Exhibit No.:	
Issues:	Report on Revenue Requirement Cost of Service, Overview of Staff's Filing
Witness:	Stephen M. Rackers
Sponsoring Party:	MoPSC Staff
Type of Exhibit:	Direct Testimony
Case No.:	GR-2010-0363
Date Testimony Prepared:	November 8, 2010

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

STEPHEN M. RACKERS

UNION ELECTRIC COMPANY d/b/a AMERENUE

CASE NO. GR-2010-0363

Jefferson City, Missouri
November 8, 2010

TABLE OF CONTENTS OF

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Q. Please state your name and business address.

A. Stephen M. Rackers, 111 North 7th Street, Suite 105, St. Louis, MO 63101.

Q. By whom are you employed and in what capacity?

A. I am employed by the Missouri Public Service Commission ("the Commission") as a Regulatory Auditor V.

Q. Please describe your educational background and work experience.

A. I attended the University of Missouri in Columbia, Missouri, and received a Bachelor of Science degree in Business Administration, with a major in Accounting, in 1978. I have been employed in the Commission's Auditing Department since June 1, 1978.

Q. Are you a Certified Public Accountant ("CPA")?

A. Yes, I am. I passed the Uniform Certified Public Accountant examination and I am licensed in the State of Missouri as a CPA.

Q. Have you previously filed testimony before this Commission?

A. Yes, I have. Please refer to Schedule SMR-1, which is attached to this Direct Testimony, for a list of cases in which I have previously filed testimony as well as the issues that I have addressed in testimony.

Q. What knowledge, skills, experience, education and training do you have in the areas of which you are testifying as an expert witness?

A. I have been employed by this Commission as a Utility Regulatory Auditor for over 30 years, and have submitted testimony on revenue, expense, and rate base ratemaking matters numerous times before the Commission. I have also been responsible for the supervision of other Commission employees in rate cases and other regulatory proceedings many times. I also participate in proceedings that involve the enforcement, interpretation and writing of the Commission's rules. I have received continuous training at in-house and outside seminars on technical ratemaking matters since I began my employment at the Commission. My responsibilities auditing the books and records of the utilities regulated by the Commission require that I review statutes applicable to the Commission or the utilities regulated by the Commission, the Commission's rules, utility tariffs, contracts and other documents relating to the utilities' operations.

Q. Have you participated in the Commission Staff's ("Staff") audit of Union Electric Company d/b/a AmerenUE[1] ("AmerenUE" or "the Company") concerning its request for a rate increase for its Missouri jurisdictional gas operations in this proceeding?

A. Yes, I have, with the assistance of the other members of the Staff. I am the Utility Services Division ("Division") "co-case coordinator", facilitating the work of the Division's Staff members, and in this role I confer with Staff from other Commission Divisions involved in Staff's direct case.

EXECUTIVE SUMMARY

Q. Please summarize your Direct Testimony in this proceeding.

[1] In a letter dated September 10, 2010, Union Electric Company notified the Commission that it had adopted the trade name "Ameren Missouri" and intended to use such name in communications with the Commission, customers, and stakeholders regarding its Missouri jurisdictional operations commencing October 1, 2010. For the sake of consistency and historical accuracy in reference to the test year employed in this case Staff has selected to refer to Union Electric's Missouri jurisdictional operations as "AmerenUE" and does not do so in an attempt to distinguish that entity from "Ameren Missouri".

A. I am sponsoring the Staff's Revenue Requirement Cost of Service Report ("Report") that is being filed concurrently with this Direct Testimony. I also provide in this Direct Testimony an overview of Staff's revenue requirement determination, which is reflected in the Staff's Accounting Schedules. Staff has conducted an audit of all the components (capital structure, return on equity, rate base, operating revenues and operating expenses) that determine the revenue requirement for the gas operations of AmerenUE. As a result of its audit, as shown on Accounting Schedule 1, Staff's recommended revenue requirement for AmerenUE in this proceeding ranges from approximately $6.0 million to $7.9 million and is based on a return on equity range of 8.10% to 9.10%.

<u>REVENUE REQUIREMENT COST OF SERVICE REPORT</u>

Q. How is the Staff's Report organized?

A. The Staff's Report has been organized by topic as follows:

I. Executive Summary

II. Background

III. Test Year and True-Up Recommendation

IV. Major Issues

V. Rate of Return

VI. Development of Accounting Schedules and Adjustments

VII. Depreciation Rates

The Development of Accounting Schedule and Adjustments section has several subsections that explain each specific Accounting Schedule and any adjustments made by Staff to the twelve month test year ending December 31, 2009. The respective Staff member responsible for writing each specific section of the Report is identified and that person is the

Staff's expert/witness for that particular section of the Staff's Report. The affidavit of each Staff member who contributed to the Report is included in an appendix to the Report.

Staff may have different and/or additional experts/witnesses when it files rebuttal and/or surrebuttal testimony in this rate proceeding.

OVERVIEW OF STAFF'S RECOMMENDED REVENUE REQUIREMENT

Q. In its investigation and audit of AmerenUE in Case No. GR-2010-0363, has Staff examined all of the cost of service components comprising the revenue requirement?

A. Yes. The revenue requirement for a regulated investor owned public utility can be defined by the following formula:

Revenue Requirement = Cost of Providing Utility Service (i.e. Cost of Service)

Or

RR = O + (V-D)R; where,

RR	=	Revenue Requirement
O	=	Operating Costs (Payroll, Maintenance, etc.) Depreciation and Taxes
V	=	Gross Valuation of Property Required for Providing Service (including plant and additions or subtractions of other rate base items)
D	=	Accumulated Depreciation Representing Recovery of Gross Depreciable Plant Investment.
V-D	=	Rate Base (Gross Property Investment less Accumulated Depreciation = Net Property Investment)
R	=	Rate of Return Percentage
(V-D)R	=	Return Allowed on Rate Base (Net Property Investment)

The revenue requirement calculated by this formula represents the utility's *total* revenue requirement. For ratemaking purposes, revenue requirement generally refers to the increase or decrease in revenue a utility needs as measured by the difference between revenues produced by the utility's existing rates and the Company's total cost of service.

Q. What is the objective of a ratemaking audit of a regulated investor-owned public utility?

A. The objective of an audit is to determine the appropriate level of the ratemaking components identified above in order to calculate the revenue requirement for a regulated utility. All relevant factors are examined and a proper relationship of revenues, expenses and rate base is determined and subsequently recommended. The process for making that revenue requirement determination can be summarized as follows:

1) <u>Selection of a test year.</u> The test year income statement represents the starting point for determining a utility's existing annual revenues, operating costs and net operating income. Net operating income represents the return on investment based upon existing rates. The test year approved by the Commission for this case is the twelve months ending December 31, 2009. "Annualization" and "Normalization" adjustments are made to the test year levels when the unadjusted results do not fairly represent the utility's most current and ongoing annual level of revenues and operating costs. Annualization and normalization adjustments are explained in more detail later in this Direct Testimony.

2) <u>Selection of a "test year update period".</u> A proper determination of revenue requirement is dependent upon matching the components of rate base, return on investment, revenues and operating costs at the same point in time. This ratemaking principle is commonly referred to as the "matching" principle. It is a standard practice in ratemaking in

Missouri to utilize a period beyond the established test year for a case in which to match the major components of a utility's revenue requirement. It is necessary to update test year financial results to reflect information beyond the established test year in order to set rates based upon the most current information that can be subjected to a complete and reliable audit. In this case the parties have agreed to perform a true-up through September 30, 2010 and are not performing an update of the test year.

3) Selection of a "true-up date" or "true-up period". A true-up date generally is established when a significant change in a utility's cost of service occurs after the end of the update period. The type of cost included is one the parties and/or the Commission have decided should be considered for cost of service recognition in the current case. In this proceeding, the parties have agreed to perform a true-up to consider additional information through September 30, 2010.

4) Determination of rate of return. A cost of capital analysis is performed to determine a fair rate of return on investment to be allowed on AmerenUE's net investment (rate base) used in the provision of utility service. Staff witness Zephania Marevangepo, of the Staff's Financial Analysis Department, has performed a cost of capital analysis for this case and is sponsoring a section of the Staff's Report to explain and provide the results of his analysis.

5) Determination of rate base. Rate Base represents the utility's net investment used in providing utility service. In developing the majority of the items used to determine the rate base for its case, Staff has relied on September 30, 2010 data, or the most current information available. Staff will true-up the rate base to consider September 30, 2010 information for all items when the data becomes available.

6) Determination of net operating income from existing rates. The starting point for determining net income from existing rates is the unadjusted operating revenues, expenses, depreciation, and taxes for the test year which is the twelve-month period ending December 31, 2009, for this case. All of the utility's specific revenue and expense categories are examined to determine whether the unadjusted test year results require adjustments in order to fairly represent the utility's most current level of operating revenues and expenses. Numerous changes occur during the course of any year that will impact a utility's annual level of operating revenues and expenses. The December 31, 2009 test year has been adjusted to reflect Staff's determination of the appropriate ongoing levels of revenues and expenses based on the latest information available. Staff will perform a true-up audit to consider September 30, 2010 information for all items when the data becomes available.

7) Determination of net operating income required. The net income required for AmerenUE is calculated by multiplying Staff's rate base by the recommended rate of return. Net income required is then compared to net income available from existing rates as discussed in item 6 above. The difference, when factored up for income taxes, represents the incremental change in the Company's rate revenues required to cover its operating costs and provide a fair return on investment used in providing gas service.

If a utility's current rates are insufficient to cover its operating costs and a fair return on investment, the comparison of net operating income required (rate base times recommended rate of return) to net income available from existing rates (operating revenue less operating expense, depreciation expense and income taxes) will result in a positive amount, which would indicate the utility requires a rate increase. If the comparison results in a negative amount, this indicates that the utility's current rates may be excessive.

Q. Please identify the types of adjustments made to unadjusted test year results in order to reflect a utility's current annual level of operating revenues and expenses.

A. The types of adjustments made are as follows:

1) Normalization adjustments. Utility rates are intended to reflect normal ongoing operations. A normalization adjustment is required when the test year reflects the impact of an abnormal event. One example of this type of adjustment that is made in all gas rate cases is Staff's revenue adjustments to normalize weather. Actual weather/climate conditions during the test year are compared to "normal" temperature values. The weather normalization adjustment restates the test year sales volumes and revenue levels to reflect normal weather conditions.

2) Annualization adjustments. Annualization adjustments are required when changes have occurred during the test year, update and/or true-up period, which are not fully reflected in the unadjusted test year results. For example, a portion of AmerenUE's employees received a wage increase during the test year. As a result, only a portion of the twelve months ending December 31, 2009 reflects the impact of this wage increase. An annualization adjustment was made to capture the full financial impact of the payroll increase for the portion of the test year prior to the time of the wage increase.

3) Disallowance adjustments. Disallowance adjustments are made to eliminate costs in the test year results that are not considered appropriate for recovery from ratepayers. An example of this is long-term incentive compensation costs. In Staff's view, these costs are incurred to primarily benefit shareholder interests, and it is not appropriate to pass these costs along to customers in rates. Therefore, these costs should be eliminated

from the cost of service borne by ratepayers, and Staff has proposed to disallow these costs from recovery in rates.

4) Proforma adjustments. Proforma adjustments reflect the impact of items and events that occur subsequent to the test year. These items or events significantly impact the revenue, expense and rate base relationship and should be recognized to address the forward-looking objective of the test year. Caution must be taken when recognizing proforma adjustments to ensure that all items and events subsequent to the test year are examined to avoid not recognizing offsetting adjustments. In addition, some post-test year items and events may not have occurred yet and/or may not have been sufficiently measured. As a result, quantification of some proforma adjustments may be more difficult than for others. A true-up audit that considers a full range of items and events that occur subsequent to the test year attempts to maintain the proper relationship among revenues, expenses and investment and should also address the difficulty in quantification associated with making proforma adjustments.

Q. What rate increase amount did the Company request from the Commission in this case?

A. The Company requested that its annual revenues be increased by approximately $11.9 million based on a return on equity ("ROE") of 10.5%. Staff notes that effective July 1, 2010, the Company began recovering approximately $3.4 million in annual revenues through its current Infrastructure System Replacement Surcharge ("ISRS") as approved by this Commission. As discussed in greater detail later in this testimony, AmerenUE included ISRS revenues in its determination of revenue requirement, while Staff did not. Including ISRS revenues has the effect of understating the amount of revenue requirement.

Q. What is Staff's recommended revenue requirement for AmerenUE for this case?

A. The results of Staff's audit of AmerenUE's rate increase request can be found in the Staff's Accounting Schedules and are summarized on Accounting Schedule 1, Revenue Requirement. This Accounting Schedule shows that Staff's recommended revenue requirement for AmerenUE in this proceeding ranges from approximately $6.0 million to $7.9 million.

Q. What is the weighted cost of capital the Staff recommending in this case?

A. Staff is recommending an ROE range of 8.10% to 9.10% with a midpoint of 8.60%, as calculated by Staff witness Marevangepo. Staff's recommended capital structure for AmerenUE is 51.26% common stock equity, 47.26% long-term debt and 1.48% preferred stock. Based upon this capital structure Staff's resulting cost of capital to apply to rate base is in the range of 7.039% to 7.551% with a midpoint value of 7.295%. Staff's recommended weighted cost of capital is explained in more detail in Section V of the Report.

Q. What items are included in the Staff's recommended rate base in this case?

A. The largest components of rate base, plant and depreciation reserve reflect the actual September 30, 2010 balances. The accumulated deferred income taxes reflect the estimated balance at September 30, 2010. Several items were also based on 13-month averages ending either December 31, 2009 or September 30, 2010. When the actual September 30, 2010 amounts become available, Staff will consider this data in its true-up of all the components of rate base. The items included in rate base are:

- Net Plant in Service
- Accumulated Deferred Income Tax
- Customer Advances for Construction
- Customer Deposits
- Rate Base Offsets
- Gas Stored Underground
- Pension and OPEB Tracker Balances
- Prepayments
- Propane Inventory
- Cash Work Capital Requirement
- Materials and Supplies

Q. What are the significant income statement adjustments the Staff made in determining AmerenUE's revenue requirement for this case?

A. The following discussion is a summary of the Staff's significant income statement adjustments:

Operating Revenues

Retail Revenues were adjusted for the elimination of ISRS surcharges, gas cost, gross receipts taxes, rate refunds and unbilled revenues to reflect test year revenues at base rates. Staff then adjusted retail base revenues for changes in customer levels, load changes, rate switching and weather normalization.

Depreciation

Depreciation expense was annualized based upon the plant in service as adjusted for changes through the September 30, 2010 true-up cut-off date and the depreciation rates recommended by Staff witness David Williams.

Payroll, Payroll Taxes and Employee Benefits

Payroll expense was annualized on the basis of the current wage levels as of December 31, 2009 and any wage increases that became effective by September 30, 2010. Payroll taxes were annualized consistent with Staff's annualization of payroll. Adjustments to employee benefits, including pensions and other post-retirement benefits, reflect the most current information available as of Staff's filing. Staff has also disallowed the portion of incentive compensation programs based on earnings.

Other Non-Labor Expenses

The Staff has also adjusted expense for the following items:

- Normalization of bad debt expense ("uncollectibles");
- Normalization of injuries and damages expense;
- Disallowance of dues and donations;
- Inclusion of an appropriate level of rate case expense;
- Disallowance of miscellaneous expenses;
- Annualization of insurance expense;
- Inclusion of energy efficiency and weatherization costs;
- Capitalization of credit facility fees;
- Inclusion of rate case expense; and
- Annualization of property taxes

Q. What reliance did you place on the work or conclusions of other Staff members involved in the case?

A. I relied on the work from numerous other Staff members in calculating a revenue requirement for AmerenUE in this case. Weather normalized sales and the recommended ROE are just two examples of data and analysis supplied to the

Auditing Department as inputs into Staff's revenue requirement cost of service calculation. Affidavits and the qualifications for all Staff members who are responsible for sections of the Report are attached as an appendix to the Report. Further, the individual who is responsible for a section of Staff's Report is identified at the conclusion of the section he or she authored as Staff expert/witness responsible for that section.

Q. What are the biggest differences between the rate increase request filed by the Company and the Staff revenue requirement recommendations being filed in this proceeding?

A. There are five primary revenue requirement differences between Staff and the Company. As indicated below, there is a significant difference related to the level of net plant (plant less depreciation reserve). However, part of the difference is due to the fact that the Company's original estimates of the change in net plant are different than the actual change experienced. In addition, AmerenUE originally filed its case based on a true-up through November 30, 2010, but the parties to the case subsequently agreed to a true-up through September 30, 2010.

Also, the Company has annualized the ISRS rates that were in effect during the test year ending December 31, 2009 and included this amount in the calculation of revenue requirement. This presentation has the effect of showing how much of an increase AmerenUE is recommending above the total rates, both permanent and interim ISRS, that were being charged to ratepayers during the test year. However, the increase in permanent/base rates will be larger than depicted by the Company, since the interim ISRS rates will be reset to zero and the associated revenue requirement will be collected through permanent/base rates. Staff's presentation of revenue requirement eliminates the interim

ISRS revenues, thus showing the entire increase in permanent/base rates as its calculation of the revenue requirement in this case. Therefore, the actual difference between Staff's and AmerenUE's revenue requirements is approximately $1.9 million greater than the difference indicated by comparing the Company's $11.9 million rate increase request to Staff's revenue requirement shown on Accounting Schedule 1. The five primary revenue requirement differences between Staff and the Company as indicated as follows:

- Return on Equity;
- Net Plant;
- Cash Working Capital;
- Revenues; and
- Rate Case Expense

Q. Is it possible that significant differences exist between Staff's revenue requirement positions and those of the other parties besides AmerenUE in this proceeding?

A. Yes. However, the other parties to the case are filing their direct testimony concurrent in timing with Staff's direct filing. Until Staff has an opportunity to examine the direct testimony filed by the other parties, it is impossible to determine what differences exist and how material they may be at this time.

Q. Please identify the Staff experts/witnesses responsible for addressing each area where there is a known and significant difference between Staff and the Company that is addressed in this direct testimony or in the Staff Report in Section IV, Major Issues.

A. The following is a list of areas and the corresponding Staff experts/witnesses who are sponsoring the issues.

Issue	Staff Witness
Return on Equity	Zephania Marevangepo
Net Plant	Lisa Ferguson
Cash Working Capital	Lisa Ferguson
Revenues	Kofi Boateng
Rate Case Expense	Lisa Ferguson

Q. When will Staff be filing its customer class cost of service/rate design direct testimony and report in this proceeding?

A. Staff’s direct testimony regarding rate design and Staff’s customer class cost of service/rate design report will be filed on November 19, 2010.

Q. Does this conclude your Direct Testimony?

A. Yes, it does.