

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



In the Matter of Union Electric Company, d/b/a)
AmerenUE's Tariffs to Increase Its Annual)
Revenues for Electric Service)

File No. ER-2010-0036
Tariff Nos. YE-2010-0054
and YE-2010-0055

REPORT AND ORDER REGARDING INTERIM RATES

Issue Date: January 13, 2010

Effective Date: January 23, 2010

John B. Coffman, John B. Coffman, LLC, 871 Tuxedo Blvd., St. Louis, Missouri 63119-2044;

For AARP and the Consumers Council of Missouri.

Roger W. Steiner, Sonnenschein Nath & Rosenthal, LLP, 4520 Main Street., Suite 1100, Kansas City, Missouri 64111;

For Kansas City Power & Light

Thomas R. Schwarz, Jr., Blitz, Bardgett & Deutsch, L.C., 308 East High Street, Suite 301, Jefferson City, Missouri 65101;

For the Missouri Retailers Association

Douglas L. Healy, Healy & Healy, LLC, 939 Boonville, Suite A, Springfield, Missouri 65802;

For the Missouri Joint Municipal Electric Utility Commission.

CHIEF REGULATORY LAW JUDGE: Morris L. Woodruff

REPORT AND ORDER

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The Missouri Public Service Commission, having considered all the competent and substantial evidence upon the whole record, makes the following findings of fact and conclusions of law. The positions and arguments of all of the parties have been considered by the Commission in making this decision. Failure to specifically address a piece of

evidence, position, or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision.

Procedural History

On July 24, 2009, Union Electric Company, d/b/a AmerenUE, submitted a tariff designed to implement a general rate increase for electric service. The Commission has suspended the effective date of that general rate increase tariff until June 21, 2010, and a hearing on the general rate increase is scheduled to begin on March 15, 2010. Along with its general rate increase tariff, AmerenUE filed a separate tariff to implement an interim rate adjustment increasing AmerenUE's rates by approximately \$37.3 million, which would amount to a 1.67 percent increase for its customers. That interim rate tariff was to go into effect on October 1, 2009.

On September 24, 2009, the Commission suspended AmerenUE's interim rate tariff from October 1, 2009, until October 10, 2009. Thereafter, on October 7, 2009, the Commission further suspended that tariff until January 29, 2010. In the same order, the Commission directed the parties to prefile direct, rebuttal, and surrebuttal testimony and scheduled an evidentiary hearing to take place on December 7, 2009.

In compliance with the established procedural schedule, the Commission conducted an evidentiary hearing on December 7, 2009. AmerenUE, Staff, Public Counsel, Missouri Industrial Energy Consumers (MIEC), Kansas City Power & Light Company (KCP&L), and Laclede Gas Company, filed post-hearing briefs on December 21, 2009.

Findings of Fact

AmerenUE's interim rate tariff would allow the company to recover approximately \$37.3 million of its total requested annual rate increase on an interim basis, subject to refund.¹ The proposed interim rate would end when the Commission establishes "permanent" rates following completion of the general rate increase procedure. The money AmerenUE would collect under the interim rate tariff would be subject to refund, with interest, pending the Commission's final determination regarding AmerenUE's request for a general rate increase.²

AmerenUE requested \$37.3 million as its interim rate increase because that amount is the cost of net plant the company placed in service from October 1, 2008, through May 31, 2009.³ The balances used by AmerenUE to support that \$37.3 million figure are reflective of the plant and depreciation reserve balances recorded in AmerenUE's general ledger at May 31, 2009.⁴ However, other parties do not agree that \$37.3 million is an appropriate amount to be recovered through an interim rate increase if such a rate increase were otherwise appropriate. They contend that various adjustments would need to be made to that amount to reflect the revenue requirement associated with the net plant additions. In response, AmerenUE explained that it chose the \$37.3 million cost of net plant as a likely number for its interim rate increase simply as a means of illustrating why it needs the interim increase. The company contends the number chosen could as easily

¹ Weiss, Interim Direct, Ex. D, Page 2, Lines 6-7.

² Proposed Tariff No. YE-2010-0055.

³ Baxter, Interim Direct, Ex. A, Page 7, Lines 13-14.

⁴ Rackers, Interim Direct, Ex. J, Page 3, Lines 10-13.

have been expressed simply as a percentage of the total amount of permanent increase it is requesting. In either event, it contends the exact derivation of the chosen number does not affect the company's rationale for an interim rate increase.⁵

AmerenUE asserts the Commission should allow it to receive an interim rate increase to help mitigate the effect of what it describes as excessive regulatory lag. Regulatory lag is simply the delay between when a regulated utility incurs a cost or receives an item of income and when that cost or income is recognized in the rates the regulatory body allows the utility to charge. As AmerenUE concedes, some level of regulatory lag is a good thing for both customers and utilities.⁶ Such lag creates a strong economic incentive for a utility's management to aggressively manage costs between rate cases to be as efficient as possible.⁷ Furthermore, regulatory lag works in both directions. When a utility's costs are increasing or its income is decreasing, regulatory lag will tend to erode the utility's profits. But when costs are decreasing or income is increasing, regulatory lag will allow a utility to earn increased profits during the delay encountered while the regulatory agency acts to decrease the utility's rates to match the decreased costs or increased income.

AmerenUE does not propose to eliminate all regulatory lag. Rather, it would impose an interim rate increase to alleviate what it describes as excessive regulatory lag. AmerenUE claims it is suffering from excessive regulatory lag because for several years it has been earning substantially less than its authorized rate of return as established by the Commission in the company's last two rate cases. For the 27 months from June 2007 through August 2009, AmerenUE's average earned return on equity was 8.06 percent,

⁵ Transcript, Pages 320-322, Lines 8-25, 1-25, 1-15.

⁶ Baxter, Interim Direct, Ex. A, Page 8, Lines 10-12.

⁷ Gorman, Interim Direct, Ex. Q, Page 2, Lines 22-23.

which is more than 200 basis points below the 10.2 percent return authorized in Case No. ER-2007-0002 and the 10.76 percent return authorized in Case No. ER-2008-0318.⁸ If AmerenUE's return on equity is adjusted to reflect the unavailability of the Taum Sauk Plant, the company's average return on equity for that same period increases to just 8.52 percent, still substantially below the authorized rate of return.⁹

Between January 1, 2007, and June 30, 2009, AmerenUE experienced a negative free cash flow of approximately \$1.6 billion.¹⁰ Because of its large negative free cash flow, AmerenUE must borrow more money and pay more interest, or must defer making certain desirable capital investments in its electrical system.¹¹ AmerenUE cites these facts as support for its claim that it is suffering from excessive regulatory lag.

Furthermore, AmerenUE asserts that excessive regulatory lag is a systemic problem in Missouri, caused by four key drivers.¹² First, the rate case review process in Missouri generally takes eleven months from the time a rate case is filed until revised rates go into effect. Some other states process rate cases more quickly. Second, Missouri uses historical costs to set rates while some other states use projected costs. Third, Missouri law does not permit utilities to include construction work in progress (CWIP) in rate base. Fourth, Missouri law does not permit the use of a mechanism to periodically adjust rates between rate cases to reflect the return, property taxes, and depreciation associated with increases in net plant in service. To illustrate these problems, AmerenUE submitted the testimony of Johannes Pfeifenberger, whose comparison of five regulatory factors that

⁸ Weiss, Interim Direct, Ex. D, Page 3, Lines 7-21.

⁹ Weiss, Interim Direct, Ex. D, Page 5, Lines 1-13.

¹⁰ Baxter, Interim Direct, Ex. A, Page 3, Lines 6-7.

¹¹ Transcript, Page 392, Lines 19-25.

¹² Baxter, Interim Direct, Ex. A, Page 5, Lines 11-23.

affect regulatory lag among the fifty states concluded that the regulatory lag in Missouri is greater than the lag present in all but two other states.¹³ AmerenUE contends the Commission could alleviate this systemic tendency toward excessive regulatory lag if it allows AmerenUE, and similarly situated utilities, to implement an interim rate increase early in the rate case process.

While AmerenUE claims that systemic excessive regulatory lag would justify the Commission in approving its request for an interim rate increase, a closer examination of the facts indicates otherwise.

First, AmerenUE's recent inability to earn its allowed rate of return is attributable more to the ongoing global financial crises than to any systemic regulatory lag problem in Missouri. AmerenUE made frequent reference to a chart showing actual monthly earned returns on equity compared to allowed returns.¹⁴ That chart shows AmerenUE's earnings from June 2007 through August 2009. It also reveals that between June 2007 and August 2008, AmerenUE was slightly under earning, with actual returns on equity generally ranging between 9 and 10 percent, compared to an allowed return on equity of 10.2 percent. AmerenUE's actual return on equity did not really start dropping until September 2008, when it quickly fell to below 6 percent. That substantial drop coincides with the onset of the global financial crises that has harmed not only AmerenUE, but its ratepayers as well.¹⁵ Thus, much of AmerenUE's inability to earn its allowed return on equity can be attributed to general economic factors rather than systemic regulatory lag peculiar to Missouri. Indeed, Warner Baxter, President and Chief Executive Officer of AmerenUE, acknowledged that

¹³ Pfeifenberger, Interim Direct, Ex. I, Page 3, Lines 1-10.

¹⁴ The chart is found at Baxter, Direct, Ex. A. Page 3, Line 4.

¹⁵ Transcript, Page 406, Lines 1-9.

economic factors resulting from the unprecedentedly severe global financial crises have reduced the company's revenues and earnings.¹⁶ Baxter also acknowledged, and the Commission finds, that if the economy improves, that portion of the under-earnings problem facing the company would be mitigated.¹⁷

Second, while AmerenUE is currently experiencing a large negative cash flow, some amount of negative cash flow for an electric utility such as AmerenUE is normal.¹⁸ Indeed, AmerenUE has not had a positive cash flow since 2000.¹⁹ Cash flows did not turn sharply negative until 2005 when AmerenUE sharply increased its capital expenditures.²⁰ Thus, while AmerenUE's concern about negative cash flows certainly explains the company's desire for an interim rate increase, the evidence does not demonstrate that any systemic regulatory lag problem in Missouri is causing AmerenUE's negative cash flow.

Despite AmerenUE's current negative cash flow of approximately \$150 million for 2009,²¹ the company's bond ratings have remained stable. Currently the company maintains an investment grade bond rating of BBB, A3, and A from Standard & Poor's, Moody's and Fitch respectively, and that bond rating outlook is stable.²² Furthermore, Standard & Poor's has continued to rate AmerenUE as having an excellent business risk profile.²³

¹⁶ Transcript, Page 385, Lines 9-18.

¹⁷ Transcript, Page 359, Lines 8-20.

¹⁸ Transcript, Page 439, Lines 2-4.

¹⁹ Transcript, Page 482, Lines 12-13.

²⁰ Transcript, Page 483, Lines 5-12.

²¹ Transcript, Page 482, Lines 21-24.

²² Gorman, Interim Direct, Ex. Q, Page 9, Lines 18-20, as corrected at Transcript, Page 505, Lines 14-17.

²³ Transcript, Page 472, Lines 4-12.

Third, Johannes Pfeifenberger’s study of regulatory lag in the various states, which purports to show that Missouri has more regulatory lag than all but two other states, is of doubtful validity. When questioned at the hearing, Pfeifenberger acknowledged that he had not verified the accuracy of the data included in the tables in his study.²⁴ He further acknowledged that some of the data he used is, in fact, inaccurate.²⁵ In any event, the assertion that Missouri has more regulatory lag than some other states does not establish that regulatory lag in Missouri is excessive.

Ultimately, the most important fact is that AmerenUE will continue to provide safe and adequate service to its customers with or without an interim rate increase.²⁶ As the company freely acknowledges, AmerenUE is not facing any sort of financial emergency.²⁷

Conclusions of Law

AmerenUE is an electrical corporation and a public utility, as those terms are defined by Section 386.020(15) and (43), RSMo Supp. 2008. As such, the Commission has jurisdiction over AmerenUE pursuant to Sections 386.250(1), RSMo 2000, and 393.140, RSMo 2000.

Section 393.150, RSMo 2000, allows the Commission to suspend a tariff filed by an electric utility for a maximum of 120 days, plus six months, beyond the date the tariff would otherwise become effective. That statute provides that “after a full hearing, ... the commission may make such order in reference to such rate, ... as would be proper in a proceeding initiated after the rate, ... had become effective.” The statute also states “[a]t

²⁴ Transcript, Pages 495-496, Lines 18-25, 1-5.

²⁵ Transcript, Page 498, Lines 10-14.

²⁶ Transcript, Page 410, Lines 10-21.

²⁷ Transcript, Pages 419-420, Lines 18-25, 1-4.

any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the ... electrical corporation, ...” In deciding whether a proposed rate is just and reasonable, the Commission must consider all relevant factors.²⁸ Ultimately, the Commission’s purpose is to fix a rate that is just and reasonable both to the utility and to ratepayers.²⁹

The Commission’s authority to grant an interim rate increase was recognized by the Missouri Court of Appeals in a 1976 case involving Laclede Gas Company.³⁰ The *Laclede* decision found that the Commission has an implied power to grant interim rate adjustments under the “file and suspend” provisions of the statutes that require public utilities to change rates by filing tariffs and that allow the Commission to suspend a rate change tariff to allow time to conduct a full hearing to determine whether that tariff will result in just and reasonable rates.³¹ Specifically, the *Laclede* decision holds that “the Commission has power in a proper case to grant interim rate increases within the broad discretion implied from the Missouri file and suspend statutes and from the practical requirements of utility regulation.”³²

Thus, the Commission has “broad discretion” to determine whether to grant an interim rate adjustment. In the *Laclede* case, the Commission applied an emergency standard to determine that Laclede was not facing an emergency and thus should not be

²⁸ *State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission*, 585 S.W.2d 41 (Mo. banc 1979).

²⁹ *State ex rel. Valley Sewage Co. v. Public Service Commission*, 515 S.W.2d 845, 850 (Mo. App. K.C. Dist. (1974).

³⁰ *State ex rel. Laclede Gas Co. v. Public Service Commission*, 535 S.W.2d 561 (Mo. App. K.C. Dist. 1976).

³¹ *Laclede*, at 565-567.

³² *Laclede*, at 567.

allowed to implement an interim rate increase. The *Laclede* decision upheld the Commission's use of such an emergency standard against Laclede's contention that the existing rates were so unreasonably low as to result in a confiscation of Laclede's property.³³ However, the decision does not limit the Commission's "broad discretion" by requiring the Commission to use an emergency standard when considering an interim rate adjustment.

An interim rate increase request is part of the same proceeding as the permanent rate increase request. "Consequently, orders made in the interim request cannot be considered as having been made in an action separate and apart from the permanent request. ... Thus, under such conditions an appeal from a final order made in the permanent rate case will subject to review orders made in connection with the interim case."³⁴

Decision

Based on its findings of fact and conclusions of law, the Commission finds that it has broad discretion to determine whether AmerenUE may implement an interim rate increase. In determining when an interim rate increase is appropriate, the Commission is not limited to an emergency or near emergency standard. However, any rate, including an interim rate, the Commission approves must be just and reasonable to both the utility and its ratepayers.

By its nature, an interim rate increase will take money from the pocket of ratepayers and give it to the utility's shareholders before the complete review of the company's earnings and expenses that will occur during the full rate case process. In some situations,

³³ *Laclede*, at 573-574.

³⁴ *State ex rel. Fischer v. Public Service Commission*, 670 S. W. 2d 24, 26 (Mo. App. W.D. 1984).

an interim rate increase may be appropriate, but interim rate increases should not be granted routinely and should not be implemented simply to benefit the utility's rate of return.

A utility does not need to be facing a dire emergency to justify an interim rate increase. The Commission would want to act to remedy the problem long before such a situation would arise. However, the Commission will not act to short circuit the rate case review process by granting an interim rate increase unless the utility is facing extraordinary circumstances and there is a compelling reason to implement an interim rate increase.

The Commission is sympathetic to the financial challenges facing the investor-owned electric utilities and recognizes that excessive regulatory lag may be a part of those challenges. There may be additional mechanisms or regulatory adjustments that would allow AmerenUE and the other electric utilities to deal with those challenges in the future. However, an interim rate increase should be used only in situations requiring a quick infusion of cash into a utility. An interim rate increase is not merely another regulatory tool in the Commission's tool box. It is an extraordinary tool that should only be used in extraordinary circumstances.

AmerenUE also expresses concern about the connection between its bond rating and what it calls excessive regulatory lag. It suggests that allowing it to implement an interim rate increase would partially offset the alleged adverse effects excessive regulatory lag may have on those bond ratings. However, this is a solution without a problem in that AmerenUE already maintains stable, investment-grade bond ratings. Given the effects of the current global financial crisis, attributing AmerenUE's bond ratings and related credit problems to analyst perceptions of excessive regulatory lag is merely unsubstantiated speculation.

AmerenUE did not meet its burden of proving that it is facing extraordinary circumstances and has not demonstrated a compelling reason to implement an interim rate increase. There is no systemic problem in Missouri causing excessive regulatory lag. Rather, the ongoing global financial crisis is causing AmerenUE to experience some of the same financial difficulties currently afflicting its ratepayers. Despite the difficulties cause by the economic recession, AmerenUE continues to have a solid and stable investment grade bond rating. Most importantly, AmerenUE will continue to provide safe and adequate service to its customers without the benefit of an interim rate increase.

AmerenUE is not facing an extraordinary circumstance and there is no compelling reason to implement an interim rate increase. Therefore, the Commission will reject the tariff that would implement such an increase.

IT IS ORDERED THAT:

1. The tariff sheets filed by Union Electric Company, d/b/a AmerenUE, on July 24, 2008, and assigned tariff tracking number YE-2010-0055, are rejected.
2. This report and order shall become effective on January 23, 2010.

BY THE COMMISSION



Steven C. Reed
Secretary

(S E A L)

Gunn and Kenney, CC., concur,
Clayton, Chm., concurs with separate concurring opinion attached,
Davis and Jarrett, CC., dissent, with dissenting opinions to follow.
and certify compliance with the
Provisions of Section 536.080, RSMo.

Dated at Jefferson City, Missouri,
on this 13th day of January, 2010.