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 No. YE-2010-0054

REPORT AND ORDER

Issue Date: May 28, 2010

Effective Date: June 7, 2010

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For the City of O'Fallon, the City of University City, the City of Rock Hill, and the St. Louis County Municipal Group (The Municipal Group).

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For the Missouri Retailers Association.

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.

Summary

This order allows AmerenUE to increase the revenue it may collect from its Missouri customers by approximately $226.3 million based on the data contained in the Revised True-up Reconciliation filed by the Missouri Public Service Commission Staff on April 14, 2010.

Procedural History

On July 24, 2009, Union Electric Company, d/b/a AmerenUE filed tariff sheets designed to implement a general rate increase for electric service. The tariff would have increased AmerenUE's annual electric revenues by approximately $401.5 million. The tariff revisions carried an effective date of August 23, 2009. By a separate tariff also issued on July 24, AmerenUE sought to implement an interim rate adjustment that would have allowed it to recover $37.3 million as an interim rate increase. The interim rate adjustment tariff carried an October 1, 2009 effective date.

By order issued on July 27, 2009, the Commission suspended AmerenUE's general rate increase tariff until June 21, 2010, the maximum amount of time allowed by the controlling statute.[1] In the same order, the Commission directed that notice of AmerenUE's tariff filing be provided to interested parties and the public. The Commission also established August 17, 2009, as the deadline for submission of applications to intervene. The following parties filed applications and were allowed to intervene: The International Brotherhood of Electrical Workers Locals 2, 309, 649, 702, 1439, and 1455, AFL-CIO and International Union of Operating Engineers Local 148 AFL-CIO (collectively the Unions); The Missouri Industrial Energy Consumers (MIEC);[2] The Missouri Energy Group (MEG);[3] The Missouri Department of Natural Resources; Laclede Gas Company; The Consumers Council of Missouri; AARP; The Missouri Retailers Association; The Natural Resources

[1] Section 393.150, RSMo 2000.

[2] The following members of MIEC were allowed to intervene as individual entities and as an association: Anheuser-Busch Companies, Inc.; BioKyowa, Inc.; The Boeing Company; Doe Run; Enbridge; General Motors Corporation; GKN Aerospace; Hussmann Corporation; JW Aluminum; MEMC Electronic Materials; Monsanto; Pfizer; Precoat Metals; Proctor & Gamble Company; Nestlé Purina PetCare; Noranda Aluminum; Saint Gobain; Solutia; and U.S. Silica Company.

[3] The members of MEG are Barnes–Jewish Hospital; Buzzi Unicem USA, Inc.; and SSM HealthCare.

Defense Council; the Missouri Association of Community Organizations for Reform Now (MO-ACORN); the City of O'Fallon, the City of University City, the City of Rock Hill, and the St. Louis County Municipal League (the Municipal Group); the Midwest Energy Users' Association (MEUA);[4] Charter Communications, Inc.; the Missouri Joint Municipal Electric Utility Commission; and Kansas City Power & Light Company.

On September 14, 2009, the Commission established the test year for this case as the 12-month period ending March 31, 2009, trued-up as of January 31, 2010. In its September 14 order, the Commission established a procedural schedule leading to an evidentiary hearing regarding AmerenUE's general rate increase tariff.

The Commission addressed AmerenUE's interim rate increase tariff separately. The Commission suspended that tariff from its October 1, 2009 effective date until January 29, 2010. After accepting prefiled testimony and conducting an evidentiary hearing on December 7, 2009, the Commission rejected the interim rate increase tariff in a Report and Order issued on January 13, 2010.

In January and February, 2010, the Commission conducted seventeen local public hearings at various sites around AmerenUE's service area. At those hearings, the Commission heard comments from AmerenUE's customers and the public regarding AmerenUE's request for a rate increase.

In compliance with the established procedural schedule, the parties prefiled direct, rebuttal, and surrebuttal testimony. The evidentiary hearing began on March 15, 2010, and continued through March 26. The parties indicated they had no contested true-up issues and the Commission cancelled the true-up hearing scheduled for April 12 and 13, 2010.

[4] The members of MEUA are Wal-Mart Stores and Best Buy Co. Inc.

The parties filed post-hearing briefs on April 23, 2010, with reply briefs following on April 30. Based on the revised true-up reconciliation filed by Staff on April 14, 2010, AmerenUE has reduced its rate increase request to $286,930,749.

Pending Motion

Following the hearing, on April 22, Staff and AmerenUE filed a written motion offering certain true-up exhibits into evidence. The written motion was necessary because the true-up hearing was cancelled at the request of the parties. The Commission issued an order on April 23 that established April 26 as the deadline for the parties to object to the admission of any of the submitted exhibits. MIEC filed a response on April 26 entitled Objection to True-Up Reconciliation. Despite its title, MIEC's pleading did not object to the admission of the true-up reconciliation that had been submitted by Staff as exhibit 244. Rather, MIEC's pleading asked the Commission to modify that reconciliation to correctly reflect MIEC's position on steam production – net salvage. The Commission issued an order on April 27 that modified the reconciliation as requested by MIEC and admitted all the true-up exhibits into evidence.

On May 3, AmerenUE filed a motion asking the Commission to modify a portion of its April 27 order admitting the true-up exhibits into evidence by rejecting the modification to the reconciliation offered by MIEC. MIEC filed suggestions in opposition to that motion on May 3.

AmerenUE contends the reconciliation should not be modified to reflect MIEC's asserted position on depreciation because that position is not supported by the evidence in the record. MIEC responds by asserting that its adjustment is correct. The challenged exhibit is simply Staff's reconciliation that purports to evaluate the monetary value of the

positions asserted by the various parties. At any rate, AmerenUE's motion indicates its motion will be moot if the Commission uses the life span approach to depreciation advocated by the company. This report and order does use the life span approach advocated by AmerenUE, so the motion is moot. On that basis, AmerenUE's Motion to Modify Order Admitting True-Up Exhibits is denied.

The Partial Stipulations and Agreements

During the course of the evidentiary hearing, various parties filed four nonunanimous partial stipulations and agreements resolving issues that would otherwise have been the subject of testimony at the hearing. No party opposed those partial stipulations and agreements. As permitted by its regulations, the Commission treated the unopposed partial stipulations and agreements as unanimous.[5] After considering both stipulations and agreements, the Commission approved them as a resolution of the issues addressed in those agreements.[6] The issues resolved in those stipulations and agreements will not be further addressed in this report and order, except as they may relate to any unresolved issues.

On March 17, 2010, the Office of the Public Counsel, Noranda, MIEC, AARP and the Consumers Council of Missouri, and the Missouri Retailers Association filed an additional non-unanimous stipulation and agreement that would have resolved various class cost of service and rate design issues.[7] MEUA opposed that non-unanimous stipulation and agreement, and as provided in the Commission's rules, the Commission will consider that

[5] Commission Rule 4 CSR 240-2.115(C).

[6] The Commission issued an *Order Approving First Stipulation and Agreement* on March 24, 2010. The Commission issued an *Order Approving Second Stipulation and Agreement, Third Stipulation and Agreement, and Market Energy Prices Stipulation and Agreement* on April 14, 2010.

[7] The same parties filed an addendum to their stipulation and agreement on March 26, 2010. MEUA also opposed that addendum.

stipulation and agreement to be merely a position of the signatory parties to which no party is bound.[8] The issues that were the subject of that stipulation and agreement will be determined in this report and order.

Overview

AmerenUE is an investor-owned integrated electric utility providing retail electric service to large portions of Missouri, including the St. Louis Metropolitan area. AmerenUE has approximately 1.2 million retail electric customers in Missouri, more than 1 million of whom are residential customers.[9] AmerenUE also operates a natural gas utility in Missouri but the rates it charges for natural gas are not at issue in this case.

AmerenUE began the rate case process when it filed its tariff on July 24, 2009. In doing so, AmerenUE asserted it was entitled to increase its retail rates by $401.5 million per year, an increase of approximately 18 percent.[10] AmerenUE attributed approximately $227 million of that increase to the rebasing of fuel costs that would otherwise be passed through to customers by operation of the company's existing fuel adjustment clause.[11] AmerenUE set out its rationale for increasing its rates in the direct testimony it filed along with its tariff on July 24. In addition to its filed testimony, AmerenUE provided work papers and other detailed information and records to the Staff of the Commission, Public Counsel, and to the intervening parties. Those parties then had the opportunity to review AmerenUE's testimony and records to determine whether the requested rate increase was justified.

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[8] Commission Rule 4 CSR 240-2.115(2)(D).

[9] Baxter Direct, Ex. 100, Page 4, Lines 14-15.

[10] Baxter Direct, Ex. 100, Page 5, Lines 7-8.

[11] Baxter Direct, Ex. 100, Page 5, Lines 8-11.

Where the parties disagreed, they prefiled written testimony to raise those issues to the attention of the Commission. All parties were given an opportunity to prefile three rounds of testimony – direct, rebuttal, and surrebuttal. The process of filing testimony and responding to the testimony filed by other parties revealed areas of agreement that resolved some issues and areas of disagreement that revealed new issues. On March 8, the parties filed a list of the issues they asked the Commission to resolve.

As previously indicated, a number of the identified issues were resolved by the approved partial stipulations and agreements and will not be further addressed in this report and order. The remaining issues will be addressed in turn.

Conclusions of Law Regarding Jurisdiction

A. AmerenUE is a public utility, and an electrical corporation, as those terms are defined in Section 386.020(43) and (15), RSMo (Supp. 2009). As such, AmerenUE is subject to the Commission's jurisdiction pursuant to Chapters 386 and 393, RSMo.

B. Section 393.140(11), RSMo 2000, gives the Commission authority to regulate the rates AmerenUE may charge its customers for electricity. When AmerenUE filed a tariff designed to increase its rates, the Commission exercised its authority under Section 393.150, RSMo 2000, to suspend the effective date of that tariff for 120 days beyond the effective date of the tariff, plus an additional six months.

Conclusions of Law Regarding the Determination of Just and Reasonable Rates

A. In determining the rates AmerenUE may charge its customers, the Commission is required to determine that the proposed rates are just and reasonable.[12] AmerenUE has the burden of proving its proposed rates are just and reasonable.[13]

[12] Section 393.150.2, RSMo 2000.

B. In determining whether the rates proposed by AmerenUE are just and reasonable, the Commission must balance the interests of the investor and the consumer.[14] In discussing the need for a regulatory body to institute just and reasonable rates, the United States Supreme Court has held as follows:

> Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.[15]

In the same case, the Supreme Court provided the following guidance on what is a just and reasonable rate:

> What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.[16]

The Supreme Court has further indicated:

> '[R]egulation does not insure that the business shall produce net revenues.' But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated.

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[13] *Id.*

[14] *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603, (1944).

[15] *Bluefield Water Works & Improvement Co. v. Public Service Commission of the State of West Virginia*, 262 U.S. 679, 690 (1923).

[16] *Id*. at 692-93.

> From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.[17]

C. In undertaking the balancing required by the Constitution, the Commission is not bound to apply any particular formula or combination of formulas. Instead, the Supreme Court has said:

> Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances.[18]

D. Furthermore, in quoting the United States Supreme Court in *Hope Natural Gas*, the Missouri Court of Appeals said:

> [T]he Commission [is] not bound to the use of any single formula or combination of formulae in determining rates. Its rate-making function, moreover, involves the making of 'pragmatic adjustments.' … Under the statutory standard of 'just and reasonable' it is the result reached, not the method employed which is controlling. It is not theory but the impact of the rate order which counts.[19]

The Rate Making Process

The rates AmerenUE will be allowed to charge its customers are based on a determination of the company's revenue requirement. AmerenUE's revenue requirement is calculated by adding the company's operating expenses, its depreciation on plant in rate base, taxes, and its rate of return multiplied by its rate base. The revenue requirement can

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[17] *Federal Power Commission v. Hope Natural Gas Co.,* 320 U.S. 591, 603 (1944) (citations omitted).

[18] *Federal Power Commission v. Natural Gas Pipeline Co*. 315 U.S. 575, 586 (1942).

[19] *State ex rel. Associated Natural Gas Co. v. Pub. Serv. Comm'n*, 706 S.W. 2d 870, 873 (Mo. App. W.D. 1985).

be expressed as the following formula:

Revenue Requirement = E + D + T + R(V-AD+A)
Where: E = Operating expense requirement
D = Depreciation on plant in rate base
T = Taxes including income tax related to return
R = Return requirement
(V-AD+A) = Rate base
For the rate base calculation:
V = Gross Plant
AD = Accumulated depreciation
A = Other rate base items

All parties accept the basic formula. Disagreements arise over the amounts that should be included in the formula.

The Issues

1. Rate of Return

Findings of Fact:

Introduction:

1. This issue concerns the rate of return AmerenUE will be authorized to earn on its rate base. Rate base includes things like generating plants, electric meters, wires and poles, and the trucks driven by AmerenUE's repair crews. In order to determine a rate of return, the Commission must determine AmerenUE's cost of obtaining the capital it needs.

a. Capital Structure

2. The relative mixture of sources AmerenUE uses to obtain the capital it needs is its capital structure. All parties agree that AmerenUE's actual capital structure as of the true-up date, January 31, 2010, should be used for purposes of establishing its rates in this case. Staff's True-Up Accounting Schedules described AmerenUE's actual capital structure as of January 31, 2010 as:

Long-Term Debt 47.26%

Short-Term Debt	00.00%
Preferred Stock	01.48%
Common Equity	51.26%[20]

Since all parties accept this capital structure, the Commission will not further address this matter.

3. Similarly, AmerenUE's calculation of the cost of its long-term debt and preferred stock is not disputed by any party,[21] and will not be further addressed.

b. Return on Equity

Introduction:

4. Determining an appropriate return on equity is without a doubt the most difficult part of determining a rate of return. The cost of long-term debt and the cost of preferred stock are relatively easy to determine because their rate of return is specified within the instruments that create them.[22] In contrast, in determining a return on equity, the Commission must consider the expectations and requirements of investors when they choose to invest their money in AmerenUE rather than in some other investment opportunity. As a result, the Commission cannot simply find a rate of return on equity that is unassailably scientifically, mathematically, or legally correct. Such a "correct" rate does not exist. Instead, the Commission must use its judgment to establish a rate of return on equity attractive enough to investors to allow the utility to fairly compete for the investors' dollar in the capital market, without permitting an excessive rate of return on equity that would drive up rates for AmerenUE's ratepayers. In order to obtain guidance about the

[20] Staff True-Up Accounting Schedules, Ex. 243, Schedule 12.

[21] Transcript, Page 1953, Lines 3-5.

[22] Lawton Direct, Ex. 304, Page 9, Lines 4-5.

appropriate rate of return on equity, the Commission considers the testimony of expert witnesses.

5. Four financial analysts offered recommendations regarding an appropriate return on equity in this case. Dr. Roger A. Morin testified on behalf of AmerenUE. Dr. Morin is Emeritus Professor of Finance at Robinson College of Business, Georgia State University, and Professor of Finance for Regulated Industry at the Center for the Study of Regulated Industry at Georgia State University. He holds a Bachelor of Engineering degree and an MBA in Finance from McGill University, as well as a Ph.D. in Finance and Econometrics from the Wharton School of Finance, University of Pennsylvania.[23] He recommends the Commission allow AmerenUE a return on equity of 10.8 percent.[24]

6. David Murray testified on behalf of Staff. Murray is the Acting Utility Regulatory Manager of the Financial Analysis Department for the Commission. He holds a Bachelor of Science degree in Business Administration from the University of Missouri – Columbia, and a MBA from Lincoln University. Murray has been employed by the Commission since 2000 and has offered testimony in many cases.[25] Murray recommends a return on equity within a range of 9.0 percent to 9.7 percent,[26] with a recommended midpoint of 9.35 percent.[27]

7. Stephen G. Hill also offered rate of return testimony on behalf of Staff. Hill is self-employed as a financial consultant, specializing in financial and economic issues in regulated industries. He earned a Bachelor of Science degree in Chemical Engineering from Auburn University, and a Masters degree in Business Administration from Tulane

[23] Morin Direct, Ex. 111, Page 1, Lines 6-16.

[24] Morin Rebuttal, Ex. 112, Page 52, Line 13.

[25] Staff Report – Revenue Requirement/Cost of Service, Ex. 200, Appendix 1, Page 42.

[26] Staff Report – Revenue Requirement/Cost of Service, Ex. 200, Page 37, Lines 24-26.

[27] Transcript, Page 2022, Lines 24-25.

University.[28] Hill did not offer a recommended a return on equity for AmerenUE. Instead, he offered testimony to support Murray's recommended rate of return, and to rebut the testimony offered by the other testifying return-on-equity witnesses.[29]

8. Michael Gorman testified on behalf of MIEC. Gorman is a consultant in the field of public utility regulation.[30] He holds a Bachelors of Science degree in Electrical Engineering from Southern Illinois University and Masters Degree in Business Administration with a concentration in Finance from the University of Illinois at Springfield.[31] Gorman recommends the Commission allow AmerenUE a return on equity within a range of 9.5 percent to 10.5 percent, with a recommended midpoint of 10.0 percent.[32]

9. Finally, Daniel J. Lawton testified on behalf of Public Counsel. Lawton is a consultant who holds a Bachelor of Arts degree in Economics from Merrimack College and a Master of Arts in Economics from Tufts University.[33] Lawton recommends the Commission allow AmerenUE a return on equity within a range of 9.3 percent to 10.9 percent,[34] with a recommended midpoint of 10.1 percent.[35]

Specific Findings of Fact:

10. A utility's cost of common equity is the return investors require on an investment in that company. Investors expect to achieve their return by receiving dividends and stock

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[28] Hill Rebuttal, Ex. 212, Page 1, Lines 7-15.

[29] Hill Surrebuttal, Ex. 213, Pages 22-23, Lines 20-26, 1-23.

[30] Gorman Direct, Ex. 408, Page 1, Line 5.

[31] Gorman Direct, Ex. 408, Appendix A, Page 1, Lines 10-12.

[32] Gorman Direct, Ex. 408, Page 2, Lines 9-11.

[33] Lawton Direct, Ex. 304, Schedule DJL-1.

[34] Lawton Direct, Ex. 304, Page 5, Lines 11-12.

[35] Transcript, Page 2186, Lines 15-17.

price appreciation[36] Financial analysts use variations on three generally accepted methods to estimate a company's fair rate of return on equity. The Discounted Cash Flow (DCF) method assumes the current market price of a firm's stock is equal to the discounted value of all expected future cash flows. The Risk Premium method assumes that all the investor's required return on an equity investment is equal to the interest rate on a long-term bond plus an additional equity risk premium to compensate the investor for the risks of investing in equities compared to bonds. The Capital Asset Pricing Method (CAPM) assumes the investor's required rate of return on equity is equal to a risk-free rate of interest plus the product of a company-specific risk factor, beta, and the expected risk premium on the market portfolio. No one method is any more "correct" than any other method in all circumstances. Analysts balance their use of all three methods to reach a recommended return on equity.

11. Before examining the analyst's use of these various methods to arrive at a recommended return on equity, it is important to look at another number. For 2009, the average return on equity awarded to integrated electric utilities by state commissions in this country was 10.59 percent, as reported by Regulatory Research Associates.[37]

12. The Commission mentions the average allowed return on equity not because the Commission should, or would slavishly follow the national average in awarding a return on equity to AmerenUE. However, AmerenUE must compete with other utilities all over the country for the same capital. Therefore, the average allowed return on equity provides a reasonableness test for the recommendations offered by the return on equity experts.

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[36] Gorman Direct, Ex. 408, Page 15, Lines 10-12.

[37] Morin Rebuttal, Ex. 112, Page 2, Lines 11-14.

13. In his direct testimony filed on behalf of AmerenUE, which he submitted in July 2009, Dr. Morin recommended AmerenUE be allowed a return on equity of 11.5 percent.[38] By February 11, 2010, when he submitted his rebuttal testimony, Dr. Morin had reduced this recommended return on equity to 10.8 percent.[39] Dr. Morin did not change his methodology, but his updated analysis used December 2009 stock prices that were higher than the prices he had used in his July 2009 testimony.[40] He testified that his rebuttal testimony was intended to supersede his direct testimony[41] and that a recommendation of 11.5 percent would be ludicrous at the time of the hearing.[42] The Commission will consider Dr. Morin's recommendation of 10.8 percent when deciding an appropriate return on equity for AmerenUE.

14. Three of the four return on equity experts offered recommendations between 10.0 percent and 10.8 percent. The fourth recommendation, the 9.35 percent recommended by Staff's witness David Murray, is lower than the other recommendations, and is substantially lower than the 2009 national average of allowed returns on equity of 10.59 percent.[43]

15. Murray's recommendation is low because the three stage DCF analysis he performed relies on an unreasonably low long-term growth estimate of 3.1 percent. Murray based his long-term growth rate on the Energy Information Administration's projection of long-term growth in the usage of electricity plus an inflation factor.[44] Murray's calculation of

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[38] Morin Direct, Ex. 111, Page 5, Lines 17-20.

[39] Morin Rebuttal, Ex. 112, Page 56, Lines 9-11.

[40] Morin Rebuttal, Ex. 112, Pages 52-53.

[41] Transcript, Page 1828, Lines 1-4.

[42] Transcript, Page 1898, Lines 19-20.

[43] Morin Rebuttal, Ex. 112, Page 6, Lines 22-28.

[44] Staff Report – Revenue Requirement/Cost of Service, Pages 26-27, Lines 6-28, 1-8.

a long-term growth rate based on the anticipated growth of demand for electricity is inconsistent with the requirements of the DCF model, which relies on earnings/dividends growth.[45] If Murray had instead relied on the historical growth in real GDP for the United States from 1929 through 2008, plus an inflation factor, he would have derived a long-term growth forecast of 6.0 percent.[46]

16. Murray's DCF analysis also contrasts sharply with the DCF analysis performed by the other return on equity experts, who relied on forecasted growth rates published by reputable investment analysts. As Public Counsel's witness, Daniel Lawton, explained at the hearing, the growth in the use of electricity is not a good measure of the actual growth in an electric utilities earnings because earnings growth can come from more than just the growth in the demand for electricity.[47] Lawton also defended his, and other analyst's use of forecasted growth rates, testifying: "relying on published price, dividend and growth rate data and forecasts is not different or unique. … this is what regulatory authorities typically consider to determine a reasonable return for setting fair and just rates for consumers."[48] Lawton testified that he would never use projected growth in electricity demand as a component in the growth rate in a DCF analysis so long as analyst forecasts were available[49] and that he has never seen another analyst use such a projection in the way Murray used it.[50]

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[45] Morin Rebuttal, Ex. 112, Page 18, Lines 1-2.

[46] Morin Rebuttal, Ex. 112, Page 18, Lines 6-22.

[47] Transcript, Page 2183, Lines 19-25.

[48] Lawton Surrebuttal, Ex. 306, Page 5, Lines 15-18.

[49] Transcript, Page 2211, Lines 8-15.

[50] Transcript, Pages 2210-2211, Lines 12-25, 1-7.

17. In an attempt to support the reasonableness of his very low return on equity recommendation, Murray cites several analyst reports that suggest they anticipate AmerenUE will earn a return on equity of under 9 percent.[51] As further support, Murray points to information from the Missouri State Employees' Retirement System's website that would indicate the pension fund expects future returns on equities of only 8.5 percent.[52]

18. Murray's reliance on analyst reports to support his recommendation is misplaced. Most investors do not have access to the specific analyst reports that Murray examined and thus they cannot rely on them in deciding where to invest their money.[53] More fundamentally, the analyst reports upon which Murray relies are designed to project what the analyst expects a company to earn, not what would be a reasonable return for the company to earn.[54] In other words, an analyst may conclude that AmerenUE will not earn a reasonable return and recommend that investors not invest in that company. That analyst's projection should not then be used to test the reasonableness of a recommendation of the amount a company will need to earn to attract investment.

19. Similarly, Murray's use of information about the investment expectations of a state pension fund to test the reasonableness of his recommendation is not appropriate. Murray indicated he is not aware of any other analyst who uses such information in that manner;[55] although Staff's other return on equity witness, Stephen Hill, recently had a similar

[51] Staff Report – Revenue Requirement/Cost of Service, Ex. 200, Pages 31-35.

[52] Staff Report – Revenue Requirement/Cost of Service, Ex. 200, Page 35, Lines 20-27.

[53] Transcript, Page 2213, Lines 4-24.

[54] Transcript, Page 2298, Lines 3-11.

[55] Transcript, Page 2058, Lines 2-8.

argument rejected by the California PUC.[56] The problem with using a pension fund's expectations in this way is that pension funds have different investment goals and thus are not well suited to assessing the cost of equity capital in a rate proceeding.[57]

20 The Commission finds that Staff's recommended return on equity of 9.3 percent is not an appropriate return on equity for AmerenUE.

21. The other three witnesses who recommend rates of return used similar methods of analysis and achieved similar results.[58] The recommendations offered by Gorman for MIEC and Lawton for Public Counsel are very close to each other, with Gorman at 10.0 percent and Lawton at 10.1 percent. Dr. Morin is higher at 10.8 percent.

22. Part of the reason Dr. Morin's recommendation is higher than the other recommendations is that the only DCF model he relied on was a constant growth DCF model. As Gorman explained in describing why he did not rely on this own constant growth DCF results that showed a return on equity of 11.2 percent, "the constant growth DCF return is not reasonable and represents an overstated return for AmerenUE at this time."[59] He went on to explain that the constant growth DCF result is overstated because it is based on a unsustainably high dividend yield and median growth rate.[60] Morin's constant growth DCF suffers from the same deficiencies as Gorman described for his own constant growth analysis.[61]

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[56] Morin Rebuttal, Ex. 112, Page 26, Lines 1-30, *citing, In re S. Cal Edison Co.,* 262 P.U.R. 4th 53, 72 (Ca. Pub. Utils. Comm'n. 2007).

[57] Morin Rebuttal, Ex. 112, Pages 26-27, Lines 33-34, 1-5., *see also,* Transcript, Page 2212, Lines 4-19.

[58] Transcript, Page 1839, Lines 8-13.

[59] Gorman Direct, Ex. 408, Page 24, Lines 11-12.

[60] Gorman Direct, Ex. 408, Page 24, Lines 12-16.

[61] Gorman Rebuttal, Ex. 409, Page 10, Lines 1-6.

23. Gorman and Lawton took those deficiencies into account and based their recommendations on additional sustainable growth DCF and multi-stage DCF models. Gorman's sustainable long-term growth rate resulted in a median DCF return of 10.2 percent,[62] while his multi-stage growth rate resulted in a DCF return of 10.16 percent.[63] Lawton's two-stage DCF analysis showed a cost of equity between 10.2 and 10.4 percent,[64] compared to the 10.9 to 11.1 percent cost of equity shown by his constant growth DCF analysis.[65]

24. In contrast, despite his belief that it is important to "use a whole bunch of techniques",[66] Morin relied on his constant growth DCF analysis and did not analyze any other form of DCF. However, in his rebuttal testimony, Gorman reworked Morin's constant growth DCF analysis as a multi-stage growth analysis, using updated stock price data, current dividends and recent analysts' growth rate estimates. Gorman arrived at a 10.0 percent cost of equity, which is 56 basis points lower than his similar reworking of Morin's constant growth DCF analysis.[67] All three analysts balanced the results of their DCF analysis with risk premium and CAPM analyses that ranged between the low to mid 9 percent and the low ten percent area. Thus, the chief difference between their recommendations is their non-constant growth analyses. Therefore, it is reasonable to believe that if Dr. Morin had performed a multi-stage DCF analysis, as he should have, his recommendation might be in the low 10 percent area along with Gorman and Lawton.

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[62] Gorman Direct, Ex. 408, Page 31, Lines 13-14.

[63] Gorman Direct, Ex. 408, Page 34, Lines 5-8.

[64] Lawton Direct, Ex. 304, Page 25, Lines 19-21.

[65] Lawton Direct, Ex. 304, Page 24, Lines 15-16.

[66] Transcript, Page 1890, Lines 23-24.

[67] Gorman Rebuttal, Ex. 409, Page 12, Lines 1-8.

25. Based on its consideration of the testimony of all the experts, the Commission finds that a return on equity of 10.1 percent is a fair and reasonable return on equity for AmerenUE at this time. That is the return on equity recommended by Lawton and the Commission finds that Lawton was the most credible and reliable expert witness. However, 10.1 percent is a reasonable return on equity aside from the fact that it happens to match the recommendation of one of the witnesses. The Commission's decision to use the return on equity recommended by Lawton should not be taken to disparage the credibility of the other witnesses.

26. A return on equity of 10.1 percent is somewhat lower than the 10.59 percent 2009 average return on equity awarded to integrated electric utilities by state commissions. However, as Dr. Morin and the other expert witnesses indicated, economic facts have changed substantially since 2009. Dr. Morin's own recommendation dropped 70 basis points between July 2009 and February 2010 due to changes in the capital market.[68] Therefore, a slight reduction in allowed return on equity from the 2009 average is reasonable.

Conclusions of Law:

A. In assessing the Commission's ability to use different methodologies to determine just and reasonable rates, the Missouri Court of Appeals has said:

> Because ratemaking is not an exact science, the utilization of different formulas is sometimes necessary. … The Supreme Court of Arkansas, in dealing with this issue, stated that there is no 'judicial mandate requiring the Commission to take the same approach to every rate application or even to consecutive applications by the same utility, when the commission in its expertise, determines that its previous methods are unsound or inappropriate

[68] Transcript, Page 1827, Lines 9-21.

> to the particular application' (quoting *Southwestern Bell Telephone Company v. Arkansas Public Service Commission,* 593 S.W. 2d 434 (Ark 1980).[69]

Furthermore,

> Not only can the Commission select its methodology in determining rates and make pragmatic adjustments called for by particular circumstances, but it also may adopt or reject any or all of any witnesses' testimony.[70]

B. In another case, the Court of Appeals recognized that the establishment of an appropriate rate of return is not a "precise science":

> While rate of return is the result of a straight forward mathematic calculation, the inputs, particularly regarding the cost of common equity, are not a matter of 'precise science,' because inferences must be made about the cost of equity, which involves an estimation of investor expectations. In other words, some amount of speculation is inherent in any ratemaking decision to the extent that it is based on capital structure, because such decisions are forward-looking and rely, in part, on the accuracy of financial and market forecasts.[71]

Decision:

Based on the evidence in the record, on its analysis of the expert testimony offered by the parties, and on its balancing of the interests of the company's ratepayers and shareholders, as fully explained in its findings of fact and conclusions of law, the Commission finds that 10.1 percent is a fair and reasonable return on equity for AmerenUE. The Commission finds that this rate of return will allow AmerenUE to compete in the capital market for the funds needed to maintain its financial health.

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[69] *State ex rel. Assoc. Natural Gas Co. v. Public Service Commission,* 706 S.W. 2d 870, 880 (Mo. App. W.D. 1985).

[70] *Id.*

[71] *State ex rel. Missouri Gas Energy v. Public Service Commission*, 186 S.W.3d 376, 383 (Mo App. W.D. 2005).

2. Depreciation

Findings of Fact:

Introduction to Depreciation Issues:

1. Depreciation is the means by which a utility is able to recover the cost of its investment in its rate base by recognizing the reduction in value of that property over the estimated useful life of the property. Depreciation rates should be designed to allow the utility to recover, over the average service life of the assets in that account, the original cost of the assets, plus an estimate of any cost to remove the asset, less scrap value of the asset.[72]

2. The fundamental goal of depreciation is to ensure that the correct amount of depreciation is recovered from each generation of customers over the actual service life of the property.[73] If a depreciation rate is set too high, an excess amount will be recovered from current customers. If a depreciation rate is set too low, the cost of the asset will not be fully recovered during its life, and the unrecovered cost will be dumped on the customers receiving service at the time the asset is retired.

3. The parties disagreed about several aspects of depreciation. The most fundamental disagreement is about whether to use a life span or a mass property approach to determine an appropriate depreciation rate for AmerenUE's steam and hydraulic electric production plant accounts. That is the first depreciation issue the Commission will address.

a. Use of Life Span Versus Mass Property Approach to Determine Depreciation Rates for Steam and Hydraulic Plant Accounts

Introduction:

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[72] Staff Report – Revenue Requirement/Cost of Service, Ex. 200, Page 96, Lines 9-11.

[73] Wiedmayer Rebuttal, Ex. 105, Page 15, Lines 2-5.

4. John Wiedmayer, a consultant with Gannet Fleming, Inc., sponsored the depreciation study submitted by AmerenUE[74] His depreciation study uses a life span approach for determining appropriate depreciation rates for steam and hydraulic plant accounts. The steam and hydraulic plants to which these depreciation rates would apply, are AmerenUE's four coal-fired steam generating electric plants, the Meramec, Sioux, Labadie, and Rush Island stations, and hydraulic generating plants at Osage (Bagnall Dam), Keokuk, and Taum Sauk.

5. Arthur Rice, a Utility Regulatory Engineer I for the Commission sponsored a depreciation study submitted by Staff.[75] Staff's depreciation study treats all steam production and all hydraulic plant as mass property.

6. James Selecky, a consultant with Brubaker & Associates,[76] and William Dunkel, a consultant with William Dunkel and Associates,[77] offered testimony on behalf of MIEC that proposed adjustments to the depreciation studies of both AmerenUE and Staff. Selecky advocated the use of a mass property approach because this Commission has used that approach in the past. As an alternative, Selecky suggested modifications to AmerenUE's life span approach if the Commission decided to use that approach.

7. The life span approach to depreciation is premised on the fact that the equipment in a power plant does not remain unchanged during the life of the plant. Instead, interim additions, replacements, and retirements occur regularly throughout the life of the plant.[78] For example, a particular valve on a boiler might have an estimated service life of 50 years.

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[74] Wiedmayer Direct, Ex. 104, Page 1, Lines 10-11.

[75] Staff Report – Revenue Requirement/Cost of Service, Ex. 200, Appendix 1. Page 51.

[76] Selecky Direct, Ex. 404 NP, Page 1, Lines 5-6.

[77] Dunkel Rebuttal, Ex. 407, Page 1, Lines 6-7.

[78] Wiedmayer Direct, Ex. 104, Page 5, Lines 9-10.

A depreciation rate for that valve would be set accordingly. In a power plant that went into service in 1960, that valve might be replaced in 2010 with a new valve that again has an estimated service life of 50 years. However, the valve installed into the plant in 2010 has been installed in a power plant that is already 50 years old. If it is assumed that the entire power plant will be retired when it is 60 years old, in 2020, the estimated service life of the valve installed in 2010 will have to be truncated at 10 years. Thus, the depreciation rate for that valve will need to be set to recover its cost over 10 years instead of 50. The life span approach reflects the unique average service lives that are experienced by each year of installation by recognizing the amount of time remaining between the year of installation and the anticipated final retirement of the power plant.

8. For purposes of its life span depreciation study, AmerenUE engaged the services of Black & Veatch Corporation to prepare a study to estimate the retirement dates for its steam powered electric plants.[79] Larry Loos, a Professional Engineer employed by Black & Veatch, sponsored that study through his testimony. The Black & Veatch study estimated the following retirement dates for AmerenUE's steam generating plants:

Meramec	2022
Sioux	2033
Labadie – Units 3 and 4	2038
Labadie – Units 1 and 2	2042
Rush Island	2046[80]

[79] Loos Direct, Ex. 107, Page 5, Lines 18-19.

[80] Loos Direct, Ex 107, Page 14, Lines 2-8.

9. To estimate retirement dates for the hydraulic plants, AmerenUE assumed that the plants would be retired when the operating licenses for the plants expire.[81] The resulting estimated retirement dates for the hydraulic plants are as follows:

Osage	2047
Keokuk	2055
Taum Sauk	2049[82]

10. Staff contends that estimated retirement dates for power plants are inherently unreliable. For that reason, Staff advises the Commission to use a mass property approach to establish depreciation rates for those accounts. Under a mass property approach, all steam plant property from all the plants is examined in a single mortality study. That single study does not differentiate between interim and final retirements; all retirements are considered when determining an estimated service life for the property. Because final retirements that occur when an entire power plant is retired are included in the mix, Staff contends the early retirement of some property will be taken into account when depreciation rates are established.[83]

Specific Findings of Fact:

11. There is nothing wrong with the use of a mass property approach in theory. For some items of property it is perfectly appropriate and is properly used for many purposes in the depreciation studies of both AmerenUE and Staff. For example, the mass property approach is used to determine depreciation rates for items such as poles, meters, and line transformers. Every year AmerenUE adds thousands of poles, meters, and line

[81] Wiedmayer Rebuttal, Ex. 105, Page 12, Lines 3-12.

[82] Wiedmayer Direct, Ex. 104, Schedule JFW-E1, Page III-6.

[83] Staff Report – Revenue Requirement/Cost of Service, Ex. 200, Page 104, lines 1-29.

transformers to its system. Those individual poles may be retired at any age, depending upon accidents, lightning strikes, road construction, insect damage, or any number of independent causes.[84] The key point is that the life of each pole is independent of other poles. One may be hit by a truck when it is only one year old, while another may still be in service 60 years later. But there are enough poles in service to allow for a meaningful study to determine how long an average pole will remain in service and establish a depreciation rate accordingly.

12. The problem with treating power plant equipment as mass property is that retirements of large electric power plants are rare events. When Staff's witness examined AmerenUE's property retirement data, that data included final retirement data from only four steam plants, Mound, Cahokia, Venice 1 and Venice 2.[85] The first three of those retired plants were old, small, and inefficient plants retired in the 1970s.[86] Venice 2 was retired in 2002 after a fire.[87] Furthermore, there is very little retirement date available from even those plants because the dollars involved are very small compared to AmerenUE's investment in its current steam plants.[88] There is no final retirement data for the hydraulic plants, as AmerenUE has never shut down a hydraulic plant.[89]

13. Thus, the available retirement data for AmerenUE's steam and hydraulic plants is only indicative of interim retirements that occur during the life of the power plants and fails to provide any useful information about final retirements. As a result, a mass property

[84] Wiedmayer Rebuttal, Ex. 105, Page 8, Lines 6-12.

[85] Transcript, Page 1384, Lines 11-16.

[86] Selecky Rebuttal, Ex. 405, Page 4, Lines 1-14. See also, Wiedmayer, Surrebuttal, Ex. 106, Page 4-5, lines 21-23, 1.

[87] Selecky Rebuttal, Ex. 405, Pages 4-5, Lines 15-24, 1-5.

[88] Transcript, Pages 1384-1385, Lines 21-25, 1-2.

[89] Transcript, Page 1385, Lines 3-8.

analysis will overstate the average service life of the steam plant property.[90] Indeed, when cross-examined, Staff's witness agreed that he did not have enough data to obtain a true mass property result for the steam or hydraulic plants.[91]

14. The problem of a lack of reliable data is likely the reason all authority cited by the parties states that life span is the appropriate method to use in determining depreciation rates for power plant accounts. *Public Utility Depreciation Practices*, published in 1996 by the National Association of Regulatory Utility Commissioners (NARUC), specifically states that electric power plants are to be treated as life span property.[92] Similarly, the leading textbook on depreciation accounting, *Depreciation Systems*, written by Dr. Frank Wolf and Dr. Chester Finch, clearly indicates that electric generating equipment is to be depreciated using a life span approach instead of a mass property approach.[93] Even Staff's own depreciation manual, which Staff's witness relied upon in preparing his depreciation study,[94] indicates the life span approach is appropriately used to determine depreciation for electric power plants.[95]

15. Not surprisingly, given the support in the literature for the use of the life span approach when determining depreciation rates for electric power plant property, it appears that every other state commission around the country uses the life span approach for

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[90] Wiedmayer Surrebuttal, Ex. 106, Page 9, Lines 1-11.

[91] Transcript, Page 1385, Lines 9-16.

[92] Wiedmayer Rebuttal, Ex. 105, Pages 12-13, Lines 13-25, 1-4.

[93] Wiedmayer Rebuttal, Ex. 105, Page 13, Lines 6-25.

[94] Transcript, Page 1362, Lines 17-21.

[95] *Contents & Outline of a Depreciation Study*, Ex. 231, Pages 44-45. Specifically, that manual states: "Unlike mass utility property such as poles, mains, conductors, etc. there exists utility property that requires some forecast as to its date of retirement. Types of plant applicable to this type of analysis are buildings, *electric power plants*, telephone switching equipment, gas storage fields, etc." (emphasis added).

electrical production facilities.[96] Unfortunately, it appears that the only state commission that has used a mass property approach to determine depreciation rates for electric production facilities is this commission. In an earlier AmerenUE rate case, ER-2007-0002[97], the Commission authorized the use of a mass property approach for electric production facilities. The Commission did so because of frustration over the inadequate evidence AmerenUE presented to establish reasonably likely retirement dates for its electric power plants.

16. In that earlier case, AmerenUE initially estimated that all its power plants would be retired in 2026. After the other parties criticized that retirement date as arbitrary, the company arbitrarily estimated that all its power plants would be retired 60 years after they went on line. In accepting Staff's proposed mass property proposal in that case, the Commission said "without better evidence of when those plants are likely to be retired, allowing the company to increase its depreciation expense based on what is little more than speculation about possible retirement dates would be inappropriate."[98] Thus, the Commission authorized the use of a mass property approach in that particular case, but did not reject the life span approach in general.

17. For this case, AmerenUE presented a detailed study by Black & Veatch that presented thoughtfully calculated retirement dates for each of its coal-fired steam production plants. Those estimated retirement dates would retire the steam production

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[96] Wiedmayer Direct, Ex.104, Pages 30-31, Lines 5-23, 1-10.

[97] *In the Matter of Union Electric Company d/b/a AmerenUE's Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area,* Report and Order, Case No. ER-2007-0002, May 22, 2007.

[98] *Id*. at Page 84.

plants after between 61 and 72 years of service,[99] which is on the high-end of estimated retirement dates used for life span analysis for other utilities by other state commissions.[100]

18. Aside from a proposal to extend the life span of the Meramec unit, which will be addressed in detail later in this Report and Order, MIEC's expert witness, James Selecky, agreed that the Black & Veatch study produced reasonable retirement dates that he used to develop his own life span depreciation rates. He also agreed that the Black & Veatch study was reasonable and logical, and substantially better than the approach AmerenUE used in ER-2007-0002.[101]

19. Staff's expert witness, Arthur Rice, agreed that the Black & Veatch study is "relatively complete and logical" and "well done".[102] He also agreed that the estimated retirement dates presented by AmerenUE are "reasonable."[103] Although Staff's brief claims that AmerenUE's estimated retirement dates are unreliable because AmerenUE did not perform an economic study regarding the retirement of those plants, the number of assumptions and the nature of the assumptions required to make such an economic analysis for events that will happen 12 to 37 years in the future, render such analysis impractical.[104]

20. The Black & Veatch study does not independently establish retirement dates for AmerenUE hydraulic production plants. Instead, AmerenUE's life span study assumes that

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[99] Selecky Direct, Ex. 404 NP, Schedule JTS-2.

[100] Transcript, Page 1482, Lines 14-21.

[101] Transcript, Page 1483, Lines 3-23.

[102] Transcript, Page 1397, Lines 2-12.

[103] Exhibit 168.

[104] Loos Surrebuttal, Ex. 108, Page 8, Lines 9-11.

those plants will be retired when their operating licenses expire.[105] That is the same assumption the Commission has previously used to estimate the retirement date of AmerenUE's Callaway nuclear production plant for purposes of a life span depreciation calculation.[106] AmerenUE's estimated retirement dates would have Taum Sauk retire after 86 years of service, Osage after 94 years of service, and Keokuk after 142 years of service.[107]

21. There is no way to know for sure when the hydraulic plants will be retired. The same can be said about the steam production plants. But it is unreasonable to assume that the plants will last forever. As previously indicated, a mass property approach is not appropriate because of the lack of available retirement data upon which such a study could be based. A life span depreciation study requires an estimated retirement date and the assumed retirement dates for the hydraulic plants are reasonable.

22. It is important to remember that the assumed retirement dates for purposes of a depreciation study are not fixed forever and certainly do not mean that the plant will actually be retired on the assumed retirement date. Future depreciation studies in future rate cases may rely on different estimated retirement dates as further information becomes available and circumstances change. Ultimately, depreciation rates will be adjusted to match the new information so that the correct amount of depreciation is recovered from each generation of customers over the actual service life of the property.

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[105] Wiedmayer Rebuttal, Ex. 105, Page 12, Lines 3-12.

[106] *In the Matter of Union Electric Company d/b/a AmerenUE's Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area,* Report and Order, Case No. ER-2007-0002, May 22, 2007, Pages 87-88.

[107] Selecky Direct, Ex. 404 NP, Schedule JTS-2.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

The Commission finds that it is appropriate to use a life span approach to determine depreciation rates for AmerenUE's steam and hydraulic electric production accounts. The Commission finds that the estimated retirement dates proposed by AmerenUE for that purpose are reasonable, with the exception of the retirement date for the Meramec steam production plant, which is addressed later in this order.

b. Proposed Extension of the Lifespan of the Meramec Plant

Findings of Fact:

Introduction:

23. AmerenUE currently operates the Meramec coal-fired steam production plant, located southeast of St. Louis, at the confluence of the Meramec and Mississippi Rivers. The Meramec Generating Station has four pulverized coal subcritical power generating units. Units 1 and 2 were built in 1953 and 1954 respectively; each has a capacity of 138 MW. Unit 3, which has a capacity of 289 MW, was built in 1959, while Unit 4, which has a capacity of 359 MW, was built in 1961.[108] The Black & Veatch study upon which AmerenUE relies to calculate depreciation rates for its steam production plant estimates that AmerenUE will retire its Meramec coal-fired steam production plant in 2022.[109] MIEC's

[108] Loos Direct, Ex. 107, Schedule LWL-E1, Appendix B, Page B-2.

[109] Loos Direct, Ex. 107, Page 14, Line 4.

witness, James Selecky, contends the estimated retirement date for the Meramec plant should be extended by five years to 2027.[110]

Specific Findings of Fact:

24 There are two reasons the estimated retirement date for the Meramec plant should be extended. First, AmerenUE forecasts an average life span for its other steam production units of approximately 69 years. AmerenUE's predicted life span for Meramec Unit 3 is only 63 years, with a predicted life span for Meramec Unit 4 of 61 years. Extending the predicted life span of Meramec by five years would bring it more in line with the predicted life span of the other coal-fired plants.[111]

25. Second, the Black & Veatch study, upon which AmerenUE based its predicted life spans, indicates that its choice of an expected retirement date for the Meramec plant is based, at least in part, on the assumptions of AmerenUE's Integrated Resource Plan.[112] That plan assumed that AmerenUE would build a second nuclear reactor at its Callaway plant to replace the capacity of the Meramec plant,[113] but AmerenUE is no longer planning to build Callaway 2,[114] and has no plans on how to replace the Meramec plant's capacity.[115] That implies that AmerenUE may keep Meramec in operation beyond 2022.

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[110] Selecky Direct, Ex. 404 NP, Page 22, Lines1-15.

[111] Selecky Direct, Ex. 403HC, Page 22, Lines 3-8.

[112] Loos Direct, Ex. 107, Page 14, Lines 1-13. The Black & Veatch study is attached to Loos' direct as Schedule LWL-E1. The study's reference to the IRP filing is found at page 3-4 of the schedule.

[113] Transcript, Page 1286, Lines 14-18.

[114] Birk Rebuttal, Ex. 103, Page 12, Lines 16-.

[115] Transcript, Page 1286, Lines 19-22.

26. Indeed, the study prepared for AmerenUE by Burns & McDonnell Engineering Company indicates the Meramec plant could be kept in operation substantially past 2022 if its capacity is needed and if its operation is economically viable.[116]

27. Of course, no one can know for certain whether the continued operation of the Meramec plant beyond 2022 will be economically viable. As AmerenUE's own witness testified, the number of assumptions and the nature of the assumptions required make that sort of economic analysis impractical.[117] AmerenUE's estimated retirement dates are not set in stone and may change in a future depreciation study as more information becomes available. But based on the evidence presented, the Commission finds that it is reasonable to assume an additional five years of life for the Meramec plant. This adjustment will reduce AmerenUE's revenue requirement by approximately $10 million.[118]

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

AmerenUE shall calculate depreciation for its steam production plant based on the assumption that the Meramec steam production plant will be retired in 2027.

c. Net Salvage Percentage for Account 312 Boiler Equipment

Findings of Fact:

Introduction:

28. Net salvage is the salvage value of property retired, less the cost of removal. Net salvage value is positive if the salvage value exceeds removal cost and negative if removal

[116] Ex 434 HC, Page 5-2. The entire exhibit is highly confidential so the Commission will not disclose the details of the report.

[117] Loos Surrebuttal, Ex. 108, Page 8, Lines 9-11.

[118] Transcript, Page 1523, Lines 14-19.

costs exceed the salvage value.[119] AmerenUE chose not to request depreciation recovery of terminal net salvage[120] for its power plants, so the net salvage percentages at issue are only for interim net salvage.[121] AmerenUE's depreciation witness, John Wiedmayer, testified that the historical net salvage indication for Account 312, Boiler Plant Equipment is negative 25 percent. He adjusted his net salvage estimate to 15 percent on the assumption that 60 percent of the retirements are interim retirements, based on an estimated interim survivor curve.[122] Presumably, the other 40 percent of retirements would be terminal, when the power plant is finally retired.

29. MIEC's depreciation witness, James Selecky, recommended the net salvage ratio for this account be reduced from negative 15 percent to negative 10 percent.[123] Selecky recommends this reduction because of his contention that AmerenUE's current interim net salvage depreciation rates have allowed the company to collect more depreciation from customers than the depreciation expenses the company has actually experienced.[124] To avoid what he describes as an over collection, Selecky calculated the average amount of depreciation expense AmerenUE has experienced over the last five and ten years, adjusted that average for inflation to derive an annual amount AmerenUE could expect to recover over the next thirty years, and reduced the net salvage ratio to allow AmerenUE to recover only that amount.

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[119] Wiedmayer Rebuttal, Ex. 105, Page 60, Lines 5-9.

[120] Terminal net salvage relates to decommissioning and dismantlement costs associated with the final retirement of power plants.

[121] Wiedmayer, Rebuttal, Ex. 105, Page 47, Lines 16-19.

[122] Wiedmayer Rebuttal, Ex. 105, Page 47, Lines 19-23.

[123] Selecky Direct, Ex. 404 NP, Page 23, Lines 7-12.

[124] Selecky Direct, Ex. 404 NP, Page 24, Lines 1-7.

Specific Findings of Fact:

30 Selecky's reliance on recent historical levels of interim net salvage expense to set future rates is misplaced. As Wiedmayer explains in his rebuttal testimony:

> net salvage percents are likely to increase as plants age due to the increasing average age of retirements. As the average age of retirements increase, the price level change from the year of initial construction to the year the asset is retired becomes more pronounced and this has an impact on the historical net salvage percents due to the effect of inflation.[125]

For example, a valve that is on the company's books at a cost of $100 when it was installed in 1960, might have cost $125 to remove if it had been replaced in 1990. Because of inflation, to remove the same $100 valve in 2010, might cost $150. To remove it in 2020 might cost $175. Thus, for each year that passes, the ratio of cost of removal to the cost of the valve will increase. For that reason, net salvage estimates need to consider what is likely to occur in the future and properly reflect that information in the estimates.

31. Selecky's proposed reduction to the net salvage ratio simply looks at recent historical depreciation expenses and inflates those number by a constant three percent per year.[126] This arbitrary approach contrasts with Wiedmayer's considered analysis to arrive at a conservative net salvage ratio of 15 percent. In fact, that analysis revealed that a three-year moving average of net salvage percents is above negative 30 percent for every three-year period since 1998.[127]

32. Selecky's only response to Wiedmayer's detailed analysis was to criticize Wiedmayer's decision to reduce his net salvage estimate from negative 25 percent to negative 15 percent based on an assumption that 60 percent of the retirements will be

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[125] Wiedmayer Rebuttal, Ex. 105, Page 48, Lines 8-12.

[126] Selecky Direct, Ex. 404 NP, Schedule JTS-6.

[127] Wiedmayer Rebuttal, Ex. 105, Page 48. Lines 14-19.

interim retirements, meaning that the remaining 40 percent would be final retirements. Selecky points out that elsewhere in his testimony, Wiedmayer states that when the four coal plants currently in service retire nearly 50 to 80 percent of the retirements will be final retirements. Selecky implies that this supposed inconsistency makes Wiedmayer's study unreliable and justifies his simpler approach based on recent historical expenses.[128]

33. The supposedly inconsistent statement is in Wiedmayer's rebuttal testimony. When discussing the general mix of interim and final retirements and the difference between life span and mass property analysis, Wiedmayer said "a substantial portion, nearly 50 to 80 percent, of the retirements associated with life span property will occur on one date in the future when the plant is retired."[129] Wiedmayer's general statement applied to all of the numerous plant accounts for which the company used a life span approach to calculate depreciation rates. For Account 312, the account at issue, the actual data shows that 65 percent of the investment in that account will be retired by interim retirement.[130] Thus, a closer look at the supposed inconsistency in Wiedmayer study indicates there is no inconsistency.

34. The Commission finds that AmerenUE's use of a negative 15 percent net salvage ratio is well supported by the company's data on interim retirements. The Commission also finds that MIEC's proposed adjustment is not supported by the evidence. MIEC's proposed adjustment to require the use of a negative 10 percent net salvage ratio is rejected.

Conclusions of Law:

There are no additional conclusions of law for this issue.

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[128] Selecky Surrebuttal, Ex. 406, Pages 1-15, Lines 11-24, 1-10.

[129] Wiedmayer Rebuttal, Ex. 105, Page 20, Lines 3-5.

[130] Wiedmayer Direct, Ex. 104, Schedule JFW-E1, Page A-5.

Decision:

AmerenUE's use of a negative 15 percent net salvage ratio for Account 312 Boiler Equipment is appropriate. The adjustment to a negative 10 percent net salvage ratio proposed by MIEC is rejected.

d. Inclusion of Retired Steam Generators in Depreciation Analysis for the Callaway Nuclear Plant

Findings of Fact:

Introduction:

35. James Selecky, the witness for MIEC, proposed certain adjustments to AmerenUE's depreciation rates for the Callaway nuclear plant. Those adjustments are predicated on Selecky's adjustment to remove from the plant's retirement history a retirement of four steam generators in 2005.[131] Excluding this particular retirement from the plant's retirement history reduces the interim retirement activity, thereby increasing the average remaining life from 29.8 years to 32.6 years, and decreases the net salvage ratio from a negative 10 percent to a negative 1.2 percent.[132] These changes would reduce AmerenUE's depreciation expense by approximately $5 million.[133] Both AmerenUE and Staff oppose Selecky's proposed adjustment.

Specific Findings of Fact:

36. In 2005, AmerenUE replaced the four, twenty-year old, steam generators at Callaway. Selecky contends the retirement of the steam generators should not be considered as part of the Callaway plant's retirement history because this retirement is not

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[131] Selecky Direct, Ex. 404 NP, Page 18, Lines 5-6.

[132] Selecky Direct, Ex. 404 NP, Page 19, Lines 7-8.

[133] Selecky Rebuttal, Ex. 405, Page 8, Lines 1-8.

typical and dominates the retirement history. This single retirement represents approximately 46 percent of the total retirement in this account from 1986 through 2008. The net salvage expense associated with this retirement is approximately 80 percent of the total net salvage expense this account has incurred since 1986.[134]

37. While this single retirement is substantial compared to retirements that have occurred early in the life of the plant, AmerenUE plans further significant major component replacement projects in the next five years. The retirements associated with those projects will total approximately $48 million.[135] Once these retirements occur, the dollars associated with the steam generator replacements will not be extraordinary in relation to the dollars retired in the future.[136]

38. Also, it is not surprising that equipment retirement has been relatively rare early in the life of the plant. However, interim retirements of equipment will increase as the plant ages, meaning that if actual retirement experience from when the plant is young is excluded from the calculation, the calculation will not be representative of the retirement to be expected in the future when the plant is older.[137]

39. The retirement of the steam generators was also unusual in that while the expected design life of the steam generators was 40 years, the steam generators were only

[134] Selecky Direct, Ex. 404 NP, Page 18, Lines 8-12.

[135] Wiedmayer Rebuttal, Ex. 105, Page 39, Lines 12-14.

[136] Wiedmayer Rebuttal, Ex. 105, Page 39, Lines 6-9.

[137] Wiedmayer Rebuttal, Ex. 105, Page 41, lines 16-20.

approximately 20-years old at the time of replacement.[138] That means their actual life was only half of what was expected.[139]

40. The shortened life of the generators was due to problems with deteriorating tubes.[140] Because of the problems with the generators, AmerenUE asserted a claim against the manufacturer that resulted in a settlement whereby Westinghouse paid AmerenUE $10 million in cash. AmerenUE also received a fuel credit of $20 million and a non-fuel related credit of $5 million.[141]

41. Selecky asserts that the payments from Westinghouse are a further indication that the premature retirement of the steam generators is abnormal and should be excluded from the company's retirement history.[142] Indeed, Staff's witness agreed that retirements should be removed from the life analysis if they are found to be reimbursed retirements from insurance proceeds or third party payments.[143] However, the payments AmerenUE received from Westinghouse do not make this a reimbursed retirement because none of the payments were booked against accumulated depreciation.[144]

42. The weakness of Selecky's position is demonstrated by the very low net salvage ratio that he calculates. Selecky proposes a net salvage ratio of just negative 1.2

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[138] Wiedmayer Rebuttal, Ex. 105, Page 37, Lines 14-16.

[139] Selecky Rebuttal, Ex. 405, Page 6, Lines 13-16.

[140] Wiedmayer Rebuttal, Ex. 105, Page 38, Line 16.

[141] Selecky Rebuttal, Ex. 405, Page 6, Lines 17-20. The settlement agreement between Westinghouse and AmerenUE is Ex. 438 HC.

[142] Selecky Rebuttal, Ex. 405, Page 6, Lines 9-12.

[143] Rice Rebuttal, Ex. 216, Page 4, Lines 14-16.

[144] Transcript, Page 1421, Lines 7-12. Ex. 169 describes how AmerenUE accounted for the payment received from Westinghouse.

percent.[145] Using that ratio would allow AmerenUE to accumulated only $8.9 million for net salvage for Account 322 over the next 36 years of the life of the Callaway plant. The company has already incurred $32 million in net salvage in that account over the first 24 years of operation. That means Selecky's net salvage estimate would not allow AmerenUE to recover the amount it has already spent on removal costs, let alone the additional costs it will surely incur over the remaining life of the plant.[146]

43. The most important fact is that the steam generators have in fact been retired. That retirement occurred sooner than AmerenUE expected, but it is a part of the plant's retirement history and is not so unusual that it should be ignored. In fact, most nuclear plants have experienced problems with their steam generators and most have replaced or are planning to replace their steam generators.[147] The Commission will reject Selecky's proposed adjustments predicated on the exclusion of the steam generator retirement from the Callaway plant's retirement history.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

The Commission rejects Selecky's adjustments to the proposed depreciation rates for the Callaway nuclear plant and accepts the depreciation rates proposed by AmerenUE and Staff.

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[145] Selecky Direct, Ex. 404 NP, Schedule JTS-4.

[146] Wiedmayer Surrebuttal, Ex. 106, Pages 12-13, 16-26, 1-16.

[147] Wiedmayer Rebuttal, Ex. 105, Page 38, Lines 4-7.

e. Transmission and Distribution Plant Depreciation

Findings of Fact:

Introduction:

44. AmerenUE's transmission and distribution accounts include items such as poles and fixtures, overhead conductors and devices, and line transformers.[148] In other words, the equipment used to transmit and distribute electric power to the company's customers. MIEC's witness, James Selecky, asserts that AmerenUE is accruing too much net salvage expense in these accounts and would establish an accrual offset of $25 million to reduce the depreciation expense the company recognizes for these accounts.[149] Staff and AmerenUE oppose Selecky's proposal to establish an accrual offset.

Specific Findings of Fact:

45. The depreciation studies submitted by AmerenUE and Staff both calculated net salvage for these accounts using the accrual method that allows a utility to recover future net salvage over the life of plant through the use of current depreciation rates.[150] The Commission upheld the use of the accrual method in a 2005 decision involving Laclede Gas Company.[151] Subsequently, the Commission upheld AmerenUE's use of the accrual method in AmerenUE's 2007 rate case.[152]

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[148] A list of the accounts included in Transmission and Distribution Plant may be found at Selecky Direct, Ex. 404 NP, Schedule JTS-8.

[149] Selecky Surrebuttal, Ex. 406, Page 16, Lines 1-7.

[150] Wiedmayer Rebuttal, Ex. 105, Page 49, Lines 15-18.

[151] *In the Matter of Laclede Gas Company's Tariff to Revise Natural Gas Rate Schedules*, Third Report and Order, 13 Mo. P.S.C. 3d 215 (2005).

[152] *In the Matter of Union Electric Company d/b/a AmerenUE's Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area*, Report and Order, Case No. ER-2007-0002, May 22, 2007, Page 92

46. Selecky does not oppose the continued use of the accrual method, but he contends AmerenUE is accruing what he describes as excessive amounts of net salvage expense that greatly exceed the level of net salvage expense the company actually incurs.[153] Indeed, AmerenUE's average actual annual net salvage expense over the last five years is $15.1 million and over the last ten years, that average expense has been $11.8 million.[154] Selecky contrasts those actual expenses with the $55 million annual net salvage expense AmerenUE will accrue under the depreciation studies prepared by Staff and AmerenUE. Over the years, AmerenUE has accrued approximately $582 million for future net salvage. This amount "seems excessive" to Selecky and he proposes a $25 million offset to reduce that accrual.[155]

47. The amount of Selecky's proposed offset is arbitrary. In his direct testimony, he proposed a $35 million offset,[156] based on his calculation showing that AmerenUE's proposed depreciation expense would include $76.1 million for annual net salvage.[157] After acknowledging a calculation error in his direct testimony, Selecky agreed that AmerenUE's proposed depreciation expense would be only $55 million, a reduction of $21 million.[158] However, he reduced his recommended offset by only $10 million, to $25 million.[159] In fact,

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[153] Selecky Direct, Ex 404 NP, Page 25, Lines 21-23.

[154] Selecky Direct, Ex. 404 NP, Page 27, Lines 8-11.

[155] Selecky Surrebuttal, Ex. 406, Page 16, Lines 12-23.

[156] Selecky Direct, Ex. 404 NP, Page 31, Lines 8-9.

[157] Selecky Direct, Ex. 404 NP, Page 27, Lines 7-8.

[158] Selecky Surrebuttal, Ex. 406, Page 15, Lines 18-22.

[159] Selecky Surrebuttal, Ex. 406, Page 16, Lines 8-18.

Selecky acknowledged the arbitrariness of the amount of his proposed offset when he described it as just a number that he ran up the flagpole.[160]

48. Although Selecky says he is not opposing the use of accrual accounting to calculate net salvage costs, his claim that an offset is needed is firmly based in the discredited method of expensing those costs that the Commission rejected in the *Laclede* decision.[161] His claim that AmerenUE is accruing too much net salvage expense makes sense only if it is accepted that the company's net salvage collections should be limited to something approaching its actual current expenses. As the Commission has held on numerous occasions, expensing is not a reasonable way to calculate net salvage costs and would ensure that the company would under-recover its net salvage costs to the detriment of future generations of ratepayers who would have to pay a disproportionate share of unrecovered net salvage costs when the plant is actually retired.

49. The fact that AmerenUE is currently accruing more than its actual net salvage expense is reasonable and necessary because the transmission and distribution systems are continuously growing and because inflation will make future removal costs more expensive that the cost to remove plant in the past.[162] The size of AmerenUE's system has nearly doubled in the last 50 years and the total distribution plant investment has increased by a factor of sixteen.[163] Current net salvage accruals are larger than current net salvage costs because AmerenUE is accruing dollars for a larger system than the system that

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[160] Transcript, Page 1516, Lines 12-24.

[161] *In the Matter of Laclede Gas Company's Tariff to Revise Natural Gas Rate Schedules*, Third Report and Order, 13 Mo. P.S.C. 3d 215 (2005).

[162] Wiedmayer Rebuttal, Ex. 105, Page 69, Lines 9-12.

[163] Wiedmayer Rebuttal, Ex. 105, Page 69, Lines 16-18.

existed 40 or 50 years ago when the property currently being retired was added to the system. In addition, current accruals are for future net salvage costs and those future costs will be higher than current expenses due to the effect of inflation.[164] In fact, the theoretical reserve amount related to net salvage for transmission and distribution is $720 million, and the company has thus far accrued only $582 million for that purpose. Thus, far from over-accruing for net salvage, the company is behind in its recovery of net salvage.[165]

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

Selecky's proposed allocation offset of $25 million is arbitrary, is based on a expensing method the Commission has previously rejected, and is unnecessary and inappropriate. That proposed allocation offset is rejected and the net salvage rates proposed by AmerenUE for its Transmission and Distribution accounts are accepted.

3. Coal-Fired Plant Maintenance Expense

Findings of Fact:

Introduction:

1. AmerenUE spends a large sum of money each year to maintain its coal-fired electric generating fleet. During the test year, the twelve months ending March 31, 2009, the company spent $118,967,000 for that purpose.[166] Part of that maintenance expense is incurred for routine maintenance on the power plants, and part is associated with major

[164] Wiedmayer Surrebuttal, Ex. 106, Page 19, Lines 4-13.

[165] Wiedmayer Surrebuttal, Ex. 106, Page 20, Lines 1-12.

[166] Meyer Direct, Ex. 400, Page 4, Chart at Line 9.

overhauls of the production plant that occur during scheduled outages.[167] AmerenUE contends future maintenance expenses will be at or near that test-year level and would use that amount to establish rates in this case.[168]

2. Staff notes that the test-year maintenance expense was substantially higher than the expense for previous years, and, for that reason, proposes to normalize the test-year expense by averaging AmerenUE's maintenance expense over the last three years and using that amount to set rates.[169] Specifically, Staff averaged AmerenUE's non-labor maintenance costs for the 36 months ending at the true-up date, January 31, 2010, and subtracted that amount from the non-labor portion of AmerenUE's test-year maintenance expense, to arrive at a negative adjustment in the amount of $14,939,835.[170] Thus, Staff would subtract $14,939,835 from the test-year expense of $118,967,000, to arrive at an expense level of $104,027,165.

3. MIEC's witness, Greg Meyer, also proposed to normalize AmerenUE's maintenance expense, but he used a more complex method than that proposed by Staff. For each of AmerenUE's four coal-fired production plants Meyer calculated a base level of maintenance expense. That is, a level of maintenance expense that will be incurred each year regardless of whether that power plant undergoes the extra maintenance associated with a scheduled outage. As a second step, Meyer calculated the amount of expense associated with a scheduled outage at each power plant. He then averaged those scheduled outage expenses based on the anticipated number of years between scheduled outages to derive

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[167] Transcript, Page 1075, Lines 11-21.

[168] Birk Rebuttal, Ex. 103, Page 17, Lines 3-8.

[169] Staff Report – Revenue Requirement/Cost of Service, Ex. 200, Page 93, Lines 6-14.

[170] Grissum True-Up, Ex. 242, Page 2, Lines 1-11.

an estimate of the annual expense associated with scheduled outages. He added the base level of maintenance expense to the annual expense associated with scheduled outages to arrive at a total annual steam production maintenance expense of $104.6 million.[171] Meyer then rounded that number up and recommended $105 million as a normalized level of expense for purposes of establishing rates.

Specific Findings of Fact:

4. Undeniably, AmerenUE's test-year coal plant maintenance expenses of $119 million were significantly higher than they had been in previous years. In the 12 months ending March 31, 2006, those expenses totaled $88.9 million, for the same period ending March 31, 2007, they totaled $93.4 million, and for the twelve-month period ending March 31, 2008, they totaled $91 million.[172] Furthermore, the level of expenses can vary from year to year depending upon how many scheduled outages are planned for that year. That situation requires the Commission to consider whether the test year expense is truly representative of the level of expense the company is likely to experience while the rates established in this case are in effect.

5. AmerenUE offered two reasons why the test-year level of expense is representative of future expense levels. First, in 2003, AmerenUE decided to approximately double the length of scheduled maintenance outage cycles for its coal-fired power plants. As a consequence, AmerenUE undertook fewer scheduled maintenance outages for those plants in the years immediately following 2003. The scheduled outages that would have been undertaken in those years were instead pushed back into later years, with the

[171] Meyer Surrebuttal, Ex. 402 NP, Pages 4-7.

[172] Meyer Direct, Ex. 400, Page 4, Chart at Line 9.

attendant costs also being pushed back.[173] A calculation of actual scheduled outages during the periods of 2001 – 2004 and 2005-2008, and planned outages for 2010 and 2011, was received in camera during the hearing.[174] Those numbers are considered highly confidential so they will not be stated in this order, but they confirm that the number of scheduled outages decreased during the period 2005 to 2008, and that the number of scheduled outages in 2010 and 2011 was expected to return to the level seen in 2001 to 2004.

6. Second, AmerenUE contends the test-year level of expense is representative of future expense levels because of the effects of the global financial crises of 2009. AmerenUE was concerned that it would not be able to obtain the financing needed to perform the maintenance work associated with scheduled outages, and therefore deferred the scheduled outages planned for 2009 into 2010.[175] That deferral has the effect of increasing the level of scheduled outage expense AmerenUE will incur in the future.

7. The Commission traditionally determines a representative future level of expense by looking at numbers in a historic test year. The goal 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. The presumption is that test year expenses will be the best measure of future expenses. However, that presumption is not always correct and it may be appropriate to normalize certain expenses if it appears that a normalized level of expense will be more representative of future expenses.

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[173] Birk Rebuttal, Ex. 103, Page 14, Lines 1-23.

[174] Transcript, Pages 1132-1133, Lines 11-25, 1-9. *See also*, Ex. 162 HC.

[175] Transcript, Page 1049, Lines 6-16.

8. It is, however, inappropriate to blindly "normalize" a test year expense by calculating an average expense from years of lower expense without considering whether the resulting expense level is truly representative of likely future costs. Yet, Staff never looked at the history of scheduled outages to consider whether the period it used to normalize maintenance expense was likely to be representative of future expenses.[176] In fact, Staff's witness testified she ignored everything except the historical numbers.[177] Therefore, Staff's purported normalization is unreliable.

9. MIEC's proposed normalization is more carefully thought out to give appropriate consideration to whether the normalized expense level will be representative of future costs. It does that by taking into account the scheduled outages for each of the power plants and recognizing the effect those scheduled outages will have on the expenses the company will incur.

10. AmerenUE criticizes MIEC's proposed normalization on two bases. First, it contends MIEC's normalization uses expenses from five or six years ago that have not been adjusted to recognize the effect of inflation.[178] However, the Commission finds that MIEC's numbers do not have to be adjusted for inflation because the base line for maintenance expense, excluding scheduled outage expense, remained essentially flat between 2005 and 2007, indicating that despite inflation, other techniques, technologies, or cost of materials have decreased enough to offset the cost of inflation.[179]

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[176] Transcript, Page 1190, Lines 8-16.

[177] Transcript, Page 1212, Lines 9-21.

[178] Birk Supplemental Testimony, Ex. 158, Page 3, Lines 17-19.

[179] Transcript, Pages 1144-1145, Lines 9-25, 1-19.

11. AmerenUE's second criticism of MIEC's normalization is that it fails to take into account the reduced number of scheduled outages that occurred during the period it used to normalize the maintenance expenses. That criticism is valid, but can be avoided if Meyer's normalization technique is applied to the actual outages planned for the period when the rates established in this case will be in effect.

12. AmerenUE anticipates filing its next rate case sometime before the end of 2010, meaning the rates established in this case will likely remain in effect for only about 18 months.[180] During an in camera cross examination of Mr. Birk, MIEC elicited testimony that took Meyer's estimation of a base level of annual maintenance expense and added his estimation of the expense associated with each scheduled outage AmerenUE plans to undertake in 2010.[181] That calculation resulted in an estimated expense for 2010 of $110.2 million.[182]

13. MIEC offered that number to show that Meyer's normalization method would result in an estimate relatively close to the amount AmerenUE has budgeted for maintenance expense in 2010. However, using that number, which is based on the scheduled outages actually planned for 2010, as the basis for establishing rates also eliminates AmerenUE's criticism that the normalization fails to take into account the increasing number of scheduled outages that will occur while the rates established in this case are in effect. Therefore, the Commission finds that $110.2 million is a reasonable normalization of AmerenUE's coal-plant maintenance expense.

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[180] Transcript, Page 1098, Lines 7-12.

[181] Transcript, Pages 1009-1013. See also Ex. 443.

[182] Ex. 443 HC.

Conclusions of Law:

A. In a 1984 case addressing a Commission rate case decision, the Missouri Court of Appeals described the concept of normalization of a test-year expense as follows:

> The test year is a period past, but is employed as a vehicle upon which to project experience in a future period when the rates determined in the case will be in effect. Normalization of a test year cost by multi-year averaging of the cost based on experience assumes that the cost rises and falls, with the consequence that the actual cost incurred in the test year is not representative.[183]

That means that in normalizing a test year expense, the Commission is attempting to establish rates that will allow the utility a reasonable opportunity to recover its anticipated expenses. For that reason, the Commission must consider whether a proposed normalized test year expense is reasonably related to anticipated future expenses.

Decision:

The Commission concludes that $110.2 million is a reasonable normalization of AmerenUE's annual coal-plant maintenance expense.

4. Nuclear Fuel Expense

Findings of Fact:

Introduction:

1. AmerenUE's Callaway nuclear plant is refueled every 18 months. During each refueling, about half of the uranium fuel assemblies in the reactor core are removed and replaced with new assemblies.[184] AmerenUE refueled the Callaway plant beginning in April

[183] *State ex rel. Missouri Power and Light Co. v. Public Service Com'n*, 669 S.W.2d 941, 945, (Mo App. W.D. 1984).

[184] Irwin Rebuttal, Ex. 127, Page 3, Lines 13-15.

2010, with fuel assemblies purchased and delivered to the plant before January 31, 2010.[185]

2. AmerenUE would include the increased cost of the fuel assemblies installed during the April 2010 refueling in the average nuclear fuel cost to be recovered in base rates resulting from this case.[186] Staff, supported by MIEC, would base AmerenUE's nuclear fuel cost on its average cost for fuel actually burned during the fifteen-month period beginning October 2008 and continuing through January 31, 2010, the true-up cut off date established for this case.[187] Under Staff and MIEC's proposal, AmerenUE would not be allowed to recover the increased cost of the nuclear fuel loaded into the Callaway plant in April 2010. The difference between the proposals amounts to approximately $11 million.[188]

Specific Findings of Fact:

3. The facts surrounding this issue are not in dispute. AmerenUE has bought and paid for nuclear fuel assemblies to refuel the Callaway nuclear power plant beginning in April 2010. Those assemblies are highly engineered and specifically designed for use at Callaway.[189] The Callaway plant must be shut down to be refueled and a shut-down is costly, so AmerenUE must purchase those fuel assemblies and have them available on-site well in advance of the shut-down.[190]

4. The nuclear fuel assemblies are accounted for as construction work in progress until they are fully assembled; once assembled they are accounted as nuclear fuel assembly

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[185] Irwin Rebuttal, Ex. 127, Page 4, Lines 2-5.

[186] Finnell Direct, Ex. 130, Page 9, Lines 5-7.

[187] Grissum Surrebuttal, Ex. 224, Page 2, Lines 9-12. See also, Transcript, Page 2657, Lines 6-14.

[188] Revised True-Up Reconciliation, Ex. 242.

[189] Irwin Rebuttal, Ex. 127, Page 4, Lines 20-22.

[190] Transcript, Pages 2665-2666, Lines 21-25, 1-7.

stock. The fuel assemblies were completed and accounted for as stock in October 2009.[191] When burned in the reactor, the assemblies are expensed as fuel expense.[192] During the time after the fuel assemblies are completed, until the time they are loaded and burned in the reactor, the company receives no carrying costs on those fuel assemblies.[193]

5. The nuclear fuel price is based on the amortization of the initial costs of the fuel assemblies. As such, the nuclear fuel price AmerenUE proposes to include in rates in this case has not and will not occur until the new fuel assemblies have been loaded into the Callaway reactor during refueling and the Callaway unit is placed back in-service sometime in June 2010.[194] This will be approximately four months after the January 31, 2010 true-up date.

6. If AmerenUE's increased nuclear fuel costs are not included in base rates, the company will be able to recover those costs through the operation of its fuel-adjustment clause, subject to the 95/5 sharing mechanism included in that fuel adjustment clause.[195] Because of the way the fuel adjustment clause works, AmerenUE would not be able to fully recover its 95 percent share of those increased costs until September 30, 2011.[196]

7. In AmerenUE's last rate case, ER-2008-0318, AmerenUE was allowed to recover the increased cost of nuclear fuel associated with a refueling that occurred approximately

[191] Transcript, Page 2665, Lines 12-15.

[192] Transcript, Page 2664, Lines 12-20.

[193] Transcript, Page 2665, Lines 16-20.

[194] Grissum Surrebuttal, Ex. 224, Page 3, Lines 17-22.

[195] Transcript, Page 2660, Lines 4-25.

[196] Transcript, Pages 2661-2662, Lines 1-25, 1-7.

one month after the true-up cut off date for that case. No party in that case objected to AmerenUE's recovery of those costs.[197]

Conclusions of Law:

A. The disagreement between the parties concerns the application of the true-up cut-off date. The Commission employs a test-year concept to evaluate a utility's income and expenses for the purpose of setting just and reasonable rates. For this case, the test year was established as the twelve-month period ending March 31, 2009, with an additional true-up period extending through January 31, 2010. That means that for that test-year period, extended through the true-up, the Commission has examined the company's income and expenses to determine the amount of revenue the company should be allowed to generate through the rates to be established as a result of this case. The goal is to match income and expenses over the same period so that a true level of required revenue can be determined.

B. The increased cost of the fuel assemblies loaded into the Callaway reactor during the April shut-down will not begin to be expensed until the reactor is back in operation, and thus will fall outside the test-year and the true-up period. In most situations, the Commission will not allow for out-of-period adjustments because to do so risks upsetting the matching principle. That is, reaching outside the test year to pull in an expense could allow the company to recover excess revenue if that out-of-test-year expense would otherwise have been offset by some unconsidered item of out-of-test-year income.

C. However, the matching principle is not an absolute bar to an appropriate out-of-period adjustment. When faced with this question in the past, the Commission has said

[197] Transcript, Pages 2658-2659, Lines 21-25, 1-6.

"when such known and measurable increases in expenses occur it is more equitable to allow such an expense to be reflected in the revenue requirement than to disallow it for the sole reason that corresponding revenues may be lacking."[198] On that basis, the Commission has, for example, allowed a company to recover for a known postage rate increase that would occur outside the test year,[199] and a known wage increase and FICA withholding tax increase, again outside the test year.[200]

D. In this case, AmerenUE's cost to purchase the fuel assemblies is absolutely known and measurable, and has been known and measurable since October 2009. The fuel assemblies are presumably now in place and will be generating electricity at the time rates resulting from this case go into effect. Ultimately, AmerenUE would recover 95 percent of its increased nuclear fuel costs through operation of its fuel adjustment clause, but it would have to wait many months to fully recover those costs.

E. 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.

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[198] *In the Matter of St. Louis County Water Company, St. Louis, Missouri, for Authority to File Tariffs to Increase Water Service Provided to Customers in the Missouri Service Area of the Company,* Report and Order, 29 Mo. P.S.C. (N.S.) 425, 435 (1988).

[199] *Id.*

[200] *In the Matter of Citizens Electric Corporation of Ste. Genevieve, Missouri, for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Missouri Service Area of the Company,* Report and Order, 24 Mo. P.S.C. (N.S.) 450, 457 (1981).

Decision:

AmerenUE shall recover its increased nuclear fuel costs associated with the April 2010 refueling of the Callaway nuclear plant as part of its base fuel costs. The adjustments proposed by Staff and MIEC that would deny that recovery are rejected.

5. Vegetation Management and Infrastructure Inspection Expense

Findings of Fact:

Introduction:

1. AmerenUE's vegetation management and infrastructure inspection expense is closely associated with two Commission rules. Following extensive storm related service outages in 2006, the Commission promulgated new rules designed to compel Missouri's electric utilities to do a better job of maintaining their electric distribution systems. Those rules, entitled Electrical Corporation Infrastructure Standards[201] and Electrical Corporation Vegetation Management Standards and Reporting Requirements,[202] became effective on June 30, 2008.

2. The rules establish specific standards requiring electric utilities to inspect and replace old and damaged infrastructure, such as poles and transformers. In addition, electric utilities are required to more aggressively trim tree branches and other vegetation that encroaches on transmission lines. In promulgating the stricter standards, the Commission anticipated utilities would have to spend more money to comply. Therefore, both rules include provisions that allow a utility the means to recover the extra costs it incurs to comply with the requirements of the rule.

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[201] Commission Rule 4 CSR 240-23.020.

[202] Commission Rule 4 CSR 240-23.030.

3. In ER-2008-0318, the Commission allowed AmerenUE to recover $54.1 million in its base rates for vegetation management costs, and $10.7 million for infrastructure inspection costs. However, since the rules were new, the Commission found that AmerenUE had too little experience to reasonably know how much it would need to spend to comply with the vegetation management and infrastructure inspection rules. Because of that uncertainty, the Commission established a two-way tracking mechanism to allow AmerenUE to track its vegetation management and infrastructure costs.

4. The base level for that tracker was set at $64.8 million ($54.1 million for vegetation management plus $10.7 million for infrastructure inspection). The order required AmerenUE to track actual expenditures around that base level. In any year in which AmerenUE spent below that base level, a regulatory liability would be created. In any year in which AmerenUE's spending exceeded the base level, a regulatory asset would be created. The regulatory assets and liabilities would then be netted against each other and would be considered in AmerenUE's next rate case. The tracking mechanism contained a 10 percent cap so if AmerenUE's expenditures exceeded the base level by more than 10 percent it could not defer those costs under the tracking mechanism, but would need to apply for an additional accounting authority order. The Commission's order indicated that the tracking mechanism would operate until new rates were established in AmerenUE's next rate case.[203]

5. This is, of course, the next rate case, and AmerenUE asks that the tracker be continued. Staff, MIEC, and Public Counsel contend the Commission should eliminate the

[203] *In the Matter of Union Electric Company, d/b/a AmerenUE's Tariffs to Increase its Annual Revenues for Electric Service*, Report and Order, Case No. ER-2008-0318, January 27, 2009, Pages 48-49.

tracker and establish an allowance for vegetation management and infrastructure inspection expenses based on the company's expenditures during the test year.

Specific Findings of Fact:

6. The Commission must resolve two issues regarding these vegetation management and infrastructure expenses. First, the Commission must decide whether the existing tracker should be continued.

7. The Commission approved a tracker in the last rate case because the vegetation management and infrastructure rules were still very new. As a result, no one knew with any certainty how much AmerenUE would need to spend to comply with the rules' provisions.[204] AmerenUE has now been operating under those rules for two years. Although the rule went into effect on June 30, 2008, AmerenUE began complying with the requirements of the rules on January 1, 2008.[205]

8. Staff and MIEC contend that experience is sufficient to allow the Commission to confidently set AmerenUE's rates without renewing the tracker. However, the new rules impose substantial new requirements for tree trimming[206] and infrastructure inspections. AmerenUE has not yet completed a full four/six year vegetation management cycle on its entire system. Over half of its circuits have not yet been trimmed to the new standards. That is important because 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

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[204] *In the Matter of Union Electric Company, d/b/a AmerenUE's Tariffs to Increase its Annual Revenues for Electric Service*, Report and Order, Case No. ER-2008-0318, January 27, 2009, Page 41.

[205] Meyer Rebuttal, Ex. 402NP, Page 11, Line 13.

[206] Transcript, Page 1759, Lines 8-13.

by the rules.[207] Therefore, it is still difficult to predict what AmerenUE's normal level of vegetation management expenses will be.[208] The same is true for AmerenUE's efforts to comply with the infrastructure inspection rule.[209]

9. As the Commission said in the last rate case, the tracker serves to protect both the company and its ratepayers during this initial period of uncertainty about the cost to comply with the new rules. If the company spends less than the base level set in the tracker, the excess allowance will be tracked and returned to ratepayers in the next rate case. That is exactly what has happened in this case, and thus, ratepayers have already benefited from the existence of the tracker.

10. AmerenUE's system reliability has improved since the new rules went into effect,[210] and the Commission believes that vegetation management and infrastructure inspection is very important to that improved reliability. The Commission wants to encourage AmerenUE to continue to spend the money needed to improve reliability. Because there is still a great deal of uncertainty about the amount of spending needed to comply with the rules, the Commission finds that the tracker is still needed. That does not mean the tracker will become permanent. AmerenUE's witness suggests the company will have a level of experience needed to better predict costs in two to four years.[211] It may not take that long, and the Commission will certainly revisit this issue in AmerenUE's next rate case, but for this case, the Commission will renew the existing vegetation management and infrastructure inspection tracker.

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[207] Wakeman Rebuttal, Ex. 109, Page 8, Lines 7-8.

[208] Wakeman Rebuttal, Ex. 109, Page 7, Lines 1-23.

[209] Wakeman Rebuttal, Ex. 109, Pages 8-9, Lines 16-23, 1-11.

[210] Zdellar Direct, Ex. 157, Pages 3-15.

[211] Wakeman Rebuttal, Ex. 109, Page 7, Lines 20-21.

11. Having renewed the tracker, the Commission must decide the dollar amount to be included as a base level for that tracker. AmerenUE spent $50.4 million on vegetation management in the twelve-month period ending at the true-up date, January 31, 2010.[212] For the same period, AmerenUE spent $7.6 million on infrastructure inspection expenses.[213] That is a total of $58 million. The non-AmerenUE parties would use those actual expenditures to establish AmerenUE's rates for this case.

12. AmerenUE contends its forecasted expenditures for 2010 and 2011 should be used to set its new rates. The average forecasted expenditures for those two years are $53.7 million for vegetation management and $8.9 million for infrastructure inspections, for a total of $62.6 million.[214] AmerenUE would use that amount as the base level for a renewed two-way tracker.

13. In general, the Commission prefers to use historical information rather than forecasts to establish rates. In the last rate case, the Commission used the company's forecasted budget amounts to set the base level of the tracker. It did so because at that time there was very little historical information upon which to base its decision. More information is available now and while there is still enough uncertainty to justify the continuation of the tracker, the additional historical information is sufficient to set a reasonable base level for that tracker. Therefore, the Commission will set the base level of the tracker at $58 million,

14. One other matter remains to be resolved. Through February 28, 2010, AmerenUE has collected approximately $5 million more than it actually incurred to comply with the

[212] Meyer Rebuttal, Ex. 402NP, Page 10, Lines 7-10.

[213] Meyer Rebuttal, Ex. 402NP, Page 14, Lines 1-5.

[214] Wakeman Rebuttal, Ex. 109, Page 10, Lines 14-20.

Commission's vegetation management and infrastructure inspection rules.[215] Staff proposed to reduce that over-collection by $2 million, which is the amount the company incurred from October 1, 2008 through February 28, 2009, in excess of the amount included in rates.[216] That would indicate a remaining over-collection of $3 million, but Staff updated that number at the end of the hearing to $3.4 million.[217]

15. Staff recommends that the $3.4 million remain in the tracker as an addition or offset to any future amounts deferred. The Commission would then address ultimate disposition of any amounts deferred in the next rate case.[218] AmerenUE did not offer a proposal on how the $3.4 million over-collection should be returned to its customers until its initial brief. At that time, the company recommended that the over-collection be returned to customers, amortized over three years.[219]

16. Staff's proposal would potentially offset an increase in AmerenUE's expenses for the next rate case and thereby decrease any rate increase that would result from that future case. AmerenUE's proposal has the advantage of decreasing the rate increase that will result from this decision. The Commission will accept AmerenUE's proposal and directs that the $3.4 million over collection be returned to customers, amortized over three years.

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[215] Rackers Surrebuttal, Ex. 203, Page 4, Lines 11-12.

[216] Rackers Surrebuttal, Ex. 203, Page 4, Lines 19-21. In ER-2008-0318, the Commission allowed AmerenUE to accumulate and defer those expenses in an Accounting Authority Order for consideration in this rate case.

[217] Exhibit 240.

[218] Rackers Surrebuttal, Ex 203, Page 5, Lines 4-9.

[219] Post-Hearing Brief of AmerenUE, Pages 119-120.

Conclusions of Law:

A. Commission Rule 4 CSR 240-23.020 establishes standards requiring electrical corporations, including AmerenUE, to inspect its transmission and distribution facilities as necessary to provide safe and adequate service to its customers. Specifically, 4 CSR 240-23.020(3)(A) establishes a four-year cycle for inspection of urban infrastructure and a six-year cycle for inspection of rural infrastructure.

B. Commission Rule 4 CSR 240-23.020(4) establishes a procedure by which an electric utility may recover expenses it incurs because of the rule. Specifically, that section states as follows:

> In the event an electrical corporation incurs expenses as a result of this rule in excess of the costs included in current rates, the corporation may submit a request to the commission for accounting authorization to defer recognition and possible recovery of these excess expenses until the effective date of rates resulting from its next general rate case, filed after the effective date of this rule, using a tracking mechanism to record the difference between the actually incurred expenses as a result of this rule and the amount included in the corporation's rates … .

C. Commission Rule 4 CSR 240-23.030 establishes standards requiring electrical corporations, including AmerenUE, to trim trees and otherwise manage the growth of vegetation around its transmission and distribution facilities as necessary to provide safe and adequate service to its customers. Specifically, 4 CSR 240-23.030(9) establishes a four-year cycle for vegetation management of urban infrastructure and a six-year cycle for vegetation management of rural infrastructure. The vegetation management rule also includes a provision that would allow AmerenUE to ask the Commission for authority to accumulate and recover its cost

of compliance in its next rate case.[220]

Decision:

AmerenUE shall establish a tracking mechanism to track future vegetation management and infrastructure costs. That tracking mechanism shall include a base level of $58 million ($50.4 million + $7.6 million = $58 million). Actual expenditures shall be tracked around that base level with the creation of a regulatory liability in any year where AmerenUE spends less than the base amount and a regulatory asset in any year where AmerenUE spends more than the base amount. The assets and liabilities shall be netted against each other and shall be considered in AmerenUE's next rate case. The tracking mechanism shall contain a ten percent cap so expenditures exceeding the base level by more than ten percent shall not be deferred under the tracking mechanism. If AmerenUE's vegetation management and infrastructure inspection costs exceed the ten percent cap, it may request additional accounting authority from the Commission in a separate proceeding. The tracking mechanism shall operate until new rates are established in AmerenUE's next rate case.

The $3.4 million AmerenUE over-collected from its ratepayers under its previous tracking mechanism shall be returned to its ratepayers, amortized over three years.

6. Storm Restoration

Findings of Fact:

Introduction:

1. AmerenUE must spend money each year to restore electric service after its electric system suffers damage as the result of storms. Each year some of that damage results

[220] Commission Rule 4 CSR 240-23.030(10).

from normal, routine storms. But occasionally, the electric system is struck by a truly extraordinary storm that can greatly increase restoration costs.

2. The Commission has generally allowed an electric utility to recover the Operations and Maintenance (O&M), excluding internal labor, costs to restore service after normal storms by including an amount in the cost of service based on some multiyear average level.[221] For the costs to restore service after an extraordinary storm, the Commission has usually allowed the utility to accumulate and defer those costs through an accounting authority order, an AAO.[222] The accumulated and deferred costs are then considered in the utility's next rate case. Generally, the Commission allows the utility to recover those costs amortized over a five-year period.[223]

3. Staff would use that same procedure in this case. Staff proposes to use a four-year average of AmerenUE's normal O&M, non-labor related, storm restoration costs to allow $6.4 million in AmerenUE's cost of service for normal storm restoration costs. AmerenUE's actual storm restoration cost during the test year totaled $10.4 million. Staff would remove $4 million from that amount as related to extraordinary storms, and allow AmerenUE to recover that $4 million amortized over five years.[224] MIEC's witness, Greg Meyer advocates the same approach, although he would allow only $5.2 million in AmerenUE's

[221] A utility may also incur substantial capital investment costs to replace things like power poles after a storm. Those investment costs are added to the company's rate base and recovered in that manner. This issue does not concern those capital costs.

[222] Rackers Rebuttal, Ex. 202, Page 2, Lines 21-24.

[223] Rackers Rebuttal, Ex. 202, Page 2, Lines 5-11.

[224] Staff Report – Revenue Requirement/Cost of Service, Ex. 200, Pages 89-90, Lines 25-29, 1-16.

cost of service, as that was the amount allowed in the company's previous rate case, ER-2008-0318.[225]

4. AmerenUE proposes to use a new approach to the recovery of storm restoration expenses. It would have the Commission set the base level of storm restoration O&M costs at the actual amount incurred during the test year, which is $10.4 million. AmerenUE then proposes that the Commission establish a tracking mechanism to track actual expenses against that base level. If AmerenUE spent less than the base level, the difference could be returned to rate payers in the next rate case. If expenses exceeded the base level, AmerenUE could seek to recover the difference in its next rate case.[226]

Specific Findings of Fact:

5. The O&M non-labor cost AmerenUE incurs can vary greatly from year to year depending upon whether the electric system is struck by a major storm. For 2004 and 2005, those costs were only $1 million and $2 million respectively. For 2006 and 2007, the costs jumped to $26 million and $33 million. For 2008 and 2009, they fell again to $4 million and $9 million.[227] Under the approach the Commission has used in past cases, the company may under recover in years when costs are high, but may over recover in years when costs are low. If the company incurs truly extraordinary storm restoration costs in a particular year, it is able to recover those costs through the accounting authority mechanism. In this case, AmerenUE is recovering amortized storm restoration costs from five different storm events.[228]

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[225] Meyer Direct, Ex. 400, Pages 27-28, Lines 17-23, 1-2.

[226] Zdellar Direct, Ex. 157, Page 21, Lines 1-12.

[227] Rackers Surrebuttal, Ex. 203, Page 6, Chart at Line 6.

[228] Staff Report – Revenue Requirement/Cost of Service, Ex 200, Pages 90-91.

6. No party disputes that AmerenUE has provided good storm restoration service in recent years, and no one has alleged that any of its storm restoration expenses have been imprudent.

7. The Commission is unwilling to implement another tracker. As the Commission has previously indicated, trackers should be used sparingly because they tend to limit a utility's incentive to prudently manage its costs. If all such costs can simply be passed on to ratepayers, there is a natural incentive for the company to simply incur the cost. If the company must consider whether it will be able to recover a cost, it is more likely to think before it spends and maximize any possible cost savings.

8. The storm cost recovery method the Commission has used in the past has worked reasonably well. The company will ultimately recover its extraordinary costs resulting from unpredictable extraordinary storms through the accounting authority order mechanism, but the company still has a strong incentive to minimize its costs. Staff's proposal to include the four-year average of $6.4 million for storm restoration costs, while amortizing the extra $4 million in test year expense over five years is reasonable. MIEC's alternative proposal to include only $5.2 million in the company's cost of service is based only on the amount allowed in the last rate case. As such it is arbitrary and unsupported by any evidence offered in this case.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

AmerenUE's request to establish a tracking mechanism is denied. AmerenUE shall include $6.4 million in its cost of service for storm restoration costs. The remaining $4

million in test year storm restoration expense shall be amortized and recovered over five years.

7. Union Issues

Findings of Fact:

Introduction:

1. The various unions that represent AmerenUE's employees appeared at the hearing to support the company's request for a rate increase. However, they asked the Commission to order AmerenUE to spend more money on employee training and to take specific steps to increase its internal workforce so that it will use fewer outside contractors. AmerenUE contends it is currently providing safe and adequate service and argues the Commission has no authority to manage the day-to-day affairs of the company.

Findings of Fact:

2. Michael Walter is the Business Manager of International Brotherhood of Electrical Workers Local 1439, AFL-CIO.[229] He testified that AmerenUE has not spent enough on training new workers and as a result has over-relied on outside contractors to perform normal and sustained work.[230] In particular, Walter is concerned that AmerenUE's trained work force is aging and he sees a need for increased training of new workers capable of stepping in when the current workforce retires.[231] He asks the Commission to require AmerenUE to spend a portion of its rate increase to improve training and increase the portion of the workload performed by its internal workforce.[232] AmerenUE's witness replied

[229] Walter Rebuttal, Ex. 650, Page 1, Lines 2-3.

[230] Walter Rebuttal, Ex. 650, Pages 2-7.

[231] Transcript, Page 2575, Lines 18-24.

[232] Walter Rebuttal, Ex.650, Pages 7-9.

that the company must rely on outside contractors to meet some of its normal workforce needs because of a shortage of qualified personnel.[233]

3. In response to those concerns, Commissioners Davis and Jarrett asked the AmerenUE witnesses how the company would spend extra money to training power plant operators if provided additional training funds as a result of this case.[234] In response to Commissioners Davis' and Jarrett's questions, AmerenUE filed an exhibit detailing how it would spend extra money on training. AmerenUE also agreed to assess the incremental value to customers of its additional training investments and to present those findings to Staff and Public Counsel by December 31, 2011.[235] AmerenUE's witness explained that these additional funds would be used to train AmerenUE's distribution employees.[236]

4. The Commission finds that the evidence presented by the union witnesses does not demonstrate that AmerenUE has failed to supply safe and adequate service to the public. Furthermore, for reasons fully explained in its Conclusions of Law, the Commission does not have the authority to dictate the manner in which AmerenUE conducts its business. Therefore, the Commission will not attempt to dictate to the company regarding its use of outside contractors.

5. However, the union witnesses and AmerenUE agree that there is a need for improved training to replace skilled workers nearing retirement age. It takes five to seven

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[233] Wakeman Surrebuttal, Ex. 110, Page 10, Lines 5-15.

[234] Transcript, Page 2619, Lines 3-20, and Page 2621, Lines 5-9. The Commission allocated extra money for additional training in AmerenUE's last rate case, ER-2008-0318. AmerenUE explained how that money was spent in the direct testimony of Mark Birk, Ex. 102, Pages 15-16.

[235] Ex. 179.

[236] Transcript, Page 2783, Lines 21-24.

years of training to replace a skilled electrical worker.[237] For several job classifications, many workers are nearing retirement age and will soon be leaving the company.[238] Thus, the Commission finds that there is a need for additional training to attempt to meet that need.

6. Therefore, the Commission will add $1.29 million to AmerenUE's cost of service to fund increased training staff. The Commission will also allow AmerenUE $2.1 million for additional training equipment and materials, to be amortized over five years and recovered in rates. That would increase AmerenUE's cost of service by an additional $420,000 per year, for a total annual increase of $1,710,000.

Conclusions of Law:

A. The Commission has the authority to regulate AmerenUE, including the authority to ensure that 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.[239]

Therefore, the Commission does not have the authority to dictate to the company whether it must use internal workforce rather than outside contractors to perform the work of the company.

Decision:

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[237] Transcript, Page 2576, Lines 21-25.

[238] Transcript, Page 2593, Lines 4-9.

[239] *State ex rel. Harline v. Public Serv. Com'n*, 343 S.W.2d 177, 182 (Mo. App. 1960)

The evidence presented by the union witnesses does not demonstrate that AmerenUE has failed to provide safe and adequate service and the Commission will not dictate to the company whether it must use its internal workforce or outside contractors to perform the company's work. However, the Commission will add $1,290,000 to AmerenUE's cost of service to fund increased training staff. The Commission will also allow AmerenUE $2,100,000 for additional training equipment and materials, to be amortized over five years and recovered in rates. That increases AmerenUE's cost of service by $1,710,000 per year. AmerenUE shall assess the incremental value to customers of these additional investments and provide that assessment to Staff and Public Counsel by December 31, 2011.

8. Fuel Adjustment Clause

Findings of Fact:

Introduction:

1. In AmerenUE's last rate case, ER-2008-0318, the Commission allowed AmerenUE to implement a fuel adjustment clause.[240] The approved fuel adjustment clause includes an incentive mechanism that requires AmerenUE to pass through to its customers 95 percent of any deviation in fuel and purchased power costs from the base level. The other 5 percent of any deviation is retained or absorbed by AmerenUE.[241]

2. In the direct testimony of its witness, Lynn Barnes, AmerenUE proposed that its existing fuel adjustment clause be continued, with a few minor refinements.[242] When it filed

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[240] *In the Matter of Union Electric Company, d/b/a AmerenUE's Tariffs to Increase its Annual Revenues for Electric Service*, Report and Order, Case No. ER-2008-0318, January 27, 2009, Pages 69-70.

[241] *Id.* at Page 76.

[242] Barnes Direct, Ex. 121, Page 3, Lines 2-10.

its direct testimony, Staff agreed that AmerenUE's existing fuel adjustment clause should be continued with the refinements proposed by AmerenUE and some additional modifications proposed by Staff.[243] The minor modifications to the fuel adjustment clause were resolved in the First Stipulation and Agreement that the Commission approved on March 24, 2010. Therefore, the Commission will not further address those modifications.

3. In an order issued on February 17, 2010, after the parties had filed rebuttal testimony, the Commission indicated it wanted to hear more evidence from the parties about the continued appropriateness of the 95 percent pass-through mechanism in AmerenUE's current fuel adjustment clause. To that end, the Commission offered the parties an opportunity to file additional direct, rebuttal, and surrebuttal testimony on an expedited schedule before the start of the hearing.[244]

4. AmerenUE responded by filing extensive additional testimony explaining why the company still needs a fuel adjustment clause that incorporates the current sharing mechanism. MIEC, Public Counsel, and Staff also filed additional testimony regarding the fuel adjustment clause.

5. MIEC refiled the testimony that its witness, Maurice Brubaker, offered regarding the fuel adjustment clause in AmerenUE's last rate case.[245] In that testimony, Brubaker advised the Commission to implement an 80/20 sharing mechanism that would allow the company to pass-through to customers only 80 percent of the changes in fuel cost and off-

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[243] Staff Report – Revenue Requirement/Cost of Service, Ex. 200, Pages 105-111.

[244] *In the Matter of Union Electric Company, d/b/a AmerenUE's Tariffs to Increase its Annual Revenues for Electric Service*, Order Directing the Parties to Submit Testimony Concerning the Appropriateness of AmerenUE's Current Fuel Adjustment Clause, File No. ER-2010-0036, February 17, 2010.

[245] ER-2008-0318.

system sales.[246] Brubaker would, however, cap the impact of the sharing mechanism so that the sharing would have no more than a 50 basis point impact on AmerenUE's return on equity.[247]

6. Public Counsel also offered testimony supporting an 80/20 sharing mechanism. Ryan Kind offered his opinion that such a sharing percentage is necessary to ensure that AmerenUE continues to make its best efforts to minimize fuel costs and maximize its off-system sales margins.[248]

7. Staff filed supplemental testimony explaining that since little time has passed since AmerenUE's fuel adjustment clause went into effect, it has not compiled enough data to meaningfully analyze that fuel adjustment clause. As a result, Staff suggests the Commission leave the current fuel adjustment clause in place without changing the sharing mechanism.[249]

Specific Findings of Fact:

8. In AmerenUE's last rate case, the Commission found that AmerenUE should be allowed to establish a fuel adjustment clause because its fuels costs were substantial, beyond the control of the company's management, and volatile in amount. The Commission also found that AmerenUE needed a fuel adjustment clause to have a sufficient opportunity to earn a fair return on equity and to be able to compete for capital with other utilities that have a fuel adjustment clause.[250] In the same rate case, the

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[246] Brubaker Additional Direct – FAC, Ex. 413, Attachment 2, Page 11 of 19.

[247] Brubaker Additional Direct – FAC, Ex. 413, Attachment 2, Page 11 of 19.

[248] Kind Additional Direct – FAC, Ex. 301, Page 2, Lines 3-18.

[249] Mantle Supp. Direct – FAC, Ex. 221, Pages 5-6, Lines 15-23, 1-7.

[250] *In the Matter of Union Electric Company, d/b/a AmerenUE's Tariffs to Increase its Annual Revenues for Electric Service*, Report and Order, Case No. ER-2008-0318, January 27, 2009,

Commission found that a 95/5 sharing mechanism would give AmerenUE a sufficient opportunity to earn a fair return on equity, while protecting customers by preserving the company's incentive to be prudent.[251]

9. Nothing has changed in the months since the Commission established AmerenUE's fuel adjustment clause to cause the Commission to change that decision. The Commission finds that AmerenUE's fuel and purchased power costs are clearly substantial, comprising 47 percent of the company's total operations and maintenance expense. Furthermore, the revenue the company receives from off-system sales, which is also tracked through the fuel adjustment clause, is also substantial.[252] These fuel and purchased power costs continue to be dictated by national and international markets, and thus are outside the control of AmerenUE's management.[253] Finally, these costs and revenues continue to be volatile. For example, the price AmerenUE was able to obtain in the market for off-system electricity sales declined by nearly half from 2008 to 2009.[254]

10. Furthermore, the Commission finds that AmerenUE still needs a fuel adjustment clause to help alleviate the effects of regulatory lag as net fuel costs continue to rise. AmerenUE's regulatory lag problems have not improved since its last rate case. In recent years, the company has been unable to earn its allowed rate of return, and in large part, that problem is due to fuel-related issues.[255] Even with the fuel adjustment clause in place, AmerenUE's return on equity for the year ending December 2009, was only 7.27 percent.

Pages 69-70.

[251] *Id*., at Page 76.

[252] Barnes Direct, Ex. 121, Page 7, Lines 17-23.

[253] Barnes Direct, Ex. 121, Page 7, Lines 23-26.

[254] Haro Additional Rebuttal – FAC, Ex. 126, Page 13, Lines 13-19.

[255] Transcript, Page 2409, Lines 5-11.

Without a fuel adjustment clause, that return would have dropped to 6.69 percent, over 400 basis points below the company's authorized return on equity of 10.76 percent.[256] In addition, AmerenUE still must compete in the capital markets with other utilities and the vast majority of those utilities have fuel adjustment clauses.[257]

11. For the forgoing reasons, the Commission finds that AmerenUE should be allowed to continue to operate under a fuel adjustment clause. However, the Commission's chief concern about the existing fuel adjustment clause, and the reason it asked the parties to present additional testimony about this matter, is an uncertainty about the appropriate amount of sharing required to assure that AmerenUE continues to make its best efforts to control its fuel-related costs and to maximize its off-system sales.

12. The majority of electric utilities operate with a fuel adjustment clause that does not have any sort of sharing mechanism.[258] Yet, the Commission is concerned that allowing an uncontrolled pass-through of costs will reduce a utility's incentive to carefully examine and perhaps reduce those costs. In the last rate case, the Commission decided that a 95/5 sharing mechanism was appropriate to allow the company to recover its prudently incurred costs while still protecting ratepayers. But the Commission wanted to know how well that sharing mechanism was working in practice.

13. MIEC and Public Counsel advocated for a revised sharing mechanism that would require AmerenUE to absorb a larger percentage of increasing fuel costs to increase its incentive to properly manage those costs. However, the testimony those parties presented was based on little more than the opinions of their witnesses about an appropriate sharing

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[256] Barnes Additional Direct – FAC, Ex. 122, Page 5, Lines 16-19.

[257] Transcript, Page 2421, Lines 1-6.

[258] Transcript, Page 2421, Lines 7-14.

percentage. No party presented any evidence that would indicate how the 95/5 sharing mechanism is working in practice for this company. Certainly, no evidence was produced to show that AmerenUE had acted imprudently with regard to its procurement of fuel and off system sales since the fuel adjustment clause went into effect in March 2009. On the contrary, the efficiency of AmerenUE's power plant performance as measured by equivalent availability improved in 2009, after the fuel adjustment clause was put into effect.[259]

14. As Staff explained in its testimony, the implementation of AmerenUE's fuel adjustment clause has only just begun. Staff will not complete its first prudence review of AmerenUE's operations under the existing fuel adjustment clause until August 2010.[260] The prudence review is very important to Staff in determining whether the fuel adjustment clause was working in the manner intended, as is seeing whether AmerenUE has changed its practices regarding their purchase and hedging of fuel and regarding off-system sales.[261] Until that review process is complete, Staff concluded it would not have sufficient data to meaningfully analyze the effectiveness of AmerenUE's fuel adjustment clause.[262]

15. Substantially changing the existing fuel adjustment clause without a meaningful analysis could have severe adverse consequences for AmerenUE and ultimately for ratepayers. Gary Rygh, a witness for AmerenUE explained that a significant modification to AmerenUE's fuel adjustment clause outside the context of a prudence review process could lead investors to conclude either that AmerenUE was improperly managing its net

[259] Barnes Additional Direct – FAC, Ex. 122, Page 8, Lines 10-11.

[260] Mantle Supplemental Direct – FAC, Ex. 221, Page 12, Lines 15-16.

[261] Transcript, Page 2517, Lines 17-23.

[262] Mantle Supplemental Direct – FAC, Ex. 221, Page 6, Lines 3-7.

fuel costs, or that the Commission was acting rashly in overturning regulatory stability in Missouri.[263] Julie Cannell, another witness for AmerenUE, explained that investors value certainty, fairness, stability, and predictability. She indicated "a lack of consistency in a commission's actions or decisions serves to increase the investment risk associated with a utility."[264] Increased financial risk results in an increase in a company's cost of borrowing, ultimately increasing costs that will be passed on to ratepayers.[265]

Conclusions of Law:

A. Section 386.266.1, RSMo (Supp. 2009), the statute that allows the Commission to establish a fuel adjustment clause provides as follows:

> Subject to the requirements of this section, any electrical corporation may make an application to the commission to approve rate schedules authorizing an interim energy charge or periodic rate adjustments outside of general rate proceedings to reflect increases and decreases in its prudently incurred fuel and purchased-power costs, including transportation. The commission may, in accordance with existing law, include in such rate schedules features designed to provide the electrical corporation with incentives to improve the efficiency and cost-effectiveness of its fuel and purchased-power procurement activities.

Subsection 4 of that statute sets out some of the provisions that must be included in a fuel adjustment clause as follows:

> The commission shall have the power to approve, modify, or reject adjustment mechanisms submitted under subsections 1 to 3 of this section only after providing the opportunity for a full hearing in a general rate proceeding, including a general rate proceeding initiated by complaint. The commission may approve such rate schedule after considering all relevant factors which may affect the cost or overall rates and charges of the corporation, provided that it finds that the adjustment mechanism set forth in the schedules:

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[263] Rygh Rebuttal – FAC, Ex. 120, Pages 5-6, Lines 20-23, 1-5. Rygh is a Managing Director at Barclays Capital, Inc., an investment bank in New York.

[264] Cannell Rebuttal, Ex. 117, Pages 25-26, Lines 21, 1-2. Cannell is a securities analyst in New York.

[265] Cannell Rebuttal – FAC, Ex. 118, Page 5, Lines 2-3.

> *(1) Is reasonably designed to provide the utility with a sufficient opportunity to earn a fair return on equity;*
>
> (2) Includes provisions for an annual true-up which shall accurately and appropriately remedy any over- or under-collections, including interest at the utility's short-term borrowing rate, through subsequent rate adjustments or refunds;
>
> (3) In the case of an adjustment mechanism submitted under subsections 1 and 2 of this section, includes provisions requiring that the utility file a general rate case with the effective date of new rates to be no later than four years after the effective date of the commission order implementing the adjustment mechanism. …
>
> (4) In the case of an adjustment mechanism submitted under subsections 1 or 2 of this section, includes provisions for prudence reviews of the costs subject to the adjustment mechanism no less frequently than at eighteen-month intervals, and shall require refund of any imprudently incurred costs plus interest at the utility's short-term borrowing rate. (emphasis added)

Subsection 4(1) is emphasized because that is the key requirement of the statute. Any fuel adjustment clause the Commission allows AmerenUE to implement must be reasonably designed to allow the company a sufficient opportunity to earn a fair return on equity.

B. Subsection 7 of the fuel adjustment clause statute provides the Commission with further guidance, stating the Commission may:

> take into account any change in business risk to the corporation resulting from implementation of the adjustment mechanism in setting the corporation's allowed return in any rate proceeding, in addition to any other changes in business risk experienced by the corporation.

Finally, subsection 9 of that statute requires the Commission to promulgate rules to "govern the structure, content and operation of such rate adjustments, and the procedure for the submission, frequency, examination, hearing and approval of such rate adjustments." In compliance with the requirements of the statute, the Commission promulgated Commission Rule 4 CSR 240-3.161, which establishes in detail the procedures for submission, approval, and implementation of a fuel adjustment clause.

C. Specifically, Commission Rule 4 CSR 240-3.161(3) establishes minimum filing requirements for an electric utility that wishes to continue its fuel adjustment clause in a rate case subsequent to the rate case in which the fuel adjustment clause was established. AmerenUE has met those filing requirements.

Decision:

The Commission concludes AmerenUE should be allowed to continue to implement the fuel adjustment clause the Commission approved in the company's last rate case. Given the short amount of time AmerenUE's fuel adjustment clause has operated and the resulting lack of information about how effective the current sharing mechanism has been, the Commission will not modify that clause, except as provided in the previously approved stipulation and agreement. The Commission expects to further review AmerenUE's fuel adjustment clause and the appropriate sharing mechanism to be included in that clause as part of AmerenUE's next rate case.

9. Rate Design and Class Cost of Service Issues

a. Rate Design

Findings of Fact:

Introduction:

1. After the Commission determines the amount of rate increase that is necessary, it must decide how that rate increase will be spread among AmerenUE's customer classes. The basis principle guiding that decision is that the customer class that causes a cost should pay that cost.

2. During the course of the hearing, Public Counsel, MIEC, AARP and the Consumers Council of Missouri, and the Missouri Retailers Association filed a nonunanimous stipulation

and agreement that reached an agreement on how the rate increase should be allocated to the customer classes. AmerenUE and Staff did not sign the stipulation and agreement but do not oppose the compromise agreement. MEUA, however, does oppose that agreement. Subsequently, the parties that signed the original stipulation and agreement submitted an addendum to that stipulation and agreement. MEUA also opposed the addendum.

3. Because the stipulation and agreement and the addendum to that stipulation and agreement are opposed, the Commission cannot approve the stipulation and agreement or the addendum. Nevertheless, the compromise described in the stipulation and agreement and addendum remains the position of the signatory parties and the Commission can consider that position as it decides this issue.

4. AmerenUE has seven customer classes.[266] The Residential class is comprised of residential households. The Small General Service and Large General Service classes are comprised of commercial operations of various sizes. The first three classes receive electric service at a low secondary voltage level. The Small Primary Service and the Large Primary Service are larger industrial operations that receive their electric service at a high voltage level. The Large Transmission Service class takes service at a transmission voltage level.

5. There is only one member of the Large Transmission class, Noranda Aluminum, Inc.[267] Noranda operates an aluminum smelter in Southeast Missouri and purchases

[266] Cooper Direct, Ex. 134, Page 4, Lines 8-22.

[267] Staff's Class Cost-Of-Service and Rate Design Report, Ex. 205, Page 27, Lines 17-18.

massive amounts of electricity from AmerenUE. When the smelter is at full production, Noranda pays AmerenUE approximately $140 million per year for electricity[268]

6. AmerenUE's last customer class is the Lighting class, which consists of both area and street lighting.[269] The Lighting class has a unique load pattern in that it is on at night and, for the most part, off during the day. For that reason, its class load is typically very low during periods of peak demand.[270]

Specific Findings of Fact:

7. To evaluate how best to allocate costs among these customer classes, four parties prepared and presented class cost of service studies. The studies presented by AmerenUE and MIEC used versions of the Average and Excess Demand Allocation method (A&E). An A&E allocation method considers both the maximum rate of use (demand) and the duration of use (energy). The A&E method conceptually splits the system into an average component and an excess component. The average demand is the total kWh usage divided by the total number of hours in the year. This is the amount of capacity that would be required to produce the energy if it were taken at the same demand rate each hour. The system excess demand is the difference between the system peak demand and the system average demand. The average demand is allocated to the various classes in proportion to their average demand (energy usage). The difference between the system average demand and the system peak or peaks is then allocated to customer classes on the basis of a measure that represents their peaking or variability in usage [271]

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[268] Gregston Direct, Ex. 422, Page 3, Lines 5-14.

[269] Cooper Direct, Ex. 134, Page 4, Lines 15-16.

[270] Staff's Class Cost-Of-Service and Rate Design Report, Ex. 205, Page 12, Lines 15-16.

[271] Brubaker Direct, Ex. 429, Pages 23-24, Lines 15-22, 1-5.

8. Staff and Public Counsel also presented class cost of service studies, but they used a different allocation method known as a Peak and Average Demand Allocation method. Staff's allocation method is based on the assumption that an electric utility adds capacity to meet its entire load rather than to just meet its peak load demand.[272] Public Counsel also presented a second study using a time of use method.

9. The following chart compares the results of each of the class cost of service studies, indicating the percent change in class revenues required to equalize class rates of return, as well as the dollar amounts needed to bring a class to its indicated cost of service. A negative number means the class is paying more than its indicated share of costs. A positive number means the class is paying less than its indicated share. All dollar figures are in millions.

Study	Residential	Small General Service	Large General Service	Large Primary Service	Large Transmission Service
Staff - 4 CP A&P[273]	8.67% $83.5	-4.24% $(10.5)	-11.40% ($73.7)	-0.55% ($0.9)	3.57% $5.0
AmerenUE[274]	7.99% $78.0	-7.01% ($17.6)	-9.74% ($64.8)	1.21% $2.1	1.63% $2.3
OPC (TOU)	1.23% $11.8	-9.40% ($23.3)	-3.77% ($24.4)	8.80% $14.7	15.27% $21.2
OPC (A&P)[275]	3.35% $32.2	-7.60% ($18.9)	-4.69% ($30.3)	7.17% $12.0	3.56% $5.0
MIEC[276]	13.30% $129.6	-4.30% ($10.7)	-12.70% ($84.6)	-7.40% ($12.7)	-15.50% ($21.6)

[272] Scheperle Rebuttal, Ex. 207, Page 2, Lines 13-19.

[273] Ex. 553.

[274] Ex. 551.

[275] Ex. 552.

[276] Brubaker Revised Direct, Ex. 429, Schedule MEB-COS-5.

For example, Staff's study indicated the Residential class is currently paying $83.5 million less than AmerenUE's cost to serve that class. In contrast, according to Staff's study, the Large General Service class is currently paying $73.7 million more than AmerenUE's cost to serve that class. Although the exact numbers vary among the various studies, all the studies agree that the Residential class is currently paying substantially less than its cost of service and that the Large General Service class is currently paying substantially more than its cost of service.

10. In starting the process to develop just and reasonable rates, the first question the Commission must resolve is which of the submitted class cost of service studies best describes AmerenUE's cost to serve its various customer classes. As a first step, the Commission will discard the Staff and Public Counsel studies that utilize a Peak and Average Demand production demand allocation method.

11. Staff asserts that its Peak and Average Demand allocation method is superior to the Average and Excess method because it considers each class' contribution to the system's total peak rather than each class' excess demand at peak.[277] However, what Staff describes as its method's strength is actually its downfall because the Peak and Average demand method double counts the average demand of the customer classes.

12. Some customer classes, such as large industrials, may run factories at a constant rate, 24 hours a day, 7 days a week. Therefore, their usage of electricity does not vary significantly by hour or by season. Thus, while they use a lot of electricity, that usage does not cause demand on the system to hit peaks for which the utility must build or acquire additional capacity. Another customer class, for example, the residential class, will

[277] Scheperle Rebuttal, Ex. 207, Page 5, Lines 11-14.

contribute to the average amount of electricity used on the system, but it will also contribute a great deal to the peaks on system usage, as residential usage will tend to vary a great deal from season to season, day to day, and hour to hour.

13. To recognize that pattern of usage, the Average and Excess method separately allocates energy cost based on the average usage of the system by the various customer classes. It then allocates the excess of the system peaks to the various customer classes by a measure of that class' contribution to the peak. In other words, the average and excess costs are each allocated to the customer classes once.

14. The Peak and Average method, in contrast, initially allocates average costs to each class, but then, instead of allocating just the excess of the peak usage period to the various classes to the cost causing classes, the method reallocates the entire peak usage to the classes that contribute to the peak. Thus, the classes that contribute a large amount to the average usage of the system but add little to the peak, have their average usage allocated to them a second time. Thus, the Peak and Average method double counts the average system usage, and for that reason is unreliable.[278]

15. Public Counsel also offered a time of use study that assigns production costs to each hour of the year that the specific production occurs. The method then sums each class' share of hourly investments based on only those hours when the class actually uses the system.[279] Public Counsel's time of use method is also unreliable because it considers every hour in the year to be a demand peak. As a result, the actual peaks in usage are given no additional weight. This, of course, benefits the residential class, which tends to

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[278] Brubaker Rebuttal, Ex. 430, Pages 12-14. See also, Transcript, Pages 3095-3096, Lines 24-25, 1-22.

[279] Meisenheimer Direct, Ex. 307, Page 7, Lines 5-7.

drive peaks, at the expense of industrial users of electricity that have high load factors and contribute little to the peaks in usage.[280]

16. Since the class cost of service studies offered by Staff and Public Counsel are unreliable, the Commission must choose between the Average and Excess method studies submitted by AmerenUE and MIEC. That task is difficult in this case because most of the testimony offered by AmerenUE and MIEC's witnesses criticize the methods used by Staff and Public Counsel and offer little criticism of each others studies. Yet, the studies do reach different results.

17. Significantly, MIEC's study tends to shift more cost causation from the Large General Service, Large Primary Service and especially the Large Transmission Service classes to the Residential class than does the AmerenUE study. AmerenUE's witness, William Warwick, explained those cost shifts in his rebuttal testimony.[281] In the allocation of transmission costs, non-fuel generation expenses, off-system sales revenue, and general plant, MIEC advocated modifications to AmerenUE's study that would tend to decrease the allocation of those costs to the large industrial customers who are the members of MIEC.[282] AmerenUE contends most of these adjustments are inappropriate.

18. However, AmerenUE's witness agrees that one of the adjustments proposed by MIEC's witness is credible. In his class cost of service study, MIEC's witness, Maurice Brubaker allocated revenues from off-system sales to customer classes on the basis of class energy (kWh) requirements.[283] Staff made a similar allocation of revenues in its class

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[280] Brubaker Rebuttal, Ex. 430, Page 18, Lines 12-19.

[281] Warwick Rebuttal, Ex. 147.

[282] Warwick Rebuttal, Ex. 147, Pages 2-8.

[283] Brubaker Direct, Ex. 429, Page 30, Lines 11-14.

cost of service study, and AmerenUE's witness concedes that such an allocation could be appropriate.[284] In addition, Brubaker's allocation is consistent with the methodology the Commission approved in a slightly different context in a recent Kansas City Power & Light rate case, ER-2006-0314.[285]

19. If AmerenUE's class cost of service study is modified to allocate revenues from off-system sales on the basis of class energy requirements, then that study would show that the large transmission service class is currently paying approximately 8 percent more than its indicated revenue share. The revised study would also show that the large general service class is overpaying by 11 percent and the residential class is underpaying by 11 percent.

20. After carefully considering all the studies, the Commission finds that AmerenUE's class cost of service study, modified to allocate revenues from off-system sales on the basis of class energy requirements, is the most reliable of the submitted studies.

21. Evaluating the submitted class cost of service studies is only the Commission's first step in designing just and reasonable rates for AmerenUE. In general, it is important that each customer class carry its own weight by paying rates sufficient to cover the cost to serve that class. That is a matter of simple fairness in that one customer class should not be required to subsidize another. Requiring each customer class to cover its actual cost of service also encourages cost effective utilization of electricity by customers by sending correct price signals to those customers.[286] However, the Commission is not required to precisely set rates to match the indicated class cost of service. Instead, the Commission

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[284] Warwick Rebuttal, Ex. 147, Pages 5-7.

[285] Brubaker Direct, Ex. 429, Page 30, Line 14.

[286] Cooper Direct, Ex. 134, Pages 16-17, Lines 13-22, 1-2.

has a great deal of discretion to set just and reasonable rates, and can take into account other factors, such as public acceptance, rate stability, and revenue stability in setting rates.

22. AmerenUE and, initially, Public Counsel, proposed that any rate increase should be allotted equally to each customer class. In other words, each class would receive the system average percentage increase.[287] That would leave the existing disparities revealed in the class cost of service studies unchanged.

23. Staff proposed that a small adjustment be made to shift $3 million in revenue responsibility from the large general service class to the residential class. Staff's adjustment would represent approximately a 0.3 percent increase in revenue responsibility to the residential class and a 0.5 percent decrease in revenue responsibility to the large general service class.[288]

24. MIEC proposed that each customer class be moved 20 percent toward its cost of service as shown in MIEC class cost of service study. That move would require a 2.6 percent revenue neutral increase from the residential class,[289] to collect $25.9 million in additional revenue from the residential class.[290] However, MIEC would not stop there: Brubaker also advocated that the Large Transmission class, whose only member is Noranda, be moved entirely to its cost of service as shown in MIEC's class cost of service

[287] Cooper Direct, Ex. 134, Page 18, Lines 12-13. *See also*, Kind Direct, Ex. 300, Page 8, Lines 7-11.

[288] Staff's Class Cost-of-Service and Rate Design Report, Ex. 205, Page 24, Lines 8-15.

[289] Brubaker Revised Direct, Ex. 429, Page 36, Lines 13-19.

[290] Brubaker Revised Direct, Ex. 429, Schedule MEB-COS-6.

study. That extra movement would require an additional $8.2 million from the residential class and would reduce the rate relief that would otherwise flow to the other rate classes.[291]

25. Finally, MEUA, whose members take electric service as part of the large general service class, recommended the Commission adopt MIEC's proposed 20 percent revenue neutral adjustment, but without the extra adjustment to move the large transmission class to its cost of service.[292]

26. The stipulation and agreement to which MEUA objected would shift revenue responsibility to the residential, small general service and large primary service classes from the large transmission class and to a lesser extent, the large general service and small primary service classes. The addendum to the stipulation and agreement, to which MEUA also objected, would allocate a slightly larger revenue responsibility reduction to the large general service class.

27. Specifically, for an overall rate increase of $225 million, which is approximately the rate increase that will result from this order, the addendum to the stipulation and agreement would impose a roughly 1.5 percent revenue-neutral increase on the residential and small general service classes. That amounts to a revenue neutral increase of $14.5 million for the residential class and $3.8 million for the small general service class. It would also impose a 1.25 percent revenue neutral increase, amounting to an additional $2 million, on the large primary class.

28. On the other side of the coin, the large transmission class, whose only member is Noranda, would receive a revenue neutral reduction of 11.74 percent, which amounts to a reduction of approximately $16.3 million. That means Noranda would receive an actual

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[291] Brubaker Revised Direct, Ex. 429, Schedule MEB-COS-6.

[292] Chriss Rebuttal, Ex. 550, Page 11, Lines 3-12.

rate reduction of approximately $2.1 million, or a 1.54 percent overall reduction. That would occur while the residential class received an 11.70 percent rate increase. The large general service/small primary service class would receive a smaller revenue neutral reduction of 0.7%, amounting to $4.579 million. That means the large general service/small primary service class would receive an overall rate increase of 9.59 percent.

29. The reallocation of revenue responsibility the signatories agreed to in the stipulation and agreement, now their joint position, bears some resemblance to the results of AmerenUE's modified class cost of service study, which the Commission found to be the most reliable of the submitted studies. AmerenUE's study, and indeed, all the submitted studies, indicate that the residential class is paying substantially less than its actual revenue responsibility. The stipulated position would bring that revenue class closer to its actual cost of service. The stipulated position would also provide the large transmission service class, Noranda, with the largest rate reduction, even though AmerenUE's modified class cost of service study indicates the large general service class is currently overpaying its actual cost of service by a larger percentage.

30. MIEC, and in particular, Noranda, attempt to justify these results by claiming that Noranda needs special rate consideration to remain competitive with other aluminum smelters in the United States, lest it be forced to close, resulting in economic devastation to Missouri.

31. There is no doubt that the closure of Noranda's New Madrid aluminum smelter would have a severe impact on the economy of Southeast Missouri. Noranda directly employs some 900 people at its smelter, at an annual payroll of $60 million. Were the plant to close,

the Southeast Missouri region could lose over 3,200 jobs from its economy and state and local governments would lose $16 million per year in tax revenues.[293]

32. Noranda's aluminum smelter produces molten aluminum from aluminum oxide, known as alumina. The alumina is brought up the Mississippi river by barge for delivery to the smelter.[294] The processing of the alumina into aluminum requires a tremendous amount of electricity. When the smelter is at full production, at current electric rates, Noranda pays AmerenUE $140 million for electricity each year. The cost of electricity represents a little less than one-third of the smelter's cost of producing aluminum.[295]

33. Electricity is not the only cost factor affecting the continued viability of the New Madrid smelter, and MEUA demonstrated that the New Madrid smelter appears to possess certain competitive advantages over other competing smelters apart from the cost of electricity. For example, the smelter's geographic location on the Mississippi river reduces its cost to transport supplies of alumina.[296] If the market price of aluminum rises, Noranda may also benefit from paying a fixed rate for electricity while many of its competitors pay a rate for electricity that varies with the market price of aluminum.[297] Noranda expects that aluminum prices will rise in the future.[298] Still, while there is no evidence to indicate that Noranda is on the verge of shutting down its smelter with or without an electric rate increase, the smelter's long-term viability is dependent upon maintaining reasonably competitive electric rates.

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[293] Coomes Direct, Ex. 419, Page 2, Lines 4-12.

[294] Gregston Direct, Ex. 422, Page 1, Lines 12-17.

[295] Gregston Direct, Ex. 422, Page 3, Lines 5-14.

[296] Transcript, Page 2948, Lines 17-21.

[297] Transcript, Page 2948, Lines 2-7.

[298] Transcript, Page, 2959, Lines 1-5.

34. The large general service customer class is also currently paying more than its indicated revenue share and the stipulated position would provide that class with $4,579,000 of rate relief. But no evidence was presented that would show that the members of the large general service customer class need rate relief to remain competitive in the same way that Noranda needs that relief.

35. Clearly, Noranda will be affected by the rate increase that will result from this case. But the same can be said about all the other businesses and families that must pay AmerenUE for the electricity they need. The reduction proposed by the stipulated position would give Noranda an actual rate decrease of $2.147 million while all other customers have to absorb a rate increase. That result is inappropriate. While generally accepting the joint position, the Commission will modify that position to provide that the revenue neutral reduction in the large transmission service class's rate shall be set at a level that leaves that class' total revenue contribution unchanged. The joint position's revenue increase for the residential class shall be reduced by the amount taken from the large transmission class' revenue reduction. The lighting class' class revenue responsibility will be addressed in the next section of this report and order.

36. The objected to stipulation and agreement also purports to resolve certain issues regarding customer charges, Rider B voltage credits, and the Reactive Charge. No party, including MEUA, objects to that aspect of the stipulation and agreement.[299]

37. Specifically, the signatories agree that the residential customer charge should be set at $8.00 per month, with the remaining revenue assigned to the residential class to be allocated to volumetric charges. AmerenUE proposed that the residential customer charge

[299] *See.* Initial Posthearing Brief of Midwest Energy Users Association, Page 11.

be increased to $10.00 per month from its current level of $7.25.[300] Staff recommended the residential customer charge be increased to $8.50 per month.[301] However, neither Staff nor AmerenUE objects to a residential customer charge of $8.00 per month. The Commission finds that $8.00 per month is a reasonable residential customer charge.

38. The signatories also agree as follows:

> the Small Power Service (SPS), Large Primary Service (LPS) and Large Transmission Service (LTS) customer charges should be set to $234.33, then those customer charges should be increased by the same percentage as the system average percentage increase, i.e., each will be increased by the same percentage and each will be the same. The signatories agree the rates for Rider B voltage credits (Tariff Sheet 99) should remain the same for all applicable rate schedules. The existing Rider B voltage credits should be increased by the same percentage as the system average percentage increase. The particular Rider B voltage credits as they now exist follow:
>
> - A monthly credit of $0.90/kW of billing demand for customers taking service at 34.5 or 69kV.
> - A monthly credit of $1.06/kW of billing demand for customers taking service at 115kV or higher.
>
> The Signatories agree the rate for the Reactive Charge should be the same for all applicable rate schedules and that the existing Reactive Charge should be increased by the same percentage as the system average percentage increase. The current Reactive Charge for SPS (Tariff Sheet 37), LPS (Tariff Sheet 67.1) and LTS (Tariff Sheet 68) classes are $027 per kVar. The Signatories agree the customer charge associated with Time-of-Day rates should be the same for all applicable non-residential rate schedules and that the existing Time-of-Day customer charge should be increased by the same percentage as the system average percentage increase. The current Time-of-Day customer charge for the Large General Service class (LGS)(Tariff Sheet 34), SPS (Tariff Sheet 37, LPS (Tariff Sheet 67.1) and LTS (Tariff Sheet 68) is $15.25. The Signatories agree the Small General Service class (SGS) customer charge should be $9.28 for single-phase service and $18.56 for three-phase service (Tariff Sheet 32). With the foregoing exceptions, all other rate elements within each rate schedule shall be increased by an equal percentage basis so that collectively all rate elements on that schedule are designed to collect the revenue assigned to the class to which that rate schedule applies.

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[300] Cooper Direct, Ex. 134, Page 21, Lines 1-7.

[301] Staff's Class Cost-of-Service and Rate Design Report, Ex. 205, Page 24, Line 18.

The agreed upon positions are generally consistent with the positions taken by Staff and AmerenUE and neither party has objected to those positions. The Commission finds that the agreed upon positions stated in the stipulation and agreement are reasonable and the Commission adopts those positions.

39. The signatories also agreed to adopt Staff's position that the following features should be returned to uniformity:

- The value of the customer charge be uniform across rate schedules, with the customer charges on the SPS, LPS, and LTS rate schedules being the same.
- The rates for Rider B voltage credits be the same under all applicable rate schedules.
- The rates for the Reactive Charge be the same for all applicable rate schedules.
- The rates associated with Time-of-Day meter charge be the same for all applicable non-residential rate schedules.[302]

Staff's testimony explained that these features had been uniform until implementation of the rate design in AmerenUE's last rate case. The Commission finds that the agreed upon position is reasonable and that position is adopted.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

The Commission generally accepts the joint position, but will modify that position to provide that the revenue neutral reduction in the large transmission service class's rate shall be set at a level that leaves that class' total revenue contribution unchanged. The joint position's revenue increase for the residential class shall be reduced by the amount

[302] Staff's Class Cost-of-Service and Rate Design Report, Ex. 205, Page24, Lines 1-6.

taken from the large transmission class' revenue reduction. The lighting class' class revenue responsibility will be addressed in the next section of this report and order.

b. Street Lighting

Findings of Fact:

Introduction:

40. The members of the lighting class of customers largely consists of municipalities that purchase electricity from AmerenUE to light their streets at night. The lighting class has a unique load pattern in that the street lights are generally on only at night. That means street lights are drawing power when demand from other users tends to be low, and as a result the lighting class does not contribute much to peak demand. As previously discussed, peak demand tends to drive costs, so the lighting class does not fit well into a general class cost of service study.[303] For that reason, the class cost of service studies submitted by Staff and AmerenUE did not separately calculate the cost of serving the lighting class. Instead, their cost of service studies allocated all direct lighting costs and revenues to the other classes based on each class' share of AmerenUE's total cost-of-service.[304] That allocation method assumes that the company's rates for lighting service have been established at or near their cost of service,[305] but it does not actually determine whether that assumption is correct.

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[303] Staff's Class Cost-of-Service and Rate Design Report, Ex. 205, Page 12, Lines 15-21.

[304] Staff's Class Cost-of-Service and Rate Design Report, Ex. 205, Page 12, Lines 21-25.

[305] Staff's Class Cost-of-Service and Rate Design Report, Ex. 205, Page 13, Lines 1-3. *See also*, Warwick Direct, Ex. 146, Page 4, Lines 1-15.

41. The same allocation method was used in AmerenUE's last two rate cases, and no actual cost of service study has been done for the lighting class over that time.[306] AmerenUE may have last performed a comprehensive street lighting study sometime in the1980's but it has been unable to locate that study.[307] Since AmerenUE's cost to serve the lighting class has not been studied since at least the 1980's, the lighting class has simply been allocated the same across the board rate adjustments allocated to the other rate classes. AmerenUE and Staff would continue that practice in this case.

42. The lighting class has not been represented in AmerenUE's previous rate cases, but the Municipal Group intervened in this case to bring the lighting class' issues to the Commission's attention. In the First Stipulation and Agreement, filed on March 10, before the start of the hearing, the signatory parties agreed that AmerenUE would cooperate with all interested parties in preparing a cost of service study regarding the lighting class for use in the company's next rate case.[308] The Municipal Group did not sign that stipulation and agreement, but it did not oppose it, and the Commission approved the stipulation and agreement on March 24.[309]

43. Despite the stipulation and agreement's provision for a future class cost of service study, the Municipal Group continues to seek immediate relief in this case. Specifically, the Municipal Group seeks:

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[306] Transcript, Page 2871, Lines 3-20.

[307] Transcript, Page 2872, Lines 1-4.

[308] First Nonunanimous Stipulation and Agreement, Page 7.

[309] 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, Order Approving First Stipulation and Agreement (March 24, 2010).

1. A moratorium on any new street lighting rates under the 5M and 6M tariffs pending the outcome of the cost of service study and its introduction in AmerenUE's next rate case, or, in the alternative that AmerenUE hold in escrow any increase ordered for the 5M and 6M street lighting rates pending the review of the street lighting cost of service study in AmerenUE's next rate case; and

2. The elimination of any future pole installation charges from 5M customer bills until such pole installation charges can be justified in AmerenUE's next rate case; and

3. A credit for the 5M customers for all other revenues received by AmerenUE for itself and other entities for their use of these same poles for telephone, cable TV, electric distribution lines, etc.[310]

Specific Findings of Fact:

44. AmerenUE currently collects roughly $31 million per year system-wide from the lighting class.[311] That represents about 1.4 percent of the company's total base rate revenues.[312] The company collects a part of that revenue from its 5M and 6M rates for street lighting, but the exact amount AmerenUE collects under those two particular rates is not revealed in the record.

45. The 5M classification is for street lights that are owned and maintained by AmerenUE. Those street lights are not metered. Instead, the 5M customer is billed by

[310] Initial Brief of the Municipal Group, Pages 10-11.

[311] Transcript, Page 2869, Lines 6-15.

[312] Warwick Direct, Ex. 146, Page 4, Lines 11-12.

fixture and pole type according to the number of lights in each rate category.[313] The street lighting bill can be a significant expense for a municipality. For example, the City of University City budgets approximately $640,000 per year for 5M street lighting.[314] The 6M classification covers metered and unmetered street lighting that is owned by the customer rather than AmerenUE.[315]

46. After comparing the 5M rate to the 6M rate, the Municipal Group contends it is being overcharged for maintenance portion of the 5M rate.[316] The Municipal Group also contends it is being overcharged under the 5M rate for pole installation charges for poles installed before 1988. The Municipal Group claims that having collected an installation charge for more than 20 years, AmerenUE should have recovered its installation costs by now.[317]

47. Finally, the Municipal Group notes that AmerenUE collects revenue from other entities for various installations added onto the street lighting poles, such as cable TV lines. The municipalities contend that since they are in effect renting the poles, they should receive a cut of that revenue.[318] AmerenUE explains that it accounts for that extra revenue as an offset to its base rate revenues in its rate cases. In other words, a dollar collected from a cable company for hanging a line on a light pole would be a dollar the company would not collect from its customers, including the lighting customers.[319] Thus, the Commission finds that those revenues do, at least indirectly benefit the lighting customers.

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[313] Eastman Rebuttal, Ex. 750, Page 4, Lines 3-13.

[314] Eastman Rebuttal, Ex. 750, Page 4, Lines 15-17.

[315] Eastman Rebuttal, Ex. 750, Page 6, Lines 11-14.

[316] Eastman Rebuttal, Ex. 750, Page 9-11.

[317] Eastman Rebuttal, Ex. 750, Page 14, Lines 5-18.

[318] Transcript, Pages 2878-2880.

[319] Transcript, Page 2878, Lines 11-20.

48. AmerenUE generally denies that it is overcharging its lighting customers, but concedes that there is no specific cost study to support those rates. That deficiency should be corrected by the completion of such a cost study for the development of rates in the company's next rate case. The Municipal Group claims that pole installation charges are unfair, but could offer nothing other than speculation to prove that contention. Since there is no basis at this time to conclude that the current rates are not justified, the Commission will not eliminate future pole installation charges at this time. But the fairness of those charges should become clearer after completion of the costs study and may be revisited in the next rate case.

49. The record does not indicate the amount of revenue AmerenUE collects from 5M and 6M rates apart from the general lighting revenue numbers. Therefore, the Commission cannot exempt just the 5M and 6M ratepayers from the increased rates that will result from this rate case. However, because no class cost of service study has examined the lighting class since at least the 1980s, the entire class has been given rates that may or may not bear any resemblance to the cost to serve that class. The lighting class is only a small part of AmerenUE's entire customer base, but street lighting is a significant cost for the municipalities that take that service. Under the circumstances, the Commission will exempt the entire lighting customer class from the rate increase that will result from this report and order.[320]

50. The lighting class currently generates $31.295 million in revenue for AmerenUE. The roughly 10.2 percent system average rate increase that will result from this case would

[320] The Municipal Group's alternative proposal to have AmerenUE hold the rate increase collected from the lighting group in escrow, subject to refund, would not be fair to AmerenUE because, if the lighting group's rates were found to be too high, the company would not be able to go back and collect any revenue shortfall after the fact from the other customer classes.

generate an additional $3.2 million in revenue from the lighting class. AmerenUE shall instead collect that $3.2 million of revenue from the other rate classes on a pro rata basis.

Conclusions of Law:

There are no additional conclusions of law for this issue.

Decision:

The entire lighting class is exempted from the rate increase that will result from this report and order. The additional revenue that would have been collected from the lighting class under a system average rate increase shall instead be collected from the other rate classes on a pro rata basis. The adjustments necessary to exempt the lighting class shall be made after the general adjustments made pursuant to section 9a of this Report and Order.

IT IS ORDERED THAT:

1. The tariff sheets filed by Union Electric Company, d/b/a AmerenUE on July 24, 2009, and assigned tariff number YE-2010-0054, are rejected.

2. Union Electric Company, d/b/a AmerenUE is authorized to file a tariff sufficient to recover revenues as determined by the Commission in this order. AmerenUE shall file its compliance tariff no later than June 8, 2010.

3. This report and order shall become effective on June 7, 2010.

BY THE COMMISSION

(S E A L)

Steven C. Reed
Secretary

Davis, C., concurs, with concurring opinion to follow,
Jarrett, Gunn, and Kenney, CC., concur,
Clayton, Chm., dissents, with dissenting opinion to follow.
and certify compliance with the provisions
of Section 536.080, RSMo.

Dated at Jefferson City, Missouri,
on this 28th day of May, 2010.