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-2010-0036

POST-HEARING BRIEF OF AMERENUE

Steven R. Sullivan, # 33102
Sr. Vice President, General Counsel and Secretary
Thomas M. Byrne, # 33340
Managing Assoc. General Counsel
Wendy K. Tatro, #60261
Assoc. General Counsel
Ameren Services Company
P.O. Box 66149
St. Louis, MO 63166-6149
Phone (314) 554-2514
(314) 554-3484
Facsimile (314) 554-4014
AmerenUEService@ameren.com

James B. Lowery, #40503
SMITH LEWIS, LLP
Suite 200, City Centre Building
111 South Ninth Street
P.O. Box 918
Columbia, MO 65205-0918
Phone (573) 443-3141
Facsimile (573) 442-6686
lowery@smithlewis.com

James M. Fischer, #27543
FISCHER & DORITY, P.C.
101 Madison Street, Suite 400
Jefferson City, MO 65101
Phone (573) 636-6758
Facsimile (573) 636-0383
jfischerpc@aol.com

Attorneys for Union Electric Company d/b/a AmerenUE

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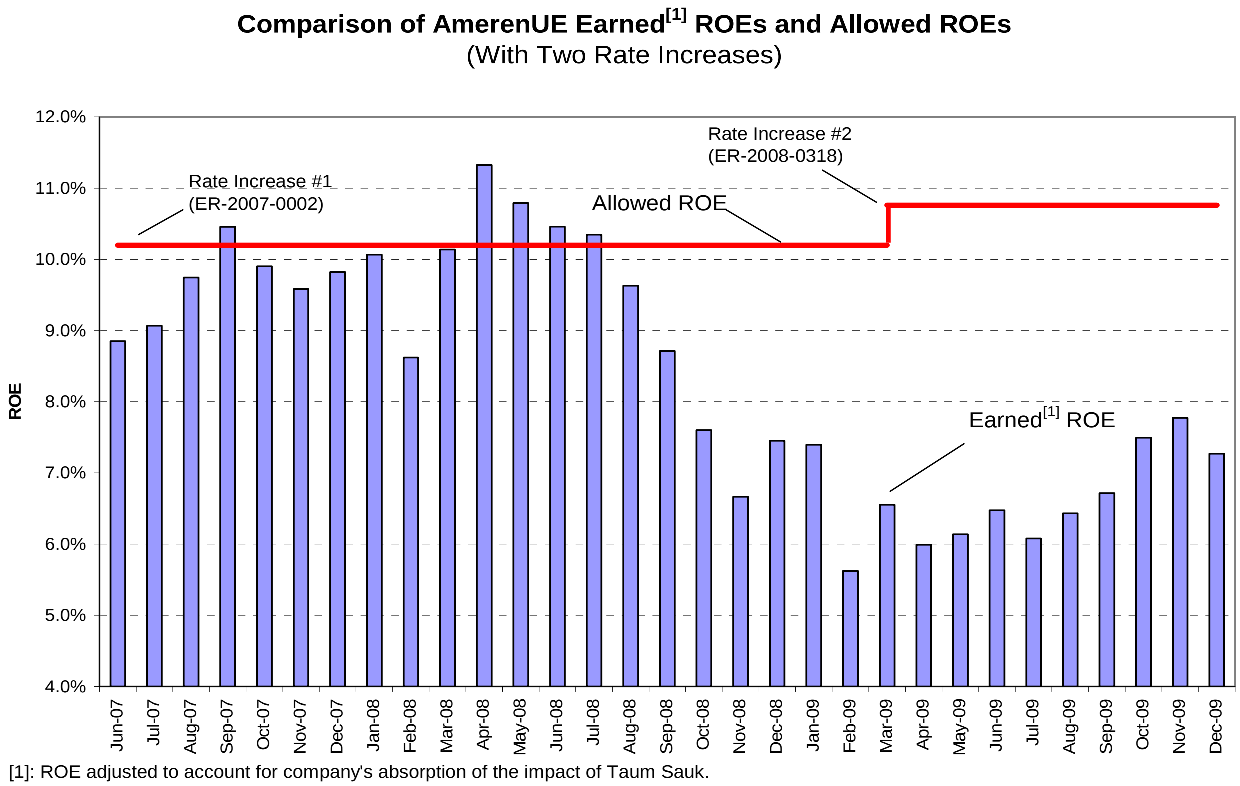
INTRODUCTION

AmerenUE is seeking a $287 million per year rate increase in its revenue requirement in this case. Of this amount, $118 million (or approximately 41% of the proposed increase) reflects a re-basing of increased net fuel costs, and the remaining $169 million (or approximately 59% of the proposed increase) reflects the increase in revenue requirement caused by the incremental investment in rate base and increased operational expenses AmerenUE has incurred and continues to incur in order to provide its customers safe and reliable electric service. Even with this proposed increase, AmerenUE's rates will still be materially lower than the rates of the other investor-owned utilities in Missouri, and will be more than 30% below the national average retail electric rates across the U.S. Moreover, the St. Louis Metropolitan Area will continue to have among the lowest electric rates of any major metropolitan area in the country.

AmerenUE had to file this rate increase request—its third in the last three years—simply because its rates have been persistently insufficient to permit it to recover its prudently-incurred cost of service and permit its shareholders to have a reasonable opportunity to earn anywhere close to the rate of return on their equity investment that this Commission has authorized. Throughout this proceeding, AmerenUE has presented various versions of the chart below, which tells a compelling story. It shows that the rolling 12-month average of returns actually earned by AmerenUE, beginning with the 12-month period ending in August, 2008 and ending with the last period for which data was available, the 12-month period ending December, 2009, was in all cases below, and in most cases far below, the return on equity authorized by this Commission. In other words, because rates set during that entire period (September, 2007 through December, 2009) were insufficient for the Company to recover its cost of service, it was unable to earn its authorized return during any of those 12 month periods.



The chart shows that since the 12 month period ending in October, 2008, the Company's earnings have been reduced by between 200 and 400 basis points for each rolling 12-month period, with each 100 basis points representing an earnings deficiency of approximately $46 million over the 12 months. In short, because the Company's rates have not been set at a level sufficient to cover its costs, its earnings have been substantially deficient for several years.

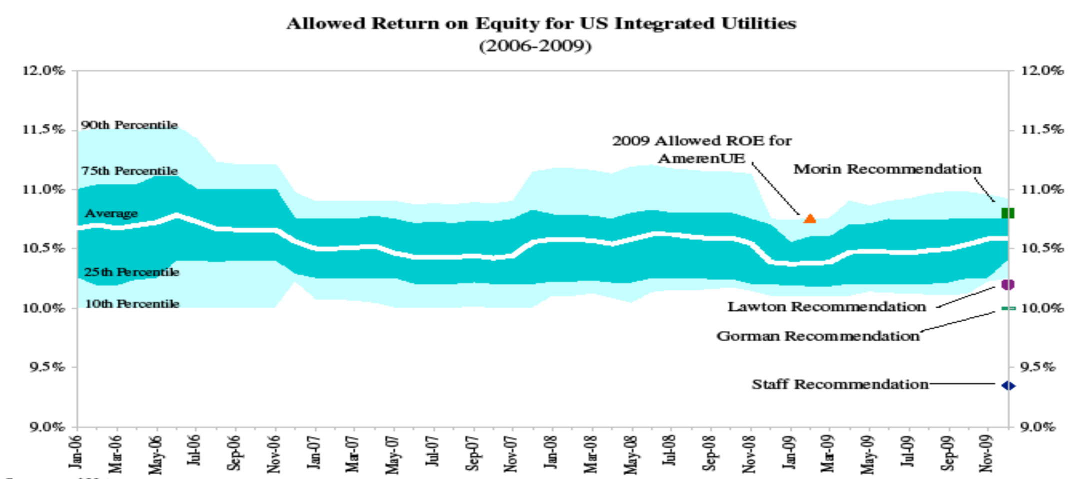
There are at least three causes that have contributed to this poor earnings performance. First, the Company has invested hundreds of millions of dollars in capital investment since the true-up cut-off date from its last rate case that is already serving customers, but has not yet been reflected in its rates due to the long regulatory lag in Missouri. Specifically, as AmerenUE Chief Executive Officer Warner Baxter testified, AmerenUE has invested approximately $650 million in infrastructure improvements since October 1, 2008, but has not recovered any return, taxes or depreciation on that extremely significant investment.[1] Second, AmerenUE's expenses have been increasing steadily as reflected in the revenue requirement for this case. And finally, as the Commission recognized in its Report and Order Regarding Interim Rates, the global financial crisis that occurred in late 2008 and early 2009 adversely impacted AmerenUE.

AmerenUE's past inability to recover its costs is admittedly not directly related to the Commission's determination of just and reasonable rates for AmerenUE to implement on a going-forward basis, but it provides a context in which the Commission should consider the positions of the parties in this case. Specifically, other parties have taken unusual and punitive positions on the remaining contested issues which, if adopted, will continue to prevent AmerenUE from fully and timely recovering its prudent cost of service, which in turn will deprive AmerenUE of a reasonable opportunity to earn a fair return in the future. If adopted, these positions on revenue requirement issues will damage AmerenUE financially, handicap its ability to compete for a limited pool of capital with other utilities, and compromise the Company's ability to continue making investments in its system necessary to provide the high level of service its customers and this Commission expect. As a consequence, these positions should be rejected.

One example of an unreasonable and punitive position in this case is Staff witness David Murray's recommended return on equity of 9.35%. Mr. Murray's approach to calculating return on equity (ROE), which he acknowledges many view as "radical," would place AmerenUE's

[1] Tr. p. 870. Recovery of the return, taxes and depreciation on that investment is not just delayed—it is permanently lost for the period before rates can be changed to reflect the additional investment.

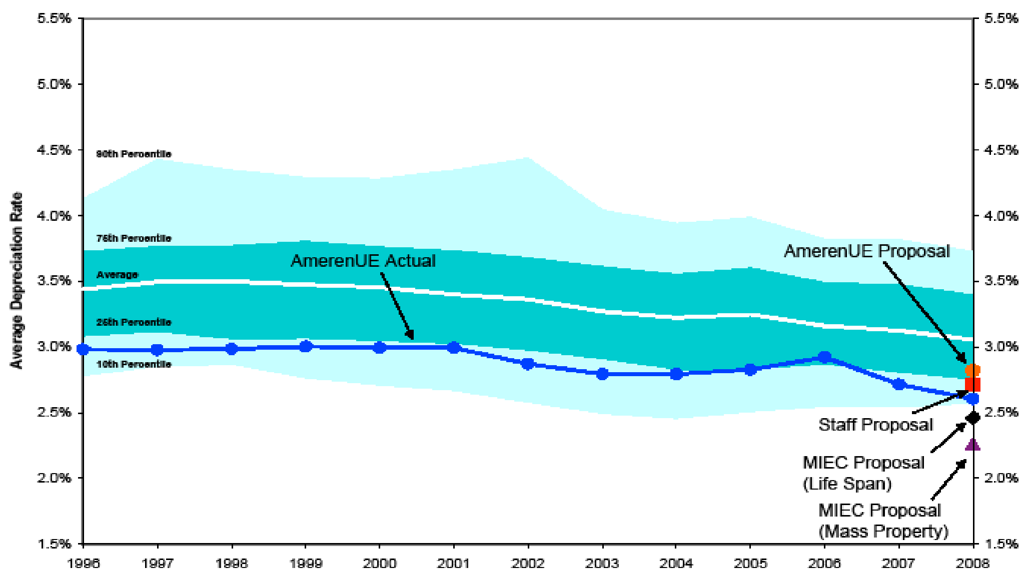
return on equity a full 124 basis points below the current (calendar year 2009) national average of returns authorized for integrated electric utilities, and 85 basis points below the lowest return authorized for any integrated electric utility in 2009. The return recommended by Mr. Murray is staggeringly low, and if adopted would have serious adverse financial consequences for AmerenUE and ultimately its customers. Although the upper end of the ranges recommended by the other return on equity witnesses (Michael Gorman for the Missouri Industrial Energy Consumers (MIEC) and Daniel Lawton for the Office of the Public Counsel (OPC)) are much more reasonable, their midpoint recommendations still fall far below the ROEs authorized for other utilities. The positions of the parties regarding the appropriate ROE for AmerenUE are depicted in the chart below.



Sources and Notes:
Analysis of data compiled by Regulatory Research Associates.
[1]: Allowed ROE calculated as 12-month rolling average of commission-approved returns.
[2]: Average and percentiles exclude decisions that apply only to electric distribution companies or individual generating plants.

The Staff and MIEC positions on depreciation are also unusual and punitive. Both parties refuse to incorporate reliable estimated retirement dates for AmerenUE's coal plants into the calculation of the estimated lives of the plant accounts. This position is contrary to authoritative texts on depreciation and depreciation practice in virtually every other state. As a consequence of this and other depreciation positions, Staff is recommending the adoption of composite depreciation rates that would place AmerenUE at approximately the 20th percentile of all integrated utilities in the U.S. MIEC's position is even more extreme, and would result in depreciation rates that are literally off the chart. Again, if these positions are adopted AmerenUE will be denied the ability to recover its costs and its ability to continue to invest in its system. The recommended composite depreciation rates of the parties are shown on the chart below.

Average Depreciation Rate for Investor-Owned Electric Utilities in the US (Total Plant)



Sources and Notes:
Depreciation and amortization rates and AmerenUE actual based on FERC Form 1 data for total electric plant.

The Staff and MIEC also take positions that undermine AmerenUE's recovery of expenditures for system reliability measures--power plant maintenance, vegetation management, infrastructure inspection and storm restoration expenses. With regard to power plant maintenance expense, these parties are seeking to "normalize" (i.e. reduce) a test year expense that is representative of the future level of costs and should not be normalized. The normalization will simply deprive AmerenUE of prudently incurred power plant maintenance expenses and create a disincentive for the Company to spend money to maintain its plants, to the ultimate detriment of customers. With regard to the vegetation management and infrastructure inspection costs, these parties propose to terminate the Commission-authorized cost tracking mechanisms put in place just one year ago. Because the Commission's vegetation management and infrastructure inspection rules are new, AmerenUE does not yet have sufficient experience to know what compliance costs will be, and so continuation of the trackers is necessary. Similarly, these parties oppose the implementation of a storm restoration cost tracker to permit AmerenUE to recover the volatile and unpredictable storm restoration costs that are incurred from year to year. These tracking mechanisms will allow AmerenUE to recover no more and no less than the exact amount of these important reliability expenses, yet they are opposed by the Staff and MIEC.

The Staff and MIEC also oppose the inclusion of the cost of nuclear fuel that was bought, paid for and physically delivered to the Callaway site well before the January 31, 2010 cut-off date for true up items, on the grounds that these costs are not sufficiently "known and measurable" to warrant inclusion in rates. Of course this argument is completely meritless—the nuclear fuel costs are known and measurable and will reflect the cost of nuclear fuel used to generate power before rates set in this case take effect. If these costs are excluded, AmerenUE will eventually recover them through its fuel adjustment clause (FAC), but it will unfairly be delayed in recovering the cost, and be required to absorb 5% of these prudently incurred costs. Failure to include these costs in rates amounts to a failure to rebase the Company's net fuel costs as accurately as possible.

Finally, MIEC and OPC propose increasing the Company's sharing percentage under the FAC even though not even one FAC cycle has been completed and the first prudence review has only recently begun. Increasing the sharing percentage would move AmerenUE even further outside the mainstream (most states permit 100% recovery of prudently incurred costs through the FAC) and significantly damage AmerenUE's credit quality. Moreover, this would effectively require AmerenUE to potentially absorb tens of millions of dollars in prudent fuel costs, such as the nuclear fuel costs that Staff and MIEC are proposing to exclude from base rates. Moreover, given the fact that power prices have been set at a level that greatly exceeds current power prices for purposes of modeling off-system sales revenues, there is likely to be an immediate and substantial adverse impact on AmerenUE if the sharing percentage is increased. In other words, given the structure of the FAC, AmerenUE does not have an equal chance of sharing in cost reductions or cost increases. It will almost certainly have to absorb more prudently incurred costs if the sharing percentage is increased.

Adoption of the punitive treatment proposed by the parties in their revenue requirement recommendations will harm AmerenUE and ultimately its customers. AmerenUE has conscientiously invested in its system to improve reliability, and is now in the top quartile in terms of system reliability. AmerenUE has materially enhanced its storm restoration practices and was widely praised for its response to the devastating ice storm that hit southeast Missouri in January, 2009. AmerenUE has meticulously complied with the Commission's new rules on vegetation management and infrastructure inspection to the benefit of system reliability, and has maintained its power plants so that its equivalent availability is in the top quartile of electric utilities across the country. And AmerenUE has taken steps to significantly reduce expenses, including material reductions to its capital budget, a freeze on management salaries and both voluntary and involuntary severance programs to reduce employee headcount.

However, if AmerenUE is to remain financially strong and have the ability to continue to invest in its system for the benefit of its customers, it must be permitted to recover its costs and must truly be afforded a reasonable opportunity to earn a return commensurate with other similar utilities.

Shortly after the 1913 enactment of the Public Service Commission Act, the Missouri Supreme Court addressed the fundamental purpose of the new law. The Supreme Court said:

> The enactment of the Public Service Commission Act marks a new era in the history of public utilities. Its purpose is to require the general public not only to pay rates which will keep public utility plants in proper repair for effective public service, but to further insure to the investors a reasonable return upon funds invested. The police power of the state demands as much. We can never have efficient service, unless there is a reasonable guarantee of fair returns for capital invested….These instrumentalities are a part of the very life blood of the state, and of its people, and a fair administration of the act is mandatory. When we say "fair," we mean fair to the public, and fair to the investors. *State ex rel. Washington University v. Public Service Commission,* 272 S.W. 971, 973 (Mo. banc 1925).

AmerenUE seeks no more than fair treatment in this case: recovery of its prudently incurred costs, and a reasonable opportunity to earn a fair return on its investment. Approval of AmerenUE's rate request will ensure that it will continue to be able to provide efficient and reliable service to its customers and contribute to the "life blood" of the state through prudent investment in its system to the ultimate benefit of its customers and the state as a whole.

CONTESTED ISSUES

I. RETURN ON EQUITY.

Determination of an appropriate ROE for a public utility is a difficult undertaking requiring the Commission to evaluate complicated methodologies that are commonly used to estimate the cost of equity throughout the country. There is often disagreement among ROE experts about which methodologies to use, what inputs are appropriate for the methodologies which are selected, and how the results of the various methodologies should be weighted or combined in order to develop a final estimated ROE. The Commission has the difficult task of evaluating the qualifications and credibility of the experts and the subjective decisions they have made in developing their recommendations in order to reach a result that fairly compensates the utility's shareholders for the cost of their equity capital while protecting customers from being overcharged.

However, one aspect of this process that all parties agree on is the legal standards that govern the Commission in its decision making process. The standards for determining the cost of equity for a regulated utility are set forth in two landmark U.S. Supreme Court cases—*Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923), and *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591 (1944). These cases have been cited by witnesses for all of the parties that are submitting recommended ROEs in this case.

The *Bluefield* case initially established the standard for setting a just and reasonable return on equity 87 years ago. The Supreme Court stated:

> 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***…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 money necessary for the proper discharge of its public duties (emphasis added).

The *Hope* court expanded on the guidelines set forth in *Bluefield:*

> [t]the 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 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 attract capital*** (emphasis added)**.**

The *Bluefield* and *Hope* decisions were more recently confirmed in *Permian Basin Rate Cases*, 390 U.S. 747 (1968) in which the Supreme Court stressed that a regulatory agency's rate of return order should:

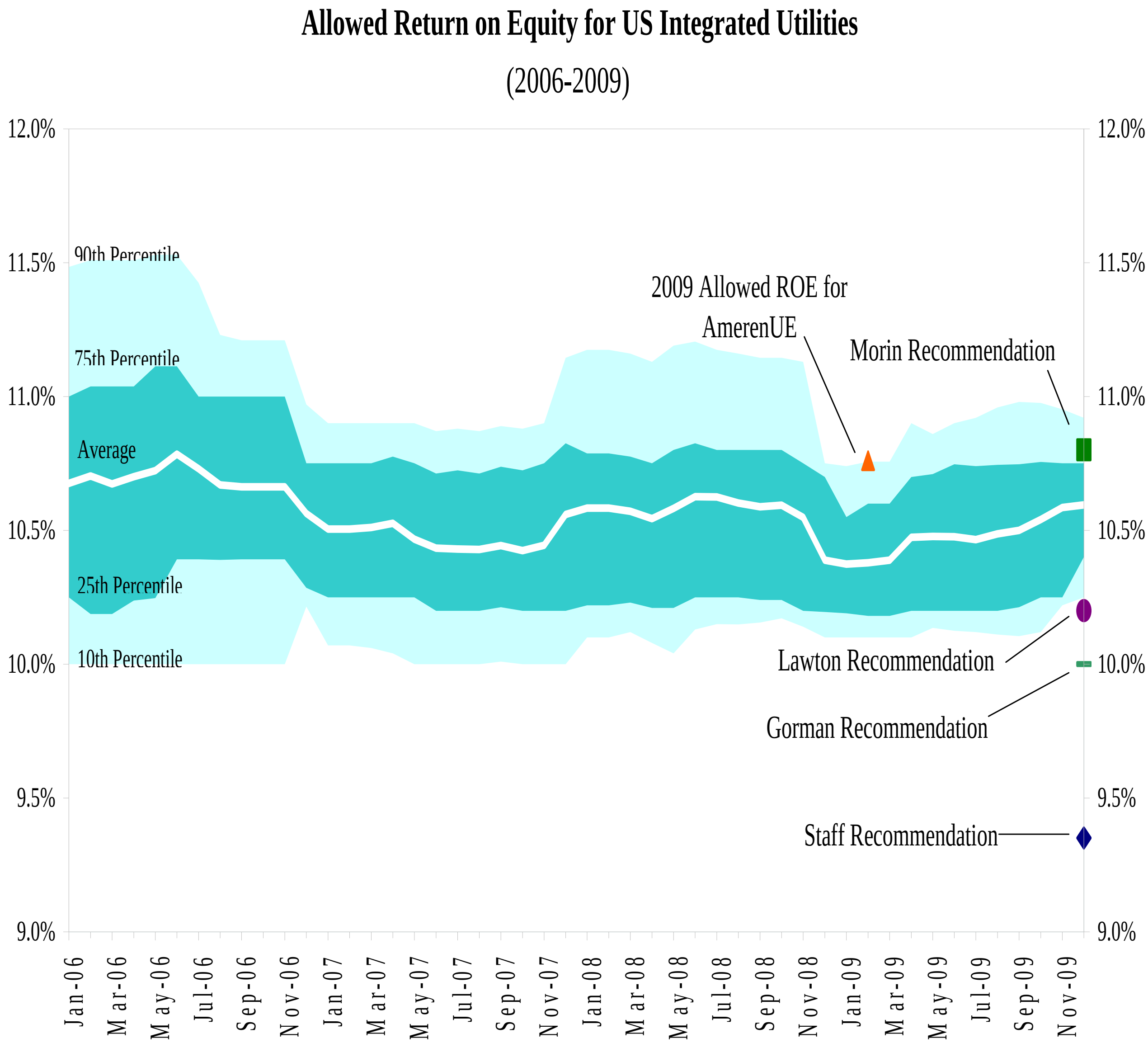
> …reasonably be expected to maintain financial integrity, attract necessary capital, and fairly compensate investors for the risks they have assumed…

Based on these cases, the end result of the Commission's decision should be an ROE that allows AmerenUE the opportunity to earn a return on equity that is: (1) commensurate with returns on investments in other firms having corresponding risks, (2) sufficient to assure confidence in the Company's financial integrity, and (3) sufficient to maintain the Company's creditworthiness and ability to attract both debt and equity capital on reasonable terms.

The parties to this case are proposing the following ROEs:

Party	**Witness**	**Recommended Range**	**Midpoint**
AmerenUE	Morin		10.8%
Staff	Murray/Hill	9.0%-9.7%	9.35%
OPC	Lawton	9.3%-10.9%	10.1%
MIEC	Gorman	9.5%-10.5%	10.0%

As the above table indicates, the Company's 10.8% ROE recommendation is within or near the top end of the range of returns recommended by both the OPC and MIEC. Staff's recommended range, with its upper end only at 9.7% and its midpoint of 9.35%, is the clear outlier. This information is again depicted on the chart below, which compares each of the parties' recommendations to the national average ROE awarded to integrated electric utilities, which has remained relatively steady over the last several years.



Sources and Notes:

Analysis of data compiled by Regulatory Research Associates.

[1]: Allowed ROE calculated as 12-month rolling average of commission-approved returns.

[2]: Average and percentiles exclude decisions that apply only to electric distribution companies or individual generating plants.

Again, this chart shows that the Staff's recommendation is a significant outlier, far below the 10th percentile represented by the light blue area on the chart. Although Mr. Lawton and Mr. Gorman's recommendations are also below the 10th percentile, they are much closer to the national average than the Staff's recommendation.

The reasons the analyses of Staff, OPC and MIEC produced unusually low ROE estimates are different. Staff witness David Murray relied on a single analysis (his multi-stage Discounted Cash Flow (DCF) analysis) and corrupted that analysis by using unconventional, inappropriate, and extremely low growth rates for two of the three stages. He then "tested the reasonableness" of his very low result by using unconventional measures that he thought of himself--comparing his results to earnings projections developed by equity analysts, estimates of future earnings by the Missouri State Employee Retirement System (MOSERS) and applying a "rule of thumb" about the relationship of equity returns to bond interest rates. Mr. Murray describes himself as a "radical" for using these unconventional means that are not used by other ROE experts. However, his extremely low ROE recommendation does not withstand scrutiny and should be given no weight by the Commission in determining AmerenUE's ROE.

The OPC and MIEC witnesses (Daniel Lawton and Michael Gorman) properly conducted conventional analyses, and their recommended ranges (running to 10.9% and 10.5% respectively) encompass ROEs that would be reasonable for AmerenUE. However, the midpoints and lower ends of their ranges are significantly influenced by risk premium analyses (the Capital Asset Pricing Model (CAPM) and Risk Premium methods), which are generally not as reliable for estimating ROEs as DCF methods, and which are producing unusually and inappropriately low ROE estimates today. The unusually low ROE estimates being produced by the CAPM and Risk Premium methods are due to several factors. As Dr. Morin testified, the CAPM and Empirical CAPM (ECAPM) estimates are not significantly above the cost of new debt and underestimate the cost of equity capital due to unsettled market conditions, including a substantial decline in government interest rates due to Federal Reserve policy.[2] Because of the substantial decline in government interest rates and increases in utility bond rates, failure to take

[2] Ex. 111, p. 37, l. 1-17.

the inverse relationship between interest rates and risk premia into account lead to a downward bias in the cost of equity estimates using these risk premium methodologies.[3] Therefore, as Dr. Morin testified and Mr. Lawton and Mr. Murray acknowledged, caution should be exercised when using the CAPM / ECAPM and Risk Premium results at this point in time.[4] If Mr. Lawton's and Mr. Gorman's analyses had weighted DCF results more heavily than risk premium results they would have produced more reasonable ROEs in line with ROEs approved for other utilities. Moreover, Mr. Gorman has taken steps to "water down" his DCF results in ways that are inconsistent with his DCF analyses in other recent cases. Adjusting for these inconsistencies would further increase Mr. Gorman's ROE estimate.

Of all the ROE experts filing testimony in this case, AmerenUE's witness, Dr. Roger Morin is the most qualified, and he has produced the most defensible recommendation. Dr. Morin's recommendation is based on both DCF and risk premium methods, but by conducting four separate DCF analyses he has given appropriate weight to the DCF results, given the shortcomings of the risk premium methods. As a consequence, Dr. Morin's recommended ROE of 10.8% should be adopted.

A. Dr. Morin's Recommendation.

1. Dr. Morin's recommended 10.8% ROE is reasonable and should be adopted.

The Company's recommended ROE of 10.8% is sponsored by Dr. Morin, a well-respected expert on utility finance matters. Dr. Morin is currently Emeritus Professor of Finance at the College of Business at Georgia State University and Professor of Finance for Regulated Industry at the Center for the Study of Regulated Industry at Georgia State University. He is also

[3] Ex. 112, p. 44, l. 1-11.
[4] Ex. 111, p. 37, l. 1-17; Ex. 304, p. 27, l. 21-22; Staff Report, p. 4, l. 22-24.

a principal in Utility Research International, an enterprise engaged in regulatory finance and economics consulting.

Dr. Morin's experience in addressing utility finance issues is extensive. He holds a Bachelor of Engineering degree from McGill University in Montreal, Canada and a Ph.D. in finance and econometrics from the Wharton School of Finance at the University of Pennsylvania. Dr. Morin has taught at a number of universities including the University of Pennsylvania, Dartmouth College and Georgia State University. Over the last thirty years he has conducted numerous national seminars on "Utility Finance," "Utility Cost of Capital," "Alternative Regulatory Frameworks" and "Utility Capital Allocation" in conjunction with Public Utilities Reports, Inc.

Dr. Morin has authored or co-authored several books, monographs and articles in academic scientific journals on the subject of finance that have appeared in *The Journal of Finance, The Journal of Business Administration,* and *International Management Review and Public Utilities Fortnightly*. In 1984 he published a widely used treatise on regulatory finance—*Utilities' Cost of Capital*, Public Utilities Reports, Inc., Arlington, VA. In 1994 Dr. Morin published *Regulatory Finance*, a widely-used textbook on the application of finance to regulated utilities. A revised and expanded edition of this book entitled *The New Regulatory Finance* was published in 2006. Dr Morin has provided cost of capital testimony in nearly 50 jurisdictions in the U.S. and Canada, and he is a nationally, and in fact internationally, recognized expert in this field.[5]

To develop his estimated ROE in this case, Dr. Morin employed a number of standard methodologies used by experts to determine cost of capital. These methodologies fall into three categories: CAPM, Risk Premium and DCF methodologies. Dr. Morin testified that he relied on

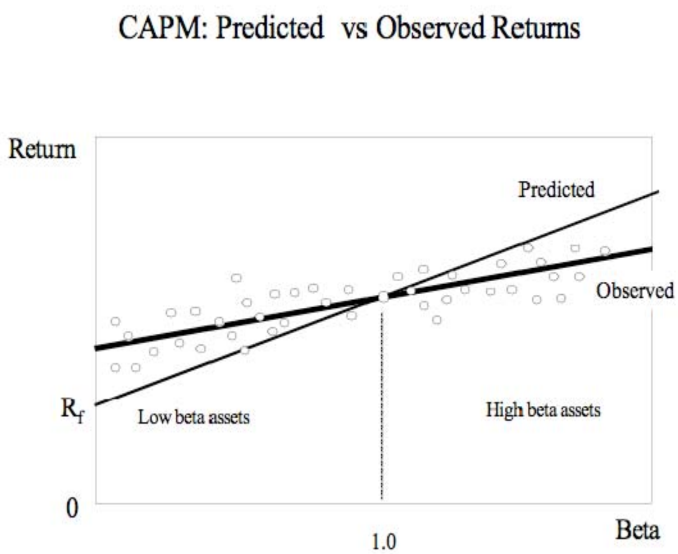
[5] Ex. 111, pp. 1-3 (Morin direct).

multiple methodologies because "[n]o one individual method provides the necessary level of precision for determining a fair return, but each method provides useful evidence to facilitate the exercise of an informed judgment. Reliance on any single method or preset formula is inappropriate when dealing with investor expectations because of possible measurement difficulties and vagaries in individual companies' market data."[6] Dr. Morin used seven separate methodologies falling into these three categories, as explained in his direct testimony. Although these methodologies resulted in an initial recommendation of 11.5% in his direct testimony (filed in July, 2009 and based on data from early 2009), when they were re-calculated with updated data and adjusted to reflect the Commission's practice of excluding flotation costs and accounting for the quarterly payment of dividends, they support Dr. Morin's updated recommendation of 10.8% as reflected in his rebuttal testimony (filed in February, 2010).[7]

Dr. Morin estimated ROEs using two separate CAPM analyses—the "plain vanilla" CAPM and the Empirical CAPM (ECAPM). Dr. Morin testified that determination of the expected return using the "plain vanilla" CAPM method involves determining a risk free rate of return and then adding an appropriate risk premium. For his risk free return, Dr. Morin used long-term (30-year) Treasury bond yields as of December 2009—4.6%.[8] Dr. Morin calculated the risk premium portion of the formula by multiplying an appropriate "beta," which is a measure of the relative movement in the rate of return on a particular company's stock compared to the market as a whole, by a Market Risk Premium applicable the stock market as a whole. Since AmerenUE stock is not publicly traded, it was necessary to use a proxy for AmerenUE's beta, and Dr. Morin used the average beta (.74) of his integrated electric utilities group--one of the two proxy groups of utilities similar to AmerenUE that he used in his analyses. For his

[6] *Id*. p. 20, l. 20 to p. 21, l. 3.
[7] Dr. Morin's updated analysis uses data from a similar period to that used by Messrs. Gorman and Lawton, who filed their direct testimonies on December 18, 2009.
[8] Ex. 112, p. 53, l. 9-10 (Morin rebuttal).

Market Risk Premium, Dr. Morin used the long-term historical premium that the stock market has returned above the income component of long-term Treasury bonds—6.5%.[9] Based on this methodology, Dr. Morin's updated CAPM estimate was 9.4%.[10] Dr. Morin also calculated a second CAPM—the Empirical CAPM. Dr. Morin testified that it is one of the most well-known results in finance that the "plain vanilla" CAPM underestimates the return required from low-beta securities (such as AmerenUE and other integrated electric utilities) and overstates the return on high-beta securities, based on the empirical evidence. This phenomenon is addressed in a chapter in Dr. Morin's textbook, and it is illustrated graphically below:[11]



The ECAPM corrects for this flaw in the "plain vanilla" CAPM model by adding a factor to the formula ("alpha") to account for the tendency of the CAPM to understate or overstate required returns.[12] The updated ECAPM analysis produced an ROE estimate of 9.8%.[13]

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[9] *Id.*, p. 53, l. 10.
[10] *Id.*, p. 55, l. 8.
[11] Ex. 111, p. 33, l. 16 to p. 34, l. 1.
[12] *Id.*, p. 34, l. 3-7.

Appendix A attached to Dr. Morin's direct testimony contains a full discussion of the ECAPM and its theoretical underpinnings.

Dr. Morin next estimated AmerenUE's ROE using the Risk Premium method. The Risk Premium method calculates the premium that utility stockholders have historically earned above utility bond returns, in order to compensate them for the additional risk of owning stock rather than bonds. Then this risk premium is added to an appropriate current bond interest rate to determine the ROE. Dr. Morin calculated the historical premium by computing the actual realized return on equity capital for the S&P Utility Index for each year, beginning in 1930, and subtracted the long-term utility bond return for that year. The resulting average premium over that period was then added to the current yield on A-rated utility bonds. Dr. Morin's updated Risk Premium calculation produced an ROE of 10.82%.

Finally, Dr. Morin conducted four DCF analyses. The DCF is the method most commonly used by the Missouri Commission and other commissions in estimating ROEs for regulated utilities.[14] The idea behind the DCF is that the return required for a particular equity is equal to the future stream of dividends that can be expected, plus anticipated growth in the value of the stock. The basic formula is as follows: Expected Return = Current Dividend Yield + Expected Growth in Dividends and Stock Price.[15]

For the dividend yield component of the DCF, Dr. Morin used current dividend yields based on average results from a large group of companies reported by Value Line. Dr. Morin explained that using dividend yields from a large group of companies reduces the concern that idiosyncrasies of individual company stock prices will result in an unrepresentative yield.[16]

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[13] Ex. 112, p. 55, l. 9.
[14] Ex. 111, p. 16, l. 15-17.
[15] *Id.* p. 41, l. 21-23.
[16] *Id.* p. 48, l. 13-17.

The component of the DCF model that is most difficult to estimate is growth. Since no explicit estimate of AmerenUE's expected growth rate is observable, proxies must be employed. Dr. Morin applied the DCF model to two proxy groups of utilities: a group of investment-grade, dividend paying integrated electric utilities (Integrated Electric Utilities) and a second group consisting of the electric utilities that make up Standard and Poor's Utility Index. Dr. Morin screened these proxy groups to exclude companies that were unlike AmerenUE because, for example, they were below investment grade, or they did not pay dividends.[17] Both Mr. Gorman and Mr. Lawton used the same proxy groups as Dr. Morin.

Dr. Morin developed four DCF estimates because he applied two separate growth estimates to the two proxy groups he selected. He used analysts' long-term growth rates for the proxy groups as provided by Zacks Investment Research Inc. (Zacks) and Value Line. Dr. Morin noted that these growth estimates are developed by professional analysts employed by large investment brokerage institutions. They are readily available to investors, and they are actually used by institutional investors to determine the desirability of investing in different securities. As a consequence, these growth estimates provide a sound basis for estimating the cost of equity with the DCF model.[18]

Dr. Morin's updated DCF results are as follows;

Vert. Integrated Utilities/Value Line Growth	11.0%
Vert. Integrated Utilities/Zacks Growth	11.0%
S&P Electric Utilities/Value Line Growth	10.5%
S&P Electric Utilities/Zacks Growth	11.5%

And the CAPM/ECAPM and Risk Premium results previously discussed are:

CAPM	9.4%
ECAPM	9.8%
Risk Premium Electric	10.82%

[17] *Id.*, p. 48, l. 19 to p. 49, l. 8.
[18] *Id.*, p. 42, l. 19 to p. 43, l. 6.

The average of all Dr. Morin's updated results is 10.6%, the truncated mean is also 10.6% and the median result was 10.82%. Consequently, Dr. Morin recommended a 10.8% ROE, which gives appropriate weight to Dr. Morin's DCF results, but also includes some consideration of the lower CAPM and Risk Premium Results.

Dr. Morin pointed out that his recommended ROE was conservative, because the Company's exposure to regulatory lag is more significant than average due to the use of historical test years rather than forward test years in Missouri and the Missouri statutory prohibition on inclusion of construction work in progress in rate base. Dr. Morin also noted that AmerenUE has been unable to earn its allowed rate of return for several years, and the testimony provided by AmerenUE witnesses Warner Baxter and Gary Weiss shows that the Company has been unable to earn anywhere close to its authorized return in recent months.[19] Dr. Morin testified that the inability to earn its authorized return is very specific to Ameren (in other words it is not simply a result of general economic conditions that affect all utilities), it matters to investors, and it is part of the reason that Ameren stock is on the sell list.[20] The Company's inability to actually earn a reasonable return is an important reason that the Commission should be reluctant to lower its authorized return below the existing level. Finally, Dr. Morin pointed out that AmerenUE's high reliance on coal-fired generation exposes it to a higher risk for potential environmental cost increases, which also suggests that the 10.8% ROE recommended by Dr. Morin is conservative.

Based on all of the foregoing, the Commission should adopt the 10.8% ROE recommended by Dr. Morin.

[19] Ex. 112, p. 55, l. 18 to p. 56, l. 7.
[20] Tr. p. 1920, l. 19-24; p. 1932, l. 16 to p. 1933, l. 3.

B. Mr. Murray's Recommendation.

1. <u>Staff Witness David Murray's extremely low ROE recommendation should be given no weight.</u>

Staff witness David Murray has proposed an extremely low ROE recommendation of 9.35% (based on his range of 9.0%-9.7%). As previously mentioned, this recommendation is approximately 125 basis points below the national average of authorized ROEs for integrated electric utilities in 2009 based on Regulatory Research Associates (RRA) data and far below the 10th percentile of awarded ROEs over the last several years.[21] It is 85 basis points below the very lowest ROE (10.2%) awarded by any commission in the country to an integrated electric utility in 2009.[22] If adopted, Mr. Murray's punitive ROE recommendation would damage AmerenUE financially, and ultimately harm both the Company and its customers.

Mr. Murray has limited experience with regard to utility finance matters.[23] Although he has an undergraduate degree in business from the University of Missouri and an MBA from Lincoln University, his experience consists of filing testimony on behalf of the Staff over the last nine years in rate cases in which Mr. Murray has often recommended very low ROEs. More significantly, Mr. Murray acknowledges that he is viewed as a radical because he proposes low ROEs based on unconventional methodologies that are not typically recommended by other witnesses or recognized by commissions in setting ROEs. At the hearing, Mr. Murray testified as follows:

Q. Why do you think people think you're a radical?

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[21] Ex. 101, p. 5, l. 15 to p. 6, l. 5. (Baxter rebuttal)

[22] See schedule RAM-ER11-6 to Ex. 112 (Avista Corporation).

[23] Both Missouri Gas Energy and The Empire District Electric Company have unsuccessfully attempted to have Mr. Murray's testimony excluded on the ground that he is not qualified to provide expert testimony on ROE. In both cases the Commission determined that Mr. Murray's qualifications were sufficient to meet the minimum qualifications for an expert witness, but that his qualifications could go to the weight of the evidence he presented. *Re: Missouri Gas Energy*, Case No. GR-2004-0209 *Order Regarding MGE's Motion to Exclude Certain Testimony and Opinions of David Murray*, (June 8, 2004) p. 5; *Re: The Empire District Electric Company*, Case No. ER-2004-0570 *Report and Order* (March 10, 2005), p. 16.

A. *Because my cost of equity estimates are* ***not based on what other people come up with in regulatory ratemaking arenas.***[24] *(emphasis added).*

In this case, Mr. Murray's radical approach was manifested in three ways: First, he completely rejected the constant growth DCF method which the Commission and the Staff have traditionally relied upon, and based his recommendation exclusively on the multi-stage DCF method which produces a lower return; second, he selected unconventional and inappropriate growth estimates for both the multi-stage DCF and the constant growth DCF (which he calculated but then rejected); and finally he used unconventional and inappropriate measures to test the reasonableness of his results. For all these reasons, Mr. Murray's ROE recommendation should be given no weight at all.[25]

a. <u>Mr. Murray's rejection of the constant growth DCF and his exclusive reliance on the multi-stage growth DCF are inappropriate.</u>

Mr. Murray recognizes that the Staff has traditionally relied on the constant growth DCF model in developing recommended ROEs for Missouri utilities. In fact, the Staff Report Revenue Requirement/Cost of Service (Staff Report) in this case acknowledges that the constant growth DCF "…in most situations is considered to be ideal for estimating the cost of common equity for regulated utilities due to the maturity of the regulated utility industry."[26] For that reason the Staff used the constant growth DCF for developing electric utility ROEs until Mr. Murray decided to depart from that practice in two 2009 cases involving Kansas City Power & Light Company (KCPL) and KCPL's Greater Missouri Operations, which consist of the former Aquila properties. In those cases (Case Nos. ER-2009-0089 and ER-2009-0090) Mr. Murray for the first time proposed ROEs based exclusively on the multi-stage DCF. However, those cases

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[24] Tr. p. 2060, l. 21-25

[25] Mr. Murray also made a number of mistakes in his calculations which Dr. Morin corrected. Ex. 112, p. 15, l. 6 to p. 16, l. 9. Dr. Morin testified that he does not believe Mr. Murray understands the material or knows how to manipulate data to achieve a desired outcome. Tr. p. 1872, l. 14-18.

[26] Ex. 200, p. 21, l. 23-25 (Staff Cost of Service Report).

were settled and as a result this case is the Commission's first opportunity to determine whether Mr. Murray's exclusive reliance on the multi-stage DCF is appropriate.[27]

Mr. Murray's exclusive reliance on the multi-stage DCF in setting ROEs for electric utilities is inappropriate and should be rejected. Exclusive use of the multi-stage DCF is inconsistent with the Staff's approach in past electric cases and the approach it continues to take in gas cases, where the constant growth DCF is still universally relied upon.[28] As Mr. Murray acknowledged, regulatory consistency is important to both utilities and customers,[29] and therefore using one method of calculating ROEs for gas utilities and a separate method for calculating lower ROEs for electric utilities is not appropriate. In addition, as Dr. Morin testified, it is not good practice to estimate an ROE based on a single method as Mr. Murray has done.[30] All of the other witnesses to this case, and indeed almost all other ROE witnesses in other cases, use multiple methods to determine the appropriate ROE for utilities. For this reason as well, Mr. Murray's exclusive reliance on the multi-stage DCF method should be rejected.

b. Mr. Murray selected unconventional and inappropriate growth estimates for his DCF analyses.

Mr. Murray's DCF analyses are flawed because he selected and applied inappropriate growth parameters. With respect to his multi-stage DCF, the growth parameter that he used for the first stage (running from years 1-5), published analysts' growth projections for next five years, is the type of parameter that is typically used and it is appropriate. However, the growth projection Mr. Murray selected for the third stage, extending from year 11 to infinity, is completely inappropriate. Since the second stage (year 6 to year 10) is simply an interpolation of

[27] Tr. p. 2032, l. 20 to p. 2033, l. 3.
[28] Tr. p. 2034, l. 4-7.
[29] Tr. p. 2035, l. 20-23.
[30] Ex.111, p. 20, l. 20 to p. 21, l. 3.

the results from the first and third stages, it too is corrupted by the inappropriate growth rate Mr. Murray selected for the third stage.

For the third stage of his analysis, Mr. Murray used projected growth in electricity demand, adjusted for inflation, as his growth component. Mr. Murray acknowledged that using electricity demand as the growth parameter was his own idea first advanced in the 2009 KCPL and GMO cases, that he was unaware of any commission anywhere that had used growth in electricity demand as a growth parameter in a DCF formula, and that he was unaware of any cost of capital witness, other than himself, recommending such a growth rate.[31]

Not surprisingly, the use of electricity demand produces an extremely low growth rate for stage 3 (and by extension, stage 2). Due to anticipated conservation and energy efficiency measures, long-term growth in electricity demand is expected to be less than 1%, and with expected inflation barely above 2%, Mr. Murray's growth rate for stage 3 is an anemic 3.1%.[32] There is absolutely no logic for tying AmerenUE's ROE to the low level of anticipated demand for electricity. In fact, declining growth in electricity demand is an added risk that electric utilities face, and should result in an increase in the ROE, not a decrease, to compensate for that risk. There is absolutely no basis to use this as a growth component in a DCF analysis, as even OPC witness Daniel Lawton acknowledged at the hearing.[33]

Mr. Murray's use of the growth in electricity demand for the growth rate in stage 3 produced a stunningly low multi-stage DCF result of 9.2%. Mr. Murray originally planned to recommend an ROE range of 50 basis points on either side of this estimate, but because he believed that a recommendation below 9% would "frighten" people because they would not

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[31] Tr. p. 2045, l. 1-22.
[32] Tr. 2042-2043.
[33] Mr. Lawton testified that he had never seen projections in electricity demand used as a growth rate. Tr. p. 2211, l. 12 to p. 2212, l. 7. He also explained at length why use of a projection of electricity demand is not a proper measure of growth given the potential for increases in services (smart meters, for example) that would be unrelated to growth in demand. Tr. p. 2183, l. 7-25.

believe it to be possible, he truncated his range at 9%.[34] As a consequence, Mr. Murray's recommended range became 9.0%-9.7%, with a midpoint of 9.35%.

Mr. Murray's use of the growth in electricity demand as a growth component is clearly inappropriate and unsupported. His multi-stage DCF analysis, which is the basis of his very low ROE recommendation, must be rejected.

Mr. Murray also calculated (but rejected) the more conventional constant growth DCF for AmerenUE (which he calculated to be within a range of 9.2% to 10.2%).[35] Not surprisingly, Mr. Murray used unsupported and inappropriate growth parameters in that calculation as well. Specifically, Mr. Murray used a 4%-5% growth rate, which he described as a "very generic growth rate" that he had "just thrown in."[36] These growth rates were purely based on Mr. Murray's judgment, and unlike all of the growth rates supported by all of the other witnesses in this case, they were not based on any type of calculation or quantification of anything. Mr. Murray acknowledged that if he had used analysts' projected growth rates as the Staff has done in the past and as the other witnesses have done in this case, his constant growth DCF result would have been 11.22%, not his anemic 9.2%-10.2%.[37]

c. <u>Mr. Murray used unconventional and inappropriate methods to test the reasonableness of his results</u>.

Mr. Murray used three unconventional and inappropriate methods to "test the reasonableness" of his extremely low ROE recommendation. First, he used equity analysts' reports that projected earnings for various companies. Again Mr. Murray acknowledged this type of information has not traditionally been used to confirm the results of a cost of capital

[34] Tr. p. 2030, l. 13 to p. 2031, l. 2, 14-15.
[35] Ex. 200, p. 23, l. 29-31
[36] Tr. p. 2037, l. 14-21.
[37] Tr. p. 2040, l. 6-10.

analysis,[38] and that it was his own idea to start using analysts' reports in that way.[39] The reports generally provided earnings *projections* for various companies.[40] Although Mr. Murray read the reports he did have access to, and did not examine any of the analyses underlying those reports.[41]

Mr. Murray's novel use of equity analysts' reports of projected earnings to confirm an estimate of the cost of equity is clearly inappropriate. In some circumstances analysts can project little or no earnings for a particular company (or even negative earnings), but that does not mean that the cost of equity for the company in question is zero or negative. For a regulated firm using low earnings projection would lead to the circular result that the "cost of equity" (i.e. authorized ROE) would be very low, which would in turn create even lower projected earnings. At the other extreme, analysts might project huge earnings for a particular company that far exceed the cost of equity, which could lead to the same circular, and wrong, result described above, but in the other direction. Mr. Murray's theory simply makes no sense.

In the case of Ameren Corporation, Goldman Sachs has projected earnings for the company, but then issued a "sell with conviction" recommendation.[42] If those projected earnings in fact matched the cost of equity (i.e., a fair ROE), then Goldman would not be recommending that Ameren stock be sold, but rather, would recommend that it at least be held. This obvious fact demonstrates that projected earnings bear little or no resemblance to the cost of capital for a company. OPC witness Lawton also testified that he would not use analysts' reports in the way that Mr. Murray did because investors do not have access to these reports, and therefore they do not influence investor decisions.[43]

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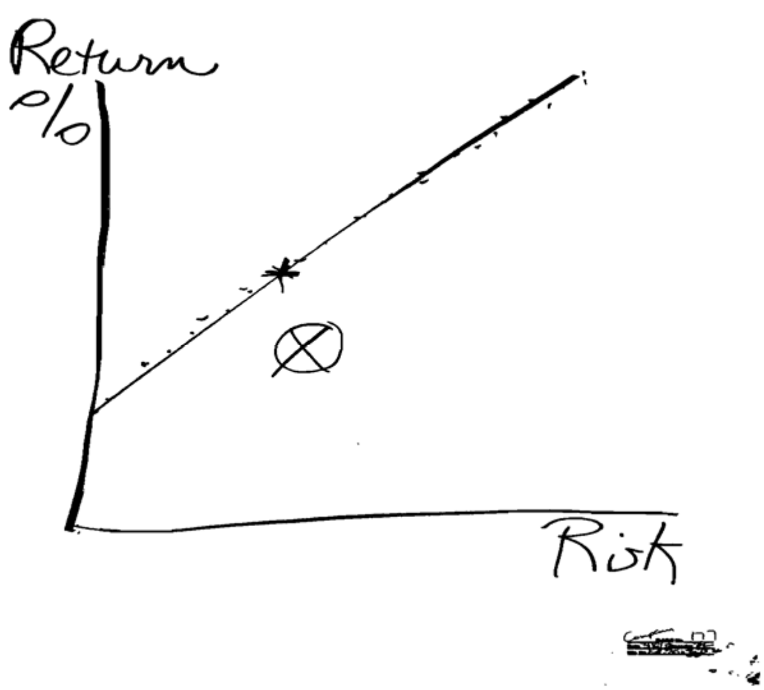
[38] Tr. p. 2047, l. 4-12.
[39] Tr. p. 2048, l. 6-7.
[40] Tr. p. 2049, l. 4-5.
[41] Tr. p. 2051, l. 3-8.
[42] Tr. p. 2051, l. 9-16
[43] Tr. p. 2213, l. 4-22.

AmerenUE witness Julie Cannell, who has spent much of her career developing and reviewing the kind of equity analysts' reports that Mr. Murray has misused, succinctly explained why Mr. Murray's use of those reports to test the reasonableness of his ROE recommendation is inappropriate. As Ms. Cannell testified, there is often a difference between an expected (projected) return, which is what equity analyst reports address, and a required return (the cost of equity or ROE), which is what this Commission must address. Where the expected return is lower than the required return, equity analysts issue a sell recommendation for the stock, as Goldman Sachs has issued for Ameren Corporation. Because expected returns often deviate from required returns, equity analysts' reports cannot be used to test the reasonableness of any particular ROE recommendation in a rate case, as Mr. Murray has creatively proposed.

The relationship between expected returns and required returns was illustrated by Ms. Cannell graphically at the hearing, and her graph is reproduced below.



[44]

[44] Ex. 177.

As Ms. Cannell explained at the hearing, the line on this graph represents the expected returns of all the investable stocks in the universe, and that line also represents the required returns on equity capital. When the projected earnings of a particular company, such as Ameren (represented by the X), are below that line, the projected earnings are not representative of the cost of equity or required return. That is why analysts issue a “sell” recommendation for stocks that are projected to earn below the cost of equity. That is also why analysts’ earnings projections should not be used as a benchmark for the cost of capital for a regulated utility.[45]

In addition to Mr. Murray’s reliance on equity analysts’ reports, he also cited two other unusual sources of information in an effort to test the reasonableness of his ROE recommendation. One was the expected returns of the Missouri State Employees Retirement System (MOSERS) pension fund. Again, Mr. Murray acknowledged that he was breaking new ground in using the expected earnings of a retirement plan for this purpose.[46] He could cite to no Commission decision and no other ROE expert who had ever used state retirement fund data in this way.[47]

Once again, Mr. Murray has relied on inappropriate data in an effort to justify his low ROE recommendation. As Mr. Murray acknowledged, pension plans may have investment objectives that are quite different than the goals of utility equity holders. The assets in pension plans often include bonds and other conservative, liquid investments that are not comparable to electric utility stocks.[48] Mr. Lawton agreed that these different investment goals made use of pension fund data for the purpose of determining an ROE problematic. Mr. Murray acknowledged that he did not review the analysis underlying the expected return for MOSERS

[45] Tr. p. 2299, l. 2-23.
[46] Tr. p. 2058, l. 6-7.
[47] Tr. p. 2058, l. 2-8. Mr. Lawton also testified that he had never seen an ROE expert use pension fund information in that way. Tr. p. 2211, l. 21 to p. 2212, l. 3.
[48] Tr. p. 2058, l. 9-12; p. 2059, l. 3-7.

and did not have access to the data.[49] Moreover, as with Mr. Murray's use of analysts' projections of earnings, there is a mismatch between an expected return and a required return, which could be much higher or lower. As a consequence, MOSERS information does not confirm the reasonableness of Mr. Murray's recommendation, or tell us anything at all about the cost of equity for AmerenUE.

Finally, Mr. Murray relied on a "rule of thumb" that stocks should earn roughly 3-4% more than bonds. Again, this is an unconventional and inexact method of testing the reasonableness of Mr. Murray's low ROE recommendation, and should be rejected. Like Mr. Murray's other tests of reasonableness, it is not endorsed by authoritative texts addressing the determination of ROEs for public utilities, and it has seldom, if ever, been used by commissions to set an ROE.[50]

The bottom line is that Mr. Murray did an unconventional and unreasonable analysis which led to an extremely low result. Then he "tested the reasonableness" of that result using methods he invented, which are not appropriate for setting a return on equity for a public utility and which are not used by other ROE experts or commissions. His recommendation should be given no weight, and his "radical" approach to estimating cost of equity for utilities should be rejected.

C. Mr. Gorman's Recommendation.

1. MIEC Witness Gorman's and OPC Witness Lawton's midpoint ROE recommendations are too low.

The ROE recommendations of MIEC witness Michael Gorman and OPC witness Daniel Lawton do not suffer from the same fundamental defects as Mr. Murray's recommendation.

[49] Tr. p. 2058, l. 13 to p. 2059, l. 2.
[50] Tr. p. 2060, l. 4-8.

Both Mr. Gorman and Mr. Lawton are experienced ROE experts, as Dr. Morin acknowledges.[51] They have employed standard analyses and used conventional inputs. Dr. Morin agrees that the analyses they employed are theoretically sound.[52] The high ends of the ranges of ROEs they support are in the vicinity of Dr. Morin's recommendation, and in the vicinity of the national average of ROEs authorized for integrated electric utilities (currently at about 10.6%).
Mr. Gorman's range runs up to 10.55%, and Mr. Lawton's range goes to 10.9%, 10 basis points higher than Dr. Morin's recommendation. Since both witnesses have testified that the Commission's adoption of any result that is within their range would be reasonable,[53] their recommendations converge with Dr. Morin's in the 10.55%-10.9% range.

The problem with their recommendations is that the midpoint and lower portion of their ranges are clearly too low. Mr. Gorman's midpoint recommendation, 10.0% is a full 59 basis points below the national average, and it is 20 basis points below the lowest ROE authorized for any integrated electric utility in 2009.[54] Mr. Lawton's midpoint, 10.1%, is 49 basis points below the national average and 10 basis points below the lowest authorized for any integrated electric utility in 2009. These differences are material—as previously mentioned each 100 basis points of difference equates to approximately $46 million per year in revenue requirement.[55] If the Commission were to adopt either of these midpoints, it would be sending a strong signal to investors and utilities that investment in Missouri will not pay a fair, competitive return, particularly given the fact that AmerenUE has been, and is likely to continue to be, unable to earn close to whatever return is authorized.

[51] Tr. p. 1839, l. 22-24.
[52] Tr. p. 1839, l. 5-7.
[53] Tr. p. 1959, l. 4; p. 2187, l. 18.
[54] Ex. 112, Schedule RAM-ER11-6 (Avista).
[55] Tr. p. 1926, l. 21-22.

The primary reason that Mr. Gorman's and Mr. Lawton's midpoint ROE recommendations are so low is that they are disproportionately influenced by the results of risk premium methodologies (the CAPM and Risk Premium methods)[56] and they do not adequately weight the DCF analyses that the Commission has traditionally relied upon in setting authorized ROEs, and which are much more reliable methods for determining an appropriate ROE. The record in this case contains numerous references to the fact that the CAPM and Risk Premium analyses are currently producing unusually low ROE estimates, and should be viewed with caution. There is also consensus among the experts that the DCF is the best method for estimating an ROE for a public utility.

For example, Mr. Lawton testified about the virtues of the DCF method compared to risk premium methods. In his direct testimony he stated:

> It is my opinion that ***the best analytic technique for measuring a utility's cost of common equity is the DCF methodology.*** Other return on equity modeling techniques such as the Capital Asset Pricing Model ("CAPM") and risk premium are often used to check the reasonableness of the DCF results.[57]

As a consequence, Mr. Lawton testified that the DCF is the principal method that he employs, and over time it produces consistent, reliable results.[58]

Mr. Lawton was also critical of the CAPM and risk premium methods. Mr. Lawton testified that the risk premium approach has "problems and drawbacks."[59] He pointed out that "[i]n practice, there is considerable debate as to the time period to analyze in the determination of the bond/equity return risk spread. Historical debt/equity risk spreads measured over many decades may not be relevant to current capital market requirements."[60] With regard to the CAPM method, Mr. Lawton testified: "Like the risk premium discussed above, the CAPM is

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[56] The CAPM is a form of the risk premium method. Ex. 304, p. 27, l. 9-10.
[57] Ex. 304, p.11, l. 16-20 (Lawton direct).
[58] Tr. p. 2192, l. 21 to p. 2193, l. 3.
[59] Tr. p. 2193, l. 22-25.
[60] Ex. 304, p. 27, l. 3-7.

subject to measurement uncertainties. First, the general problem of how to measure the equity risk premium and the time period for which the premium is analyzed is subject to considerable debate. This problem and associated criticisms is generic to all variants of the risk premium model. Second, measures of beta are often unstable from period to period and may not reflect the equity risk spread measure." For all those reasons, Mr. Lawton testified that "risk premium methods should be viewed with considerable caution."

Like Mr. Lawton, Mr. Gorman also expressed some concerns about the CAPM, in particular related to the sharply declining risk premium used in that analysis. Mr. Gorman testified:

> However, the market risk premium based on actual investment results of stock market versus Treasury bond investments, indicates the market risk premium at the end of 2008 decreased considerably from previous years. For example, at end of year 2007, the total investment return market risk premium was estimated to be 6.60%. I believe the market disruption created an aberration to the market risk premium estimated from historical data through year-end 2008.
>
> While I believed the methodology that underlies the 2008 market risk premium estimate of 5.70% is more accurate, I believe that this point estimate was severely impacted by the 2008 market disruptions. Therefore, I will not take issue with the market risk premium of 6.50% used by Dr. Morin, because it appears to be in line with a normalized market risk premium.[61]

Dr. Morin also testified that the CAPM understates the cost of capital and is an outlier among the analyses, which should be given less weight. Dr. Morin explained this issue at the hearing:

> Q. [c]ould you elaborate a little bit about why those CAPMs are outliers and what significance that has?
>
> *A. Okay. As a result of the financial crisis, the utility stocks were increasingly disconnected from the rest of the marketplace because they were perceived to be safer havens, and when you disconnect utility stocks from the overall market, that means a lower beta because beta is a measure of that connection with the market.*

[61] Ex. 409, p. 5, l. 10-20 (Gorman rebuttal).

> *And betas are measured historically over the last five years, and I think they're downward biased in capturing the current, today's risk posture of utilities. And that's one of the problems when you're dealing with historical betas over 5-year periods.*

Q. I mean, is there an argument for giving them less weight because of that?

A. Yes there is. I make that argument. Mr. Lawton makes that argument as well.[62]

Finally, even Staff witness Murray recognized the deficiencies of the CAPM approach:

> Staff also performed its traditional CAPM cost of common equity analysis on the comparable companies. However, due to recent significant stock market declines through the end of 2008, ***these CAPM results should not be given much consideration in this case.*** Before the significant market contraction that occurred from the fall of 2008 through the spring of 2009, Staff previously indicated that it believed the risk premium estimates based on the differences in earned returns between stocks and risk-free bonds may be too high considering higher stock valuation levels. Now, ***Staff believes estimates using earned return spreads may be too low considering the significant decreases in equity returns through the end of 2008*** **(emphasis added)**.[63]

Mr. Murray also testified:

> The CAPM analysis using the long-term arithmetic average risk premium and the long-term geometric average risk premium produces estimated costs of common equity of 7.94 percent and 6.81 percent, respectively. ***Staff does not believe these current CAPM results are reliable indicators of the cost of common equity for the proxy group and therefore, AmerenUE. Although for the reasons mentioned above Staff does not believe these current CAPM results should be used for purposes of recommending a fair and reasonable return on common equity for AmerenUE, they do illustrate the impact of the stock market declines that occurred in 2008 have had on CAPM analyses*** using historical earned return risk premium differences (emphasis added).[64]

Although as previously mentioned, AmerenUE believes it was inappropriate for Mr. Murray to rely only on a single multi-stage DCF analysis to develop his estimated ROE for AmerenUE, his criticisms of the CAPM, like the criticisms of the risk premium methods advanced by the other ROE witnesses, are well founded.

[62] Tr. p. 1944, l. 17 to p. 1945, l. 8.
[63] Ex. 200, p. 29, l. 22-29 (emphasis supplied).
[64] *Id., p.* 31, l. 9-17.

In spite of the agreement among the experts that risk premium methodologies are producing unusually low ROEs and should be "viewed with caution," the midpoints of both Mr. Gorman's and Mr. Lawton's analyses are heavily influenced by the results of their risk premium analyses, and that is a significant reason why they are so far below Dr. Morin's recommended ROE, and so far below the national average of ROEs authorized for integrated utilities.

2. **<u>Mr. Gorman's midpoint ROE is influenced too much by his CAPM results and is influenced too little by his DCF results.</u>**

Mr. Gorman's midpoint ROE recommendation is the midpoint of a range bounded at the top by an average of the results of three separate DCF analyses, and at the bottom by his CAPM result. Both ends of his range are lower than they should be. As mentioned, the CAPM has been criticized by many of the witnesses in this proceeding as producing ROEs that are too low and that are unreliable. By using his very low CAPM ROE (9.54%) as the lower end of his range, Mr. Gorman has given 50% weight to the CAPM result in calculating his midpoint. This is unreasonable and unsupportable given the testimony in this case regarding the concerns surrounding the CAPM. Although it may be appropriate to give some consideration to the CAPM in determining an ROE, as Dr. Morin has, establishing an ROE based 50% on the CAPM result is not justifiable based on the record in this case.

The top end of Mr. Gorman's ROE range is also unreasonably low for several reasons. First, Mr. Gorman has "watered down" the results of the standard, constant growth DCF analysis (which he calculated to be 11.10%) by averaging that result with two other less commonly used versions of the DCF method that produce lower ROEs—the multi-stage growth DCF (10.16%) and the sustainable growth DCF (10.20%)—to achieve an average DCF of 10.46%, which he then uses as the top end of his range (rounded to 10.5%). As Mr. Gorman acknowledged, this

Commission has typically used only the constant growth DCF method in the past.[65] In recent cases it has also considered the multi-stage DCF method, but to Mr. Gorman's knowledge this Commission has never used Mr. Gorman's third DCF method, the sustainable growth DCF, to set an ROE.[66] If the results of Mr. Gorman's DCF methods had simply been considered separately in establishing his range (rather than being averaged), his constant growth DCF result would have helped offset the extremely low and problematic CAPM result and his range would have been from 11.02%-9.54%, with a midpoint of 10.28%.[67] Moreover, if the impact of the very low CAPM result (9.54%) had been tempered by averaging it with Mr. Gorman's risk premium result (10.06%) to set the bottom end of the range,[68] the range would have run from 11.02% to 9.8%, with a midpoint of 10.41%. Adjusting Mr. Gorman's range in this way does not challenge any of the methods that Mr. Gorman used, but it does provide less weight to the unusually low ROE produced by the CAPM method , and more weight to the ROE produced by the constant growth DCF that the Commission has most often relied upon in past cases. Moreover, it is a result that comes closer to the ROEs authorized for other integrated electric utilities across the country.

In addition to suggesting this recombination of Mr. Gorman's results to produce a more reasonable range and midpoint, less impacted by the CAPM, AmerenUE does take issue with the way Mr. Gorman conducted two of his DCF analyses. Mr. Gorman has arbitrarily changed the way that he conducted both his constant growth and his sustainable growth DCF analyses from the way those analyses were conducted in AmerenUE's last rate case, which was tried just over

[65] Tr. p. 1961, l. 22-25.
[66] Tr. p. 1962, l. 10-16.
[67] Tr. p. 1974, l. 8 to p. 1975, l. 1.
[68] This is not a novel idea. In AmerenUE's last rate case Mr. Gorman averaged his CAPM and Risk Premium results to establish one end of his range, in that case the top end. Tr. p. 1964, l. 8-24.

one year ago. The impact of Mr. Gorman's changes to these methods, as one might expect, has been to materially lower his ROE recommendation from what it would otherwise be.

With regard to his constant growth DCF analysis, Mr. Gorman has opportunistically switched from using the *averages* of results for the two proxy groups (which he used in the last case) to the *medians*. Although that may seem like an insignificant change, in this case that change alone reduced Mr. Gorman's constant growth DCF result from 12% to 11.02%.[69] There are advantages and disadvantages to using both medians and averages. Averaging has the advantage of considering all available data, while using medians excludes outlier data. But Mr. Gorman's abrupt switch from using averages to medians in just over a year seems to be designed to produce a lower constant growth DCF result in this case. If Mr. Gorman had split the difference by averaging all four figures—the median results and the average results for the two proxy groups—he would have had a constant growth DCF result of 11.51%, which would have more fairly offset the very low CAPM result.[70] But Mr. Gorman's complete failure to consider his average results in this case, just one year after he relied on those averages in estimating AmerenUE's ROE, is not reasonable.

With regard to Mr. Gorman's sustainable growth DCF, he again calculated both median and average results for the two proxy groups. Again, he departed from his practice of using averages in the last rate case[71] and focused on the median results. This time, he also completely excluded the median results for one of his two proxy groups, apparently simply because he considered it to be too high. As a consequence, Mr. Gorman arbitrarily selected the lowest of the

[69] Tr. p. 1967, l. 5 to p. 1969, l. 3. If Mr. Gorman had used this adjusted constant growth DCF result (12%) as the upper end of his range, and his CAPM result (9.54%) as the lower end of his range, his midpoint would have been 10.77%. Ex. 172

[70] If Mr. Gorman had used 11.51% as the upper end of his range and his CAPM result (9.54%) as the lower end of his range, his midpoint would have been 10.52%.

[71] Mr. Gorman did calculate a sustainable growth DCF in AmerenUE's last rate case based on the average results for the proxy groups, although he did not directly use it in determining his ROE recommendation. Tr. p. 1963, l. 10-15; p. 1971, l. 3-22.

four results (10.2%) for his sustainable growth DCF. If he had used the average results for both proxy groups, as he did last rate case,[72] his sustainable growth DCF result would have been 11.13%.[73] If he had averaged all four results, the medians and averages for both proxy groups, his sustainable growth DCF result would have been 10.99%.[74] By arbitrarily using only the lowest of the four numbers he calculated, Mr. Gorman was able to reduce his sustainable growth DCF result, and by extension his overall ROE recommendation.

Although AmerenUE does not object to the theoretical underpinnings of Mr. Gorman's analyses, every one of the choices that Mr. Gorman made—averaging his DCF analyses for the upper end of his range, using his very low CAPM result as the lower end of his range, switching to the use of median results rather than average results for his DCF analyses, and completely excluding the results of one proxy group in developing his sustainable growth estimate—are downward biased and thus drove his estimate below where it would otherwise be.[75] If the Commission is to use Mr. Gorman's recommendation as a starting point to set an authorized ROE in this case, it must adjust his recommendation to remove these biases.[76]

3. Mr. Lawton's midpoint roe is influenced too heavily by his CAPM and Risk Premium results and is influenced too little by his DCF results.

Mr. Lawton's midpoint ROE recommendation suffers from the same type of deficiency as Mr. Gorman's in that it gives substantial weight to CAPM and risk premium results, which Mr. Lawton himself testified should be viewed with considerable caution. Specifically,

[72] Tr. p. 1971, l. 19-22.
[73] Tr. p. 1971, l. 23 to p. 1972, l. 5.
[74] Tr. p. 1972, l. 7-10.
[75] The downward bias in Mr. Gorman's recommended ROE is also demonstrated by the fact that he is currently recommending a 10% ROE for Ameren's Illinois electric utilities, which are "wires only" utilities. As Mr. Gorman acknowledged in response to questions from Commissioner Davis, the Ameren Illinois utilities have no operational risk associated with generating facilities and they are permitted to recover 100% of their purchased power costs. Tr. p. 1983, l. 25 to p. 1985, l. 7.
[76] Mr. Gorman's recommendation should also be adjusted to account for the quarterly payment of dividends. Dr. Morin provided an extensive explanation of why an adjustment for quarterly dividends is appropriate. Tr. p. 1875, l. 10 to p. 1877, l. 3.

Mr. Lawton's range of ROEs is bounded on the lower end by his very low (9.3%) CAPM and Risk Premium results, giving 50% weight to those results. The upper end of his range is the lower of his two constant growth DCF calculations based on the proxy group average (10.9%), which is also weighted 50%.

Mr. Lawton's results are summarized on the following chart, which appears on p. 31 of his direct testimony:[77]

Model	Comparable Group Range
Constant Growth DCF	10.9%-11.1%
Two-Stage DCF	10.2%-10.4%
Risk Premium	9.3%-10.6%
CAPM	8.9%-9.3%

In setting his range, Mr. Lawton excluded lowest and highest numbers on the chart, resulting in his recommended range of 9.3%-10.9%, with a midpoint of 10.1%.

Mr. Lawton's two separate constant growth and two-stage DCF results represent the proxy group average and median for each method. However, the Risk Premium and CAPM numbers comprise two separate types of analyses. Specifically, for the Risk Premium analysis, the higher percentage (10.6%) includes an adjustment to account for the fact that bond rates and equity rates do not move in linear fashion. As Mr. Lawton testified, this adjustment "explains the inverse relationship between interest rates and risk premiums" and is "not an unreasonable approach."[78] Based on the foregoing, it would have been more appropriate for Mr. Lawton to use his adjusted Risk Premium amount of 10.6% as his Risk Premium result, rather than including the much lower 9.3% figure, which ended up forming the lower end of his range.

[77] Ex. 304, p. 31, l. 12.
[78] Tr., p. 2203, l. 7-14.

With regard to Mr. Lawton's CAPM results, they include a "plain vanilla" CAPM of 8.9% and an Empirical CAPM of 9.3%. Mr. Lawton testified that the Empirical CAPM or ECAPM was designed to "address the flaws" in the CAPM.[79] The ECAPM adjusts the results of the CAPM to reflect the fact that the plain vanilla CAPM will understate the return for low beta securities and understate the required return for high beta securities.[80] Mr. Lawton does not dispute that this is an appropriate adjustment.[81] Moreover, Dr. Morin explains in detail, in a 15-page Appendix A attached to his direct testimony, why the ECAPM adjustment is required. Under these circumstances, it was appropriate for Mr. Lawton to exclude the plain vanilla CAPM in establishing his range.

In addition, Mr. Lawton testified at the hearing that if his CAPM analyses were to be updated, they would be 20-30 basis points higher.[82] Moreover, if Mr. Lawton had used the 30-year Treasury bond rate in effect on March 16, 2010, his CAPM analyses would have increased by 40 basis points.[83] Mr. Lawton pointed out that he used a 3-month average of Treasury bond rates to smooth out variability, but in any event Mr. Lawton has admitted that an updated CAPM analysis would increase at least 20-30 basis points, which would in turn increase his recommendation.

Like Mr. Gorman's analysis, Mr. Lawton's analysis is too heavily influenced by risk premium methodologies which form one end of his range and influence his midpoint by 50%. As AmerenUE pointed out at the hearing, if Mr. Lawton had used only his DCF results to establish his range and midpoint, his midpoint would have been 10.65%. If he had weighted his

[79] Ex. 304, p. 30, l. 22-24 (Lawton direct).
[80] Tr. p. 2203, l. 23 to p. 2204, l. 6; Id. p. 30, l. 19-21.
[81] Tr. p. 2204, l. 13-15.
[82] Tr. p. 2197, l. 8-14.
[83] Tr. p. 2198, l. 23 to p. 2199, l. 1.

average DCF results 2/3 and weighted his risk premium/CAPM results 1/3, his midpoint would have been 10.44%.[84]

In any event, nit-picking Mr. Lawton's analysis is really not necessary. The range of Mr. Lawton's results runs up to 10.9%, well above Dr. Morin's recommended ROE and Mr. Lawton testified twice at the hearing that any ROE within his range would be reasonable. For example, in an exchange between Mr. Lawton and Commissioner Davis, Mr. Lawton made it clear that an ROE of 10.2% (which was mistakenly identified as Mr. Lawton's midpoint in his direct testimony) or 10.1% would be reasonable because both are within his range.

Q. [T]he table that everyone…asks about. Actually, I'm not…going to ask you. Just lines 14 through 16 you said, "The midpoint estimate for the comparable group is about 10.2%"

A. Yes, sir.

Q. 10.1 percent is about 10.2 percent.

A. Yes, I think I cleared that up in surrebuttal, sir.

Q. Okay. And—and so just to be clear, 10.2 percent is a reasonable estimate—

A. Yes.

Q. --on AmerenUE's cost of equity?

A. Yes, sir. It's within that—as I said to Mr. Byrne, anything within that range is reasonable, and 10.2 is within my range.[85]

AmerenUE believes that if the Commission uses Mr. Lawton's recommendation in this case, it should select an ROE at or near the top of his range.

D. Conclusion.

[84] Ex. 176; Tr. p. 2196, l. 4-13; Tr. p. 2201, l. 17 to p. 2202, l. 4.
[85] Tr. p. 2229, l. 14 to p. 2230, l. 4.

In setting an authorized ROE for AmerenUE, the Commission should take a step back and look at the big picture. *Bluefield* and *Hope* set the standards for the Commission decision. They hold that the authorized ROE must be sufficient not only to maintain the financial integrity of AmerenUE, but it must be also be commensurate with returns being earned by other enterprises having corresponding risks. It is not enough that the Commission set an ROE that will avoid AmerenUE suffering an immediate credit downgrade or other financial catastrophe—the return must also be commensurate with the returns available to investors from other alternative investments having similar risks.

The Commission has found and even the non-AmerenUE ROE witnesses have acknowledged that AmerenUE has about average risk for an integrated electric utility.[86] As a consequence, the average ROE awarded to integrated electric utilities, which has hovered in the vicinity of 10.6% for the past several years, has a great deal of relevance to this issue and is an important point of reference. In fact, the evidence in this case suggests that since AmerenUE is less able to earn its authorized return than other integrated electric utilities due to unusual regulatory lag in Missouri,[87] an authorized ROE higher than the national average is needed to enable AmerenUE to have the opportunity to actually earn a return commensurate with the returns being earned by other integrated electric utilities.[88]

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[86] "AmerenUE is an average company with average risk." *Re: Union Electric Company d/b/a AmerenUE*, Case No. ER-2007-0002, *Report and Order* (May 22, 2007) p. 41; Gorman: "Q: And you would agree with me that AmerenUE has about average risk for an integrated electric utility? A: I agree with that, yes." Tr. 1960. Murray: "Q: Let me—taking a step back, it's my understanding that your opinion is that the overall risk AmerenUE faces is about average for comparable companies; is that correct? A: Yes." Tr. 2030.

[87] Regulatory lag in Missouri is reflected in the 11-month rate case process, the statutory prohibition against CWIP in rate base, the use of historic rather than projected test years, and the use of interim rates only in emergencies. Dr. Morin, who has testified in more than 50 jurisdictions, testified that Missouri is in the bottom decile in terms of regulatory lag. Tr. 1935.

[88] The Commission has found that the utilities covered by RRA data are the market in which AmerenUE raises capital. Case No. ER-2007-0002, *supra*, p. 38.

There are other points of reference worth considering as well. This Commission recently issued an order authorizing a 10% ROE for Missouri Gas Energy,[89] a gas distribution utility with no generation assets and a straight-fixed variable rate design that virtually guarantees recovery of costs. Mr. Gorman and Mr. Lawton both acknowledged that gas distribution utilities having straight-fixed variable rate design are less risky than integrated electric utilities.[90] Mr. Lawton explained why there is a significant difference in the risk profiles of the two types of companies:

> Q: Okay. And you would agree, would you not, that integrated electric utilities are more risky than gas distribution companies that use straight fixed variable rate design?
>
> *A: Yes.*
>
> Q: And aren't even wires-only electric utilities riskier than a gas distribution company that uses straight fixed variable rate design?
>
> *A: Yes.*
>
> Q: All right. And isn't that because gas distribution utilities with—using straight fixed variable rate design are not subject to any consequences for load variation—any revenue recovery consequences due to load variation?
>
> *A: That—no. That would be correct. They're not subject to consequences through variation and throughput of gas, but they are subject to variation for loss of customers which obviously were very low.*
>
> Q: Okay. I mean, is—wouldn't it be fair to say that a gas utility with a straight fixed variable rate design is effectively guaranteed cost recovery absent customers leaving its system?
>
> *A: Yes.*
>
> Q: Okay. And would you agree that having straight fixed variable rate design is a significant risk mitigation factor?
>
> *A: In terms of recovery of revenues, absolutely*.[91]

[89] *Re: Missouri Gas Energy* File No. GR-2009-0355, *Report and Order* (February 10, 2010) p. 37.
[90] Lawton: Tr. 2188-2189; Gorman: Tr. 1959.
[91] Tr. 2188-2189.

This Commission's recent authorization of a 10% ROE for MGE, a gas distribution utility with no generation assets, a straight-fixed variable rate design that virtually guarantees cost recovery, and a purchased gas adjustment mechanism that allows 100% recovery of gas costs, is also a point of reference that suggests an ROE in the neighborhood of the national average for integrated electric utilities is warranted for AmerenUE.

A third point of reference worth considering is AmerenUE's existing authorized ROE of 10.76%. Since AmerenUE has not been able to earn anywhere close to this authorized ROE, and in fact has earned returns in the 6-8% range over the last two years, the Commission should be reluctant to reduce the Company's earnings even further by reducing the authorized ROE. This point of reference too supports adoption of the Company's proposed ROE.

Finally, the Commission should keep in mind the whole point of setting a fair ROE for a utility—to attract capital for the ultimate benefit of customers. Establishment of a reasonable ROE comparable to those authorized for other integrated electric utilities will help AmerenUE attract equity investors. But it will also encourage the Company to make capital investments in the state, beyond those minimum investments necessary to meet its statutory obligation to provide customers "safe and adequate" service. The Company's ability to make investments in smart grid, renewables, energy efficiency, and capital projects to enhance reliability depend in no small part on its ability to recover its costs in a timely manner and earn a fair return on its investment. Establishment of a reasonable ROE plays a significant role in that process, and will help ensure that AmerenUE has the ability to continue to invest in infrastructure that is important to the Company's customers and the state as a whole.

II. DEPRECIATION.

The depreciation issues in this case can generally be categorized as follows:

A. Should depreciation expense for the Company's steam production plants (the Labadie, Rush Island, Sioux and Meramec Plants) be determined by treating these four steam plants as mass property or by treating these plants as life span property;[92]

B. If the life span approach is used, should certain adjustments proposed by MIEC alone be made to these four steam production plants' depreciation rates;[93]

C. Regardless of how these four steam production plants' depreciation expense is determined, should an adjustment proposed by MIEC alone to the Company's proposed depreciation expense for the Callaway Nuclear Plant be made;[94] and

D. Should the "offset" proposed by MIEC alone be made to the Company's proposed depreciation expense applicable to its transmission and distribution (T&D) facilities or should depreciation expense for the T&D plant accounts be set using the standard or traditional approach?[95]

The depreciation issues in this case were the subject of testimony from AmerenUE witness John F. Wiedmayer, who performed a comprehensive depreciation study in accordance with the Commission's depreciation rules (Sch. JFW-ER1 to Ex. 104 (Wiedmayer direct)), including a life and net salvage analysis; Staff witness Arthur Rice, who also performed a comprehensive

[92] The same issue exists (as between the Company and the Staff) regarding the Company's hydroelectric facilities; MIEC takes no position on the hydroelectric facilities. MIEC has also provided a set of mass property depreciation rates for the Company's steam production accounts. As will be discussed further below, MIEC determined its set of mass property depreciation rates using essentially the same flawed parameters used by the Staff in Case No. ER-2007-0002, which the Staff now agrees are unreliable. For the reasons outlined herein, neither the Staff's nor MIEC's mass property depreciation rates for the steam production plants should be adopted, but if the mass property approach were to be used, the Staff's proposed rates for steam production and hydroelectric production facilities should be used, which would reduce the Company's depreciation expense for those accounts by $19.424 million (*see* the true-up reconciliation filed by the Staff). The Staff's proposed rates for production plant are accurately summarized on Schedule AWR-2B to Ex. 217 (Rice surrebuttal), as corrected by Sch. AWR-2Bcorr (which is part of Ex. 230, which was sponsored by Mr. Rice during the evidentiary hearings).

[93] If the life span approach is used, and assuming rejection of MIEC's proposed adjustments to the steam production plants' depreciation expense, the depreciation expense for the steam production and hydroelectric plants would be set according to AmerenUE's proposed depreciation expense (determined using the life span approach) for all of the steam production and hydroelectric plant accounts. The Company's proposed rates for production plant are accurately summarized in Mr. Rice's Schedules AWR-2B and AWR-2Bcorr, referenced in the prior footnote.

[94] The Company and the Staff propose identical depreciation expense and rates for the nuclear plant accounts.

[95] The Staff's and the Company's proposed depreciation expense for T&D facilities are summarized in Mr. Rice's Schedule AWR-3B to his surrebuttal testimony (Ex. 217), as corrected by Schedule AWR-3Bcorr (Ex. 230), in the last two columns. The Company recommends the Commission approve its proposed expense, but does not object to adoption of the Staff's proposed expense for T&D facilities, which is very similar to the Company's recommendation; the total T&D depreciation expense recommended by the Company varies from that recommended by the Staff by less than $200,000.

study; and MIEC witness James Selecky, who addressed certain isolated issues but did not perform a comprehensive study. AmerenUE witness Larry W. Loos of Black & Veatch also performed an analysis (Sch. LWL-ER1 to Ex. 107 (Loos direct)) from which he determined estimated life spans for each of AmerenUE's four large steam production power plants – Labadie, Rush Island, Sioux and Meramec. There exists only one substantive issue in dispute between the Company and the Staff, that is, issue "A" listed above, which relates to the use of life span versus mass property depreciation rates for the steam production power plants. All of the remaining depreciation issues arise from various "adjustments" advocated by MIEC alone to the depreciation rates proposed by the Company.

A. Life Span Treatment of Power Plants.

Every witness in this case agrees that *Public Utilities Depreciation Practices* and *Depreciation Systems* are authoritative sources of depreciation accounting practices for public utilities.[96] It is also undisputed that both of these sources classify power plants as "life span property" and that power plants do not fall within the definitions and parameters set forth in these sources for "mass property."[97] The Staff's own depreciation study manual describes life span property as follows:

> Unlike mass utility property such as poles, mains, conductors, etc., there exists utility property that *requires* some forecast as to its date of retirement. Types of plant applicable to this type of analysis are buildings, *electric power plants . . . (emphasis added).*[98]

[96] *Public Utilities Depreciation Practices*, National Association of Regulatory Utility Commissioners (1996) (sometimes called the "NARUC Manual"); *Depreciation Systems*, Wolf, Frank K. and W. Chester Fitch (Ia. St. U. Press 1994). Ex. 104 (Wiedmayer direct), p. 8, l. 13 to p. 9, l. 24; Tr. p. 1390, l. 15-18; Ex. 231, p. 88; Tr. p. 1466, l. 9-17.
[97] Life span property includes "electric power plants" (NARUC Manual, p. 141) or as described by *Depreciation Systems* "equipment used to generate electrical power and housed in either a dam or a building" (i.e., power plants) (*Depreciation Systems*, p. 255). The NARUC Manual (p. 141) states that power plants are "most appropriately" studied using the life span method. This is discussed in more detail in Mr. Wiedmayer's direct testimony, Ex. 104, p. 8, l. 13 to p. 9, l. 25.
[98] Ex. 231, p. 44.

The only three experts in this case who have ever performed depreciation studies in other states, Messrs. Wiedmayer, Loos, and Selecky, are unanimous in their use of the life span method to determine depreciation expense for power plants.[99] Mr. Wiedmayer specifically testified that despite the fact that his firm performs depreciation studies for utilities in virtually every state, he was aware of *no* other state that fails to recognize that power plants are life span property.[100] This makes sense – authoritative sources all contemplate treating power plants as what they are – life span property. Mr. Loos, who like Mr. Wiedmayer is a member of the Society of Depreciation Professionals, who himself performs depreciation studies, and who has been with Black & Veatch since 1971, testified that he is more comfortable with the life span method and that the life span approach eliminates intergenerational subsidies, but that the mass property approach will always produce such intergenerational subsidies.[101] Indeed, the Staff itself uses the life span approach for the Callaway Plant.[102]

The point is not that the Commission should automatically use the life span approach just because literally everyone else does, but when the record shows that every authoritative source, all other jurisdictions and all other qualified witnesses in this case all regularly use the life span approach for electric power plants, it raises the serious question of why the Staff, and the Staff alone,[103] advocates treatment of AmerenUE's steam generating plants as if they were like poles and wires, when obviously they are not. This outlier position should be particularly troubling when one considers that the depreciation rates the Staff is recommending would place AmerenUE's depreciation rates at barely the 20th percentile nationally.[104]

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[99] Mr. Selecky proposed mass property rates in this case, but it is the only time he has ever done so in the past 25 years of his practice with Brubaker and Associates. Tr. p. 1476, l. 17 to p. 1477, l. 25; Ex. 170.
[100] Ex. 104, p. 30, l. 7-10.
[101] Tr. p. 1297, l. 14-21; p. 1321, l. 3-7.
[102] Tr. p. 1268, l. 25 to p. 1269, l. 24.
[103] Save Mr. Selecky's one-time presentation of mass property rates in this case, as addressed below.
[104] Ex. 105, p. 5, l. 18-21 (Wiedmayer rebuttal).

1. **<u>The Staff's treatment of these power plants as mass property when they are in fact undeniably life span property fails to recover the service value of the plants over their service lives and thus contravenes the fundamental goal of depreciation.</u>**

Mr. Rice authored the depreciation section of the Staff Report (starting at page 94), and therein introduces a concept not found in any authoritative source, something he calls "true mass property treatment."[105] The premise of this "true mass property treatment" is that *if* the final retirement history in the Company's data is sufficient; *if* it is representative of the current power plants so as to allow a valid and statistically significant analysis, it in theory should lead to a result that is similar to the result reached using the life span method. However, as is demonstrated by this record, the Staff's so-called true mass property treatment leads to false results because it relies upon *insufficient* data that does not allow a statistically significant analysis. Consequently, mass property treatment of these plants will leave an un-depreciated balance when they are retired, which will create an intergenerational shift of costs that should be paid by ratepayers now to ratepayers who will not then be receiving service from the retired plant. Moreover, those same future ratepayers who will not then be taking service from the plant will have to pay the costs of replacement resources that will then be serving them, whether those replacement resources are more power plants, demand-side measures, or power from renewables. That result contravenes *the* fundamental goal of depreciation accounting – the recovery of the service value of the plant over its service life. As explained by Mr. Wiedmayer, the service value of a plant – e.g., the Labadie Plant – is the investment in that plant plus its net salvage. The service life of the plant is, as the phrase implies, the period during which the plant provides service.[106] These definitions are prescribed by the Uniform System of Accounts (USOA), which

[105] Ex. 200, p. 103, l. 17-28 (Staff's Cost of Service Report).
[106] Ex. 104, p. 6, l. 15 to p. 7, l. 20.

requires utilities to "use a method of depreciation that allocates in a systemic and rational manner the service value of depreciable property over the service life of the property."[107]

The Staff claims that its "true mass property treatment" "should" accomplish that goal, but as we show below, the record in this case demonstrates with great clarity that it does not. In so-called "true mass property treatment," the Staff lumps all of the power plants together (i.e., treats them as mass property, even though they are unlike mass property) and then tries to rely upon final power plant retirement data in the Company's depreciation database or history to predict the proper depreciation parameters (i.e., the average service lives of plant components) in each of the individual accounts that make up a steam production plant. The average service life is important, because in the mass property approach, it drives the depreciation rate.

To take an example, assume a power plant is installed in 1970, retires in 2030, and that at 10-year intervals between those dates substantial additions to the plant were made. With mass property treatment, the same average service life is applied to the addition made in 2020 as to the initial construction in 1970. We *know* that the actual life of these various components will *not* be the same because it is obvious that the investment made in 1970 that remains in service when the plant is retired in 2030 will have had a service life of 60 years, while the addition made in 2020 will have had a service life of at most just 10 years. Yet the Staff uses the same average service life for all plant components, regardless of at what point in the life of the plant they were installed. The Staff's method simply does not recognize the obvious fact that when the plant is ultimately retired, all plant components of all vintages will be simultaneously retired.

By contrast, under the life span approach every vintage of plant addition (e.g., a 1970 vintage versus a 2010 vintage) has a unique life because, obviously, every vintage will in fact "live" for a different period of time. In the life span approach ignoring interim retirements, we

[107] 18 CFR Part 101 USOA, General Instruction 22.

depreciate the 1970 addition over 60 years and the 2020 addition over 10 years, recognizing the simultaneous retirement of all vintages at the end of the plant's life.[108]

The problem for the Staff is that there is *insufficient* final retirement history in the Company's database to lead to a "true" (and thus reasonably accurate and reliable) depreciation rate, as Mr. Rice readily admits:

> Q. You've got some concerns about whether you've managed to accomplish a true mass property result in this case, don't you?
>
> *A. Yes.*
>
> Q. And the reason you question whether the data is sufficient, the reason for your concerns is because there's not much information in that data at all about final steam plant retirements, is there?
>
> *A. That's correct. I mean, there is information in there, but it's – it's nowhere near the number of dollars that are currently in service.*[109]
>
> * * *
>
> Q. And then you go on to say a little farther down that, "If the Staff and the Company each had a historical database which represented the existing plants, the analysis result – analysis result by either method would have been closer." Right, did you say that?
>
> *A. Yes.*
>
> Q. But again, that's that big if we talked about before, right? That is the condition and the condition **is not met, *right?***
>
> *A. Correct.*[110](emphasis in **bold**).

The impropriety of treating this life span property as mass property is thus obvious. The Staff has tried to predict what the average service lives of every component of these four large

[108] Staff would argue that if the 60-year life estimate for the plant turns out to be wrong then the right amount of depreciation may not be collected. That will not, however, be a problem because a new depreciation study *must* be performed no less frequently than every five years (4 CSR 240-3.175), and within three years if there is a rate case. This means that the life estimates will be updated (and depreciation rates can be adjusted accordingly) on a regular basis so that at the end of the life of a power plant it will have been depreciated fully, *no more and no less*.
[109] Tr. p. 1383, l. 25 to p. 1384, l. 10. So when the Staff counsel, in her mini-opening statement on the depreciation issue, told the Commission that "if you have a representative history [of final retirements in the database], you 'should' get the same result," that "if" was a "big if," a point with which Mr. Rice agreed. Tr. p. 1383, l. 19-24.
[110] Tr. p. 1404, l. 6-15.

power plants will be using final retirement data from much smaller power plants that were (in most cases) retired decades ago using the same kind of actuarial analysis it uses for mass property (poles, wires, transformers, which exist by the tens of thousands). The problem is that the data upon which it bases its flawed actuarial analysis contains an extremely small and inadequate level of retirement history consisting of a comparatively small number of dollars invested decades ago in those old plants. This small level of dollars, which is "nowhere near" the billions of dollars invested in Labadie, Rush Island, Sioux and Meramec, creates a flawed actuarial result which in turn leads to a level of depreciation expense that will not recover the investment in these plants by the time they retire. As Mr. Rice conceded, it is "probably correct" that this inadequate retirement history will result in customers who are served by those plants *failing to pay* the plant's full cost over its life.[111] Yet the fundamental goal of depreciation accounting is to ensure that customers served by the plant in fact do pay the plant's full cost over its life.[112]

Mr. Rice made additional concessions in this regard. The Staff's Report indicates that when the mass property approach is used the "data [relied upon] are checked for reasonableness . . . to ensure sufficient data exist to perform a statistically significant analysis."[113] Yet Mr. Rice admits the data failed to pass this important reasonableness test:

> Q. Is it correct that in your testimony you say that part of the process you must go through when you are using the mass property approach is to check the data for reasonableness to ensure sufficient data exists to perform a statistically significant analysis; do you remember saying that?
>
> *A. Yes.*
>
> Q. Mr. Rice, you're not even sure if the final retirement data in the steam production plant accounts is sufficient to perform a statistically significant analysis, are you?

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[111] Tr. p. 1402, l. 3 to p. 1403, l. 18.
[112] Ex. 105, p. 15, l. 2-5.
[113] Ex. 200, p. 98, l. 1-3.

A. *No, I have no way of knowing that.*

Q. In fact, you have some serious doubts about whether there is—whether it is sufficient to perform a statistically significant analysis, don't you?

A. *When I look at the curves and the way they come out, it looks like there's insufficient data.*[114]

* * *

Q. And when you look at that very limited amount of data, and then you look at these four large existing steam production plants, that limited amount of data doesn't give you a whole lot to go on about what the life of these large, existing, more modern plants is going to be, does it?

A. *No, it does not.*[115]

Not only does Mr. Rice readily admit that his so-called "true mass property" result is flawed, but he admits that he *can't* use the mass property approach on these facts:

Q. Under what circumstances would you find it appropriate to use the life span approach to develop depreciation rates for steam production plant?

A. *If there was no or inadequate retirement history for the type of plant that you are looking at . .*
.

Q. So if the retirement history of the Company is inadequate, you really can't use a mass property approach. Is that another way of saying that?

A. *Correct.*[116]

But he used it nonetheless.

The nature of life span property strongly suggests that there will always be inadequate retirement history to treat life span property as something that it is not, which explains why authoritative sources and other states universally recognize that life span property requires use of the life span approach.

[114] Tr. p. 1386, l. 9 to p. 1387, l. 3.
[115] Ex. 108, p. 9, l. 8 to 22 (Loos surrebuttal) (quoting Rice Deposition, p. 74, l. 18-23).
[116] *Id.*, p. 10, l. 14-23 (quoting Rice Deposition, p. 25, l. 15 to p. 26, l. 2).

Consider power plants like the four large steam plants at AmerenUE. The older vintage steam plants in the database examined by Mr. Loos lasted, on average, about 44 years. Mr. Loos estimates that AmerenUE's steam plants will last between 61 and 72 years. So what happens is that a vintage of power plant, using a particular technology and design, is installed decades earlier and then eventually is retired in a "lump" and will likely be replaced with technology and design that probably could not have been contemplated when the old plant was installed. And due to inflation and other factors, the dollars needed to build that new plant are many, many times greater than the dollars invested in the old, retired plant. Take for example the Meramec Plant, which was installed in the mid-1950s to early 1960s. The Meramec Plant is less efficient than the other AmerenUE plants, and as Mr. Birk testified, two of the Meramec units are the last of their kind operating across the country.[117] But even after the Meramec Plant is retired, which will very likely occur before the retirement of any of the other three plants, it is doubtful that the final retirement history for AmerenUE will be sufficient to develop lives for the remaining three plants or for plants that will replace Meramec and ultimately Labadie, Rush Island and Sioux. This is because as we move through time the dollars associated with the plants that have not been retired dwarf the dollars associated with the older plants that have been retired.[118] Moreover, the dollars associated with building new plants in the future will almost certainly dwarf to an even greater degree the dollars associated with plants retired in the past.

If power plants were retired regularly – every couple or few years – then the database, this history – might at some point become sufficient to allow actuarial analysis of that regular and robust retirement history to be used to predict the retirement of power plants in the future. But that's not what happens with large power plants, and that is why they are "unlike" mass

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[117] Tr. p. 2709, l. 13-19.

[118] Consider, for example, that the Sioux Plant was built in the late 1960s for $140 million. From just 2006 to 2010, the Company is investing many times that amount in just the Sioux Plant alone. Ex. 104 HC, p. 20, l. 9, 17-22.

property. Mass property, like poles, wires, transformers, cross-arms, etc., is retired month-after-month, year-after-year in relatively large numbers. Over time sufficient retirement history is developed to allow reasonably accurate actuarial analyses. That is why depreciation experts (and all authoritative sources) treat poles, wires, transformers, and cross-arms as "mass property," and power plants as life span property. Indeed, NARUC's *Depreciation Practices* teaches that life span property *requires* a different analysis than does mass property:

> Lifespan and mass property have different retirement patterns and ***require*** different analysis. Mass property accounts use an age distribution or generation arrangement of survivors produced by the actuarial or computed mortality method. The lifespan accounts use primarily the unit investment surviving at a given date [i.e., at the estimated retirement date of the plant] (emphasis supplied).[119]

And Staff witness Rice admits that life span property requires different analysis, but nevertheless contradicts himself and uses the same analysis for power plants as he does for poles:

> Q. The passage you just read, that first sentence, it indicates that the lifespan and mass property require different analyses, right? Those approaches require different analyses, right?
>
> *A. Yes.*
>
> Q. But you're using the same analysis for a [sic] transmission and distribution plant which you would certainly characterize as mass property as you were using for the steam plants, right?
>
> *A. Correct.*[120]

The bottom line is that what we have is the Staff stubbornly adhering to a theory of their own making that they admit on the facts of this case *fails;* that they admit *is wrong*; that they admit *can't be used* for AmerenUE because of the insufficient retirement history (and, we would submit, makes no sense for life span property in any event because of the inherent differences between life span property and mass property). And if "true mass property treatment" doesn't

[119] Tr. p. 1392, l. 9-15 (quoting *Depreciation Practices*, p. 141).
[120] Tr. p. 1393, l. 1-10.

work then the service value of these plants will not be recovered over their service lives. This violates the USOA, it contravenes authoritative depreciation texts, and creates intergenerational inequity because customers served during the life of the plant will not fully pay for it, while future customers who will never take a single kWh from the plant will have to pay for part of it, while also, at the same time, paying for other resources that will then be needed to serve them.

2. The Commission has never "rejected" the life span approach.

Staff tries several weak justifications for its use of the mass property approach, the first of which is its suggestion that the Commission had "rejected" the life span approach for power plants, and that the Commission had a "policy" of doing so. Indeed, in the Staff Report, Mr. Rice misleadingly characterized the approach he was taking as being consistent with the "*Commission's* Depreciation Rate Formula" (emphasis supplied), the suggestion being that the Staff was following Commission policy, while the Company was not.[121] In his rebuttal testimony, Mr. Rice stated (incorrectly) that "the Commission rejected the life span approach in Case No. ER-2007-0002."[122] In his surrebuttal testimony, Mr. Rice (or so it appeared) went even further, claiming that Staff's advocacy of using the mass property approach for these plants was "Staff and Commission Policy," citing as support for this assertion a 2004 decision involving The Empire District Electric Company.[123] As it turned out, the Staff wasn't entirely forthright about the basis for its approach and its suggestion that its approach was "Commission policy" is false:

> *A.* *… those Commission decisions did not say that they [the Commission] rejected life span; it simply said they did not believe the dates that were chosen.*
>
> Q. To put it another way, the Commission – and you correct me if I'm – at any time – if I mischaracterize what you're saying, obviously you should

[121] Ex. 200, p. 97, l. 19.
[122] Ex. 216, p. 1, l. 23-24 (Rice rebuttal).
[123] Ex. 217, p. 10, l. 13 (Rice surrebuttal).

correct me. What you're saying is, it's your understanding, and the Staff's understanding, that the Commission has never said that the life span approach is an inappropriate approach for developing depreciation rates for steam production plant?

A. *That's correct.*[124]

***

Q. Mr. Rice, you have a diagram at the bottom of page 10 of your surrebuttal testimony don't you?

A. *Yes.*

Q. Now, your heading for this diagram at the bottom of page 10 of your surrebuttal testimony, it says, quote, Staff and Commission Policy For Computation of Depreciation Rate. Is that what you said?

A. *Well, I signed the affidavit, yes.*

Q. Did you write that, Mr. Rice?

A. *No.*

Q. It cites Commission Order ER-2004-0570, doesn't it?

A. *Yes.*

Q. Who wrote that that's the Staff and Commission policy for computation of depreciation rate if it wasn't you?

A. *Apparently it got in there during the edits.*

Q. It's not true is it?

A. *No.*

Q. Does the Commission's order in the Empire case say anywhere that it's the Commission's policy to treat steam production plant as mass property?

A. *No.*

Q. In the Empire case, the Commission just didn't believe the evidence about the estimated retirement dates based on the particular evidence in that case; isn't that right?

[124] Ex. 108, p. 1, l. 6-16 (Loos surrebuttal) (quoting Rice Deposition, p. 15, l. 23 to p. 16, l. 6).

A. *That's the way I read it, yes.*

Q. Empire's evidence in that case has nothing to do with the evidence in this case, does it?

A. *Not really.*

Q. So this citation to the Empire case really doesn't have any relevance to this case does it?

A. *That's the way I understand it, yes.*[125] (emphasis supplied in **bold**).

What is the Staff's explanation for these kinds of misstatements or exaggerations? The best the Staff could do is to suggest, during Staff Counsel's redirect of Mr. Rice, that because the graph at issue was a JPEG or BMP file the heading could not be edited.[126] If it is wrong and could not be edited, then it should never have been included in the first place.

3. <u>The Staff's contention that it has "no information" that these plants will retire is rebutted by the record in this case.</u>

Staff also pleads ignorance or is perhaps willfully blind with respect to its attempt to justify its use of the mass property approach. During the depreciation issue "mini-opening" the Commission was told that the "Staff is just saying that we have *no information* indicating that UE's existing coal fleet is going away for good any time soon, never to be replaced" (emphasis supplied).[127] That statement is contradicted by the Staff's depreciation witness:

> "Overall, I believe the estimated retirement dates presented by [Company witnesses] Wiedmayer and Loos to be reasonable. Short of a reversal of the environmental movement, and/or a decade long economic depression, I believe these plant [sic] will be slowly going away over the next 12 to 36 years."[128]

That statement is also contradicted by additional portions of the record in this case. The Staff had the Black & Veatch study supported by the testimony of Mr. Loos. Not only did the

[125] Tr. p. 1409, l. 23 to p. 1410, l. 1; p. 1410, l. 7-24; p. 1411, l. 12 to p. 1412, l. 8 (emphasis added).
[126] Tr. p. 1445, l. 25 to p. 1446, l. 4.
[127] Tr. p. 1239, l. 24 to p. 1240, l. 2
[128] Ex. 168. Perhaps the Staff will seek the parse words and argue that 12 to 36 years isn't "any time soon." The Commission can judge for itself the credibility of that position.

Staff have the Black & Veatch study, but Mr. Rice agreed that "the approach that Mr. Loos and Black & Veatch took in estimating the retirement dates is relatively complete and logical" and that the study was well done.[129] Indeed, Mr. Rice has no criticism of the study, given the limitations of trying to estimate the retirement dates of large steam units decades into the future.[130] Moreover, Mr. Wiedmayer presented information showing that there indeed have been retirements of units similar to units at the Meramec Plant, and that there have been announced or actual retirements of approximately 25 steam units just in the past year or so.[131] The recently announced or actual retirements demonstrates that plants of roughly the Meramec era (mid-1950s; early 1960s) are starting to retire.[132] As Mr. Wiedmayer testifies, this will inevitably occur with the Labadie, Rush Island and Sioux Plants, which were all placed in service substantially after the Meramec Plant.[133] The point is the record refutes the Staff's contention that it has "no reason" to believe these plants will in fact retire (and that the Staff just ignored the information it did have), including:

- The fact that its *own witness believes* these plants will go away between 2022 and 2046 – as estimated by the Company;

- The fact that the average age at retirement of the nearly 600 steam units reported in Appendix A-2 of the Black & Veatch report was approximately 44 years – AmerenUE's existing steam units *already* range in age from 33 to 57 years old;[134]

- The fact that other utilities and state commissions (see Appendix A-1 of the Black & Veatch report) were using a life span of approximately 55 years for final retirement of nearly 150 currently in-service steam units (AmerenUE's estimates are considerably longer – 61 to 72 years); and

- The fact that we are starting to see actual retirements of plants of similar vintage to AmerenUE's oldest plant, Meramec.

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[129] Tr. p. 1397, l. 5-12
[130] Tr. p. 1400, l. 6-13.
[131] Ex. 106, Schs. JFW-SR19 and JFW-SR20 (Wiedmayer surrebuttal).
[132] Ex. 106, p. 3, l. 13 to p. 4, l. 2.
[133] *Id.*
[134] Ex. 107 (Sch. LWL-E1, Table 1-1, p. 1-3).

4. **<u>Staff's argument that it chose to use the mass property approach because it had "no information" is also disingenuous because the Staff made up its mind to follow its flawed approach without even considering the evidence in this case.</u>**

For reasons that are not clear, the Staff was blind to, or willfully ignored, the severe data and methodological problems with its made-up "true mass property" approach and indeed ignored the overwhelming evidence that undermines its stubborn adherence to this approach. This is demonstrated by the fact that Mr. Rice was in effect *ordered* to use the mass property approach, regardless of its merits, and that this decision was made *before the Staff read or reviewed even one word* of the evidence in this case.

When Mr. Rice was asked about when and how the decision to use the mass property approach came about, he testified as follows:

> Q. When Mr. Gilbert[135] discussed with you – and this is my words – the virtues of using the mass property approach for steam production and the problems with using the life span approach, what had you reviewed from UE's filing at that time, when he first discussed it with you?
>
> *A. I think these discussions occurred prior to Ameren's filing for this case.*
>
> Q. So let me understand your testimony. Prior to seeing Mr. Wiedmayer's testimony, Mr. Loos' testimony, the Black and Veatch Report, Mr. Gilbert had essentially told you that the staff will use the mass property approach for steam production in a rate case; is that correct?
>
> *A. Yes. He indicated that – and now I think I'm taking it out of context – indicated that Staff's policy was to use the mass property method . . .*
>
> Q. …And did you take it from his recitation of the staff's policy that if you were asked to do a depreciation study in an electric race [sic] case for a utility that had steam production plants that you would be using the mass property approach?
>
> *A. For the steam production plants, that's correct.*[136]

[135] Mr. Gilbert is Mr. Rice's supervisor.
[136] Ex. 108, p. 11, l. 8 to p. 12, l. 8 (quoting Rice Deposition p. 21, l. 8 to p. 22, l. 9).

Not only did the Staff prejudge the issue; decide to use the flawed mass property approach for what is obviously life span property before they even considered the evidence *in this case*, but the Staff continued to stick to its guns as the case progressed:

> Q. When you [Mr. Rice] went to Mr. Gilbert and brought up good points that Mr. Wiedmayer or Mr. Loos had made, basically he told you it doesn't matter, the Staff believes they should use the mass property approach. Isn't that basically what he told you?
>
> *A. In general, yes.*
>
> Q. So isn't it fair to say that regardless of how meritorious the points Mr. Wiedmayer made about using lifespan for steam production plants, the Staff wasn't going to do it, were they?
>
> *A. Staff was going to offer the mass property approach, yes.*
>
> Q. Regardless of how good the points that Mr. Wiedmayer made?
>
> *A. Basically.*[137]

And Mr. Wiedmayer made good points, by the Staff's own admission:

> Q. Did you ever go to Mr. Gilbert and say, you know, Wiedmayer has a lot of concerns about this mass property, and I think he made some good points. What do you think about that?
>
> *A. Yes, I have done it.*
>
> * * *
>
> Q. And you do think Mr. Wiedmayer provided some reasonable information and that he had some good points don't you?
>
> *A. Yes.*[138]

5. <u>The Staff appears to have made up excuses for ignoring the fact that it should have treated these power plants as life span property.</u>

In the Staff Report, Mr. Rice tries to suggest that his true mass property approach is superior to the life span approach for these large power plants. As reasons, he states that it "removes the reliance on uncertain predictions of future retirement dates" and it guards against

[137] Tr. p. 1380, l. 17 to p. 1381, l. 6.
[138] Tr. p. 1379, l. 13-17; l. 20-23.

what he claims would be "a fixed mentality towards the actual retirement of that site, regardless of changing circumstances that might result in beneficial continuation of the use of the site."[139] Neither of these arguments withstands scrutiny.

First, the average service lives used by the Staff in treating this life span property as mass property are "uncertain predictions" – they are estimates, and as shown earlier, they are woefully flawed estimates derived from an inadequate retirement history that does not allow the Staff to perform a statistically significant actuarial analysis.[140] It is true that estimated life spans such as those developed by Mr. Loos are also estimates, but that is no reason to try to fit a square peg into a round hole and to treat life span property as mass property, when it is obvious that it is not. As the Commission recognized in its Third Report and Order in Case No. GR-99-315, "estimates are frequently used in the ratemaking process."[141] Indeed, in this case we have clear evidence that the retirement history is inadequate and thus has produced average service life estimates used by the Staff that will not produce a so-called "true" mass property result. By contrast, we have clear evidence that the estimated retirement date study done by Mr. Loos was logical, well done, and is the kind of study depreciation experts do when estimating power plant life spans. Indeed, save Mr. Selecky's argument that the estimated retirement date for the Meramec Plant should be extended (which we address later in this brief) no one claims that the estimated retirement dates developed by Mr. Loos are unreliable, wrong, or unreasonable and in fact there

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[139] Ex. 200, p. 104, l. 13-18.

[140] "Q. But ultimately, they're estimates of what the average service life is going to be, right? A. Correct." Tr. p. 1396, l. 21-23. Mr. Rice would argue that his estimates are "equally flawed" as compared to Mr. Loos' estimates. Tr. p. 1385, l. 17-23. His argument is specious. The record establishes that Staff's analysis isn't worth the paper it was written on. As discussed below, Mr. Rice had virtually no criticism of Mr. Loos' study, Mr. Selecky had no criticism at all, and indeed, the estimated life spans developed by Mr. Loos are in line with (indeed on high end of) those Mr. Selecky typically sees in cases around the country.

[141] *Re Laclede Gas Co*., 2005 WL 65953 (Mo. P.S.C.), Case No. GR-99-315 (Jan. 11, 2005).

is substantial evidence that they are *conservative*; i.e., perhaps too long, which lowers depreciation expense.[142]

Second, Mr. Rice, on cross-examination, totally abandoned his "fixed mentality" argument, demonstrating that his argument is false and provides no basis for treating life span property as mass property:

Q. You stated that, "In addition to being unreliable for any specific steam unit, a fixed retirement date for a specific plant site can result in a fixed mentality towards the actual retirement of that site regardless of the change in circumstances that might result in beneficial continuation of that site." Was that your testimony?

A. Yes.

Q. You didn't cite me to any specific example where utilities shut down a power plant because it had previously estimated a retirement date for depreciation purposes, you can't cite me to a single example, can you?

A. No.

Q. You can't cite me to a single example where any company that owned an industrial plant shut it down because it had previously estimated a retirement date for depreciation purposes, can you?

A. No.

Q. I mean, that statement that you made was made -- based upon -- solely upon your personal experience at a smaller Monsanto plant where you used to work where Monsanto had decided 18 or 24 months out that they were going to shut down the facility, right?

A. Correct.

Q. And that one personal experience is not analogous at all to the estimated retirement dates for electric power plants that are 10, 20, 30, 40 years into the future, is it?

A. Not 10, 20, 30 years, no.

Q. The Staff -- the statements you made at page 104, lines 15 to 18 is **nothing more than pure speculation, isn't it**?

[142] Tr. p. 1482, l. 16-21.

A. *That's correct.*[143] (emphasis supplied in **bold**).

6. <u>**The Staff woefully failed to show any valid criticism of the estimated retirement dates developed by Mr. Loos.**</u>

As noted, no valid criticisms of the dates Mr. Loos developed were presented. It is true that the Staff very briefly focused on Appendix A-2 to the Black & Veatch study and suggested that the retired units in that database are dissimilar to AmerenUE's current units, and he suggested that an "economic analysis" would have been better as the underlying basis for the retirement date estimates. But note that nowhere did the Staff *actually* take issue with whether the estimated 61 to 72 year life spans of these power plants were in fact unreasonable. All of the other parties in this case, including MIEC witness Selecky (except for Meramec, as we address below), took no issue with the reasonableness of those dates for use in developing depreciation rates for these plants using the life span method.[144]

Mr. Loos effectively addressed both of these minor criticisms. With regard to the first criticism, Mr. Loos pointed out that while Staff had a minor criticism of the data in Appendix A-2, the Staff totally ignored the data in Appendix A-1 and ignored the 12 other factors Mr. Loos considered in developing his estimated retirement dates.[145] Indeed, these timid criticisms are at odds with Mr. Rice's deposition testimony (quoted in Mr. Loos' surrebuttal testimony, Ex. 108, p. 7, l. 18-31), where he testified:

- He [Mr. Rice] spent *"enough time and"* has *"enough knowledge to be able to understand Larry Loos' testimony and thought it well done."*[146]

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[143] Tr. p. 1389, l. 4 to p. 1390, l. 13.
[144] "Q. That 61 to 73 years, that's on the high end of what you've typically been seeing used for other utilities that are using the lifespan approach in the rate cases to set the depreciation rates, right? A. I would say yes. * * * Q. And in fact, the manner in which Mr. Loos and Black & Veatch went about in – in developing those dates, that's essentially what you yourself have done in the past, isn't it? A. Something similar, yes. Q. You agree that the Black & Veatch analysis was reasonable and logical, wasn't it? A. It seems his approach was reasonable and logical, yes." Tr. p. 1482, l. 16-21; p. 1483, l. 10-18 (Mr. Selecky).
[145] See Ex. 108, p. 6, l. 1 to p. 7, l. 8.
[146] Rice Deposition, p. 26, l. 24 through p. 27, l. 2.

- *"What Mr. Loos did is rational."*[147]

- *"What Black & Veatch done (sic) is relatively complete, logical."*[148]

- The Black & Veatch study *"is as reliable, or at least within a reasonable range of reliability, of what could be done today."*[149]

- He does not *"really have any criticism of what they (Black & Veatch) did given the limitations of trying to estimate the retirement of large steam units decades into the future."*[150]

- *"They did pretty much probably all they could."*[151]

With regard to the criticism that Mr. Loos did not perform an economic study, Mr. Rice agreed that such a study *cannot be done*.[152] Moreover, Mr. Loos testified that the advantage of any such analysis over the study he conducted would be very minimal, and that in any event he would not conduct such an analysis without also having the benefit of some of the analyses he conducted for this case.[153] Indeed, had Mr. Gilbert let Mr. Rice use the life span approach (which by now we respectfully suggest should have been used by the Staff), Mr. Rice "would have done something very similar to what Mr. Loos did to estimate retirement dates" for these four large steam plants.[154]

7. <u>As the Staff recognizes, its refusal to use the life span approach is inconsistent with its treatment of the Callaway Plant, and is problematic for the Company's hydroelectric plants.</u>

The Company has five large baseload power plants – Labadie, Rush Island, Sioux, Meramec and the Callaway Nuclear Plant. The Staff properly treats the Callaway Plant as life

[147] Rice Deposition, p. 68, l. 5.
[148] Rice Deposition, p. 110, l. 8-11.
[149] Rice Deposition, p. 110, l. 12-15.
[150] Rice Deposition, p. 110, l. 16-21.
[151] Rice Deposition, p. 110, l. 20-21.
[152] Ex. 108, p. 8, l. 1-6 (citing Rice Deposition, p. 110, l. 2-3).
[153] *Id.* p. 8, l. 14-17.
[154] Tr. p. 1400, l. 15-18.

span property. There is no logical reason to fail to do the same for Labadie, Rush Island, Sioux and Meramec, as recognized by the Staff's lead auditor on this case, Mr. Rackers:

> I just finished reading Wiedmayer's depreciation testimony in the UE case. On page 31 he says that the Missouri Commission uses Life Span for nuclear production plants. Hopefully this is a mischaracterization considering how we have always opposed the Life Span method and since in ER-20007-0002 was stipulated between Staff and Company on depreciation I don't think it is necessarily "Commission" use or acceptance. However, I know we are calculating rates differently for Callaway than we are for Wolf Creek so I'm concerned that what we have done can even be portrayed as acceptance of life span. * * * Something about what we did in establishing the depreciation rates for Callaway is or looks enough like life span that Wiedmayer is claiming it is and this will be used against us on the coal units.[155]

Mr. Rackers is right about the Staff being inconsistent, but his "hope" that Mr. Wiedmayer was mischaracterizing something fails, as Mr. Wiedmayer didn't mischaracterize anything. The point is that life span is appropriate for *all* of these large baseload units – nuclear and steam – not because anyone can know the precise date any plant will be retired,[156] but because we do know that they will be retired, as a unit, and that most of the components of the plants, regardless of if they were installed 50 years before retirement or just 5 years before retirement, will be retired concurrently. This is because power plant components are largely dependent on the overall life of the facility; that is, as future additions are made they become an integral part of the entire plant and when the plant goes away, so will its components.[157] This means one must capture the shorter-lived components in the depreciation expense, or else an un-depreciated balance will remain when the plant itself retires. But that will not happen under the Staff's approach as Mr. Rice admitted:

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[155] Ex. 167 (E-mails from Steve Rackers).

[156] The parties use an expected expiration date of a future Nuclear Regulatory Commission license that hasn't even yet been applied for to depreciate the Callaway Plant, assuming the current license will be extended. A future license may also be extended, or the plant may not last that long. However, this estimate is reasonable, just as the Black & Veatch estimates are reasonable and can, and should, be used to depreciate the steam plants.

[157] Ex. 105, p. 9, l. 2-7.

Q. And he told you that the mass property approach would not capture the short-lived equipment that remain in the plant when it retired and, in fact, he also told you that, in fact, if you do not have representative plants in your data, the mass property approach will not capture that short-lived property, will it?

A. That's what Mr. Wiedmayer said, yes
.
Q. And the problem Mr. Wiedmayer identified, in fact, does exist in this case, doesn't it?

A. Yes.[158]

The operation of the hydroelectric plants (except Keokuk, which was in-service before licenses were required) depends on licenses from the Federal Energy Regulatory Commission (FERC). This is analogous to the license requirement for the Callaway Plant from the NRC. Logic would dictate that if one is going to use an NRC license expiration date to depreciate the components of the Callaway Plant, the same approach should be used with the FERC licenses for the Taum Sauk and Osage hydroelectric plants.[159] It is true that those licenses may later be extended (just as it is true that the parties are assuming that the current NRC license at the Callaway Plant will be extended, even though the license extension has not yet been applied for), but if that occurs the retirement date will be adjusted during those every three to five year depreciation studies required by the Commission's rules. Indeed, the fact that depreciation studies must be performed periodically will allow adjustments to the life span estimates and any needed adjustments to the depreciation rates so that any re-balancing that needs to occur to allow the "right" amount of depreciation expense to be collected as of the time the plant is retired can occur.[160]

[158] Tr. p. 1387, l. 7-18.
[159] This is what Mr. Selecky does when he uses the life span approach, which as noted below, he always uses. Tr. p. 1474, l. 23 to p. 1475, l. 9.
[160] That this will occur was recognized by the Commission in the *Laclede* case: "The Commission's rule requiring the submission of depreciation studies no less frequently than every five years provides a mechanism for monitoring the depreciation reserve so that this balancing can occur." Third Report and Order, Case No. GR-99-315.

8. MIEC's alternative mass property depreciation rates for the steam plants are flawed and must also be rejected.

In the 25 years he has been a consultant with Brubaker and Associates, this case is the *only* case in which Mr. Selecky presented mass property depreciation rates for steam production to a state regulatory commission.[161] He admits that a steam production plant is unlike mass property, saying they are "different animals."[162] He admits that while he said in his direct testimony that the Commission "rejected the lifespan method," what he literally said was not true.[163] And finally, he admits that the life span method is more equitable than the mass property method:

> Q. In your opinion, in fact, it's more equitable to estimate a date when each plant is going to be retired and depreciate it based on that date, and as you point out, every three to five years update your depreciation study as opposed to using a 115-year average service life which assumes that at least one of these plants will last 230 years, correct?
>
> *A. That is the method I've used the most, yes, sir.*
>
> Q. And that's the method that you think is more equitable; isn't that right?
>
> *A. Generally, yes.*[164]

Despite all of that, Mr. Selecky opportunistically recommends reducing the Company's proposed depreciation expense for the steam production plants by more than $42 million based upon his selective use of the mass property approach in this case alone! And from where did he get his depreciation parameters that led to these shockingly low depreciation rates? Essentially he took them from a study the Staff did two rate cases ago that the Company pointed out then was flawed, and that the Staff itself now admits is flawed and unreliable.

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[161] Tr. p. 1476, l. 24 to p. 1477, l. 18.
[162] Tr. p. 1480, l. 21-25.
[163] Tr. p. 1480, l. 5-10.
[164] Tr. p. 1492, l. 24 to p. 1493, l. 11.

As outlined earlier, one could only in theory use the mass property approach to depreciate a power plant if there were sufficient final retirement history data upon which to base an actuarial analysis. Sufficient data does not exist, and this is a central problem with Staff's rates. But Mr. Selecky doesn't just use insufficient data – he uses *no data at all.* Mr. Selecky *ignores* what little final retirement data there is which leads to shockingly long *average* service lives which would suggest these plants will live longer than he admits they are likely to live. Mr. Rice explained the fatal flaw in Mr. Selecky's mass property rates during the evidentiary hearings:

> Q. What Mr. Selecky has done with the mass property rates he calculated is essentially to make precisely the same mistake that Jolie Mathis of the Staff made two rate cases ago; is that right?
>
> *A. That's my understanding, yes.*
>
> Q. Well, when you say it's your understanding, you've looked at what he did and –
>
> *A. I've looked at what he did, and the best I can tell, that is what he did.*
>
> Q. I mean, his average service lives and his net salvage percentages against [sic] mass property rates are essentially – not exactly, but they're very close to what Ms. Mathis used, correct?
>
> *A. Correct.*
>
> Q. And there are problems with the average service lives Ms. Mathis used, aren't there?
>
> *A. Correct.*
>
> Q. He doesn't even – Mr. Selecky doesn't even come close to true mass property treatment, right?
>
> *A. Correct.*
>
> Q. I mean, the problem is, you've got a sufficiency-of-data problem because you don't have very much final retirement history, but he ignores final retirement history, right?
>
> *A. Correct.*

Q. So he's got the problem you have, only he's got it a lot worse, doesn't he?

A. Yes.

Q. So Staff's analysis from ER-2007-0002 is invalid, and Mr. Selecky's is just as invalid, isn't it?

A. That's my conclusion, yes.[165]

Mr. Selecky doesn't deny that he is essentially using the same, long average service lives as used by Staff witness Mathis two rate cases ago.[166] And Mr. Selecky also admits that if these plants are retired within the next 25-34 years (when even the youngest of them would be about 70 years old, which is longer than the approximately 60 years Mr. Selecky typically sees in use in calculating depreciation rates) there is a "pretty strong potential" that there will be an un-recovered balance that is not depreciated that will have to be recovered from future ratepayers not then being served by the plants.[167] In summary, Mr. Selecky's alternative mass property rates for the steam plants should be totally ignored.[168]

B. Other Production Plant Depreciation Issues.

MIEC, in what appears to the Company is an attempt to hedge its bets in case its mass property rates are rejected, seeks to lower AmerenUE's depreciation rates for its production plants in other ways. These recommendations should be approached with great skepticism insofar as Mr. Selecky was willing to suggest a $42 million reduction to the Company's steam production plant depreciation rates using a mass property approach he has never used before and

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[165] Tr. p. 1416, l. 5 to p. 1417, l. 13.
[166] Tr. p. 1487, l. 8-12. Mr. Wiedmayer's testimony confirms this as well. Ex. 105, Table 1, p. 22.
[167] Tr. p. 1 491, l. 16 to p. 1492, l. 21.
[168] As another point of reference demonstrating the unreasonableness of Mr. Selecky's mass property rates, consider the fact that in the largest steam production plant account (Account 312, Boiler Equipment), Mr. Selecky uses an *average* service life of 115 years. Use of an *average* service life of 115 years implies that one or more of the four existing coal-fired steam plants will live approximately *230 years*! – until about the year 2183 to 2206. Yet Mr. Selecky admits that he found all of the life span estimates determined by Black & Veatch to be reasonable (with one exception – he thinks five years needs to be added to the Meramec Plant life span). Those life span estimates range from 61 to 72 years – not 230 years.

while using depreciation parameters that he admits will likely leave an un-recovered balance for these plants. Perhaps, as he did regarding transmission and distribution plant depreciation, Mr. Selecky was just "running something up the flagpole" in the hope the Commission might cut the Company's depreciation expense, regardless of the evidence. In any event, just as Mr. Selecky's mass property rates are not credible, neither are his other recommendations.

The first way in which Mr. Selecky tries to cut power plant depreciation expense (even if the life span approach is used) is to argue that the estimated retirement date for the Meramec Plant should be extended for five years. His second attempt to cut depreciation expense is to use a variant of the repeatedly-rejected argument that one should rely on actual net salvage expense levels in the recent past to determine future net salvage. Not surprisingly, he chooses to take this "approach" using the largest steam production account, Account 312 (Boiler Equipment), which we would submit not coincidentally would result in the largest possible reduction of depreciation expense among all of the steam production accounts. Third, Mr. Selecky proposes to selectively ignore the retirement of the steam generators at the Callaway. As noted earlier, the Staff disagrees with each of these proposals.

MIEC also brought in another witness, William Dunkel, to attack one aspect of the Staff's mass property rates for steam production. Mr. Dunkel argues that if the mass property rates were used, a portion of the net salvage should be removed from the computation of the rates, yet Mr. Selecky performed no such removal in his own mass property rates.

1. <u>Like Black & Veatch's other informed estimated retirement dates, the estimated retirement date for the Meramec Plant is reasonable.</u>

The first Meramec Plant unit went on line in 1953. The end of the plant's estimated life span in this case is 2022 – 69 years later. Mr. Selecky proposes to extend the life span of Meramec for depreciation purposes to 2027, which would require the assumption that Meramec will live for 74 years – that is, this requires the assumption that the oldest, least efficient plant in the fleet will live longer than the estimated life of *any* of the other plants.[169] This assumption makes no sense whatsoever.

The bases for his proposal are arbitrary and speculative. First Mr. Selecky looks at how old the units at AmerenUE's *other* steam plants (Labadie, Rush Island, and Sioux) would be at the time of their estimated retirement dates, and notes that the youngest of those other units at retirement will be approximately five years older than the youngest unit at Meramec as of the estimated retirement date of 2022. He then takes that irrelevant comparison and jumps to the conclusion that the Meramec units should be assumed to last that long as well. Second, Mr. Selecky implies that perhaps a scrubber will be added to Meramec, the suggestion being that such an investment would require a long pay-back period and would necessitate a life extension.[170] Third, he cites to a Burns and McDonnell study that did not purport to estimate what the life span of the Meramec Plant should be or is likely to be, but rather, was nothing more than an engineering analysis of the dollars that it would take to extend the Meramec Plant's life without regard to economic or environmental considerations, which are likely to be the two main drivers of the Meramec Plant's retirement.[171] Finally, he implies that because AmerenUE has not announced a specific resource to replace Meramec the estimated retirement date should be extended.

With regard to the first contention, and in fact all three of these contentions, AmerenUE witness Mark Birk testified that Meramec is a less efficient plant which requires higher fuel and

[169] Acceptance of Mr. Selecky's argument would reduce AmerenUE's proposed steam production plant depreciation expense by approximately $10 million. Tr. p. 1523, l. 9-14.
[170] Mr. Selecky makes this implication at page 12, l. 14-19 of his direct testimony (Ex. 403), and suggests it again at page 22, l. 3-10 of his surrebuttal testimony (Ex. 406).
[171] "*Should* AmerenUE find that they can continue to operate Meramec economically beyond the 2021/2025 time frame; a determination must then be made on future capital expenditures . . . [and] the potential financial impacts of environmental regulations are not factored into the estimates" (Emphasis added). Ex. 434 HC, p. 1-2.

emissions costs to operate.[172] He also testified that these facts make justification of major component replacement and/or environmental capital expenditures for the Meramec units much more difficult, which is "they key reason why it is estimated that the Meramec Plant will retire in 2022."[173] Mr. Selecky agrees that it is reasonable to expect less efficient plants to be retired before more efficient plants, yet he argues Meramec will live longer than the more efficient plants – this argument makes no sense.[174] Moreover, in rebuttal to the illogical argument that "just because the youngest of the units at the three other plants at retirement will be five years older than the youngest unit at Meramec suggests that Meramec will live for five more years," Mr. Birk pointed out that the historical operation of the Meramec Plant in cycling mode has put more stress and wear on the Meramec units as compared to the units at the other plants. That, coupled with inferior boiler metallurgy at Meramec vis-à-vis the other plants debunks Mr. Selecky's "theory" because it is unreasonable to assume the least efficient plant, which has been operated in a cycling mode, will live longer than the more efficient plants, which have been operated in steady baseload mode.[175]

With regard to the second contention, the Burns and McDonnell study sheds no light on a reasonable, expected retirement date for the Meramec Plant. The study gave *no consideration* to whether economics or environmental considerations would allow a life extension, but rather, simply said "what dollars might it take to keep producing power from the plant" *if* economics and environmental considerations would support spending the dollars at all. In the words of the study its purpose was to "determine what capital and O&M costs are required to continue

[172] Ex. 103, p. 12, l. 7-9.
[173] *Id.* p. 12, l. 9-12.
[174] Tr. p. 1496, l. 25 to p. 1497, l. 5.
[175] *Id.* p. 11, l. 12 to p. 12, l. 5.

operation of the Meramec Plant within the time frames provided."[176] The Burns and McDonnell study concluded that to extend the plant's life beyond 2021, capital expenditures at Meramec would need to be on the order of $50 million *per year* from 2009 to 2014, and then $20 million per year thereafter.[177] However, in the 2009 to 2011 time frame AmerenUE has spent/plans to spend in the area of just $50 million *total*, not the $150 million needed during those three years according to the Burns and McDonnell study.[178] Thus the study undermines extending the life beyond 2022.

With respect to Mr. Selecky's "implied life extension" arising from his speculation that scrubbers could be installed at Meramec, it suffices to say that Mr. Selecky has no basis for this claim, as he admits: "Q. You don't have any information that suggests that scrubbers will be installed at Meramec, right? *A. I have not.*"[179] In fact, there is a lot of evidence suggesting that scrubbers will not be installed. AmerenUE's Environmental Compliance Plan reflects no plan, and indeed no consideration of a plan, to install scrubbers at Meramec.[180] Moreover, the Black & Veatch study notes physical constraints on the ability to install scrubbers at Meramec.[181]

With respect to an option to repower Meramec, Mr. Birk testified that this would be unlikely:

> *A. I think if we were going to look to convert say Meramec 3 and 4 to natural gas, I think what you'd look to also is would it be more economically viable to, if you're going with natural gas [i.e., repowering], to go with a combined cycle plant somewhere else that would employ maybe 10 percent of the people and have much – all the – the amount of equipment that you described, it would probably be much, much less at a new plant that has a much better heat rate, that doesn't have all those water systems,*

[176] Ex. 434 HC, p. 1-1. Environmental considerations were not taken into account at all by Burns and McDonnell. Tr. p. 2755, l. 5-11.
[177] Tr. p. 2753, l. 20 to p. 2755, l. 5.
[178] *Id.*
[179] Tr. p. 1495, l. 15-18.
[180] Ex. 102 HC, Sch. MCB-E5, pp. 5-1 and 5-2. In contrast, it contains specific plans to engage in preliminary engineering to install scrubbers at Labadie and Rush Island if needed, and of course, a scrubber is currently being installed at Sioux.
[181] Tr. p. 1318, l. 2-7.

doesn't have all those air systems, that's really set up to burn natural gas like a combustion turbine system. I think when you go to decide, well, do you convert [repower] Meramec, the option you have to weigh are, how does that compare to a brand-new combined cycle plant somewhere that ultimately is much more efficient and has less equipment to operate and takes much less people to operate.[182]

Mr. Birk went on to point out that there are gas supply problems at Meramec,[183] and to expand on the unlikelihood of continuing operation of Meramec as a gas-fired plant, noting that:

- The Company has no plans to convert Meramec to a gas-fired plant;[184] and

- That it's not even on his radar screen to study given the amount of old components in the plant, the high heat rate, higher staffing needs [It takes 230 employees to run Meramec – 900 MW; six to ten employees to run the new combined-cycle plant at Venice – 600 MW], and higher O&M needed to run a re-powered Meramec Plant with all of its old components.[185]

Finally, the fact that AmerenUE has not announced a specific capacity replacement for Meramec is a red herring. Three of the four large steam plants at AmerenUE were built within just a 10-year period[186] – Meramec's estimated retirement date is 12 years away – so there is ample time to address replacement capacity. In fact, AmerenUE will file another Integrated Resource Plan in 2011, which will address its 20-year capacity needs and explain how, as of 2011, it might expect to meet those needs. Mr. Birk indicated that the Meramec capacity would likely be replaced with a combination of some form of additional gas-fired generation, some form of renewables, and some form of energy efficiency/demand response.[187] In addition, AmerenUE has recently acquired a large amount of intermediate and peaking capacity, and is long on total capacity.[188] There is ample time to determine "replacement capacity," if it is even

[182] Tr. p. 2720, l. 19 to p. 2721, l. 9. *See also* Tr. p. 2757, l. 19 to p. 2758, l. 10.
[183] Tr. p. 2719, l. 18 to p. 2720, l. 2; p. 2750, l. 12-22; p. 2751, l. 21 to p. 2752, l. 7.
[184] Tr. p. 2757, l. 19-22.
[185] *See generally* Tr. p. 2757, l. 23 to p. 2761, l. 17.
[186] Ex. 107, Table 1-1, p. 1-3 (Sioux, Rush Island, and Labadie were placed in service between 1967 and 1977).
[187] Tr. p. 2756, l. 8-13.
[188] Tr. p. 1500, l. 14 to p. 1501, l. 12.

required after 2022. The fact that such a decision has not been made today does not support the notion that this old, less efficient plant will live, as Mr. Selecky argues, longer than the estimated lives of the Company's newer, more efficient steam production plants, which no one has criticized.

2. **<u>The Company's estimated net salvage for Account 312, Boiler Equipment, is reasonable and supported by the depreciation study in this case.</u>**

Mr. Selecky's second attempt to find ways to reduce depreciation expense (by approximately $4.8 million) is to selectively reduce (i.e., make less negative) the net salvage percentage for the largest steam production plant account. His proposal is to discard Mr. Wiedmayer's net salvage recommendation of -15% in favor of his recommendation of -10%. Mr. Selecky bases this adjustment on his review of net salvage expense in the past (past interim retirements), related to plant components that are no longer in service. This is similar to the approach he takes for T&D net salvage (discussed later in this brief), where he looks at the *past* expense levels and then arbitrarily offsets what the *actuarial analysis* suggests the accrual for *future* net salvage needs to be. In the case of transmission and distribution expense, his first "offset" was a level he just "ran up the flagpole."[189] An examination of Mr. Selecky's Account 312 recommendation indicates it too fails to match the results of an actuarial analysis of the Company's history.[190]

Mr. Selecky's only analysis underlying his proposal regarding Account 312 is to simplistically start with an examination of recent past expense levels (which deals with plant retired in the past, which of course cost less to remove due to the impact of inflation), and then to escalate that past level of expense by a figure he pulled out of thin air -- 3% per year.

[189] Tr. p. 1516, l. 12-24.

[190] Note that in contrast to the amount of available *final* retirement history for steam plants, there have been a lot of *interim* retirements of equipment in Account 312, which allows one to perform an actuarial analysis for purpose of estimating net salvage relating to *interim* retirements.

As Mr. Wiedmayer explains, by contrast Mr. Wiedmayer used actual, interim retirement experience (over many decades – see page A-6 to A-7 to Schedule JFW-1 to Exhibit 104 (Wiedmayer direct)) to estimate the percentage of the components in Account 312 that will be retired on an interim basis versus the percent that will be retired upon final retirement of the plants.[191] Mr. Wiedmayer focuses on just the interim retirements to make sure he did not capture net salvage related to final retirements to the extent it existed in the data, because the Company made the decision in this case not to ask for final (terminal) net salvage. Mr. Wiedmayer explains that he accomplished this not by relying on recent past expense (which covers only a limited history during the lives of these four plants) and also without relying on an arbitrary 3% factor, but rather, by actually looking at what the data suggests will be the split between interim and final retirements when final retirement of the plant occurs. This is shown on page A-5 of Schedule JFW-1 to Mr. Wiedmayer's direct testimony, which is a part of the detailed depreciation study he performed.

Looking at page A-5 one can see there exists more than 50 years of interim retirement data (i.e., the "xxx" go out past 50 years). We can also see that at the point where the survivor curve is truncated (approximately 72 years – which is the longest of the estimated life spans for the four steam plants) the percent surviving will be approximately 35%; i.e., 35% of the components in this account will remain at final retirement, meaning the net salvage associated with those components will be terminal, not interim net salvage. As Mr. Wiedmayer explains at pages 47 to 49 of his rebuttal testimony (Ex. 105), the data suggests that approximately 60% of the retirements in this account will be interim. Consequently, Mr. Wiedmayer multiplied the

[191] Mr. Wiedmayer discusses his approach starting at p. 47, l. 9 through p. 49, line 2 of his direct testimony (Ex. 104).

actual net salvage experience over the life of this account (-25%) by 60%, resulting in a net salvage percentage for the interim retirements he was analyzing of -15%.[192]

This actuarial analysis, based on real Company data, supports Mr. Wiedmayer's net salvage percentage of -15% for this account. Moreover, common sense suggests that as these power plants age there will be more and more interim retirements (i.e., component replacements) and as we move through time, it will cost more and more to perform those retirements. This means net salvage will become increasingly negative over time.[193] That trend is apparent when one looks at the actual interim retirement (and net salvage) experience in Account 312. The data shows that the three-year moving average net salvage percentages have been above (more negative) -30 percent for *all but one three-year period* since 1998.[194] AmerenUE's depreciation expert conservatively used a net salvage percent of just -15 percent. As time passes that net salvage percent will need to become more negative. Mr. Selecky's proposal to make it even less negative (-10%) goes the wrong direction, is not supported by the Company's experience and should be rejected.

3. **The retirement of the steam generators at the Callaway Plant does not "dominate the history" and should be included in the life and net salvage analyses for the Callaway Plant, as was done by both the Company and the Staff.**

Mr. Selecky's final proposal seeks to reduce AmerenUE's depreciation expense by another approximately $4.9 million. The basis for this proposal has continued to shift as this case has progressed. Initially, Mr. Selecky claimed the retirements of the steam generators at the Callaway Plant were "not typical" and "dominat[ed] the history and thus should be excluded."[195] However, Mr. Wiedmayer pointed out in his rebuttal testimony that in just the next five years

[192] Page B-6 (Sch. JFW-E1) to Ex. 104 (Wiedmayer direct).
[193] Mr. Selecky agrees that net salvage percentages tend to become more negative over time. Tr. p. 1518, l. 20-22.
[194] Ex. 104, Sch. JFW-E1, p. B-7.
[195] Ex. 403, p. 18, l. 13 (Selecky direct).

there will be other major plant components that will also be retired (nearly $50 million worth), which is 60% of the dollars associated with the steam generator retirements.[196] Given that for depreciation purposes it is assumed that the Callaway Plant has lived less than half its estimated life (24 of 60 years), it is reasonable to expect that there will be many more substantial replacements at the Callaway Plant, that the steam generator plants will not "dominate the history" and that if they are ignored, it will "almost certainly overstate the remaining life calculations, which artificially reduces depreciation expense."[197]

What is Mr. Selecky's answer? He claims that Mr. Wiedmayer wants to include future retirements to raise depreciation rates now.[198] That claim is untrue. The depreciation rates for the Callaway Plant that were calculated by Messrs. Wiedmayer and Mr. Rice are simply based on a life analysis that includes *what actually happened*—and the steam generator retirements did actually happen. Mr. Wiedmayer's reference to the likelihood of substantial future retirements is an illustration that shows that Mr. Selecky's claim that the steam generator retirements are "not typical" is not true. The life and net salvage analyses in this case from which Messrs. Rice and Wiedmayer developed the depreciation rates for the Callaway Plant do not rely in any way on future retirements.

What Mr. Selecky is really arguing now (there was no mention of this in his direct testimony) is that payments by Westinghouse were "reimbursed retirements" (Ex. 406, p. 4, l. 4-5). He even claims that Mr. Rice, who agrees with the Company, has a "factual misunderstanding."[199] Actually it is Mr. Selecky who has the misunderstanding.

Despite MIEC's counsel's attempt to "convert" Mr. Rice to Mr. Selecky's views on this topic at the hearing, Mr. Rice pointed out that the payments from Westinghouse were applied to

[196] Ex. 105, p. 39, l. 10 to p. 40, l. 7.
[197] *Id.*, p. 40, l. 4-7.
[198] Ex. 406, p. 12, l. 2-3.
[199] *Id.*, p. 4, l. 10.

expenses, which means they were not applied to accumulated depreciation and were thus not "reimbursed retirements."[200] Mr. Rice was very clear on this point:

> Q. Am I correct that Exhibit 169, the response to Staff's DR 364, it indicates that none of these payments from Westinghouse or fuel credits or other credits the Company received, none of them were booked against accumulated depreciation?
>
> *A. Correct. That's my understanding.*
>
> * * *
>
> Q. [Quoting Mr. Rice's rebuttal testimony] "Retirements are removed from the life analysis if they are found to be reimbursed retirements." That would be one circumstance. These weren't reimbursed retirements were they, these generators?
>
> *A. I do not believe they were.*
>
> Q. And this other circumstance when you would do that is if there was evidence of – of a legal action showing fraud or misconduct, like if the Company engaged in fraud or misconduct?
>
> *A. Well, it may be the supplier in this case, but that's generally true, yes.*
>
> Q. And there's no evidence in any of these documents that we've seen relating to these steam generator retirements that there was misconduct or fraud, is there?
>
> *A. Not that I know of.*[201]

Mr. Rice did not have a factual misunderstanding. There is another reason that Mr. Selecky's argument that these retirements are not typical and thus should be ignored fails. As Mr. Wiedmayer points out, most nuclear plants have experienced problems with their steam generators, and have replaced or are planning to replace them.[202] Both Mr. Rice and Mr. Wiedmayer properly recognize that over a plant life now estimated to be 60 years, it is not atypical to have a large retirement of a plant component (and this is particularly true where most nuclear plants have replaced their steam generators), and to exclude that large retirement from

[200] Tr. p. 1357, l. 3-5.
[201] Tr. p. 1421, l. 7-12; p. 1421, l. 21 to p. 1422, l. 12.
[202] Ex. 105, p. 38, l. 1-7.

the life analysis will skew the life analysis and understate depreciation. Consequently, Mr. Selecky's adjustment should not be made.

Mr. Selecky's life analysis for Account 322, Reactor Plant Equipment is very rudimentary. He uses one data point to determine his life estimate while Staff and the Company used 24 data points (one for each year of the plant's operation) and visually fit an Iowa curve to those 24 data points. Also, Mr. Selecky simply calculates the average annual retirements, excluding the steam generators, for the first 24 years of Callaway's life. He then divides the plant exposures surviving at the plant's midpoint life (age 11.5 years) into the average annual retirement amount in order to determine a retirement ratio which he assumes is appropriate to use for every year in the plant's life from age 0 to 60.[203] However, this shortcut life analysis method is not appropriate when actuarial analyses of mortality data are available. The life estimates, i.e., the interim survivor curve, used by Staff and the Company were based on the retirement rate method of life analysis using *actual* Company data related to interim retirements.

In addition, it is inappropriate to determine an average annual retirement amount based on the first 24 years of a plant's life and use that amount to make projections of future retirement levels as Mr. Selecky did, since retirements levels are lower early-on in a plant's operating life than they are later when retirement levels increase as the plant ages. Mr. Selecky's argument is analogous to examining the retirement history of a brand new home over its first 10-15 years and using that history to project retirement costs over the home's 50-75 year life. During the early years there will be little in the way of major work done on the house, but as it ages, the work (and the cost) will accelerate (new roofs, furnaces, air-conditioners, siding, driveways, etc.).

[203] This overly simplistic shortcut methodology is reflected on Schedule JTS-4 to Mr. Selecky's direct testimony (Ex. 403 HC).

Consequently, doing what we almost always do, that is, using the entire retirement history in the account to develop the average service life, is appropriate.

With regard to net salvage in Account 322, leaving the steam generator retirements in the net salvage analysis does not skew the results, as claimed by Mr. Selecky. The actual experienced net salvage in Account 322 is -18 percent.[204] Mr. Selecky proposes to drastically reduce this net salvage percent down to just -1.2 percent. (Even if one excludes the steam generator replacement, the actual experience would be approximately -7 percent, not -1.2 percent).[205] The Company and the Staff both use a -10 percent net salvage percent,[206] which properly recognizes that perhaps 50% of the retirements at the Callaway Plant will be final retirements (which are accounted for in dollars collected from ratepayers and placed in the separate decommissioning trust fund required by federal law). This is why Mr. Wiedmayer did not unthinkingly use the -18 percent actually experienced. However, to use Mr. Selecky's incredibly low -1.2 percent essentially fails to accrue any costs for future interim removals at the Callaway Plant at all. Thus, the service value of the investment in this account will not be recovered over its life, which is contrary to sound depreciation accounting principles, authoritative texts, and the USOA.

4. <u>Mr. Dunkel's proposed adjustment to the Staff's mass property rates is inappropriate.</u>

For the reasons discussed in detail in Section II.A. above, the Staff's mass property rates for the four steam plants – Labadie, Rush Island, Sioux and Meramec – should not be used at all.[207] However, if the Commission chooses to implement the Staff's mass property rates, Mr. Dunkel's proposal to ignore a portion of the net salvage actually present in the retirement

[204] Ex. 105, p. 42, l. 17-19.
[205] *Id.*
[206] Schedule AWR-2B to Ex. 217 (Rice surrebuttal) (next to last column, row for Account 322 "(10)").
[207] If the life span approach is used, Mr. Dunkel's adjustment is moot and he does not recommend it be made.

history of the Company is improper.[208] This is because if the mass property approach is used, the underlying theory is that the depreciation reserve across all of the steam production accounts will cover all costs – the original investment, interim retirements (and salvage) and final retirements (and salvage). In other words, by definition when the mass property approach is used one must use all of the retirement history (i.e., you can't study just interim retirements, which is what Mr. Selecky did and which is why Mr. Selecky's average service lives are even more unreasonable than the Staff's). As the Staff points out, removal of a portion of the net salvage is not consistent with the USOA.[209]

Moreover, Mr. Dunkel's adjustment is inconsistent with MIEC's own mass property rates for steam production because Mr. Selecky, like the Staff, did not remove a portion of the net salvage from his net salvage percentages.[210]

Finally, as discussed in connection with the mass property versus life span issue, the mass property approach makes no distinction between interim and final retirements. Thus, it is logically inconsistent to draw that distinction, as Mr. Dunkel does, when his own client's expert, Mr. Selecky, is using a method that ignores that distinction.

C. Transmission and Distribution Plant Depreciation.

The Company's transmission and distribution plant depreciation expense was determined in precisely the manner sanctioned by this Commission in the *Laclede* case, *supra*, as affirmed in the Commission's subsequent decision involving Empire in Case No. ER-2004-0570, and in the Company's last rate case where depreciation was at issue, Case No. ER-2007-0002. Indeed, the Commission states that the method used by the Staff and the Company – the traditional or

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[208] Mr. Dunkel's proposal would, *if* the Staff's mass property approach for steam production were used, reduce the Staff's depreciation expense by approximately $5.7 million. Tr. p. 1461, l. 2-6.

[209] Ex. 217, p. 13, l. 4-13.

[210] For example, the actual net salvage percent for Account 312 (largest steam production account) is -25%. Ex. 104, Sch. JFW-E1, p. B-6. Mr. Selecky used a net salvage percentage of -25% for Account 312, meaning he did not make the adjustment Mr. Dunkel argues for. Ex. 403, Sch. JTS-5, p. 1.

accrual method addressed in detail in the *Laclede* decision discussed earlier – is required and that it is the "policy of the Commission" to use the traditional accounting methods for net salvage.[211] The Company (and the Staff) employed the method used in those cases by conducting an actuarial analysis of the decades of retirement and removal history related to its T&D plant, and from that analysis developed average service lives and net salvage percentages which were used in developing the depreciation rates. Mr. Selecky speculates that these analyses *could* be allowing the collection of more net salvage expense than the Company needs to cover net salvage for plant in service today, but offers absolutely no proof that his speculation is true.

When Mr. Selecky filed his direct testimony, he recommended a $35 million "offset" to the Company's proposed depreciation expense for T&D plant, claiming at that time that AmerenUE was proposing approximately $58 million of what he termed as "excess net salvage expense."[212] By "excess" he meant "more than recent levels of expense.[213] But by proposing a $35 million offset he was recommending to the Commission, in sworn testimony, that AmerenUE should be allowed to accrue approximately $41 million, or approximately $24 million more than these recent expense levels.[214] As discussed below, a couple of months later he arbitrarily revised his recommendation and now recommends that the Company be allowed to accrue just $28 million for net salvage – less than one-half of what an analysis of the Company's actual data indicates is necessary to cover the expected net salvage costs for the large quantity of T&D plant that is, today, serving customers.

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211 Report and Order, *In re: The Empire District Electric Co.*, Case No. ER-2004-0570 (March 10, 2005), pp. 54-55.
212 Sch. JTS-10, Ex. 403. The $58 million was based upon Mr. Selecky's belief that the net salvage built into AmerenUE's proposed T&D rates was $76 million versus a recent expense level of $17.1 million.
213 "The requested annual net salvage component of depreciation expense is significantly higher than AmerenUE's actual annual net salvage experience." Ex. 403, p. 26, l. 10-11. Mr. Selecky drew that conclusion from his examination of net salvage expenses during the past 10 years. Ex. 403, Sch. JTS-10. As discussed below, Mr. Selecky made a substantial mistake, however (an approximately $23 million per year overstatement) in his determination of the net salvage expense included in AmerenUE's proposed rates that he argued was too high.
214 His recent expense levels were based on five- and ten-year historical averages of net salvage costs for plant retired in the past. Ex. 403, Sch. JTS-10.

Mr. Selecky's revised $28 million per year accrual for net salvage exists because in his surrebuttal testimony Mr. Selecky proposed a $25 million, not a $35 million "offset" to the accrual for net salvage recommended by the Company.[215] Mr. Selecky apparently amended his position (but in an inconsistent and illogical manner, as we address below) because when he first advised this Commission in his direct case that it should allow AmerenUE approximately $41 million annually for T&D net salvage, he thought that AmerenUE was proposing to collect approximately $76 million of net salvage-related depreciation expense per year. Mr. Wiedmayer pointed out in his rebuttal testimony that Mr. Selecky had made a mistake, and that the correct figure was just $53 million per year.[216] Mr. Selecky admits he made a mistake (he claims the figure is $55 million, but agrees the difference between the two figures is "not significant").[217]

Logic (and consistency and intellectual honesty) would suggest that if an appropriate amount of net salvage for T&D on December 18, 2009 when Mr. Selecky filed his direct testimony was approximately $24 million more than recent expense levels (a $41 million accrual v. a $17.1 million recent expense level based upon historical averages), then barely two months later (even if one were to assume that Mr. Selecky's speculation that there might be "excess" net salvage accruals in the proposed depreciation rates had merit) a $41 million accrual should have remained appropriate. What that would suggest is that after discovering his mistake, his offset should have become $12 million ($53 million less $41 million) and not his made-up $25 million offset.[218] After all, nothing changed – the plant balance used to set depreciation rates didn't change; the recent historical net salvage expense levels didn't change; and the fact that an

[215] Ex. 406, p. 16, l. 5-7.
[216] Ex. 105, p. 55, l. 16-23.
[217] Ex. 406, p. 15, l. 21-22. Mr. Selecky apparently uses the Staff's accrual for net salvage of $55 million instead of the Company's accrual of $53 million. Since Mr. Selecky is proposing an offset to the Company's rates, the correct figure for comparison is the Company's figure, $53 million.
[218] *See generally* Tr. p. 1514, l. 24 to p. 1516, l. 24.

allowance above recent expense levels is needed to cover future net salvage expense didn't change.

The bottom line is that Mr. Selecky wants the Commission to believe that historical average levels of net salvage expense should be used to suggest that the net salvage expense proposed by the Company (and by the Staff now) is too high. It is, however, obvious Mr. Selecky has no idea by how much, or even if in fact the proposed net salvage expense is in fact too high (it just "seems" so to him), so to use his own words, he just "ran something up the flagpole" in an apparent hope that the Commission will let it fly there.[219]

1. **Past net salvage expense levels cannot be expected to form the basis for future net salvage accruals because the universe of T&D plant in service today is much, much larger than the universe retired in the recent past.**

In 1950, AmerenUE had a total investment in its distribution plant of just $29.6 million, and served 443,563 customers.[220] In 2009, those figures had become $4.2 billion and 1,033,362, respectively.[221] As Mr. Wiedmayer explained in detail, the "net salvage accrual [in depreciation expense] exceeds net salvage expense today because the transmission and distribution systems have been continuously growing and because inflation will make future removal costs more expensive than the costs to remove plant in the past."[222] Mr. Selecky agrees that it is not surprising at all that retirements in the recent past of plant placed in service decades ago cost a lot less than the retirements we must accrue for now to retire a much larger universe of plant decades from now.[223] Thus he agrees that past expense levels will be inadequate to cover future

[219] Tr. p. 1514, l. 24 to p. 1516, l. 24.
[220] Ex. 105, Sch. JFW-ER16.
[221] *Id.* The transmission system has also grown substantial, with the investment in transmission plant having nearly tripled since 1970. *Id.*
[222] Ex. 105, p. 69, l. 9-12.
[223] Tr. p. 1517, l. 15 to p. 1518, l. 22.

net salvage costs associated with plant in service today. He also agrees there will be inflation, and he agrees it will cost a lot more to remove T&D plant in the future than it did in the past.[224]

In attempting to explain how he came up with his new $25 million "offset" Mr. Selecky said that the past accrual for net salvage over the life of these T&D accounts ($582 million) "*seems* excessive" (emphasis added).[225] That hardly constitutes substantial and competent evidence to rebut the actuarial analyses conducted by the Company and the Staff, both of which support the conclusion that the proposed net salvage accrual is in fact not excessive. To support his contention that the past accrual "seems" excessive, Mr. Selecky makes a totally irrelevant comparison of that figure to the dollars collected since 1984 for the final decommissioning of the Callaway Plant. This comparison is irrelevant because first, terminal retirement costs at a *power plant* have nothing to do with, and there is no evidence that they bear any relationship to, the ongoing, constant net salvage expense incurred year after year after year when poles, conductors, transformers, etc. on the T&D system are retired. As discussed earlier in connection with the life span approach applicable to power plants, in Mr. Selecky's words mass property (like the T&D plant) and power plants (life span property) are "different animals."

Second, Mr. Selecky is comparing final (terminal) net salvage for a power plant, the un-depreciated investment in which is $2.8 billion, to net salvage costs for a vast universe of T&D plant, the un-depreciated investment in which is sixty percent larger, nearly $4.5 billion.[226] At bottom, Mr. Selecky is speculating and using irrelevant comparisons in an attempt to justify what to him "seems" too much. In point of fact, he has performed no analysis whatsoever that demonstrates that the net salvage expense proposed by the Company (and the Staff) is in fact excessive.

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[224] Tr. p. 1510, l. 4-16.
[225] Ex. 406, p. 16, l. 14.
[226] Sch. JFW-E1, pp. III-5, III-7 and III-8 (to Ex. 104).

2. <u>Use of the method employed by the Company and the Staff provides a better estimate of future net salvage costs (including future inflation) than does Mr. Selecky's arbitrary and shifting "offset."</u>

Mr. Selecky, as he did in Case No. ER-2007-002, complains that it "may not be a reasonable assumption" to project past inflation in accruing for future net salvage.[227] The Commission previously had this to say on that topic:

> [MIEC's] proposal to substitute projections of future inflation [which is effectively what Mr. Selecky's guess at his offset does] for historic rates of inflation is flawed by an overstatement of the average age of historical retirements used in the formulas for substituting projected future inflation for historic rates of inflation . . . . Even more fundamentally, MIEC and Public Counsel have failed to demonstrate any reason to believe their estimates of future inflation are a more reliable predictor of future inflation than the past history used by Staff and AmerenUE in their calculations. Expert predictions of future inflation can be little more than guesswork. It is impossible to accurately predict what inflation might occur 30 or 40 years in the future . . . . The Commission finds past history to be a better predictor of future inflation for ratemaking purposes.[228]

Not only has the Commission rejected this very argument, but Mr. Selecky admits he doesn't even know if his argument holds water in that he only claims it "may" not be a reasonable assumption. Inflation "may" be more than it has been historically; as the Commission recognized, "it is impossible" to predict for sure, but Mr. Selecky's conjecture that history "may" not be a good predictor of the future inflation is pure speculation.

3. <u>Mr. Selecky's suggestion that the net salvage expense determined by the Company and the Staff may be arbitrary fails to withstand scrutiny.</u>

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Mr. Selecky also tries to support his position in this case by testifying that "net salvage for plant is often determined quite arbitrarily."[229] Whether or not that's true in other cases not involving the Company we don't know, but there is no evidence the net salvage was determined arbitrarily in this case:

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[227] Ex. 403, p. 34, l. 14-15.
[228] Report and Order, Case No. ER-2007-002, p. 93.
[229] *Id.* p. 34, l. 9.

Q. You haven't even contended that the net salvage percentages used by the Company in this case were determined arbitrarily, have you?

A. *No, I took no issue with that* --[230]

4. <u>Mr. Selecky's approach is, in substance, in conflict with several recent Commission decisions and the approach used by the vast majority of state commissions.</u>

As noted above, for decades, Missouri utilities accrued future net salvage costs for their T&D plant through their depreciation rates based upon an actuarial analysis of their actual retirement and net salvage histories. In 1999, Laclede Gas Company filed a general rate case (Case No. GR-99-315). In that case, Laclede calculated depreciation based on the traditional method of recovering future net salvage ratably over the life of gas plant as it had done for many years. However, Staff witness Mr. Paul Adam recommended an entirely new approach, that is, that net salvage costs be treated in a manner similar to a normalized operating expense for ratemaking purposes. He did this by calculating the most recent five-year average net salvage and then used that amount as his net salvage allowance for ratemaking purposes.[231] Initially, the Commission agreed with Staff witness Adam when it issued its first Report and Order in the rate case on December 23, 1999.

Laclede Gas Company (along with intervenor AmerenUE) appealed the Commission's decision. The Staff at that time presented arguments similar to those offered by Mr. Selecky in this case; namely, that if utilities recover more through net salvage accruals than they are currently spending, they are (the Staff alleged) "over-recovering" (*cf.*, "seems too high") from ratepayers. The Missouri Court of Appeals rejected this line of argument, stating that the Commission (when it initially accepted the Staff's contention) "fail[ed] to provide a reasonable

[230] Tr. p. 1519, l. 19-22. In fact, while saying they are "often" determined arbitrarily, he admits he conducted no study to determine if in fact *in this case* they were determined arbitrarily, and indeed, he admits that *he used the net salvage ratios* determined by the Company. Tr. p. 1520, l. 1-11. The Staff's net salvage percentages are also almost identical to the Company's.
[231] The starting point for Mr. Selecky's approach is to also use five- and ten-year historical averages.

basis for its decision." *State of Missouri ex rel. Laclede Gas Co. and Union Elec. Co. d/b/a AmerenUE v. Pub. Serv. Comm. of Mo.*, 103 S.W.3d 813, 819 (Mo. Ct. App. 2003). It thus remanded the case back to the Commission for findings of fact sufficient to support its prior resolution of the net salvage issue.

On remand, in early 2005, the Commission ruled that indeed there was no support for the Staff's non-traditional approach (which depended on reliance on historical averages in the recent past) to net salvage and returned to the traditional, majority approach to the issue. The Commission found that prospectively accruing for future net salvage through depreciation rates as calculated by the Company and the Staff in this case was the proper ratemaking treatment for net salvage.

In doing so, the Commission recognized that it is "undisputed that using the accrual method for this purpose [for the purpose of including future net salvage in the depreciation accruals] is supported by the overwhelming weight of authority on such matters" (*Id.*, p. 8); that "such method is consistent with the Uniform System of Accounts" (*Id.*, p. 9); and that the accrual method is consistent with the fundamental goal of depreciation accounting, that is "to allocate the full cost of an asset, including its net salvage cost, over its economic or service life so that utility customers will be charged for the cost of the asset in proportion to the benefit they receive from its consumption" (*Id.*). Moreover, the Commission rejected the theory that relying on current or recently-historical net salvage expense levels was more equitable (a claim also made by Mr. Selecky on page 26 of his direct testimony in this case). In this regard, the Commission stated that "the accrual method comes closer to matching the costs to the benefits derived" and that "intergenerational equity will be promoted by the continued use of the accrual method." (*Id.*, p. 13).

5. **Mr. Selecky's offset recommendation is not faithful to the accrual method.**

Mr. Selecky would have the Commission believe that he is making a recommendation that is faithful to the accrual method, when in fact his approach is grounded on the dubious claim that recent expenditures for net salvage (for a smaller universe of plant no longer providing service) should form the basis for setting future net salvage accruals. The fact is that Mr. Selecky is not being faithful to the accrual method because all he is doing is running a new but no less arbitrary number ($25 million offset) up the flagpole *based upon his examination of current or recently-historical net salvage expense levels.*

Mr. Wiedmayer demonstrated why Mr. Selecky's arbitrary approach will not provide for full recovery of net salvage over the life of the asset in the examples contained in his Schedule JFW-ER15 to Ex. 105. Those schedules show that Mr. Selecky's proposal will result in a huge (nearly $758 million) under-recovery for Account 364, Poles, and in Account 365, Overhead Conductors, over the life of current plant in service. The $758 million under-recovery is the sum of the shortfall for Account 364 ($524,377,972 – page 2 of Schedule JFW-ER15) and the shortfall for Account 365 ($233,774,201 – page 4 of Schedule JFW-ER15).[232]

That the substance of what Mr. Selecky is really recommending is nothing more than a variant of the expense approach this Commission and nearly every other Commission has rejected is demonstrated by Mr. Selecky's own testimony. In support of his original $35 million offset, Mr. Selecky points to four other states that he says have relied on recent historical expense levels as a basis for reducing the net salvage accruals determined in the manner calculated by the Company and the Staff.[233] Aside from the fact that this leaves 46 states that

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[232] These figures were based upon Mr. Selecky's original $35 million "offset." While he has reduced his offset from $35 million to $25 million (a 28.6% drop), the shortfall will remain very substantial at approximately $541 million [(1-.286) * $758].
[233] Ex. 403, p. 35, l. 19 to p. 35, l. 18.

reject Mr. Selecky's theory, Mr. Selecky is nevertheless recycling old news. A review of the record in the *Laclede* case indicates that the Commission was aware of how at least three of these states handled net salvage when that case was re-tried in 2004.[234] At least one of them, and perhaps two of them, must base net salvage on historical expenses, as a result of a statute.[235] Moreover, there are recent decisions not mentioned by Mr. Selecky that reject variants of his approach. See, e.g., *In the Matter of the Application of Consumers Energy Company for Accounting Approval of Depreciation Rates for Gas Utility Plant*, Case No. U-15629 (Mi. P.S.C. Sept. 29, 2009), where Mr. Selecky's argument that recent historical expenditures should be used to determine future net salvage was summarized by the Michigan Commission as follows:[236]

> James T. Selecky, a consultant in the field of public utility regulation and a principal in the firm of Brubaker & Associates, Inc., testified on behalf of ABATE. According to Mr. Selecky, Consumers' proposed depreciation rates are excessive because the cost of removal component of the depreciation rates reflects unreasonable amounts for future inflation. As a result, the cost of removal expense included in the depreciation rates greatly exceeds the actual net salvage expense currently incurred and the net salvage expense likely to be incurred in the near future.
>
> Mr. Selecky testified that Consumers' proposed net salvage ratios produce an annual net salvage expense of $52.92 million. However, according to Mr. Selecky, Consumers' average actual annual net salvage expense over the last five years was $6.89 million, an amount that is 8 times lower than the company's proposed cost of removal expense. 3 Tr 298. Mr. Selecky testified that based on his analysis, Consumers has overstated the amount of net salvage that is included in depreciation rates and that this overstatement of net salvage places an unreasonable burden on today's ratepayers and provides a substantial benefit to future ratepayers. Mr. Selecky opined that the amount of net salvage included in Consumers' depreciation rates should be reduced to reflect a more accurate expectation of the level of net salvage expense that the company expects to incur over the next five to ten year period. Mr. Selecky testified that the disparity between net salvage expense included in Consumers' depreciation rates and actual net salvage costs is largely attributable to an overestimate of future inflation rates.
>
> Mr. Selecky recommended that Consumers' net salvage expense should be based

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[234] Tr. p. 1455, l. 5; p. 1456, l. 15; p. 2009, l. 19-21 (Case No. GR-99-315 – hearings September 22 to 24, 2004) (Where the approaches used in Pennsylvania, New Jersey and Georgia were discussed).
[235] Ex. 105, p. 65, l. 1-7.
[236] A discussion of this case is contained at pages 65 to 66 of Ex. 105.

> on the actual net salvage cost experience of the company over 15 years, the longest period for which data was available. Once the historical 15-year average was identified, this amount was then grossed-up for inflation over a period of 10 years to determine an average accrual of $9.956 million for net salvage. 3 Tr 314-315; Exhibits AB-3 and AB-4. Mr. Selecky noted that periodic depreciation cases will allow for adjustments if cost of removal expense increases in the future.
>
> In addition to Mr. Selecky's expense-based argument, the Michigan Attorney General argued for a "present value" method like that cited by Mr. Selecky from Maryland (Selecky direct, p. 35).

The Michigan Commission did not adopt Mr. Selecky's proposal, rejected the "present value" approach, and endorsed the continued use of the accrual method, stating as follows:

> As discussed by Mr. Watson in his rebuttal testimony, the net present value approach proposed by the Attorney General has been consistently rejected by most Commissions and does not comport with depreciation methods recommended by authoritative sources on depreciation accounting. The accrual for net salvage must be based on estimates of the future cost that will be incurred, not the removal cost at today's price level. Therefore, it is appropriate to ask current customers to pay for future costs of removal at inflated price levels, and, as Mr. Watson pointed out, the rate base offset compensates rate payers for the prior payment for the costs incurred by the utility. Finally, the Commission finds that the Attorney General's proposed method significantly decreases the cash flows available to utilities to meet their infrastructure and other public service obligations. This, in turn, has a negative financial effect on both the utility and its customers by requiring that such obligations be met with more expensive sources of external financing and by driving up the cost generally of obtaining money in the capital markets. The Commission finds that the Attorney General has not shown that the adoption of the net present value method would justify these increased costs for utility consumers.

The arguments made by Mr. Selecky in Michigan were in substance the same arguments he makes here. The Michigan Commission didn't buy them; and this Commission, like almost every other, has previously rejected them as well. That rejection should continue in this case.

6. The net salvage expense contained in the Company's proposed depreciation rates must substantially exceed recent historical levels in order to provide for recovery of the full service value of the plant serving customers today over that plant's service life.

Mr. Wiedmayer convincingly and thoroughly explains why this is so in his rebuttal testimony.[237] As he testifies, the net salvage accrual exceeds the net salvage expense today because the transmission and distribution systems have been continuously growing and because inflation will make future removal costs much more expensive than the costs to remove plant in the past. Inflation between installation and removal is already taken into account because net salvage is a percent of original cost based on historical experience. The accrual for net salvage is related to the current plant in service, which includes $4.208 billion of distribution plant investment and $639.496 million of transmission plant investment that serves over one million residential customers. The size of AmerenUE's system has nearly doubled in the last 50 years, and the total distribution plant investment has increased by a factor of sixteen. The growth in distribution plant investment, transmission plant investment, and customers served is shown in Schedule JFW-ER16 (to Ex. 105).

As a result of this growth, the system has not reached a steady state, which is to say that each year the amount of plant added exceeds the amount of plant retired. Because this growth has occurred over a long period of time (and continues), the amount of plant retired is not equal to the plant balance divided by the average life. Only when the plant reaches this steady state position will the net salvage accrual equal the net salvage cost for the total plant in service.

Another way of considering the situation of AmerenUE is to recognize that the plant currently being retired served fewer customers during its life than the plant that is currently in service. The current net salvage cost should have been recovered over the course of the related plant's life. The amount of net salvage accrued, and presumably collected from customers, for this retired plant was based on the plant that was in service during its life. This amount of plant was sufficient to serve, on average, 500,000 to 600,000 customers, and perhaps as many as

[237] Ex. 105, p. 68, l. 19 to p. 70, l. 14.

650,000. What this means is that neither the past net salvage accruals nor the net salvage costs incurred in recent history were based on the much larger universe of plant that serves customers today; that is, the plant that is necessary to serve over a million customers now. Thus, historic levels of net salvage costs, computed for plant serving just about half the current customer base, will not (and logically should not) compare to the current net salvage accrual computed for the plant necessary to serve the current, much larger customer base.

Finally, while Mr. Selecky seems to be concerned that net salvage accruals in the depreciation rates "seem" to be excessive, and wants them reduced, he expresses no concern about the fact that the sum of additional investments made in the Company's T&D infrastructure plus the year-by-year costs for net salvage exceed the total depreciation expense proposed by the Company. That is, the Company is spending more on T&D than it is receiving through depreciation.[238] This occurs because the same growth in T&D plant that causes the net salvage accruals in the depreciation rates to exceed past historical expense levels also causes the plant additions to the exceed the accruals in the depreciation expense for new investment. If Mr. Selecky was consistent with his concerns that the Company recover only those levels it has recently spent, he would have pointed out the disparity in plant additions as well. But of course doing so would suggest that there should be higher, not lower depreciation expense related to new investment, which perhaps explains Mr. Selecky's inconsistency.

III. COAL-FIRED POWER PLANT MAINTENANCE EXPENSE.

A. The Staff's "Normalization."

1. <u>Staff's adjustment to test year coal-fired power plant maintenance expense reflects the Staff's misuse of both the test year and "normalization" concepts of ratemaking.</u>

[238] *See* Sch. JTS-ER18 to Ex. 105.

Rates set in this case will likely take effect in June, 2010, and there is substantial evidence of record to suggest that those new rates will remain in effect for approximately 12 to 18 months – from mid-2010 through mid-2011 to perhaps the end of 2011.[239] Consequently, for the Company to have a reasonable opportunity to earn a fair return during that period of time, it is imperative that the rates that are set in this case be based upon a level of revenues and expenses that is as representative as possible of the revenues and expenses that can reasonably be expected during that period of time.[240] Indeed, it is well-settled that the "test year is a period past, but is employed as a vehicle upon which to project experience in a future period when rates determined in the case will be in effect."[241] Or as the Commission itself describes it: "The purpose of using a test year is to create or construct a reasonable *expected* level of earnings, expenses and investment during the *future period during which the rates, to be determined herein, will be in effect"* (emphasis supplied).[242] It is true that expenses are sometimes normalized based upon the assumption that the cost will rise and fall "with the consequence that the actual cost incurred in the test year is not representative," of that future period when rates will be in effect. *If* that circumstance exists, then normalization is proper, and the normalized figure should be such that it "project[s] a reasonable allowance in determining a rate producing a fair return *in future years*" – i.e., the normalization should reflect an expected level of expense during the future years *when rates will be in effect.*[243] But if the test year level of a cost *does* "project a reasonable allowance" for the period when rates will be in effect, normalization is not necessary and should *not* occur.

[239] The Company's Sioux plant scrubbers will be placed in service in late 2010 or early 2011, necessitating the filing of another rate case.
[240] As the evidence in this case demonstrates, when a utility is making substantial investments in its energy infrastructure and is otherwise operating in a rising cost environment, the use of an historic test year makes it extremely challenging to earn a fair return; inappropriate normalizations of test year costs exacerbate those challenges.
[241] *State ex rel. Missouri Power & Light Co. v. Pub. Serv. Comm'n*, 669 S.W.2d 941, 945 (Mo. App. W.D. 1984).
[242] *Re: KCP&L et al.*, Case Nos. ER-81-42, ER-80-48, 43 P.U.R.4th 559 (Jun. 17, 1981).
[243] *Id.* at 944 (emphasis added).

Despite the existence of these well-established principles of utility ratemaking, Staff witness Roberta Grissum (and to some extent MIEC witness Greg Meyer) went to great lengths to attempt to justify what the record indicates is these parties' total lack of concern regarding whether the expense levels they recommend will be representative of expenses incurred during the period of time when rates will be in effect. Indeed Ms. Grissum, with just a few years' experience as an auditor, demonstrated that she completely misunderstands the well-established principles of utility rate making quoted above:

> Q. You agree, do you not, that the update or trued-up test year is a period past but that [it] is employed as a vehicle on which to project experience in a future period when rates determined in this case are going to be in effect, correct?
>
> *A. No, we do not do a projection.*[244]

Notably, her answer during the evidentiary hearing was different than the answer she gave in her deposition less than two weeks earlier,[245] and appears to reflect an after-the-fact attempt to justify the Staff's normalization of an expense based upon data from a period of time during which the evidence in this case strongly demonstrates was *abnormal* and indeed was quite *un-reflective* of the conditions that can reasonably be expected when rates will be in effect, as we will discuss in detail below. Yet the Staff seems unapologetic with respect to its total failure to care about whether the expense levels it recommends to this Commission are expected to reflect expense levels when rates are actually in effect. Ms. Grissum testified as follows:

> Q. What if Staff has a lot of information that there are a lot of unusual and abnormal events going on during the period when [the historic figures were examined] . . . that makes [those historic figures] . . . unrepresentative, does that impact your analysis?

[244] Tr. p. 2666, l. 8-13. Ms. Grissum started as a regulatory auditor in 2003; has never normalized power plant maintenance expense before; is not an engineer; has no knowledge of what is involved in maintaining a boiler or a turbine; didn't even consider the impact of scheduled outages on maintenance expense. Tr. p. 1151, l. 1 to p. 1156, l. 23.

[245] Tr. p. 2666, l. 14 to p. 2667, l. 21.

A. *No, because the Company has the right to explore those costs and decide themselves if that warrants a need for rate recovery and to come back and file another rate case.*

Q. So you ignore – you ignore everything except the historical numbers, is that your testimony?

A. *Correct.*[246]

Staff's cavalier disregard of whether the allowance it recommends for power plant maintenance bears any resemblance to the level of expense that can reasonably be expected when rates set in this case are in effect is shocking, particularly given that the Staff *actually expects* power plant maintenance expense to be higher in 2010 and 2011 (when rates from this case will be in effect) than it was during the historical (and abnormal) period Staff examined. Again Ms. Grissum's testimony bears this out:

Q. Since the outages were being delayed during this period, would you expect 2010 and 2011 to be higher since the Company is or will be in a catch-up mode?

A. *Yes.*[247]

2. <u>Key facts.</u>

From approximately 2005 through 2007, the Company performed far fewer scheduled maintenance outages than it would normally perform both before and after that period.[248] This was because the Company was transitioning to longer intervals between its major coal-fired unit outages.[249] In 2009, the Company performed essentially no maintenance outages at all due to deferrals necessitated by the global financial crisis that arose in the latter part of 2008. During the years when a greater number of maintenance outages were actually performed, the Company's maintenance expense was, predictably, materially higher. For example, in the early

[246] Tr. p. 1212, l. 9-17
[247] Tr. p. 1231, l. 22 to p. 1232, l. 1.
[248] Tr. p. 1044, l. 5 to p. 1045, l. 7.
[249] *Id.*

2000s (e.g. from March 2001 through October 2004), the Company, on average, took 3.5 maintenance outages per year, at an average cost of approximately $103.6 million per year (in nominal—non-inflation adjusted—dollars).[250] From 2005 through 2007, the Company took just an average of 1.68 maintenance outages and annual average maintenance costs were, predictably, lower at just approximately $90 million per year.[251] In 2008, when the Company emerged from the transition period and two major maintenance outages plus two "mini" maintenance outages were taken, maintenance expense rose (again, predictably) substantially, to nearly $120 million for that year.[252] In 2009, when all maintenance outages were deferred due to the financial crisis, maintenance expense dropped to $96.5 million.[253] Had the financial crisis not occurred and had the outages planned in 2009 been taken, it is reasonable to expect that 2008 and 2009 expense levels would have been similar, and indeed would have been similar to the test year level of $118.9 million. These facts demonstrate the direct correlation between maintenance outage activity (or lack thereof) and the level of power plant maintenance expense, yet the Staff ignored this obvious fact entirely in proposing its adjustment.

In 2010 and 2011, the Company plans to take an average of 3.5 scheduled outages per year – essentially the same number as it took in the early 2000s before the transition period occurred.[254] Understandably, given that more outages will be taken than during the period of time used by the Staff for normalization, and given inflation, the budgeted maintenance expense is higher ($117.5 million in 2010; $122 million in 2011) than the Staff's historical average.[255] These facts show a consistent result – during normal periods, when two to three major unit

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[250] Ex. 160 HC (last page); Ex. 162; Ex. 103 (Birk rebuttal) p. 16.
[251] Ex. 160 HC (last page).
[252] Tr. p. 1044, l. 5 to p. 1045, l. 7.
[253] Ex. 103, p. 16.
[254] Ex. 162 HC.
[255] As AmerenUE witness Mark Birk testified, applying a conservative inflation factor of just 3 percent annually to the maintenance expense levels in the early 2000s (3.5 maintenance outages, on average) to 2010-2011 (3.5 maintenance outages planned, on average) generates a maintenance expense level in current dollars close to the actual amount incurred in the test year and 2010-2011 budgeted figures.

outages are being taken, the annual maintenance expense (in current dollars) is quite close to the test year level. The evidence in this case reflects that a major outage is already underway in 2010 at one of the Company's largest units (Rush Island 2), that another outage has already been taken at Meramec Unit No. 2 in 2010, and that either later this year or in early 2011, maintenance outages will have to be taken on Sioux Unit Nos. 1 and 2. No party disputes these basic facts.

By contrast, during the three 12-month periods used by the Staff for its normalization (April 2006 through March 2009), the Company took, on average, just 1.3 scheduled maintenance outages per 12-month period.[256] The number of scheduled outages was literally at its lowest point (just one per 12 months) in two of the three 12-month periods relied upon by the Staff.[257]

Given these essentially undisputed facts, is there justification to normalize power plant maintenance expense in this case? The record in this case indicates that the answer to that question is a resounding "no."

3. <u>Ms. Grissum's approach is flawed, mechanistic, and ignores the facts.</u>

As noted, the first problem with Ms. Grissum's approach is that it ignores what the Staff should have been trying to do – include power plant maintenance expense in rates at a level that one could reasonably expect to be reflective of the level of expense that will be experienced when rates are in effect. She never considered that this was (or should have been) her goal; indeed she purports to re-write established ratemaking principles by now disavowing this as a goal. At bottom, she mechanistically looked at numbers on a page, saw a fluctuation in those numbers during the period she examined, and (incorrectly) concluded that the fluctuation

[256] Ex. 165.
[257] Ex. 165. 2009, when outages were deferred due to the banking crisis, also saw just one outage.

necessitated normalization. She leaped to this conclusion without apparently even asking herself *why* such a fluctuation might be occurring or whether her historical period would "project a reasonable allowance in determining a rate producing a fair return in future years."[258]

And when provided information that contradicted her flawed hypothesis (i.e., the hypothesis that fluctuation automatically means that the Staff "must normalize by averaging") she ignored the information and appears to have developed after-the-fact rationalizations for why she was "right" all along. Consider the facts outlined below.

First, Ms. Grissum had never normalized power plant maintenance expense before. She had normalized "incident repairs in a Missouri American Water [case] and also tank painting maintenance" and had done so using "a normalization methodology very similar to what we used in this case."[259] On that basis it appears that she made the leap of logic that if the cost to repair water mains and paint tanks varied and "required normalization" then surely power plant maintenance was the same regardless of the facts occurring during the historic period she used for normalization, or what level of power plant maintenance can reasonably be expected when rates are in effect. It should have been obvious, however, that a power plant is a far more complex and far different animal than a water main or tank. And the considerations surrounding the need to perform major boiler or turbine work at scheduled intervals on a power plant are far more complex than the considerations that go into a decision to paint a tank or repair a broken water main. It also should have been obvious that since AmerenUE was in the middle of a major change in how it approached maintenance outages at its 12 coal-fired units then the Staff needed to consider how that major change may impact power plant maintenance expense on a going-forward basis. Yet Ms. Grissum just "looked at the numbers" and blindly forged ahead to

[258] *In re: KCPL, supra*.
[259] Tr. p. 1151, l. 22 to p. 1152, l. 9.

normalize AmerenUE's power plant maintenance expense, apparently because that's what she had done in a prior water case involving totally different circumstances.

Ms. Grissum also made assumptions which drove her decision to normalize this expense, yet those assumptions were not supported by any facts. For example, despite being provided a detailed history of scheduled outages at all 12 of the coal-fired units, Mr. Grissum incorrectly assumed that the "bulk" of the transition from shorter to longer outage intervals occurred between 2003 and 2005.[260] This flawed assumption led to one of the major problems in her analysis; that is, she normalized power plant expense over a three-year period when the frequency of scheduled outages was at or near its lowest level because the transition period was *actually occurring* during most of that time. Moreover, when challenged on her assumption she tried to deflect blame for its inaccuracy, first claiming it was her "understanding" from a conversation with Mr. Birk.[261] However, she then admitted she could point to no statement from the Company that supported her assumption.[262] In fact, she back-tracked upon further cross-examination, admitted that her supposition that the bulk of the transition took place from 2003 to 2005 was "simply my opinion" and that it was based upon her observation that the maintenance costs were "rather steady" during that time period.[263] And when confronted with contrary facts, she back-tracked some more. First, she admitted that expenses in 2003 and 2004 were in fact *higher* than expenses in 2005 to 2007. Yet it is obvious that *if* the "bulk of the transition" was occurring during 2003 to 2005, as she had claimed, the *opposite* should have been true.[264]

Ms. Grissum's refusal to simply admit that she was mistaken about when the transition occurred is odd given that at other times she staunchly argued that it didn't matter to her in any

[260] Tr. p. 1184, l. 19 to p. 1185, l. 2.
[261] Tr. p. 1184, l. 17-18.
[262] Tr. p. 1185, l. 4-13. In fact, when confronted with Mr. Birk's data request response (Ex. 160 HC) she admitted that he did not indicate to her that the bulk of the transition was occurring in 2003 to 2005.
[263] Tr. p. 1185, l. 17 to p. 1186, l. 2.
[264] Tr. p. 1186, l. 3-23; Tr. p. 1188, l. 2-22.

event. For example, she testified that she was not looking at outages at all when she made her adjustment.[265] Indeed, she claimed she didn't use the outage information:

> Q. But you didn't use that information to see whether or not the number of outages that occurred in 2003, '4, '5, '6, '7 and '8, whether that number of outages bore out your conclusion that the build of the transition occurred from 2003 to 2005, you didn't use that information, right?
>
> *A. No, because what I was attempting to do was to use three years that I believed would be a good basis for performing a normalization that would provide me with a normal level of expense on a going-forward basis* . . .[266]

Of course, the number of outages does matter in determining an appropriate level of power plant maintenance expense, which explains why Ms. Grissum didn't want to admit that she was mistaken about when the "bulk of the transition" in fact took place.

There are other indications that Ms. Grissum was mechanically normalizing an expense without having a good understanding of whether the facts called for normalization, and without fully understanding the information she was relying upon. In his rebuttal testimony, Mr. Birk pointed out that maintenance costs escalated over the years due to inflation and that all one had to do was look back to when a normal number of outages was being taken in the early 2000s and then look at the test year level and the 2010 budget, and one could see that cost escalation would explain the difference. This, Mr. Birk explained, demonstrated the reasonableness of the test year figure.[267] Mr. Birk also testified that maintenance expense is heavily driven by labor costs (approximately 2/3 of the expense consists of labor costs) and that labor contract increases and employment cost index increases have been about 3% and 3.44%, respectively, in recent years.[268] The Staff apparently recognizes this and apparently intended to only normalize the non-labor portion of power plant maintenance expense (in that way, as wage and benefit costs

[265] Tr. p. 1190, l. 5-7.
[266] Tr. p. 1190, l. 24 to p. 1191, l. 9.
[267] Ex. 103, p. 16, l. 1 to p. 17, l. 2.
[268] Ex. 158, p. 5, l. 1-5.

increase the higher costs will be reflected in test year or true-up figures in the per-book payroll and benefit expenses).

Ms. Grissum in fact *thought* she was normalizing just the non-labor component of the expense, but she was mistaken, as she finally admitted after a protracted series of cross-examination questions during the evidentiary hearing.[269] It is true that Ms. Grissum's mistake did not drastically change the dollar amount of her "normalization" adjustment recommendation (it did lower it from $17.82 million to $15.3 million).[270] However, her stubborn refusal to admit that she made a mistake at all raises at least two concerns.

First, it is a further indication that she was only marginally familiar with the topic she was being asked to address. She used a "similar" methodology as she had used for water company mains and tanks, and she didn't really understand the data she was using (she got her "understanding" of what the data reflected from "speaking with another Staff member looking at other work papers in previous cases.")[271]

Second, she was unreasonably reluctant to consider any facts that might undermine any part of her opinion, just as she had been extremely reluctant to admit that she was dead-wrong about the transition period discussed earlier and just as she changed her deposition testimony to try to contradict established ratemaking principles that tend to undermine her position.[272] Like her claim (proven incorrect, as outlined earlier) that the Company had told her that the transition period occurred from 2003 to 2005, Ms. Grissum also had to retract her claim that it was the Company's fault that she failed to understand the data that she had been given. She admitted that

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[269] Tr. p. 1162, l. 8 to p. 1179, l. 23; p. 1225, l. 3-15.
[270] As part of the true-up, Ms. Grissum has lowered her adjustment some more so that it is now approximately $14.8 million.
[271] Tr. p. 1175, l. 1 to p. 1176, l. 5.
[272] A theme seems to be emerging in the Staff's case; that is, the Staff decides to take unreasonable positions, finds a Staff member to sponsor them, and then develops after-the-fact rationales to try to salvage those positions – e.g., return on equity, life span versus mass property depreciation for coal-fired power plants, and, now, power plant maintenance expense.

she used the Company's response to Staff Data Request No. 51 to obtain the power plant maintenance figures she normalized, and she admitted she was familiar with Company 19607 reports, which broke those figures down between labor and non-labor components. Yet after being confronted with the fact that the labor and non-labor components on the 19607 reports and the totals that she used matched exactly, she continued at first to argue that "I'm confident that I looked at non-labor."[273] She even went so far as to try to argue that perhaps the Company could read the Staff's collective mind and thus "understood" that what the Staff was asking for in Data Request No. 51 was "non-labor" only. However, cross-examination made clear that power plant maintenance had not been an issue between the Company and the Staff in the past, and that there isn't likely to have been any conversation about what the Staff may have intended (but did not ask for) given the lack of past disagreement on this issue. Cross-examination made clear that the Company answered the question it was asked, and answered it accurately – it was Ms. Grissum who didn't understand the data that she asked for.[274]

In summary, Ms. Grissum's normalization adjustment should be rejected for the following reasons:

- Contrary to one of the most fundamental concepts in ratemaking, she made no attempt to reflect a level of power plant maintenance expense in the Staff's revenue requirement that is reflective of normal conditions to be reasonably expected during the time when rates set from this case are likely to be in effect;

- The record is replete with evidence that during the period of time she used to "normalize" this expense the level of maintenance expense was abnormally low due to the very low number of scheduled maintenance outages occurring during that period, yet Ms. Grissum at first tried to argue that the transition to longer periods between outages had mostly already occurred, and when confronted with the fact that she was wrong, then tried to argue it didn't matter;

[273] Tr. p. 1173, l. 21-24.
[274] *See* Ex. 164 (Response to Staff Data Request 51), which provided exactly what the Staff asked for.

- The record reflects several mistaken "assumptions" and other suppositions on Ms. Grissum's part that are not borne out by the facts. These flawed assumptions led her to make additional mistakes both respecting the decision to normalize this expense at all, and the manner in which it was normalized;

- The record suggests that Ms. Grissum lacks the experience, training or guidance to properly evaluate a normal level of power plant maintenance expense;

- The record reflects that while Ms. Grissum ultimately relied upon an average of non-labor-only maintenance expenditures for the 36-month period starting in April 2006 – four years ago – she failed to account for the time value of money. Given that it is undisputed that a 2010 dollar is worth less than a 2006 dollar, her failure to account for this obvious fact further undermines her recommendation;

- The record reflects that in the first year after the transition was complete, when a more normal level of scheduled outages occurred, the maintenance expense level was quite close to the test year amount ($119.7 million versus $118.9 million);

- The record reflects that the reason 2009 power plant maintenance expense was materially lower was due to deferral of planned maintenance outages due to the financial crisis; and

- The record reflects that there are, on average, 3.5 outages scheduled in both 2010 and 2011, with two outages already underway or complete, and additional outages at both Sioux units to occur in the first several months after rates are set in this case, demonstrating that the test year amount is reasonable (given the 2010 and 2011 budget of $117.5 million and $122 million, respectively, versus a test year amount of $118.9 million).

B. MIEC's "Normalization."

1. <u>MIEC's "normalization" also fails to reflect a level of power plant maintenance expense that can reasonably be expected when rates set in this case will be in effect.</u>

MIEC's initial position on power plant maintenance expense in this case was even more unreasonable (and unreasoned) than the Staff's. MIEC witness Greg Meyer first recommended that this Commission set the Company's power plant maintenance expense at almost the absolute lowest level he could find during the past several years – the actual expenditures during the 12 months ending March 31, 2008 (just $91 million) – a period ending fully one year before the test year ended, and more than two years ago.[275] For the first time in surrebuttal testimony, Mr. Meyer totally changed his position (and his approach) and increased his recommendation to approximately $105 million.[276]

After accounting for Ms. Grissum's correction during the evidentiary hearing, Staff, based upon flawed reasoning and improper normalization as discussed above, now recommends inclusion of approximately $104.1 million of power plant maintenance in rates, with Mr. Meyer recommending slightly more, $105 million. Neither level can reasonably be expected to reflect expenses that will be incurred when rates are in effect, and both recommendations arise from "normalizing" the test year level of expense, in spite of the fact that the record shows that power plant maintenance expenditures over the next couple of years can reasonably be expected to be consistent with actual amount spent in the test year.

There are several similarities between the Staff and MIEC on this issue. MIEC witness Meyer, like Ms. Grissum, is not an engineer, has never had responsibility relating to a power plant or maintaining a power plant, and doesn't have any knowledge about the design or operational differences among the various generating units, or what it takes to maintain them.[277] Mr. Meyer also seems unconcerned with whether his recommendation bears any resemblance to the level of expense that can reasonably be expected when rates are in effect since he was unable to express an opinion about whether the Company's 2010 budget ($117.5 million) is a reasonably accurate expectation for 2010.[278] Mr. Meyer admits that the purchasing power of a dollar is less in 2010 than it was in 2004, 2005, 2006, etc., yet he made no effort to account for

[275] Ex. 400, p. 5, l. 9-11 (Meyer direct).
[276] Ex. 401 HC, p. 3, l. 21-22 (Meyer surrebuttal).
[277] Tr. p. 1091, l. 4 to p. 1093, l. 14.
[278] Tr. p. 1099, l. 20 to p. 1100, l. 9.

this obvious fact in his revised surrebuttal methodology.[279] And while he tried to change his story during the evidentiary hearing, he admits that the reason he didn't account for inflation is based upon his examination of historical average expense levels over a trailing five- and ten-year period.[280] The problem with ignoring inflation on that basis is that those historical averages include un-inflated dollars (ignoring compounding, a dollar in 2001 is probably worth 30 percent less than a dollar in 2010), and include a multi-year period when the Company was taking less maintenance outages than can be expected in the coming years, due to the transition discussed earlier in this brief.

As Mr. Birk's supplemental testimony shows, merely escalating the dollars calculated by Mr. Meyer would move his recommendation up to more than $113 million. That escalation is necessary is obvious when one considers where Mr. Meyer obtained his data.

Mr. Meyer used a total of 19 different figures (what he claims to be a "routine" level of maintenance expense and what he claims to be maintenance expense associated with outages) to arrive at his $105 million recommendation. Those data points are listed in Exhibit 162HC. Nearly half of the data points fall between 2004 and 2007 – from three to six years ago; the remainder (with one exception) fall between 2008 and 2009. Because the Commission's task here is to set rates reflective of the revenue requirement in 2010 and 2011, reliance on a methodology using dollars from as far back as 2004 without accounting for inflation is an obvious problem.

Moreover, there is ample evidence to suggest that even escalating Mr. Meyer's dollars does not fully close the gap between what is needed to maintain these power plants and what an escalated Meyer figure would produce. In the test year, which is always the starting point, the

[279] Tr. p. 1101, l. 16 to p. 1102, l. 5.
[280] Tr. p. 1110, l. 12 to p. 1111, l. 18.

Company spent $118.9 million; in 2010, when at least three maintenance outages are scheduled, the budget is $117.5 million; and in 2011, when at least three maintenance outages are planned, the budget is $122 million.

Mr. Birk, whose qualifications and experience to manage the Company's high-performing coal-fired generating fleet are not questioned, testified that it is inappropriate to rely upon data points from those earlier years without escalating the dollars (i.e., accounting for inflation), particularly considering that about two-thirds of the maintenance costs are associated with labor, which clearly has experienced a three-plus percent annual escalation.[281] Mr. Birk also pointed out that the data used by Mr. Meyer was taken from a time when (for the most part) an abnormally low number of outages were being taken, and that had Mr. Meyer looked at a more normal period, the data would have looked much different.[282]

Mr. Birk was also clear that the test year level of expense provides adequate dollars for the required maintenance of these plants, but MIEC's recommendation does not. He testified that the Company is at a point now that the transition (and financial crisis in late 2008/2009) is over, where he "cannot go much longer at all with those [Rush Island/Labadie units, which are the Company's largest units] units," and that they "have to be done" [i.e., maintenance outages must be taken] in the relatively near-term.[283]

In summary, "normalization" of the test year level of an expense should not occur simply because in past periods the expense has fluctuated, particularly when (a) the past periods themselves were abnormal; and (b) when there is substantial evidence to support the conclusion

[281] Ex. 158, pp. 4-5; Tr. p. 1013, l. 21-25. Mr. Birk also testified that three to four percent escalation should be applied to maintenance projects in general. Tr. p. 1057, l. 1-24.
[282] Ex. 158, p. 5, l. 10-22.
[283] Tr. p. 1007, l. 24 to p. 1008, l. 7; p. 1052, l. 9 to p. 1053, l. 7. Mr. Birk also testified that he is 90 to 95 percent sure that outages scheduled in 2010 and 2011 (a total of at least six outages) will be taken as laid out in the Company's plan. Tr. p. 1054, l. 17 to p. 1055, l. 15. This too indicates that the test year sum, which is close to the 2010 and 2011 budgets, is reflective of a "normal" level of maintenance expense during the time rates are to be in effect from this case.

that the appropriate level of the expense on a going-forward basis (when rates will be in effect) will be consistent with the test year. Establishment of the appropriate level of any expense for a public utility is not an exact science, but the test year is and should be the starting point. Staff and MIEC have failed to demonstrate that the test year level of AmerenUE's power plant maintenance expenditures should be disregarded, and the Company has demonstrated that use of the test year level of expenditures will do the best job of "project[ing] a reasonable allowance in determining a rate producing a fair return *in future years.*"[284] Consequently, the Staff's and MIEC's normalization adjustments should be rejected.

It is important to customers that the power plants be adequately maintained so that fuel costs can be kept low, off-system sales opportunities can be maximized and reliability can be maintained. The top quartile equivalent availability of the Company's plants have provided benefits for customers, but if the Company is to maintain that high level of performance, it must be given an adequate amount of power plant maintenance expense. In this case it should be given an amount equal to the test year expense, because the test year is a reasonable proxy for the expense it will incur during the time when rates set in this case will be in effect.

IV. NUCLEAR FUEL COSTS.

Before rates set in this case take effect, another every-18-month refueling outage will have occurred at the Callaway Plant.[285] Both the Staff and MIEC oppose reflecting in the revenue requirement in this case the higher costs of the nuclear fuel that everyone agrees will be loaded into the reactor during that refueling outage. They base their opposition not on any concern about whether the nuclear fuel costs are known and measurable as of the true up date for this case, but rather, on the mere fact that the true-up date in this case was through January 31,

[284] *In Re: KCPL, supra.*
[285] The outage was scheduled to begin on April 17, 2010 and to be complete well before the June 21, 2010 operation of law date in this case. Ex. 127, l. 4-5 (Irwin rebuttal). The prior refueling outage concluded in November, 2008.

2010 and the refueling outage will occur after that date. No party opposed the similar inclusion of higher nuclear fuel costs in the Company's last rate case even though the nuclear fuel assemblies in that case also were not going to be loaded into the reactor until after the true-up date in that case.[286]

The Staff has recommended a nuclear fuel cost based upon a 15-month backward looking average of costs incurred through January 31, 2010.[287] The Company has included the post-refueling cost of nuclear fuel, as calculated by AmerenUE witness Randall J. Irwin and contained in the true-up direct testimony and schedules of AmerenUE witness Gary S. Weiss.

In her supplemental testimony regarding the fuel adjustment clause, Staff witness Lena Mantle in effect chastised other electric utilities in the state for, in her view, not paying as much attention to accurately rebasing their fuel costs during rate cases now that they have fuel adjustment clauses.[288] Yet, with known higher nuclear fuel costs to be incurred by AmerenUE before rates set in this case will take effect, the Staff is advocating that the Commission ignore those costs, which will tend to inject inaccuracy into re-basing the fuel costs in the FAC. Indeed, Staff witness Roberta Grissum, who supported the Staff's refusal to recognize these higher nuclear fuel costs, argues that because there is an FAC in place for AmerenUE there isn't a need to rebase the fuel costs to include the higher nuclear fuel costs because AmerenUE would "be able to recoup changes in its fuel costs, including these nuclear fuel cost changes, through its fuel

[286] Tr. p. 2658, l. 1-7; l. 21–25; p. 2659, l. 2. And it is not just that higher costs should be reflected. If the costs for nuclear fuel before rates will take effect were lower, those lower costs should also be reflected.

[287] Tr. p. 2657, l. 6-10. MIEC apparently agrees with the Staff, that is, according to the reconciliation filed by the Staff with the true-up. MIEC indicates that its opposition to including these higher nuclear fuel costs in the Company's revenue requirement is the same as the Staff's reason; that is, that since the cost increase occurs after January 31 it should be ignored. Ex. 417, p. 5, l. 8-17 (Dauphinais surrebuttal). As noted, in the last case neither of these parties took this position even though the facts were similar. While they will argue that going beyond the true-up date by between one and two months (like the last case) was acceptable to them, and that going beyond by between three and four months is not acceptable to them, the logic of the two different positions is inconsistent.

[288] Ms. Mantle was pointing to Kansas City Power & Light Co.- GMO and The Empire District Electric Company, not AmerenUE. Ex. 221, p. 10, l. 3 to p. 11, l. 15.

adjustment clause."[289] Ms. Mantle's point seemed to be that the presence of an FAC should not diminish the rigor with which fuel costs are rebased in rate cases. The Company agrees, which is why the Commission should do what it did in the Company's last rate case – include these higher, known nuclear fuel costs in the revenue requirement.

In fact, we would submit that like the power plant maintenance normalization issue, the position taken by the Staff and by MIEC distorts the test year concept by drawing an artificial line in the sand for a known cost increase that will take effect before rates are set, because their position doesn't even attempt to set a level of nuclear fuel costs in rates that can reasonably be expected to be incurred when rates are actually in effect. And, contrary to their unsupported claims, inclusion of this known cost will not upset the balance between rate base, revenues and expenses reflected as of the January 31 true-up date.

Nuclear fuel assemblies are unique, and must be fabricated specifically for each reactor.[290] In fact, the assemblies at issue in this case were purchased by the Company and delivered to the Callaway Plant in October 2009 – three months before the true-up date in this case.[291] Unlike coal or natural gas, once the nuclear fuel assemblies are bought, AmerenUE knows exactly what they cost.[292] As Mr. Irwin explains, during each refueling outage approximately half of the nuclear fuel rods in the reactor are replaced. The nuclear fuel costs are calculated by amortizing the cost of the rods that were not replaced and the cost of the new rods

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[289] Ex. 224, p. 2, l. 22 to p. 3, l. 5 (Grissum surrebuttal). She admits, however, that any portion of the fuel costs that is shared by the Company would in fact not be "recouped" without unidentified offsetting cost reductions. Tr. p. 2660, l. 15-25.
[290] Ex.127, p. 4, l. 20 to p. 5, l. 1.
[291] Tr. p. 2664, l. 9 to p. 2665, l. 20. We would note that because of the unique nature of nuclear fuel assemblies, they are unlike coal or natural gas in that they are considered construction work in progress (CWIP) until delivered to the Company, at which time the accrual of allowance for funds used during construction (AFUDC) stops and the Company must simply hold them with no compensation until they are used to start producing electricity. *Id.*
[292] While AmerenUE hedges its coal costs and to a lesser degree its gas costs, this does not entirely fix the price of those commodities on a going-forward basis. For example, most coal contracts contain escalation provisions and diesel surcharges, and not all of the coal needs are hedged.

that were put into the reactor. Because the Company knows what those (both old and new) rods cost, the Company can accurately determine the fuel cost. As Mr. Irwin testifies:

> The unamortized cost of the fuel assemblies currently in the reactor is known. In addition, the cost of the new fuel assemblies to be loaded into the reactor in April 2010 is also known because the fuel and fuel assemblies have been purchased and are on-site at the Callaway Plant. Consequently, the costs which form the basis for the 2010 nuclear fuel expense, both before and after the April refueling, are known and measurable as of January 2010.[293]

Staff witness Grissum believes there is a "line in the sand" when it comes to a true-up date; that is, if the true-up goes to January 31, 2010, judgment cannot be used to include an expense even if it is known that it will occur before rates to be set will take effect.[294] That there is no such line in the sand makes sense given the purpose of using a test year. As discussed earlier, the entire point of using a test year is to attempt to set rates (and the expenses, revenues and rate base upon which they depend) so that they will be representative of the period during which rates will be in effect. If the cost (or revenue) can't be known before rates take effect then it is understandable that the Commission wouldn't include it, even if the Commission had a high level of certainty that the cost or revenue would change materially. But here, where the cost is known and measurable by the true-up cutoff date, and where the cost will be incurred prior to new rates taking effect, it is poor policy to ignore it.

In rigidly refusing to cross a line that does not exist, Ms. Grissum failed to consider some unique facts regarding the Callaway Plant. She didn't consider the fact that under normal conditions the Callaway Plant runs at full load 24 hours per day, 7 days per week; that the MWhs generated at the Callaway Plant don't vary based on nuclear fuel costs or demand for electricity; and that even with the increase in nuclear fuel cost, the Callaway Plant is the cheapest unit

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[293] Ex. 127, p. 4, l. 10-14.

[294] Tr. p. 2659, l. 15-19. Again, this is at odds with the position Staff took in just the last rate case. It is also at odds with prior Commission decisions. *See, e.g. In re: St. Louis County Water Co.*, 5 Mo. PSC 3d 341, 1996 Mo. PSC LEXIS 99 (Dec. 31, 1996) (Where the Commission included a wage increase that occurred after the true-up cutoff date, but before rates would take effect).

AmerenUE has, save its hydroelectric units.[295] What these facts mean is that when rods are loaded into the Callaway plant and the cost of those rods is known, then the amortization of the costs of those rods into fuel expense will also be known because generation at the plant can be predicted with a very high level of accuracy.

Ms. Grissum (and MIEC witness James Dauphinais) argues that the relationship between revenues, expenses and rate base as of January 31 must be maintained at all costs, but recognizing higher nuclear fuel costs for bought-and-paid-for fuel assemblies will not upset that relationship. The Company's labor costs, its non-fuel O&M costs, and its capital investment (i.e. rate base) aren't in any way affected by including these known nuclear fuel costs in rates in this case:

> Q. So the only change that will take place in revenues, expenses, and rate base is the nuclear fuel cost change itself, right?
>
> *A. Correct.*[296]

There is no valid justification for not doing precisely what was done in the Company's last rate case: including these known, higher nuclear fuel costs in the revenue requirement in this case. Even Ms. Grissum agrees that "the goal in the case when it comes to fuel cost is to rebase those costs as accurately as possible regardless of whether the Company has a fuel adjustment clause."[297] The Company's cash flows are already extremely negative, and the Company has been unable to come anywhere close to its authorized return on equity for an extended period of time. Even though 95% of these higher nuclear fuel costs would eventually be recovered under the Company's fuel adjustment clause, there is no justification for effectively disallowing even 5% of these prudently incurred costs – the fuel is bought, paid for and being loaded into the reactor as of the writing of this brief. And even if the higher costs are, in Ms. Grissum's words,

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[295] Tr. p. 2668, l. 24 to p. 2669, l. 18.
[296] Tr. p. 2672, l. 18-21.
[297] Tr. p. 2675, l. 5-9.

mostly "recouped," the design of the fuel adjustment clause means that there will be a lag as long as 19 months between incurring these higher costs and recovering them. Section 386.266, RSMo. and the Company's fuel adjustment clause (as required by the statute) require that customers pay interest on higher fuel costs during the lag between incurrence by the Company and payment by the customers. Why in effect borrow to pay for fuel costs that will certainly be higher before rates set in this case take effect? And why put even more pressure on the Company's cash flows at a time when the Company continues to need to invest in its system?

The Staff's and MIEC's proposed disallowance of these known and measurable nuclear fuel costs should be rejected.

V. VEGETATION MANAGEMENT/INFRASTRUCTURE INSPECTION.

No party in this case alleges any imprudence in the Company's operation of its vegetation management or infrastructure inspection programs. Nor has any party recommended any change or improvement to any of these programs. Parties have only taken issue with one aspect of the Company's request and that is the cost recovery mechanism, the two-way trackers which were previously approved by the Commission in Case No. ER-2008-0318.

In 2009, the Commission included in AmerenUE's revenue requirement an amount equal to the two-year average of the expected level of spending on vegetation management and infrastructure inspections (base level). The Commission also established tracking mechanisms for these expenditures to track any amount spent above or below the base level through the creation of a regulatory asset or liability. In AmerenUE's previous rate case, the Commission stated:

> The Commission does not intend to allow the overuse of tracking mechanisms in this case, or in future cases. However, the tracker proposed by AmerenUE in this case is appropriate. This is a limited tracker that will have only a limited effect on AmerenUE's business risk…Furthermore, because the vegetation management rule is still very new, no one can know with any certainty how much AmerenUE

> will need to spend to comply with the rule's provisions. The tracker will ensure AmerenUE does not over-recover for its actual expenditures, as much as it ensures it does not under-recover those expenditures. Thus, the risk for ratepayers, as well as for AmerenUE, is reduced by operation of the tracking mechanism.[298]

For all of the same reasons that it initially approved these trackers, the Commission should authorize the continuation of both the vegetation management tracker and the infrastructure inspection tracker.

AmerenUE appreciates the Commission approving the use of these trackers in its last rate case. They are important to the Company, as they represent steps towards reducing excessive regulatory lag and improving cash flows, two things that Mr. Baxter identified at the hearing as very important to the Company's ability to continue investment in its system.[299] AmerenUE witness David Wakeman's testimony provided more detail to Mr. Baxter's statement, as he discussed the choices he faces in deciding what projects to fund given each year's budget.[300] As Mr. Wakeman testified, there are programs each year which would help to improve the reliability of service to AmerenUE's customers that he cannot implement or fully fund due to cash constraints.[301] Including in the revenue requirement an amount estimated to be needed to comply with the Commission's rules and the use of trackers is beneficial to the Company and its customers because it provides more timely cash flows and a greater assurance of full cost recovery, which in turn facilitates more complete implementation of these beneficial programs.

The record is replete with justification to continue these trackers. Mr. Wakeman testified that the Company's programs are not at full maturity nor have the amounts expended to comply with the Commission's rules leveled off.[302] Continuing the trackers will protect the Company's

[298] Case No. ER-2009-0318, Report and Order, January 27, 2009, p. 41.
[299] Tr. p. 905, l. 15-24.
[300] Tr. p. 1611, l. 2-17.
[301] Tr. p. 1612, l. 4-7; p. 1621, l. 16 to p. 1622, l. 2.
[302] Ex. 109, p. 6, l. 5-8 (Wakeman rebuttal).

efforts to comply with the Commission-imposed rules in the event that it must spend more than is included in the revenue requirement and protect our customers in the event that the Company spends less than is included in the revenue requirement. The trackers protect all parties.[303]

Importantly, no one in this case disputes any of the facts relied upon by Mr. Wakeman in reaching his assessment of the Company's continuing need for these trackers. Staff and MIEC have taken a statement that was made in the Company's direct testimony (that the Company is "in compliance" with the Commission's rules) and have attempted to twist that phrase into meaning that the *cost of compliance* with these rules is known. It is not, as Mr. Wakeman testified.[304] Mr. Wakeman is the only witness to provide testimony about the Company's vegetation management and infrastructure inspection programs upon which the Commission can base its decision. Mr. Wakeman is responsible for ensuring AmerenUE complies with the Commission's rules. He is responsible for budgeting for this work. He is the only witness in this case who is familiar with the work already done and the work that remains to be done. The Commission should base its decision on these trackers upon the facts put forth by Mr. Wakeman.

Other parties in this case argue that because AmerenUE is "in compliance" with the Commission rules and because AmerenUE has been trimming vegetation on a four and six year cycle (4/6 year cycle)[305] since December of 2008, one can infer the appropriate expense level for this work from the test year. The better course of action is to examine AmerenUE's vegetation management and infrastructure inspection programs, which clearly shows that the test year cannot be considered representative of what the Company may spend in the future. Staff and MIEC witnesses failed to undertake such an examination and repeatedly admitted that fact when cross-examined at hearing.

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[303] Tr. p. 1728, l. 20 through p. 1729, l. 3.
[304] Ex. 109, p. 6, l. 4-7.
[305] Four year cycle for urban circuits, six year cycle of rural circuits.

Specifically, Mr. Meyer admitted that he did not visit AmerenUE's facilities to learn about the Company's vegetation management and infrastructure inspection practices.[306] In fact, as revealed during cross-examination, Mr. Meyer was unfamiliar with the status of AmerenUE's vegetation management or infrastructure programs, was unfamiliar with when various aspects of the programs had started[307] and had not even reviewed filings made at the Commission by the Company related to these programs.[308]

While Mr. Beck testified that he'd viewed AmerenUE's vegetation management practices as he'd "driven by" portions of the system,[309] he admitted that he hadn't specifically toured the system nor had he talked with Mr. Wakeman about any of the specifics of the vegetation management program.[310] Similarly, Mr. Beck admitted that prior to the Commission's adoption of the infrastructure inspection rules, AmerenUE did not have regularly scheduled streetlight or overhead facility inspections[311] and Mr. Beck could not say what percentage of the required infrastructure inspections had been completed by AmerenUE to date.[312]

Staff witness Stephen Rackers, when asked whether or not he reviewed the Company's vegetation management or infrastructure inspection programs, stated that he performed "an accounting analysis, auditing analysis."[313] On redirect, Mr. Rackers was asked the question, "Do you need to be an expert to make an accounting adjustment, or do you need to be an engineering expert to make an accounting adjustment?" To which Mr. Rackers responded, "I don't believe

[306] Tr. p. 1739, l. 21 to p. 1741, l. 21.
[307] Tr. p. 1744, l. 7-22.
[308] Tr. p. 1741, l. 11-14.
[309] Tr. p. 1756, l. 1-9.
[310] Tr. p. 1757, l. 11-16.
[311] Tr. p. 1770, l. 21 to p. 1771, l. 5.
[312] Tr. p. 1771, l. 9-25.
[313] Tr. p. 1776, l. 9-15.

so." Mr. Rackers was then asked, "And you're not claiming that you're an expert in this case?" Answer, "No."[314]

It is clear that the recommendations to end the vegetation management and infrastructure inspection trackers did not consider the impact of the operational realities and uncertainties faced by the Company in completing a full cycle of vegetation management and a full cycle of inspections throughout its entire system under the more stringent requirements of these rules, which have been in effect for less than two years. It is also clear that the recommendations to end these trackers were made with very limited knowledge of the "facts on the ground" about AmerenUE's programs. Despite this lack of familiarity with AmerenUE's current programs, all three witnesses assert that the Company has sufficient data to determine the cost of compliance with these rules. This contention is nothing more than pure speculation for which there is no basis in the record.

AmerenUE is trimming its circuits on the 4/6 year cycle. Yet the commonality between AmerenUE's previous commitments (in 2004 and 2007) on vegetation management and those required by the Commission rules is nothing more than the frequency of the work—AmerenUE's agreement to the 4/6 year cycles. As a result of the new rules, the *amount* of work required during each 4/6 cycle has changed significantly.[315] This fact was not even considered by the Staff or MIEC witnesses, who didn't look any further than the length (i.e., 4/6 years) of the trim cycle. The Company's vegetation management practices prior to the Commission's adoption of its vegetation management rules used a significantly different trim standard. For example, prior to the Commission's rules, AmerenUE did not remove the overhead overhang from its 3 phase backbone distribution lines.[316] The Company did not trim vegetation back ten feet from

[314] Tr. p. 1784, l. 20 to p. 1785, l. 1.
[315] Tr. p. 1737, l. 6-23.
[316] Ex. 110, p. 3, l. 21-22 (Wakeman surrebuttal). (Tr. p. 1737, l. 13-16).

distribution lines (between 600 and 50,000 volts).[317] Staff witness Daniel Beck confirmed these differences when he was on the witness stand.[318] Mr. Beck also admitted that it involves more work to remove the overhang, especially in the first trim cycle (which the Company is in the middle of) and, accordingly, it involves more cost.[319] The same statement can be made for all of the new requirements of the Commission's rules.

Staff and MIEC appear to believe that the cost of trimming one circuit is an appropriate measure of what it will cost to trim another circuit. Mr. Wakeman testified that this assumption cannot be made, explaining that each circuit is unique and requires a different amount of work to bring it to the Commission's standards.[320] At the hearing, MIEC witness Greg Meyer admitted that removal of vegetation does not cost the same amount for every circuit,[321] thus nullifying his argument to discontinue the tracker.

At this point in time, AmerenUE does not have the experience necessary to confidently forecast what it will cost to comply with the Commission's new rules. Under the vegetation management rules, AmerenUE has not trimmed half of its urban circuits and two-thirds of its rural circuits, meaning approximately 60% of its total circuit miles that have never been trimmed to the Commission's new vegetation management standards.[322] Under the infrastructure inspection rules, the percentage is even higher. As of February of this year, 78% of the Company's underground facilities and 70% of the Company's streetlights had not been inspected under the Commission's rules, just to provide a few examples.[323] These programs have certainly not reach full maturity.

[317] Tr. p. 1761, l. 11-18.
[318] Tr. p. 1759, l. 1-4.
[319] Tr. p. 1759, l. 8-13; p. 1760, l. 6-11.
[320] Ex. 109, p. 8, l. 7-8.
[321] Tr. p. 1746, l. 17 to p. 1748, l. 4.
[322] Ex. 109, p. 7, l. 15-20.
[323] *Id.* p. 9, l. 2-5.

The admissions of the Staff and MIEC witnesses noted above, when coupled with the fact that the majority of AmerenUE's system has not been trimmed or inspected even once using the standards required by the Commission's new rules,[324] can only lead to the conclusion that ending the trackers at this time is premature and should be rejected.

The vegetation management and infrastructure inspection trackers have been beneficial for the Company and for AmerenUE's customers. In the first year of the tracker, the Company spent less than the amount included in its revenue requirement. Because the actual expenditures were tracked against a base level, customers will get that money credited back to them. Next year, the Company may spend more than the amount included in its revenue requirement. Because of the tracker, the Company would not lose the additional money required to comply with the Commission's rules. As the Commission observed in the quote cited earlier, a tracker protects all parties. In 2009, the Commission wanted to find a mechanism that best matched the amount included in the Company's revenue requirement with its actual expenditures incurred in order to comply with these new rules.[325] The tracker mechanisms provide that match and should be continued in order to ensure that neither the Company nor its customers are harmed by costs which the Company cannot at this time predict but which must be incurred in order to comply with Commission regulations. AmerenUE asks the Commission to reauthorize both trackers and to set the base levels at $53.7 million for vegetation management and $8.9 million for infrastructure inspections (totaling $62.6 million).[326]

As noted, AmerenUE collected more than it spent during the first year of these trackers, so the Company requests the Commission offset this over-collection with the amount accumulated in a regulatory asset between October 1, 2008 and February 28, 2009. That leaves

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[324] Ex. 110, p. 3, l. 13-16.
[325] Case No. ER-2008-0318, Report and Order, January 27, 2009, p. 34.
[326] Ex. 109, p. 10, l. 16-20.

an over-collection in the amount of $3.4 million. AmerenUE agrees that if the Commission continues the trackers, it should also credit that amount back to customers, amortized over three years, just as it amortized the amount under-collected between January 1, 2008 and October 1, 2008.[327]

VI. STORM RESTORATION TRACKER.

This issue presents the Commission with a clear illustration of AmerenUE's need to reduce excessive regulatory lag and to relieve the cash flow problems that lag imposes upon the Company. To address these concerns, AmerenUE is requesting different treatment for storm restoration costs than it has sought in the past; it is requesting that a larger amount be placed in AmerenUE's revenue requirement (base amount) and a tracker be established for any differences between the Company's actual expenditures and that base amount. The request stems from the cash flow needs of the Company and, specifically, the impact that restoring customers after a major storm has upon AmerenUE's cash flows. As Mr. Baxter testified, the Company's ability to undertake certain projects is directly related to its ability to have the cash flows to be able to fund those projects.[328] Mr. Wakeman pointed out that after a major storm, AmerenUE is expected to restore customers as quickly as possible, that the restoration work requires significant expenditures and that cash flow constraints may require the Company to borrow the funds necessary to support that effort.[329] This is part of the excessive regulatory lag and cash flow issues which negatively impact the Company's ability to further invest in its system.[330]

To help reduce the impact of these storm restoration expenditures, AmerenUE asks the Commission to set the amount in its revenue requirement for storm restoration costs (base amount) equal to the actual level experienced by the Company in the test year, $10.4 million, and

[327] Tr. p. 1725, l. 1-7.
[328] Tr. p. 904, l. 13-22.
[329] Tr. p. 1595, l. 1-7.
[330] Tr. p. 905, l. 15-24.

to establish a tracking mechanism to capture any amounts spent above or below the base amount to be considered in setting future rates (which may lead to collecting or refunding the difference, as the case may be) in the Company's next rate case. The Company recognizes this represents a shift in how these expenditures have historically been handled but AmerenUE believes its request for this change is justified.

As Staff points out in Mr. Rackers' rebuttal testimony, currently, if a major storm strikes a portion of AmerenUE's service territory, AmerenUE could either request an Accounting Authority Order (AAO) or, if the restoration costs were incurred during a test year, ask that the amount expended be amortized over five years.[331] In most cases, these requests have been approved by the Commission. However, AmerenUE has been forced to make this request multiple times over the past several years, as demonstrated by the listing of amortizations in the Staff Report. The Staff Report lists five different amortizations and mentions significant storm restoration costs which AmerenUE offset against its SO_2 allowance sales revenue rather than collect through an amortization.[332]

The fact that the Company is currently recovering storm restoration costs through this many amortizations indicates that the amount included in the Company's revenue requirement is insufficient to cover the restoration costs of these storms. Of course, that is not surprising given Staff's traditional methodology for developing "normalized" storm expense, which consists of removing the costs of all severe storms from the calculation and then averaging the costs of non-severe storms over a multiple of years.[333] By definition, there is nothing included in the revenue requirement for restoration of service after severe storms. Other parties are content to label those

[331] Ex. 202, p. 2, l. 5-11 (Rackers rebuttal).
[332] Ex. 200, p. 90, l. 17 to p. 91, l. 21.
[333] Ex. 202, p. 2, l. 21-24.

costs as "extraordinary" and deal with them through an after-the-fact amortization, with no interest on the unamortized balance. It is time for the Commission to change this practice.

The current method of recovering prudently expended amounts over the course of several years is problematic for the Company. As Mr. Wakeman testified, while the Company is likely to eventually recover its expenditures (not including the time value of money), this methodology imposes significant regulatory lag for expenditures AmerenUE must make immediately after a major storm.[334] Additionally, recovery is less certain. For example, in Case No. ER-2008-0318, some of the parties proposed a start date for the amortization period which would make it difficult for AmerenUE to recover its expenditures, thus denying the Company a reasonable opportunity to recover those expenses due to timing.[335] AmerenUE's proposed storm restoration cost tracker is the best mechanism to match those expenditures with recovery while protecting the Company as well as its customers.

No one in this case denies that severe storms occur. MIEC witness Greg Meyer agreed that the storms are beyond the control of AmerenUE.[336] Mr. Rackers agreed that the number and severity of storms varies from storm to storm and from year to year.[337] Additionally, no one in the case has alleged any imprudence in AmerenUE's efforts to restore service after a major storm. As Mr. Wakeman testified in response to questions from Chairman Clayton, AmerenUE has made a number of improvements to its storm restoration practices. The Company has added mobile storm trailers, which are material trailers that are pre-staged throughout its service territory; it has also improved its logistics operations and improved materials handling. The Company has even invested in a new weather reporting system so that it can access actual

[334] Ex. 110, p. 6, l.7-10 (Wakeman surrebuttal).
[335] ER-2008-0318, Report and Order, January 27, 2009, p. 50.
[336] Ex. 401 HC, p. 16, l. 17-18 (Meyer surrebuttal).
[337] Ex. 203, p. 7, l. 10-13 (Rackers surrebuttal).

weather information throughout the state in a more timely manner.[338] All of these improvements allow AmerenUE to better respond to customers left without service after a major storm.[339] This Commission and our customers have urged us to make storm restoration efforts a priority[340] and we have done so. Staff and other parties have acknowledged this improvement, including in the Staff report filed in Case No. EO-2008-0218 where Staff stated, "[t]his report is Staff's fifth storm report involving AmerenUE's restoration efforts in the last five (5) years. In summary, Staff's overall conclusion is that AmerenUE has applied the lessons it learned from previous storm restoration efforts to this ice storm, evidenced by the faster restoration times."[341] Staff continued, "[based] on the Staff's experiences during the restoration process and the feedback received from various city and county emergency management personnel directly involved in the restoration process, AmerenUE was the IOU [investor owned utility] singled out for outstanding assistance in the days after the storm."[342]

In this case, there are two questions left for the Commission to decide. First, what level of storm restoration costs should be included in AmerenUE's revenue requirement? And should the Company be granted a tracker to capture variations in actual expenditures which are above or below the base amount? It is no longer appropriate to fail to build any amount into rates for major storm restoration work has been frequently required in the past and which will certainly be required in the future. AmerenUE believes the amount incurred during the test year is the correct level for the base amount and that a tracker is appropriate as it makes this change in a manner that in practice protects all parties.

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[338] Tr. p. 1582, l. 15 to p. 1583, l. 16.
[339] Tr. p. 1583, l. 17-23.
[340] Ex. 171.
[341] Case No. EO-2008-0218, Cover pleading to Final Report of Staff Investigation of the January 2009 Southeast Missouri Ice Storm, p. 2.
[342] *Id.*, p. 7 of the report.

AmerenUE is aware of the Commission order in its last rate case (referencing the Company's requested vegetation management and infrastructure inspection tracker) in which the Commission said it did not "intend to allow the overuse of tracking mechanisms." This quote was cited by Mr. Rackers[343] and by Mr. Meyer[344] as a reason to deny AmerenUE's request for a storm restoration cost tracker. It is incorrect, however, to interpret this statement as saying the Commission would never approve another tracker. The next two sentences of that order provide: "However, the tracker proposed by AmerenUE is this case is appropriate. This is a limited tracker that will have only a limited effect on AmerenUE's business risk."[345]

Those two sentences also apply to AmerenUE's current request for a storm restoration cost tracker. The proposed storm restoration cost tracker is appropriate. The Company does not control when a major storm damages its service territory and the Company has little control over the costs it must incur to get service promptly restored to its customers.[346] AmerenUE is not asking to track all expenditures, only the limited O&M expenses related to restoration of customers after a major storm. Just as it did with the vegetation management and infrastructure inspection trackers, the Company is asking for a solution that protects all parties. AmerenUE is protected if it experiences a year with higher than expected storm restoration costs and our customers are protected if the Company experiences a year with lower than expected storm restoration costs. AmerenUE asks the Commission to include the $10.4 million actual test year amount as the base amount in its revenue requirement for storm restoration costs and to allow the Company to track any differences in a regulatory asset or liability to be collected from or returned to customers in AmerenUE's next rate case.

VII. UNION ISSUES.

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[343] Ex. 203, p. 8, l. 5-10.
[344] Ex. 401 HC, p. 18, l. 21-25 (Meyer surrebuttal).
[345] Case No. ER-2008-0318, Report and Order, January 27, 2009, p. 41.
[346] Tr. p. 1597, l. 1-8; p. 1631, l. 21 to p. 1632, l. 22.

A. The Unions' Testimony.

In this rate case, International Brotherhood of Electrical Workers Local 1439, (Union) filed the rebuttal testimony of Mr. Michael Walter (Union Representative). The Union Representative supported the need for a rate increase in this proceeding.[347] However, this witness also raised issues related to the level of training of employees as well as AmerenUE's use of outside contractors. In his testimony, the Union Representative requested that the Commission order AmerenUE to (i) expend a substantial portion of the rate increase on investing and re-investing in its regular employee base: hiring, training and utilizing its internal workforce to maintain its normal and sustained workload; (ii) renew its commitment to the internal workforce to insure that the portion of the ratepayers' monies that are attributable to employment will largely remain in Missouri and within the AmerenUE service areas; and (iii) "demand all jobs, internal or outsourced, be filled first within the AmerenUE service territory, second, in the State of Missouri, and third, never be offshore."[348] 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 is detailed below.

AmerenUE witness David N. Wakeman addressed the specific concerns raised by the Union Representative.[349] Mr. Wakeman initially pointed out that one of the job responsibilities of the Union Representative is to lobby for more in-house employees rather than the use of outside contractors.[350] As a result, the Union Representative's criticisms of AmerenUE's

[347] Ex. 650, p. 7, l. 7-8; Tr. p. 2570, l. 20-25 (Walter direct).
[348] *Id.* p. 8, l. 18-19.
[349] Ex. 110, pp. 9-11 (Wakeman surrebuttal).
[350] *Id.* p. 9, l. 19-21. During cross-examination, Mr. Walter candidly conceded that his job as a union representative included responsibilities to encourage union membership. Tr. p. 2573, l. 9-14.

management practices with regard to the outside contractor issue should be recognized as self-serving and should be viewed skeptically by the Commission.[351]

Mr. Wakeman disagreed that AmerenUE's reliance on outside contractors has caused a nationwide shortage of skilled labor. He pointed out that the industry as a whole is facing a shortage of skilled workers because of the retirement of many linemen trained during period of more rapid growth in the system. He also testified that, until recently, AmerenUE had offered a hiring bonus for persons who qualified as a journeyman lineman.[352] He also testified that the lack of qualified personnel is why AmerenUE, and most other electric utilities, have no choice but to rely on outside contractors for at least a portion of their normal workforce needs.[353]

While Mr. Wakeman agreed with Mr. Walter that the training provided by AmerenUE for its employees is outstanding, he also testified that the individuals employed by AmerenUE's outside contractors also receive excellent training. In fact, much of that training is the same as the training that AmerenUE employees undergo.[354] Mr. Wakeman also pointed out that AmerenUE audits the performance of outside contractors for compliance with AmerenUE standards for workmanship and safety.[355] Finally, Mr. Wakeman testified that the decision to use contract labor versus employee labor is a management decision, and the Commission has not historically been involved in discussions between the Company and its labor unions.[356]

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

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[351] *Id.* p. 9, l. 21 to p. 10, l. 2.
[352] *Id*. pp. 9-10.
[353] *Id.* p. 10, l. 12-14.
[354] *Id.* p. 10, l. 23.
[355] *Id.* p. 11, l 2-3.
[356] *Id.* p. 11, l. 14-16.

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. 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 AmerenUE's last rate case the Commission concluded:

> The Commission has the authority to regulate AmerenUE, including the authority to ensure the utility provides safe and adequate service. However, the Commission does not have authority to manage the company. In the words of the Missouri Court of Appeals,
>
> > The powers of regulation delegated to the Commission are comprehensive and extend to every conceivable source of corporate malfeasance. 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.
>
> Therefore, the Commission does not have the authority to dictate to the Company whether it must use its internal workforce rather than outside contractors to perform the work of the Company.[357]

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

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[357] *Report & Order*, Re AmerenUE, Case No. ER-2008-0318, pp. 313-14 (January 27, 2009).

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.[358] The Commission has also found limited authority to dictate Southwestern Bell Telephone Company's (SWB) 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."[359] 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.[360]

Applying these principles to the instant case, the Commission should not and indeed lacks the authority to dictate, as the Union Representative has requested, that AmerenUE (i) expend a substantial portion of the rate increase on investing and re-investing in its regular employee base: hiring, training and utilizing its internal workforce to maintain its normal and sustained workload; (ii) renew its commitment to the internal workforce to insure that the portion of the ratepayers' monies that are attributable to employment will largely remain in Missouri and within the Ameren service areas; and (iii) require all jobs, internal or outsourced, be filled first within the AmerenUE service territory; second, in the State of Missouri; and third, never be offshore. 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

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[358] *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).
[359] *PSC Staff v. Southwestern Bell Telephone Co.*, Case No. TC-93-224 (1994).
[360] *See* Section 386.315(1), RSMo 2000.

public utility's recognized right to manage its business. Consistent with decades of regulatory law and practice, the Commission should reject such an approach, and decline to adopt the Union Representative's recommendations in this case. In addition, there is no competent and substantial evidence to support the Unions' recommendations, or demonstrate that there is an underlying problem with AmerenUE's quality of service or power plant operations. For these reasons, the Commission should decline to adopt the Union Representative's recommendations.

B. Training Proposal in Response to the Request of Commissioners Davis and Jarrett.

During the hearing, Commissioners Davis and Jarrett 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.[361] In response to the inquiries of the Commissioners, AmerenUE witness David Wakeman provided the Commission with some specific recommendations of measures that could be taken by AmerenUE to improve the training and recruitment of employees if additional funds were included in the Company's cost of service in this case.[362] These recommendations included the following:

AmerenUE would propose an additional $1.71 million to its revenue requirement.

CAPITAL:

Addition to the Company's training facility at the Dorsett Complex

New smart grid switchgear used for training
New training equipment
Mobile trailer to train lineman on new smart grid equipment
Additional equipment (non-training) for new employees

Total: $2.1 million
Amortized over five years: $420 thousand per year

[361] Tr. p. 2591, l. 7-25; p. 2617, l. 22 to p. 2621, l. 5.
[362] Ex. 179; Tr. p. 2768, l. 23 to p. 2772, l. 16; p. 2779, l. 6 to p. 2780, l. 15.

O&M:

Fourteen additional employees
    One Training Supervisor
    Thirteen employees, including distribution system technicians, system relay testers and substation mechanics.
Minor tools (non-capital)

Total: $1.29 million

AmerenUE agrees to assess the incremental value to customers of these additional investments and to provide that assessment to Commission Staff and to the Office of Public Counsel by December 31, 2011.

On March 31, 2010, the Union filed the Unions' Position Statement With Regard to Exhibit 179 in which the Union stated that "it fully supports AmerenUE's proposal for the spending of additional revenue on training and hiring as a good start toward addressing the Unions' stated concerns."

AmerenUE believes it would be helpful and appropriate to adopt Mr. Wakeman'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.

VIII. FUEL ADJUSTMENT CLAUSE.

AmerenUE filed a fuel adjustment clause (FAC) tariff in this case that is essentially the same as the FAC first approved just over one year ago in Case No. ER-2008-0318. In her direct testimony, AmerenUE witness Lynn M. Barnes explained that the conditions that were present when the Commission first approved AmerenUE's FAC still do exist today, and continuation of the FAC is just as important now as it was then. She testified that the FAC is necessary to allow the Company to timely reflect changes in volatile net fuel costs that are beyond its control, earn a return closer to its authorized return, improve its cash flows and preserve its credit quality.[363] She also testified that given the increasing fuel costs and decreasing off-system sales revenues that the Company is facing, and given the 11-month rate case process, the FAC continues to be necessary to allow the Company to have a sufficient opportunity to earn a fair return on equity.[364]

Ms. Barnes also noted that there are three other factors that the Commission typically considers when reviewing FAC requests, that is, whether the changes in the costs/revenues tracked in the FAC are:

1. Substantial enough to have a material impact upon revenue requirements and the financial performance of the business between rate cases;
2. beyond the control of management, where the utility has little influence over experienced revenue or cost levels; and
3. volatile in amount, causing significant swings in income and cash flows if not tracked.

Ms. Barnes pointed out that the Company's fuel and purchased power costs are clearly substantial—they continue to represent the Company's largest single cost item, comprising over $841 million in the test year and 47% of the Company's total operations and maintenance expense. The main category of revenues tracked through the FAC, off-system sales revenues are also substantial, estimated to be $306 million per year based upon normalized energy prices and conditions at the time of Ms. Barnes direct testimony.[365]

Ms. Barnes also testified that coal and coal transportation costs, natural gas costs, nuclear fuel costs and power prices for off-system sales continue to be dictated by national and international markets beyond the control of the Company's management. And finally, she testified that those markets continue to be volatile, producing significant swings in the Company's financial performance and earnings unless tracked through an FAC. For example,

[363] Ex. 121, p. 3, l. 12-18 (Barnes direct).
[364] Ex. 121, p. 6, l. 1-7; p. 6, l. 18-p. 7, l. 6.
[365] Ex. 121, p. 7, l. 7-23.

Ms. Barnes noted that the annual average of wholesale power prices had already fallen approximately 25% since the end of the true-up period in AmerenUE's last rate case, less than one year before her testimony was filed.[366] For all of these reasons, Ms. Barnes testified that AmerenUE's FAC should be continued.

Ms. Barnes also provided all of the information necessary to comply with the extensive minimum filing requirements prescribed by 4 CSR 240-3.161 (A) through (S), which are required whenever an electric utility proposes to continue an FAC. Barnes, Schedule LMB-E1 through LMB-E3.

Finally, Ms. Barnes recommended two minor housekeeping changes to the FAC. Specifically, she proposed a refinement of the true-up process to allow each true-up to occur after a recovery period, and she proposed the addition of a sulfur quality adjustment component applicable to certain coal contracts.[367]

Staff generally agreed with Ms. Barnes' recommendations in the Staff Report. Specifically, Staff agreed that the Commission should approve continuation of the FAC with the modifications Ms. Barnes suggested. In addition, Staff proposed its own minor housekeeping modifications, and some additional filing requirements, with which the Company agreed.[368] No other party filed testimony addressing AmerenUE's FAC or its 95%/5% sharing percentage. Following the filing of rebuttal testimony on February 17, 2010, the Commission *sua sponte* issued an order inviting the parties to submit testimony addressing the Company's fuel adjustment clause, in particular addressing the sharing mechanism therein. The parties were

[366] Ex 121, p. 7, l. 23-p. 8, l. 11. Power prices have fallen even further since then.
[367] Ex. 121, p. 10, l. 11-17.
[368] Ex. 200, p. 108, l. 1 to p. 111, l. 15.

given until February 22, 2010, to file direct testimony on this topic, rebuttal testimony was due February 26, 2010, and surrebuttal testimony was due March 5, 2010.[369]

In response to this order, Ms. Barnes filed additional testimony in support of the Company's need for the FAC and the appropriateness of the existing sharing mechanism. Ms. Barnes explained the damaging impact on AmerenUE's earnings of eliminating the FAC, and explained in detail why the Company would have no reasonable opportunity to earn its authorized return without the FAC. She testified that continuation of the FAC is "absolutely necessary" for the Company to have any reasonable chance to earn its authorized return.[370] She also testified that AmerenUE's FAC is critical to maintaining the Company's credit quality and its attractiveness to investors, given that over 90% of the integrated electric utilities across the country operate with a FAC.[371] Ms. Barnes also noted that changing regulatory policy so soon after the Company's FAC was approved would erode investor confidence in the state.[372] Finally, Ms. Barnes testified that there is absolutely no evidence that the Company is not reasonably and prudently managing its net fuel costs, noting that AmerenUE's power plants have been operating at a high equivalent availability, the Company continues to invest in power plant maintenance, and continues to operate in a manner to achieve the lowest prudent net fuel costs for its customers. The absorption of 5% of net fuel cost changes, the risk of a prudence disallowance, and, most significantly, the risk that the Commission will disapprove the use of the FAC provide the Company with powerful incentives to continue to operate prudently.[373]

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[369] It is noteworthy that the parties had agreed to and the Commission had previously approved a procedural schedule which explicitly required all parties to file any testimony "relating to changes to AmerenUE's fuel adjustment clause, including the structure, terms and continuation of the fuel adjustment clause" by December 18, 2009. Joint Proposed Procedural Schedule, Related Procedural Items, and Test Year True-Up Cut-Off Date, filed September 11, 2009, pp. 2-3; approved by the Commission in its *Order Adopting Procedural Schedule and Establishing Test Year* (September 14, 2009) p. 1.

[370] Ex. 122, p. 5, l. 7 to p. 6, l. 9; p. 10, l. 6-10.

[371] *Id.* p. 7, l. 3-19.

[372] *Id.* p. 7, l. 20 to p. 8, l. 3.

[373] *Id.* p. 8, l. 8 to p. 9, l. 17.

Other parties filed limited direct testimony regarding the FAC. Staff witness Lena Mantle filed testimony reiterating the Staff's filed position to continue the FAC in its present form, with the minor housekeeping changes proposed by or otherwise agreed to by the Company.[374] Ms. Mantle had some complaints about the way FACs had worked for other utilities, but during cross-examination she made it clear that those issues did not apply to AmerenUE.[375] MIEC witness Maurice Brubaker simply refiled the testimony from the Company's last case, in which he had proposed an 80%/20% sharing mechanism with a 50 basis point cap.[376] Notably, Mr. Brubaker provided no information or analysis that would justify accepting his old proposal now, it having been rejected just over one year ago. OPC witness Ryan Kind filed a short (4 page) piece of testimony stating nothing more than his "belief" that AmerenUE's FAC did not provide it sufficient incentive to minimize fuel procurement costs and maximize off-system sales margins. Mr. Kind testified that he believes that at a minimum AmerenUE should have 20% "skin in the game" to have an adequate incentive to use its best efforts to minimize fuel costs.[377] Mr. Kind's testimony was totally devoid of any evidence that substantiated his belief and indeed the record in this case rebuts it.

In response to the direct testimony of these witnesses, AmerenUE filed an exhaustive reply. AmerenUE witnesses Ms. Barnes (overall policy considerations), Timothy Finnell (accuracy of net fuel cost determination), Randall J. Irwin (nuclear fuel costs), Jaime Haro (off-system sales), Robert K. Neff (coal costs), James Massmann (gas costs), Julie Cannell (equity investor considerations), and Gary Rygh (debt investor considerations) provided comprehensive testimony concerning the Company's fuel and power costs/off-system sales revenues, the volatility of those costs/revenues, the Company's inability to control those costs/revenues and

[374] Ex. 221, p. 6, l. 10-13 (Mantle supplemental direct).
[375] Tr. p. 2522, l. 9 to p. 2529, l. 6.
[376] Ex. 413, p. 2, l. 12-15.
[377] Ex. 301, p. 2, l. 7-18.

the Company's prudent and reasonable operations. In addition, Ms. Cannell and Mr. Rygh provided comprehensive discussions of the devastating impact on AmerenUE's position in the credit and equity markets discontinuation or material modification of the FAC would have. Mr. Rygh testified as follows:

> A reduction in the 95% pass-through mechanism via this ad hoc process, without the lack of significant justifiable cause, would create negative perceptions of the regulatory climate in Missouri and financial stability of AmerenUE that would cause significant harm to the ratepayers over the long-term. Investors expect and rely on the Commission to hold AmerenUE accountable when it does not perform or does not act prudently. However, from an investor perspective, it is my opinion that making a significant adjustment to the sharing mechanism in the FAC in the absence of any performance issues would be viewed as lacking in sufficient cause and doing so would create a much less favorable environment in which to consider deploying capital to AmerenUE.[378]

The testimony of all these witnesses provides overwhelming evidence that continuation of the FAC in its present form is vital to AmerenUE and ultimately to its customers. It provides all the information that the Commission could conceivably need to continue AmerenUE's FAC. Without belaboring this issue, there is simply no competent and substantial evidence in this record that would permit the Commission to eliminate or materially alter the FAC. Staff endorses the continuation of the FAC. OPC's testimony provides nothing more than Mr. Kind's "belief" that a higher sharing percentage, one far in excess of the sharing percentages in most other jurisdictions, should be imposed on AmerenUE. And Mr. Brubaker has simply recycled his testimony from the last case, which the Commission has already rejected. There is no evidence that there has been any material change that would warrant discontinuance or material modification of the FAC—in fact, the volatility of power prices and fuel costs, and the potential impact of these items on AmerenUE's earnings and cash flows has become greater.

[378] Ex. 120, p. 15, l. 16 to pg. 16, l. 3.

One more important consideration needs to be mentioned about AmerenUE's FAC. AmerenUE's net base fuel costs do not actually reflect the fuel costs that AmerenUE will incur once rates for this case take effect. In fact, the net base fuel cost built into base rates will be significantly lower than actual fuel costs, simply because the off-system sales revenue component of net base fuel costs is based on a multi-year average of power prices. Since power prices have dropped sharply in recent months, that multi-year average is likely to be too high, and the off-system sales revenue component of the net base fuel cost is likely to be too high as well, meaning rates will probably be a bit too low. This does not matter as much if the FAC is left as it is. Eventually the customers will pay the higher actual cost of fuel under the FAC and the Company will be made whole (except for the 5% of prudent net fuel cost changes that it must absorb). But if the FAC sharing percentage were changed to 80%/20%, AmerenUE would have to bear 20% of the difference, even if all costs are ultimately deemed prudent.[379] A similar situation will occur with regard to any fuel cost that is not included in the net base fuel costs, but is incurred when rates take effect. For example, if the Commission were to exclude the nuclear fuel costs addressed earlier in this brief, as the Staff and MIEC propose, AmerenUE will have to absorb its share of those costs as well, despite the fact that no party claims any imprudence whatsoever respecting those nuclear fuel costs. The same would apply to any other fuel costs not included in net base fuel costs. This is another reason that increasing AmerenUE's sharing percentage of prudently incurred net fuel costs is inappropriate

[379] Off-system sales are likely to be deemed prudent because AmerenUE typically sells excess power into the transparent MISO market.

IX. 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, rebuttal and surrebuttal testimonies of AmerenUE witnesses Wilbon L. Cooper,[380] William M. Warwick[381] and James R. Pozzo.[382] 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 fairly consistent with the rate design approved by the Commission in the Company's last rate case (Case No. ER-2008-0318).[383]

Other issues in the rate design area are the appropriate method to use 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 and Excess method for allocating these assets, which gives proper weighting to both class peak demands and to class energy consumption (average demands).[384] AmerenUE believes its allocation method is the most appropriate for this proceeding.

B. Non-Unanimous Stipulation and Agreement on Class Cost of Service and Rate Design Issues.

On March 17, 2010, prior to commencement of the hearings on the rate design and class cost of service issues, OPC, the MIEC, AARP, the Consumers Council of Missouri and the Missouri Retailers Association ("Signatory Parties"), filed a 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 in the event that the Commission finds that AmerenUE's rates should be

[380] Ex. 134, 135, and 137 (Cooper direct, rebuttal and surrebuttal).
[381] Ex. 146, 147, and 148 (Warwick direct, rebuttal and surrebuttal).
[382] Ex. 153 (Pozzo direct).
[383] Ex. 135, p. 9, l. 16-17.
[384] Ex. 135, p. 3, l. 6-8.

increased.[385] The Stipulation and Agreement specified the agreement of the Signatory Parties on the rate design and the spread of any revenue increase among the customer classes, assuming allocation of revenue increases from $100 million to $325 million, in $25 million increments.

Several parties, including the Midwest Energy Users Association (MEUA) and the City of O'Fallon, the City of University City, the City of Rock Hill and the St. Louis County Municipal League (collectively The Municipal Group) initially filed Objections to the Stipulation and Agreement filed on March 17, 2010.[386] The Municipal Group, however, announced at the hearing that they were withdrawing their objection to the proposed Stipulation and Agreement filed on March 17, 2010.[387]

On March 26, 2010, the Signatory Parties to the Stipulation and Agreement filed an Addendum To Stipulation and Agreement which stated that the Signatory Parties continued to support their Stipulation and Agreement filed on March 17, 2010, but also offered in the Addendum a resolution of the class cost of service/rate design issues in this case that: 1) implements a revenue-neutral shift away from the Large General Service (LGS)/Small Primary Service (SPS) class that is fixed at $4,579,000 for all revenue increases from $100 million to $325 million.[388]

At the hearings, AmerenUE's counsel announced that the Company had not been involved in the negotiations of the Stipulation and Agreement and its Addendum. As a result, the Company indicated that it would not be a Signatory Party to the settlement proposal.

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[385] *Stipulation And Agreement* (filed March 17, 2010).
[386] *See Objection To Non-Unanimous Stipulation And Agreement* filed by The Municipal Group and MEUA on March 19 and 22, 2010, respectively.
[387] Tr. p. 2800.
[388] *Addendum To Stipulation And Agreement* (filed March 26, 2010).

However, AmerenUE does not support or oppose the adoption of the provisions of the Stipulation and Agreement or the Addendum recommended by the Signatory Parties.[389]

The Commission Staff did not assert that any party's proposal on rate class shifts was unreasonable, but the Staff suggested that the Staff proposal was the "most reasonable" and should be adopted by the Commission.[390] In effect, the Staff did not support or oppose the adoption of the terms of the Stipulation and Agreement. Instead, the Commission Staff proposed to have a revenue neutral shift of $3.0 million to the Residential class (increase of 0.31%) and a revenue neutral adjustment to the Large General Service class of -$3.0 million (decrease of 0.46%), prior to spreading the remainder of the increase on an across-the-board equal percentage basis, including the lighting class.[391]

MEUA was a primary opponent of the Stipulation and Agreement. MEUA believes that the LGS class should receive a less than a system-wide average percentage increase in this case. In MEUA's Position Statement, MEUA asserts, given the unanimous agreement that LGS / SPS rates are above cost of service, that "significant movement towards cost of service should be a revenue allocation goal in this docket regardless of the approved model." MEUA argued that the Commission should make class cost of service adjustments which move the LGS / SPS classes 20% towards their class cost of service under any approved study.[392] AmerenUE takes no position on the appropriateness of the MEUA proposal.

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 Stipulation and Agreement or

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[389] Tr. p. 2785, l. 8-10.
[390] Tr. p. 2786, l. 9-13.
[391] Ex. 206, p. 5, l. 17-25 (Scheperle direct).
[392] MEUA Position Statement, March 10, 2010, p. 2.

the Addendum or the position asserted by MEUA, the Company will not further argue its position on these issues at this time.

C. Municipal Lighting Issues.

In the First Unanimous Stipulation and Agreement which was approved by this Commission on March 24, 2010,[393] the Signatory Parties, including The Municipal Group, agreed to the following with regard to the issues raised related to municipal lighting:

> 13. With regard to municipal lighting, AmerenUE agrees:
>
> a. to immediately commence a cost of service study for all rates under service classifications 5M and 6M, and upon completion of that study to share the results, all work papers and underlying data with financial and accounting consultants for the Municipal Group, Public Counsel, the Staff and other interested signatories. Prior to commencing such study, AmerenUE will meet with the Municipal Group's financial and accounting consultants and those at the Public Counsel's office and with the Staff, and those representing other interested signatories in a collaborative fashion in an attempt to agree on the parameters and general guidelines for the study.
>
> b. to develop a methodology for determining the value of systems within municipal boundaries and negotiate in good faith with any 5M municipal streetlighting customer who wishes to purchase or take ownership of any streetlight systems within its jurisdictional boundaries, subject to final approval by the Commission.
>
> c. to develop a database to insure that streetlighting customers are informed of the location of poles within their boundaries, by type, etc. and that streetlighting customers will only be charged for those facilities.

AmerenUE believed that its agreement with The Municipal Group had resolved the issues raised by The Municipal Group. However, counsel for The Municipal Group recommended in his opening statement that there should be no increase in rates to The Municipal Group, and alternatively, any rate increase to The Municipal Group should be escrowed, subject to refund,

[393] See *Order Approving First Stipulation And Agreement*, Case No. ER-2010-0036 (approved March 24, 2010).

and "trued-up" during the next rate case.[394] For the reasons stated herein, this proposal of The Municipal Group should be rejected by the Commission.

AmerenUE has already committed to perform a class cost of service study that will include the lighting class in its next rate case, and this commitment has been approved by the Commission.[395] Any change in the lighting class's relative share of revenues will be reviewed in the context of that case when there will be a comprehensive cost of service study available for the Commission's review; indeed, that is the purpose of the study – to consider the study results and if warranted change rates in the next rate case.

The Municipal Group's proposal to escrow any rate increase, and make it "subject to refund," pending the results of the next rate case, is unreasonable and unlawful. The Municipal Group's proposal is unreasonable because there is no competent and substantial evidence to support a finding that the lighting class rates are excessive. In addition, any refund based upon a rate design change in a future case would create a revenue shortfall that could not be recovered from other customer classes.[396]

AmerenUE also questions whether it is lawful for the Commission to impose interim rates "subject to refund" for one class of customers under any circumstance without the agreement of the public utility, but it is undoubtedly unlawful to do so as advocated by The Municipal Group. The Commission concluded in its 1993 decision to adopt an alternative regulation plan for Southwestern Bell Telephone Company that included customer credits if specified earnings thresholds were exceeded, that the Commission did not have the authority to order credits (or refunds) without the agreement of the company. ("The Commission could not order the credits, but it believes that SWB may agree to make the credits as part of its acceptance

[394] Tr. p. 2799, l. 1 to p. 2800, l. 5.
[395] Tr. p. 2896, l. 14-18.
[396] Tr. p. 2898, l. 20 to p. 2899, l. 4.

of an alternative regulation plan...").[397] Similarly, the commodity rates for natural gas are routinely made "interim subject to refund," but only after the natural gas companies have voluntarily filed PGA/ACA tariffs under which the public utilities have agreed to make their PGA rates "interim and subject to refund" pending an ACA audit. In this case, AmerenUE has not agreed to make any of its rates "interim, subject to refund."

Any refund ordered in a subsequent rate case would require a finding that the lighting class rates resulting from AmerenUE's current rate case were not "just and reasonable." Such a finding and refund order would be the very definition of retroactive ratemaking. Under Missouri law, the Commission may consider past excess recovery insofar as it is relevant to the Commission's determination of what rate is necessary to provide a just and reasonable return <u>in the</u> <u>future</u> and avoid any <u>further</u> excess recovery.[398] However, the Commission cannot re-determine rates already established and paid without depriving the utility of its property without due process.[399]

For the reasons stated herein, the proposals of The Municipal Group to exempt the lighting class from any rate increases, or alternatively, to escrow the lighting class's rate increase, and make it "subject to refund" in a future rate case, should be rejected by the Commission.

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[397] *Report & Order*, *Staff v. Southwestern Bell Telephone Co.*, Case No. TC-93-224 & TO-93-192, 2 Mo.P.S.C.3d 479, 585 (December 17, 1993).
[398] *See*, *State ex rel. General Tel. Co. v. Public Serv. Comm'n*, 537 S.W.2d 655 (Mo. App 1976).
[399] *See*, *State ex rel. UCCM v. Public Service Commission* 495 S.W.2d 45, 58 (Mo. 1979). *See also Lightfoot v. City of Springfield*, 236 S.W.2d 348, 353 (Mo. 1951); *Southwestern Bell Telephone Company v. Public Service Commission*, 645 S.W.2d 45 (Mo. App. 1979).

Dated: April 23, 2010

Respectfully submitted:

/s/ Thomas M. Byrne__
Steven R. Sullivan, #33102
Sr. Vice President, General Counsel and Secretary
Thomas M. Byrne, #33340
Managing Assoc. General Counsel
Wendy K. Tatro, #60261
Asst. General Counsel
Ameren Services Company
P.O. Box 66149
St. Louis, MO 63166-6149
Phone (314) 554-2514
(314) 554-3484
Facsimile (314) 554-4014
AmerenUEService@ameren.com

SMITH LEWIS, LLP

/s/ James B. Lowery
James B. Lowery, #40503
Suite 200, City Centre Building
111 South Ninth Street
P.O. Box 918
Columbia, MO 65205-0918
Phone (573) 443-3141
Facsimile (573) 442-6686
lowery@smithlewis.com

/s/ James M. Fischer
James M. Fischer, #27543
FISCHER & DORITY, P.C.
101 Madison Street, Suite 400
Jefferson City, MO 65101
Phone (573) 636-6758
Facsimile (573) 636-0383
jfischerpc@aol.com

Attorneys for Union Electric Company d/b/a AmerenUE

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 23rd day of April, 2010.

Nathan Williams
Missouri Public Service Commission
200 Madison Street, Suite 800
P.O. Box 360
Jefferson City, MO 65102-0360
Nathan.Williams@psc.mo.gov
GenCounsel@psc.mo.gov

Lewis R. Mills
Missouri Office of Public Counsel
200 Madison Street, Suite 650
P.O. Box 2230
Jefferson City, MO 65102-2230
Lewis.mills@ded.mo.gov
opcservice@ded.mo.gov

Michael C. Pendergast
Rick E. Zucker
Laclede Gas Co.
720 Olive Street, Ste. 1520
St. Louis, MO 63101
mpendergast@laclede.com
rzucker@laclede.com

Diana M. Vuylsteke
Bryan Cave, LLP
211 N. Broadway, Ste. 3600
St. Louis, MO 63102
dmvuylsteke@bryancave.com

Thomas G. Glick
7701 Forsyth Blvd., Ste. 800
St. Louis, MO 63105
tglick@dmfirm.com

Sherrie A. Schroder
Michael A. Evans
7730 Carondelet, Suite 200
St. Louis, MO 63105
saschroder@hstly.com
mevans@hstly.com

Lisa C. Langeneckert
Sandberg Phoenix & Von Gontard, P.C.
One City Centre, 15th Floor
515 North Sixth Street
St. Louis, MO 63101-1880
llangeneckert@sandbergphoenix.com

John C. Dodge
Davis, Wright and Tremaine, LLP
1919 Pennsylvania Ave. NW, Ste 200
Washington, DC 20006
johndodge@dwt.com

Mark W. Comley
Newman, Comley and Ruth
PO Box 537
601 Monroe St., Ste. 301
Jefferson City, MO 65102
comleym@ncrpc.com

John B. Coffman
871 Tuxedo Blvd.
St. Louis, MO 63119-2044
john@johncoffman.net

Shelley A. Woods
Sarah B. Mangelsdorf
P.O. Box 899
Jefferson City, MO 65102-0899
shelley.woods@ago.mo.gov
sarah.mangelsdorf@ago.mo.gov

Douglas Healy
939 Boonville, Suite A
Springfield, MO 65802
dhealy@mpua.org

David Woodsmall
428 E. Capitol Ave., Suite 300
Jefferson City, MO 65101
dwoodsmall@fcplaw.com

James B. Deutsch
Thomas R. Schwarz
308 E. High St., Suite 301
Jefferson City, MO 65101
jdeutsch@blitzbardgett.com
tschwarz@blitzbardgett.com

Karl Zobrist
Roger W. Steiner
Sonnenschein Nath & Rosenthall LLP
4520 Main Street, Suite 1100
Kansas City, MO 64111
kzobrist@sonnenschein.com
rsteiner@sonnenschein.com

Sam Overfelt
Missouri Retailers Association
618 E. Capitol Avenue
P.O. Box 1336
Jefferson City, MO 65102
moretailers@aol.com

Henry B. Robertson
705 Olive Street, Suite 614
St. Louis, MO 63101
hrobertson@greatriverslaw.org

Leland Curtis
Carl Lumley
Kevin O'Keefe
Curtis, Heinz, Garrett & O'Keefe PC
130 S. Bemiston, Suite 200
St. Louis, MO 63105
314-725-8788
314-725-8789
lcurtis@lawfirmmail.com
clumley@lawfirmmail.com
kokeefe@lawfirmmail.com

/s/ James B. Lowery
James B. Lowery