BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Tariff Filings of Union Electric Company d/b/a Ameren Missouri, to Increase Its Revenues for Retail Electric Service.	)))	File No. ER-2011-0028

INITIAL POST-HEARING BRIEF OF AMEREN MISSOURI

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Electric Company d/b/a Ameren Missouri, to	)	File No. ER-2011-0028
Increase Its Revenues for Retail Electric Service.	)	

INTRODUCTION

Based on the trued-up revenue requirement, Ameren Missouri is seeking an approximately $211 million per year increase in its revenue requirement in this case. Of this amount, approximately $105 million relates to the revenue requirement associated with the Company's capital investment in scrubbers at its Sioux Plant, approximately $52 million reflects a re-basing of increased net fuel costs, and nearly all of the remaining approximately $54 million reflects the revenue requirement associated with other capital investments the Company has made in its system that are serving its customers today. In fact, the Company has placed more than $1 billion of capital investments in service since the conclusion of its last rate case in June 2010.[1] In summary, the drivers of this case are all factors over which the Company has little or no control.

The Company cannot avoid compliance with the ever-increasing environmental regulations that necessitated the scrubbers at its Sioux Plant, cannot avoid the other significant rate base investments needed to provide service to customers, and cannot control the markets for coal, coal transportation and other fuels, which continue to cause higher fuel costs. Nor can the Company control the market for off-system sales, which in recent years has continued to be depressed, resulting in lower off-system sales revenues and higher net fuel costs. With respect to factors over which the Company has greater control – administrative, general and non-fuel

[1] Ex. 100, p. 6, l. 2-3 (Baxter Direct).

operating and maintenance costs – the revenue requirement in this case reflects that such costs have actually decreased since the conclusion of the last case.[2]

Despite its diligent cost management efforts, and in large part because of the continuing requirement and need to invest in its system, the Company continues to struggle to earn a fair return on its shareholder's investment. While the Company for a month or two was able to earn its allowed return on equity (10.1 percent currently) as a result of the extremely hot weather last summer, for most of the past four years and in recent months the Company has earned far less, including approximately 200 basis points less recently.[3] While it is true that the Company's past struggles in earning even its allowed return on equity ("ROE") are not the main consideration in what its revenue requirement should be today, that fact, coupled with the Company's disciplined cost management efforts and the essentially unavoidable investments and net fuel cost increases that are driving this case, demonstrate that for several reasons granting the Company's $211 million rate increase request, and approving the regulatory mechanisms the Company seeks in this case, are reasonable and necessary steps that the Commission must take. These reasons include: the need to afford the Company a reasonable opportunity to earn a fair return; the need to provide the Company with the cash flows it needs to continue to make the investments its customers expect; and the need to provide the Company rates that will allow it to remain in a solid financial position over the long-term so that it can continue to meet its customers' needs and expectations. It is against that backdrop that the Commission should consider the positions of the parties on the remaining contested issues in this case.

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[2] Ex. 100, p. 7, l. 1-3.
[3] Tr., p. 116, l. 1-15; Ex. 100, p. 18, l. 19 to p. 20, l. 7.

This is particularly true with respect to the ROE issue in this case.[4] As has become routine, Staff witness David Murray once again recommends a punitive, outside-the-zone-of-reasonableness ROE of just 8.75 percent that deserves no consideration. Indeed, his recommendation is approximately 150 basis points or more below the average ROE awarded to integrated electric utilities during the past 12 months. If Mr. Murray's recommendation were adopted, it would have severe negative consequences for the Company and its customers. In contrast, Ameren Missouri ROE expert Robert B. Hevert recommends an ROE that is just approximately 40 basis points above that average, in recognition of the Company's higher than average risk given the market's view of the regulatory environment in Missouri and the Company's greater than average reliance on coal-fired generation. Mr. Hevert's testimony supports a 10.7% ROE, but in any case, demonstrates that an ROE of not less than 10.4 percent is required to assure capital attraction at a reasonable cost, and to ensure Ameren Missouri's financial integrity, as required by the controlling *Hope* and *Bluefield* cases, discussed below.

The testimony of the other two ROE witnesses in this case, Missouri Industrial Energy Consumers ("MIEC") witness Michael Gorman and Missouri Energy Group ("MEG") witness Billie Sue LaConte also support an ROE of 10.4% or more. Their "point" recommendations (9.9 percent for Mr. Gorman and 9.7 to 10 percent for Ms. LaConte) are unreasonably low. In the case of Mr. Gorman (who himself concedes that an ROE of 10 percent is reasonable), his 9.9 percent recommendation is 25 basis points below his true midpoint, that is, when proper weighting is given to his discounted cash flow modeling results. In the case of Ms. LaConte, her recommendation is well below her midpoint (10.2 percent) and is also between 60 and 90 basis points below the 10.6 percent ROE she agrees would be reasonable. In summary, when one

[4] The value of this issue, ignoring Mr. Murray's outlier recommendation, is between approximately $40 and $45 million, based upon the difference between Mr. Hevert's recommendation and the recommendations of Mr. Gorman and Ms. LaConte.

considers the true midpoints of all three witnesses' recommendations, an ROE of 10.35 percent is indicated for Ameren Missouri, which is close to the bare minimum recommended by Mr. Hevert. But because of the Company's greater risk as outlined above and in more detail hereinafter in this Brief, and given the difficulty the Company is likely to have in earning its allowed ROE, the 10.7 percent return is the most appropriate ROE for Ameren Missouri in this case.

Another significant issue in this case is the approximately $31 million disallowance proposed by the Staff relating to the Sioux Scrubbers, which is premised on the Staff's completely uninformed and unsupported argument that despite the Global Financial Crisis facing the Company and the country in late 2008, the Company should not have, in the Staff's view, slowed down construction on the scrubber project in an effort to conserve as much as $15 million per month.[5] As detailed below, the evidence in this case demonstrates that the Company's decision to slow down the project was clearly a prudent one. The Staff has entirely failed to create any doubt, let alone a serious doubt, about the prudence of that decision, which means that the Company's presumptively prudent investment in the scrubbers must be included in rate base in this case as a matter of law. And while it is not the Company's burden to affirmatively demonstrate the prudence of its decision in the absence of evidence creating a serious doubt, the evidence shows that the Company indeed faced an unprecedented liquidity crisis in late 2008. The evidence also shows that the Staff had no idea about the liquidity crisis the Company faced because the Staff auditor recommending the disallowance (a) did not appreciate the severity of the financial crisis; and (b) did not analyze the Company's liquidity position or its cash needs. In

[5] The revenue requirement impact of this issue is approximately $4.6 million, but if the Staff's position were adopted, the Company would lose its $31 million investment, and any opportunity to earn a fair return on it, forever.

summary, the record in this case demonstrates that the Staff's proposed disallowance relating to the Sioux scrubbers must be rejected.

Another significant issue in this case arises from the completely unsupported attempt by the Office of the Public Counsel ("OPC") (supported by AARP and the Consumers Council of Missouri ("CCM")) to disallow forever the $89 million of allowed costs relating to the new upper reservoir at the Taum Sauk Plant which the Company seeks to include in rate base in this case.[6] It is undisputed that those costs are "allowed costs" under the Company's settlement with the "State Parties" (as defined below), and there is absolutely no evidence that creates any doubt about the prudence of those expenditures. There is also no doubt that the State Parties were fully apprised of the nature and extent of the costs the Company is seeking in this case, and that the State Parties agree that the recovery sought in this case is indeed allowed by the state settlement. It is also undisputed that customers will receive tremendous benefit from the considerable enhancements included in the new facility, including the greatly enhanced safety features, the greatly enhanced life of the facility, and the tremendous energy and capacity benefits the new upper reservoir will deliver to customers over at least the next 80 years. There is also absolutely no evidence to refute the definitive opinion of Ameren Missouri witness Dr. Paul C. Rizzo that even absent the breach of the old upper reservoir, costs far in excess of the $89 million at issue in this case would have been required. This is because of the Federal Energy Regulatory Commission's ("FERC") new Potential Failure Modes Analysis ("PFMA") inspection process, which would have occurred at the Taum Sauk Plant in 2008, would have required the Company to either essentially rebuild the old reservoir, or to shut-down and retire the site, in either case at a cost of hundreds of millions of dollars. The record in this case supports only one resolution of

[6] The revenue requirement impact of this issue is just approximately $10.3 million, but if the Staff's position were adopted, the Company would lose its $89 million investment, and any opportunity to earn a fair return on it, forever.

this issue: inclusion of the Company's $89 million investment in the new upper reservoir in rate base.

There are two other material revenue requirement issues in this case. First, MIEC proposes to include *no* property taxes additions in the revenue requirement at all for the Sioux scrubbers and the Taum Sauk additions, despite the fact that those assets were in-service and providing benefits to customers prior to the date used to assess *all* of the Company's assets for 2011 property tax purposes. As discussed below, both the Staff and the Company agree that property taxes that the Company is already required to expense today, and that it will continue to owe once rates take effect from this case, must be recognized in the revenue requirement. MIEC's position should be rejected. Second, the Staff and MIEC propose to "normalize" the Company's non-labor storm repair expense but without including all of the Company's actual historical non-labor storm repair costs in their "normalization" calculations. The record shows that these unorthodox methods are inconsistent with the Commission's historical treatment of storm costs, and reflect an inappropriate "normalization" method.

Finally, there are three significant issues that do not directly affect the revenue requirement in this case that we will address here.[7] The first of these relates to the Staff's desire to conduct an "experiment" relating to the sharing mechanism in the Company's fuel adjustment clause ("FAC"), an experiment that the Staff concedes would be an expensive one indeed. But the record shows that there is simply no basis to depart from the sharing mechanism that has been in place for FACs in Missouri since 2007 (and for the Company since 2009) because there is no evidence that the Company lacks sufficient incentive to properly manage its net fuel costs. Indeed, the Commission just weeks ago rejected a similar experiment proposed by the Staff for Kansas City Power & Light – Greater Missouri Operations. The second issue arises from the

[7] There are a handful of other non-revenue requirement issues that are also addressed in this Brief.

Company's proposal to address the throughput disincentive inherent in the operation of energy efficiency programs and the unfortunate reticence of the other parties to this case to recognize that for energy efficiency to grow in Missouri the throughput disincentive must be addressed. As we discuss further below, the time is now, in this case, for the Commission to take steps to align the interests of shareholders with the interests of customers in a manner that will promote the Company's continued significant investment in energy efficiency. The billing unit adjustment mechanism proposed by the Company does that in a manner that is fair to shareholders and customers alike, and should be adopted. Lastly, the Commission should continue the vegetation management and infrastructure inspection tracker, as recommended by the Staff and the Company. The Company is still in the midst of completing its first compliance cycle under the Commission's rules, and the reasons given by the Commission just approximately one year ago for continuing the tracker continue to exist today.

As noted at the beginning of this Introduction, the Company seeks this rate increase because it must have this increase if it is to operate under just and reasonable rates; i.e., in order to be afforded any reasonable opportunity to earn a fair return. The positions of the Company in this case are fair – they are fair to shareholders, and they are fair to customers. Adopting fair positions goes to the heart of the Commission's role as public utility regulators,[8] and the Company asks the Commission to do so by approving the rate increase and the regulatory mechanisms the Company seeks in this case.

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[8] *See State ex rel. Washington Univ. v. Public Serv. Comm'n*, 272 S.W. 971, 973 (Mo. *banc* 1925) ("When we say 'fair', we mean fair to the public, and fair to the investors.").

CONTESTED ISSUES

I. RETURN ON EQUITY.

Regulated utilities finance the plant, property and equipment necessary to provide service through investor-supplied debt and equity capital for which a reasonable return must be paid. The return paid to investors is part of a regulated utility's cost of doing business. While the costs of debt and preferred stock are directly observable, the cost of common equity is not. It must be estimated based on observable market information. In establishing an authorized ROE for Ameren Missouri, the Commission must attempt to discern the return necessary to adequately compensate current investors and attract future investment. The Company's witness, Mr. Robert Hevert, testified that an ROE of 10.7 percent would satisfy these objectives. A slightly lower return might be sufficient, but in no event should the authorized ROE be less than 10.4 percent. The two witnesses who testified on behalf of industrial customers also performed analyses supporting a 10.4 percent ROE. Staff's witness recommends a substantially lower ROE of 8.75 percent, but this recommendation is clearly an outlier that need not (and should not) be given serious consideration.

Four witnesses provided ROE testimony in this proceeding. In addition to Mr. Hevert, Mr. Michael Gorman testified on behalf of the MIEC, Ms. Billie Sue LaConte on behalf of MEG, and Mr. David Murray on behalf of Staff. Their respective recommendations are as follows:

	Range	**Recommendation**
Hevert	10.4 – 11.25	10.7
Gorman	9.8 – 10	9.9
LaConte	9.7 – 10.6	9.7 – 10
Murray	8.25 – 9.25	8.75

There is no legal requirement for the Commission to authorize a specific ROE. Its discretion in this area is broad, limited only by the constitutional constraints articulated in

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). *Bluefield* established that "[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…."[9] Whereas *Bluefield* focused on the utility's perspective, *Hope* focused on that of the investor. "[T]he 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."[10]

These Supreme Court decisions establish that state commissions cannot treat public utilities like charitable organizations. Investors in public utilities are entitled to a reasonable and non-confiscatory return on invested capital. Ratepayers are entitled to rates that are no higher than necessary to reasonably compensate investors and attract future investment.[11] Over the past 12 months, state regulators have determined that, on average, an authorized ROE of 10.3 percent (excluding the 10.5 percent return authorized by the Illinois Commerce Commission for Commonwealth Edison Company on May 24, 2011)[12] satisfies these objectives and is fair to both shareholders and ratepayers.[13] The record in this case establishes that Ameren Missouri faces unique risks that justify a return above the national average.

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[9] 262 U.S. at 692.
[10] 320 U.S. at 603.
[11] Mr. Gorman acknowledges that Ameren Missouri's rates are "reasonably competitive" and "in the middle, or possibly even below the average" of the 25 to 30 states in which he regularly testifies. Tr., p. 1230, l. 18-22.
[12] *Re: Commonwealth Edison Company*, Docket No. 10-0467, *Report and Order* (May 24, 2011), p. 154.
[13] Ex. 123, p. 6, l. 10-11 (Hevert Surrebuttal).

Experts generally estimate a utility's ROE using one or more analytical techniques that rely on market-based data to quantify investor expectations. The use of more than one approach allows for the selection of an authorized ROE based on a range of quantitative results as well as other relevant qualitative information. Strict adherence to a single approach – and likewise strict adherence to the assumptions and inputs underlying that approach – can lead to flawed conclusions.[14] "No one method is any more 'correct' than any other method in all circumstances."[15] Nor does the process necessarily lend itself to a strict mathematical solution. The key consideration is that the methodologies and information relied on reasonably reflect investors' views of the financial markets and the subject utility.[16] Any methodology with inputs and assumptions that lead to an estimated ROE inconsistent with investors' expectations is entitled to little or no weight.

In this case, each witness arrived at his or her recommendation using different variations of standard analytical approaches: the Discounted Cash Flow ("DCF") approach, Capital Asset Pricing Model ("CAPM") and Risk Premium methods. For the most part, the analytical approaches are not in dispute. That the witnesses used similar analytical models but arrived at different recommendations is largely a function of the inputs and assumptions used in their models, not the models themselves. Mr. Hevert provides empirical support, based on publicly-available data, for the key assumptions in his models. The other witnesses, by and large, do not.

Setting aside differences in inputs and assumptions, the recommendations of Mr. Gorman and Ms. LaConte do not jive with their analytical results. Mr. Gorman gives too little weight to his DCF results and too much to his CAPM. This explains why none of his three DCF results are within his recommended range; two are above it and the other substantially below. Giving

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[14] Ex. 121, p. 18, l. 1 to p. 19, l. 17 (Hevert Direct).
[15] *Re Union Electric Co., d/b/a AmerenUE*, Case No. ER-2010-0036, *Report and Order* (May 28, 2010), p. 17.
[16] Ex. 121, p. 17, l. 11-13.

appropriate weight to his results would produce a range of 9.8 to 10.5 percent, with a midpoint of 10.15 percent.[17] Similarly, Ms. LaConte declined to include her CAPM results in her recommended range, but cites those results as the basis for a recommendation at the low end of her range, rather than her 10.2 percent midpoint. She concedes, however, that a return of up to 10.6 percent would be reasonable.[18]

The average of Mr. Hevert's recommendation of 10.7 percent, Ms. LaConte's midpoint of 10.2 percent and Mr. Gorman's "real" midpoint of 10.15 percent (with appropriate consideration given to his DCF results) indicates an ROE for Ameren Missouri of 10.35 percent. Including Mr. Murray's recommendation would significantly reduce the average, but this recommendation is such an outlier, and so inconsistent with the evidence provided by the other witnesses in this case, that it is entitled to no weight. The reasonable recommendations in this case all coalesce around 10.4 percent.

A. Mr. Hevert's recommendation.

Mr. Robert Hevert, a Chartered Financial Analyst and President of Concentric Energy Advisors, Inc., provided ROE testimony on behalf of Ameren Missouri. Mr. Hevert earned a Bachelor of Science degree in Finance from the University of Delaware and a Master of Business Administration degree from the University of Massachusetts.[19] He has provided rate of return analyses for investor and municipally owned gas and electric utilities in over 50 different proceedings across 20 different jurisdictions.[20] He has also advised numerous energy and utility clients on the determination of the cost of capital for valuation purposes.[21] Mr. Hevert estimates

[17] Tr., p. 1245, l. 3-21.
[18] Tr., p. 1216, l. 6-7.
[19] Ex. 121, p. 1, l. 16-18.
[20] *Id*., Attachment A.
[21] *Id*., p. 1, l. 23 to p. 2, l. 2.

that the Company's cost of equity is between 10.4 and 11.25 percent.[22] He recommends that the Commission authorize an ROE of 10.7 percent, which is somewhat below the midpoint of his range.[23] Mr. Hevert explains that an authorized ROE of less than 10.4 percent would not be sufficient to attract necessary capital and yield a reasonable return.[24]

1. Mr. Hevert's recommended ROE of 10.7 percent is reasonable based on the relevant quantitative and qualitative data.

Mr. Hevert identified a group of similarly-situated companies that possess a set of operating characteristics comparable to Ameren Missouri's electric operations as a basis for the derivation and assessment of the Company's ROE. That determination, however, must necessarily include consideration of Ameren Missouri's specific risks relative to the proxy group associated with its regulatory environment and reliance on coal-fired generation.[25]

Mr. Hevert considered the results of several analytical approaches in developing his ROE recommendation. He applied two forms of the DCF model – a Constant Growth and Multi-Stage model – and two forms of the CAPM, as well as the Risk Premium approach. He placed greater weight on the Multi-Stage DCF results because of the Commission's traditional reliance on the DCF model in general, and the weight placed on the Multi-Stage model in Ameren Missouri's last rate case.[26] He used the results of the CAPM and Risk Premium approaches as a check on the reasonableness of the DCF results.[27] The analytical results of these models, the expected capital market risks and the relative business risks of the Company indicate a required ROE in the range of 10.40 percent to 11.25 percent. As discussed below, the average authorized ROEs over the past twelve months both nationally (10.3 percent) and in states neighboring Missouri

[22] Ex. 123, p. 8, l. 5-6.
[23] *Id.*, p. 8, l. 8.
[24] Ex. 123, p. 8, l. 5.
[25] *See generally* Ex. 121, pp. 47-52.
[26] *Id.*, p. 3, l. 19-21; *see also In Re: Kansas City Power & Light Co.*, Case No. ER-2007-0291, *Report and Order* (Dec. 6, 2007), p. 15 ("Thus, a multistage growth DCF model is often used to minimize the speculative aspects of the model. . . .").
[27] Ex. 121, p. 17, l. 17-18.

(10.2 percent) further support the reasonableness of Mr. Hevert's recommendation. Accordingly, Mr. Hevert's recommended ROE of 10.7 percent remains a reasonable estimate of Ameren Missouri's required ROE.

Current market conditions require an authorized ROE for Ameren Missouri that is above the national average. The recent financial market crisis and recession has led to a general decrease in the availability of equity capital for all market sectors, including utilities.[28] Widely-recognized measures of investor risk sentiment indicate that current levels of risk aversion remain significantly higher than levels prior to the recession.[29] Capital-intensive companies such as Ameren Missouri continue to face the risks and costs associated with this volatile capital market environment.[30] The prospects of increasing interest rates, declining stock prices and increased costs of attracting equity capital remain significant market risks, reflecting the need for commensurately higher ROEs.[31]

2. <u>Mr. Hevert's DCF results fully support the reasonableness of his recommended ROE.</u>

DCF models are widely used to determine the required ROE for regulated utilities, and are the models most often relied on by the Missouri Commission and other state commissions.[32] The DCF approach assumes that a stock's current price represents the present value of the Company's expected future cash flows. In its simplest terms, the DCF model expresses the cost of equity as the sum of the expected dividend yield and long-term growth rate.[33]

The Constant Growth DCF model rests upon four assumptions: constant growth in earnings and dividends, a stable dividend payout ratio, a constant price-to-earnings ratio and a

[28] *Id.*, p. 7, l. 5-7.
[29] Ex. 122, pp. 19-24 (Hevert Rebuttal).
[30] Ex. 121, p. 9, l. 7-9.
[31] *Id.*, p. 9, l. 12-13.
[32] *Id.*, p. 21, l. 4-9; *In Re: Kansas City Power & Light Co.*, *supra*, p. 15 ("The DCF model is the most widely used ROE estimation model….").
[33] Ex. 121, p. 21, l. 9-11.

discount rate greater than the expected growth rate.[34] An appropriate measure of the long-term growth rate is the average of analysts' estimated forecasted earnings per share.[35] Estimates of growth in earnings per share are more indicative of long-term investor expectations than dividend growth estimates or book value, given that investors tend to value common equity on the basis of Price/Earnings ratios.[36] In Ameren Missouri's last rate case, the Commission accepted a return on equity recommended by OPC witness Daniel Lawton, who relied on an average of forecasted earnings per share growth rates in estimating the Company's ROE.[37] Here, Mr. Hevert relied on analysts' earnings growth projections, as published by *Zacks*, *First Call* and *Value Line*.[38] Because these services represent consensus estimates, the results are less likely to be biased than a forecast developed by an individual analyst.[39] The mean ROE in Mr. Hevert's updated Constant Growth DCF analysis ranges from 10.39 percent to 10.52 percent.[40]

In addition, to address some of the limiting assumptions underlying the Constant Growth model, Mr. Hevert also considered the results of a multi-period (three-stage) DCF model.[41] As with the Constant Growth model, the Multi-Stage model defines the cost of equity as the value of future cash flows discounted to present value.[42] In the third stage, "cash flows" equals both dividends and the expected "terminal" price at which the stock will be sold at the end of the period.[43] Differences in the terminal growth rates assumptions account for much of the difference in the experts' respective Multi-Stage results. Whereas Mr. Murray's and Mr. Gorman's growth projections are based on economists' forecasts for periods that end before the

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[34] *Id*., p. 22, l. 8-10.
[35] *Id*., p. 22, l. 19 to p. 23, l. 3.
[36] *Id*., p. 24, l. 8-10; Ex. 122, p. 34, l. 16-18, p. 35, l. 4 to p. 36, l. 17, p. 39, l. 7-13.
[37] Ex. 121, p. 24, l. 13-19 & n.22; *see also Union Electric Co., supra,* p. 19.
[38] Ex. 121, p. 25, l. 1-11.
[39] Ex. 122, p. 34, l. 20-23.
[40] Ex. 123, p. 68, Tbl. 8.
[41] *See generally* Ex. 121, pp. 25-30.
[42] *Id*., p. 25, l. 18-20.
[43] *Id*., p. 26, l. 4-6.

terminal year of their analyses, Mr. Hevert's analysis is based on long-term projections of Gross Domestic Product ("GDP") growth that extend beyond the terminal year.[44] Moreover, Mr. Hevert's long-term growth estimates are based on publicly available data and specifically incorporate market-derived measures of expected inflation.[45] This approach – relying on projected historical growth in GDP adjusted for inflation – is consistent with the methodology endorsed by the Commission previously.[46] The mean ROE in Mr. Hevert's updated Multi-Stage DCF analysis, with 5.65 percent terminal growth, ranges from 10.87 percent to 11.19 percent.[47]

Estimating future growth rates for Ameren Missouri and comparable utilities is a market driven exercise. As shown by Staff's DCF analysis, relying solely on historical data can produce results inconsistent with investor sentiment and current and expected conditions in capital markets.[48] But relying on the wrong type of projected data can produce inaccurate estimates of the required return. A valuation analysis used to establish stock price targets is not intended to estimate the market-required ROE.[49] GDP growth estimates are not intended to be extrapolated for periods beyond which those estimates are intended to remain in effect.[50] In a Multi-Stage DCF model, relying on long-term historical growth in GDP, adjusted based on publicly available information to reflect long-term forecasts for inflation, is the only appropriate measure of long-term growth.[51] This approach is consistent with the method sanctioned by the Commission in

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[44] Ex. 123, p. 8, l. 17-19; p. 44, l. 3-21; p. 53, l. 17 to p. 55, l. 2.
[45] *Id.*; *see also* Tr., p. 1102, l. 5-14; p. 1123, l. 23; p. 1124, l. 2; p. 1126, l. 9-17.
[46] In the Company's last case, the Commission stated that if Mr. Murray "had instead relied on historical growth in real GDP from 1929 through 2008 plus an inflation factor, he would have derived a long-term growth forecast of six percent." Tr., p. 1104, l. 15-21 (*quoting Re Union Electric Co., supra,* p. 19).
[47] Ex. 123, p. 71, Tbl. 9.
[48] Ex. 122, p. 32, l. 8 to p. 33, l. 16, p. 40, l. 3 to p. 42, l. 9.
[49] *Id.*, p. 46, l. 6-8; Tr., p. 1128, l. 12 to p. 1129, l. 6; p. 1201, l. 2-4.
[50] Ex. 122, p. 72, l. 10-20; Ex. 123, p. 47, l. 12 to p. 48, l. 4.
[51] Ex. 122, p. 44, l. 3-21.

Ameren Missouri's last rate case.[52] There is no sound reason for the Commission to reject that approach here.

3. Mr. Hevert's CAPM and Risk Premium analyses confirm the reasonableness of his recommended ROE.

The CAPM is a Risk Premium approach that estimates the cost of equity as a function of a risk-free return plus a Risk Premium to compensate investors for the non-diversifiable or "systematic" risk of that security.[53] As Mr. Hevert explained, the equity losses during the recent financial crisis render a historical market Risk Premium in the CAPM models unreliable because it produces results inconsistent with current market conditions.[54] Consequently, Mr. Hevert developed two forward-looking (*ex ante*) estimates of the market Risk Premium and recalculated the CAPM model using a near-term beta as well as current and near-term projected 30-year Treasury bond yields as the risk free rate.[55] The use of a projected market Risk Premium, near-term Beta and near-term projected Treasury bond yields produced a range of results generally consistent with the range produced by Mr. Hevert's other ROE methodologies.[56]

As Staff, MEG and MIEC's CAPM analyses all demonstrate, reliance largely on historical data for the market Risk Premium, Beta and Treasury yields produces results that do not reflect investors' sentiment or current market conditions.[57] Although Mr. Hevert gave no specific weight to his CAPM results, his forward looking CAPM analysis confirmed the reasonableness of his recommended ROE.[58] In contrast, Staff's CAPM estimates, which are as low as 7.04 percent, demonstrate why it is not appropriate to rely on a CAPM method that relies

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[52] *Union Electric Co., supra,* p. 19; *see also* Tr., p. 1159, l. 5-10.
[53] Ex. 121, p. 33, l. 8-10.
[54] *Id.*, p. 17, l. 19-20, p. 34, l. 15-20; Ex. 122, p. 19, l. 20 to p. 20, l. 4; p. 50, l. 7 to p. 54, l. 8.
[55] Ex. 121, p. 35, l. 11 to p. 41, l. 9.
[56] *Id.*, p. 41, l. 3-9.
[57] Ex. 122, p. 50, l. 7 to p. 54, l. 8; p. 74, l. 4 to p. 76, l. 14; p. 100, l. 1 to p. 103, l. 2.
[58] Ex. 121, p. 42, l. 2-7.

heavily on historical data.[59] Using updated market information, Mr. Hevert's CAPM analysis produced a range of ROE estimates from 10.12 percent to 11.31 percent.[60]

In addition to relying on a CAPM model as a corroborating analysis, Mr. Hevert also employed a bond yield plus Risk Premium approach.[61] The Risk Premium approach recognizes that equity investors bear the residual risk associated with equity ownership and must be compensated for bearing that risk with a premium over the return they would earn as a bondholder.[62] To estimate the equity Risk Premium, Mr. Hevert compared actual authorized returns for electric utilities from 1992 through March 2011 to the current and near-term projected 30-year Treasury bond yield.[63] In contrast, Mr. Gorman's approach of relying on the difference between average authorized returns and concurrent A-rated and Baa-rated utility bond yields ignores that the equity Risk Premium is inversely related to interest rates.[64] Mr. Hevert's updated Risk Premium results yield a range from 10.64 percent to 10.74 percent.[65]

4. Mr. Hevert's recommended ROE range is within the Commission's zone of reasonableness.

Ameren Missouri must compete with other utilities all over the country for the same limited pool of capital.[66] Although the Commission's return on equity finding should not unthinkingly mirror returns authorized in other jurisdictions, the national average of allowed ROEs provides an indicator of the capital market in which Ameren Missouri will have to compete for necessary capital. "Therefore, the average allowed return on equity provides a reasonableness test for the recommendations offered by the return on equity experts."[67] The

[59] Ex. 122, p. 56, l. 1-12.
[60] Ex. 123, p. 73, l. 3-7.
[61] Ex. 121, p. 42, l. 8 to p. 44, l. 10.
[62] *Id*.
[63] *Id*.; Ex. 123, p. 73, l. 11-18.
[64] Ex. 122, p. 79, l. 8 to p. 80, l. 5; Ex. 123, p. 62, l. 1-12.
[65] Ex. 123, p. 73, p. 11-18.
[66] *Union Electric Co., supra*, p. 17.
[67] *Id*.

Commission's "zone of reasonableness" extends from 100 basis points above or below the national average.[68]

For 2010, Regulatory Research Associates ("RRA") reports an average authorized ROE for *all electric utilities* of 10.35 percent.[69] For integrated electric utilities across the United States from January 2008 through December 2010, RRA reports that only nine of the 95 rate decisions authorized an ROE of 10 percent or lower.[70] Of the 488 electric utility rate case decisions reported from January 1992 through February 2011, there was only one ROE authorization of 9 percent or lower.[71]

For the past 12 months, the national average authorized ROE for *integrated electric utilities* was 10.3 percent.[72] Thus, the Commission's "zone of reasonableness" for this proceeding is 9.3 to 11.3 percent.[73] If a regional, as opposed to a national, average were the Commission's guide, for states neighboring Missouri, the average authorized ROE for integrated electric utilities over that same period was 10.23 percent.[74] This does not include the 10.5 percent ROE authorized for Commonwealth Edison Company in Illinois on May 24, 2011.[75] The entirety of Mr. Hevert's recommended ROE range falls within these ranges. Whether the Commission is concerned with Ameren Missouri competing for capital nationally or regionally, Mr. Hevert's recommended ROE is appropriate and reasonable given recent authorized ROEs.

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[68] *Id*.
[69] Ex. 122, p. 16, l. 8-10.
[70] *Id*., p. 5, l. 9-10 & Chart 1.
[71] *Id*., p. 15, l. 21 to p. 16, l. 1 & Chart 2.
[72] Ex. 123, p. 6, l. 10-11.
[73] *Id*., p. 70, l. 9.
[74] Ex, 123, p. 6, l. 16.
[75] *Re: Commonwealth Edison Company*, Docket No. 10-0467, *Report and Order* (May 24, 2011), p. 154.

5. Ameren Missouri's business risks relative to the proxy group support an above-average authorized ROE.

The quantitative results of ROE models do not necessarily provide an appropriate estimate of the utility's cost of equity; the utility's relative risks also must be considered.[76] From the perspective of equity investors, the authorized return must be adequate to provide a risk-comparable return on the equity portion of the utility's capital investments.[77] In the case of Ameren Missouri, the Company's regulatory risks relative to Mr. Hevert's proxy group and its reliance on coal-fired generation support an above-average ROE.

A utility's regulatory environment can significantly affect the utility's access to, and cost of, capital.[78] The predictability and stability of the utility's regulatory framework is a key credit consideration for ratings agencies and investors.[79] The more uncertain the environment, the riskier the investment. The timeliness of recovery of prudently incurred costs, for instance, is critical for the utility to avoid financial stress.[80] The impact of regulatory decisions on the utility's future cash flows, both from internally generated funds and efficient access to capital markets, is also important to both debt and equity investors.[81] The more often a utility is required to seek a rate increase, the more the utility is exposed to these and other regulatory risks that impact earnings and cash flow (and thus dividends).[82] As Mr. Hevert's analysis shows, the credit community attributes a higher regulatory risk to Ameren Missouri than to his proxy group.[83] This above-average regulatory risk supports an above-average authorized ROE.[84]

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[76] *Hope*, 320 U.S. at 603 ("[T]he return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks….").
[77] Ex. 121, p. 49, l. 15-17.
[78] *Id*., p. 47, l. 4 to p. 48, l. 14.
[79] *Id*., p. 47, l. 7-22.
[80] *Id*., p. 47, l. 23 to p. 48, l. 1.
[81] *Id*., p. 48, l. 5-14.
[82] *Id*., p. 48, l. 1-4.
[83] *Id*., p. 50, l. 1-15.
[84] *Id*., p. 50, l. 16-21.

Ameren Missouri also faces risks associated with its heavy dependence on coal-fired generation.[85] Coal-fired plants face risks associated with capital recovery in the event of market structure changes or plant failure, or replacement cost recovery in the event of extended or unplanned outages.[86] In addition, coal-fired assets may require significant capital expenditures to comply with changes to environmental laws.[87] The rising costs associated with environmental compliance for utilities such as Ameren Missouri that are dependent on coal-fired generation – and the associated risks to the utility's financial performance – should be acknowledged.[88] Since the Company obtains a materially larger percentage of its generation from coal-fired plants (76.61 percent) than the proxy group average (63.57 percent), an above-average authorized ROE is appropriate.[89]

B. Mr. Gorman's recommendation.

MIEC's Mr. Gorman recommends an ROE of 9.9 percent, but agrees that 10 percent is also reasonable.[90] Any ROE below 9.8 percent or above 10 percent would be unreasonable in Mr. Gorman's opinion.[91]

Mr. Gorman's recommendation is flawed in three significant respects. First, through creative averaging, he gives insufficient weight to his DCF results and over-weights his CAPM results. Second, his Sustainable Growth DCF model is unreliable. Mr. Hevert tested and disproved the key assumption of this model. Third, Mr. Gorman uses analysts' 10-year forecast of GDP growth as a proxy for final stage growth in his Multi-Stage DCF. Because final stage growth does not begin until year 11 of the Multi-Stage DCF, there is a mismatch between the

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[85] *Id*, p. 51, l. 2 to p. 52, l. 4. In addition, as pointed out by Commissioner Jarrett and explained by Mr. Hevert, recent tragic events in Japan raise the prospect of additional risk for U.S. utilities that own nuclear generation. Tr., p. 1202, l. 21 to p. 1204, l. 3.
[86] *Id*., p. 51, l. 6-9.
[87] *Id*., p. 51, l. 9-13.
[88] *Id*., p. 52, l. 1-4.
[89] *Id*., p. 52, l. 5-10.
[90] Tr., p. 1243, l. 2-23.
[91] Tr., p. 1240, l. 24 to p. 1241, l. 2.

period in which the growth rate is being forecast and the period in which Mr. Gorman assumes this growth will occur. Correcting the flaws in Mr. Gorman's analyses produces ROE estimates that fully support Mr. Hevert's recommendation.

1. <u>Mr. Gorman's DCF results are under-weighted and CAPM results over-weighted.</u>

Table 1 below compares the results of Mr. Gorman's direct and surrebuttal analyses:

Table 1

	Direct	**Surrebuttal**	**Difference (bps)**
Constant Growth DCF	10.17	10.47	30
Sustainable Growth DCF	9.67	9.38	(29)
Multi-stage DCF	9.86	10.16	30
Combined DCF Midpoint	9.90	9.93	3
Risk Premium (midpoint)	9.77-10.25 (10)	9.90 - 10.10 (10)	-
CAPM	9.5	9.79	29
Range/Recommendation	9.5 - 10 / 9.75	9.8 - 10 / 9.9	15

Two things are notable about Table 1. The first is that the Sustainable Growth DCF is the only updated analysis that produced a lower ROE. The reasons for this (and the reasons why the results of this model should be rejected) are discussed below. The second notable feature is that Mr. Gorman's recommendation effectively ignores his DCF results. Indeed, *none of Mr. Gorman's DCF results are within his recommended range.* The average of the three DCF analyses falls at approximately the midpoint of Mr. Gorman's recommendation only because the Sustainable Growth ROE of 9.38 percent – an ROE that Mr. Gorman agrees is unreasonably low – skews the constant growth and multi-stage ROEs of 10.47 and 10.16 percent, respectively. So the answer to the question that Commissioner Davis posed to Mr. Gorman at hearing, "Isn't that

just averaging it down to get a specific number?"[92] is "Yes." Mr. Gorman dismissed the Constant Growth ROE results as too high.[93] The easiest way to get that ROE and the second highest DCF ROE to something south of 10 percent was to average them with the unreasonably low and unreliable Sustainable Growth ROE.

Given his admission that any ROE below 9.8 percent would be unreasonable,[94] Mr. Gorman's range should have been bounded by the 9.8 percent CAPM at the low end and the 10.5 percent constant growth DCF at the high end. This would produce a midpoint of 10.15 percent, which is approximately equal to the results of the Multi-Stage DCF model for which the Commission historically has given significant weight. Disregarding both the Constant Growth and Sustainable Growth ROEs and relying exclusively on the Multi-Stage DCF results would get the Commission to the same place.

This is not the first case in which Mr. Gorman has presented ROE results in ways that best suit MIEC's purpose. Testimony that "gives the Commission concern" was pointed out in the recent Kansas City Power & Light Company rate case.[95] The Commission observed that Mr. Gorman used median growth rates in his DCF analyses, rather than average growth rates, which would have increased his ROE calculations.[96] Mr. Gorman's surrebuttal testimony takes creative averaging to a new level. Four of his five updated analyses resulted in increased ROEs – two of them by 30 basis points. He raised the low end of his range by 30 basis points. He raised his midpoint by 15 basis points. He raised his final recommendation by 15 basis points as well. But he did not raise the high end of his range. How the low-end of his range, his midpoint and his

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[92] Tr., p. 1246, l. 12-13.
[93] Tr., p. 1246, l. 14 to p. 1247, l. 11.
[94] Tr., p. 1240, l. 24 to p. 1241, l. 2.
[95] *Re: Kansas City Power & Light Company*, Case No. ER-2010-0355, *Report and Order* (Apr. 12, 2011), p. 117, para. 344.
[96] *Id*., p. 118, para. 346-347. In addition, the Commission found it "ironic" that the industrial groups criticized DCF results "essentially agreeing" with the company's witness. *Id*., p. 117, para. 344. As noted, Mr. Gorman's constant growth DCF results are within the range of returns recommended by both Mr. Hevert and Ms. LaConte.

final recommendation can increase while the high end of his range remains unchanged is not explained.

The net effect of the manner in which Mr. Gorman presents his results is that he effectively gives 50 percent weight to his CAPM results. All of the witnesses in this proceeding used a CAPM to test their DCF results, but none purported to primarily rely on the CAPM to recommend an ROE.[97] Historically the Commission has not placed much emphasis on the CAPM.[98] There is no reason to do so now. If anything, the CAPM should receive less emphasis than it has historically because recent economic conditions have affected the CAPM model in a number of important ways. As Mr. Hevert explained, the risk free rate, represented by long-term U.S. Treasury rates, is lower than the historical norm because of the recent financial crisis.[99] Investors reacted to extreme market volatility by investing in low-risk U.S. Treasuries, resulting in historically low yields on these securities.[100] Likewise, as a result of the extraordinary loss in equity values in 2008, the market Risk Premium is unusually low – a fact with which Mr. Gorman agrees.[101] The typical approach of using two and five year historical betas reported by *Value Line* and *Bloomberg* also produces anomalous results in the current market environment.[102] Beta estimates calculated over these time periods include the effects of the financial market dislocation, resulting in betas much lower than the historical average.[103] Mr. Gorman acknowledges that the CAPM model is problematic at this time. He relied on his high-end CAPM estimate because he was concerned about the low estimates his CAPM results were

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[97] *See*, *e.g.*, Tr. 1122, l. 3-12 (Hevert); Tr., p. 1181, l. 6-9 (Murray).
[98] *Re: Kansas City Power & Light Co.*, Case No. ER-2007-0291, *Report and Order* (Dec. 6, 2007) p. 15 (noting that the CAPM model is "not used in many regulatory jurisdictions because of the additional data requirements and potentially questionable underlying assumptions").
[99] Ex. 121, p. 34, l. 7-14.
[100] *Id.*
[101] Tr., p. 1234, l. 20 to p. 1235, l. 6.
[102]Ex. 121, p. 34, l. 21 to p. 35, l.10.
[103] *Id.*, p. 35, 1. 2-10.

producing.[104] Indeed, all of the witnesses' CAPM results are significantly below the ROEs indicated by their respective DCF analyses.

The inputs and assumptions in Mr. Gorman's CAPM analysis are also troublesome. He develops a market Risk Premium based on the historical relationship between the returns on the S&P 500 and long-term government bonds.[105] But this approach suggests that the market Risk Premium *decreased* from 2007 to 2010, despite the fact that market volatility significantly *increased* after 2007.[106] Mr. Gorman's exclusive reliance on five year beta calculations also does not accurately reflect current market conditions.[107] Reasonable assumptions based on current market data for the market Risk Premium and betas would increase Mr. Gorman's CAPM results to 10.4 to 10.85 percent.[108]

2. **The Commission should reject Mr. Gorman's Sustainable Growth DCF.**

Mr. Gorman's Sustainable Growth DCF is a constant growth (single stage) model that uses an "internal growth methodology" to develop the growth rate.[109] The data used to estimate the growth rate is based on the utility's current market-to-book ratio and *Value Line*'s three to five year projections of earnings, dividends, earned return on book equity and projected stock issuances.[110] A Sustainable Growth rate is based on the percentage of earnings that is retained and reinvested in rate base.[111] The fundamental assumption of "Sustainable Growth" is that "[a]s the payout ratio declines, the earnings retention ratio increases. An increased earnings retention ratio will fuel stronger growth because the business funds more investments with retained

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[104] Ex. 407, p. 34, l. 11-18 (Gorman Direct); Tr., p. 1234, l. 12-16.
[105] Ex. 122, p. 74, l. 20 to p. 75, l. 5.
[106] *Id.*
[107] *Id.*, p. 76, l. 8-14.
[108] Ex. 123, p. 61, l. 4-12.
[109] Ex. 407, p. 20, l. 19 to p. 21, l. 17.
[110] *Id.*, p. 21, l. 11-14.
[111] *Id.* p. 20, l. 21-22.

earnings."[112] Mr. Gorman's Sustainable Growth DCF produces an ROE of 9.38 percent – over 40 basis points *less* than what he concedes would be a reasonable ROE.[113]

The Sustainable Growth DCF should be rejected for at least two reasons. First, the fundamental assumption of the model is that higher earnings retention ratios are necessarily associated with higher future earnings growth rates. Mr. Hevert performed a regression analysis to test this assumption. His empirical research demonstrates that there is a significant *negative* relationship between the five year earnings growth rate and the earnings retention ratio.[114] In other words, not only is the fundamental assumption underlying Mr. Gorman's Sustainable Growth model wrong; the opposite is true. Based on the historical *Value Line* data that Mr. Gorman used, earnings growth actually *decreased* as the retention ratio increased.[115] Mr. Hevert's findings are supported by three published studies establishing a negative, rather than positive, relationship between retention ratios and future earnings growth.[116]

Second, there is a disconnect between Mr. Gorman's Sustainable Growth rate and analysts' consensus expectations of future long-term growth. Estimating return on equity is an exercise in capturing and reflecting investor requirements and expectations.[117] Mr. Gorman agrees that publicly-available data is "superior" to other types of information for capturing investor requirements.[118] To the extent there is a consensus about certain investor assumptions, it is appropriate to rely on consensus data rather than data from a single individual or analyst.[119]

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[112] *Id*., p. 21, l. 3-5.
[113] Tr., p. 1240, l. 17 to p. 1241, l. 2.
[114] Ex. 122, p. 66, l. 4 to p. 67, l.2.
[115] *Id*.
[116] *Id*., p. 67, l. 3-15; *see also* Tr. 1160, l. 3-25.
[117] Ex. 121, p. 17, l. 3-13.
[118] Tr., p. 1231, l. 10-17.
[119] Tr., p. 1231, l. 7-17; *see also* Tr., p. 1265, l. 15-23.

As Mr. Gorman explained, "I think research has shown that consensus data is more reflective of investor expectations and valuation decisions than is other types of data."[120]

Mr. Gorman's calculations of sustainable growth rates do not reflect investor expectations. In direct testimony, Mr. Gorman calculated a median Sustainable Growth rate of 4.76 percent.[121] In surrebuttal, he revised the growth rate downward to 4.55 percent.[122] Analysts, however, revised their forecasts to *increase* growth rate estimates. The consensus analysts' 10 year forecast of GDP growth as reported by *Blue Chip*, which Mr. Gorman used as a proxy for final stage growth in his Multi-Stage DCF, increased from 4.7 percent at the time Mr. Gorman submitted direct testimony to 4.9 percent by the time he filed surrebuttal.[123] In other words, from the same starting point of approximately 4.7 percent, Mr. Gorman revised his long term growth projection in the opposite direction that *Blue Chip* analysts revised theirs.

A comparison of Mr. Gorman's DCF results from Ameren Missouri's last rate case to this case reveals a further disconnect between the Sustainable Growth DCF results and other DCF models. In Ameren Missouri's last electric rate case, Mr. Gorman's Sustainable Growth DCF produced a median return of 10.2 percent – slightly higher than the Multi-Stage DCF return of 10.16 percent that he presented in that case.[124] In this case, Mr. Gorman's Multi-Stage DCF produced the same return as the last case – 10.16 percent. But the Sustainable Growth DCF results in this proceeding are 9.38 percent – 82 basis points less than the last case. And while there was only a four basis point spread between Mr. Gorman's Sustainable Growth and Multi-Stage DCF results in the last case, in this case the gap is 78 basis points. Market conditions alone cannot explain this disparity. That Mr. Gorman's Sustainable Growth DCF is the only

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[120] Tr., p. 1232, l. 3-5.
[121] Ex. 407, p. 21, l. 17.
[122] Ex. 409, MPG-SR-7, p. 1 (Gorman Surrebuttal).
[123] Ex. 407, p. 18, l. 5-7; Ex. 409, p. 22, l. 9-11.
[124] *Re Union Electric Co., d/b/a AmerenUE*, Case No. ER-2010-0036, *Report and Order* (May 28, 2010) p. 22.

analytical model that produced a *lower* ROE on surrebuttal further demonstrates the unreliability of this approach.

Mr. Gorman's Sustainable Growth calculation is also subject to the same criticism he lodges at Mr. Hevert's calculation of long-term GDP growth; *i.e.*, that the growth rate is not publicly available. Although the underlying data used to calculate a Sustainable Growth rate is available through *Value Line*, "[i]t's not a growth rate that is pulled from a *ValueLine* publication . . . ."[125] The Sustainable Growth rate that Mr. Gorman calculated is essentially *his* forecasted growth rate, not *Value Line's,* an analyst's or any group of analysts.[126] If the Commission is to consider Mr. Gorman's calculation of Sustainable Growth, it must also consider Mr. Hevert's GDP growth projections.

Mr. Gorman's 9.38 Sustainable Growth ROE is a clear outlier. It is barely within the zone of reasonableness. It is below what Mr. Gorman himself would consider the minimum required return. And it masks his constant growth return of approximately 10.5 percent. Excluding Mr. Gorman's Sustainable Growth DCF results would yield an average DCF return of 10.3. That the national average ROE authorized for integrated electric utilities during the past 12 months is also 10.3 percent confirms that Mr. Gorman's Sustainable Growth model understates the Company's required ROE.

3. <u>Analysts' 10 year projections of GDP growth do not match the period in which Mr. Gorman assumes this growth will occur.</u>

Mr. Gorman's Multi-Stage DCF uses forecasted nominal GDP growth rates published in *Blue Chip Economic Indicators* as a proxy for terminal (*i.e.*, third stage) growth.[127] Mr. Hevert's

[125] Tr., p. 1237, l. 19 to p. 1238, l. 2.
[126] *See generally* Tr., pp. 1238-1239.
[127] Ex. 407, p. 23, l. 7-18. Mr. Murray also performed a Multi-Stage DCF analysis using the *Blue Chip* forecast of GDP growth as the final stage growth rate. Ex. 123, p.44, l. 5-7.

final stage growth rate is also based on nominal GDP growth.[128] Whereas Mr. Hevert used publicly-available data to calculate GDP growth during the third stage of his model, Mr. Gorman did not. He relied on projected GDP growth for the period 2017 – 2021 for the term in his model that does not begin until 2021. As a consequence, the 4.9 percent growth rate that Mr. Gorman uses in his calculations does not match the period in which Mr. Gorman assumes this growth will occur.[129]

Regardless of whether it is appropriate to consider GDP growth a "ceiling" for long-term growth of an electric utility,[130] GDP growth must be measured properly if it is to be used in this fashion. Mr. Gorman uses estimates of GDP growth that extend five to ten years into the future. As noted by Mr. Hevert, it is not appropriate to extrapolate GDP growth estimates for periods beyond which those estimates are intended to remain in effect when there is other publicly available, market-based data that can be used for that purpose.[131] The *Blue Chip* forecast is technically available to the public, but only by subscription.[132] And it does not provide forecasts of GDP growth beyond 10 years.[133] Therefore, it is appropriate to consider market-based estimates of long-term inflation to calculate long-term nominal GDP growth.[134] Publicly available, market-based data indicate long-term nominal GDP growth of 5.65 percent beginning in 2021.[135] To be conservative, Mr. Hevert's Multi-Stage DCF analyses reflect terminal stage growth of 5.275 percent; the midpoint of his calculation of long-term nominal GDP growth and

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[128] Ex. 121, pp. 29-30; Ex. 122, p. 44, l. 6-16.
[129] *See* Tr., p. 1234, l. 1-11.
[130] Tr., p. 1217, l. 20-25 (Ms. LaConte agreeing that "[a]lthough your growth rate is higher than the forecast that Mr. Gorman relied on in his model, you don't believe that the fact your growth rate is higher or even higher than GDP precludes the use of that growth rate in [your]Multi-Stage DCF.")
[131] Ex. 123, p.47, l. 20 to p.48, l. 1.
[132] *Id*., p. 48, l. 15-17.
[133] *Id*., p. 52, l. 10-11.
[134] *Id*., p. 48, l. 10-13.
[135] *Id*., p. 44, l. 3-21; p.53, l. 15; p. 54, l. 16.

Mr. Gorman's. It so happens that 5.275 percent is not much higher than Mr. Gorman's updated calculation of average Sustainable Growth of 5.08 percent.[136]

Small but reasonable changes to Mr. Gorman's assumptions would produce Multi-Stage DCF results that overlap with Mr. Hevert's. Adopting the mid-year discounting convention (that is, assuming that cash flows are received, on average, mid-way through the year, rather than at year-end) and using a long-term growth rate of 5.275 percent produces a median ROE estimate of 10.53 percent.[137] This is within five basis points of Mr. Gorman's constant growth DCF results and comfortably within the range of what his CAPM results would have been had he used reasonable inputs and assumptions. Mr. Gorman's work in this case fully supports Mr. Hevert's minimum recommended return of 10.4 percent.

C. Ms. LaConte's recommendation.

Ms. LaConte estimated Ameren Missouri's cost of equity using two variations each of the constant growth DCF, two stage DCF, Risk Premium method and CAPM.[138] Her range is 9.7 to 10.6 percent, with a recommended ROE at the "lower end" of her range; *i.e.,* between 9.7 to 10 percent.[139] She agrees, however, that any authorized ROE up to and including her high-end estimate of 10.6 percent would be reasonable.[140] Ms. LaConte corroborates the final stage growth rate that Mr. Hevert used in his Multi-Stage DCF, but fails to explain why the Commission should authorize a return at the "low end" of her range instead of her 10.2 percent midpoint.

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[136] Ex. 409, MPG-SR-7, p. 1. Mr. Gorman, however, used the *median* Sustainable Growth rate of 4.55 percent in his Sustainable Growth recommendation.
[137] Ex. 123, p. 5, l. 9 to p. 6, l. 7. Table 2c of Mr. Hevert's surrebuttal shows the incremental effect of changes in Mr. Gorman's inputs to (a) adopt the mid-year discount convention; (b) revise long-term growth from 4.7 to 4.9 percent, (c) remove Northeast Utilities and Progress Energy from the proxy group due to merger announcements and (d) revise long term growth to 5.275 percent. Mr. Gorman's updated analysis adopts two of these changes. He revised his growth rate to 4.9 percent and removed Northeast and Progress from the proxy group. The changes increased his Multi-Stage DCF results by 30 basis points, to 10.16 percent.
[138] Ex. 450, p. 2, Tbl 1 (LaConte Direct).
[139] Ex. 452, p. 7, l. 6 – p. 8, l. 11 (LaConte Surrebuttal); Tr., p. 1214, l. 12-18.
[140] Tr., p. 1216, l. 3-7.

1. Ms. LaConte corroborates Mr. Hevert's long term growth forecast.

Like other witnesses, Ms. LaConte's constant growth DCF relies on analysts' consensus forecasts for growth rates. For the second stage of her two stage DCF, she utilized the same 5.75 percent growth rate that Mr. Hevert presented in his direct testimony.[141] She did not adopt this growth rate blindly. She independently verified Mr. Hevert's growth rate by reviewing his work papers and calculations, and in her professional opinion determined that 5.75 percent[142] was a reasonable – indeed, "conservative" – estimate of long-term growth.[143] She would not have used this growth rate in her calculations if she thought otherwise.[144] And she disagrees with Mr. Gorman's assertion that final stage growth in a Multi-Stage DCF model cannot exceed forecasted GDP.[145]

2. Ms. LaConte provides no rationale for an ROE below her 10.2 midpoint recommendation.

In her direct and rebuttal testimony and at deposition, Ms. LaConte recommended an ROE of 10.2 percent; the midpoint of her range. Her range remains at 9.7 to 10.6 percent, and her midpoint at 10.2 percent.[146] But she now advocates an ROE at the "low end" of her range because of an apparent revelation about her CAPM results. "Including the CAPM and ECAPM estimates would expand my recommended range to 9.0% -10.6%, with a midpoint of 9.8%."[147]

In direct testimony, Ms. LaConte explained that she relied on her CAPM analysis as a "check of reasonableness" for the DCF and Risk Premium analyses, but she did not adopt the

[141] Tr., p. 1216, l. 12-22.
[142] As noted previously, Mr. Hevert revised his long-term GDP growth calculation to 5.65. Tr., p. 1123, l. 23 to p. 1124, l. 2; Ex. 123, p. 69, l. 1-17.
[143] Tr., p. 1217, l. 4-13.
[144] *Id.*
[145] Tr., p. 1217, l. 20-25.
[146] Ex. 452, p. 6, l. 17; Tr., p. 1218, l. 17-25.
[147] Ex. 452, p.7, l. 8-9. If the Commission considers Ms. LaConte's 9 percent CAPM results as the low end of her range (and it should not), it should also consider Mr. Gorman's 10.47 constant growth DCF as the high end of his range.

CAPM analyses to establish the low end of her range.[148] Nor did she use the CAPM results as the low end of her range in rebuttal testimony.[149] The first time she suggested the CAPM results should be considered as the low end of her range was in surrebuttal testimony.[150] But at hearing she confirmed that her CAPM results continue to support her direct and rebuttal midpoint recommendation of 10.2 percent.[151]

MEG cannot explain why CAPM results that support a midpoint recommendation of 10.2 percent now justify a recommendation as low as 9.7 percent. A range spanning 160 basis points (9 to 10.6 percent) is too wide a target to be taken seriously. And nothing in the Commission's recent Order in *Re: Kansas City Power & Light Company*, Case No. ER-2010-0355 (April 12, 2011) ("KCP&L") compels Ms. LaConte to give any more weight to her CAPM results now than she did in direct or rebuttal testimony. Although Ms. LaConte implies that the KCP&L order signals a policy shift away from emphasis on DCF methods,[152] the Order says no such thing. In the portion of the Order Ms. LaConte cites in her surrebuttal testimony, the Commission simply observed that it "may select its methodology in determining rates and make pragmatic adjustments called for by particular circumstances. It may employ a combination of methodologies and vary its approach from case-to-case and from company-to-company."[153] This statement does not represent a policy shift or pronouncement. It is a simple statement of Missouri law that has existed for decades, if not longer.[154] Contrary to walking away from the

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[148] Ex. 450, p. 16, l. 4-7; Tr., p. 1219, l. 13-18.
[149] Tr., p. 1219, l. 19-21.
[150] Tr., p. 1219, l. 22-25.
[151] Tr., p. 1220, l. 1-3.
[152] Ex. 452, p. 7, l. 6 to p. 8, l. 11.
[153] Ex. 452, p. 8, l. 3-7 (*quoting Re: Kansas City Power & Light Co.*, Case No. ER-2010-0355, *Report and Order* (Apr. 12, 2011) pp. 123-24, para. 38).
[154] *State ex rel. Associated Natural Gas Co. v. Public Service Comm'n of Mo.*, 706 S.W.2d 870, 880 (Mo. App., W.D. 1985); *State ex rel. City of Lake Lotawana v. Public Service Comm'n*, 732 S.W.2d 191, 194 (Mo. App., W.D. 1987); *State ex rel. Arkansas Power & Light Co. v. Mo. Public Service Comm'n*, 736 S.W.2d 457, 462 (Mo. App., W.D. 1987).

DCF methodology, the KCP&L order confirms: "The DCF is the most widely used regulatory ROE method."[155]

Ms. LaConte's midpoint of 10.2 percent is within 20 basis points of Mr. Hevert's low end recommendation of 10.4 percent. She confirms that a recommendation *exceeding* the low end of Mr. Hevert's range by 20 basis points (*i.e.*, 10.6 percent) would be reasonable. Ms. LaConte's analysis therefore corroborates Mr. Hevert's recommendation of 10.7 percent, and fully supports his low-end estimate of 10.4 percent.

D. Mr. Murray's recommendation.

Mr. Murray continues to tilt at windmills. In his view, "most mainstream rate of return witnesses are approaching the estimation of the cost of equity all wrong."[156] It is this philosophy that drives Mr. Murray's recommendation of 8.75 percent; the midpoint of his range of 8.25 to 9.25 percent.[157]

The issue with Mr. Murray's recommendation is not whether it should be rejected, but for how many reasons. The Company will focus on the top three. First, the recommendation is outside the zone of reasonableness. If the Commission considers it at all, it must do so with great skepticism. Second, the 3 to 4 percent growth rates that Mr. Murray uses in his DCF analyses are unsupported, unreasonable and contrary to investor expectations and requirements. Third, analyst reports and valuations do not support Mr. Murray's recommendation. Mr. Murray overlooks or ignores critical assumptions in the materials he cites, and twists data in a manner that is overtly inconsistent with the purpose for which these analyses were prepared. His ROE recommendation in this case should not be taken seriously.

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[155] *Re: Kansas City Power & Light Co.*, Case No. ER-2010-0355, *Report and Order* (April 12, 2011) p. 107.
[156] Tr., p. 1185, l. 15-23.
[157] Ex. 201, p. 1, l. 13 (Staff Report Revenue Requirement Cost of Service); Tr., p. 1168, l. 8-24.

1. **Staff's recommendation is outside the zone of reasonableness and therefore entitled to no weight.**

As discussed above, the zone of reasonableness for vertically integrated electric utilities based on recent national authorized ROEs is 9.30 to 11.30 percent, or 9.23 to 11.23 percent if based on ROEs authorized in neighboring jurisdictions.[158] Mr. Murray's midpoint 8.75 percent recommendation is well below the zone under either measure. Assuming only the 10.23 percent average of neighboring integrated utilities, the high end of Mr. Murray's range touches the low end of the zone or reasonableness, but just barely.

As the Commission recognized in Case No. ER-2007-0004, the zone of reasonableness is "a tool to help the Commission to evaluate the recommendations offered by various rate of return experts. It should not be taken as an absolute rule that would preclude consideration of recommendations that fall outside that zone. *However, a recommendation that greatly varies from the national norm will be viewed with skepticism.*"[159] While the Commission should not "unthinkingly mirror the national average," it has recognized that "it is simply common sense to use national average ROEs as a reference point because that gives the Commission insight about the capital market in which [the utility] must compete for equity dollars."[160] "The Commission has an obligation under the law as well as a matter of practical necessity, to allow [the utility] an opportunity to earn a return that will allow it to compete in the capital market. No one, including ratepayers, benefits if [the utility] is starved for capital."[161] Thus, the national average of

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[158] In Case No. ER-2007-0291, the Commission recognized that vertically integrated utilities tend to receive higher ROEs, and that distribution companies operating in some form of restructured environment are less risky. *Re: Kansas City Power & Light Co.*, Case No. ER-2007-0291, *Report and Order* (Dec. 6, 2007) p. 14.

[159] *Re: Aquila, Inc. d/b/a Aquila Networks*, Case No. ER-2007-0004, *Report and Order* (May 17, 2007) p. 57 (emphasis added); *see also Re: Union Electric Co. d/b/a AmerenUE*, Case No. ER-2007-0002, *Report and Order* (May 22, 2007), p. 39.

[160] *Re: Kansas City Power & Light Co.*, Case No. ER-2006-0314, Report and Order (Dec. 21, 2006) pp. 20-21.

[161] *Re: Missouri Gas Energy*, Case No. GR-2004-0209, *Report and Order* (Sept. 21, 2004) p. 19-20 (observing that Staff and OPC ROE recommendations were 200 basis points below the national average).

authorized ROEs provides "a good indicator of the capital market in which [the utility] will have to compete for the equity needed to finance its operations."[162]

Mr. Murray acknowledges that his recommended ROE is outside the zone of reasonableness and, if adopted, would punish investors:

> Q. Well, in terms of what state Commissions authorize for utility ROEs, an award of nine percent or less would be outside the mainstream and, in fact, is outside the Commission's zone of reasonableness, correct?
> *A. Based on the Commission's hundred basis points above and below, nine percent is below the approximately 9.25, that's correct.*
>
> Q. And if the commission adopted your recommended ROE, you would expect Ameren Corp's stock to decrease, correct?
> *A. Yes.*[163]

Investors will look at whether authorized ROEs in Missouri are comparable to ROEs issued in other jurisdictions.[164] Analysts will make buy and sell stock recommendations based on authorized ROEs.[165] In Ameren Missouri's last rate case, the Commission found Staff's recommended ROE of 9.3 percent to be an inappropriate return on equity to allow the utility to compete for capital, in part because it was substantially lower than the 2009 national average of 10.59 percent.[166] Less than a year later, Mr. Murray is again recommending a midpoint ROE that falls well below the zone of the reasonableness. His recommendation in the last case was not considered credible, and it is no more credible here.

2. Mr. Murray's Multi-Stage DCF returns are the result of unreasonably low final stage growth rates.

Mr. Murray gives primary weight to the results of his Multi-Stage DCF, which consists of three stages.[167] Growth rates for the first stage are based on consensus analysts' three to five

[162] *Re: Kansas City Power & Light Co.*, Case No. ER-2007-0291, *Report and Order* (Dec. 6, 2007), p. 13.
[163] Tr., p. 1186, l. 8-18.
[164] Tr., p. 1218, l. 3-8.
[165] Tr., p. 1218, l. 9-11.
[166] *Re Union Electric Co., d/b/a AmerenUE*, Case No. ER-2010-0036, *Report and Order* (May 28, 2010), pp. 18, 20.
[167] Tr., p. 1168, l. 12-15.

year earnings forecasts; the same data used in the other witnesses' Multi-Stage DCF analyses. But Mr. Murray's final stage growth rates are highly unconventional, and based on flawed data and assumptions. The unreasonably low growth rates assumed in Mr. Murray's Multi-Stage DCF explain most of the disparity between his results and Mr. Hevert's. Had Mr. Murray used the same final stage growth rate as Mr. Hevert, their results would be similar.[168]

Mr. Murray estimated a final stage growth rate of 3 to 4 percent.[169] This estimate is based on two "studies" – one based on a 2003 *Mergent* publication; the other on historical *Value Line* information.

The "*Mergent* Study" was performed during the most recent KCP&L rate case, Case No. ER-2010-0355.[170] For this "study," Mr. Murray reviewed historical utility growth rates for the period 1947-1999.[171] In the KCP&L proceeding, it was brought to Mr. Murray's attention by the Company's ROE witness that the Mergent data could not be replicated with other publicly-available information.[172] Mr. Murray then performed a "more comprehensive review" of the *Mergent* data, and confirmed that the growth rate percentages could not be verified:

> Q. You aren't able to say that the *Mergent* numbers are exactly correct; is that right?
> *A. That's correct. I did not see the workpapers.*
>
> Q. Well, not only did you not see their work papers, you saw that *Mergent* was reporting one set of data and you couldn't identify what they were reporting with other publicly available information?
> *A. Specifically for the latter years, that's correct.*[173]

Recognizing the problems with the *Mergent* data, Mr. Murray set about to further investigate historical growth rates.[174] His "*Value Line* Study" examined earnings per share,

[168] Tr., p. 1169, l. 14-18.
[169] Tr., p. 1170, l. 5-7.
[170] Tr., p. 1171, l. 8-11.
[171] Tr., p. 1170, l. 24 to p. 1171, l. 3.
[172] Tr., p. 1171, l. 12-20.
[173] Tr., p. 1172, l. 2-11.

dividends per share, and book value per share for a proxy group of 10 companies during the period 1968 through 1999.[175] Mr. Murray "did not apply rigid selection criteria" for the proxy companies, and the proxy companies used in the study were different than the proxy group used in this case.[176] Nevertheless, Mr. Murray determined that the historical growth rate for the companies in the *Value Line* study was 3.59 percent.[177]

The final stage of Mr. Murray's DCF model measures future cash flows beginning in 2021.[178] But the data set he used to establish a growth rate that *begins* in 2021 covered a period that *ended* in 1999. Mr. Murray simply has not connected the dots to show that average historical growth for a 30 year period that ended in 1999 represents growth likely to occur beginning in 2021. He assumes this to be the case, but provides no corroborating evidence. To the contrary, he admits not performing any studies extending his analysis beyond 1999.[179]

Mr. Murray insists that his long term growth estimate is not only reasonable, but "conservative" in light of growth rates used by the financial community to value assets or set price targets for stocks.[180] This argument is a variation (albeit a slight one) of Mr. Murray's testimony in the Company's last rate case, where he claimed that analysts' recommendations and expected pension fund returns justified an ROE below 9 percent.[181] As in the last case, Mr. Murray either does not understand, or chooses to ignore, the assumptions and data from which he draws his conclusions.

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[174] Tr., p. 1172, l. 16-20.
[175] Tr., p. 1172, l. 21 to p. 1173, l. 1.
[176] Ex. 201, p. 22, l. 22-23; Tr., p. 1173, l. 17-21.
[177] Ex. 201, p. 23, l. 13.
[178] Tr., p. 1174, l. 8-12.
[179] Tr., p. 1174, l. 3 to 1175, l. 6.
[180] Tr., p. 1175, l. 10.
[181] Case No. ER-2010-0036, *Report and Order* (May 28, 2010) p. 20, para. 18.

In Ameren Missouri's last rate case, the Company's rate of return witness provided workpapers to Staff that included a September 2009 research report from Goldman Sachs.[182] That report is now an exhibit to the Staff Report in this case.[183] Mr. Murray cites the report as evidence that "Goldman Sachs generally assumes a perpetual growth rate of 2.5% when performing a DCF analysis of regulated electric utility companies."[184] But the Goldman Sachs report presents a valuation analysis used to establish stock price targets; it is not intended to establish a market-required ROE.[185] Mr. Murray has not talked to anyone at Goldman Sachs, and he doesn't know whether the 2.5 percent growth rate represents a consensus.[186] When Mr. Hevert pointed out that the 2.5 percent figure in the Goldman Sachs report is a *real growth* rate (which excludes inflation), not a *nominal growth* rate necessary to estimate the cost of equity, Mr. Murray conceded the point.[187] And while Mr. Murray would "hope" that Goldman Sachs makes investment decisions consistent with its published research,[188] the report upon which he relies contains an express disclaimer to the contrary:

> Our salespeople, traders and other professionals may provide oral or written market commentary or trading strategies to our clients in our proprietary trading desks that reflect opinions that are contrary to the opinions expressed in this research. Our asset management area, our proprietary trading desks, and investment business may make investment decisions that are inconsistent with the recommendations or views expressed in this research.[189]

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[182] Tr., p. 1175, l. 19 to p. 1176, l. 5.
[183] Ex. 201, App'x. 2, Attach. E.
[184] Ex. 201, p. 23, l. 26-27.
[185] Ex. 122, p. 46, l. 6-8.
[186] Tr., p. 1176, l. 6-12.
[187] Tr., p. 1177, l. 3-13.
[188] Tr., p. 1178, l. 23 to p. 1179, l. 3.
[189] Tr., p. 1179, l. 25 to p. 1180, l. 8 (*quoting* disclosure in Goldman Sachs Report, Ex. 201, App'x 2, Attach. E, p.35).

Mr. Murray also acknowledges that in more recent reports, Goldman Sachs has "quit discussing the dividend discount model" used in the September 2009 report and now uses an approach similar to Mr. Hevert's.[190]

Mr. Murray also cites a UBS investment research report as corroborating a 2.5 percent growth rate.[191] Like the Goldman Sachs report, the UBS report provides a CAPM valuation of Ameren Corporation for purposes of establishing a price target for its stock.[192] It does not value the cost of equity of Ameren Missouri, and Mr. Murray admits that he did not consider this report in developing his cost of equity recommendation in this proceeding.[193] And while UBS used the CAPM as a primary valuation approach, Mr. Murray used this model only as a check on his DCF results.[194] Moreover, updating the UBS CAPM with current market data would yield CAPM results ranging from 10.07 to 10.52 percent.[195]

If growth rates investment banks use to estimate stock price targets were relevant to a determination of a utility's required ROE, surely some ROE witness, somewhere, would have convinced a state commission to authorize an ROE modeled with these growth rates. When asked, "Do you know any mainstream ROE witness[es] that use a two and a half percent perpetual growth rate for the DCF analysis?," Mr. Murray responded, "I don't recall anybody off hand."[196] Mr. Murray provides no reason for this Commission to accept an ROE recommendation based on growth rates that are far below those used by mainstream ROE witnesses.

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[190] Tr., p. 1176, l. 13 to p. 1177, l. 2.
[191] Tr., pp. 1180-81; Ex. 236.
[192]Ex. 123, p.30, l. 11-18; Tr., 1181, l. 3-5.
[193] Tr., p. 1180, l. 24 to p. 1181, l. 2.
[194] Tr., p. 1181, l. 6-9.
[195] Ex. 123, p. 30, l. 19 to p.31, l. 17.
[196] Tr., p. 1177, l. 24 to p. 1178, l. 4; *see also* Tr., p. 1189, l. 18-19 ("I just don't know if any other ROE witnesses in general have used [a] two and a half percent perpetual growth rate.")

3. <u>Analyst reports and valuations do not support Mr. Murray's ROE recommendation.</u>

In Ameren's last rate case, Mr. Murray attempted to support his "very low" return on equity recommendation by reference to analyst reports suggesting Ameren Missouri would earn a return on equity of less than 9 percent.[197] The Commission found Mr. Murray's reliance on these reports "misplaced" because "[m]ost investors do not have access to the specific analyst reports that Murray examined and thus cannot rely on them in deciding where to invest their money."[198] Despite the Commission's findings in the last case, Mr. Murray again cites published analyst reports in an attempt to support his unreasonably low recommendation. He compounds this error in this case by also citing internal, non-public reports, prepared outside the ratemaking context, as after-the-fact justification for his absurdly low recommendation.

Mr. Murray believes that "experts involved in the field of asset valuation consistently apply a much lower cost of equity to cash flows generated from regulated utility operations as compared to the cost of equity from not only company ROR witnesses, but all ROR witnesses involved in the ratemaking process."[199] This happens, he believes, because the inputs and assumptions that ROR witnesses typically use in their models to estimate the cost of equity aren't used in the "real world" to value assets or estimate stock prices.[200] "The assumptions seem to be a little bit off compared to what I understand asset valuation and equity valuation to be based on."[201] Because ROR witnesses do not estimate the cost of equity the same way "real world" professionals value assets or estimate stock prices, in Mr. Murray's opinion "most mainstream rate of return witnesses are approaching the estimation of the cost of equity all

[197] *Re Union Electric Co., d/b/a AmerenUE*, Case No. ER-2010-0036, *Report and Order* (May 28, 2010) p. 20, para 17.
[198] *Id.*, p. 20, para. 18.
[199] Ex. 219, p. 13, l. 6-9 (Murray Rebuttal).
[200] Tr., p. 1184, l. 23 to p. 1185, l. 4.
[201] Tr., p. 1185, l. 8-11.

wrong."[202] He cites three pieces of data that he believes corroborates his theory: (1) a goodwill impairment study performed by Duff & Phelps ("D&P Report"); (2) a 2009 Ameren Corporation board presentation summarizing Lazard & Associates valuation of Ameren's generation assets ("Lazard Study"); and (3) a July 2010 Bank of America research report.

There are several problems with Mr. Murray's theory. For starters, he is not qualified to opine about what "real world" professionals do. ASC 820 is an accounting standard that provides guidelines for estimating the fair value of a subject asset.[203] Mr. Murray has never specifically applied ASC 820 in his professional work and does not consider himself an expert in the application of this standard.[204] He has never performed a valuation of a physical asset, such as a power plant or other utility property or equipment.[205] He has never drafted a fairness opinion, never rendered a professional opinion about the value of a public company and never rendered advice to buy or sell stock.[206] He has never performed a goodwill impairment test and does not consider himself qualified to do so.[207] Mr. Murray's opinions about what is supposedly done in the "real world" must be considered with his lack of qualifications in mind.

The D&P Report estimated the fair value of each of Ameren Corporation' business units to test whether goodwill associated with the unregulated competitive generation operations owned by Ameren Corporation's subsidiary, Ameren Energy Generating Company, was impaired.[208] As part of this exercise, D&P discounted to present value the future cash flows of each business unit. Since cash flows are a function of net income, the assumed ROE was a

[202] Tr., p. 1185, l. 15-19.
[203] Tr., p. 1181, l. 22-25.
[204] Tr., p. 1182, l. 1-3.
[205] Tr., p. 1182, l. 7-10.
[206] Tr., p. 1182, l. 11-21.
[207] Tr., p. 1181, l. 10-15.
[208] Ex. 123, p. 17, l. 22 to p.18, l. 5.

significant variable in the fair value analysis.[209] The authorized ROEs that D&P assumed in its analysis *exceed* Mr. Hevert's minimum recommendation of 10.4 percent.[210] But rather than focus on D&P's assumed ROEs, Mr. Murray focuses on the discount rate used by D&P to determine the present value of future cash flows. As Mr. Hevert explained, there is no reason why the discount rate used by D&P in its present value analysis would be relevant to the ROE determination in this proceeding, while the ROE assumption on which the cash flow projects are based are not.[211]

Mr. Murray also fails to appreciate that the D&P Report was produced for purposes other than determining the appropriate ROE for Ameren Missouri.[212] D&P's assessment of "fair value" is based on FAS 157, which requires a determination of the value of the subject entity to a prospective buyer.[213] Whereas the D&P Report estimated a fair value of the Ameren business units as discreet assets to an individual buyer, the objective in this proceeding is to infer the market required return on equity for Ameren Missouri based on market data reflecting the investment decisions of multiple investors valuing a minority interest in the equity of Ameren Missouri.[214] These are "fundamentally different exercises."[215] The *in camera* discussion of the Lazard Study at the hearing reveals a similar misunderstanding of the inputs and assumptions in that study and the purpose for which it was prepared.[216]

Mr. Murray's lack of expertise in asset valuation may explain why he fails to appreciate that the principles and methods used to value assets and securities are different than the principles and methods that mainstream ROE professionals use to estimate the cost of equity.

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[209] Ex. 123, p. 21, l. 20-22.
[210] *See* Ex. 123-HC, p. 22, l. 1 to p. 23, l. 10.
[211] Ex. 123., p. 23, l. 11-16.
[212] Ex. 123, p. 16, l. 15-17.
[213] Ex. 123, p. 20, l. 1-32.
[214] *Id*., p. 16, l. 19 to p. 17, l. 1-3.
[215] Tr., p. 1129, l. 5-6.
[216] Tr., p. 1146, l. 4 to p. 1147, l. 20 (in camera).

Ms. LaConte, who did asset valuation work in the late 1990s, agreed that "the principles and methods involved in valuing physical assets like power plants are different than the principles and methods involved in estimating a utility's cost of equity."[217] Likewise, Mr. Gorman agrees that the basic DCF and CAPM models can be used to value both assets and the cost of equity, but the inputs in these models will be different depending on what is being valued.[218] It should not be a surprise that valuation experts and ROE witnesses reach different results. They value different things for different purposes.

As the Commission observed in Ameren Missouri's last rate case, "Most investors do not have access to the specific analyst reports that Murray examined and thus cannot rely on them in deciding where to invest their money."[219] If this is true for published analyst reports, it is especially true for internal, confidential reports prepared by the Company's consultants for purposes other than estimating a market-required ROE. The D&P Report and Lazard Study simply do not advance Mr. Murray's cause.

The Bank of America report also does not help Mr. Murray. The report shows an "implied return" and "required return," 10.8 percent and 8.8 percent, respectively, for electric utilities.[220] Staff tried to make the point that its recommendation represents Ameren Missouri's "required" return on equity.[221] Despite acknowledging that "I can't, obviously, verify this unless I talk to them,"[222] Mr. Murray speculates that "required, to me, means that's the required return on equity, which is the cost of equity, which is the very same thing we're trying to estimate in all

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[217] Tr., p. 1215, l. 15-21.
[218] *See* Tr., p. 1224, l. 22 to p. 1225, l. 2.
[219] Case No. ER-2010-0036, *Report and Order*, p. 20, para. 18.
[220] Ex. 241; Tr., p. 1135, l. 12-22.
[221] Tr., p. 1141, l. 13-22 (in camera).
[222] Tr., p. 1192, l. 2-7. Mr. Murray admitted that he has not talked to anyone at Bank of America. Tr., p. 1197, l. 4-6.

of these processes that we go through."[223] He acknowledges that one is forced to guess at what Bank of America means by "implied" versus "required" returns, but apparently believes that his guess is worth more than anyone else's because "mine's an educated guess."[224] In any event, regardless of what Bank of America was attempting to convey in its report, Staff concedes that state regulatory commissions do not appear to give primary weight to these types of reports.[225]

Mr. Murray's unorthodox approach to estimating the cost of equity explains why the next time the Commission adopts his ROE recommendation will be the first time. The Commission should reject Mr. Murray's recommendation as it has consistently done in the past.

E. Conclusion.

When the Commission issues its Order in this proceeding, the authorized ROE will be a "headline number" to investors and the financial community.[226] Analysts will look at the Company's authorized return to make buy-sell recommendations of Ameren Corporation's stock.[227] As pointed out by Ameren Missouri's Chief Executive Officer, Mr. Warner Baxter, the Company has not earned its authorized rate of return for several years.[228] In the most recent calendar year, it earned a return of 10 percent or greater in only three months.[229] Adopting an authorized ROE that is lower than Mr. Hevert's recommendation will not stop that trend; it will only worsen it. To compete for investor capital in the open market with comparable utilities (and have an opportunity to earn its allowed return), Ameren Missouri must receive an authorized return sufficiently adequate to attract capital at reasonable terms.

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[223] Tr., p. 1192, l. 8-14.
[224] Tr., p. 1196, l. 15-23.
[225] Tr., p. 1142, l. 13-21 (in camera).
[226] Tr., p. 1184, l. 8-11.
[227] Tr., p. 1218, l. 9-12
[228] Tr., p. 100, l. 15-18.
[229] Tr., p. 1194, l. 9-19.

Of the four ROE recommendations in this case, three deserve consideration. Mr. Gorman and Ms. LaConte agree that any recommendation within their range would be reasonable.[230] The high end of Ms. LaConte's range is 10.6 percent. Mr. Gorman's Constant Growth DCF produced a return of approximately 10.5 percent. This should be considered the high end of his range. Alternatively, excluding his Sustainable Growth DCF results and averaging his constant growth and Multi-Stage results yields an average DCF return of 10.3 percent. This could also be considered the high end of his range. Either way, the analytical results of both industrial witnesses are consistent with the national average ROE of 10.3 percent, fully support a minimum ROE of 10.4 percent and corroborate Mr. Hevert's recommendation of 10.7 percent.

II. TAUM SAUK.

A. Background

As the Commission is well aware, on December 14, 2005, the upper reservoir of Ameren Missouri's Taum Sauk pumped storage plant was overtopped, and the reservoir failed, sending a large amount of water down the mountain where the reservoir was located. The breach caused extensive damage, including destroying the house where a park ranger and his family were living, and damaging Johnson's Shut-Ins State Park. Thankfully, no loss of life resulted from the breach.

As the record in this case shows, there were several causes of the breach. Specifically, the Company's water level measuring devices did not prevent the over-pumping as they were designed to do. As Ameren Missouri witness Mark Birk testified, the Company did not understand the severity of the problems it was having with the water level measuring devices.[231] The original design and construction of the upper reservoir in the late 1950's and early 1960's

[230] Tr., p. 1240, l. 12 to p. 1241, l. 2; Tr., p. 1215, 22-25.
[231] Tr., p. 711, l. 6 to p. 712, l. 14.

also played a role in the failure. Although the design of the structure was consistent with industry practice at the time,[232] it was not consistent with modern design standards. In particular, the original design did not include an overflow relief structure, which would have prevented the failure. In addition, the original construction of the upper reservoir was not done in accordance with the design specifications.[233] As a consequence, the rock-filled dam had earth, vegetation, and other "fines" mixed with the rock, and the dam had an inadequate foundation.[234] This weakened the structure of the dam and contributed to its failure.

Since the date of the failure, up to and including this case, Ameren Missouri has taken full responsibility for the failure, and committed to prevent its customers from bearing the associated costs. Both FERC and this Commission conducted extensive investigations of the failure, and Ameren Missouri cooperated fully with those investigations. In addition, the Company entered into a Consent Judgment with the State of Missouri, MDNR and the Missouri Conservation Commission (collectively referred to as the "State Parties") that resolved a lawsuit that those parties had filed in Reynolds County, Missouri related to the breach. Pursuant to the terms of the Consent Judgment (which was approved by the Reynolds County Circuit Court), Ameren Missouri committed to spend tens of millions of dollars to pay for Natural Resource Damages, Compensatory Damages, Response Costs, Remediation, Monitoring Payments, Tax Base Support, the funding of a Tourism and Economic Development Non-Profit Entity, and the funding of the Reynolds County School Fund, among other things.[235] In addition, the Consent Judgment contained the following provision, which embodies the Company's commitment to prevent customers from paying the costs resulting from the breach:

Ratepayer Protection. AmerenUE acknowledges that it will not attempt

[232] Tr., p. 801, l. 6-9.
[233] Ex. 106 p. 25, l. 14-15 (Birk Direct).
[234] Ex. 117, p. 20, l. 23 to p. 23 (Rizzo Direct).
[235] Ex. 157.

> to recover from ratepayers in any rate increase any in-kind or monetary payments to the State Parties required by this Consent Judgment or construction costs incurred in the reconstruction of the Upper Reservoir Dam (***expressly excluding, however, "allowed costs," which shall mean only enhancements, costs incurred due to circumstances or conditions that are currently not reasonably foreseeable and costs that would have been incurred absent the Occurrence [the breach] as allowed by law***), and further acknowledges the audit powers of the Missouri Public Service Commission to ensure that no such recovery is pursued. In the event that Ameren intends to seek recovery for allowed costs, it shall notify the State Parties in writing at least seven (7) business days in advance of its initial application for the recovery of these costs. If AmerenUE fails to provide the required notice, it shall forfeit whatever legal right it has to seek such recovery.

Pursuant to the terms of the Consent Judgment, Ameren Missouri's shareholders have to date absorbed approximately $94 million of costs that do not qualify as "allowed costs."[236]

In addition, the Company has not sought recovery of, nor will it seek recovery of, the considerable costs of clean up, restoring Johnson's Shut-Ins State Park, payment of liability claims and other items enumerated in the Consent Judgment. Although these items are currently the subject of litigation involving the Company's liability insurance policies, Ameren Missouri will never seek recovery of these items from ratepayers, regardless of the outcome of this litigation. If these considerable additional costs are not fully paid for by insurance, the approximately $94 million of costs absorbed to-date will grow.

The only items that the Company is seeking recovery of are those portions of the new upper reservoir construction costs that (a) were not covered by property insurance claim payments,[237] (b) qualify as "allowed costs" under the Consent Judgment, and (c) were prudently incurred. The entire cost of constructing the new upper reservoir was approximately $489 million,[238] and payments under the Company's property insurance policies, including the portion

[236] *See* Tr., p. 432, l. 5-11 (Where Mr. Birk corrected an error in addition in his direct testimony). Mr. Birk's direct testimony (Ex. 106, p. 39, l. 4-15) lists the specific items, after correcting the error, that total to the approximately $94 million that has been absorbed by the Company.
[237] The Company's claims under its property insurance policies, unlike its claims under its liability insurance policies, have been finally resolved.
[238] Ex. 107, p. 28, l. 6-8 (Birk Rebuttal).

of the deductible attributable to the construction of the new upper reservoir, totaled approximately $400 million.[239] The remaining approximately $89 million in construction costs constitute prudently incurred "allowed costs" under the Consent Judgment, and should be included in the Company's rate base.

B. The Taum Sauk Costs Ameren Missouri Seeks to Recover Constitute "Allowed Costs" Under the Terms of the Consent Judgment.

No party to this case has provided any evidence, or even argued that the costs Ameren Missouri seeks to recover are not "allowed costs" under the Consent Judgment. The Public Counsel, the only party that has provided any evidence in opposition to the recovery of Ameren Missouri's investment in the new upper reservoir, admitted that he does not disagree that these costs constitute "allowed costs." Specifically, in his opening statement, Public Counsel Lewis Mills stated: "Mr. Lowery, in his opening statement, pointed out that the cost that the company seeks to recover in this case, the capital investments, are allowed costs under the consent agreement. And I don't disagree with that."[240]

The other parties to the Consent Judgment, specifically the Attorney General, MDNR, and the Department of Conservation, were all provided written notice shortly before the filing of this case that Ameren Missouri was going to seek recovery of these costs, as required by the Consent Judgment.[241] In addition, the Company went beyond the requirements of the Consent Judgment, and met with senior leadership at each of these agencies to explain in detail the nature of the costs it was seeking to recover.[242] None of these agencies has objected to the recovery of the Taum Sauk costs or even contended that these costs do not constitute "allowed costs" under the Consent Judgment, although they had ample notice and an opportunity to do so, had they

[239] Tr., p. 881, l. 10-13.
[240] Tr., p. 57, l. 9-13
[241] Ex. 158.
[242] *Id.*

believed the recovery sought by the Company in this case was in violation of the Consent Judgment. The MDNR, which did intervene in this case and which provided evidence on energy efficiency issues, has provided no evidence that the Taum Sauk costs Ameren Missouri seeks to recover are not "allowed costs." If Ameren Missouri was violating the letter or the spirit of the Consent Judgment by improperly seeking recovery of costs that do not qualify as "allowed costs," these agencies would have every incentive to provide evidence to the Commission supporting disallowance of those costs. In fact, if these agencies believed that Ameren Missouri was violating the Consent Judgment, they would have every incentive to pursue enforcement actions or contempt proceedings in the Reynolds County Circuit Court, which they have not done.

The position of the agencies in this case was made crystal clear in a discussion between Commissioner Kenney and Assistant Attorney General Jennifer Frazier, who was involved in part of the Reynolds County case and who represents MDNR in this case. The State Parties' position regarding the Company's request to recover the approximately $89 million of allowed costs was described by Ms. Frazier as follows:

> COMMISSIONER KENNEY: Right. Well, you're saying that all the parties clearly knew what you [the Company] would be seeking. Did they [the State Parties] clearly know the dollar amount you'd be seeking?
>
> …..
>
> MS. FRAZIER: Excuse me, Commissioner Kenney. This is Jennifer Frazier with the Attorney General's office. I can address your question, I think. The—I am authorized to say that the Attorney General's office did review Ameren's request for reimbursement after this case was filed and we have no evidence to believe that the request is inconsistent with or in violation of the consent judgment on record in Reynold's County.
>
> And in reaching that conclusion, we did consult, as you've heard, with the Staff, with the Office of Public Counsel, the Department of Natural Resources. We did not consult independently with the Department of Conservation, but they did not approach us after their meeting with Ameren and we just did not do that.

> And further, we do recognize that the Public Service Commission was not a party to the consent judgment and that it's not binding upon the Commission. But that the Commission's role, in some respect, is to use the consent judgment as a basis for disallowing costs. But that is—but we have no reason to believe that the costs requested are in violation of the consent judgment. And in fact, after this rate case was filed, the action in Reynolds County was closed by the Court without objection by the Attorney General's office, recognizing that if we thought it was—they were in violation, we could seek contempt, but we have not done so.[243]

In addition, the significant competent and substantial evidence of record presented by the Company and the Commission Staff affirmatively demonstrates that the costs Ameren Missouri seeks to recover in this case in fact do constitute "allowed costs."

1. **The Costs Ameren Missouri Seeks to Recover Are the Costs of Enhancements to the Upper Reservoir.**

One category of costs that the Company is specifically allowed to seek recovery of according to the Consent Judgment is enhancements to the upper reservoir. It is logical that Ameren Missouri would be allowed to recover the costs of enhancing the reservoir. Enhancements provide incremental benefits to customers, in the form of a safer, or more efficient, or more productive, or longer lasting upper reservoir. The Consent Judgment recognizes that it is only fair that customers, as the beneficiary of those enhancements, pay for them.[244]

In his direct testimony, Mr. Birk enumerated and quantified the cost of several "discrete enhancements" in the new reservoir. Mr. Birk explained that discrete enhancements included only features of the new upper reservoir that did not exist at all in the old upper reservoir.[245] For example, an improved foundation would not constitute a "discrete enhancement" because the old

[243] Tr., p. 2124, l. 1 to p. 2125, l. 8.
[244] At the hearing, Commissioner Davis asked a number of questions focused on the additional energy that the new upper reservoir can generate. His valid point was that customers ought to pay for the benefits this additional energy generation will provide. But this point is equally valid for other enhancements to the upper reservoir, whether they be safety features, such as improved instrumentation or an overflow relief structure, or features which add to the life of the facility.
[245] Ex. 106, p. 32, l. 4 to p. 33, l. 5.

upper reservoir contained a foundation, albeit an inferior foundation. Mr. Birk identified the following discrete enhancements in the new upper reservoir which cost a total of approximately $67 million:

- **The Overflow Relief Structure** is an area approximately 800 feet long on the southeast portion of the dam where the crest is 2 feet lower than the rest of the dam. Should all of the level control and protection systems fail to shut off the pumps, the water will flow over the overflow relief structure, down energy dissipation steps that are part of the structure, and into a "stilling basin." It will then flow down an uninhabited portion of Proffit Mountain (all on Ameren Missouri's property), and back into the lower reservoir.

- **The Drainage and Inspection Gallery** runs through the center portion of the dam and runs the entire perimeter. The crest to gallery drains and foundation drains both drain to this gallery, where the leakage is quantified and safely routed out of the dam. The gallery contains vibrating wire piezometers, an accelerometer, joint meters, and flumes—all instruments to measure the "health" of the dam and provide real time information to the operators on dam performance.

- **The Continuous Upstream Grout Curtain** installed on the upstream portion of the dam consists of holes drilled at very close spacing around the inside perimeter and filled with pressurized cementitious grout. The purpose of the grout curtain is to fill in any cracks or voids to keep water from leaking under the dam.

- **The Cementitious Floor** seals the exposed bedrock (to keep water from leaking through the floor) and to ensure positive drainage to the vertical shaft. During periodic maintenance of the upper reservoir, the new floor is expected to keep the major siltation away from the dam walls and allow for much quicker access to the dam interior.

- **The New Crest Roadway and Guardrail** allows for the passage of two vehicles, and has a robust downstream guardrail. It is much more durable and safe, in that it allows maintenance personnel to keep the roadway clear in the winter months. The previous dam crest was a gravel roadway, only wide enough for one vehicle, it was susceptible to frequent icing and winter weather problems, and did not have a downstream guardrail.

- **Crest-to-Gallery and Foundation Drains** provide significantly enhanced drainage to the drainage gallery.

- **Significantly Improved Instrumentation** including level control and protection equipment as well as video cameras, is located within the

> drainage gallery, on the dam crest, and within the instrumentation house.[246]

In the absence of the breach, the cost of all of these discrete enhancements would be fully recoverable from customers if they had been (or could have been) added to the old upper reservoir because they provide benefits to customers in the form of safer, more reliable power from Taum Sauk. They are no less recoverable as part of the new upper reservoir, because they are providing customers with the same incremental benefits.

But the discrete enhancements aren't the only enhancements, or even the primary enhancements, of the upper reservoir. The facility is significantly enhanced because it was built of new roller-compacted concrete as opposed to the almost 50-year-old rock-filled concrete faced structure that was replaced. This provides a much safer, more reliable, and much longer lasting facility. In addition, the foundation of the upper reservoir was significantly improved during the construction process. Mr. Birk explained the improvements to the foundation in his direct testimony:

> The old foundation was not even built on bedrock in a significant number of areas and it was constructed of dumped rock-fill. By contrast, the new foundation is set on bedrock—in some cases approximately 60 feet below grade level—and is made entirely of concrete. The new foundation was constructed to stringent seismic design standards, which have increased dramatically since the previous reservoir was designed approximately 50 years ago. The engineer-of-record, PCR, utilized the new FERC seismic standards when the new reservoir was designed. As a result, the new reservoir is designed to withstand much stronger seismic events, and has new strong motion (accelerometer) instrumentation to monitor and alarm when events like these occur. The new dam is capable of withstanding a magnitude 7.7 event in the New Madrid Seismic Zone or a 5.8 event within the local area around the Taum Sauk Plant. The cost of constructing this enhanced foundation was approximately $127 million.[247]

[246] Ex. 106, p. 33, l. 6 to p. 34, l. 15.
[247] Ex. 106, p. 34, l. 23 to p. 35, l. 11.

The new foundation provides customers a significant benefit in the form of a safer, more reliable structure that could withstand an earthquake similar to the earthquake that occurred at the New Madrid Fault in the early 1800's—the most significant earthquake in North America.[248] It is appropriate, and entirely consistent with the Consent Judgment that customers pay for this significantly improved foundation, notwithstanding the fact that there was a dumped rock-fill foundation that was part of the old upper reservoir.

The non-discrete enhancements that make the structure more robust and safe can be seen in the photographs of the old and new facilities which are contained in Dr. Rizzo's direct testimony, but which are again reproduced below for the Commission's convenience.[249] In particular, the improvements to the foundation can be seen at the base of the structure, and the greater stability and integrity provided by the roller-compacted concrete material can also be observed.

ORIGINAL UPPER RESERVOIR CONCRETE FACED ROCKFILL DAM

[248] Tr., p. 841, l. 4 to p. 842, l. 8.
[249] Ex. 117, p. 5, p.7.

THE NEW ROLLER COMPACTED CONCRETE UPPER RESERVOIR DAM

In addition to the enhancements listed above, although the new facility has the same *capacity* as the old facility (440 MW), it is capable of generating slightly more *energy* than the old facility. Over the greatly extended life of the new facility, Ameren Missouri has very conservatively estimated the value of this incremental energy to be approximately $7 million in 2010 dollars.[250] Moreover, the new reservoir is expected to last at least 80 years longer than the old facility. The Company has conservatively estimated that the plant's life extension allowed by the enhanced upper reservoir provides a combined energy and capacity benefit (excluding the $7 million of incremental energy referenced above) to be an additional $170 million in 2010 dollars.[251]

The Staff's Construction Audit and Prudence Review of the Taum Sauk reconstruction project ("Staff Audit Report") fully supports the Company's testimony regarding the significant

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[250] Ex. 106, p. 37, l. 9-11. As Commissioner Davis pointed out, the cost of constructing a new generating unit to provide this energy would be considerably higher than the $89 million Ameren Missouri requests to include in rate base.

[251] Ex. 106, p. 35, l. 17 to p. 36, l. 14. The actual benefits are likely to be substantially more (as much as $700 million), insofar as the value of capacity and energy used in these calculations was held constant at estimated 2013 levels (for the capacity) and at estimated 2015 levels (for the energy) for the remaining 77 and 75 years of the analysis, even though it is highly likely that capacity and energy values will continue to escalate over time. Tr., p. 1494, l. 16 to p. 1497, l. 1.

enhancements made to the plant. Staff engineer and geologist Guy Gilbert, who has closely followed this project from the very beginning[252] and who has a deep understanding of the plant's operation, discussed many of the enhancements in the Staff Audit Report, including the drainage gallery, the grout curtain, the roadway, the spillway, improved instrumentation, the enhanced energy generation and the significantly longer life of the facility.[253] Mr. Gilbert was present during the development and construction of many of those enhancements. In addition, Mr. Gilbert testified that there is "no comparison" between the old and new foundations, and that the new foundation makes the structure safer.[254] Moreover, Mr. Gilbert testified that the material used in constructing the new upper reservoir makes it "considerably more robust than stacked rocks with concrete slabs."[255] Based on its extensive audit and examination of these enhancements, the Staff recommended that the entire $89 million of investment sought by the Company in this case be included in rate base.

The parties opposing inclusion of the Taum Sauk costs in rates provided no competent and substantial evidence whatsoever that would support a conclusion that these costs do not represent enhancements to the reservoir or that would support a disallowance for any other reason. OPC witness Ryan Kind, the only adverse witness to provide any testimony regarding the Taum Sauk issue, admitted that (a) he is not an engineer (b) he did no quantitative analysis to support his proposed disallowance of 100 percent the Taum Sauk costs,[256] (c) his proposed disallowance is not based on any individualized review of each of the specific enhancements to

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[252] Among other things, Mr. Gilbert attended 19 Board of Consultants meetings at the Taum Sauk Plant, wrote a separate report on each of those meetings and visited the plant several additional times. Tr., p.894, l. 23 to p. 895, l. 6.
[253] Ex. 203, p. 17, l. 1 to p. 19, l. 24, (Staff Construction Audit and Prudence Review of Taum Sauk Project for Costs Reported as of October 31, 2010).
[254] Tr. 900, l. 23 to p. 901, l. 1; Tr., p. 901, l. 7-9.
[255] Tr., p. 903, l. 4-6.
[256] Tr., p. 944, l. 10-17.

the upper reservoir,[257] (d) he never physically examined the enhancements to the new upper reservoir or the deficiencies of the old upper reservoir,[258] (e) he never even visited the old or the new upper reservoir as an adult,[259] and (f) at the time of his deposition (after he made his recommended disallowance) he did not know basic facts about the Taum Sauk reservoir, such as what material the new reservoir was made of[260] or what the gallery or tail race of the plant were.[261] However, Mr. Kind did agree that the new upper reservoir is "a substantial improvement" over the old upper reservoir.[262] In short, Mr. Kind's testimony, the only evidence provided by any party opposed to the inclusion of the Company's Taum Sauk investment in rate base, provides absolutely no evidentiary basis to find that the enhancements to the upper reservoir do not far exceed the $89 million of investment the Company seeks to include in rate base in this case.

2. <u>The Costs Ameren Missouri Seeks to Recover are Also Costs That Would Have Been Incurred Absent the Breach.</u>

In addition to the fact that the Company's Taum Sauk costs are "allowed costs" under the Consent Judgment because they reflect enhancements that provide incremental benefits to customers, the costs also qualify as "allowed costs" because the overwhelming weight of the evidence shows that they are costs that would have been incurred in the absence of the breach. Specifically, as discussed in more detail below, Dr. Paul Rizzo, a dam safety engineer with over 40 years of experience in FERC dam inspection and licensing, testified that in the absence of the breach, the Taum Sauk Plant was scheduled to undergo a rigorous PFMA inspection for the first time in 2008, the result of which would have required that the plant be shut down or that it

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[257] Tr., p. 955, l. 16-21.
[258] Tr., p. 955, l. 9-15.
[259] Tr., p. 954, l. 16 to p. 955, l. 8.
[260] Tr., p. 956, l. 4-8.
[261] Tr., p. 957, l. 2-19.
[262] Tr., p. 943, l. 4-11.

essentially be rebuilt, in either case, at a cost far in excess of the $89 million at issue here. Dr. Rizzo's uncontradicted testimony thus establishes that substantially more than $89 million would have been expended in the absence of the breach.[263]

In support of his conclusion, Dr. Rizzo described the difference between a PFMA inspection and the inspections previously conducted by FERC as follows:

> Where the previous inspection process focused on only a limited number of standard-based concerns such as the hydraulic capacity of spillways and the stability of structures under a relatively narrow set of pre-defined load conditions, the PFMA broadened the scope of the evaluation considerably to include potential failure scenarios that may have been overlooked in past investigations. In fact, a PFMA broadened the scope of the evaluation considerably to include potential failure scenarios that may have been overlooked in past investigations. In fact, a PFMA is an exercise to identify all potential failure modes under static loading, normal operating conditions, as well as flood and earthquake conditions, including consideration of all external loading conditions for water retaining structures. It is also an exercise in assessing potential failure modes of enough significance to warrant visual observation, monitoring, and remediation as appropriate.[264]

Dr. Rizzo also testified that unlike the past FERC inspection process, a PFMA involves a whole team of inspectors rigorously examining all available data in an effort to identify potential failure modes. He stated:

> A PFMA is typically conducted by a team of engineers and inspectors, who conduct a formal identification and examination of all potential failure modes for an existing dam, based on a comprehensive review of all existing data and information, input from field and operations personnel, a site inspection, and a review of completed engineering analyses. The team identifies potential failure modes, causes and developments, and determines the consequences of each type of failure. The PFMA is intended to provide enhanced understanding and insight on the risk exposure associated with the Dam. This is accomplished by seeking input from a diverse group of people that have information about the Dam. Based on the results of the PFMA, a Performance Monitoring Program is developed to monitor the water retaining structures based on the PFMA. Ultimately, as a

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[263] The lack of an evidentiary basis to disallow these costs, coupled with the Public Counsel's admission that the $89 million all reflect allowed costs under the Consent Judgment, means that OPC's position that the $89 million should be disallowed simply cannot be sustained.

[264] Ex. 117, p. 18, l. 5-14.

> consequence of the PFMA, remediation measures may be required to address safety issues, or an unsafe dam may be required to shut down.[265]

Given the rigorous review that would have occurred in connection with the 2008 PFMA, Dr. Rizzo testified that the following deficiencies would have been identified:

- Improper use of the parapet wall for water retention;
- Foundation failure of the parapet wall;
- Poor CFRD foundation conditions;
- Fines in the rockfill;
- Inadequate seismic design; and
- Voids under the concrete facing.[266]

Dr. Rizzo testified that following the initial investigation, the Company would have been required to immediately lower the water level in the upper reservoir until a more detailed investigation could be completed over the next several years. Dr. Rizzo stated: "Although it is theoretically possible that such an investigation might have permitted AmerenUE to continue operating the Reservoir after a substantial remediation costing approximately $272 million, in my opinion such a remediation would not have been practical or completely effective. Instead, AmerenUE would have had to rebuild a new Reservoir, as it did after the failure."[267] Dr. Rizzo acknowledged that it also would have been possible to retire the Taum Sauk Plant, but the Company would have had to incur approximately $840 million in retirement costs, not to mention costs associated with the permanent loss of the plant.[268] And of course if the breach had not occurred, there would have been no insurance proceeds to offset any of these costs.

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[265] Ex. 117, p. 18, l. 15 to p. 19, l.2.
[266] Ex. 117, p. 19, l. 7-17.
[267] Ex. 117, p. 32, l. 21-25.
[268] Ex. 117, p. 33, l. 1-25.

Like the Company's and Staff's evidence regarding the enhancements to the upper reservoir, Dr. Rizzo's testimony regarding the costs that would have been incurred in the absence of the breach is unrefuted by any other witness or by any evidence in the record.

C. The Costs Ameren Missouri Seeks to Recover Were Prudently Incurred.

Just because the Company's investment in Taum Sauk qualifies as "allowed costs" under the Consent Judgment does not mean that the costs are automatically recoverable. The Consent Judgment itself recognizes the Commission's power to audit the Company's investment in Taum Sauk, and to disallow any imprudently incurred costs. In this case, the Staff has conducted a comprehensive prudence review of the Taum Sauk construction project. In addition, Mr. Gilbert's close involvement with the engineering aspects of the project, Staff accountants reviewed numerous documents associated with the project, including:

- Board of Directors' meeting minutes;
- The Company's internal procedures and policies;
- Meeting minutes for the Board of Consultants and the Independent Panel of Consultants;
- FERC's Investigation Report;
- The Quality Control and Inspection Program;
- The Final Design and Construction Report;
- The Consent Judgment;
- Change Order Requests and Requests for Work Order Extensions;
- Purchase Order Summaries;
- Internal/External Audit Reports and Findings; and
- The Company's direct testimony and workpapers.[269]

[269] Ex. 203, p. 8, l. 12-28.

In addition, Staff auditors reviewed a sample of approximately 1,400 invoices related to the project.[270] Following this comprehensive prudence review, Staff concluded that all of the investment which the Company seeks to include in rate base in this case was prudent. Once again, no party provided any evidence that contradicted Staff's conclusions about the prudence of the Company's investment.

D. The Arguments for Disallowance Advanced by OPC, AARP, and CCM Must be Rejected.

OPC, AARP, and CCM argue that all costs related to Taum Sauk must be disallowed regardless of whether they qualify as "allowed costs" under the Consent Judgment, regardless of whether they provide incremental benefits to customers, and regardless of whether the costs were prudently incurred or not. Their position is if the new structure can produce incremental energy, customers are entitled to that incremental energy for free; if the new structure will last decades longer, customers are entitled to the benefits that extra life will provide for free; if there are new video cameras and new instrumentation at the facility, customers are entitled to the benefits that equipment will provide for free; and if there are discrete enhancements—enhancements that did not exist at all on the old reservoir—customers are entitled to have the benefit of those enhancements at no cost. And, following their logic, if additional enhancements are added to the upper reservoir in the future, their position means that customers should be entitled to have the benefit of those enhancements for free as well, simply because they are part of the Taum Sauk Plant.

The position of OPC, AARP, and CCM is not only illogical and unfair to the Company, but if adopted by the Commission it would be unlawful. As the Commission again recognized

[270] Ex. 203, p. 8, l. 29-30.

only a few weeks ago,[271] a utility's expenditures including large rate base additions are presumed to be prudent. *State ex rel. Associated Natural Gas v. Pub. Serv. Comm'n*, 984 S.W.2d 520, 528-29 (Mo. App. W.D. 1997). The burden is on other participants – OPC, AARP, or CCM here – to create a serious doubt about that prudence in order to rebut the presumption. *Id.* Absent competent and substantial evidence of record that creates such a serious doubt, the Company's investment must be included in rate base as a matter of law. Not only is there no such evidence of record in this case, but the Company's and the Staff's evidence, much of which is discussed above, affirmatively demonstrates that the investment in the new upper reservoir was prudent.

In summary, the position taken by OPC, AARP, and CCM is supported by neither the Consent Judgment signed by the Attorney General on behalf of the State of Missouri, nor by any evidence presented in this case. The unrefuted evidence shows that the new upper reservoir is a much safer facility that will last decades longer than the existing facility and will produce more energy each day than could be produced before. The unrefuted evidence shows that the benefits to customers of the new facility will far exceed the $89 million Ameren Missouri proposes to include in rate base, and that the costs it proposes to include have been prudently incurred. The unrefuted evidence shows that in the absence of the breach, the Company would have incurred more costs to remediate or retire the upper reservoir following the 2008 PFMA. Based on this evidence, the Commission must permit Ameren Missouri to include this investment – an investment that will benefit customers for decades to come – in rate base.

III. COSTS RELATED TO SIOUX SCRUBBER PROJECT DELAY.

The sole disallowance proposed by Staff for the Sioux Wet Flue Gas Desulfurization Project ("Sioux Scrubber Project" or "Project") is for $31 million in costs associated with Ameren Missouri's decision in November 2008 to slow down construction on the Project in an

[271] *See In re: KCP&L,* Report and Order, Case No. ER-2010-0355 (April 12, 2011).

effort to preserve cash during the global financial crisis.[272] In order to overcome the presumption afforded Ameren Missouri that its decision was prudent, Staff's burden requires that it create a "serious doubt" as to the prudence of the Company's decision.[273] Moreover, the test for prudence is not based upon hindsight, but upon a reasonableness standard:

> [T]he company's conduct should be judged by asking whether the conduct was reasonable at the time, under all the circumstances, considering that the company had to solve its problem prospectively rather than in reliance on hindsight. In effect, our responsibility is to determine how reasonable people would have performed the tasks that confronted the company.[274]

Because Staff has utterly failed to create the "serious doubt" necessary to rebut the prudence of the Company's decision to delay the Sioux Scrubber Project in November 2008, the Commission should reject the proposed disallowance in its entirety.

A. The global financial crisis beginning in late 2008 was very real.

Staff's recommendation to disallow the costs associated with delaying the Sioux Scrubber Project betrays its failure to appreciate the true extent and severity of the financial crisis in late 2008 and early 2009. As Company witness and Vice President and Treasurer Jerre Birdsong testified, turmoil in the capital markets arising from subprime mortgage problems actually started to become a serious concern in June 2007 when Bear Stearns suffered significant losses and ultimately collapsed in March 2008.[275] Even though the Federal Reserve continued to cut interest rates during this period, the spread between yields on non-government bonds and the yields on U.S. Treasury securities increased five-fold, indicating a true crisis in the capital markets.[276] By September 2008 the crisis had become severe. That month saw the takeover of Fannie Mae and Freddie Mac, the acquisition of Merrill Lynch by Bank of America, the largest

[272] Ex. 200, p. 42, l. 17-20; Tr., p. 586, l. 12-21 (Staff's Construction Audit and Prudence Review of Sioux Wet Flue Gas Desulfurization Project for Costs Reported as of September 30, 2010).
[273] *Associated Natural Gas*, 984 S.W.2d at 528-29.
[274] *Id.*
[275] Ex. 109, p. 5, l. 16 to p. 6, l. 1 (Birdsong Rebuttal).
[276] *Id.*, p. 6, l. 1-9.

bankruptcy in U.S. history filed by Lehman Brothers, the Fed bailout of A.I.G., the largest bank failure in history, rejection of a proposed bailout plan and the resulting largest point loss on record of the Dow Jones Industrial Average with a $1.1 trillion loss in market value.[277]

As a result of these unprecedented events, surviving banks held on to capital rather than provide the credit necessary to businesses—even large, credit-worthy businesses—for normal working capital and to fund expansion.[278] At one point in the fall of 2008, access to the capital markets was available only to those companies that held the highest credit rating.[279] Ameren Missouri was not untouched by these events. As Mr. Birdsong explained, the electric utility industry is the second most capital-intensive sector in the United States and the primary concern of utilities, including Ameren Missouri, was the ability to maintain sufficient liquidity through reliance upon their credit facilities to meet expected and unexpected demands for cash in order to provide service to customers.[280] According to Mr. Birdsong, funds available from credit facilities are used to fund large cash requirements such as payments to equipment suppliers for construction projects, payments to suppliers of coal and natural gas, funding payroll and making tax payments.[281] Even though these credit facilities were contractual obligations for short-term lending between a group of lenders and the utility, there was no assurance on a day-to-day basis that the funds would actually be available from the lenders.[282]

As Mr. Baxter testified at the hearing in this case, Ameren Missouri's "life blood" was its access to these credit facilities because the Company's expenditures for capital projects and

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[277] *Id.*, p. 7, l. 3-13.
[278] *Id.*, p. 9, l. 4-13.
[279] Tr., p. 171, l. 8-17. Even Staff witness David Murray agreed that this was the case, although he implies that Ameren Missouri could have accessed the commercial paper market at the time, albeit at a higher cost. *Id.*, p. 542, l. 16 to p. 543, l. 5. As Mr. Birdsong noted, however, issuing commercial paper (something Ameren Missouri could not do) does not improve a company's liquidity but is only a replacement for other available credit because any such commercial paper would have to be backed-up by other cash. *Id.*, p. 525, l. 1 to p. 526, l. 2.
[280] Ex. 109, p. 11, l. 11-15.
[281] *Id.*, p. 11, l. 19-22.
[282] *Id.*, p. 11, l. 15-18; Tr., p. 528, l. 9-15.

operations exceeded the amount brought in by operations.[283] Because of Ameren Missouri's negative free cash flow at this time, access to credit was essential to Ameren Missouri's continued operation, and if large portions of this credit were to become unavailable, its operations would literally be threatened.[284] In fact, the Lehman Brothers' bankruptcy in September 2008 reduced the $1.15 billion credit facility ($500 million of which was directly available to Ameren Missouri) by $121 million and one-third of the remaining lenders obligated under the facility were rumored to be on the brink of insolvency.[285] As a result, the Company had very real concerns about its ability to rely on its part of the credit facility as a reliable source of capital and had very real concerns about its ability to renew even the existing credit facility; in fact, efforts to replace the reduction in credit from Lehman Brothers' failure with a new lender were unsuccessful.[286] This was the storm of events bearing down on the Company in the fall of 2008. To paraphrase *Associated Natural Gas*, the task confronting the Company was how to avoid the significant damage the Company and its customers might incur if that storm made access to credit even more difficult than it had already become.

B. The Company's decision to preserve cash by reducing capital expenditures—including its decision to slow down the Sioux Scrubber Project—was prudent.

The significance of the Company's inability to meet its day-to-day cash flow needs should the financial crisis worsen was not lost on Company management. As Mr. Birdsong explained, as a company's liquidity position deteriorates, the company will initially experience a loss of counterparty/supplier confidence, receive a downgrade of its credit rating, incur higher interest rates, and be required to post significant collateral.[287] For Ameren Missouri, this could

[283] Tr., p. 152, l. 15 to p. 153, l. 5.
[284] Ex. 109, p. 12, l. 4-8.
[285] *Id.*, p. 12, l. 9-17.
[286] *Id.*, p. 13, l. 1-9.
[287] *Id.*, p. 14, l. 15-20.

result in the loss of its ability to obtain the natural gas or coal supplies necessary to produce electricity.[288] While a non-utility might have the option to curtail its day-to-day operations under these circumstances, an electric utility does not; rather, it is obligated to generate and deliver power to customers.[289] As a result, Ameren Missouri could not "take its chances" in terms of whether it would run out of the cash needed to deliver utility service.[290]

How real was this threat? *

[291]

[292]* Hence, the threat was quite real.

Faced with these facts, Ameren Missouri did what other utility companies did at the time:[293] it investigated ways to reduce near-term expenditures in order to preserve cash. In October 2008, Ameren Corporation and Ameren Missouri investigated ways to reduce capital expenditures by evaluating every capital project and operating and maintenance expense based upon whether the delay or deferral of the expense would negatively impact safety or system reliability, result in noncompliance with legal requirements, and whether it would have more than a minimal impact on the Company's employees.[294] Capital construction projects and operating and maintenance costs for each operating company owned by Ameren Corporation

[288] Tr., p. 517, l. 17-21.
[289] Ex. 109, p. 14, l. 22 to p. 15, l. 2.
[290] *Id.*, p. 15, l. 2-3.
[291] *Id.*, p. 14, l. 1-4; Tr., p. 532, l. 17-24.
[292] Tr., p. 532, l. 12-16.
[293] *Id.*, p. 518, l. 14-18.
[294] *Id.*, p. 443, l. 25 to p. 444, l. 6; Ex. 109, p. 15, l. 16-20.

were identified for potential deferral or delay.[295] Although the Company recognized that many of these project delays would result in an increase in Allowance for Funds Used During Construction ("AFUDC"), Ameren Missouri did not base its analysis on whether it could recover increased AFUDC costs in the future; rather, its analysis was simply whether it could delay or defer a project in order to avoid a situation where it had no cash flow.[296] Projects considered for delay or deferral (which were, in fact, delayed or deferred) included, for example, all major overhauls on the plants, plant upgrades at the Labadie Plant, and work on transformers at the Keokuk facility.[297]

Also on that list was the Sioux Scrubber Project.[298] Why? According to Mark Birk, Vice President of Power Operations for Ameren Missouri,[299] the Sioux Scrubber Project met all of the criteria supporting consideration for delay of the Project: construction was not required at the time for compliance with environmental laws, it did not endanger safety of operations or the reliability of the generating plants, and delay of the Project would have minimal impact on employees.[300] Moreover, it was logical that the Company would consider delaying the Project because it was the single largest construction project for Ameren Missouri at the time, costing Ameren Missouri approximately $17 million each month—much of that in labor costs for outside contractors.[301] Ameren Missouri did not merely rely upon its own internal analysis as to the delay of the Project, however; it also had had its owner/engineer on the Project provide an analysis of the schedule and cost implications associated with a one-year delay of the Project.[302] Because it had no idea how long the financial crisis would last, Ameren Missouri's plan involved

[295] See Ex. 152HC; Tr., p. 464, l. 11 to p. 466, l. 13; p. 482, l. 1 to p. 483, l 24.
[296] Tr., p. 450, l. 6 to p. 451, l. 13.
[297] *Id.*, p. 442, l. 8-20; p. 443, l. 19-25.
[298] Ex. 152HC.
[299] Ex. 106, p. 1, l. 10-11.
[300] Tr., p. 438, l. 17 to p. 439, l. 9.
[301] *Id.,* p. 435, l. 19-25; Ex. 107, p. 17, l. 23 to p. 18, l. 3 (Birk Rebuttal).
[302] *Id.,* p. 480, l. 23 to p. 481, l. 7; p. 485, l. 25 to p. 486, l. 17; Ex. 153HC.

completion of the critical components of the Project currently under construction, followed by a slowdown (at a reduction in spending of approximately $15 million per month) that would become a complete work stoppage if the financial crisis worsened.[303] Based upon its analysis, Ameren Missouri ordered a slowdown of the Project in November 2008.[304] This was not the only project delayed or deferred, however.

Demonstrating the seriousness of the situation, Ameren Missouri put in place a plan in the fall of 2008 to reduce capital expenditures by approximately $420 million through 2009.[305] In Power Operations alone, Ameren Missouri's decision to slow down the Sioux Scrubber Project as well as other capital projects and maintenance resulted in approximately $218 million in savings in 2009.[306] Deep reductions did not just take place for Ameren Missouri. To the contrary, Ameren Missouri's merchant generation affiliate in Illinois also significantly reduced its capital expenditures at this same time—even more than Ameren Missouri, though it is a much smaller company.[307] Although Illinois' environmental regulations required the installation of the scrubber units on its affiliate's Duck Creek and Coffeen plants in order for those plants to continue operation, even construction on the Coffeen plant was slowed down during this time.[308] While the economic situation began to show signs of improvement in early 2009, Ameren continued its efforts to free up cash by reducing its corporate dividend (which was expected to free up an extra $215 million annually) and also reduced executive compensation.[309] As the

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[303] *Id.,* p. 442, l. 23 to p. 443, l. 16; p. 444, l. 23 to p. 445, l. 15.
[304] Ex. 107, p. 17, l. 17-18.
[305] Ex. 109, p. 16, l. 2-9.
[306] Tr., p. 442, l. 8-10.
[307] *Id.,* p. 513, l. 10-16; p. 629, l. 2-6.
[308] *Id.,* p. 200, l. 4 to p. 202, l. 4. The Duck Creek scrubber project was nearly complete and set to be placed into service in January 2009, so there was no opportunity to delay completion of the Project. *Id.,* p. 473, l. 4-8. Moreover, the state requirement that these plants be completed in 2009 was not waived by Illinois, despite Ms. Grissum's assumption otherwise. *Id.,* p. 473, l. 14-19; p. 612, l. 22 to p. 614, l. 11.
[309] Ex. 109, p. 18, l. 8-11.

economic situation began to improve, the very first project that was ramped back up by Ameren Missouri was the Sioux Scrubber Project in late January 2009.[310]

Did Ameren Missouri have any option to increase its liquidity position (other than to reduce capital expenditures) that if not pursued by Ameren Missouri would have made its decision to delay the Sioux Scrubber Project imprudent in light of the global financial crisis? No—at least in Staff's view. *

[311]

[312]* As a result of Staff's vehement opposition to its request and the immediacy of Ameren Missouri's need to immediately improve its liquidity position, Ameren Missouri abandoned the idea of filing a contested filing case before the Commission.[313]

Although Ameren Missouri does not bear the burden of proving that its construction expenses were prudent unless and until Staff has demonstrated a serious doubt as to the prudency of those costs (which it has utterly failed to do), the weight of the evidence clearly demonstrates that Ameren Missouri's decision to delay the Project was prudent. The facts and circumstances known to Ameren Missouri at the time were ominous: the loss of $121 million of the joint credit

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[310] Tr., p. 474, l. 12-18.
[311] *Id.,* p. 507, l. 9-17. Ameren Missouri is unaware of any justification for the Staff's rule restricting a long-term debt request to the outstanding short-term debt, particularly in light of a credit crisis where cash is the best form of liquidity. *Id.,* p. 526, l. 22 to p. 527, l. 3.
[312] *Id.,* p. 552, l. 8 to p. 553, l. 6; p. 574, l. 20-24; Ex. 234HC.
[313] Ex. 109, p. 17, l. 5-13.

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facility and potential loss of an additional approximately $500 million because of the threat that other large lenders, like Wachovia, might too fail,[314] the inability to obtain additional credit as a result of the credit freeze, and the inability to quickly issue long-term debt financing—all while the Company was spending more cash each month than it was taking in. While Ameren Missouri had no idea at the time how long the financial crisis would last, it did know the result of an extended crisis would be an inability to provide service to its customers. There can be no question, then, that Ameren Missouri acted reasonably and prudently in delaying the Sioux Scrubber Project and the other construction and maintenance projects in an effort to preserve cash during the global economic crisis.

C. Staff has utterly failed to create any "serious doubt" as to the prudency of Ameren Missouri's decision to slow down the Sioux Scrubber Project.

In its initial filing in this rate case, Ameren Missouri identified the reason for its decision to delay the Sioux Scrubber Project in November 2008—that it had to defer capital expenditures due to the severe liquidity crisis in the fall of 2008 and early 2009.[315] Even before this, the Staff auditor who conducted the prudency audit of the Sioux Scrubber Project, Roberta Grissum, admitted that she was aware in Ameren Missouri's last rate case that the "driving force" for the Company's delay of the Project was the financial crisis.[316] Before she completed her audit report, Ms. Grissum was provided with even more detail as to the Company's claim that the financial crisis had resulted in a liquidity crisis for the Company.[317]

[314] As Mr. Birdsong testified, fully one-third of the lenders in the credit facility were rumored to be on the brink of insolvency, and Wachovia would have failed had Wells Fargo not rescued it. Exh. 109, p. 12, l. 13-15. Mr. Birdsong also testified that the Company was also specifically concerned about Goldman Sachs, which had $161 million of the credit facility; thus, the situation facing the Company was that Lehman Brother's commitment ($171 million) had been at risk (and $121 million of it was actually lost), Wachovia's ($156 million) was almost lost, and there was also a specific concern about the viability of Goldman Sachs ($161 million), meaning that nearly $500 million of the overall $1.15 billion facility was at risk due to the risk that just those three lenders might fail. Tr., p. 516, l. 1 to p. 517, l. 1.
[315] Ex. 106, p. 20, l. 3-4; Tr., p. 592, l. 20 to p. 593, l. 3.
[316] Tr., p. 593, l. 25 to p. 595, l. 23.
[317] Ex. 156.

Knowing full well that this was the Company's repeated justification for delaying the Project and faced with the decision of whether to challenge recovery of an additional $31 million in costs attributed to that delay, there are at least two very basic – and critical – questions that Ms. Grissum should have asked herself when evaluating the prudency of Ameren Missouri's decision. First, were the financial conditions in the fall of 2008 such that access to credit was a valid concern? Second, did Ameren Missouri have sufficient liquidity that would have allowed it to continue construction of the Sioux Scrubber Project?

Based upon Ms. Grissum's audit report of the Sioux Scrubber Project, one would assume that she investigated those questions. After all, the justification in that report for Staff's proposed disallowance of the delay costs suggested that she had asked and answered those very same questions. In her audit report, Ms. Grissum concluded that Ameren Missouri was wrong—that in spite of the financial crisis, the Company had sufficient access to capital available in its credit facility in the fall of 2008 such that it should not have delayed the Sioux Scrubber Project.[318] This assumption—that Ms. Grissum conducted even a cursory investigation of the facts and circumstances underlying Ameren Missouri's reasoning—is, however, simply wrong.

As difficult as it is to believe, not only did Ms. Grissum fail to have a basic understanding of the global financial crisis that came to a head in the fall of 2008, she hadn't even conducted any investigation into the particulars of that financial crisis at the time she decided to reject the Company's reason for delaying the Project.[319] Ms. Grissum testified that she was not even aware of the specific events of the financial crisis in 2008 until she had read Mr. Birdsong's rebuttal testimony.[320] Although she had some general knowledge that bankruptcies may have been going on at the time, Ms. Grissum denied knowing whether the Lehman Brothers' bankruptcy occurred

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[318] Ex. 200, p. 42, l. 3-11.
[319] Tr., p. 598, l. 21-23.
[320] *Id.,* p. 597, l. 13-20.

at that time.[321] Not only was she unaware of the impact of the financial crisis on credit spreads during the crisis, Ms. Grissum did not even conduct an investigation as to what the market conditions were at the time—in spite of knowing of Ameren Missouri's claim that the financial crisis prevented it from being able to access credit.[322] Even though she asserted in her audit report that Ameren Missouri could have issued long-term debt to obtain additional capital, Ms. Grissum admits that she had not even examined what the interest rates would have been in the fall of 2008 until after she had been asked about them in a deposition just days before the hearing.[323] The stark truth is that the only research that Ms. Grissum conducted that was even remotely related to the financial crisis at the time Ameren Missouri was faced with the decision to delay the Sioux Scrubber Project was her review of Ameren Missouri's own SEC filings so that she could bolster the justification for her disallowance in her surrebuttal testimony.[324]

Ms. Grissum's complete failure to examine and evaluate the depth of the global financial crisis in the fall of 2008 might not have been fatal to her audit recommendation had she at least examined and evaluated the second question—whether Ameren Missouri had sufficient liquidity to continue its operations and still fund the Sioux Scrubber Project at the time. While it is almost incomprehensible, Ms. Grissum also failed to conduct any meaningful evaluation of this question before recommending that the delay costs be disallowed.

In fact, it is not entirely clear that Ms. Grissum even understood this second question. In her audit report, the single paragraph setting out the basis for the disallowance simply concludes that because Ameren Missouri had $540 million[325] in available credit under its credit facility, it

[321] *Id.,* p. 597, l. 21 to p. 598, l. 2.
[322] *Id.,* p. 598, l. 3-8; p. 599, l. 10-14.
[323] *Id.,* p. 622, l. 11 to p. 623, l. 10.
[324] *Id.,* p. 599, l. 5 to p. 600, l. 1.
[325] When she submitted her audit report, Ms. Grissum relied solely on David Murray's calculation of the amount available; much later in the process, Ms. Grissum performed her own analysis and concluded that Ameren Missouri had only $205 million in available credit from the credit facility. *Id.,* p. 600, l. 20 to p. 602, l. 14.

had sufficient credit available to continue the Project.[326] In fact, Ms. Grissum admits that she viewed the question in a very straightforward manner: "Why would the Company add $31 million to a project when they could have continued the project and drawn the $31 million out of the credit facility?"[327] While this question, admittedly, is a simple one; it, at best, belies a very naïve and incorrect understanding of the decision that Ameren Missouri faced at the time.

Perhaps the most basic flaw in Ms. Grissum's thinking is that in the fall of 2008, it was not a question as to whether it could simply withdraw $31 million from its credit facility in order to continue the Project. On the contrary, Ameren Missouri was spending approximately $17 million each month to fund the Sioux Scrubber Project alone, and it hoped to reduce those costs to $2 million each month—if not suspend those costs entirely during the summer of 2009.[328] Although it had no idea how long the financial crisis would continue (and, consequently, no idea that the ultimate delay costs would total $31 million),[329] Ameren Missouri's anticipated savings from the proposed slowdown totaled $15 million each month. Faced with the credit freeze and diminishing liquidity, Ameren Missouri's focus was on whether it could fund the monthly Project expense of $17 million (and not the delay costs) along with its other capital expenditures and maintenance costs, yet still have sufficient cash for operating expenses. Indeed, the question was never—and could never be—whether Ameren Missouri could continue construction simply by drawing $31 million from its credit facility.[330]

An equally simplistic (and incorrect) assumption underlying Ms. Grissum's view of the decision facing Ameren Missouri in November 2008 is her admission that in comparing the delay costs for the Sioux Scrubber Project with the amount of credit available to Ameren

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[326] Ex. 200, p. 42, l. 3-11.
[327] Tr., p. 603, l. 4 to p. 604, l. 2.
[328] *Id.,* p. 443, l. 11-12; p. 457, l. 1-13.
[329] *Id.,* p. 468, l. 6-18.
[330] *Id.,* p. 471, l. 17 to p. 472, l. 16.

Missouri in the fall of 2008, she was only concerned with the cost of the Project itself and not on the other capital expenditures or operating and maintenance expenses Ameren Missouri had at the time.[331] Obviously, Ameren Missouri was not in the business of constructing scrubbers; first and foremost, it is a public utility charged with providing reliable service to its customers. To act otherwise would be patently imprudent. Because the Company must have cash available to operate, the analysis of Ameren Missouri's ability to continue construction of the Project in the fall of 2008 *required* an analysis of more than just the cost to continue that construction, yet Ms. Grissum neither conducted nor considered such an analysis before proposing her $31 million disallowance.

At the time Ms. Grissum proposed her disallowance, she did so because of a belief that Ameren Missouri's stated liquidity concerns did not justify the slowdown; however, she freely admits that she had no idea what Ameren Missouri's cash needs were at the time.[332] When she adopted the paragraph drafted by Mr. Murray that she used in her audit report to justify the disallowance, she had no idea whether Mr. Murray had performed a liquidity analysis; in fact, she didn't even think that she needed to know if Mr. Murray had performed such an analysis (he hadn't).[333] Totally lacking any knowledge about the Company's liquidity needs at the time and totally lacking any knowledge about Ameren Missouri's ability to access capital during the financial crisis,[334] Ms. Grissum still maintained that her proposed disallowance was appropriate.

At the evidentiary hearing, however, Ms. Grissum faulted Ameren Missouri for not providing her with a liquidity analysis to support its decision to delay—something she had not

[331] *Id.,* p. 604, l. 7-20.
[332] *Id.,* p. 605, l. 23 to p. 7; p. 608, l. 10 to p. 609, l. 2.
[333] *Id.*, p. 542, l. 5-12; p. 606, l. 8 to p. 608, l. 9; p. 621, l. 11 to p. 622, l. 10.
[334] Similarly, Ms. Grissum's reliance on the Company's issuance of long-term debt in March 2009 and common equity in September 2009 is equally irrelevant to the Company's ability to do so in November 2008 when it needed the cash. Ex. 109, p. 4, l. 12-14; p. 18, l. 13-18.

even told the Company she needed until six days before the hearing.[335] Ms. Grissum admitted, however, that when she actually read the Company's responses to Staff data requests (at the request of the Company's attorney), she discovered that Ameren Missouri had indeed provided Staff with a liquidity analysis, an analysis of the various projects and expenses being considered for deferral, as well as a specific analysis of the delay of the Sioux Scrubber Project.[336] This was the same liquidity analysis Ms. Grissum claimed to have been looking for, and it was an analysis which demonstrated that the Company would run out of cash by the second quarter of 2009.[337]

Despite these facts and the fact that she had not performed a liquidity analysis of her own and the fact that she had had not identified a single capital project, any operations expense or maintenance cost that she believed the Company could have deferred or delayed so that it could continue funding the Sioux Scrubber Project, Ms. Grissum remained convinced that Ameren Missouri's liquidity concerns did not justify slowdown of the Project.[338] Ms. Grissum never explained at the evidentiary hearing why she remained so convinced; indeed, it is unclear what argument Staff is left with to support the proposed disallowance other than a stubborn and unsupported adherence to a position the evidence shows was never justified in the first place. Stubborn adherence to an opinion held in contradiction of known facts, however, can never create doubt—let alone serious doubt—as to the prudency of Ameren Missouri's decision to delay the Sioux Scrubber Project. Because Ms. Grissum has failed to offer evidence to create this serious doubt, Ameren Missouri's decision retains its presumption of prudence, and this Commission has no basis to disallow the costs associated with the delay of the project.

[335] Tr., p. 610, l. 6 to p. 612, l. 15; p. 638, l. 16 to p. 641, l. 19.
[336] *Id.,* p. 627, l. 21 to p. 628, l. 23; p. 630, l. 9 to p. 631, l. 23.
[337] Ex. 109, p. 14, l. 1-4; Tr., p. 532, l. 17-24.
[338] Tr., p. 605, l. 14 to p. 606, l. 7,

D. The delay of the Sioux Scrubber Project resulted in a benefit to the ratepayer that negated the additional cost of that delay.

While the Company is under no obligation to prove an affirmative benefit from the delay, indeed, the existence of such a benefit is irrelevant to whether the Company's decision to slow down the project was prudent, the Company has established that such a benefit did exist, in response to a request for information from Commissioner Kenney.

That benefit arises from Ameren Missouri's ability (though unanticipated in November 2008) to take advantage of lessons it learned from the construction and operation of the other scrubber projects already in-service due to its decision to delay the Project. After the Duck Creek and Coffeen scrubbers were placed in service, the flake glass lining used in the interior of the absorber units experienced failures.[339] The flake glass linings, a type of spray-on coating, failed almost immediately after those scrubbers began operation, allowing the potential for corrosion of the underlying steel structure.[340] Because the delay of the Sioux Scrubber Project had resulted in a delay in the installation of this same lining in the absorbers at Sioux, Ameren Missouri made the decision to replace the flake glass lining with a Stebbins Tile lining.[341] As a result, the Sioux Scrubber Project benefitted from having a "beefier" lining which would result in less maintenance and better operation of the scrubber because it had less temperature restriction.[342] In addition, the flake glass lining has an expected life of only 10 years, while the Stebbins Tile lining is expected to last the life of the scrubber unit – through 2033 rather than 2020.[343] Even Staff agreed that this decision was a prudent one.[344]

[339] Ex. 106, p. 16, l. 3-9; Tr., p. 446, l. 2-12.
[340] Tr., p. 447, l. 1-16,
[341] *Id.,* p. 446, l. 13-20; p. 447, l. 17-20.
[342] *Id.,* 447, l. 17 to p. 448, l. 4.
[343] *Id.,* 448, l. 5-11.
[344] *Id.,* p. 478, l. 10-13; p. 509, l. 25 to p. 510, l. 21.

As noted, at the evidentiary hearing, Commissioner Kenney requested that the Company attempt to quantify the savings related to the decision to replace the flake glass lining with a Stebbins Tile lining.[345] Exhibit 155, submitted by Ameren Missouri and admitted into evidence without objection,[346] set out the savings the Company realized simply by not having to replace the flake glass lining:

Cost Savings Realized by Change to Stebbins

Cumulative Present Worth of Revenue Requirements to Replace Flake Glass Lining

FORWARD PRICE CURVE		FIXED AT 2016	NOT FIXED
2022 (YR 12)	U1	$15,761,522	$17,509,020
	U2	$14,739,162	$15,825,409
		$30,500,684	$33,334,429
2026 (YR 16)	U1	$12,138,769	$15,907,195
	U2	$11,361,440	$14,375,061
		$23,500,209	$30,282,256
2030 (YR 20)	U1	$ 9,356,876	$16,267,030
	U2	$ 8,765,862	$16,515,413
		$18,122,738	$32,782,443

Assumes liner replacement required prior to 30-year life of scrubbers due to performance issues.

This exhibit depicts the cumulative present value of various revenue requirements necessary to maintain the Sioux scrubbers by replacement of the flake glass lining, which is no longer necessary due to the change to Stebbins Tile.[347] The “Fixed” column shows the cumulative present value revenue requirement impact associated with replacement costs, which ranges from $30.5 million down to $18.1 million (in 2011 dollars) based upon the conservative assumption that power prices remain fixed or constant after the year 2014, depending on when the replacement occurs.[348] The “Not Fixed” column portrays the more realistic assumption—that power prices do not remain constant during this same time period. This more realistic assumption results in a cumulative present value revenue requirement impact associated with

[345] *Id.,* p. 448, l.12-13; p.
[346] *Id.,* p. 2619, l. 8-9.
[347] Docket Item No. 376, ¶ 2.
[348] *Id.,* ¶ 3.

replacement costs (in 2011 dollars) ranging from $33.3 million down to $30.3 million—again depending on when that replacement occurs.[349]

Assuming the most likely scenario—that the lining would have required replacement at least one time in order to maintain operation of the Sioux scrubbers and that power prices will not remain fixed after 2014—the costs associated with the decision to delay the Sioux Scrubber Project in November 2008 were, for all practical purposes, entirely negated by the savings resulting from the Company's decision to switch to the Stebbins Tile lining. Staff witness Murray believed that if there was a savings as a result of the switch in excess of the Staff's $31 million proposed disallowance, he would no longer support the disallowance of the delay costs.[350] Similarly, Staff witness Grissum also agreed that if the savings achieved by replacement with Stebbins Tile exceeded $31 million, she would not recommend disallowance of the delay costs.[351] This only makes sense. Even if Staff had been able to offer evidence creating a serious doubt that the delay costs were imprudently incurred, it would be illogical to disallow these costs where the ratepayer received a similar benefit made possible only because of that delay.

Given that the November 2008 decision to delay the Sioux Scrubber Project was prudent and resulted in the unexpected benefit to the ratepayer of savings ranging from $30 million to $33 million this Commission has absolutely no reason to disallow the delay costs. Consequently, Staff's proposed disallowance should be rejected in its entirety.

In summary, there is no evidence that creates a serious doubt about the presumptively prudent decision to slow down the Project in the face of the Global Financial Crisis in late 2008, which means that the Commission has no basis whatsoever to disallow any of the $31 million

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[349] *Id.*, ¶ 4.
[350] Tr., p. 565, l. 12 to p. 566, l. 3.
[351] *Id.*, p. 633, l. 3-12.

cost of that delay. Moreover, the Company's virtually un-rebutted evidence affirmatively demonstrates that its decision was prudent in light of the circumstances the Company faced, and given the tasks the Company had to perform in the face of those circumstances. Consequently, the Company's entire investment in the Project should be included in rate base.

IV. FUEL ADJUSTMENT CLAUSE.

The only fuel adjustment clause issues remaining in this case are (a) whether the Commission should change the sharing mechanism under the Company's FAC from 95%/5% to 85%/15% as recommended by Staff witness Lena Mantle and OPC witness Ryan Kind, (b) whether the recovery period under the FAC should be reduced from 12 months to 8 months, as recommended by Ms. Mantle and Company witness Lynn Barnes, and (c) whether a provision that expressly recognizes the ability of the Commission to correct errors in FAC true-up proceedings should be added to the FAC tariff as recommended by Ms. Barnes.

A. The FAC Sharing Percentage Should Remain 95%/5%.

Since the FAC was first approved for electric utilities in Missouri, the Commission has consistently required every Missouri utility utilizing an FAC to share in 5% of the changes in fuel costs, whether they be increases or decreases. The Commission has indicated that it has adopted this sharing mechanism because by allowing 95% of the changes in fuel costs to pass-through the FAC, the utility is protected from extreme fluctuations in fuel and purchased power costs, yet it retains an incentive to take all reasonable actions to keep fuel and purchased power costs as low as possible, while still having a reasonable opportunity to earn a fair return.[352] The sharing percentage supplements the powerful incentives inherent in the operation of FACs in Missouri, including the mandated, regular prudency reviews and the Commission's inherent

[352] *See, e.g., In re: KCP&L-GMO*, *Report and Order*, Case No. ER-2010-0356 (May 4, 2011), p. 209.

authority reflected in Senate Bill 179 to take away an FAC from any electric utility that engages in consistently imprudent behavior.

In this case, Ms. Mantle argues that the sharing percentage should be increased to 85%/15% as an "experiment" to see whether increasing the percentage will change Ameren Missouri's behavior.[353] Ms. Mantle admits that she doesn't know whether the current sharing percentage already provides Ameren Missouri with sufficient incentive, and she does not know whether the use of a different sharing percentage would have changed the Company's behavior in the past.[354] Most significantly Ms. Mantle acknowledges that the Staff has no reason to believe the Company has entered into any imprudent transactions related to its FAC in the more than two years that it has been in existence. In response to questions from Ameren Missouri attorney Lowery, Ms. Mantle provided the following testimony:

> Q: And putting aside the issues in the EO-2010-0255 docket, Staff's prudence report in that first prudence review alleges no imprudent behavior on behalf of the Company. Correct?
> *A. Other than the—what is in that docket, that's correct.*
>
> Q. So no imprudence regarding coal or coal transportation, purchasing, procurement. Correct?
> *A. That's correct.*
>
> Q. No imprudence regarding natural gas expense or any other fuel for generation. Correct?
> *A. That is correct.*
>
> Q. No imprudence regarding purchased power energy costs or –or off-system sales. Correct?
> *A. That is correct.*
>
> Q. No imprudence regarding the way it's managed its plant outages. Correct?
> *A. That is correct.*
>
> Q. And the report addressed all of the issues I just walked through with you. Correct?
> *A. The report—what are you referring to as "the report"?*

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[353] Tr., p. 1577, l. 17-23.
[354] Tr., p. 1575, l. 6-12; Tr., p. 1576, l. 23 to p. 1577, l. 5.

Q. The – the prudence report in that docket—in that prudence review docket addressed all of those areas that we just talked about. Correct?
A. The Staff report—

Q. Yes.
A. --addressed all—all those, yes.

Q. All those areas. Right? Just so the record's clear?
A. *Yes.*[355]

Commissioner Jarrett addressed generally a similar issue with Ms. Mantle:

Q. Can you –can you point me to any time in the past since the fuel adjustment clause has been in effect that Am—that Ameren has made an imprudent purchase of fuel?
A. No.

Q. And has Staff done audits to look into the prudence of purchasing fuel?
A. They've done an audit of the first seven months.

Q. All right. And did Staff conclude that Ameren's purchase of fuel during those seven months was prudent?
A. Yes.[356]

In the absence of any showing of imprudence on the part of the Company, and when the evidence in fact affirmatively shows that the Company has been completely prudent in managing its net fuel costs, there is neither any basis for the Commission to "experiment" by adjusting the sharing percentage, nor is there any competent and substantial evidence to support engaging in such an experiment.

The evidence also shows that increasing the sharing percentage would have several negative consequences. For one thing, since, despite the Company's efforts, net fuel costs are increasing, increasing the sharing percentage is tantamount to a disallowance of the Company's actual fuel costs without any showing of imprudence on the part of the Company. Ms. Barnes testified that over the 12 months ended February 28, 2011, the Company was required to absorb

[355] Tr., p. 1575, l. 17 to p. 1576, l. 22.
[356] Tr., p. 1691, l. 14 to p. 1692, l. 1.

$7.5 million in net fuel costs under the existing 5% sharing mechanism. If the sharing percentage had been 15% as Ms. Mantle proposes, the amount of the Company's "share" would have been an *additional* $15 million (for a total of $22.5 million) during that twelve month period.[357]

At the hearing, Ms. Mantle herself conceded that her "experiment" would be an expensive one indeed.[358] She testified that had her proposed sharing percentage been in place during the first 23 months of the operation of the FAC, the Company would have absorbed an *additional* $22 million beyond what it absorbed under the 5% sharing.[359] There is absolutely no justification for requiring the Company to absorb prudently incurred net fuel costs of this magnitude without any showing of imprudence.

Although in theory the sharing percentage could permit the Company to share in the benefit of net fuel cost decreases, as a practical matter, because of the way net fuel costs are calculated, that is much less likely to happen. Specifically, because base fuel costs are set to reflect historical costs, they do not include scheduled cost increases for coal, coal transportation, nuclear fuel and other fuel costs that the Company experiences as time passes.[360] Also, since power prices have sharply declined in recent years, the use of a three-year average of power prices to model off-system sales revenues virtually guarantees that the Company will be unable to achieve the level of off-system sales baked into base rates.[361] As a consequence, increasing the Company's sharing percentage simply means that the Company will have to absorb more of its legitimate fuel costs.

[357] Ex. 103, p. 8, l. 14-23 (Barnes Rebuttal).
[358] Tr., p. 1577, l. 21-23.
[359] Tr., p. 1583, l. 3-16; Ex. 166.
[360] Ex. 103, p. 8, l. 7-10.
[361] Ex. 103, p. 8, l. 2-7.

As Ameren Missouri witness Gary Rygh[362] has testified, increasing the sharing percentage with no showing of imprudence would be viewed very negatively by investors, particularly when most jurisdictions have FACs with no sharing at all.[363] Mr. Rygh testified:

> The concern with the Commission adopting the FAC sharing mechanism modification recommended by Mrs. Mantle is that it will communicate several very negative impressions to investors, including: (1) that the Commission is not concerned about the volatility and operational/financial difficulties created for Ameren Missouri by fuel cost changes; (2) that the Commission has little regard for regulatory certainty and stability in Missouri; (3) that the Commission does not believe Ameren Missouri deserves the opportunity to earn a fair return on capital; and, most concerning, (4) that the Commission must believe that Ameren Missouri is not prudently managing its fuel and purchased power costs and off-system sales, or has some other reason to make a severely negative modification to the FAC.[364]

These investor issues will limit Ameren Missouri's access to capital and increase the cost of capital to the ultimate detriment of customers if the sharing percentage is increased.

The Commission's very recent decision in the KCP&L-GMO rate case, addressed an experiment similar to that proposed by Ms. Mantle, and the Commission's decision in that case is instructive. There, the Staff argued that the sharing percentage should be increased from 95%/5% to 75%/25%. The Commission rejected Staff's proposal stating:

> 575. Given the lack of findings of imprudence by GMO in its fuel procurement practices, there is no basis for changing the existing FAC and past-through [sic] mechanism so that GMO is not able to pass through to its customers 95% of its prudently incurred fuel and related costs. [365]

Significantly, Gary Rygh provided similar testimony in that case regarding the reaction of the investment community to any increase in the sharing percentage, and the Commission found Mr.

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[362] Mr. Rygh is a managing director of Barclays Capital, Inc, the investment banking division of Barclay's Bank PLC, a leading global financial institution with over $2.5 trillion of total assets. (Ex. 126, p. 1, l. 4-8 (Rygh Rebuttal)).
[363] Tr., p. 1514, l. 12-14.
[364] Ex. 126, p. 7, l. 10-18.
[365] KCP&L-GMO, Report and Order, *supra*, p. 211.

Rygh's opinion on this issue "authoritative and credible." *Id.* On that subject the Commission made the following finding:

> 574. Given that there is no evidence in the record that GMO has not competently managed its fuel operating expense, the investment community would take a negative view of the proposals before the Commission to change the 95/5 sharing mechanism to 75/25 or 70/30. *Id.*

In light of the Commission's very recent decision in the KCP&L-GMO case, and the similar facts in this case, there is absolutely no basis to increase the sharing percentage for Ameren Missouri's FAC. In fact, Ms. Mantle testified that in Staff's view, KCP&L-GMO needed more incentive than Ameren Missouri as part of its FAC because KCP&L-GMO did not initially propose to re-base its fuel costs in its recent rate case. Consequently, in Staff's view at least there is even more justification to leave Ameren Missouri's sharing percentage at 95%/5% than there is to leave KCP&L-GMO's sharing percentage at that level.

The justifications Ms. Mantle and Mr. Kind have used to support their proposed changes in the sharing percentages are not persuasive. Ms. Mantle complains that Ameren Missouri has had two contested cases regarding its fuel adjustment clause. However, neither case involved any allegation of an imprudent transaction that increased fuel costs. In Case No. EO-2010-0255, the Staff and other parties complained that the Company had misclassified contracts with American Electric Power Operating Companies ("AEP") and Wabash Valley Power Association, Inc. ("Wabash") as long-term requirements contracts and thereby improperly excluded the associated revenues from the FAC.[366] But even the parties adverse to Ameren Missouri in that case acknowledged that it was prudent and appropriate for the Company to enter into those contracts following its loss of load to its largest customer, Noranda Aluminum, Inc., in the January, 2009 ice storm. The existence of this case provides no basis whatsoever to change the

[366] Staff's position was ultimately upheld by a 3-2 vote of the Commissioners.

sharing percentage and is really irrelevant to that issue. The second case cited by Ms. Mantle, Case No. ER-2010-0274, involves a mistake that was made in calculating the Company's initial net base fuel costs at the transmission level rather than at the generation level. This mistake (if not corrected) will cause the Company to absorb approximately $5 million that would have been passed on to customers through the FAC if the mistake had not occurred. Again this case does not involve any alleged imprudent transaction by the Company, and it provides no basis to change the sharing percentage.

Ms. Mantle also initially testified that since Ameren Missouri's off-system sales volumes had declined over the first five FAC accumulation periods even as the average price for off-system sales increased, this might suggest that there is little or no incentive for the Company to reduce fuel costs and make off-system sales.[367] Ms. Mantle also argued that the Taum Sauk Plant's return to service made additional off-system sales possible, presumably making the decline in off-system sales volumes even more inexplicable to her.[368]

The Company's evidence demonstrated that the decline in off-system sales that Ms. Mantle had observed was completely attributable to (a) increased native load sales, including the return of the Noranda load following the ice storm and (b) major scheduled plant maintenance and refueling outages.[369] With regard to the return of the Taum Sauk plant to service, the evidence shows that Taum Sauk is a net *consumer* of power, making fewer megawatt-hours of power available for off-system sales while it is operating.[370] The Company's evidence completely refuted Ms. Mantle's implication that it was not diligently pursuing off-system sales.

[367] Ex. 201, p. 115, l. 5-7 (Staff Report Revenue Requirement and Cost of Service).
[368] Ex. 201, p. 115, l. 16-18.
[369] Ex.125, p. 16, l. 1 to p. 22, l. 17 (Haro Rebuttal); Tr., p. 1606, l. 24 to p. 1607, l. 17.
[370] Ex.125, p. 21, l. 8 to p. 22, l. 5. The power generated by Taum Sauk is typically more valuable than the power it consumes, however, which means that it produces an overall reduction in net fuel costs, 95% of the benefit of which flows to customers.

In the end Ms. Mantle agreed with the Company's testimony on these points,[371] and acknowledged that despite the information she provided in the Staff's direct case she is not contending that the Company lacks incentive to make off-system sales.[372] In short, the evidence in this case demonstrates that none of the arguments initially advanced by Ms. Mantle provide any basis to alter the sharing percentage in the Company's FAC.

Mr. Kind provided one additional argument in support of changing the sharing percentage. He pointed out that the elimination of Ameren's coal pool, whereby Ameren Missouri's coal was pooled with that of an unregulated affiliate, eliminated an incentive that had previously existed to keep coal prices low. While it is true that the coal pool provided Ameren Missouri with one of many incentives to keep coal prices low, Ameren was required to eliminate the coal pool under new FERC rules.[373] Nonetheless, Ameren Missouri still has the same incentives that other electric utilities (that never had a coal pool) have to act prudently in procuring coal under the FAC. Ameren Missouri faces prudence disallowances, the risk that the FAC will be eliminated and a 5% sharing, among other things. The FERC's requirement that coal pools be eliminated provides no basis to change the sharing percentage under the FAC.

B. The Recovery Period Under the FAC Should Be Reduced From 12 to 8 Months.

Ms. Mantle also recommends that the recovery period under Ameren Missouri's FAC be reduced from 12 months to 8 months, and the Company supports this recommendation. Ms. Mantle points out that the current recovery period for The Empire District Electric Company is only 6 months, and although the recovery period for KCP&L-GMO is 12 months, it is twice the length of KCP&L-GMO's accumulation period. If Ameren Missouri's recovery period were reduced from 12 months to 8 months, it would also be twice the length of the Company's

[371] Tr., p. 1606, l. 24 to p. 1607, l. 17.
[372] Tr., p. 1605, l. 23 to p. 1606, l. 1.
[373] Tr., p. 1459, l. 20 to p. 1460, l. 20.

accumulation period. Ms. Mantle points out that reducing the recovery period from 12 to 8 months will help reduce regulatory lag.[374]

MIEC witness Maurice Brubaker opposes reducing the recovery period. He argues that a longer recovery period "has the benefit of moderating the adjustment by spreading out any recovery/refund over a full calendar year." He also argues that "[s]ince there is no way to know in advance during what months of the calendar year over- or under-recoveries will occur, a 12-month recovery period is neutral and avoids concentrating this reconciliation in a shortened period where some classes could have a disproportionate share of usage."[375] Mr. Brubaker's arguments are not persuasive. "Spreading out" the costs just increases regulatory lag for the Company, which, as the Commission knows, is a significant issue. Moreover, a longer recovery period means that more interest will be charged (or credited) to customers, and it is less likely that the same customers who benefitted from the fuel costs will ultimately pay those costs. In addition, a longer recovery period blunts price signals which can encourage customers to conserve energy when fuel costs are high.[376] The importance of sending the right price signal through the FAC was recently again recognized by the Commission, in connection with its discussion of the importance of re-basing fuel costs.[377]

With regard to the issue of certain customer classes having a disproportionate share of usage during certain 8-month periods, Ms. Barnes provided the following table[378] showing sales at the generation level for each customer class during the 12 months of the test year, and three 8-month periods:

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[374] Ex. 201, p. 117, l. 12-p. 118, l. 18.
[375] Ex. 405, p. 14, l. 13-18.
[376] Ex. 104, p. 3, l. 5-14 (Barnes Surrebuttal).
[377] KCPL-GMO, *supra*, pp. 206-210, in particular, ¶563 and Decision – FAC Rebasing. We would also note that greater sharing percentages, such as recommended by the Staff, also reduce the accuracy of the price signal being sent to customers.
[378] Ex. 104, p. 2, l. 1-13, Table 1.

Table 1: Distribution of Sales By Class @ Generation Level for Twelve- and Eight-Month Periods

Customer Class	Twelve Months	Oct-May	Feb-Sept	Jun-Jan
Residential 1(M)	37.8%	38.2%	37.5%	37.7%
Small General Service 2(M)	9.7%	9.7%	9.7%	9.6%
Large General Service 3(M)	22.1%	21.8%	22.3%	22.3%
Small Primary Service 4(M)	9.4%	9.3%	9.5%	9.5%
Streetlighting 5(M), 6(M), and 7(M)	0.6%	0.7%	0.6%	0.6%
Large Primary Service 11(M)	9.9%	9.7%	10.1%	10.0%
Large Transmission Service 12(M)	10.5%	10.7%	10.4%	10.3%

This table shows that there is no basis for Mr. Brubaker's concern that classes will have disproportionate usage during certain 8-month periods. The relative usage of each class does not change significantly regardless of which period is used.

Ms. Mantle's proposal has the benefit of slightly reducing regulatory lag, and it has no significant drawbacks. Consequently it should be adopted.

C. The Company's FAC Tariff Should be Modified to Expressly Recognize the Commission's Ability to Correct Errors in the True-Up.

The Company has proposed to amend its FAC tariff to recognize the Commission's ability to correct errors made in calculating the FAC adjustments as part of the true-up. Staff witness David Roos opposes this modification arguing that it would "open the true-up filings to 'fix' all types of 'errors.'" He also argued that since Staff has only 30 days to review the true-up filing, the addition of this language could result in a delay in returning/billing the difference between what was to be collected and what was actually billed in the accumulation period.[379]

The Company disagrees with Mr. Roos' concerns about this proposed change. First of all, we should be interested in fixing any errors that may occur. It is critical to the Company and

[379] Ex. 225, p. 5, l. 2-6 (Roos Surrebuttal).

its customers that customers be accurately charged only for the prudently incurred cost of net fuel—no more and no less. If an error is discovered it should be fixed, whether it benefits the Company or the customers. This is consistent with Senate Bill 179, which requires that the true-up result is an accurate reflection of the fuel costs tracked in the FAC.

With regard to the timing issue, if an error cannot be resolved within the timeframes allowed for true-up, the Commission can and should allow the "normal" true-up adjustment to be made in a timely manner, and make a further adjustment at a later date to correct any error that is proven. Timing considerations do not justify ignoring errors that would result in customers paying too much or too little for service.

Mr. Roos has provided no persuasive reason not to correct errors as part of the FAC true-up process, and therefore the Company's proposed tariff change should be accepted.

V. PROPERTY TAX EXPENSE.

A. Property taxes associated with the Sioux Scrubbers and the Taum Sauk additions.

As to the question of what amount of property tax expense relating to the Sioux Scrubbers and the Taum Sauk additions should be included in the revenue requirement used to set rates in this case, Ameren Missouri and the Staff are in complete agreement: both parties recommend that the Commission include in rates property tax expense of approximately $10.8 million, an estimate that is based on the property tax rates for each taxing jurisdiction that were in effect for 2010 applied to the January 1, 2011, values of the Sioux Scrubbers and Taum Sauk additions, which will constitute the assessed valuation used for actual property tax bills for property tax due for 2011 that will be issued later this year. MIEC, on the other hand, argues that no property tax expense whatsoever for those plant additions should be included in the revenue requirement in this case. MIEC bases its argument on the fact that the exact amount of 2011

property taxes related to the Sioux Scrubbers and Taum Sauk additions is not currently known and will not be known until Ameren Missouri receives its 2011 tax bills.

Despite the disagreements described above, certain key facts regarding the property tax issue are not in dispute. For example, no one disputes that both the Sioux Scrubbers and the Taum Sauk additions were in service and providing benefits to customers by the end of 2010. There also is no dispute that the value of these plant additions were included in the information Ameren Missouri sent to state and local tax authorities in January 2011 – well before the end of the true-up period in this case – that will constitute the Company's 2011 assessed valuation for property taxes owed for 2011. In addition, there is no dispute that, as required by FERC accounting rules, Ameren Missouri has been accruing on its books since the beginning of this year property tax expense related to these plant additions.[380] And, finally, there is no dispute that the Company's 2011 property tax bill, which will not be issued until later this year, will be based on the value of the Sioux Scrubbers and Taum Sauk additions as of January 1, 2011.[381]

The main issue in dispute is whether the amount of property tax expense associated with these plant additions is known and measureable to a sufficient degree to warrant the inclusion of that expense in the Company's cost of service. MIEC claims it is not because Ameren Missouri will not receive its property tax bills until later this year and will not have to pay those taxes until December 31, 2011.[382] Although, the Company and the Staff concede that the exact amount of property tax payable on the Sioux Scrubbers and the Taum Sauk additions will not be absolutely known until tax bills are received, both these parties argue that a reasonable estimate of Ameren Missouri's property tax liability can be calculated by applying 2010 tax rates to the valuations of

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[380] This means that Ameren Missouri, starting January 1, 2011, must expense on its income statement property tax costs for the Sioux Scrubbers and Taum Sauk additions. Those costs will never be recovered because there will be no property tax expense for those additions reflected in its rates until approximately August 1 of this year.
[381] Ex. 131, p. 2, l. 18 to p. 3, l. 14 (Weiss Rebuttal).
[382] Ex. 400, p. 16, l. 12-16.

those two plant additions that were submitted to taxing authorities in January 2011.[383] They further argue that this estimate, which the Company's witness Gary Weiss characterized as "conservative" based on his belief that 2011 tax rates likely will be higher than those for 2010,[384] is both reasonable and sufficiently known and measureable that it can – and should – be used to set rates in this case.

MIEC's contention that the "known and measureable" standard requires the Commission to know the exact amount of an item expense item before that expense can be included in the cost of service used to set rates elevates form over substance and is contrary to the way in which regulatory commissions, including the Missouri Commission, routinely function. While it might be preferable to know the exact amounts of expense items that are used to set rates, that is not always possible. Therefore, regulatory commissions, including the Missouri Commission, routinely rely on estimates of expenses for ratemaking purposes. For example, the Commission routinely uses normalized levels of expense – *e.g.* normalizations to eliminate the effects of abnormal weather conditions – to set rates. But normalized expenses are merely estimates based on historical averages. Similarly, annualized costs – *e.g.* annualized payroll costs – also are routinely used for ratemaking. But annualizations are merely estimates of the annual amount of an expense based on projections of less than twelve months of actual data. Because normalized and annualized expenses are sufficiently exact to allow them to be included for ratemaking purposes, it would be unreasonable and inconsistent to not similarly rely on the reasonable estimate of property tax expense proposed by Ameren Missouri and the Staff in this case.

MIEC's position regarding property tax expense also should be rejected for two additional reasons. First, based on the standard that MIEC asks the Commission to adopt for the

[383] Ex. 131, p. 3, l. 17-22; Ex. 201, p. 91, l. 7-9.
[384] Tr., p. 1323, l. 4-12.

Sioux Scrubbers and the Taum Sauk additions – that property taxes are not known and measurable until the Company receives its 2011 tax bills – none of Ameren Missouri's 2011 property tax expense is truly known and measureable. But even MIEC has not proposed to exclude *all* property taxes for ratemaking purposes. If the property tax the Company booked in 2010 is sufficiently reliable to allow the Commission to use that amount to estimate future property tax expense for all of Ameren Missouri's other property, why would that same methodology not also provide an equally reliable estimate for the Sioux Scrubbers and the Taum Sauk additions? The Company's 2010 tax expense was based on the valuations it provided to taxing authorities in 2010 and tax rates ultimately set by those same taxing authorities. The estimated tax expense for the Sioux Scrubbers and Taum Sauk additions was calculated in exactly the same manner. In fact, there is no substantive difference for property tax purposes between a pole or a transformer placed in service on the same day as the Taum Sauk additions or the Sioux Scrubbers and the Taum Sauk additions and the Sioux Scrubbers themselves. All of those items of property were serving customers at the end of 2010, they all are part of the 2011 property tax assessment, and the precise amount of tax due on all of them will not be known with absolute certainty until later in 2011 when the taxing authorities actually issue the tax bills.

Second, MIEC's technical arguments to the contrary notwithstanding, the choice the Commission faces in deciding this issue is really between two estimates of what property tax expense will be during the period rates set in this case will be in effect. What the Commission is trying to do is to set rates that will be just and reasonable in the future based upon a reasonable proxy; that is, based upon the trued-up test year revenue requirement, which, as we noted, inherently contains estimates of some items. The Company and the Staff ask the Commission to find that because of the addition of the Sioux Scrubbers and the Taum Sauk additions future property tax expense will be approximately $10.8 million per year more than was actually

incurred in 2010. In contrast, MIEC asks the Commission to find that the Company will owe *no* property tax on these two plant additions in 2011 whatsoever. The correct choice between those alternatives is obvious.

MIEC makes one additional argument against including property taxes related to the Sioux Scrubbers and the Taum Sauk additions that warrants some comment. In his surrebuttal testimony, MIEC's witness, Greg Meyer, argues that the Commission should disallow approximately $10.8 million in property tax expense because "Ameren Missouri filed its case prematurely if it wanted to include the increased estimated property taxes associated with the Sioux scrubbers and the Taum Sauk rebuild in its cost of service."[385] According to Mr. Meyer's argument it would have been prudent for the Company to delay the filing of its rate case for as much as a year in order to know, with absolute certainty, how much additional property tax it would owe for these two plant additions. On its face, MIEC appears to make the absurd argument that Ameren Missouri should have postponed filing a $263 million rate case based on the timing of approximately $10.8 million in additional property tax expense. On closer analysis, however, MIEC's argument is much more absurd than that. Because there can be no reasonable doubt that Ameren Missouri's 2011 property tax bill will include the value of both the Sioux Scrubbers and the Taum Sauk additions, the only real uncertainty with respect to this issue is the difference between actual tax expense, which will be based on 2011 tax rates, and the Company and the Staff's estimated tax expense, which is based on 2010 tax rates. That difference, either above or below the estimated tax expense, most likely will be measured in thousands of dollars, not millions. So, in reality, Mr. Meyer really argues that Ameren Missouri

[385] Ex. 401NP, p. 9, l. 18-20.

should have delayed its rate case filing based on a few thousand dollars of property tax expense.[386]

Based on the foregoing discussion, the question presented to the Commission for decision is whose position on this issue is most reasonable and most consistent with well-established regulatory principles, including the matching principle and the principle that obligates the Commission to set rates based on costs that, as closely as possible, reflect Ameren Missouri's actual experience during the period rates set in this case will be in effect. Only the position advocated by the Company and the Staff is consistent with those principles and obligations. Ameren Missouri's witness Gary Weiss testified that the property taxes at issue in this case represent approximately five percent of the rate increase proposed by the Company. He further testified that if MIEC's position is adopted and more of the tax costs related to the Sioux Scrubbers and the Taum Sauk additions are allowed in rates, the funds necessary to pay those taxes will have to come from earnings. If this happens, Ameren Missouri will not have a reasonable opportunity to earn whatever rate of return the Commission authorizes in this case.[387]

B. Refunds of 2010 Property Taxes.

Ameren Missouri currently is appealing its property tax payments for 2010, and if that appeal is successful the Company will receive a refund of a portion of those payments. Because the Staff recommends that all of the property taxes paid for 2010 be included in the cost of service used to set rates in this case, Staff also recommends that any and all refunds that Ameren Missouri receives as a result of its appeal be returned to ratepayers in a future rate proceeding.[388]

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[386] The Commission should note that even with the current timing of this rate case Ameren Missouri will fail to recover through rates property taxes for the Sioux Scrubbers and the Taum Sauk additions that are attributable to the period from January 2011 through August 2011 when rates set in this case take effect. If Ameren Missouri had delayed filing its rate case until its 2011 property tax bill was received or otherwise could have been taken in to account, it would have had to absorb these unrecovered costs for an even longer time.

[387] Tr., p. 1325, l. 18-25.

[388] Ex. 201, p. 91, l. 10-17.

Because the outcome of its pending property tax appeal is unknown, Ameren Missouri agrees that it should be required to keep track of the amount of any refund it receives. However, the Company does not believe it should be required automatically to return to its customers the full amount of that refund. Instead, Ameren Missouri proposes that no such issues should be considered by the Commission until the tax appeal and all related court appeals are completely and finally adjudicated and that all issues related to any refund should be deferred to a future rate case. At that time the amount of the property tax refund, if any, will be known and the Company and all other parties to the future rate case can fully present all relevant evidence and arguments to the Commission for its consideration and the issue of whether, and under what circumstances, the tax refund should be returned to customers.

VI. ENERGY EFFICIENCY/DEMAND SIDE MANAGEMENT.

Ameren Missouri has demonstrated a strong commitment to energy efficiency over the past several years, as can be seen in the increasing level of investment in energy efficiency that it has made compared to just a few years ago. In fact, Ameren Missouri has taken a major leadership role by launching full-scale energy efficiency programs even before receiving regulatory treatment that aligns the interests of the Company and its customers. Ameren Missouri has reached a point, however, where this level of investment is unsustainable without major changes to the regulatory treatment of its energy efficiency programs. Unfortunately, the current regulatory framework makes Ameren Missouri a victim of its own success in that the successful implementation of energy efficiency causes the Company financial harm. Looking forward, the Company anticipates future investment levels which will allow it to continue its progress towards achieving all cost-effective energy efficiency, but this is dependent upon constructive regulatory treatment that addresses the throughput disincentive associated with

energy efficiency programs.[389] For that progress to continue, Ameren Missouri needs Commission action in this case.

A. Ameren Missouri's current energy efficiency programs.

Ameren Missouri's investment in energy efficiency has been significant and growing. In the years 2008 and 2009, the Company spent approximately $13.5 million while in 2010 it significantly increased that investment to $23 million.[390] That amount grew even more in 2011, with the Company anticipating expenditures of approximately $33 million on energy efficiency programs.[391] Ameren Missouri currently offers five different residential programs and four different business programs,[392] and the Company is on track to meet the megawatt-hour ("MWh") savings goals set forth in its 2008 Integrated Resource Plan.[393] All of these programs have been evaluated and found to provide savings for the Company's customers.[394] In fact, not a single party to this case has proposed that Ameren Missouri programs not be continued. This fact highlights the expectation from all parties to this case that the programs have resulted in savings, will continue to result in savings, have been cost-effective for customers, and will continue to be cost-effective for customers. There is no reason why the Commission should not approve the continuation of Ameren Missouri's programs[395] predicated on the approval of Ameren Missouri's billing unit adjustment mechanism, which is outlined in the pre-filed rebuttal testimony of Ameren Missouri witness William Davis.

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[389] Ex. 110, p. 7, l. 6-10 (Mark Rebuttal).
[390] Ex. 111, p. 4, l. 4-5 (Mark Surrebuttal).
[391] Ex. 111, p. 4, l. 6.
[392] Ex.113, p. 3, l. 7-18 (Laurent Surrebuttal).
[393] Ex. 111, p. 4, l. 7-8.
[394] Ex. 113, p. 4 l. 6-11. The one exception is the Residential HVAC CheckMe! Program, which was not implemented until July of 2010 and so has not yet undergone an evaluation.
[395] Ex. 113, p. 4, l. 21 to p. 5, l. 3.

This is a critical time for Ameren Missouri's energy efficiency programs as all of the Company's electric programs expire on September 30, 2011.[396] This is critical because Ameren Missouri has established momentum in its energy efficiency programs in the marketplace, a momentum the Company does not want to lose.[397] Over the past several years, Ameren Missouri has developed an energy efficiency infrastructure of trade allies, retailers, and manufacturers.[398] The fate of that infrastructure is inextricably linked to the continuation of Ameren Missouri's programs, which is inextricably linked to addressing the throughput incentive in this case. We are also at a time of great change for energy efficiency programs in Missouri. There is now a statute addressing encouragement of energy efficiency in the state, the Missouri Energy Efficiency Investment Act ("MEEIA"),[399] and the Commission has adopted rules to implement MEEIA.[400] Energy efficiency programs in Missouri are in a time of transition and Ameren Missouri needs the Commission's assistance to bridge this transition in a manner that supports the continuation of the Company's energy efficiency programs.

B. The throughput disincentive.

At this time, the most critical barrier to utility energy efficiency efforts is the throughput disincentive.[401] The throughput disincentive is the factor that currently prevents the alignment of company and customer interests as referenced in MEEIA.[402] As Mr. Davis testified:

> Under traditional ratemaking, if electricity sales increase beyond those used to develop the utility's rates, the utility keeps the additional revenue. This creates an incentive for the utility to maximize the "throughput," or sales. Typically the additional revenues are not simply a bonus to the utility but rather an offset to the rising costs of service, like wages and general material costs, between rate cases. Thus, a traditional ratemaking system does not align the utility's financial

[396] Ex. 113, p. 4, l. 12-15.
[397] Ex. 113, p. 6, l. 21-22.
[398] Ex. 113, p. 2, l. 6-8.
[399] § 393.1075 RSMo.
[400] See File Number EX-2010-0368.
[401] Ex. 111, p. 5, l. 20 to p. 6, l. 4.
[402] § 393.1075.3 RSMo.

> incentives with helping customers use energy more efficiently, because cost recovery and fair returns on investment are achieved by selling volumes of electricity.[403]

Traditional ratemaking creates a strong disincentive for the utility to engage in any activity that could reduce sales, like promoting energy efficiency programs. As Ameren Missouri witness Richard Mark testified, "Every time a utility invests in an energy efficiency program, it is spending money to persuade its customers to use less of its product. So every megawatt-hour of savings that an effective energy efficiency program generates is a lost sale for the utility."[404] No party in this case disputes the existence of the throughput disincentive. In fact, Staff witness John Rogers agreed the throughput disincentive exists,[405] that it negatively impacts utility revenues,[406] and that it discourages the aggressive promotion of energy efficiency.[407] This disincentive is not insignificant. Mr. Davis testified that the Company will have lost $15 million between 2009 and the effective date of new rates in this case.[408]

Load growth does not resolve this problem. Mr. Rogers testified that he had no reason to dispute Mr. Davis' findings that 80% of Ameren Missouri's load growth is from new customers and he agreed that the costs associated with that load growth are not included in the Company's current revenue requirement.[409] The remaining 20% consists mostly of growth in the industrial class, which was identified as an uncertain factor in Ameren Missouri's forecast.[410] It is true that new customers bring in additional revenues which would offset some of those additional costs, but this was explained by Mr. Davis, "There are additional costs associated with adding

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[403] Ex. 114, p. 6, l. 15-23 (Davis Direct).
[404] Ex. 110, p. 3 l. 14-16.
[405] Tr., p. 1963, l. 2-4.
[406] Tr., p. 1963, l. 5-7.
[407] Tr., p. 1963, l. 8-11.
[408] Ex. 115, p. 4, l. 21-22 (Davis Rebuttal). The key is the MWh saved and not the expenditure level. The Company's billing unit proposal is calculated on MWh saved, so the commitment should be viewed in those same terms.
[409] Tr., p. 1965, l. 19 to p. 1966, l. 6.
[410] Ex. 115, p. 3, l. 18-20.

customers to the system, and the additional revenues from customer growth help offset those additional costs. Instituting energy efficiency programs puts the full recovery of those costs at risk by reducing revenues collected from customers."[411] When trying to address the throughput disincentive, however, the load growth discussion is a red herring. A reduction in revenue is a reduction in revenue and if the Company didn't offer an energy efficiency program, it would not experience that particular revenue reduction. Mr. Rogers agreed that utility officers have a fiduciary responsibility to consider the revenue impact of expenditure decisions, that Company management cannot prudently set expenditure levels without knowing how those expenditures will be recovered and that Company management must know how the throughput disincentive is (or isn't) resolved before making decisions about energy efficiency.[412] Mr. Mark discussed this dilemma in his surrebuttal testimony.

> From my point of view, as the Senior Vice President in charge of Ameren Missouri's electric and natural gas distribution operations and customer service operations, which includes the Company's energy efficiency programs, when a decision is being made as to what level of funding the Company is willing to commit to energy efficiency, management does not make that decision without first assessing how we believe the investment will impact both the Company and its customers.
>
> Decisions about investments in energy efficiency require assessing tradeoffs between expected utility costs, including how those costs are recovered in the regulatory framework, and benefits to customers. Because of that assessment, the level of funding for energy efficiency programs is highly dependent upon how those costs (including costs associated with the throughput disincentive) will be treated for ratemaking purposes, and how that ratemaking treatment impacts the Company's cash flow and earnings. We cannot commit to spending tens of millions of dollars on energy efficiency programs, which will result in tens of millions of dollars in losses due to the throughput disincentive, until the Commission adopts a regulatory framework that better aligns the interest of our customers and the Company. For the Company to commit to additional funding before knowing how the Commission will remove the throughput disincentive would be poor management, for all the reasons I stated in my rebuttal testimony.[413]

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[411] Ex. 115, p. 3, l. 22 to p. 4, l. 2.
[412] Tr., p. 1966, l. 14 to p. 1967, l. 6.
[413] Ex. 111, p. 2, l. 16 to p. 3, l. 14.

Given the importance of addressing the throughput disincentive, the Company has withdrawn its request to shorten the program cost recovery period from six to three years.[414] At this point in time, addressing the throughput disincentive is clearly the linchpin to the continuation of Ameren Missouri's energy efficiency programs at a meaningful level.

C. Ameren Missouri's Proposal Versus Filing under MEEIA.

This case is the appropriate forum in which constructive action should be taken to offset the throughput disincentive. Presuming the throughput disincentive can be mitigated in this case, the Company proposes to spend approximately $25 million to achieve 136,604 MWh of savings in 2012 and 121,042 MWh of savings in 2013.[415] Without mitigation, if Ameren Missouri were to continue spending $25 million per year on energy efficiency over the next two years, about $53 million of additional revenues would be lost assuming no rate case was filed.[416] Initially, the Company proposed a Fixed Cost Recovery Mechanism[417] but recognized the basic inconsistency between its proposal and the Commission's newly adopted definition of "Lost Revenues" in the MEEIA rules. Accordingly, the Company proposed a billing unit adjustment mechanism designed to address the same throughput disincentive problem but in a way that does not conflict with the Commission's definition of Lost Revenues[418] because it in fact prevents lost revenues from ever occurring in the first place, rather than seeking recovery of them after they take place. This is a significant factual distinction; the billing unit adjustment proactively offsets the throughput disincentive and, accordingly, makes the definition of Lost Revenues irrelevant for the purposes of this proposal. This proposal is a reduction to billing units after all rate design

[414] Ex. 111, p. 6, l. 1-4.
[415] Ex. 111, p. 4, l. 10-13.
[416] Ex. 115, p. 5, l. 1-5.
[417] Ex. 114, p. 8, l. 7 to p. 10, l. 19.
[418] Ex. 115, p. 6, l. 7 to p. 7, l. 21.

work has been completed. It lowers residential billing units by 255,285 and business billing units by 226,489.[419] The exact breakout by customer class can be found in Schedule WRD-ES8.

Staff and other parties offered several technical obstacles to the Company's proposal – examples include that the Company hasn't asked for approval under MEEIA,[420] the Commission hasn't hired an independent evaluator,[421] the requested mechanism is different than the treatment granted to Kansas City Power & Light Company ("KCPL"),[422] and the mechanism violates the matching principle.[423]

Other objections raised include the contradictory position taken by Staff, with Mr. Rogers recommending rejection of the Company's billing unit proposal because it did not detail how customers would invoke their right to opt-out;[424] yet, at the same time, Staff witness Ms. Mantle testified that Staff does not have a position regarding whether the billing unit proposal is a "demand-side cost" or a "charge."[425] The answer, of course, is that the billing unit mechanism stems from costs that customers cannot opt-out of paying. Ameren Missouri witness Mr. Davis testified that the throughput disincentive is not an additional charge associated with energy efficiency but is rather revenue the Company would collect under traditional ratemaking without energy efficiency programs.[426] In addition, Ms. Mantle opined on the stand a concern about how class cost of service allocations would be impacted by the billing unit proposal[427] without acknowledging that Staff is not proposing the Commission establish rates consistent with the class cost of service studies in the case. Ameren Missouri has also testified that the net base fuel costs should remain unaffected by the billing unit reduction. As Company witness Mr. Davis

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[419] Ex. 116, Schedule WRD-ES8 (Davis Surrebuttal).
[420] Ex. 303, p. 7, l. 18-20 (Kind Surrebuttal); Ex. 222, p. 6, l. 36-39 (Rogers Surrebuttal).
[421] Ex. 303, p. 8, l. 1-34.
[422] Ex. 303, p. 11, l. 27-33.
[423] Ex. 420, p. 4, l. 16-17 (Brosch Supplemental Direct).
[424] Ex. 246, p. 7, l. 17-18 (Rogers Supplemental Direct).
[425] Ex. 247, p. 8, l. 3-4 (Mantle Supplemental Direct).
[426] Tr., p. 1890, l. 16-23 and p. 1891, l. 7-15.
[427] Tr., p. 2003, l. 6-17.

explained during oral testimony, the throughput disincentive is about the effects of utility-run energy efficiency programs and the associated forgone collection of fixed costs through volumetric rates. The concept is simply not applicable to variable costs being collected through a fuel adjustment clause.

Finally, there is the objection of OPC witness Ryan Kind to the Commission awarding Ameren Missouri treatment which is different than that given to Kansas City Power & Light in their last rate case, Case No. ER-2010-0355.[428] For the basis of his argument, he quoted the following portion of the Commission's Report and Order in that case:

> The Commission concludes that the continuance of the DSM programs is in the public interest as shown by the customer participation and clear policies of this state to encourage DSM programs. **In the absence of a clear proposal for a cost recovery mechanism and during the gap between the end of the true-up for this case and the implementation of a program under MEEIA**, the Commission concludes that the Companies should continue to fund and promote or implement, the DSM programs in the 2005 Agreement (KCP&L only), and in its last adopted preferred resource plan (both KCP&L and GMO). In addition, the Commission directs that those costs be placed in a regulatory asset account and be given the treatment as further described below. (Emphasis added.)[429]

What Mr. Kind overlooked is the dramatic difference between the record in the KCPL case and the current Ameren Missouri case. The sentence in bold is the key – KCPL did not request treatment different than what the Commission approved. Ameren Missouri has been very clear in identifying the problems it needs the Commission to address and the mechanism it requests to resolve those problems. In that sense, the quote above should be read to lend support to Ameren Missouri's billing unit mechanism rather than as a reason to reject the Company's proposal.

Despite all of these objections, no party testified the billing unit adjustment mechanism *couldn't* work, only that there was some "technicality" that stood in the way of the Commission approving it at this time. Ameren Missouri does not agree with most of the objections that have

[428] Ex. 303, p. 11, l. 1-11.
[429] ER-2010-0355, *Report & Order*, April 12, 2011, p. 91.

been raised but if there is a technicality that needs to be addressed, the Commission has the ability to address it. The Commission can: approve the programs under MEEIA or waive whatever portion of the MEEIA rule the Commission believes conflicts with the billing unit proposal. This is analogous to other steps the Commission sometimes takes, such as making adjustments beyond the test year in order to give the utility a reasonable opportunity to recover its prudent costs.[430] The important point is that the Commission can better align the interests of the Company and its customers when it comes to energy efficiency by giving the Company the tools it needs to be able to continue to pursue energy efficiency; that is, by approving in this case the billing unit adjustment mechanism the Company has proposed.

Staff recommends that the Commission do nothing in this case and, rather, that Ameren Missouri be required to make a separate filing under the new MEEIA rules.[431] This proposal only pushes off any potential resolution of the throughput disincentive issue and, as a result, is not sufficient to keep Ameren Missouri's energy efficiency programs funded at the $25 million level. First, as Mr. Rogers conceded, a MEEIA filing cannot be completed in time to prevent Ameren Missouri's current programs from expiring on September 30, 2011.[432] Second, the Commission's MEEIA rules do not allow for changes in rates outside of a rate case except for the recovery of program costs themselves.[433] This means the most critical impediment to continued funding of the Company's energy efficiency programs, the throughput disincentive, could not be remedied in a MEEIA filing in a manner that corrects for the throughput disincentive on a going-forward basis. Rather, the Company would have to wait until another

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[430] See Case No. ER-2010-0316, *Report and Order,* p. 57. "The matching principle is important, but the ultimate purpose of a test year is to establish rates that will give a utility a reasonable opportunity to recover its prudent costs during the period when the rates are in effect. Allowing AmerenUE to recover its increased fuel costs in its base rates is necessary to allow the company a reasonable opportunity to recover its prudent costs."
[431] Ex. 221, p. 2, l. 22 to p. 3, l. 5 (Rogers Rebuttal).
[432] Tr., p. 1976, l. 24 to p. 1977, l. 14.
[433] 4 CSR 240-20.093(4).

rate case is concluded to implement whatever mechanism was approved by the Commission. Finally a MEEIA filing does not provide Ameren Missouri management with the timely information necessary to make a decision on what level of energy efficiency investment it can make after September 30th. That missing piece of information is, of course, the knowledge of how the throughput disincentive will be addressed. Ameren Missouri's proposal is the only constructive proposal in the case. Rather than waiting and hoping that the next filing will present a solution, the Commission should act now. Issues of program timing and the Commission's own rules make this rate case the only viable vehicle for addressing the treatment necessary to extend the Company's energy efficiency programs beyond September 30, 2011.

D. All cost effective energy efficiency.

MEEIA sets a goal of all cost-effective energy efficiency,[434] but does not define what is "all cost-effective." Neither do the Commission's MEEIA rules. Mr. Mark defined "all cost-effective" as meaning the programs are cost-effective for both customers and utility shareholders.[435] Mr. Mark explained, "The cost-effectiveness to customers is primarily measured by the Total Resource Cost (TRC) test while the cost-effectiveness to shareholders is largely measured by how well utility financial incentives are aligned with helping customers use energy more efficiently."[436]

Other parties appear to believe all cost-effective requires expenditures geared toward achieving the Realistic Achievable Potential ("RAP") levels of MWh savings.[437] The fatal flaw in this belief is that it overlooks the immediate and negative impact of achieving this savings upon the utility's revenues, the throughput disincentive. Ameren Missouri's interpretation is the

[434] § 393.1075.4 RSMo.
[435] Ex. 111, p. 4, l. 21 to p. 5, l. 1.
[436] Ex. 111 p. 5, l. 1-4.
[437] Ex. 222, p. 3, l. 1-10 (Staff); Ex. 303, p. 7, l. 11-17 (OPC); Ex. 802, p. 6, l. 10-13 (Wolfe Surrebuttal) (MDNR).

only view which aligns the interests of the utility with that of helping its customers use energy more efficiently – the alignment of interests required by MEEIA.[438]

Significantly, it should be noted that if Ameren Missouri spends $25 million on energy efficiency, it will be taking another meaningful step towards achieving RAP levels of MWh savings.[439] $25 million represents 75% of the investment needed to achieve RAP in 2012.[440] Ameren Missouri understands that some parties would prefer the Company jump in with a full-fledged proposal containing all of the elements needed to fully pursue RAP.[441] As Mr. Baxter testified, the Company is still in the early stages of its energy efficiency efforts and will apply the lessons it learns as time progresses.[442]

E. Rate design modification.

The MEEIA statute contains language prohibiting the Commission from implementing a "rate design modification" before it "…conclude[s] a docket studying the effects thereof…."[443] Surprisingly, in answer to a question about this portion of the statute from Commissioner Kenney and in answering cross examination questions from Ameren Missouri, Staff witness Ms. Mantle opined that *anything* that impacts rates is a rate design modification:

> Q. (by Commissioner Kenney) I have one question about the proposed billing units adjustment, and I asked Mr. Rogers if he would characterize it as a rate design modification, so I want to ask you the same questions. Would you characterize it as a rate design modification?
> *A. To the extent that it modifies the rates that would be implemented, yes.*
>
> Q. (By Ms. Tatro) Ms. Mantle…Commissioner Kenney just asked you about the rate design modification. Do you recall that question?
> *A. Yes.*
>
> Q. And your answer was, If it modifies rates, yes.

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[438] § 393.1075.3 RSMo.
[439] Ex. 110, p. 7, l. 6-10.
[440] Ex. 111, p. 4, l. 10-13.
[441] Ex. 201, p. 43, l. 6-12.
[442] Tr., p. 225, l. 11-24.
[443] § 393.1075.5 RSMo.

A. Right.

Q. So wouldn't any input, under your definition, modify rates?
A. I'm sorry. Any input?

Q. If you change the revenue requirement, it's going to modify rates, wouldn't it?
A. *Yes*.

Q. Isn't the revenue requirement different than rate design?
A. Revenue requirement is part of rate design.

Q. So the cost of service study submitted by Staff is part of rate design?
A. You can't do rate design unless you know how much revenue you're going to recover.

Q. So you define rate design so broadly as to encompass to include anything -- anything in this hearing?
A. It changes revenue that requires a change in the rates. That can be rate modification, yes. Rate design -- it doesn't -- it doesn't change whether we put a demand charge in or put different blocks in, but it is modifying the rate.

Q. So the level of off-system sales you consider a rate design modification?
A. If it changed, yes.

Q. The level of incentive compensation allowed in rates is a rate design modification.
A. It changed the level of rates, yes.

Q. Any input
A. Yes.[444]

Ms. Mantle's interpretation of the phrase "rate design modification" is nonsensical to the point of rendering the clause in the statute essentially meaningless. Unless the Commission believes the legislature intended that no utility recover any energy efficiency expenditure until the Commission opened a docket to study every possible rate input, Ms. Mantle's absurdly broad definition of rate design must be disregarded. Additionally, Ms. Mantle's willingness to make, and repeat multiple times, the statement that everything in a rate case qualifies as a rate design modification is a perfect illustration of the unwillingness of Staff to work with utilities to find a

[444] Tr., p. 2019, l. 24 to p. 2021, l. 6; p. 220, l. 15 to p. 2022, l. 1.

constructive resolution and of its apparent desire to simply throw up every conceivable roadblock, even ones that risk the credibility of their own testimony. When other witnesses were asked by Commissioner Kenney if Ameren Missouri's proposal was a rate design modification, not a single witness testified that the proposal was a rate design modification; nor did a single witness, besides Ms. Mantle, testify that incentive compensation changes qualified as a rate design modification.[445]

Ameren Missouri's billing unit proposal is not a rate design modification, as it simply accommodates the fact that the revenue requirement needs to be collected over less billing units. In this regard, Ameren Missouri is "normalizing" for the effects of its energy efficiency programs, akin to weather normalizing or annualizing test year sales. In short, the billing unit proposal has no impact on the structure of how revenues are mechanically collected from customers nor on the portion of the total revenue requirement being collected from the various charge types; i.e., it does not change the allocation of the revenue requirement between the various rate classes.

VII. VEGETATION-INFRASTRUCTURE TRACKERS/STORM COSTS.

A. Continuation of Trackers.

Following the adoption of comprehensive rules prescribing minimum standards applicable to investor-owned electric utilities in Missouri for infrastructure and vegetation management and reporting,[446] the Commission, in Case No. ER-2008-0318, first authorized Ameren Missouri to implement a two-way tracker mechanism for the costs and expenses the Company would incur to comply with those rules. In its *Report and Order* in that case, the Commission explained its rationale for the tracker as follows:

[445] Tr., p. 2028, l. 1-8; Tr., p. 1986, l. 21-24.
[446] 4 CSR 240-23.020 and 4 CSR 240-23.030.

> [B]ecause 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 will ensure it does not under-recover those expenditures. Thus, the risk for ratepayers, as well as for AmerenUE, is reduced by the operation of the tracking mechanism.[447]

In Case No. ER-2010-0036, both the Staff and MIEC argued that the tracker mechanism no longer was necessary, but the Commission rejected those arguments and authorized Ameren Missouri to retain the tracker. The Commission noted that not all of the Company's circuits had yet been trimmed to meet the new standards, which made retaining the tracker necessary:

> [B]ecause every circuit is unique, with different amounts of vegetation that must be trimmed, and requires a different amount of work to meet the standards imposed by the rule. Therefore, it is still difficult to predict what AmerenUE's normal level of vegetation management expenses will be. The same is true for AmerenUE's efforts to comply with the infrastructure inspection rule.[448]

Based primarily on this finding, the Commission concluded that "[b]ecause there is still a great deal of uncertainty about the amount of spending needed to comply with the rules" the tracking mechanism should be continued.[449]

Ameren Missouri asks the Commission to allow the Company to continue the infrastructure and vegetation management tracker currently in place, and the Staff concurs with that request. MIEC is the only party that argues that the tracker should be discontinued. But a fair consideration of all of the evidence presented on this issue shows that only the position espoused by the Company and Staff is consistent with available facts and projections, the infrastructure inspection and vegetation management rules, and the Commission's stated reasons for creating and continuing the tracker.

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[447] *Report and Order* in Case No. ER-2008-0318, p. 41 (January 27, 2009).
[448] *Report and Order* in Case No. ER-2010-0036, pp. 60-61 (May 28, 2010).
[449] *Id.*, p. 61.

For example, 4 CSR 240-23.020 prescribes intervals for the visual inspection of all of equipment and structures on the Company's system for the purpose of identifying potential problems and hazards. For urban areas, which the rule defines as areas where there are thirty-five or more customers per circuit mile, the maximum interval between inspections is four years. For rural areas, where the population density is less than thirty-five customers per circuit mile, the maximum interval is six years. David Wakeman, the Company's Vice President of Energy Delivery – Distribution Services, testified that as of the end of the true-up period in this case (February 28, 2011), Ameren Missouri will be approximately three-quarters of the way through its initial four-year urban inspection cycle and slightly more than half-way through its initial six-year rural cycle.[450] Consequently, the Company does not yet have sufficient hands-on experience to allow it – or anyone else – to accurately predict the actual cost of complying with the Commission's rules through one full urban and rural inspection cycle. Therefore, at this point, the actual cost for Ameren Missouri to fully comply with the Commission's infrastructure and vegetation management rules is unknown.

MIEC witness Greg Meyer argued against continuation of the tracker, claiming "annual expense under the 2008 vegetation management rule has shown little volatility."[451] But Mr. Meyer's claim is demonstrably incorrect. Mr. Wakeman testified that, on an annualized basis, the amounts the Company has budgeted for inspections and vegetation management for each of the calendar years 2011 and 2012 exceeds actual expenditures for the twelve-month period running through the end of the true-up period in this case. Through the end of that period, Ameren Missouri had spent $52.2 million on vegetation management and $7.7 million on infrastructure inspections. Comparable budgeted amounts for calendar year 2011 are,

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[450] Ex. 105, p. 9, l. 18-21 (Wakeman Rebuttal).
[451] Ex. 400, p. 9, l. 5-9 (Meyer Direct).

respectively, $53.7 million and $8.4 million and for 2012 $55.3 million and $8.6 million.[452] These budgeted increases above current base costs – more than seven percent for 2011 and more than ten percent for 2012 – demonstrate that the Company's costs of complying with the Commission's rules are neither stable nor predictable enough to warrant discontinuance of the tracker at this time.

The Commission's infrastructure inspection and vegetation management rules already have had a positive impact on Ameren Missouri's service reliability, and that impact is likely to continue into the future. But, as Mr. Wakeman noted in his testimony, that impact comes at a cost. Because sufficient data are not yet available to determine an annual level of cost for full compliance with the Commission's rules, the Commission should authorize the Company to continue the tracker mechanism that is currently in place.

As the Commission has pointed out in its final orders in each of Ameren Missouri's last two general rate cases, the current tracker mechanism serves to protect the interests of both the Company and its customers. If actual expenditures for inspections and vegetation management are less than the amount included in base rates, the mechanism allows that difference to be tracked so that it can be returned to ratepayers. Conversely, if actual costs exceed those included in base rates, the mechanism provides a means to make Ameren Missouri whole for expenditures made to comply with the Commission's rules. Continuation of the tracker mechanism will allow the Commission to continue to monitor the actual cost of the Company's compliance with the infrastructure inspection and vegetation management rules while at the same time ensuring that customers, who are the primary beneficiaries of increased system reliability that compliance with those rules brings, neither overpay nor underpay for that benefit.

[452] Ex. 105, p. 9, l. 5-15.

B. Normalized Level of Non-Labor Storm Costs.

The Commission's *Report and Order* in Case No. ER-2010-0036 includes a multi-page discussion of how Missouri utilities traditionally are allowed to recover the costs they incur to repair storm damage and restore service to customers. In that decision, the Commission described two principles of ratemaking that have governed the recovery of storm costs by utilities in this state. First, the Commission noted that it routinely provides for the recovery of costs incurred to repair damaged facilities after *normal* storms by including in a utility's cost of service used for ratemaking an amount based on a multi-year average of actual, incurred storm repair costs. Second, the Commission stated that costs incurred to restore service after *abnormal* storms are accumulated and deferred for consideration in the utility's next rate case, where the Commission generally allows recovery of those costs over a five-year period.[453] Although the Commission acknowledged that "the company may under recover in years when costs are high, but over recover in years when costs are low,"[454] it nevertheless found that the storm cost recovery protocol based on these two principles "has worked reasonably well."[455]

In calculating the amounts of non-labor storm costs to be included in the revenue requirement used for ratemaking purposes in this case, Ameren Missouri dutifully followed each of the regulatory principles articulated by the Commission in its *Report and Order* in the Company's last rate case. Because storm repair costs fluctuate significantly from year to year, Ameren Missouri determined a normalized level of expense based on a 47-month arithmetic average of actual incurred costs.[456] This calculation yielded a normalized cost for repairs after normal storms of $7,096,592.[457] In addition, because some of the storm activity experienced

[453] *Report and Order* in Case No. ER-2010-0036, p. 66 (May 28, 2010).
[454] *Id.*, p. 67.
[455] *Id.*, p. 68.
[456] Ex. 103, p. 14, l. 1-2; p. 14, l. 15-16.
[457] *Id.*, p. 15, l. 17-18.

through the end of the true-up period was abnormal, the Company proposes to segregate a portion of its actual, non-labor storm costs through that period – an amount totaling $1,037,146, which represents the difference between actual incurred storm costs and the calculation of normalized annual storm costs described in the preceding sentence – for recovery over a five-year period.[458]

However, the method for determining non-labor storm costs proposed by Staff is in sharp contrast to, and inconsistent with, the method proposed by the Company in this case and endorsed by the Commission in Case No. ER-2010-0036. Although both Ameren Missouri and the Staff used actual cost data from the same 47-month period to calculate a normalized level of storm costs, the Staff did not base its calculation on a straight arithmetic average. Instead, the Staff excludes from its calculation more than 30 percent of Ameren Missouri's actual costs incurred during that period.[459] The number this calculation produces is not a true historical average at all; instead, it is a skewed average that "cherry picks" available data. Moreover, because it is based on only a portion of available data – the portion after all historical cost peaks were shaved-off and excluded from the averaging process – it produces a result that significantly understates a true, normalized level of non-labor storm costs. The primary reason that Staff uses this erroneous methodology is that the Staff confuses and conflates two ratemaking principles – normalization and amortization – that are materially different in both function and purpose.

"Normalization" is the process through which regulators attempt to determine the normal level of an item of expense that historically fluctuates significantly from year to year. As the Commission noted in its *Report and Order* in Case No. ER-2010-0036, a calculation based on a multi-year average is the method most commonly used to normalize storm costs. A historical

[458] *Id.*, p. 15, l. 11-22.
[459] Ex. 207, p. 7, l. 3-14 (Cassidy Surrebuttal); Tr., p. 374, l. 22 to p. 375, l. 15.

average smoothes out the peaks and valleys that can occur from year to year in the amount of an expense that a utility actually incurs. Because a normalized expense is based on an average, if the expense continues to fluctuate in the future, the normalized amount can be expected to be more than actual incurred expense in some years and less in others. Despite this fact, regulators continue to use historical averages to normalize certain expenses because they believe that it is the best available predictor of what a utility's actual cost experience will be over a multi-year future time period.

"Amortization," however, is much different. Unlike normalization, amortization is not a forward-looking process that attempts to predict the future level of an expense. Instead, amortization is a backward-looking process designed to allow a utility to collect through future rates a discrete amount of cost that a utility incurred in the past. Amortization adjustments generally are limited to circumstances where a utility unexpectedly and unavoidably incurred substantial costs to satisfy its service obligation to its customers. Regulators allow amortizations out of a sense of fairness: because the costs were unexpected, they were not included in past rates so without an amortization the utility would be forever barred from recovering legitimate costs of providing service; and because they were substantial, denying a utility the ability to recover those costs through future rates would significantly affect its earnings and therefore its ability to earn a fair rate of return. But allowing such costs to be recovered through amortization has another benefit, as well: it eliminates any disincentive for a utility to promptly and fully respond to unexpected events based on concerns about the effect the cost of responding will have on the utility's earnings. Maximum effort to ensure quick recovery from the damage caused by severe storms is very important to the Company's customers, and allowing for full recovery of the cost of repair is one way to make sure that kind of response can and will be made. That is why

extraordinary storm costs are one of the types of costs that this Commission allows utilities, like Ameren Missouri, to recover through amortization.

Despite the significant differences between these two regulatory principles, the Staff asks the Commission to exclude from the 47-month average of actual, incurred non-labor storm costs all amounts for past storms that currently are being recovered through amortizations. The Staff's rationale for this proposal is the argument that to do otherwise would result in a "double recovery" of the amortized costs.[460] But this argument is nonsense. There will be no double recovery of past storm costs that currently are being amortized; those costs will be recovered once, and only once, through the amortization. But excluding certain costs from the historical average could result in the under-recovery of normal storm costs that will be incurred in the future. Using a historical average to normalize storm cost expense is not designed to specifically collect any of the costs that are used to calculate the average. Instead past costs are used to predict future costs, and if some of those past costs are excluded from the normalization calculation the Commission will be denied the full benefit that past experience holds as to what Ameren Missouri's future non-labor storm costs will be.

Past storm costs are what they are, and the amounts of those costs that the Company actually incurred over the 47-month period used by both Ameren Missouri and the Staff to calculate their respective historical averages are not in dispute. What the Commission must decide in this case is whether a true historical average is one based on all available data or one based only on selected data. There is no credible evidence on the record in this case to support the Staff's claim that failing to exclude certain past costs from the calculation of a true historical average will result in a double collection of certain expenses. In contrast, however, there is ample evidence that excluding those costs from the average will significantly understate both the

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[460] Ex. 207, p. 9, l. 19-22.

amount of normal storm costs Ameren Missouri has incurred in the past and the amount it likely will incur over the future period when rates set in this case will be in effect.

But as flawed as Staff's calculation of non-labor storm costs is, the calculation proposed by MIEC is even worse. Rather than use a historical average to determine the normalized level of storm costs for ratemaking purposes, MIEC asks the Commission to allow only $4.9 million in storm costs in the revenue requirement used to calculate rates in this case, which Mr. Meyer describes as "the average annual storm cost level Ameren Missouri has experienced since the beginning of the test period in this case."[461] But the evidence in this case shows that the amount of storm costs booked through the end of the test period was well below annualized historical levels of Ameren Missouri's incurred costs over the 47-month period used by both the Company and the Staff to calculate their respective historical averages.[462] Consequently, MIEC's proposal significantly understates the annual storm cost expense Ameren Missouri likely will incur during the period rates set in this case are in effect.

MIEC's grossly understated calculation of storm cost expense appears to be motivated by its belief that because the amount of storm costs that Ameren Missouri actually incurred during the test year in this case is less than the amount of storm costs that were included in rates set in Case No. ER-2010-0036 storm cost expense in this case should be limited to the amount of costs actually incurred during the test year.[463] But MIEC's rationale is faulty for several reasons. First, it ignores the fact, which the Commission has acknowledged in past orders, that any normalized amount of storm costs will exceed actual incurred costs in some years and be less than incurred

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[461] Ex. 401NP, p. 23, l. 21-22. Mr. Meyer never explains how his calculation could be considered an "average" since it is based solely on actual incurred expense during the test year.

[462] See Ex. 151. During cross-examination, the Staff's witness, John Cassidy, acknowledged that Ameren Missouri's actual incurred storm costs for the 47-month period used to calculate normalized those costs were as follows: approximately $5.8 million for the period April through December 2007; approximately $4.8 million for the 12 months ending December 2008; and more than $9 million for the 12 months ending December 2009. Tr. p. 372, l. 3-15.

[463] Ex. 401NP, p. 23, l. 4-15.

costs in others.[464] Second, as noted above it ignores the fact that the $4.9 million of storm costs that MIEC proposes in this case is significantly less than the annualized 47-month historical average of actual storm costs incurred by the Company ($5.9 million). Third, MIEC's test year calculation also ignores the fact that Ameren Missouri incurred more than $8 million in storm costs through the end of the true-up period that the Commission prescribed for this case.[465] And finally, MIEC asks the Commission to look at a single item of expense, storm costs, and compare the Company's actual experience to the amount allowed in rates in the last rate case, while ignoring the fact that there were differences between allowed and incurred costs for most, if not all, of the categories of expense used to set rates in that case.

Based on the weight of competent and substantial evidence presented in this case and the Commission's consistent regulatory practice with respect to storm cost recovery, the Commission should: 1) continue the amortizations of storm costs previously authorized in Case Nos. ER-2008-0318 and ER-2010-0036; 2) include in the revenue requirement used to set rates in this case normalized storm costs of $7,096,592 based on the 47-month average of actual storm costs; and 3) include an additional $1,037,146, to be amortized over five years, for recovery of abnormal storm costs incurred through the end of the true-up period.

VIII. RENEWABLE ENERGY STANDARD COMPLIANCE COSTS.

A. Revenue Requirement Amount.

Missouri's investor owned utilities, including Ameren Missouri, are under a statutory mandate to provide a certain level of its electricity from renewable resources. This statute is known as the Renewable Energy Standard ("RES").[466] The RES also requires Ameren Missouri to pay a rebate to customers who install solar panels on their residence or business. The

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[464] *Report and Order* in Case No. ER-2010-0036, p. 67 (May 28, 2010).
[465] Ex. 103, p. 15, l. 14-16.

Company is just starting to incur costs as a result of this statute but as of the end of the true up period, the Company had paid out $885,000 on solar rebates.[467]

Staff's position is that the Commission should include in rates the amount the Company spent on rebates in calendar year 2010, which was $488,000.[468] Staff provided no justification for using the calendar year 2010 expenditure level except for stating that it is less than the 1% limitation found in the RES.[469] Of course, this is not a reason to prefer the calendar year number over the true-up amount as $885,000 is also well below the 1% limitation.[470] Ameren Missouri's recommendation is not unusual and Staff often uses the true-up level for many expenditures,[471] leaving the recommendation to use the calendar year expenditure without support in the record.

The Commission should use the true-up amount, although the Company believes that even the true-up level will likely be less than the amount the Company will spend going forward. This belief is based upon two facts. First, the Company continues to be obligated to pay solar rebates under the RES statute,[472] a fact no one disputes. And second, the Commission previously approved the Company's standard offer contract ("SOC"), which provides up to $2 million for Ameren Missouri to purchase solar RECs from its customers. The $885,000 does not reflect any SOC payments.[473]

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[466] § 393.1030 RSMo, et. seq.
[467] Tr., p. 2193, l. 6-10.
[468] Ex. 229, p. 3, l. 15-18 (Taylor Rebuttal); Tr., p. 2192, l. 2-4.
[469] Tr., p. 2192, l. 5-17.
[470] Ex. 130, p. 31, l. 8-10 shows the Company's revenue requirement as approximately $2.9 billion before the requested rate increase. 1% of that number is $29 million.
[471] In this case, Staff (and the Company) use the true-up levels for rate base, customer growth, MISO transmission revenues and expenses, level of employees, wage increases, components of the net base fuel cost, vegetation management and infrastructure inspections expenses, other employee benefits, depreciation expense and various amortizations.
[472] Ex. 131, p. 16, l. 9-11.
[473] Ex. 131, p. 16, l. 8-11; l. 21-22.

B. Cost Recovery Mechanism.

Ameren Missouri asks the Commission to grant its request for an Accounting Authority Order ("AAO"), as is explicitly allowed by 4 CSR 240-20.100(6)(D). The AAO would be for the $885,000 spent prior to the true-up date but not collected in its current rates, for amounts spent after the true-up date and prior to new rates in this case, and for any amount it spends above the $885,000 after new rates go in effect in this case.[474] These expenditures can be reviewed for prudency (and to ensure they do not violate the 1% limitation) in Ameren Missouri's next rate case.[475]

Staff's position (and perhaps MIEC witness Brosch's position) is that the Company should use the Renewable Energy Standard Rate Adjustment Mechanism ("RESRAM") set forth in the Commission rules. Staff provides no rationale as to why the RESRAM should be used other than stating it is available under the Commission's rules.[476] Staff's argument is true, but it doesn't provide a complete picture of the rules. What Staff's argument does not address is the fact that the Commission's rules provide two alternative cost recovery mechanisms: one is the Staff's proposed mechanism, the RESRAM, and the other is the AAO requested by the Company.[477] Staff's witness acknowledged during the hearing that the Commission's rules explicitly provide for the approval of an AAO, as Ameren Missouri requests.[478] He also acknowledged that no RESRAM tariff had been drafted, offered or approved.[479] Consequently, there is no reason to not allow Ameren Missouri the AAO it seeks, as described above.

MIEC witness Brubaker recommends the Commission require the Company to recover the costs of the solar rebates over 10 years, noting that the solar panels, for which the rebates are

[474] Ex. 131, p. 16, l. 8-22.
[475] Ex. 131, p. 16, l. 23.
[476] Ex. 229, p. 3, l. 3-9.
[477] Ex. 131, p. 17, l. 16-25.
[478] Tr., p. 2189, l. 7-10.
[479] Tr., p. 2189, l. 11-12.

paid, are expected to have a 10 year life.[480] The fact that solar panels may or may not have a 10 year life is irrelevant to the question of how Ameren Missouri should recover rebate expenditures. These expenditures give Ameren Missouri no ownership interest in the solar panels, which the Company neither operates nor owns.[481] Therefore, these expenditures are materially different from investments in plant that is owned and operated by Ameren Missouri, the costs of which are normally recovered over the life of the asset. Mr. Brubaker acknowledged this fact when testifying.[482] These rebates are solely an expense which is required by the RES and should be treated just as any other expense is treated by the Commission – as part of the Company's ongoing O&M expense by including the true-up level in the Company's revenue requirement in this case.

IX. MUNICIPAL LIGHTING.

The Commission must answer two questions with regard to the municipal lighting issue. First, what portion of the rate increase is properly charged to the lighting class as a whole, and second, how should the increase be collected from the different lighting subclass members?

These are the same type of issues the Commission addresses on a regular basis in any rate case, but they are somewhat complicated in this case by the fact that the witness for The Municipal Group, Ms. Petree Eastman, presumed that the removal of certain charges in the lighting class tariffs meant a commensurate reduction would be made to the lighting class revenue requirement. This confusion likely stems from Ms. Eastman's lack of familiarity with the ratemaking process. Ms. Eastman admitted that she has had no training on class cost of service ("CCOS") studies,[483] or rate design issues[484] and that she is not an expert on utility

[480] Ex. 404, p. 19, l. 17 to p. 20, l. 9.
[481] Ex. 131, p. 17, l. 6-8.
[482] Tr., p. 2194, l. 16-21.
[483] Tr., p. 1051, l. 15-16.
[484] Tr., p. 1051, l. 18-20.

revenue requirement issues, customer class cost of service studies or rate design issues.[485] She did not know the difference between a CCOS study sponsored by Ameren Missouri witness William Warwick and the lighting study sponsored by Ameren Missouri witness Philip Difani in this case.[486]

A. Revenue requirement increase appropriately charged to the lighting class as a whole.

Ameren Missouri's position is that the lighting class, as a whole, should receive the system average increase. Pursuant to the Non-Unanimous Rate Design Stipulation ("Joint Recommendation on Rate Design"), the lighting class would receive a 4% increase on a revenue neutral basis and then a portion of the overall increase which varies depending upon the final increase granted by the Commission. In general, if the Commission was to grant the Company's full request in the case, then the increase for the class as a whole would be at least 10%.

While the Company prefers its rate design methodology, either proposal is justified by the class cost of service studies in this case. Ameren Missouri's CCOS study, sponsored by Mr. Warwick, shows that the lighting class is underpaying by 36%.[487] Of course, no one in this case is recommending that the lighting class be given the full amount of this increase, but neither is anyone disputing the accuracy of this number – not even The Municipal Group.[488] Accordingly, the Commission can accept either Ameren Missouri's recommendation or the Joint Recommendation on Rate Design and find support for the increases to the street lighting class in Ameren Missouri's CCOS study.

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[485] Tr., p. 1052, l. 1-9.
[486] Tr., p. 1052, l. 13-16.
[487] Ex. 136, Schedules WMW-E1 and WMW-E2.
[488] Ex. 750, p. 4, l. 14-17 (Eastman Direct). Other than to make a blanket statement that they are not in agreement with methodology or results of Ameren Missouri's CCOS study, The Municipal Group offered no specific objection to Ameren Missouri's study. Ms. Eastman's direct testimony says she is not addressing the CCOS study and reserves the right to address it in her rebuttal testimony. Her rebuttal testimony, Ex. 751, only responds to Staff's direct testimony and is silent on Ameren Missouri's CCOS study.

B. Revenue requirement recovery within the lighting class.

The central issue the Commission must address in this case, which the Joint Recommendation on Rate Design does not address, is how the increase assigned to the lighting class should be distributed among the various lighting tariffs. Ameren Missouri has several lighting tariffs – 5M, 6M and 7M. The Municipal Group is primarily concerned about the 5M rate, which is the rate for Company owned streetlights.[489]

1. <u>Pole and span charge elimination</u>.

Currently, a 5M class customer who requests that the Company install a certain new streetlight facility (e.g., a wood pole and wire spans) pays an upfront fee for the installed cost of the facility and the eventual replacement of the facility.[490] These costs have not always been recovered in this manner. Prior to 1988, the Company charged a monthly pole and span fee to cover these costs.[491] So today, some 20 plus years later, a customer who had a streetlight installed prior to 1988 is still paying that monthly fee.[492] As part of his work in analyzing how any increase should be applied to the various street lighting tariffs, Mr. Difani determined that the pole and span charges should be eliminated.[493] It is a fact that after the 20 plus years, municipalities with pre-1988 installations have paid more than those customers who paid the up-front charge after 1988. This is consistent with the statement made by Ms. Eastman, who, in response to a data request from Ameren Missouri, explained that "the Municipal Group does not contend that 'pole installation charges' are 'costs' but charges that have been paid by Lighting Class customers for poles installed prior to September 1988. The Municipal Group does not

[489] Ex. 120, p. 2, l. 6-9 (Difani Rebuttal). The Company's 6M rate is applicable to customer owned lights.
[490] Ex. 120, p. 6, l. 17-22.
[491] Ex. 120, p. 6, l. 14.
[492] Ex. 120, p. 7, l. 1-7.
[493] Ex. 120, p. 7, l. 5-7.

believe that any 'costs' remain…."[494] It should be noted that regardless of the length of these charges and the age of these facilities, the Company has a continuing obligation to maintain and replace these facilities, when required. Staff opposes the elimination of this charge, arguing that it will cause unfair subsidization from those customers who paid up-front installation costs.[495] This argument, however, does not address the reality that the customers paying the pole and span charges have paid these charges for 20 plus years. Ameren witness Difani's direct testimony provides adequate rationale for the elimination of these charges and The Municipal Group supports same.[496] Staff provided no direct testimony to refute Mr. Difani's rationale; rather it relies on the aforementioned subsidy argument. These charges, while just and reasonable when approved by the Commission in 1988 and for years afterwards, have progressed to the point where they should not be retained and the Company requests the Commission eliminate these charges.

This leaves a level of cost associated with the street lighting class and requires a decision about how to spread that cost between the various lighting tariffs. Ameren Missouri proposes to keep the cost to serve each tariff within each tariff. As Mr. Difani explains:

> …the elimination of this charge does not mean there is a corresponding elimination of the cost of providing service to the Lighting Class or a reduction to the portion of the Company's overall revenue requirement that is allocated to that class. Instead, the elimination of the pole and span charge simply means that the portion of the revenue requirement allocated to the Lighting Class that was previously met through revenues received from that charge must now be recovered through increases to the charges that remain.[497]

This is the issue that most confused The Municipal Group's witness. The CCOS studies show the portion of the revenue requirement which should be collected from the various rate classes, including the lighting class. If the pole and span charges are no longer an appropriate

[494] Ex. 159.
[495] Ex. 228, p. 3, l. 8-13 (Scheperle Surrebuttal).
[496] Ex. 119, p. 8, l. 16 to p. 9, l. 6 (Difani Direct).
[497] Ex. 120, p. 7, l. 19 to p. 8, l. 2.

way to collect a part of that revenue requirement, then it must be collected through another mechanism. Removing the charges does not change how much a class should pay; it only impacts the mechanism through which the payment is made.

The Municipal Group proposes removing the portion of the revenue requirement previously associated with these charges. It is unclear if Ms. Eastman's proposal is for those costs to be completely removed from the Company's revenue requirement or if she believes they should be borne by classes other than the lighting class.[498] Either way, her proposal misses the point. The revenue requirement to serve the lighting class is undisputed. The Commission must now simply determine the most appropriate manner of collecting that revenue requirement from the lighting class. Ameren Missouri believes it is most appropriate to eliminate the pole and span charges and to collect all costs to serve the class through the remaining 5M charges for lighting service. This will impact different municipalities in different ways. Some of their bills will increase and some will decrease.[499] With the Company's proposed elimination of the pole and span charges, the differing impact on municipal street lighting bills is necessary and expected as the Commission moves rates for the lighting class closer toward paying what it actually costs to serve that group of customers.[500] For these reasons, the cost to serve the class and each tariff in the class should be paid by the group of customers which take service under each tariff, which is what Ameren Missouri has proposed in this case.

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[498] Tr., p. 1058, l. 12 to p. 1059, l. 14 – At one point, while on the witness stand, Ms. Eastman seemed to indicate the Company's total revenue requirement should be reduced by the amount previously collected through the charge, although she admits she has no evidence supporting this elimination. At another point, Ms. Eastman testified that these costs should be spread to other classes. Tr., p. 1067, l. 20 to p. 1068, l. 11. In her prefiled direct testimony, Ex. 750, p. 10, l. 1-3, she only asked the Commission to remove these costs from the lighting class' revenue requirement, which would require those amounts to be added to the revenue requirement for the non-lighting classes.

[499] Ex. 750, p. 6, l. 18 to p. 8, l. 7.

[500] It only moves the rate a portion of the way to the actual cost to serve. Remember, the lighting class is currently underpaying by 36%. Neither Ameren Missouri's recommended rate design nor the Rate Design Stipulation moves the lighting class rate 36%.

2. **Other proposals from The Municipal Group.**

The Municipal Group offered other proposals to reduce the overall cost of lighting, without developing an evidentiary record to support them. It proposed splitting the street lighting tariff into one for municipal customers and one for non-municipal customers, or increasing the discount offered to street lighting customers who have granted Ameren Missouri a franchise.[501] There is no evidence in the record to support any of the one-line proposals offered by Ms. Eastman and, accordingly, they must be rejected by the Commission. The commonality of all of these proposals is the fact that this is a difficult time for many of the municipalities in Ameren Missouri's service territory. Ms. Eastman described the situation as the municipalities being in "dire straights [sic]."[502] Ameren Missouri does not dispute that these are difficult economic times for many of its customers, including the municipalities, but the Company's street lighting tariffs are not the cause of or even a major contributor to this difficult situation. For example, Ms. Eastman testified that a fair estimation of University City's (where, until recently, she was Assistant City Manager) annual budget was in the range of $28 million and that 90% of that budget is spent on personnel.[503] Further, she testified that University City paid approximately $642,000 per year for 5M street lights.[504] That means University City's 5M bill accounts for just over 2% of its annual budget. The dire straits facing the municipalities are not a utility bill problem and Ms. Eastman admits that none of the proposals offered in this case would resolve the economic dilemma facing the municipalities today.[505] Ameren Missouri, and the signatories to the Joint Recommendation on Rate Design, acknowledged and addressed the economic dilemma facing the municipalities by not assigning the class the entire increase which

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[501] Ex. 750, l. 1-5.
[502] Ex. 751, p. 3 (Ms. Eastman's rebuttal testimony does not have page numbers, but the quoted phrase can be found on the third page of the testimony), l. 55.
[503] Tr., p. 1062, l. 20 to p. 1063, l. 11.
[504] Tr., p. 1063, l. 17-19.
[505] Tr., p. 1071, l. 4 to p. 1072, l. 4.

was justified by the CCOS studies submitted in this case. The Municipal Group has asked for additional concessions, however, they have not provided support for any of the proposals and the Commission must deny each of these requests in this case.

X. RATE DESIGN/CLASS COST OF SERVICE.

On May 13, 2011, the Public Counsel and several intervenors[506] filed a non-unanimous stipulation and agreement that settled, among the signatory parties, all issues related to class cost of service allocation and rate design. On May 17, 2011, Ameren Missouri, who was not a signatory, filed its response stating that it did not intend to assert its rights under 4 CSR 240-2.115(2)(B) and oppose the stipulation and agreement. In that response, the Company stated that it "continues to believe that the equal, across-the-board allocation of the rate increase sought in this case reflects the most appropriate rate design for its customers." The basis for this belief was described as follows by Ameren Missouri's witness Wilbon Cooper:

> The Company recognizes that factors other than cost of service are relevant to determining class revenue requirements. These factors may include, but are not limited to, revenue stability, rate stability, effectiveness in yielding total revenue requirements, public acceptance, and value of service.
>
> . . .
>
> While cost based rates are an important starting point in developing class revenue targets and rate design, the aforementioned other factors of revenue stability, effectiveness in yielding total revenue requirements, public acceptance, and value of service should be considered when determining class revenue requirements and designing rates. Considering the prolonged nature of the country's challenging economic conditions, these other factors take on more importance. Judgmental weighting of all these factors drove the Company's equal percentage of increase proposal.[507]

[506] In addition to the Public Counsel, the following parties were signatories to the stipulation and agreement: MIEC, MRA, AARP, Consumers Council of Missouri, MEUA, and MEG.
[507] Ex. 133, p. 19, l. 6-12 (Cooper Direct).

During the hearing held May 20, 2011, Mr. Cooper confirmed that, for the reasons stated in his pre-filed testimony, Ameren Missouri continues to favor an across-the-board allocation of any increase in rates that is authorized in this case.[508]

Because The Municipal Group timely filed an objection to the non-unanimous stipulation and agreement regarding class cost of service and rate design issues, under the Commission's rules that stipulation will be considered merely a position statement of the signatory parties. Accordingly, the Commission is free to adopt the positions represented by the stipulation or any other position that was expressed on the record and that is supported by competent and substantial evidence.

The Company's preferred method for allocating any increase in rates that is granted in this case is described in the direct, rebuttal, and surrebuttal testimonies of its witnesses, Mr. Cooper and William Warwick, and is fully supported by competent and substantial record evidence. In addition, as discussed elsewhere in this brief, Ameren Missouri's proposals for the allocation of any rate increase to the lighting class are described in the testimony of Mr. Difani and also are fully supported by competent and substantial record evidence. Consequently, should it see fit to do so, the Commission can adopt any or all of the Company's rate design proposals in lieu of the positions taken by the signatory parties to the stipulation and agreement.

XI. LED LIGHTING.

The Staff asks the Commission to order Ameren Missouri to complete an ongoing Light Emitting Diode ("LED") lighting study within twelve months of the date of the Report & Order in this case and, upon completion of the study, either file an LED tariff or update the Commission as to when the Company will file such a tariff.[509] For the reasons stated in its

[508] Tr., p. 2445, l. 20 to p. 2446, l. 9.
[509] Ex. 204, p. 35, l. 19-22.

prepared testimony in this case, although Ameren Missouri intends to complete the LED lighting study, it opposes being required to file an LED lighting tariff following the completion of that study. Moreover, because a stipulation and agreement approved in Case No. ER-2010-0355 obligates the Commission to sponsor a workshop on a broad range of outdoor lighting issues, including LED lighting, the Company believes that it would be premature, imprudent, and unfair to require Ameren Missouri to take any action on that issue prior to the completion of the workshop.[510]

A critical review of the evidence in this case shows that the Staff's LED lighting recommendations can best be viewed as a solution in search of a problem. In his surrebuttal testimony, Dr. Hojong Kang stated that one of the factors that motivated the Staff's recommendations was the desire to give municipal customers the option to use LED technology for street lighting should they desire to do so.[511] However, under cross-examination, Dr. Kang acknowledged that none of the municipalities that intervened in this case had indicated through testimony in this case that they want LED lighting, or that they support the Staff's proposal.[512] He also acknowledged that Wal-Mart, another intervenor who Dr. Kang identified as a possible

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[510] The "Non-Unanimous Stipulation and Agreement As to Outdoor Lighting Issues," which was approved by the Commission in Case No. ER-2010-0355, states, in relevant part, as follows:

> The Signatories jointly recommend that the Missouri Public Service Commission ("Commission") sponsor a Workshop regarding Outdoor Lighting Issues that would address a variety of issues including, but not limited to, LED lighting, converting tariff lamp listings from wattage/lumens to illuminance based rates, the propriety of referencing/associating outdoor lighting with safety, security and/or crime prevention, and shielding methodologies. The Signatories agree that a broad group of stakeholders should be invited to participate in such Workshop, including, but not limited to, representatives of: International Dark Sky Association; investor-owned, municipal and cooperative electric utilities; municipal customers; Customer Program Advisory Group ("CPAG"); law enforcement; Missouri Department of Natural Resources; environmental groups; homeowners' associations; and commercial and industrial customers.

Tr., p. 2148, l. 24 to p. 2149, l. 14.

[511] Ex. 215, p. 2, l. 9-10 (Kang Surrebuttal).

[512] Tr., p. 2156, l. 11-22.

beneficiary of the Staff's push for an LED lighting tariff, also had filed no testimony expressing its interest in that technology or its support for the Staff's proposal.[513]

Dr. Kang further testified that another factor behind the Staff's proposal was "the cost-effectiveness of the LED SAL system."[514] But the only evidence he offered in support of this assertion was some photographs of a few slides presented at a recent outdoor lighting conference that suggested that the City of Los Angeles, California, had reported energy savings of 55 percent from the installation of LED lighting fixtures.[515] However, Dr. Kang admitted that neither he nor any other member of the Staff had audited the results presented by the City of Los Angeles to verify what energy savings, if any, actually were achieved.[516] Dr. Kang also acknowledged that the City of Los Angeles is served by an unregulated municipal electric utility, but provided no evidence that establishes, or even suggests, how a municipal utility's experience with LED lighting might apply to a regulated, investor-owned utility like Ameren Missouri. Without such evidence, the results from the LED lighting program undertaken in Los Angeles are, at best, of questionable value.

In addition, the Staff's unverified assertions about the cost-effectiveness of LED technology currently available for outdoor lighting were conclusively rebutted by the detailed evidence presented by Ameren Missouri's witness on this issue, Kyle Shoff. He testified that although research on LED street lighting continues to evolve, "none of the new, cutting edge street lighting technologies are cost effective at this time."[517] For example, LED lighting facilities typically are three to five times as expensive as equivalent high pressure sodium lamps, which constitute approximately 65 percent of the street lighting fixtures currently employed in

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[513] Tr., p. 2156, l. 23 to p. 2157, l. 7.
[514] Ex. 215, p. 3, l. 2.
[515] *Id.*, l. 10-14.
[516] Tr., p. 2158, l. 2-8.
[517] Ex. 149, p. 2, l. 9-10 (Shoff Rebuttal).

Ameren Missouri's service area.[518] Mr. Shoff also noted that because LED fixtures do not put out the same amount or quality of light as existing fixtures, the space between LED light poles may differ from the spacing interval currently used for outside lighting facilities. And because pole spacing is a "key cost consideration," replacing or re-spacing current light poles could significantly increase the cost of LED technology.[519] He also testified that because LED lighting technology is in its infancy, significant technical issues remain unresolved that will affect the cost of implementing that technology. These issues include, but are not limited to, variations in the color and light patterns of LED fixtures, power supply and ballast variances between LED fixtures, lumen degradation characteristics of LED fixtures that could affect their useful lives, and an overall lack of quality control.[520]

Because numerous important questions regarding LED outdoor lighting technology remain unanswered, Mr. Shoff recommends that the Commission reject the Staff's proposal in favor of an approach that allows for a less hurried and more thorough review of a range of issues related to outdoor lighting. He testified that the Company will continue the LED lighting project that is currently underway and that it will share its analysis of the results of that project with the Commission, the Staff, and all other interested stakeholders.[521] Mr. Shoff also noted that there are intermediate outdoor lighting technologies – *e.g.* induction lighting – that should be studied to determine if they may represent a short-term alternative that is more cost-effective than LED technology.[522] But all of the issues raised and recommendations made by Mr. Shoff will take time to consider and/or complete – much more time than would be available should the Commission adopt Staff's recommendations in this case.

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[518] *Id.*, p. 7, l. 12-13; p. 3, l. 2-3.
[519] *Id.*, p. 12, l. 1-15.
[520] *Id.*, p. 5, l. 8-22.
[521] *Id.*, p. 1, l. 21-23; p. 6, l. 6 to p. 7, l. 5.
[522] *Id.*, p. 7, l. 17 to p. 10, l. 3.

There is no evidence that the Commission needs to be in a rush to order Ameren Missouri to implement a tariff for LED outdoor lighting. Indeed, even Dr. Kang acknowledged that "[t]ime is not important."[523] Therefore, it would be much more appropriate for the Commission to approach the issue of LED lighting more deliberately and to defer any action until the outdoor lighting workshop agreed to in Case No. ER-2010-0355 is completed. For that reason, and for all of the other reasons described in the Company's testimony and in this brief, the Commission should reject Staff's LED lighting proposal in this case.

XII. UNION ISSUES.

As it did in Ameren Missouri's last rate case, the International Brotherhood of Electrical Workers Local 1439, AFL-CIO, on behalf of itself and various other local unions representing certain of the Company's employees (collectively, the "Union"), filed testimony that supported the need for a rate increase and also asked the Commission to order Ameren Missouri to take steps and make expenditures related to hiring and training its internal workforce and to limit its use of outside contractors. More specifically, the Union's witness, Michael Walter, asked the Commission to order the Company to: (i) expend a substantial portion of any rate increase granted in this case on hiring and training additional internal employees; (ii) make a commitment to its internal workforce by ensuring that new employees will be recruited from within the Company's Missouri service area; and (iii) only hire outside contractors from Missouri.

Just as in Ameren Missouri's last rate case, the Union's requests are not based on any competent and substantial evidence that the Company's workforce is inadequate or on any claim that the service currently being provided to customers is inadequate or deteriorating. Instead, the

[523] Tr., p. 2153, l. 14-17.

motivation for these requests appears to have been the Union's desire to further the interests of its members.[524]

Ameren Missouri's witness David Wakeman rebutted the Union's assertions when he testified that the Company closely monitors its employee needs because of the lengthy training process required to fill many bargaining unit positions, and further stated that at the present time there is no need for either additional internal employees or for additional training for those employees currently on the payroll.[525] Mr. Wakeman also suggested that the Union's concerns about Ameren Missouri's use of outside contractors are both selective and self-serving. "Mr. Walter has no concern with the use of contactors for seasonal work or during extreme weather. However, he asserts that the use of outside contractors for other work is problematic."[526] He also stated his belief that the Company already maintains "an appropriate balance between regular employees and contractors that is most beneficial to our customers,"[527] and he rejected the idea that outside contractors are unqualified or that the work they do is substandard:

> The contractors used by Ameren Missouri receive training, much of which is the same as that our employees undergo. In addition, when we utilize outside contractors on a day-to-day basis, we audit their performance to verify compliance with our standards for workmanship and safety. The assertion that Ameren Missouri is risking safety and/or system reliability with the use of untrained contractors is untrue.[528]

But beyond the lack of any factual basis for the Union's requests, the relief sought by the Union in this case is beyond the scope of the Commission's regulatory powers. Although under Section 393.140(5), RSMo., the Commission has the authority to examine and be kept informed of the methods and practices employed by Ameren Missouri in the conduct of its business, the Missouri Supreme Court has held that the Commission's authority to regulate does not include

[524] Ex. 105, p. 5, l. 19-20 (Wakeman Rebuttal).
[525] *Id.*, p. 5, l. 10-16.
[526] *Id.*, p. 4, l. 12-14.
[527] *Id.*, p. 6, l. 12-14.
[528] *Id.*, p. 4, l. 16-20.

the right to dictate the manner in which a utility shall conduct its business. *State ex rel. City of St. Joseph v. Pub. Serv. Comm'n*, 30 S.W.2d 8 (Mo. *banc* 1930). *See also State of Missouri ex rel. Southwestern Bell Co. v. Pub. Serv. Comm'n*, 262 U.S. 276, (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. W.D. 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 Case No. ER-2008-0318 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.

Thus, well-established legal precedent has consistently held that 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.[529]

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

[529] *Report & Order*, Case No. ER-2008-0318, pp. 112-113 (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.[530] 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."[531] 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.[532]

Applying these principles to the instant case, the Commission should not – and indeed lacks the authority to – dictate, as the Union has requested, that Ameren Missouri (i) expend a substantial portion of any rate increase granted in this case on hiring and training additional internal employees; (ii) make a commitment to its internal workforce by ensuring that new employees will be recruited from within the Company's Missouri service area; and (iii) only hire outside contractors from Missouri. To the Company's knowledge, the Commission has never attempted to assert jurisdiction over issues such as whether a utility uses its own employees to install utility facilities or perform other services versus hiring outside contractors to do such work. The Commission has refrained from doing so for good reason – namely because such intrusions would strike at the heart of a public utility's recognized right to manage its business. Consistent with decades of legal precedent and regulatory practice, the Commission should reject

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[530] *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).
[531] *PSC Staff v. Southwestern Bell Telephone Co.*, Case No. TC-93-224 (1994).
[532] *See* Section 386.315(1), RSMo 2000. The record evidence in this case establishes that there is a collective bargaining agreement in effect between the Company and IBEW Local 1439 and that the agreement has established procedures for dealing with contract disputes. Moreover, the terms of the collective bargaining agreement specifically gives Ameren Missouri the right to use outside contractors and the exclusive right to determine the number of people it will employ. (Tr., pp. 2270-2273)

such an approach, and decline to adopt the Union's recommendations in this case. Moreover, there is no competent and substantial evidence to support the Union's recommendations, or to demonstrate that there is an underlying problem with Ameren Missouri's quality of service or operations.

And there is one additional reason why the Commission should reject the Union's request in this case. In Ameren Missouri's last two rate cases, the Commission has authorized more than $6 million in additional rate increases to cover training costs requested by the Union.[533] In its *Report and Order* in the last rate case, the Commission ordered the Company to "assess the incremental value to customers of these additional investments and provide that assessment to Staff and Public Counsel by December 31, 2011."[534] Because that assessment has not yet been completed, it is impossible to determine if customers have received any incremental value from the expenditures authorized in the past. Consequently, in addition to all of the other reasons for denying the Union's requests in this case, Ameren Missouri believes it would be premature, and possibly imprudent, to require still more expenditures for training of the Company's internal workforce until the analysis ordered in the last rate case is completed.

XIII. LOW INCOME WEATHERIZATION PROGRAM.

Ameren Missouri and MDNR have agreed that it is appropriate for the Company to continue its funding of MDNR's low income weatherization program at $1.2 million annually. This program is administered through MDNR's Environmental Improvement and Energy Resources Authority ("EIERA"). The $1.2 million is collected from Ameren Missouri's customers. Additionally, it was agreed that the Company would complete a process and impact

[533] Tr., pp. 2265-2266.

[534] *Report & Order* in Case No. ER-2010-0036, p. 72 (May 28, 2010).

evaluation of the program by April 30, 2012, covering the time period of January 1, 2010, through December 31, 2011. Evaluations would then be conducted every two years thereafter.

Although the majority of the parties in this case, Staff, MIEC, MEG, MEUA, AARP and Consumers Council, do not object to this agreement, OPC has objected to the biannual evaluations of the program. OPC's objection is unfounded and inconsistent with the way energy efficiency programs are evaluated by Ameren Missouri and even with the Commission's new MEEIA rules. The MEEIA rules require utilities to hire an independent contractor to perform an evaluation of each energy efficiency program, that the evaluation budget not exceed 5% of the total budget for energy efficiency programs and that the utility have evaluation plans.[535] As indicated in the testimony of Ameren Missouri witness Dan Laurent, this program has not undergone an evaluation since 2009.[536] The agreement between Ameren Missouri and MDNR would result in spending 5% of the Company's budget for this program on the evaluation. Additionally, all of Ameren Missouri's energy efficiency programs undergo regular evaluations, as the information provided can be used to improve the program and program administration.[537] No one in this case has argued that Ameren Missouri ought to be doing fewer evaluations of its energy efficiency programs, nor has anyone provided testimony indicating why the low income weatherization program ought not withstand the evaluation process. OPC's objection has no basis and the Commission should reject their concern and approve the program according to the terms of the Company's agreement with MDNR.

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[535] 4 CSR 240-20.093(7) and 4 CSR 240-20.094(3)(A)2.
[536] Ex. 112, p. 8, l. 15.
[537] Ex. 112, p. 3, l. 21 to p. 4, l. 3 and Ex 113, p. 4, l. 1-7.

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