STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Central Illinois Light Company d/b/a AmerenCILCO **Proposed general increase in rates for delivery service (tariffs filed December 27, 2005)**	)	**Docket No. 06-0070** **(Cons.)**
Central Illinois Public Service Company d/b/a AmerenCIPS **Proposed general increase in rates for delivery service. (tariffs filed December 27, 2005)**	)	**Docket No. 06-0071**
Illinois Power Company d/b/a AmerenIP **Proposed general increase in rates for delivery service (tariffs filed December 27, 2005)**	)	**Docket No. 06-0072**

INITIAL BRIEF OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

SEAN R. BRADY
JOHN C. FEELEY
CARMEN L. FOSCO
CARLA SCARSELLA
Office of General Counsel
Illinois Commerce Commission
160 North LaSalle Street, Suite C-800
Chicago, IL 60601
Phone: (312) 793-2877
Fax: (312) 793-1556
sbrady@icc.illinois.gov
jfeeley@icc.illinois.gov
cfosco@icc.illinois.gov
cscarsel@icc.illinois.gov

Counsel for the Staff of the Illinois Commerce Commission

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STAFF OF THE ILLINOIS COMMERCE COMMISSION

Staff of the Illinois Commerce Commission ("Staff"), by and through its counsel, pursuant to Section 200.800 of the Rules of Practice (83 Ill. Adm. Code 200.800) of the Illinois Commerce Commission's ("Commission"), respectfully submits its Initial Brief in the above-captioned matter.

INTRODUCTION

Central Illinois Light Company d/b/a AmerenCILCO, Central Illinois Public Service Company d/b/a AmerenCIPS, and Illinois Power Company d/b/a AmerenIP (collectively, "Ameren" or the "Ameren Companies" or the "Companies") filed new tariff sheets on December 27, 2005, in which they proposed a general increase in rates for delivery service. On January 25, 2006, the Commission entered a Suspension Order commencing the instant investigation of the Ameren Companies' proposed general increase in rates and suspending operation of the Filed Rate Schedule Sheets, and on May 17, 2006 entered a Re-suspension Order extending the suspension to and including November 25, 2006. In due course, the Administrative Law Judges ("ALJs") assigned to this proceeding established a schedule for the submission of pre-filed testimony, hearings and briefs. (Tr., pp. 21-22)

In response to the Company's filing, the following parties filed Petitions to Intervene, which were granted: Dynegy, Inc.; Local Unions 51, 309, 649, 702 and 1306 of the International Brotherhood of Electrical Workers, AFL-CIO ("IBEW"); Citizens Utility Board ("CUB"); BlueStar Energy Services, Inc.; Illinois Industrial Energy Consumers ("IIEC"); People of the State of Illinois ("AG"); Kroger Co. ("Kroger"); University of Illinois; Constellation NewEnergy, Inc., MidAmerican Energy Company, and Peoples Energy Services Corporation as Collation of Energy Suppliers ("CES"); Wal-Mart Stores, Inc. ("Wal-Mart"); City of Champaign and the City of Urbana; Town of Normal; City of Bloomington; and Champaign County.

The following witnesses submitted testimony on behalf of Staff: Scott A. Struck (ICC Staff Exhibit 1.0; ICC Staff Exhibit 12.0(Corrected)), Theresa Ebrey (ICC Staff Exhibit 2.0; ICC Staff Exhibit 13.0(Corrected)), Burma C. Jones (ICC Staff Exhibit 3.0; ICC Staff Exhibit 14.0), Janice Freetly (ICC Staff Exhibit 4.0 Corrected; ICC Staff Exhibit 15.0); Alan S. Pregozen (ICC Staff Exhibit 5.0; ICC Staff Exhibit 16.0 Corrected), Peter Lazare (ICC Staff Exhibit 6.0; ICC Staff Exhibit 17.0), Cheri L. Harden (ICC Staff Exhibit

7.0; ICC Staff Exhibit 18.0), Mike Luth (ICC Staff Exhibit 8.0; ICC Staff Exhibit 19.0), Greg Rockrohr (ICC Staff Exhibit 9.0; ICC Staff Exhibit 20.0), James D. Spencer (ICC Staff Exhibit 10.0; ICC Staff Exhibit 21.0), Thomas L. Griffin (ICC Staff Exhibit 11.0), and Eric P. Schlaf (ICC Staff Exhibit 22.0).

During the course of the proceeding, Staff proposed various adjustments and changes to the Companies' December 27, 2005 requests. The Companies accepted certain of Staff's modifications and Staff withdrew others. Appendix A includes (1) a summary of Staff's final recommendations to the Commission in this proceeding (see Schedule 5 (CIL), (CIPS), and (IPC) of Appendix A); and (2) Staff's revised Revenue Requirement[1]. Staff's recommended cash working capital requirement for each company is presented on each respective Schedule 9. (see Schedule 9 (CIL), (CIPS), and (IPC) of Appendix A). The cash working capital requirement calculation for AmerenIP distinguishes between the interest on Transitional Funding Trust Notes ("TFTN") and other interest as discussed more fully in the Cost of Illinois Power TFTNs section of this brief.

As indicated in Appendix A, Schedule 1 (CIL), page 1, line 3, column (e), AmerenCILCO's proposed rates reflect a base rate revenue increase of $45,794,000, or 47.05% ($45,794/$97,333). (Respondents' Exhibit 16.1) Staff proposes adjustments to AmerenCILCO's request totaling approximately $15,447,000, resulting in a Staff adjusted base rate revenue increase of approximately $30,347,000, or 31.18%. (Appendix A, Schedule 1 (CIL), p.1, line 3, column (h) and lines 24 and 25, column (i))

[1] Appendix A is the updated Schedules 12.01 through 12.08(CIL), 12.02 through 12.08(CIPS) and 12.01 through 12.07 (IPC) attached to ICC Staff Exhibit 12.0 Corrected.

As indicated in Appendix A, Schedule 1 (CIPS), page 1, line 3, column (e), AmerenCIPS' proposed rates reflect a base rate revenue increase of $26,693,000, or 12.65% ($26,693/$210,983). (Respondents' Exhibit 16.2 Rev.) Staff proposes adjustments to AmerenCIPS' request totaling approximately $25,308,000, resulting in a Staff adjusted base rate revenue increase of approximately $1,385,000, or 0.66%. (Appendix A, Schedule 1 (CIPS), p.1, line 3, column (h) and lines 24 and 25, column (i))

As indicated in Appendix A, Schedule 1 (IPC), page 1, line 3, column (e), AmerenIP's proposed rates reflect a base rate revenue increase of $148,408,000, or 58.07% ($148,408/$255,556). (Respondents' Exhibit 16.3 Rev.) Staff proposes adjustments to AmerenIP's request totaling approximately $59,344,000, resulting in a Staff adjusted base rate revenue increase of approximately $89,064,000, or 34.85%. (Appendix A, Schedule 1 (IPC), p.1, line 3, column (h) and lines 24 and 25, column (i))

For the reasons stated below, Staff's proposed adjustments should be adopted by the Commission.

ARGUMENT

I. RATE BASE

A. Summary of Uncontested/Settled Issues

1. Major Capital Additions-Prudence and Used and Useful

Staff witness Rockrohr testified regarding AmerenCIPS', AmerenIP's and AmerenCILCO's major capital additions to net plant. AmerenCIPS and Ameren IP each filed a Schedule F-4 that listed additions to plant placed in service since the last rate case where costs associated with those additions exceeded the costs set forth in 83 Ill. Adm. Code 285.6100. Because AmerenCILCO and AmerenCIPS had few or no capital projects required to be listed in their respective Schedule F-4s, Staff witness Rockrohr requested that those two utilities identify their ten most costly additions to net plant that occurred within the last 5 years. Mr. Rockrohr then selected a sample of the more costly capital projects for each of the Ameren Companies, and reviewed the project description, project justification, project dates, project costs, and project alternatives. (Rockrohr Dir., ICC Staff Exhibit 9.0, pp. 3-4)

Mr. Rockrohr reviewed the projects to determine whether the projects were both prudent and used and useful. Based upon his review, Mr. Rockrohr concluded that the investments were prudently incurred and upon completion the projects were used and useful in providing service to customers. Mr. Rockrohr did acknowledge that the time constraints of the rate case did not allow him sufficient time to review every capital project which the Ameren Companies seek to included in rates. He added however, that although the projects he reviewed represented only about 1% of the rate base proposed by each of the Ameren Companies, he believes the projects are representative of all capital projects for each company, and therefore he has no reason to recommend excluding any of the capital project additions from recovery in rates on the basis of prudence and used and useful. (*Id*.)

2. Staff Adjustment to Materials and Supplies Inventory

Staff witness Ebrey proposed an adjustment to decrease the Ameren Companies' test year Materials and Supplies Inventory balances based on an average of the most recent thirteen months of balances reduced by the associated accounts payable averaged over the same thirteen month period. (Ebrey Dir., ICC Staff Exhibit 2.0, pp. 20-21) The Ameren Companies accepted Staff's adjustment for each of the Companies. (Stafford Reb., Ameren Ex. 16.0, p. 27)

3. Adjustment to Accumulated Deferred Income Taxes ("ADIT")

The Ameren Companies reflected an adjustment to ADIT related to AmerenIP's Pro Forma Plant Additions (Stafford Reb., Respondents' Exhibit 16.11). Staff is not contesting this adjustment. (Ebrey Reb., ICC Staff Exhibit 13.0 (Corrected), p. 2)

4. Cash Working Capital: Treatment of Payroll Withholding Taxes

For a summary of the treatment of payroll withholding taxes as a separate line item including the expense lead, see Section I.G. of this Initial Brief.

5. AMS General and Intangible Plant

Staff witness Jones proposed adjustments to remove the Ameren Services Company's ("AMS") general and intangible plant included in each Company's rate base. AMS is an affiliate of the Ameren Companies, and it is inappropriate to include an affiliate's plant in each utility's rate base. (Jones Dir., ICC Staff Exhibit 3.0, pp. 10-11) Neither AmerenCIPS, AmerenCILCO nor AmerenIP has an ownership investment in the assets used by AMS to provide its services. As a result, the Ameren Companies have no need to earn a return on an investment they have not made and, therefore, do not have. (*Id.*, pp. 12-13)

Compensation for use of capital is specifically addressed in the Security and Exchange Commission ("SEC") rules regarding service companies. According to the SEC rule at 17 CFR 25.01-12, a services company should be compensated for the use of capital in the same way it is compensated for other costs by the companies it services; i.e., AMS should bill the respective company for its allocated share. (*Id.*, p. 14)

The Ameren Companies agree that the material investment in AMS general and intangible plant is recouped through the AMS billing process and concur with Staff's adjustment to remove AMS general and intangible plant included in each Company's rate base. (Stafford Reb., Ameren Ex. 16.0, p. 26) Thus, the issue is uncontested.

B. Plant Additions

The Commission should adopt Staff's proposed adjustment to reduce each of the Ameren Companies' rate bases for those plant additions that each Company failed to substantiate when it was repeatedly asked to do so. Staff witness Ebrey proposed adjustments to reduce utility plant in service based on her analysis of plant additions since the last DST rate case for each Company for unsupported costs. (Ebrey Reb., ICC Staff Exhibit 13.0 (Corrected), Schedules 13.02 (CIL), (CIPS), and (IPC)) The Ameren Companies argued that they had provided support for their costs throughout the case. (Stafford Reb., Ameren Exhibit 16.0, pp. 30 – 36; Stafford Sur., Respondents' Exhibit 36.0, pp. 36 – 41)

The Ameren Companies take issue with Staff's adjustment. In particular, they claim that Staff 1) made certain mathematical errors; 2) did not accept contractual documentation as adequate support; 3) did not accept a sample of employee expense reports as adequate documentation for all employee expense reports; and 4) applied the adjustment percentage to all plant additions. (Stafford Sur., Respondents' Exhibit 36.0, p. 37) However, the evidence shows that each of the Ameren Companies' criticisms of Staff's adjustment is misplaced.

What Ameren characterizes as Staff's "mathematical error" is in regard to AmerenCILCO work order 3648 and in reality is Ameren's own error because the

Company provided documentation of costs in excess of those costs disallowed by Staff. During cross examination, Ameren witness Stafford admitted that, of the unsupported costs for the work order in question, he had failed to provide any documentation in support of either the $421,600 invoice from a single vendor or the $12,201.16 representing employee expense vouchers. The remaining cost disallowed by Staff as unsupported was $60,381.78. Mr. Stafford provided three invoices that totaled $75,681.13 in his rebuttal testimony to support the costs remaining for work order 3648. (Tr., pp. 462 - 466) Based upon the documentation Ameren had eventually provided, Staff allowed $60,381.78, that portion of the plant Staff had previously disallowed. If the Company believes the costs of the work order were not properly aggregated on the books of the Company and that the Company is now entitled to include a cost in rate base for the work order that is greater than the cost recorded on the books of the Company, that does not represent a “mathematical error” on Staff’s part.

The Ameren Companies claimed that the Commission has previously accepted purchase orders as support for plant additions, citing the minimum filing requirements for electric distribution rates as its basis for providing such documents in support of plant additions. (Stafford Reb., Respondents’ Exhibit 36.0, pp. 38-39) During cross examination, Ameren witness Stafford acknowledged that the portion of the minimum filing requirements he relied upon pertain to pro forma adjustments for plant additions occurring after the test year and not to the actual plant additions that were placed in service prior to the end of the historical test year that was the subject of Staff’s adjustment. (Tr., pp. 467 - 468) The Ameren Companies’ reliance upon purchase orders alone to substantiate and verify plant additions that were placed in service and recorded in their books prior to the end of the test year is misplaced. Staff's rationale for disallowing plant for which the Ameren Companies have not provided cost documentation provides a legitimate basis for disallowance.

The Ameren Companies ask the Commission to rely on Ameren's own analysis of the employee expense reports for only one single work order instead of relying on all the employee expense reports for all of the work orders included in Staff's sample. (Ameren Exhibit 16.14, Schedules 1, 2, and 3, page 3 of 3) During cross examination, Mr. Stafford admitted that there were thousands of projects for all three utilities included in the total plant additions from 2001 – 2004. He also acknowledged that Staff's sample of 36 projects represented a relatively small sample from all plant additions. Then Mr. Stafford made the incredulous claim that his analysis of the employee expense reports from only **one** project was an adequate sample. (Tr., pp. 468 - 471) Staff's adjustment considers all the employee expense reports provided by the Ameren Companies. This criticism of Staff's adjustment is baseless and the Ameren Companies' efforts to further limit the sample is unreasonable and should be rejected.

Further, the Ameren Companies criticize Staff for applying its adjustment percentage to all gross plant additions without regard to whether such additions were in fact included in utility plant in service. (Stafford Sur., Respondents' Exhibit 36.0, p. 37) Contrary to the understanding or assumption underlying the Ameren Companies' criticism, Staff did not make its adjustment to particular accounts which may (or may not) have been included in utility plant in service. Instead, as acknowledged by Mr. Stafford during cross examination, Staff's adjustment was made to utility plant in service and not to any individual plant accounts or group of accounts. (Tr., pp. 473 - 474)

Moreover, Staff based its analysis on the information the Ameren Companies provided in their own schedules regarding plant additions. Ameren witness Stafford acknowledged that Statement on Auditing Standards No. 39 defines audit sampling as "the application of an audit procedure to less than 100% of the items within an account balance or class of transactions for the purpose of evaluating some characteristic of the balance or class". In evaluating plant additions, Staff appropriately applied audit sampling to the population of plant additions per the Ameren Companies and applied the resulting percentage of unsupported plant costs from the sample to the population. The Companies' criticism of Staff's auditing procedure is thus unfounded.

Additionally, Mr. Stafford presented amounts he alleged were not included in the Ameren Companies' plant balances but which Staff had included in its adjustment. (Respondents' Exhibits 36.1, 36.2 and 36.3) However, when Mr. Stafford was given the opportunity on cross-examination to indicate where Staff had included these amounts in Staff's adjustment (*see* Struck Reb., ICC Staff Exhibit 12.0, Schedules 12.04 (CIL), (CIPS), and (IPC)), he was unable to do so. (Tr. pp. 472 - 473) The evidence demonstrates that this criticism of Staff's adjustment is baseless as well.

Mr. Stafford further claimed that full support had been provided for AmerenIP Work Order 25438. (Stafford Sur, Respondents' Exhibit 36.0, pp. 39 – 40) Staff's adjustment related to this work order considered only costs that had been supported by documentation provided to Staff by the AmerenIP. (Ebrey Reb., ICC Staff Exhibit 13.0 (Corrected), Schedule 13.02 (IPC), page 2 of 2) The Ameren Companies later acknowledged that "full support" for this project was not provided to Staff. (Statement of Ameren Companies filed on e-docket on August 17, 2006) Also, the Ameren

Companies acknowledge that their recomputations of Staff's adjustment in Schedules 16.14 and 36.9 are not fully supported. (*Id.*)

Staff's adjustments to plant additions should be approved because Staff's proposed adjustment is consistent with the supporting documentation provided to Staff by the Ameren Companies. The Ameren Companies failed to meet the burden of proof to substantiate the level of plant investment proposed to be included in the respective rate bases.

C. Pro forma Plant Additions

The Commission should accept Staff's revised proposed adjustment of $193,000 to reduce AmerenIP's pro forma adjustment to plant additions for the electric delivery portion of the Customer Service System ("CSS") Integration from $8.059 million (per Schedule B-2.1) to $7.866 million, the level of costs AmerenIP was able to substantiate. (*See* Appendix A, Schedule 8 (IPC)) AmerenIP took issue with Staff's unrevised adjustment and further contends that the full amount of the electric delivery portion per its total claimed supported costs should be included.

Staff witness Ebrey originally proposed an adjustment to limit this pro forma plant addition to $7.736 million based on her determination that AmerenIP had not provided support for the full amount of CSS Integration costs sought to be included in rate base. (Ebrey Reb., ICC Staff Exhibit 13.0 (Corrected), Schedule 13.03 (IPC)) This determination was based on applying the 67.50% electric distribution factor per the Ameren Companies' Schedule B-2.1, line 2 to the $478,000 of unsupported costs to arrive at the electric distribution portion of unsupported costs ($478,000 * 67.50% = $323,000 rounded), and subtracting $323,000 from the electric distribution portion of the

CSS Integration costs shown per AmerenIP's Schedule B-2.1, line 3 ($8,059,000 - $323,000 = $7.736 million). (Tr., pp. 550-551) During cross examination, AmerenIP pointed out that Staff's analysis of unsupported costs was based on the total costs for CSS Integration (including the non-electric delivery portion) of $12.131 million as shown on Respondents' Exhibit 36.7. (Tr., pp. 547-549, 552-553; Respondents' Exhibit 36.7) Staff agrees that the total costs offered for review as supported costs were $12.131 million and has revised its adjustment based on the level of supported costs of the total $12.131 million. Thus, it follows that $11.653 million of total CSS Integration costs were supported ($12.131 million total costs less $478,000 unsupported costs). Staff's adjusted CSS Integration pro forma adjustment has been modified accordingly to $7,866 million to reflect the level of costs actually supported by the Company multiplied by the Electric Distribution Allocation factor ($11.653 multiplied by 67.50% electric distribution factor per the Ameren Companies Schedule B-2.1, line 2).

AmerenIP argues that $8.189 million -- the full amount of the electric delivery portion of the total project costs shown on Respondents' Exhibit 36.7 – should be included in the revenue requirement (Stafford Sur., Respondents' Exhibit 36.0, p. 36 and Respondents' Exhibit 36.8, Schedule 1), but since only $11.653 million of total CSS Integration costs was supported, only $7.866 million should be approved as the electric delivery portion of the total CSS Integration costs.

D. G&I Plant

1. Functionalization of Plant

The Ameren Companies have significantly overstated the levels of G&I plant to be included in the delivery services rate base. The overstatement arises because the

Companies' proposed method of functionalizing G&I plant to distribution directly conflicts with the Commission decisions in the last round of delivery service cases. The Commission should instead accept Staff's proposed adjustments which undo the Ameren Companies' efforts to undermine past Commission decisions and produce more reasonable levels of G&I plant for the Ameren Companies.

All three Ameren Companies propose significant increases in the levels of G&I plant. The increase for AmerenCIPS is from $52.3 million to $121.9 million, a rise of $69.6 million or 133%. For AmerenIP, G&I plant would increase by $72.2 million or 54% from $134.3 million to $206.5 million. In addition, AmerenCILCO G&I plant would increase by $13.2 million or 46% from $28.9 million to $42.1. (Lazare Dir., ICC Staff Exhibit 6.0, p. 7)

The Ameren Companies state that their proposed level of G&I plant was based on what they term an Asset Separation Project ("ASP") which employed a variety of direct assignments and allocations of plant to the electric distribution business. The Ameren Companies identify the process as follows:

> Where possible, an asset was directly assigned to a particular line of business. If an asset supported more than one line of business, an allocator was employed to assign the cost of the asset to each line of business it supported.

(Adams Dir.; AmerenCILCO Exhibit 7.0, p. 4; AmerenCIPS Exhibit 7.0, p. 4; AmerenIP Exhibit 7.0, p. 4 (note: AmerenIP testimony is identical to the quoted language except that the last word is "supports" rather than "supported".))

The use of the ASP has resulted in a significant shift to distribution of G&I plant that the Commission previously determined to be outside the revenue requirement for two of the three Ameren companies. AmerenCIPS used the ASP to reallocate back to distribution rate base $61.1 million in 1999 test year G&I plant that the Commission excluded in Docket No. 00-0802. For AmerenIP, the company proposal restores to distribution rate base $123.6 million in 2000 test year G&I plant the Commission removed in Docket No. 01-0432. The ASP has the opposite effect on AmerenCILCO in that it removes $13.7 million in 2000 test year G&I plant from the distribution rate base that the Commission approved in Docket No. 01-0637. (Lazare Dir., ICC Staff Exhibit 6.0, pp. 8-9) Combining the $61.1 and $123.6 millions reallocated back to distribution with the $13.7 million reallocated in the opposite direction, produces an overall net increase of $171.0 million in G&I rate base for the Ameren Companies. (*Id*., p. 9)

The Ameren Companies' proposal to reverse the Commission's allocation of costs in the previous round of delivery service cases based on the ASP is problematic. The ASP is a flawed methodology that the Commission considered and rejected in previous delivery service cases. (*Id.*, p. 9) In addition, it is used in the current proceeding in a narrow, limited fashion which further undermines its effectiveness as a functionalization tool. (*Id*., p. 11)

The asset separation method was first proposed to functionalize G&I plant to distribution for IP's initial delivery service case, Docket No. 99-0134. The Commission considered IP's arguments concerning its "Asset Separation Study" and concluded as follows:

> The Commission concludes that IIEC's proposed labor allocator for general plant is reasonable and should be approved. A labor allocator has been commonly utilized for allocation of general plant. The adoption of the labor allocator is particularly appropriate in light of the problems associated with IP's Asset Separation Study. The Commission agrees with IIEC's position that costs associated with general plant may not be amenable to direct assignment to a particular function.

(ICC Docket No. 99-0134, Order at 16).

The ASP in this docket falls considerably short of the Asset Separation Study that the Commission previously found lacking. In its current incarnation, the asset separation study presents a limited analysis that functionalizes costs only between functions of the utility companies themselves and leaves production out of the analysis. The Ameren Companies explain their decision to exclude production as follows:

> The asset separation project did not allocate or assign any general plant [intangible plant] assets to Ameren Generating Company because the assets recorded on the books of AmerenCIPS [AmerenIP, AmerenCILCO] are not used by nor do they support the operations of Ameren Generating Company. The assets addressed by the asset separation project are used solely in support of AmerenCIPS'[, AmerenIP's, and AmerenCILCO's] gas, electric transmission and electric distribution business. (Ameren Companies Response to PL 6.1, 6.2 & 6.3)

(Lazare Dir., ICC Staff Exhibit 6.0, p. 11)

The failure to factor production into the analysis is particularly problematic given past Commission decisions on this issue. In this case, the Ameren Companies propose to reallocate to distribution G&I plant that the Commission had allocated to production in the previous round of delivery service cases. The Ameren Companies' decision to exclude production costs from the analysis in this case means there is no substantial support for the Ameren Companies' proposed reallocation of these costs from production to distribution. (*Id*., pp. 11-12)

The Ameren Companies erroneously presume that production is no longer a consideration in the process of functionalizing G&I plant to the delivery service rate base by placing this plant outside the scope of their analysis of the issue. However, the production plant previously owned by CIPS and CILCO is still owned by Ameren Corporation ("Ameren Corp.") and would still require G&I plant. How much G&I plant production would need is a relevant issue for this proceeding. Nevertheless, with no substantive evidence on the issue, Ameren Corp. is asking the Commission to take its word that production has received a reasonable allocation of G&I plant. (*Id*., p. 12)

Another problem is that the Ameren Companies' analysis assumes the divestiture of production to an unregulated subsidiary of Ameren Corp. somehow changes the relationships governing the functionalization of G&I plant. However, there is no evidence that the physical relationships governing the incurrence of these costs have changed. In particular, the Ameren Companies have failed to introduce any evidence that Ameren Corp's production subsidiary requires any less G&I plant today than before restructuring. (*Id*., p. 12)

In rebuttal, Ameren witness Adams sought to buttress the Ameren Companies' argument with an explanation of its proposed method of functionalizing G&I plant to distribution. He concluded that the proposed level of distribution G&I expenses developed using the ASP is reasonable, stating "[t]he G&I plant assets which are recorded on the books of AmerenCILCO, AmerenCIPS and AmerenIP represent assets which are used exclusively in support of each Companies' regulated lines of business." (Adams Reb., Respondents' Exhibit 17.0, p. 3)

This explanation falls short because it fails to address the failure of the Ameren Companies' ASP methodology to include the unregulated production subsidiary in the functionalization process. Mr. Adams then seeks to justify this omission with the following argument:

> It is not necessary to consider ARG [AmerenEnergy Resources Generating Company] or AGC [Ameren Energy Generating Company] when functionalizing the Companies' G&I plant. None of the G&I plant assets recorded on the Companies' books are used to support ARG's or AGC's business operations.

(*Id*., p. 13)

This argument is problematic. The restatement of G&I plant balances that coincided with the divestiture of production plant should not be considered binding upon the Commission. These amounts were never specifically approved by the Commission. Nevertheless, the restatement provides the basis for Mr. Adams to conclude that the functionalization of G&I plant to the regulated utility is a settled issue. If Mr. Adams' argument is accepted, then the Ameren Companies will be permitted to decide for themselves how these assets should be factored into the development of the utility's revenue requirement. The Commission's role in the process would decline accordingly. (Lazare Reb., ICC Staff Exhibit 17.0, p. 3)

A similar argument was presented and rejected by the Commission in Illinois Power's last delivery service case, Docket No. 01-0432. (*Id*., p. 4) Before that proceeding, IP divested its generation and sold or transferred associated G&I assets, leaving the balance of G&I plant with the regulated transmission and distribution utility. However, when IP sought to recover this level of G&I plant in delivery service rates, the Commission objected, stating as follows:

> IP has argued that because of divestiture of it generation function all assets that were not sold or transferred remain to support the remaining operations of the Company. The Commission finds such argument to be deficient in that there has been no showing that the remaining operations require such a large increase in G&I relative to the amount established by the Commission in 1999.

(Docket No. 01-0432, March 28, 2002, Order at 17) Thus, the Commission asserted its authority over the determination of G&I plant balances to be included in delivery service rates.

In effect, the Ameren Companies proposal is nothing more than a collateral attack of the Commission's decision in Docket No. 01-0432. Collateral attacks are impermissible and AmerenIP's proposal must be viewed in this light. Illinois courts have held that a party to a pending action cannot initiate a new proceeding seeking relief that is or could have been the subject of another pending proceeding. (*East Side Levee and Sanitary District v. Madison County Levee and Sanitary District*, 54 Ill. 2d 442, 445, 298 N.E.2d 177, 179 (1973); *Illini Coach Co. v. Illinois Commerce Commission*, 408 Ill. 104, 110, 113 (1951)).

It is clearly unreasonable for utilities to divide up G&I plant between regulated and non-regulated entities on their own and present the Commission with a fait accompli. Utilities must demonstrate to the Commission's satisfaction that G&I plant was functionalized properly between the unregulated production affiliates and the regulated utility. The Ameren Companies have failed to perform this essential and necessary step. (Lazare Reb., ICC Staff Exhibit 17.0, p. 4)

Mr. Adams also sought to deflect Staff criticism by presenting a perfunctory explanation of how G&I plant was functionalized between the utility and the unregulated production subsidiary. His discussion was limited to certain items such as land and structures and transportation equipment and referenced the Ameren Companies' continuing property records offering "limited detail" based on "location codes" that provide the foundation for the functionalization of G&I plant. (Adams Reb., Respondents' Exhibit 17.0, pp. 15-16)

Mr. Adams' explanation is sorely lacking. He has offered a limited discussion that falls woefully short of evidence necessary to demonstrate the reasonableness of the Ameren Companies' proposed functionalization approach. The fact that Mr. Adams makes this belated effort to explain this phase of the functionalization process should be regarded as recognition of the Ameren Companies' deficiencies in this area. Nevertheless, the explanation falls woefully short. (Lazare Reb., ICC Staff Exhibt 17.0, p. 5)

What Mr. Adams cannot explain away is the Ameren Companies' decision to remove the large majority of production (and presumably associated G&I plant) from the equation before the functionalization process begins. Thus, the most important step in the functionalization process transpires outside the scope of this proceeding. This leaves the regulatory process unable to determine the reasonableness of the Ameren Companies' proposed refunctionalization of these costs to the revenue requirement. (*Id.*, pp. 5-6)

Ameren witness Adams also seeks to attack Staff's position on this issue. He asserts that Staff testimony "lacks any factual foundation or explication" and fails to reflect how G&I plant "is actually used". He goes on to complain that Staff has failed to demonstrate that Ameren's proposed G&I assets do not support the distribution business. (Adams Reb., Respondents' Exhibit 17.0, p. 5)

This argument has been raised and addressed in a number of delivery service cases. Staff did not address G&I plant on an asset-by-asset basis because the Commission has concluded that these costs are not conducive to a direct assignment approach and should be instead allocated on a general basis. (Lazare Reb., ICC Staff Exhibit 17.0, p. 7)

Focusing on the functionalization of individual assets is particularly problematic in this case because the Ameren Companies have failed to demonstrate how G&I plant was functionalized between the regulated utilities and the unregulated production subsidiaries. Thus, there is no reasonable alternative to Staff's approach in this proceeding. (*Id*., p. 7)

Mr. Adams also contends that Staff has failed to take into account events since the last round of DST cases. He cites factors such as the changes in Ameren's corporate structure since the last round of DST cases as a basis for the Company revised approach to these costs. (Adams Reb., Respondents' Exhibit 17.0, pp. 7-8) In fact, these changes are not relevant to the functionalization of G&I plant. The fact that Ameren Corp. has merged with IP and CILCO or divested production plant should not provide an excuse to restore G&I plant to distribution. (Lazare Reb., ICC Staff Exhibit 17.0, p. 8)

By arguing that the landscape has changed, Mr. Adams is suggesting that ratepayers should pay a price for Ameren Corp.'s decision to purchase other utilities and divest generation. These were business decisions made in the interests of shareholders. Seeking to raise the revenue requirement expressly because of these decisions would be unreasonable and unfair. (*Id*., p. 8)

Ameren witness Adams seeks to undermine Staff's position with the complaint that it has not "conducted a review of the Companies' G&I plant assets" or "even attempted to determine which lines of business use or benefit from the G&I plant assets" (Adams Reb., Respondents' Exhibit 17.0, p. 9). This argument, in effect, seeks to place the burden of proof on Staff to justify the removal of these costs from the revenue requirement. However, Ameren has offered no persuasive evidence in this proceeding to demonstrate that they should have been included in the first place. Furthermore, Mr. Adams undermines his criticism of Staff by stating, "[c]learly the burden of proof as to the use of the Companies' G&I plant resides with the Companies". (*Id.*, p. 9) The Ameren Companies must demonstrate the reasonableness of their proposed functionalization and not simply argue that Staff's alternative is somehow deficient.

Mr. Adams in his surrebuttal contends that Staff's argument somehow breaks down when applied to AmerenIP. Mr. Adams notes that AmerenIP did not own generation in its last delivery service case. Therefore, he argues that the Staff criticism of the ASP for failing to include non-regulated production subsidiaries has no meaning for AmerenIP. (Adams Sur., pp. 9-10) Despite Mr. Adams' protestations, the Staff criticisms of AmerenIP's functionalization of G&I plant remain relevant. For one, the Company proposal in this proceeding still restores to delivery service rate base G&I plant that the Commission explicitly excluded in the Company's last delivery service case, Docket No. 01-0432. Why costs that the Commission previously considered unnecessary should now be essential to delivery services is not explained by the Company. Second, it should be remembered that the ASP methodology is not a new concept but rather has been proposed by Illinois Power and rejected by the Commission in the Company's two previous delivery service dockets (Docket 99-0134 and Docket 01-0432). Thus, the Commission has already found the ASP to be an unreliable tool for functionalizing costs to delivery services and it would clearly be inappropriate to refunctionalize G&I plant back to distribution in this case based on the application of this methodology for AmerenIP.

Mr. Adams' arguments on the issue take an erratic turn when he chooses in surrebuttal to criticize the calculation of the G&I adjustment submitted by Staff in direct.

He then goes on to state that the Company has corrected the Staff calculation and restated downward the level of the proposed adjustment. (Adams Sur., Respondents' Exhibit 37.0, pp. 22-26) This argument is clearly ill-considered. The Staff adjustment was presented in the direct stage of this case. However, the Company did not say a word about the reasonableness of the calculation in rebuttal and waited instead until surrebuttal to register its complaint. At that juncture in the proceeding, Staff has no opportunity to evaluate the basis for the Company's alternative calculation. This last minute effort to confuse the record should be rejected by the Commission as clearly inappropriate.

The gaping deficiencies in the Ameren Companies' argument on the functionalization of G&I plant are tacitly recognized in the surrebuttal testimony provided by Mr. Getz. Finally, in this last round of testimony filed only days before hearings begin, Ameren witness Getz submits testimony which seeks to "explain the accounting procedures used by Ameren for general plant and the balances of general plant at the various Ameren companies to demonstrate that the general plant rate base balances are appropriate". (Getz Sur., Respondents' Exhibit 38.0, p. 2) This is a textbook example of far too little, much too late. It is testimony that should have been provided at the beginning of the case but was instead thrown in at the end. What this late submission shows is that the Ameren Companies have utterly failed in this proceeding to lay any kind of reasonable foundation for their proposed functionalization of G&I plant. One of the first, basic elements necessary for Staff and the Commission to understand and evaluate the the Ameren Companies' proposed functionalization of G&I plant is an explanation of the accounting procedures employed for these costs. That explanation was not forthcoming until surrebuttal, at which point it was too late to facilitate the review process. The only purpose this testimony served is to underscore the weaknesses in the Company's case.

Staff's Proposed Adjustment

Staff's just and reasonable proposal is to keep the costs previously excluded from rate base outside the delivery service rate base for this case as well. That would align the current DST rate case with the decision handed down by the Commission in the previous round of delivery service cases for the Ameren Companies.

For AmerenCIPS, Staff removed from rate base the $61,053,000 in 1999 test year G&I plant that the Commission excluded in Docket No. 00-0802 and AmerenCIPS seeks to restore in this case. For AmerenIP, the $123,631,000 in 2000 test year G&I plant that the Commission excluded in Docket No. 00-0802 and AmerenIP seeks to restore in this case was removed. For AmerenCILCO, Staff proposes to add back the $13,717,000 in 2000 test year G&I plant that the Commission included in Docket No. 00-0802 and AmerenCILCO seeks to remove in this case. These adjustments are balanced by accompanying revisions to accumulated depreciation, depreciation expense and deferred income taxes for the three companies. (Lazare Dir., ICC Staff Exhibit 6.0, pp. 16-17)

2. Plant transfer

3. G&I Plant Amortization

E. Reallocation of Depreciation Reserve

The Commission should reject AmerenIP's proposal to reallocate its depreciation reserve. An electric depreciation study commissioned by the Ameren Companies indicates a large disparity in the actual versus the calculated depreciation reserve by account for AmerenIP. Instead of requesting a change to its depreciation rates, in its rebuttal testimony AmerenIP requested the Commission's permission to reallocate its depreciation reserve in order to mitigate future impacts of changes in depreciation rates. According to AmerenIP, a reallocation of the reserve will not automatically increase or decrease rates and will smooth out rates over time. (Stafford Reb., Ameren Ex. 16.0, pp. 12-13)

Staff witness Jones recommends that the Commission deny AmerenIP's request to reallocate its depreciation reserve because reallocation does nothing to correct the problem of inaccurate depreciation rates and there is nothing to indicate that reallocation is acceptable under the rules of Generally Accepted Accounting Principles ("GAAP"). Also, AmerenIP's reallocation as originally filed in its rebuttal testimony was inequitable to customers. (Jones Reb., ICC Staff Exhibit 14.0, pp. 8-9)

Inaccurate depreciation rates

Reallocation does nothing to correct the problem of inaccurate depreciation rates. The purpose of depreciation accounting is "...to distribute the cost or other basic value of tangible capital assets, less salvage (if any), over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner."[2] To

[2] Hahne & Aliff. Accounting for Public Utilities. Release No. 14. Section 6.03[1].

achieve this goal, depreciation rates must be evaluated periodically by means of a study and changed when found to be inaccurate. (*Id.*)

Mr. Stafford's surrebuttal testimony gives the impression that depreciation expense in this proceeding will increase by approximately $17 million if reallocation is not allowed. (Stafford Sur., Respondents' Exhibit 36.0, p. 18) The simple truth is that reallocating the depreciation reserves will have no impact on AmerenIP's revenue requirement in the current rate proceeding. (Tr., p. 492)

<u>Generally Accepted Accounting Principles ("GAAP")</u>

Ms. Jones found nothing to indicate that reallocation of the depreciation reserve is acceptable under the rules of GAAP. (Jones Reb., ICC Staff Exhibit 14.0, p. 9)

In surrebuttal testimony, Company witness Stafford refers to Statement of Financial Accounting Standards ("FAS") 71: Accounting for the Effects of Certain Types of Regulation to demonstrate that reallocation of the depreciation reserve is acceptable under GAAP. (Stafford Sur., Respondents' Exhibit 36.0, p. 17) He states that FAS 71 provides guidance that can be construed as supportive of the Ameren Companies' request; although, on the witness stand, Mr. Stafford admits that, to his knowledge, FAS 71 does not specifically address reallocation of depreciation reserves. (Tr., p. 494) It is Staff's opinion that Mr. Stafford grossly misconstrues FAS 71, which merely specifies how the effects of different types of rate actions are reported in general-purpose financial statements.

Inequitable to customers

As originally filed, the reallocation of over/under accumulated depreciation affected all electric depreciable plant categories – other production, transmission, distribution, and general plant (part of which is allocated to gas customers). Under this scenario, each group of customers (transmission, distribution, gas) would not receive its correct share of the true up of the over/under depreciation when the depreciation rates were eventually corrected. (Jones Reb., ICC Staff Exhibit 14.0, p. 9) Shortly before Staff filed its Rebuttal Testimony, the Ameren Companies filed Respondents' Exhibit 16.8 (Second Revised) that reallocated AmerenIP accumulated depreciation only for distribution and general plant categories. The change addresses Staff's concern that the reallocation is inequitable to customers, but it has no effect on Staff's other reasons for recommending that the Commission deny AmerenIP's request to reallocate its depreciation reserve.

The depreciation study supports a large increase in depreciation rates for AmerenIP, yet it has chosen not to change its rates. (Stafford Sur., Respondents' Exhibit 36.0, p. 150) Ms. Jones believes that reallocation of the depreciation reserve, which has no effect on the current proceedings, is simply a way to make it appear that the Company is making some use of the depreciation study in order to justify recovery of the cost of the study through rate case expense. Ms. Jones recommends that the Commission deny AmerenIP's request to reallocate its depreciation reserve because (1) reallocation does nothing to correct the problem of inaccurate depreciation rates and (2) there is nothing to indicate that the methodology is acceptable under GAAP.

F. OPEB Liability

1. Unfunded OPEB

The Commission should accept the adjustment proposed by both Staff witness Jones and AG witness Effron to reduce rate base by the unfunded post-employment benefits ("OPEB") liability at December 31, 2004. (Jones Reb., ICC Staff Exhibit 14.0, p. 19; Effron Dir., AG Exhibit 1.0, Schedule B) This adjustment is appropriate because the unfunded liability reflects a cost-free source of capital on which shareholders are not entitled to receive a return. OPEB expenses are included in the cost of service calculation and, thus, are provided for in base rates. An OPEB liability reflects that the Companies have recorded more OPEB expense than they have actually paid. (Jones Reb., ICC Staff Exhibit 14.0, p. 19)

Ameren witness C. Kenneth Vogl argues that there is no excess of funds. He cites the OPEB expense included in AmerenCIPS prior order to buttress his opinion that, "... Ameren has contributed far more for OPEB than it has collected from ratepayers." (Vogl Reb., Respondents' Exhibit 21.0, pp. 6-7)

It is inappropriate from an accounting perspective to single out any particular component of the cost of service and analyze that item in isolation. The cost of service must be considered in the aggregate. The components of cost of service are dynamic, in that the costs of some things increase, while the costs of other things decrease. One cannot simply identify the amount of OPEB expense included in the cost of service on which current rates are based and say that is the amount the Companies have recovered each year that the rates have been in effect. The appropriate comparison is to compare what has been expensed with what has been funded. (Jones Reb., ICC Staff Exhibit 14.0, p. 19)

The adjustment to reduce rate base by the unfunded OPEB liability at December 31, 2004 is appropriate and should be adopted by the Commission.

2. ADIT Treatment

In tandem with the unfunded OPEB adjustment, Staff witness Jones proposed an adjustment to add accumulated deferred income taxes ("ADIT") related to OPEB to the ADIT balance reflected in rate base. (Jones Reb., ICC Staff Exhibit 14.0, p. 20) Although ADIT related to OPEB was included in the ADIT reduction to rate base in Ameren's 285 filing, the Ameren Companies removed it in rebuttal testimony in response to AG witness Effron's rationale that reflecting the OPEB liability in rate base is consistent with reflecting the related ADIT in rate base. To be consistent, the Ameren Companies chose to exclude the related ADIT rather than include the OPEB liability. (Stafford Reb., Ameren Ex. 16.0, pp. 27-28)

If the Commission adopts the adjustment to reduce rate base by the unfunded OPEB liability, it should also adopt this adjustment to reflect the related ADIT in rate base.

G. Cash Working Capital

The Commission should accept Staff witness Ebrey's proposed adjustments to reduce the level of cash working capital ("CWC") to be included in rate base to $(1,575,000) for AmerenCILCO, $(3,470,000) for AmerenCIPS and $(6,613,000) for AmerenIP. (Ebrey Reb., ICC Staff Exhibit 13.0 (Corrected), Schedules 13.01 (CIL), (CIPS) and (IPC))

For the calculation of Cash Working Capital for the Ameren Companies, Staff witness Ebrey proposed the treatment of payroll withholding taxes as a separate line item including the expense lead. (Ebrey Reb., ICC Staff Exhibit 13.0 (Corrected), pp. 14-16) During the evidentiary hearings on July 25, 2006, Ameren witness Michael Adams stated that the Ameren Companies had accepted Staff's position. (Tr., pp. 529 - 530) Thus, the remaining cash working capital items are in dispute.

1) Lead/lag methodology
2) Interest expense lead;;
3) Capitalized payroll in CWC requirements; and
4) Expense levels to which CWC factors are applied.

1. Lead/lag methodology

The Commission should accept Staff's proposal to use the Gross Lag methodology in the determination of the cash working capital requirement in this case since it does a better job than the Net Lag methodology of ensuring that non-cash revenues are excluded from the determination of the CWC allowance. By applying the gross revenue lag to actual revenues, the Gross Lag methodology produces a more accurate result in that it not only accounts for the revenue lag in terms of time but also in terms of actual dollars. (Ebrey Reb., ICC Staff Exhibit 13.0 (Corrected), p. 6)

Under the Ameren Companies' Net Lag approach, the expense leads for each expense classification are netted against the overall revenue lag. The net of the overall revenue lag and specific expense lead (stated as a period of time) is converted to a ratio (e.g., if the net lead/lag is 10 days on an annual (365 day) basis, the resulting ratio is 10/365ths) and applied to the expense level for the applicable expense classification.

Although Ameren's methodology excludes non-cash expense categories, the overall level of revenue provided by ratepayers is not considered. Under Staff's Gross Lag methodology, the revenue lag is converted to a ratio and applied to net revenues (excluding revenues for non-cash items) and the expense leads are applied to each expense classification (again excluding non-cash items). (Ebrey Reb., ICC Staff Exhibit 13.0 (Corrected), p. 5)

Staff's proposed Gross Lag methodology more accurately excludes the effects of non-cash items from the determination of cash working capital. Ameren's Net Lag methodology does not consider the **amount** of cash revenues provided by ratepayers through base rates. Conversely, the Gross Lag methodology does consider the amount of cash revenues (i.e., revenues received on account of cash expenses). (*Id.)*

In opposing the use of the Gross Lag methodology, the Ameren Companies claim that the Commission approved the net lag methodology in Docket Nos. 02-0798/03-0008/03-0009 (Cons.). (Adams Sur., Respondents' Exhibit 37.0, p. 38) While the Commission made a cash working capital determination based on a lead-lag study utilizing the Net Lag methodology, the appropriate calculation methodology was neither a contested issue nor the subject of Commission analysis and discussion. Rather, the decision made by the Commission in Docket Nos. 02-0798/03-0008/03-0009 (Cons.) weighed Staff's position that the AmerenCIPS and AmerenUE had failed to meet their burden of proof and should be allowed zero cash working capital against the Ameren Companies' position that their proof was adequate, and found that the record in that proceeding supported the Ameren Companies' position that there should be a positive cash working capital allowance. (*Central Illinois Public Service Co. and Union Electric*

Co., Docket Nos. 02-0798/03-0008/03-0009 (Cons.), (Final Order, Oct. 22, 2003), pp. 15, 18) The Commission did not weigh one approach against another in making its determination. In fact, the only mention of net lag or gross lag in the Order was in relation to an adjustment proposed by the AG to remove the Ameren Companies' recognition of a separate lag for PGA revenue. The Commission's analysis and conclusion in this regard was that the AG's adjustment, which was calculated on a gross lag basis, should be calculated on a net lag basis since the underlying cash working capital figures reflected a net lag approach. (*Id.*) This conclusion in the Final Order, however, in no way endorses either methodology over the other.

In a further attempt to discredit the use of the Gross Lag methodology, Ameren witness Adams tries to detail benefits of the net-lag methodology over the gross lag methodology. (Adams Sur., Respondents' Exhibit 37.0, pp. 37-45) His first claim is that one lead-lag study was performed across Ameren's regulated utilities, regardless of the jurisdiction. In particular, he stated that it is beneficial to employ one lead-lag study for all of the Illinois Companies rather than performing separate studies employing different methodologies for each operating company. (*Id.*, pp. 38-39) Under cross examination, however, Mr. Adams admitted that Staff was able to make its proposal utilizing the gross lag methodology without performing an independent lead-lag study; instead, "Staff used the results of our [Ameren Companies'] study, modified those [results]." (Tr., p. 535) In fact, with respect to the lead-lag study both Mr. Adams and Staff are in agreement in all but one CWC factor (the interest expense lead days). (*Id.*) Thus, the Ameren Companies' argument in this regard is a red herring. The net lag and gross lag methodologies differ in the *manner* in which the results of the lead-lag study are applied, not in the conduct of the underlying studies; and the record shows that the same lead-lag study results were used by both Staff and the Ameren Companies. Thus, the Ameren Companies' argument that they will be required to sponsor different studies lacks merit and must be rejected.

Mr. Adams also claimed that interrogatories (i.e., data requests) would likely be easier to respond to and lessen the number of interrogatories when one methodology is employed for all Companies. (Adams Sur., Respondents' Exhibit 37.0, p. 39) To the contrary, to the extent that "different methodologies" generate additional data requests, it is the difference between Staff and the Ameren Companies on the appropriate methodology rather than a difference with the Ameren Companies' affiliates that drives the need for data requests. Moreover, under cross examination, Mr. Adams agreed that only 7 of the 56 cash working capital data requests served on the Ameren Companies by Staff during this case were related to the net lag versus gross lag methodologies. (Tr., pp. 535 - 536) Further, Mr. Adams' argument at best establishes that whatever method is used, it should be consistently applied when multiple companies file a case together. It does nothing to establish the superiority of one method over another. Thus, this argument likewise lacks merit and should be disregarded.

Mr. Adams contends that "the gross lag methodology produces illogical results and adds unnecessary confusion to the determination of the Companies' cash working capital requirements". (Adams Sur., Respondents' Exhibit 37.0, p. 43) However, this is the first time in Illinois that Mr. Adams or his consulting firm has proposed cash working capital based on anything other than the Gross Lag methodology which he now criticizes. (Tr., pp. 532 - 533) In fact, Mr. Adams' final proposal in the latest Illinois

Power gas rate proceeding, Docket No. 04-0476, used the exact same format and gross lag methodology Staff has proposed in this proceeding. (ICC Staff Cross Exhibit 15) This history undermines the credibility of Mr. Adams' argument that "the gross lag methodology produces illogical results and adds unnecessary confusion to the determination of the Companies' cash working capital requirements."

The Ameren Companies accuse Staff witness Ebrey of "flip-flopping" regarding the methodology used to determine the CWC requirements for the Ameren Companies. (Adams Reb., Respondents' Exhibit 17.0 (Revised), p. 29) While inapposite labeling may be the unfortunate reality of modern day campaign tactics, it is hardly expert opinion worthy of consideration in a Commission proceeding to resolve issues on the merits. While Staff does not deny that it advocates a methodology in this docket different from the methodology utilized in a prior case, Staff has also fully explained the reasons for the utilization of a different methodology and the reasoning underlying the position advocated in this docket. To the extent that taking a different position is somehow a valid issue in and of itself, the previous paragraph illustrates that it is Mr. Adams, rather than Staff witness Ebrey, who is "flip-flopping" on the reasoning supporting his ultimate position. Further, as explained in her rebuttal testimony, Ms. Ebrey was unable to calculate a reasonable level of cash working capital in the 2003 CIPS/UE gas rate case due to problems she faced with lead/lag study in that docket. . (Ebrey Reb., ICC Staff Exhibit 13.0 (Corrected), p. 6) She did not use either the net lag or the gross lag methodology in that proceeding; thus she was, and is, consistent in her analysis and recommendations. (*Id*.)

Based on the foregoing, Staff strongly recommends that the Commission use the Gross Lag methodology in the calculation of cash working capital.

2. Interest Expense Lead

The Commission should adopt Staff's calculation of 91.5 interest expense lead days because it is based on the actual number of days in the 2004 test year (366 days). (Ebrey Reb., ICC Staff Exhibit 13.0 (Corrected), p. 10) The Ameren Companies argued that 365 days or 91.25 interest expense lead days should be used. (Adams Sur., Respondents' Exhibit No. 37.0, p. 47) During cross-examination, the Ameren Companies insinuated that Staff was inconsistent since Ms. Ebrey used 365 days for computing the expense lead for property taxes. However, Ms. Ebrey explained that she used the actual number of days in the year during which the expense was incurred – 2003 for property taxes paid in 2004 and 2004 for the interest expense paid in 2004. (Tr., p. 557) Therefore, Staff is consistent in this regard. Staff's well-reasoned calculation should therefore be approved and the appropriate interest expense lead is 91.5.

3. Capitalized Payroll in CWC Requirements

The Commission should accept Staff's proposal to include total payroll including the amounts charged to Construction, Removals, Stores, Clearing Accounts, and Miscellaneous as well as that charged directly to expense accounts in the CWC calculation since all require cash. (Ebrey Reb., ICC Staff Exhibit 13.0 (Corrected), pp. 15-16) The Ameren Companies claim that Staff's proposal includes the capitalized portion of payroll which would already be included in rate base. (Adams Sur., Respondents' Exhibit 37.0, p. 46) However, during cross examination, Ameren witness

Adams agreed that the capitalized payroll included in rate base in this proceeding does not include any payroll costs going forward; that is, no portion of the January 2007 payroll is included in rate base in the current proceeding. (Tr., pp. 531 - 533) Thus, the cash working capital necessary to cover payroll after January 2007, when the rates in this proceeding go into effect, does not include any costs already included in rate base in this proceeding.

Ameren witness Stafford agreed that if Staff's position with regard to gross payroll versus expensed payroll is approved, Staff's calculations on ICC Staff Exhibit 13.0, Schedule 13.01 for each utility would be correct. (Tr., pp. 419 – 422, 440, 448 - 449) Staff's proposal, which uses total base payroll in the CWC requirement calculation, correctly reflects cash needs of the Ameren Companies and should be approved rather than the Ameren Companies' proposal which only considers payroll costs charged directly to salary and wages expense accounts.

4. Expense levels to which cash working capital factors are applied.

The Commission should use Staff's cost levels, adjusted as necessary based on the final revenue requirement approved in this case, to derive the final cash working capital requirements for each Company. The Ameren Companies did not support or adequately explain the source of the amounts they used to derive each Company's CWC allowance.

Staff's CWC calculations are based on the levels of costs included in Staff's rebuttal revenue requirement and other source documents provided by the Companies as referenced on ICC Staff Exhibit 13.0 (Corrected), Schedules 13.01 (CIL), (CIPS), and (IPC). (Ebrey Reb., ICC Staff Exhibit 13.0 (Corrected), p. 16) During cross examination, Ameren witness Stafford admitted that, while he was the appropriate witness to address the level of cost used in the CWC calculation, he had not responded to Staff's concerns communicated in both direct and rebuttal testimonies regarding the levels of costs which the Ameren Companies used. (Tr., pp. 402 - 405)

During the lengthy questioning regarding the differences between the level of costs Mr. Stafford used for the specific Company's CWC requirements and the level of costs Staff witness Ebrey used, it became apparent that Mr. Stafford's cost levels were not supported. (Tr., pp. 406-457) To the contrary, Staff witness Ebrey's cost levels were in fact supported by the very documents Mr. Stafford claimed supported his cost levels.

When questioned about pensions and benefits expense, Mr. Stafford claimed that the amounts Staff referenced from Revised Schedule C-1 were incomplete in that they did not include certain costs that were included in the pensions and benefits expense levels he used in determining the cash working capital allowance. However, Mr. Stafford was unable to explain why, if that explanation was true, his expense level for pensions and benefits was less than that proposed by Staff. Mr. Stafford did agree that the pensions and expense levels proposed by Staff were consistent with Ameren Companies' schedules and Staff adjustments which the Ameren Companies had accepted. (Tr. pp. 414 – 417, 437 - 439, 446 - 448)

When questioned about gross revenue taxes, sales and use taxes, gross receipts taxes, energy assistance charge and capital/electric distribution tax, Mr. Stafford agreed that Staff's workpapers (ICC Staff Cross Exhibit 8 and ICC Staff Cross Exhibit 9) correctly showed the totals for each of the expense levels based upon his response to Staff data request TEE 2.03 (ICC Staff Cross Exhibit 6). (Tr. pp. 422 – 433, 441 - 444, 449 - 452)

While Mr. Stafford attempted to cast doubt on Ms. Ebrey's calculations, he was unable to provide any reference to a specific document other than ICC Staff Cross Exhibit 6 in which he ever provided a reconciliation of his cost levels in any supporting documentation provided to Staff. (*Id.*, pp. 417 - 418) In addition, while he insinuated that Staff did not carry out certain allocations in arriving at cost levels, he admitted that the only support the Ameren Companies provided for the level of costs Mr. Stafford used was that included on ICC Staff Cross Exhibit 6. (*Id.*, pp. 450 - 452) Thus, Mr. Stafford was unable to reconcile his cost amounts using the information the Ameren Companies had provided to Staff or placed in the record. However, he was able to reconcile the cost amounts used by Staff using the information the Ameren Companies had provided to Staff or placed in the record.

Staff's cost levels used to derive cash working capital requirements on ICC Staff Exhibit 13.0 (Corrected), Schedules 13.01 (CIL), (CIPS), and (IPC) are supported by evidence in the record, unlike those cost levels proposed by the Ameren Companies. Staff and the Ameren Companies agree that the amounts for Federal and State income taxes, interest expense, and other operations and maintenance expense should be based on the final revenue requirement approved in this case. (Tr. pp. 434 – 436, 444 – 445, and 453) Therefore, Staff's cost levels on the referenced schedules, adjusted as necessary based on the final revenue requirement approved in this case, should be approved in deriving the final cash working capital requirements for each utility.

Based on the foregoing, Staff's cash working capital requirements (ICC Staff Exhibit 13.0 (Corrected), Schedules 13.01 (CIL), (CIPS), and (IPC)) should be approved, adjusted as necessary based on the final revenue requirement approved in this case.

H. Other

II. OPERATING EXPENSES AND REVENUES

A. Summary of Uncontested/Settled Issues

1. Uncollectibles Expense

Staff witness Jones proposed adjustments to normalize uncollectibles expense ("uncollectibles") in the test year. Because the write off of uncollectible accounts fluctuates from year to year, it is more appropriate for ratemaking purposes to establish a normal level of uncollectibles than to use the actual uncollectibles in the test year. (Jones Dir., ICC Staff Exhibit 3.0, p. 8) The normalization method used by Ms. Jones calculates uncollectibles as a percent of revenue based on several years' historical experience. (*Id*., p. 9) The effect of Ms. Jones' adjustments is a decrease to test year operating expense for AmerenCIPS and AmerenCILCO and an increase to test year operating expense for AmerenIP. (*Id*., p. 10)

The Ameren Companies accepted Staff's adjustment to normalize uncollectibles expenses. (Stafford Reb., Ameren Ex. 16.0, p. 4) Thus, the issue is uncontested.

2. Pension and OPEB Expense

Staff witness Jones proposed an adjustment to correct an error identified and quantified by AmerenIP in its response to a data request from AG witness Effron. The adjustment reduces test year pension and OPEB expense. (Jones Reb., ICC Staff Exhibit 14.0, pp. 16-17) Staff's adjustment, which is not dependent on the Commission's decision regarding the adjustment to AmerenIP's pension and OPEB expense proposed by AG witness Effron, is uncontested. (Stafford Sur., Respondents' Exhibit 36.0, p. 9; Effron Reb., AG Exhibit 3.0, p. 4)

3. Injuries and Damages Expense

See discussion of Staff's adjustment to disallow reinstatement of Dynegy eliminations included in Section II.C. of this Initial Brief.

4. Major Medical

See discussion of Staff's adjustment to test year employee benefits expense for AmerenCILCO to reflect material changes in the 2006 budget amounts for major medical expense included in Section II.E.4 of this Initial Brief.

B. Vegetation Management/Tree Trimming

1. Introduction and Background

The Commission has adopted as its rules under Part 305 (Construction Of Electric Power And Communication Lines) certain portions of the National Electrical Safety Code (2002 edition, approved June 4, 2001, published by the Institute of Electrical and Electronics Engineers, Inc., 3 Park Avenue, New York NY 10016-5997). (83 Ill. Adm. Code 305.20) National Electric Safety Code ("NESC") Rule 218 is one of the NESC rules adopted under Part 305, and provides in relevant part as follows:

> 218. Tree Trimming
>
> A. General
>
> 1. Trees that may interfere with ungrounded supply conductors should be trimmed or removed.

> NOTE: Normal tree growth, the combined movement of trees and conductors under adverse weather conditions, voltage, and sagging of conductors at elevated temperatures are among the factors to be considered in determining the extent of trimming required.
>
> 2. Where trimming or removal is not practical, the conductor should be separated from the tree with suitable materials or devices to avoid conductor damage by abrasion and grounding of the circuit through the tree

(NESC, Section 21, Rule 218 (2002); 83 Ill. Adm. Code 305.20)

One of the issues presented in this proceeding is the meaning of the requirement in NESC Rule 218 as adopted under Part 305 that "[t]rees that may interfere with ungrounded supply conductors should be trimmed or removed." It is Staff's position that NESC Rule 218 as adopted in Part 305 requires the Ameren Companies to trim trees near their lines in their service territories such that there are no tree contacts with their energized primary conductors before they return to trim them again. (*See* Spencer Dir., ICC Staff Exhibit 10.0, pp 7-8, 12-14, 18-23; Spencer Reb., ICC Staff Exhibit 21.0, pp. 8-10, 15, 19-20) As explained below, the Commission should expressly confirm Staff's position that NESC Rule 218 as adopted in Part 305 requires the Ameren Companies to trim trees so as to avoid contact with energized primary conductors between tree trimming cycles. The Ameren Companies disagree with Staff's position on the applicable tree trimming standard, but also contend that if the Commission accepts Staff's position there should be an increase to their pro forma level of operation and maintenance expense for their electric delivery services business for additional costs they claim will result from implementation of a "no-contact" tree trimming approach. (*See* Stafford Dir., AmerenCILCO Ex.. 6.0, p. 12; Stafford Dir., AmerenCIPS Ex. 6.0, p.

12; Stafford Dir., AmerenIP Ex. 6.0, p. 15; Stafford Reb., Ameren Ex. 16.0, p. 4-5; Wiesehan Reb., Ameren Ex. 25, pp. 11-12; Stafford Sur., Respondents' Ex. 36.0, pp. 3-4; Wiesehan Sur., Respondents' Ex. 46, pp. 10-11) As explained below, the Ameren Companies have failed to provide adequate support for the additional costs they contend will result from implementation of a no-contact tree trimming approach, and such request should be denied.

2. Interpretation of NESC Rule 218 as Adopted in Part 305

NESC Rule 218 addresses tree trimming practices which are essential to providing safe and reliable electric service. The connection between tree trimming practices and safe and reliable electric service was explained by Staff witness James D. Spencer as follows:

> Adequate and effective tree trimming is essential to providing safe and reliable electric service. Power interruptions are often associated with contact between power lines and tree limbs (vegetation), and such contact can be significantly reduced by an appropriate tree trimming program. Public and utility worker safety concerns are associated with high voltage electric wires that are broken by falling trees or tree limbs and fall to the ground, thereby creating a potential electrocution hazard. The electrocution hazard is also present when trees in residential areas mask the existence and location of high voltage wires where children may be climbing trees and homeowners may be handling objects like metal ladders and other devices.

(Spencer Dir., ICC Staff Exhibit 10.0, p. 5) The Commission has adopted NESC Rule 218 as a Commission rule under Part 305. (83 Ill. Adm. Code 305.20) Section 305.30 of the Commission's rules confirms that the Part 305 requirements are intended to promote safe and reliable electric service. (83 Ill. Adm. Code 305.30 (Electric supply lines and equipment "shall be designed, constructed and maintained to meet the requirements of this Part [305] to enable service to be safe, adequate and dependable."))

NESC Rule 218 as adopted in Part 305 provides that "[t]rees that may interfere with ungrounded supply conductors should be trimmed or removed." (NESC, Section 21, Rule 218 (2002); 83 Ill. Adm. Code 305.20) Staff witness Spencer explained that "contact" is only one of the ways that trees can interfere with conductors because trees can cause "physical" as well as "electrical" interference. (Spencer Dir., ICC Staff Exhibit 10.0, p. 21) Thus, trees may interfere with supply conductors by physical contact causing the wires to break or fall, and also by contact or close proximity causing current to flow from the conductor to ground through the tree. Mr. Spencer also noted that additional tree clearance may be required to avoid interference with high voltage lines because the possibility for "electrical flashover from the conductor to the tree" increases at very high voltages. (*Id*.)

Staff witness Spencer testified that "[t]he potential exists for electric service reliability and public safety to be compromised anytime electrical contact or flashover occurs." (*Id*., pp. 21-22) Mr. Spencer also explained that physical and electrical interference can have both immediate and future impacts on electric service reliability and public safety:

> Any interference between an energized electrical conductor and a tree, whether caused by contact or by electrical flashover, will result in some deterioration of the reliability and/or the quality of power that the customer receives. The effect on reliability can vary from momentary interruptions to lengthy outages of service to the customers. Tree limbs falling into or against power lines can cause the wires to fall, interrupting power and creating safety hazards to the public. Even minor contacts between small limbs blowing in the wind and electrical conductors will cause some leakage current to flow to ground through the tree, which may or may not be of sufficient magnitude to be noticed by the customers. In addition,

> there is always a heating effect associated with the leakage current, which sometimes causes burns to both the utility's electrical conductor and the tree. Repeated burning of the utility's conductor can lead to eventual failure of the wire, resulting in a power interruption and a safety hazard to the public.

(*Id*.)

Both Staff and the Ameren Companies agree that there are safety concerns associated with the proximity of trees to overhead conductors, including injuries to people. (Clapp. Reb., Respondents' Ex. 26.2, pp. 1-2; Spencer Reb., ICC Staff Exhibit 21.0, p. 11) While Ameren witness Clapp contends that injuries associated with trees and overhead conductors are not related to tree trimming practices, there is agreement that such incidents may result in either injury or death to persons. (*Id*., Respondents' Ex. 26.2, pp. 3-4; ICC Staff Exhibit 21.0, pp. 12-13) Staff witness Spencer testified that Mr. Clapp incorrectly discounts the relevance of tree trimming to public safety since inadequate tree trimming can obscure or conceal the presence of energized conductors in or near trees and increase the likelihood of unintended contact by the public with such conductors. (Spencer Reb., ICC Staff Exhibit 21.0, p. 13)

Mr. Spencer also testified that tree trimming practices should be designed to minimize such potential injuries and fatalities, notwithstanding Mr. Clapp's assertion that such incidents occur on an infrequent or rare basis. (*Id*.) Mr. Spencer also provided data on accidents reported by Illinois regulated utilities to the Commission from 1986 through 2005 involving people contacting or being shocked by conductors in or close to trees. (*Id*., pp. 13-14) This data indicates that on average over this twenty year period there has been approximately 1 death and 3 injuries each year from incidents involving electric utility lines in or near trees. (*Id*.) While there are not a high number of such occurrences, there are continuing and repeated occurrences of injuries and deaths associated with trees in or near conductors. The history of and potential for fatalities or serious injury is sufficient reason in Staff's view to take steps to mitigate the potential for such incidents, and tree trimming programs that maintain better clearances and better visibility of utility conductors are likely to reduce the number of such occurrences. (*Id*.) Thus, Staff submits that its view of NESC Rule 218 as adopted in Part 305 better promotes the public safety goal of the Part 305 rules. (*See* 83 Ill. Adm. Code 305.30)

NESC Rule 218 also includes a "Note" listing "[n]ormal tree growth, the combined movement of trees and conductors under adverse weather conditions, voltage, and sagging of conductors at elevated temperatures" as a non-exclusive list of "factors to be considered in determining the extent of trimming required." (NESC, Section 21, Rule 218 (2002); 83 Ill. Adm. Code 305.20) Mr. Spencer testified that each of the listed factors affects the likelihood that trees and energized wires will come in contact with each other . . . ." (Spencer Dir., ICC Staff Exhibit 10.0, p. 22) Thus, the Note to NESC Rule 218 demonstrates that the focus of NESC Rule 218 is for utilities to trim trees so as to avoid contact with energized conductors under various expected conditions ranging from the movement of trees and conductors during storms to the sagging of lines at high temperatures.

Ameren witness Mr. Clapp asserted that limits placed on trimming by governmental authorities such as city, county or state departments of transportation may preclude trimming to a no-contact approach. (Clapp Reb., Respondents' Ex. 26.2, p. 2) Staff does not read NESC Rule 218 to require trimming to a no-contact approach where matters beyond the control of the utility – such as governmental limitations on how or when a utility may trim trees – make it impossible to trim consistent with a no-contact approach. (*See* Spencer Reb., ICC Staff Exhibit 21.0, pp. 19-20) However, even in those situations, the utility should be required to work with the governmental unit involved to reach a workable tree trimming agreement that allows no-contact trimming.

Staff's position that NESC Rule 218 as adopted in Part 305 requires the Ameren Companies to trim trees near their lines such that there are no tree contacts with their energized primary conductors before they return to trim them again is reasonable and proper, and should be expressly affirmed by the Commission. The "primary rule of statutory construction is to give effect to legislative intent by first looking at the plain meaning of the language." *See e.g.,* Davis v. Toshiba, 186 Ill. 2d 181, 184-85 (1999). The language of NESC Rule 218 clearly states that "[t]rees that may interfere with ungrounded supply conductors should be trimmed or removed." As supported by the testimony of Staff witness Spencer discussed above, trees that contact ungrounded supply conductors can cause electrical or physical interference with those conductors and negatively impact electric service reliability and public safety. Consequently, trees that are physically contacting conductors are clearly trees that "may interfere with ungrounded supply conductors." Since NESC Rule 218 specifies that trees that may interfere should be trimmed, this means at a minimum[3] that trees should be trimmed to avoid contact at all times. Any other interpretation of NESC Rule 218 would essentially change it to a requirement to trim trees that "are" interfering with conductors.

Moreover, as explained above, the Note to NESC Rule 218 makes clear that the focus of NESC Rule 218 is for utilities to trim trees so as to avoid contact with energized

[3] Since electrical interference can occur via electrical flashover from the conductor to the tree, NESC Rule 218 could also be interpreted to require trimming to maintain a clearance adequate to prevent electrical flashover.

conductors under various expected conditions. Thus, Staff's interpretation is consistent with and supported by the language of the Note to NESC Rule 218 adopted as part of the Commission's rules. Further, Staff's interpretation of NESC Rule 218 is consistent with the public safety goal of the Part 305. Trimming to a no-contact approach will maintain better clearances and better visibility of utility conductors, thus reducing the likelihood of contact by members of the public with utility conductors near trees. Data submitted by Staff shows that injuries and deaths from contact with conductors in or near trees do occur in Illinois. While the number of such occurrences is not high, it is worthwhile and consistent with the public safety goal of Part 305 to attempt to reduce the number of such occurrences which is likely to occur with a no-contact tree trimming approach.

For all the foregoing reasons, Staff respectfully requests that the Commission expressly affirm Staff's position that NESC Rule 218 requires the Ameren Companies to trim trees near their lines so that those trees to not contact their energized primary conductors before they return to trim the trees again.

3. Additional Costs For A No-Contact Approach To Tree Trimming

The Ameren Companies have failed to provide adequate support for their claim of additional costs to trim to a no-contact approach. In direct testimony Ameren Companies witness Mr. Stafford claimed there would be additional costs related to a no-contact tree trimming approach but did not specify the amount of any such costs. (*See* Stafford Dir., AmerenCILCO Ex.. 6.0, p. 12; Stafford Dir., AmerenCIPS Ex. 6.0, p. 12; Stafford Dir., AmerenIP Ex. 6.0, p. 15) Staff witness Spencer responded that he had not seen any credible information demonstrating that a no-contact approach would have any significant impact on the Ameren Companies' tree trimming costs. (Spencer Dir., ICC Staff Exhibit 10.0, p. 23) Moreover, Mr. Spencer observed that a no-contact approach could result in some savings of operations and maintenance ("O&M") costs due to fewer power interruptions and less damage to Company facilities. (*Id*.)

In rebuttal testimony, the Ameren Companies asserted an increase of maintenance expense under the no-contact approach of $27.538 million for all three companies. (Stafford Reb., Ameren Ex. 16.0, pp. 4-5; Respondents' Ex. 16.5) The underlying basis for this estimate is a blanket switch from the current four year tree trimming cycle to a two year tree trimming cycle. (*See* Wiesehan Reb., Ameren Ex. 25, p. 11) With respect to the potential O&M savings resulting from a no-contact approach, the Ameren Companies asserted that "there is no basis for the Commission to conclude that the increased tree trimming expense would be offset dollar for dollar by decreased outage costs" and included no offsetting savings in its estimate. (Stafford Reb., Ameren Ex. 16.0, p. 5)

Staff witness Spencer observed that the Ameren Companies' response to his additional expense testimony appeared to misrepresent his direct testimony. (Spencer Reb., ICC Staff Exhibit 21.0, p. 16) Mr. Spencer's direct testimony stated that he had not seen any information indicating that the Ameren Companies would incur significant additional tree trimming costs. Such testimony is not equivalent to an assertion that the Ameren Companies would not incur significant additional costs, and the Ameren Companies' claim that there is no basis for Mr. Spencer's alleged assertion that a no-contact approach would not lead to significant additional costs amounts to an inappropriate attempt to transfer the burden of proof from the Companies to Staff. (*See*

220 ILCS 5/9-201 (In any hearing to consider the propriety of proposed rates, "the burden of proof to establish the justness and reasonableness of the proposed rates . . ., in whole and in part, shall be upon the utility."))

Mr. Spencer also opined that compliance with a no-contact approach would not necessarily require a more frequent tree trimming cycle. (Spencer Reb., ICC Staff Exhibit 21.0, p. 16) For instance, "no-contact" might be achieved by trimming to achieve clearances adequate to avoid contact over the length of the existing tree trimming cycle. (*Id.*) With respect to costs, Mr. Spencer testified that it might also be possible to achieve a no-contact approach through a more efficient allocation of existing resources. (*Id.*, pp. 16-17) With respect to O&M savings from a no-contact approach, Mr. Spencer reconfirmed that in his opinion it is obvious that there will be some savings of O&M costs because better trimmed trees will result in fewer callouts of Company linemen to respond to power interruptions and less damages to Company facilities. (*Id.*, p 17) Mr. Spencer also observed that he had not attempted to quantify a specific amount of O&M savings as implied by the Ameren Companies' witnesses, and that such savings may or may not be a dollar for dollar offset any additional costs. (*Id.*)

Staff witness Mr. Spencer also noted that the Ameren Companies' estimate of additional costs to trim to a no-contact approach is roughly equal to their total current annual tree trimming costs, thus presenting a doubling of costs. (*Id.*, p. 18) Ameren Companies witness Mr. Clapp testified that the Ameren Companies' current vegetation management program combines "(a) a 4-year pruning cycle with (b) identifying and scheduling any faster growing trees or trees with pruning limitations such that they might become *cycle busters* for interim inspection and pruning . . . ." (Clapp Reb., Respondents' Ex. 26.0, p. 8 (emphasis in original)) Mr. Spencer explained, based on his extensive observations of the state of tree trimming in the Ameren Companies' service territories, that the Ameren Companies had work to do to meet a no-contact policy, but were already completing much of the work needed as a result of their combined 4-year and mid-cycle "cycle buster" programs. (Spencer Reb., ICC Staff Exhibit 21.0, p. 18) Mr. Spencer testified that in his opinion any additional costs to meet a no-contact approach "would not come anywhere near doubling the present costs . . . ." (*Id*., pp. 18-19) He also reiterated that any incremental costs to achieve a no-contact approach would be offset to some extent by O&M costs savings. (*Id*., p. 19) Accordingly, Mr. Spencer concluded that the Ameren Companies had not demonstrated that they should or would incur such additional costs to trim consistent with a no-contact policy, and recommended that their requests for additional costs to trim to a no-contact approach be denied. (*Id*.)

As demonstrated by the foregoing analysis and review of the relevant testimony, the Ameren Companies have provided an overly simplistic and ham-handed estimate of additional costs they seek to recover if the Commission finds, as it should, that they must trim to a no-contact approach. The Ameren Companies have made very clear their strong opposition to the no-contact approach, and Staff can only posit that the estimated doubling of current total costs represents a "sky is falling" cry intended to ward off the underlying issue rather than reasonably address any additional costs. The Ameren Companies' cost estimate is the obvious product of an overkill approach. While moving from a 4-year to a 2-year tree trimming cycle would appear certain to achieve compliance with a no-contact approach, the Ameren Companies have provided no evidence demonstrating that such a drastic change is required. This is not surprising since, as Staff witness Spencer testified, the amount of additional work required to trim consistent with a no-contact approach is small – particularly in comparison to their total annual tree trimming costs.

While Staff does not want to downplay the fact that improvement is needed and required, the required change is more in the nature of an adjustment to the current program rather than the wholesale reduction of the trimming cycle to half its current length. Moreover, as Staff witness Spencer testified, movement towards a no-contact approach may also be achieved by means that do not add appreciably to total tree trimming costs – such as by trimming to greater clearances. Further, while the Ameren Companies tout their cycle buster program in the context of defending their existing tree trimming activities, they are deafeningly silent on the cost efficiency of enhancing their activities under that program (instead of a wholesale doubling of their periodic tree trimming) to achieve compliance with a no-contact approach. Further, there is every reason to expect moving to a no-contact approach will result in an offsetting reduction in O&M expenses due to a reduction in outages and damage to facilities. The Ameren Companies estimate fails to account for any offsetting cost reductions, and in that regard is patently unreasonable.

The Ameren Companies have the burden of proof to establish that the costs they propose to recover are just and reasonable, and this burden does not change just because the costs at issue relate to an obligation they dispute. The estimated costs proffered by the Ameren Companies in rebuttal testimony for additional tree trimming costs are based on a fatally flawed and unsupported assumption that they need to move to a 2-year tree trimming cycle to comply with a no-contact approach. Staff has also demonstrated other deficiencies in the Ameren Companies estimate as set forth above, and the Commission should find that the Ameren Companies have failed to satisfy their burden of proof and deny their request for addition costs.

C. Injuries and Damages Expense

The Commission should accept Staff witness Jones' proposed adjustments to replace AmerenCILCO's and AmerenCIPS' 2004 reserve accrual component of injuries and damages expense with a normalized amount of claims paid during the test year.

The reserve accrual component of injuries and damages expense represents an estimated amount set aside for expected claims payments. The revenue requirement should reflect actual claims paid but, because these payments can fluctuate greatly from year to year, it is more appropriate to determine a normal level of annual claims paid than to use the claims paid in the test year. (Jones Dir., ICC Staff Exhibit 3.0, p. 23)

To determine a normal level of annual claims paid for AmerenCILCO and AmerenCIPS, Ms. Jones calculated the percent of claims charged against the reserve to the amounts accrued to the reserve. Data from 2001 through 2005 was considered, but the 2005 data for AmerenCILCO and the 2002 data for AmerenCIPS appeared to be abnormal and were removed from the respective calculation. The percents thus obtained for AmerenCILCO and AmerenCIPS represented four-year weighted averages that were applied to the respective 2004 accrual to the reserve to calculate the appropriate amount to include in test year injuries and damages expense. (*Id.,* p. 24)

AG witness David J. Effron also proposed adjustments to normalize test year injuries and damages expense for AmerenCILCO and AmerenCIPS. Mr. Effron's adjustments reflect a five year average of actual cash payments charged against the reserve for the period 2001-2005. (Effron Dir., AmerenCILCO AG Exhibit 1.0, p. 18 and AmerenCIPS AG Exhibit 1.0, pp. 15-16)

The Ameren Companies accepted Staff's adjustments to normalize injuries and damages expense on the basis that the adjustments weight payments against accrued expense and eliminate what Staff considers to be outlying data. (Stafford Reb., Ameren Ex. 16.0, p. 8)

Additionally, Staff witness Jones also proposed an adjustment to disallow the "reinstatement of Dynegy eliminations" included in AmerenIP's pro forma adjustment to 2004 injuries and damages expense, AmerenIP Schedule C-2.13. The adjustment was made in response to AmerenIP's claim that injuries and damages expense allocations removed from test year expenses in its pro forma adjustment to eliminate Dynegy allocations on Schedule C-2.12 are also included in the credit amount labeled "Other Adjustments Allocated to Electric" on AmerenIP workpaper WPC-2.13, which forms the basis for its pro forma adjustment to injuries and damages. However, based on a review of information provided by AmerenIP, it is Ms. Jones' opinion that the Dynegy allocations are not part of AmerenIP's total reduction to test year injuries and damages expense, have not been deducted twice, and should not be reinstated. (Jones Dir., ICC Staff Exhibit 3.0, pp. 25-26)

The Ameren Companies accepted Staff's adjustment to disallow reinstatement of Dynegy eliminations. (Ameren Ex. 16.0, p. 8) Thus, the issue is uncontested.

Based on the foregoing, Staff strongly recommends that the Commission accept it adjustments with respect to injuries and damages expense. The Ameren Companies accepted Staff's adjustments to normalize injuries and damages expense and to disallow reinstatement of Dynegy eliminations.

D. Rate Case Expense

1. Delivery Services

The Commission should accept Staff witness Jones's proposed adjustments to remove from rate case expense costs for which Ameren failed to provide adequate documentation to support the requested amounts. The Companies' original rate case expense estimates are based mainly on verbal communications with its outside service providers. (Jones Reb., ICC Staff Exhibit 14.0, p.4) Because the Ameren Companies provided Staff no information with which to determine if their various rate case expense estimates are reasonable, Ms. Jones reviewed invoices received prior to the filing of her rebuttal testimony to determine what percent of the rate case expense requested by the Ameren Companies had been incurred for each service provider and should be included in the revenue requirements. (*Id*., p. 5)

Ms. Jones disallowed the invoices from CSS Consulting and Manpower, Inc. because they contained no information with which to identify that the services provided were for the rate case proceedings. Ms. Jones disallowed the estimated amounts for travel expense related to the instant proceedings for Ameren personnel and a rate case expense item labeled "miscellaneous surrebuttal/rebuttal support" because the Ameren Companies did not provide any information with which to determine the reasonableness of the estimates. Per the Ameren Companies' response to data request BCJ 11.01, no specific calculations were performed to determine the estimated amounts. (*Id*., pp. 5-6)

Staff realizes that it will not see all of the actual invoices related to rate case expense, and unforeseen situations may arise that warrant adjustments to rate case expense. However, it is the Ameren Companies' responsibility to reasonably estimate rate case expenses when preparing its initial filing in order to minimize the need for post-filing adjustments. (Tr., p. 591) It is also the Ameren Companies' responsibility to provide sufficient information about how they derived their estimates so that other parties can evaluate the reasonableness of the Ameren Companies' assumptions and how they arrived at the proposed amounts based upon those assumptions. The Ameren Companies failed to do so. Therefore, Staff witness Jones' adjustment should be adopted by the Commission because the Ameren Companies should be allowed to recover from ratepayers only those costs that they have adequately and properly supported.

2. Post-2006 Basic Generation Services

The Commission should accept Staff witness Jones' proposed adjustments to remove procurement proceedings costs from rate case expense because they are not related to delivery services. The procurement proceeding costs were incurred to support the proceedings regarding Post-2006 Basic Generation Services, Docket Nos. 05-0160, 05-0161, and 05-0162 (Consolidated). If the costs were allowed to remain in delivery services rate case expense, Ameren customers who take delivery services only, i.e., purchase power from another source, would be charged with costs related to the procurement of the power supply. (Jones Dir., ICC Staff Exhibit 3.0, p. 5)

According to the Ameren Companies, "[t]he BGS Proceeding was a necessary part of restructuring the electricity industry in Illinois ..... and was beneficial to all ratepayers" (Stafford Reb., Ameren Ex. 16.0, p. 13), presumably because "[u]nder the BGS Proceeding's final order, the Ameren Companies are in fact offering supply service options to all customers." (*Id.*, p. 14) However, the fact that the Ameren Companies must offer service to whoever wants it is an ongoing obligation that predates the BGS Proceeding.

> A public utility shall, upon reasonable notice, furnish to all persons who may apply therefor and be reasonably entitled thereto, suitable facilities and service, without discrimination and without delay.

(220 ILCS 5/8-101)

The BGS Proceeding simply established how the Ameren Companies will acquire power supply beginning in January 2007. Thus, the costs of that proceeding can reasonably be characterized as power supply costs and should be borne by the customers who purchase their power from the Ameren Companies. Requiring all delivery service customers to pay for the Ameren Companies' power supply costs by allowing recovery of the BGS costs in the instant proceedings imposes costs based on eligibility, rather than on the traditional ratemaking tenet of cost causation. (Jones Reb., ICC Staff Exhibit 14.0, pp. 11-12)

Ms. Jones recommends that BGS expenses be recovered through Ameren's proposed Supply Procurement Adjustment ("SPA").[4] In this manner, only those customers for whom the Ameren Companies supplies power will pay for the costs of the

[4] SPA is explained in Supplemental Direct Testimony of Wilbon L. Cooper, AmerenCIPS Exhibit 8.0S, pp. 2-7.

procurement proceedings. Furthermore, only the BGS tariff support costs that have been substantiated should be recoverable. (Jones Dir., ICC Staff Exhibit 3.0, p. 7) Ameren agrees that it is possible to fairly recover its procurement ("BGS") proceeding costs through the SPA, as recommended by Staff. (Stafford Reb., Ameren Ex. 16.0, p. 14) Finally, Staff's recommendation is consistent with the Commission's recent decision on this same issue in the ComEd rate case, Docket 05-0597:

> At issue is whether or not ComEd should be allowed to recover the costs associated with the procurement case through its delivery service rates. ComEd argues that it should be allowed to recover the costs incurred as a result of the procurement case through delivery service rates as those costs are ultimately a benefit to all customers. Staff opposes ComEd's proposal and in the alternative proposes that ComEd only be allowed to recover its unamortized balance of its procurement case expenses through the SAC. Staff's proposal assigns the cost of the procurement proceeding to those customers who benefit from the procurement process rather than to all customers including those who do not take supply from ComEd and those whose electric supply service has been declared competitive. The Commission agrees with Staff that ComEd's proposal to amortize its estimated legal fees and expenses related to the procurement proceedings should be rejected since the costs are not related to delivery services. The Commission finds Staff's proposal more closely aligns with cost causation principles. For this reason, the Commission deems Staff's proposed recovery methodology reasonable and it is hereby adopted. The reduction to procurement expense referenced in the preceding conclusion, which was derived from Staff Exhibit 12.11, page 2 of 2, lines 5-10, will reduce the amount of the procurement expense ComEd will be allowed to collect through the Supply Administration Charge.

(*Commonwealth Edison Co.*, Docket 05-0597, (Final Order, July 26, 2006), p. 50, corrected August 1, 2006)

3. Depreciation Study

The Commission should accept Staff witness Jones' proposed adjustments to disallow the cost of the electric depreciation study included in the Ameren Companies rate case expenses because the Ameren Companies have not made reasonable use of the results of the study, as evidenced by a lack of adjustments for the changes supported by the study. The study supports a change in depreciation rates, but the Ameren Companies chose not to make any changes. Thus, there is no indication that the study was a necessary part of the instant proceeding. Although it is good business practice for a company to periodically evaluate its depreciation rates, the cost of a depreciation study does not automatically qualify as a recoverable rate case expense, even though it occurs in a test year. (Jones Dir., ICC Staff Exhibit 3.0, p. 4)

In rebuttal testimony, Company witness Stafford explained that the depreciation study was a necessary expenditure to determine appropriate depreciation rates for all of the Ameren Companies, especially because they are moving from a period of frozen rates. (Stafford Reb., Ameren Ex. 16.0, p. 12) Per the Ameren Companies' response to Staff data request BCJ 15.05, "the depreciation studies conducted support a change in depreciation rates for each of the Ameren Companies, including AmerenIP." (Jones Reb., ICC Staff Exhibit 14.0, p. 8) Per Mr. Stafford's surrebuttal testimony, the studies support "a very large increase in depreciation rates for AmerenIP." (Stafford Sur., Respondents' Exhibit 36.0, p. 15)

Although the depreciation study indicates that a change in depreciation rates is warranted, "[t]he Ameren Companies determined that the results of the depreciation study under prevailing circumstances supported maintaining the status quo." (*Id.*, p. 16) Presumably, Ameren's management made the decision to disregard the results of the study, yet it expects ratepayers to pay for the study as part of its recoverable rate case expense.

AmerenIP is requesting the Commission's permission to reallocate its depreciation reserve in order to mitigate future impacts of changes in depreciation rates. Ms. Jones recommends that the Commission deny the request, for reasons discussed at Section I.F of this Initial Brief. Ms. Jones believes that the reallocation, which has no effect on the current proceedings, is simply a way to make it appear that the Ameren Companies is making some use of the depreciation study in response to Staff's proposed adjustment.

Based upon the foregoing, Staff strongly recommends that the Commission accept Staff's adjustment to disallow the cost of the electric depreciation study included in the Ameren Companies' rate case expenses.

E. A&G Expenses

1. Functionalization

Staff's proposed adjustments to A&G expenses for AmerenCIPS and AmerenCILCO as revised in rebuttal testimony are eminently reasonable and should be adopted by the Commission. They reflect a necessary correction to the Company's proposed allocation of Ameren Services (AMS) costs among the various corporate subsidiaries that is fair and reasonable to the companies and ratepayers alike.

Staff had initially proposed a more significant adjustment of AMS-related A&G expenses that impacted all three Ameren Companies. However, in rebuttal, the Ameren Companies offered a revised version of Staff's proposed adjustment that corrected some errors in the original analysis. (Stafford Reb., Respondents' Exhibit 16.10, Schedule 2, p. 1) This obviated the basis for Staff's adjustment of AmerenIP A&G

expenses and reduced the corresponding adjustments for AmerenCIPS and AmerenCILCO. (Lazare Reb., ICC Staff Exhibit 17.0, pp. 16-17)

Ameren in its filing proposes significant increases in A&G expenses for all three companies. The current and proposed A&G expenses with accompanying levels of increase are as follows:

(in $000s)

Company	Current 1/	Proposed 2/	Increase	%
AmerenCIPS a/	26,209	42,939	16,730	63.8
AmerenCILCO	6,733	33,278	26,545	394.3
AmerenIP	16,555	77,448	60,893	367.8
Total	49,497	153,665	104,168	210.5

Sources: 1/ Ameren Companies responses to PL 3.1, 3.3 & 3.5.
2/ Schedule C-1.

Note: a/ Current revenues for AmerenCIPS include revenues for AmerenUE whose territory was taken over by AmerenCIPS since the last delivery service case.

These significant increases are defended by Ameren witness Lyons. Mr. Lyons claims that a "principal driver of A&G in this case is pensions and post retirement benefits." (Lyons Dir., AmerenCILCO Exhibit 2.0, p. 8, line 171; AmerenCIPS Exhibit 2.0, p. 8, line 171; AmerenIP Exhibit 2.0, p. 8, line 171) Furthermore, he argues that expenses have risen at AmerenIP and AmerenCILCO since the mergers "as Ameren has taken steps to move these companies onto the Ameren information systems and operating platforms and improve each company's level of service and operations to a level consistent with Ameren standards". (*Id.*, AmerenCILCO Exhibit 2.0, pp. 8-9; AmerenCIPS Exhibit 2.0, pp. 8-9; AmerenIP Exhibit 2.0, pp. 8-9) Mr. Lyons goes on to identify other factors in the increase such as "investments in technology in communication equipment and services and computer equipment and software, requiring information technology support and employee training". (*Id*., AmerenCILCO Exhibit 2.0, p. 9; AmerenCIPS Exhibit 2.0, p. 9; AmerenIP Exhibit 2.0, p. 9) He also suggests that salary and wage increases have raised the level of A&G costs. (*Id*., AmerenCILCO Exhibit 2.0, p. 9; AmerenCIPS Exhibit 2.0, p. 9; AmerenIP Exhibit 2.0, p. 9)

Mr. Lyons' arguments are fundamentally flawed. While identifying areas of potential cost increases, he has failed to document the extent of these increases or to specify how they translate into increases of 63% to 394% (or 210% on a collective basis) for the three Ameren companies. (Lazare Dir., ICC Staff Exhibit 6.0, p. 19)

The proposed increases in A&G expenses present another problem because they far exceed the proposed increases in direct expenses. In contrast to the collective 210% increase in A&G expenses proposed for the three operating companies, the Companies propose increases in direct expenses on average of 12.1% over the levels approved in the last round of delivery service cases. (*Id.*)

These differential increases suggest that the success of the Ameren Companies in controlling direct expenses does not extend to A&G expenses. The Companies do not explain why they can control one set of costs more effectively than another. (*Id*., p. 20)

These disproportionate increases also call into question the Ameren Companies' argument that A&G expenses have risen at AmerenIP and AmerenCILCO due to efforts to make each company's level of service and operations consistent with Ameren standards. (Lyons Dir., AmerenCILCO Exhibit 2.0, pp. 8-9; AmerenCIPS Exhibit 2.0, pp. 8-9; AmerenIP Exhibit 2.0, pp. 8-9) Any efforts to improve service and operations should affect not just A&G expense levels but direct expense levels as well. Nevertheless, the Ameren Companies are proposing extraordinary increases in A&G expenses only. (Lazare Dir., ICC Staff Ex. 6.0, p. 20-21)

One factor in this extraordinary increase is that the Ameren Companies propose to reallocate costs associated with Ameren Services Company ("AMS") to delivery services. AMS is an unregulated subsidiary that provides services to other Ameren Companies. However, AMS costs are allocated among Ameren subsidiaries according to principles that directly conflict with Commission decisions in the last round of delivery service cases for both AmerenCIPS and AmerenCILCO. These deviations leave the Ameren Companies' customers with unreasonably high levels of A&G expense. (*Id*., p. 21)

In the previous delivery service cases all A&G expenses for these two companies including AMS costs were functionalized on the basis of a general allocator. That approach allocated a minority of the overall A&G expenses to distribution for both operating companies, 46% for CILCO (Docket No, 01-0637, Staff Ex 16.0, Schedule 2) and 34.33% for AmerenCIPS (as well as 31.76% for AmerenUE) (Docket No. 00-0802 WP-AD-008-1f). (*Id*., p. 22)

In the current proceeding, AmerenCIPS and AmerenCILCO have adopted a significantly different allocator for the component of A&G expenses represented by AMS costs. Specifically, the allocation of A&G-related AMS costs to distribution for AmerenCIPS and AmerenCILCO has risen dramatically to 49.53%. (Stafford Reb., Respondents' Exhibit. 16.10, Schedule 2, p. 1 of 2) This represents a shift of this key component of A&G expenses to distribution now that AmerenCIPS and AmerenCILCO have divested generation and restructured themselves as transmission and distribution utilities. (Lazare Dir., ICC Staff Exhibit 6.0, p. 22)

The Ameren Companies have made a unilateral decision to reverse the Commission decisions in the previous rounds of delivery service cases by shifting responsibility for a significant component of the overall A&G expenses to delivery service customers in this proceeding. This reallocation is unreasonable. The Ameren Companies have offered no reasonable argument for discarding the allocation methodology adopted by the Commission in the previous round of CIPS and CILCO delivery service cases. (*Id*., p.23)

Staff proposes to address this unwarranted reallocation by proposing a downward adjustment in A&G expenses. The adjustment would reflect a more reasonable allocation of A&G-related AMS expenses to distribution. (*Id*., p. 24)

Staff's proposed adjustment is indeed modest. It is a far smaller adjustment than would be appropriate based on the precedent from IP's last delivery service case (Docket No. 01-0432). Docket No. 01-0432 represented the first case where the Commission allocated A&G expenses for a T&D utility that had divested generation. In that case, the Commission decided that the level of increase for A&G expenses should be tied to the percentage increase for direct operating expenses, stating as follows:

> The Commission accepts Staff's contention that based on the 1999 DST Order, IP should be required to allocate a portion of it's a&G expense to "generation' even though prior to the test year in this case IP divested all of its generation, and had essentially no generation facilities, business or labor expense during the 2000 test year. The Commission also accepts the arguments of Staff and IIEC that based on the 1999 DST Order, the

> mathematical relationships between A&G expenses in distribution operating expenses and distribution labor expense must be maintained in this case.

(Docket No. 01-0432, Order at 48)

In rebuttal, Ameren witnesses Vogl and Langenhorst seek to buttress the argument for the Ameren Companies' proposed increases in A&G expenses. Mr. Vogl focuses on pension and other post employment benefits (OPEB) costs, arguing that these expenses collectively account for almost half of the Companies' proposed collective increase in A&G expenses, $50.9 million out of $102.6 million. (Vogl Reb., Respondents' Exhibit 21.0, p. 5) Furthermore, Mr. Vogl states that the increase in these expenses is due to factors such as interest rates, returns on equity investments, and medical inflation which he states are "beyond the control of Ameren". (*Id*., p. 4)

Ms. Langenhorst discusses major medical costs for Ameren. She indicates that the specific levels of major medical expenses proposed include $1.8 million for AmerenCILCO, $3.9 million for AmerenCIPS and $6.7 million for AmerenIP. This sums to a total of $12.4 million for the three operating companies. (Langenhorst Reb., Respondents' Exhibit 22.0, p. 4) Ms. Langenhorst argues that these proposed levels are reasonable because the Company has been successful in controlling the growth of major medical costs in recent years. She indicates that Ameren has held the increase in Major Medical expenses to an average of 3.9% over the last three years which is significantly below the national average increase of 6.1% over this time. (*Id*., p. 5)

The testimony of Ms. Langenhorst and Mr. Vogl fall short because they only explain about half of the proposed increase in A&G expenses for the Ameren Companies. The 3.9% increase over three years in Major Medical expenses to a total of $12.4 million corresponds to an increase of less than $1.4 million over that period.

When added to the $50.9 million increase in pension and OPEB expenses discussed by Mr. Vogl, that would account for $52.3 million out of the total increase of $102.6 million. Stated otherwise, $50.3 million of the proposed increase remain unexplained by Ms. Langenhorst and Mr. Vogl.

Ameren witness Stafford also jumps into the fray, arguing that a number of factors have contributed to an increase in A&G expenses. He cites increased security costs since September 11th, costs associated with the passage of the Sarbanes-Oxley act in 2002 and costs stemming from an increasingly complex legal and regulatory environment in support of his claim. (Lazare Reb., ICC Staff Exhibit 17.0, p. 12)

The argument falls short because Mr. Stafford provides no accompanying cost support to document the impact these factors have on A&G expenses. Whether these factors make a meaningful contribution to the proposed increases in A&G expenses cannot be determined from Mr. Stafford's testimony. (*Id*., pp. 12-13)

Mr. Stafford goes on to criticize the Staff approach for taking a "generalized view" Ameren cost data which fails to consider "the real dollars being spent due to real world cost increases" and even "ignores Staff's own field work audit of the Ameren Companies' accounting practices". He goes on to contend that this approach "is contrary to FERC and ICC practices". (Stafford Reb., Respondents' Exhibit 16.0, p. 17)

His argument is simply incorrect. Despite his claim to the contrary, Staff's proposed approach is consistent with ICC practices. In fact, a similar Staff approach to A&G expenses was adopted by the Commission in the last delivery service case for IP (Docket 01-0432). In that case, Staff presented two alternatives, an adjustment based on general principles as well as specific adjustments proposed by Accounting Staff.

The Commission for its part went with the general approach. Furthermore, the Commission's decision on this issue was upheld by the Courts in response to an appeal by Illinois Power Company. (Lazare Reb., ICC Staff Exhibit 17.0, p. 14)

Mr. Stafford also contends in rebuttal that Staff's proposed adjustment is calculated incorrectly. He states that the adjustment reflects incorrect figures for AmerenCIPS, AmerenCILCO and non-regulated subsidiaries. In addition, Mr. Stafford claims that the Staff adjustment fails to include AMS allocations for some Ameren deregulated subsidiaries including AmerenEnergy Resources Generating, AmerenEnergy, AmerenCIPS Sales Expense and AmerenCILCO Sales Expense. (Stafford Reb., Respondents' Exhibit 16.0, pp. 22-23)

Mr. Stafford has gone on to present adjustments for AmerenCIPS, AmerenCILCO and AmerenIP based upon these revised figures. For AmerenCIPS and AmerenCILCO, Mr. Stafford calculates alternative adjustments of $3,345,118 for AmerenCIPS and $4,952,701 for AmerenCILCO. (*Id.*, Schedule 2, p. 2) This amounts to a combined downward adjustment of $8,297,820 for the two companies. (*Id.*, Schedule 2, p. 1) However, he calculates an upward adjustment of $6,697,747 for AmerenIP. This results in a revised net A&G adjustment based on the Staff methodology of 1,600,072. (*Id.*, Schedule 2, p. 2)

Staff finds the revised adjustments presented by Mr. Stafford for AmerenCIPS and AmerenCILCO to be reasonable and has accepted his revised figures of $3,345,118 for AmerenCIPS and $4,952,701 for AmerenCILCO. However, Mr. Stafford's revised upward adjustment for AmerenIP is not reasonable. It should be remembered that the starting point for Staff's proposed adjustment of AmerenIP's A&G

expenses was the Commission decision in the Company's previous delivery service case, Docket 01-0432. In that case, the Commission limited the percentage increase in A&G expenses to the same percent as the increase in direct O&M expenses. This served as precedent for limiting the increase in AmerenIP's A&G expenses to 13.5%, the percentage increase in direct O&M expenses proposed by the Company in this proceeding. Despite this precedent, Staff proposed a smaller adjustment for AmerenIP in direct to be consistent with AmerenCILCO. (Lazare Reb., ICC Staff Exhibit 17.0, p. 16)

Now, based on revised rebuttal numbers, Staff's methodology would produce a greater increase for AmerenIP than the company proposes. To find that result acceptable, there must be some evidence to indicate that the company should receive an even greater increase than it proposed in direct. There is no such evidence available in this proceeding. Instead, any Staff adjustments to AmerenIP's A&G expenses will be based solely on the proposals made by Staff Witness Jones. (*Id*., pp. 16-17)

In surrebuttal, Mr. Stafford seeks to counter the argument that AMS costs have been improperly allocated to the regulated utilities. He states his argument accordingly:

> Q. Given the above, is it reasonable to assume that costs recorded on the books of AmerenCIPS and/or AmerenCILCO are somehow supporting the non-regulated production functions of the other six Ameren affiliates, as alleged by Mr. Lazare and Mr. Chalfant?
>
> A. No. These costs can't be recorded on the books of two companies, and are independent of each other.

(Stafford Sur., Respondents' Exhibit 36.0, p. 23) The above statement reveals the extent to which Mr. Stafford confuses the issue. It is not a issue of having a set of costs on the books of two companies. Rather, the issue is that the costs are on the books of the wrong companies. In this case, Ameren chooses to overallocate AMS costs to AmerenCIPS and AmerenCILCO and underallocates to unregulated subsidiaries. This translates into higher rates for ratepayers and lower costs (and higher profits) for the unregulated subsidiaries. It is this unreasonable outcome that Staff's proposed adjustment of A&G expenses for AmerenCIPS and AmerenCILCO seeks to address.

2. Incentive Compensation

The Commission should accept Staff witness Jones' proposed adjustments to operating expense to disallow labor expense and the associated payroll tax expense related to incentive compensation payouts. The costs related to incentive compensation plans should be disallowed because (1) the plans are dependent upon financial goals of the Ameren Companies that primarily benefit shareholders; (2) ratepayers would provide funding even when no costs were incurred by the Company because the plans' goals were not met; and (3) the plans are discretionary and may be discontinued at any time. Prior Commission practice supports the disallowance of incentive compensation on these grounds. (Jones Dir., ICC Staff Exhibit 3.0, p. 16)

<u>Financial goals</u>

There is no doubt that Ameren's incentive compensation plans ("ICP") are ultimately dependent on financial performance goals, as measured by earnings-per-share ("EPS"). The Ameren Companies themselves acknowledged this when they included the following statements with the 2004 costs associated with each incentive compensation plan.

> The costs associated with Ameren's incentive plans are dependent upon organizational performance. If the organization does not meet pre-defined

> EPS goals (as stated in the Plans), incentive awards are not available. Incentive opportunity (and therefore costs), vary based on EPS performance.

(Company filing for 83 Ill. Adm. Code 285.150 (n)

ICP documents also indicate that Ameren must achieve certain levels of financial success, as measured by EPS, to have money available to fund the ICP. Finally, Ameren witness Bauer states, "Ameren Services sets an annual threshold earnings-per-share target that determines the annual funding level of the plans." (Bauer Reb., Respondents' Exhibit 23.0, p. 3)

With respect to ratemaking, these types of goals are based upon circular reasoning; that is, the larger the rate increase granted, the more success Ameren will have in achieving its earnings goals, which will enhance its ability to award incentive compensation. Financial performance goals primarily benefit shareholders; therefore, shareholders should bear the cost of paying incentive compensation. (Jones Dir., ICC Staff Exhibit 3.0, p. 17)

In surrebuttal testimony, Ms. Bauer attempted to obfuscate the issue by claiming that the Commission should allow at least a partial recovery of incentive compensation costs because Ms. Jones states that shareholders are the primary beneficiaries of incentive compensation packages, which implicitly acknowledges that ratepayers receive benefits, also. (Bauer Sur., Respondents' Exhibit 44.0, pp. 6-7) Ms. Bauer has grossly misconstrued that portion of Ms. Jones' testimony to which she cites as the basis for this ridiculous postulation. The testimony cited states, "the plans are dependent upon financial goals of the Companies that primarily benefit shareholders." (Jones Reb., ICC Staff Exhibit 14.0, p. 13) The phrase "primarily benefit shareholders" refers to the Companies financial goals, not to its incentive compensation plans. Ms.

Bauer has chosen to incorrectly interpret the testimony to fit her own agenda. (Tr., p. 806)

Ratepayer funding and discretionary nature of plans

Even if the Ameren Companies were to incur no incentive compensation expense because (1) the target EPS for funding incentive compensation is not achieved or (2) business unit and/or individual performance goals are not met, ratepayers would continue to provide funding if rates were based on a revenue requirement that includes recovery for incentive compensation. (Jones Reb., ICC Staff Exhibit 14.0, pp. 14-15) Ms. Bauer's testimony reinforces this fact. She states unequivocally that even if the Ameren Companies' financial goals are met, an employee may not benefit under the plan. (Bauer Reb., Respondents' Exhibit 23.0, pp. 5-6) Also, "[o]nce the plans are funded, incentives are awarded (or withheld) based on the performance of an employee's business unit and/or their individual performance." (*Id*., p. 3) The Commission has been concerned about this issue in the past, stating as follows:

> The Commission is also concerned that if the ICP payments are not made, the Company still recovers the cost through rates. If the Company's financial goals are not met or if an individual's goals are not met, MEC may choose not to pay the incentive compensation portion of wages. Under MEC's proposal, however, it would still recover the cost through rates.

(*MidAmerican Energy Company*, ICC Docket No. 01-0696, p. 17, (Order, Sept. 11, 2002))

> [T]he Commission is concerned that ratepayers are not protected if IP fails to achieve the financial goals and incentive compensation payments are not made. Under that scenario, ratepayers would still pay for the incentive compensation plan if IP's position were adopted.

(*Illinois Power Company*, ICC Docket Nos. 99-0120/99-0134 Cons., p. 44, (Order, Aug. 25, 1999))

> Furthermore, the Commission is not persuaded that ratepayers are protected in the event that the targeted return on capital investment is not achieved. Under CILCO's proposal, ratepayers would still fund the test year level of incentive payments even if that level is not achieved. While failure to achieve the efficiencies that would result in the projected level of incentive payments may penalize individual managers, ratepayers receive no benefit from this "penalty." Shareholders, on the other hand, would benefit.

(*Central Illinois Light Company*, ICC Docket Nos. 99-0119/99-0131 Cons., p. 38 (Order, Aug. 25, 1999))

Furthermore, the Ameren Companies' incentive plans are discretionary. (Bauer Reb., Respondents' Exhibit 23.0, p. 7) The Ameren Incentive Plan ("AIP") for contract employees plainly states, "As in past years, Ameren reserves the right to revise, modify, continue or discontinue this plan beyond the current plan year." This would not be an unusual or unlikely event. Ameren invoked that right as recently as 2003 when it notified contract employees that it was not currently planning to offer the AIP in 2003 due to the current financial situation and the wage freeze imposed on management employees. (Jones Dir., ICC Staff Exhibit 3.0, p. 19)

All else being equal, net income is enhanced when a Company is allowed to recover an expense that has been provided for in rates but that is not incurred. Once rates are set, the rates remain in effect until the next rate proceeding. So if the Company were allowed to include incentive compensation in its revenue requirement, ratepayers would provide funding (through rates) even if no cost were incurred by the Company because plan goals were not met – or because the Company decided to suspend the incentive plan. (*Id.*, p. 20)

Precedent for disallowing incentive compensation

Although every case stands on its own merits, the Commission has rejected the costs for incentive compensation plans in the following cases. (*Id*., pp. 20-21)

- MidAmerican Energy Company: Docket Nos. 01-0696, 01-0444 and 99-0534;
- Northern Illinois Gas Company: Docket No. 04-0779;
- Central Illinois Light Company: Docket Nos. 01-0465/01-0530/01-0637 (Cons.), 99-0119/99-0131 (Cons.), and 94-0040;
- Illinois Power Company: Docket Nos. 01-0432, 99-0120/99-0134 (Cons.), 93-0183, and 91-0147;
- AmerenCIPS and AmerenUE: Docket Nos. 03-0008, 03-0009 and 00-0802;
- Consumers Illinois Water Company: Docket Nos. 95-0641, 95-0307/95-0342 (Cons.); and
- Citizens Utilities Company of Illinois: Docket No. 94-0481.

Staff witness Jones' adjustments to disallow labor expense and the associated payroll tax expenses related to incentive compensation plans are just and reasonable and should be adopted by the Commission.

3. Pension and OPEB Expense

4. Major Medical

The Commission should accept Staff witness Jones' proposed adjustments to test year employee benefits expense for AmerenCILCO and AmerenIP to reflect material changes in the 2006 budget amounts for major medical expense. The updated amounts were provided by the Ameren Companies in response to Staff data requests

BCJ 10.02 (AmerenCILCO) and BCJ 10.05 (AmerenIP). Each proposed adjustment reduces test year employee benefits expense, which decreases the respective revenue requirement. (Jones Dir., ICC Staff Exhibit 3.0, p. 22)

AG witness Effron proposed an adjustment for AmerenCILCO that is similar to Staff's adjustment for AmerenCILCO. (Effron Dir., Docket No. 06-0070, AG Exhibit 1.0, pp. 15-16) AmerenCILCO agrees that the adjustment is appropriate. (Stafford Reb., Ameren Ex. 16.0, pp. 9-10) Thus, major medical expense for AmerenCILCO is an uncontested issue.

AmerenIP agrees that Staff's adjustment to AmerenIP's major medical expense is appropriate. (*Id*.) However, the issue is contested in that major medical expense is a component of the adjustment proposed by AG witness Effron to AmerenIP's level of "employee benefits costs other than pension". (Effron Dir., Docket No. 06-0072, AG Exhibit 1.0, pp. 14-15) Whereas Staff's adjustment reflects a material change in the 2006 budget amount, Mr. Effron's adjustment reflects 2005 actual costs. (*Id*., p. 15) If the Commission accepts Mr. Effron's adjustment to AmerenIP's "employee benefits costs other than pension", Staff's adjustment to AmerenIP's major medical expense would no longer be necessary.

5. Other A&G

F. Effect of Ameren Ownership on Illinois Power Expenses

G. Other

III. RATE OF RETURN

A. Summary of Uncontested/Settled Issues

B. Capital Structure

Staff's proposed capital structures for the Ameren Companies should be adopted because they are based upon an appropriate capital structure measurement period and date. The capital structures proposed by Staff demonstrate that the respective utility possesses the financial strength necessary to access the capital markets for funding under most economic conditions and can do so at a cost that is reasonable. The Administrative Law Judges issued a common outline for the parties, however, there are a number of issues impacting Capital Structure, and for clarity, Staff has added sub-categories to some parts of the common outline so as to clearly delineate the issues.

Within Section III.B.1 Capital Structure Measurement Period, there are three issues. The first two issues relate to the differing capital structure measurement dates proposed by each party. Staff proposes a measurement date of June 30, 2005 for AmerenCILCO and AmerenCIPS and accepts AmerenIP's initial capital structure measurement date – December 31, 2004. The Ameren Companies revised their position in rebuttal testimony, and now propose a measurement date of December 31, 2005 for all three utilities. The capital structure measurement period for AmerenCILCO and AmerenCIPS is addressed in Section III.B.1(a), and the capital structure measurement period for AmerenIP is addressed in Section III.B.1(b).

The third issue within Section III.B.1 is the difference between Staff's and the Ameren Companies' balance for AmerenCILCO's short-term debt. This difference is due to the fact that AmerenCILCO treats a $100 million equity infusion that actually occurred in May of 2005 as if it occurred in January of 2005. This issue is addressed in Section III.B.1(c).

Section III.B.2 addresses whether or not an imputed capital structure should be used. Staff proposes to accept the Companies' actual capital structures, whereas CUB and IIEC use imputed capital structures. As explained in Section III.B.2 Imputed Capital Structure, the actual capital structure of each Ameren Company can be used because it promotes the financial strength necessary for each Ameren Company to access the capital markets under most economic conditions at a cost that is reasonable.

Section III.B.3 addresses the difference between Staff's and the Companies' proposals for the balance and cost of AmerenCILCO's preferred stock. Staff and AmerenCILCO disagree with regard to the need to document the issuance expense for the $4.64 series.

The table below summarizes the parties' proposals (except for the Cities, who accepted the Ameren Companies' capital structure unless AmerenIP's return on equity exceeded 9.46% (Cuthbert Corr. Reb., Cities Exhibit 2.0 Corr., p. 16)). The differences between the proposals arise primarily from (1) the use of different capital structure measurement dates, (2) the determination by a party to use either actual or imputed capital structures, and, to a lesser extent, (3) disagreements over proper documentation of expenses and general errors.

	Component	Ameren Companies[5]	Staff [6]	CUB	IIEC
AmerenCILCO	Short-term Debt	9.584%	16.12%	20.04%	3.44%
	Long-Term Debt	28.248%	29.66%	36.86%	34.28%
	Preferred Stock	8.881%	8.66%	8.66%	10.00%
	Common Equity	53.287%	45.56%	34.44%	52.28%
AmerenCIPS	Short-term Debt	0.415%	0.33%	0.49%	2.81%
	Long-Term Debt	46.044%	46.07%	67.16%	45.25%
	Preferred Stock	4.622%	4.73%	4.73%	4.55%
	Common Equity	48.920 %	48.87%	27.63%	47.39%
AmerenIP	Short-term Debt	0.093%	0.00%	0.00%	0.0%
	TFTNs	14.468%	15.41%	15.41%	15.4%
	Long-Term Debt	30.163%	30.97%	41.07%	40.3%
	Preferred Stock	2.205%	2.06%	2.06%	2.1%
	Common Equity	53.071%	51.56%	41.46%	42.3%

1. Capital Structure Measurement Period

There are three basic questions before the Commission regarding the capital structure measurement period. The first question is whether June 30, 2005 or December 31, 2005 is the appropriate capital structure measurement date for AmerenCILCO and AmerenCIPS. As explained in subsection (a) below, the measurement date should be June 30, 2005. The second question is whether the capital structure measurement date for AmerenIP should be December 31, 2004 or December 31, 2005. As explained in subsection (b) below, the measurement date for AmerenIP should be December 31, 2004. The third question is whether pro forma adjustments should be made to AmerenCILCO's short-term debt balance. As explained

[5] Ameren Companies measured the long-tem components of the capital structure as of 12/31/2005 and short-term debt over the twelve months ending 12/31/2005.

[6] Staff measured the long-term components of the capital structures for AmerenCILCO and AmerenCIPS as of June 30, 2005, using a 12-month average short-term debt balance centered on that date, and measured AmerenIP's capital structure as of December 31, 2004.

in subsection (c) below, pro forma adjustments should not be made, rather, the best estimate of AmerenCILCO's short-term debt balance would be obtained by taking a twelve-month average of its short-term debt centered in time as of June 30, 2005.

a. Capital Measurement Period for AmerenCILCO and AmerenCIPS

The Ameren Companies propose that the long-term components of the capital structure for all three Companies be measured as of December 31, 2005, with short-term debt measured as a trailing 12-month average ending on December 31, 2005. (O'Bryan Reb., Respondents' Exhibit 15.1, p. (page numbers omitted from exhibit)) This should be rejected in favor of Staff's proposal. Staff proposes that AmerenCILCO's and AmerenCIPS' long-term components be measured on June 30, 2005, (Pregozen Dir., ICC Staff Exhibit 5.0, p. 15) and that the short-term debt be a twelve-month average centered in time on that same date. (*id*., pp. 16 and 22)

In its initial filing, the Ameren Companies proposed a capital structure measurement date of December 31, 2004 for each Ameren Company. They also made pro forma adjustments to AmerenCILCO's and AmerenCIPS' respective capital structures to reflect "known and measurable" changes (*i.e.*, debt refinancings and equity infusions) that occurred before and after the capital structure measurement date of December 31, 2004. However, the Ameren Companies treated those changes as if they happened before they actually did. (See *id*., explanations of adjustments to AmerenCILCO's short-term debt and common equity and adjustments to AmerenCIPS' long-term debt and common equity)

Staff responded to these pro forma adjustments by proposing that the measurement date be moved to June 30, 2005. The benefits of this proposal are that it eliminates the need for the $75 million pro forma adjustment to AmerenCILCO's balance of short-term debt, the $67 million pro forma adjustments to AmerenCIPS' balances of long-term debt and common equity, and the $20 million pro forma adjustment to AmerenCIPS' balance of long-term debt. Furthermore, moving the measurement date to 6/30/2005 ensures consistent measurement of the various capital components. (*Id*., p. 15)

In rebuttal testimony, the Ameren Companies changed their long-term capital measurement date from December 31, 2004 to December 31, 2005, with short-term debt equal to the average of the 2005 monthly short-term debt balances (i.e., a 12-month trailing average). (O'Bryan Reb., Respondents' Exhibit 15.1, p. (page numbers omitted from exhibit) The Ameren Companies claim that their proposal provides consistency by measuring "all" capital components as of December 31, 2005. (*Id*.) In addition, the Ameren Companies claim that Staff's proposal mismatches the measurement date of long-term and short-term capital, based on the assertion that the measurement date for long-term capital should match the ending date, rather than the midpoint, of the short-term debt measurement period. Despite the change in measurement date proposed by the Ameren Companies, they continue to maintain that a pro forma adjustment is needed for AmerenCILCO's short-term debt balance, treating the May 2005 retirement of $100 million of short-term debt with equity, as though it happened on January 1, 2005. Conversely, the Ameren Companies criticize as "subjective speculation" Staff's argument that the actual short-term debt balances best represent AmerenCILCO's use of short-term debt. (O'Bryan Reb., Respondents' Exhibit 15.1, p. (page numbers omitted from exhibit))

The Ameren Companies' arguments are erroneous and should be rejected. First, their proposal does not match the measurement date of long-term and short-term capital any better than Staff's proposal; in fact, it worsens the alignment. Despite the Ameren Companies' implication, not "all" of the components of the capital structure would be measured as of December 31, 2005 under the Ameren Companies' proposal. (Pregozen Corr. Reb., Staff Exhibit 16.0 Corr., p. 2) Rather, the Ameren Companies' proposal measures short-term as an average of thirteen month-end balances from December 31, 2004 to December 31, 2005. Moreover, there is no rule requiring the *end* of the measurement period for short-term debt be aligned with the measurement date for long-term capital. Indeed, Staff demonstrated that a twelve-month short-term debt measurement period with a midpoint that coincides with the measurement date of the long-term capital structure components better aligns the average balance of short-term debt with the long-term capital structure components. (*Id*., pp. 3-5) Consistent with that finding, Staff's proposal aligns the midpoint of the twelve month timeframe – December 31, 2004 to December 31, 2005 – over which short-term debt is measured with the June 30, 2005 measurement date for long-term capital. Staff notes that matching the midpoint of the short-term measurement period with the measurement date of the long-term capital structure components was not possible with a December 31, 2005 capital structure measurement date, since short-term debt balances through June of 2006 were not available at the time of filing Staff's rebuttal testimony. (*Id*., pp. 2-3)

Second, the Ameren Companies' suggestion that Staff's reliance on the *actual* short-term debt balances amounts to "subjective speculation" is absurd. This proposition has no weight, especially in light of the Ameren Companies' pro forma adjustment to AmerenCILCO's short-term debt balance, which pretends that a $100 million short-term debt refinancing occurred five months prior to the actual refinancing. (Pregozen Dir., Staff Exhibit 5.0, p. 14) The Ameren Companies' proposal to deviate from AmerenCILCO's actual debt balance is entirely unsupported. In contrast, Staff presented evidence to support its position, as discussed in Section III.B.1.(c) below. Based on the foregoing arguments, the Ameren Companies' capital structure proposals should be rejected and Staff's proposal should be adopted.

b. Capital Measurement Period for AmerenIP

Staff accepts the original December 31, 2004 capital structure measurement date AmerenIP proposed in its initial filing. Unlike AmerenCILCO and AmerenCIPS, Staff found no reason to object to AmerenIP's capital structure measurement date.

In its rebuttal testimony, however, AmerenIP changed its measurement date to December 31, 2005 for "all" capital structure components (i.e., short-term debt and long-term components (however, as noted previously, AmerenIP's short-term debt is calculated using a 2005 12-month trailing average short-term debt balance)). (O'Bryan Reb., Respondents' Exhibit 15.1, p. (page numbers omitted from exhibit) AmerenIP changed its measurement date to coincide with the date it proposes for AmerenCILCO and AmerenCIPS, and to incorporate fair value adjustments to its capital structure made during 2005. This rationale has no weight. First, there is no legal or financial policy basis for requiring such a change. The Ameren Companies are not required to have the same measurement date and are not responsible for each other's obligations. (Pregozen Corr. Reb., ICC Staff Exhibit 16.0 Corr., pp. 8-9) Indeed, Ameren Company witness Nickloy acknowledged that "the fact they are affiliated does not directly influence their capital structures." (Nickloy Reb., Respondents' Exhibit 14.0, p. 15) Therefore, as a separate utility, AmerenIP does not need to have the same measurement date as the other two Ameren Companies.

Second, with regard to the AmerenIP's "fair value" argument, fair value adjustments are to be excluded from AmerenIP's capital structure. Fair value adjustments made after December 31, 2004 were never in AmerenIP's December 31, 2004 capital structure; knowledge of post-December 31, 2004 fair value adjustments is necessary only if a capital structure measurement date is adopted that is after December 31, 2004. (Pregozen Corr. Reb., ICC Staff Exhibit 16.0 Corr. , p. 9) Hence, no need exists to move IP's December 31, 2004 capital structure to eliminate fair value adjustments that were not made until 2005.

Staff witness Pregozen presented two additional reasons for rejecting AmerenIP's proposal. First, AmerenIP's outstanding balances of short-term debt, CWIP, and CWIP accruing AFUDC for June 30, 2006 were not yet available as of the filing date of Staff's rebuttal testimony. Therefore, it was not possible to center the short-term debt balance on December 31, 2005. Second, Staff witness Pregozen could not recommend the Commission accept the accuracy of the fair value adjustment, given the abbreviated time allotted for review during the rebuttal phase of the proceeding and the number of mistakes in the Ameren Companies' previous filings in this docket. The number of mistakes made by the Ameren Companies in their original and supplemental filings warranted a close review of the journal entries that support the fair value adjustments. However, Staff witness Pregozen did not have sufficient time to conduct such a review.[7] Thus, Staff cannot support the accuracy of the adjustment. (Pregozen Corr. Reb., ICC Staff Exhibit 16.0 Corr., p. 9)

Thus, Staff recommends that the Commission adopt the capital structure measurement date that AmerenIP proposed in its initial filing – December 31, 2004.

c. Retirement of Short-Term Debt in May 2005

Both Staff and the Ameren Companies propose that AmerenCILCO's short-term debt be measured using the same 12-month average (from December 31, 2004 to December 31, 2005). Nevertheless, Staff and the Ameren Companies disagree on the resulting short-term debt balance. The Ameren Companies support a $100 million pro forma adjustment to AmerenCILCO's actual short-term debt balance to reflect a May 2005 equity infusion of $100 million used to retire an equal amount of short-term debt. (O'Bryan Reb., Respondents' Exhibit 15.1, p. (page numbers omitted in exhibit)) The Ameren Companies argue that the equity infusion was made to permanently eliminate that short-term debt. (O'Bryan Sur., Respondents' Exhibit 35.0, p. 5) Thus, they suggest that AmerenCILCO's actual short-term debt balance (without an adjustment) does not represent AmerenCILCO's "correct" short-term debt balance, and its use

[7] Mr. O'Bryan's claim that IP made persons available to discuss its fair value adjustments with Staff (O'Bryan Sur., Respondents' Ex. 35.0, p. 6) implies that Ameren informed Staff of the availability of such persons (it did not) and speculates, without foundation, that Staff had sufficient time to prepare for such a discussion and analyze whatever information IP might provide.

would overstate the short-term debt in AmerenCILCO's capital structure. (O'Bryan Reb., Respondents' Exhibit 15.1, p. (page numbers omitted in exhibit))

The Ameren Companies' $100 million pro forma adjustment to short-term debt is entirely speculative and should be rejected. (Pregozen Dir., ICC Staff Exhibit 5.0, pp. 16-17) The Ameren Companies provided no evidence to support their deviation from the use of AmerenCILCO's actual short-term debt balance. In contrast, Staff presented evidence indicating that AmerenCILCO's actual short-term debt balance better represents AmerenCILCO's outstanding balance of short-term debt. AmerenCILCO's response to Staff data request CS 1.04 shows that AmerenCILCO's balance of short-term debt began to increase shortly after the $100 million of debt was retired in May 2005. (*Id*., p. 17) Thus, although the $100 million of short-term debt was "permanently" retired in May of 2005, AmerenCILCO began to replace it with "new" short-term debt shortly thereafter. In Staff's judgment, that indicates that the $100 million refinancing merely represents a transition from one bridging cycle to another. Indeed, the $134 million average short-term debt balance over AmerenCILCO's previous full bridging cycle was greater than the $72 million balance Staff proposes.[8] (Pregozen Corr. Reb., ICC Staff Exhibit 16.0 Corr., pp. 6-7 and Schedule 16.06) The above indicates that the actual twelve-month average Staff proposes is a better estimate of AmerenCILCO's short-term debt usage than the adjusted balance the Companies propose.

Thus, the Companies' $100 million pro forma adjustment to AmerenCILCO's short-term debt balance should be rejected and Staff's short-term debt balance recommendation should be adopted.

[8] In contrast, AmerenCILCO's pro forma adjustment to the balance of short-term debt would misrepresent that balance as $34 million (Pregozen Corr. Reb., ICC Staff Exhibit 16.0 Corr., pp. 7-8).

2. Imputed Capital Structures

CUB proposes that an imputed, or hypothetical, capital structure be used for all of the Ameren Companies. (Bodmer Dir., CUB Exhibit 1.0, p. 86-91; Bodmer Reb., Cub Exhibit 3.0, pp. 7-14) Likewise, IIEC proposes that an imputed capital structure be used for AmerenIP. (Gorman Dir., IIEC Exhibit 3.0, pp. 6-15; Gorman Reb., IIEC Exhibit 6.0, pp. 9-16) In contrast, Staff found no need to consider hypothetical capital structures at this time and, thus, recommends that the actual capital structure of each of the Ameren Companies be used. (Pregozen Dir., ICC Staff Exhibit 5.0, p. 32; Pregozen Reb., ICC Staff Exhibit 16.0, p. 22)

The CUB and IIEC proposals to impute capital structures for the Ameren Companies should be rejected. The Commission should impute a capital structure only if the utility's actual capital structure is inappropriate. (Pregozen Dir., ICC Staff Exhibit 5.0, pp. 4-6) To evaluate the appropriateness of the Ameren Companies' actual capital structures, Staff witness Pregozen looked at the Ameren Companies' debt ratios and Staff witness Freetly's analysis of the effect of Staff's proposed revenue requirement on two other S&P benchmark ratios.[9] Mr. Pregozen found that the debt ratios for each of the Ameren Companies is consistent with that of an obligor that has a "strong capacity to meet its financial commitments." (*Id.*, pp. 31-32) In addition, Staff witness Pregozen found that his capital structure recommendations combined with Staff's proposed revenue requirements would provide AmerenIP with financial strength that "is commensurate with a strong but not excessive degree of financial strength" but that AmerenCILCO's and AmerenCIPS' capital structures "might be unnecessarily costly."

[9] Those two ratios were the funds from operations interest coverage and funds from operations as a percentage of average debt. (Pregozen Corr. Reb., ICC Staff Exhibit 16.0 Corr., p. 32)

(*Id*.) Nevertheless, Staff does not believe that it is clear that the actual capital structures are inappropriate at this time, particularly "given the uncertainty associated with the recovery of purchased power costs." (*Id*.) Therefore, Staff does not recommend an imputation of capital structures. (*Id*.)

3. CILCO $4.64 Preferred Stock Expense

The issuance expense related to AmerenCILCO's $4.64 Series preferred stock should be eliminated from AmerenCILCO's preferred stock schedule. AmerenCILCO has not provided supporting documentation. (Pregozen Dir., ICC Staff Exhibit 5.0, p. 19 (referring to Staff data request CS 3.05, to which AmerenCILCO failed to provide the requested supporting documentation) Section 9-201(c) of the Illinois Public Utilities Act squarely places the burden upon the utility to prove its requested increase in rates. (220 ILCS 5/9-201(c))

AmerenCILCO argues that its proposed issuance expense for its $4.64 Series preferred stock should be counted in its preferred stock balance because the Staff accepted it in previous dockets. (O'Bryan Reb. Respondents' Exhibit 15.1, pp. (page numbers omitted from exhibit) The acceptance of a preferred stock expense in a previous proceeding has nothing to do with the outcome in this proceeding.[10] The Commission is legally required to base its ruling exclusively on the evidence in the record of this case. *E.g.*, 220 ILCS 5/10-103, 10-201(e)(iv). To do otherwise would be reversible error. The law is clear that this case must be decided based exclusively on

[10] CILCO had no qualms about seeking recovery of losses on preferred stock that Staff had rejected in Docket No. 94-0040. (Pregozen Corr. Reb., ICC Staff Exhibit 16.0 Corr., p. 13) Apparently, to the Companies, positions Staff has taken in previous cases has precedential implications only when those positions favor the Companies.

the evidence in the record, and that past Commission Orders are not legal precedents, nor are they *res judicata*. (e.g., *United Cities Gas Co. v. Illinois Commerce Comm'n*, 163 Ill. 2d 1, 22-23 (1994), *Mississippi River Fuel Corp. v. Illinois Commerce Comm'n*, 1 Ill. 2d 509, 513, (1953)).

Moreover, AmerenCILCO's argument seems to imply that it is Staff's burden to maintain documentation to prove or disprove the petitioner's claims. On the contrary, it is not Staff's duty to warehouse all financial records that ever come into its possession on the chance that a petitioner may someday find them useful. Rather, it is the Company's burden to maintain records to substantiate the expenses it claims. (Pregozen Corr Reb., Staff Ex. 16.0 Corr., p. 13) Thus, the issuance expense related to AmerenCILCO's $4.64 Series preferred stock should be removed from AmerenCILCO's preferred stock schedule.

C. Measurement date of Short-term and Variable Interest Rates

Within the Cost of Capital, there is an issue related to the interest rate measurement date for short-term debt and variable rate long-term debt: whether the cost of capital should be adjusted to reflect interest rates as of April 4, 2006 or May 19, 2006, for short-term debt and variable rate bonds.

In his rebuttal testimony, Ameren Company witness O'Bryan updated all of the variable auction rate securities to their prevailing rates as of May 19, 2006. (O'Bryan Reb., Respondents' Exhibit 15.1, pp. (page numbers omitted from exhibit)) In this instance, the Ameren Companies failed to update the cost of common equity. (Pregozen Corr. Reb., ICC Staff Exhibit 16.0 Corr., p. 10) Staff does not endorse the allowance of updates in later rounds of testimony, unless good cause is shown (*i.e.*, not simply for the sake of increasing the revenue requirement, such as the Ameren Companies are proposing). From a policy perspective, the allowance of *optional* updating from case to case would encourage utilities to selectively update only in proceedings in which such updates would increase the cost of capital. More generally, Staff does not endorse updating in later rounds of testimony, whether optional or compulsory, because the period allotted for responsive testimony typically does not provide the time needed to verify the accuracy of the updates and evaluate the impact of those updates on capital structure balances and the embedded costs of debt and preferred stock. (*Id*.) The period allotted for responsive testimony is simply not the proper time to change a primary case. The Companies did not provide sufficient justification for altering their primary case during a responsive phase of the proceeding. (O'Bryan Reb., Respondents' Exhibit 15.1, pp. (page numbers omitted from exhibit)) The Companies' rationale that more recent rates are more reflective of current market rates is true at every phase of the proceeding. Obviously, to update at every phase of the proceeding is impractical. Nevertheless, if updates proposed simply for the sake of updating are allowed, the sponsor should update **all** of the components of the cost of capital. Such an update ensures that the components of the cost of capital are measure consistently in order to avoid selective component updates that may distort the cost of capital. Since the Ameren Companies did not update all of the components (i.e., failing to update the common equity), Staff cannot ensure that the cost of capital is not distorted, and is realistic. (*Id*.)

Thus, the Commission should reject the Ameren Companies' proposal to use the interest rates, as of May 19, 2006, for short-term debt and variable rate bonds. Rather, the Commission should adopt Staff's proposal to measure the interest rate for the Companies' variable rate pollution control bonds on April 4, 2006. (Pregozen Corr. Reb., ICC Staff Ex 16.0, pp. 10-11) The reason for adopting this measurement date is that it coincides with the measurement date for the cost of short-term debt and Ms. Freetly's estimate of the Ameren Companies' cost of common equity. (*Id*., p. 11) Staff has fully evaluated the impacts on the embedded cost of debt and made the necessary changes for each Ameren Company. The Commission should adopt an April 4, 2006 measurement date for the interest rate for each of the Companies' variable rate pollution control bonds.

D. Cost of Illinois Power TFTNs

The annualized cost of AmerenIP's TFTNs[11] should be calculated by multiplying the monthly discount rate for the TFTNs by twelve, as Staff proposes, and not by the method proposed by the Ameren Companies. The Ameren Companies propose a methodology for calculating a TFTN coupon rate that reflects monthly compounding (O'Bryan Reb., Respondents' Exhibit 15.1, p. (page numbers omitted from exhibit)), which improperly inflates the TFTN coupon rate. (*See*, Pregozen Dir., ICC Staff Exhibit 5.0, p. 28, for example describing AmerenIP's calculation methodology)

[11] AmerenIP's capital structure includes Transitional Funding Trust Notes ("TFTNs"), which are debt instruments securitized with intangible transition property. Those debt instruments give the holder the right to collect instrument funding charges from AmerenIP's retail customers. (Pregozen Dir., ICC Staff Exhibit 5.0, p. 26)

The Companies methodology for calculating the TFTN coupon rate is incorrect because the costs of TFTNs are embedded. Staff witness Pregozen explained that an embedded cost is a cost that is calculated from the utility's perspective, not that of the investor. (*Id*., p. 27) Embedded costs are calculated on an annual basis by multiplying the periodic rate by the number of periods in a year. For example, bonds that pay interest semi-annually will have an annual coupon interest rate that is 2 times the semi-annual coupon interest rate. (*See*, *id*., p. 28, for another example describing Staff's calculation methodology) Since AmerenIP presented its TFTN cash flows in monthly terms in AmerenIP Exhibit 5.4, Staff multiplied the implied monthly rate by 12 to get the annual rate.

The Companies contend that TFTNs are not like traditional fixed income securities, noting that funds are available to AmerenIP longer for traditional debt due to the contrast between the daily remittance of payments for TFTNs and the quarterly remittance for traditional debt. (O'Bryan Reb., Respondents' Exhibit 15.1, pp. (page numbers omitted from exhibit); O'Bryan Sur., Respondents' Exhibit 35.0, p. 8) Therefore, the Companies conclude that TFTNs should be treated differently than traditional fixed income securities when calculating their cost. The Companies' logic is flawed. Although TFTNs differ from traditional fixed income securities in certain respects, they are precisely like traditional fixed income securities in one important respect: both reflect embedded costs. In fact, AmerenIP Exhibit 5.4 acknowledges that the costs of TFTNs are embedded costs, bearing the title "Embedded Cost of Transition Funding Trust Notes." While the payment remittance for TFTNs is more frequent than that for traditional debt, that merely demonstrates that the lead related to traditional fixed income securities payments is longer than that for TFTNs. Such leads should be accounted for with a working capital adjustment, not a cost of capital adjustment in the form of a compounded interest rate. That is precisely why Staff's working capital allowance included a 91.5-day lead for conventional debt and a 2 day lead for TFTNs. (Staff IB, Appendix A, Schedule 9 (IPC), page 1, lines 9 and 10)

Thus, the Companies' methodology for calculating the TFTN coupon rate is incorrect and should be rejected. In contrast, Staff's proposal properly calculates the coupon rate for TFTNs and should be adopted.

E. Cost of Equity

Staff presents the Cost of Equity in four parts. The first part presents Staff's case-in-chief; summarizing Staff's methodologies and findings in developing its recommended rate of return on common equity. The second part briefly summarizes each parties approach to developing its proposal for a rate of return on common equity. That summary provides context for the more detailed discussions presented in the third part – Cost of Equity Issues. In that third part, Staff addresses the arguments put forward in this proceeding through seven sub-parts, which reflect the primary issues addressed in testimony. Finally, the fourth part presents Staff's recommended rate of return on common equity.

1. Staff's Analysis of Cost of Equity

Staff witness Janis Freetly estimated the investor-required rate of return on common equity to be 9.99% for AmerenCILCO, 9.85% for AmerenCIPS and 9.96% for AmerenIP. (Freetly Reb., ICC Staff Exhibit 15.0, pp. 3-7) Ms. Freetly measured the investor-required rate of return on common equity with the discounted cash flow ("DCF") and Capital Asset Pricing Model ("CAPM") analyses. She applied those models to a sample of utility companies with similar business and financial risk levels to that of the Ameren Companies. Her utility sample consists of domestic publicly traded electric utilities and gas distribution companies listed within Standard & Poor's ("S&P") Utility Compustat that are assigned an S&P business profile score of three, four or five and an S&P credit rating of BBB or higher; have a long-term growth rate from Zacks Investment Research ("Zacks"); and have neither pending or recently completed significant mergers, acquisitions, or divestures. (Freetly Corr. Dir., ICC Staff Exhibit 4.0 Corrected, pp. 2-5)

a. DCF Analysis

DCF analysis assumes that the market value of common stock equals the present value of the expected stream of future dividend payments to the holders of that stock. Since a DCF model incorporates time-sensitive valuation factors, it must correctly reflect the timing of the dividend payments that a stock price embodies. The companies in Ms. Freetly's utility sample pay dividends quarterly. Therefore, Ms. Freetly applied a constant-growth quarterly DCF model. (*Id.*, p. 5)

DCF methodology requires a growth rate that reflects the expectations of investors. Staff witness Freetly measured the market-consensus expected growth rates with projections published by Zacks. The growth rate estimates were combined with the closing stock prices and dividend data as of April 4, 2006. Based on this growth, stock price, and dividend data, Ms. Freetly's DCF estimate of the cost of common equity was 9.11% for the utility sample. (*Id.*, pp. 7-9)

b. Risk Premium Analysis

According to financial theory, the required rate of return for a given security equals the risk-free rate of return plus a risk premium associated with that security. The risk premium methodology is consistent with the theory that investors are risk-averse and that, in equilibrium, two securities with equal quantities of risk have equal required rates of return. Staff witness Freetly used a one-factor risk premium model, the Capital Asset Pricing Model ("CAPM"), to estimate the cost of common equity. In the CAPM, the risk factor is market risk, which cannot be eliminated through portfolio diversification. (*Id.*, pp. 10-11)

The CAPM requires the estimation of three parameters: beta, the risk-free rate, and the required rate of return on the market. For the beta parameter, Ms. Freetly combined betas from Value Line and a regression analysis. The average Value Line beta estimate was 0.83, while the regression beta estimate was 0.68. (*Id.*, pp. 16-19) For the risk-free rate parameter, Ms. Freetly considered the 4.76% yield on four-week U.S. Treasury bills and the 4.97% yield on thirty-year U.S. Treasury bonds. Both estimates were measured as of April 4, 2006. Forecasts of long-term inflation and the real risk-free rate imply that the long-term risk-free rate is between 5.4% and 5.8%. Thus, Ms. Freetly concluded that the U.S. T-bond yield is currently the superior proxy for the long-term risk-free rate. (*Id.*, pp. 14-15) Finally, for the expected rate of return on the market parameter, Ms. Freetly conducted a DCF analysis on the firms composing the S&P 500 Index. That analysis estimated that the expected rate of return on the market was 13.42% for the first quarter of 2006. (Freetly Reb., ICC Staff Exhibit 15.0, pp. 1-2) Inputting those three parameters into the CAPM, Ms. Freetly calculated a cost of common equity estimate of 11.39% for the utility sample. (*Id.*, p. 2)

c. Recommendation

Based on her DCF and risk premium analyses, Staff witness Freetly estimated that the cost of common equity for the utility sample is 10.25%. To determine the suitability of that cost of equity estimate for AmerenCILCO, AmerenCIPS and AmerenIP, Ms. Freetly assessed the risk level of her utility sample relative to that of each of the Ameren Companies. The S&P credit rating and business profile score for the utility sample average A- and 4, respectively. (Freetly Corr. Dir., ICC Staff Exhibit 4.0 Corrected, Schedule 4.01) To estimate the risk of the Ameren Companies going forward, Ms. Freetly compared the financial strength implicit in the revenue requirement Staff recommends for each company to utility benchmarks. (Freetly Reb., ICC Staff Exhibit 15.0, pp. 3-6)

S&P categorizes debt securities on the basis of the risk that a company will default on its interest and principal payment obligations. The resulting credit rating reflects both the operating and financial risks of a utility. Although no formula exists for determining a credit rating, S&P publishes utility benchmark values, by business profile score, for the financial ratios it uses to determine credit ratings. Therefore, Ms. Freetly compared the values for the benchmark financial ratios that result from Staff's proposed revenue requirement to S&P's benchmarks for utilities with a business profile score of 4. The funds from operations ("FFO") interest coverage ratio and FFO to total debt ratio benchmark values for utilities with a business profile score of 4 as well as those same ratios resulting from Staff's proposed revenue requirements are presented below in Table 1 – Benchmark Ratios. (Freetly Reb., ICC Staff Exhibit 15.0, pp. 3-5)

Table 1 – Benchmark Ratios

	AA	A	BBB	Implied Credit Rating
Financial Guideline Ratios				
FFO/IC	4.2-5X	3.5-4.2X	2.5-3.5X	
FFO/Debt	28-35%	20-28%	12-20%	
Staff Proposal – AmerenCILCO				AA-
FFOIC	5.1X			
FFO/Debt		25.6%		
Staff Proposal – AmerenCIPS				AA
FFOIC	5.8X			
FFO/Debt	29.6%			
Staff Proposal – AmerenIP				A+
FFOIC	4.7X			
FFO/Debt		24.2%		

The Ameren Companies' financial ratios indicate greater financial strength than that implied in the utility sample's A- average credit rating, which in turn indicates that the Ameren Companies' electric delivery service operations are less risky than the sample. Since investors require lower returns to accept lower exposure to risk, Ms. Freetly concluded that downward adjustments to the cost of common equity of her utility sample are required given the difference between the implied forward-looking credit ratings for the Ameren Companies and the A- average credit rating for the utility sample. Thus, Ms. Freetly adjusted the 10.25% utility sample's investor-required rate of return downward to 9.95% for the 30 basis point spread between A- rated and AA- rated 30-year utility debt yields for AmerenCILCO, to 9.85% for the 40 basis point spread between A- rated and AA rated 30-year utility debt yields for AmerenCIPS, and to 9.96% for the 29 basis point spread between A- rated and A+ rated 30-year utility debt yields for AmerenIP. (Freetly Corr. Dir., ICC Staff Exhibit 4.0 Corrected, pp. 24-26 and Schedule 4.07; Freetly Reb., ICC Staff Exhibit 15.0, pp.5-7)

Finally, Ms. Freetly adjusted the investor-required rate of return for AmerenCILCO for flotation costs. This adjustment increases AmerenCILCO's cost of common equity from 9.95% to 9.99%. The common equity issuance cost adjustment is calculated using the following formula:

$$\textit{Issuance Cost Adjustment} = \frac{\textit{ROE} \times \textit{Unrecovered Issuance Costs}}{\textit{Common Equity Balance}}$$

where $ROE \equiv$ the investor-required rate of return on common equity.

AmerenCILCO's Schedule D-5 lists $2,273,429 in common equity issuance costs that have not been recovered. Using AmerenCILCO's June 30, 2005 balance of common equity of $534,220,626 and an investor-required rate of return of 9.95%, the common equity issuance cost adjustment equals 0.04%. (Freetly Corr. Dir., ICC Staff Exhibit 4.0 Corrected, pp. 26-28; ICC Staff Exhibit 15.0, p. 4)

2. Summary of Parties Analysis of Cost of Equity

a. Ameren Companies' Analysis

Ameren witness Kathleen C. McShane recommended an 11.0% rate of return on common equity for each of the Ameren Companies. Ms. McShane utilized both the DCF and risk premium analyses. She applied the DCF analyses to a sample of 12 local gas distribution companies ("LDCs"). (McShane Dir., AmerenCILCO Exhibit 3.0, pp. 13-15; AmerenCIPS Exhibit 3.0, pp. 13-15; AmerenIP Exhibit 3.0, pp. 13-15)

For the DCF, she utilized both the constant growth model and the two-stage model. For the equity risk premium test, Ms. McShane used the CAPM and two direct estimates of utility equity risk premiums, one based on historic achieved equity risk premiums for LDCs and the other based on forward-looking equity risk premium estimates for LDCs. (*Id*., p. 34) She also used the comparable earnings analysis as a test of the reasonableness of the DCF and equity risk premium results.

Ms. McShane proposed several adjustments to the cost of equity estimates[12] that she used: a minimum adjustment for financing flexibility, another adjustment to account for the difference between market and book value of equity, and a third adjustment to reflect the replacement cost/book value ratio. (*Id*., pp. 25-33)

b. IIEC's Analysis

IIEC witness Michael Gorman recommended a 10.0% return on equity for each of the Ameren Companies. (Gorman Dir., IIEC Exhibit 3.0, p. 30) Mr. Gorman measured the investor-required rate of return on common equity for the Ameren Companies with a constant growth DCF model, a bond yield plus equity risk premium model, and a CAPM. He applied those models to an electric utility proxy group and Ameren witness McShane's LDC proxy group. (*Id*., pp. 16-17)

c. CUB's Analysis

CUB witness Edward C. Bodmer recommended an 8.00% cost of common equity. (Bodmer Corr. Dir., CUB Exhibit 1.0 Corr., p. 6) Mr. Bodmer derived his

[12] Resulting from the DCF and risk premium models.

estimate using the DCF, CAPM and price to earnings ratio analyses and verified the results using a market to book analysis. He applied those models to Ms. McShane's LDC sample and a sample of "wires-only" electricity distribution companies. (*Id.*, p. 30) Mr. Bodmer also presented a cost of common equity that he derived from a valuation study Morgan Stanley performed for the Exelon and PSE&G merger. (*Id.*, pp. 84-86)

d. Cities' Analysis

Richard W. Cuthbert recommended a 9.46% rate of return on common equity for AmerenIP on behalf of the Cities of Champaign, Urbana, Bloomington and Normal, Illinois. Mr. Cuthbert employed DCF and equity risk premium analyses. For the DCF approach, he utilized both constant growth and two-stage growth analyses. For the equity risk premium approach, he used both an interest rate risk premium analysis and a CAPM analysis. He completed all of those analyses for Ameren and a proxy group of comparable electric utility companies. His recommended return on equity was based on the results for Ameren and he gave more weight to the DCF results. (Cuthbert Dir., Cities Exhibit 1.0)

3. Cost of Equity Issues

Throughout the proceeding the arguments presented by the parties on the cost of equity related primarily to six issues: (a) risk adjustment, (b) growth rates, (c) beta, (d) market to book ratios, (e) equity risk premiums and (f) comparable earnings. In addition, CUB raised a few issues that Staff is addressing separately in section (g).

a. Risk Adjustment: Staff's Downward Adjustment to its Sample's Average Cost of Equity Reflects the Lower Risk of Ameren Companies

The Ameren Companies argued that the downward adjustments to the cost of common equity of the Staff utility sample that Staff witness Freetly made for each of the Ameren Companies are not justified. (McShane Reb., AmerenCILCO Exhibit 3.0, pp. 6-7; AmerenCIPS Exhibit 3.0, pp. 6-7; AmerenIP Exhibit 3.0, pp. 6-7; McShane Sur., Respondents' Exhibit 33.0, pp. 5-6) Ms. McShane is wrong; financial theory rests upon the foundation that investors require higher returns to accept greater exposure to risk. (Freetly Reb., ICC Staff Exhibit 15.0, p.12) Conversely, the investor required rate of return is lower for investments with less exposure to risk. Estimation of the cost of equity is not a precise mathematical calculation; any estimate includes error. Because of the measurement error inherent in estimating the cost of equity, the analyst's judgment must be applied to adjust for any known bias. Ms. Freetly minimized measurement error through use of a sample and adjusted the results of that sample to reflect the lower risk of the Ameren Companies in comparison to her sample.

Ms. McShane pointed out that the mean and median DCF costs for all of the utilities in the various samples rated in the BBB category (9.5% and 8.7%, respectively) were lower than the mean and median DCF costs for all of the utilities rated in the A category (9.7% and 9.1%, respectively). (McShane Sur., Respondent's Exhibit 33.0, pp. 5-6) This outcome is the opposite of that which financial theory predicts. Ms. Freetly's downward adjustments were not made to her DCF cost of equity estimates alone. Rather, Ms. Freetly adjusted the average of the DCF and risk premium estimates of her utility sample's cost of common equity. Staff used the results of both methodologies due to the measurement error inherent in estimating the cost of equity.

Ms. McShane identified a financial anomaly in the DCF estimates only. In contrast, no such anomaly is found in the CAPM estimates. The mean and median betas for all of the utilities rated in the BBB category were 0.87 and 0.85, respectively, while the mean and median betas for all of the utilities rated in the A category were 0.81 and 0.80, respectively. (ICC Staff Cross Exhibit 1) When those mean betas are combined with Ms. Freetly's estimates of the 13.42% required rate of return on the market and 4.97% risk-free rate, the CAPM estimates the cost of equity is 12.29% for all of the utilities rated in the BBB category and 11.81% for all of the utilities rated in the A category.[13] The return on equity is higher for the companies with lower credit ratings. The average of the DCF-derived results Ms. McShane presented and the CAPM results presented here is also higher for the riskier, lower rated, companies (10.91% for the BBB utilities and 10.74% for the A utilities). Hence, when both methodologies are taken into account, the basis of financial theory, that investors require higher returns to accept greater risk, is confirmed.

In response to Staff's use of S&P credit ratings, Ameren witness Nickloy testified that it is not appropriate to use S&P's published financial ratio guidelines as the basis for the reasonableness of a recommendation for a given cost of equity. (Nickloy Reb., Respondents' Exhibit 14.0, pp. 3-5) However, the Ameren Companies misunderstood Staff's application of the S&P benchmark ratios. In fact, Staff used the S&P benchmark ratios in a manner consistent with Mr. Nickloy's use of those benchmark ratios in Docket No. 06-0179, AmerenIP's application for a certificate of public convenience and

[13] Since regression betas are not available for all the utilities the cost of equity witness' used in their analyses, the CAPM analysis necessarily relies on Value Line betas only. Staff does not endorse allowing the Companies to earn the higher cost of equity estimates that result. Staff addresses the beta issue below.

necessity to construct a transmission line. (Tr., pp. 264-274) Mr. Nickloy concluded that there could be negative pressure on AmerenIP's credit ratings based solely on how financing the transmission line would affect the funds from operations ("FFO") interest coverage ratio and FFO to total debt ratio (ICC Staff Cross Exhibit 2). Yet, in this rate proceeding, Mr. Nickloy argued that those same two FFO ratios should not be used to assess the projected financial condition of the Ameren Companies. As Mr. Nickloy's own analysis in Docket No. 06-0179 confirms, the S&P FFO ratios provide a good indication of the relative riskiness of the Ameren Companies under varying scenarios. (Tr., pp. 264-274)

S&P uses the benchmark ratios as part of its evaluation of the credit quality of utilities. Although credit ratio analysis is an important part of S&P's rating process, these benchmark ratios are not the only critical financial measures that S&P uses in its analytical process. S&P also analyzes a wide array of financial ratios that do not have published guidelines. Consequently, Ms. Freetly does not use the benchmark ratios to predict credit ratings. Rather, she uses the benchmark ratios as a measure of the financial strength the Ameren Companies could possibly attain given their level of business risk and the impact of Staff's proposed revenue requirement and capital components and costs in this proceeding. The Commission should not ignore the level of financial strength implied by the benchmark ratios in comparing the riskiness of the Ameren Companies versus the proxy sample. The FFO interest coverage ratios and FFO to total debt ratios for each of the Ameren Companies indicate that Staff's proposed rates are sufficient to support financial strength that is commensurate with a credit rating of AA- for AmerenCILCO, AA for AmerenCIPS and A+ for AmerenIP. Since these implied forward-looking credit ratings are higher than the average A- credit rating of Ms. Freetly's sample, a downward adjustment is necessary to reflect the basic tenet of financial theory -- the investor-required rate of return is lower for investments with less exposure to risk. (Freetly Reb., ICC Staff Exhibit 15.0, pp. 12-13)

At hearing, the Ameren Companies presented Ameren Cross Exhibit Freetly 1, which explains that Moody's downgraded ratings of AmerenCIPS and AmerenCILCO on July 26, 2006. The downgrade reflects the difficult political and regulatory environment for electric utilities in the state of Illinois. (Ameren Cross Exhibit Freetly 1) Staff witness Freetly accounted for regulatory uncertainty by using the S&P business profile score of 4 as a measure of the Companies' business risk.[14] S&P reports for AmerenCILCO, AmerenCIPS and AmerenIP explicitly state that post-2006 regulatory uncertainties are reflected in the business profile scores. Ms. Freetly's analysis of the implied financial strength of the Ameren Companies going forward is not an attempt to predict the credit ratings. Ms. Freetly simply calculated the financial ratios using Staff's proposed capital components and costs and the revenue requirement for each Ameren Company. She then translated the ratios into implied ratings for the delivery service operations of the Ameren Companies in order to have comparable metrics for assessing the relative riskiness of each of the Ameren Companies to the sample.

[14] An S&P business profile score reflects S&P's assessment of a company's business risk, on a scale of one to ten, with a rating of one denoting below average business risk and a rating of ten denoting above average business risk.

b. Growth Rates: Staff's Use of Analyst Growth Rates Reflects Investors Expectations

The growth rate used in the DCF model should be an estimate of the market's forecast that is embedded in the current share price. Analyst growth rates, such as the Zacks growth rates used by Staff witness Freetly in her DCF analysis, provide a realistic and representative growth proxy for what investors expect. Regardless of whether investors accurately predict the future, the market efficiently reflects investors' expectations in the price they are willing to pay for the stock. Therefore, even if investors are irrationally exuberant (or downcast), the growth proxies used in DCF model should reflect that outlook. (Freetly, Reb., ICC Staff Exhibit 15.0, pp. 7-9)

Three other parties addressed growth rates – Ameren Companies, CUB and the Cities. The Ameren Companies proposal should be rejected because their growth rates are not appropriate estimates of the long-term growth in dividends per share expected by investors, and are based on unsupported assumptions. Moreover, the Commission has recently rejected the use of GDP growth rates as an estimate of long-term growth of a company. (Order, Docket No. 05-0597, p. 154 (July 26, 2006)) CUB's proposal should be rejected because their witness relies upon studies that have generalized findings and contain data contradicting his findings. Finally, the Cities' proposal to use sustainable growth rates should be rejected because they are more prone to estimation error than the analyst growth rates used by Staff.

In applying her constant growth DCF model, Ameren Companies' witness McShane relied on four different estimates of growth, including the consensus forecasts of long-term earnings growth compiled by IBES, the Value Line forecasts of both earnings and cash flow per share growth, as well as estimates of sustainable growth derived from Value Line forecasts. In applying her two-stage DCF model, she relied on the IBES consensus forecasts as the estimate of investor growth expectations during Stage 1 and the consensus forecast for long-term growth in the economy for Stage 2. (McShane Dir., AmerenCILCO Exhibit 3.0, p. 20; AmerenCIPS Exhibit 3.0, p. 20; AmerenIP Exhibit 3.0, p. 20)

The Value Line earnings and cash flow per share growth rates that Ms. McShane used in her constant growth DCF analysis are not appropriate estimates of the long-term growth in dividends per share expected by investors. In the long run, earnings and dividends per share growth will equal because all earnings will ultimately be paid out in dividends. If a company's earnings retention ratio is relatively constant, growth in earnings per share will accurately estimate growth in dividends per share. However, if the retention ratio is expected to increase during the measurement period, growth in earnings per share will overstate the expected growth in dividends per share. Ms. McShane's Value Line reports forecast an increasing retention ratio for her sample companies, which indicates that growth in earnings per share will be higher than growth in dividends per share as the companies sacrifice dividend growth in the short-run for the prospect of higher dividend growth in the long-run. The Value Line data confirms this: the forecast of growth in dividends for her LDC sample for the period through 2008-2010 averages only 2.3%, while the corresponding forecast of growth in earnings for her LDC sample for the same period averages 6.2%. Of course the growth in earnings per share resulting from an increasing earnings retention ratio is not sustainable since the retention ratio cannot increase beyond 100%. Since the Value Line growth rates of both earnings per share and cash flow per share reflect Value Line's forecast of increasing retention rates, they are upwardly biased estimators of long-term growth in dividends per share. (Freetly Corr. Dir., ICC Staff Exhibit 4.0 Corrected, pp. 29-30)

In addition, the two-stage DCF model employed by the Ameren Companies is based on unsupported assumptions. The GDP growth rate that Ms. McShane used as the Stage 2 growth rate in her two-stage DCF analysis over-estimates the long-term growth in dividends per share that investors expect from utility companies. Use of forecasted GDP growth as a proxy for the investor expected growth in dividends per share implies that the gas utilities that compose Ms. McShane's LDC sample are expected to grow at the overall rate of growth for the economy. (Freetly Corr. Dir., ICC Staff Exhibit 4.0 Corrected, pp. 30-31) Ms. McShane failed to demonstrate that her assumption is reasonable. Indeed, evidence from her own analysis indicates that it is not a reasonable assumption. (Id., pp. 31-32)

The Value Line forecasts of the earnings retention rates for Ms. McShane's sample companies indicate that the expected GDP growth of 5.5% is not a reasonable estimate of the sustainable growth of the individual companies in her sample. The use of a GDP growth rate may be a reasonable long-term growth proxy for an average growth company. However, an individual company's growth rate can be less than that of the overall economy over an infinite horizon. Indeed, the data Ms. McShane relied upon suggests that, relative to the overall market, the utility companies composing her sample are, in fact, below average growth companies. Specifically, relative to the overall market, the retention rate for utility companies is typically well below average, as evidenced by the Value Line forecasts of the retention rate for the companies in Ms.

McShane's sample in comparison to the retention rate for the S&P 500. (Freetly Corr. Dir., ICC Staff Exhibit 4.0 Corrected, p. 31)

Further, one would expect utilities overall to earn below average returns due to the below average risk reflected in their below average betas (*i.e.*, betas less than one), such as the 0.78 average beta Ms. McShane adopted for her LDC Sample. Since sustainable growth is the product of the return and the retention rate, and utilities are below average in both factors, one would expect utilities to have below average growth rates relative to the overall economy as measured by GDP. Correspondingly, if one assumes that both Ms. McShane's 11.0% final cost of equity recommendation and the Value Line retention rate forecasts she relied on are fairly reasonable estimates, then the sustainable growth rate for the companies in her LDC Sample would average approximately 4.64%. The 4.64% estimate is much more comparable to the sample average for the IBES company-specific growth rate of 4.5% than to the GDP growth rate of 5.5%. Yet, Ms. McShane's use of the economy-wide GDP growth rate implicitly assumes that the companies in her sample are average growth companies. Thus, her use of a GDP growth rate overstates the growth rate for the utility companies in her samples. (Freetly Corr. Dir., ICC Staff Exhibit 4.0 Corrected, pp. 30-32; Freetly Reb., ICC Staff Exhibit 15.0, p.8)

In addition, the Commission has recently rejected the use of GDP growth rates as an estimate of long-term growth of a company. The Order in Docket No. 05-0597, the proceeding to set rates for the delivery service operations of Commonwealth Edison Company, the Commission rejected ComEd's use of GDP growth and stated that "use of GDP growth rates to estimate long-term growth leads to an improper and overstated estimate of the cost of capital."[15]

Ms. McShane claimed that the Zacks' growth rates that Ms. Freetly used in her DCF analysis are relatively low in comparison to the average rate of growth forecast by analysts for a sample of relatively low risk utilities since 1993. (McShane Reb., Respondent's Exhibit 13.0, pp. 2-4 and Schedule 2) For Ms. McShane's argument to carry any weight, one would have to assume that the forecasted growth rates for her sample of relatively low risk utilities from 1993 through 2004 are correct. Staff witness Freetly explained that reliance only on past growth rates may be misleading, since they might reflect changes in the fundamental variables that investors do not expect to continue in the future, or fail to capture changes that investors do expect. (Freetly, Reb., ICC Staff Exhibit 15.0, pp. 7-8) Staff recommends the use of analyst growth forecasts, such as the Zacks' growth rates Ms. Freetly relied upon, since they encompass both history and current and expected conditions. This is supported by published empirical studies that demonstrate that analyst's growth forecasts (e.g., Zacks' growth rates) represent an appropriate source of DCF growth rates, are reasonable indicators of investor expectations and are more accurate than forecasts based on historical growth. (*Id.*)

CUB witness Bodmer cited to some research that indicates that analyst growth rates are upwardly biased. (Bodmer Corr. Dir., CUB Exhibit 1.0 Corr., pp. 18-19, 30-32 and 44) Utility growth rates do not appear to be upwardly biased estimators of achieved growth five years ex-post because the studies Mr. Bodmer relies upon have generalized

[15] Order, Docket No. 05-0597, July 26, 2006, p. 154.

findings and even contain data contradicting Mr. Bodmer's findings. The studies Mr. Bodmer cited report generalized findings and do not suggest that analyst estimates of utility growth are overstated relative to achieved growth. Indeed, one of the studies he cited indicates that analyst growth rate estimates for utilities are not overstated. The authors of that study sorted by growth rate all domestic firms with available IBES long-term growth rate estimates, forming value-weighted portfolios in each quintile after each year, and found that the growth rates for portfolios of companies falling in the highest quintiles (*i.e.*, having the highest growth rates) tend to be overstated relative to the growth achieved over the five years post ranking. However, that study also indicates that the growth rates for portfolios of companies falling in the lowest quintile -- which includes utilities -- shows no such tendency. Thus, utility growth rates do not appear to be upwardly biased estimators of achieved growth five years ex post. (Freetly Reb., ICC Staff Exhibit 15.0, pp. 13-14)

The Cities' witness, Mr. Cuthbert, used a sustainable growth rate in his constant growth DCF and for the short-term growth rate in his non-constant growth DCF model. (Cuthbert Dir., Cities Exhibit 1.0, pp. 23-25) Mr. Cuthbert's position should be rejected because the sustainable growth rate he uses ("BR+SV") is problematic, and the non-constant growth DCF model he uses is the same as the constant growth DCF model with a different growth rate input. The BR+SV growth estimate introduces circularity in to the estimate of return on common equity "R". The formula requires an estimate for "R" in order to estimate a growth rate. The resulting growth rate is then used in a calculation to estimate the return on common equity "R". The BR+SV method of estimating growth also suffers from the need to estimate four variables (B, R, S and V), which increases the sources of estimation error four-fold compared to the single source of estimation error when growth is estimated directly. Empirical research has shown that the sustainable growth method of determining growth is not as highly correlated to measures of value as are analyst's growth rates. (Freetly, Reb., ICC Staff Exhibit 15.0, pp. 22-23)

Cuthbert's two-stage DCF analysis is actually an additional constant growth DCF. In the two-stage DCF model, the short-term growth rate is applied to the first five years and the long-term growth rate is applied into perpetuity. Mr. Cuthbert simply applied the average of his short-term and long-term growth rate estimates to his low and high dividend yields. Hence, his two-step analysis actually employs the same constant growth DCF model described previously with a different growth rate input.

c. Beta: Staff's Methodology for Calculating Beta is Superior to the Methodologies of Other Parties and was Accepted by the Commission in Previous Dockets

The Ameren Companies and CUB challenge Staff witness Freetly's beta. Their arguments should be rejected and Staff's beta accepted. (Freetly Corr. Dir, ICC Staff Exhibit 4.0 Corr., pp. 16-20) The methodology that Staff witness Freetly used to calculate the regression betas for her sample has been approved by the Commission in previous dockets.[16] The Ameren Companies identify one case in which Staff used a different methodology, specifically Docket No. 00-0802, but that case is distinguishable from the instant case. CUB argues that betas should not be adjusted to a market mean

[16] Order, Docket No. 02-0837, pp. 37-38 (October 17, 2003); Order, Docket Nos. 02-0798/03-0008/03-0009 Cons., p. 85 (October 22, 2003); Order, Docket No. 00-0340, p. 25 (February 15, 2001); and Order, Docket No. 03-0403, p. 42 (April 13, 2004).

of 1.0, however, this has no weight given that independent studies indicate that adjusted betas provide better forecasts.

Ameren Companies' witness McShane argued that Staff witness Freetly's regression beta should be disregarded because it is significantly lower than the betas calculated by Value Line. (McShane Reb., Respondents' Exhibit 13.0, pp. 5-6) The Value Line methodology is not inherently superior to Staff's methodology. The methodology that Staff witness Freetly used to calculate the regression betas for her sample has consistently been approved by the Commission in previous cases[17] and employs the same monthly frequency of stock price data as Merrill Lynch and is widely accepted. As would be expected, different beta estimation methodologies can produce different betas. In the past, Staff had little need to include Value Line beta estimates in its analyses because the Staff regression and Value Line methodologies produced very similar results. However, the difference that currently exists between the Value Line results and Staff's regression analysis results led Staff witness Freetly to include the Value Line beta with the regression beta Staff regularly uses. (Freetly Reb., ICC Staff Exhibit 15.0, pp. 10-11)

Ameren Companies' witness McShane cited Docket No. 00-0802 as an instance in which Staff relied exclusively on Value Line betas for its CAPM analysis. (McShane Reb., Respondents' Exhibit 13.0, p. 5) That case, however, is distinguishable from the instant matter. In Docket No. 00-0802, Staff relied solely upon the Value Line betas because of the impact some outlying observations had on the regression betas. In that docket, the time period used to estimate beta was March of 1996 through February of

[17] *Id.*

2001. In this docket, the time period used to estimate beta is March of 2001 through February of 2006. Hence, none of the same data was employed and the problem of outlying observations is not present[18]. (*Id.*, p. 11)

Another distinction between the analysis Staff performed in Docket No. 00-0802 and what was performed in this case, is that Staff utilized the S&P 500 Index as a proxy for the market return in its regression analysis in Docket No. 00-0802. Since the S&P 500 Index continued to produce unreasonably low beta estimates, Staff switched to the New York Stock Exchange Composite Index ("NYSE Index") as a proxy for the market return in its regression analysis. (Freetly Reb., ICC Staff Exhibit 15.0, p. 11)

CUB witness Bodmer claimed that betas should not be adjusted for reversion to a market mean of 1.0. (Bodmer Corr. Dir., CUB Exhibit 1.0 Corr., pp. 56-62) Mr. Bodmer's claim should be given no weight because studies indicate that adjusted betas provide better forecasts. The beta parameter is generally derived from historical data, but, in theory, it should be a forward-looking number. Staff witness Freetly adjusted the raw (*i.e.*, historical) betas for the companies in her sample to estimate forward-looking betas. Ex post empirical tests of the CAPM suggest that the linear relationship between risk, as measured by raw beta, and return is flatter than the CAPM predicts. That is, securities with raw betas less than one tend to realize higher returns than the CAPM predicts. Conversely, securities with raw betas greater than one tend to realize lower returns than the CAPM predicts. Adjusting the raw beta estimate towards the market mean of 1.0 results in a linear relationship between the beta estimate and realized

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[18] This is evident in the large difference between the extremely low 0.05 raw beta estimated for the Staff sample from Docket No. 00-0802 and the more typical 0.52 raw beta Freetly estimated for her sample in this case. (Freetly Reb., ICC Staff Exhibit 15.0, p. 11)

return that more closely conforms to the CAPM prediction. Thus, adjusted betas surpass raw betas as predictors of future returns and are, therefore, superior forward-looking betas. Studies have shown that such adjustments result in appreciably better forecasts, finding that the reduction in both bias and inefficiency is greater the further away from one the beta in question is. (Freetly Reb., ICC Staff Exhibit 15.0, pp. 17-18)

CUB witness Bodmer alleged an article by Gombola and Kahl supports his argument that the benchmark mean beta for utilities should be 0.5 rather than the market mean of 1.0. (Bodmer Corr. Dir., CUB Exhibit 1.0 Corr., p. 59) However, the applicability of the Gombola and Kahl findings to this proceeding is doubtful. First, that study does not explicitly conclude that utilities should be assumed to revert to a mean of 0.5. Rather, it more broadly concludes that the market mean of 1.0 is too high, and the typical adjustment rate of 0.35 is too low. Further, the Gombola and Kahl study is based on a 15-year sample period ending in 1981. Since the mean beta for a given industry has changed over time, the estimate of the industry mean should be updated to coincide with the period of time used to derive the company specific beta. Finally, estimation of the true industry mean beta is problematic. Gombola and Kahl's findings are based on an industry portfolio beta mean. As noted above, the farther below the market mean a raw beta is, the more likely its estimate error is to be negative. Thus, the average of a portfolio of low betas, most of which are likely to be biased downward, will, itself, likely be biased downward. (Freetly, Reb., ICC Staff Exhibit 15.0, pp. 18-19)

d. Market to Book: The Market to Book Adjustments Proposed by Ameren and CUB are Inappropriate

The Ameren Companies' and CUB incorrectly propose adjustments to the cost of equity to account for the difference between the market value and the book value of the

Ameren Companies' common equity. Their proposed adjustments should be rejected. The Ameren Companies' argument is based on a flawed premise. In addition, the Commission rejected this same proposal in their requested increase to natural gas rates in Docket Nos. 02-0798/03-0008/03-0009. Staff's review of CUB's proposal finds that it also suffers from several flaws, which are explained in detail below.

Ameren Companies' witness McShane argued that if the market value of equity differs significantly from the book values, adjusting a cost of equity estimate derived from market values is necessary when that estimate is to be applied to book values of equity to determine utility rates. (McShane Dir., AmerenCILCO Exhibit 3.0, pp. 25-33; AmerenCIPS Exhibit 3.0, pp. 25-33; AmerenIP Exhibit 3.0, pp. 25-33) Market to book adjustments such as Ms. McShane's are based on the flawed argument that a market-derived required rate of return does not produce a "fair" return when applied to a book value rate base if the market to book value ratio differs from one. That argument fatally equates secondary investing (*i.e.*, the purchase of existing shares of stock from other investors) with primary investing (*i.e.*, the purchase of new shares of stock directly from the company or the retention of earnings for reinvestment). The former does not affect the amount of money available to the company to buy assets because the proceeds from the sale go to the previous stockholder, not to the company. Thus, a rise in the price of existing common stock traded in secondary markets does not increase the amount of capital actually serving customers. It only reveals that investors' expectations for the future cash flows of the company have risen or that their required rate of return has fallen. In contrast, primary investment directly contributes capital to the company that is available to buy assets to serve customers. Under original cost ratemaking, ratepayers provide a return only on the amount of capital that is invested in assets that serve ratepayers. Inflating that return to compensate investors for capital not invested in plant and equipment is neither fair nor appropriate; moreover, such an adjustment would render the establishment of original cost rate base a pointless exercise.

As indicated above, the amount of money contributed to a company for the purchase of assets that serve ratepayers is not necessarily equal to the market value of that company's stock. This is because the market value of a company's stock is based on the cash flows expected to be generated by all of its assets discounted by the investor-required rate of return. Utilities frequently have other sources of cash flows in addition to the operating income component of the revenue requirement set by the Commission. For example, many utility companies own non-regulated assets that generate cash flows for investors. Also, investment tax credits, deferred taxes and positive working capital balances contribute to utilities' cash flows. The revenue requirement calculation does not recognize these "other" cash flows and, thus, is not adjusted downward to offset them. Therefore, some utilities may be able to earn more than their ratemaking operating income, which would drive the market values of utilities above their book values. Clearly, the Commission should not further increase allowed rates of return when the benefits that utilities receive from other sources of earnings not recognized by the rate setting process increase stock prices above book value. To do so would compensate utilities twice for the same sources of cash flow.

Finally, allowing upward adjustments to the allowed rate of return based on a market to book value ratio greater than one, when taken to its logical conclusion, would require the Commission to continually make upward adjustments to the allowed rate of return, since such an upward adjustment would tend to again increase the market to book value ratio, thereby warranting another increase, resulting in a never ending upward movement in the allowed rate of return. To establish utility rates, regulators apply a market-based rate of return to a book value rate base. If that process provided a return that did not meet investor requirements, market prices would fall towards book value. Yet, the market prices of utility stocks continue to exceed book value. The market to book adjustment argument has consistently been rejected by the Commission, including in Docket Nos. 97-0351, 99-0121 and 03-0403.[19] (Freetly Corr. Dir., ICC Staff Exhibit 4.0 Corrected, pp. 32-37)

Ms. McShane argued that "the competitive model indicates that equity market values tend to gravitate toward the replacement cost of the underlying assets," (McShane Dir., AmerenCILCO Exhibit 3.0, AmerenCIPS Exhibit 3.0, p. 30; AmerenIP Exhibit 3.0, p. 31) and that "absent inflation and technological change, the market value and replacement cost of firms operating in a competitive environment would tend to equal their book value or cost." (McShane Dir., AmerenCILCO Exhibit 3.0, AmerenCIPS Exhibit 3.0, p. 31; AmerenIP Exhibit 3.0, p. 32) The implication is that absent inflation, replacement costs would equal book values. Therefore, Ms. McShane concludes that in order for the DCF model to produce a return compatible with the premise that regulation is a surrogate for competition, the DCF cost must be adjusted to reflect the replacement/book value ratio, which should correspond to the long-run equilibrium market/book ratio. (McShane Dir., AmerenCILCO Exhibit 3.0, AmerenCIPS

[19] Amended Order, Docket No. 97-0351, p. 42 (June 17, 1998); Order, Docket No. 99-0121, p. 68 (August 25, 1999); Order, Docket No. 03-0403, p. 42 (April 13, 2004).

Exhibit 3.0, pp. 30-31; AmerenIP Exhibit 3.0, pp. 31-32) That is, one must make a market to book ratio adjustment to the DCF cost in order to compensate for inflation. However, that argument is incorrect because inflation is already compensated through an inflation premium included in investor-required rates of return. In requesting a replacement cost adjustment, Ms. McShane is effectively requesting compensation for inflation on top of the inflation-adjusted return the investors are already receiving. Moreover, nothing in financial theory suggests that stock prices are based on replacement costs. Market values do not equal the cost of replacing current assets, they equal the present value of expected future cash flows generated by current assets and anticipated new investment. (Freetly Corr. Dir., ICC Staff Exhibit 4.0 Corrected, p. 38)

Ms. McShane made the same adjustment to her market-derived cost of equity estimates in Docket Nos. 02-0798/03-0008/03-0009 Consolidated. The Commission Order rejected her proposed market-to book adjustment stating

> the Commission has a long history of applying its estimated market required rate of return on common equity to its book value, net original cost rate base for Illinois jurisdictional utilities…. There is no evidence that this practice has ever served as an impediment to a utility's ability to raise capital or maintain its financial integrity.

(Order, Docket Nos. 02-0798/03-0008/03-0009 (cons.), p. 87 (October 22, 2003)) That Order further states,

> In the Commission's view, there is no reason for adjusting the authorized return on common equity because the market value of a utility's assets is different than the replacement cost of those assets. As with the market-to-book adjustment, this concept is inconsistent with the regulatory practice of establishing a net original cost rate base and providing common equity investors the opportunity to earn the market required rate of return on the proportion of net original cost rate base financed by common equity

> investors. Neither the market value nor the replacement value of a utility's assets has any bearing on the regulatory ratemaking process.

(*Id.*)

The Commission should again reject Ms. McShane's market to book adjustments. As with previous arguments that have been rejected by the Commission in past cases, the market to book adjustments are based on the false argument that an adjustment to a cost of equity estimated derived from market values of equity is necessary when that estimate is to be applied to book values of equity to determine utility rates.

Ms. McShane argued that if the Commission should reject the full market to book adjustment then, at a minimum, a financing flexibility adjustment should be allowed for the recovery of all flotation costs associated with equity financing. (McShane Dir., AmerenCILCO Exhibit 3.0, AmerenCIPS Exhibit 3.0, p. 25; AmerenIP Exhibit 3.0, p. 26) However, she has provided no basis for her argument. In fact, AmerenIP and AmerenCIPS are not requesting compensation for unrecovered common equity issuance costs in this proceeding. (AmerenCIPS and AmerenIP Schedule D-5) The proper flotation cost adjustment for AmerenCILCO was discussed in Staff witness Freetly's direct testimony. (Freetly Corr. Dir., ICC Staff Exhibit 4.0 Corrected, pp. 26-28)

The Commission has rejected the use of generalized flotation cost adjustments in previous cases. Ms. McShane proposed the same financing flexibility adjustment in Docket Nos. 02-0798/03-0008/03-0009 Consolidated, which the Commission rejected. The Order in that proceeding states

> The Commission has traditionally approved flotation cost adjustments only when the utility anticipates it will issue stock in the test year or when it has demonstrated that costs incurred prior to the test year have not been recovered previously through rates. The record does not suggest that

> CIPS or UE issued common stock during the test year or that either entity has not recovered any previously incurred flotation costs. Ameren's generalized flotation cost adjustment is not an appropriate basis for increasing utility rates.

(Order, Docket No. 02-0798/03-0008/03-0009 (cons.), p. 89, (October 22, 2003, p. 89))

The Commission Order in Docket No. 94-0065 makes a similar statement and cites Orders from Docket Nos. 91-0193, 91-0010, and 91-0147 as examples of its previous decisions on the issue. [20] Moreover, the Commission decisions assign the burden of proof on this issue to the utility. Once again, Ms. McShane presented a flotation cost adjustment that was not based on costs specifically incurred by any of the Companies. Thus, Ms. McShane's argument for a flotation cost adjustment is unsubstantiated and should be rejected by the Commission. (Freetly Corr. Dir., ICC Staff Exhibit 4.0, pp. 41-42)

CUB presented a market to book value analysis, which estimated the return on equity that would result in a market to book ratio of 1.0 using statistical analysis. (Bodmer Corr. Dir., CUB Exhibit 1.0 Corr., pp. 80-84) Mr. Bodmer's market to book analysis contains several flaws. First, market to book value ratios combine the discounted value of <u>future cash flows</u> with <u>historical book earnings</u>. The numerator and denominator of the market to book ratio are inconsistent with respect to time and construction.

Second, his analysis is based on the premise that one should expect a utility company to <u>precisely</u> earn its cost of capital on a continuing basis. (*Id*., p. 78) That premise is oversimplified. There are many utility ratemaking practices (*e.g.*, deferred

[20] Order, Docket No. 94-0065, pp. 94-95 (January 9, 1995); Order, Docket No. 91-0193, (March 18, 1992); Order, Docket No. 91-0010, p. 30 (November 8, 1991); Order, Docket No. 91-0147, p. 128 (February 11, 1992).

taxes and depreciation) that could result in a utility's market value exceeding its book value. That is, the authorized return for each company in his sample is not the only factor influencing its earnings. Thus, a market to book ratio in excess of one does not necessarily mean the authorized rate of return is too high.

Third, the Value Line betas for the seventy companies he used in his analysis range from 0.60 to 1.85. (*Id.*, p. 78) Such a range indicates substantial variation in the riskiness of those companies. Despite this variation he suggests that there is a single correct cost of equity (*i.e.*, 6.48%), which would equate market value to book value, for all seventy companies in his analysis. Even if Mr. Bodmer were correct that the market to book value ratio for a utility that earned its required rate of return on common equity would equal one, companies with different risks must have different required rates of return. Thus, Mr. Bodmer's cross-sectional analysis is not useful for establishing the Ameren Companies' cost of common equity given that he failed to establish that the Ameren Companies' risk is equal to the average risk of the seventy companies used in his analysis. (Freetly Reb., ICC Staff Exhibit 15.0, pp. 19-20) In addition, the Commission recently rejected Mr. Bodmer's market to book analysis in Docket No. 05-0597 and stated that it may not adequately reflect a utility's cost of equity. (Order, Docket No. 05-0597, p. 155 (July 26, 2006))

Thus, the Ameren Companies' common equity does not need to be adjusted to account for the difference between the market value and the book value of the Ameren Companies' common equity

e. Equity Risk Premium: Staff's Risk Premium is Reasonable Because it uses Current Data

Staff's risk premium methodology (use of CAPM) is consistent with the theory that investors are risk-averse and that, in equilibrium, two securities with equal quantities of risk have equal required rates of return and is superior to what is proposed by the Ameren Companies, the Cities and CUB. The Ameren Companies and the Cities used historical data in performing their equity risk premium analysis. As discussed in detail below, the equity risk premium analysis performed by both parties should be rejected because historical premiums are not reliable proxies of current or future risk premiums, and the Commission has consistently ruled against use of historical data in cost of equity models. CUB's proposal suffers from a different failing, it lacks current data, as explained below.

Ameren witness McShane used historical data in her equity risk premium analysis. To compute the achieved equity risk premium for local gas distribution companies ("LDC"), she calculated the achieved equity risk premium for the S&P/Moody's Gas Distribution Index over the period 1947-2004 relative to the 20-year U.S. Treasury bond income return. She also relied on historic information to compute the DCF-based equity risk premium for LDCs. (McShane Dir., AmerenCILCO Exhibit 3.0, AmerenCIPS Exhibit 3.0, pp. 44-45; and AmerenIP Exhibit 3.0, p. 45-46)

The Cities' witness Cuthbert also employed historical risk premiums and used average interest rates in his risk premium models. In his interest rate risk premium model, Mr. Cuthbert computed the risk premium by comparing the ten-year history of return on equity levels of Value Line electric utilities to the annual average interest rates on 10-year Treasury securities, Aaa corporate bonds, and Baa corporate bonds from

1996 to 2005. He then added those 10-year average risk premiums to the average interest rates for the 12-month period and the 3-month period ended March 31, 2006. (Cuthbert Dir., Cities Exhibit 1.0, pp. 26-27 and 40-41; Exhibit RWC-5, p. 1) For his CAPM model, Mr. Cuthbert's risk-free rate is based on 3-month Treasury bills, 5-year Treasury notes and 20-year Treasury bonds for the six-month period ended March 31, 2006. His risk premium was derived by comparing average market rates from 1926 to 2004 and corresponding historical interest rates for each of the three securities employed as his risk-free rate. (*Id*., p. 41; Exhibit RWC-5, p. 2)

Historical risk premiums do not adequately measure investors' current return requirements because historical risk premiums are based on realized returns. Due to unpredictable movements in financial markets and the economy, the difference between realized and expected returns can be substantial. Even if an investment's return equaled investor requirements in a given period, both the price of, and the investment's sensitivity to, each source of risk changes over time. Consequently, the past relationship between two investments, such as utility common equity and long-term government bonds, is unlikely to remain constant. Further, the magnitude of the historical risk premium depends upon the measurement period. Unfortunately, no widely accepted guidelines exist for determining the appropriate measurement period. Thus, historical premiums are not reliable proxies of current or future risk premiums. Furthermore, average interest rates over a three, six or twelve month period might also reflect outdated information that investors no longer deem relevant. The Commission has consistently ruled against use of historical data in cost of equity models, noting that the investor-required return on common equity is a forward-looking concept.[21] (Freetly Corr. Dir., ICC Staff Exhibit 4.0 Corr., p. 45-47)

CUB witness Bodmer summarized academic research that he alleged indicated that the proper expected equity market risk premium for determining the investor-required rate of return is between 3 and 5%. (Bodmer Corr. Dir., CUB Exhibit 1.0 Corr., pp. 62-69) The research that he cited represents a few academics' opinions of the equity risk premium investors should have expected at the time of their findings, which is not necessarily the same as what investors were expecting at that time or are expecting currently. Since the relationship between the returns of the stock market and U.S. Treasury bonds is not stable over time, current returns provide the best indication of what investors are expecting going forward. Hence, Staff's estimate of the equity risk premium, based on current returns, provides the actual difference between returns on risk-free and risky securities that exists in today's market. (Freetly Reb., ICC Staff Exhibit 15.0, p. 21)

f. Comparable Earnings: Ameren's Comparable Earnings Test is Based on an Erroneous Assumption

The Ameren Companies' comparable earnings model should be rejected, as the Commission has done in previous orders. The Ameren Companies use the comparable earnings analysis as a test of the reasonableness of the DCF and equity risk premium results. This analysis uses the average historical earned return on book value of common equity for a proxy group of 139 low-risk U.S. industrial companies over the

[21] Order, Docket No. 92-0357, p. 66 (July 21, 1993); Order, Docket No. 95-0076, p. 69 (December 20, 1995); Order, Docket Nos. 99-0122/0130 Consol., p. 10 (August 25, 1999); Order, Docket Nos. 01-0528/0628/0629 Consol., p. 12 (March 28, 2002); Order, Docket No. 02-0837, p. 37 (October 17, 2003).

period 1994-2004. The average achieved return for those 139 companies was approximately 13.25-13.75%, which Ms. McShane deemed to be a reasonable proxy for the required rate of return for that sample of industrial companies. To estimate the required return for a typical gas distribution utility, she adjusted her estimate for the 139 consumer-oriented industrial companies to reflect the lower risk of her sample of twelve local gas distribution companies ("LDC sample"), as measured by the groups' median Value Line betas. With that adjustment, her estimate of the required rate of return for the LDC sample was 12.75 – 13.25%. (McShane Dir., AmerenCILCO Exhibit 3.0, pp. 51-58; AmerenCIPS Exhibit 3.0, pp. 51-58; AmerenIP Exhibit 3.0, p. 50-57)

The comparable earnings methodology is not appropriate for determining the cost of equity because it is based on the erroneous assumption that earned or expected returns on book equity are acceptable substitutes for investor-required returns. (Freetly Corr. Dir, ICC Staff Exhibit 4.0 Corr., pp, 42-47) Investor return requirements are a function of risk and manifested in the market prices of securities. In contrast, Ms. McShane's comparable earnings analysis is based on accounting returns, which are largely unresponsive to market forces. The return on book value of common equity is entirely unaffected by changes in the investor required rate of return. For example, in response to a decline in risk, risk premiums, or the time value of money, investors would bid up the price of a stock, thereby reducing the implied required rate of return, but the anticipated return on book equity would not change. (*Id*., p. 43)

The Commission has consistently and repeatedly rejected the comparable earnings methodology. Ms. McShane presented a comparable earnings model in Docket Nos. 02-0798/03-0008/03-0009 Cons. and the Commission rejected it. (Order, Docket Nos. 02-0798/03-0008/03-0009 Cons., p. 88 (October 22, 2003)) The Commission also rejected the comparable earnings methodology in Docket Nos. 03-0676/03-0677 Cons. The Order in Docket Nos. 03-0676/03-0677 Cons. states "The Commission finds, as it has in prior dockets, that the comparable earning approach has little value because it constitutes an accounting-return based approach rather than a market-based methodology, and fails to reflect the investor-required rate of return." (Order, Docket Nos. 03-0676/03-0677 Cons., p. 40 (October 6, 2004)) The Commission also rejected use of the comparable earnings methodology in Docket Nos. 01-0528/01-0628/01-0629 Cons., 99-0121, 92-0448/93-0239 Cons., and 89-0033. (Order, Docket Nos. 01-528/01-0628/01-0629 Cons., p. 13 (March 28, 2002); Order, Docket No. 99-0121, p. 68 (August 25, 1999); Order, Docket Nos. 92-0448/93-0239 Cons., p. 173 (October 11, 1994); Order on Remand, Docket No. 89-0033, p. 15 (November 4, 1991))

Since there are no significant differences between the comparable earnings analysis Ms. McShane presented in this proceeding and those rejected by the Commission in past cases, the Commission should once again disregard Ms. McShane's comparable earnings analysis. (Freetly Corr. Dir., ICC Staff Exhibit 4.0 Corrected, pp. 42-44)

g. Other Problems with CUB's Cost of Common Equity Analysis

There are a few other items that CUB introduced in testimony which Staff found to be problematic, and should not be adopted nor given any weight. The first item CUB introduced is a substitute for the DCF model known as the P/E model. As discussed below, there are a number of drawbacks with this model, namely that the calculation increases the likelihood of error. The second item CUB introduced is the weighted average cost of capital used by investment banks in their exchange ratio analysis for the recent Exelon/PSEG merger.

CUB witness Bodmer introduced a cost of equity model based on price to earnings ("P/E") ratios as an alternative to the DCF model. (Bodmer Corr. Dir., CUB Exhibit 1.0 Corr., pp. 48-49) Mr. Bodmer's P/E model can be stated as:

$$k = [(EPS \times (1 - g / ROE)] / P + g.$$

In comparison, the DCF model is stated as:

$$k = D_1 / P + g.$$

The only difference between those two models is that Mr. Bodmer's P/E model substitutes the term $[(EPS \times (1 - g / ROE)]$ for the D_1 used in the DCF model. Thus, Mr. Bodmer's P/E model is merely a form of the DCF in which the D_1 term is not estimated directly, but rather, is calculated from the ground up based on estimates of earnings per share ("EPS"), growth ("g"), and return on equity ("ROE"). The most significant problem with this approach is that it increases measurement error, since it requires the estimation of unobservable investor expectations for three variable (EPS, g, and ROE) rather than two (D_1 and g). (Freetly Reb., ICC Staff Exhibit 15.0, pp. 15-16)

In addition, Mr. Bodmer claim that his P/E model "has advantages because it does not depend on the dividend payout ratio, the cost of capital is less sensitive to growth, and the cost of equity capital is driven by the fundamental drivers of value" is false. (*Id.*) First, Mr. Bodmer's P/E model clearly does depend on the dividend payout ratio, since the term $(1 - g / ROE)$ used in Mr. Bodmer's P/E model is the formula for the dividend payout ratio. (*Id.*) Second, his P/E model is, if anything, *more sensitive* than the DCF to growth. In both models, the growth rate estimate is added directly onto the dividend yield; however, in the P/E model, the growth rate estimate is also used in the calculation of the dividend yield. (*Id*.) Third, the cost of equity capital derived from Mr. Bodmer's P/E model is no more driven by the fundamental drivers of value than the DCF model is, since both are essentially forms of the same model. (*Id*.)

Mr. Bodmer also presented the weighted average cost of capital ("WACC") investment banks used in their exchange ratio analysis for the recent Exelon/PSEG merger. Mr. Bodmer claimed that the implicit cost of equity in the Morgan Stanley WACC was 7.75%. CUB's claim should be given no weight. An investment banks' estimate of the after-tax unlevered cost of capital is not appropriate for estimating the cost of equity for ratemaking purposes. The record is silent on how the investment banks derived those estimates; there is no evidence regarding what data the investment banks relied upon, let alone what analyses they performed, if any. The Commission rejected Mr. Bodmer's investment bank estimate in the ComEd case, Docket No, 05-0597, and should do the same here. (Order, Docket No. 05-0597, p. 154. (July 26, 2006))

4. Staff's Recommended Rate of Return on Common Equity

The Commission should accept Staff's estimates of the cost of common equity for AmerenCILCO, AmerenCIPS and AmerenIP. A thorough analysis of the required rate of return on common equity requires both the application of financial models and the analyst's informed judgment. Because techniques to measure the required rate of return on common equity necessarily employ proxies for investor expectations, judgment is necessary to evaluate the results of such analyses. The models from which

Ms. Freetly derived the individual company estimates are correctly specified and thus contain no source of bias. Ms. Freetly minimized measurement error through the use of a sample, since estimates for a sample as a whole are subject to less measurement error than individual company estimates. Ms. Freetly's downward adjustment properly reflects the lower risk of the Companies relative to her utility sample. The proper investor-required rate of return on common equity for the Ameren Companies is as follows:

Ameren Company	Rate of Return on Common Equity[22]
AmerenCILCO	9.99%
AmerenCIPS	9.85%
AmerenIP	9.96%

F. Other

G. Recommended Rate of Return on Rate Base

Staff proposes the following rate of return on rate base for each Ameren Company:

Ameren Company	Rate of Return on Rate Base[23]
AmerenCILCO	7.88%
AmerenCIPS	7.95%
AmerenIP	8.26%

[22] Freetly Reb., ICC Staff Exhibit 15.0, p. 2.

[23] Pregozen Corr. Reb., ICC Staff Exhibit 16.0, Schedule 16.06.

The rate of return for each company incorporates the rate of return Staff witness Freetly recommends for common equity.

IV. RATE DESIGN

A. Summary of Uncontested/Settled Issues

1. Basic Structure of Ameren Companies Rates for Delivery Services

Generally, Staff accepts the basic structure of the Ameren Companies' proposed rates for delivery service, which includes a separate uniform customer and meter charge for each customer class across the service territories for all three Ameren distribution companies. (Luth Dir., ICC Staff Exhibit 8.0, p. 2) For example, the AmerenIP DS-1 customer and meter charges would be different from the AmerenIP DS-2 customer and meter charges, but the AmerenIP DS-1 customer and meter charges would be the same as the AmerenCIPS and AmerenCILCO DS-1 customer and meter charges. Similarly, the respective AmerenIP DS-2, DS-3, and DS-4 customer and meter charges would be the same as the corresponding AmerenCIPS and AmerenCILCO DS-2, DS-3, and DS-4 customer and meter charges. Distribution and demand charges for each customer class would be separately determined for each Ameren distribution company. (Luth Reb., ICC Staff Exhibit 19.0, p. 7-8)

Rates are designed to recover revenue requirement, consistent with the Commission's conclusions on revenue requirement, customer class cost of service, and rate design. Staff and the Ameren Companies support different revenue requirements. It is possible, if not likely, that the Commission would find another revenue requirement appropriate in these dockets. In that event, rates must be adjusted to recover the revenue requirement authorized in the Commission's Order.

Staff and the Ameren Companies appear to agree on how to adjust rates in the event that the revenue requirement authorized in the Commission's Order differs from revenue requirement supported by the Ameren Companies. (Jones Sur., Respondents' Exhibit 41.0, p. 18) To summarize this agreement, all charges should be adjusted by the ratio of the Order's revenue requirement to the Ameren Companies' proposed revenue requirement. Since the Ameren Companies have proposed, and Staff supports, uniform customer and meter charges for each separate customer class across the service areas of all three Ameren Companies, the revenue requirement for all three Ameren Companies should be combined to determine the ratio to apply to the customer and meter charges. (Luth Reb., ICC Staff Exhibit 19.0, p. 8)

However, this step would not apply if the difference in the DS-1 customer and meter charges is less than 25¢ per month, which is a revenue requirement adjustment of less than 2.3 percent. (*Id.*) Remaining revenue requirement recovered through distribution and demand charges would be adjusted by developing a ratio between the Order revenue requirement and Ameren's proposed revenue requirement for each distribution company, and then applying the ratio to the Ameren Companies' proposed distribution and demand charges for each company. (*Id.*, pp. 8-9) The result would be that revenues from customer and meter charges based upon the combined revenue requirement for all three Ameren distribution companies, added to revenues from distribution and demand charges based upon the revenue requirement for each separate Ameren distribution company, would total the combined revenue requirement for all three Ameren distribution companies.

2. Other Charges – Local Government Fees and Adjustments, Supplemental Customer Charges, Tax Additions charge, Miscellaneous Fees and charges, Rider RDC and Rider EEA

Staff does not object to the Ameren Companies' proposed other charges for local government fees and adjustments, supplemental customer charges, tax additions, miscellaneous fees and charges, or Riders RDC and Rider EEA. However, Staff witness Luth notes that the Commission should have the opportunity to review each Local Government Fee and Adjustment the Ameren Companies may propose to charge. (Luth Dir., ICC Staff Exhibit 8.0, pp. 7-8)

The Ameren Companies should be required to obtain the Commission's authorization to implement any new charge or change in an existing charge under Local Government Fees and Adjustments, Sheet No. 36. Any notification to the Commission and request for authorization to implement a new or revised charge under Local Government Fees and Adjustments should include supporting calculations for the proposed charge. The Ameren Companies should also include a listing of Local Government Fees and Adjustments by local government authority, similar to the listing of Municipal Tax Additions included in the tariff for Tax Additions, Sheet No. 37. (*Id.*, p. 8)

The Ameren Companies agreed with Staff witness Luth's proposal, stating that they would:

- notify the Commission and seek authorization of potential Local Government Fees and Adjustments,

- properly document the proposed charges and supporting calculations behind the charges, and
- list all such charges in an appendix to the tariff sheet explaining the charges. (Carls Reb., Respondents' Exhibit 31.0, pp. 12-13)

The Commission should order the Ameren Companies to properly seek Commission approval of proposed Local Government Fees and Adjustments with proper documentation and support, and to include and update as necessary a summary listing of all such local government fees and adjustments.

3. Embedded Cost of Service Study

Staff does not object to the Ameren Companies' embedded cost of service studies. (Harden Dir., ICC Staff Exhibit 7.0, p. 3) The Ameren Companies analyzed all elements of investment and expenses which were classified into their customer-related or demand-related components for the purpose of allocating such items to each customer class utilizing factors based on customer counts and demands by customer class. (DiFani Dir., AmerenCILCO Exhibit 9.0, pp. 5-7; DiFani Dir., AmerenCIPS Exhibit 9.0, pp. 5-7; and DiFani Dir., AmerenIP Exhibit 9.0, pp. 5-7) The Ameren Companies have allocated costs among rate classes in a manner that is similar to what was approved by the Commission in Ameren's Procurement Auction Proceedings -- Docket Nos. 05-0160/05-0161/05-0162 Consolidated, Final Order dated January 24, 2005, p. 204). (Harden Dir., ICC Staff Exhibit 7.0, p. 4) Staff found no issue that would prevent each embedded cost of service study's acceptance for ratemaking purposes; therefore, Staff does not object to the studies. (*Id.*, p. 3)

4. Rider QF-Second Section-QSWEFS

Staff witness Griffin testified that certain changes were necessary for the Ameren Companies proposed Rider QF, second section, concerning Qualified Sold Waste Energy Facilities ("QSWEF"). Mr. Griffin previously has testified or participated in citation cases and approval proceedings involving QSWEFs on a number of occasions. In addition to his other accounting duties, Mr. Griffin monitors and deals with issues relating to tax credits taken by Electric Utilities and tax credit repayments to the State of Illinois from QSWEFs pursuant to Section 8-403.1 of the Act (220 ILCS 5/8-403.1). (Griffin Dir., ICC Staff Exhibit 11.0, pp. 2-3)

Mr. Griffin had three recommendations regarding the Ameren Companies proposed Rider QF. He first recommended that with respect to the second section of Rider QF, the term "QSWEF" should be used rather that "SWQF" as proposed by the Ameren Companies. Mr. Griffin explained that "QSWEF" is the term that the Commission consistently uses when referring to qualified solid waste energy facilities in its orders and it is Staff's practice to use the term QSWEF. Second, Mr. Griffin recommended that rider QF contain a section entitled "Sworn Statement Requirement". Third, Mr. Griffin recommend that rider QF clearly state that a determination by the Illinois Commerce Commission that the QSWEF qualifies under Section 8-403.1 is required before service will be permitted under rider CF. Mr. Griffin explained that while the Ameren Companies current proposed language can be interpreted as requiring that, a more direct statement on this issue in rider CF would greatly clarify that point. With respect to the sworn statement requirement, Mr. Griffin explained that by having this section in Rider QF, the Ameren Companies would be able to better control and monitor QSWEF's operating in the Ameren Companies service territories. Mr. Griffin further testified that since QSWEF's receive a benefit that requires State funds, it is reasonable that QSWEF's be required to provide assurances that it is in fact entitled to those benefits. (*Id.*, pp. 3-4)

Mr. Griffin's suggested changes to the Ameren Companies' proposed Rider QFs were set forth on attached Schedule 11.01 to his testimony. (Id.) The Ameren Companies in their rebuttal testimony accepted all of Mr. Griffin's proposed changes to the second section of Rider QF. (Jones Rebut., Respondents' Exhibit 20.0, p. 34) For the reasons set forth above and further explained in Mr. Griffin's testimony, Mr. Griffin's proposed changes to the Ameren Companies' proposed Rider QF second section as set forth in Schedule 11.01 to his direct testimony should be adopted by the Commission.

5. Supply Procurement Adjustment: Recovery of supply-related costs

For a discussion of allocation of costs among the Ameren Companies, cash working capital rate, and uncollectibles rate, see Section IV.F.1. of this Initial Brief.

6. Customer Owned Transformers

In his direct testimony Staff witness Rockrohr testified that existing customers who owned their own transformers and who were metered on the high-voltage side of those transformers would be penalized financially under the Ameren Companies' proposed rates. (Rate DS-2 Small General Delivery Service, Rate DS-3 General Delivery Service and Rate DS-4 Large General Delivery Service) (Rockrohr Dir., ICC Staff Exhibit 9.0, pp. 10-13; Rockrohr Reb., ICC Staff Exhibit 20.0, p 2) Mr. Rockrohr testified that the penalty resulted because, though these customers would avoid a Transformation Charge, the Customer Charge and Meter Charge that these customers would pay, both of which are based on metering voltage, would increase significantly if the metering were located on the high-voltage side of the customer-owned transformer. The higher Customer Charge, by itself, would more than offset any savings realized by owning the transformer and avoiding the Transformation Charge, and the higher Meter Charge would exacerbate the unfair situation. (Rockrohr Dir., ICC Staff Exhibit 9.0, pp. 11-12) Mr. Rockrohr therefore recommended that the Ameren Companies propose a mechanism to remove the financial penalty. (*Id*., p. 14)

In response to Mr. Rockrohr's testimony the Ameren Companies' witness Jones explained that of the three Ameren Companies, only AmerenCIPS had a practice of installing metering on the high side of customer-owned transformers. (Jones Reb., Respondents' Exhibit 20.0, p. 15) Therefore, Mr. Jones proposed that AmerenCIPS, but not AmerenIP or AmerenCILCO, would assess a Customer Charge and Meter Charge to the relevant customers as if those customers were metered on the low voltage side of the transformation. Mr. Jones further proposed that, since AmerenCIPS' DS-3 and DS-4 customers that owned their own transformers would still avoid the Transformation Charge, those customers would be assessed a $75/month Metering Reassignment Charge. (Jones Reb., Respondents' Exhibit 20.0, pp. 16-17)

Mr. Rockrohr agreed with the Ameren Companies proposal to only provide special consideration to AmerenCIPS' customers based on AmerenIP's and AmerenCILCO's historically metering customers on the secondary side of customer-owned transformers. (*Id*.) In addition, Mr. Rockrohr agreed that AmerenCIPS' proposal to assess a Metering Reassignment Charge for AmerenCIPS' DS-3 and DS-4 customers was reasonable since it would partially offset the lower monthly Customer and Meter Charges but still did not financially penalize those customers for owning the transformer. (*Id*., p. 3)

7. Loss Multipliers

As set forth in the testimony of Staff witness Rockrohr, loss multipliers or distribution loss adjustment factors, are factors used by a utility to estimate the energy which is lost on the utility's system as that energy is transported from the transmission system to the individual customer. (Rockrohr Dir., ICC Staff Exhibit 9.0, p. 21) In this proceeding the Ameren Companies are proposing to change its current practice of separate and fixed multipliers and instead use variable distribution loss multipliers. The loss multipliers the Ameren Companies propose are based upon quadratic equations that use the hourly system load as the independent variable. The Ameren Companies will then apply the calculations to the customers' energy usage each hour for the combined Ameren Illinois system. (Stephens Dir., IIEC Exhibit 4.0, p. 4) Staff witness Rockrohr requested the Ameren Companies provide the methodology used to develop the loss multipliers and stated that he might file supplemental or amended testimony following his review. (Rockrohr Dir., ICC Staff Exhibit 9.0, p. 21) Mr. Rockrohr did not file any supplemental or amended testimony. While Staff does not contest the Ameren Companies on this issue, Staff agrees with many of the observations made by IIEC witness Stephens; in particular that theoretically the Ameren Companies' proposal could be more accurate than past practices, but is also more complex. (Stephens Reb., IIEC Exhibit 4.0, pp. 5-7)

8. Reactive Demand Charge

In his direct testimony Staff witness Rockrohr testified that on a conceptual level he reviewed the reactive demand charge that the Ameren Companies proposed for Rate DS-4 customers. He explained that the Ameren Companies' approach to install capacitors for dealing with the affects of reactive demand on lower voltage systems was reasonable. He further found that at voltages greater than 100 kV the Ameren Companies' proposals to assign utility-incurred costs for power factor correction directly to the customer but only if corrective measures are implemented was reasonable. (Rockrohr Dir., ICC Staff Exhibit 9.0, pp. 20-21) For the above reasons Staff does not take issue with the Ameren Companies on the Reactive Demand Charge.

B. Customer Class Issues

DS-1 rates proposed by the Ameren Companies in direct testimony do not fully recover DS-1 cost of service. (Jones Dir., AmerenCILCO Exhibit 10.0, p. 6; AmerenCIPS Exhibit 10.0, p. 6; AmerenIP Exhibit 10.0, p. 6)[24] As a result, other rate classes would pay rates that recover more than their respective customer class' (*i.e.*, DS-1, DS-2, DS-3 and DS-4) costs of service so as to subsidize the DS-1 class. The Ameren Companies propose to increase the rates for only two customer classes -- the DS-2 and DS-3 classes. (Jones Reb., Respondents' Exhibit 20.0, p. 2 and pp. 5-6) If the Commission finds that DS-1 rate relief is appropriate in this docket, Staff recommends that the DS-4 class also contribute to the subsidy. Including the DS-4

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[24] *See e.g.*, AmerenCILCO Exhibit 10.1, AmerenCIPS Exhibit 10.1, AmerenIP Exhibit 10.1, pages 2, 4, and 6, column (5) for DS-1 is lower than column (2) by the amount shown in column (8), column (5) is higher than column (2) for DS-2 and DS-3 by the amounts shown in column (8) at the corresponding Ameren distribution company, while page 6 AmerenCILCO DS-4 column (10) indicates an increase compared to the cost of service decrease indicated in column (3).

customer class in the contribution to DS-1 rate relief will reduce the increase to higher-cost DS-2 and DS-3 (relative to DS-4) rates because the rate relief can be spread over a larger revenue base.

In general, the Ameren Companies' proposal in its direct testimony would not only require revenues from rate classes DS-2 and DS-3 to be higher than the DS-2 and DS-3 cost of service, but would also require revenues from AmerenCILCO's DS-4 class to be higher than cost of service. IIEC witness Stephens (Stephens Dir., IIEC Exhibit 1.0, p. 10) and Kroger witness Higgins (Higgins Dir., Kroger Exhibit 1.0, pp. 4-12) disagreed with the Ameren Companies' proposal, as set forth in its direct testimony, to reduce the increase to the DS-1 class through an increase to DS-2, DS-3 and Ameren CILCO's DS-4 customer class. However, Kroger witness Higgins also recognized that it might be appropriate to provide DS-1 rate relief. Mr. Higgins recommended, to the extent DS-1 rate relief is necessary, that all non-subsidized rate classes, including the DS-4 class, contribute to rate relief provided in this docket. (Higgins Dir., Kroger Exhibit 1.0, p. 12 and Higgins Reb., Kroger Exhibit 2.0, pp. 4-5)

In rebuttal testimony, the Ameren Companies eliminated the increase to AmerenCILCO DS-4 delivery service rates resulting from the reduced increase to DS-1, but kept in place the increase to DS-2 and DS-3 delivery service rates. (Jones Reb., Respondents' Exhibit 20.0, p. 2 and pp. 5-6)[25] Staff witness Luth, in rebuttal testimony, included a comparison of the Ameren's proposed distribution rates for the various customer classes not only in terms of percentage of increase in delivery service, but

[25] *See e.g.*, Respondents' Exhibit 20.1, pages 2, 4, and 6, column (5) for DS-1 is lower than column (2) by the amount shown in column (8), column (5) is higher than column (2) for DS-2 and DS-3 by the amounts shown in column (8).

also in terms of the average amount paid per kilowatt-hour ("kWh"). (Luth Reb., ICC Staff Exhibit 19.0, pp. 4-5 and Schedule 19.1)

ICC Staff Exhibit 19.0, Schedule 19.1 demonstrates that, among customer classes DS-1 through DS-4, DS-3 would have the highest percentage increase in delivery service rates per average kWh under the Ameren Companies' proposed rates. (ICC Staff Exhibit 19.0, Schedule 19.1, lines 15 and 16) For AmerenIP, DS-4 would have the highest individual percentage increase, at nearly 115 percent. Looking at the amount paid per kWh, however, shows that the DS-4 customer class would pay far less per average kWh than any of the other customer classes -- less than 9 percent of the amount paid per average kWh by the DS-1 customer class, approximately 11 percent of the amount paid per average kWh by the DS-2 customer class, and approximately 17 percent of the amount paid per average kWh by the DS-3 customer class. (*Id.*, line no. 4, DS-4 divided by DS-1, DS-2, and DS-3, respectively) In other words, DS-1 rates under the Ameren Companies' proposal would be more than 11 times higher per kWh than DS-4 rates, DS-2 rates would be more than 9 times higher per kWh than DS-4 rates, and DS-3 would be more than 5 times higher per kWh than DS-4 rates. (*Id.*, DS-1, DS-2, and DS-3 respectively divided by DS-4).

Staff witness Luth also explained why it is reasonable for the Commission to consider rate mitigation for the DS-1 customer class at this stage in the development of the competitive power supply market (Luth Reb., ICC Staff Exhibit 19.0, p. 5-7), despite the self-interest objections of some intervenor customer groups. There are two basic reasons that make rate relief for DS-1 customers a reasonable consideration. The first reason is that a larger increase per kWh for delivery service means that, without a compensating reduction in the cost of power supply compared to other rate classes, the total cost of electricity service for the DS-1 customer class will increase more than other rate classes that will pay less per kWh for delivery service. (Luth Reb., ICC Staff Exhibit 19.0, p. 5) The second reason is that the opportunity for the DS-1 customer class to obtain benefits through the alternative power supply market appears non-existent at this time because the delivery of power from alternative suppliers to residential customers in the year 2005 totaled zero. (Luth Reb., ICC Staff Exhibit 19.0, pp. 5-6) In contrast, Large and Industrial customers apparently have some power supply options because 16 to 37 percent of the kWhs they received via the three Ameren Companies were purchased from Retail Electric Suppliers in 2005. (Id., pp. 6-7)

The Ameren Companies' rebuttal rate proposals did not include an increase in DS-4 rates above cost of service to compensate for DS-1 delivery service rate relief, although the rate proposal the Ameren Companies' presented in direct testimony had AmerenCILCO's DS-4 rates set above cost of service (Jones Dir., AmerenCILCO Exhibit 10.0, p. 6; AmerenCIPS Exhibit 10.0, p. 6; AmerenIP Exhibit 10.0, p. 6). Ameren witness Jones explained that the DS-4 customer class was ultimately not included in the contribution to Ameren's proposed DS-1 rate relief because the delivery service component of DS-4 total cost of electric service, which includes an estimate of the cost of power supply, was relatively small compared to the DS-2 and DS-3 customer classes. (Jones Reb., AmerenCILCO Exhibit 20.0, AmerenCIPS Exhibit 20.0,,and AmerenIP Exhibit 20.0, pp. 6-7) Mr. Jones included a proxy of power supply costs when equalizing the increase among the DS-1, DS-2, and DS-3 customer classes. Mr. Jones suggested that using the same approach to equalize the increase to DS-4 delivery service rates would result in those rates no longer resembling cost-based rates. To compensate for the Ameren Companies' proposed rate relief for the DS-1 customer class, the Ameren Companies propose to increase only the delivery service rates of the DS-2 and DS-3 customer classes above cost of service.

In considering whether revenue from the DS-4 customer class should contribute to DS-1 rate relief, the Ameren Companies' linking of DS-4 delivery service rates to a power proxy price is not necessary because power supply costs are not at issue in this docket. Since the percentage of the delivery service component in the total cost of electric supply cost to the DS-4 customer class is expected to be substantially lower than the percentage of the delivery service component in the total cost of electric supply cost to the DS-2 and DS-3 customer classes, an increase in DS-4 delivery service rates to contribute to DS-1 rate relief would cause less of an adverse impact on the total cost of electric service to the DS-4 customer class, not more. Contrary to the Ameren Companies' approach, the fact that DS-4 delivery service rates represent a far smaller component of overall electric service as compared to other customer classes is the very reason that it is reasonable for the DS-4 customer class to contribute to DS-1 rate relief.

Furthermore, the DS-4 customer class has the largest kWh usage over the combined Ameren Companies' service area, totaling 15.87 billion kWh in the test year compared to 9.63 billion DS-2 and DS-3 kWh, or 64.9 percent more (from Jones Reb., Respondents' Exhibit 20.0, Schedule 20.6, sum of DS-4 kWhs compared to sum of DS-2 and DS-3 kWhs shown under the "Units" column). Thus, including the DS-4 customer class in DS-1 rate relief would therefore result in a supporting kWh service base that, at 25.6 billion kWh, is more than double the 9.63 billion kWh service base proposed by the

Ameren Companies that includes only DS-2 and DS-3. With a larger customer and kWh usage supporting DS-1 rate relief, the increase to the DS-2 and DS-3 customer classes will be lower if the DS-4 customer class is included in the support of DS-1 rate relief.

Kroger witness Higgins also recognized that it might be appropriate to provide DS-1 rate relief. Mr. Higgins recommended, to the extent DS-1 rate relief is necessary, that all non-subsidized rate classes, including the DS-4 customer class, contribute to rate relief provided in this docket. (Higgins Dir., Kroger Exhibit 1.0, p. 12 and Higgins Reb., Kroger Exhibit 2.0, pp. 4-5) As Staff Exhibit 19.0, Schedule 19.1 demonstrates, Mr. Higgins' recommendation to include DS-4 in the support of DS-1 rate relief is reasonable.

Therefore, if rate relief is to be provided to the DS-1 customer class, it should be accomplished through increases to lower-priced delivery service rates for other customer groups. The DS-4 customer class is:

(1) the largest customer group in terms of kWh usage,

(2) the customer group with the lowest average delivery service rate per kWh by a substantial margin, and

(3) the customer group with more apparent opportunities to offset increases in delivery services costs with economically beneficial options in the alternative power supply market compared to other customer groups.

As a result, the DS-4 customer class is better able to absorb a contribution to DS-1 rate relief than customer groups DS-2 and DS-3. Additionally, including revenue from the DS-4 customer class in the contribution to DS-1 rate relief will reduce the increase to higher-cost DS-2 and DS-3 customer classes because the rate relief can be spread over a larger revenue base.

C. Cost of Service Issues

1. Segregation and accounting for delivery service and generation-related uncollectible expenses

2. Development of Meter Costs v. Customer Costs

Ameren witness Jones presents the Ameren Companies' proposed rates in this proceeding. (Jones Dir., AmerenCILCO Exhibit 10.0, AmerenCIPS Exhibit 10.0, AmerenIP Exhibit 10.0, Schedule 10.6, Proposed Unit Charge column) Based upon Staff witness Luth's review, it was apparent that the Ameren Companies' proposed rates recover some of the costs included in meter-related accounts through the customer charge rather than the meter charge. (Luth Dir., ICC Staff Exhibit 8.0, pp. 2-7)

In rebuttal testimony, Ameren witness Jones agrees that the Ameren Companies are proposing to recover some meter-related costs through the customer charge, but explains that it is appropriate to recover some meter-related costs through the customer charge in accordance with the Order in Docket No. 99-0013. (Jones Reb., Respondents' Exhibit 20.0, pp. 12-13) Based on the Order in Docket No. 99-0013, the cost of Current Transformers ("CT") and Potential Transformers ("PT"), while recorded in meter-related accounts, is not subject to unbundled metering service and are therefore more appropriately included in costs recovered through the customer charge which is not subject to unbundling as is the metering charge. (*Id.*)

Staff notes that the percentage of costs in meter-related accounts that the Ameren Companies propose to include in the metering charge varies considerably among the rate classes, from nearly 100 percent of meter-related accounts for customer class DS-1 to as little as 3 percent of meter-related accounts for customer class DS-4 at AmerenIP. (Luth Reb., ICC Staff Exhibit 19.0, pp. 2-4) Staff witness Luth also notes that the overall percentages of costs in meter-related accounts recovered through the meter charge are within range of the percentage discussed in the Order in Docket No. 99-0013. Since meter service is a competitive service, it is important to properly differentiate costs recorded in meter-related accounts. (*Id.*, pp. 3-4, explaining the need for tracking meter service costs so as to prevent pricing of services that may discourage competition) Thus, in order to ensure a proper differentiation of costs included in the meter charge and costs included in the customer charge, the Commission should direct the Ameren Companies to continually review its accounting for costs recorded in meter-related accounts so that the potential development of the alternative meter service provider market is not impaired as a result of understated meter charges.

D. Inter-Class Allocation Issues

1. Allocation methodology

Staff only takes issue with the revenue allocation methodology as it is applied to one of the three Ameren Companies -- AmerenCILCO. Staff proposes that the rates for AmerenCILCO's DS-2 class increase to 4.51% instead of the 13.02% proposed by AmerenCILCO with the remaining revenue requirement added to DS-3 rates. (Harden Dir., ICC Staff Exhibit 7.0, pp. 7-8)

The Ameren Companies use a two-step criteria revenue allocation methodology. The first step targets the DS-1 through DS-3 classes, adjusting them so they receive an equal percent rate change from existing to proposed "rebundled" service. The second step of the revenue allocation criteria ensures that the DS-4 class receives at least a 5 percent increase to delivery service. (Jones Dir., AmerenCILCO Exhibit 10.0, pp. 5-6; Jones Dir., AmerenCIPS Exhibit 10.0, pp. 5-6; Jones Dir., AmerenIP Exhibit 10.0, pp. 5-6) The goal of the Ameren Companies is for each class to recover the revenue requirement based on an equalized rate of return – balancing the increase for the DS-1, DS-2 and DS-3 classes. (*Id.*, p. 5) While Staff agrees with the overall approach taken by the Ameren Companies, Staff cautions the Commission that such an approach should not be applied to the extent it causes rate shock to a class of customers. And Ameren's proposal causes such a shock to AmerenCILCO's DS-2 class (small general).

The Ameren Companies' two-step approach increases AmerenCILCO's DS-2 rates by more than 10% -- increasing from its current level of 1.83% to 13.02%. (Harden Reb., ICC Staff Exhibit 18.0, p. 4) This is a disproportionate increase to DS-2 rates, considering Ameren is proposing to reduce the rates for AmerenCILCO's DS-1 class by over 5% (*id.*), and to increase the rates for CILCO's DS-3 class by less than 1%. (Respondents' Exhibit 20.0, Schedule 20.1, p. 6 of 6, col. 4) Therefore, to reduce rate shock to AmerenCILCO's DS-2 customers, Staff proposes that AmerenCILCO's DS-2 rates increase to 4.51%, with the remaining revenue requirement recovered from DS-3 customers.

2. Minimum Distribution System Study

The Commission should reject Alan Chalfant's proposal (Chalfant Dir., IIEC Exhibit 2.0) to introduce a minimum system to allocate distribution costs ("minimum distribution system"). The Commission has consistently rejected the concept of the minimum distribution system and IIEC did not present any new evidence in this case that would warrant the Commission to change its position from previous cases.

IIEC's witness, Mr. Chalfant, supports the minimum distribution system and criticizes the ECOSS sponsored by the Ameren Companies because it fails to incorporate this concept. According to Mr. Chalfant, the minimum distribution system

> is critical to accurately allocate the costs of the distribution system. Since it is only distribution costs that are at issue with respect to delivery service rates, this omission in the Company's cost of service study is extremely important.

(Chalfant Dir., IIEC Exhibit 2.0, p. 18) He also states that "[t]he split of distribution costs between demand-related and customer-related is typically measured using either a zero intercept approach or a minimum size approach". (*Id.*, pp. 18-19) Further, Mr. Chalfant justifies his proposed minimum distribution system as follows:

> The distribution system is sized not only to accommodate demand requirements but must also be designed just to physically connect each customer's service – irrespective of size – to the system. This is above and beyond the service drop to a customer's premises because there must be an infrastructure to which the service drop can be connected.

(*Id.*, p. 19)

Consequently, Mr. Chalfant concludes that while a customer's demand requirements will influence the particular size of the distribution facilities installed, the fact that some facilities of at least a minimum size must be constructed relates to the existence and location of customers within the service territory. Unless this factor is taken into consideration, the cost of service study will depart from cost causation. (*Id.*, p. 20)

The arguments by IIEC witness Chalfant are not new nor are they persuasive. The Commission has consistently rejected the allocation of distribution costs on a customer basis (*See* Order, Docket No. 01-0444 (MidAmerica), pp. 17-19 (March 27, 2002); Order, Docket No. 00-0802 (Ameren), pp. 37-43 (Dec. 11, 2001); and Order, Docket No. 99-0121 (CIPS), p. 71 (Aug. 25, 1999)). As a result, no electric or gas utility in Illinois currently employs a minimum system to allocate costs among customer classes. (Harden Reb., ICC Staff Exhibit 18.0, p. 7)

Mr. Chalfant, for his part, does not recommend specific action in this proceeding, but asks that "… the Commission order Ameren to recognize a minimum distribution component in its next delivery service rate case or, at the very least, make available to parties the results of either a zero intercept analysis or minimum system study of its distribution Accounts 364 through 368." (Chalfant Dir., IIEC Exhibit 2.0, p. 22) IIEC has not provided compelling evidence in this docket to impose upon the Ameren Companies an obligation to perform studies for an issue which the Commission has consistently rejected. (Harden Reb., ICC Staff Exhibit 18.0, p. 8) In the absence of evidence that would indicate that the Commission may change its position in future dockets, it would be unreasonable to impose a burden upon the Ameren Companies to perform either a zero intercept analysis or minimum system study in the next rate case.

Therefore, Staff recommends that the Commission reject IIEC's proposal because IIEC has not presented any new information that would warrant the Commission changing its position from previous cases and justifying a need for the Ameren Companies to perform studies related to the minimum distribution system. (Harden Reb., ICC Staff Exhibit 18.0, p. 8)

E. Rider QF

Staff took issue with certain aspects of the Ameren Companies' proposed Rider QF. Rider QF is divided into two sections. The first section applies to Qualifying Facilities ("QF"s) and the second section applies to Qualified Solid Waste Energy

Facilities ("QSWEF"). (Rockrohr Dir., ICC Staff Exhibit 9.0, p. 16) Staff and the Ameren Companies have no contested issues concerning the second section of Rider QF that is concerning QSWEFs. (See, IV.A of this brief) However, Staff and the Ameren Companies do have a contested issue concerning first section of Rider QF.

The Ameren Companies are proposing Rider QF to replace numerous rates and riders for the respective Ameren Companies. (*Id*., p. 17) Staff witness Rockrohr took issue with Rider QF since it would not include a fixed rate of compensation in cents per kilowatt-hour that the Ameren Companies would pay a QF customer who wanted to sell excess generation to the utility. (*Id*.) Staff witness Rockrohr testified that in his opinion the ability of a customer to be able to reference a stated compensation in cents per kilowatt-hour, which the Ameren Companies current riders and rates provide for, is very helpful to the small QF operators/owners when they are deciding whether to install self-generation, or whether to connect to the utility to sell excess generation. (*Id*.) Mr. Rockrohr further testified that the terms of the proposed Rider QF could be confusing and the pricing could appear to be arbitrary, so that some QF owners might find it impossible to conduct a cost analysis. (*Id.*, p. 18)

To address his concerns, Mr. Rockrohr recommended that the Ameren Companies include in addition to their proposed language an additional compensation option that provides a fixed rate in cents per kilowatt-hour. He recommended a fixed rate be provided for summer peak, summer off-peak, winter peak, and winter off-peak periods. Mr. Rockrohr concluded that if his additional compensation option was adopted he would not object to retaining the other compensation methods the Ameren Companies propose in Rider QF. (*Id*.)

The Ameren Companies in the rebuttal testimony of witness Jones rejected Staff witness Rockrohr's proposal. (Jones Reb., Respondents' Exhibit 20.0, pp. 29-34) In particular, Mr. Jones stated that the Commission previously approved the Ameren Companies' proposal to apply purchased QF energy to Rider RTP-L customers, and therefore the Ameren Companies' avoided cost would be the cost avoided under BGS-LRTP Supplier Forward Contracts. He points out that if Mr. Rockrohr's fixed price option were adopted RTP-L customers would be at risk for any differences between the BGS-LRTP Supplier Forward Contract price and the Rider QF fixed price. (Id., p. 32) Staff witness Rockrohr pointed out that over time a fixed price option would likely have very little effect on the energy costs that RTP-L customers would pay, since the Ameren Companies would have all available information to determine avoided costs. Mr. Rockrohr testified that the same data sources which the Ameren Companies proposed to make available to QF customers could be used by the Ameren Companies to develop a fixed price option for Rider QF customers, in a manner generally similar to the development of historical QF rates. Mr. Rockrohr noted that utilities have been estimating avoided energy costs when determining QF rates since 83 Ill. Admin. Code Part 430 became effective in June of 1981. (Rockrohr Reb., ICC Staff Exhibit 20.0, p. 6)

Staff witness Rockrohr's position regarding Rider QF is consistent with the position taken by Staff in Commonwealth Edison Company's ("ComEd") recent delivery services rate case, ICC Docket No. 05-0597. In that case, ComEd proposed a tariff similar to Rider QF which ComEd called Rider POG (Parallel Operation of Retail Customer Generating Facilities) The Commission in its Final Order in Docket 05-0597 rejected ComEd's Rider POG as proposed and found merit in Staff's position regarding a fixed price option. (ICC Docket No. 05-0597, Order at 232-233) The Commission ultimately ordered that ComEd modify its proposed Rider POG to include a fixed price option for the QF customer. The Commission ordered ComEd to annually update the rate just as ComEd had done in the past. (*Id*.) For the above stated reasons and those set forth in detail in Staff witness Rockrohr's testimony the Ameren Companies should be ordered by the Commission to modify Rider QF to include a fixed price option.

F. Supply Procurement Adjustment

1. Recovery of supply-related costs

The Ameren Companies agreed with three of Staff's proposals with respect to the recovery of supplied related costs. They are as follows:

a. Allocation of Costs Among the Ameren Companies-Uncontested

Staff witness Ebrey proposed a change to the Supply Procurement Adjustment (SPA) to allocate the total costs for recovery based on the relative kilowatt-hour sales of each utility rather than an equal one-third allocation proposed by the Ameren Companies. (Ebrey Dir., ICC Staff Exhibit 2.0, p. 24) The Ameren Companies accepted Staff's proposed allocation basis. (Stafford Reb., Ameren Exhibit 16.0, p. 36)

b. Cash Working Capital Rate-Uncontested

Staff did not contest the Ameren Companies' proposed cash working capital rate of .3080% associated with power supply, but recommended that the rate be recalculated in future rate cases. (Ebrey Dir., ICC Staff Exhibit 2.0, pp. 24-25) The Ameren Companies agreed to recalculate the CWC rate in future delivery service rate cases. (Stafford Reb., Ameren Exhibit 16.0, p. 38)

c. Uncollectibes Rate-Uncontested

Staff took issue with the Ameren Companies' proposed uncollectibles rate and, instead, proposed that the same uncollectibles rate agreed to by the Ameren Companies for the delivery services rates be used as the uncollectibles rate for the SPA adjustment. (Ebrey Reb., ICC Staff Exhibit 13.0 (Corrected), pp. 24-25) The Ameren Companies agreed with Staff's recommendation. (Stafford Sur., Respondents' Exhibit 36.0, p. 42)

2. Amount of supply-related costs

Staff does not take issue with the original total costs ($812,857) the Ameren Companies proposed to recover under the Supply Procurement Adjustment ("SPA") charge. (Ebrey Reb., ICC Staff Exhibit 13.0 (Corrected), p. 26) However, Staff and the Ameren Companies do not agree on the appropriate treatment of the BGS tariff support costs to be recovered through the SPA. It is the Ameren Companies' position that BGS tariff support costs should be recovered through base rates. (Stafford Reb., Ameren Ex. 16.0, pp. 13-14) It is Staff's position that BGS tariff support costs should be recovered through the respective SPA charges, but only those costs that the Ameren Companies can substantiate. These costs would be in addition to the total SPA costs of $812,857 proposed by the Ameren Companies. (Jones Dir., ICC Staff Exhibit 3.0, pp. 6-7)

Similar to the methodology used to determine recoverable rate case expense, Staff reviewed invoices received prior to the filing of rebuttal testimony to determine what percent of the BGS tariff support costs requested by the Ameren Companies had been incurred in that prior case for each service provider and should be included in the

SPA. (Jones Reb., ICC Staff Exhibit 14.0, p. 10) The recoverable costs thus determined amount to $2,243 million. (*Id.*, Schedule 14.02 (CIL), (CIPS), (IPC))

The Ameren Companies agree that, regardless of the recovery mechanism, BGS tariff support costs recovered should be amortized over a three-year period. (Tr., pp. 490-491) Thus, the total annual amount of BGS tariff support costs to be recovered through the SPA charges is $747,667, which is in addition to the total annual SPA costs of $812,857 proposed by the Ameren Companies.

CNE/PES witness O'Connor has identified additional costs he characterizes as being procurement related. (O'Connor Reb.,CNE/PES Ex. 4.0, pp. 7–9) Staff does not agree that the identified costs have been adequately identified as being procurement related, but recommends that to the extent the Commission finds such costs to be recoverable through the SPA, a corresponding decrease to the revenue requirement would need to be made. (Ebrey Reb., ICC Staff Exhibit 13.0 (Corrected), p. 27)

3. SPA tracking through the Market Value Adjustment Factor

Staff opposed the Ameren Companies proposal that the Market Value Adjustment Factor (MVAF) be the tracking mechanism for "precise recovery" of the SPA costs. First, the Ameren Companies claim that the MVAF was approved by the Commission in the proceedings that established a procurement mechanism for electric power and energy supply, Docket Nos. 05-0160/05-0161/05-0162 (Cons.). (Cooper Sup. Dir., AmerenCIPS Exhibit 8.0S, p. 4, lines 72 – 75) While the MVAF was approved to ensure equality between amounts paid to suppliers and amounts billed to retail customers, it was not approved to track SPA costs. In fact, the Commission recently rejected this very proposal. The Order in Docket Nos. 05-0160/05-0161/05-0162 (Cons.) states:

> While the Commission understands that Ameren is concerned about the possibility of under-recovery due to fluctuating kWh sales, the Commission is not prepared to adopt Ameren's proposed Rider MV tracking mechanism for SPA costs at this time.

(*Central Illinois Light Co., Central Illinois Public Service Co., and Illinois Power Co.*, ICC Docket Nos. 05-0160/05-0161/05-0162 (Cons.), (Order, Jan. 24, 2006), p. 229)

Second, the same arguments presented in the procurement proceeding have been repeated in the instant proceeding. No new arguments for the approval of SPA tracking through the MVAF have been put forth; thus, the Commission has no more reason to adopt the Ameren Companies proposal now than it did in Dockets 05-0160/05-0161/05-0162 (Cons.).

The MVAF as approved in the procurement proceeding is to ensure equality between amounts paid to suppliers and amounts billed to customers. Tracking the SPA through the MVAF would not ensure SPA costs incurred are equal to SPA costs billed, but would compare defined costs set in a past test year with actual amounts recovered from customers in the current period. In order to achieve the kind of true-up the Ameren Companies seek, one must reconcile costs actually incurred in a particular period with recoveries for that same period. Instead, the Ameren Companies' proposal reconciles recoveries for the Determination Month with the absolute dollar amounts from the test year in the last rate case. Such a reconciliation results in a mismatch of costs and recoveries from two different periods, which would likely reflect different levels of sales and different levels of costs.

When a rate is set in a rate case, that rate reflects a relationship between a given level of service and the cost to provide that level of service. So long as the relationship between costs and the level of service reflected in that rate remains within appropriate parameters, appropriate cost recovery occurs even when the level of service varies over periods of time. (Ebrey Dir., ICC Staff Exhibit 2.0, pp. 26-28)

The Ameren Companies counter Staff's testimony claiming that Staff had not "recognized the significant transition that will take place post 2006." (Cooper Reb., Respondents' Exhibit 18.0, p. 5) In fact, Ameren witness Cooper does not seem to know if the transition to market-based rates "*will result* in greater switching" (Cooper Reb., Respondents' Exhibit 18.0, p. 4) or if the transition simply "*could result* in significant customer switching". (*Id.*, p. 5) Further, Mr. Cooper stated that the Ameren Companies have not developed any estimates of post 2006 levels of switching activity, nor is there a need to develop the estimate of switching. (Ebrey Reb., ICC Staff Exhibit 13.0 (Corrected), p. 25, citing to Companies' Response to Staff data request TEE 10.09) While Staff did agree that it is possible some level of switching may occur post 2006, the Ameren Companies offered no estimate of any level it supposes might occur. Lacking any support for the Ameren Companies' claim, it must not be considered in the determination of the issue of tracking the SPA costs through the MVAF. (Ebrey Reb., ICC Staff Exhibit 13.0 (Corrected), p. 25)

Summary

Staff supports the Ameren Companies' proposal to recover the $812,857 of supply procurement related charges through the SPA charge. This level of costs should be adjusted for BGS support costs to the extent that a level of costs has been supported as addressed by Staff witness Jones (Jones Reb., ICC Staff Exhibit 14.0, pp. 10-11) and for any other costs the Commission deems appropriate for recovery through the SPA charge. The Ameren Companies have agreed that the allocation of costs should be based on kilowatt hours for each operating Company, and that the CWC factor should be recalculated at the time of each succeeding rate case. For consistency, the uncollectibles gross-up factor should be based on the uncollectibles rate proposed by Staff and accepted by the Companies. The "true-up" of SPA costs through the MVAF is nothing more than a novel ratemaking theory to attempt to collect a relatively insignificant amount through a rider, and thus should not be approved.

G. Line Extension Refunds

Staff witness Greg Rockrohr testified regarding distribution line extension provision to individual customers as proposed in the various Ameren Companies' Standard and Qualification sections of their respective tariffs. (e.g. Central Illinois Light Company, Ill. C.C. No. 18, Original Sheet No. 4.009, 2nd paragraph) As set forth in Mr. Rockrohr's testimony, Subsection 3.B.1(a) of each of the Ameren Companies' Standards and Qualifications states as follows:

> The Company shall provide Extensions of the Distribution System as described in this Section in lieu of 83 Ill. Admin. Code Part 410.

(Rockrohr Dir., ICC Staff Exhibit 9.0, pp. 4-5)

Mr. Rockrohr explained that the Ameren Companies are proposing a treatment of refundable deposits received from applicants that does not comply with the Commission's rules. The Ameren Companies' proposed line extension provision requires that an applicant for residential service make a refundable deposit when the free extension length is exceeded. The refundable deposit would then be subject to refund without interest for a 5 year period. This aspect of the Ameren Companies' provision is less favorable to applicants than the Commission's provisions, which under the same circumstances provides that the deposit be subject to refund for a 10 year period (83 Ill. Adm. Part 410, Section 410.410(c)(2)). (Rockrohr Dir., ICC Staff Exhibit 9.0, p. 6)

In Section 410.410(a)(2) the Commission requires that a provision in lieu of 83 Ill. Admin. Code Part 410, such as the provision the Ameren Companies propose, must be demonstrated to be "generally more favorable to applicants than the provisions of subsections (b) and (c)". (83 Ill. Adm. Part 410, Section 410.410(a)(2)) However, Mr. Rockrohr in his testimony explained why a five year versus a ten year refund period was less favorable to applicants. He found it to be less favorable due to the manner in which refunds are determined. Mr. Rockrohr explained that a refund of all or part of the applicant's deposit will occur only if the utility uses the facilities that were covered by the deposit to supply additional customers. The shorter period of time for refunds in the Ameren Companies' provision (5-years instead of 10-years) is less favorable to applicants than the Commission's provision, since the period of time for potential refund(s) is only half as long. In addition Mr. Rockrohr testified that the Ameren Companies had not demonstrated that other aspects of their proposed line extension provision would cause their provision, as a whole, to become generally more favorable to applicants. (Rockrohr Dir., ICC Staff Exhibit 9.0, pp. 6-7)

Mr. Rockrohr did acknowledge that some aspects of the Ameren Companies provisions might be considered more favorable to some non-residential applicants given that those non-residential customers who might normally be required to pay a refundable deposit might instead receive an extension at no cost. (Id., p. 7) However, the plain language of Section 410.410(a)(2), despite Mr. Carls' claims to the contrary (Carls Rebut., Respondents' Exhibit 31.0, p. 10), requires that the provision must be generally more favorable to "applicants" not just more favorable to some non-residential applicants. Mr. Rockrohr's testimony supports this interpretation as well when Mr. Rockrohr testified "I do not believe that the Ameren Companies' provision meets the requirements of Subsection 410.410(a)(2) simply because it might at times be more favorable to a certain type of applicant." (Id., p. 8)

In its rebuttal testimony the Ameren Companies suggested additional benefits its proposed provision would offer to residential customers, those being:

> a) an option for a reduced upfront charge that assumes there will be one new customer extended from this extension, in return for making the payment become a non-refundable contribution; b) the change from existing practices to make the demarcation point between line/service extensions be the customer's property line, which will result in more extensions meeting the definition of 'service' instead of 'line', and c) an option for the customer to install conduit for service extensions and possibly for some line extensions, which could reduce the amount, if any, of the required payment.

(Carls Reb., Respondents' Exhibit 31.0, pp. 10-11)

In Mr. Carls' opinion these three "benefits" are all "'generally more favorable'" to residential customers than those required by Part 410. (Id., p. 11) Staff witness Rockrohr in his rebuttal testimony explained how these three additional "benefits" i.e. a, b and c above suggested by Mr. Carls did not cause the Ameren Companies' extension provisions to be generally more favorable to applicants than the Commission's provisions. In particular, Mr. Rockrohr pointed out that "benefit" a) would only benefit an applicant if no additional applicants utilized the line extension but would be of no benefit if other applicants did. (Rockrohr Rebut., ICC Staff Exhibit 20.0, p. 9) With regard to "benefit" b) Mr. Rockrohr acknowledged that changing the demarcation point could result in the refundable deposit being reduced due to a shorter line extension length, but it logically would follow that the applicant's non-refundable contribution for longer service would likely increase. (Id., pp. 9-10) Therefore on an overall basis the cost to an applicant might "go up, down or stay about the same". (Id., p. 10) Finally with respect to "benefit" c) since Mr. Carls did not explain and the Ameren Companies did not provide the criteria to be used to determine if an applicant would be allowed to install conduit for a line extension, one could not determine that a benefit even existed. Therefore, even after considering "benefits" a, b, and c, Mr. Rockrohr could not conclude that the line extension provision the Ameren Companies propose was generally more favorable than the Commission's provisions. (Id.)

To eliminate the Section 410.410(a)(2) compliance issue, Mr. Rockrohr recommended that the Ameren Companies modify their extension provisions so that Section 410.410(a)(1) applied rather than Section 410.410(a)(2) by allowing applicants the choice of (1) obtaining the line extension as the Ameren Companies propose or (2) obtaining the line extension under the Commission's provisions contained in Subsections 410.410(b) and (c). (Id.) The Ameren Companies rejected this alternative in Mr. Carls' Surrebuttal testimony (Carls Sur., Respondents' Exhibit 51.0, p. 3) The Commission should not allow Ameren to offer its proposal for a 5-year refund period in lieu of the Commission provisions set forth in 410.410(b) and (c), in particular 410.410(c)(2) (ten year refund time period provision)). Should the Commission reject the proposed 5-year refund period, which it should, the Ameren Companies indicate that instead of offering applicants the choice of obtaining the line extension under either the

Ameren Companies' or the Commission's provisions, as Mr. Rockrohr suggests, the Ameren Companies would prefer to change the refund tracking period in its provision from 5 to 10 years. Staff's concern with the Ameren Companies' proposed line extension provision was that the provision limited the time an applicant would qualify for a deposit refund to five years. (Carls Sur., Respondents' Exhibit 51.0, p. 3)

Staff finds the alternative extension provision, which the Ameren Companies conditionally proposed in surrebuttal testimony in the event the Commission rejected their initial proposal, to be acceptable. That is, changing the proposed refund period from 5 to 10 years for applicants who are required to pay refundable deposits for line extensions, and continuing to offer the Ameren Companies' line extension provision "in lieu of" Part 410 is acceptable to Staff.

H. Residential RTP Program

Staff witness Schlaf explained that real-time pricing ("RTP") is a form of demand response ("DR"), a category that includes measures such as energy efficiency and load response programs that are generally intended to induce customers to shift or reduce their consumption when market prices are expected to be relatively high. Dr. Schlaf stated that implementation of DR programs can potentially result in number of societal benefits, including a reduction in price volatility, improved reliability, and improvements in the environment. (Schlaf Reb., ICC Staff Exhibit 22.0, p. 4)

CUB witness Thomas recommended that residential RTP customers be permitted to take that service without paying the incremental metering fees that customers that switch from bundled service to RTP service would typically pay. The incremental metering fees arise because an interval recording meter ("IDR") is required to measure the hourly consumption of RTP customers, and IDR meters are more costly than the watt-hour meters that normally installed on a residential customer's premises. (Thomas Dir., CUB Exhibit 2.0 (Corrected), p. 31) Under Mr. Thomas' proposal, incremental metering costs would be spread among all residential customers to reduce the financial barriers that may inhibit the introduction of RTP among such customers. (*Id.*) Mr. Thomas also provided an estimate of monthly incremental charges that would be imposed on non-RTP customers as a result of his proposal, assuming that 20,000 residential customers would select RTP service in the Ameren service territories during 2007-2010. (Thomas Reb., CUB Exhibit 4.07)

Dr. Schlaf expressed doubt that the CUB proposal would provide net benefits – that is, benefits in excess of costs – to the residential customers that pay do not take RTP service unless a very high percentage of residential customers switched their usage from peak periods to off-peak periods. (Schlaf Reb., ICC Staff Exhibit 22.0, p. 9) As Dr. Schlaf testified, the Ameren Companies are members of the Midwestern Independent Transmission System Operator ("MISO") market, a large energy market of which the Ameren system is only a small part. Dr. Schlaf concluded that a switch of 20,000 residential customers to RTP service would be unlikely to affect energy prices in the MISO market to a sufficient degree so as to justify the proposed cross-subsidies that are at the heart of the CUB proposal. (*Id.*) He also concluded that other potential benefits of the CUB proposal would not have more than a negligible impact on the Ameren system. (*Id.*) While CUB cited studies that it believes provides supports for its proposal (Thomas Dir., CUB Exhibit 2.0 (Corrected), pp. 23-25), Dr. Schlaf explained that these studies have only a tangential relevance to the question of net benefits and should not be relied upon as support for Mr. Thomas' real-time pricing proposal.

For all of these reasons, Staff does not recommend approval of the CUB proposal.

Furthermore, on June 30, 2006, Governor Blagojevich signed into law Public Act 94-0977, legislation that requires utilities to file real-time pricing tariffs for Commission review. The Commission must review the tariffs from a net benefits perspective. The newly enacted Section 16-107(b)(5) of the Public Utilities Act states:

> The Commission may, after notice and hearing, approve the tariff or tariffs, provided that the Commission finds that the potential for demand reductions will result in net economic benefits to all residential customers of the electric utility. In examining economic benefits from demand reductions, the Commission shall, at a minimum, consider the following: improvements to system reliability and power quality, reduction in wholesale market prices and price volatility, electric utility cost avoidance and reductions, market power mitigation, and other benefits of demand reductions, but only to the extent that the effects of reduced demand can be demonstrated to lower the cost of electricity delivered to residential customers.

(220 ILCS 5/16-107(b)(5))

In his surrebuttal testimony, Ameren witness Jones sponsored a tariff, Rider ESP, that Ameren believes meets the requirements of Public Act 94-0977. (Jones Reb., Respondents' Exhibit 41.0, p. 31; Tr., pp. 909-910) However, the Ameren Companies have not supported Rider ESP with evidence about any of the potential benefits that are listed in Section 16-107(b)(5) of the Public Utilities Act (220 ILCS 6/16-107). Nor has Ameren has presented a net benefits calculation for the Commission's consideration. (Ameren Response to ICC Staff Data Requests EPS 1.08 and EPS 1.09, ICC Staff Cross Exhibit 16) Therefore, Staff does not consider Rider ESP to be responsive to Public Act 94-0977 and does not recommend its approval. Thus, Ameren's proposed recovery of a total of $1,484,531, as described in the Ameren response to ICC Staff Data Request EPS 1.05 (ICC Staff Cross Exhibit 16), should not be included in Ameren's revenue requirement.

Ameren witness Jones notes that Rider ESP could serve as the basis for a pilot program. (Jones Sur., Respondents' Exhibit 41.0, p. 32) While Staff does not have a position as to whether Rider ESP is the appropriate tariff to enable Ameren residential customers to take RTP service on a pilot basis, Staff is not averse to discussing the implementation of a residential RTP pilot program with Ameren, CUB, and other interested parties.

I. Other

1. RES Issues

Except for an issue involving Supply Procurement Adjustment charges, the Memorandum of Understanding between Ameren and CNE-PES (Ameren CNE-PES Joint Exhibit 1), which Staff did not object to, appears to resolve all issues between Ameren and CNE-PES.

V. MISCELLANEOUS SERVICE ISSUES

A. Line and Service Extensions

B. Metering Services

1. Staff Electric Meter Audits

Given that delivery service rates are not only determined by the revenue requirement but also by the amount of power and energy an electric utility delivers to its customers, Staff offered testimony in this proceeding on its findings concerning the Ameren Companies' electric meter testing facilities and electric meter testing practices.

(Rockrohr Dir., p. 21-22) Pursuant to the Commission's rules, 83 Ill. Adm. Code Part 410.140(e), an authorized representative of the Commission is to perform an audit of a electric meter testing equipment and the testing methods at least every three years. (*Id*., p. 22) For the Ameren Companies Mr. Rockrohr performed these duties in June 2003 for AmerenCIPS, October 2004 for AmerenIP and October 2005 for AmerenCILCO. Mr. Rockrohr in his testimony also noted that if a utility chooses to adopt manufacturer test results, the Staff audits the manufacture's testing facilities and practices in order to verify compliance with the Commission's metering rules. *(Id*.)

Staff's findings from its most recent audits of the Ameren Companies are contained in letters sent to the Ameren Companies, copies of which were attached to Mr. Rockrohr's direct testimony as Schedule 9.08 (CIL), 9.08 (CIPS) and 9.08 (IP). As noted in Mr. Rockrohr's direct testimony, Staff found the Ameren Companies complied with most of the requirement included in Part 410, but AmerenCIPS and AmerenIP each failed to demonstrate compliance with six of Part 410's requirements. (*Id*., p. 23) However, as further noted in Mr. Rockrohr's testimony, the Ameren Companies responded to the Staff letters and provided plans to address Staff's findings and recommendations. (*Id*., pp.23-24)

Finally, Mr. Rockrohr noted that one electric metering issue has arisen since the time that Staff performed its audits, that issue being Staff's understanding that as part of an automated meter reading expansion the Ameren Companies plan to remove older electric meters from service and then reinstall them. Subsection 410.120(e) requires that for any meter installed after January 1, 2001 the meter must meet standards set forth in Section 4.7 of American National Standards Institute' ("ANSI") Code for

Electricity Metering, 1995 edition ("ANSI C12.1-1995"). Many of the older meters the Ameren Companies plan to remove from service and then reinstall have not been certified to meet the standards set forth in Section 4.7 of ANSI C12.1-1995. Staff witness Rockrohr acknowledge that the Ameren Companies along with other Illinois electric utilities filed a petition on April 24, 2006 seeking a declaratory ruling regarding the requirements of subsection 410.120(e). That matter was docketed as ICC Docket No. 06-0338. Given the petition for declaratory ruling filed by the Ameren Companies and the other Illinois electric utilities the Commission need not address the subsection 410.120(e) issue in this docket.

C. Vegetation Management/Tree Trimming

Staff has addressed the Ameren Companies' obligation to trim trees consistent with a no-contact approach under NESC Rule 218, as adopted under Part 305, in Section II.B. above, as a preliminary issue in connection with the Ameren Companies' request to recover additional costs if the Commission finds they are required to trim trees consistent with a no-contact approach. Of course, the Ameren Companies' request to recover additional costs if the Commission finds they are required to trim to a no-contact approach necessarily admits that they do not trim trees in compliance with a no-contact requirement at this time. (*See* Spencer Dir., ICC Staff Exhibit 10.0, pp. 5-9, 13-15, 19-20) In addition to finding that the Ameren Companies are obligated under NESC Rule 218 as adopted in Part 305 to trim trees consistent with a no-contact approach, the Commission should notify the Ameren Companies that they will be expected to bring their operations into full compliance with this requirement. Staff also provided information on the status of the Ameren Companies' tree trimming efforts to consider in connection with system reliability. This information is provided below in Section III.D.

D. Other

1. Three-phase Residential Customers Grandfather Clause-Uncontested

AmerenIP and AmerenCILCO proposed discontinuing 3-phase service to residential customers as part of a standard offering. (Rockrohr Reb., ICC Staff Exhibit 9.0, p. 15) Staff witness Rockrohr recognized that the service is uncommon and found utilizing excess facilities rules for new three-phase residential services to be reasonable. However he recommended that the Ameren Companies include an additional paragraph in the “Grandfathering Provisions” section of Rate DS-1 that states that existing customers can continue three-phase service without having to pay an excess facilities charge. (*Id*., pp. 15-16) Mr. Rockrohr found a “Grandfathering Provision” to be reasonable because had three phase customers known an excess facilities charge was going to be imposed they might have decided to eliminate their need for three-phase service by purchasing their own converter or utilizing single-phase equipment. (*Id*., p. 15) Ameren Company witness Jones included in his rebuttal testimony “Grandfathering Provision” language which generally was acceptable to Mr. Rockrohr with minor revisions. (Rockrohr Reb., ICC Staff Exhibit 20.0, p. 4) The language Mr. Rockrohr proposed is set forth in detail in his testimony at lines 84 to 89. (*Id*.) The Ameren Companies agreed to those minor revisions in their rebuttal and surrebuttal testimony of witness Jones. (Jones Reb., Respondents’ Exhibit 20.0, pp. 17-18 and Jones Sur., Respondents’ Exhibit 41.0, pp. 19-20) For the above reasons and those set forth in Mr.

Rockrohr's testimony, Mr. Rockrohr's proposed language as set forth in his rebuttal testimony should be adopted. (Rockrohr Reb., ICC Staff Exhibit 20.0, p. 4)

2. Tariff Clarifications-Uncontested

a. Stand-alone generator-Uncontested

In his direct testimony Staff witness Rockrohr recommended that the Ameren Companies add a statement to Section 14.D of Customer Terms and Conditions to make it clear that they did not intend to prohibit a customer from using a stand-alone generator. Ameren witness Jones in his rebuttal testimony confirmed that was not Ameren's intent and agreed to provide the clarifying language in the Customer Terms and Conditions section. (Jones Reb., Respondents' Exhibit 20.0, p. 38) Ameren confirmed that understanding again in its surrebuttal testimony. (Jones Sur., Respondents' Exhibit 41.0, p. 20) For the above reasons, the language agreed to by Staff and the Ameren Companies should be adopted.

b. Non-refundable deposit calculation –Uncontested

In his direct testimony Staff witness Rockrohr testified that certain language in Subsection 3.B.1(d)(i) of each of the Ameren Companies' Standards and Qualifications for Electric Service was confusing on the issue of how to calculate the Non-Refundable Contribution. (Rockrohr Dir., ICC Staff Exhibit 9.0, pp. 19-20) To clear up the confusion Ameren witness Carls agreed to include an amendment to the language originally proposed for Subsection 3.B.1(d)(i). (Carls Reb., Respondents' Exhibit 31.0, p. 12) Staff witness Rockrohr found the proposed language to be adequate. (Rockrohr Reb., ICC Staff Exhibit 20.0, p. 11) For the above reasons the language agreed to by Staff and the Ameren Companies as set forth in Mr. Carls' rebuttal testimony should be adopted.

3. Staff's Reports on Service Reliability

a. AmerenCILCO

Staff witness Rockrohr offered testimony on AmerenCILCO's service reliability with the intent of providing the Commission with information to gauge the effectiveness of AmerenCILCO's service reliability efforts and expenditures. (Rockrohr Dir., ICC Staff Exhibit 9.0, p. 25) Mr. Rockrohr based his evaluation of AmerenCILCO's service reliability for the past year upon information provided in AmerenCILCO's annual reliability report for calendar year 2004 which was filed in June of 2005, information provided in response to Staff data requests, and the results of his own field inspections. (*Id.*) Mr. Rockrohr's evaluation was documented in a Staff report that was adopted by the Commission within Docket 06-0213. (*Id.*) While the details of Mr. Rockrohr's evaluation are contained in the Staff report which was attached to his testimony as Schedule 9.09, Mr. Rockrohr noted in his testimony that AmerenCILCO reported improved reliability indices during 2004 when compared to 2003. Mr. Rockrohr testified that AmerenCILCO's improved indices indicated that on average, AmerenCILCO's customers experienced fewer and shorter interruptions in 2004 compared to 2003. (*Id.*) However, Mr. Rockrohr further noted that when a comparison is made to other utilities in Illinois, AmerenCILCO's system reliability performance appears to be below the average. (*Id.*) Mr. Rockrohr further noted that AmerenCILCO had a high CAIDI for several consecutive years. Mr. Rockrohr explained that a higher CAIDI indicates that when a customer has an interruption that customer is out of service for a longer period of time. Mr. Rockrohr recommended that AmerenCILCO undertake several steps to further improve its reliability performance, including: (1) inspect distribution circuits and equipment more frequently (including substation equipment), (2) more promptly remedy problems discovered as a result of inspections, (3) modify its practices associated with underground equipment related interruptions to reduce CAIDI and (4) assure its trees are trimmed in such a manner that they do not contact power lines. (*Id*., p. 26)

b. AmerenCIPS

Staff witness Spencer offered testimony on AmerenCIPS' service reliability with the intent of providing the Commission with information to gauge the effectiveness of AmerenCIPS' service reliability efforts and expenditures. (Spencer Dir., ICC Staff Exhibit 10.0, pp. 8-9) Mr. Spencer based his evaluation of AmerenCIPS' service reliability for the past year upon information provided in AmerenCIPS' annual reliability report for calendar year 2004 which was filed in June of 2005, information provided in response to Staff data requests, and the results of his own field inspections. (*Id*.) Mr. Spencer's evaluation was documented in a Staff report that was attached to his testimony as Schedule 10.01 (CIPS). (*Id*., p. 9, Schedule 10.01 (CIPS)) While the details of Mr. Spencer's evaluation are contained in the Staff report, Mr. Spencer quoted in his testimony some of his key findings regarding AmerenCIPS' reliability, including the following:

- AmerenCIPS' reported company-wide system average interruption frequency index ("SAIFI") for 2004 was 22% higher (worse) than reported for year 2003, and is 5% higher than reported for 2002. Its overall SAIFI performance was sixth highest (worst) among the nine reporting utilities in 2004. AmerenCIPS' worst circuit SAIFI for 2004 was 13.5% worse than that reported for 2003 and has been worsening in each of the past three years. AmerenCIPS' worst circuit SAIFI in 2004 was the worst of all the reporting Illinois utilities.

- AmerenCIPS' reported company-wide customer average interruption duration index ("CAIDI") for 2004 was 20.4% worse that it reported for year 2003, and has shown a steadily worsening trend since 2000. AmerenCIPS ranked exactly in the middle of the nine-utility group in this category in 2004. AmerenCIPS' worst circuit CAIDI for 2004 was more than double what it reported for 2003, but was 17.5% better than in 2002. At 2,481 minutes (over 41 hours), AmerenCIPS ranked seventh among the nine reporting utilities in this category in 2004, with only AmerenIP and AmerenCILCO performing worse.

- AmerenCIPS underspent its distribution O&M budget by nearly 20% in 2004. While budgeting nearly $44 million for distribution O&M in 2004, AmerenCIPS reported that its actual expenditures for distribution O&M were nearly $8.7 million below that figure and well below what it has spent for distribution O&M in each of the past three years. This reduction in distribution O&M spending is reflected in the significant reduction in electric service reliability during the same time period.

- Staff found two National Electrical Safety Code (NESC) violations during its circuit inspections that AmerenCIPS resolved after notification from Staff. Staff also noted the need for more animal guards, the need for more lightning arresters, and several other problems on AmerenCIPS' worst performing and other circuits inspected this year. AmerenCIPS should perform field inspections of all circuits on a regular basis and correct the problems found which can significantly affect reliability or public safety.

(*Id*., p. 10)

While AmerenCIPS disputed some of the findings in Staff's report, Mr. Spencer explained why AmerenCIPS' assertions lacked merit and failed to undermine the importance to system reliability of Staff's findings. (*Id*., pp. 11-12) In particular, with respect to AmerenCIPS claim that the budgeted and actual O&M expenditures were not stated on a comparable basis, Mr. Spencer pointed out that this assertion was not consistent with statements in its data request response to Staff and, most importantly, the Company failed to provide figures that were comparable. (*Id*.) In short, the only available information provides a reasonable basis for Staff to conclude that AmerenCIPS under-spent its 2004 O&M budget by a significant amount. (*Id*.)

With respect to tree trimming, Mr. Spencer provided information on a recent tree trimming inspection he performed. In an April 2005 random inspection of AmerenCIPS distribution lines in Herrin, Illinois, Mr. Spencer found no tree contacts. (*Id*., p. 12) In Staff's reliability assessment report (Schedule 10.01 (CIPS)), Mr. Spencer further noted that AmerenCIPS reported that it achieved a four-year tree trimming cycle on June 22, 2004, and that Staff had observed improvement compared to prior years in AmerenCIPS' tree trimming program. (*Id*.) He noted, however, that the number of Staff field observations were very limited in 2005. (*Id*.) Moreover, notwithstanding the apparent improvement, Mr. Spencer pointed out that Staff's report highlighted the need to comply with NESC Rule 218 to assure that there are no contacts between trees and energized conductors before it returns to trim again. (*Id*., p. 13)

c. AmerenIP

Staff witness Spencer offered testimony on AmerenIP's service reliability with the intent of providing the Commission with information to gauge the effectiveness of AmerenIP's service reliability efforts and expenditures. (Spencer Dir., ICC Staff Exhibit 10.0, pp. 14-15) Mr. Spencer based his evaluation of AmerenIP's service reliability for the past year upon information provided in AmerenIP's annual reliability report for calendar year 2004 which was filed in June of 2005, information provided in response to Staff data requests, and the results of his own field inspections. (*Id*., pp. 15-16) Mr. Spencer's evaluation was documented in a Staff report that was attached to his testimony as Schedule 10.01 (IPC). (*Id*., p. 16, Schedule 10.01 (IPC)) While the details of Mr. Spencer's evaluation are contained in the Staff report, Mr. Spencer quoted in his testimony some of his key findings regarding AmerenIP's reliability, including the following:

- AmerenIP's reported company-wide SAIFI for 2004 worsened by 17% from that reported for year 2003, and nearly 30% from that reported for 2002. Its overall

SAIFI performance was exactly in the middle of the nine-utility group in 2004. AmerenIP's worst circuit SAIFI for 2004 was 13% better than that reported for 2003 and was slightly worse than average among the other utilities, with three utilities performing worse in this category in 2004.

- AmerenIP's reported company-wide CAIDI for 2004 was 17.5% worse that it reported for year 2003, and has shown a significantly worsening trend since 2001. Only AmerenUE (278 minutes) reported a worse average overall customer interruption duration than AmerenIP's 268 minutes in 2004. AmerenIP's worst circuit CAIDI for 2004 was 32.4% worse than for 2003 and has shown a significant worsening trend since 2001. At 3,011 minutes (over 50 hours), AmerenIP ranked last among the nine reporting utilities in this category in 2004.

- Staff found fourteen National Electrical Safety Code (NESC) violations during its inspections of AmerenIP electric circuits this year, all of which pose a threat to service reliability and public safety. At Staff's request, AmerenIP field checked all of its electric line crossings of interstate highways and found 110 of those crossings were not in compliance with the current NESC. Numerous structural and lightning arrester problems were also noted on AmerenIP's worst performing and other circuits inspected this year. Many of these problems, while not necessarily causes of poor performance in 2004, will have adverse effects on reliability and public safety in the future if not corrected. AmerenIP should perform field inspections of all circuits on a regular basis and correct the problems found which can significantly affect reliability or public safety.

(*Id.*, pp. 16-17; Schedule 10.01 (IPC)) Mr. Spencer also noted that Staff's report included a recommendation that:

> AmerenIP should take a more proactive role in finding and addressing National Electric Safety Code (NESC) violations throughout its electric system and in preventing such occurrences in the first place. Staff discovered fourteen NESC violations on AmerenIP circuits this year [2005], all of which pose a risk to service reliability and public safety. While AmerenIP has been responsive in resolving these issues when discovered by Staff, it should not rely on Staff to cause the code violations to be addressed.

(*Id.*, p. 17)

Mr. Spencer also stated that AmerenIP expressed concern about two of the findings in Staff's report. One concern related to Staff's statement that it was not clear if incorporation of Ameren's fuse tap program for AmerenIP was a reliability improvement. (*Id.*) Mr. Spencer explained that although he agrees additional fuse taps are generally considered a reliability improvement, Staff stood by its statement in that no information was provided indicating that Ameren's fuse tap program is an improvement over AmerenIP's existing fuse tap practices. (*Id.*) The second concern expressed by AmerenIP addressed the same budget versus actual O&M expenditures discussed above for AmerenCIPS. (*Id.*, p. 18) Similar to the discussion above, Mr. Spencer explained that the Company failed to provide figures that were comparable. (*Id.*)

With respect to tree trimming, Mr. Spencer provided information on recent tree trimming inspections he performed. In the May and June 2005 inspections of AmerenIP overhead lines in Decatur and Jacksonville, Illinois, Mr. Spencer found noticeable improvement in the Company's tree trimming but also found many contacts in both cities. (*Id.*, p. 19) Mr. Spencer also pointed out that Staff's report highlighted the need to comply with NESC Rule 218. (*Id.*, p. 19)

d. Conclusion

Staff is hopeful that the Commission finds the information concerning the Ameren Companies' reliability performance helpful in gauging the effectiveness of AmerenCILCO's service reliability efforts and expenditures.

VI. RESPONSES TO COMMISSIONERS' QUESTIONS

Commissioners Ford and Lieberman provided a list of questions to the Administrative Law Judges to which the parties were asked to provide responses. The Commissioners' questions generally concerned the subject of demand response and barriers to the implementation of demand response programs.

Dr. Schlaf addressed the Commissioners' question on behalf of Staff. He testified that he agreed with a statement made by Joseph Kelliher, the Chairman of the Federal Energy Regulatory Commission. Chairmen Kelliher stated:

> . . . One of the acknowledged weaknesses of electricity markets, is lack of effective demand response. That has implications for wholesale markets, leads to great price volatility in wholesale markets, but, ultimately a demand response program revolves around and is centered on the retail consumer. . .

In agreeing with Chairman Kelliher's statement, Dr. Schlaf stated that the success of any particular demand response program will depend to a great extent on the actions of retail customers in response to market prices. (Schlaf Reb., ICC Staff Exhibit 22.0, pp. 16-17) Further, Dr. Schlaf expects that the Commission's policies with respect to demand response will be developed in the demand response rulemaking proceeding. As to a distribution company's role in promoting demand response, Dr. Schlaf noted that his understanding of 83 Illinois Administrative Code Part 452 may limit an electric utility's ability to promote demand response programs. (*Id.*, p. 16)

Dr. Schlaf also testified about a report concerning demand response that was completed by the Department of Energy ("DOE") and submitted to the Congress. He stated that the DOE Report identifies several potential systemwide benefits of demand response programs, including "market-wide financial benefits," "reliability benefits" and "market performance benefits." (DOE Report, p. vi). (*Id.*, p. 17) He testified that the subject of how or whether the Commission should promote demand response programs and how the potential benefit of demand response programs could be captured is likely a subject for the demand response rulemaking proceeding. (*Id.*, 18)

Dr. Schlaf stated that he agreed with the DOE Report that historically utility customers have faced fixed rates and thus do not respond to market prices. Since customer demand for rates that are not fixed is extremely low, very few customers are willing to trade the possible benefits of receiving wholesale prices for the cost associated with constantly monitoring market prices in order to determine when the most appropriate time to consume electricity might be on any given day. (*Id.*, p. 19) He added that the lack of price response in retail markets might contribute to concerns about market power in wholesale markets. (*Id.*)

Dr. Schlaf also stated that he believed that Commission rules restrict the ability of utilities to promote their services; thus, any proposed demand response program would have to be reviewed with those rules in mind. He also believed that utilities cannot be compelled to offer any services that were not being offered when the Customer Choice Law was enacted in December 1997. Further, since there is a difficulty in valuing the benefits of demand response programs. (See, for example, the DOE Report, at p. xvii), Dr. Schlaf recommended that the demand response rulemaking address the valuing of benefits of demand response programs. (*Id.*, p.21)

Finally, Dr. Schlaf testified that there are potential systemwide benefits that could be realized from some demand response programs, which could include a reduction in wholesale price volatility, improved reliability, and improvements in the environment. However, he stated that the benefits are more likely to be realized if there is significant participation among a utility's largest customers because they have the greatest potential to affect market prices through their combined actions in response to market prices. (*Id.*, pp. 21-22)

In summary, Staff witness Schlaf noted that Docket No. 06-0389[26] may address the subject of many of the Commissioners' questions, such as the electric utilities' role, if any, in promoting demand response programs; how (or whether) the Commission should promote demand response; how potential benefits of demand response programs may be captured; and, the appropriate methods by which the value of the implementation of demand response programs may be captured. (*Id.*, p. 18)

[26] Staff notes that, on July 26, 2006, subsequent to the filing of Staff rebuttal testimony in this proceeding, the Commission ordered the initiation of a second demand response rulemaking (Docket No. 06-0526).

CONCLUSION

Staff respectfully requests that the Illinois Commerce Commission approve Staff's recommendations in this docket.

Respectfully submitted,

SEAN R. BRADY
JOHN C. FEELEY
CARMEN L. FOSCO
CARLA SCARSELLA
Office of General Counsel
Illinois Commerce Commission
160 North LaSalle Street, Suite C-800
Chicago, IL 60601
Phone: (312) 793-2877
Fax: (312) 793-1556
sbrady@icc.illinois.gov
jfeeley@icc.illinois.gov
cfosco@icc.illinois.gov
cscarsel@icc.illinois.gov

Counsel for the Staff of the Illinois Commerce Commission

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