proposed return on equity was extreme when at the hearing he indicated an eleven percent return on equity, in line with the amounts that the Commission has allowed Kansas City Power & Light and The Empire District Electric Company in recent cases, "would be a benchmark that the financial community would look at" [footnote omitted].
>
> On the other side of the thicket, the returns on equity proposed by some of the experts are clearly too low. If the Commission were to impose the return on equity they advocate, AmerenUE would have the lowest allowed return on equity in the country. AmerenUE is an average company with an average risk. It should be allowed something close to an average return on equity.
>
> In setting rates, the Commission's obligation is to reasonably balance shareholder and ratepayer interests. This is not an intellectual game designed to fatten or drive down the company's bottom line. Economic theories must be tempered by a realistic appraisal of the effect the numbers derived from those theories will have on the company and on ratepayers. ***For once, the Commission would like to see a rate case in which the witnesses present a balanced analysis rather than race to the extremes.*** (Emphasis added)

[2] Had Ms. McShane and Dr. Vander Weide not included their financial risk premium adjustments, which the Commission rejected, their recommendations would have been 11% and 11.5%, respectively. Case No. ER-2007-0002, *Report and Order* (June 1, 2007) p. 40 (AmerenUE Order).

[3] *Id.* p. 38.

AmerenUE took these words to heart and used them as a touchstone when it prepared this rate case. The Company hired a different ROE expert who did not make the financial risk upward adjustment that the Commission had previously rejected.[4] Dr. Morin, the Company's well-qualified expert,[5] conducted sound analyses and recommended an ROE that is consistent with the national average for integrated electric utilities (10.62%)[6] and in line with ROEs recently awarded by this Commission to The Empire District Electric Company (Empire) (10.8%) and Kansas City Power & Light Company (KCP&L) (10.75%).[7] Dr. Morin's analysis and recommendation clearly cannot be fairly characterized as a "race to the extreme." Instead he has presented a mainstream recommendation for an ROE consistent with the ROEs recently awarded to other integrated electric utilities with whom AmerenUE must compete for capital, and appropriate for an integrated utility facing average or a bit above-average risk.[8]

The same cannot be said for Mr. Hill's 9.5% ROE recommendation. His recommendation falls far below the national average of awarded ROEs (even including wires only companies)—just about as far from the average ROE as his very low recommendation in the last case, since both Mr. Hill's recommendation and the average ROE have slightly increased since then. Mr. Hill's 9.5% recommendation is also much lower than the ROEs awarded to other Missouri utilities in recent rate cases—130 basis points below the ROE approved for Empire and 125 basis points below the ROE approved for KCP&L. Mr. Hill's recommendation

[4] The Company does not agree that it inflated its ROE request in the last case with a financial risk upward adjustment. However, it did not include such an adjustment in this case in recognition of the Commission's ruling on that issue.
[5] In a prior Missouri Gas Energy rate case, the Commission recognized Dr. Morin as the most credible of all of the ROE experts for all parties in that case. *In re: Missouri Gas Energy*, Case No. ER-2004-0209, 2004 WL 2267213 (Oct. 2, 2004).
[6] Ex. 4 (Morin Rebuttal) p. 5, l. 15-18.
[7] *In re: The Empire District Electric* Company, Case No. ER-2008-0093, *Report and Order* (Aug. 9, 2008), p. 27 (Empire Order); *In re: Kansas City Power & Light Company*, Case No. ER-2007-0291, *Report and Order* (Dec. 16, 2007) p. 29.
[8] AmerenUE is actually more risky than average given its current bond rating, as discussed below.

is in fact 50 basis points below the cost of long-term, secured debt recently issued by AmerenUE's sister company, Illinois Power Company,[9] and is almost as low as current bond yields for Baa rated companies.[10] Common sense dictates that a utility's cost of equity cannot possibly be below (or even near) the cost of *secured utility debt* given that equity holders are subordinate to bondholders and thus face more risk (and require a higher return).[11]

If Mr. Hill's recommended ROE was adopted, AmerenUE would in fact have the lowest ROE of any integrated utility in the country.[12] Mr. Hill's recommendation is so low that not even the consumer advocates in this case—the Office of the Public Counsel and the attorneys representing the State of Missouri (who are well known for zealous advocacy for their clients)—could bring themselves to support this recommendation.[13] A chart (see next page) depicting the

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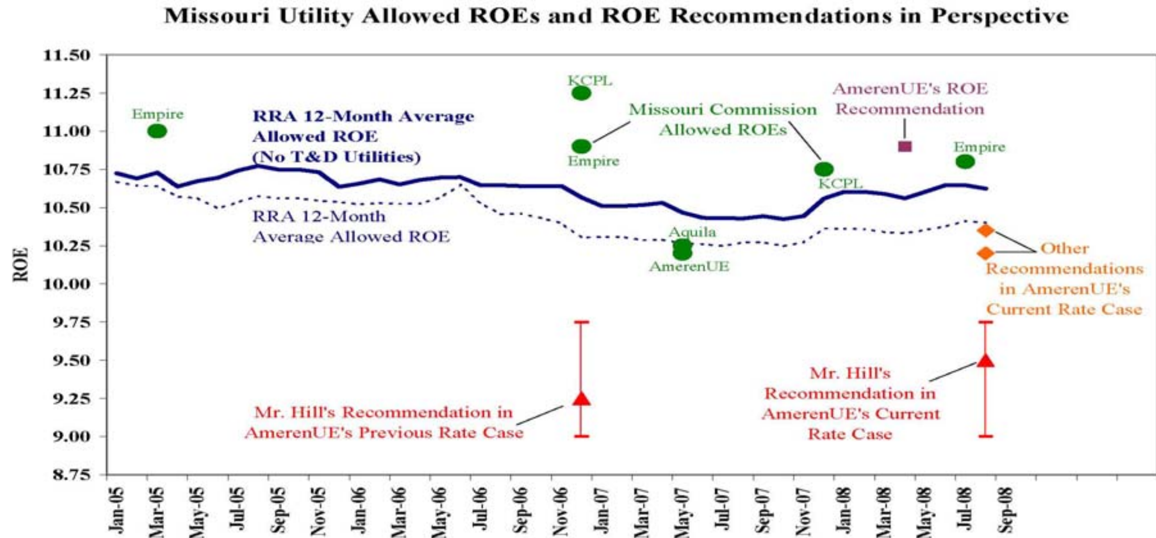
[9] Tr. p. 119, l. 21 to p. 120, l. 6 (Mr. Voss).
[10] Ex. 59.
[11] As Dr. Morin put it: "to induce an investor to buy stock, you've got to give that investor more than he can get on the bonds." Tr. p. 463, l. 14-20.
[12] See Ex. 60, p. 4 for ROEs awarded to all electric utilities in 2008. The few entries below 10% are coded "D" meaning that they apply to distribution (lines) only utilities.
[13] *See* Statements of Position of the Office of the Public Counsel and the State of Missouri.

degree to which Mr. Hill's recommendation departs from the mainstream and represents a "race to the extreme" is shown below.



Mr. Hill's recommendation, if adopted, would reduce AmerenUE's revenue requirement by approximately $65.4 million. If the Commission's admonition to the parties in the last case to avoid a race to the extremes is to have any meaning, the Commission must give Mr. Hill's recommendation no weight whatsoever in its determination of AmerenUE's ROE. If Mr. Hill's recommendation is given any weight at all, it will encourage all parties to take extreme and unsupportable positions on ROE, in the hope that they will benefit from the Commission "splitting the difference" among recommendations or giving some weight to any recommendation advocated by any expert.

Why and how Mr. Hill came to his recommendation of a 9.5% ROE are important considerations in evaluating his recommendation. Why he came to this recommendation is

obvious—Mr. Hill is a lifelong consumer advocate, who approaches his recommendation regarding the appropriate return on equity for a utility from a consumer advocate's point of view. In other words, Mr. Hill does not approach his recommendation from an objective point of view, despite being hired by the Staff, which ought to be presenting a balanced, objective revenue requirement without favoring either utility or consumer interests.

Mr. Hill's career as an ROE expert began in the early 1980s, when he was hired by the Virginia Consumer Advocate's Office—the Virginia equivalent of the Office of the Public Counsel.[14] Mr. Hill worked at that office for several years. In the late 1980s, Mr. Hill formed a part-time consulting business because he began to meet people around the country that had a need for a cost of capital witness "because there are not too many folks that do it on the consumer side."[15] Mr. Hill testified that he has represented public advocate parties in 75-80% of the cases in which he has testified, including the Office of the Public Counsel in Missouri.[16] He has represented only one utility company in his long career, and only because that utility wanted to use a "consumer advocate type" witness in their case.[17]

Mr. Hill's positions in cases have historically been recognizable as extreme consumer advocate positions. For example, in AmerenUE's last rate case, Mr. Hill's recommended ROE was only 9.25%. He also testified in this case that he believes that the average cost of equity for the last four to five years for electric utilities has been "pretty solidly between 8.75% and 9.75%," far below the ROEs that this Commission and other commissions across the country have awarded.[18]

[14] Tr. p. 491, l. 9-22.
[15] Tr. p. 492, l. 13-20.
[16] Tr. p. 492, l. 21 to p. 493, l. 2.
[17] Tr. p. 493, l. 10 to p. 494, l. 13.
[18] Tr. p. 498, l. 20-25.

Why the Staff would hire Mr. Hill to provide Staff testimony on such an important issue in this case is hard to imagine. Again, it is the Company's belief that the Staff should be presenting objective evidence that balances utility and consumer interests, not hiring consumer advocates in an effort to drive utility ROEs as low as they can. Unfortunately, that is exactly what the Staff has attempted to do in this case by hiring Mr. Hill as its ROE expert.

As addressed in detail below, exactly how Mr. Hill was able to generate a recommended ROE as low as 9.5% is also illuminating. The primary driver of his low ROE recommendation is the growth component of his discounted cash flow (DCF) analysis, which is one of the main analyses all of the ROE experts in this case have relied upon. Mr. Hill is supporting the use of a 5.04% growth rate in the DCF formula based entirely on his "judgment" of what the growth rate is for each of the companies in his proxy group.[19] As Dr. Morin has explained, Mr. Hill simply looked at a broad array of growth rate estimates for each of his proxy companies, and then selected an arbitrary growth rate for each company.[20] There is no way to replicate any analysis Mr. Hill may have used to select particular growth rates for any particular proxy company, and in fact, based on Mr. Hill's own testimony, it appears that he performed no such analyses.[21] As Dr. Morin testified "[t]he growth estimates simply appear out of thin air without scientific foundation, derivation or ability to replicate."[22] Mr. Hill's growth rates for his proxy companies are, in short, completely unsupported.

The 5.04% growth rate Mr. Hill winds up using in his DCF calculation (which was derived from the growth rates he judged to be appropriate for his proxy companies) is also extremely low. In the very recent (August, 2008) *Empire* rate case, the Staff witness, Matthew Barnes, used growth rates in his DCF formula ranging from 5.55%-6.63%. The high end of that

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[19] Tr. p. 503, l. 3-8.
[20] Ex. 4 (Morin Rebuttal) p. 8, l. 13 to p. 9, l. 1.
[21] Tr. pp. 501-503.
[22] Ex. 4 (Morin Rebuttal) p. 11.

range provided the foundation for an ROE of 10.8%, which was ultimately adopted by the Commission.[23] The growth rate Mr. Hill is using in this case is *159 basis points* below that level. Mr. Hill's growth rate is also much lower than the growth rates the Staff used for its DCF calculation in the most recent *KCP&L* case, Case No. ER-2007-0291. In that case the Staff's range of growth rates ran from 5.34%-6.50%, quite consistent with the subsequent Staff recommendation in the *Empire* case, but not at all consistent with the "judgment" Mr. Hill exercised in selecting growth rates for this case.[24]

Dr. Morin is critical of some of the types of growth rates Mr. Hill examined for his proxy companies (although there is no way to tell to what degree any particular growth rate he examined impacted the growth rates he judged to be appropriate). In particular, Dr. Morin is critical of Mr. Hill's apparent reliance on the "sustainable" or "internal" growth method to develop some growth estimates. Dr. Morin points out that the sustainable/internal growth method is based on circular logic, because one must assume an expected ROE before this method can be used to estimate the ROE. In addition, the sustainable growth technique is not consistent with empirical evidence. The empirical evidence shows that it is a "very poor explanatory variable of market value."[25]

Dr. Morin is also critical of Mr. Hill's consideration of historical growth rates rather than growth forecasts. Dr. Morin points out that historical growth rates are largely redundant because they are already incorporated in analysts' growth forecasts that should be used in the DCF model.[26] Staff relied primarily on projected growth rates in both the *Empire* and *KCP&L* cases.[27] Dr. Morin points out that if Mr. Hill had used analysts' forecasts to determine the

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[23] *See* Ex. 65.
[24] *Id.*
[25] Ex. 4 (Morin Rebuttal) p. 11, l. 12 to p. 12, l. 12.
[26] *Id.* p. 13, l. 9 to p. 14, l. 5.
[27] Ex. 65.

growth rate for AmerenUE, exactly as the Staff used in the recent *Empire* case, average growth rates would have been forecast in the range of 6.3%-7.3%, and the ROE produced by Mr. Hill's DCF analysis would have been 10.6%-11.6%, excluding consideration of any flotation costs.[28]

Dr. Morin has identified numerous other flaws in Mr. Hill's testimony which do not merit exhaustive discussion, but are briefly identified below:

- Mr. Hill improperly used disguised versions of the DCF as "checks" on his DCF results. For example, Mr. Hill admits that his Market/Book Ratio Methodology "is derived algebraically from the DCF model and, therefore, cannot be considered a strictly independent check of that method."[29]

- Mr. Hill erroneously relied on the "plain vanilla" version of the Capital Asset Pricing Model (CAPM) analysis, which Dr. Morin testified understates the ROE for relatively low beta (low risk) enterprises such as electric utilities—one of the most widely known empirical findings in the financial literature.[30]

- Mr. Hill improperly used the geometric mean market risk premium rather than the arithmetic mean market risk premium in his CAPM analysis. Dr. Morin has provided an exhaustive explanation of the theoretical underpinnings, empirical validation and the consensus of academics on why geometric means are inappropriate for forecasting and estimating the cost of capital in Appendix A-1 to his direct testimony.

In summary,

- Mr. Hill is a lifelong consumer advocate witness who does not approach his analysis from an objective point of view and has recommended an extremely low ROE of 9.5%. This ROE is far below the ROEs recommended by the other witnesses in this case, it is far below the average of ROEs awarded throughout the country and in this state, and it is even below the cost of long-term secured debt issued by at least one electric utility in recent months.

- Mr. Hill's analysis contains numerous flaws identified by Dr. Morin. Most importantly, Mr. Hill selected an arbitrary, and extremely low growth rate of 5.04% to be used in his DCF analysis. This growth rate is approximately 150 basis points below the high end of the range Staff recommended in recent cases for Empire and KCP&L, which formed the basis of the ROEs the Commission adopted in those cases.

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[28] Ex. 4 (Morin Rebuttal) p. 16, l. 15-20.
[29] Ex. 203 (Hill Direct) p. 41, l. 3-4.
[30] Ex. 4 (Morin Rebuttal) p. 20, l. 13 to p. 21, l. 7.

- Mr. Hill's analysis and recommendation constitute a "race to the extreme" which should be given no weight at all in this case.

B. Ms. LaConte's ROE Recommendation of 10.2% Should Be Afforded Little Weight.

Billie Sue LaConte, the ROE witness for MEG, supports an ROE of 10.2%. However, Ms. LaConte's recommendation on this issue should be afforded little weight. Ms. LaConte readily admits that she has no specialized training and little experience in calculating ROEs.[31] Of the 4-5 times she has ever offered any testimony on ROE,[32] it appears that she herself has never before done an independent study supporting a particular ROE. For example, in AmerenUE's last rate case, Ms. LaConte filed just 15 pages of testimony on ROE, and admitted that she did not conduct a DCF analysis or an analysis using any other methodology.[33] In a 2003 Missouri-American Water Company case, Ms. LaConte filed just five pages of testimony on ROE, and again did not do any independent analysis.[34] In a 2002 Interstate Power & Light Company case, she also did not do an independent analysis or make an independent ROE recommendation.[35] Ms. LaConte has never had any ROE that she recommended be adopted by any Commission.[36]

The point of this discussion is not to impugn Ms. LaConte's credentials as a utility consultant. As her resume reflects, she has many years of experience dealing with a number of utility issues including cost allocation, rate design and power cost forecasting.[37] These are the topics about which she typically testifies.[38] However, she has extremely limited training and experience with regard to calculating ROEs. This is important because the results of the DCF

[31] Tr. p. 284, l.10-23.
[32] Tr. p. 285, l. 18-20.
[33] Tr. p. 285, l. 18 to p. 286, l. 11.
[34] Tr. p. 287, l. 21 to p. 288, l. 10.
[35] Tr. p. 288, l. 19 to p. 289, l. 2.
[36] Tr. p. 289, l. 9-11.
[37] Ex. 650 (LaConte Direct) Appx. A, p. 1.
[38] Tr. p. 285, l. 10-14.

and other analyses depend so heavily on inputs selected based on the informed judgment of the analyst. Without sufficient training or experience, these judgments by definition cannot possibly be informed, and are thus likely to be flawed.

Consistent with her limited approach to dealing with ROE issues in previous cases, Ms. LaConte conducted only limited analyses in this case. In this case, she did conduct her own DCF analysis, which resulted in an average ROE estimate of 10.6%, and she conducted her own CAPM analysis, which resulted in a 10.4% ROE.[39] Finally, she used Dr. Morin's Risk Premium results, but then she improperly adjusted them to reflect a lower return, resulting in a 10.1% ROE. The results of all three of these analyses are shown on the following table:

Results of Ms. LaConte's ROE Methods[40]

Method	**ROE**
CAPM	10.4%
Risk Premium	10.1%
DCF	10.6%
Average	10.3%

From these results, Ms. LaConte inexplicably recommends a 10.2% ROE (within her range of 10.1% to 10.6%)[41] if AmerenUE is not permitted to use an FAC, and 10.0% (within her adjusted range of 9.9%-10.4%) if AmerenUE is permitted to use an FAC.[42]

Dr. Morin identified numerous flaws in Ms. LaConte's calculations, which are addressed below. But even assuming that the results of Ms. LaConte's analyses were correct, it is hard to imagine how they support her recommendation. For one thing, it appears that her initial

[39] If Ms. LaConte had used the median of the DCF results for her sample rather than the average, the DCF result would have been 11.1%. Ex. 4 (Morin Rebuttal) p. 50, l. 3-9.
[40] Ex. 650 (LaConte Direct) p. 14.
[41] It is noteworthy that Ms. LaConte has acknowledged that any ROE within her range would be a reasonable ROE for AmerenUE. (Tr. p. 295, l. 21-24.) That would include a 10.6% ROE at the upper end of her range, which is just 30 basis points below Dr. Morin's recommendation.
[42] Tr. p. 296, l. 21-24.

recommendation should be the average of the three methodologies she relied upon--10.3%. Second, since virtually all integrated electric utilities in the U.S. currently have use of a fuel adjustment clause, including those in Ms. LaConte's sample group, a higher ROE would be required if AmerenUE is placed in the unusual position of not having an FAC. Ms. LaConte mistakenly argues that her recommended ROE should be lowered if an FAC is approved for AmerenUE. In short, Ms. LaConte's recommendation makes no sense based on the results of her own analyses.

As previously mentioned, Dr. Morin has identified numerous specific flaws in Ms. LaConte's analyses. Among other things:

- Ms. LaConte's growth proxy for the DCF analysis was substantially understated because she relied exclusively on Value Line growth forecasts, which are not representative of investors' consensus forecast.[43] Inclusion of consensus analysts' growth forecasts would have changed the average ROE for the sample group to 11.8% and the median ROE to 10.9%.[44]

- Ms. LaConte erroneously relied on the "plain vanilla" CAPM analysis which understates the cost of capital for low-beta (i.e. relatively low risk) entities such as electric utilities.[45]

- Ms. LaConte improperly reduced the ROE in Dr. Morin's risk premium study by using only the first component of the study (the allowed Risk Premium, which yielded a 10.1% ROE), but excluding second component (the historical risk premium study, which yielded a 10.5% ROE).[46]

Correction of even some of these errors would have increased Ms. LaConte's recommendation materially.

In summary:

- Ms. LaConte is an untrained and inexperienced ROE witness who lacks the informed judgment necessary to conduct reliable ROE analyses, so her analyses should be viewed with some skepticism.

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[43] Ex. 4 (Morin Rebuttal), p. 48.
[44] *Id.* p. 49.
[45] *Id.* p. 50, l. 10-16.
[46] *Id.* p. 51, l. 12-23.

- Even if the results of Ms. LaConte's analyses were accepted, her recommended ROE range, 10.1%-10.6%, should apply only if AmerenUE is permitted to utilize an FAC. The ROE should be higher if no FAC is approved.

- Ms. LaConte has acknowledged that adoption of any ROE in her range, including the high end of 10.6%, would be reasonable.

- Ms. LaConte's analyses contain several flaws as explained by Dr. Morin. If even some of these flaws are corrected, Ms. LaConte's recommended ROE would be materially higher.

C. Mr. Gorman's Recommended ROE Should Be Adjusted to Include Consideration of His Single-Stage DCF Analysis and Reflect Other Adjustments Consistent With the Commission's decision in the *Empire* Case.

Mr. Gorman's ROE analysis and recommendation do not suffer from the same types of deficiencies as Mr. Hill's and Ms. LaConte's. Mr. Gorman is an experienced ROE witness, and in fact his analyses have been relied upon by the Commission in part in reaching their decisions on ROE in previous cases, as have Dr. Morin's. Dr. Morin is, however, critical of some aspects of Mr. Gorman's analyses.

For example, Dr. Morin criticizes Mr. Gorman's use of the "plain vanilla" CAPM, which understates the ROE suggested by the CAPM analysis for a low-beta company such as AmerenUE by approximately 50 basis points.[47] In addition, Dr. Morin criticizes Mr. Gorman for using *total* returns on government bonds, rather than just *income* returns to calculate the market risk premium, which also negatively impacts the ROE suggested by the CAPM analysis by another 50 basis points.[48] And finally, Dr. Morin criticizes Mr. Gorman's failure to account for the inverse behavior between authorized risk premiums and interest rates in his Risk Premium analysis. The impact of this error is again a reduction in the ROE produced by the Risk Premium analysis of approximately 50 basis points.[49]

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[47] Ex. 4 (Morin Rebuttal) p. 42.
[48] *Id.* p. 42.
[49] *Id.* pp. 43-44.

But the primary problem with Mr. Gorman's analysis is that in performing his DCF analysis he has completely excluded his own single-stage (or constant growth) DCF calculation from consideration, and used only the results of his two-stage and multi-stage DCF analyses in developing his ROE recommendation. Mr. Gorman acknowledges that the single-stage DCF model is the DCF model that is normally given "primary consideration" in determining the ROE and it "normally is appropriate" to use that model in a rate proceeding.[50] It is the model that Mr. Gorman himself has relied upon in the overwhelming majority of his ROE recommendations dating back to the late 1980s.[51] However, just 12-18 months ago, Mr. Gorman decided to stop exclusively relying on the constant growth DCF model and begin using the two-stage DCF model in conjunction with the single-stage model.[52] At some point even more recently than that, Mr. Gorman stopped giving any weight at all to the single-stage DCF model, on the basis that it would project growth to be greater than the growth rate of the overall United States economy and is therefore too high.[53]

The single-stage DCF model is the standard, mainstream DCF model that has consistently been utilized by this Commission and other commissions throughout the country for many, many years. Except for Mr. Gorman, all of the other ROE witnesses in this case used the single-stage DCF model in developing their recommendations.[54] Mr. Gorman himself calculated a single-stage DCF, filed testimony explaining his calculation, but then omitted the result of his analysis from his ROE calculation. The result of the single-stage DCF analysis clearly should be included in developing AmerenUE's ROE in this case. Even though it produces a result

[50] Tr. p. 560, l. 6-17.
[51] Tr. p. 563, l. 18 to p. 564, l. 2. Mr. Gorman testified that he abandoned the single-stage DCF model for a period of a few years in the late 1990s. Tr. pp. 564-565. Other than that, it appears that the single-stage DCF model has been the main DCF model used by Mr. Gorman throughout his career.
[52] Tr. p. 567, l. 16 to p. 568, l. 11.
[53] Ex. 600 (Gorman Direct) p. 19, l. 4-13.
[54] Ex. 650 (LaConte Direct) p. 19, l. 2; Tr. 499, l. 1-10 (Mr. Hill); Ex. 3 (Morin Direct) pp. 48-51.

somewhat higher than the other DCF analyses, the impact of the result of any one analysis is mitigated by considering it in conjunction with the others. This is the reason multiple analyses are typically used in arriving at an overall ROE recommendation. Moreover, in the recent *Empire* case, the Commission explicitly rejected the logic Mr. Gorman relies on for ignoring his single-stage DCF results. The Commission stated:

> Gorman contends the two-stage DCF model is more reliable because the 7.4 percent analyst growth rate is irrational in that it would project growth to be greater than the growth rate of the overall United States economy. Logically, the growth of a particular company cannot continue to exceed the growth rate of the overall economy forever because eventually the single company would overtake the entire economy. However, that fact does not make Gorman's constant growth DCF model unreliable.
>
> Investors use analysts' growth rates to value stocks in the marketplace and therefore Companies do not have to grow at the same rate forever for the single-stage DCF model to be [a] reasonable approximation of how prices are determined in capital markets. Furthermore, Gorman's assumption that the companies will grow at the forecasted rate for five years instead of four or six years is essentially arbitrary. As Vander Weide indicates, since investors use analysts' growth forecasts in making decisions to buy and sell stock, the analysts' growth forecasts should be used to estimate the growth component of the DCF model, whether or not Mr. Gorman believes those growth forecast[s] are rational.
>
> Rather than simply being discarded, the results of Gorman's single-stage DCF model can reasonably be averaged against the results of his two-stage DCF model. The average of those results is 10.5%. [footnotes omitted.][55]

There are several ways that the results of Mr. Gorman's single-stage DCF analysis could be used to adjust his recommendation in this case. Mr. Gorman's single-stage DCF result could simply be included with all of his other ROE analyses. That adjustment would produce a mid-point ROE of 10.8%[56] and an average ROE of 10.51%. As another alternative, the Commission could exactly follow its decision in the *Empire* case and include only the single-stage and two-stage DCF analyses (and exclude the multi-stage DCF analysis). This adjustment would produce a mid-point ROE of 10.63% and an average of 10.63%. Finally, the Commission could use only

[55] Empire Order, pp. 18-19.
[56] Mr. Gorman's recommended ROE is based on the mid-point of his analyses. Ex. 600 (Gorman Direct) p. 37.

the single-stage DCF analysis (as it has typically done in the past). That would produce a mid-point ROE of 11.16% and an average ROE of 10.98%. These figures are reflected in the chart below, and the accuracy of these calculations was confirmed by Mr. Gorman at the hearing.[57]

Gorman Analyses

	Methods	Range	Mid-Point	Average
Recommended ROE	Two-stage DCF Multi-stage DCF CAPM Risk Premium	9.81% - 10.55%	10.20%	10.2
Addition of Constant Growth DCF	Constant Growth DCF Two-stage DCF Multi-stage DCF CAPM Risk Premium	11.86-9.73	10.80	10,51
Constant Growth DCF Only	Constant Growth DCF CAPM Risk Premium	11.86-10.46	11.16	10.98
Empire Decision Constant Growth and Two-stage DCF Averaged	Constant Growth DCF/Two-stage DCF Averaged CAPM Risk Premium	10.46-10.80	10.63	10.63

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In addition to including the results of the single-stage DCF analysis, there are two other adjustments that should be made to Mr. Gorman's overall recommendation based on the *Empire* order. First, an adjustment should be made to reflect the fact that the average bond rating for the sample groups used by Mr. Gorman is higher than AmerenUE's bond rating, which means that AmerenUE is a company with higher financial risk than the financial risk of Mr. Gorman's sample groups. In a November, 2007 Virginia State Corporation Commission case Mr. Gorman admitted that there is a relationship between bond credit rating and the risk that shareholders are

[57] Tr. pp. 569-573.

subject to, meaning that equity investors will demand greater returns for companies with lower bond ratings. In that case, Mr. Gorman testified:

> My proxy group's average bond rating from S&P is lower than EPCO [the utility] senior secured credit rating of A minus from S&P. The peer group's bond rating from Moody's is identical to that of EPCO's, comma, A3. Bond rating is an indication of the overall or total investment risk of a utility company. Shareholders' risk is impacted by the credit risk because credit rating is an indication of likelihood that a utility will be able to fully meet its fixed financial obligations and thereafter meet equity investors' return expectations. Hence, the stronger the credit rating, the lower the risk and lower the cost of common equity.[58]

This Commission applied this same logic in the *Empire* case in adjusting Mr. Gorman's ROE recommendation to reflect the fact that his proxy group had a higher bond rating than Empire's. The Commission stated:

> Moreover, the proxy groups used by Vander Weide, Gorman and Barnes are all, on average, less risky than Empire. Each of the proxy groups has an average S&P bond rating of BBB+ whereas Empire's current S&P bond rating is BBB-. For determining an appropriate cost of equity, the difference between a BBB- rating and a BBB+ rating can add between 25 and 50 basis points to a reasonable return on equity. (footnotes omitted)[59]

In the end, the Commission added 25 basis points to Mr. Gorman's recommendation to account for this fact.[60] In this case, the three proxy groups used in Mr. Gorman's analyses have average credit ratings that are consistently higher than AmerenUE's. AmerenUE's S&P bond rating, for example, is BBB-, but Mr. Gorman's "Comparable Risk" and "S&P Integrated Electric Utility" proxy groups both have an S&P bond rating that averages BBB+. The third proxy group used by Mr. Gorman, the "Moody's Electric Utility" proxy group, has an even higher average S&P bond rating of A-.[61] There is a similar difference in Moody's ratings.

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[58] Tr. p. 574, l. 20 to p. 576, l. 7.
[59] Empire Order, p. 20.
[60] *Id.* p. 21.
[61] Ex. 600 (Gorman Direct) Sch. MPG-3, pp. 1-3.

AmerenUE's Moody's bond rating is Baa1.[62] Although the "Comparable Risk" proxy group had the same Moody's bond rating, the other two proxy groups had a higher Moody's bond rating of A3.[63] The difference in bond ratings between the average of Mr. Gorman's proxy groups and AmerenUE reflects a material difference in risk that must be recognized. The Commission should follow its decision in *Empire* and add at least 25 basis points to Mr. Gorman's recommendation to reflect this consideration.

Finally, in *Empire* the Commission added 5 more basis points to the ROE because Mr. Gorman's DCF model assumes the annual payment of dividends rather than the quarterly payment of dividends.[64] In this case Mr. Gorman again used an annualized dividend in his DCF calculations.[65] Although Dr. Morin testified that the impact of using annual dividends could be as much as 20 basis points,[66] at a minimum a 5 basis point adjustment to Mr. Gorman's analysis is appropriate based on the *Empire* decision.

In summary:

- Mr. Gorman's analyses have technical flaws identified by Dr. Morin which, if corrected, would add 100 basis points to the ROE produced by Mr. Gorman's CAPM analysis, and 50 basis points to the ROE produced by Mr. Gorman's Risk Premium analysis.

- Mr. Gorman's overall ROE recommendation should also be adjusted to reflect inclusion of the results of his single-stage DCF analysis. The single-stage DCF analysis is the standard, mainstream DCF analysis that has been used for many years by this Commission, commissions in other jurisdictions and Mr. Gorman himself. All of the other ROE experts in this case used the single-stage DCF analysis, and the Commission adjusted Mr. Gorman's DCF analysis to include the single-stage DCF in the very recent *Empire* case. Inclusion of the single-stage DCF analysis (even without the adjustments to the risk premium and CAPM analyses noted above) will increase Mr. Gorman's overall ROE recommendation

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[62] In May 2008, Moody's downgraded AmerenUE's issuer credit rating to Baa2, but Mr. Gorman's schedule apparently failed to reflect this downgrade, meaning an even greater upward adjustment to Mr. Gorman's recommendation may be necessary.
[63] Ex. 600 (Gorman Direct) Sch. MPG-3, pp. 1-3.
[64] Empire Order, p. 21.
[65] *See, e.g.,* Ex. 600 (Gorman Direct) p. 27, l. 11-14.
[66] Tr. p. 433, l. 16 to p. 435, l. 10.

to somewhere between 10.51% and 11.16%. By simply including the single-stage DCF analysis with the other analyses Mr. Gorman has used, and using Mr. Gorman's own mid-point approach, the adjusted ROE supported by his analyses would be 10.8%.

- Mr. Gorman's overall ROE recommendation must also be adjusted to reflect the fact that the average S&P and Moody's bond credit rating for his proxy groups are higher than AmerenUE's bond credit ratings. Consistent with the *Empire* decision, this should result in a further adjustment of at least 25 basis points.

- Finally, consistent with the *Empire* decision, Mr. Gorman's recommendation must be adjusted at least an additional 5 basis points to reflect the fact that his DCF analyses assume annualized, rather than quarterly, dividend payments.

The calculation of a properly adjusted ROE recommendation for Mr. Gorman is as follows:

Base Recommendation Including Single-Stage DCF Results:	10.80%
Minimum Adjustment to Account for Difference in Bond Ratings for Proxy Groups:	.25%
Minimum Adjustment to Reflect Quarterly Payment of Dividends:	.05%
Total Adjusted ROE Recommendation	11.15%

D. AmerenUE's Proposed ROE of 10.9% Should Be Adopted.

Assuming that the Commission approves AmerenUE's proposed fuel adjustment clause, a return on equity of 10.9%, as proposed by AmerenUE witness Dr. Morin, should be approved. Supporting adoption of AmerenUE's position on this issue are the impeccable resume and credentials of Dr. Morin, which as noted earlier have previously been recognized by the Commission. Dr. Morin is currently Emeritus Professor of Finance at the Robinson College of Business, and Professor of Finance for Regulated Industry at the Center for the Study of Regulated Industry, both at Georgia State University. He received a PhD in Finance and Econometrics from the Wharton School of Finance at the University of Pennsylvania. He has taught at several top-tier universities and has conducted numerous seminars on utility finance

and cost of capital. He is also the author or co-author of several books, monographs and articles on these subjects including three widely used textbooks on utility finance. Dr. Morin has also provided cost of capital testimony in dozens of proceedings before more than 50 regulatory bodies in North America dating back to the early 1980s.[67] Dr. Morin is clearly among the most well-trained, experienced and knowledgeable utility cost of capital experts in the country.

Dr. Morin performed a number of widely accepted analyses in deriving his recommended ROE. In particular, Dr. Morin performed two CAPM analyses, one using the standard CAPM and the other using the empirical version of the CAPM (ECAPM). He also performed two risk premium analyses—a historical risk premium analysis on the electric industry and a study of the risk premiums reflected in ROEs allowed in the electric utility industry. Finally, he performed DCF analyses on two proxy groups of electric utilities, using growth rates from two different sources.[68] The technical details of each analysis are explained in Dr. Morin's direct testimony, but the results were as follows:

Study	**ROE**
CAPM	11.2%
Empirical CAPM	11.5%
Risk Premium Electric	10.5%
Allowed Risk Premium	10.1%
DCF-Group 1 Value Line Growth	10.4%
DCF-Group 1 Zacks Growth	11.6%
DCF-Group 2 Value Line Growth	11.1%
DCF-Group 2 Zack's Growth	11.0%
Overall CAPM	*11.4%*
Overall Risk Premium	*10.3%*
Overall DCF	*11.0%*
Average	10.9%[69]

Dr. Morin also testified that his recommended ROE is predicated upon the Commission's approval of a fuel adjustment clause for AmerenUE. Dr. Morin noted that FACs have become

[67] Ex. 3 (Morin Direct) pp. 2-3, Sch. RAM-E1.
[68] *Id.* p. 5.
[69] *Id.* p. 65.

the norm in the electric utility business and the vast majority of the companies that make up his comparable groups possess such clauses. Dr. Morin testified:

> My assessment of UE's business risk, hence of the Company's cost of common equity, is dependent on the adoption of the FAC. I believe that the absence of a FAC harms UE's financial condition, causes deterioration in its credit metrics (and thus puts downward pressure on its credit ratings), and puts its customers at risk of having to pay higher rates due to access to capital becoming more expensive for UE. Because of the magnitude of the energy cost component in its cost of service, these effects could be significant. I note that the Company's bonds are already under review for possible downgrade by Moody's and under "negative outlook" by Fitch.[70]

As a consequence, if an FAC were not approved for AmerenUE, Dr. Morin recommended the addition of 25 basis points to his recommendation, making it 11.15%.

Dr. Morin's recommendations fall well within the "zone of reasonableness"[71] for electric utilities based on data published by SNL, formerly Regulatory Research Associates. For calendar year 2007, the average ROE awarded to *all* electric utilities (including wires only utilities) was 10.36%. But the average 2007 award for integrated electric utilities was 10.56%. The Commission explicitly found in *Empire* that it is more appropriate to compare the return allowed to an integrated electric utility to the returns allowed for other integrated electric utilities because integrated electric utilities are more risky, translating into a higher cost of equity. This is because integrated utilities must make large investments in electric generation plants, operate those plants, and buy fuel to run those plants.[72]

Using more recent data, it appears that the zone of reasonableness has moved up since this rate case was filed in early April, 2008. In particular, Exhibit 60 shows that for the first three quarters of 2008, the average ROE awarded to *all* utilities rose to 10.51%. And Dr. Morin

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[70] *Id.* p. 67, l. 3-11. Indeed, AmerenUE was downgraded by Moody's just a few weeks after Dr. Morin filed his direct testimony, as discussed in the FAC section of this Brief below.

[71] The "zone of reasonableness" is a 100 basis point zone around the average of ROEs awarded during a recent period, which the Commission has considered in recent cases.

[72] Empire Order, pp. 22-23.

determined that, with this additional data, the more applicable average ROE awarded to vertically integrated utilities for the 12 months ending September 30, 2008 was 10.6%.[73]

Dr. Morin's recommendation is also the most consistent with the ROEs awarded by this Commission in recent cases. For example, it is only 10 basis points higher than the 10.8% ROE approved only a few months ago for Empire, and it is only 15 basis points higher than the 10.75% ROE recently approved for KCP&L. Dr. Morin's recommendation is much closer to these previous awards than any of the other experts' recommendations. Dr. Morin's recommended ROE is also the most consistent with the applicable legal standards governing the appropriate ROE. As the Commission has previously recognized, these legal standards are set forth in the oft-cited *Hope* and *Bluefield Water Works* cases.[74] In the *Bluefield* case, the U.S. Supreme Court held:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.[75]

Similarly in *Hope*, the later case, the Supreme Court stated:

> [t]he investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with

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[73] Tr. p. 455. This is very close to the 10.62% ROE for integrated electric utilities using SNL data for the 12 months ending August 30, 2008. Ex. 4 (Morin Rebuttal) p. 5, l. 15-19.

[74] *Fed. Power Comm'n v. Hope Nat. Gas Co.,* 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); *Bluefield Water Works & Improv. Co. v. Pub. Serv. Comm'n of West Virginia,* 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923).

[75] *Bluefield, supra,* 262 U.S. at 692-93, 43 S.Ct. at 679, 67 L.Ed. at 1182-1183.

> returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.[76]

Of the recommended ROEs in this case, Dr. Morin's most clearly satisfies the standards of *Hope* and *Bluefield.* His recommendation is closest to the ROEs that have been awarded to other integrated utilities throughout the country and in this state—business undertakings which are attended by corresponding risks and uncertainties. Moreover, Dr. Morin has carefully considered the specific risks that AmerenUE faces and the problems the Company has had in the credit markets in making his recommendation. He has proposed an ROE that will be sufficient to assure confidence in the financial integrity of the Company, so as to maintain its credit and attract capital, in accordance with *Hope* and *Bluefield.*

In summary:

- Dr. Morin's qualifications make him one of the most well-trained, experienced and knowledgeable ROE experts in the country.
- In this case, Dr. Morin has conducted thorough DCF, CAPM and Risk Premium analyses to support his recommended ROE of 10.9% with an FAC, and 11.15% if no FAC is approved.
- Dr. Morin's recommendation is well within the "zone of reasonableness" and consistent with the most recent SNL data, which shows that an average ROE of 10.6% was approved for integrated electric utilities over the 12 months ending September 30, 2008.
- Dr. Morin's recommendation is more consistent with ROEs recently awarded to other Missouri electric utilities than the recommendations of the other ROE experts.
- Of the ROE recommendations in this case, Dr. Morin's is the most consistent with the requirements of *Hope* and *Bluefield* that AmerenUE's ROE be consistent with other enterprises facing similar risk, and that it be sufficient to allow adequate access to capital.

E. <u>Flotation Costs Should Be Included In the ROE Calculation</u>.

[76] *Hope, supra,* 320 U.S. at 603, 64 S.Ct. at 288, 88 L.Ed. at 345.

Flotation costs, which are the costs of issuing equity,[77] are prudent and reasonable costs of providing service and they should be included in the return on equity. Dr. Morin has included these costs in his calculations, and has testified that they comprise 20 basis points of his 10.9% recommended ROE.[78] The other ROE witnesses have not included any flotation costs in their calculations.

As Dr. Morin has testified, flotation costs are a legitimate cost of issuing securities, and they should be included in the Company's cost of service.[79] Although one alternative is for flotation costs to be included in rates as an expense, AmerenUE's rates have not included flotation costs as an expense. Indeed, AmerenUE did not have rate cases for approximately 20 years, so flotation costs were not flowed through rates during that time period. As a consequence, the ROE approved in this case should include an adjustment to reflect flotation costs.

The Commission has included an adjustment for flotation costs in numerous past cases.[80] The Commission has allowed flotation cost recovery even when the utility has no plans to issue stock in the immediate future.[81] Consequently, the Commission should approve the allowance for flotation costs contained in Dr. Morin's recommended ROE.

F. <u>Impact of the Credit Crisis</u>.

All of the ROE witnesses in this case developed their recommendations before the current national financial crisis occurred. Based on the record in this case, it is clear that the

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[77] Flotation costs include compensation to the security underwriter for (i) marketing/consulting services, (ii) the risks involved in distributing the issue, and (iii) any operating expenses associated with the issue (printing, legal, prospectus, etc.) as well as downward pressure on the stock price resulting from the issuance. Ex. 4 (Morin Rebuttal) pp. 31-32.
[78] Tr. p. 402.
[79] Ex. 3 (Morin Direct) pp. 61-64; Ex. 4 (Morin Rebuttal) pp. 31-35.
[80] *See, e.g., In re: Missouri-American Water Co.,* 1995 WL 789411 (Nov. 21, 1995); *State ex rel. Associated Natural Gas Co. v. PSC,* 706 S.W.2d 870 (Mo. App. 1985); *In re: Kansas City Power & Light Co.,* 43 P.U.R.4th 559, 599-501 (June 17, 1981); *In re: Kansas City Power & Light Co.,* 38 P.U.R.4th 1, 30-31 (July 19, 1979).
[81] *In re: Laclede Gas Co.,* 27 P.U.R. 4th 241, 274-75, 22 Mo. P.S.C. (N.S.) 360 (Nov. 16, 1978).

crisis has significantly impaired the access to capital for electric utilities throughout the country and for AmerenUE in particular.[82] As Dr. Morin explained:

> Capital markets are currently in a state of turmoil. Borrowers are now forced to compete in a market virtually devoid of funds. As a result, the cost of money for corporations has increased, and new debt/stock issues are almost non-existent. Accessibility to the commercial paper market has become severely reduced, even for highly-rated companies. The debt markets have witnessed record high yield spreads (the incremental yield over Treasury rates needed to issue debt) and a more severe differentiation between the spreads charged to companies with different credit ratings.[83]

Dr. Morin concluded that based on the financial crisis, it would not be unreasonable to increase the Company's ROE an additional 25 basis points.[84] Dr. Morin did not actually adjust his own recommendation by 25 basis points, but he pointed out that his recommended ROE is even more conservative in the existing capital market environment. As a consequence, any adjustment the Commission may be tempted to make to Dr. Morin's recommended ROE should be tempered by this consideration.

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[82] *See* Ex. 46 (Rygh Rebuttal).
[83] Ex. 5 (Morin Surrebuttal) p. 2, l. 18 to p. 3, l. 2.
[84] *Id.* p. 3, l. 13-16.

II. CAPITAL STRUCTURE.

AmerenUE proposes that rates in this case should be set based on the Company's actual capital structure, consisting of the following:

Long-Term Debt	45.532%
Short-Term Debt	0.722%
Preferred Stock	1.737%
Common Equity	52.009%
Total	100.000%[85]

In his rebuttal testimony, Company witness Michael O'Bryan corrected the capital structure he originally filed to reflect the fact that certain unregulated subsidiaries were no longer owned by AmerenUE as of the end of the test year.[86] Because these subsidiaries were no longer owned by AmerenUE, it was no longer appropriate to deduct any undistributed earnings of these subsidiaries from AmerenUE's retained earnings. This correction meant that the Company's actual percent of common equity, as of the end of the test year, was approximately one percent higher than reflected in Mr. O'Bryan's earlier, incorrect testimony (approximately 52% versus approximately 51%).

Staff witness Stephen Hill is the only witness who filed testimony taking issue with this correction. Mr. Hill argues that the original, incorrect common equity balance provided by Mr. O'Bryan in his earlier testimony (51%) should continue to have been used in this case. However, Mr. Hill has provided no reason for deviating from the Company's actual capital structure, including its actual common equity, as reflected above. As a consequence, the Company's actual capital structure should be used to set rates in this case.

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[85] Ex. 8 (O'Bryan Rebuttal) Sch. MGO-RE1.

[86] All of these components of the Company's capital structure are actual per-book figures as of the end of the test year. The correction that was made by Mr. O'Bryan was necessary because while Mr. O'Bryan knew these subsidiaries were not owned as of the end of the test year when he filed his earlier testimony, the books of account he relied upon at that time had inadvertently not been updated to reflect that these subsidiaries were not then owned by AmerenUE, which resulted in him picking up incorrect numbers when he made his original calculations.

III. FUEL ADJUSTMENT CLAUSE.

AmerenUE's request to implement a fuel adjustment clause (FAC) should be granted. It should be granted under the standard set forth in Senate Bill 179 (SB 179) – because an FAC is necessary to give AmerenUE a sufficient opportunity to earn a fair ROE; it should be granted because it is critical to the Company's access to capital at a reasonable cost, and to the Company's overall financial health; and it should be granted because AmerenUE's FAC request is supported by all three of the other factors the Commission has typically considered in evaluating FAC requests under SB 179.

Those who oppose the Company's FAC request – the Staff, OPC and the State[87] – have presented virtually no credible, substantial or competent evidence to rebut the overwhelming evidence in this record that demonstrates the appropriateness of establishing an FAC for AmerenUE. Indeed, a careful examination of the record reveals that the FAC opponents gave no serious consideration to the merits of the Company's FAC request at all. Rather, their testimony – whether pre-filed, in deposition, or on cross-examination – reveals a near total failure to objectively consider how the lack of an FAC affects (a) AmerenUE's ability to earn a fair ROE; (b) AmerenUE's income and cash flows; (c) AmerenUE's access to (and the cost of) capital; and (d) the overall short- and long-term financial health of AmerenUE.

This FAC section of the Company's Brief will address the following key points:

1. It will outline the basic terms of the proposed FAC (including the FAC tariff and FAC rate design issues that have been settled);

2. It will summarize the substantial, indeed overwhelming, evidence supporting the Company's FAC request, including under both the SB 179 standard and in light of the three other factors previously considered by the Commission; and

[87] Noranda is conditionally supporting the Company's FAC request, MIEC is neither supporting nor opposing the Company's FAC request, but agrees that the Company's request is properly structured in including off-system sales as a component of net fuel costs to be tracked in the FAC, and none of the other parties to the case have presented any testimony regarding the Company's FAC request.

3. It will address the importance of a fair, mainstream FAC (including the 95%/5% sharing mechanism twice before adopted by this Commission) to AmerenUE's overall financial health, including why a fair, mainstream FAC is important in enabling the Company to access capital at a reasonable cost, particularly given the rising operating costs being incurred by the Company and given the very large capital investments the Company is making in its system.

A. **The Basic Terms of the Proposed FAC**.

The terms of the proposed FAC are outlined in detail in the direct testimony of AmerenUE witness Martin Lyons, with certain noteworthy but fairly minor modifications reflected in the *Stipulation and Agreement as to All FAC Tariff Rate Design Issues* (the "FAC Rate Design Settlement") and in Appendix A to the FAC Rate Design Settlement.[88]

In summary, the Company's proposed FAC would track changes in the Company's net fuel costs with customer rates to be adjusted three times per year to account for the change in those net fuel costs from the prior accumulation period.[89] Changes in net fuel costs (whether up or down) occurring during a particular accumulation period would then be reflected (subject to the 95%/5% sharing mechanism) in customer rates over a succeeding 12-month recovery period. The Company's net fuel costs consist of the sum of fuel (coal, gas, nuclear, and oil) and purchased power costs, less off-system sales revenues.[90] The proposed FAC would be based upon historical net fuel costs during each accumulation period as required by Commission rules,

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[88] The FAC Rate Design Settlement was approved by the Commission on December 30, 2008. Appendix A to the FAC Rate Design Settlement is an agreed-upon FAC tariff which would be implemented (with the sharing percentage adopted by the Commission) if the Commission approves an FAC for AmerenUE.

[89] The level of net fuel costs against which FAC adjustments will be tracked was agreed upon in the *Stipulation and Agreement as to Off-System Sales Related Issues*, which was approved by the Commission on December 30, 2008 (OSS Settlement).

[90] As reflected in the OSS Settlement, there are certain other costs and revenues that are appropriately included in the calculation of fuel and purchased power expense, such as charges from the Midwest Independent Transmission System Operator, Inc. (the "Midwest ISO") associated with the energy taken to serve the Company's native load, certain Midwest ISO revenues, gas pipeline capacity charges, and the amounts from the trued-up test year which have been agreed to in the OSS Settlement. The fuel (CF), purchased power (CPP), off-system sales (OSSR), and factors "TS" and "S", which also include these other costs and revenues, are compared against the net base fuel costs (NBFC) to yield the adjustments to the FAC rates. In general, when the parties have referred to "net fuel costs" in testimony in this case, they are often referring only to fuel and purchased power costs, less off-system sales revenues, without consideration of these other costs and revenues.

will be trued-up annually, and will be subject to a full prudence review at least every 18 months, all as required by the Commission's rules.

As noted earlier, the FAC Rate Design Settlement contains a few modifications to the FAC originally proposed by the Company. Noteworthy among those modifications are the following:

(a) The base against which rate changes will be made (called factor "NBFC" (net base fuel costs) in the tariff) will be seasonally differentiated so that there is a NBFC for the Summer months (June to September) and a different NBFC for the non-Summer months (October to May);
(b) There will be three 4-month accumulation periods (except the very first accumulation period, which is expected to encompass three months, not four months (March to May 2008)) to align FAC-related rate changes with the existing seasonal rate changes in May and September;
(c) Three rate adjustments will occur each year, but two of them will coincide with the normal seasonal rate adjustments that already occur under AmerenUE's rate schedules, meaning there is just one additional "FAC only" rate adjustment in February of each year;
(d) Factors CF (fuel), CPP (purchased power) and OSSR (off-system sales) have been clarified slightly to reflect the Company's agreement to use its reasonable best efforts to maintain at least its current level of replacement power insurance coverage; and
(e) The "S" factor settlement adjustment discussed in the OSS Settlement has been incorporated into the FAC tariff.

B. <u>The Merits of the Proposed FAC.</u>

i. Summary of undisputed or largely undisputed facts.

No FAC opponent has made any serious challenge to the following undisputed or largely undisputed basic facts, all of which are supported by substantial and competent evidence of record:

- Reliance on the time-consuming ratemaking process[91] has caused AmerenUE to under-recover its fuel costs by tens of millions of dollars in 2007 and in 2008. During this period, delivered coal cost under-recoveries *alone* will have totaled approximately $114 million by the time new rates set in this case take effect.[92]

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[91] *See In Re: Aquila, Inc.*, Case No. ER-2007-004, *Report and Order*, p. 36 (Aquila Order).
[92] Ex. 41 (Lyons' Rebuttal) p. 2, l. 18-21.

- While FAC opponents are quick to point out that a large percentage of AmerenUE's expected delivered coal costs are locked-in for 2009 and a lower, although still substantial portion are locked-in for 2010, they do not seriously dispute that coal cost under-recoveries alone, for 2007 through 2010, even if AmerenUE were to try to optimally time another rate case in mid-2009, would total approximately **__________**.[93] **____________** is nearly one-half of AmerenUE's entire annual pre-tax earnings, based upon AmerenUE's recommended ROE of 10.9%. Without an FAC, these under-recoveries will continue to undermine AmerenUE's overall financial health. The average annual budgeted delivered coal costs increases (which include varying levels of hedged coal costs) through 2012 are approximately **_____** million per year, or more than 100 basis points of AmerenUE's after-tax earned ROE.[94]

- There is no serious dispute about the fact that AmerenUE is operating in a rising cost environment – rising fuel costs, rising operating costs, and rising capital costs.[95] When asked to identify specific cost reductions elsewhere that might offset the higher fuel costs AmerenUE indisputably is facing, FAC opponents are completely unable to point to any specific cost reductions.[96] Indeed, a fair reading of the record in this case shows that no one seriously disputes the large past fuel cost under-recoveries due to lack of an FAC, the future fuel cost increases that will occur, or the higher level of capital investments being made by AmerenUE.

- The costs and revenues to be tracked in the proposed FAC are extremely large – normalized total fuel and purchased power costs exceed $700 million annually, with a normalized offset of off-system sales revenues of approximately $450 million annually.[97] Contrary to the suggestion of FAC opponents, this means that AmerenUE's net fuel costs have substantial exposure to volatile coal, natural gas

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[93] *Id.* p. 2, l. 25-27.
[94] Ex. 47 (Neff Rebuttal) p. 3, l. 5-7.
[95] Some have attempted to imply that costs may not rise. The record belies this implication. Mr. Voss testified that it is very unlikely that other cost savings could offset higher fuel costs given just how large fuel costs are. Tr. p. 116, l. 9-13; p. 259, l. 15 to p. 260, l. 12 He also pointed out how AmerenUE's capital expenditures are far higher than just a few years ago (approximately $1 billion in 2008 versus less than $500 million in 2004 (Ex. 1 (Voss Direct) Sch. TRV-E2); and he noted that even if some capital expenditures are deferred in 2009 due to the current liquidity crisis, the capital expenditures will remain at a high level (over $700 million) in 2009, with the likelihood of still higher expenditures prospectively. Tr. p. 264, l. 1 to 15. With respect to operating and maintenance costs, Mr. Voss testified that regardless of the economic conditions, operating and maintenance costs will be higher in 2009 than they were for the test year in this case. Tr. p. 264, l. 16 to p. 265, l. 1. This is a phenomenon not just being observed at AmerenUE, but is in fact an industry-wide reality, as discussed in some detail by AmerenUE witness Dr. Kenneth Gordon in his direct testimony (Ex. 44).
[96] And lest someone would argue that higher off-system sales revenues can be counted on to offset these higher fuel costs, the Commission must remember that everyone who expressed an opinion on this issue in this case agrees that there is no correlation between AmerenUE's locked-in fuel cost increases and volatile spot power prices, a subject which will be addressed in more detail, below.
[97] These figures are based upon the agreed-to normalized fuel and purchased power costs and off-system sales revenues in the OSS Stipulation.

and power markets that is similar to the exposure to volatile markets faced by Aquila and Empire.[98]

- AmerenUE's net fuel costs are volatile and uncertain because all of the components of AmerenUE's net fuel costs are volatile and uncertain.[99]
    - The coal markets from which AmerenUE buys its coal are volatile and have been generally rising (in part due to international demand) – indeed, prices in coal markets now exhibit volatility that is similar to the volatility seen in the natural gas markets;[100]
    - The power markets in which AmerenUE buys power and sells its off-system sales are volatile;[101] and
    - AmerenUE's off-system sales, which significantly reduce customer rates, are very large and most of these sales are exposed to spot power market volatility.
- AmerenUE does not control the coal commodity and coal transportation markets, does not control the natural gas and nuclear fuel markets, and does not control the power markets.[102]
- Due at least in part to the lack of an FAC, AmerenUE has been unable to earn its allowed ROE (and certainly not its current cost of equity) since its last rate case concluded, has had its credit ratings downgraded since its last rate case, and faces the possibility of further downgrades and continued deterioration in its financial health absent an FAC.[103]

Why do these facts matter? They matter because SB 179 (and indeed, sound regulatory policy) says they matter. As this Commission itself stated:

> Section 386.266.4 sets out the following *standard* for the Commission to use when evaluating a cost recovery mechanism: 4. The Commission shall have the power to

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[98] Ex. 23 (Arora Rebuttal) p. 13, Table AKA-R1 (Natural gas and power exposure as a percent of total fuel, purchased power and off-system sales as a percentage of total retail revenues: 20% for Aquila, 24% for Empire and 20% for AmerenUE).
[99] Tr. p. 2708, l. 1-16 (Dr. Proctor); Proctor Depo. p. 84, l. 2-14.
[100] Ex. 48 (Neff Rebuttal) p. 7, l. 3-21 (demonstrating that, within just a few months, Mr. Neff's projected high coal commodity prices for a *five year period* were breached); p. 4, Figure RKN-R1 (showing spot PRB coal prices at about $15.50/ton up to over $19/ton and back down to less than $13/ton, all within just a six-month period); Proctor Depo. p. 169, l. 17-23 (agreeing that coal and natural gas prices exhibit similar volatility). Natural gas markets are volatile (Ex. 34 (Glaeser Direct)), and volatility has also been seen in nuclear fuel markets (Ex. 49 (Irwin Direct)). Figure AKA-SR1 at page 14 of Mr. Arora's surrebuttal testimony (Ex. 24) shows the volatility in forward prices for coal as well.
[101] Ex. 27 (Schukar Direct) pp. 16-17.
[102] *See* the discussion in subsection v., below.
[103] *See* the discussion in subpart iii., below.

approve, modify, or reject adjustment mechanisms submitted under subsections 1 to 3 of this section … The Commission may approve such rate schedules after considering all relevant factors which may affect the costs or overall rates and charges of the corporation, **provided that it find that the adjustment mechanism set forth in the schedules: (1) is reasonably designed to provide the utility with a sufficient opportunity to earn a fair return on equity** (*Added emphasis in Italics;* **Commission's emphasis in bold**).[104]

Similarly, the Commission has stated in prior orders that "a fuel adjustment clause may be necessary to allow a utility an opportunity to earn a reasonable return on its investment."[105]

FAC opponents ignore this standard. Indeed, an examination of the FAC opponents' testimony[106] reveals that they *don't even mention it*! The FAC opponents entirely ignore the relationship between an FAC and the utility's ability to have a sufficient opportunity to earn a fair ROE. In fact, the State takes the position that the standard the Commission applies, as it must, from SB 179, is "not a standard,"[107] and OPC also ignores this standard by proposing an unprecedented and punitive 50/50 sharing mechanism which would likely force the Company to continue to absorb tens of millions of dollars of net fuel cost increases.[108] As discussed below, the Staff FAC witness has not even evaluated the financial impact or credit rating implications for AmerenUE of not having an FAC.

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[104] Aquila Order, p. 32.

[105] AmerenUE Order, p. 17. A common theme of FAC opponents in this case is to cite to the Commission's order in AmerenUE's last rate case, where the Commission indicated (citing to then State witness Michael Brosch's testimony to this effect) that known and rising fuel costs were the "worst reason" to grant an FAC. As Mr. Lyons discussed in his surrebuttal testimony (Ex. 43, pp. 4-5), the Company's last FAC request was the first FAC request in 30 years, and neither the Company nor the Commission had any experience with evaluating such a request. The Company didn't do the job it should have done in focusing on the very real impact net fuel cost uncertainty and regulatory lag has on its financial condition, absent an FAC. Since the rate case order in the Company's last case, the Commission has provided much more guidance regarding when an FAC is appropriate and its evaluation of FAC requests has evolved. The Commission has also undeniably recognized that when fuel costs are rising and when this impairs the utility's opportunity to earn a fair ROE and undermines the utility's financial health, an FAC is appropriate. "Empire's fuel and purchased power costs have increased by substantial amounts in recent years." Empire Order, p. 42; "Aquila has experienced an increase of between 13% and 20% annually for each of the last 3 years." Aquila Order, p. 52. It is obvious from reading both of these orders that these increases had prevented Empire and Aquila from earning a fair ROE, which is precisely the problem AmerenUE is facing today.

[106] For purposes of this Brief, the Staff's testimony includes portions of the Staff's Cost of Service Report.

[107] State counsel Iveson's FAC opening statement, Tr. p. 2131, l. 2-3.

[108] The Commission should keep in mind that OPC has opposed every FAC request made since SB 179 was adopted, and in the past advocated a "substantial threat to financial viability" standard for evaluating FAC requests, which this Commission rejected as being "unreasonable, unduly burdensome and overly vague." Aquila Order, p. 36.

FAC opponents also ignore the Commission's most recent pronouncements respecting key considerations relating to its evaluation of FAC requests. Staff, for example, gives no weight to the fact that use of an FAC is indeed the mainstream of regulation.[109] As the Commission has noted, "[i]ndeed, this statute and the accompanying rules have merely transported Missouri back into the mainstream of utility regulation."[110] FAC opponents ignore the fact that the Commission itself has also made specific note of the fact that this "mainstream of regulation recognizes that it is impossible for a utility to earn its allowed return on equity in a rising cost environment without a fuel adjustment clause."[111] The Staff parses words when they deny that the under-recoveries of fuel costs for both Aquila and Empire, caused by the regulatory lag inherent in time-consuming rate cases, was in part the reason the Commission approved FACs for both Aquila and Empire. In fact, Staff essentially claims that regulatory lag is irrelevant because the Commission "did not mention regulatory lag" in its orders in the Aquila and Empire cases.[112]

The Staff's position is disingenuous in view of the facts of both of those cases. The reason Aquila and Empire were under-recovering their fuel costs is because even with the most optimally timed rate case filing, it takes many months – often 18 months or more[113] – to reflect higher fuel costs in rates. This delay in recovery between the date the higher costs were incurred and when higher rates to reflect those costs are implemented is universally understood to constitute regulatory lag.[114]

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[109] Mantle Depo. p. 72, l. 8-12 ("**Q. What if not having a fuel adjustment clause puts Ameren UE [sic] out of the mainstream of other integrated electric utilities, is that a – is that a consideration that matters to you?** A. No. It doesn't matter to me.")
[110] Empire Order, p. 34.
[111] *Id.*
[112] Ex. 224 (Mantle Surrebuttal) p. 10, l. 16-21.
[113] Hence the Commission's mention of the inability of the time-consuming rate case process to keep up. Aquila Order, p. 36.
[114] *See, e.g., Re Missouri Public Service*, 118 P.U.R.4th 215, 1990 WL 488941 (Mo.P.S.C.) (1990) ("regulatory lag can be defined as the interval between Company incurring costs and those costs being recovered in rates"). *Re St.*

ii. The available evidence demonstrates that AmerenUE is deprived of a sufficient opportunity to earn a fair ROE without an FAC.

AmerenUE's earned ROE since the rate increase implemented in June 2007 has, on average, fallen short of the ROE allowed in AmerenUE's prior rate case by nearly 100 basis points – and by nearly 160 basis points when compared to AmerenUE's current cost of equity. This earnings shortfall has occurred at fuel cost levels that did not even include the additional delivered fuel cost increases that became effective just a few days ago (on January 1, 2009, delivered coal costs based upon the expected burn for 2009 went up nearly **__________** annually – this **_________** annual cost is not included in the revenue requirement in this case). This earnings shortfall also occurred without taking into account the additional delivered coal cost increases that will take effect on January 1, 2010 (an additional approximately **____ _______** annually based upon the expected coal burn).

Given these facts, how do FAC opponents propose that AmerenUE recover its prudently incurred fuel and purchased power costs? The answer: they make no proposal whatsoever, other than their suggestion (which they are unwilling to even state directly) that somehow AmerenUE may get by with off-system sales that might or might not show up, or with other cost reductions that they cannot identify. The facts are – and the record in this case clearly shows – that it is highly unlikely; indeed that it is pure speculation, to assume that off-system sales will somehow "save the day" by offsetting the known fuel cost (and capital costs and non-fuel operating cost) increases AmerenUE faces such that AmerenUE could maintain a reasonable opportunity to earn a fair ROE.

Louis County Water Company, 1995 WL 769951 (Mo.P.S.C.) (1995) ("Regulatory lag may be defined as the lapse of time between a change in a utility's revenue requirement and reflection of that change in the utility's rates.").

History and the record in this case overwhelmingly demonstrate that this is not the case. In the last rate case, the State and OPC advocated that the Commission use the Company's 2007 budgeted off-system sales margin figure for setting rates in that case. What happened? The Company fell short of that budget by more than $50 million in 2007,[115] while, as noted above, also failing to recover higher 2007 fuel costs ($42 million worth) for the first five months of 2007. In 2008, despite unusually high power prices last Spring and extending into mid-Summer,[116] the Company has consistently been unable to earn even its allowed ROE. Power prices have since dropped precipitously with available evidence pointing to lower, not higher, off-system sales revenues and margins in 2009, when AmerenUE's fuel costs will be even higher (as noted earlier, delivered coal costs are expected to be **__________ ** higher in 2009).[117] In summary, the record in this case points to the conclusion that, from June 2007 (when rates from the prior rate case took effect) until March 2009 (when rates from this case will take effect), the Company is likely to have fallen short of its allowed ROE from the last rate case by at least 100 basis points – probably more – which equates to more than $50 million of under-recovered costs and lost after-tax earnings *annually* for a period stretching nearly two years (June 2007 to March 2009).

[115] Ex. 42 (Lyons Rebuttal) p. 14, l. 15 to p. 15, l. 3.

[116] High enough that the Staff agreed that prices in June and July 2008 were abnormally high (Ex. 223 (Maloney Surrebuttal) p. 5, l. 5-10), and indeed unusually high earlier in the year as evidenced by the fact that on-peak prices in the Winter (February and March of this year) were actually higher than the on-peak prices in middle of the Summer (July and August of last year). (Ex. 30 (Schukar Surrebuttal) p. 5, l. 9 to the table on p. 6).

[117] As of the time of the evidentiary hearings in this case, around-the-clock (ATC) forward energy prices for calendar year 2009 at AmerenUE's generating stations were down to less than $39/MWh – more than $4 lower than the normalized ATC price at AmerenUE's generating units recommended by AmerenUE witness Shawn Schukar in his rebuttal testimony. Tr. p. 2440, l. 18-25; p. 2441, l. 1-9 (Mr. Arora) (2009 ATC prices of $41/MWh, or with a 95% basis differential at AmerenUE's generating units, the ATC price for 2009 would be $38.95/MWh). *See also* Figure AKA-SR1 in Mr. Arora's surrebuttal testimony (Ex. 24, p. 14), which shows power prices have dropped to approximately $39/MWh from unusually high prices earlier in 2008.

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The FAC opponents in this case have presented virtually *no* evidence to rebut these facts and indeed did not even consider earnings implications, as evidenced by the record in this case, portions of which are addressed later in this Brief.

Take the Staff's testimony (or the lack thereof) relating to how the absence of an FAC impacts AmerenUE. When Staff took its position in opposition to the Company's FAC request in its Cost of Service Report, there was not one word that acknowledged the impact of an FAC on earnings or the existence of the earnings standard contained in SB 179! Ms. Mantle, the Staff's main FAC witness, readily admits that she did not consider the need for an FAC in view of the Company having a reasonable opportunity to recover the Company's cost of service.[118] Having admitted as much, she then also acknowledges that this is a standard that should be considered.[119] If it should be considered, then why wasn't it? Ms. Mantle, taking a classic "it wasn't my job to do that" position, suggests that someone else on the Staff was responsible for considering this standard.

Indeed, Ms. Mantle's deposition, together with Mr. Hill's testimony, makes clear that no one on the Staff gave any consideration to the role of an FAC as it relates to the Company's financial health and its opportunity to earn a fair ROE (witness the complete lack of testimony on this issue from the Staff, or anyone else for that matter). This is proven conclusively given that, when asked who on the Staff represented considerations relating to the Company's ROE and how ROE relates to the Company's FAC request, Ms. Mantle indicated that Mr. Schallenberg "represented that consideration"[120] and that she typically leaves that to the return expert.[121]

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[118] Tr. p. 2640, l. 13 to p. 2641, l. 1. Incredibly, Ms. Mantle was entirely unaware of the fact that AmerenUE's coal and coal transportation contracts escalate from year-to year. Mantle Depo. p. 35, l. 14-19; p. 37, l. 5-7.

[119] "Typically I leave that [the relationship between an FAC and the opportunity to earn a fair ROE] for the return analyst, rate of return analyst." Mantle Depo. p. 68, l. 24 to p. 69, l. 4; p. 30, l. 17 to p. 31, l. 4 (The standard in SB 179 should be considered).

[120] *Id.* p. 70, l. 8-11. *See also* Tr. p. 2643, l. 6-15; p. 2643, l. 23 to p. 2644, l. 5 ("**Q. Did Mr. Schallenberg or anyone from the financial analysis department discuss their analysis of those issues [cost of capital] with you**

However, all the return expert – Mr. Hill (who was hired by Mr. Schallenberg and his direct report, Mr. Bible) – knew when he made his cost of equity estimates was that the Staff opposed an FAC.[122] Mr. Schallenberg could not possibly have "represented that consideration" by hiring Mr. Hill since Mr. Hill was given no direction to himself "represent that consideration." Mr. Hill did what he always does – he ran some ROE analyses for comparable utilities (almost all of which have an FAC) and came up with an ROE recommendation (indeed, far and away the lowest ROE recommendation in this case). He did not examine AmerenUE's fuel costs, capital investments, and operating expenses to see whether AmerenUE had been under-earning in the past or was likely to under-earn in the future, absent an FAC. Moreover, given that Mr. Hill was strictly a cost of *equity* witness, he could not possibly have given consideration to how the lack of an FAC affected the Company's access to or the cost of *debt*.

In fact, apparently no one on Staff gave any consideration to the issue of AmerenUE's financial health. This is demonstrated by the fact that Ms. Mantle testified that she "did not know" if impairment of AmerenUE's access to credit due to lack of an FAC was important to her;[123] she admitted that it did not matter to her if the lack of an FAC put AmerenUE out of the mainstream of other integrated utilities (with whom AmerenUE must compete for capital);[124] she admitted that it wouldn't matter to her if AmerenUE was the only electric utility in the country without an FAC;[125] and she admitted that, while how credit ratings agencies would view having

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at the time the Staff made its decision to oppose AmerenUE's fuel adjustment clause? A. I can't say. I don't remember. **Q. Did any of them provide you with any written analysis that analyzed those issues.** A. No.").

[121] Mantle Depo. p. 68, l. 24 to p. 69, l. 4.

[122] Tr. p. 531, l. 3-13 (Mr. Hill). Mr. Hill was hired by Messrs. Schallenberg and Bible. Ex. 64 (The Staff's Response to DR UE-Staff 22).

[123] Mantle Depo. p. 70, l. 15-18.

[124] *Id.* p. 72, l. 8-12.

[125] Tr. p. 2645, l. 2-5.

or not having an FAC is an important consideration for the Commission, she did not consider this factor at all.[126]

Adding to the paradoxical nature of her testimony and the position taken by the Staff, Ms. Mantle went on to agree that we are in a rising cost environment and said she had no reason to disagree with the Commission's statement to the effect that it is impossible for a utility to earn its allowed ROE in a rising cost environment without an FAC.[127] Yet, as noted above, no one on the Staff gave any consideration to the importance of an FAC to AmerenUE's opportunity to earn a fair ROE.

The Staff's failure to consider the SB 179 earnings standard and factors that the Staff admits are important is *astounding*. At bottom, it appears that Staff decided early-on that it was going to try to prevent AmerenUE from obtaining an FAC, without regard to the facts in this case, the specific proposal in this case, the need for an FAC from the standpoint of AmerenUE's opportunity to earn a fair ROE, AmerenUE's need to shore-up its credit ratings and finances, or indeed without regard to much of anything other than the Staff's attempt to rely upon a different record at a different time with respect to a different FAC proposal from the Company's last rate case.[128]

What about the other two FAC opponents, OPC and the State? What evidence did they produce to rebut the severe impact to AmerenUE's ROE caused by the fuel costs AmerenUE faces? They too presented essentially no evidence on this issue at all. OPC witness Kind's testimony simply states that OPC opposes AmerenUE's fuel adjustment clause request. This is

[126] Tr. p. 2642, l. 1-20.

[127] Tr. p. 2645, l. 17 to p. 2646, l. 2.

[128] Some have argued that "nothing has changed" since the Company's last rate case and that therefore an FAC should be denied again. To the contrary, much has changed. We have a demonstrable and consistent record of under-earnings, caused in part by under-recovery of our fuel costs. Coal and power markets are becoming increasingly volatile. The Company's credit rating has been downgraded, with the lack of an FAC being cited as a reason for the downgrade. In summary, the record *in this case* demonstrates the appropriateness of an FAC for AmerenUE.

no surprise – OPC has yet to support an FAC request for any Missouri utility. Indeed, it is obvious that OPC opposes FACs on philosophical grounds and that OPC's opposition has nothing to do with, and in fact ignores, the standard contained in SB 179 and largely ignores the other factors this Commission has previously considered in connection with other utilities' FAC requests.[129]

The State's opposition is similar, and consists of the testimony of a former consumer-advocate from Illinois with a bachelor's degree in English whose principal experience is with the restructured Illinois electricity industry of the last decade.[130] Like Mr. Kind, Mr. Cohen did no quantitative analysis to support his opposition to AmerenUE's FAC request, including no analysis to determine if an FAC is necessary for AmerenUE to have an opportunity to earn a fair ROE and no analysis of the impact of not having an FAC on AmerenUE's credit rating.[131] Indeed, Mr. Cohen's testimony reveals an unyielding condemnation of the very rate adjustment mechanisms authorized by SB 179, and goes so far as to suggest that any such mechanisms violate "traditional" regulatory principles when in fact the opposite is true. This Commission itself recognizes that use of an FAC, not reliance on time-consuming rate cases, *is the mainstream* of regulation.

iii. Capital Market Access and Cost of Capital Issues.

Closely related to the importance of an FAC to provide the Company with a sufficient opportunity to earn a fair ROE is the importance of an FAC to the Company's ability to access

[129] Mr. Kind did no quantitative analysis of any kind respecting the impact of his 50/50 sharing proposal, did not even know how much AmerenUE's fuel costs had increased at the time his deposition was taken (and obviously did not know this or consider it when he took his position in opposition to the FAC request), and did not analyze the impact of having or not having an FAC on AmerenUE's cost of debt or equity. Tr. p. 2745, l. 8-23; p. 2746, l. 4-9; p. 2747, l. 6-18; p. 2750, l. 8-13 (Mr. Kind).
[130] Tr. p. 2574, l. 15 to p. 2575, l. 1; p. 2576, l. 10 to p. 2577, l. 14 (Mr. Cohen).
[131] Tr. p. 2579, l. 5-20 (Mr. Cohen).

capital markets to issue the billions of dollars of debt (and, as needed, to raise the equity capital) upon which the Company depends to build and maintain its system.

Since being denied an FAC in its last rate case and being allowed a 10.2% ROE (which the Company has consistently been unable to achieve), the Company's credit ratings have been downgraded by both Standard and Poor's Rating Services ("S & P") and Moody's Investor Service ("Moody's).[132] Both downgrades explicitly cited the lack of an FAC as one of the main reasons for the downgrade.[133] Indeed, Moody's, which rates AmerenUE on a standalone basis, specifically stated as follows:

> The downgrade also reflects the challenging regulatory environment for electric utilities operating in the state of Missouri, as Union Electric is one of the relatively few utilities in the country operating without fuel, purchased power, and environmental cost recovery mechanisms.

As outlined in Schedules MJL-RE8 and MJL-RE9 to Mr. Lyons' rebuttal testimony (Ex. 42), 93% of non-Missouri integrated utilities nationally and 97% in nearby states (including 96% of heavily-coal based utilities in nearby states) operate with FACs. The lack of such automatic recovery provisions creates uncertainty regarding timely recovery of the higher costs and investments being incurred and leads to significant regulatory lag, which harms AmerenUE's financial condition and credit standing.[134]

Moody's also indicates that the Commission's decisions regarding AmerenUE's FAC in this case may further affect its credit ratings:

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[132] Ex. 8 (O'Bryan Rebuttal) p. 2, l. 1-7.
[133] *Id. See also* Ex. 46 (Rygh Rebuttal) pp. 25-26.
[134] "Moody's Downgrades Union Electric; Places Ameren and AmerenGenco on Review," May 21, 2008, p. 1 (*See* Ex. 45 (Gordon Surrebuttal) Sch. KG-SE2, p. 1 of 4).

What Could Change the Rating – Up

An increase in the supportiveness of the regulatory environment for electric utilities in Missouri; the implementation of fuel, purchased power and/or environmental cost mechanisms….

What Could Change the Rating – Down

An adverse outcome in its pending rate case, including the inability to implement a fuel adjustment clause….[135]

Why is this important? Because after the recent downgrades, AmerenUE's credit rating is just one (or two, in the case of Moody's) notches above junk-bond status, a rating situation that already shuts AmerenUE out of the commercial paper market entirely, and that puts AmerenUE at significant disadvantage in the long-term debt markets as well.[136] As AmerenUE witness O'Bryan explains, AmerenUE will need to attempt to issue long-term bonds in 2009 as short-term debt will need to be repaid and "termed out" on a long-term basis.[137] However, the current credit crisis is creating a backlog of other issuers who will also need to issue long-term debt at the same time, making debt issuances highly competitive and hence, more costly.[138] As Mr. O'Bryan puts it, "[t]he lack of an FAC will give these investors [for whose dollars AmerenUE must compete with other debt issuers] just that excuse [i.e., to decline to invest or to demand higher interest rates] when examining AmerenUE."[139]

Dr. Kenneth Gordon, a University of Chicago trained Ph.D Economist with nearly 30 years of experience in the utility industry (including holding the position of President of NARUC in 1992)[140] had this to say about the need for an FAC for AmerenUE:

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[135] Moody's August 14, 2008 Union Electric Company Credit Opinion ((*See* Ex. 45 (Gordon Surrebuttal), Sch. KG-SE2, p. 2 of 4).

[136] This severe problem is discussed at pages 4 to 7 of the rebuttal testimony of AmerenUE witness Michael G. O'Bryan (Ex. 8).

[137] In fact, AmerenUE will need to issue $1.3 billion in new debt over just the next three years – an amount equating to more than 20% of its existing rate base. Tr. p. 2271, l. 16-24 (Mr. Lyons).

[138] Ex. 8 (O'Bryan Rebuttal) p. 7, l. 1-19.

[139] *Id*. p. 7, l. 13-16.

[140] Dr. Gordon filed both direct and surrebuttal testimonies, Exs. 44 and 45.

> Much has changed in both the financial and energy markets since the Commission decided not to implement an FAC for the Company in the previous rate proceeding. Implementing an FAC for AmerenUE is an important—and justified—step that the Commission can take to signal its commitment to supporting the long-term interests of the Company's ratepayers, who need, and expect, the Company to continue to provide efficient, safe, adequate and reliable service. Doing this requires investment in the Company's system, which in turn requires large sums of capital. Large sums of capital require ready access to the debt and equity markets, which in turn depends on sound credit ratings and a sound financial condition. AmerenUE's ability to accomplish all of this will be improved substantially with an FAC, with the benefits ultimately flowing to customers.[141]

Mr. Gary Rygh of Barclay's Capital,[142] who has assisted utilities with raising capital for the past 13 years, also provided extensive testimony outlining the challenges facing utilities generally, and AmerenUE in particular, in raising the capital they will need at reasonable rates. Mr. Rygh made specific note of the following market realities faced by AmerenUE and the Commission:

> The robust credit markets that had prevailed until the summer of 2007 will likely not be experienced for some time (if ever again). AmerenUE and its regulators must recognize that challenges lie ahead in procuring reasonably priced capital from investors (both equity and debt). With the current turbulence in the financial markets not likely to subside in the near future, AmerenUE, its regulators and other concerned parties should be proactively addressing key investor and credit rating agency concerns such as regulatory lag, needed rate relief, the rising cost of procuring fuel and volatile and increasing costs to ensure access to the lowest cost capital available.[143]

As both Dr. Gordon and Mr. Rygh discuss in their testimonies, the utility industry is entering an investment cycle not seen for some time. Unfortunately, this is occurring at the same time utilities are facing the difficult capital market described by Mr. Rygh throughout his testimony, difficulties which are actually being experienced by AmerenUE, as explained by Mr. O'Bryan. This means that "equity and fixed income investors' ever increasing aversion to risk,

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[141] Ex. 45 (Gordon Surrebuttal) p. 4, l. 8-18. *See also* Section IV, pp. 18 to 20 (to l. 12) of Dr. Gordon's surrebuttal testimony (Ex. 45).
[142] Mr. Rygh filed rebuttal testimony, Ex. 46.
[143] Ex. 46 (Rygh Rebuttal) p. 6, l. 6-16.

coupled with the anticipated . . . supply of utility related financing, will create a highly competitive market for capital."[144] AmerenUE will have to compete for that capital and the cost of that capital "will be highly correlated to the perception of risk at AmerenUE, which is predominantly regulatory related."[145] This leads to the obvious conclusion that investors will continue to perceive AmerenUE as more risky and less desirable (and thus withhold investment capital or at least demand a higher cost for it) so long as AmerenUE is one of the very last electric utilities in the 33 nonrestructured states that does not have an effective FAC in place.

The role of improved credit ratings (which an FAC will promote for AmerenUE, as noted earlier) and an FAC on AmerenUE's ability to access capital at the lowest possible rates is indeed unmistakable, as Mr. Rygh observed:

> As has been stated in other testimony, the majority of utilities with which AmerenUE has to compete for capital benefit from the inclusion of an FAC in their ratemaking process. As I address earlier, that competition for capital now and in the foreseeable future will be difficult and intense, and will be even more difficult for AmerenUE if it must compete for capital without the benefit of an FAC. Indeed, investors, credit rating agencies and others will likely penalize AmerenUE for the risk associated with the inability to better manage the burden associated with procuring fuel for customers unless an FAC is approved for AmerenUE. In a good environment these penalties would be visible, in the current environment and in the environment we expect for the foreseeable future, they could be severe.[146]

When asked how important (on a scale of one to ten) an FAC was for those who might loan money to AmerenUE, Mr. Rygh stated that it was a nine, with only a shutdown of the Callaway Plant being more important.[147] Mr. Rygh also opined that an FAC for AmerenUE was going to be necessary for AmerenUE to complete some of the projects it might have to defer given the current liquidity crisis.[148]

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[144] *Id.* p. 13, l. 14-16.
[145] *Id.* p. 13, l. 19-20.
[146] *Id.* p. 23, l. 25 to p. 24, l. 13.
[147] Tr. p. 2368, l. 9 to p. 2369, l. 6.
[148] *Id.* p. 2367, l. 9-15.

AmerenUE spent approximately $1 billion dollars on investments in its system in 2008.[149] Even if some planned 2009 projects are deferred, AmerenUE will spend in excess of $700 million in 2009 (versus less than $500 million just three or four years ago).[150] AmerenUE needs to spend, on average, more than $800 million per year through at least 2012.[151] These investments are being driven by the demands and needs of the Company's customers, by the expectations of the Commission (e.g., to comply with the Commission's new reliability-related rules), by environmental investments, and by the continued need to invest in the Company's aging generating plants in order to maintain the high level of performance AmerenUE has been able to achieve from those plants. It is thus imperative that AmerenUE maintain its financial health, which today is at risk, and which will deteriorate even further without an FAC. The Commission said it best: "[t]here are circumstances when the use of a fuel adjustment clause may be appropriate to preserve the financial health of the utility, and no one, including ratepayers, benefits when a utility becomes financially unhealthy."[152]

iv. Application of the first-non-statutory factor – whether the changes in costs and revenues that are to be tracked are substantial enough to have a material impact on AmerenUE's revenue requirement and financial performance between rate cases – supports an FAC for AmerenUE.

Having addressed the statutory standard in SB 179, and the closely related access to and cost of capital issues relating to a FAC for AmerenUE, we now turn to the first of the three non-statutory factors the Commission has previously considered when evaluating FAC requests.

As noted earlier, the components of AmerenUE's net fuel costs are very large (fuel and purchased power costs of approximately $735 million and off-system sales revenues of approximately $450 million), which means that even a small year-to-year change in one of those

[149] Tr. p. 264, l. 1-8 (Mr. Voss).
[150] *Id.*; Ex. 1 (Voss Direct) Sch. TRV-E2-1.
[151] Ex. 1 (Voss Direct) Sch. TRV-E2-2.
[152] Empire Order, p. 35.

components, or in net fuel costs as a whole, could materially, indeed greatly, affect AmerenUE's earnings and financial performance between rate cases if an FAC is not in place.[153] We have already seen this occur, as documented earlier. Even Ms. Mantle is of the opinion that five or ten million dollars of earnings impact "starts becoming significant."[154] This seems obvious given that there are plenty of issues in a rate case that are worth less than five million dollars that the parties view as significant enough to take to hearing.

Even AmerenUE's net fuel costs reflected in the revenue requirement in this case are nearly $300 million dollars, meaning just a 2% change will have a $6 million earnings impact. It follows that it takes just a 5% change to have an earnings impact of $15 million, and a 10% change to have an earnings impact of $30 million. Obviously, if not tracked, changes in these net fuel costs can have a significant impact on net income and cash flows. Changes of that magnitude, and more, are quite possible. Consider again that delivered coal cost increases alone are averaging more than **_________** each year. Similarly, a 10% increase or decrease of off-system sales or revenues, entirely plausible given the volatile nature of power markets, would move net fuel costs up or down by approximately $45 million annually, and that fails to account for the increases in fuel costs that are occurring. This is in part because the Company has locked-in (hedged) significant quantities of its expected fuel needs.[155] However, just because fuel is hedged does not prevent significant changes and uncertainty in net fuel costs between rate cases, as discussed further below. These facts lead to the very obvious conclusion that

[153] Also note that assessing AmerenUE fuel cost risk by only looking at its net fuel costs of less than $300 million (as Mr. Brubaker suggested) greatly understates the substantial size of AmerenUE's earnings exposure due to the uncertainties associated with the much larger individual components, i.e., total fuel costs of over $700 million and OSS revenues of approximately $450 million.

[154] Mantle Depo. p. 47, l. 1-23.

[155] Some people suggest hedged costs should not be considered. However, these hedged costs will in fact cause substantial changes in the costs being tracked in the FAC, thus supporting an FAC under this factor.

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significant changes in AmerenUE's net fuel costs between rate cases support an FAC for AmerenUE.

But year-to-year increases in the delivered cost of fuel, including delivered coal cost increases, are not the only significant changes that can occur and that can thereby materially affect income and cash flows if not tracked. While it is true that going into any particular year, the Company typically hedges a high percentage of its *expected* coal and coal transportation needs for the upcoming year (e.g., in late 2007, the Company had hedged a high percentage of the coal it thought it would need for 2008), this does not mean AmerenUE's financial performance and revenue requirement will not experience substantial impacts and changes within a given year if net fuel costs are not tracked through an FAC. As Mr. Neff testified,[156] the variation in a given year's coal burn and in diesel surcharge costs versus the costs that were expected, even in a year when some would say that AmerenUE is "fully hedged," can be just under **_________** – on delivered coal costs alone (ignoring changes in natural gas costs and certainly ignoring changes in off-system sales, which we address below). **_________** moves AmerenUE's ROE by a substantial **__** basis points (after-tax). But this approximately **_________** variation due to the variation in the coal burn and diesel surcharge costs only tells a small part of the story.

While AmerenUE's expected coal and coal transportation costs are substantially hedged in 2009 and 2010 (**____** of expected PRB needs in 2009 and **____** of expected PRB coal needs in 2010),[157] the combination of the approximately **_________** intra-year variation in the coal burn/diesel surcharges and price uncertainty for the unhedged portion of the expected coal needs in 2010, given the regulatory lag inherent in the time-consuming rate case

[156] Ex. 48 (Neff Rebuttal) p. 10, l. 8 to p. 11, l. 10.
[157] Tr. p. 2467, l 2-14 (Mr. Neff). AmerenUE is exposed to the market for approximately 50% of its delivered coal needs over the next five years. Tr. p. 2485, l. 8-15 (Mr. Neff).

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process, could create tens of millions of dollars of additional swings between rate cases. Consider AmerenUE's hedged position for coal[158] and a hypothetical rate case filed July 1, 2009 to address higher 2010 coal costs, the rates from which would not take effect until June 1, 2010. Under that scenario, between rates set in this and the next rate case, AmerenUE is exposed to intra-year uncertainty relating to the approximately **_________** of diesel and burn uncertainty discussed above from March 1, 2009 through June 1, 2010. In addition, AmerenUE is also exposed to more price uncertainty relating to the unhedged portion of the higher 2010 coal costs for the first five months of 2010 that existed at the time of the September 30, 2008 true-up date in this rate case. As Mr. Neff's rebuttal testimony shows, the range of the possible increase in coal costs for 2010 is wide – (a **__________** range, reflecting a low case of **___________** to a high case of **____________ **).[159] These uncertainties mean that in the 15 months between the end of this rate case and the end of the hypothetical mid-2009 rate case, AmerenUE could have the following exposure to swings in its financial performance, despite its aggressive coal hedging program:

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[158] These numbers reflect the Company's hedged position as of the time this rate case was filed, which is the actual uncertainty AmerenUE faced when it had to make a decision about a rate case filing. The hedged percentages for, e.g., 2010, increased some as the case progressed (from about 69% to 82% as noted above, leaving a substantial (18%) of expected 2010 coal needs unhedged even as of the true-up cutoff date).

[159] Ex. 48 (Neff Rebuttal) Table RKN-R2 (p. 6) and Table RKN-R3 (p. 19), the fourth rows of which show the high and low case projected delivered coal cost increases for 2010. Note also that this range assumes the high and low coal price figures Mr. Neff provided in his direct testimony, which indeed turned out to be conservative since the highs that Mr. Neff predicted might occur in the next five years in his direct testimony were breached within just a few months. Ex. 48 (Neff Rebuttal) p. 6, l. 17 to p. 7, l. 21.

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Delivered Coal Cost Uncertainty 3/1/09 to 6/1/10
(i.e., between this rate case and the end of a hypothetical 7/1/09 rate case)

**____[160]

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____[162]

______________**

It is undeniable that these kinds of potential changes, which are in delivered coal costs alone, can cause significant (almost **___** basis points (after-tax))[163] swings in income if not tracked – all despite very substantial hedging of delivered coal costs by AmerenUE.[164]

A second component of AmerenUE's fuel costs is the cost of natural gas burned for generation. FAC opponents of course point out that AmerenUE is much less reliant on gas than are Aquila and Empire, and this is true. But they cannot ignore the (increasing) significance of gas for generation costs at AmerenUE and the fact that the *dollars* involved are significant. As outlined by Mr. Glaeser, in 2007 gas for generation costs were 13% of AmerenUE's total fuel costs even though the megawatt hours produced from gas were between 1 and 2% of the total megawatt hours produced from the entire generation fleet.[165] Thirteen percent of AmerenUE's normalized fuel costs for the trued-up test year is approximately $85 million.[166] If the gas burn varies by a very modest 20% from expected levels (expected to be **__________** MMBtu in

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[160] Intra-year burn/diesel variation.
[161] *Id.*
[162] Price uncertainty – unhedged coal 2010.
[163] $72 million annually [$90.8 X 12/15 = $72.6].
[164] Even if the dollars of uncertainty involved (e.g., for 2010) were somewhat less by the end of the September 30, 2008 true-up cutoff date in this rate case because more 2010 expected coal had been hedged than the above estimate made when this case was filed, the dollars remain substantial: as of the time this case was filed, the uncertainty associated with unhedged 2009 coal costs were still **___________** (Ex. 48 (Neff Rebuttal) Table RKN-R2 (p. 6) and Table RKN-R3 (p. 10)). 2010 uncertainty as of September 30, 2008 must be expected to exceed this magnitude. However, even if the dollars were cut in half we are still talking about delivered coal cost uncertainty of nearly $50 million faced by AmerenUE between the current and a2009 rate case – a very significant 100 basis points of ROE.
[165] Ex. 34 (Glaeser Direct) p. 13, l. 14-17.
[166] Based upon the $651 million of normalized fuel costs reflected in Appendix A to the OSS Settlement.

2009[167]), at a hypothetical but realistic gas cost of $6.50/MMBtu, the Company's gas for generation costs would vary by more than $10 million. That gas volumes could vary by 20% is conservative given that AmerenUE's gas burn from 2005 through 2007 varied from its forecast by *181%*.[168] Although a portion of higher gas costs may be offset by higher off-system sales, it is also important to remember that gas-fired generation is often dispatched for reliability and not economic reasons. The Midwest ISO, which has dispatch control over AmerenUE generation, will dispatch AmerenUE gas generating units for system reliability conditions such as transmission congestion, voltage support, and loss of baseload generation throughout the Midwest ISO control area. These Midwest ISO dispatches are based on reliability concerns and not for economics.[169]

Another large component of AmerenUE's fuel costs is nuclear fuel. In this case, Staff strongly suggested that the Company should have just waited to file a rate case in July 2008, which Staff would argue would have allowed the Company to reflect higher delivered coal costs effective January 1, 2009 in rates set in this case. Aside from such a scenario also causing the Company to prolong the three more months of under-earnings the Company was already experiencing since June 2007, such a scenario may not always allow recovery of higher nuclear fuel costs either. Consider what happened in the Company's last rate case. In that case, delivered coal costs went up substantially on January 1, 2007, and as noted earlier those higher coal costs were reflected in rates set in that case on June 4, 2007 (after five months of them had been lost). However, a Callaway refueling outage occurred in the Spring of 2007 (after the rate case hearings were over), and those higher nuclear fuel costs were *not* reflected in rates in that

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[167] Ex. 34 (Glaeser Direct) p. 12 (table).
[168] *Id.* p. 12, l. 7-8. A 181% variation, at a gas price of $6.50/MMBtu, would cause a variance in AmerenUE's gas for generation costs from those that were expected of approximately $45 million [(**_________** MMBtu forecast in 2009 * 1.81) * $6.50 = $45 million].
[169] *Id.* page 10, lines 16-18.

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case.[170] Another Callaway refueling outage, at substantially higher costs (expected to be approximately **___** higher[171]) will occur in the Spring of 2010, which, without an FAC, will likely also not be reflected in AmerenUE's rates until yet another (2010 or later) rate case could again be filed and completed.[172]

The final component of AmerenUE's net fuel costs are purchased power costs and off-system sales. We will address off-system sales in greater detail below, but one only needs to consider two or three basic figures to understand that even small changes in off-system sales can have a material impact on AmerenUE's net fuel costs (and thus its income, cash flows and financial performance) between rate cases if not tracked. Those figures are as follows: normalized off-system sales revenues: approximately $450 million; normalized off-system sales volumes: approximately 10 million MWhs; typical level of volumes that are unhedged during any given 12-month period: **_______** MWhs; and a 20% movement in average power prices from expected prices in 2009 of just under $39/MWh, results in an approximately plus or minus $8/MWh swing in off system sales revenues. This entirely realistic range of power price movements within a year, all else being equal, would produce a swing in net fuel costs of plus or minus **_________**, which would increase or decrease earned returns by more than 60 basis points (after tax) and is significant by any definition.

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[170] In this case, the Staff did reach slightly beyond the true-up cutoff date and include higher nuclear fuel costs from the refueling outage that was completed in October-November 2008 in rates. Note, however, that Staff only did this given that the refueling outage was complete even before the evidentiary hearings in this case were completed. The Company seriously doubts that any party would support including higher nuclear fuel costs in rates when those costs are attributable to a refueling outage that is occurring well after the evidentiary hearings in a case are complete, as would be the case for Callaway's next refueling outage, even assuming the Company filed another rate case in mid-2009. Indeed, Ms. Mantle characterized including fuel costs as of January 1, 2007 in a rate case tried in March 2008 as being "at the very end of what we could do as an update period." Tr. p. 2649, l. 12-15.

[171] Ex. 49 (Irwin Direct) p. 7, Table 4 (**__________** total reload costs in November 2008 versus **_____ ______** in April 2010).

[172] This is only one example illustrating that, given Missouri's current regulatory policies, rate cases simply cannot be timed to avoid such under-recoveries of any one cost item. In addition to the regulatory lag, there are simply too many factors that determine when a utility should file a rate case. For example, a filing date that might reduce under-recovery of coal costs may increase under-recovery of nuclear costs or the cost of rate base additions.

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Incredibly, despite these facts, Ms. Mantle nevertheless testified that fuel cost uncertainty does not, in her view, support granting an FAC for AmerenUE.[173] Frankly, it appears impossible to reconcile Ms. Mantle's opinion about this factor with her own testimony, cited above, that $5 to $10 million is significant given that it is obvious that these net fuel cost changes could easily be not just $5 or $10 million, but tens of millions of dollars from year to year.[174]

v. Application of the second non-statutory factor supports an FAC for AmerenUE because changes in AmerenUE's net fuel costs, indeed in each component of them, are beyond AmerenUE's control and AmerenUE has little influence over them.

FAC opponents in this case carefully choose their words when addressing this factor, generally suggesting that AmerenUE "has some influence"[175] over fuel costs and off-system sales. There is, however, not a single shred of evidence in this case that supports the conclusion that AmerenUE controls the price it pays for coal, gas, nuclear fuel or diesel, or that it controls the price it receives for making off-system sales. Staff and others have readily agreed that AmerenUE cannot control these prices.[176] Moreover, the factor considered by the Commission is not "does the utility have 'some influence' over their total fuel costs?" The Commission recognizes that the issue is whether the Company has significant influence (not just a little influence), which obviously cannot be the case when the Company has no control whatsoever over all of the markets that affect its net fuel costs.[177] The Company agrees it can influence its total net fuel costs, to a point, just like all utilities, including some that are larger coal buyers

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[173] Tr. p. 2625, l. 22 to p. 2626, l. 2.
[174] Tr. p. 2628, l. 3-7.
[175] Tr. p. 2632, l. 17-20 (Ms. Mantle).
[176] Tr. p. 2631, l. 6 to 2632, l. 16 (Ms. Mantle -- no control over coal commodity, coal transportation, diesel, uranium, and gas markets). Brubaker Depo. p. 79, l. 21 to p. 80, l. 4 (No control over the spot market for coal or for power or for gas). Mr. Brubaker also acknowledges that despite AmerenUE's considerable effort to manage its coal costs those coal costs and transportation costs have increased nonetheless. Brubaker Depo. p. 77, l. 7-19.
[177] For example, Dr. Proctor conceded that the companies like AEP, Southern (Georgia Power, Alabama Power, Gulf Power, Mississippi Power, and Savannah Electric and Power) and Entergy, all of whom have FACs (*see* Ex. 41 (Lyons Direct), Sch. MJL-E6), are heavy in coal-fired generation and he agreed that at least AEP and Southern are larger coal buyers than Ameren. Tr. p. 2709, l. 1 – 20. If the Staff's "AmerenUE has some influence" theory held true, then those utilities should not have FACs either.

than AmerenUE, as pointed out in the preceding footnote. It can and does hedge delivered coal costs (up to five years out) and off-system sales (up to just 12 months out). So to that extent it fixes a price (although volumes remain uncertain) and thus influences its costs associated with those hedged volumes. But at the end of the day these commodity markets will move up and down irrespective of what AmerenUE does and, over time, the Company's contracts will follow these markets.

The record is full of examples of the Company's inability to "control" its net fuel costs. Over the past few years, AmerenUE has seen its delivered coal costs increase by more than $100 million in 2007 over 2006 levels, by more than $60 million in 2008 over 2007, and by more than **_________** in 2009 over 2008.[178] Gas costs have also increased (e.g., $44.2 million in 2006 to $79 million in 2007).[179] The cost to reload the Callaway Plant every 18 months has risen from $46.2 million in May 2004 to approximately **_______** for the reload just completed in the fall of 2008.[180] Off-system sales margins often vary greatly from their expected values. For example, off-system sales margins were approximately $225 million in 2007 (versus a budget of $276 million) and as of September 24, 2008, were projected to be approximately **____ _______ ** in 2008 (versus a budget of **________**).[181] At bottom, if UE could control its net fuel costs then it would not be seeing the relentless and substantially unpredictable increases in its fuel costs that it indisputably is seeing, and it would not fall short of its budgeted off-system sales margins by tens of millions of dollars – when, in fact, it is seeing those fuel cost increases and it has fallen short of those margins.

Factor two provides strong support for an FAC for AmerenUE.

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[178] Ex.48 (Neff Rebuttal) p. 4, Table RKN-R1.
[179] Ex. 43 (Glaeser Direct) p. 13, l. 13-14.
[180] Ex. 49 (Irwin Direct) p. 4, Table 2 and p. 7, Table 4.
[181] Ex. 432HC. We would note that power prices have in fact dropped further since the $291 million projection was made (on September 24, 2008), which may result in a further shortfall in 2008 margins versus budgeted margins at AmerenUE. Tr. p. 2442, l. 5-8 (Mr. Arora).

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vi. Non-statutory factor three supports an FAC for AmerenUE because changes in AmerenUE's net fuel costs are "volatile in amount, causing significant swings in income and cash flows if not tracked."

AmerenUE's proposed FAC tracks net fuel costs – fuel and purchased power costs net of off-system sales. The question then is whether the amount of those net fuel costs – period to period – may vary from the amount that was expected (i.e., the amount the Commission included in base rates and that would not be tracked without an FAC) such that those variations cause "significant swings in income and cash flows if not tracked." Despite much parsing of words by FAC opponents about what is and is not "volatile," and how it should be defined, it is exceedingly easy to see, based upon the evidence in this case, that this factor supports an FAC for AmerenUE.

We have already cited to uncontroverted evidence demonstrating that even as the Company approaches a given calendar year (e.g., the end of 2008, as 2009 approaches), the volume of coal that is burned and the transportation costs associated with that coal, due to things like uncertain diesel surcharges and varying loads, can easily move delivered coal costs by **__________** or more within that immediately following year and that the Company also faces tens of millions of dollars of additional coal cost variations due to the price uncertainty associated with the expected coal needs that the Company has not yet hedged. This potential range of variation in those costs grows even more during each succeeding 12 month period (e.g., the range of variation is wider for 2010 than for 2009 and wider still in 2011 versus 2010) because the percentage of expected coal needs that are hedged becomes less and less the farther in time one goes. As noted earlier, when Mr. Neff filed his direct testimony in early 2008, the

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delivered coal cost uncertainty for 2009 (i.e., starting less than a year out) still exceeded $100 million.[182]

As also noted earlier, the evidence in this case overwhelmingly supports the conclusion that coal markets, gas markets, uranium markets, diesel markets and power markets are highly uncertain and volatile. And while some (principally the Staff) attempt to downplay the uncertainty in AmerenUE's net fuel costs, others readily agree that indeed there is a lot of uncertainty around what AmerenUE's net fuel costs will be from year to year.[183] To use the Commission's words, that uncertainty can "cause significant swings in income and cash flows if not tracked."[184]

What Staff suggested in the Company's last rate case (although more explicitly then) and what Staff merely implies now is that *perhaps* offsetting cost decreases elsewhere in the Company's business or offsetting revenues (e.g., off-system sales revenues), might allow AmerenUE to cover higher fuel costs and thus might allow AmerenUE to earn a fair ROE. But not only has this not happened in 2007 or in 2008, there are a great many indicators suggesting it

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[182] Ex. 48 (Neff Rebuttal), Table RKN-R2 (p. 6) and Table RKN-R3 (p. 10). Note, however, that focusing on coal of course ignores other uncertainties in the components of net fuel costs, such as the gas burn, which as we noted above, is itself very uncertain, and off-system sales, which are large and highly uncertain and which, as noted earlier, have fallen short of expected values in both 2007 and 2008.

[183] Brubaker Depo. p. 56, l. 11-14 ("**Q. Do you agree that there's a lot of uncertainty around what the level of net fuel cost would be from year to year?** A. Yes."); Even Ms. Mantle agrees that a ten percent change – perhaps even a five percent change – is volatile. Mantle Depo. p. 44, l. 24 to p. 45, l. 16. Consequently, even under her definition, movements of just $15 million to $30 million in AmerenUE's net fuel costs would reflect volatility. The record in this case demonstrates conclusively that such movements are well within the range of possibility; indeed the changes and uncertainty in annual net fuel costs (up or down) are *likely* to exceed this level in every year.

[184] One can come up with many different definitions of the word "volatility." The Commission's statement of this third factor – i.e., that the changes in the costs/revenues (here, net fuel costs) being tracked can cause significant swings in income and cash flows if not tracked itself demonstrates that what is meant by volatility in this context is uncertainty; unpredictability. I.e., if we simply attempt to set a fixed level of net fuel costs in base rates and we don't track them, the utility's income and cash flows could go up or go down significantly because the net fuel costs, as the Company has seen, are difficult to predict and are highly uncertain. Authoritative publications confirm that this is what is commonly meant by the term "volatile." For example, the Electric Power Research Institute defines volatility as "a measure of the uncertainty in a future commodity price." Ex. 79. Similarly, *Webster's Collegiate Dictionary* (10th ed.) defines volatile as being "characterized by or subject to rapid or unexpected change."

is also unlikely to happen in 2009.[185] Indeed, whether or not it happens, particularly via a so-called "offset" from off-system sales, is purely speculative.[186] What is not purely speculative are the locked-in higher fuel costs faced by AmerenUE, the significant remaining fuel cost uncertainty, and the large volumes of off-system sales that are not locked in and that are thus highly uncertain.

For example, as Mr. Arora explained in his surrebuttal testimony, for increases in off-system sales revenues to offset the higher coal costs AmerenUE is virtually certain to face in the coming years, power prices realized by AmerenUE at its generating units would have to increase by about *four times as much* as its coal costs are increasing.[187] This is a mathematical reality driven by the fact that AmerenUE generates approximately 40 million MWhs from its coal-fired units, while selling just about 10 million MWhs of that power off-system. This fact, coupled with the higher delivered coal costs AmerenUE will face in 2009 and 2010 would mean that 2010 power prices would have to increase nearly **___**/MWh over their current test year level – a move that is highly unlikely particularly when considering the sharp recent decline in forward prices.[188] Even Staff's analytical expert, Dr. Proctor agrees that power prices realized by AmerenUE would have to increase fourfold to cover increases in delivered coal costs, based upon AmerenUE's normal level of coal-fired generation and off-system sales from coal-fired generation.[189]

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[185] "**Q. Are the Company's fuel costs going down?** A. No, they're not. They're largely hedged for 2009. So really all this shows is that the company has complete down side because of the reduction in expected power prices for 2009." Tr. p. 2450, l. 21 to 2451, l. 1 (Mr. Arora).

[186] And let's assume we get lucky and fuel costs go up but so do off-system sales, what then? Under the Company's FAC proposal, if off-system sales go up enough to drive net fuel costs down customers get 95% of the reduction.

[187] Ex. 24 (Arora Surrebuttal) p. 6, l. 12 to p. 8, l. 11.

[188] *Id.* p. 7, l. 15-21 (Power prices did increase by more than this just one time in the last ten years – from 2004 to 2005, with 2005 being a year that Dr. Proctor terms as "unusual.").

[189] Proctor Depo. p. 129, l. 3 to p. 130, l. 7.

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Indeed, Dr. Proctor was quick to point out when he was deposed that he does not contend that off-system sales will in fact offset higher fuel costs.[190] Mr. Brubaker also agrees that off-system sales are highly uncertain and that they cannot necessarily be counted on to offset higher fuel costs.[191]

One of the reasons this offset cannot be counted on is that there simply is no correlation between *AmerenUE's* own contracted-for (i.e., hedged) delivered coal costs and variable spot market power prices:

Q. You've agreed with me in the past, Dr. Proctor, that because a majority of Union Electric's off-system sales are not hedged, so the prices for those sales are obviously not fixed, so any variation in power prices for those unhedged off-system sales are not going to be correlated with UE's fixed hedged coal prices, correct?

A. That's correct.[192]

Given the above-facts, which are largely undisputed, the Chairman's question to Staff Counsel Dottheim about exactly what the Staff's cross-examination of Mr. Arora was trying to show was a very reasonable question. The sum total of Staff's "evidence" on this third factor is this: Dr. Proctor's rebuttal testimony picks at the edges of the volatility and uncertainty analysis conducted by Mr. Arora in an attempt to convince the Commission that AmerenUE's net fuel costs *may* not be *as* uncertain as apparently the Staff has subjectively decided they need to be for an FAC to be granted. Not once, however, does Dr. Proctor ever say AmerenUE's net fuel costs are not uncertain – *in fact*, he agrees with all of the following points:

Q. Dr. Proctor, you've agreed that there's uncertainty in each of the components in net fuel costs, isn't that right?

A. That's correct.

Q. There's uncertainty in gas prices and volumes.

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[190] *Id.* p. 133, l. 13-21.
[191] Tr. p. 2547, l. 3-21.
[192] Tr. p. 2709, l. 22 to p. 2710, l. 4.

A. Yes.

Q. There's uncertainty in coal prices and volumes of coal to be burned?
A. Yes.

Q. There's uncertainty in power prices and off-system sales volumes?
A. Yes.

Q. You agree off-system sales revenues are difficult to forecast, correct.
A. Yes. [193]

Q. Loads?
A. Yes.[194]

Certainly the Company and the Staff can spar forever about just "how uncertain is uncertain," and Dr. Proctor can attempt to Monday morning quarterback Mr. Arora's analysis, but at the end of the day it does not take dueling analysts for the Commission to understand that when all of the components of net fuel costs are being tracked, all of which are themselves uncertain and difficult to forecast, then the net fuel costs themselves are similarly going to be uncertain and difficult to forecast. And if that is true, then the net fuel costs can certainly cause material swings in income and cash flows if not tracked. Finally, if that is true, then factor three supports granting an FAC for AmerenUE.

While we will not go into great detail about the results of Mr. Arora's analysis – because the evidence and common sense as discussed above establishes that AmerenUE's net fuel costs are volatile and uncertain without dissecting that analysis – a few key results (and real world evidence confirming those results) are worth considering more closely. As Mr. Arora explained, his Table 1 in his direct testimony shows the results of 250 different iterations of net fuel cost simulations produced using a production cost model that simulated the operation of AmerenUE's system with varying coal, nuclear, gas and power costs (i.e., each of the 250 simulations

[193] Tr. p. 2708, l. 1-16. To illustrate the volatility the Company is seeing, consider that PRB coal has exhibited tremendous volatility, from $12 per ton then up to $20 per ton then back down to $14 or $15 per ton, all within 2008, as has nuclear fuel ($78 per pound to $140 per pound to $90 per pound). Tr. p. 184, l. 16-19 (Mr. Voss).
[194] Proctor Depo. p. 84, l. 2-14.

represents a possible (one of 250 possible) calendar years). These simulations, which were undertaken with the same software tools that the Company uses for its risk management, show results for five 12-month periods, including a 12 month period he labeled as the "test year with uncertainty." As he explained in his surrebuttal testimony and at the hearing, the "test year with uncertainty" case is simply a representation of the conditions AmerenUE would face at the beginning of a year.[195] As an example of what Table 1 shows, consider that the average net fuel cost from the 250 iterations for this "going into the test year" case is **__________**, with a range from the 25th to 75th percentile that is **_________** wide (**___________** to **__________**).[196]

If that range is reasonable, then it suggests strongly that Mr. Arora's analysis is also reasonable. In fact, real-world evidence we have in our hands today demonstrates that it is indeed reasonable. As Mr. Arora testified at the evidentiary hearing, using the DOE forecasts Dr. Proctor himself suggested might be appropriate to use in forecasting net fuel cost uncertainty, we see large swings in DOE's forecast of 2009 gas prices within the approximately one-year period from January to November 2008. Dr. Proctor's point was that the measure of uncertainty used by Mr. Arora (changes in forward prices) might overstate the uncertainty as compared to use of forecasts from DOE. Yet, the DOE's forecast of average gas prices for calendar year 2009 has moved about 20% during 2008.[197] Mr. Arora's assumed annual uncertainty in gas prices was just 12% in his analysis.[198] So one can see that, if anything, the uncertainty in gas

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[195] Tr. p. 2436, l. 1-6 (which means that this test year case would assume a high percentage of AmerenUE's expected coal needs are hedged).
[196] See also Table AKA-SR1 at p. 9 of Ex. 24 (Arora Surrebuttal), which shows that AmerenUE's actual forecasts for net fuel costs for 2007, 2008 and for 2009 have varied by a similar amount, and more due to a variety of factors, including plant availability and power market conditions. The 75th percentile net fuel cost means that there is a 25% chance that fuel costs will be higher than that level; the 25th percentile net fuel cost means that there is an additional 25% chance that fuel costs are lower than that level. This means that there is a 50% chance that fuel costs will be outside the range from the 25th to 75th percentile.
[197] Tr. p. 2437, l. 15 to p. 2438, l. 24; p. 2440, l. 1 to p. 2441, l. 9 (Mr. Arora, citing DOE forecasts).
[198] Ex. 22 (Arora Direct) Schedule AKA-E1.

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prices used in Mr. Arora's modeling may have been conservative, and may understate, not overstate, the real world uncertainty that AmerenUE faces in its net fuel costs. The uncertainty of power prices will be similar.

In fact, the power prices we are seeing today also support the reasonableness of Mr. Arora's modeling results. Looking again at Table 1 on page 29 of Mr. Arora's direct testimony, the simulated results suggest that there is a 25% chance that net fuel costs could be greater than **__________ ** for the "going into the test year case" (i.e., there is a 75% chance that they could be lower than **__________**). As of the time he testified at the evidentiary hearings, the most recent net fuel cost forecast for 2009 (as of October 2008) being used by AmerenUE estimated net fuel costs to be just six percent below this **___________** figure – **___ ______**. But that figure may very well be too low because it was projected at a time when forward power prices for 2009 were higher than the $41 current forward price cited by Mr. Arora during the hearings.[199] Because a small drop in power prices applied to **____** million MWh of unhedged off-system sales (AmerenUE's normal level of unhedged off-system sales volumes) would increase net fuel costs by tens of millions of dollars, one could easily see net fuel costs as high as **__________** – the 75th percentile in the test year case in Mr. Arora's Table 1.[200] These are real world facts that demonstrate that indeed Mr. Arora's analysis is reasonable.

The bottom line is that Dr. Proctor never actually testified that Mr. Arora's derived uncertainties for AmerenUE's net fuel costs were in fact too high, except to the extent he suggested that Mr. Arora *might* have overstated uncertainty by a factor of four.[201] And, the only reason Dr. Proctor could speculate about this possible overstatement was because his analysis improperly ignored 2005 data, as we address further below. In fact, Dr. Proctor testified that he

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[199] Tr. p. 2440, l. 18 to p. 2441, l. 9.
[200] Mr. Arora indicated that power prices for 2009 had dropped since October. Tr. p. 2442, l. 5-8.
[201] Tr. p. 2700, l. 25 to p. 2701, l. 20.

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could not say how uncertain AmerenUE's net fuel costs were because he had done no such analysis:

Q. Do you have an opinion about the level of uncertainty/volatility in AmerenUE's net fuel costs?
A. Can I try -- can I try rephrasing it, Jim?

Q. Give it a try.
A. I have not -- well. I have not performed a study in which I could testify to that I have a -- have determined what the level of variation or uncertainty or volatility or whatever word we want to use is for AmerenUE's net fuel costs. I have not performed such a study.

Q. And without performing such a study or essentially endorsing a study performed by somebody else, you don't feel like you're in a position to express an opinion about yes, their net fuel costs are uncertain, or no, they're not, or this is how uncertain they are, or this is how uncertain they're not. Is that fair to say?
A. That's fair to say, yes.[202]

What Dr. Proctor did do is *suggest* (without proof) that Mr. Arora may have overstated the uncertainty of power markets. But in order to make that suggestion, Dr. Proctor had to ignore 2005 data to come up with a power price trend line and to then calculate power price standard deviations (which is a measure of volatility) that excluded 2005, even though 2005 undeniably happened. Mr. Arora aptly explained why Dr. Proctor's selective exclusion of data from a particular year is inappropriate for an electric utility that faces the operational reality that it must sell power in the real world into volatile and uncertain power markets it can't control:

> If I recall correctly, he [Mr. Dottheim] was trying to have me exclude 2005, and I don't think in my opinion you can selectively exclude years because the volatility that AmerenUE faces is shown in the years. For example, if we try to exclude 2005, one might think you want to exclude 2002 because it's the lowest of the nine years. One might think that if oil prices have gone from $147 to less than [$]43 in 2008, 2008 is an unusual year. One might think if there's an economic recession in 2009, 2009 may be an unusual year. The fact is that AmerenUE is impacted by the prices in all of those years. If I start

[202] Proctor Depo. p. 14, l. 3-23.

> excluding four out of the last nine years, I don't have enough data points to make these analyses.[203]

Consider another real-world example of uncertainty faced by AmerenUE, this one involving the changes in delivered coal costs AmerenUE experienced as 2008 unfolded. Early in 2008, AmerenUE had hedged about **___** of its expected 2009 coal commodity needs (ignoring transportation). By the end of 2008, AmerenUE had hedged nearly **____** of those expected 2009 coal commodity needs. Does that mean that early in 2008, when **____** remained unhedged, AmerenUE had a high level of certainty regarding what its 2009 coal commodity costs would be, even if one assumed the coal burn in 2009 turns out exactly as was predicted? The answer is an unqualified "no." Because the coal markets move up and down as more and more hedges are being put into place, AmerenUE faced a significant **__________** uncertainty for 2009 delivered coal costs[204] and experienced a significant *$29 million* realized change just in its coal commodity costs for 2009 as calendar year 2008 unfolded and AmerenUE put more hedges for 2009 in place during 2008.[205] Note again that this $29 million figure ignores coal transportation costs, and ignores burn variations. Instead, this $29 million variation was caused simply because of the movement or market prices for the coal commodity itself within a period of just a few months (from early 2008 to the fall of 2008).

Finally, consider one other way of examining the volatility of AmerenUE's net fuel costs, that is, a comparison of the costs and revenues being tracked in Aquila's FAC, in Empire's FAC, and that would be tracked in AmerenUE's FAC.[206] Reproduced below is Table AKA-R1 from Mr. Arora's rebuttal testimony (page 13). Table AKA-R1 shows that AmerenUE's exposure to the volatility inherent in the natural gas and power markets in terms of all the costs and revenues

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[203] Tr. p. 2445, l. 10-24.
[204] Ex. 48 (Neff Rebuttal), Table RKN-R2 (p. 6) and Table RKN-R3 (p. 10).
[205] Ex. 23 (Arora Rebuttal) p. 3, l. 7 to p. 7, l. 11.
[206] Aquila's FAC does not track off-system sales. Empire's FAC does track the comparatively small off-system sales Empire makes, so like AmerenUE's proposed FAC Empire's FAC does track net fuel costs.

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tracked in AmerenUE's FAC versus those tracked in the FACs of Aquila and Empire is indeed *quite similar* (see green shaded rows [14] and [16]).[207] This of course makes sense given that a material part of AmerenUE's fuel costs (13% in 2007) were for natural gas, and given that AmerenUE's off-system sales (made in volatile power markets) provide a large (more than one-half) offset to total fuel and purchased power costs.

Table AKA-R1

Comparison of Fuel and Power Market Exposure for Aquila, Empire, and AmerenUE
($ Millions, Based on 2007 FERC Form 1, Unless Noted)

		Aquila	Empire	AmerenUE	
				FERC Form 1	Staff Run with OSS
		[1]	[2]	[3]	[4]
Nuclear	[1]	$0	$0	$46	$47
Coal	[2]	$121	$32	$510	$562
Hydro	[3]	$0	$0	-$4	$0
Gas and Oil	[4]	$34	$81	$78	$36
Total Fuel Costs ([1] + [2] + [3] + [4])	[5]	***$155***	***$114***	***$630***	***$645***
Short-Term, Non-Firm, and Other Non-Requirements Purchases	[6]	$128	$26	$37	$52
Short-Term, Non-Firm, and Other Non-Requirements Sales	[7]	$44	$17	$427	$450
Net Short-Term Purchases or Sales (abs([6] - [7]))	[8]	***$84***	***$9***	***$391***	***$398***
Long-Term and Contract Purchases	[9]	$8	$32	$32	$24
Long-Term and Contract Sales	[10]	$0	$0	$0	$0
Net Long-Term Purchases or Sales (abs([9] - [10]))	[11]	***$8***	***$32***	***$32***	***$24***
Total Natural Gas and Net Short-Term Purchases or Sales ([4]+[8])	[12]	**$118**	**$91**	**$469**	**$434**
Total Fuel and Net Power Purchases or Sales ([5] + [8] + [11])	[13]	$247	$155	$1,053	$1,067
Natural Gas and Net Power Exposure ([12] / [13])	[14]	***48%***	***58%***	***45%***	***41%***
2007 Total Retail Revenues	[15]	$580	$381	$2,222	$2,222
Natural Gas and Net Power Exposure ([12]/[15])	[16]	***20%***	***24%***	***21%***	***20%***

Sources and Notes:
[1]: 2007 FERC Form 1 for Missouri jurisdictions only.
[2]: 2007 FERC Form 1 includes all jurisdictions (89% MO).
[3]: 2007 FERC Form 1.
[4]: Staff run with OSS derived from Rahrer workpapers, Commission Baseline Run (August 2008).

Sales and purchases reflect energy costs only.

In summary, it strains credulity for FAC opponents to argue that the costs and revenues to be tracked in AmerenUE's FAC are not volatile in amount from year to year such that they can and likely will cause significant swings in income and cash flows if not tracked. AmerenUE's

[207] Ms. Mantle has performed a similar analysis in the staff report and her surrebuttal testimony but failed to consider any of AmerenUE's substantial OSS revenues that are part of the FAC and that are exposed to the same type of uncertainty as Aquila's and Empire's purchased power costs.

net fuel costs indeed can cause those swings, meaning that this factor, like the others, supports an FAC for AmerenUE.

C. **The Appropriate Structure for the FAC.**

Having established that the standard in SB 179, AmerenUE's need for access to huge sums of capital at reasonable cost, and the non-statutory factors applied by the Commission, based upon the record in this case, overwhelmingly support an FAC for AmerenUE, and given that all tariff and rate design issues relating to the FAC have been settled, the only remaining FAC issue is the appropriate sharing of changes in net fuel costs between the Company and customers.

As has been typical when the Commission considered other FAC requests, others have proposed (often as a "fallback position" in connection with their outright opposition to an FAC at all) large, out-of-the-mainstream sharing percentages with respect to the changes in the costs and revenues to be tracked in the FAC. In the Empire case, OPC proposed a 60%/40% sharing percentage, while the Staff proposed a 70%/30% sharing percentage.[208] Mr. Brubaker had multiple proposals ranging from 80%/20% sharing with a dead band to different bands with 90% and 95% sharing.[209] In this case, OPC proposes a 50%/50% sharing mechanism while Mr. Brubaker proposes an 80%/20% sharing mechanism with a cap that equates to a significant 50 basis points of ROE.[210]

There are several problems with these kinds of unusual, out-of-the-mainstream proposals:

- While these sharing proposals, at first blush, might appear to be symmetrical, it is likely that they will *operate* asymmetrically and punitively given the rising cost environment in which AmerenUE, like most utilities, is operating. This creates a

[208] Empire Order, p. 43.
[209] *Id.*
[210] Note that in the Company's last rate case, OPC witness Kind proposed an off-system sales tracker that contained no financial incentive for the Company *at all.* It seems that Mr. Kind only believes in financial incentives if they result in the utility foregoing dollars that flow directly to ratepayers, regardless of the financial impact on the utility. Tr. p. 2755, l. 2 to p. 2757, l. 21 (Mr. Kind).

high likelihood that AmerenUE will simply continue to under-recover large sums of prudently incurred fuel costs, even with an FAC, thus in part defeating the benefits the Commission would be trying to achieve in granting an FAC for AmerenUE. Consider, for example, Mr. Brubaker's proposal and the approximately $100 million of 2010 delivered coal cost increases (ignoring other fuel cost increases, such as higher nuclear fuel costs in the Spring of 2010) that AmerenUE will almost certainly face. Under Mr. Brubaker's proposal, at least $20 million dollars would be under-recovered -- simply gone forever. Under Mr. Kind's proposal, the situation would be even worse, with at least $50 million of prudently incurred fuel cost under-recoveries.[211] These kinds of under-recoveries do not provide the kind of financial support AmerenUE needs, and would effectively cut whatever just and reasonable allowed ROE the Commission awards to AmerenUE by 50 or 100 basis points or more.

- These sharing proposals exacerbate characteristics of the proposed FAC (driven in part by the Commission's FAC rules) that already tend to make FACs in Missouri somewhat less effective than FACs utilized by most utilities in other states. For example, nearly two-thirds of utilities with FACs in other non-restructured states use *projected* fuel costs as the basis for their FAC rates and adjustments.[212] Missouri's rules require the use of historic costs, which increases the deferrals created in the FAC and, thus, the lag in recovering prudently incurred fuel costs. Missouri's rules allow, at most, four adjustments per year (AmerenUE's proposed FAC will have just three adjustments per year), while many FACs in other states are adjusted monthly.[213]

- Sharing of changes in the overall costs and revenues tracked in an FAC also is a distinctly minority FAC structure to begin with. As the Commission recognized in the Empire case, "the vast majority of those states [with FACs] allow 100 percent pass-through of fuel costs."[214] Importantly, those FACs with sharing often use *projected* (not historic) costs as the basis for sharing (e.g., the Wyoming example Mr. Brubaker cited in the Empire case),[215] which, again, tends to reduce the under-recoveries for the utility in rising fuel cost environments (making the effective sharing percentages smaller).

- An FAC with a sharing percentage that is different than the sharing percentage already approved for Aquila and Empire will not only continue an unreasonably and punitive high level of under-recoveries in prudently incurred fuel costs for AmerenUE, but it will not provide the financial support needed to help improve AmerenUE's credit standing and access to capital at the most reasonable cost

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[211] Opponents say that other cost or revenue changes (e.g., off-system sales) *might* offset some of the fuel cost increases. As discussed above, whether that would be true is speculative at best, and if by chance it does occur, customers, under the Company's proposal, would get 95% of that benefit.
[212] Ex. 41 (Lyons' Direct) Sch. MJL-E5.
[213] *Id.*
[214] Empire Order, p. 41; Tr. p. 2369, l. 19 to p. 2370, l. 4 (Most allow 100% pass through, with just six or eight (two of which are Empire and Aquila) that allow less than 100%, with most of the rest close to 90% pass-through).
[215] Tr. p. 2553, l. 3 to p. 2554, l. 6.

possible. This is because the quality and effectiveness of an FAC in terms of actually allowing timely recovery of prudently incurred fuel costs matters a great deal. For example, S&P was clear in stating that "[w]e analyze the quality of special tariff mechanisms to determine their effectiveness in producing the cash flow stability they are designed to achieve."[216]

- Mr. Rygh was similarly clear on this point as well:

  - [In addressing 50%/50% sharing] "If two other utilities in that state, very good examples, had just gone and gotten 95% and this utility goes and gets 50%, it's going to really raise a tremendous amount of questions with investors as to . . . where that utility stands as far as how it's regulated in that state . . . as a signal as to what they can expect as they're spending not only that, you know, whatever the bill – that first billion dollars in that first year, but the second billion. That's – it's going to be a pretty difficult signaling event if that were to happen."[217]

  - [In addressing 80%/20% sharing] "**Q. What do you think the difference is between a – a cost sharing mechanism, say the one proposed by Ameren that's 95/5 versus the one that's proposed that's say 80/20?** A. Well, I think there's – there's still – when you're talking about the size of the exposure here, $400 million, that 15 percent is a pretty significant number when they – they're still not earning their allowed ROEs."[218]

  - [In also addressing Mr. Brubaker's 80%/20% proposal] "**Q. Just one more question. Would you be more comfortable with the 80/20 sharing mechanism that Commissioner – Chairman Davis discussed if the mechanism had a 50 basis point limit on its impact?** A. I don't think so, no. Like I said, it's a signal, and you know, the markets are looking for bad news and the credit rating agencies are already really focused on this. I think that – that would be a fairly tough thing for them to swallow."[219]

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[216] Ex. 61, p. 3.
[217] Tr. p. 2370, l. 23 to p. 2371, l. 8.
[218] Tr. p. 2371, l. 9-17.
[219] Tr. p. 2374, l. 13-21. Mr. Conrad in particular attempted to suggest by his cross-examination that investors and credit rating agencies don't care about the effectiveness of an FAC, for example, through his questioning of an ROE witness, Dr. Morin. While Dr. Morin did say "bond rating agencies tend to think all or nothing basically" that statement must be put into context, in that he also testified that they [the credit rating agencies] "do favor sort of mainstream *one on one or close to one on one pass throughs"* (emphasis added). Tr. p. 438, l. 4-12. Dr. Morin also testified as follows: "**Q. Would this paragraph [from Ex. 61] suggest that the terms of the FAC are important to credit rating agencies?** A. Yeah. I think they would be concerned with a marked deviation from the conventional practice of one to one. They would look at the terms of the adjustment clause. **Q. And when you say one to one what do you mean?** A. I mean one on one pass through of all fuel costs as opposed to 90/10 or 50/50." Tr. p. 459, l. 12-21. Mr. Gorman also disagreed with Mr. Conrad's notion that the credit rating agencies don't care about the quality of the FAC or its terms: "**Q. I think Mr. – or Mr. Hill characterized that as parsing the clause. That was his term, and I thought it made some sense. It's kind – in your view, it's kind of a yes, no,**

- A sharing percentage greater than 95%/5% is unnecessary in that AmerenUE has sufficient incentive to continue to properly manage its net fuel costs absent any sharing, including the following incentives that exist irrespective of any sharing at all:

  - **Coal Pool.** As discussed by Mr. Neff in his testimonies, AmerenUE's Powder River Basin (Wyoming) (PRB) coal, which accounts for most of AmerenUE's purchases, is purchased via a coal pool that includes coal purchases for unregulated Ameren merchant generating companies operating in Illinois. As a consequence, AmerenUE's unregulated affiliates must pay the exact same prices as AmerenUE for coal purchased from the pool. This creates a significant financial incentive for AmerenUE's coal procurer, AmerenEnergy Fuels and Service Company, to minimize coal costs for the pool.[220]

  - **Individual Employee Incentives.** There are three key groups of employees who have the most impact on minimizing net fuel costs: AmerenUE's Asset Management and Trading Group (which makes off-system sales), AmerenUE's Power Operations Group (which runs the Company's fossil-fueled power plants), and AmerenEnergy Fuels and Services (AmerenUE's fuel procurement agent). Each of these groups has specific financial incentives designed to make sure those employees make decisions that lead to lower net fuel costs.[221]

  - **Prudence Reviews**. The Legislature (which specifically included mandatory prudence reviews in S.B. 179) and the Commission both recognize that prudence reviews provide a powerful incentive for electric utilities to properly and prudently manage net fuel costs. Regulators commonly use prudence reviews to ensure only prudently incurred fuel costs are flowed through to customers. Notably, this Commission has effectively utilized prudence reviews for Missouri gas utilities' purchased gas adjustment clauses for more than 40 years.[222]

  - **Cash Flow Lags.** As Mr. Voss's direct testimony indicates, the Company faces very large investment needs in the coming years, and the likelihood of needing to build a large base load generating plant within a decade. Given the fact that Missouri is one of the few states that requires FAC adjustments based on historical rather than projected costs, there is a

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they have one, they don't; is that fair, from the rating agency' perspective? A. No. I think the rating agencies are capable of understanding a fuel adjustment clause and understanding the – the effect of that clause in allowing a utility to produce the cash flows necessary to support financial obligations. So I think they are – are familiar with regulatory mechanisms and the implications of those mechanisms on a utility's cash flows." Tr. p. 545, l. 10-21.

[220] Ex. 42 (Lyons' Rebuttal) p. 21. Others agree that the coal pool provides an incentive for AmerenUE to properly manage its coal costs: Brubaker Depo., p. 92, l. 15 to p. 93, l. 6 ("**Q. It's a pretty powerful incentive, isn't it.**" A. Yeah.").

[221] *Id.* p. 21.

[222] *Id.* pp. 21-22.

substantial lag between AmerenUE's incurrence of its fuel costs and its recovery of those fuel costs from customers. This puts added pressure on the Company's credit metrics, which will tend to increase capital costs and decrease the Company's earnings and stock price. The problem is exacerbated by the long (12 month) recovery period in the Company's proposed FAC which, while less than ideal, was proposed to mitigate rate impacts from net fuel cost changes to customers. The Company has the incentives to reduce fuel costs to the extent possible to mitigate these cash flow pressures.[223]

- **Heat Rate/Efficiency Testing.** The Commission's FAC rules require a detailed heat rate/efficiency testing plan, which is outlined in the testimony of AmerenUE witness Mark Birk. This plan establishes not only an objectively-measured baseline of the Company's generating unit efficiency today, but provides for ongoing monitoring and reporting of that efficiency throughout the period when the FAC will operate. This provides a powerful tool that allows the Commission to guard against imprudent operation and maintenance of the Company's generating units and any resulting higher net fuel costs.[224]

- **Periodic Review of any FAC.** The Commission put it this way: "A fuel adjustment clause is a privilege, not a right, which can be taken away if the company does not act prudently."[225] Under Missouri's FAC statute and regulations, each time an electric utility files a rate case, its FAC once again is at issue, and indeed it must be addressed in a rate case no less frequently than every four years. It would indeed be foolish on the Company's part to stop acting prudently to manage its net fuel costs when the Company knows it will have to stand before this Commission again to justify its FAC in the near term.[226]

All of these incentives, coupled with the additional incentive the 95%/5% sharing mechanism like that adopted for Aquila and Empire and as proposed by AmerenUE in this case, are not only adequate, but indeed they together create a powerful incentive for AmerenUE to do what it has always done: manage its fuel costs and off-system sales prudently and run its power

[223] *Id.* p. 22.
[224] *Id.*. Mr. Brubaker, for example, also agreed that this creates an incentive for AmerenUE to properly operate and manage its power plants even with an FAC. Brubaker Depo. p. 102, l. 5-13.
[225] Empire Order, p. 45-46.
[226] Ex. 42 (Lyons' Rebuttal) p. 23, l. 1-8. *See also* Brubaker Depo. p. 97, l. 7-12 ("**Q. But the fact that UE will have to come back every four years gives it some incentive to continue to do a good job in other areas or else the commission might very well punish it for making changes that are detrimental to its net fuel cost, correct?**" A. I would agree with that.").

plants efficiently.[227] Large, out-of-the-mainstream sharing percentages weaken the FAC to the point that the FAC will fail to achieve the necessary support for the Company's financial health, and importantly, for its credit quality, particularly under circumstances when the Commission has already approved a 95%/5% sharing mechanism for the only two other utilities in the state that have an FAC.

Mr. Voss perhaps summed it up best in the following exchange at the evidentiary hearing:

> **Q. Indeed, isn't it true that you're suggesting that there are already some incentives in the form of regulatory lag and so no more incentives are needed?**
>
> A. That's not true. There's plenty of other incentives. We have incentives in the individual performance indicators with individual employees. We have incentives involved with our coal pooling program. We have incentives involved with the fact that our employees are supposed to live Ameren's values, and part of those values is to deliver good service to our customers at our lowest cost, something we've been doing for over 100 years and aren't likely to change in the future.
>
> **Q. So you have a setup, then, where employees apparently need this incentive as an encouragement to produce value for customers and shareholders, but at the same time Ameren isn't willing to accept a meaningful financial incentive to keep its fuel costs low, isn't that correct?**
>
> A That's not correct. I think we feel we have plenty of financial incentives even with the proposed fuel adjustment rider as we proposed it to ensure that we still do a very good job of serving our customers. In fact, if you look at our PGA analysis in gas, we really have no particular financial incentives involved for the employees over and above their own individual key performance indicators. I think everyone would recognize that these employees have done an outstanding job over many, many years that we've had a gas adjustment mechanism without any other kind of adjustments needed, and that's just 100 percent plan [i.e., 100% pass through]."[228]

[227] "Our intention with an FAC would be to continue the hedging programs that we have in place today for coal procurement, for gas procurement, transportation procurement as well as off-system sales management, purchased power management." Tr. p. 2173, l. 5-8 (Mr. Lyons). "With an FAC we would intend to maintain and improve our generation units as we have worked to do in the past * * * [w]e would aggressively pursue opportunities for off-system sales as we have in the past." Tr. p. 2190, l. 3-14 (Mr. Lyons).

[228] Tr. p. 111, l. 7-19; p. 112, l. 3-21.

The record in this case demonstrates that AmerenUE satisfies the standard in SB 179, the three other factors the Commission considers when evaluating FAC requests, and that indeed AmerenUE needs an FAC to improve and maintain its financial health.

IV. VEGETATION MANAGEMENT/INFRASTRUCTURE INSPECTION.

A highly visible and important component of AmerenUE's commitment to improve the reliability of the electric service it provides is its vegetation management and infrastructure inspection and repair programs. Although not required to implement the Commission's new rules until mid-2008,[229] the Company voluntarily began compliance with the rules on January 1, 2008. Recognizing the Commission's purpose behind these rules was to improve service reliability for customers, AmerenUE has embraced the rules. Staff's position is that AmerenUE should not be allowed to recover the additional expenditures based on the reasoning that the costs were incurred prior to the effective date of the rule. Staff's position is not based upon what expenditures were prudent or whether a utility should be encouraged to do the right thing. Staff prefers to rely upon a technical reading of the Commission rules and not to do anything more than what is specifically required by that technical reading. AmerenUE believes this interpretation is unreasonable and defies common sense. The Commission should encourage utility investment designed to improve service reliability. Staff's opposition to these types of prudent investments and the Staff's overall minimalist, overly technical approach discourages investment and should be rejected by the Commission.

AmerenUE is asking for three types of treatment for its vegetation management and infrastructure inspection and repair costs. The Company is asking the Commission to allow it to amortize over three years the $10.9 million it actually incurred (above the amount in rates) from January 1, 2008 through September 30, 2008. Secondly, the Company requests an accounting

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[229] Largely because of an administrative error in the Commission's rulemaking that delayed adoption of the rules.

authorization for costs actually incurred (above the amount in rates) between October 1, 2008 and February 28, 2009. Finally, the Company asks the Commission to allow a tracker for these costs with the base amount included in rates set at $78 million ($54.1 for vegetation management and $23.9 for infrastructure inspection and repair), which is equal to the two year average of AmerenUE's budget for these expenditures.[230] AmerenUE's tracker request is modeled after the tracker granted in the recent *Empire* case, *supra*. The tracker proposed by AmerenUE would set a base level for vegetation management and infrastructure inspection and repair costs in rates equal to the two year average of AmerenUE's budgeted expenditures in those areas. Actual expenditures would be tracked against that base level, with the creation of a regulatory liability in any year where the Company spends less than the target amount and a regulatory asset if more is spent.[231] Those assets and liabilities would be netted against each other and considered in AmerenUE's next rate case.[232]

Because Staff's positions on these three requests are different for vegetation management and infrastructure inspection and repair, AmerenUE will address each separately. OPC offered a witness who supported Staff's positions on vegetation management expenditures in surrebuttal testimony. OPC also made additional arguments on that subject, which will be discussed after Staff's positions are addressed. OPC did not address AmerenUE's infrastructure inspection and repair cost requests.

A. Vegetation Management Expenses.

Staff opposes the three year amortization request for vegetation management expenditures from January to September 2008, above the sums included in rates, and also opposes the October to February accounting authorization for these same expenditures. Staff

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[230] Ex 76.
[231] Ex. 16 (Zdellar Rebuttal) p. 7, l. 15-22.
[232] *Id.*

supports a tracker for vegetation management compliance costs starting with the effective date of new rates from this case, but would make significant modifications to AmerenUE's proposal. Staff would limit the tracker to one year, would set the base amount at the amount spent during the true-up test year, and would impose a 10% cap.[233]

i. ***Three Year Amortization Request and Accounting Authorization Request.***

Staff's arguments against the three year amortization request for vegetation management expenditures are two-fold. Staff argues, first, that the Commission rules on vegetation management did not take effect until June 30, 2008, and second, that AmerenUE had agreed to a one-way vegetation management tracker of $45 million in its previous rate case and so the Company should not now be allowed to recover more than $45 million for those expenditures.

AmerenUE believes the effective date of the rules should not control when its prudent expenditures should be recovered. AmerenUE began its compliance efforts in January of 2008, several months before the effective date of the new rules. Staff admits that the rules would have been effective by January of 2008, but for a clerical error at the Commission during the rulemaking proceedings.[234] Additionally, the Commission's reasoning in the *Empire* case is applicable here. The Commission said, "It is very important for Empire, as well as Missouri's other electric utilities, to improve the reliability of the service it offers its customers. For Empire to take immediate action to increase the scope of its tree-trimming activities would be in the public interest and it should be provided the financial resources needed to accomplish that goal in this rate case."[235] AmerenUE's request to amortize costs incurred between January and September of this year is based upon the same concept. AmerenUE voluntarily went beyond the technical requirements of the Commission's rules, by starting prior to the effective date, in an

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[233]Staff Statement of Position p. 3. Tr. p. 1673, l. 6-12. Tr. p. 1684, l. 12-16.
[234] Tr. p. 1680, l. 4-24 (Mr. Beck).
[235] Empire Order, pp. 67-68.

effort to improve customer reliability. The Commission should provide "the financial resources needed to accomplish that goal in this rate case" and approve AmerenUE's request to recover these expenditures, including its request to set the base in the tracker equal to its average budgeted levels over the next two years..

Staff makes no claim of imprudence for AmerenUE's expenditures and, in fact, agrees that it was good practice to begin those efforts early.[236] Further, Staff admits that the Commission has the ability to grant AmerenUE's request to amortize expenditures and to grant the accounting authorization, even though the requests may vary from the specific mechanism included in the Commission's rules.[237] Staff appears reluctant to voice support for a request not explicitly provided for in the rules, but agrees that the Commission is free to grant that relief.[238]

AmerenUE believes the second objection lodged by Staff is an equally insufficient reason to reject AmerenUE's request. In Case No. ER-2007-0002, AmerenUE committed to spend $45 million annually on vegetation management as part of a one-way tracking mechanism approved in that case. It has fulfilled that commitment and there is no disagreement between any parties on that question. Without the Commission's imposition of new rules governing vegetation management, AmerenUE's fulfillment of its $45 million commitment would be the end of the Commission's analysis. However, the tracking mechanism adopted in the last rate case did not anticipate the Commission's new rules. Consequently, the expenditure level contemplated at the time that mechanism was adopted was superseded by the higher costs associated with the Commission's new vegetation management rules. That the tracker from the last case could not have contemplated the new rules is evidenced by the fact that the tracker was agreed to by

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[236] Tr. p. 1681, l. 6 to p.1683, l. 14 (Mr. Beck). Beck Depo., p. 19, l. 4 to p. 20, l. 10; p. 22, l. 10-14.
[237] Tr. p. 1671, l. 10 to p. 1672, l. 17 (Mr. Beck).
[238] *Id.*

AmerenUE in March of 2007, before any proposed rules were docketed.[239] Nor could AmerenUE have anticipated what form any new vegetation management rules might take. Staff eventually circulated one version and certain Commissioners developed a significantly different proposal.

Staff's next argument implies that because AmerenUE is already trimming vegetation on a 4/6 year cycle while Empire was and is significantly further behind, the Commission should reject AmerenUE's request. The Commission's decision on this request should not be based on which company is furthest behind in its compliance efforts. All utilities in Missouri should be given the opportunity to recover prudent expenditures which are required by regulation. Additionally, it is a misstatement to characterize the Commission's new rules as merely requiring 4/6 year trim cycles. The reality is that these rules require much more. The new rules require customer notification and education, mid-cycle inspections, vertical overhang removal and other minimum clearance requirements, and impose an obligation to attempt to remove off-easement danger trees.[240] None of these requirements existed prior to the adoption of the Commission's new rules and AmerenUE's vegetation management did not fully include those practices prior to January of 2008.[241] Given the significantly broader requirements of the rule, the fact that AmerenUE spent more than the $45 million included in its rates should not be surprising nor was it imprudent. AmerenUE believes the Commission should avoid penalizing the Company for complying with the rules early and should allow amortization of its additional expenditures.

The same reasons justify the additional amounts requested to be collected in a regulatory asset from October 2008 through February 28, 2009. Importantly, these expenditures will have

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[239] The first formal, proposed rules were not filed in the rulemaking docket until June of 2007 – approximately three months *after* AmerenUE made its $45 million commitment. Tr. p. 1692, l. 19-23.

[240] Tr. p. 1674, l. 16 to p. 1676, l. 3. Moreover, as Mr. Zdellar testified, compliance may require more than a 4/6 year cycle, which will create additional costs. Tr. p. 1659, l. 16-22 (Mr. Zdellar).

[241] *Id.*

occurred after the rules are effective, meaning AmerenUE is required by the regulation to make these expenditures. The Commission should allow recovery of costs incurred in response to the Commission's rules. Staff's only reason for opposing this request is the $45 million tracker from the previous rate case. As explained above, this argument is no more logical regarding these expenditures than it was in regard to the January through September expenditures.

ii. Prospective Tracker Request.

Staff agrees that the Commission should grant AmerenUE a tracker for vegetation management costs incurred after the effective date of new rates in this case. However, Staff would set the base at the amount spent during the updated test year, limit the tracker to one year and impose a 10% cap over the vegetation management amount spent in the true-up test year.[242] Staff argues a cap is necessary to provide AmerenUE with an economic incentive to limit vegetation management expenditures.[243] Staff provides no reason that this bold assertion is true. Staff concurs there is no evidence in the record that AmerenUE has spent imprudently on its vegetation management.[244] Staff admits that it has no basis to believe AmerenUE would spend imprudently in the future other than some generic risk that any utility could spend imprudently.[245] Staff agrees, if a cap is imposed, it is possible that expenditures required by the Commission's rules could force the Company to spend more than the cap.[246] At a time when AmerenUE is increasing its vegetation management expenditures in order to meet Commission imposed requirements and when the total cost of compliance is still an unknown, an arbitrary cap on those expenditures is inappropriate.[247] The Commission rejected a similar argument made in the *Empire* case. In the *Empire* case, the Commission noted that capping the utility's ability to

[242]Staff Statements of Position, p. 3.
[243]Ex. 218 (Beck Surrebuttal) p. 7, l. 15-19.
[244] Tr. p. 1685, l. 7-10 (Mr. Beck).
[245] Tr. p. 1686, l. 10 to p. 1687, l. 14 (Mr. Beck).
[246] Tr. p. 1686, l. 6-18 (Mr. Beck).
[247] Ex. 17 (Zdellar Surrebuttal) p. 7, l. 14-18.

recover compliance costs at a fixed level "would give the company a strong disincentive to spend the needed money."[248]

Staff and the Commission have access to large amounts of information regarding AmerenUE's vegetation management expenditures over the past several years and will continue to receive that information going forward. AmerenUE filed its vegetation management plan for 2009 with the Commission in July of 2008 in Case No. EO-2009-0012. Staff's review to date has found nothing indicating imprudent expenditures are planned.[249] When AmerenUE files its next rate case and requests the tracker balance be placed into rates, Staff will be free to recommend a disallowance of any imprudent expenditure. There is no need for an arbitrary cap on AmerenUE's vegetation management expenditures. AmerenUE already has a sufficient incentive to ensure that its expenditures are prudent to avoid disallowance of any imprudent expenditures in its next rate case.

AmerenUE requests that the tracker remain in place until such time that new rates are established in the Company's next rate case. A decision about whether or not it should be continued can be made during that next rate case. Staff's suggestion that the tracker run for only one year is made without any support other than that this was how Staff originally interpreted the Company's request. AmerenUE believes it makes more sense to continue the tracker at least until the next rate case. Certainly AmerenUE's approach benefits its customers, in that if the Company's expenditures start to decline, AmerenUE's customers will capture that decrease in the tracker.

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[248] Ex. 17 (Zdellar Surrebuttal) p. 3, l. 15-17, *quoting* the Empire Order, p. 72.
[249] Tr. p. 1688, l. 15 to p. 1689, l. 12 (Mr. Beck).

iii. OPC's Additional Arguments.

The Office of Public Counsel offers one witness who addressed AmerenUE's requests in this area in surrebuttal testimony. Generally, OPC merely mimicked the positions of Staff, as set forth in Public Counsel's Position Statement.[250] Mr. Ted Robertson, OPC's surrebuttal witness, did offer two additional arguments.

First, Mr. Robertson alleges AmerenUE is partially responsible for the need to incur the additional amounts it is spending on vegetation management and therefore customers shouldn't bear the increased cost. Interestingly, the only evidence offered by Mr. Robertson is a quote from KEMA, a consultant hired by the Company to provide an independent analysis of AmerenUE's storm response practices. The KEMA report discussed AmerenUE's vegetation management practices and points out that AmerenUE experienced budget cuts in this area in 2003. However, Mr. Robertson failed to acknowledge the entirety of that portion of the report, including the previous sentence. The sentence prior to the "evidence" upon which Mr. Robertson relies says, "AmerenUE's practices in these areas [vegetation management] are consistent with industry standards and what is considered good utility practice."[251] Contrary to Mr. Robertson's apparent theory, a budget cut does not automatically translate into imprudence. In fact, as the KEMA report states, AmerenUE's practices met industry standards and were considered good utility practice.[252]

Mr. Robertson also testified that trackers should be avoided in general and only used in limited circumstances.[253] Of course, this instance is a fairly limited circumstance. The Commission does not impose new vegetation management requirements on a frequent basis and all parties agree the rules require significant changes to the normal practices of Missouri utilities.

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[250] Public Counsel's Position Statement, pp. 1-2.
[251] Tr. p. 1709, l. 17-20.
[252] *Id.*
[253] Tr. p. 1711, l. 20-24.

Additionally, the Commission has considered and rejected these very arguments in the recent *Empire* case.[254] Mr. Robertson admitted that the Commission had found the costs incurred to manage vegetation and inspect its infrastructure were legitimate costs for providing reliable service to customers.[255] Mr. Robertson also admitted that the Commission found in the Empire rate case that allowing the incremental costs would provide a stronger incentive for Empire to spend the money necessary to fully comply with the Commission's rules.[256] The Commission stated,

> If its estimated costs are included in the rates established in this case, Empire will have a stronger incentive to spend the money it needs to spend now to fully comply with the rules. If the company were instead forced to wait until its next rate case to recover the money it spends to comply with the rules, its interest in managing its cash flow would give it an incentive to spend only what it absolutely must to meet the requirements of the rule…the Commission wants to encourage Empire to take the steps and spend the money needed, to quickly improve the reliability of its electric service. Furthermore, by including an estimate of Empire's likely cost of compliance in the rates established in this case, the customers who will immediately benefit from the improved reliability will pay the costs required to bring about that improvement, thus improving the match between cost causation and payment for those costs. For both reasons, it is appropriate to allow Empire to recover its anticipated costs of compliance in this case.[257]

AmerenUE has demonstrated its strong commitment to implementing the Commission's new rules and to improving the reliability of service for its customers. Consequently, the Commission should provide the Company with a mechanism which allows it to recover those costs.

B. Infrastructure Inspection and Repair.

Staff opposes the three year amortization request for infrastructure inspections and repair as well as the October to February accounting authorization request for infrastructure inspection

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[254] Tr. p. 1712, l. 20-23 (Mr. Robertson).
[255] Tr. p. 1713, l. 15-20 (Mr. Robertson).
[256] Tr. p. 1714, l. 3-9.
[257] Empire Order, p. 70.

costs. Staff supports a tracker for infrastructure inspection compliance costs starting with the effective date of new rates from this case, but would not include repair costs associated with items discovered during the inspections.[258] Staff would set the amount in rates based upon the level of inspection expenditures reflected as of the end of the true-up cutoff date in this case.[259]

i. Three Year Amortization Request and Accounting Authorization Request.

Staff's main argument against the three year amortization request and the accounting authorization request for expenses incurred between October and February boils down to the mere fact that the Commission's new rules on infrastructure inspection and repair did not take effect until June 30, 2008. For the reasons outlined above relating to the vegetation management rules, Staff's argument should be rejected.

ii. Tracker Request.

Staff agrees that the Commission should grant AmerenUE a one year tracker for infrastructure inspection costs incurred after the effective date of new rates in this case. However, Staff would set the base at the amount spent during the trued-up test year and would exclude infrastructure repair costs.[260]

For the reasons stated above in connection with the proposed vegetation management tracker, AmerenUE requests that the tracker be in place until such time that rates from the Company's next rate case become effective, and that its average budgeted costs for the next two years be used to get the base amount to be included in its rates.

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[258] Ex. 218 (Beck Surrebuttal) p.11, l. 1-3, 5-7. Excluding repair costs is inappropriate given that the rule requires utilities to take "corrective action" (i.e., repair) conditions discovered during the inspections. 4 CSR 240-23.020(3)(H) and 4 CSR 240-23.020(2)(A).

[259] Staff's Statements of Position, p. 3. Like the vegetation management tracker, the Company believes the base amount should equal the average of its budgeted level of these expenditures for the next two years, as was approved in the *Empire* case. Empire Order, p. 72.

[260] Staff's Statements of Position, p. 3.

The only issue that is different for the infrastructure and repair tracker is Staff's belief that the repair costs associated with items discovered during the infrastructure inspections should not be included in the tracker due to a risk of double recovery, arguing some repair costs would already be included in AmerenUE's cost of service.[261] Mr. Zdellar addressed this concern in-depth in his surrebuttal testimony. As Mr. Zdellar explained, the very purpose of requiring infrastructure inspections is to identify and correct problems earlier than had been occurring under normal utility practice.[262] But for these inspections, these repair needs would not have been revealed.[263] Staff agreed with this statement at the hearing.[264] Accordingly, it cannot be true that all of the O&M costs resulting from the Commission's infrastructure inspection rule are already included in AmerenUE's current revenue requirement.[265] Staff has indicated that they would not oppose the inclusion of these repair costs if there was a mechanism to ensure no double recovery occurred.[266] The Company has taken steps to address this concern. AmerenUE has set up separate accounting designations so that it will know exactly what system repairs were generated by the infrastructure inspections and which ones were caused by normal means of identification.[267] Only those repairs identified by the infrastructure inspections will be included in the tracker.[268]

V. INCENTIVE COMPENSATION.

Like the overwhelming majority of utilities and other companies, AmerenUE pays a portion of its employees' market-based salaries in the form of incentive compensation. The Company has found that placing a portion of its employees' total compensation "at risk" and

[261] Tr. p. 1697, l. 2-6 (Mr. Beck).
[262] Ex. 17 (Zdellar Surrebuttal) p. 10, l. 9-11.
[263] *Id.*
[264] Tr. p. 1698, l. 12-16 (Mr. Beck).
[265] Ex. 17 (Zdellar Surrebuttal) p. 10, l. 6-11.
[266] Beck Depo. p. 61, l. 22-25.
[267] The normal method of identification would include system failure, customer notification, etc.
[268] Ex. 17 (Zdellar Surrebuttal), p. 10, l. 16 to p. 11, l. 2.

subject to the achievement of specific performance objectives focuses the efforts of its employees on goals that benefit both the Company and its customers. Incentive compensation costs comprise a significant portion of AmerenUE's payroll costs – approximately 7%, and these costs totaled slightly less than $22 million in the test year for this case.[269] The Company's incentive compensation can be broken down into three categories—long-term incentive compensation, which accounts for approximately $7 million of the test year payment, short-term incentive compensation, which accounts for approximately $13.3 million, and the Exceptional Performance Bonus Plan, which accounts for approximately $850,000. The Staff has proposed to disallow approximately 98% of AmerenUE's total incentive compensation costs from rates.[270] The exclusion of these substantial, legitimate payroll costs is unreasonable, it is not supported by the evidence presented in this case, and it should be rejected.

A. <u>Incentive Compensation Is a Necessary Component of Market-Based Pay for the Company's Employees</u>.

There is really no dispute in this case that the incentive compensation paid by the Company to its employees is necessary to bring those employees' pay to market level. Krista Bauer, Ameren's Manager of Compensation and Performance, testified that incentive compensation is part and parcel of a competitive total rewards package for our industry and is very commonly used by other companies with whom AmerenUE competes for employees.[271] She pointed out that based on an August, 2008 Hewitt & Associates survey, 97.3% of Ameren's peer utility companies have short-term incentive compensation for their executive populations, and 100% have long-term incentive compensation for the same population. Similarly, information recently compiled by Towers Perrin indicates that 93.7% of utilities surveyed

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[269] This amount excludes all incentive compensation for officers, which AmerenUE is not seeking to recover in rates.
[270] Tr. p. 1500, l. 25 to p. 1501, l. 7 (Mr. Hagemeyer).
[271] Ex. 25 (Bauer Rebuttal) p. 3, l. 5-9.

provide short-term incentive compensation to their middle management and professional employees.[272] Clearly incentive compensation programs are in widespread, almost universal use by other utilities.

Ms. Bauer also testified that Ameren annually engages in a rigorous process using reliable third party data to determine the amount of both base and incentive components of compensation for each employee's position. To this end, each year the Company participates in a dozen or more salary surveys conducted by reputable consulting firms such as Mercer HR Consulting, Towers Perrin, Hewitt & Associates and Buck Consulting. Data is broken down by company revenue, geographic location and discipline.[273] As a consequence, our employees' base and incentive compensation is determined based on reliable, current and relevant market information.

Ms. Bauer explained that there is considerable value to the Company and its customers in placing a portion of each employee's market-based pay "at risk" and subject to performance objectives. Employees who bring value to the Company and its customers by meeting or exceeding performance targets are rewarded, whereas employees who do not meet performance goals are compensated at below market based total compensation levels.[274] The payment of a portion of an employee's compensation in incentive form also allows the Company to focus the efforts of its employees on issues that are particularly important to the Company and its customers. For example, achieving plant operational performance, reliability, customer satisfaction, safety or cost control objectives improves service to customers and reduces costs over the short and long run.

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[272] *Id.* p. 6, l. 8-20.
[273] *Id.* p. 8, l. 23 to p. 9, l. 11.
[274] *Id.* p. 8, l. 15-20.

Ms. Bauer also testified that it has become increasingly critical for AmerenUE to pay market-based compensation to its employees because of conditions in the marketplace today. Like the rest of the utility industry, AmerenUE faces the significant challenges presented by an aging workforce. The Company projects that over the next 10 years alone, over 50% of its work force will leave the organization due to retirement or other forms of attrition.[275] Due to less interest in engineering and skilled craft positions among individuals entering the workforce, it is becoming more difficult for AmerenUE to compete for the limited pool of employees with such skill sets that are critical to our business. For example, AmerenUE has begun offering a $15,000 hiring bonus for experienced line workers, we have developed a co-op program with local schools to attract engineers and the Company has taken other proactive steps, but skilled and experienced workers remain very hard to attract.[276] At the hearing, Ms. Bauer testified that the Company has faced recent difficulty retaining experienced employees in many fields, including the coal section of the business, power traders, attorneys, engineers, nuclear plant operators and skilled craft positions in non-nuclear plants.[277] Although the Company believes it should always be permitted to recover the cost of paying market-based compensation to its employees, this is a particularly critical point in time to pay market compensation for skilled employees.

The Staff, the only party to actively oppose the inclusion of incentive compensation costs in rates, had no basis to disagree with any of Ms. Bauer's testimony on these points. Staff witness Jeremy Hagemeyer testified that he had no reason to doubt that (a) AmerenUE is facing a number of challenges with regard to its workforce,[278] (b) 50% of the Company's workforce is

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[275] Similar attrition is anticipated industry-wide according to a 2007 report from the Center for Energy Workforce Development. (Ex. 25 (Bauer Rebuttal) p. 7, l. 2-11).
[276] Ex. 25 (Bauer Rebuttal) p. 7, l. 9-15.
[277] Tr. pp. 1457-1460.
[278] Tr. p. 1471, l. 18-21.

projected to retire or leave the organization due to attrition over the next 10 years,[279] (c) skilled and experienced workers remain very hard to recruit,[280] (d) the overwhelming majority of utilities pay short-term (93%) and long-term (100%) incentive compensation,[281] (e) AmerenUE's incentive compensation is necessary to bring AmerenUE's compensation to market levels,[282] and (f) if AmerenUE fails to pay a competitive compensation package that over the long term it will not be able to attract or retain a high-quality workforce.[283]

Mr. Hagemeyer also acknowledged that failure to attract a high-quality workforce might create a number of problems for AmerenUE, including causing service to customers to decline and operation of the system to decline. In addition, he acknowledged that it could potentially lead to operational inefficiencies.[284]

Mr. Hagemeyer also admitted that AmerenUE's base salaries are in line with other utilities' base salaries, and its incentive compensation is in the range of incentive compensation offered by other utilities.[285] As a consequence, he cannot dispute Ms. Bauer's testimony that the Company's incentive compensation plans are market based.

Since there is no dispute that AmerenUE's incentive compensation is required to bring its employees' compensation to market level, there should also be no dispute that these costs are appropriate for recovery through rates, regardless of the specific parameters of the incentive compensation plans. In fact, as Mr. Hagemeyer himself nearly admitted in response to a question from Commissioner Murray (asked by Judge Woodruff), if the incentive payments were

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[279] Tr. p. 1472, l. 14-23.
[280] Tr. p. 1474, l. 21-24.
[281] Tr. p. 1474, l 25 to p. 1475, l. 20.
[282] Tr. p. 1481, l. 1-21.
[283] Tr. p. 1478, l. 16-22.
[284] Tr. p. 1479, l. 7-20.
[285] Tr. p. 1552. Mr. Hagemeyer's testimony is somewhat inconsistent on this issue. At other points in the hearing he claimed that he did not even look at incentive plans for other utilities (Tr. p. 1546, l. 7-10) or market-wide salaries or compensation packages. (Tr. p. 1481, l. 10-13). If he did not even look at such plans for other utilities it is difficult to imagine how Mr. Hagemeyer can support a disallowance of any of the Company's incentive compensation costs.

included unconditionally in the base salaries of AmerenUE employees, the Staff would not have proposed any disallowance of the costs at all:

> **Q. If the entire incentive compensation were instead rolled into a base level of compensation, would Staff be recommending a disallowance?**
> A. I don't believe so.
>
> **Q. Okay. Is your objection to a long-term plan—**
> A. I'm sorry, Sir, may I clarify?
>
> **Q. Sure.**
> A. Not having looked at the—the base compensation myself, I believe there was another Staff member who looked at that, I really don't know on that question.[286]

The point is that market based pay for utility employees should be recovered in rates, regardless of whether the pay is given unconditionally in the form of base pay, or subject to performance metrics as incentive compensation. For that reason alone, the entire amount of AmerenUE's test year incentive compensation payments to its employees should be included in rates, and the Staff's proposed adjustments, which disallow 98% of those costs, should be rejected.

B. At a Minimum, a Significant Portion of the Company's Incentive Compensation Costs Should Be Included in Rates.

If the Commission rejects the argument that the cost of the Company's incentive compensation programs should be included in total because they represent a necessary component of market-based pay, the issue of which portions of the incentive compensation costs should be accepted and which should be disallowed becomes a bit more complicated. As previously mentioned, AmerenUE has three sets of incentive compensation plans that are at issue in this case. The first set of plans, dealing with long-term incentive compensation, is driven by total shareholder return provided by Ameren Corporation over various time periods. The second

[286] Tr. p. 1546, l. 11-23.

set, addressing short-term incentive compensation, is driven by employees' achievement of Key Performance Indicators, or KPI's—targeted metrics measuring performance in various areas of the business over the course of the year. Finally, the third type of program, the Exceptional Performance Bonus Plan, is driven by the exceptional performance of an individual employee in a particular situation.

i. Long-Term Incentive Compensation.

The Staff has proposed 100% disallowance of the Company's test year long-term incentive compensation (approximately $7 million) because the plans are funded and paid based on financial performance. AmerenUE acknowledges that its long-term incentive compensation plans are based on total shareholder return metrics. However, such plans provide significant benefits to customers in addition to the benefits they provide shareholders. In the long run, steps employees take to increase earnings, such as achieving additional revenues from off-system sales or reducing operating costs, are reflected in lower rates for customers. In addition, a financially sound utility (with a reasonable level of earnings) has more and better access to needed capital, which ultimately benefits customers. Finally, as explained in the previous section, AmerenUE's long-term incentive compensation plans are an important part of the market-based compensation package that permits the Company to attract and retain skilled employees to the ultimate benefit of its customers. At a minimum, the Commission should weigh the benefits that AmerenUE's long-term incentive provides to shareholders vs. customers, and allow an appropriate and fair portion of the long-term incentive compensation costs in rates.

ii. Short-Term Incentive Compensation.

The Staff has proposed to disallow almost all of AmerenUE's test year short-term incentive compensation costs (which total approximately $13.3 million). This proposed disallowance is particularly inappropriate because the Company has revised its short-term

incentive plans to substantially de-couple them from earnings, based on input from the Staff and the Commission. As the short-term plans are now structured, payments are made based on the employees' achievement of Key Performance Indicators, or KPIs, which establish measurable performance standards in areas such as operational performance, safety, customer satisfaction and cost control.[287] The Company's short-term plans are well-designed to provide direct benefits to customers, and clearly should not be disallowed. Indeed, it would be hard to imagine how to design an incentive compensation plan more directly tied to metrics that benefit customers.

The Staff's standards for including or excluding the short-term incentive costs, which were apparently invented by Mr. Hagemeyer for this case, are illogical and should be rejected. First, Mr. Hagemeyer proposes the disallowance of all costs associated with any "project based KPI," which Mr. Hagemeyer believes "does not improve existing performance and essentially is asking an employee to do a certain project that could be handled within the normal course of business."[288] However, it is easy to imagine project-based KPIs which do directly benefit customers. For example, AmerenUE had a specific project reflected in KPIs for its Energy Delivery employees in 2007 and 2008 to reduce the number of customers who experienced 4 or more outages per year by 50%.[289] This is the kind of KPI that is very beneficial to customers even though it is a "project."[290] Similar discrete project-based KPIs, such as completion of a particular plant outage within a certain timeframe, or installation of a substation on time and under budget are also legitimate types of KPIs which provide direct benefits to customers and should not be excluded from rates. As a consequence, Mr. Hagemeyer's proposed exclusion of the costs related to "project-based KPIs" should be rejected.

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[287] Ex. 25 (Bauer Rebuttal) p. 9, l. 13 to p. 10, l. 18.
[288] Tr. p. 1515, l. 13-17.
[289] Ex. 25 (Bauer Rebuttal) p. 11, l. 5-8.
[290] Curiously, Mr. Hagemeyer testified that this particular KPI would be acceptable to him, but it is difficult to understand why this does not constitute a "project-based" KPI.

In the context of the Company's short-term incentive plans, Mr. Hagemeyer also proposes to exclude all costs associated with "financial" KPIs. In this context, Mr. Hagemeyer is not talking about KPIs tied to corporate earnings, but instead he is talking about any KPI associated with cost control measures or budget compliance. He believes that these KPIs should be excluded because they do not "relate to a service-oriented goal" and they may encourage the Company to defer maintenance or sacrifice efficiencies that would otherwise be gained.[291]

Again, Mr. Hagemeyer's disallowance is completely illogical and should be rejected. Even though cost control measures do not relate to a "service-oriented goal" they are quite valuable to customers because they keep rates low. Like all corporations, AmerenUE uses a budgeting process as the primary tool to manage and control its costs. Most of its employees have some share of their short-term incentive compensation tied to budget compliance. There is nothing sinister about this. Budget compliance leads to lower rates and more satisfied customers. Mr. Hagemeyer's argument that KPIs calling for budget compliance might lead to the deferral of maintenance or the sacrificing of efficiencies is meritless. Mr. Hagemeyer provided no example of a situation where this occurred, and it is clear from an examination of all of the Company's KPIs that employees have plenty of incentives to achieve operational excellence as well as budget compliance.[292]

Notwithstanding the fact that Mr. Hagemeyer inappropriately excluded all "project-related" and "financial" KPIs, his analysis still showed that over 76% of AmerenUE's KPIs

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[291] Tr. p. 1514, l. 8-21.

[292] Exhibit No. 75 HC contains a complete list of all of the KPIs for all work groups for the test year for incentive compensation paid in the test year. This exhibit shows that although budget compliance is a common KPI for most work groups, it comprises only a small portion of the incentive for each group. Other metrics, addressing things like (a) operational goals, such as achievement of equivalent availability targets for plants, (b) safety goals, such as reduction of lost workdays away, and (c) customer service goals, such as reduction in SAIFI, a metric that addresses the frequency of customer interruptions, comprise the majority of the incentive. For the Commission's convenience, a copy of this exhibit is attached to this Brief as Attachment A.

comprised "the basis for a good incentive plan."[293] However, Mr. Hagemeyer did not include anywhere close to 76% of the costs of the short-term plans in rates, because he also disallowed any KPI whose "target" had not been fully met as of September 30, 2008. Mr. Hagemeyer's logic was that if performance falls short of the "stretch goals" embodied in the targets, base pay is sufficient to pay for the performance.

Again, Mr. Hagemeyer's basis for the disallowance does not withstand scrutiny. First, AmerenUE's base pay alone, which Staff has effectively admitted is below market,[294] does not compensate AmerenUE's employees even for "normal" levels of performance. Second, as Ms. Bauer explained, "threshold" performance, which is the lowest level of performance for which any incentive pay can be earned, represents continuous improvement on the part of the employee.[295] As the following excerpt from the hearing transcript shows, Mr. Hagemeyer apparently didn't understand this when he disallowed the cost of all KPIs below target level.[296]

> **Q. What do you base your idea that target would be an improvement beyond what could be expected of an employee?**
> A. Well, the setting of target as a goal to which employees should strive, in my mind, is borne from improvement over existing performance.
>
> **Q. So did you study each key performance indicator to determine if, in fact, it was targeted as opposed to threshold level that would—that would indicate a performance above what was existing with that—with that key performance indicator?**
> A. I'm sorry. Could you clarify that, please?
>
> **Q. Yeah. Did you do any analysis of each specific key performance indicator to determine what the—what the cutoff point is, whether the—whether the target was, in fact, the cutoff point where improved performance over existing performance was measured?**

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[293] Tr. p. 1490, l. 1-11.

[294] Again, Mr. Hagemeyer acknowledged that AmerenUE's base pay is in the range of other utilities' base pay. Since other utilities offer incentive compensation, AmerenUE's base pay alone is necessarily not sufficient to meet the market level of compensation.

[295] Tr. p. 1418, l. 9-15.

[296] Mr. Hagemeyer specifically cited Case No. EC-87-114 which he testified establishes "improvement over existing performance" as a standard for including incentive compensation in rates. (Tr. p. 1511, l. 16-18).

A. No.[297]

Since Ms. Bauer testified that "threshold" performance in fact represents continuous improvement, based on Mr. Hagemeyer's logic, these costs should be included in rates.

Finally, and most significantly, Mr. Hagemeyer's disallowances due to the employees' failure to meet target level metrics were based on data for 2008 year-to-date performance aggregated by scorecard for each employee group.[298] Because the data was aggregated by scorecard, and because performance for only a portion of the year was captured, it is not surprising that almost no employee groups achieved annual target levels based on just three quarters of performance. Under the various short-term incentive plans, Mr. Hagemeyer testified that **___** of the AmerenUE and Ameren Services managers and directors (the EIP plan) did not achieve the target level of performance on their scorecards. For the plan applicable to other management employees (the AMIP plan), **____** of the work groups did not achieve the target level of performance on their scorecards. And **____** of the union workers did not achieve the target level of performance on their scorecards.[299] The problems with this analysis, which results in the lion's share of Mr. Hagemeyer's proposed disallowance, are obvious. It is simply not possible to evaluate the achievement of annual target levels of performance until the year is complete. In addition, aggregation of KPIs by scorecard distorts the evaluation of the work group's performance. Poor performance on one KPI will drag the average scorecard performance down below target, even if other KPIs meet the target. Mr. Hagemeyer's analysis is flawed and therefore his proposed disallowance of almost all AmerenUE's short-term incentive compensation because of failure to meet the target level of performance should be rejected. A more representative level of target performance achievement is contained on Exhibit No. 75 HC

[297] Tr. p. 1512, l. 6-25.
[298] Tr. p. 1516, l. 22-25; p. 1519, l. 7 to p. 1520, l. 7.
[299] Tr. p. 1519, l. 7 to p. 1520, l. 2.

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(Appendix A hereto), which shows substantial achievement of targeted performance in 2007, the last period for which a full year's data is available.[300]

In disallowing almost all of AmerenUE's short-term incentive compensation costs, Mr. Hagemeyer cites Commission orders that were issued 15-20 years ago, before the existence of incentive compensation became so prevalent. However, in more recent cases, the Commission has explicitly recognized the value of incentive compensation. In the most recent case addressing the issue, an Empire District Electric Company rate case, the Commission stated: "There are sound reasons to use incentive pay. The Commission does not agree with the Staff that the spread of incentive-based compensation is a slippery slope, but does understand the Staff's discussion of the use of objective criteria that it can apply even-handedly."[301] In that case the Commission disallowed only the portions of Empire's incentive compensation for meeting earnings goals, charitable activities, activities unrelated to the provision of retail electric service, discretionary awards and stock options.[302] None of these standards for disallowance even arguably apply to AmerenUE's short-term incentive compensation plans. Similarly, in a recent Kansas City Power & Light Company rate case, the Commission disallowed just 35% of KCP&L's incentive compensation payments on the grounds that that portion was either tied to earnings per share or is awarded for vague reasons.[303] Again, the standards for disallowance in

[300] The 2008 short-term incentive plans are somewhat different from the 2007 plans in that steps have been taken to de-couple payments under the plans from earnings, and funding is based exclusively on the achievement of KPIs, rather than partially on individual employee performance. However, Ms. Bauer testified that if the 2008 plan had been in effect during 2007, the total payment made during the test year would have been nearly the same–$12.7 million, based upon an analysis conducted by her department. Ex. 25 (Bauer Rebuttal) p. 16, l. 6 to p. 17, l. 3.
[301] *Re: The Empire District Electric Company,* Case No. ER-2006-0315, *Report and Order Upon Reconsideration* (effective April 5, 2008), p. 56.
[302] *Id.* p. 57.
[303] *Re: Kansas City Power & Light Company*, Case No. ER-2006-0314, *Report and Order* (effective Dec. 31, 2006), p. 58

the KCP&L case do not even arguably apply to AmerenUE's well-defined short-term incentive compensation plans.[304]

AmerenUE believes that its short-term incentive compensation costs clearly satisfy the standards applied in the most recent cases in which the Commission has addressed the incentive compensation issue. But more importantly, the Company's short-term incentive compensation costs should be approved because they are: (a) necessary to attract and retain skilled employees, (b) substantially de-coupled from earnings metrics, and (c) funded and paid largely based on measurable KPIs designed to provide benefits to customers. The analysis underlying Mr. Hagemeyer's proposed disallowance of almost all of these legitimate costs is flawed, and should be rejected.

Mr. Hagemeyer's disallowance of the Company's short-term incentive compensation costs also suffer from a lack of evidentiary support. As previously discussed, Mr. Hagemeyer is proposing disallowances of short-term incentive compensation for three distinct reasons—use of "project-based KPIs," use of "financial KPIs" and failure to achieve target levels of performance. However, Mr. Hagemeyer's extremely short testimony on this $13.3 million issue (consisting of just 4 pages in the Staff Report and barely over 4 pages of surrebuttal testimony) does not even bother to quantify the impact of each of his proposed adjustments. Mr. Hagemeyer's testimony presents the Commission with the option to take all of his adjustments to short-term incentive compensation costs or leave them. And based on this record, it is clear that the Commission must leave them.

[304] It is noteworthy that the Illinois Commerce Commission recently approved inclusion of a substantial portion of the incentive compensation costs of Ameren's Illinois affiliates in rates. Illinois Commerce Commission Docket Nos. 07-0585, 07-0586, 07-0587, 07-0588, 07-0589, 07-0590 (cons.), *Order* (September 24, 2008), pp. 106-108.

iii. Exceptional Performance Bonuses

The Company's Exceptional Performance Bonus Program, which totaled approximately $850,000 during the test year, provides one-time bonuses generally in the range of $500 to $3,000 for employees who demonstrate truly superior performance. For example, one such award was provided to a supervisor, not eligible for overtime pay, who successfully coordinated an ice storm restoration on his day off.[305] Mr. Hagemeyer proposes to disallow these costs because there are no "specific criteria" that determine when an award will be given. [306] This is consistent with Mr. Hagemeyer's view that any incentive compensation that is based on a subjective determination by a supervisor should be disallowed from rates.[307]

The Company believes that the Exceptional Performance Bonus Program is a legitimate means of rewarding extraordinary performance by its employees, which ultimately benefits customers. Because the potential for exceptional performance is so broad, it would be unwise, and in fact impossible to write objective standards to determine by rote when an employee is to receive this award. Mr. Hagemeyer's position that any incentive compensation based on the subjective review by a supervisor must be disallowed is again illogical and inconsistent with practices that are required in the real world to allocate compensation of all forms to employees. Consequently, Mr. Hagemeyer's proposed disallowance of this cost should be rejected.

VI. MIDWEST ISO DAY 2 EXPENSES.

This issue is worth $6.1 million of revenue requirement. There is no dispute that (a) these are legitimate, prudently incurred costs that AmerenUE had no choice but to pay; (b) these costs were paid during the test year; (c) these costs are material or significant; and (d) these costs would have been recognized in the revenue requirement in the Company's last rate case (and

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[305] Ex. 25 (Bauer Rebuttal) p. 18, l. 11-17.
[306] Ex. 222 (Hagemeyer Surrebuttal) p. 3, l. 19-22.
[307] Tr. p. 1537, l. 18-21.

would have thus increased the rate increase the Commission approved) but for a mistake made solely by the Midwest ISO.[308]

More specifically, the record demonstrates that during the test year, AmerenUE paid the Midwest ISO approximately $12.4 million in Day 2 market charges that related to operation of the Day 2 market during the period April 1, 2005 through the end of 2006.[309] This test year payment was required as the result of a Federal Energy Regulatory Commission (FERC) order that found that the Midwest ISO had failed to follow its Energy Market Tariff (EMT) for that period. As a consequence, the FERC required the Midwest ISO to go back and "resettle" market transactions that had taken place during that period.[310]

The Staff, in two short paragraphs in its Cost of Service Report, proposes to force shareholders to absorb this legitimate, prudently incurred $12.4 million expense on the grounds that it is non-recurring. The flaws in the Staff's position are several, including that it ignores (a) how this expense arose, including that it would have been included in the Company's revenue requirement in the last case, but for the Midwest ISO's unilateral failure to follow its own EMT; (b) that AmerenUE has consistently under-earned since the rate last case, meaning that exclusion of this material and significant expense through no fault of AmerenUE unfairly forces shareholders to bear a legitimate cost that benefitted ratepayers at a time when the Company was falling far short of earning its allowed ROE; and (c) that as evidenced by numerous instances when non-recurring expenses have been allowed in rates, there is no ratemaking principle that necessarily precludes recovery of a non-recurring item.

During the hearing, Mr. Dottheim, through his cross-examination of Mr. Weiss, attempted to suggest that the Uniform System of Account's (USOA) definition of

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[308] Tr. p. 801, l. 2 to p. 802, l. 1 (Mr. Hagemeyer).
[309] Because these charges were accumulated over an approximately two year period, the Company is proposing to amortize them over two years.
[310] These facts are outlined in the rebuttal testimony of AmerenUE witness Gary S. Weiss (Ex. 12) at p. 6, l. 7-20.

"extraordinary" somehow disqualified this $12.4 million item from consideration for recovery in this case.[311] This argument fails for several reasons. First, there is no hard and fast "extraordinary" standard applied by the Commission when dealing with non-recurring items. Non-recurring items are often amortized and recovered in rates. *See, e.g., Re: Missouri Gas Energy*, Case No. GR-96-285, 1997 WL 233139 (Jan. 22, 1997).[312] Here the Company is proposing a 2-year amortization consistent with the period in which the charges accumulated. Second, the USOA provision cited by the Staff only applies to accounting adjustments to the Company's income statement and has nothing to do with how the Commission must or can treat a legitimate expense incurred during *the test year*.[313] Even if it did, it wouldn't matter, because as everyone agrees, the Commission is not bound by the USOA for ratemaking purposes.[314] Third, fairness is a relevant factor in how the Commission treats non-recurring items, and fairness undoubtedly supports recovery of this expense here. *See, e.g.*, *Staff v. Union Electric Co.*, Case No. EC-87-114, 1987 WL 258074 (Dec. 21, 1987).[315] Given that this is the Midwest ISO's mistake, and that but for that mistake the Company would already have been recovering this expense in rates set in the last rate case, the Company's request to recover this significant expenditure is reasonable and fair. That this is true is reinforced by the fact that the Company is

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[311] That definition, for USOA purposes, defines extraordinary as an item that is at or above approximately 5% of net income.

[312] In that case, a very small non-recurring expense of $18,466 was allowed in rates because the expense "ha[d] the potential of providing a direct benefit to ratepayers" and the utility's request to recover them was "reasonable." *See also Re Laclede Gas Co*, Case No. GR-96-193, 1996 WL 553131 (Aug. 28, 1996) (Where the Commission allowed recovery of another relatively small non-recurring environmental expense of just $600,000). Surely the Staff isn't arguing that these relatively small sums exceeded 5% of the net income of Missouri Gas Energy and Laclede Gas Company and that thus the Commission erred in allowing recovery.

[313] Tr. p. 782, l. 22 to p. 783, l. 1; p. 794, l. 9-17 (Mr. Weiss).

[314] Tr. p. 1371, l. 1-11 ("The Commission has adopted its [the USOA's] use, but we can deviate from that.") (Staff Accountant Steve Rackers); Tr. p. 794, l. 18-23 ("The Commission has authority to deviate from the Uniform System of Accounts for Ratemaking purposes.") (Mr. Weiss); This authority is made explicit by the Commission's rule 4 CSR 240-20.030(4): "(4) In prescribing this system of accounts, the commission does not commit itself to the approval or acceptance of any item set out in any account for the purpose of fixing rates or in determining other matters before the commission."

[315] Allowing the $873,000 cost of a management audit ordered by the Commission, noting that it would be "inequitable to order a management audit of the Company and then deny recovery of the expense."

participating in the Midwest ISO because of a Commission-approved Stipulation and Agreement in which all signatories – including the Staff -- agreed that the Company's participation was "prudent and reasonable." Ratepayers benefitted from the Company's Midwest ISO participation, and ratepayers should bear the legitimate, prudently incurred costs incurred by the Company in connection with that participation. This is particularly true given that it was the Midwest ISO's mistake, through no fault of AmerenUE, which led to the failure of these costs to be included in the Company's revenue requirement in the last rate case. Indeed, Staff witness Jeremy Hagemeyer makes no attempt to deny that but for the Midwest ISO's mistake these costs would have been included in rates in the last rate case.[316]

The Staff's only other argument (not raised until surrebuttal) was that there was what Mr. Hagemeyer called another non-recurring $1.6 million "metering error" by the Midwest ISO that the Company agreed should not be included in its revenue requirement in this case, which Mr. Hagemeyer suggested showed that the $12.4 million caused by the Midwest ISO's mistake should also not be included. But as Mr. Hagemeyer conceded on cross-examination, the $1.6 million was not similar to the Midwest ISO's mistake in failing to follow its EMT tariff. In fact, the $1.6 million was not a mistake by the Midwest ISO. Rather, it was simply a bookkeeping error by Ameren, that occurred during the test year and that was discovered and corrected within that same test year. Moreover, it had nothing to do with the 2005 – 2006 period in which the $12.4 million of Midwest ISO charges were accumulated.[317] It thus provides no support for the Staff's position.

Resolution of this issue is simple. The Company paid a legitimate, test year expense for the benefit of ratepayers. No one claims the Company had any choice but to pay it or that it was

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[316] Tr. p. 802, l. 25 to p. 803, l. 5 (Mr. Hagemeyer).
[317] Tr. p. 810, l. 12 to p. 812, l. 12; p. 813, l. 4-10 (Mr. Hagemeyer).

imprudent. But for the Midwest ISO's mistake, the Company would have been recovering this expense in rates set in the last rate case. The Company has consistently under-earned since then. This $12.4 million should be amortized over two years and included in rates in this case at $6.1 million annually.

VII. ADVERTISING.

A. Introduction.

As the Commission is aware, the major storms that struck AmerenUE's service territory in 2006 and 2007 forced the Company to re-evaluate the manner in which it provides service. As a result of that re-evaluation, significant changes have been made. AmerenUE hopes this Commission and all parties recognize the value of those changes, including the Company's renewed commitment to improving the reliability of service for its customers. Part of that commitment is to increase the amount of information the Company shares about these efforts so that the public is informed and knowledgeable about the improvements that are occurring, and so that the public can be actively engaged in providing input about the service AmerenUE provides. That this is important was obvious from the over 500 meetings with customers and community leaders that AmerenUE held during 2007.[318] During those meetings, again and again, the Company was told two things: improve the reliability of service provided to customers, and communicate what you are doing to improve the reliability of that service.[319]

The vast majority of the advertising in question in this case, worth a total of approximately $1.355 million, is advertising done in direct response to customer requests for AmerenUE to tell them what steps are being taken to improve the reliability of their electric service. While these Project Power On (Power On) communications can be generically classified

[318] Ex.19 (Mark Direct) p. 4, l. 18-22.
[319] *Id.* p. 5, l. 4-11.

as "advertising," they are really just the best mechanism available to communicate information about Power On to customers.[320] The Company believes the costs of these communications are valid and prudent expenditures that should be recovered in its revenue requirement.[321]

B. Project Power On.

As noted, the Power On advertisements at issue are worth approximately $1.355 million in revenue requirement. As initially explained by Mr. Mark in his direct testimony, this advertising was specifically designed to communicate with customers about the significant investment made by AmerenUE in its distribution system – just the kind of communication our customers have demanded.[322] Staff failed to provide any rebuttal testimony on this subject and even its advertising surrebuttal testimony made absolutely no attempt to address or rebut in any way Mr. Mark's direct testimony about the importance of communicating with customers.[323]

Staff's proposed disallowance is based upon its attempt to discredit the legitimacy of this advertising expense by arguing that it should be classified as "image advertising."[324] The evidence in the record, however, does not support Staff's classification. To the contrary, the evidence shows that this advertising was undertaken after AmerenUE conducted over 500 meetings with individuals, community leaders, neighborhood associations, senior citizen centers, legislators and business owners, with the purpose of those meetings being to listen to our customers and to determine what our customers wanted from AmerenUE. Consistently, these customers told the Company that they wanted to be informed about the steps the Company was

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[320] Tr. p. 1010, l. 3-21.
[321] There is also a second group of advertisements at issue (which related to the Dollar More program and are worth $60,257), which we address further below.
[322] Ex. 19 (Mark Direct) p. 17, l. 20 to p. 18, l. 8.
[323] Tr. p. 1034, l. 18 to p. 1035, l. 1.
[324] Ex. 219 (Carle Surrebuttal) p. 8, l. 19-22.

taking to improve its distribution system and to harden the system against the impacts of vegetation and weather.[325]

The vague and highly subjective "standard" used by Staff to evaluate each advertisement was whether or not the advertisement provided, in Staff's view, "sufficient information."[326] When pressed as to how one would determine what information was sufficient, Staff witness Erin Carle could only state that she "just looked at the ads" to determine if "the ratepayer…can gain anything from the advertisement."[327] Regardless, even if the Staff's vague standard were valid, it supports recovering the costs of these advertisements.

The Power On advertisements do exactly what AmerenUE customers have requested – they communicate information about the Company's efforts to invest in and improve its distribution system.[328] In fact, on cross-examination, when each advertisement she had previously excluded was reviewed with her, Ms. Carle changed her recommendation to include the cost of the majority of the Power On advertisements, deciding that *all* of the television and radio advertisements should be allowed into AmerenUE's revenue requirement.[329] In fact, Ms. Carle admitted many of the Power On advertisements contained information and should be recovered.

About Schedule 2-11, Ms. Carle testified as follows:

Q. All right. You really –you're not changing your mind on this particular ad I'm talking about, 2-11? You believe it doesn't convey information?

A. This one conveys more information than the others.

Q. Okay. So—but still not enough?

A. It conveys information about the program. Yes.

[325] Ex. 19 (Mark Direct) p. 4, l. 18 to p. 5, l. 3.
[326] Tr. p. 1040, l. 12-20.
[327] Tr. p. 1041, l. 15-17.
[328] Tr. p. 1024, l. 5-18.
[329] Tr. p. 1045, l. 18-24; p. 1047, l. 23 to p. 1048, l. 1-2; p. 1052, l. 25 to p. 1053, l. 15; p. 1054, l. 17-25; p. 1055, l. 8-16 and 23 to p. 1056, l. 2.

Q. Does it convey enough information about the program that you believe it should be recoverable?
A. This one, possibly.[330]

Schedule 2-12:
Q. Do you reconsider your recommendation? It's got the web site, right?
A. I'd have to think more about this one?

Q. Can I mark it a possibility?
A. You can mark it a possibility.[331]

Exhibit 72, radio advertisement
Q. At the bottom, it says, For more information, go to Ameren.com/PowerOn, right?
A. Yes.

Q. That's all information?
A. Yes.

Q. Do you think it's recoverable?
A. This does convey information, yes.

Q. So should it be recoverable?
A. Yes.[332]

Q. And, of course, at the very end, like all of them, it says Ameren.com/PowerOn for more information, correct?
A. Yes.

Q. So it is conveying useful information, isn't it?
A. Yes.

Q. So should this one be recovered?
A. Yes.[333]

Q. You'd say the majority of them [radio advertisements] have information in them?
A. Yes.

Q. Useful information?
A. As far as offering the website where they can look up more information, yes.

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330 Tr. p. 1045, l. 18-24;
331 Tr. p. 1047, l. 23 to p. 1048, l. 1-2
332 Tr. p. 1052, l. 25 to p. 1053, l. 15
333 Tr. p. 1054, l. 17-25

Q. So your recommendation as to recoverability? Shouldn't we recover those?
A. Yes.[334]

Television advertisements
Q. I have the television ads here. I don't know if we have the ability to play them. But if they convey the same information, wouldn't you agree that they should also be recoverable?
A. Yes.[335]

Ultimately, Ms. Carle conceded that any advertisement that contained the Power On website address should also be recovered in rates.[336] This concession represents a complete reversal of position by Ms. Carle and eliminates the Staff's disallowance of most all of the Power On advertisements, as it is the practice of AmerenUE to put the Power On website address on its advertisements as part of its effort to encourage our customers to visit our Power On website for further information about the program.[337] Schedules 2-1 through 2-10 to Ms. Carle's surrebuttal are each advertisements which contain the website address and so, by Ms. Carle's own standard as she admitted on cross-examination, are recoverable.

Using Ms. Carle's standard, the only advertising[338] done by AmerenUE which did not include the Power On website are the billboard advertisements.[339] AmerenUE believes that even these advertisements should be included in its revenue requirement as they were an integral portion of the overall advertising campaign and promoted the same message as the newspaper, television and radio advertisements. It just isn't practical to place a website address on a medium that a person is driving past. The idea was to provide the same message to customers

[334] Tr. p. 1055, l. 8-16
[335] Tr. p. 1055, l. 23 to p. 1056, l. 2.
[336] Tr. p. 1064, l. 3-6.
[337] Tr. p. 1022, l. 20 to p. 1023, l. 3.
[338] There were three other items that did not contain the Power On website. Although they were submitted as part of the advertising costs, they do not fit the category of advertising very well. These include a trade show display, a stencil for the side of trucks and envelopes for mailing letters. These items impact the revenue requirement by $6,394.23. Ex. 219 (Carle Surrebuttal) Schedules 2-17 through 2-21.
[339] Ex. 219 (Carle Surrebuttal) as Schedule 2.

over and over. Repetitive delivery of a message is the best way to increase the reach and recall of a message, as Ms. Carle agreed.[340]

Looking forward, AmerenUE believes the Commission may want to revisit the standards it uses for evaluating advertising expenditures. Clearly, communicating with the very large number of AmerenUE customers is not an easy task and to do that requires AmerenUE use a variety of methods to get across the desired information. AmerenUE's goal is to provide the reliable service that its customers expect. Customers in this day and age, when electric service is more important than ever, desire information about the efforts a utility is undertaking in order to meet that expectation; therefore, the cost of that communication is a prudent expenditure and should be recovered by the Company, regardless of which "pigeonhole" category of advertising they may fit into under older Commission decisions.

C. Dollar More.

As noted earlier, there are other advertisements at issue in this case, the cost of which was approximately $60,257, relating to AmerenUE's Dollar More program. These ads were a portion of a Rams football sponsorship, the majority of the cost of which AmerenUE is not seeking to recover.[341] The two advertisements that were part of the Rams sponsorship for which the Company is seeking recovery promoted the Company's Dollar More program. As the Commission is likely aware, this program uses contributions to provide energy assistance to customers in need.[342] Staff recommended the associated costs be disallowed by the Commission.[343] Staff witness Erin Carle testified that the advertisements did not contain "enough information" and that when she looked at the advertisements, she "saw football."[344] However,

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[340] Tr. p. 1060, l. 16-19.
[341] Tr. p. 1015, l. 11-19.
[342] Tr. p. 1015, l. 22 to p. 1016, l. 3.
[343] Ex. 219 (Carle Surrebuttal) p. 7, l. 20-22.
[344] *Id.* p. 8, l. 2-5; Tr. p. 1035, l. 16-18; p. 1037, l. 22-24.

she was unable to provide any standard or criteria for determining what is "enough information." In fact, Ms. Carle did not deny that the two advertisements in question contained sufficient information to inform viewers their contribution would go to help a family in need and provided the website address for obtaining more information.[345]

The subjective arguments advanced by the Staff provide an insufficient basis to disallow these actual, prudently incurred costs. The Staff does not reject the advertisements because of their subject matter. In fact, Ms. Carle admits that the subject matter of the advertisements is one that is appropriate for recovery.[346] AmerenUE agrees. As Mr. Mark stated in his rebuttal testimony, Dollar More is an important program which benefits low income individuals in the Company's service territory.[347] The Commission should encourage the Company to publicize Dollar More by supporting recovery of these legitimate advertising costs.

VIII. DEPRECIATION.

The depreciation issue in this case has an impact on the Company's revenue requirement of approximately $7.1 million. The issue arose because a witness hired by OPC, William Dunkel, filed direct testimony arguing that the depreciation rates for five specific nuclear plant accounts should be reduced in this case. Mr. Dunkel complains that the existing Commission-approved depreciation rates for these particular accounts are based on "theoretical" reserve amounts, and he believes that the depreciation rates for those accounts should be reduced to reflect the higher book reserve amounts.

Both the Staff and the Company oppose Mr. Dunkel's proposed adjustments to the depreciation rates of the five accounts he has selected, primarily because Mr. Dunkel is proposing these adjustments in the absence of a comprehensive study to update depreciation

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[345] Tr. p. 1036, l. 22 to p. 1037, l. 24.
[346] Tr. p. 1035, l. 22-25.
[347] Ex. 20 (Mark Rebuttal) p. 4, l. 4-10.

rates for all of AmerenUE's accounts. The Commission approved depreciation rates for these accounts less than two years ago in Case No. ER-2007-0002. In that case, AmerenUE filed a comprehensive study that enabled the Commission to set depreciation rates for all of the Company's accounts simultaneously. The Commission approved the use of *whole life* depreciation rates for all of AmerenUE's accounts in that case. As Company witness John Wiedmayer has testified, neither the theoretical reserve nor the book reserve are required in order to calculate whole life depreciation rates, because the whole life technique does not consider past levels of capital recovery in calculating the depreciation rates.[348] Where a significant difference between the theoretical and book reserve occurs, it is possible and sometimes appropriate to amortize this difference. However, in Case No. ER-2007-0002 the Commission explicitly addressed this issue and elected not to amortize the difference. The Commission stated:

> In her direct testimony for Staff, Jolie Mathis indicated AmerenUE's theoretical reserve has become imbalanced with actual book accumulated depreciation. At the time Mathis filed her testimony, Staff did not recommend any adjustment to correct that imbalance, but noted the imbalance would need to be monitored *in future depreciation studies.* (footnote omitted, emphasis added.)

After citing Ms. Mathis' testimony, the Commission approved a provision of the non-unanimous stipulation and agreement concerning depreciation issues that provided in part: "AmerenUE shall not seek to recover from its customers the difference between the book reserve balance and the theoretical reserve balance reserve [sic] for any account."[349]

The Commission should stick to its decision in Case No. ER-2007-0002 and not change depreciation rates in the five nuclear accounts, in isolation, to include an amortization of the

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[348] Ex. 13 (Wiedmayer Rebuttal) p. 3, l. 11 to p. 4, l. 11. Staff witness Guy Gilbert testified that the whole life formula is used to calculate depreciation rates in Missouri. Tr. p. 873, l. 7-8.
[349] *Re: Union Electric Company*, Case No. ER-2007-0002, *Report and Order* (effective June 1, 2007), pp. 94-95.

difference between book and theoretical reserve[350] for several reasons. First, as Staff witness Guy Gilbert has pointed out, it is almost unprecedented to change depreciation rates for individual accounts in the absence of a comprehensive depreciation study. In Mr. Gilbert's tenure as a Commission Staff member dating back to 1994, he is not aware of the Commission ever having changed depreciation rates outside the context of a full and comprehensive depreciation study unless mandated by law.[351] There is a very good reason for this practice—changes in depreciation expense applicable to some accounts may be offset by changes in other accounts. In this case there is ample evidence that even if the Commission adopted Mr. Dunkel's proposal and reduced depreciation rates for the five nuclear accounts he has chosen to consider[352] increases in depreciation expense applicable to other accounts would more than offset those decreases. As Mr. Gilbert has pointed out, the $7.1 million adjustment Mr. Dunkel is proposing is only a small part of the $300 million annual accrual for all AmerenUE plant accounts.[353] Mr. Gilbert also observed that AmerenUE is currently investing substantial capital in its system. Considering only $800 million of the investment in Project Power On (which is currently under way), Mr. Gilbert has calculated that AmerenUE's annual depreciation expense for the impacted

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[350] Mr. Dunkel admits that he is simply seeking to amortize the difference between the book and theoretical reserve for the five nuclear plant accounts he has selected through his adjustments in this case. Ex. 400 (Dunkel Surrebuttal) p. 8, l. 4-7. He has not considered any changes to the dispersion (curves) or net salvage factors that may also impact depreciation rates the five accounts he addressed, which would also be considered in a complete depreciation study. Ex. 401 (Dunkel Direct) p. 16, l. 11-14; Tr. p. 872, l. 2-6.

[351] Ex. 209 (Gilbert Rebuttal) p. 4, l. 3-5. In a single previous case in 2006, Mr. Gilbert proposed a reserve amortization in the absence of a comprehensive depreciation study, where both the Company and the Staff agreed on the amortization. But this amortization did not constitute a change to depreciation rates as Mr. Dunkel has proposed here. Tr. p. 888, l. 21 to p. 889, l. 7.

[352] AmerenUE does not agree that Mr. Dunkel's position regarding the five nuclear accounts is correct. Mr. Wiedmayer has testified that Mr. Dunkel's position amounts to the use of "remaining life" depreciation rates for the nuclear accounts while "whole life" rates are used for the many other plant, transmission, distribution and general accounts. In Mr. Wiedmayer's view, this inconsistency is neither systematic nor rational, so it should not be adopted. Ex. 13 (Wiedmayer Rebuttal) p. 4, l. 15 to p. 5, l. 7.

[353] Ex. 209 (Gilbert Rebuttal) p. 2, l. 22 to p. 3, l. 2.

accounts will increase by $21.6 million—roughly three times the reduction in depreciation accruals proposed by Mr. Dunkel in this case.[354]

AmerenUE witness Wiedmayer has also provided testimony on the topic of offsetting depreciation expense increases. He points out that AmerenUE's current depreciation rates for steam production plant are among the lowest he has observed in 22 years that he has been conducting depreciation studies for electric companies. The composite depreciation rate for AmerenUE's steam production plant excluding coal cars is 1.91% — significantly less than the industry average of 3%. The service lives established for individual plant accounts appear to be illogically long. For example, the "Structures and Improvements" account (Account 311) depreciation rate (which covers such items as elevators, HVAC, roofs and floor coverings) is based on an *average* service life of 115 years for the account. Similarly, the "Accessory Electrical Equipment" account (Account 315) is based on an *average* service life of 90 years. Mr. Wiedmayer argues that a flaw in the Staff's analysis in the last case led to these extremely long life estimates, but whatever the cause, adjustment of these lives to more appropriate levels will increase AmerenUE's depreciation expense when another depreciation study is conducted.[355]

Mr. Dunkel's primary argument supporting his position that the Callaway accounts should be addressed in isolation is that there has been a "major change" since the last case that significantly impacts the Callaway Plant. The "major change" Mr. Dunkel cites is AmerenUE's announcement that it will be filing an application for a 20 year extension of the operating license

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[354] *Id.* p. 4, l. 6-18.

[355] Mr. Dunkel argues that he submitted discovery seeking information about other accounts which presumably could have been used in the development of a full depreciation study. Ex. 400 (Dunkel Surrebuttal) p. 5, l. 10-20; Ex. 401 (Dunkel Direct) p. 18, l. 9-13. However, AmerenUE objected to those discovery requests on the ground that they improperly sought to require AmerenUE to "engage in research, compile data and perform analysis rather than seeking discovery of facts known or existing documents or data…"—a very legitimate objection. Tr. p. 828, l. 11-25. The record for this case reflects that OPC did not further pursue this discovery following these objections. Having not pursued this discovery, OPC has no grounds to now complain.

for the Callaway Plant, to extend the expiration to 2044.[356] This is no major change at all. In deciding the last case, the Commission assumed that AmerenUE would be filing for such a license extension, and used 2044 as the retirement date for the Callaway Plant in approving the depreciation rates applicable to the plant accounts.[357] In other words, the Commission significantly reduced the depreciation rates for the Callaway Plant accounts in the last case based on the assumption that the Nuclear Regulatory Commission would grant a 20 year operating license extension for Callaway. Given this treatment in the last case, AmerenUE's decision to apply for a license extension is a non-event for purposes of calculating depreciation rates. It certainly provides no justification for taking the unusual step of re-opening consideration of depreciation rates applicable to the Callaway Plant accounts in isolation, in the absence of a complete depreciation study.

Finally, it is worth noting that a comprehensive depreciation study, where the issues that Mr. Dunkel, Mr. Wiedmayer and Mr. Gilbert have raised can be given full consideration will not be long in coming. As Mr. Gilbert has testified, the Commission's rules require AmerenUE to submit a complete depreciation study every three years if it files a rate case, or at a minimum every five years. This schedule is more than sufficient to address changes to AmerenUE's depreciation rates, and in the mean time there is no justification for the Commission to allow OPC, or any other party, to cherry pick depreciation rates for particular accounts to be adjusted up or down.

Based on all of the foregoing, Mr. Dunkel's proposed isolated reductions to the depreciation rates applicable to the Company's nuclear accounts must be rejected.

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[356] Ex. 401 (Dunkel Direct) p. 3, l. 7-19.
[357] *Re: Union Electric Company*, Case No. ER-2007-0002, *Report and Order* (effective June 1, 2007) pp. 86-88.

IX. ICE STORM AAO.

Severe ice storms have the potential to cause widespread electrical outages to any electric utility's service territory. AmerenUE is no different. Over the past few years, AmerenUE has made a concerted effort to restore customers' service as quickly as possible following storms in order to minimize the inconvenience of power outages to its customers. On January 13, 2007, a significant ice storm hit AmerenUE's service territory and the Company incurred expenses of $24.56 million in its efforts to restore service to its customers. AmerenUE is proud of this restoration effort and believes it resulted in an efficient restoration process, given the amount of damage to the system. In Case No. EU-2008-0141, the Commission approved an Accounting Authority Order (AAO) to capture these out-of-test year restoration expenses. There is no issue as to whether these expenses were prudently incurred, there is no issue as to what is the amount of the restoration costs, and there is no question of how long the costs will be amortized.[358] The only outstanding issue for the Commission to resolve is on what date the amortization of these prudently incurred costs should begin.

Staff argues that the amortization period should begin retroactively, on February 1, 2007, which is just a little over two weeks after the storm hit the AmerenUE system. This date is unreasonable for several reasons. Most significantly, starting the amortization on that early date virtually guarantees that AmerenUE will be unable to recover the full amount of the costs it incurred. If Staff's position were accepted, by the time rates from this case take effect and the amortization can begin to be reflected in those rates, over 40% of the costs, incurred prudently and in good faith by AmerenUE at a time when it was already under-earning, as discussed below will already be amortized away and lost forever.[359]

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[358] The parties agreed to amortize the restoration costs over five years.
[359] Tr. 1844, l. 1-6.

As noted, not only would legitimate prudently incurred costs be lost, but they would be absorbed by shareholders at a time when AmerenUE was already under-earning. When this storm hit AmerenUE's service territory, the Company was in the middle of a rate case in which the Commission found that AmerenUE's rates were too low by $43 million. This under-earning has continued even after a rate increase was granted by the Commission in that case.[360]

It is also unreasonable to start the amortization on February 1, 2007, because at that point in time the exact amount of the restoration costs was not yet known. As AmerenUE witness Lynn Barnes has testified, AmerenUE continued to get invoices related to that storm restoration until June of 2007 and received a final credit from one of the utilities that helped us with the restoration effort as late as the fall of 2007.[361] Starting the amortization before the final costs were even known does not make sense and also demonstrates the unreasonableness of the Staff's position on this issue.

Staff has also advanced the argument that AmerenUE could have sought to have these costs included in its last rate case, even though the storm hit just 13 days after the true-up cutoff date. While parties can glibly claim that such a request could have been made and would have been granted, if AmerenUE had made such a request, it is likely that the other parties (including the Staff) would have argued that the costs were beyond the true-up cutoff or that the request was premature (because the costs were not then known and measurable), since the Company did not know the actual cost of its restoration efforts until much later in the year.[362] The theoretical and speculative possibility that these costs could have been recovered in the last case, notwithstanding the fact that they were included after the true-up cutoff in that case, is no reason

[360] Ex. 26 (Barnes Rebuttal) p. 9, l. 1.
[361] *Id.* p. 7, l. 16-19.
[362] Ex. 26 (Barnes Rebuttal) p. 7, l. 16-19.

to reject AmerenUE's request to begin the amortization concurrent with the effective date of new rates in this case.

The Commission clearly has the authority to order the amortization to commence as AmerenUE has requested. Although there have been two AAO cases[363] where the amortization of ice storm costs was started retroactively so that it began immediately following the storms, those were cases in which the utilities agreed to the amortization start date. AmerenUE cannot speculate what may have motivated other utilities to agree to this condition, but it is noteworthy that neither utility had a pending rate case at the time the amortization began. In any event, conditions that other utilities may have agreed to in two specific cases cannot deprive AmerenUE of the opportunity to recover its legitimate, prudent costs of responding to this ice storm.

In numerous other cases involving accounting authority orders, the Commission has permitted the amortization of legitimate costs to begin at a point in time when the utility would have the opportunity to recover the costs. For example, in addressing costs incurred by utilities to comply with a 2005 emergency amendment to the Cold Weather Rule, the Commission approved an accounting authority order "…that allows current losses due to the rule to be separately accounted, thus preserving the uncollected, deferred fees until the next rate case."[364] Significantly, in MGE's subsequent rate case, the Commission ordered the AAO to be amortized over three years, but did not require the amortization period to begin prior to the effective date of the Report and Order in that case.[365]

Even in cases where the amortization began prior to a rate case, the amortization was not started prior to the effective date of the order approving the AAO. In *Kansas City Power &*

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[363] *Re: Kansas City Power & Light,* Case No. EU-2002-1048, *Order Granting Accounting Authority*, 2002 WL 31107509 (Aug. 9, 2002), and *Re: Aquila, Inc.,* Case No. EU-2002-1053, *Order Granting Accounting Authority*, 2002 WL 31993236 (July 7, 2002), are two examples.
[364] *State ex rel. Missouri Gas Energy v. Public Service Commission*, 210 S.W.3d. 330, 336 (Mo. App. W.D. 2006).
[365] *Re: Missouri Gas* Energy, Case No. GR-2006-0422, *Order Granting Motion for Accounting Authority Order,* 2006 WL 2819980 (Sept. 21, 2006); *Report and Order*, 2007 WL 1030228, pp. 22-23 (Mar. 30, 2007).

Light Company AAO case, *supra*, amortization of ice storm costs began on the effective date of the order authorizing the AAO. And in a *St. Louis County Water Company* case,[366] the costs of water main replacement program were deferred for up to 24 months, provided that the utility filed a rate case in that period. Finally, in a *Missouri-American Water Company* case,[367] the parties agree that 9/11 security costs deferred through an AAO should be amortized beginning with the effective date of the order authorizing the AAO.

Prompt restoration of utility service following storms is very important to customers as well as to this Commission. The Company has acted accordingly. AmerenUE did a very good job in quickly restoring service following the January 13, 2007 storm under extremely adverse conditions.[368] The Commission can facilitate the prompt restoration of service after storms by allowing utilities the opportunity to recover their legitimate costs of performing these restorations.

Staff argues that if the Company's amortization start date is used, it will be possible for the Company to over-recover its costs.[369] That can only occur if AmerenUE waits more than five years to complete another rate case. That is an unlikely scenario. For one thing, if AmerenUE is permitted to use a fuel adjustment clause, it will be required to file a rate case within 37 months. If no fuel adjustment clause is granted, it becomes even more likely that the Company will have to file a rate case in the near term given the rising operating and capital costs being faced by the Company, and utilities generally, particularly given the problems of regulatory lag relating to higher fuel and other costs inherent in reliance on time-consuming rate cases in a jurisdiction that has traditionally relied on historic test year rate cases to set rates.

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[366] 1995 WL 769951 (Mo. P.S.C.).
[367] 237 P.U.R. 4th 353 (2004).
[368] As outlined in AmerenUE's Response to Staff's Recommendation to Grant Accounting Authority Order filed in Case No. EU-2008-0141, AmerenUE received the Edison Electric Institute's "Emergency Recovery Award", recognizing its outstanding efforts in restoring service following the January 13, 2007 ice storm.
[369] Ex. 226 (Cassidy Surrebuttal), p. 12, l. 11-13.

Regardless, the potential for over-recovering these costs is an issue related entirely to when the amortization period ends, not when the amortization period begins.[370] The risk that a rate case will not be perfectly timed to coincide with the end of the amortization period is speculative. Knowing that AmerenUE will lose the opportunity to recover 40% of its prudently incurred costs with a retroactive start date is not speculative and should be of greater concern to the Commission.

The fairest treatment is to start the amortization on the effective date of rates for this case. That is the approach that the Commission has taken in dealing with the amortization of other extraordinary costs in past cases, and that approach will provide AmerenUE with a real opportunity to recover the full amount of the costs that it incurred in responding to the storm rather than picking a date that starts with a loss of 40% of the costs to the Company. In these circumstances, starting the amortization on the effective date of rates for this case is most reasonable, and it sends the signal to electric utilities that if they prudently incur extraordinary storm restoration costs, those costs will be fully recoverable.

X. ACCUMULATED DEFERRED INCOME TAXES.

The accumulated deferred income tax issue in this case has a **__________**[371] impact on the Company's revenue requirement. Deferred income taxes arise from temporary differences between book and tax treatment of an item of income or expense. The effect of deferred taxes is in essence an interest-free loan from the government to the taxpayer by delaying the collection of taxes. In the context of utility regulation, well-established principles require deferred taxes to serve as a reduction to rate base, to provide customers with the benefit of the

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[370] Tr. p. 1852, l. 8-12.
[371] The precise impact will depend on the ROE adopted by the Commission.

interest-free loan that the utility is receiving from the government.[372] AmerenUE supports this treatment of deferred taxes as a general rule.

The issue in this case is that Staff witness John Cassidy has proposed to treat the full amount of tax deferrals associated with uncertain tax positions AmerenUE has taken as a component of deferred taxes and a reduction to rate base. In other words, Mr. Cassidy proposes to treat the potential deferral of taxes associated with uncertain tax positions as cost-free capital.

As the name suggests, "uncertain tax positions" are positions that AmerenUE has taken that may or may not ultimately be sustained by the Internal Revenue Service or by the courts. There are many ambiguities and uncertainties in the tax law, and AmerenUE takes uncertain tax positions in an effort to minimize its tax liability to the ultimate benefit of its customers. Due to the length of the government's audit and administrative appeals processes, as well as the length of the litigation process (should that become necessary or appropriate), it often takes several years before uncertain tax positions are finally resolved. To the extent that AmerenUE's positions are rejected and the Company is ultimately required to pay taxes associated with uncertain tax positions, it will have to make payment to the IRS with interest. As a consequence, tax deferrals based upon uncertain tax positions do not effectively constitute an interest-free loan from the government.[373] Treating such liabilities as cost-free capital, as Mr. Cassidy proposes to do, is simply incorrect.

Generally Accepted Accounting Principles (GAAP) provide rules to account for uncertain tax positions under SFAS 109 and Financial Accounting Standards Board Interpretation No. 48 (FIN 48). These accounting rules require the taxpayer to estimate the amount that it *ultimately expects it will have to repay* the government, with interest, upon the

[372] Ex. 21 (Nelson Rebuttal) p. 4, l. 1-16.
[373] *Id*. p. 5, l. 1-6.

resolution of uncertain tax positions (the FIN 48 liability) and provide standards to calculate that estimate. This calculation must be reviewed quarterly by the taxpayer and adjusted to take into account changes in laws and regulations that might impact the final resolution of the uncertain tax positions. Moreover, external auditors are also required to review this estimate quarterly. In sum, there is a constant true-up process for the FIN 48 liabilities.[374]

AmerenUE has proposed to exclude the FIN 48 liabilities from deferred taxes because they do not constitute an interest-free loan from the government, but rather the best available estimate of the amount of uncertain tax positions that will ultimately have to be repaid to the government with interest. In contrast, Staff has included the *total* amount of the uncertain tax positions in deferred taxes with no allowance for any amount that might have to be repaid to the government with interest, even though the Company expects it will have to repay these sums.

The effect of Staff's position will be to unfairly penalize AmerenUE if *any* of its uncertain tax positions are not ultimately resolved in the Company's favor. This is bad policy for two reasons. First, it is unreasonable to subject AmerenUE to the near certainty that it will under-recover its prudently incurred tax costs just because it is taking uncertain tax positions in an effort to lower its taxes, to the ultimate benefit of customers. Second, adoption of the Staff's position will discourage all Missouri utilities from taking uncertain tax positions because they will be justifiably afraid they will not be able to recover the costs of doing so.[375]

Staff witness Cassidy testified at the hearing that it would be unreasonable to do the opposite of what Staff is proposing, and assume for ratemaking purposes that AmerenUE will lose all of the uncertain tax positions it has taken.[376] But the Staff's position, assuming for ratemaking purposes that AmerenUE will prevail on 100% of its uncertain tax positions, is no

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[374] *Id.* p. 5, l. 7 to p. 6, l. 2.
[375] Staff witness Cassidy testified at the hearing that AmerenUE should be encouraged to pursue uncertain tax positions. (Tr. p. 1086, l. 23 to p. 1087, l. 9). But adoption of Staff's position will have the opposite effect.
[376] Tr. p. 1089, l. 2-23.

less unreasonable. The Company has taken the more reasonable middle ground approach of excluding from deferred taxes the FIN 48 costs, which are the portion of the uncertain tax liabilities it *expects* to have to repay to the government with interest. Since this estimate is calculated based on FIN 48 standards, updated quarterly, and subject to audit by an outside auditor, it is reliable and current. Utilization of this process to estimate the outcome of uncertain tax positions is clearly more reasonable than Staff's punitive approach of presuming 100% recovery by the Company. As a consequence, Staff's proposed inclusion in deferred taxes of all of the liabilities associated with uncertain tax positions (including the FIN 48 portion of those liabilities) should be rejected.

XI. NRC CONSTRUCTION AND OPERATING LICENSE (COLA).

This issue is worth approximately $5.0 million[377] in revenue requirement.

As addressed at pages 30 and 31 of the surrebuttal testimony of Mr. Ajay Arora, the 2005 federal Energy Policy Act (EPAct) provides very substantial production tax credits for new nuclear plants so long as a Combined Construction and Operating License Application (COLA) was submitted to the Nuclear Regulatory Commission (NRC) by the later of (a) December 31, 2008, or (ii) the date on which the aggregate nameplate capacity of advanced nuclear facilities for which COLAs had been filed with the NRC equals or exceeds 6,000 megawatts.[378] AmerenUE met this requirement by submitting the COLA in July of this year. AmerenUE's analysis indicates that these production tax credits could potentially save ratepayers approximately $500 million if a second unit is built at the Callaway Plant site.[379] Consequently, it was clearly prudent for the Company to file the COLA when it did to avoid the loss of these

[377] The precise impact will depend on the ROE adopted by the Commission.
[378] Ex. 24 (Arora Surrebuttal) p. 31, l. 4-9.
[379] *Id.* p. 30, l. 22 to p. 31, l. 3.

potential benefits forever. Stated another way, AmerenUE's COLA filing preserves those benefits for ratepayers if a regulated Callaway unit 2 is ultimately built.

During the test year, AmerenUE invested approximately $45.3 million in the COLA. AmerenUE seeks to include that sum in rate base in this case, meaning it would recover a return on its rate base (approximately $5.0 million annually, as noted above). If the Commission allows this return in rates and if a regulated Callaway unit 2 were not built, the return collected on the COLA expenditures could be refunded to ratepayers or amortized over a period of years with interest, thus making the ratepayers whole.[380]

Those who oppose allowing the Company to recover a return on the COLA costs through rates argue that doing so violates Proposition One (Section 393.135, RSMo.). But this is incorrect because the COLA is a separate asset that may have value apart from construction of an AmerenUE-owned regulated power plant.[381] It is thus not dependent upon construction of a regulated plant by AmerenUE, and thus does not violate the construction work in progress prohibition in Proposition One.

The effect of the positions taken by those who oppose recovery a return on the COLA costs is to unfairly impose 100% of the risks associated with pursuing the COLA on AmerenUE's shareholders, despite the fact that no one disputes the fact that AmerenUE's pursuit of the COLA may enable customers to enjoy hundreds of millions of dollars of production tax savings. That this is true is obvious by the fact that the Staff would not commit to support cost recovery of the COLA costs at a later time even if a Callaway unit two is not built, and even if the COLA-related costs are indeed prudently incurred costs.[382]

[380] Tr. p. 1300, l. 19 to p. 1301, l. 8 (Mr. Weiss).
[381] Tr. p. 128, l. 24 to p. 129, l. 5 (Mr. Voss); p. 1319, l. 15-18 (Mr. Arora).
[382] Tr. p. 1374, l. 2-12 (Mr. Rackers).

Under these facts, ratepayers should bear their fair share of the cost and risk associated with the COLA, which means that the Company's investment in the COLA should be included in rate base. The Company's proposal fairly shares this risk between ratepayers and shareholders with the shareholders providing the investment and the ratepayers providing a return on that investment.

XII. DSM REGULATORY ASSET.

In the Company's last rate case, Lena Mantle, on behalf of Staff, originally suggested the use of a regulatory asset for demand-side management (DSM) costs in order to "overcome regulatory barriers to…developing and implementing demand-side resources."[383] AmerenUE supported Staff's suggestion and, ultimately, the parties to that case filed a Stipulation and Agreement which adopted Staff's suggestion.[384] But that stipulation did not address the issue of netting revenues associated with these programs against the costs of the programs in the regulatory asset. AmerenUE believes it is important for the Commission to clarify its expectations on this issue.

A. <u>The interplay of this issue with AmerenUE's request for an FAC</u>.

Before getting into the details of this matter, however, AmerenUE believes it is important that the Commission recognize that a decision to grant AmerenUE its requested FAC will mean that this issue is moot. The root of the "netting" concept is crafting a mechanism that ensures any benefit, typically a sale of wholesale energy or capacity, is credited against the cost of the program which made that sale possible. If off-system sales are run through the FAC, as proposed by AmerenUE, then netting is occurring, just through two different mechanisms (the DSM regulatory asset and the FAC). Even OPC is in agreement with this statement. Mr. Kind

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[383] ER-2007-0002, Mantle Direct, p. 4, l. 8-9
[384] ER-2007-0002, *Stipulation and Agreement as to Certain Issues/Items*, Mar. 15, 2007, p. 5. Approved by Commission in *Order Approving Tier I Partial Stipulation and Agreement Filed on March 15, 2007*(Apr. 11, 2007).

testified, "There would be a netting. But it would be through the combination of two mechanisms rather than just in one single mechanism. The netting would occur by the fact that these DSM programs would cause the companies' periodic adjustments under a fuel adjustment clause. They would cause upward adjustments to be smaller than they would otherwise be. Or downward adjustments would be larger than they would otherwise be. So that would effectively be a netting. They wouldn't be netted in a single mechanism, but the netting would still be accomplished, I believe."[385]

B. The netting requirement is most appropriately limited to demand response programs.

In the Staff Report filed in this case, Staff witness Henry Warren requests the Commission clarify the net expenditures to be included in the regulatory asset account.[386] OPC joined in that request.[387] To be clear, AmerenUE does not oppose the netting of costs and revenues related to its demand response efforts, but does not believe it appropriate for energy efficiency programs. If the Commission desires the inclusion of energy efficiency programs in this netting requirement, AmerenUE believes it has language which would provide the clarity it seeks.

The Company is in the process of investing large amounts of money in various demand side and energy efficiency programs. Those types of programs are often collectively referred to as DSM programs.[388] Yet the two are very different types of programs. A demand response program typically involves a small number of customer load curtailments for a small number of

[385] Tr. p. 943, l. 8-19.
[386] Staff Report on Cost of Service, August 28, 2008, p. 9.
[387] Ex. 404 (Kind Rebuttal) p. 13, l. 18 to p. 14, l. 2.
[388] Ex. 18 (Voytas Surrebuttal) p. 3, l. 16.

hours in a year. An energy efficiency program typically reduces energy consumption across most hours of the year.[389]

Because of this difference, netting makes sense for most demand response programs but does not make sense for the typical energy efficiency program.[390] Both OPC and Staff agreed with this concept, in general, at the hearing. Mr. Kind testified that although the language of his proposal covered both demand response and energy efficiency programs,[391] the only netting he could conceive of for energy efficiency programs would occur if Midwest ISO created some type of mechanism to allow energy efficiency programs credit through the Midwest ISO's capacity markets[392] or if AmerenUE developed such a large energy efficiency program that reduced its load by hundreds of megawatts.[393] Mr. Kind conceded that there would be no revenue to net from home weatherization programs.[394] Mr. Kind also conceded that he was familiar with the energy efficiency programs planned by AmerenUE and he did not foresee those programs creating any additional capacity sales that would need to be credited against expenses in this regulatory asset.[395]

Mr. Warren's testimony was consistent with that of Mr. Kind on this issue. He was taken through a list of potential energy efficiency programs - programs that promote the use of more efficient lighting or appliances,[396] home energy audits,[397] more efficient heaters or air conditioners[398] efficient motors[399] or weatherization[400] - and agreed that none of these examples

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[389] *Id.* p. l. 8-10.
[390] *Id.* p. l. 16-21.
[391] Tr. p. 931, l. 16-24.
[392] Tr. p. 932, l. 19-24.
[393] Tr. p. 933, l. 14-25.
[394] Tr. p. 932, l. 5-24.
[395] Tr. p. 934, l. 1-9.
[396] Tr. p. 980, p. 8-14.
[397] Tr. p. 980, l. 15-21.
[398] Tr. p. 980, l. 22 to p. 981, l. 1.
[399] Tr. p. 982, l. 4-10.
[400] Tr. p. 983, l. 10 to p. 984, l. 1.

would produce any revenue or other funds which should be offset against the expenses in the regulatory asset. Mr. Warren could not identify an energy efficiency measure at this time that would create any revenue or other funds which would offset costs in the regulatory asset.[401]

Much as Mr. Kind discussed the possibility that the Midwest ISO could create a market for energy efficiency credits, Mr. Warren agreed that his desire to maintain the possibility of crediting back some revenues for energy efficiency programs was based on the theoretical possibility that such an avenue might someday exist.[402]

The simple resolution of this issue is to limit the crediting requirement to demand response programs. AmerenUE also believes the discussion at the hearing about limiting netting for energy efficiency programs to those revenues that were "immediate, identifiable and measurable" would work.[403] Having said that, as Mr. Voytas testified, the "devil is in the details."[404] For example, at the hearing, there was discussion about how any credits should have an "identifiable link" to the energy efficiency program, to which Mr. Kind agreed.[405] After agreeing, Mr. Kind then followed up with the comment, "I mean, it depends on what you mean by a link. But the way I – I think we might have different interpretations of what a link might be."[406]

It is this very real possibility of "different interpretations" that might arise *after* AmerenUE has made significant investment in DSM programs that causes the Company great concern. If the Commission does not grant AmerenUE an FAC, the Company asks that it order very specific language so that all parties will know going forward what revenues are and are not

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[401] Tr. p. 981, l. 23 to p. 982, l. 3; p. 982, l. 11-16.
[402] Tr. p. 982, l. 17-24.
[403] Tr. p. 979, l. 17 to p. 980, l. 3.
[404] Tr. p. 948, l. 2.
[405] Tr. p. 935, l. 16 to p. 936, l. 7.
[406] Tr. p. 936, l. 9-11.

expected to be credited back to the regulatory asset. To that end, AmerenUE proposes the following language, which is consistent with the discussions that occurred during the hearing:

> DSM should be booked as net expenditures when DSM has a *transactionable, identifiable and measurable*[407] increase in revenue to the Company. *Transactionable* refers to tradable products with an identifiable counter-party which provides a value. *Identifiable* refers to the linkage whereby specific revenue streams can be tied to specific programs. *Measurable* means that there is a protocol established as the basis for cash settlement.

The Company believes this language is consistent with what was discussed at the hearing and should be adopted by the Commission, if a FAC were not granted.

XIII. LOW INCOME WEATHERIZATION.

There are two questions which require Commission determination on this topic. The first question is whether or not AmerenUE has paid the amount it was ordered from Case No. ER-2007-0002. AmerenUE's position is that it has paid the appropriate amount. The second question is what level of funding should AmerenUE be required to provide to DNR's Environmental Improvement and Energy Resources Authority (EIERA) as part of the Company's low income weatherization efforts and whether that funding should be a continuous obligation that extends beyond any new rate case filing. AmerenUE requests this Commission set $600,000 as the amount for low income weatherization funding and that the entire $600,000 be included in its revenue requirement. AmerenUE opposes any requirement that this funding obligation extend past its next rate case, for reasons set forth below.

A. ER-2007-0002 Report and Order.

In addressing this issue, the facts are not in dispute. It is undisputed that in the last AmerenUE rate case, the Commission ordered AmerenUE to contribute $1.2 million to weatherization efforts. Half of that amount was to be funded by ratepayers and half was to be

[407] Tr. p. 935, l. 6-11.

funded by AmerenUE shareholders. The parties have stipulated to this fact.[408] The exact language of that portion of the Report and Order from Case No. ER-2007-0002 reads, "Therefore, the Commission directs that the low-income weatherization program continue with funding provided $600,000 by ratepayers and $600,000 by AmerenUE's shareholders."[409]

The Report & Order was issued May 22, 2007, and the new rates went into effect June 1, 2007. The Company entered into an agreement, titled *Cooperation and Funding Agreement* (Agreement), to pay the weatherization funds to EIERA, much as had been done in previous years. The Agreement was signed by AmerenUE, DNR, EIERA and the Commission.[410] Although DNR wants to point to this Agreement as proving their contention that AmerenUE has not fully funded its obligation, the Agreement is not relevant to the question to be decided by the Commission. The language in the Agreement may have independent legal meaning, but it cannot change or modify the Commission's Order in Case No. ER-2007-0002. Indeed, the Commission has no authority to adjudicate contract rights between contracting parties.[411] The issue before the Commission is what the Report and Order requires from AmerenUE in terms of providing weatherization funding. The terms of the Agreement are not relevant to that determination.[412]

At the end of June, 2008, AmerenUE made a payment of $900,000 to EIERA.[413] DNR is requesting that Commission find the Company should pay EIERA an additional $300,000.

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[408] Tr. p. 1001, l. 10-16.
[409] Case No. ER-2007-0002, Report & Order, p. 113.
[410] A copy of this agreement is attached to the direct testimony of DNR witness Laura Wolfe (Ex. 550), as her Exhibit LW-2.
[411] Well-established law in this state holds that "The commission has exclusive power to determine and fix reasonable rates irrespective of the rates fixed by the franchise ordinance, but it has no jurisdiction to construe or enforce the contract **. . ..**" *State ex rel. Kansas City Public Svc. Co. v. Latshaw*, 30 S.W.2d 105, 110 (Mo. 1930); *See also, e.g. Kansas City Power & Light Co. v. Midland Realty Co.*, 93 S.W.2d 954, 958 (Mo. 1936) ("[O]ur Public Service Commission is not a court and cannot enforce contracts.").
[412] If the Commission or DNR believes AmerenUE has violated the terms of this contract, enforcement is available under traditional legal avenues.
[413] Tr. p. 1001, l. 21-23.

AmerenUE does not believe that it is or should be required to make the additional payment of $300,000. Although, as explained below, if the Commission continues the $600,000 of funding in rates, the Company acknowledges it would owe EIERA an additional $150,000.

At the time AmerenUE made the $900,000 payment, the instant rate case was pending. The new rates from the instant case are expected to go into effect as of March 1, 2009. Because AmerenUE does not know what the Commission will order going forward, the Company could not know if it would continue to collect in rates the $600,000 from customers after February of 2009. At the same time, AmerenUE knew that the current rates would remain in effect through February of 2009. That additional nine months meant the Company knew it would collect three fourths of $600,000 from customers, which is $450,000. So $450,000 of the annual customer contribution was paid to EIERA. AmerenUE has asked the Commission to continue this source of funding.[414] If the Commission grants its request, the Company will make the final payment of $150,000 to EIERA.

The same reasoning applies to the $600,000 which was ordered to be paid by AmerenUE shareholders. However, AmerenUE does not believe that any continuation of this shareholder funding should or indeed can lawfully be ordered by the Commission.[415]

B. <u>Future Funding Levels</u>.

As stated above, AmerenUE requests the Commission continue the $600,000 funded through rates. AmerenUE believes it appropriate to continue that level of funding. AmerenUE does not believe it is appropriate for the Commission to order an additional amount, if that additional amount is required to be funded by shareholders.[416] AmerenUE makes many charitable donations and the choice of recipients for those donations is not something that should

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[414] Ex. 20 (Mark Rebuttal) p. 7, l. 14-17.
[415] *Id.* p. 7, l. 4-17.
[416] *Id.* p. 7, l. 5-7.

be dictated by the Commission.[417] AmerenUE does not deny that the weatherization program provides an important service for low income individuals in the State of Missouri. In fact, the low income weatherization program may well be a recipient of additional funds in the future from AmerenUE.[418] However, shareholder contributions should be made at the discretion of AmerenUE, not the Commission.

Additionally, AmerenUE believes that ordering its shareholders to provide a portion of this funding is outside of the Commission's legal authority. As a matter of law, the Commission must set the Company's revenue requirement based upon a recovery of the full cost of providing the utility service, which includes the utility's operating costs and depreciation, taxes and a fair return on shareholder equity. This has been the law for decades.[419]

AmerenUE recognizes that $600,000 is not a large portion of its overall revenue requirement, but this does not change the nature or extent of the Commission's limited authority. There is nothing in the Commission's enabling statutes, and there is no exception from the principle enunciated in *West Ohio* and it progeny, that allows the Commission to force utilities to fund utility programs with shareholder money just because it is a small amount or might not be viewed as an undue burden.

AmerenUE would note the long held principle that the Commission is not the manager of the utility and cannot mandate services or service terms at shareholder expense is fundamental, has existed for decades and is embodied in cases dating back to the very beginning of public

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[417] *Id.* p. 7, l. 7-9.
[418] *Id.* p. 7, l. 9-13.
[419] *See, e.g.*, *The Mountain States Tele. And Tele. Co. et al. v. Fed. Comm. Comm'n*, 939 F.2d 1021, 1029 (D.C. Ct. App. 1991) ("More than a half-century ago, the Supreme Court admonished regulatory agencies to 'give heed to all legitimate expenses that will be charges on income during the term of regulation.' [*quoting* West Ohio Gas Co. v. Pub. Utilities Comm'n of Ohio*, 294 U.S. 63, 55 S.Ct. 316, 79 L.Ed. 761 (1935)].* We ourselves have observed that 'if expenses are properly incurred, they must be allowed as part of the composition of the rates. Otherwise, the so-called allowance of a return upon the investment, being an amount over and above expenses, would be a farce.'').

utility regulation in this states, as illustrated by *City of Joplin v. Wheeler*.[420] In *Wheeler*, the City of Joplin attempted to require the local water utility to pay for service lines from the water main to the residence/business with shareholder funds. The City argued that doing so was part of the "rate-fixing power' of the City.[421] This would be the similar to the request before the Commission today. In *Wheeler*, the court disposed of this argument, noting that "this expense to the operating company must be ultimately paid by the consumer."[422] The Court drew an important distinction between *regulating* a service the utility provides and *forcing* a utility to do something at shareholder expense, something that the utility never had to do in the first place. This distinction was summed up well in the Court's opinion, "The city council [nor this Commission] can no more compel a public service corporation to do or abstain from doing anything not pertaining to the public service itself than can it compel a private individual…"[423]

Historically, the Commission has respected these principles of law and should do so again. In *Re: Southwestern Bell Tel. Co*, the Commission recognized it was Southwestern Bell's decision whether to include Caller ID in three service offerings it had proposed.[424] The Commission found it was a business decision of Southwestern Bell and declined to require Caller ID service.[425] Stated another way, the "customers of a public utility have a right to demand efficient service at a reasonable rate, but they have no right to dictate the methods which the utility must employ in the rendition of that service."[426]

For all of these reasons, the Commission does not have the legal authority to mandate that shareholders provide a portion of the funding to be sent to EIERA. The Commission simply

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[420] 158 S.W. 924 (Mo. App. S.D. 1913)
[421] *Id.* p. 927.
[422] *Id.*
[423] *Id.* p. 928; see also *Home Tele Co v. Carthage*, 139 S.W. 547 (Mo. 1911), holding that telephone company shareholders could not be forced to provide only private phone lines as opposed to party lines.
[424] 1993 Mo. PSC LEXIS 11, 2 Mo P.S.C.3d 125 (1993).
[425] *Id.*
[426] *Joseph v. Pub. Serv. Comm'n*, 30 S.W.2d 8 (Mo. 1930).

cannot mandate AmerenUE to fund a program yet ignore the cost of that funding as a legitimate expense to be included in the Company's revenue requirement.

In addition to DNR's request for $1.2 million a year in funding, DNR requests the Commission to order this funding continue beyond AmerenUE's next rate case. It is inappropriate for AmerenUE to commit to, or for this Commission to order, any level of funding past the effective date of rates in AmerenUE's next rate case.[427] While the Company understands DNR's desire for continuous funding, the Company takes this position because of the realities of operating in a regulated environment and how its rates are set. As Mr. Mark explained, as long as the $600,000 is included in rates, the Company will continue to provide it to EIERA. However, the filing of a new rate case will necessarily place that funding in question given that all facts and circumstances of necessity are considered in every rate case. This Commission cannot bind future Commissions to include this contribution in rates. It is a case-by-case decision that has to be made by the Commission based upon the record in each, separate rate case. Accordingly, it is necessary that the funding commitment extend only until AmerenUE's next rate case. If AmerenUE is able to go years without filing a rate case, then the funding will remain stable. However, continual cost increases mean that AmerenUE will likely be forced to file additional rate cases. This necessarily introduces more uncertainty into its funding for the weatherization program. AmerenUE understands how this is a concern for DNR, but it is an uncertainty that cannot be avoided.[428]

XIV. HOT WEATHER CREDITS.

AARP's proposed Hot Weather bill credit program has undergone many changes, but the organization currently seeks approval of a two year pilot program for 2,400 participants which is

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[427] Ex. 20 (Mark Rebuttal) p. 7, l. 18-21.
[428] Ex. 20 (Mark Rebuttal) p. 7, l. 21 to p. 8, l. 7.

estimated to cost $125,000 annually.[429] Originally, the proposal was to offer a bill credit to all households at or below 175% of the federal poverty guidelines which included someone who was age 65 or older or a child less than two years of age.[430] AARP then modified its proposal to a two year pilot program for households in the City of St Louis or Jefferson County which are at or below 175% of federal poverty guidelines and had someone in the household aged 65 or older.[431] The current proposal is significantly different from even this proposal, and thus represents the third different proposal made by AARP in this case.

While AmerenUE recognizes that many of the changes made by AARP to its proposal were done in response to suggestions received during the hearing, the fact that this proposal has continued to be a moving target goes to the very heart of AmerenUE's concern with AARP's idea. While the proposal may be based upon laudable ideals, there is no proof that it will work or that serious consideration has been given to the details of the program as it has now developed. Finally, there is the question of why such a proposal is made at the Commission rather than at the state legislature. Is it appropriate to ask the Commission to adopt a social service program and to effectively fund it with a "tax" on ratepayers? Is it appropriate for any public utility, including AmerenUE, to effectively collect this tax to fund this experiment? The Company believes that it is quite obvious that if AARP believes this social program is appropriate, then AARP should be asking the legislature to debate, evaluate and fund it.

A. Substantive flaws with AARP's proposal.

The proposal is premised on the idea that there are elderly, low-income customers of AmerenUE who own air conditioners but who will not run them during periods of high heat. The bill credit is supposed to offset their concern about the cost so that they will turn on the air

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[429] Ex. 853.
[430] Ex. 850 (Howat Direct) p. 7, l. 21-23 and p. 9, l. 2-4.
[431] Ex. 851 (Howat Surrebuttal) p. 4, l. 4-8.

conditioning. AARP's witness, John Howat, admits he has never before proposed such a program and that, to the best of his knowledge, this program has never been implemented anywhere in the United States.[432] That alone, of course, does not mean the proposal is inherently flawed, but it does mean that AARP should be required to provide some basis for believing that its proposal will work. The Commission should not be in the practice of throwing money at a problem, even in a pilot program, without having some evidence that the proposed solution will work.

AARP has repeatedly made the statement a bill credit would serve as a means of encouraging customers to use air conditioners in their homes during particularly hot weather,[433] but there is nothing beyond that mere *assertion* in the record to demonstrate that it will actually occur. The evidence in the record shows that these individuals may hold deep convictions and that their own families are unable to convince them to run an air conditioner. As Schedule JH-3 to Mr. Howat's direct testimony (a Missouri Department of Health bulletin (the most specific evidence to Missouri in the record)), pointed out, "For some, even encouragement from relatives and friends could not convince them to use their air conditioner."[434] If encouragement from a relative does not convince someone to turn on their air conditioner during period of high heat, how can the Commission presume that a bill credit will produce a different result? When asked if he was proposing it as a pilot because he didn't know if the proposal was going to work, AARP's own witness admitted, "That's correct, this is a thesis. You know, I'm – I'm pretty clear about that."[435] Mr. Howat also admitted that the basis upon which he recommended the proposal was "an assumption" that recipients of the bill credit would be "less reluctant" to

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[432] Tr. p. 1145, l. 7 to p. 1146, l. 13.
[433] Ex. 850 (Howat Direct) p. 4, l. 8-11.
[434] Ex. 850 (Howat Direct) JH-3, p. 1.
[435] Tr. p. 1165, l. 23 to p. 1166, l. 2.

operate their air conditioner.[436] When questioned further, Mr. Howat admitted that a participant could take the bill credit, still not run the air conditioner and have $47 extra with which to buy groceries or medicine.[437]

Even if a bill credit could be a mechanism to encourage these individuals to run their air conditioning, there is nothing in the record indicating that $47 is the correct amount to provide that encouragement. Mr. Howat proposes $47 because it is half the annual cost to operate an Energy-Star qualified air conditioner.[438] Mr. Howat agreed that Energy-Star air conditioners were generally more efficient than non-Energy-Star units.[439] Yet AARP doesn't know how many of its target participants have access to an Energy-Star rated air conditioner or how many could afford to buy one, if they so desired.[440]

Mr. Howat was questioned on how the program would identify individuals who weren't participating in good faith, whether that was by not running their air conditioner or by being an "energy hog."[441] Mr. Howat admitted that he was not sure from a practical perspective how that would be done and that there would need to be more thought into how controls could be built into the pilot.[442]

As part of its "evidence" supporting the proposal, AARP attached five letters of support from various community agencies. One letter, from the City of St. Louis, was withdrawn. Noting similarities in the language of the remaining letters, AmerenUE asked AARP for all communication between the organizations and AARP around this proposal. AARP provided an email from John Coffman to various community agencies asking them to submit a letter of

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[436] Tr. p. 1165, l. 8-16.
[437] Tr. p. 1166, l. 12-17.
[438] Ex. 850 (Howat Direct) p. 5, l. 7-12.
[439] Tr. p. 1162, l. 22 to p. 1163, l. 6.
[440] Tr. p. 1163, l. 7-20.
[441] Tr. p. 1183, l. 2 to p. 1184, l. 16.
[442] *Id.*; Tr. p. 1184, l. 6-16.

support and including a sample letter.[443] Mr. Howat agreed, that out of the four letters, three were “very similar” to the draft version Mr. Coffman had provided.[444] These agencies may like any program that would provide them additional funding with which to support their efforts, but any specific assertion in the letter cannot be relied upon by the Commission as a reason to fund this request. This is because these are form letters written by Mr. Coffman and the agencies were just told to sign them.[445] Consequently, they carry little, if any, weight.

While not related directly to this proposal, AmerenUE sponsored a recent survey that indicates its customer population, age 60 or over, runs their air conditioning units during the hottest periods of the summer.[446] While this study was not done for the purpose of evaluating AARP’s proposal and was not limited to low-income customers, it is specific to AmerenUE’s service territory and the experiences of its elderly customers.[447] The survey found that 98% of those surveyed answered “yes” when asked “Do you routinely run your air conditioning unit during heat waves, that is, the hottest days of the summer months?”[448] This survey, while not directly on point, is as close as anything provided by AARP and may provide some indication that the need for this program is less urgent than AARP would suggest.

Finally, AmerenUE would point out that it does not oppose this program because it is unsympathetic to the needs of low-income customers. AmerenUE has implemented many programs to assist low-income individuals, ranging from Dollar More to distributing new air conditioners to low-income customers, a program Mr. Howat commended.[449] In fact, AmerenUE participated in many discussions about AARP’s proposal with AARP, Staff and OPC

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[443] Ex. 74.
[444] (Missouri Budget Project) Tr. p. 1151, l. 2-8; (Southwest Missouri Office on Aging) Tr. p. 1150, l. 13-23; (Missouri Association for Social Welfare) Tr. p. 1151, l. 9-12.
[445] Tr. p. 1223, l. 21-23.
[446] Ex. 20 (Mark Rebuttal) p. 9, l. 16 to p. 10, l. 6; Sch. RJM-RE3.
[447] *Id.*; Tr. p. 1217, l. 18-24.
[448] *Id.* p. 10, l. 1-6; Sch. RJM-RE3.
[449] Tr. p. 1160, l. 9-12.; Ex. 20 (Mark Rebuttal) p. 8, l. 21 to p. 9, l. 15.

outside of this rate case.[450] The end result of those meetings was that AmerenUE did not believe the proposal would work and at least one Commission Staff member shared that concern and characterized the proposal as "a waste of time internally to UE."[451] Instead, the group decided to focus on an information campaign.[452] AARP is now asking the Commission to override the considered rejection of the concept by AmerenUE.

B. **Concerns with the Commission imposing a social program.**

Importantly, the Commission must also address the question of whether or not this proposal is one that the Commission should consider or if it is more suited to be implemented by the legislature.[453] AARP is a very large, nationwide organization; if they believe the idea is worth promoting, they could better fund an in-depth study to fully develop a program that would be most effective in meeting their goal rather than asking this Commission to adopt a less than well thought out proposal by which they hope to gain some insight.

Assuming the Commission adopts this proposal, what will come next? The last rate case saw the Missouri Association for Social Welfare ask the Commission to adopt an essential service rate, sometimes referred to as a life-line rate.[454] As Mr. Howat concurs, if the Commission adopts this program, there is nothing to stop future intervenors from seeking to expand the program by changing the age cut off or to including households with children under the age of two, or even to allowing all low-income households to participate.[455] In fact, Mr. Howat indicated that type of expansion would be something he would support.[456] It seems

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[450] Ex. 20 (Mark Rebuttal) p. 8, l. 17-20.
[451] Ex.854; Tr. p. 1228, l. 11-14; p. 1229, l. 1-10.
[452] Tr. p. 1231, l. 7-9.
[453] Ex. 20 (Mark Rebuttal) p. 10, l. 12-18.
[454] Direct Testimony of Robert Quinn, ER-2007-0002, Dec. 29, 2006.
[455] Tr. p. 1193, l. 15 to p. 1195, l. 12.
[456] Tr. p. 1195, l. 1-9.

obvious to the Company, as a matter of practical reality and law, that the Commission is not the right forum for adopting a social program of this type.

XV. UNION ISSUES.

A. The Unions' Testimony.

In this rate case, International Brotherhood of Electrical Workers Locals 2, 309, 649, 702, 1439, 1455, AFL-CIO and International Union of Operating Engineers Local 248, AFL-CIO (Unions) filed the direct testimony of four witnesses, Messrs. Michael Datillo, David Desmond, Michael Walter and Donald Giljum (Union Representatives). The Union Representatives supported the need for a rate increase in this proceeding.[457] However, these witnesses also raised issues related to the level of training of employees as well as AmerenUE's use of outside contractors. In their respective testimonies, the Union Representatives request that the Commission order AmerenUE to (i) expend a substantial portion of the rate increase on investing in its employee infrastructure; (ii) require subcontractors to meet standards of training and certification similar to those required by Ameren of its internal workforce; and (iii) set in place a process by which it will be able to accomplish the Company's work load solely using its permanent employees within the next three years. However, as explained below, these criticisms are not based upon competent and substantial evidence of any deficiencies in AmerenUE's quality of service, or employee safety records, and should be discounted in this proceeding. In fact, the relief sought by the Unions is unlawful, as also outlined below.

AmerenUE witnesses Mark Birk[458] and Ronald Zdellar[459] addressed the specific concerns raised by the Union Representatives. Mr. Birk disagreed that AmerenUE had allowed internal staffing levels to decline, or used uncommitted contractors and unqualified employees

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[457] Ex. 900 (Datillo Direct) p. 2; Ex. 901 (Desmond Direct) p. 2; Ex. 902 (Walter Direct) p. 1-2; Tr. p. 1757; Ex. 903 (Giljum Direct) p. 1.
[458] Ex. No. 15 (Birk Rebuttal) pp. 5-8.
[459] Ex. No. 16 (Zdellar Rebuttal) pp. 10-13.

hired from other industries to work on power plants.[460] He explained that AmerenUE's management of its workforce has achieved very reliable, low cost performance from its generating plants. He also testified that AmerenUE relies on both internal workers and outside contractors to operate its power plants because the use of both types of workers provides the Company with the greatest flexibility to operate the plants efficiently and cost effectively.[461] He explained that by hiring workers from other industries that already have skills and knowledge that are transferable to power plant operations, the Company is far more efficient than hiring completely unskilled workers and training them from the ground up at the customers' expense.[462]

Mr. Birk demonstrated that there have been significant improvements in equivalent availability (and net capacity factors) at AmerenUE's coal plants over the past 10 years with equivalent availability factors improving from 79.91% in 1998 to over 90% in 2008.[463] Mr. Birk also produced competent and substantial evidence that OSHA incident rates have fallen from 9.0 in 1998 to 1.9 in 2008.[464] Based upon this competent and substantial evidence, Mr. Birk concluded that "the facts show that Mr. Giljum's depiction of AmerenUE's generation as inefficient, unreliable and unsafe are simply not accurate."[465]

Mr. Zdellar also responded to the criticisms of Messrs. David Desmond, Michael Datillo, and Michael Walter related to the use of outside contractors.[466] Mr. Zdellar initially pointed out that one of the job responsibilities of the various union witnesses is to lobby for more in-house employees rather than the use of outside contractors.[467] As a result, the Union Representatives'

[460] Ex. No. 15 (Birk Rebuttal) pp. 5-6.
[461] *Id.* p. 6.
[462] *Id.*
[463] *Id.* p. 6-7.
[464] *Id.* p. 7-8.
[465] *Id.* p. 8.
[466] Ex. 16 (Zdellar Rebuttal) pp. 10-13.
[467] *Id.* p. 10. During cross-examination, Mr. Walter candidly conceded that his job as a union representative included responsibilities to encourage union membership. Tr. p. 1761.

criticisms of AmerenUE's management practices with regard to the outside contractor issue should be viewed as self-serving, and should be viewed skeptically by the Commission.[468]

Even the Unions' own testimony regarding the quality of the workers employed by outside contractors does not support the Unions' position in this case. Mr. David Desmond testified that he believed IBEW 2's members who worked for outside contractors were well qualified and well trained to perform the jobs that they are doing at AmerenUE.[469] He also testified that IBEW 2 members, including those members who work for subcontractors, generally work efficiently, perform their jobs well, and have good safety records.[470]

Mr. Donald Giljum also testified that AmerenUE has recently purchased a new training center for training generation personnel.[471] He believes that AmerenUE's purchase of the new training center is a step in the right direction.[472] He also acknowledged that, although it has been difficult over the years to attract enough journeyman linemen even with AmerenUE's signing bonus program, AmerenUE has been successful recently in hiring employees to fill vacancies that have existed for several years.[473]

While the Commission certainly has the regulatory powers to examine and be kept informed of the methods and practices employed by AmerenUE in the transaction of its business, as provided in Section 393.140(5), RSMo 2000, the Missouri Supreme Court has stated that the Commission's authority to regulate does not include the right to dictate the manner in which the company shall conduct its business. *State ex rel. City of St. Joseph v. Public Service Commission*, 325 Mo. 209, 30 S.W.2d 8 (Mo. Banc 1930). *See also State of Missouri ex rel.*

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[468] In 1999, AmerenUE and the union representatives discussed the use of outside contractors during contract negotiations. At that time, there was a change in the labor agreement that permitted the use of outside contractors as long as AmerenUE did not have lay-offs of its internal workforce. Tr. p. 1834.
[469] Tr. pp. 1738-40.
[470] *Id.*
[471] Ex. 903 (Giljum Direct) p. 2; Tr. p. 1776, l. 19-25.
[472] Tr. p. 1777.
[473] Ex. 903 (Giljum Direct) p. 2; Tr. p.1778.

Southwestern Bell Co. v. Public Service Commission, 262 U.S. 276, 43 S.Ct. 544, 67 L.Ed. 981 (1923). As the Missouri Court of Appeals succinctly stated in *State ex rel. Harline v. Public Service Commission of Missouri*, 343 S.W.2d 177, 181-82 (Mo. App. 1960):

> The powers of regulation delegated to the Commission are comprehensive. . . . Those powers do not, however, clothe the Commission with the general power of management incident to ownership. The utility retains the lawful right to manage its own affairs and conduct its business as it may choose, as long as it performs its legal duty, complies with lawful regulation and does no harm to public welfare.

The Commission has repeatedly followed this principle. In a recent complaint case involving Laclede Gas Company and its union, the Commission struck from the Complaint a union request that Laclede be required to utilize "non-managerial" personnel to install Automatic Meter Reading (AMR) devices. In that case, the Commission held that: "Laclede correctly argues that the Commission cannot dictate how Laclede manages its business." As a result, the Commission found that it would strike the request for relief that would require Laclede to use "non-managerial" personnel to install AMR devices.[474] The Commission has also found limited authority to dictate Southwestern Bell's management policies regarding business meal expenses, stating: "It is not the function of the Commission to tell SWB how to run its business; rather its duty is to set just and reasonable rates."[475] In addition, Missouri statutes make it clear that the Commission's authority does not extend to management-labor issues that are the subject of a collective bargaining agreement between the utility and a labor organization.[476]

Applying these principles to the instant case, the Commission should not and indeed lacks the authority to dictate, as the Union Witnesses have requested, that AmerenUE (i) expend a substantial portion of the rate increase on investing in its employee infrastructure; (ii) require

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[474] *USW Local 11-6 v. Laclede Gas Company*, *Order Denying Motion To Dismiss, Granting Motion For More Definite Statement, Granting Motion To Strike, In Part, Setting Procedural Teleconference, And Directing Filing*, Case No. GC-2006-0390, 2006 WL 2357103 (Aug. 10, 2006).

[475] *PSC Staff v. Southwestern Bell Telephone Co.*, Case No. TC-93-224 (1994).

[476] *See* Section 386.315(1), RSMo 2000.

subcontractors to meet specific standards of training and certification similar to those required by Ameren of its internal workforce; or (iii) set in place a requirement that the Company utilize its own employees rather than outside contractors to accomplish the various tasks necessary to provide service to its customers. To AmerenUE's knowledge, the Commission has never attempted to assert jurisdiction over issues such as whether a utility uses its own employees to install utility facilities or perform other services versus hiring outside contractors to do such work. The Commission has refrained from doing so for good reason—namely because such intrusions would strike at the heart of a public utility's recognized right to manage its business. Yet the Union Representatives presume that the Commission may exercise such authority, and solely that incorrect presumption underlies the Unions' testimony in this rate case proceeding. Consistent with decades of regulatory law and practice, the Commission should reject such an approach, and decline to adopt the Union Representatives' recommendations in this case. The Union Representatives' recommendations are largely irrelevant to the issues in this rate case proceeding, and are beyond the statutory authority and jurisdiction of the Commission to implement. In addition, AmerenUE believes that there is no competent and substantial evidence to support their recommendations, or demonstrate that there is an underlying problem with AmerenUE's quality of service or power plant operations. Perhaps more importantly, these recommendations cross over the line into the management of the Company. For these reasons, the Commission should decline to adopt the Union Representatives' recommendations.

B. Training Proposal in Response to the Chairman's Request.

During the hearing, Chairman Davis inquired about whether there were additional measures that could be implemented to improve training activities if additional funds were

included in this rate case for this purpose.[477] In response to the Chairman's inquiry, AmerenUE witness Mark Birk generally testified that he would fully establish the Company's training center and continue the Company's mentoring program.[478] In addition, Mr. Birk subsequently provided the Commission with some specific recommendations of measures that could be taken by AmerenUE to improve the training and recruitment of employees if an additional $3 million was included in the Company's cost of service in this case.[479] These recommendations included the following:

Immediate Power Operations Training Center needs are:

Staffing:

- *Increased staff numbers*-5 fulltime Training Supervisors and 4 skilled craft plant Journeyman Instructor Assistants to facilitate increased daytime class schedule. Cost **$1,050,000.00 annually**.

- *An additional increase of 3 Training Supervisors*- would allow Ameren to offer night classes to those employees and/or potential employees who, because of scheduling problems, cannot attend day classes. This schedule would enhance the opportunities of internal promotions as well as increase the employment opportunities into our skilled workforce. By placing 36 high school students into an intern program, with mentor, during the day, and attending evening classes 1 night per week, a student could work in a plant to experience that work environment prior to major commitments by either party. Cost of **$360,000 annually.**

Equipment/materials:

- *Training Aids and Equipment-for hands-on training*:

  - Purchase of plant specific equipment. **$100,000**.

  - Annual update/upkeep of controls training systems and mock boiler systems. **$500,000**

  - Purchase of advanced training aids (heater mock ups, valve and pump cutaways, generator sync mock-ups, operational examples/displays). **$500,000**

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[477] Tr. pp. 1820-1822.
[478] Tr. p. 1821.
[479] Ex. 78, p. 2.

• *Increased use of training supplies and material (boiler tube, lower slope parts, welding rods, conduit, wire, lathe material, tooling,)* **$300,000**

External costs:

• *Specific Vender Training*- Sending students to specific vender training required for full understanding of specific equipment. **$250,000**.

• *Training Supervisor Certification Program*-Certify the Training Supervisors as classroom and performance training professionals through PG&E. **$150,000**.

Total Expenditures listed $3,210,000

AmerenUE believes it would be helpful and appropriate to adopt Mr. Birk's recommendations if additional funds are provided through rates to implement them. However, if no additional funds are provided for such activities in this rate case, it would not be reasonable for the Commission to direct that these recommendations be adopted since they would represent an unfunded mandate to perform additional training activities and make training-related investments without funds to cover the costs of the programs.

XVI. PURE POWER.

Pure Power[480] is a voluntary program, approved by the Commission in Case No. ER-2007-0002, available to AmerenUE customers who desire to support the development of renewable energy. AmerenUE customers requested that AmerenUE offer a green energy option, so AmerenUE began to look for methods to provide an option to customers in a timely manner. The Company is in the process of developing wind power, but that takes time. Based on discussions with other utilities and industry experts, the Company determined a renewable energy credit (REC) program could be implemented in a faster timeframe while also providing a means to promote renewable energy development. A request for proposals was issued to

[480] AmerenUE's tariff refers to its Pure Power program as the Voluntary Green Program. It is two different names for the same program.

companies who had successfully developed such voluntary REC programs across the country. Ultimately, 3 Degrees was selected. Discussions and contract negotiations took approximately one year and then AmerenUE received permission from the Commission to offer its Pure Power program.[481]

Participants in this program voluntarily pay an additional amount ($15 per MW equivalent) to purchase a REC. A REC reflects the intangible attributes of green electricity rather than the electricity itself.[482] RECs assist in the promotion of renewable energy development. The RECs are purchased from a third party, 3 Degrees, at a price set by contract. This price is locked-in for the entire five year term of the contract with 3 Degrees. 3 Degrees, in turn, has the risk and responsibility to purchase the RECs from certified green power producers. 3 Degrees is responsible for program development, marketing and for ensuring program compliance with Green-e standards as set forth by the Center for Resource Solutions (CSR).[483] Green-e standards are nationally recognized standards for RECs and provide stringent environmental and consumer protection standards.[484] This fact was recognized by Commissioner Gunn when he referred to CSR as providing the REC "gold standard" for the industry.[485]

Despite the fact that AmerenUE has delivered the program as promised in Case No. ER-2007-0002, Staff is asking the Commission to prematurely end the program and to take Pure Power away from the Company's customers. Staff witness Michael Ensrud makes several arguments for ending the program, arguing there is "no proof" RECs promote green power

[481] Ex. 9 (Barbieri Rebuttal) p. 3, l. 16-21.
[482] Ex. 9 (Barbieri Rebuttal) p. 3, l. 8-14.
[483] *Id.*
[484] Ex. 9 (Barbieri Rebuttal) p. 4, l. 21 to p. 5, l. 1.
[485] Tr. p. 740, l. 23-25 to p. 741, l. 1.

production, asserting customers are misled into believing they are actually purchasing green electricity and claiming not enough of the $15 goes to the purchase of the REC.[486]

A. RECs promote production of renewable energy.

Staff witness Michael Ensrud testified that he does not personally believe RECs stimulate the production of additional green energy because he did not find a study that proved that fact to his satisfaction.[487] Mr. Ensrud's testimony seemed to indicate he would require some sort of guarantee that every dollar received in exchange for a REC was reinvested or he wouldn't consider anything to be "proven."[488] While Mr. Ensrud may not be personally convinced, it appears his opinion is in the minority. Mr. Ensrud acknowledges his out of the mainstream position when he stated, "…Staff will concede it is a widely-held belief that REC sales eventually contribute to green generation expansion…"[489] Further, on the stand Mr. Ensrud admitted that the United States Department of Energy (DOE),[490] the National Renewable Energy Laboratory (NREL),[491] and the United States Environmental Protection Agency (EPA)[492] all believe RECs are a viable method of promoting renewable energy. In fact, the EPA has stated, "RECs are increasingly seen as the 'currency' of renewable electricity and green power markets."[493] NREL has found that RECs have assisted in over 1,000 MWs of new renewable projects coming online,[494] leading NREL to conclude that RECs continue "to be a viable strategy for supporting the development of new renewable energy sources."[495]

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[486] Ex. 220 (Ensrud Surrebuttal) p. 3, l. 1-4; p. 7, l. 21 to p. 8, l2; p. 9, l. 18-22.
[487] Tr. p. 669, l. 15-17.
[488] Ex. 220 (Ensrud Surrebuttal) p. 9, l. 21-22; Tr. p. 670, l. 6-13.
[489] Ex. 220 (Ensrud Surrebuttal) p. 10, l. 16-18.
[490] Tr. p. 634, l. 4-10.
[491] Tr. p. 637, l. 3-9.
[492] Tr. p. 637, l. 13-17.
[493] Ex. 9 (Barbieri Rebuttal) Sch. WJB-RE3, *Renewable Energy Certificates*, publication of EPA's Green Power Partnership, July 2008, p. 1.
[494] Ex. 9 (Barbieri Rebuttal) p. 7, l. 9-11.
[495] Ex. 9 (Barbieri Rebuttal) p. 7, l. 12-13, quoting NREL publication *Trends in Utility Green Pricing Programs*, October 2007.

Mr. Ensrud also acknowledged that the Clean Energy Initiative ballot measure (otherwise known as Proposition C), recently passed by Missouri voters, requires Missouri utilities to generate or purchase certain amounts of electricity from renewable energy sources such as solar, wind, biomass and hydropower.[496] One compliance mechanism available to Missouri utilities is to purchase RECs, without the associated electricity, in order to fulfill the proposition's mandate.[497] As the voters approved the measure on November 4, 2008, Missouri will not be the only state using RECs to comply with renewable portfolio standards. Based on information published by the DOE, 28 states currently have renewable portfolio standard requirements and, of those 28, 26 states allow for the use of RECs to meet the mandatory requirement.[498] AmerenUE did not make up the concept of RECs; they are in wide use throughout the United States and many states use RECs as a method of meeting green energy goals. The EPA has said, "Increasingly, federal, state and local governments are also using RECs as a credible means to meet environmental goals for renewable energy generation."[499]

As Commissioner Gunn recognized, the real question about Pure Power shouldn't be whether the Commission believes RECs are a good thing; the REC concept has been accepted across the nation and there is no need to debate that topic. The real question is whether AmerenUE's program is appropriately designed so as to not confuse customers and to ensure an appropriate amount of the customer dollars go towards supporting green power.[500]

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[496] Tr. p. 644, l. 19-22.
[497] Ex. 9 (Barbieri Rebuttal) p. 12, l. 11-22.
[498] *Id.*
[499] Ex. 9 (Barbieri Rebuttal) Schedule WJB-RE3, *Renewable Energy Certificates*, publication of EPA's Green Power Partnership, July 2008, p. 1.
[500] Tr. p. 736, l. 20-23.

B. RECs represent the intangible attributes of green power production but not electricity.

Mr. Ensrud expresses concern that participating customers could be confused by some of the Pure Power literature and mistakenly believe they are purchasing green electricity rather than just the intangible attributes of green energy.[501] AmerenUE shares this concern and has strived in this first year to ensure the information supplied to customers is accurate. The Company recognizes that certain of its literature, mostly the initial literature it used for this program, failed to distinguish between RECs and actual electricity as well as it could have. Refinements continue to be made and the use of most of the initial literature had been discontinued. For example, AmerenUE's Pure Power website has been redesigned and, Mr. Ensrud admitted, improved.[502] Mr. Ensrud still had concerns about customer confusion, but his concerns were related to his belief that RECs don't promote renewable energy rather than the distinction between RECs and electricity.[503] Additionally, there was a welcome letter introduced at the hearing as Exhibit 415. That letter contained language which appeared to say participating customers were buying green electricity. That letter is no longer used and the new letter does not contain that reference.[504] All marketing material undergoes a twice yearly review by CSR and must meet their strict standards for compliance. All materials that have been distributed to customers have been approved by CSR.[505] AmerenUE is continually reviewing statements in its material to minimize any risk of customer confusion and commits to the Commission that it will continue to use the strict standards of CSR in all literature used in its Pure Power program and make sure it is clear that participating customers are purchasing RECs and not green electricity. Furthermore, customers

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[501] Ex. 220 (Ensrud Surrebuttal) p. 5, l. 19-21.
[502] Tr. p. 671, l. 14 to p. 675, l. 15.
[503] Tr. p. 675, l. 16-21.
[504] Tr. p. 712, l. 3.
[505] Tr. p. 729, l. 17-21.

have the option to cancel their participation at anytime as there are no long- term contract participation requirements for any customer who chooses to enroll in the program.

C. <u>The percentage transferred to green power producers is appropriate and will grow over time</u>.

Because of concern at least partially sparked by a discontinued REC program in Florida, Staff alleges that not enough of a customer's payment ends up with the green power producer. AmerenUE agrees to monitor this aspect of the program, but believes it is premature to judge the Pure Power program at this point. Pure Power has been around for approximately one year[506] and the contract AmerenUE has with 3 Degrees is for five years.[507] The Company believes the appropriate time to review this issue is at or towards the end of the five year contract.

AmerenUE does not desire nor does it believe it is promoting a program that is similar to the cancelled Florida Power and Light program. Even Mr. Ensrud acknowledged that there are many differences between the two programs. The Florida program was not Green-e certified[508] and it was not administered by 3 Degrees.[509] The most important distinction is when the evaluation was done during the course of the life of the program. The Florida program had been in existence for almost five years.[510] Certainly, a program still in its initial year and still in the start-up phase of its business is likely to have more administrative costs than a program that is well established.

Attached to Mr. Barbieri's surrebuttal is a breakdown of the money paid to 3 Degrees and how that money was used by 3 Degrees – procurement of RECs, education or administrative expense. AmerenUE believes the results are in line with what would be expected for a program in its first year of existence, especially for a program that is designed to contain a high degree of

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[506] Tr. p. 662, l. 12-17.
[507] Tr. p. 694, l. 1-5.
[508] Tr. p. 657, l. 24 to p. 658, l. 8.
[509] Tr. p. 658, l. 9-13.
[510] Tr. p. 658, l. 14-20.

emphasis on education.[511] The Commission will note that 3 Degrees did not make a profit on AmerenUE's Pure Power program during the first year.[512] In fact, 3 Degrees projects that it will operate at a loss after the second year as well.[513] A key reason for this loss is the amount of education 3 Degrees is providing to AmerenUE customers about the Pure Power program and renewable energy in general.[514] Mr. Ensrud agreed multiple times on the witness stand that education of customers about RECs is an important part of the Pure Power program.[515]

Mr. Ensrud also asserts AmerenUE is overpaying 3 Degrees for the services provided.[516] This statement is only an assertion; Mr. Ensrud offers absolutely no evidence supporting his claim other than to compare the $14 to some wholesale REC price.[517] Upon cross examination, Mr. Ensrud admitted that he'd made no attempt to quantify the benefit of having 3 Degrees bear certain risks. He didn't attempt to determine what the price of RECs might become over the course of the five year contract with 3 Degrees, although he did agree that the price of RECs would likely go up, especially with the passage of Proposition C in Missouri.[518] Mr. Ensrud also failed to make any attempt to determine what the other risks should be valued, including the costs of having to buy back RECs which have expired,[519] the costs associated with the Green-e audit,[520] or any other cost associated with this program. Mr. Barbieri testified that there are many cost risks which AmerenUE shifted to 3 Degrees under its contract, including the risk of

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[511] Tr. p. 750, l. 13-23.
[512] Ex. 9 (Barbieri rebuttal) p. 11, l. 10-11.
[513] *Id.*
[514] Ex. 9 (Barbieri rebuttal) p. 11, l. 11-12.
[515] Tr. p. 659, l. 20 to p. 660, l. 16 and p. 662, l. 24 to p. 663, l. 6.
[516] Tr. p. 693, l. 6-18 and Ex. 220 (Ensrud Surrebuttal) p. 13, l. 4-6.
[517] *Id.*
[518] Tr. p. 693, l. 2-25.
[519] Tr. p. 691, l. 12 to p. 692, l. 6.
[520] Tr. p. 692, l. 10-20.

changes in administrative costs[521] and the cost of educating AmerenUE customers about the program and how it works.[522]

AmerenUE negotiated a good contract with 3 Degrees, one that provides cost protection and stability for its customers, especially given its belief that the cost of RECs may increase substantially in the future. Recently, AmerenUE's Illinois affiliates paid $29 for RECs and ComEd paid $35.[523] A similar REC program offered by Duke Energy costs its customers $25 compared to AmerenUE's $15.[524] Overall, the cost of AmerenUE's Pure Power program is in line with costs of other programs; Pure Power costs more than some programs and less than others but overall charges its customers one of the lowest rates in the country compared to similar programs.[525]

3 Degrees has agreed to provide to the Commission an annual report of its expenditures broken out between amounts paid for RECs, administration and education costs, similar to the report attached to Mr. Barbieri's rebuttal testimony.[526] This report would be filed as confidential with the Commission because of the competitive implications of the information.[527] That way, the Commission is not forced into making a premature decision to terminate this program but will remain informed of these numbers as the contract term progresses.

D. Nonparticipating customers do not pay any of the costs of this program.

The final recommendation made by Mr. Ensrud was to transfer $25,895 of costs below the line to offset administrative costs incurred by AmerenUE for the Pure Power program.[528] While AmerenUE recognizes that Mr. Ensrud is attempting to protect the nonparticipating

[521] Ex. 9 (Barbieri rebuttal) p. 4, l. 13-14.
[522] Ex. 9 (Barbieri rebuttal) p. 11, l. 15-16.
[523] Tr. p. 748, l. 6-19.
[524] Tr. p. 686, l. 10 to p. 688, l. 18.
[525] Tr. p. 689, l. 8-10.
[526] Tr. p. 704, l. 5-11.
[527] *Id.*
[528] Ex. 220 (Ensrud surrebuttal) p. 18, l. 21 to p. 19, l. 2.

customer from shouldering any costs of the Pure Power program, the Company has already taken steps to ensure that costs of this program are not placed upon any customer other than those who voluntarily chose to participate. Mr. Barbieri assured the Commission that the Company has placed both the costs and the revenues associated with Pure Power below the line.[529] The time Mr. Barbieri spends on Pure Power is not charged to AmerenUE's regulated operations.[530] The initial contract cost of $375,000 was not charged to AmerenUE's regulated operations.[531] Mr. Ensrud discusses "implicit costs" that remain above the line, without being able to specify what those costs might be.[532] Upon questioning, Mr. Ensrud admits the incremental cost to print a line on an AmerenUE customer's bill is not substantial and that it wouldn't cause a need for additional postage on the bill.[533] AmerenUE believes that the recommendation to transfer any amount below the line, even in a well intentioned attempt to protect nonparticipating customers from footing the cost of ink for a single line on the bill, is nonsensical and should be rejected by this Commission.

AmerenUE believes that Pure Power offers a very important option to some of its customers. The program isn't for everyone, but the Company already has over 4,000 voluntary participants with more deciding to participate all of the time. The Company acknowledges the need to be diligent in its efforts to ensure the marketing materials are very clear about the difference between RECs and actual green electricity. AmerenUE has learned as it has gone through the first year of this program and that is one of the lessons learned. It also recognizes the Commission's interest in ensuring the program is fair to its customers and will work with 3 Degrees to provide an annual accounting to the Commission so that it remains informed of the

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[529] Ex. 9 (Barbieri rebuttal) p. 9, l. 15-16.
[530] Ex. 9 (Barbieri rebuttal) p. 9, l. 16-17.
[531] Ex. 9 (Barbieri rebuttal) p. 9, l. 17-18.
[532] Tr. p. 696, l. 4-10.
[533] Tr. p. 697, l. 15 to p. 698, l. 19.

amounts 3 Degrees is spending on RECs, administrative costs and educational efforts. AmerenUE has worked diligently in the first year of this program to ensure it meets the needs and expectations of the customers who were an instrumental reason as to why the Company undertook such a program. AmerenUE is further convinced that the Pure Power program stands out in the industry due to receiving the 2008 New Green Program of the Year Award from the U.S. Department of Energy in conjunction with the U.S. Environmental Protection Agency.[534]

AmerenUE believes it is providing an important option for our customers who desire to support renewable energy development. Mr. Ensrud's unsupported concerns do not justify the termination of this voluntary program.

XVII. RATE DESIGN AND CLASS COST OF SERVICE ISSUES.

A. AmerenUE's Position On Rate Design and Class Cost of Service Issues.

AmerenUE's position regarding the appropriate design of its rates is contained in detail in the pre-filed direct and rebuttal testimonies of AmerenUE witnesses Wilbon L. Cooper,[535] William M. Warwick[536] and James R. Pozzo.[537] The Company is proposing that the rate increase granted by the Commission in this case be spread evenly across all rate classes. The Company's proposal is similar to the rate design which was agreed upon by all parties in Case No. ER-2007-0002.

Other issues in the rate design area are the appropriate method to allocate fixed production assets. The Company's net investment in fixed production assets represents approximately 68% of net original cost rate base in this case. AmerenUE uses the 4 NCP Average

[534] Ex. 9 (Barbieri rebuttal) p. 11, l. 1-5.
[535] Ex. 39 and Ex. 40 (Cooper Direct and Rebuttal).
[536] Ex. 36 and Ex. 38 (Warwick Direct and Amended Rebuttal).
[537] Ex. 54 and Ex. 55 (Pozzo Direct and Supplemental Direct).

and Excess method for allocating these assets, which gives proper weighting to both class peak demands and to class energy consumption (average demands).[538]

B. Non-Unanimous Stipulation And Agreement.

On December 3, 2008, prior to commencement of the hearings on the rate design and class cost of service issues, the OPC, the MIEC, the MEG, the Commercial Group, and Noranda Aluminum, Inc. ("Signatory Parties), filed a Non-Unanimous Stipulation and Agreement in order to settle the class cost of service allocation and rate design issues in this rate case among the Signatory Parties.[539]

At the hearings, AmerenUE's counsel announced that the Company had not been involved in the negotiations of the Non-Unanimous Stipulation and Agreement. As a result, the Company indicated that it would not be a signatory party to the settlement. However, it would not oppose the adoption of the provisions of the Non-Unanimous Stipulation and Agreement recommended by the Signatory Parties.[540]

The Commission Staff opposed the adoption of the terms of the Non-Unanimous Stipulation and Agreement.[541] The Company continues to believe that its original across-the-board percentage increase recommendation is an appropriate resolution of the rate design and class cost of service issues in this case. However, since it is not opposed to the adoption of the Non-Unanimous Stipulation and Agreement, the Company will not further argue its position on these issues.

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[538] Ex. 40, pp. 2-9 (Cooper Rebuttal)
[539] *Stipulation And Agreement* (filed December 3, 2008).
[540] Tr. p. 1887, l. 15-21.
[541] Tr. p. 1886, l. 15 to p. 1887, l. 14.

XVIII. FERC 7-FACTOR TEST.

This is not a contested issue,[542] but is a regulatory determination requested by the Company about which the Company needs a ruling in this case. As outlined by Mr. Pfeiffer, the Agreement of Transmission Facilities Owners to Organize the Midwest Independent Transmission System Operator, Inc. (the TO Agreement) requires AmerenUE to request a determination from this Commission confirming that the Company has applied the so-called FERC 7-Factor Test to the Company's energy delivery facilities.

As noted, no party contests the request for this determination, but the Staff did provide the following pertinent testimony on this issue:

> The list provided by Mr. Pfeiffer in the current case appears to be reasonable but I have not reviewed the list and the application of the FERC 7-factor test on a line-by-line basis. **Q. If the Commission were to approve the determination requested by AmerenUE, in what context should this determination be viewed?** A. The Staff is not seeking to make a contested issue of AmerenUE's request regarding application of the FERC 7-factor test, but should the Commission accept AmerenUE's request, it should do so in the context of 4 CSR 240-20.030(4), the Commission's jurisdiction regarding transmission and Midwest ISO participation, and AmerenUE's commitment to seek approval of any fundamental change in its membership, participation, or membership status in the Midwest ISO. First, the Staff notes the following language in 4 CSR 240-20.030(4) Uniform System of Accounts – Electrical Corporations, regarding the Commission's adoption of the Uniform System of Accounts for Electrical Corporations for recordkeeping purposes: In prescribing this system of accounts, the commission does not commit itself to the approval or acceptance of any item set out in any account for the purpose of fixing rates or in determining other matters before the commission. Second, the Staff notes that the PSC maintains that it has jurisdiction over the transmission component of the rates set for Bundled Retail Load and the right to rescind its approval of AmerenUE's participation in the Midwest ISO and to require AmerenUE to withdraw from participation in the Midwest ISO on certain bases. Third, AmerenUE has agreed that if it decided to seek any fundamental change in its membership, participation, or membership status in the Midwest ISO, it would seek prior approval from the PSC.[543]

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[542] The Company raised this issue in the direct testimony of Edward C. Pfeiffer (Ex. 53). Only the Staff filed testimony on this issue (rebuttal testimony of Daniel Beck (Ex. 217, pp. 1-4).
[543] Ex. 217 (Mr. Beck) p. 3, l. 12 to p. 4, l. 16.

In summary, it appears the Staff is recommending that the Commission not make any ratemaking determinations in connection with its determination that the Company has applied the 7-Factor Test to its energy delivery facilities, and that the Commission not modify the terms of the Company's Midwest ISO participation, as reflected in the Stipulation and Agreement under which the Company is currently participating in the Midwest ISO. The Company has not asked for any ratemaking treatment in connection with the FERC 7-Factor Test determination it seeks, and has not asked to modify the terms of its Midwest ISO participation.

In summary, the Company simply requests that the Commission determine that the Company has applied the 7-Factor Test to the Company's energy delivery facilities.

Dated: January 8, 2008

Respectfully submitted:

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CERTIFICATE OF SERVICE

I hereby certify that the foregoing Post-Hearing Brief of Union Electric Company d/b/a AmerenUE was served via e-mail, to the following parties on the 8th day of January, 2009.

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APPENDIX A

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IN ITS ENTIRETY