STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Central Illinois Light Company d/b/a AmerenCILCO **Proposed general increase in electric delivery service rates. (Tariffs filed June 5, 2009)**	:	**09-0306**
Central Illinois Public Service Company d/b/a AmerenCIPS **Proposed general increase in electric delivery service rates. (Tariffs filed June 5, 2009)**	:	**09-0307**
Illinois Power Company d/b/a AmerenIP **Proposed general increase in electric delivery service rates. (Tariffs filed June 5, 2009)**	:	**09-0308**
Central Illinois Light Company d/b/a AmerenCILCO **Proposed general increase in gas delivery service rates. (Tariffs filed June 5, 2009)**	:	**09-0309**
Central Illinois Public Service Company d/b/a AmerenCIPS **Proposed general increase in gas delivery service rates. (Tariffs filed June 5, 2009)**	:	**09-0310**
Illinois Power Company d/b/a AmerenIP **Proposed general increase in gas delivery service rates. (Tariffs filed June 5, 2009)**	:	**09-0311** **(Cons.)**

ORDER

DATED: April 29, 2010

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ORDER

By the Commission:

I. PROCEDURAL BACKGROUND

On June 5, 2009, Central Illinois Light Company d/b/a AmerenCILCO ("AmerenCILCO"), Central Illinois Public Service Company d/b/a AmerenCIPS ("AmerenCIPS"), and Illinois Power Company d/b/a AmerenIP ("AmerenIP") each filed with the Illinois Commerce Commission (―Commission”) new and/or revised tariff sheets for electric and gas service. AmerenCILCO, AmerenCIPS, and AmerenIP are each a wholly owned subsidiary of Ameren Corporation ("Ameren") providing residential, commercial, and industrial electric and gas service throughout their respective service areas. AmerenCILCO, AmerenCIPS, and AmerenIP are collectively hereinafter referred to as Ameren Illinois Utilities ("AIU"). The new and revised tariff sheets ("Proposed Tariffs") proposed changes in electric and gas rates and the establishment of new riders, to be effective July 20, 2009. On July 8, 2009, the Commission entered six Suspension Orders suspending the Proposed Tariffs for each company to and including November 1, 2009 in accordance with Section 9-201(b) of the Public Utilities Act ("Act"), 220 ILCS 5/1-101 et seq. The Suspension Orders identify the specific tariff sheets filed by AIU. Upon suspension, AmerenCILCO's electric and gas filings became identified as Docket Nos. 09-0306 and 09-0309, respectively; AmerenCIPS' electric and gas filings became identified as Docket Nos. 09-0307 and 09-0310, respectively; and AmerenIP's electric and gas filings became identified as Docket Nos. 09-0308 and 09-0311, respectively. On October 7, 2009, the Commission entered Resuspension Orders renewing the suspension of the Proposed Tariffs to and including May 1, 2010.

AIU posted a notice of the filing of the proposed rate increases in each of its business offices and published a notice twice in newspapers of general circulation within each of its service areas, in accordance with the requirements of Section 9-201(a) of the Act, and the provisions of 83 Ill. Adm. Code 255, ―Notice Requirements for Change in Rates for Cooling, Electric, Gas, Heating, Telecommunications, Sewer or Water Services.” In addition, AIU sent notice of the filing to its customers in bill inserts.

On July 10, 2009, the Administrative Law Judges notified AIU of certain deficiencies in its filings in accordance with 83 Ill. Adm. Code 285, "Standard Information Requirements for Public Utilities and Telecommunications Carriers in Filing for an Increase in Rates" ("Part 285"). The deficiency letters required AIU to submit various missing information and provide explanations of certain portions of the rate filings. AIU provided information in response to the deficiency letters on August 6, 2009.

Petitions seeking leave to intervene were filed by the People of the State of Illinois through the Attorney General (―AG”), the City of Champaign (―Champaign”), Citizens Utility Board (―CUB”), AARP,[1] System Council U-05 of the International Brotherhood of Electrical Workers, AFL-CIO, an association consisting of Local Unions 51, 309, 649, 702, and 1306 ("IBEW"), Grain and Feed Association of Illinois ("GFA"), Kroger Company ("Kroger"), Constellation NewEnergy, Inc. ("CNE"), Constellation

[1] In 1999, the "American Association of Retired Persons" changed its name to simply "AARP," in recognition of the fact that individuals do not have to be retired to be members.

NewEnergy-Gas Division, LLC ("CNE-Gas"), and Charter Communications, Inc. The University of Illinois, Air Products and Chemicals Company, Archer-Daniels-Midland Company, Cargill, Inc., Caterpillar, Inc., ConocoPhillips Corporation, Enbridge Energy, LLC, Illinois Cement Company, Linde NA, Inc., Olin Corporation, Tate and Lyle Ingredients Americas, Inc., United States Steel Corporation, Viscofan USA, Inc. and Washington Mills Hennepin, Inc. also intervened as members of the Illinois Industrial Energy Consumers (—IIEC"). All of the petitions to intervene were granted. The Cities of Urbana, Decatur, and Bloomington and the Town of Normal entered appearances pursuant to Section 10-108 of the Act. Together, with Champaign, the municipalities are collectively hereinafter referred to as Local Government Interveners or "LGI." Commission Staff ("Staff") participated as well.

On September 29, October 5, October 27, and November 2, 2009, the Commission held a public forum in Springfield, Collinsville, Pekin, and Decatur, respectively, for the purpose of receiving public comment on the general increase in electric and gas rates proposed by AIU. These locations were selected because they represent some of the larger population centers in the AIU service areas. A transcript of each public forum is available on the Commission's e-Docket system.

Pursuant to due notice, status hearings were held in this matter before duly authorized Administrative Law Judges of the Commission at its offices in Springfield, Illinois on August 6 and December 10, 2009. Thereafter, evidentiary hearings were held on December 14 through December 17, 2009. Appearances were entered by counsel on behalf of AIU, Staff, the AG, LGI, CUB, AARP, GFA, IIEC, Kroger, and CNE-Gas.

At the evidentiary hearings, AIU called 31 witnesses to testify. The 31 witnesses include (1) Karen Althoff, a Regulatory Consultant employed by AmerenCILCO, (2) Ronald Amen, a Vice President with the consulting firm Concentric Energy Advisors, Inc. ("Concentric"), (3) James Blessing, Manager of Power Supply Acquisition at AmerenCILCO, (4) Chad Cloninger, Manager of Illinois Operations, Divisions I--III for AmerenCILCO, (5) Kenneth Dothage, Manager of Gas Supply for Ameren Energy Fuels and Services Company ("AFS"),[2] (6) Salvatore Fiorella, President and sole owner of SFIO Consulting, Inc., (7) Michael Getz, Controller of each AIU company, (8) David Heintz, an Assistant Vice President with Cencentric, (9) Daetta Jones, Manager of Customer Satisfaction and Business Optimization at AmerenCILCO, (10) Leonard Jones, Manager of Rates and Analysis for AmerenCILCO, (11) George Justice, Manager of Illinois Operations, Divisions IV--VI for AmerenCILCO, (12) Michael Kearney, Manager of Economic Development for Ameren Services Company ("AMS"),[3] (13) Charles Laderoute, President of the consulting firm Charles D. Laderoute, Ltd., (14) Mark Lindgren, Vice President of Corporate Human Resources for AMS, (15) Mark Livasy, Superintendent of Energy Delivery Illinois for AMS, (16) Randall Lynn, a Principal with the consulting firm Towers Perrin, (17) Kathleen McShane, President of and Senior Consultant with the economic consulting firm Foster Associates, Inc., (18)

[2] AFS is a subsidiary of Ameren that provides fuel and natural gas supply for all Ameren affiliates.
[3] AMS is the service company subsidiary of Ameren and provides various services to its affiliates, including AIU.

Robert Mill, Director of AmerenCILCO's Regulatory Policy and Rates Department, (19) Peter Millburg, Managing Supervisor of Regulatory Compliance for AmerenCILCO, (20) Craig Nelson, Vice President of Regulatory Affairs and Financial Services of each AIU company, (21) Lee Nickloy, Director of Corporate Finance for AMS, (22) Paul Normand, a Principal with the consulting firm Management Applications Consulting, Inc., (23) Michael O'Bryan, Senior Capital Markets Specialist in Treasury-Corporate Finance of AMS, (24) Ronald Pate, Vice President of Regional Operations for each AIU company, (25) Vonda Seckler, Managing Executive of Gas Supply for AFS, (26) David Sosa, a Vice President with the consulting firm Analysis Group, (27) Ronald Stafford, Managing Supervisor of Regulatory Accounting in AmerenCILCO's Regulatory Policy and Rates Department, (28) Bruce Steinke, Vice President and Controller of Ameren and AMS, (29) David Strawhun, a Career Engineer in Distribution Systems Planning for AmerenCILCO, (30) Terry Tate, AIU's Superintendent of Vegetation Management, and (31) Stephen Underwood, Manger of Gas Storage for AmerenCILCO.[4]

Thirteen witnesses testified on behalf of Staff. The Staff witnesses include (1) Richard Bridal, II, (2) Theresa Ebrey, and (3) Burma Jones, Accountants in the Accounting Department of the Financial Analysis Division of the Commission‘s Bureau of Public Utilities, (4) Janis Freetly and (5) Rochelle Phipps, Senior Financial Analysts in the Finance Department of the Financial Analysis Division, (6) Christopher Boggs, (7) Cheri Harden, and (8) Philip Rukosuev, Rate Analysts in the Rates Department of the Financial Analysis Division, (9) Peter Lazare, a Senior Economic Analyst in the Rates Department, (10) Greg Rockrohr, a Senior Electrical Engineer in the Engineering Department of the Energy Division of the Bureau of Public Utilities, (11) Eric Lounsberry, Supervisor of the Gas Section in the Engineering Department, (12) Brett Seagle, a Gas Engineer in the Engineering Department, and (13) David Sackett, an Economic Analyst in the Policy Department of the Energy Division.[5]

IIEC offered four witnesses at the evidentiary hearings. IIEC‘s witnesses include Michael Gorman, Greg Meyer, Robert Stephens, and David Stowe from the consulting firm Brubaker & Associates, Inc. David Effron, a consultant specializing in utility regulation, and Steven Fenrick, an economist with the consulting firm Power System Engineering, Inc., testified on behalf of the AG and CUB. Christopher Thomas, CUB‘s Director of Policy, also testified on behalf of CUB. Kroger called Kevin Higgins, a principal at the consulting firm Energy Strategies, LLC, to testify. Jeffrey Adkisson, GFA Executive Vice President and Treasurer, testified for GFA. Steven Brodsky and Nancy Hughes, Senior Directors with the consulting firm R.W. Beck, Inc., offered testimony for LGI. Jason Kawczynski, an Associate of Volume Management for CNE-Gas, testified on behalf of CNE-Gas.

[4] Andrew Wichmann, a Financial Specialist in AmerenCILCO's Regulatory Policy and Rates Department, prepared written testimony in these proceedings. At the evidentiary hearings, his testimony was adopted by Mr. Stafford.
[5] Mary Everson, an Accountant in the Accounting Department, prepared written testimony in these proceedings. At the evidentiary hearings, her testimony was adopted by Ms. Ebrey.

AIU, Staff, GFA, Kroger, and IIEC each filed an Initial Brief and Reply Brief. The AG and CUB jointly filed an Initial Brief and Reply Brief. LGI, AARP, CNE-Gas, and IBEW each filed an Initial Brief, but no Reply Brief. A Proposed Order was served on the parties. AIU, Staff, IIEC, and LGI each filed a Brief on Exceptions and Brief in Reply to Exceptions. The AG and CUB jointly filed a Brief on Exceptions and Brief in Reply to Exceptions. Kroger and IBEW each filed a Brief on Exceptions, but no Brief in Reply to Exceptions. All of the Briefs on Exceptions and Briefs in Reply to Exceptions were considered in the preparation of this Order. Following the submission of AIU's response to a Post-Record Data Request by the Administrative Law Judges pursuant to Section 200.875 of 83 Ill.Adm.Code 200, "Rules of Practice" ("Part 200"), the record was marked Heard and Taken on March 25, 2010. Oral argument was heard by the Commission on April 13, 2010 pursuant to Section 200.850 of Part 200.

II. NATURE OF AIU'S OPERATIONS

Ameren formed in 1997 with the merger of Union Electric Company and Central Illinois Public Service Company ("CIPS"). Thereafter, Ameren acquired Central Illinois Light Company ("CILCO") in 2002 and Illinois Power Company ("IP") in 2004. The service area of AIU covers roughly the lower two-thirds of Illinois. AmerenCILCO currently serves approximately 214,000 electric customers and 216,000 gas customers. AmerenCIPS currently serves approximately 393,000 electric customers and 185,000 gas customers. AmerenIP currently serves approximately 627,000 electric customers and 421,000 gas customers. All of AIU's operations are within Illinois, although an affiliate of AIU (Union Electric Company d/b/a AmerenUE ("AmerenUE")) provides utility service in Missouri. At one time, AmerenUE served the St. Louis Metro East area in Illinois. That area has since been subsumed within AmerenCIPS' service area. Certain electric tariff terms in the St. Louis Metro East area are different from the electric tariff terms for the remainder of the AmerenCIPS' service area. The St. Louis Metro East service area is therefore referred to as the AmerenCIPS-ME rate area. Other affiliates of AIU provide unregulated services.

III. AIU'S PROPOSED TEST YEAR AND REVENUES

AIU proposes to use the 12 months ending December 31, 2008 as the test year in this proceeding. No party objects to the use of this test year. The Commission concludes that the historical test year AIU proposes is appropriate for purposes of this proceeding.

The Proposed Tariffs reflect a total increase in delivery service revenues of approximately $225.8 million for all AIU electric and gas customers. AIU's original proposed changes in the delivery service operating revenues for each service type and territory are as follows:[6]

[6] The numbers contained in the table reflect only proposed delivery service revenues since it is only those revenues at issue in this proceeding.

	ELECTRIC		GAS	
	Revenue Change	% Change	Revenue Change	% Change
AmerenCILCO	$27,787,000	22.8	$8,836,000	11.8
AmerenCIPS	$50,562,000	21.5	$11,448,000	15.6
AmerenIP	$102,287,000	22.1	$24,922,000	14.6

AIU determined the originally requested revenues using varying returns on equity for the utility operations ranging from 11.25% to 12.25%.

Over the course of this proceeding, however, AIU lowered its total requested delivery service revenue increase to approximately $130 million. The pending proposed changes in the delivery service operating revenues for each service type and territory are as follows:

	ELECTRIC		GAS	
	Revenue Change	% Change	Revenue Change	% Change
AmerenCILCO	$17,088,000	14.0	$2,328,000	3.1
AmerenCIPS	$38,034,000	16.2	$5,420,000	7.4
AmerenIP	$59,854,000	13.0	$7,004,000	4.1

AIU determined the revised requested revenues using varying returns on equity ranging from 10.8% to 11.7%.

AIU's most recent electric and gas delivery service rate cases considered by the Commission were consolidated Docket Nos. 07-0585 through 07-0590. The Commission entered the Order in that matter on September 24, 2008 approving a total increase in electric and gas delivery service revenues of approximately $161,262,000.

IV. RATE BASE

A. Resolved Rate Base Issues

1. 2002 to 2006 Plant Additions

AIU witnesses Livasy and Getz sponsored testimony substantiating records and invoices of plant additions disallowed in AIU's 2006 and 2007 rate cases. Mr. Livasy's direct testimony also addresses concerns raised in the 2006 and 2007 rate cases that AIU's recordkeeping practices violated 83 Ill. Adm. Code 420, "The Preservation of Records of Electric Utilities," and 83 Ill. Adm. Code 510, "The Preservation of Records of Gas Utilities." Staff witness Ebrey proposed certain adjustments to historical plant additions, which Mr. Livasy accepted in his rebuttal testimony with certain minor corrections to Ms. Ebrey's calculation. The Commission finds the proposed level of plant additions for the period 2002 through 2006 agreed to by AIU and Staff to be reasonable and it is hereby approved.

2. 2007 to 2008 Plant Additions

To eliminate the plant addition sampling methodology as a contested issue in this proceeding, AIU and Staff agreed to a sampling methodology to be utilized in Staff's review of AIU's 2007 and 2008 plant additions. Staff witness Bridal reviewed the 2007 and 2008 plant additions using the stipulated sampling methodology and initially identified 22 purported misstatements out of 827 transactions reviewed. Eleven of these misstatements were subsequently rectified to Mr. Bridal's satisfaction. AIU also proposed additional adjustments to Mr. Bridal's adjustment relating to easement transactions and invoices with offered discounts. Mr. Bridal accepted AIU's plant addition adjustments as presented in Ameren Ex. 29.8.

Additionally, Staff witness Rockrohr reviewed information about certain plant addition projects placed in service since AIU's last rate case filing and included in AIU's rate base in this proceeding. AIU witness Pate discusses additions to plant in service included in AIU's Schedule F-4 filings. Mr. Rockrohr initially recommended adjustments to AIU's rate base to remove the costs for three specific projects: AmerenCILCO's renovation of a purchased building (―Washington Street Renovation"), AmerenIP's NERC-related compliance project (―Transmission Plant"), and AmerenCIPS' relocation of the Pana East Substation. AIU in rebuttal accepted Mr. Rockrohr's adjustment to remove the Transmission Plant from AmerenIP's rate base and made similar adjustments to rate base for AmerenCILCO and AmerenCIPS to remove analogous NERC-related costs. AIU also provided Mr. Rockrohr with additional information about the contested AmerenCILCO and AmerenCIPS projects, including a revision to its proposed allocation for recovery of costs for the contested AmerenCILCO Washington Street Renovation. In rebuttal, Mr. Rockrohr accepted AIU's proposed allocation of costs for the AmerenCILCO Washington Street Renovation project. The only 2007-2008 plant addition project still contested is AmerenCIPS' project to relocate the Pana East Substation.

The Commission has reviewed the information provided by AIU and Staff. With the exception of the costs associated with relocating the Pana East Substation, which is addressed below in this Order, the Commission finds the proposed 2007 and 2008 plant additions to which Staff and AIU agree to be reasonable and hereby approves them.

3. Liberty Audit Pro Forma Adjustment

AIU's direct case proposed a pro forma adjustment to rate base for 2009 and 2010 expenditures associated with the implementation of certain audit recommendations of the Liberty Consulting Group. The audit reviewed AIU's response to certain major weather events impacting service to customers. Staff recommended that this pro forma adjustment be disallowed. In order to reduce contested issues, AIU is no longer seeking recovery of 2009 and 2010 Liberty-related expenditures in this proceeding. AIU indicates that recovery of these expenditures instead is now being sought through a rider in Docket No. 09-0602. The record in this proceeding supports a finding that Staff's pro forma adjustment to rate base for 2009 and 2010 expenditures associated with implementation of the Liberty Consulting Group recommendations should be accepted.

4. Lincoln Storage Field Sulfatreat

Staff witness Seagle initially recommended that the Commission deny AmerenCILCO‘s request to recover the costs to install a fourth Sulfatreat vessel at the Lincoln Storage Field because it failed to adequately support the need for the installation. In response, AIU witness Underwood provided additional information on the Sulfatreat vessel at the Lincoln Storage Field, including a net present value analysis. Based on his review of Mr. Underwood‘s testimony and accompanying exhibits, in conjunction with a visit to the Lincoln Storage Field, Mr. Seagle concludes that AmerenCILCO has provided sufficient information to justify the installation of a fourth Sulfatreat vessel at the Lincoln Storage Field. As the Commission understands it, Staff has effectively withdrawn its proposed adjustment and there is no contested issue to be decided with regard to this issue.

5. Materials and Supply Inventory

Staff proposed an adjustment for both AIU‘s electric and gas utilities to reduce their materials and supplies inventory (including gas in storage) (—M&S Inventory”) by the amount of accounts payable associated with the purchase of materials and supplies. Staff asserts that such an adjustment is necessary because AIU‘s shareholders have no investment in an inventory account until the related account payable has been paid. In order to reduce the number of contested issues, AIU agreed to adjustments for the General Materials and Supplies and Gas Stored Underground components of the M&S Inventory. AIU, however, continued to disagree with Staff‘s calculation of the portions of the M&S Inventory in accounts payable.

Eventually, Staff and AIU agreed on a methodology for calculating the accounts payable portion of AIU‘s M&S Inventory. The parties agreed that the General Materials and Supplies component of the total Materials and Supplies Balances will be reduced by an Accounts Payable amount calculated by multiplying the 13 month average balance of general materials and supplies by an accounts payable percentage (10.53%) based on payment lead days for the Operations and Maintenance ("O&M") component of the appropriate AIU lead-lag study. The parties further agreed that the Gas Stored Underground component of Materials and Supplies Balances will be reduced by an Accounts Payable amount calculated by multiplying the 13 month average balance of Gas Stored Underground by an accounts payable percentage (6.63%) based on payment lead days for the purchased gas adjustment ("PGA") component of the appropriate AIU lead-lag study.

As the Commission understands it, except for the value of gas in storage, AIU and Staff have agreed on how the M&S Inventory should be computed for purposes of this proceeding. The discussion of the value of gas in storage is addressed below in this Order. With regard to the remaining components of M&S Inventory, the Commission finds the agreement between AIU and Staff to be reasonable and it is hereby approved.

6. Gas Tapping Fee

The Gas Tapping Fee, also known as the pro rata upfront charge for connecting with the AmerenIP gas facilities, is an $850 fee, charged to connect new home construction to the main gas line. AIU proposes to eliminate the gas tapping fee. In response, Staff agrees that the fee should be eliminated, but suggests a slight adjustment to the AmerenIP gas rate base, in order to correct AIU's calculations of the fee. Because Staff's adjustment is simply based on AIU's response to Staff data request ("DR") RWB 6.02, AIU agrees to the adjustment. The Commission finds the agreement between Staff and AIU regarding the Gas Tapping Fee to be reasonable and it is hereby approved.

7. Error Regarding A Sulfatreat Change Out

Staff witness Jones presented an adjustment to remove a duplicate charge associated with a Sulfatreat change out. The error was identified by AIU in its response to Staff data request ENG 2.08. AIU does not oppose Staff's adjustment. The Commission finds Staff's proposal to remove a duplicate charge to be reasonable and it is hereby approved.

B. Contested Rate Base Issues

1. Pro Forma Plan Additions (2009-2010)

a. AIU Position

AIU proposed a pro forma adjustment to rate base for capital plant additions to be placed into service through May 2010. Staff originally proposed to include in rate base only pro forma capital additions through August 2009, but later recommended allowance of known and measurable pro forma capital additions through February 2010. To limit the number of contested issues, AIU subsequently agreed with Staff's recommendation. AIU says no party previously challenged the appropriateness of AIU's and Staff's adjustment, nor did any party, other than Staff, previously challenge the appropriateness of AIU's proposal to include certain post-test year plant additions in rate base.

Despite having remained silent in testimony, AIU complains that AG/CUB now argues that certain strings should be attached to approval of the adjustment. Specifically, AG/CUB argues that because of alleged discrepancies between budgeted and actual spending on all capital additions for the first nine months of 2009, AIU‘s pro forma capital additions should be subject to verification and true-up based on actual plant additions, as was done in Commonwealth Edison Company‘s (―ComEd”) last rate case, Docket No. 07-0566.

According to AIU, the parties‘ agreement to file a reconciliation in Docket No. 07-0566 is not a reason to require that one be filed here. AIU says the true-up procedure that occurred in the ComEd proceeding was the result of a stipulation between the utility and Staff. AIU argues that stipulations are ordinarily the product of a give-and-take process. AIU indicates it was not privy to whatever negotiations occurred between ComEd and Staff that resulted in ComEd‘s agreement to file a post-hearing reconciliation of forecasted versus actual plant additions. AIU insists that at no point in this proceeding, until now, has anyone suggested that AIU should file a similar reconciliation or true-up.

In AIU's view, absent a stipulation or other unusual circumstances, there is no basis to require AIU to file a reconciliation of its pro forma plant adjustment for plant additions. AIU states that Section 287.40 of 83 Ill. Adm. Code 287, "Rate Case Test Year" ("Part 287"), allows pro forma adjustments for ―known and measurable changes” to operating results and plant investment. AIU insists that its pro forma capital additions through February 2010 meet the known and measurable requirement. AIU contends that this means that the capital additions are known, and that the cost of these investments is determinable. AIU asserts that no one disputes this and believes there is no need for a post-hearing reconciliation to confirm that which is already known, measurable, and determinable.

AIU claims its actual capital expenditures historically have exceeded the capital budgets. AIU contends that the so-called ―discrepancies” between its total budgeted and actual capital spending relied on by AG/CUB do not prove that AIU‘s budgets are somehow ―unreliable.” AIU also asserts that they do not establish a pattern of underspending. AIU says the data does not even look at AIU‘s actual spending for the entire 2009 calendar year; it is limited to amounts budgeted and booked for the first nine months of 2009. AIU insists that this limited snapshot necessarily does not include the amounts booked in the final quarter of 2009 as projects are completed and put in service. In addition, AIU claims AG/CUB is comparing apples and oranges. AIU says the data relied on by AG/CUB are ―the actual and budgeted total capital expenditures” for each AIU electric and gas utility, excluding transmission. AIU says this data shows budgeted and spent dollars for all capital additions, not just spending for the specific plant additions included in AIU‘s pro forma adjustment. According to AIU, amounts budgeted and spent on new business, which were not included in the pro forma adjustment, are included in this data. AIU also says that amounts budgeted and spent on specific projects not included in the pro forma adjustment are also in this data. AIU claims that as a result, the data solely relied on by AG/CUB does not justify the imposition of a post-hearing reconciliation and true-up.

AIU contends that opening up the record to reconcile forecasted versus actual plant additions would place the Commission on a slippery slope. AIU claims it would invite parties to challenge expenditures after-the-fact and outside the normal evidentiary process. AIU also asserts that it would promote a lack of discipline among parties to ensure that pro forma capital additions fully satisfy the known and measurable requirement. If pro forma capital additions become subject to after-the-fact reconciliation, AIU believes there would be less incentive during the normal hearing process to make sure that these adjustments are documented with the same precision that Staff and the Commission ordinarily demand. In AIU's view, AG/CUB's proposal is not a good idea.

b. AG/CUB Position

AG/CUB reports that AIU proposes pro forma adjustments to include post-test year plant additions through February 2010 in the test year rate bases. AG/CUB says Commission rules allow such adjustments only to incorporate all known and measurable changes in the operating results of the test year. AG/CUB also say these adjustments must be reasonably certain to occur subsequent to the historical test year within 12 months after the filing date of the tariffs and where the amounts of the changes are determinable. AG/CUB indicates that the pro forma adjustments to plant in service are based on budgets and forecasts. AG/CUB argues that based on the experience to date in 2009, AIU's budgets of plant additions have not been especially reliable.

According to AG/CUB, through September 2009, the actual year-to-date capital additions were below the budgeted capital additions for each company. AG/CUB says the sole exception was AmerenCIPS electric, which would also have been well under budget except for the plant additions related to the May 2009 storm. AG/CUB alleges that the discrepancies between budgeted and actual plant in service numbers have been quite significant. AG/CUB states that AmerenCILCO electric's actual capital additions were below budget in every month shown, and through September 2009, the actual year to date capital additions were approximately 27% below budget.

Given the differences between forecasted and actual plant additions, AG/CUB argue that if the Commission allows AIU to include plant additions through February 2010 in pro forma rate base, AIU's forecasts should be subject to verification and true-up based on actual plant additions. AG/CUB claims this procedure was applied to the forecast of post-test year plant additions in the most recent ComEd rate case, Docket No. 07-0566, and resulted in a reduction of approximately $41 million to the projected plant additions included in the pro forma rate base by ComEd in that case. AG/CUB believes the same procedure should be applied to the AIU forecasts of plant additions.

c. Staff Position

Staff believes the Commission should approve its proposed adjustment to disallow plant additions beyond February 2010 from rate base. Staff accepted pro forma plant additions related to both specific and blanket projects that will occur through

February 2010 since AIU provided documentation that the projects were known and measurable. Staff does not oppose storm restoration costs resulting from the May 2009 “inland hurricane” that AIU included in its revised pro forma adjustment. Staff notes that AIU concurs with its proposed adjustments.

d. IBEW Position

IBEW agrees that AIU has met the necessary burden to recover the costs of pro forma plant additions for 2009-2010. IBEW believes that the projects are reasonably certain to occur and their costs are determinable. IBEW states that as the facilities are likely to be in service during the period that the new rates would go into effect, disallowing a recovery of the costs of plant additions through pro forma adjustments would not accurately reflect the actual costs of providing service to customers at that time.

IBEW asserts that an inadequate cost recovery could result in a deferral or cancellation of future planned plant additions and replacements, which could have a negative impact on the reliability of future service and the level of customer satisfaction. IBEW complains that deferral or cancellation of plant additions and replacements could also lead to less work for IBEW members and other Illinois workers, causing a further negative impact on economic conditions in Illinois.

e. Commission Conclusion

AIU, Staff, and IBEW agree that pro forma plant additions through February 2010 should be included in rate base. AG/CUB proposes that AIU's pro forma plant additions included in rate base be subject to verification and true-up based on actual plant additions using the method adopted in Docket No. 07-0566. AIU opposes AG/CUB's proposal.

The Commission observes that both AIU and Staff presented testimony that pro forma plant additions through February 2010 meet the requirements of Part 287, are known and measurable, and are determinable. The Commission finds that the record supports a conclusion that pro forma plant additions through February 2010 should be included in rate base. The AG/CUB's reconciliation proposal, however, has no basis in the record. The concept first appears in this proceeding in the AG/CUB's Initial Brief. Part 287 specifically provides for pro forma adjustments relating to "plant investment." Additionally, in numerous prior rate proceedings, the Commission has evaluated evidence regarding pro forma plant additions to determine whether such proposed adjustments should be included in rate base. The AG/CUB proposal, while utilized in Docket No. 07-0566, would constitute a deviation from the Commission's normal ratemaking process. The Commission is not willing to adopt AG/CUB's proposal over the objections of AIU when there is no evidentiary support for the proposal. Instead, the Commission finds that AG/CUB's proposal must be rejected in this proceeding.

2. Accumulated Reserve for Depreciation

a. AIU Position

AIU states that the plant in service component of rate base reflects the historical cost of the capital assets used to provide service, less accumulated depreciation on those assets as of December 31, 2008. Additionally, rate base includes certain known and measurable post-test year pro forma capital additions, which will be placed in service by February 2010. AIU says it included related adjustments to accumulated depreciation to reflect the additional depreciation associated with those pro forma capital additions. AIU indicates that Staff‘s calculation of accumulated depreciation and its impact on rate base reflects the same methodology used by AIU and endorsed by the Commission.

While they do not oppose a rate base adjustment to increase plant in service to reflect certain known and measurable pro forma capital additions, AIU indicates that AG/CUB and IIEC argue that an additional adjustment to the depreciation reserve is required to reflect an increase in accumulated depreciation on embedded plant (i.e., plant in service as of the end of the test year) that will occur in the 14-month period between the end of the 2008 test year and the month ending February 2010. AIU says these parties argue that their adjustment is supported by the Commission‘s pro forma adjustment rule contained in Part 287, and by the —matching principle.” According to AIU, however, the Commission has already rejected AG/CUB's and IIEC‘s proposed additional adjustment to depreciation reserve, and their supporting arguments, in four prior cases. AIU believes these parties provide no new evidence or arguments that warrant a different outcome here. AIU maintains that the AG/CUB and IIEC adjustments violate basic ratemaking principles and the Commission‘s test year rules. AIU contends that the proposed adjustment creates a mismatch between the utility‘s test year plant in service and its depreciation reserve by effectively moving the depreciation portion of rate base to a future period outside of the test year. AIU argues this violates Section 287.40, which provides for known and measurable —changes in plant investment” to a utility‘s test year plant in service, not changes in the utility‘s net plant or rate base at a future point in time outside of the test year.

AIU indicates that the recent Commission Order in Docket No. 07-0566 rejected arguments that Section 287.40 or the matching principle requires the additional depreciation reserve adjustment proposed by AG/CUB and IIEC. According to AIU, this adjustment was first proposed and rejected in Docket No. 01-0423, a ComEd rate proceeding. AIU says that the Commission found that to accept the adjustment would improperly shift the test year just for the accumulated depreciation reserve. AIU reports that the Commission again rejected the proposed adjustment in a subsequent ComEd proceeding, Docket No. 05-0597. AG/CUB's and IIEC‘s proposed depreciation reserve adjustment, AIU avers, was rejected for a third time in Docket Nos. 07-0241/0242 (Cons.), a rate proceeding involving North Shore Gas Company ("North Shore") and Peoples Gas Light and Coke Company ("Peoples"). Finally, AIU indicates that the

Commission rejected the same proposed adjustment in ComEd's most recent rate case, Docket No.07-0566.

AIU states that in these consolidated proceedings, AG/CUB and IIEC again offer the same arguments that the Commission has previously considered and rejected. According to AIU, prior Commission Orders on this issue are clear that adjusting the test year depreciation reserve for embedded plant in service to include post-test year depreciation on that embedded plant violates the test year and pro forma adjustment rules contained in Sections 287.20 and 287.40. AIU contends that AG/CUB and IIEC seek to simply bring the depreciation reserve on the entire embedded plant forward through February 2010, in effect moving one element of rate base to a future period while all other elements of the revenue requirement remain based on a historical period. Contrary to serving the matching principle, AIU believes that AG/CUB's and IIEC's proposed adjustment expressly violates it.

AG/CUB's and IIEC's adjustments, AIU argues, also fail to meet the known and measurable requirement set forth in Section 287.40. AIU asserts that while the philosophical underpinnings of these parties' positions are the same, they rely on different assumptions, calculations, and extrapolations, which AIU believes to prove that estimating the depreciation reserve as of February 2010 is not the straightforward exercise they would have the Commission believe. Where two witnesses attempt the same adjustment under the same rationale and the results are $23 million apart, AIU contends the adjustment can not be said to represent a —known and measurable" change.

AIU expects AG/CUB and IIEC to argue that the Commission is not bound by its prior decisions, particularly given the dissenting opinion in Docket No. 07-0566. AIU claims the dissenting opinion, however, provides no basis for a majority of the Commission to do an about face on this issue. The dissenting opinion, AIU avers, is largely a repackaged version of the same arguments that AG/CUB, IIEC and others have made in prior proceedings. AIU believes this is evidenced by the fact that the dissenting opinion relies on IIEC's and CUB's legal briefs to support its conclusions.

In AIU's view, while it is one thing to say that the Commission is not strictly bound by precedent, it is quite another to say that the Commission may freely disregard precedent. AIU says the Illinois Supreme Court has recognized that —[t]he concept of public regulation includes of necessity the philosophy that the commission shall have power to deal freely with each situation as it comes before it, regardless of how it may have dealt with a similar or even the same situation in a previous proceeding." (AIU Initial Brief at 23, citing Mississippi River Fuel Corp. v. Illinois Commerce Comm'n (1953), 1 Ill. 2d 509, 513, 116 N.E.2d 394, 396-97 ("Mississippi River Fuel")) AIU contends that the Commission's discretion to decide issues on a case-by-case basis is not without limitation. AIU says the Illinois Supreme Court has recognized that where the Commission determines to depart from past practice, it may not do so in an —arbitrary or capricious" manner. (Id., citing United Cities Gas Co. v. Illinois Commerce Comm'n (1994), 163 Ill. 2d 1, 27-28, 643 N.E.2d 719, 732) AIU argues that regardless of whatever authority the Commission has to depart from prior decisions, ―the Commission cannot violate the [Public Utilities] Act or its own rules.” (Id. at 23-24, citing Business and Professional People for Public Interest v. Illinois Commerce Comm‘n (1989), 136 Ill. 2d 192, 228, 555 N.E.2d 693,709 ("BPI I"))

AIU suggests that AG/CUB and IIEC may also argue that to the extent the Commission relies on prior decisions, the Commission should reach a result consistent with the Order in Docket Nos. 02-0798/03-0008/0009 (Cons.). AIU states that in that proceeding, which were gas rate cases by AmerenCIPS and AmerenUE, the Commission found that where historical net plant in service is either declining or relatively static, as in these cases, post-test year pro forma increases to plant in service require further analysis. AIU says the Commission found that in a situation where there is a demonstrated trend of significant increases of net plant in service, the Commission might be inclined to find that post test year capital additions should be reflected in rate base. AIU indicates that the Commission therefore disallowed AmerenCIPS‘ post-test year capital additions, but partially allowed the additions for AmerenUE to the extent that they exceed increased accumulated depreciation.

According to AIU, in Docket Nos. 02-0798 et al. (Cons.), the evidence showed the AmerenCIPS‘ net plant in service was declining or static. In Docket Nos. 01-0423, 05-0597, 07-0241/0242 (Cons.), and 07-0566, AIU claims that the evidence showed that the utilities‘ net plant in service had been increasing. AIU asserts that it is undisputed here that AIU‘s net plant in service has been increasing.

AIU believes AG/CUB and IIEC also may suggest that the facts and circumstances of this proceeding are somehow different from Docket No. 07-0566 and the other prior decisions on this issue, therefore justifying a different outcome. AIU insists that the relevant and controlling facts and circumstances are no different. AIU says that AIU‘s accounting for depreciation on embedded plant and pro forma capital additions is functionally equivalent to the adjustments ComEd made in Docket No. 07-0566. AIU claims its proposal to include post-test year depreciation on test year embedded plant is functionally equivalent to the adjustment proposed in Docket No. 07-0566. In AIU's view, these parties can not make a clear showing as to the appropriateness of such a change by way of proper evidentiary and legal support to consider such departures from settled precedent.

AIU states that fundamentally, the depreciation reserve issue revolves around the interpretation of the Commission‘s rule for pro forma adjustments. AIU claims that the purpose, text, and prior decisions interpreting Section 287.40 lead to the conclusion that the rule prohibits the depreciation reserve adjustment proposed by AG/CUB and IIEC. AIU says the issue confronting the Commission is whether ―ratemaking norms” or other policy considerations warrant a change in interpretation of Section 287.40. AIU states that the Commission is bound by the Act and its rules. According to AIU, it can not ignore or circumvent its prior interpretation of Section 287.40 based on a subjective determination that ―ratemaking norms” or ―standard regulatory accounting” warrant such a departure.

AIU indicates that Staff's recommended rate bases do not include intervenors‘ proposed depreciation reserve adjustment. AIU complains that Staff appears to invite the Commission to make this adjustment anyway. In AIU's view, Staff‘s position is at best ambiguous and at worst disingenuous. According to AIU, Staff provides no useful guidance to the Commission in resolving this issue and its brief on this issue should be ignored.

AIU asserts that Staff is apparently attempting the same reversal of position in these proceedings that it unsuccessfully attempted in Docket Nos. 07-0241/0242 (Cons.). AIU states that in those dockets, Staff accepted the company‘s proposed pro forma adjustment for capital additions, without proposing an additional adjustment to depreciation reserve for embedded plant. According to AIU, it was not until the Reply Brief that Staff reversed course and withdrew its objection to the depreciation reserve adjustment. According to AIU, the Order in those dockets rejected the adjustment, despite Staff‘s changed position in its Reply Brief.

In AIU's view, Staff can not take one position during the evidentiary phase of the case and an opposite position during the briefing stage. According to AIU, to allow this to happen is to deny AIU and other parties the right to fully develop the record through submitted testimony and cross examination. AIU also says Staff can not argue that because it has not previously taken an explicit position on an adjustment, there is no inconsistency in taking a position now. AIU insists that Staff did take a position. Despite AG/CUB and IIEC testimony recommending the adjustment, AIU says Staff‘s rate base recommendation includes pro forma plant additions through February 2010 without any adjustment for additional depreciation on embedded plant. AIU believes that declining to make this adjustment is tantamount to rejecting it.

AIU says the arguments in Staff‘s Initial Brief are entirely new. In its Initial Brief, AIU indicates that Staff characterizes the dispute over this adjustment as a battle between competing principles of —regulatory lag” and the —matching principle." AIU argues that no testimony has been offered in this case, by Staff or anyone else, to support Staff‘s conclusion. According to AIU, Staff says that there is a point in which the remedy for regulatory lag intentionally overstates anticipated costs, but doesn‘t explain what that —point” is or whether this —point” has been reached in this case. AIU also complains that Staff has not identified what costs are allegedly overstated, how much they are overstated, or at what —certain point in time” they are overstated. AIU says there is no testimony in the record that regulatory lag needs to be —balanced” with the matching principle. AIU claims Staff should have made an adjustment if they believe that net plant is —overstated” in any way.

AIU says AG/CUB and IIEC argue that AIU‘s accounting for depreciation reserve violates Section 9-211 of the Act, which provides that rate base may include only the value of such investment which is both prudently incurred and used and useful in providing service to public utility customers. AIU contends that the Commission considered this argument and rejected it without comment in Docket No. 07-0566. AIU says the intervenors equate the term ―value" with ―net plant" and argue that because ―net plant" accounts for depreciation, depreciation on embedded plant must be included in the ―value" of investment. According to AIU, the purpose of Section 9-211 of the Act is to allow only those investments which are prudently incurred and used and useful in providing service to be included in rate base. AIU argues that the statute does not dictate how the Commission must calculate rate base, either in the aggregate or with respect to any individual element thereof. AIU claims this interpretation is confirmed by the statute immediately preceding, Section 9-210. AIU asserts that Section 9-210 gives the Commission ample discretion to ascertain the ―value" of rate base by allowing pro forma capital additions without deducting additional depreciation for embedded plant. AIU insists that Section 9-211 does not limit the Commission's discretion, and does not mandate the adjustment proposed by intervenors.

AG/CUB argues that AIU proposes a test year ending February 2010 for plant in service and a test year ending December 31, 2008 for depreciation reserve. AIU contends that this misstates AIU's position. AIU states that test year plant in service has been calculated, net of depreciation, as of December 31, 2008. AIU says no depreciation adjustments have been proposed for embedded plant in service. In AIU's view, the pro forma capital additions are a separate category of plant in service. AIU says these additions have been calculated, also net of depreciation, as of February 28, 2010. AIU states that the recognition of depreciation on the pro forma capital additions reflects changes affecting the ratepayers in plant investment associated with these additions. AIU insists this is what Section 287.40 allows. What the rule does not allow, AIU argues, is the recognition of additional depreciation on embedded plant, a different category of plant in service separate and unrelated to the pro forma additions. AIU contends that AG/CUB's proposal improperly moves the test year forward for the depreciation reserve for embedded plant, based solely on attrition (i.e., the decline in value of an asset over time as recognized in depreciation expense), which is prohibited by Section 287.40.

AIU says the entire section of the Order in Docket Nos. 02-0798 et al. (Cons.) discussing pro forma capital additions is just over four pages and claims the Commission conclusion section of the Order does not even discuss test year or pro forma adjustment rules. AIU asserts that there is no discussion of if, how, or why depreciation reserve on embedded plant should be calculated. According to AIU, it is not clear based on the face of the Order that depreciation on embedded plant was included in any of the utilities' rate base.

AIU asserts that the Order in Docket Nos. 07-0585 et al (Cons.) devotes 12 pages of discussion to this issue, including an analysis of Section 287.40. AIU says the Commission concluded that a major concern regarding the adjustment to test year depreciation, pointed out in the Order in Docket No. 05-0597, has not been resolved in this case. AIU asserts that the proposed adjustment does not correlate with any pro forma adjustments. AIU states the Commission found that the proposal merely takes one part of the rate base and moves it one additional year into the future.

AIU asserts that AG/CUB and IIEC also fail to explain how their interpretation of Section 287.40 should be applied in future cases. AIU says these intervenors argue that the magnitude of AIU‘s pro forma adjustment is the practical equivalent of moving the entire balance of net plant forward 14 months. It is on this basis that they argue the entire depreciation reserve for embedded plant should also be moved forward 14 months. AIU contends that they do not explain what should happen if, for example, a utility proposes a pro forma adjustment to include only a few post-test year capital projects in rate base, or perhaps one significant addition. AIU says that by their logic, the depreciation reserve on all embedded plant would have to be brought forward to whatever date the pro forma addition(s) was projected to be in service. AIU claims this could result in the depreciation reserve for embedded plant exceeding the value of gross plant for the pro forma additions. AIU complains that the utility would be financially penalized for making such an adjustment. AIU says AG/CUB and IIEC‘s interpretation seemingly compels this absurd result.

According to AIU, AG/CUB's and IIEC‘s arguments that AIU has violated the matching principle are somewhat intertwined with their test year arguments. AIU says these arguments have also been considered and rejected multiple times. AIU contends that it is AG/CUB who expressly proposes a mismatch by deducting post-test year depreciation on test year embedded plant. AIU claims that if AG/CUB were truly interested in —matching” all depreciation, it would also recommend adding 14 months of depreciation expense to the revenue requirement. AIU says its failure to do so demonstrates the selective and one-sided nature of its adjustment.

IIEC suggests that in order to comply with the matching principle, if a pro forma adjustment can be made, it must be made. AIU says the premise for this argument seems to be that because it is mathematically possible to calculate the depreciation reserve for embedded plant as of February 2010, this adjustment must be made to offset the increase in plant. AIU maintains that pro forma adjustments <u>may</u> be made for plant in service. AIU states that its adjustments include depreciation on plant in service associated with the pro forma additions. AIU argues that whether depreciation on embedded plant can be mathematically determined as of February 2010 is irrelevant to the calculation of depreciation for plant in service constituting the pro forma additions. Regardless of what any accounting literature says about the matching principle, AIU insists that the Commission‘s test year and pro forma adjustment rules prohibit selectively incorporating post-test year changes to test year rate base. AIU believes they do not have to be made in every instance where it is mathematically possible to calculate an element of rate base or operating income within 12 months of the end of the test year.

IIEC argues that the decision in Docket No. 07-0566 provides evidence of the consequences of approval of unbalanced pro forma adjustments that was not available in previous cases, and therefore supports a different result in this case. AIU contends that IIEC's analysis is an apples-to-oranges comparison of gross plant with net plant and asserts that this analysis proves nothing. AIU believes that all IIEC has shown is that if the Commission had adopted the adjustment proposed here in Docket No.

07-0566, ComEd would have had a lower revenue requirement. AIU says this conclusion is obvious without an analysis because adding post-test year depreciation to test year embedded plant will necessarily lower the revenue requirement. AIU contends that whether a pro forma adjustment increases or decreases the revenue requirement is not the standard for determining whether the adjustment is appropriate.

AIU says that in Docket No. 07-0566, IIEC argued that if its adjustment was not adopted, ComEd‘s net plant would be overstated and the Commission rejected this argument. AIU states that IIEC now argues that because the Commission‘s rejected its adjustment, ComEd‘s net plant was overstated, resulting in ComEd over-earning its authorized return. AIU says that in Docket No. 07-0566, IIEC's argument was ex ante, here it is ex post, but ultimately it is the same argument.

AIU says the only new argument that AG/CUB makes is that the Commission should just go ahead and make the depreciation reserve adjustment because AIU will not be ―penalized" if it does. AIU states that reasonable minds can disagree over whether an adjustment of this magnitude constitutes a penalty. AIU believes that whether it is a penalty is completely irrelevant to the discussion. AIU says the Commission‘s test year rules prohibit deducting even $1 for post-test year depreciation on test year embedded plant.

b. AG/CUB Position

AG/CUB indicates that AIU is proposing to adjust rate base for post-test year additions to plant in service to account for proposed plant additions through February 2010. AG/CUB observes that AIU does not recognize other changes that will also be taking place during that same pro forma time period, specifically the increase in accumulated depreciation on that plant in service. AG/CUB argues that AIU‘s determination of plant in service as of February 2010 and depreciation reserve as of December 2008 is an unbalanced and inconsistent determination of the pro forma test year rate base.

According to AG/CUB, the Commission‘s test year rules and the Act require the value of a utility‘s investment that is used and useful be reflected in rates. If rate base is adjusted to recognize plant additions through February 2010, then AG/CUB believes it is reasonable and consistent that the growth on the accumulated reserve for depreciation be recognized through the same date.

AG/CUB states that AIU proposes inclusion in rate base of capital additions through February 2010, which results in an aggregate increase to rate base of $249,027,000. AG/CUB avers The Act requires that the Commission determine a facility is prudent as well as used and useful in providing utility service to the utility's customers before its costs are included in the utility's rate base. Further, AG/CUB says the Commission must determine that the costs of the new plant, or significant additions to an existing plant, are reasonable. AG/CUB also asserts that the utility has the burden of proving that its investments meet these requirements.

AG/CUB emphasizes that Section 9-211 of the Act requires that the Commission, in any determination of rates or charges, shall include in a utility‘s rate base only the value of such investment which is both prudently incurred and used and useful in providing service to public utility customers. According to AG/CUB, the post-test year value of AIU's investment is the net value of the plant. AG/CUB says the net plant accounts for accumulated depreciation and recognizes that as plant additions become used and useful in providing service to customers, embedded plant depreciates. AG/CUB asserts that the Commission has no authority to simply ignore decreases in rate base value from the depreciation of embedded plant occurring because of the plant additions.

According to AG/CUB, AIU‘s request to include "extraordinary" increases to rate bases for post-year plant additions without reflecting the concomitant increase in accumulated depreciation would improperly inflate the rate base amounts by $169 million. AG/CUB argues that only with a recognition of the accumulated depreciation that occurs with the addition to rate base of pro forma plant additions can there be an accurate valuation of the rate base so as to ensure just and reasonable rates. In order to determine the rate of return ("ROR") upon the reasonable value of the property at the time it is being used for the public, AG/CUB avers that it becomes necessary to ascertain what that value is. AG/CUB is concerned that if adopted, AIU‘s proposal to recognize only the portion of pro forma plant additions that increases its rate base and failing to recognize the growth in depreciation reserve on embedded plant through that same time period would violate Section 9-211 of the Act.

AG/CUB says AIU opposes any adjustment to recognize the growth in depreciation reserve on embedded plant through February 2010. According to AG/CUB, the primary reason that AIU gives for opposing this adjustment is that it would violate the ―matching principle.” AG/CUB believe AIU's interpretation of the matching principle is completely inverted. AG/CUB states that utility rates are set based on a synchronized examination of all aspects of the utility‘s cost of service and sources of revenue, as well as other considerations such as the quality of service. AG/CUB claims that synchronization is the reason why a test year is used to set rates. The purpose of the test year rule is to prevent a utility from overstating its revenue requirement by mismatching low revenue data from one year with high expense data from a different year. (AG/CUB Initial Brief at 6, citing Business and Professional People for the Public Interest v. Illinois Commerce Comm‘n, 146 Ill. 2d. 238 (1991) (―BPI II”))

According to AG/CUB, AIU's position appears to be based on the theory that the pro forma adjustment for plant additions does not move the test year forward, that is, extend from 2008 through part of 2010, for other test year ratemaking elements. In AG/CUB's view, the very purpose of the adjustment is to restate the plant in service data from its balance as of December 2008 to its balance as of February 2010. AG/CUB insists that any claim that such an adjustment does not move the test year forward for any portion of the test year is contrary to the purpose of the adjustments being proposed by AIU.

AG/CUB argues that AIU can not explain how stating the plant in service as of February 2010 but the depreciation reserve as of December 2008 constitutes an appropriate “matching” as that term is typically used by regulators. In AG/CUB's view, stating plant in service as of February 2010 but depreciation reserve as of December 2008 is the textbook definition of a mismatch. AG/CUB believes that to correct this mismatch, it is necessary to recognize growth in the depreciation reserve through February 2010. AG/CUB also asserts that Section 287.40 requires all known and measurable changes in plant investment be included in a pro forma adjustment to a historical test year. AG/CUB says AIU proposes a test year ending February 2010 for plant in service and a test year ending December 31, 2008 for depreciation reserve.

According to AG/CUB, AIU suggests that any recognition of the growth in deprecation reserve that offsets these post-test year plant additions would “penalize” AIU. AG/CUB is proposing to recognize post-test growth in the depreciation reserve of $169 million, in the aggregate, as an offset to the post test year plant additions. Thus, even after properly matching the depreciation reserve to the plant additions through February 2010, AG/CUB says the pro forma adjustment for post-test year growth of net plant in service is still $80 million in the aggregate ($249 million - $169 million). AG/CUB submits that a pro forma adjustment for post-test year growth of net plant in service of approximately $80 million in no way “penalizes” the AIU.

AG/CUB states that in Docket Nos. 02-0798 et al. (Cons.) and Docket No. 01-0432 the Commission accepted adjustments to recognize post test-year growth in the depreciation reserve. AG/CUB indicates that AIU asserts that the reason stated in the Commission order in Docket Nos. 02-0798 et al. (Cons.) for a different treatment was the lack of a demonstrated trend of significant increases of net plant in service. AG/CUB says AIU asserts that in Docket No. 01-0432, the treatment was based on an agreement between Staff and the company, with little discussion of the facts and circumstances relevant to that case. AG/CUB believes the opinions of AIU on this point are not useful for distinguishing these decisions from what AIU is proposing in the present case.

AG/CUB states that Commission decisions are not *res judicata*. (AG/CUB Initial Brief at 10, citing Mississippi River Fuel, 1 Ill. 2d at 513) According to AG/CUB, the Commission is required by law to decide each case on the merits of the record evidence. AG/CUB argues that the Commission may make a different determination if the evidence before it does not support the same result as in a previous case or supports a change in a prior Commission position. AG/CUB observes that the Illinois Supreme Court stated, “past precedent is not controlling, because the Commission is a legislative and not a judicial body, and generally its decisions are not *res judicata* in later proceedings before it . . .'” (Id., citing Citizens Utility Board v. Illinois Commerce Commission et al., 166 Ill. 2d 111; 651 N.E. 2d 1089, 1097 (1989) (“Citizens”)) AG/CUB insists that the Commission must base its decision on this issue on the record before it in this case and not on its findings in prior cases.

In AG/CUB's view, the suggestion that the Commission should "blindly" follow its prior decision on this issue is unsupportable because the Commission findings contained very little substantive discussion of the issue. AG/CUB says the Commission in Docket Nos. 07-0241/0242 (Cons.) stated that it was following its findings in Docket No. 05-0597. In Docket No. 07-0566, AG/CUB indicates the Commission majority stated that it was following its findings in Docket No. 05-0597 and Docket Nos. 07-0241/0242 (Cons.). AG/CUB also cites the Dissenting Opinion in Docket No. 07-0566, which it says demonstrates why the distinction offered by AIU is irrelevant in determining the applicability of these cases.

AG/CUB says AIU cites case law in its Initial Brief that highlights the prohibition on —arbitrary and capricious" Commission rulings and asserts that adopting the AG/CUB position would amount to such prohibited behavior. AG/CUB claims that argument rings hollow. AG/CUB claims there is no basis for distinguishing the facts that led the Commission to adjust another utility‘s accumulated depreciation reserve to recognize the changes in embedded plant in Docket Nos. 02-0798 et al. (Cons.) from the instant case. AG/CUB says the finding in that case was correct and should inform the Commission‘s decision in the present case.

AG/CUB says in six other states within the last two years, none of these jurisdictions make a practice of allowing post-test year adjustments to rate base for routine plant additions without offsets for growth in the depreciation reserve. AG/CUB asserts that some of these jurisdictions do not allow adjustments for post-test year plant additions, and those that do require that growth in the depreciation reserve also be recognized. AG/CUB states that while AIU attempts to minimize the relevance of practices in other jurisdictions, it does not cite any other jurisdictions where the regulatory authorities "tolerate" a mismatch like AIU‘s proposal here. AG/CUB states that IIEC also identified where an AIU affiliate company in Missouri recently matched post-test year plant additions with depreciation reserve. AG/CUB claims there is no factual basis to treat AIU differently from AmerenUE in Missouri.

AG/CUB argues that because AIU‘s pro forma plant adjustment is based on budgets and forecasts, the derivative adjustment to depreciation reserve must necessarily entail certain assumptions and estimates. In AG/CUB's view, it is not surprising that two independent estimates of the necessary adjustment to the depreciation reserve associated with the pro forma plant additions would arrive at two different amounts. AG/CUB claims the adjustment to depreciation reserve is no less known and measurable than is AIU‘s own pro forma plant adjustment for plant additions. AG/CUB asserts that just as the uncertainties in the plant adjustment can be rectified by truing up the adjustment to the actual plant balances as of February 2010, the necessary adjustment to the depreciation reserve can also be computed when the actual balance of the depreciation reserve is available in February 2010.

AG/CUB contends that neither it nor IIEC seeks to bring the depreciation reserve on the entire embedded plant forward through February 2010. Rather, AG/CUB asserts that they both seek to bring the depreciation reserve on the embedded plant other than plant related to serving new customers forward through February 2010, to be consistent with AIU's pro forma adjustment for post-test year plant additions. AG/CUB states that the claim that AG/CUB and IIEC seek to have all other elements of the revenue requirement remain based on the historical period is a distortion of the record of the case. AG/CUB claims that neither it nor IIEC seek to eliminate AIU's pro forma adjustment for post-test year plant additions, and they both state that the proposed adjustments to depreciation reserve would not be necessary were it not for the pro forma adjustment for post-test year plant additions. (AG/CUB Reply Brief at 6-7)

AG/CUB argues that AIU's opposition to the pro forma adjustment to the depreciation reserve appears to be based on the "myth" that all other elements of the rate base that are used in the determination of its revenue requirement reflect the actual per books balances as of December 31, 2008. AG/CUB says this is not true. According to AG/CUB, the rate base can not be portrayed as reflecting actual test year balances when the largest element of rate base, plant in service, includes capital additions through February 2010. AG/CUB says AIU fails to explain how the inclusion of plant additions through February 2010 in pro forma rate base comports with its claim that all other elements of the revenue requirement remain based on the historical period.

c. IIEC Position

IIEC does not consider AIU's proposed pro forma increases to test year rate bases for planned post-test year plant additions to be separate -- or severable -- from recognition of the contemporaneous post-test year decreases to rate base that will be recorded as changes to accumulated depreciation. IIEC states that the Commission is permitted to include in AIU's ratemaking rate bases only AIU's plant in service (net plant), which can not be determined by looking at only one component of that calculated investment amount.

IIEC asserts that AIU overstates rate base as a result of a selective pro forma adjustment to reflect post-test year changes in rate base. IIEC indicates that AIU proposes to increase the gas and electric rate bases used to determine rates in this case, by the amount of each utility's planned post-test year plant additions through May 2010, a period of 17 months after the end of the 2008 test year chosen by AIU. According to IIEC, AIU proposes to add about a quarter-billion dollars in plant investment to its ratemaking rate base. IIEC avers AIU's proposed adjustment would ignore the decline in rate base value over the period of the plant additions due to depreciation the utilities are required to recognize on their books of account. Although AIU suggests that its proposed changes to recognize plant retirements and retirement-related depreciation also affected its additions to rate base, IIEC claims those items had no effect on net plant; the modifications simply removed these investments from both the asset and the liability components of rate base.

IIEC contends that rate base can increase or decrease over time, depending mostly on the change to "net" utility plant investment. IIEC says the post-test year change in net utility plant investment represents the difference between gross plant additions less the change to accumulated depreciation or depreciation reserve that will occur during the same post-test year time period. According to IIEC, plant additions will not increase net plant dollar for dollar because the plant additions will be offset by increases to accumulated depreciation reserve that will occur during the same post-test year time period. IIEC asserts that because AIU accounted almost exclusively for the plant addition increases to gross utility plant while ignoring the contemporaneous offset of changes in accumulated depreciation, AIU overstated both its net plant and the rate base on which it is authorized to earn a return.

While IIEC did not contest the amount of AIU's plant additions, IIEC does oppose AIU's proposed unbalanced adjustment, because it overstates the rate bases and the cost of equity. IIEC has proposed what it considers an appropriate correcting adjustment, which is easily modified to match whatever period of plant additions the Commission may approve.

AIU indicates that its proposed adjustment was constructed to mimic the adjustments accepted by the Commission's decisions in recent rate cases. IIEC states that both cases are now the subject of appellate judicial review. IIEC says AIU has offered no other substantive support for its proposed rate base adjustment that can stand on its own. According to IIEC, AIU depends entirely on transferring the result of those decisions to a determination on this record. IIEC asserts that the reasons those decisions can not be applied fall into two categories. IIEC says the first group consists of legal requirements, both statutory and regulatory. The second group, IIEC avers, comprises matters of fact established by the evidence in this record, on which the Commission must base its decision. IIEC believes that AIU's proposed adjustment is not supported by the manifest weight of the evidence.

According to IIEC, the record in this proceeding is the exclusive lawful basis of a decision in this case. IIEC insists that the record in this proceeding is substantively distinguishable from the record of any of the cited cases. IIEC contends that the Commission is constrained in its review of this record only by its duty to explain departures from established past policies, with its reasoning articulated in its decision. IIEC believes the prior Commission decisions cited by AIU are not a bar to a review of the evidence and arguments that were not a part of earlier records. IIEC recommends that the Commission reject suggestions that this issue has been settled and is beyond re-examination.

According to IIEC, AIU's Initial Brief relies completely on a selection of prior Commission decisions that were based on different and distinguishable records, for different utilities, at different times, under different sets of facts. In support of its position, IIEC cites the dissenting opinion in Docket No. 07-0566. IIEC also opines that AIU's Initial Brief does not provide a substantive examination of the circumstances in prior cases, or even the substantive evidence of this record. AIU argues that the —relevant and controlling facts and circumstances" are the same, because its proposed unbalanced adjustment is functionally equivalent to the adjustments ComEd made in Docket No. 07-0566.

IIEC states that Section 9-211 of the Act limits the Commission to including in a utility_srate base only the value of such investment which is both prudently incurred and used and useful in providing service to public utility customers. IIEC asserts that the value of a utility's rate base investment is affected by both the addition of new investment and the decline in investment value due to plant depreciation. In IIEC's view, AIU asks the Commission to ignore one-half of that rate base calculation by approving its unbalanced pro forma adjustment.

IIEC argues that AIU's proposed adjustment, which would calculate AIU's rate base using post-test year increases to plant in service, from plant additions, without taking account of the post-test year decreases to plant in service recorded as accumulated depreciation, will produce a rate base amount in excess of the value of plant investment used to provide service. In IIEC's view, AIU's proposed adjustment asks the Commission to violate the Act's express limitation on the Commission's authority to include in rate base amounts in excess of the value of the plant used to provide service -- net plant. IIEC also contends that no party disputes that an excessive rate base also would result in a revenue requirement that exceeded the utility's cost of capital. IIEC believes that rates set on such an excessive basis would not be just and reasonable and can not lawfully be approved by the Commission.

IIEC contends that the adjustment is inconsistent with any reasonable reading of Section 287.40 and with standard regulatory accounting conventions. IIEC also argues that neither AIU nor the prior Commission decisions on which AIU relies provide any authority for the Commission's departure from standard regulatory accounting and test year principles, as defined by the Illinois Supreme Court. IIEC asserts that the proposed adjustment violates test year principles, and it is not representative of the matched costs and revenues that will exist when rates set in this case will be in effect.

IIEC indicates that AIU proposed a 2008 historical test year for setting rates in this case. Under the Commission's test year rules, IIEC says utility costs and revenues are matched over that consistent time period, the test year. According to IIEC, data from outside that test year can be considered in setting rates only on the specific conditions defined in the Commission rules, including Section 287.40, which governs the use of post-test year data. IIEC says that section contemplates balanced adjustments for "all known and measurable changes" affecting ratepayers, in the components of AIU's revenue requirement. IIEC contends that AIU's pro forma adjustment recognizes post-test year plant investment increases that are not offset by the contemporaneous decline in plant investment value attributable to depreciation. According to IIEC, AIU proposes smaller offsets that avoid including one of the two principal components of a proper calculation of rate base investment value. IIEC states that under the Commission's accounting rules, there will be changes affecting the ratepayers in plant investment, attributable to increases in accumulated depreciation that will be recorded in AIU's reserve for accumulated depreciation over the period of the post-test year plant additions.

IIEC suggests it is important to ensure that the rates established are reflective of costs and revenues that may be expected for the period during which such rates are in place. IIEC believes the unbalanced calculation of plant investment and rate base proposed by AIU is not representative of the period rates set in this case will be in effect. According to IIEC, the proposed mismatch of February 2010 plant additions and December 2008 accumulated depreciation is one that will never exist on the books of AIU. IIEC insists that the adjustment it proposes is necessary for accurate measurement of the utility's rate base, and not just its plant additions. In IIEC's view, AIU‘s proposed pro forma adjustment by itself is an anomalous calculation that is inconsistent with test year principles and the Commission‘s test year rules.

IIEC says that in prior cases the Commission was presented with competing views of the future and the effects of its approvals. In this case, IIEC claims the Commission has hard evidence of the consequences of approval of such unbalanced pro forma adjustments. According to IIEC, there is ample expert testimony in this case from a broad range of experts showing the inconsistency of such adjustments with the Commission‘s accounting rules and conventions.

IIEC states that in ComEd's last rate case, the Commission permitted ComEd‘s rates to be set based on ComEd‘s post-test year plant addition adjustments. IIEC claims that ComEd‘s projected increase in gross plant in service was reasonably accurate. However, IIEC asserts its pro forma adjustments for plant additions, excluding accumulated depreciation reserve, substantially understated the amount of accumulated depreciation reserve on its books and records at the end of the period of its plant additions. According to IIEC, ComEd substantially overstated its net plant in service ($464 million to $521 million), equivalent to a revenue requirement effect in the range of $50 million to $60 million per year. IIEC believes that actual experience confirms the results predicted by an unbiased application of the Commission‘s accounting and test year rules. IIEC contends that to accurately match costs and revenues for the period rates are in place, if the Commission allows post-test year plant additions, it must also include adjustments to recognize the contemporaneous changes to the accumulated depreciation reserve.

According to IIEC, this record contains extensive expert testimony explaining that AIU's proposal is inconsistent with Commission accounting and depreciation rules and is not representative of the rate base that AIU will have in place when rates are in effect. IIEC argues that unreasonable costs (including, presumably, unlawful costs) can not be the basis for just and reasonable rates. While the rate base AIU uses for setting rates is increased by almost one-quarter billion dollars, IIEC complains that AIU‘s version of the matching principle allows a self-serving mismatch of investment costs through February 2010 with a static 2008 test year accumulated depreciation reserve.

IIEC states that AIU criticizes it for not proposing adjustments for every revenue requirement item that could change after the test year. IIEC responds that not every potential post-test year change is —reasonably certain to occur” or —known and measurable” as Section 287.40 requires. IIEC asserts that in contrast, the growth in the reserve for accumulated depreciation will occur as surely as night follows day. IIEC also argues that it is AIU‘s burden to prove that it has made all appropriate adjustments.

IIEC indicates that AIU also questions whether the post-test year changes in accumulated depreciation are known and measurable, pointing to a difference in the adjustment calculations of AG/CUB and IIEC. IIEC responds that AIU's witness on this issue, Mr. Fiorella, testified that he had not verified that the two amounts he compared were actually calculations of identical adjustments. IIEC also contends that AIU‘s argument that a dispute as to the proper quantification proves that an adjustment is not known and measurable, applies more aptly to AIU‘s own adjustment. IIEC says that AIU ultimately accepted an agreed, not calculated or precise, amount of —known and measurable” plant additions.

According to IIEC, AIU‘s contention that it may move gross plant (with minor modifications) to a post-test year date, but that offsetting elements of rate base can not be moved is essentially an argument that only post-test year increases to rate base are permitted by Section 287.40. IIEC claims that reading Section 287.40 to refer to variations of gross plant is not reasonable, when the only lawful changes affecting the ratepayers in plant investment are changes in net plant. IIEC says AIU‘s —increases-only” reading would bar known and measurable post-test year reductions, defeating mitigation of regulatory lag in many situations. IIEC insists that its interpretation of Section 287.40 is consistent with the Commission‘s accounting, depreciation, and other test year rules. IIEC claims that AIU‘s interpretation requires that otherwise applicable rules, conventions and procedures be abandoned to allow computation of net plant and rate base in a way not proposed or countenanced by any party in any other context.

According to IIEC, Staff frames the dispute about post-test year adjustments as one of balancing —regulatory lag” against the —matching principle.” IIEC says the precise meaning of that observation is not clear. However, IIEC does not accept that any balancing of competing elements of regulatory doctrine can displace the Act‘s express statutory prohibition against the Commission‘s inclusion of excess investment in AIU‘s ratemaking rate base. IIEC also asserts that an unexplained, unjustified departure from the accounting and depreciation requirements codified in the Commission‘s rules is a violation of law that can not be excused by a balancing of regulatory issues.

IIEC believes that Staff witness Ebrey‘s testimony on accounting fundamentals makes it clear that AIU‘s proposed adjustment would make the test year data considerably less accurate and would violate test year matching requirements and the Act. IIEC agrees with Staff that any overstatement of net plant would violate the matching principle and go beyond the remedy for regulatory lag. IIEC believes that AIU's adjustment overstates net plant and rate base, departs from Commission accounting and depreciation rules, violates the test year matching principle, and results in an unlawful, excessive rate base that the Commission lacks authority to approve.

d. Staff Position

Staff did not provide written testimony on this issue; however, during cross-examination, Staff witness Ebrey provided comments regarding the mechanics of the revenue requirement and the relationships among its various components. (Tr. at 738-747, 800-803) Staff says Ms. Ebrey confirmed that as of February 2010 the amount of net plant on the AIU books would not reflect the amount of accumulated depreciation at the December 2008 level. Ms. Ebrey further stated that, for ratemaking purposes, the matching principle would require the alignment of all components of the revenue requirement including all components of rate base, cost of service, and ROR information as of a consistent date. Finally, Ms. Ebrey concluded that the net plant as proposed by AIU in this case would be higher than the net plant included in the utilities books at the end of February 2010.

According to Staff, this issue is about balancing ―regulatory lag" (the AIU argument) with the ―matching principle" (IIEC's argument). Staff says regulatory lag is the theory that rates granted in a rate proceeding will lag behind ongoing costs since costs could be expected to rise from the filing of a rate case until the final order in the rate case is issued and rates become effective. In addition, Staff states that costs could also increase after the approved rates are actually in effect. To remedy the problem with regulatory lag, Staff says pro forma adjustments are allowed in the ratemaking process to include more current costs beyond the historic test year levels. Staff avers, however, that there is a point in which the remedy for regulatory lag intentionally overstates anticipated costs at a certain point in time or during the time that rates would be in effect. In Staff's view, the balance of net plant used to set rates in this case should not be greater than the anticipated actual net plant balance in February 2010 or during the time that rates from this case are expected to be in effect. Staff believes that any overstatement of net plant would violate the matching principle and go beyond the remedy for regulatory lag.

Staff states that AIU argues at length that the decision in this proceeding must follow the decisions made in prior rate cases associated with this adjustment proposed by both AG/CUB and IIEC. In the current cases, Staff indicates that AIU has included all distribution projects, including blanket projects estimated to be in service 14 months beyond the test year. Staff asserts that this, in effect, moves the gross plant in service balance forward 14 months. In Staff's view, AIU is guilty of exactly the same tactic that it accuses the intervenors of, that is, moving one element of rate base to a future period while other elements of the revenue requirement remain based on an historical period. Staff avers that both components of the net plant must be adjusted if either of the components is to be adjusted to comprehensively reflect overall plant investment.

According to Staff, AIU claims that the distinguishing factor in the Order in Docket Nos. 02-0798 et al. (Cons.) is that the AmerenCIPS' net plant in service was declining or static. Staff alleges that AIU omits the conclusion, as it relates to AmerenUE, in that case where net plant was not declining. Staff states that IIEC correctly calls attention to that difference in its Initial Brief when it discusses the treatment afforded AmerenUE to limit its post test year capital additions to the extent that they exceed increased accumulated depreciation. Staff asserts that even though it is undisputed that AIU's net plant in service has been increasing, the Commission has stated it —might be inclined to allow post test year additions to rate base," but only to the extent that those additions exceed increases to accumulated depreciation.

e. IBEW Position

According to IBEW, the Commission should reject the additional adjustment to AIU's accumulated depreciation reserve suggested by AG/CUB and IIEC. IBEW states that such adjustments have been raised repeatedly in prior rate cases, and have been rejected by the Commission each time. IBEW says no new rationale or evidence has been offered that would differentiate this rate case from the four prior rate cases in which the Commission has rejected the additional adjustment.

f. Commission Conclusion

On a related issue, AIU and Staff agree that pro forma plant additions to rate base through February 2010 should be included in rate base. IIEC and AG/CUB believe that the balance of the accumulated reserve for depreciation, which is a reduction to rate base and the other component in the calculation of net plant – the major element of rate base, should reflect the February 2010 balance because AIU has included in rate base pro forma gross plant additions through that date. This proposal is supported by Staff in its Initial and Reply Briefs and opposed in the briefs of IBEW. AIU also opposes the proposal, arguing that the 2008 test year balance of the accumulated reserve for depreciation should not be revised for existing (i.e., embedded) plant.

The parties' extensive arguments regarding this issue are recited in detail above. The Commission emphasizes that it has closely reviewed the parties' positions, which are clearly articulated, as well as the cases and statutory provisions cited by the parties and fully understands both points of view.

AIU argues that increasing the reserve for accumulated depreciation to reflect the February 2010 balance is not permissible under Section 287.40 and would compromise the test year net plant in service balance. AG/CUB and IIEC, on the other hand, argue that Section 287.40 provides for a pro forma adjustment to recognize certain post-test year changes in the investment dedicated to providing service to customers and that determining that amount consistently within the limitation of Section 9-211 of the Act requires taking account of declines in rate base value over the period of recognized increases in investment. Specifically, they argue that an adjustment for post-test year changes in plant investment requires that both plant additions and the reserve for accumulated deprecation be considered in determining the actual change in the value of rate base investment and that doing so yields a net plant in service balance that is consistent with the intent of the test year rules.

The Commission has reviewed the Orders in Docket Nos. 01-0423, 02-0798 et al. (Cons.), 05-0597, 07-0241/0242 (Cons.), and 07-0566. As the parties have pointed out, prior Commission decisions are not *res judicata* and the decision here must be based upon the record in this case. United Cities Gas Co., 163 Ill. 2d at 22.

This issue has been thoroughly briefed by the parties before the Commission over the last several years, allowing the Commission greater clarity in understanding the positions presented by the individual parties and the meaning and intent of the pro forma adjustment rule. This proceeding, along with prior proceedings on this same issue, has resulted in a significant evolution of the Commission's understanding of this issue. In this particular case, the predominant weight of the evidence stands in opposition to AIU's position on the issue. The record in this case provides sound reasons for a departure from certain prior Dockets, and notably, this Commission's decisions for AIU have consistently required recognition of the accumulated depreciation on embedded plant through the date of pro forma plant additions.

AIU has proposed a 2008 historical test year, which is allowed under the Commission's rules. The Commission's rules are intended to match costs and revenues over a consistent period, i.e., the test year. One "exception" to the test year requirement that costs and revenues reflect historical test year values is the provision in Section 287.40 that allows pro forma adjustments for "known and measurable" changes to a historical test year. Among other things, Section 287.40 allows pro forma adjustments for changes in plant investment. AIU cites certain previous decisions that effectively abandon the concept of a net plant investment when there is a pro forma adjustment for post-test year plant additions.

IIEC points to evidence that distinguishes this record from the recent decisions AIU asks the Commission to follow. A fresh look at the substance of the competing proposals, aided by evidence presented for the first time in this record, demonstrates that IIEC's objections to the AIU proposal are well founded. We find two portions of the record evidence to be particularly compelling. First, the opinion of the Commission Staff's accounting expert, after delineating the mechanics of the regulatory accounting for utility rate base and reviewing the new evidence in this record, was that regulatory accounting requires the plant in service balance and the accumulated reserve for depreciation balance to be representative of the same point in time. (Tr. at 734-749, 800-803) The second evidentiary presentation is IIEC's analysis showing the result of a policy that recognizes only one part of net plant in determining rate base. That analysis validates (with empirical data) the arguments and expert testimony that any adjustment recognizing only post-test year increases will overstate a utility's actual rate base and not be representative of the period rates are in effect. We refer to the evidence showing that the actual results of the adjustment approved in a recent Commonwealth Edison case was a significantly overstated rate base, as predicted by the testimony and arguments the Commission rejected in that case. We find this evidence alone to be a sufficient reason in this case to require AIU to reflect the balance of the accumulated reserve for depreciation as of February 2010 in its rate base, because AIU has included pro forma plant additions in its rate base as of February 2010.

In addition to the evidence discussed above, the Commission believes there are other reasons to make this adjustment. The Commission understands AIU's point of view with respect to the prior decisions on which it relied; however, such a pro forma adjustment is not consistent with any reading of the Commission's test year rules that is also consistent with the limitations of Section 9-211 of the Act. Section 9-211 essentially requires the Commission to ensure that a utility's approved rate base does not exceed the investment value the utility actually uses to provide service. The measure of the amount of investment so dedicated must account for both increases and decreases (over a consistent period) at any point in time. Under Section 9-211, contemporaneous increases and decreases to rate base are not severable items that can be given disparate treatments. They are opposing sides of a coin, the utility's plant in service and net plant. Accordingly, the Commission approves IIEC's correction to AIU's adjustment for plant additions through February 2010 to account for contemporaneous additions to the reserve for accumulated depreciation over that same period. The decisions cited by AIU did not address the effect of Section 9-211 in this context.

While the rule, as interpreted here, may allow for a situation where a utility's gross plant increase would be outpaced by its additional accumulated depreciation, a) this result occurs because it reflects the true reality of a utility's financial picture for the pro forma period, and b) in anticipation of such a result, the utility may elect not to seek pro forma adjustments. Thus, even as interpreted here, the rule should still only operate to increase rate base—the utility can choose to seek pro forma adjustments when increases in gross plant outpace depreciation, and elect not to seek them when they do not. But in all instances, the rule operates to give the Commission an accurate and balanced snapshot of the utility's financial picture for ratemaking purposes.

However, a reading of the rule which excludes accumulated depreciation for the pro forma period incents the utility to always seek upward pro forma adjustments regardless of any decline in actual net plant—and for an amount that ignores accompanying depreciation accumulating over the same period. This interpretation results in consistently and unavoidably inflated rate base and an inescapably inaccurate picture of the utility's finances. This reading is also plainly inconsistent with the Commission's treatment of plant investment should the utility adopt a future test year under Section 287.20(b), plainly inconsistent with basic matching principles, and inconsistent with the approach taken in at least six other states.

To avoid confusion respecting proposals in future rate cases, the Commission finds that if a utility has recovered in rates the cost of an asset through depreciation expense, the associated amount of accumulated depreciation should be deducted from rate base.

3. Pana East Substation

a. AIU Position

AIU asserts that the relocation of the Pana East Substation allowed AmerenCIPS to remediate coal tar contamination at the site in the most practical, cost-effective manner possible. AIU claims that relocating the substation also ensured that AmerenCIPS could continue to provide service to its electric customers during the remediation. In addition, during the course of the relocation, AIU says AmerenCIPS refurbished and upgraded the substation to further improve the reliability of service and enhance service for present as well as future customers. AIU believes these costs were prudent and necessary and should be included in AmerenCIPS‘ electric rate base.

AIU indicates that Staff proposes a rate base adjustment to exclude all capital costs, roughly $2 million, incurred by AmerenCIPS in relocating the substation. Staff proposes this rate base adjustment despite the fact that it does not dispute that these costs were both necessary and prudently incurred. AIU also understands that Staff does not contest that the relocated substation is used and useful in providing electric service.

Although Staff objects to allocating 100% of the substation relocation costs to AmerenCIPS' electric delivery service customers, AIU observes that Staff has not proposed any specific alternative allocation. In the absence of any evidence from Staff proving that the relocation costs should be allocated in any manner other than 100% to electric distribution customers, AIU contends that Staff has not justified allocating any portion of these costs to AmerenCIPS‘ gas ratepayers, transmission customers, or shareholders. AIU claims that Staff admits that shareholders would normally not absorb these costs. AIU complains that Staff simply proposes to exclude from rate base all capital expenditures for this project because Staff feels that electric distribution customers should pay some lesser, undefined percentage of the costs.

AIU acknowledges Staff's argument that AmerenCIPS‘ electric distribution ratepayers should pay less than 100% of the substation relocation costs because the cause for the costs is unrelated to the provision of electric service. According to AIU, Staff theorizes that if the contamination had originated from equipment in the substation, or was in some other way caused by the provision of electricity to customers, then it would be logical to allocate 100% of the substation relocation costs to facilitate clean-up to electric ratepayers. In response, AIU insists that the —cause” for the substation relocation simply does not impact the appropriate allocation and recovery of these costs. AIU argues that it is appropriate to include in a utility‘s rate base the cost to repair or relocate distribution infrastructure, assuming it was prudent and necessary to incur those costs to maintain adequate, reliable service.

AIU states that any number of factors unanticipated and beyond the utility‘s control could require a utility to repair or relocate its distribution plant. AIU notes that Staff recognizes that an extreme weather event, such a tornado or inland hurricane, could require a utility to repair damaged poles or wires. AIU adds that Staff also acknowledges that an unexpected changing environmental condition, such as the emergence of mine subsidence or a flood plain, could require a utility to relocate existing facilities. AIU asserts that Staff concedes that in these instances it would be appropriate to charge electric ratepayers for the costs to repair and relocate infrastructure if such actions were necessary to maintain adequate and reliable service. AIU maintains that the relocation of the Pana East Substation not only was the least cost option and safest way to remediate the contamination, but it also presented the least risk of a disruption of service to AmerenCIPS' customers.

AIU indicates that in 1956 and 1957, when the Pana East Substation was constructed, AmerenCIPS was not required to remove any coal tar present at the site. With changes to environmental laws and regulations since the 1950s, however, AIU says AmerenCIPS now is required to clean up the coal tar contamination underneath the substation. Removal of the contamination without disrupting service, AIU contends, dictated the need to relocate the substation. AIU insists that all other options to remediate the site without relocating the substation were rejected as impractical, unsafe, cost-prohibitive, or too risky to the adequacy and reliability of AmerenCIPS' service. AIU says that by relocating the substation, AmerenCIPS was able to clean up the site in a practical and safe manner and at a reasonable cost. AIU adds that AmerenCIPS took advantage of the need to relocate the substation to expand and modernize the facility, improving the location, design, equipment, and automation of the fifty-year-old substation. No one argues that AmerenCIPS should have cleaned up the coal tar in the 1950s or built the substation at a different location with the expectation that at some point in the future it might be required to clean up the coal tar. AIU avers that AmerenCIPS should not be denied recovery of these relocation costs simply because it is now obligated to clean up this contamination 50 years after the original substation was constructed.

Staff suggests that AmerenCIPS would not charge its electric distribution ratepayers 100% of the costs to relocate a customer's house if the property had contamination that originated from an AmerenCIPS' former manufactured gas plant. Staff asserts that there is no difference between the hypothetical costs associated with relocating the customer's house to facilitate cleanup and the actual costs associated with relocating the Pana East Substation. In response, AIU argues that the customer house in Staff's analogy was not used and useful in providing service. AIU also asserts that the remediation of the customer's property did not impair or threaten the adequacy and reliability of service. AIU adds that the relocated customer house did not provide a benefit to electric ratepayers.

Staff also claims that it would be inappropriate for AmerenCIPS to recover from electric ratepayers 100% of the relocation costs because the substation was used and useful at its former location. AIU counters that AmerenCIPS did not choose to relocate the substation just for the sake of doing so; its hand was forced by its obligation to remove the contaminated soil directly under the substation. AIU claims no other alternatives were feasible or practicable given the regulatory requirements to remove the coal tar and the need to maintain service.

According to AIU, Staff further claims that it remains a mystery why AmerenCIPS is unwilling to allocate its relocation costs in a fashion similar to the allocation of the coal tar remediation costs. AIU believes it is more mysterious why Staff refuses to propose an alternative to AIU's proposed allocation. If Staff wants AIU to allocate the relocation costs in the same manner as remediation costs, AIU contends it should just say so. AIU maintains that Staff's comparison of relocation costs to remediation costs, which Staff recognizes are properly borne entirely by ratepayers, suggests that Staff believes that relocation costs are in fact fully recoverable through rates. AIU complains that Staff, however, proposes in these rate cases to exclude these costs in their entirety.

AIU asserts that the allocation of coal tar remediation costs is not relevant to determining the proper allocation of the capital costs to relocate and rebuild the substation. AIU says the basis for allocating remediation costs between AmerenCIPS' electric and gas customers are the formulas set forth in Riders EEA and GEA. AIU claims the allocation formulas for AmerenCIPS' remediation costs, which were approved by the Commission, neither control nor are determinative of the proper allocation of AmerenCIPS' relocation costs. AIU insists that the basis for allocating capital costs is the need for the expenditure and the resulting benefit.

b. Staff Position

Staff disagrees with AmerenCIPS' proposal to charge electric ratepayers 100% of the cost to relocate the Pana East Substation and the distribution and transmission lines entering and leaving the substation as part of a coal tar remediation project. The amount in dispute equates to approximately $2 million. Staff understands that the Environmental Protection Act, 415 ILCS 5/1 et seq., assigns the cost liability of contamination clean-up to the causer of the contamination. According to Staff, Section 58.9 of the Environmental Protection Act assigns liability for the cost of the clean-up of contamination to the party or entity that caused the release, not to the party or entity that owns the property that was contaminated. Staff states that AmerenCIPS' Pana East Substation did not cause or release the contamination, nor did AmerenCIPS' electric ratepayers. Staff believes it would be inappropriate for AmerenCIPS to recover from electric ratepayers 100% of its costs for the relocation, which occurred to facilitate the coal tar contamination cleanup.

Staff suggests that if AmerenCIPS needed to relocate a customer's home for contamination clean-up, AmerenCIPS would not charge the customer, or for that matter its electric ratepayers, all of the relocation costs. Staff asserts that AmerenCIPS would instead appropriately allocate its costs for the relocation of the customer's home to its various lines of business, including its electric utility. Staff says no single line of business would pay 100% of the relocation cost. In Staff's view, costs associated with the relocation of the Pana East Substation should be allocated to AmerenCIPS' various lines of business, since the relocation occurred to facilitate contamination cleanup.

Staff indicates that AIU argues that Staff's hypothetical scenario involving relocation of a customer‘s house is dissimilar to relocation of the Pana East Substation, since the relocation of the substation was required in order to provide adequate and reliable electric service to customers during AmerenCIPS‘ clean-up activities, whereas a customer‘s relocated house would not be used and useful in the provision of electric service. In Staff's view, whether or not the newly relocated home or the newly relocated substation is used and useful in the provision of electricity should not be the only fact considered when deciding who should pay for the relocation. Staff says its position is not based upon whether the substation at its new location is used and useful. Staff's position is based upon the fact that AmerenCIPS‘ Pana East Substation was used and useful at its former location, and was providing adequate electric service to customers at that former location.

Staff asserts that if a third party were to request that AmerenCIPS relocate existing electric distribution facilities for which AmerenCIPS had adequate property rights, AmerenCIPS would require the requesting party to pay the entire relocation cost. Staff agrees with AmerenCIPS‘ policy that the third party, rather than electric ratepayers, should pay relocation costs when the utility‘s facilities are adequate and used and useful at the original location, and a relocation happens because the third party requested or needed the relocation. Staff suggests a similar situation occurred at the Pana East Substation. Staff says AmerenCIPS relocated its facilities associated with the Pana East Substation that were adequately providing service to its electric customers. Staff contends that the contaminated soil beneath the former Pana East Substation site did not conflict with this provision of electricity, was in no way caused by the substation, and if left in the ground, would not have affected the ability of the substation to provide adequate and reliable service to AmerenCIPS‘ customers in the future.

Staff does not object, generally, to AmerenCIPS‘ recovery of the relocation costs. But Staff believes that it would be more reasonable for AmerenCIPS‘ shareholders to bear some of the costs. Staff denies, however, that it has any obligation to provide an alternative allocation proposal. Staff states that this is AmerenCIPS‘ electric rate case, and AmerenCIPS should be able to justify its own additions to electric distribution plant. Staff also denies that AIU ever asked it to provide an alternative allocation and calls AIU‘s accusation that Staff refused to propose an alternative allocation troubling and disingenuous. Staff states that rather than justifying AmerenCIPS‘ proposed 100% allocation of relocation costs to electric ratepayers, which Staff requested it do, AIU elected to wait until the evidentiary hearing, where it attempted to shift the burden of establishing an appropriate cost allocation for the purposes of AmerenCIPS‘ rate recovery to Staff. Staff witness Rockrohr testifies that he would consider modifying his recommendation if AIU provided information or evidence to fully explain and justify its proposed 100% allocation. Rather than providing necessary information to support its own proposal, or proposing an alternative allocation, Staff claims AIU simply accused Staff of not suggesting an alternative cost allocation.

If the Commission determines that AmerenCIPS should recover its costs for relocating the Pana East Substation, but agrees with Staff that 100% allocation of costs to electric ratepayers is not appropriate, Staff suggests that the Commission may wish to consider an allocation that closely matches the allocation of the clean-up costs recovered through AmerenCIPS' environmental riders (Rider EEA and Rider GEA).

Staff acknowledges a concern raised by IBEW in its Initial Brief relating to possible job losses if the Commission decides not to allow AmerenCIPS to recover the relocation costs. IBEW expressed concern that if AIU fails to recover its relocation costs, it might reduce spending in other areas, such as O&M. Though it does not think it would be a good idea to do so, Staff suggests that AIU could decide to reduce its maintenance and operations expenditures for any number of reasons, independent of the Commission's decision regarding this substation relocation issue. While potential job loss might be a legitimate concern, Staff does not believe the Commission should base its decision upon this concern.

c. IBEW Position

IBEW argues that relocating the substation to facilitate the remediation was the least costly and most reliable solution available to comply with AIU's obligation to remediate the contamination while maintaining service to utility customers. IBEW says that other options such as undermining the substation while it was operating or utilizing additional portable substations would have been more costly and could have negatively impacted reliability. Additionally, IBEW claims the new Pana East Substation incorporates a number of improvements that will help maintain reliability in the future. According to IBEW, the labor and materials costs to relocate the Pana East Substation, which were incurred to perform required remediation and maintain service, should be recoverable through base rates.

IBEW is also concerned that although the work on the Pana East Substation has already been completed, failure to allow recovery of costs for the project may lead AIU to reduce spending in other areas, such as O&M expenses. IBEW says this could result in less preventative maintenance work and tree trimming, and fewer workers available to restore service during storms. IBEW claims the resulting job losses would also have negative economic effects in Illinois.

d. Commission Conclusion

AIU proposes to include in AmerenCIPS' electric rate base all of the capital costs associated with relocating the Pana East Substation and the distribution and transmission lines entering and leaving the substation. Staff has proposed an adjustment to AmerenCIPS' electric rate base to remove all of the approximately $2 million of capital costs associated with the project. If the Commission determines that AmerenCIPS should be allowed to recover the relocation costs from ratepayers, Staff suggests that the Commission consider an allocation that closely matches the allocation of the clean-up costs recovered through AmerenCIPS' environmental riders (Rider EEA and Rider GEA).

Having considered the arguments, the Commission does not believe that the record supports the suggestion that AIU shareholders should bear the costs associated with relocating the Pana East Substation. There has been no overriding policy or legal concerns raised that would justify such a decision. Staff's proposal to reduce AmerenCIPS' electric rate base by approximately $2 million effectively allocates 100% of the costs to AIU shareholders, a result that the Commission finds unreasonable and rejects.

With regard to any alternative allocation, the Commission notes that this is not simply an AmerenCIPS' electric rate case. These consolidated proceeding consist of both an electric and gas rate case for AmerenCIPS, as well as for AmerenCILCO and AmerenIP. Any party was free to suggest and support an allocation that included cost recovery from electric and gas customers (as well as shareholders). While Staff suggests as a fall back position that the Commission allocate the relocation costs in a manner consistent with AmerenCIPS' environmental riders, Staff has not sufficiently demonstrated why gas customers should bear any such costs. Nor is it clear how Staff would have the Commission implement its suggestion. The only viable alternative in the record is AIU's recommendation to include 100% of the costs associated with the Pana East Substation in AmerenCIPS' electric rate base, which the Commission adopts.

4. Hillsboro Storage Field

a. AIU Position

In 1993, IP expanded its Hillsboro Storage Field ("Hillsboro"). The Commission approved the expansion and concluded that Hillsboro would provide substantial net economic and other benefits to IP's customers and it should be considered used and useful when placed into operation. IP intended the expansion to increase the field's total storage and peak day storage withdrawal capability. IP estimated that after expansion, the storage field would contain 21.7 Billion cubic feet (―Bcf") gas-in-place, reflecting 7.6 Bcf inventory gas and 14.1 Bcf base gas.

AIU states that since the 1993 estimate, however, with the exception of the 1993-94 season, Hillsboro has not operated at or near 7.6 Bcf. AIU indicates that using newly-available technology to update its understanding of Hillsboro and its capacity, AmerenIP has determined that geological conditions at Hillsboro likely prevent the field from operating at design capacity. AIU claims Staff fails to consider this new information, which was identified by more advanced computer modeling than what was previously available. AIU states that based on this new information, AmerenIP deems it prudent to cycle the field at 6.4 Bcf, rather than the 1993-estimated design capacity of 7.6 Bcf. Staff agrees Hillsboro should be cycled at 6.4 Bcf, but claims that Hillsboro is not 100% used and useful because it is not currently cycling at 1993 estimated levels.

According to AIU, Staff calculates Hillsboro is 96.01% used and useful and proposes a used and useful disallowance.

AIU believes Staff‘s recommended used and useful disallowance is flawed and must be rejected for four reasons: (1) Staff incorrectly relies on the 1993 design capacity estimate of Hillsboro and does not recognize the importance of new information, based on previously unavailable and more advanced computer modeling, regarding Hillsboro‘s geology; (2) Staff concedes that Hillsboro should cycle 6.4 Bcf for the next several years; (3) Staff overlooks the fact that Hillsboro substantially benefits customers; and (4) Staff wrongly connects its used and useful adjustment to past operational concerns at Hillsboro. Even if the Staff‘s proposed disallowance was not flawed for these reasons, AIU argues that the Commission should not impose a disallowance where Staff‘s calculation of the field‘s used and usefulness is so near 100%.

In Illinois, a generation or production facility is used and useful only if, and only to the extent that, it is necessary to meet customer demand or economically beneficial in meeting such demand. In determining whether a facility is used and useful, AIU says the Commission considers the extent to which a plant is needed to meet the utility‘s projected demand and whether the plant provides net economic benefits to ratepayers.

According to AIU, the Commission recognizes that capacities estimated during the design and construction phases may differ from actual operational capacity, and thus, has rejected reliance on design capacity in determining used and usefulness. AIU claims that where a utility assigned a “nominal” capacity during design and construction of a plant as an approximate capability value, the Commission stated “it was not possible to determine precisely what the net output of the plant would be during its design and construction states, until it was completed, placed in service and tested.” (AIU Initial Brief at 32-33, citing Docket No. 89-0276, Order at 161-62) According to AIU, use of a “nominal” value for projected capability during design and construction of the plant was not a basis on which to establish the used and usefulness of a plant. Likewise, AIU argues that where capacity is restricted or not available due to physical constraints, such capacity should not be included in a plant‘s total effective capacity for purposes of determining used and usefulness.

To demonstrate that Hillsboro is not currently operating in “the same manner” as was originally predicted, Staff cites the Commission‘s 1992 order granting IP a certificate for Hillsboro (Docket No. 91-0499) before Hillsboro‘s expansion was complete. According to AIU, Staff essentially faults AmerenIP because Hillsboro has not operated at the projected levels since expansion. AIU contends, however, that it is Staff's reliance on design estimates of capacity that is faulty. Despite the fact that IP predicted a design cycling capacity of 7.6 Bcf in 1993 for Hillsboro, AIU claims the field‘s actual operating conditions are inconsistent with that design capacity. AIU says Hillsboro has not operated at 7.6 Bcf since 1993 and AmerenIP recently has been able to identify physical, capacity-limiting characteristics of the Hillsboro field by applying new technology – not yet developed in 1993 – and conducting a detailed study of Hillsboro (the ―Hillsboro Study").

AIU states that the Hillsboro Study employed several improved and independent engineering methods, including a reservoir simulation study and a hysteresis curve evaluation.[7] AIU asserts that with the use of these new, more advanced technologies, the Hillsboro Study identified a geological condition by which gas migrates to a less accessible region of the field. AIU says significant volumes of gas migrate from the St. Peter formation, which is located near the well bore that cycles gas from the field, into the Joachim cap rock porosity, which is not accessible to that bore. AIU claims the porosity of the Joachim formation traps the gas, causing a shortfall of gas to be cycled. According to AIU, this materially affects the field's performance relative to its design capacity. AIU says while the 1993 reservoir analysis expected the entire 21.7 Bcf of gas injected into the reservoir at the end of expansion to exist in the St. Peter formation, the Hillsboro Study revealed that approximately 3.5 Bcf of gas has since migrated from the St. Peter formation into the Joachim cap rock porosity. AIU avers that the Hillsboro Study indicated the St. Peter formation cycles only 5.8 Bcf of working gas, while the Joachim porosity cycles 0.6 Bcf. In AIU's view, the Hillsboro Study demonstrated that the best current estimate of working gas capacity is 6.4 Bcf. AIU contends that the volume currently and prudently cycled at Hillsboro, and not the estimated volume, should determine the used and usefulness of the field. AIU says the Commission has determined that ―the used and useful calculation should be based on the Company's existing capacity configuration," which the Commission terms ―actual capacity." (AIU Initial Brief at 34-35, citing Docket Nos. 87-0427 et al. at 90)

AIU also argues that modifying the amount of working gas cycled is not unusual. AIU states that underground storage reservoirs are very complex/heterogeneous geological formations, and as a result, these reservoirs are difficult to fully understand because there are multiple variables that can change and many variables that can not be discretely measured but must be interpreted. AIU claims volumes are commonly adjusted based on the field's actual operating experience and recently updated information. AIU claims that other gas utilities have similarly adjusted working volumes without a disallowance or other penalty. According to AIU, in Docket No. 90-0127, the Commission approved a working gas inventory adjustment but did not make a used and useful disallowance. AIU also says that in Docket Nos. 07-0585 et al. (Cons.), a working gas inventory adjustment was made at Sciota field without a used and useful disallowance. AIU states that in that case, like here, studies indicated the need to adjust working and base gas.

AIU says Staff asserts that AmerenIP can not make any changes to the Hillsboro specifications until it has operated the field in a certain manner because it still does not know what those specifications are, even though the field expansion took place 16 years ago. AIU claims this mischaracterizes AmerenIP's position on inventory revisions

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[7] A hysteresis curve is a plot of the gas pressure in the storage field versus the field inventory, which can be used to verify the inventory within the field and to monitor the underground storage reservoir's performance.

at Hillsboro. AIU insists that the Hillsboro Study does not state that AmerenIP needs to cycle the field in a consistent manner or can not make changes to the field specifications. Rather, AIU claims the Hillsboro Study recommends that 6.4 Bcf of gas be cycled from the field for the next several years and that verification studies be performed. AIU says the Hillsboro Study also asserts that the annual cycling of 6.4 Bcf will help the reservoir stabilize further, increasing the accuracy and validity of the reservoir engineering studies.

AIU says AmerenIP plans to consistently operate the field at 6.4 Bcf over the next few years to conduct reservoir engineering studies. AIU states that Staff does not disagree with AmerenIP's logic on seeking to operate the field at 6.4 Bcf and agrees that maintaining the field at a consistent level will allow AmerenIP to better determine the operating characteristics of the field. According to AIU, Staff acknowledges that Hillsboro may not be able to operate at its design capacity.

AIU indicates that IP invested over $154 million to expand Hillsboro in 1993. AIU insists that this investment benefits customers by allowing AmerenIP to purchase and inject gas when less costly in the summer and withdrawing it in winter; it also increases peak day deliverability. AIU claims customers' savings for the first year were estimated at $14,596,500, and says Staff does not dispute that these benefits have been, and continue to be, realized. Since it is unclear whether Hillsboro is able to operate at 7.6 Bcf, AIU contends it is unclear whether extra ratepayer benefits are achievable. Until operational parameters are further defined, AIU asserts it is imprudent to risk the additional 1.2 Bcf of gas costs.

AIU understands that Staff's used and useful proposal relates to past operational issues at Hillsboro. According to AIU, Staff argues that due to inventory corrections at Hillsboro, AmerenIP could not conduct inventory verification studies and now must operate the field consistently to determine its current operating parameters. AIU argues that regardless of what transpired in the past, AmerenIP could only now identify the geological limitations to the field's capacity because the necessary technology was not previously available. AIU says Staff agrees that information now known differs from the facts of Docket No. 04-0476, and that AmerenIP addressed prior events that impacted Hillsboro's inventory volumes. AIU relates that in Docket No. 04-0476, Staff considered volume histories to reduce withdrawal volumes, but here, Staff considers working volumes by relying on scheduled withdrawal volumes. Also, previously, AIU indicates that metering errors caused volumes reductions, while here, working volumes are reduced at Hillsboro because of geological conditions.

AIU believes the Commission should reject Staff's suggestion for a ruling to ensure AmerenIP is aware of the Commission's concerns with the operation of Hillsboro. AmerenIP believes such a ruling would be improperly punitive. AmerenIP encourages the Commission to rule on the evidence presented to determine whether the costs associated with Hillsboro were prudently incurred. (AIU Initial Brief at 39)

AIU contends that a disallowance in such a close case is inappropriate, especially given that gas storage operations can be unpredictable. If a field is prudently operated based on the information currently available, AmerenIP maintains that a disallowance is not appropriate when new information suggests the utility should change its operations. According to AIU, customers still have benefited far more by having the Hillsboro asset than not having the asset. Given the prudent operation of Hillsboro, and benefits enjoyed by customers, AmerenIP asserts that a disallowance based on a 96.01% used and useful calculation is poor policy. AIU claims Hillsboro is operating to meet current customer demand and provides net economic benefits to ratepayers and believes it is 100% used and useful.

b. Staff Position

Staff asserts that Hillsboro is not operating in the same manner that it was when IP expanded the field and placed the costs associated with the expansion into its base rates in Docket No. 93-0183. Given the manner in which AmerenIP is currently operating Hillsboro, Staff claims it is no longer 100% used and useful at providing service to AmerenIP's customers. Staff calculates a used and useful percentage for the field to equal 96.01% and recommends the Commission use this value to set the rates in this proceeding. Staff asserts further that AIU failed to maintain Hillsboro in an appropriate manner. Staff believes ratepayers should not be required to continue paying for Hillsboro as if it were operating at 100% used and useful when, in reality, Hillsboro is not operating in that fashion.

Staff relates further that the Commission previously adopted a used and useful adjustment regarding Hillsboro in Docket No. 04-0476. Staff reports that AmerenIP appealed the Commission's finding that Hillsboro was only 53.44% used and useful. The appellate court affirmed the Commission's decision on October 2, 2006.[8] Staff claims its methodology in the instant proceeding followed the same methodology accepted by the Commission and confirmed by the appellate court. Specifically, Staff's used and useful calculation was based on splitting the value of Hillsboro into two components – peak day capacity and seasonal price variation. Staff then determined that the value of Hillsboro came 79.70% from peak day capacity and 20.30% from seasonal gas costs savings. Staff used these values as allocation percentages within the used and useful calculation. Next, Staff used Hillsboro's three-year historical average, years 2006 through 2008, of the amount of peak day capacity and working gas inventory available to ratepayers to determine the used and useful percentages for the field. Staff says this calculation provided a used and useful amount of 96.01%. According to Staff, AmerenIP has not disputed the mechanics of Staff's used and useful calculation, but has disputed the need to make any used and useful disallowance at all.

Staff reports that in Docket No. 91-0499, IP received a certificate of public convenience and necessity for its expansion of Hillsboro. In Docket No. 93-0183, Staff says IP also received Commission authority to expand Hillsboro and to recover the cost of that expansion through its rates. As a result of these Orders, Staff states that IP, with

[8] The decision was issued as an unpublished Rule 23 Order.

Commission approval, conducted an extensive expansion of Hillsboro to increase its peak day capability (now rated at 125,000 Mcf/day), and the volume of inventory maintained in the field (7.6 Bcf of inventory gas and 14.1 Bcf of base gas). Further, Staff indicates that the Commission found the field to be 100% used and useful based upon those values in Docket No. 93-0183.

Staff compared the current operation of the storage field to post-expansion levels at Hillsboro. Staff states that Hillsboro has not operated near the levels discussed in Docket Nos. 91-0499 and 93-0183 since IP placed it into service for the winter season of 1993-1994. Staff claims that when the field does not operate according to its design parameters, AmerenIP passes any additional gas costs it incurs to make up for the problems at Hillsboro to ratepayers through its PGA rates. Staff argues that AmerenIP‘s customers have paid twice for some of the Hillsboro capacity. Staff asserts that this occurs because AmerenIP charges its customers base rates that include the cost of the Hillsboro expansion and charges these same customers for any additional gas cost caused by the Hillsboro facility de-rating that are included in the PGA rates.

AmerenIP notes that in its more recent rate case, Docket Nos. 07-0585 et al. (Cons.), that Hillsboro was fully operational. AmerenIP also provided an analysis in that case that showed the volumes withdrawn from Hillsboro, after accounting for the weather as well as other extraneous events. According to this analysis, Staff says the gas withdrawal levels for Hillsboro were at or near the expected withdrawal levels. According to Staff, AmerenIP indicates that various extraneous events impacted AmerenIP‘s ability to fully withdraw gas from Hillsboro in the recent 2006/2007 winter season. AmerenIP states that, excluding the temperatures experienced, it had addressed each of these events.

Staff asserts further that it does not appear that AmerenIP has resolved all of the problems at Hillsboro. Staff observes that Hillsboro has actually started to see a reduction in the seasonal withdrawal quantity. Staff claims that Hillsboro‘s withdrawal volumes are not back to the full operating capacity of the field, namely, a seasonal withdrawal quantity of 7.6 Bcf. According to Staff, winter season heating degree days ("HDD") actually experienced the last few years should not have caused any limiting factors for the withdrawals from Hillsboro. Staff asserts that while the last several winter seasons have been significantly colder than normal, AmerenIP was only able to withdraw about 6.6 Bcf in the 2007/2008 winter season and only 5.8 Bcf in the 2008/2009 winter season. Staff states that one would expect the volume of gas withdrawn from storage to be higher in a colder than normal winter season than a warmer than normal winter season. Staff says that although AmerenIP experienced the highest number of HDD during the most recent winter season, 2008-2009, the gas withdrawn from Hillsboro during the most recent winter season was the lowest volume in the last four years.

AmerenIP plans to operate Hillsboro at an annual withdrawal rating of 6.4 Bcf versus the 7.6 Bcf rated capacity and indicated its Hillsboro Study supported this withdrawal level. While it does not disagree with AmerenIP‘s reasoning for operating

Hillsboro in this manner, Staff asserts the reason for operating the field at the lower withdrawal rating is partially due to the prior measurement errors that AmerenIP experienced at the storage field. Staff contends that these measurement errors have necessitated further study of the field. Staff insists that the prior years of changing inventory volumes and the uncertainty which results from the multiple metering corrections have created a situation where AmerenIP needs additional time to study Hillsboro. Staff says the optimal method for conducting these studies is to operate the field at a consistent level.

Not only does AmerenIP need consistent operation of Hillsboro to allow the use of the hysteresis curve analysis, Staff says the past inventory problems also impact the use of the simulation model that AmerenIP relies on to review its field. When reviewing storage fields, Staff indicates the volume of gas within the field is an important assumption for the model. Staff states that AmerenIP‘s prior measurement errors at the storage field caused uncertainty in the total inventory value of the field. Staff believes the constant operation of the storage field will also allow better analysis through the simulation model in the future.

Staff claims AmerenIP does not have a good handle on all of these facets of Hillsboro‘s operation at this time. Staff states that the recent Hillsboro Study provides additional insight into the operation of the Hillsboro storage field, but it also identified additional areas to investigate. Staff complains that 16 years after the expansion of the field, AmerenIP still does not know why the Hillsboro storage field operates at its current levels or even if the original 7.6 Bcf rating is appropriate. Staff contends that this problem should not be borne by ratepayers. According to Staff, it is a function of prior problems that AmerenIP failed to identify in a timely fashion whose impact is still being felt today.

AIU attempts to place reliance on prior Commission Orders to dispute Staff‘s proposed used and useful adjustment. Staff contends that AIU fails to demonstrate how these Orders relate to the instant proceeding; instead, Staff believes AIU‘s arguments are an inappropriate subordination of the Commission‘s Orders. Further, AIU claims that prior instances where utilities have altered the working inventories of their storage fields, without a used and useful adjustment, support its claim that no adjustment is necessary in the instant proceeding. Staff disagrees.

AIU indicates that in Docket No. 89-0276, the Commission rejected reliance on design capacity in determining used and usefulness and that the Commission stated that it was not possible to determine precisely what the net output of the plant would be during its design and construction stages, until it was completed, placed in service, and tested. Staff indicates that the Commission‘s discussion within the Order determined the appropriate in-service capacity rating to assign the Clinton nuclear power plant in order to determine the appropriate percentage of the plant to place into rates. Staff believes AIU's application of this Order to this proceeding is incorrect.

Staff states that during the first winter of operation, 1993-1994, Hillsboro operated at its expected levels, or in other words, AIU tested the capability of the field. Staff argues that AIU achieved the original operating specifications: a peak day of 125,000 Mcf/day and seasonal capacity of 7.6 Bcf. In Staff's view, the Commission‘s Order in Docket No. 89-0276 does not require any deviation from the values Staff assigned to Hillsboro in its used and useful calculation for the field in the instant proceeding.

Staff indicates that AIU also references the Commission Order from Docket Nos. 87-0427, et al. AIU indicates that this Order noted that where capacity is restricted or not available due to physical constraint, such capacity should not be included in a plant‘s total effective capacity for purposes of determining used and usefulness. Staff says AIU also states that the Commission indicated that the used and useful calculation should be based on the utility‘s existing capacity configuration. Staff indicates that AIU concluded that it is not appropriate to base a used and useful calculation on design, as opposed to actual capacity, in this proceeding. AIU instead claims that the Commission‘s used and useful assessment should consider the current effective capacity of Hillsboro.

Staff says the Order in Docket Nos. 87-0427 et al. discussed effective capacity and capacity configuration in the context of whether to include the capacity from retired electrical peaking units or capacity associated with summer limitations on power production plants in the used and useful calculation. Staff states that the used and useful determination of an electric power production plant compares the utility‘s peak demand, adds a reserve margin, subtracts out total capacity without the plant in question, and then reviews what percentage of the plant is needed to meet customers‘ demands. Staff asserts that there is no corresponding topic in the instant proceeding. Staff states that AIU placed Hillsboro in service in 1993, which Staff believes is the time for Staff and the Commission to review what other resources AIU had in place to determine if AIU needed Hillsboro and if it was used and useful. According to Staff, the issue in the instant proceeding, namely AIU‘s inability to operate Hillsboro at its full capacity, is distinguishable from AIU‘s reference to Docket Nos. 87-0427 et al.

AIU also claims that other companies have adjusted working volumes within their storage fields in the past without penalty. AIU then claims that the instant proceeding is the same as these earlier cases because studies indicate the need to adjust working and base gas. Staff asserts that AIU is not proposing to alter Hillsboro‘s working or base gas inventory levels and has chosen to operate the storage field in a consistent manner to determine the operating parameters of the storage field. Staff claims these facts distinguish the instant proceeding from those referenced by AIU.

Because the Commission approved Hillsboro as operating at the higher capacity, Staff believes that Hillsboro would provide even more savings to customers if AIU operated the field at its expected levels. Staff also claims that AIU made this exact same argument in Docket No. 04-0476; however, Staff says the Commission rejected AIU‘s reasoning and determined that a used and useful adjustment was appropriate.

Regarding AIU's claim that the technology only now exists to identify the problem, Staff says AIU did not make claim this until the filing of its surrebuttal testimony. Additionally, Staff claims the underlying problem relates to the migration of gas into the Joachim layer of somewhat permeable cap rock. However, Staff contends that this migration has occurred since AIU started storing gas in Hillsboro in 1972. Staff argues that when AIU expanded the field in 1993, it likely exposed additional areas for gas to migrate. Staff states that the initial expansion took place over 15 years ago and migration was on-going during this time period. While Staff does not dispute that some migration is likely still taking place, Staff believes AIU does not have a good handle on all of these facets of Hillsboro's operation at this time. Staff believes this occurred, in part, due to the past problems AIU has had with metering errors causing inventory reductions at the field and has kept AIU from being able to properly review or operate the field in the past.

AIU claims that in Docket No. 04-0476, Staff relied on historical withdrawal volumes from the Hillsboro storage field, but in the instant proceeding is placing reliance on the scheduled withdrawal volumes. Staff disputes this claim. Staff insists it based its used and useful calculation on the historical withdrawal volumes from Hillsboro in a manner consistent with the approach used in Docket No. 04-0476.

c. AG/CUB Position

AG/CUB believes that it is not equitable for ratepayers to continue paying for Hillsboro as if it were operating at 100% used and useful, when in reality it is not and has not been so operating for some time. AG/CUB agrees with Staff that the Commission should find only 96.01% of Hillsboro used and useful. AG/CUB points out that Staff listed prior AIU cases where it raised concerns about the manner in which IP operated Hillsboro and recommended disallowance. AG/CUB notes that AIU attempts to distinguish Docket No. 04-0476 from the instant proceeding by arguing that the reduction in volumes in Docket No. 04-0476 were due to metering errors, while the reduction in the immediate proceeding is due to geological conditions inherent to Hillsboro. AG/CUB counters that AmerenIP does not know why Hillsboro operates at its current levels, or even if the original 7.6 Bcf rating is appropriate. AG/CUB believes ratepayers should not bear this problem.

d. Commission Conclusion

Staff recommends that the Commission find Hillsboro is 96.01% used and useful, and that an adjustment to AmerenIP's rate base should be made to recognize this finding. AIU disagrees, among other things arguing that Staff incorrectly relies on the 1993 design capacity estimate of Hillsboro and does not recognize the importance of new information. AIU also claims that Staff concedes that Hillsboro should cycle 6.4 Bcf for the next several years. AIU also contends that Staff overlooks the fact that Hillsboro substantially benefits customers. AIU asserts that Staff wrongly connects its used and useful adjustment to past operational concerns at Hillsboro. Finally, AIU argues that the

Commission should not impose a disallowance where Staff‘s calculation of the field‘s used and usefulness is so near 100%.

As an initial matter, the Commission observes that AIU argues that its planned operation of Hillsboro is prudent. In this proceeding, no party takes issue with the prudency of AIU's actions and the Commission simply notes that investments must be both prudent and used and useful in order to be included in rate base. With regard to AIU's assertion that Hillsboro provides benefits to customers, the Commission concurs with Staff that the method by which it calculates a used and useful percentage inherently takes such benefits into consideration.

While Staff recommends that the Commission rely on the design capacity estimate, 7.6 Bcf, AIU believes the calculation should rely on a 6.4 Bcf capacity because this is the amount of gas that should be cycled at Hillsboro for the next several years. While Staff agrees that it is reasonable for AIU to cycle 6.4 Bcf at Hillsboro for the next several years, Staff maintains that the used and useful calculation should use the design capacity estimate, 7.6 Bcf.

The Commission concurs with AIU that aquifer underground natural gas storage fields are complex structures and that adjustments to the operating characteristics are sometimes appropriate. The Commission, however, believes that IP, AmerenIP, and AIU bear much of the responsibility for the operational problems that have plagued Hillsboro for too long. While it appears that most of those problems may have been resolved or at least mitigated, it is not entirely clear to the Commission that the capacity of Hillsboro has been permanently reduced to 6.4 Bcf. As a result, for purposes of this proceeding, the Commission agrees with Staff that the 7.6 Bcf capacity figure should be utilized in the used and useful calculation. Accordingly, the Commission finds that Staff has correctly calculated that Hillsboro is 96.01% used and useful and that AmerenIP's gas rate base should be adjusted in the manner proposed by Staff.

The Commission rejects AIU's suggestion that because 96.01% is near 100% no adjustment should be implemented in this proceeding. The Commission believes that there is no sound reason for essentially overcharging AmerenIP gas customers. Finally, the Commission notes that in future rate cases, it is willing to revisit the capacity of Hillsboro to review additional data gathered or the result of any studies performed regarding the operation of that storage field.

5. Cash Working Capital

a. AIU Position

AIU explains that a cash working capital (―CWC") requirement is the amount of funds required to finance the day-to-day operations of a utility. A positive CWC requirement indicates that the utility‘s shareholders are providing funds associated with the payment of expenses prior to the collection of revenues from customers. A negative CWC requirement indicates that the utility‘s customers are providing funds via the collection of revenues prior to the payment of expenses. AIU indicates that the CWC requirement is calculated by conducting a lead-lag study, which examines the timing of cash flows, both revenues and expenses.

AIU states that the CWC requirement is $6.3 million, $4.1 million, and $10.6 million for AmerenCILCO's, AmerenCIPS', and AmerenIP's gas operations, respectively, and $0.5 million, $2.2 million, and $(1.1) million for AmerenCILCO's, AmerenCIPS', and AmerenIP's electric operations, respectively. AIU asserts that the methods employed to determine the CWC requirement for the gas and electric businesses were consistent with the Commission's decisions in AIU's prior rate case proceedings, Docket Nos. 07-0585 et al (Cons.).

Staff identified four potential issues with AIU's CWC analyses: (1) use of the Gross Lag Methodology versus the Net Lag Methodology, (2) use of consistent expense lead days for Other O&M expenses for both the gas and electric businesses, (3) use of a revenue lag of zero days for pass-through taxes, and (4) the inclusion of service lead time in the expense lead days for pass-through taxes. In its rebuttal testimony, Staff accepted AIU's presentation of bank facility fees and the expense lead time for those fees as presented in testimony and exhibits.

In all other respects, AIU says Staff adopted AIU's CWC analyses. In its rebuttal testimony, AIU states that it accepted Staff's proposed use of the Gross Lag Methodology to calculate the CWC requirements and the use of a consistent expense lead for Other O&M expenses for both the gas and electric businesses. AIU relates that it and Staff agree that the level of CWC allowed should be based upon the final level of cash expenses approved by the Commission in these proceedings. AIU indicates that IIEC submitted direct testimony proposing a collection lag of 21 days. AIU says that in its rebuttal testimony, IIEC also argues that uncollectibles should have been excluded from the calculation of the collection lag.

AIU indicates that it applies a revenue lag to all revenues, with the exception of those associated with pass-through taxes, which consisted of a service lag, a billing lag, a collection lag, a payment processing lag, and a bank float lag. Because Staff has taken the position in prior rate proceedings that pass-through taxes are not associated with the provisioning of a service, AIU excludes the service lag from the revenue lag that was applied to the pass-through taxes. AIU says the service lag excluded from the revenue lag attributed to pass-through taxes was 15.21 days (i.e., 365 days divided by 12 months divided by 2 to reflect the midpoint of the month).

AIU claims that its position reflects the reality that whether or not a service is provided, the Companies still must bill, collect and process the revenues associated with the pass-through taxes. AIU says its customers make only one monthly payment which includes both the amounts associated with monthly services received and the pass-through taxes. AIU contends that no other vehicle exists by which customers make payments.

AIU asserts that unlike arguments presented in prior cases, Staff this time argues that a revenue lag of zero days should be applied to pass-through taxes. Staff contends that there is no lag between a delivery of utility service and the receipt of cash in regard to pass-through taxes. AIU contends that Staff is incorrect and ignores the very purpose of the CWC analyses, which is to examine the timing of cash flows. In AIU's view, Staff ignores the timing of the collection of revenues associated with pass-through taxes. AIU claims Staff proposes a completely contradictory position with regard to the treatment of the expense side of the pass-through taxes.

The infirmity of Staff's position regarding the treatment of pass-through taxes in the CWC analyses, AIU contends, is best shown in Ameren Ex. 31.1. AIU says this exhibit, which uses electric gross receipt taxes as an example, compares AIU's and Staff's positions regarding the timing of receipt of revenues for and the payment of pass-through taxes. AIU asserts that the exhibit demonstrates that AIU remits payment associated with pass-through taxes after 27.53 days while the customers' payment for such taxes is not received for 31.34 days. AIU claims it is remitting payment for pass-through taxes 3.81 days prior to the receipt of payment from customers.

AIU says Staff claims that payment of the pass-through taxes occurs after 42.8 days and that the revenues are in hand for AIU's use immediately. According to AIU, Staff offers no explanation as to how AIU collects the funds associated with the pass-through taxes, if not via the customer's monthly payment. In AIU's view, Staff's position does not reflect the actual timing of cash receipts and cash payments with regard to pass-through taxes.

AIU believes Staff is correct that AIU's revenue lag for pass-through taxes includes factors for billing, collections, payment processing, and bank float and that the expense lead measures the tax period ending date with the date that the funds are removed from AIU's bank account. AIU claims these are precisely the factors which should be measured when conducting CWC analyses. AIU insists that Staff's assertion that AIU's factors do not identify the date that funds are actually received or remitted is incorrect. AIU says the CWC analyses, which Staff adopts in all respects other than the pass-through taxes, are based exclusively on actual receipt and payment dates. AIU urges the Commission to reject Staff's proposed zero-day revenue lag attributed to pass-through taxes in favor of AIU's proposed 31.32-day revenue lag. AIU maintains that its proposed revenue lag reflects the overall revenue lag of 46.53 days less the 15.21-day service lag. In AIU's view, no evidence or analyses have been presented by Staff to demonstrate how the revenues associated with the pass-through taxes are available immediately to the AIUs.

AIU argues that, consistent with its proposed treatment of the service lag, it excludes the service lead from the overall expense lead associated with the pass-through taxes. AIU's position is that if there is no service period, it should not be applied to either the revenue lag or the expense lead. Despite its position that the service lag was correctly excluded by AIU, AIU understands that Staff has proposed that the service lead continue to be included in the overall expense lead. In AIU's view, Staff's position to exclude the service lag but include a service lead is a results-oriented attempt to lower the CWC allowance.

Staff contends that the amounts related to pass-through taxes accrue over a monthly or quarterly period and are remitted, in most cases, after the end of the accrual period and that a service lead is necessary to accurately reflect the lead time. AIU responds that its CWC analyses reflect the actual timing of the payment of the pass-through taxes. AIU insists no service lead is necessary to address anything related to accruals and remittance timing differences.

AIU says the service period is associated with the timing of the provisioning of service. AIU indicates Staff has previously argued that there is no service period associated with pass-through taxes. AIU states that Staff's new position is that there is no service lag associated with the collection of the revenues associated with pass-through taxes, but that there is a service lead associated with the payment of the pass-through taxes. AIU contends that either there is a service period or there is not. AIU believes Staff's position regarding the inclusion of a service lead of 15.21 days to the overall expense lead should be rejected. AIU insists the inclusion of a service period is unsupported and inconsistently applied by Staff. AIU maintains that it accurately and consistently excludes the 15.21 days from both the revenue lag and the expenses lead.

AIU states that Section 280.90 of 83 Ill. Adm. Code 280, "Procedures For Gas, Electric, Water and Sanitary Sewer Utilities Governing Eligibility for Service, Deposits, Payment Practices and Discontinuance of Service" ("Part 280"), of the Commission's rules gives residential customers 21 calendar days from the issuance of the monthly bill to pay the bill before late charges may be assessed. AIU claims its CWC analyses reflect the reality that, while many of their customers pay their utility bills in full and on time, there are customers who are delinquent in the payment of their bills. AIU calculated a collection lag of 28.13 days, based upon an analysis of the aging of accounts receivables during the test year. AIU notes that Staff did not oppose this collection lag.

AIU also argues that the Commission rejected Staff's proposed treatment of the revenue lag for pass-through taxes in a recent Peoples rate case, Docket Nos. 07-0241/0242 (Cons.). AIU says the facts remain the same in this proceeding. According to AIU, there is only one vehicle by which AIU collects payment from its customers and that is via the monthly bill. AIU argues that Staff has provided no additional analyses to support a revenue lag devoid of a billing, collection, payment processing, and bank float lag. AIU believes the Commission decision in AIU's previous rate proceeding remains accurate and should be reaffirmed in these proceedings.

IIEC proposes that the collection lag included in the overall revenue lag should be capped at the number of days allotted for AIU's residential customers to pay their bills from the issuance of the monthly bill. AIU asserts that IIEC provides no support for the reasonableness of its position. AIU also asserts that IIEC has offered no specific suggestions for improvements in collection activities that AIU should implement. AIU claims IIEC has not identified any other companies which had a collection lag limited to the statutory time afforded a customer to pay their bill. AIU contends further that its collection compares favorably to that of other regulated utilities in Illinois. AIU says the approved collection lag for Northern Illinois Gas Company d/b/a Nicor Gas Company ("Nicor") was 33.77 days. AIU adds that Peoples and North Shore filed a collections lag of 32.72 days, while MidAmerican Energy Company has filed a collection lag of 25.68 days.

AIU indicates that in an attempt to support its recommendation, in its rebuttal testimony IIEC alleges that AIU has overstated its collection lag because uncollectible expenses were not excluded from the analyses. While disagreeing with IIEC as to whether uncollectible expenses need to be excluded from the CWC analyses, AIU says it performed a recalculation of the collection lag excluding the uncollectible expenses. AIU asserts that the exclusion of uncollectible expenses from the collection lag had no impact on the overall analysis.

AIU says IIEC disagrees with its method for reducing the percentage contributions of each bill payment period by the same factor, the percentage of revenues represented by uncollectibles. IIEC claims this merely shows that reducing ratios by the same percentage will maintain the relationships of the ratios. However, AIU insists it is realistic to assume that each collection bucket is responsible for the same percentage of uncollectibles because there is no way of knowing in each of the receivable buckets which revenues are uncollectible.

b. Staff Position

Staff indicates that the remaining contested issues between it and AIU involving CWC address the treatment of revenue lag for pass-through taxes collected and the service lead associated with total expense lead days for revenue tax expense. AIU states that the issue at hand is the elapsed time between the receipt of a customer's payment and the remittance of the funds to the appropriate taxing authority. Staff believes this portrayal of the issue oversimplifies the lead-lag study. Staff contends that if AIU was correct, there would be no need to consider billing dates or periods of time for which the pass-through taxes apply. Staff says the analysis would be limited to comparing cash receipt dates and cash disbursement dates only. Staff asserts this is an error in AIU's analysis, which purports to measure the time between receipt of funds for pass-through taxes and remittance of those funds to the taxing authorities.

Staff states that while the utility is liable for the payment of the pass-through taxes it collects from its customers, the utility does not have any investment related to pass-through taxes for which it is awaiting payment associated with that bill. Staff says AIU has an investment in the amount of gas or power that was delivered which it needs to cover by the payment of the bill by the customer. Staff argues that there is no corresponding investment as it applies to pass-through taxes billed. Staff says AIU merely functions as a collection agent for the taxing authorities. In Staff's view, the correct revenue lag for pass-through taxes is zero.

Staff believes the AIU argument regarding the service lead time for expenses is inconsistent with its own definition. Staff relates AIU's position that the service lead time is "associated with the timing of the provisioning of service." (Staff Initial Brief at 27) If there is no service lag on the revenue side, Staff contends that there can not be service lead on the expense side.

Staff argues that the amounts related to pass-through taxes accrue over a monthly or quarterly period and are remitted in most cases in the month after the end of the accrual period. According to Staff, the period of time over which the amounts are accrued is ignored in AIU's calculation. Staff believes that to accurately reflect the lead time associated with the payment of pass-through taxes, the service lead time, measured as the mid-point of the accrual period, must be reflected in the weighted lead time calculation.

According to Staff, AIU is misleading in its claim that it is remitting payment for pass-through taxes 3.81 days prior to the receipt of payment from its customers. Staff states that for the gross receipts tax to which AIU refers, the utility's liability is based upon the gross receipts which were received from customers during the preceding calendar month. Staff says the 31.34 days revenue lag is simply a calculation for the average time for all revenues to be in the control of the utility. Staff claims that this does not mean that no revenues are available to pay pass-through taxes until after day 31. To compare that number with the expense lead for pass-through taxes which are all paid on a date certain for each type of tax is, in Staff's view, misleading.

Staff believes AIU's assertion that under Staff's proposal, revenues are in hand immediately is also misleading. Staff says pass-through taxes do not represent a cost of service that the utility has provided and for which it must await recovery through revenues. Staff's position is based on the fact that pass-through taxes are not an investment on which the utility needs to earn a return through the rates it charges. AIU agrees that it simply acts as a conduit for the funds to flow through.

Staff contends that the service period, as it relates to the expense lead calculation, is based upon the period of time over which the liability is incurred. Staff asserts that for pass-through taxes, which accrue over a month or quarterly period, it is consistent with AIU's definition of expense lead to include the service period in the calculation for pass-through taxes. Staff argues that in contrast, the service period for revenues is associated with the timing of the provisioning of service. Staff says that since no service is provided by the utility related to pass-through taxes, there can be no service lag associated with the revenues.

c. IIEC Position

IIEC believes AIU's use of a 28.13-day collection lag is overstated and unreasonable for three reasons. First, a 28.13-day collection lag suggests to IIEC that on average every customer of AIU, with exception of the Non-Residential Special

Customer Type, pay its bills beyond the due date and late payment grace period. Second, the data used by AIU to develop its collection lag contains uncollectibles, and uncollectibles expenses are included as a component of AIU‘s cost of service. Third, the collection lag period is inconsistent with Commission rules. For these reasons, IIEC recommends a collection lag of 21 days.

With regard to its first criticism of AIU's 28.13-day collection lag, IIEC questions the assumption that nearly every customer pays its bills late. IIEC argues that the 21-day collection lag it recommends matches the authorized collection period for the residential class and is longer than the collection periods for commercial and industrial customers. IIEC adds that many customers pay their bills sooner than the last allowable day. IIEC submits that use of a 21-day collection lag is conservative. In response to AIU's claim that it should have provided recommendations on how a 21-day collection lag could be achieved, IIEC asserts that AIU‘s ―real world" argument does not provide substantive evidence for increasing the collection lag above and beyond the payment period defined by Commission rule. IIEC contends that it has no responsibility to prove the reasonableness of the Commission‘s collection rules. Rather, IIEC asserts that AIU must prove the reasonableness of its proposed collection period.

Concerning uncollectibles, IIEC contends that these dollars represent amounts that are included separately as a component of AIU‘s cost of service, and recovered through charges to customers who do pay their bills. IIEC argues that including the uncollectibles is an error in AIU's collection lag calculation and removing them would decrease the collection lag calculated by AIU. Inclusion of the uncollectibles in the accounts receivables, AIU explains, improperly increases the receivable balance used to develop the weighted lag periods. Those dollars, IIEC continues, will never be reduced by customer payments. IIEC states that reducing both the billed revenues used to weight AIU's average lag calculation and the accounts receivable balances for uncollectibles, which have no lag period end date, will decrease the calculated collection lag from the level proposed by AIU.

IIEC states that in the collection lag study, AIU used bill payment time periods to weight the CWC requirements beginning with current bills and going through payment periods of 0 to 30, 30 to 60, and 60 to 90 days. IIEC says these are accounts receivable that are paid before the due date, and bills paid after 0 to 30, 30 to 60 or 60 to 90 days. AIU multiplies the uncollectible percentage for each period by the test year revenue in each of the 0 to 30, 30 to 60, and 60 to 90-day bill payment periods. In doing so, IIEC says AIU assumed that each bill payment period contributed an identical percentage of its included revenues to the amount that ultimately becomes uncollectible. According to IIEC, AIU opines that this is a realistic assumption, even though AIU admits it used the same percentage simply because it does not know, for each of the bill payment periods, the actual percentage of revenues that become uncollectible. IIEC claims this unsupported default assumption shoehorns bill payment periods of different size and age into the same circle.

IIEC says AIU agrees that the size of the billing period revenue amount matters in the weighting that goes to that period. According to IIEC, AIU states the largest collection period is either the current period or the 0 to 30-day period. IIEC contends that this weighting error is added to the weighting error that resulted from failing to remove uncollectibles from the analysis. IIEC believes that AIU's failure to account for the size of the billing periods, the amount of uncollectibles in each period, and the removal of the same uncollectible percentage from each period does not give a realistic picture of the true impact of uncollectibles on the CWC analysis.

IIEC claims that AIU ignores the incentive customers have to pay their bills on time because of the ability to charge them a late payment fee. IIEC says AIU also ignores the fact that the 21-day collection lag period recommended by IIEC is more than a third longer (7 days) than the period specified in the Commission's rules for the payment of non-residential customers bills (14 days). IIEC also notes that the 28.13-day collection lag is twice the amount of time that commercial and industrial customers have to pay their bills (14 days). The collection lag period recommended by IIEC is greater than the average residential and non-residential collection period specified in the Commission's rules. IIEC states that if one considers AIU's total revenue and the percentage of that revenue that comes from the customer classes with a 14-day payment period, i.e., non-residential customers, one would find that they pay approximately 48% of total revenues for AmerenIP; 57.4% for AmerenCIPS; and 56.1% for AmerenCILCO. IIEC believes that in this factual context, AIU's assertions that it must wait, on average, more than twice the payment period applicable to half its revenues are not credible. IIEC recommends a collection lag of 21 days and argues that any greater period would need to be further investigated and should not be accepted without more evidence than AIU has provided.

In IIEC's view, comparisons to other utilities in this instance will not help the Commission in its determination. IIEC says AIU does not offer any evidence to establish whether the pertinent factual circumstances are even comparable. IIEC suggests that if those lags were calculated using the same flawed methodology used by AIU (uncollectibles included, payment period weightings distorted), those studies are also flawed and their results unrealistic. IIEC states that collection lags of 33.77 (Nicor) and 32.72 (Peoples) days suggest that on average, every customer of those utilities has two unpaid utility bills in hand every month. IIEC claims that to suggest that on average, every customer would continuously have two bills payable to the utility should raise serious questions about the validity of the analysis. IIEC believes AIU's attempt to support its collection lag with other flawed collection lags has no merit.

d. Commission Conclusion

IIEC identified what it considers to be two problems with AIU's computation of CWC: the inclusion of uncollectibles and the weightings applied to outstanding bills. To rectify these problems, IIEC recommends that AIU's CWC be based on 21 lag days rather than the AIU's lead lag studies. The basis for IIEC's 21 lag days is the Commission's rules, specifically Part 280. AIU acknowledges that uncollectibles, theoretically, should be excluded from a lead lag study but asserts that, in this instance, the inclusion of uncollectibles has negligible impact on the results of the study. With regard to the weightings, AIU asserts that it is necessary to make an assumption and the assumption it has made is reasonable.

The Commission has concerns about AIU's proposed method for calculating the CWC requirement. The Commission understands that IIEC's reason for proposing 21 lag days in that it is the maximum lawful period customers can delay payment. Section 285.2070 of Part 285 specifically contemplates the use of a lead/lag study. AIU presented a detailed lead/lag study using methods that have been adopted by the Commission in numerous previous proceedings, but AIU assumed, rather than proved, the collection lag periods used in its study. The absence of empirical evidence supporting the collection lag assumptions used in Ameren's lead/lag study weighs against the utility, which has the burden of proof in this proceeding. Under these circumstances, IIEC's proposal to use a 21 day collection lag in calculating the CWC requirement is hereby adopted.

The remaining contested issues between Staff and AIU involve the treatment of revenue lag for pass-through taxes collected and the service lead associated with total expense lead days for revenue tax expense. For revenue lag, Staff believes that pass-through taxes are different than other utility cash inflows for two reasons: there is no utility service associated with pass-through taxes and the utility does not have an "investment" associated with pass-through taxes. With regard to expense lead, Staff asserts that the amounts related to pass-through taxes accrue over a monthly or quarterly period and are remitted in most cases in the month after the end of the accrual period. It is Staff's position that the period of time over which the amounts are accrued is ignored in AIU's calculation. Staff contends that to accurately reflect the lead time associated with the payment of pass-through taxes, the service lead time, measured as the mid-point of the accrual period, must be reflected in the weighted lead time calculation. With regard to expense lead, Staff also states that AIU has omitted a service lead time for pass-through taxes, using only payment lead time and bank float lead time in determining the weighted lead time.

As an initial matter, the Commission accepts Staff's argument that the utility has no "investment" associated with pass-through taxes. Since every dollar for pass-through taxes is collected from the ratepayers, the inflows and outflows earmarked for these taxes should be perfectly balanced. Thus the need for CWC should not arise with respect to pass-through tax transactions. This conclusion is consistent with prior Commission decisions. Nicor Docket No. 08-0363 at 11-12.

Staff distinguishes pass-through taxes from other cash flows in that unlike other revenue, pass-through taxes are not directly associated with the provision of utility service. The Commission believes that Staff makes a legitimate point here. The Company would have us believe there is an additional and measurable cost to pass-through taxes but fails to illustrate how a tax that is completely ratepayer-funded could generate any costs or expense. This is simply not the case. The Commission finds that Staff's proposed adjustment to the CWC requirement must be accepted.

6. Gas in Storage

a. AIU Position

Staff asserts that AIU‘s reliance on 2008 gas costs to value its requested working capital allowance for gas in storage amount results in an overstatement of the costs due to the reduction in natural gas prices since 2008. Staff recommended in direct testimony that AIU provide in its rebuttal testimony an updated calculation for its working capital allowance for gas in storage that follows the same pricing methodology that AIU proposed and was accepted by the Commission in AIU's last rate case.

AIU believes that while it is appropriate to reflect updated information on gas in storage pricing, AIU opposes Staff‘s proposal to use 2009 gas pricing to determine the value of gas in storage. According to AIU, Staff‘s proposal does not take into account the changed circumstances that AIU is experiencing with respect to gas prices since the prior case. AIU indicates the price of gas has declined since 2008 and has exhibited significant variability since its last rate case. In order to reflect this past variation and account for the fact that further gas price variations can be anticipated into 2010, AIU argues that a more appropriate method of valuing gas in storage would be to use a three-year average of gas prices through December 2009. AIU claims the three-year average calculation smoothes out the large fluctuation of natural gas prices which can occur over a short period of time. AIU contends that natural gas is among the most volatile commodities that are traded, so using a three-year average will reduce the impact that volatility has on storage working capital. AIU adds that this methodology addresses Staff's concern about using more recent gas prices by reflecting gas prices through December 2009.

To calculate the value of gas in storage, AIU uses actual prices for December 2006 to August 2009. AIU says price estimates used to record to the general ledger were used for September 2009. AIU indicates that hedged gas and Inside FERC ("IFERC") prices were used for October 2009. AIU also states that hedged gas prices and New York Mercantile Exchange ("NYMEX") prices were used for November and December 2009. AIU asserts that these prices represent the most accurate for valuing gas in storage in this time period, since it is the end of the injection season. AIU says the volumes were also calculated as a three-year average, and adjusted for contract and other known changes.

AIU indicates that in its last rate case, Staff requested that volumes of gas in storage be updated for known contract changes. In response, AIU stated that the price of gas should be updated to match the updated volumes. AIU says it updated the value of the working capital allowance for gas in storage based on updated volumes and to reflect AIU‘s price hedging, or, where prices were not hedged, to reflect forward NYMEX strip prices for the period when rates would come into effect. According to AIU, the

Order in Docket Nos. 07-0585 et al (Cons.) found that the use of the NYMEX data for the period April through October 2008 (where 2006 was the test year), which is the traditional injection season, was appropriate. The Commission concluded that, ―in this instance, the price proposal of AIU is reasonable when used in conjunction with Staff's proposed quantities of gas." (Docket Nos. 07-0585 et al (Cons.), Order at 78) AIU says that in this case, Staff proposes use of 2009 prices, which do not reflect the forward prices for the period when the rates would come in effect (expected to be May 2010). AIU argues that Staff's approach is not consistent with the prior Order.

AIU claims that Staff's argument that 2008 gas prices are an ―outlier," confirms that gas prices are volatile and so are appropriately subject to averaging to smooth out the variations. AIU says that in the prior case, it proposed a methodology to reflect projected gas prices during the summer injection season of 2008 because the working capital allowance for storage was calculated at the beginning of the injection season (April 2008). According to AIU, that concern is not present in this case, as the working capital allowance for storage is being calculated at the end of the injection season when actual prices are known (October 2009). AIU also argues that using a three-year average is consistent with many other price calculations for commodities with variable prices AIU is proposing in this rate case, such as transportation fuels.

AIU contends that the prices used in the three-year average it is proposing include the most current prices through December 2009, which is consistent with the use in Docket Nos. 07-0585 et al (Cons.) of current pricing to match projected changes in volumes. AIU believes the three-year average calculation also sets a method or a template that can be used in future rate cases without regard to the timing of the calculation. In addition, AIU claims that it calculates the volume of gas in storage as a three-year average (reflecting known changes), so the use of a three-year pricing average matches the prices to volumes. AIU acknowledges that in utilizing a three-year average of gas prices to value gas in storage, AIU proposes a different method for valuing gas in storage in this case than the prior case. AIU asserts that circumstances have changed since the last case, and the three-year average proposal is appropriate.

AIU insists that Staff is incorrect that 2008 gas prices are so different from historical and projected prices that 2008 prices must be excluded from the valuation of gas in storage. Although Staff states that a review of the 2007, 2009, and current NYMEX future prices for 2010 and 2011 demonstrates that 2008 gas prices were outliers, AIU complains that this analysis is based on one day's NYMEX close, November 2, 2009. AIU argues that reviewing the entire trading period for a specific month provides a significantly different picture. AIU claims the simple average of the daily NYMEX closing price at which January 2011 has traded is $8.418 (January 3, 2008 through November 25, 2009). AIU states that this price represents the approximate value that AIU would have had the opportunity to purchase gas on a forward contract basis to be delivered in January 2011. AIU says if one compares this price to Staff's one day settlement price on 11/2/09 for January 2011 of $6.795 and to the 2008 price AIU used of $8.335 to $8.903, then the 2008 prices AIU uses in its analysis can not be considered outliers. AIU asserts that reviewing the entire NYMEX trading period for any one month supports the three-year average pricing to smooth out the volatility of natural gas prices.

AIU also claims that 2009 gas prices are not more representative of expected prices than AIU's proposal. AIU says that the NYMEX futures contracts provide an indication of the gas market's expectations for future prices. According to AIU, the NYMEX futures contracts also show that natural gas prices are extremely volatile. AIU says the January 2011 NYMEX contract has traded in more than a $5.00 range since it began trading until November 25, 2009 (from a low of $6.426 to a high of $11.822). AIU describes this as an extreme range and asserts that no one can know what future gas prices will be, which AIU believes supports using a three-year average approach to calculate the value of gas in storage used for working capital purposes.

b. Staff Position

Staff notes that it and AIU agree to reduce the working capital allowance for gas in storage (value of gas in storage) component of the total materials and supplies balances by an accounts payable percentage of 6.63%. Staff believes its proposed valuation of gas in storage should be used in the calculation of the accounts payable adjustment. If the Commission should reject Staff's valuation of gas in storage, and accept the AIU valuation, the AIU amount for gas in storage presented in Ameren Ex. 51.10 should be used in the calculation of the accounts payable adjustment.

Staff indicates that the only remaining issue involving AIU's requested working capital allowance for gas in storage for its gas utilities involves the gas price to apply to the gas volumes. Staff recommends the use of the 2009 gas price information, whereas AIU recommends the use of a three-year average to price this gas. As a result of this pricing difference, Staff recommends a reduction of $1,795,143 to AmerenCILCO's requested amount (Staff Ex. 25.0, Schedule 25.01 CILCO-G, l. 3), a reduction of $3,662,720 to AmerenCIPS' requested amount (Id., Schedule 25.02 CIPS-G, l. 3), and a reduction of $12,255,211 to AmerenIP's requested amount (Id., Schedule 25.03 IP-G, l. 3).

According to Staff, AIU's proposal to average the 2007-2009 gas prices to value its gas utilities' requested working capital allowance for gas in storage amounts allows AIU to place partial reliance on the gas prices it experienced in 2008 within its calculation. Staff claims the 2008 gas prices were the highest prolonged prices for natural gas that the industry has experienced during the last 20+ years. Staff contends that a review of the gas prices that AIU provided, as well as the NYMEX future prices, demonstrates that the 2008 gas prices were outliers. Staff argues that AIU's reliance on those values causes a significant increase in the average price that AIU advocates.

Staff states that a review of the NYMEX gas future prices, based on November 2, 2009 values, for the coming years shows that the market place does not currently expect the forward gas prices to return to the gas price levels experienced in 2008. Staff says the average price of NYMEX futures for 2010 and 2011 are $5.51/dekatherm

("Dth") and $6.50/Dth, respectively. Staff believes this supports its position that the 2008 gas prices are price outliers. Staff also argues that since ratepayers already experienced those high gas costs through their 2008 gas bills, it is not fair to require the customers to continue paying these higher gas costs when there is no indication that gas costs will return to those levels in the near future.

Staff admits that the 2009 gas costs include several months of data with gas prices that are significantly lower than those experienced by AIU in 2008. Staff indicates, however, that the 2009 gas cost calculation is based on the 13-month average of the month ending values from December 31, 2008 through December 31, 2009. According to Staff, this means that a portion of the 2009 gas costs includes gas volumes and values from natural gas that AIU injected into storage during 2008. Staff asserts that the 2009 gas cost calculation would have several months of data, namely, December 2008, January through March or April 2009 (depending on the specific characteristics of the leased storage service or on-system storage field) whose gas prices are primarily based on the higher than normal prices from 2008. Staff argues that while 2009 gas prices dropped significantly, these much lower gas prices were offset within AIU's weighted average cost of gas calculation by the much higher 2008 gas prices that remained in the 2009 calculation. In Staff's view, the gas prices that make up the 2009 average are a combination of both high and low gas prices and, as a result, the 2009 prices provide a reasonable proxy for the gas costs that AIU may experience once rates go into effect.

Staff states that while no one knows with certainty what the future price of gas will equal, the NYMEX futures contracts provide an indication of the gas market's expectations for future prices. Staff says those future prices show that the average NYMEX future prices for 2010 are lower than the 2009 gas costs recommended by Staff and that the average 2011 NYMEX future prices track very closely with the 2009 gas cost. Staff also says that the AIU gas utilities have locked in some of the lower gas prices that existed in 2009 through its hedging activity for 2010 and beyond. Staff asserts that for the storage injection months, roughly April through October, AIU has locked in a portion of its gas purchases, which will include some portion of the gas injected into storage. Staff contends that these values show that AIU's existing hedged positions for 2010 and 2011 are more in line with Staff's proposal to use the 2009 gas costs than AIU's proposal for a three-year average that includes the high gas prices from 2008. Staff insists that going forward its proposed 2009 gas prices are more representative of expected prices than AIU's proposal.

AIU asserts that Staff's proposal to use 2009 prices is inconsistent with the Commission's prior AIU rate case Order because the prior order approved the use of NYMEX forward pricing to determine prices in 2008, which was two years after the 2006 test year, whereas Staff's proposal in this case uses 2009 gas prices which are only one year after the 2008 test year. Staff does not dispute the timing AIU notes, but disputes AIU's argument that this timing makes Staff's proposal inconsistent with the Commission's prior Order. Staff states that in the instant case and in its most recent rate case proceeding before the Commission, AIU selected a historical test year. Staff claims that Commission rules limit changes to the test year data for historical test years to known and measureable changes. Staff says the Commission entered its Order in Docket Nos. 07-0585 et al (Cons.) on September 24, 2008, which means the evidentiary phase of the proceeding occurred during 2008. In the instant proceeding, Staff says the evidentiary phase took place in 2009. Staff claims it is making use of the most recent known and measurable data in the instant proceeding, which is consistent with the Commission‘s practice in Docket Nos. 07-0585 et al (Cons.).

AIU also notes that a review of NYMEX closing prices for the January 2011 contract for the period January 3, 2008 through November 25, 2009 shows a large variance and AIU claims that the average of that month‘s price shows AIU‘s 2008 gas prices are not outliers. Staff says that AIU is comparing a single month‘s price, January, to the average price over the year, which Staff claims is not a valid comparison. Staff also asserts that a recent (November 2, 2009) review of NYMEX future prices for 2010 and 2011 shows that the gas prices Staff used in its calculation, are higher than the NYMEX average price for 2010 and track very closely to the 2011 prices. Staff contends that the market‘s current expectation of gas prices demonstrates that AIU‘s 2008 gas prices were outliers and Staff‘s proposal more closely corresponds to the expected future prices.

c. AG/CUB Position

According to AG/CUB, AIU has failed to support the use of a different pricing methodology from what it requested and the Commission approved in AIU‘s last rate case. AG/CUB says AIU uses a three-year average that places partial reliance on 2008 gas prices. AG/CUB notes that Staff claims the 2008 gas prices were the highest prolonged prices for natural gas that the industry has experienced during the last 20+ years. In AG/CUB's view, AIU‘s goal here is clear: to develop a ―template that can be used in future rate cases," at a point in time that would include the record high natural gas prices of 2008. AG/CUB contends this is especially inappropriate given the recent downward pressure on natural gas prices. AG/CUB recommends the Commission adopt Staff‘s propose pricing methodology.

d. Commission Conclusion

To calculate the value of gas in storage, AIU uses actual prices for December 2006 to August 2009. AIU says price estimates used to record to the general ledger were used for September 2009. AIU indicates that hedged gas and IFERC prices were used for October 2009. AIU used hedged gas prices and NYMEX prices for November and December 2009. In contrast, Staff proposes that gas in storage values be determined using gas costs from calendar year 2009. AG/CUB supports Staff's recommendation.

As an initial matter, the Commission can not help but observe that on four issues – gas in storage, transportation fuel, maintenance of mains, and injuries and damages – both AIU and Staff have proposed using four different measurement periods. While the

Commission recognizes that different measurement periods might be appropriate for different circumstances, it seems that even the slightest effort and coordination of a parties' overall case would not have produced the situation present in this proceeding. As a result, the Commission suggests that in future proceedings, both AIU and Staff provide additional clarity for proposing different measurement periods so the Commission has a better understanding of why different measurement periods may be appropriate.

In the Commission's view, the record shows that natural gas prices are volatile. The gas prices that Staff characterizes as outliers are evidence of this fact. The Commission also notes that Staff's proposal relied on the most recent known and measurable information. Staff demonstrated that the current expectations of the marketplace for future gas prices are consistent with its proposal. Further, Staff demonstrated that AIU has locked in a portion of its gas costs for 2010 and beyond at levels that are more consistent with its recommendation, than AIU's proposal. Finally, the Commission notes that Staff's proposal is consistent with the Commission's ruling on this same issue in AIU's 2007 rate case proceeding. As such, the Commission accepts Staff's proposal to value AIU's working capital allowance for its gas in storage.

7. OPEB Net of ADIT

a. AIU Position

AIU notes that Staff and AG/CUB propose an adjustment to reduce rate base by the accrued liability for other post employment benefits (―OPEB"), which represent the employer's obligation for such benefits as health care, life insurance, tuition assistance, and other post retirement benefits outside of a pension plan. AIU indicates that the revenue requirement impact of this proposed adjustment is approximately $7 to $8 million, depending on which party's recommended cost of capital is assumed. AIU believes this adjustment is appropriate, in part, for AmerenIP. AIU insists that it is not appropriate for AmerenCIPS or AmerenCILCO and should be rejected.

AIU says no party disputes that AIU's prudent cost of service includes the cost of OPEBs paid for former employees and retirees. AIU indicates that OPEB is the employer's obligation for post retirement benefits, which accrues to the employee's benefit over the employee's term of service. AIU states that the accounting treatment for OPEBs is prescribed by Financial Accounting Standard ("FAS") 106. According to AIU, whenever the cumulative amount of FAS 106 expense is greater than contributions the employer has made to the trust fund used to pay OPEBs, an OPEB liability exists.

In its direct case, AG/CUB witness Effron proposed an adjustment to reduce AIU's rate base by the level of accrued OPEB liabilities. According to Mr. Effron, the accrued OPEB liabilities represent the excess of OPEB expense recorded by AIU over amounts actually paid, in other words, ratepayer-supplied OPEB funds. AIU says AG/CUB's claim that the entire accrued OPEB liability represents ratepayer-supplied funds is based on an unsupported assumption that ratepayers have supplied all of the funds giving rise to the OPEB liabilities. AIU argues that only AmerenIP historically has funded OPEBs based in part on amounts received from ratepayers. AIU believes an adjustment to reduce rate base by the accrued OPEB liability for AmerenIP is therefore appropriate, but only to the extent that AmerenIP's accrued OPEB liability represents ratepayer-supplied funds. AIU asserts that Ameren Ex. 29.17 provides the appropriate adjustment to reduce rate base by the ratepayer-supplied portion of AmerenIP's OPEB liabilities.

With respect to AmerenCIPS and AmerenCILCO, however, AIU asserts that they historically have not directly tracked ratepayer-supplied OPEB funds. Because ratepayer-supplied funds were not tracked, AIU insists it is erroneous to conclude that these liabilities were funded entirely by ratepayers AIU argues that contrary to funding OPEBs based on ratepayer supplied funds, funding considerations would have considered the availability of cash or borrowed funds to cover accounting accruals in accordance with FAS 106 or related accounting guidance.

AIU indicates that Staff adopted the AG/CUB adjustment in rebuttal and argues a similar rationale. According to Staff witness Ebrey, ―Ratepayers have supplied funds for future obligations; therefore, a source of cost free capital has been provided to the utility which should be recognized in the revenue requirement as a reduction from rate base." (AIU Initial Brief at 53, citing Staff Ex. 15.0 at 25) AIU responds that Staff's and AG/CUB's assumption that the OPEB liability represents ―ratepayer supplied funds" or a source of ―cost free capital" rests on the false premise that all funds received and spent by AIU originates from ratepayers. AIU contends this is not correct. AIU states that in the first instance, utilities are capitalized by investors. AIU contends that utilities use investor-supplied capital to invest in plant and provide service. AIU asserts that part of ratemaking theory is to compensate investors by providing a return on, and return of, capital used to provide service. AIU claims that ratepayers in effect return the investment through the rates they pay. AIU argues that if rates do not include an allowance for a certain expense, investors are not compensated for that expense.

AIU contends that ratepayers provide a source of ―cost free capital" for an expense item only to the extent that they have actually supplied funds for that expense item through the rates they pay. In determining whether OPEB liabilities constitute ratepayer-supplied funds, AIU says the question then becomes how many dollars have ratepayers contributed for OPEBs. AIU disagrees with Staff that it is possible to know the answer to this question. AIU claims the level of OPEB expense included in rates is based on FAS 106, irrespective of what the utility paid in OPEBs. According to AIU, although actual revenues and expenses may change after a rate case test year, the level of OPEB expense included in rates does not. If one assumes that cumulative FAS 106 expense has been fully reflected in rates since that adoption of FAS 106, then AIU insists the liability properly represents ratepayer-supplied funds, as AIU agrees is the case in part with AmerenIP. AIU contends the only way to prove this assumption is to analyze the level of FAS 106 expense recovered from ratepayers over the period giving rise to the liability, which Staff did not do. AIU asserts that absent such an analysis, the statement that the OPEB liability constitutes ―ratepayer supplied funds" or a ―cost free source of capital" is unsupported. AIU asserts that the AG/CUB's testimony reflects no such analysis either.

With regard to Staff's quotation from the Order in Docket Nos. 06-0070 et al (Cons.) that ―Ratepayers are not paying this cost of service as a separate line item, and it is inappropriate to treat it as such," AIU argues that this language does not mandate the deduction of the entirety of a utility's OPEB liability from rate base in all instances. (Order at 27) Although there is not a line item on customers' bills for OPEBs, AIU states that OPEBs are an element of the utility's cost of service. AIU asserts that this expense and others are aggregated to develop an overall revenue requirement. If the revenue requirement (and associated rates) does not include an allowance for OPEBs, AIU contends that it is inaccurate to say that liabilities associated with OPEBs constitute ratepayer-supplied funds. AIU argues that ratepayers supply funds for an expense only to the extent the expense is included in rates. In AIU's view, the issue is not whether ratepayers pay a portion of OPEBs as a separate line item; the threshold question is whether ratepayers have paid a portion of this cost of service at all. If they have not, AIU claims mathematics precludes the possibility that the OPEB liabilities were entirely or even partially ratepayer-funded.

AIU insists that there is no factual support for the assumption that OPEB liabilities arise entirely from ratepayer-supplied funds. Because it believes that it has no burden to disprove Staff and AG/CUB's unsupported assertions, AIU claims that it is Staff and AG/CUB's burden to prove the basis for their adjustment. In AIU's view, because Staff and AG/CUB have not adequately supported their proposed adjustment, the Commission must reject it.

b. AG/CUB Position

AG/CUB states that to the extent that the cumulative accruals for OPEB are greater than the actual cash disbursements, AIU has accrued liabilities for OPEB. AG/CUB asserts that these accrued liabilities represent ratepayer-supplied OPEB funds. AG/CUB contends that because ratepayers have supplied funds for future obligations, a source of cost-free capital has been provided to the utility, which AG/CUB believes should be recognized in the revenue requirement as a reduction from rate base.

In this instance, AG/CUB avers that the accrued OPEB liabilities as of December 31, 2008 should be deducted from plant in service in the calculation of AIU's rate bases in these cases, as proposed by Mr. Effron and supported by Staff. AG/CUB states that recognition of the ratepayer-supplied OPEB funds reduces the AmerenCILCO electric rate base by $20,077,000, the AmerenCIPS electric rate base by $3,774,000, the AmerenIP electric rate base by $14,971,000, the AmerenCILCO gas rate base by $15,535,000, the AmerenCIPS gas rate base by $1,686,000, and the AmerenIP gas rate base by $8,891,000. AG/CUB notes, however, that with the exception of AmerenIP, AIU has not recognized these balances in the calculation of rate base.

AG/CUB states that for the most part, AIU accepts AG/CUB's adjustment to reduce the AmerenIP rate base for accrued OPEB net of deferred income taxes. AIU says AIU disagrees with making the same adjustment to the AmerenCILCO and AmerenCIPS rate bases because it argues those two companies did not track ratepayer-supplied funds. According to AG/CUB, while that may be the case, AIU has not presented any sound reason to treat the AmerenCILCO and AmerenCIPS accrued OPEB differently from the AmerenIP accrued OPEB. Whether AmerenCILCO and AmerenCIPS did or did not track ratepayer-supplied funds, AG/CUB argues, has nothing to do with whether the accrued OPEB balances are ratepayer-supplied funds. AG/CUB claims there is no dispute that both AmerenCILCO and AmerenCIPS have recorded the OPEB accruals on their books of account and that the accrued balances represent the amounts that have been accrued as expense in excess of actual cash dispersed. AG/CUB states that the failure of AmerenCILCO and AmerenCIPS to directly track the extent to which expenses have been recovered in rates does not mean that the accrued balances do not represent ratepayer-supplied funds.

AG/CUB states that in a Nicor case, the Commission determined, so long as the companies continue to control the ratepayer-supplied OPEB funds, the OPEB deduction should be recognized in the determination of rate base. (AG/CUB Initial Brief at 20, citing Docket Nos. 95-0219, Order at 10) AG/CUB asserts that in a prior AIU rate case, the Commission found that AmerenCILCO, AmerenCIPS, and AmerenIP electric delivery services rate bases should be reduced by the accrued OPEB liabilities. (Id., citing Dockets Nos. 06-0070 et al (Cons.), Order at 27) Finally, AG/CUB avers that in the last AIU rate case, Docket Nos. 07-0585 et al. (Cons.), AIU agreed that the accrued OPEB should be deducted from rate base, and the Commission adopted this adjustment, finding it reasonable and appropriate. (Id. at 21, citing Docket No. 07-0585 et al (Cons.), Order at 7) AG/CUB claims that AIU has offered no change in circumstances, or any other reason to explain why the Commission should deviate from its prior treatment of OPEB in this proceeding.

c. Staff Position

Staff recommends that the Commission approve the adjustments to reflect the impact of the OPEB liabilities in the calculation of AIU's rate bases as proposed by Staff and AG/CUB. Staff says the OPEB liabilities represent ratepayer-supplied funds and should be reflected as a reduction to rate base. Staff avers that this is consistent with the last two AIU rate case proceedings, where the Commission approved the reduction to rate base for accrued OPEB liabilities. Staff reflected those adjustments in the rebuttal revenue requirements for each utility. Staff acknowledges that AIU accepts the OPEB adjustment for AmerenIP.

Staff asserts that during cross-examination, AIU tried and failed to illustrate that funds collected from ratepayers could be tracked to specific cost of service line items. Staff witness Ebrey explained that ratepayers are paying a rate based on an overall cost of service and that the rates are not tied specifically to any certain line item in the revenue requirement. Staff believes such an analysis would not be possible.

Staff avers that AIU also attempted to draw a comparison to Ms. Ebrey‘s proposal in the AIU uncollectibles rider proceeding, Docket No. 09-0399. Staff believes there are a number of significant differences that make such a comparison invalid. Staff asserts there is a direct connection between the amounts of uncollectible expense included in the revenue requirement to the pro forma revenues approved in the rate case. Staff claims this is not the case with OPEB costs because OPEB costs do not vary with the level of revenues. Staff also states that new provisions under Public Act 96-0033, effective July 10, 2009, provide for the recovery of uncollectible expense through both base rates and through the rider mechanism. Staff says that Sections 16-111.8(c) and 19-145(c) of the Act mandate that the Commission ―verify that the utility collects no more and no less than its actual uncollectible amount" in each applicable reporting period. In order for the Commission to comply with the statute, Staff asserts it was necessary to establish a method to track the recovery of uncollectible expense. Staff claims this is not the case with OPEB costs because OPEB costs are only recovered in base rates.

Staff believes its position is supported by the Commission's Order in a prior AIU rate proceeding (Docket Nos. 06-0070 et al (Cons.)) that came to the same conclusion that AG/CUB and Staff propose in this case. In Staff's view, the evidence demonstrates that the OPEB liabilities represent ratepayer-supplied funds. Consistent with its findings in prior AIU rate cases, Staff recommends that the Commission accept the same adjustment in the current cases.

d. Commission Conclusion

While AIU, AG/CUB, and Staff agree that OPEB liability should be subtracted from AmerenIP's rate base, there is disagreement as to the amount of that reduction. Mr. Effron's rebuttal testimony indicates that for AmerenIP the balance on Schedule DJE-R-4 represents the elimination of AIU witness Stafford‘s offset to the AmerenIP accrued OPEB for the portion of accrual that was not tracked. For purposes of this proceeding, the Commission finds the AG/CUB proposed adjustment to rate base for AmerenIP to be reasonable and it is hereby approved.

With regard to AmerenCILCO and AmerenCIPS, however, AIU argues that because ratepayer-supplied funds were not tracked, it is erroneous to conclude that these liabilities were funded entirely by ratepayers. Apparently, AIU does not see that one could also make the opposite argument--that because ratepayer-supplied funds were not tracked, it is erroneous to conclude that these liabilities were funded entirely by shareholders. In previous rate cases, including recent rate cases for AIU, the Commission has subtracted accrued OPEB liabilities from rate base. AIU has the burden to demonstrate that its rate bases are reasonable and with regard to this issue, the Commission finds that AIU has offered nothing but a single unsupported assertion. With respect to AmerenCILCO and AmerenCIPS, the Commission finds AIU's position must be rejected. The Commission concludes that AG/CUB's proposal to reduce

AmerenCILCO's and AmerenCIPS' rate bases by the amount of accrued OPEB liability is reasonable and it is hereby approved.

V. OPERATING REVENUES AND EXPENSES

A. Resolved Operating Expense Issues

1. Annualized Labor

Staff recommends an adjustment to AIU's proposed annualized labor expense. Specifically, Staff recommends disallowance of wage increases for management employees projected for April 1, 2010 and wage increases for union employees based on contract increases effective July 1, 2010. To reduce the number of contested issues, AIU accepts Staff's recommended adjustment to its proposed annualized labor expense. The Commission finds Staff's proposed adjustment to annualize labor expense to be reasonable for purposes of setting rates in this proceeding and it is hereby approved.

2. Federal Insurance Contributions Act Corrections

Staff recommends certain corrections to AIU's proposed adjustments to the Federal Insurance Contributions Act ("FICA") tax expense. In addition, related to its recommended adjustment to AIU's proposed annualized labor expense, Staff recommends a further adjustment to AIU's FICA tax expense. To reduce the number of contested issues, AIU accepts Staff's recommended adjustment to the proposed adjustment to the FICA tax expense. The Commission finds Staff's proposed adjustment to AIU's FICA tax expense to be reasonable and it is hereby approved.

3. Outside Professional Services

Staff recommends an adjustment to AIU's Outside Professional Services expense to remove fees paid to Jacobs Consultancy, Inc. to perform an electric utility workforce analysis study for AIU, the results of which were to be presented to the General Assembly by the Commission. To reduce the number of contested issues, AIU accepts Staff's recommended adjustment to AIU's Outside Professional Services expense. The Commission finds Staff's proposed adjustment to AIU's Outside Professional Services expense to be reasonable for purposes of this proceeding and it is hereby approved.

4. Bank Facility Fees

AIU has been in negotiations for a two-year bank facility in the amount of $635 million. Fees associated with this facility include one time arrangement and upfront fees (totaling $13.820 million, paid when the facility is put in place) and ongoing administrative agent and facility fees (totaling $5.256 million, paid quarterly after the facility is in place). AIU incurs these costs whether or not and regardless of the extent to which they borrow from the facility. Through AIU witnesses O'Bryan and Stafford, AIU initially recommended that the fees be recovered as Administrative and General (―A&G") expenses. AIU's initial proposal was that the pro forma adjustment include ongoing fees plus amortization of the one-time fees over the life of the facility allocated among the companies based on borrower sublimits.

Staff recommends the Commission reject the proposal to recover bank facility fees through A&G expenses rather than the cost of short-term debt. Specifically, Staff witness Phipps criticizes AIU's pro forma proposal, asserting that recovering the costs through a pro forma adjustment to operating expense assumes the upfront fees and facility fees are prudent and allocated properly for ratemaking purposes. She also asserts AIU's proposal incorrectly assigns AIU's non-utility costs and fails to recognize that the sublimit under the 2009 credit facility could effectively reduce AIU's sublimits to $500 million from $635 million. Additionally, Ms. Phipps asserts that each company allocates its costs between gas and electric delivery services using a labor cost allocator. Thus, she states that, unless AIU shows a clear relationship between credit facility usage and labor costs, the credit facility costs should be allocated amongst each utility's business operations based on investment, since the facility is a source of short-term debt. Finally, Ms. Phipps asserts the actual upfront and facility fees associated with the 2009 credit facilities are lower than estimates in the AIU proposal. She calculates one-time fees for AIU's proportion of the 2009 credit facilities as approximately $8.7 million and annual facility fees as $2.2 million.

For the purposes of this case, AIU accepts cost recovery via the capital structure. AIU agrees to accept Ms. Phipps' general methodology and remove bank facility fees from operating expenses and include them as a component of the capital structure consistent with Staff's recommended approach, but based on the calculation sponsored by Mr. O'Bryan. Cost recovery of this expense through AIU's capital structure is discussed below in this Order. For purposes of establishing rates in this proceeding, the Commission finds Staff's proposal to reflect bank facility fees as a component of capital structure to be reasonable and it is hereby approved.

5. Uncollectibles Expenses

AIU initially proposed pro forma adjustments to uncollectibles expense based upon a three-year average of actual values for net write-offs for 2007 and 2008 and budgeted net write-offs for 2009. Staff and IIEC both proposed adjustments to AIU's proposed uncollectibles expense based upon the 2006 through 2008 three-year average of net write-offs as compared to revenues. AIU subsequently proposed to substitute year-to-date actual September 2009 net write-offs and revenues for 2009 budgeted amounts. AIU notes that use of 2009 data to set rates more accurately reflects AIU's current uncollectibles expense, whereas use of 2006 actual data for uncollectibles expense ignores a fundamental change that took place in January 2007 for pricing of electric power supply and delivery service. Staff and IIEC accept AIU's proposal to calculate uncollectibles expense using actual 2007, 2008 and year-to-date September 2009 net write-offs. Staff also accepts AIU's proposal for the associated uncollectibles rate to be reflected in proposed uncollectibles riders approved in Docket No. 09-0399 on February 2, 2010. For purposes of setting rates in this proceeding, the Commission finds AIU's proposal to calculate uncollectible expense using actual 2007, 2008 and year-to-date September 2009 net write-offs to be reasonable and it is hereby approved.

6. Storm Expenses

AIU initially proposed to normalize its Storm Expense over a three-year period adjusted for inflation to reflect a trend in increased storm costs in recent years. Staff and AG/CUB proposed to normalize AIU‘s Storm Expense over a six-year period using expense data from 2003-2008 based on the Commission's use of a six-year average in Docket Nos. 07-0585 et al. (Cons.). AIU subsequently proposed to normalize Storm Expense using 2004 through year-to-date September 2009 data, instead of actual 2003 data, to better reflect the level of storm costs likely to be incurred during the period rates will be in effect. Staff does not object AIU‘s normalization approach as revised and accepts the Storm Expense adjustments as presented in Ameren Ex. 29.12. AG/CUB also finds AIU‘s normalization approach as revised to be reasonable. For purposes of this proceeding, the Commission finds AIU's revised proposal for calculating normalized Storm Expenses to be reasonable and it is hereby approved.

7. Automated Meter Reading Expense

Staff proposes an adjustment to remove certain conversion costs and purported non-recurring costs in the test year associated with AIU‘s Automated Meter Reading (―AMR”) upgrade. To reduce the number of contested issues, AIU accepts Staff‘s proposed adjustment to AMR expense. For purposes of this proceeding, the Commission finds Staff's proposed adjustment to AMR expense to be reasonable and it is hereby approved.

8. Smart Grid Costs

In its Order in Docket No. 07-0566, the Commission directed a collaborative workshop process be held to examine the smart grid modernization concept and its implementation. In that Order, the Commission stated that the purpose of the Illinois Statewide Smart Grid Collaborative ("ISSGC") is to develop a strategic plan to guide deployment of a smart grid in Illinois, including goals, functionalities, timelines, and analysis of costs and benefits, and to recommend policies to guide such deployment that the Commission can consider for adoption in a docketed proceeding. The Order directed AIU to participate in that workshop process. The Commission also stated in the Order that the least cost provisions require both that the chosen electric service be provided in the least cost manner and that the smart grid be at least cost, i.e., the components must be optimized to provide maximum benefits to consumers subject to competitive bids, and labor must be provided at competitive rates. Thus, the Commission wants to better understand how AIU‘s existing systems and technology can be adapted to support a statewide goal of complying with federal policy, embodied in the Energy Independence Security Act of 2007, Public Law No. 110-0140, directing states to consider smart grid initiatives. The Commission also wants to understand how implementation of smart grid technologies may alter costs and benefits considered when determining —least cost.” In other words, the Commission recognizes AIU has already implemented facilities and technologies that will support smart grid efforts and that the cost/benefits framework may change to implement the final ISSGC vision.

In this proceeding, AIU initially sought to recover $1.3 million over a three-year period, which is AIU‘s share of the costs of the third-party facilitator and workshop facility rental costs. Staff witness Bridal, however, proposes an adjustment to smart grid costs, which results from a change in the scope of Phase 2 of the project and the removal of incremental costs that Staff does not believe are known and measurable. AIU accepts Staff‘s adjustment to smart grid costs, to minimize the number of contested issues in this case. For purposes of setting rates in this proceeding, the Commission finds Staff's proposed adjustment to smart grid costs to be reasonable and it is hereby approved.

9. Homer Works Headquarters Sale

Staff proposes an adjustment to update the AmerenCILCO electric Homer Works Headquarters Sale Adjustment to replace estimated amounts with actual amounts submitted by AIU in response to Staff data request RWB 6.06. AIU accepts Staff‘s proposed adjustment. The Commission finds Staff's proposed adjustment to be reasonable and it is hereby approved.

10. Social and Service Club Dues

Staff proposes an adjustment to remove all social and service club membership dues from AIU‘s recoverable operating expenses. AIU accepts Staff‘s proposed adjustment to remove these specific expenses from the revenue requirements. The Commission finds Staff's proposed adjustment to be reasonable and it is hereby approved.

11. Charitable Contributions

Staff proposed an adjustment to remove certain contributions to community and economic development organizations from AIU‘s revenue requirement, which Staff claims are amounts for items of a promotional or business nature that should be the responsibility of shareholders, not ratepayers. AIU objected to Staff‘s proposal to include in its proposed disallowance those items that were included in AIU‘s Schedule C-7, which are recorded to Account 426, a —below-the-line” account, and thereby not included in AIU‘s requested revenue requirement. To reduce the number of contested issues, however, AIU accepts Staff‘s adjustment to reduce the amount of charitable contributions expense referenced in AIU‘s Schedule C-2.20. Staff accepts the adjustment to AIU‘s charitable contribution expense as presented by AIU in Ameren Ex. 29.13. For purposes of this proceeding, the Commission finds the agreement between

AIU and Staff regarding charitable contribution expenses to be reasonable and it is hereby approved.

12. Industry Association Dues

Staff proposed an adjustment to remove certain industry association dues attributable to lobbying activities. Staff witness Bridal calculated the adjustment by multiplying the 2008 industry association dues identified by AIU in its Schedules C-6.1 by a lobbying percentage developed from a 2007 invoice. After receiving 2008 invoice data in response to Staff data request RWB 19.01, Staff revised its adjustment for industry association dues. AIU agrees with Staff's proposal to calculate its adjustment based on 2008 test year invoice data, but notes that certain corrections need to be made based on Mr. Bridal's workpapers. Staff agrees with AIU's adjustments concerning industry association dues as presented in Ameren Ex. 51.12. For purposes of this proceeding, the Commission finds the agreement between AIU and Staff regarding industry association dues to be reasonable and it is hereby approved.

13. Advertising Expense

Staff proposed an adjustment to remove from AIU's revenue requirement all expenses recorded in Account 930, "Miscellaneous Advertising and General," or Account 930.1, "General Advertising Expenses," on the grounds that the amounts recorded in these accounts are promotional, political, institutional, or goodwill in nature. AIU accepted Staff's proposed adjustment in principle subject to certain modifications that Staff witness Bridal indicated he would make in response to additional information that AIU provided in response to data requests concerning these test year expenses. Staff now accepts the advertising expense adjustments as presented in Ameren Ex. 29.15. For purposes of this proceeding, the Commission finds the agreement between AIU and Staff regarding advertising expense to be reasonable and it is hereby approved.

14. Customer Service and Information Expenses

Staff proposed an adjustment to remove from AIU's revenue requirement certain customer service and information expenses, which Staff believed consisted mainly of purchases of clothing, promotional merchandise, and sponsorships that are promotional or goodwill in nature and not allowable under Section 9-225 of the Act. Staff witness Bridal, however, revised his adjustment for customer service and information expenses based on his review of specific transaction data provided by AIU. AIU accepts Mr. Bridal's revised adjustment for customer service and information expenses. For purposes of this proceeding, the Commission finds the agreement between AIU and Staff regarding customer service and information expenses to be reasonable and it is hereby approved.

15. Lobbying Expense

Staff proposes an adjustment to remove from AIU's revenue requirement for all electric utilities and AmerenIP gas operations lobbying expenses that were included in A&G expense accounts for the environmental services department personnel as identified in AIU's response to Staff data request RWB 18.01. AIU accepts Staff's proposed adjustment. For purposes of this proceeding, the Commission finds the agreement between AIU and Staff regarding lobbying expenses to be reasonable and it is hereby approved.

16. Rate Case Expense

Staff proposed to adjust rate case expense to account for the withdrawal and replacement of legal counsel in this proceeding and for the removal of the amortization of rate case expense from Docket Nos. 06-0070 through 06-0072 (Cons.). AIU accepts the adjustment for the removal of the amortization of rate case expense related to its prior rate case. AIU also accepts in principle Staff's adjustment to account for the withdrawal and replacement of legal counsel, but proposes that the amount of the adjustment be modified to include actual payments to prior counsel. AIU also updates its rate case expense to reflect actual, rather than estimated, amounts paid to experts and consultants and actual, rather than estimated, miscellaneous legal expenses. Staff accepts AIU's proposed changes to Staff's adjustment to rate case expense, and recommends that the Commission allow AIU to recover rate case expense in this proceeding in the amounts identified in Ameren Ex. 30.4. Staff also recommends, and AIU concurs, that the Commission expressly find that the amounts that AIU proposes to expend to compensate attorneys and technical experts to prepare and litigate this proceeding are just and reasonable pursuant to Section 9-229 of the Act.

The Commission finds the agreement between AIU and Staff regarding rate case expense to be reasonable and it is hereby approved. In addition, the Commission expressly finds that the amounts that AIU proposes to expend to compensate attorneys and technical experts to prepare and litigate this proceeding are just and reasonable pursuant to Section 9-229 of the Act. The Commission notes, however, that much of the written direct testimony for the six dockets at hand is identical. AIU could reduce rate case expense in its next rate case if it filed, to the extent possible/practical, one set of direct testimony supporting its initial tariff filing. A petition for a waiver of the requirements of 83 Ill. Adm. Code 286, "Submission of Rate Case Testimony," would be necessary. AIU is familiar with such efforts, however, given the filing of its petitions seeking waivers of other requirements of Part 285 prior to filing its tariffs leading to this proceeding. (See Docket Nos. 09-0270/09-0271 (Cons.))

17. Collateral Expense

AIU's gas operations must prepay or post collateral for certain services, due to limited access to unsecured credit. The collateral adjustment allows AIU to recover necessary costs associated with collateral posting for gas purchases. Test year gas collateral postings have been averaged over the 12-month test year from January through December 2008, and an interest rate is then applied to the average to be consistent with the method adopted by the Commission in Docket Nos. 07-0585 through 07-0590 (Cons.).

Staff witness Jones initially proposed a collateral expense adjustment to disallow interest expense associated with collateral posting for gas purchases. Ms. Jones argued that interest expense was no longer necessary and appropriate for recovery since AIU recently received a credit upgrading and now carried an investment-grade rating. AIU responded, however, that her assumption that AIU no longer incurs collateral expenses because its credit ratings were recently upgraded is incorrect. While it is true that investment grade credit ratings improve AIU's access to unsecured credit, AIU asserts that it has effective ratings at the lowest investment grade notch for the purposes of a very high percentage of contracts. Generally, the higher the effective rating, the greater the access to unsecured credit. Thus, while it now carries investment grade ratings, AIU states that it had positive collateral postings in place with its counterparties as of October 22, 2009. The amounts of collateral will vary according to the transactions executed and the applicable forward pricing curves. As long as collateral may be contractually required by its counterparties, AIU asserts that there will be a cost associated with posting such collateral. After reviewing AIU's response, Ms. Jones withdrew her proposed adjustment. For purposes of this proceeding, the Commission finds the agreement between AIU and Staff regarding collateral expense to be reasonable and it is hereby approved.

18. Company-Use Franchise Gas

Staff witness Seagle recommends that the Commission reduce AIU's request for its company-use and franchise gas expenses. Mr. Seagle states that the gas pricing that AIU used to value its requested franchise gas amounts resulted in an overstatement of gas prices on a going forward basis and recommends alternative pricing. AIU agrees with Mr. Seagle's proposal and updated the franchise gas pricing as Mr. Seagle recommends. Mr. Seagle also recommends that AIU provide rebuttal testimony that updates each of the three utility's company-use gas costs using the most recent gas pricing information available and normalizes the volumes. AIU agrees with Mr. Seagle's proposal and updated the company-use gas pricing and volumes as Mr. Seagle recommends. Staff agrees with the calculations AIU provided on rebuttal regarding AIU's company-use gas costs and franchise gas costs. For purposes of this proceeding, the Commission finds the agreement between AIU and Staff regarding company-use gas costs and franchise gas costs to be reasonable and it is hereby approved.

19. Real Estate Taxes

Staff proposes an adjustment for AmerenCIPS gas to remove amounts included in real estate taxes that Staff argues represent prior period adjustments, and not actual test year real estate taxes. To reduce the number of contested issues, AIU accepts

Staff's Schedule 4.14 adjustment for AmerenCIPS gas, as shown on Ameren Ex. 30.2, Schedule 1, Page 5 of 5, column (o). For purposes of this proceeding, the Commission finds the agreement between AIU and Staff regarding real estate taxes to be reasonable and it is hereby approved.

20. Prior Period Hazardous Materials Adjustment Clause Costs

Staff proposes an adjustment for AmerenIP electric to remove what Staff believes are 2007 Hazardous Materials Adjustment Clause ("HMAC") costs from the revenue requirement. To reduce the number of contested issues, AIU accepts Staff's proposed adjustment to remove —Prior Period HMAC costs" from the revenue requirement of AmerenIP. For purposes of this proceeding, the Commission finds the agreement between AIU and Staff regarding prior period HMAC costs to be reasonable and it is hereby approved.

B. Contested Operating Expense Issues

1. Tree Trimming

a. AIU Position

AIU states that consistent with the approach adopted by the Commission in the prior two electric delivery services rate cases, AIU proposes a pro forma adjustment to test year electric delivery services operating expenses to reflect 2010 budgeted tree trimming/vegetation management expenses. AIU says this adjustment is based on the current four-year trimming cycle applicable to all of AIU's electric operations. AIU claims its proposal does not include any cost for conversion to a —no contact" zone approach – a conversion Staff suggests and that necessitates a more frequent trimming cycle to maintain —no contact" for the entire service area. If the Commission requires AIU to convert to Staff's approach, AIU asserts that additional associated costs would need to be added to AIU's pro forma level of O&M expense for its Illinois electric delivery service operations.

AIU asserts that to ensure the reasonableness of the 2010 budget, AIU started with actual 2008 tree trimming expenses, reviewing the work performed in 2008 and related costs. AIU says this was compared to the work to be performed in 2010 and its projected costs, taking into account the four-year trim cycle requirements, Staff's expectations for reliability enhancement measures, and contracts with vegetation management contractors and local labor unions for negotiated wage increases. AIU states that in 2008, AIU's combined actual tree trimming expenses totaled $39.2 million, and the 2009 projected amount (based on 8 months of actual and 4 months of projected data) is $39.2 million. AIU says from this information, AIU's projects $39.3 million expected actual tree trimming expenses to be included in the combined revenue requirement.

AIU asserts that while trimming is planned for 24% of its total system in 2010, the percentages for each utility vary from 33% to 17% – based on number of circuits – or from 28% to 19% – based on number of circuit miles. According to Staff, this data shows that the amount of work and associated costs to maintain a four-year trim cycle within each company varies from year to year. Staff suggests that a company would not need to trim 28% of its circuit miles each year to maintain a four-year cycle, nor could a company that trims only 19% of its circuit miles each year maintain a four-year cycle. To address its concerns about the variability of such expenditures, Staff proposes to reduce AIU‘s tree trimming expenses. Staff determined its proposed adjustment by calculating an annual average expense amount using AIU‘s actual tree trimming expense for 2005 through June 30, 2009. AIU indicates that Staff's proposal allows only $34.6 million for trimming expenses, which is approximately $4.7 million less than what AIU expects to incur in 2010. Staff asserts that averaging costs over a period of time smoothes cost variances and provides a reasonable amount of tree trimming expense to include in the respective company‘s revenue requirement. Under AIU's proposal, Staff fears that some companies will receive too much revenue. Noting Staff's contention that each company may trim more or less than 25% in 2010 and still proposes to reduce tree trimming expenses for all three companies, AIU asserts that this is a mathematical impossibility if total trimming covers ¼ of the entire system. AIU contends that Staff's proposed adjustment should be rejected on arithmetic grounds alone.

AIU insists that it provided evidence to support its position that the amount of tree trimming expense projected in the 2010 budget is the appropriate amount of tree trimming expense for the 2008 historical test year. AIU says this evidence was provided in response to Staff data requests BCJ 12.01 through BCJ 12.08. AIU claims that the Superintendent of Vegetation Management for AIU sponsored several of these responses and asserts the responses accurately provide Staff with information regarding AIU‘s 2010 tree trimming activities. In AIU's view, Staff seems to disregard this evidence.

According to AIU, the viability of Staff‘s number depends, in great part, on Staff‘s restatement of costs dating back to 2005 in 2008 terms using a general inflator. AIU asserts that its number is based on what activity AIU knows it is going to be engaged in during 2010, using the costs that are applicable now, not five-year old data restated to 2008. AIU believes its adjustment is inherently superior to Staff‘s because it is fully rooted in reality and does not represent a "guess" at what AIU might be expected to spend on tree trimming in 2010.

AIU also insists that its proposed tree trimming expense level is not unreasonable within the four-year trim cycle. AIU says the 2010 number is consistent with the 2008 and 2009 levels. AIU states that Staff proposes reducing the 2010 level because, apparently, the 2008, 2009, and 2010 levels are too high in Staff‘s judgment. AIU notes that Staff does not claim that AIU is doing too much trimming. Rather, Staff claims that over four years the level of activity will average out to the number which Staff proposes.

In AIU's view, Staff's approach is reckless, and its "faux-precision" is no salvation. AIU argues that Staff puts system integrity at risk by, in effect, directing AIU to spend less on tree trimming this year because Staff believes that its restatement of old spending levels to 2008 dollars produces a figure that its sufficient. AIU believes this is unsound regulatory policy, and should be rejected by the Commission. If the Commission adopts Staff's proposal, AIU claims it will need to synchronize expenditures to rate recovery by spending $4.7 million less than the amount needed for tree trimming functions in 2010 and beyond. According to AIU, Staff's recommendation will be less than required to achieve the four-year trimming cycle across all of AIU's service areas.

AIU avers that both the Commission and Staff recognize the importance of a four-year trim cycle, as evidenced by the Commission's acceptance of Staff's repeated recommendations in its annual reliability assessment reports. AIU states that the Illinois Commerce Commission Assessment of AmerenIP's Reliability Report and Reliability Performance for Calendar Year 2007, which the Commission accepted, recommended AmerenIP ―should do whatever is necessary to maintain a four-year (minimum) tree trimming cycle that is also in compliance with 2002 NESC Rule 218 throughout its service territory." Additionally, AIU says Staff's findings in the February 14, 2008 Staff Report to the Commission, on the Assessment of the Ameren Illinois Electric Utilities' Reliability for 2006, included similar recommendations for all three utilities. AIU relates that in Docket No. 00-0699, the Commission ordered CILCO to follow a four-year trim cycle, and AmerenIP and AmerenCIPS voluntarily committed to the Commission to do the same. Thus, if the Commission adopts Staff's position, AmerenCILCO must petition the Commission to alter its four-year cycle requirement.

In addition, if Staff's adjustment is adopted, AIU claims it will not be able to continue reliability-enhancement tree trimming programs. AIU asserts it will trim fewer trees, and the likelihood for less reliable service will increase. AIU says although $4.7 million is a relatively small percentage of the total revenue request, it can have a significant impact. AIU believes Staff's proposed tree trimming adjustment is unsupported and should be rejected.

b. Staff Position

Staff proposed an adjustment to normalize tree trimming expense in the test year based on the actual amount of tree trimming expense incurred by each utility for the time period January 2005 through June 2009. Staff acknowledges that it presented no testimony regarding the appropriate amount of tree trimming or the time period over which it is to be done. In Staff's view, the only issue regarding tree trimming is how much cost is to be included in the revenue requirement. Staff says AIU's vegetation management programs are based on maintaining a four-year trim cycle, but the amount of work and associated costs to maintain that cycle vary from year to year. Staff states that while trimming is planned for 24% of the total AIU system in 2010, the percentages for each AIU vary, as discussed above. Staff suggests that the average of costs incurred by each utility over a period of time smoothes the cost variances and provides a reasonable amount of tree trimming expense to include in the respective revenue requirements.

AIU claims that Staff‗s recommended level of expenditure for tree trimming will be less than the amounts required to cover AIU‗s costs to achieve a four-year tree trimming cycle across its service territories. Staff says AIU cites compliance with four-year trim cycles, the inclusion of expanded reliability enhancement programs such as ―cycle buster" and ―prescriptive tree trimming," and wage increases as the reasons its proposed test year tree trimming expense exceeds historical average costs. Staff argues that AIU has been on four-year trim cycles since 2004; mid-cycle patrols began in 2004 for AmerenCILCO and AmerenCIPS and 2005 for AmerenIP; and prescriptive trimming began in October 2006 for all three companies. Staff claims AIU made no claim that the amount spent for tree trimming in the period from which Staff calculated an annual average, updated to 2008 dollars, was not sufficient for each utility to meet its trimming obligations.

Staff indicates that AIU takes exception to the historical time period that it used to calculate an average annual amount for tree trimming expense on the basis that it is too far removed from the time that rates will become effective. In Staff's view, the lag that exists between historical periods and the time rates go into effect is a normal consequence of filing an historical test year, which is the type of test year AIU used. Staff suggests that a utility wishing to avoid the lag can choose to file a future test year. But even if AIU had filed a future test year, Staff adds that the trimming expense in each utility‗s 2010 budget is not assumed to be the appropriate amount to include in its revenue requirement. Staff states that a future test year has its own set of requirements, including review by an independent accounting firm of the assumptions on which the numbers are based.

According to Staff, AIU attempts to compensate for the lag with pro forma adjustments based on the 2010 tree trimming budget for each utility. Regarding pro forma adjustments, Section 287.40 provides as follows:

> These adjustments shall reflect changes affecting the ratepayers . . . where such changes occurred during the selected historical test year or are reasonably certain to occur subsequent to the historical test year within 12 months after the filing date of the tariffs and where the amounts of the changes are determinable.

Staff states that while a budget may reflect an expected change in operating results, it does not reflect a known and measureable change in operating results. Staff believes that AIU‗s adjustments do not meet the ―known and measurable" criteria and are inappropriate for pro forma adjustments to a historical test year. For ratemaking purposes, Staff believes that the average annual amount of tree trimming expense calculated for each utility approximates a more normal level of expense than does the amount spent in any one year and should be adopted by the Commission.

With regard to AIU's arithmetic error claim, Staff denies that its adjustment to reduce tree trimming expense for all three companies is mathematically impossible. Staff asserts that it is possible to make such an adjustment when the annual historical average to maintain a four-year tree trimming cycle at each utility, calculated for the period January 2005 through June 2009, is less than the pro forma adjustment for the respective utility. Staff says the average of costs incurred by each utility over a period of time smoothes the cost variances and provides a reasonable amount of tree trimming expense to include in each respective revenue requirement. (Staff Reply Brief at 22)

c. IBEW Position

IBEW agrees with AIU that a reduction of $4.7 million in the amount spent on tree trimming will leave an inadequate amount to maintain a four-year tree trimming cycle and may contribute to less reliable service. IBEW echoes AIU's claim that although the reduction appears to be small compared to the entire requested rate increase, it can still have a significant impact on AIU operations as well as IBEW members and the Illinois workforce. According to IBEW, the issue of tree trimming is exemplary of the negative effect that an inadequate rate increase would have on not only customer reliability, but also the Illinois workforce. If rates are insufficient to recover costs, IBEW states that AIU would need to reduce operating and maintenance expenditures, likely including reductions in contractors and deferral of maintenance. IBEW argues that such reductions would have a negative impact on customer service, including a reduction in tree trimming. Without recovery of sufficient revenue to maintain the minimum four-year cycle recommended by the Commission, IBEW complains that fewer of the skilled union contractors which perform tree trimming could be hired. IBEW says this loss of jobs would harm the Illinois workforce.

d. Commission Conclusion

AIU proposes a pro forma adjustment to the historical test year tree trimming expenses which amounts to a total of $39.3 million in operating expenses for all three electric utilities' vegetation management efforts. Staff opposes AIU's adjustment and instead recommends basing trimming expenses on the average annual trimming expenses for the period January 1, 2005 through June 30, 2009. Staff's proposal results in a combined reduction to the three utilities' rate bases of approximately $4.7 million.

From Staff Ex. 3.0, the Commission understands that actual tree trimming expenses incurred in the years 2005 through 2008 as well as during the first six months of 2009 are as follows:

Actual Tree Trimming Expenses (in thousands of dollars)							
	AmerenCILCO		AmerenCIPS		AmerenIP		Total
2005	3,844		10,584		14,574		29,002
2006	5,372		9,099		14,597		29,068

2007	4,663		13,652		15,483		33,798
2008	4,919		17,877		16,386		39,182
2009	2,544		7,356		8,354		18,254

While some variability exists in the annual expenses, the Commission is hesitant to label the expenditures "volatile" for any of the three utilities. What variation that does exist can be characterized as a generally modest upward trend overall. But given that the Commission and Staff in the engineering department have been urging the utilities to improve their tree trimming and vegetation management practices in an effort to improve reliability, this trend is not surprising.[9] AIU's proposed expenses appear to continue this trend overall. The AIU and Staff proposed tree trimming expenses for each utility are as follows:

Proposed Tree Trimming Expenses (in thousands of dollars)							
	AmerenCILCO		AmerenCIPS		AmerenIP		Total
AIU	5,512		15,978		17,783		39,273
Staff	4,949		13,504		16,097		34,550

Given this history, it is not clear to the Commission that Staff's proposed averaging is necessary or appropriate. AIU's total proposed tree trimming expenses for the three electric utilities is essentially the same as was actually incurred in the 2008 test year. It appears that AIU's proposed pro forma adjustment to trimming expenses is primarily intended to reallocate expenses among the three utilities so that the level of expenses at each of utility matches more closely the expected expenditures in 2010 rather than the actual expenditures in 2008. The pro forma adjustment does not increase total tree trimming expenditures for the utilities in any significant way. As a result, the Commission rejects Staff's averaging proposal and accepts AIU's proposed pro forma adjustment to trimming expenses.

2. Incentive Compensation Expenses

a. Staff Position

Staff indicates that AIU accepts the portion of Staff‘s proposed adjustment to incentive compensation expenses to remove previously disallowed capitalized incentive compensation costs from the test year rate base proposed by AIU. Staff says that AIU continues to oppose Staff's proposed adjustments to remove costs associated with key performance indicators (―KPIs”) for O&M Budget Compliance and Capital Budget Compliance as well as the proposal to disallow costs which Staff believes have not been shown to result in net benefit to ratepayers.

[9] This observation should not be taken by AIU as authorization to propose even higher vegetation management expenses in future rate cases without adequate support. Any proposed expenditures must be reasonable and sufficiently justified by AIU.

Staff says the Commission did not allow costs associated with KPIs related to budget compliance in the prior rate cases and complains that AIU relies on the same argument in this case. AIU says the establishment and focus on budget targets provides benefits to ratepayers by setting a goal for managing overall expenditures for projects and services within a defined time period. AIU claims cost management/cost control is beneficial to customers to assure dollar resources are spent on priority initiatives and within the desired timeframes. AIU asserts that this helps assure that customers receive quality service in the most cost-effective manner.

Staff believes that AIU's argument merely restates what the ratepayers already expect from their utility, quality service in the most cost-effective manner. Staff claims AIU fails to acknowledge that cost management/cost control is of equal, if not greater, benefit to its shareholders, thus making it more in line with the KPI related to earnings per share ("EPS") which AIU has already removed from its revenue requirements. In Staff's view, AIU failed to demonstrate how the budget compliance KPIs is based on anything other than financially related goals. Staff insists that the costs related to those KPIs should be disallowed from recovery in the revenue requirement.

Staff says AIU offers Ameren Ex. 42.1 as further information demonstrating the ratepayer benefits of the operational goals of AIU's incentive plans. Staff complains that the exhibit merely describes what the KPIs are designed to do; the exhibit does not reflect the outcome or results of the performance of the goals, making it impossible to determine any benefit the ratepayers might gain from the goals being met. Even though the targeted goal might be reached, Staff argues that the expected outcome or benefit may not have been achieved or the benefit may in fact be less than anticipated when the goal was established. Staff contends that in response to Staff discovery, AIU was unable to provide any benefit associated with the performance of those goals.

Staff agrees that not all benefits that may be achieved are tied to financial measurement. Staff says it identified certain other KPIs for which it is proposing to allow cost recovery. Staff is proposing to disallow all amounts allocated from AMS to AIU for incentive compensation since Staff believes a portion of those costs are tied to financial goals and AIU did not demonstrate customer benefit resulting from the remainder of the goals.

According to Staff, AIU argues that because the record in its prior rate proceedings indicated that it was reasonable to pass along certain portions of incentive compensation expense to its customers for recovery through rates, similar costs should be allowed for recovery regardless of the record in the current proceedings. Staff contends, however, that the more developed record in the current proceedings demonstrates that AIU has not met the standard set by the Commission for recovery of incentive compensation expense through base rates.

Staff says AIU suggests that information regarding customer benefit was provided for both of the AIU incentive compensation plans as well as the AMS incentive compensation plans. Staff asserts that information included in Ameren Ex. 42.1 was limited to the incentive plans for AIU and no comparable information was provided for the AMS plans. Staff insists that no showing of customer benefit was made specific to the AMS plans.

b. AIU Position

The Commission, AIU avers, has a policy of permitting recovery of incentive compensation expense where the utility has demonstrated that its incentive compensation plans result in tangible benefits for ratepayers. AIU says that in a recent decision, the Commission clarified the standard when it stated that, with respect to the formulation for recovering incentive compensation, ―[t]he main and guiding criterion is that the expense be prudent, reasonable and operate in a way to benefit the utility‗s customers." (AIU Initial Brief at 73, citing Docket No. 07-0241, Order at 66)

In AIU‗s prior rate case, AIU says the Commission approved recovery of 50% of AIU‗s requested incentive compensation expense, based on the determination that incentive plans related to certain operational goals (safety, reliability and customer service) provided direct, meaningful benefits to ratepayers, and payouts for these goals were not dependent upon meeting financial targets. AIU asserts that the Commission considered evidence from AIU in that case regarding the operational and individual goals of its incentive compensation plans and how the metrics benefited AIU customers by enhancing service, increasing service reliability, and/or increasing the efficiency of operations. AIU claims it has provided more extensive information in this case regarding ratepayer benefits of incentive plan goals. AIU says the Commission did not require in the prior case that AIU demonstrate whether the targeted goals were attained, whether the expected outcome or benefit was actually achieved, or whether the actual benefit was less than anticipated when the goal was established.

AIU insists it has satisfied the above standards by providing extensive information relating the customer benefits of the incentive plans‗ operational goals in testimony and discovery responses. In light of the determination in AIU‗s prior case, it is AIU‗s position that a showing that AIU has incentive compensation plans in place that are ―related to" areas such as safety, customer service, and reliability that benefit ratepayers is sufficient to obtain recovery of incentive compensation expense. AIU claims it has provided even more extensive information demonstrating that all its KPIs provide ratepayer benefits.

AIU says it seeks recovery of the portions of incentive compensation expense related to operational goals and that expenses related to EPS financial goals were removed from its request for recovery. AIU contends that incentive compensation is a common and necessary component of the total compensation package for employees in the electric and gas utility industry. AIU asserts that its incentive plans focus primarily on awarding employees based on their performance relative to operational goals that benefit the ratepayer (e.g., customer service, reliability, safety, operational efficiency, etc.) AIU argues that by designing a market-competitive incentive plan that rewards employees for achieving operational goals that they are most able to influence and control, AIU is able to attract and retain the most qualified talent in the electric and gas utility industry while motivating the highest level of performance in key areas that have a direct, positive impact benefiting the ratepayer.

AIU states that employees participate in one of four annual incentive compensation plans: the Executive Incentive Plan for officers (—EIP-O”), which applies to all officers within AIU, the Executive Incentive Plan for managers and directors (—EIP-M”), which applies to all members of the Ameren Leadership Team (—ALT”) with the exception of officers, the Ameren Management Incentive Plan (—AMIP”), which applies to AIU‘s professionals and supervisors (excluding ALT and bargaining unit employees), or the Ameren Incentive Plan (—AIP”), which applies to employees who are represented by a bargaining unit. AIU asserts that these plans are based on individual and operational goals designed to provide tangible benefits to Illinois ratepayers. AIU says these same plans apply to both AIU and to AMS. AIU believes that recovery of requested incentive compensation expense for AMS should be permitted.

AIU acknowledges that a certain percentage of the EIP-O and EIP-M is funded based on financial performance. AIU says costs related to these financial goals have been removed from AIU‘s requested incentive compensation expense. AIU contends that the remaining goals for these programs are based on operational performance as measured by incentive KPIs. AIU asserts that incentive KPIs generally represent goals related to important operational issues such as safety, reliability, customer satisfaction, and operational excellence. AIU states that the AMIP is funded based on achievement of pre-defined incentive compensation KPIs. AIU claims these KPIs focus plan participants on key operational metrics such as safety, reliability, cost control, and customer satisfaction. AIU says the AIP is funded and paid 100% based on incentive KPI performance. According to AIU, the incentive KPIs are designed to focus employees on important operational goals that they can influence. AIU says incentive compensation paid under the AIP does not include the O&M Budget Compliance and/or Capital Budget Compliance measures.

AIU complains that despite the extensive information provided to Staff regarding AIU‘s incentive compensation expense, in Direct Testimony Staff proposed to disallow all test year incentive compensation expense, both the expense associated with O&M Budget Compliance and Capital Budget Compliance measures, as well as other expense for which Staff claims AIU failed to —quantify” ratepayer benefits or otherwise calculate the —net benefits” to customers. AIU says Staff claimed that AIU was unable to identify any benefit to customers of employee attainment of the operational goals on the 2008 Scorecards, based on its response to a Staff data request.

AIU says it provided further information in the Rebuttal Testimony of an AIU witness that it believes demonstrated that the operational goals associated with AIU‘s incentive compensation plans provide real benefits to customers. AIU asserts that Ameren Ex. 42.1 provides a detailed summary of the ratepayer benefits of significant KPIs. For example, AIU asserts that the —Meet Gas Leak Response Objectives” tracks response performance to customer initiated calls to AIU where a gas odor is present.

AIU indicates it responds to and investigates every gas leak call that is received. AIU says the accepted criteria for a prompt response are ―as soon as possible but no more than an hour." AIU claims it has gone beyond the accepted criteria and established additional KPI criteria: responding to each leak in an average of less than 25 minutes. In 2007, AIU says it responded to over 34,000 gas leaks, and within one hour 99.8% of the time and the average response time was about 23.4 minutes. AIU states that in 2006, it responded to 99.5% of all gas leaks within one hour and 24.2 minutes for an average response. AIU insists that on this KPI not only are there ratepayer benefits but there is an improvement in performance.

AIU also argues that KPIs for O&M Budget Compliance and Capital Budget Compliance provide ratepayer benefits in the EIP-M and the AMIP. According to AIU, the establishment and focus on budget targets provides benefits to ratepayers by setting a goal for managing overall expenditures for projects and services within a defined period of time. AIU claims that cost management/cost control is beneficial to customers to assure dollar resources are spent on priority initiatives and within the desired timeframe. AIU believes this helps ensure that customers receive quality service in the most cost-effective manner. In AIU's view, a focus on budget/cost control helps reinforce AIUs' culture of cost management and finding new ways to reduce expenditures while improving service and customer satisfaction. AIU insists that ratepayers benefit from this.

While the Commission has previously disallowed recovery of incentive compensation related to financial goals or triggers, AIU argues that O&M Budget Compliance and Capital Budget Compliance KPIs are not related to financial goals. According to AIU, the Commission has previously approved the recovery of incentive compensation expense related to goals of reducing O&M and capital expenses, in Docket No. 05-0597. AIU says the Commission found that focusing on the funding measure that rewards employees for reducing O&M and capital expenses meets the Commission's standard of reducing expenses and creating greater efficiencies in operations. AIU says the Commission found that lowering O&M expenses, all else being equal, has the obvious effect of reducing the expenses to be recovered in future rate cases. AIU believes it has demonstrated that the costs associated with O&M Budget Compliance and Capital Budget Compliance provide such benefits. Consistent with the Commission's ruling in Docket No. 05-0597, AIU asserts that recovery of these expenses should be allowed.

AIU says the Commission most recently confirmed that incentive compensation goals need only be designed or expected to achieve certain goals in its recent decision in a Peoples rate case Docket No. 07-0241. AIU asserts that in that case, Staff proposed to disallow incentive compensation expense related to goals ―unlikely to be achieved." AIU says the Commission rejected Staff's proposal, even though the goals might not have been achieved in the past. AIU says the Commission found that Staff's position does not recognize that the nature of incentive compensation plant is such that there is no guarantee that the goals will be met and the compensation paid to employees. AIU believes the Commission's decision in the Peoples rate case further illustrates that quantifying the actual performance and resulting benefits of incentive compensation goals is not a prerequisite to recovery of incentive compensation expense.

c. AG/CUB Position

AG/CUB says the Commission has an established policy of eliminating incentive compensation program costs unless the utility can demonstrate that the goals employees are expected to achieve would benefit ratepayers, such as the improvement of service quality, reliability, public safety, reducing absenteeism, and cost containment. AG/CUB avers that incentive compensation based on financial goals such as maximizing profitability and growth, increasing EPS, or increasing return on equity ("ROE") is beneficial only to shareholders, and not properly recoverable from ratepayers.

In AIU's last rate cases, AG/CUB indicates the Commission ―allowed [AIU] to include in operating expense 50% of the total cost of its incentive compensation expense because the Commission believes that portion provides direct, meaningful benefits to ratepayers and payouts are not dependent upon meeting financial targets that are primarily beneficial to shareholders.” (AG/CUB Initial Brief at 21-22, citing Docket No. 07-0585 et al. (Cons.), Order at 108) In the second most recent AIU rate proceeding, the Commission had found that the AIU incentive compensation funding measures all relied on EPS targets and disallowed the entire test year compensation from the revenue requirements. (AG/CUB I B at 22, citing Docket Nos. 06-0070/0071/0072 (Cons.), Order at 72)

In the present case, Staff recommends the Commission exclude those incentive compensation costs that do not result in net benefits to consumers. AG/CUB adds that AIU's defense of its incentive compensation expense merely restates what the ratepayers already expect from their utility, quality service in the most cost-effective manner. With regard to the costs which have not been shown to result in net benefits to customers, including all of the amounts allocated from AMS, AG/CUB allege that Staff demonstrates why the information provided by AIU falls short of providing the support necessary to include those costs in AIU's revenue requirements. AG/CUB argues that any incentive compensation cost that has not been shown to result in a net benefit to ratepayers must be disallowed. AG/CUB asserts that incentive compensation related to O&M Budget Compliance and Capital Budget Compliance KPIs should be eliminated from AIU's revenue requirements.

d. IBEW Position

According to IBEW, incentive compensation under the AIU incentive plans not only provides benefits to ratepayers, but also fosters a healthy workforce, and should therefore be recoverable. IBEW indicates that AIU's AIP applies to employees that it represents. IBEW contends that the AIP is 100% based on performance as measured by incentive KPIs, which focus employees on important operational goals that they can influence, including safety, reliability, customer satisfaction, and operational excellence. IBEW states further that a number of the KPIs, simply by their goal targets, illustrate a customer benefit. IBEW claims the remainder of the KPIs relate to the creation of efficiencies in operations and expenses. AIU employees that it represents, IBEW continues, rely on incentive compensation as part of their pay. If AIU discontinues portions of the incentive compensation package in order to match its costs to Staff's proposed recovery, IBEW says employees would essentially be taking a pay cut, causing further harm to the Illinois workforce.

e. Commission Conclusion

Every AIU employee participates in one of four annual incentive compensation plans. AIU seeks to recover $12,119,701 in incentive compensation plan expenses for both the operating utilities and AMS. Staff proposes adjustments to remove costs associated with KPIs for O&M Budget Compliance and Capital Budget Compliance as well as to disallow costs which Staff believes have not been shown to result in net benefit to ratepayers. Staff's adjustments disallow approximately $9.1 million from AIU's requested expense amount. AG/CUB supports Staff's proposed adjustment while AIU and IBEW oppose the proposal.

The Commission has expended a significant amount of time reviewing the record on this issue. Staff is correct that in AIU's last rate case, the Commission did not authorize AIU to recover from customers certain incentive compensation costs, including costs associated with O&M Budget Compliance and Capital Budget Compliance. The Commission continues to believe that such costs should not be borne by ratepayers because they primarily benefit shareholders.

With regard to Staff's proposal to disallow costs that it believes have not been shown to result in net benefits to ratepayers, it is true that the Commission requires a finding that incentive compensation programs are beneficial to ratepayers before they can be reflected in rates. Whether one labels the benefit as a "tangible benefit" or a "net benefit" is immaterial. The bottom line is that ratepayers must receive an overall benefit from an incentive compensation plan if they are to be expected to pay for (a portion of) it. If no net benefit is realized by ratepayers upon the attainment of the plan goal, there is no reason for ratepayers to contribute funds encouraging AIU's employees to reach that goal. The difficulty is in discerning the "net," in other words, it is not always clear that the benefits outweigh the costs. For example, if a safety KPI is met and no injuries have occurred on the job, it is difficult to say at what point the benefits of no injured workers began to outweigh the costs of the safety initiative.

In parsing through the voluminous record on this issue, and with the help of the parties' Briefs on Exceptions, the Commission has been able to identify ten specific KPI areas from the 2008 test year that Staff recommends disallowing: 1) O&M Budget Compliance, 2) Capital Budget Compliance, 3) Occupational Safety and Health Administration ("OSHA") Recordable Injuries, 4) Electric Reliability Program Objectives, 5) Energy Efficiency, 6) Gas Leak Response Objectives, 7) Safety: Lost Work Day

Away, 8) Gas Compliance, 9) Real Time Pricing ("RTP") Meter Installs, and 10) Meter Test Completion. Ameren Ex. 42.1 identifies and describes the KPIs for the 2008 test year. Schedule 7 within Ameren Ex. 51.7 Third Revised attached to Ameren Ex. 51.0 Second Revised reflects the dollar amounts associated with each KPI for the 2008 test year.

As indicated above, the Commission continues to believe that incentive compensation expenses associated with O&M Budget Compliance and Capital Budget Compliance should not be recovered from ratepayers. Of the remaining eight KPI areas that Staff proposes to disallow, the Commission agrees with four of the proposed disallowances. Specifically, the Commission is not persuaded that the benefits to ratepayers outweigh the costs associated with the Electric Reliability Program Objectives, Safety: Lost Work Day Away, RTP Meter Installs, and Meter Test Completion KPIs. AIU seeks to recover $308,144 for the Electric Reliability Program Objectives KPI. AIU describes this KPI as including, among other things, correcting NESC violations. Given its concerns about the NESC violations, the Commission is not inclined to pass on to ratepayers incentive compensation expenses associated with corrections that should not even be necessary. Because the Commission can not discern how much of this KPI expense is attributable to correcting NESC violations, the total amount for this KPI is disallowed. With regard to the Safety: Lost Work Day Away KPI, the Commission finds this KPI very similar to, if not redundant, to the OSHA Recordable Injuries KPI. It is up to AIU to decide if it wishes to establish similar goals within its incentive compensation plans; the Commission, however, sees no need to impose on ratepayers expenses that are arguably redundant and for which they do not appear to receive any additional benefit. The disallowance for this KPI amounts to $250,826. With regard to the RTP Meter Installs and Meter Test Completion KPIs, the Commission finds the record to be lacking sufficient evidence to conclude that the benefits to ratepayers outweigh the costs. Accordingly, the Commission finds that $24,042 and $36,063 for the RTP Meter Installs and Meter Test Completion KPIs, respectively, should be disallowed.

Those KPI areas for which the Commission finds recovery of incentive compensation expenses appropriate in this proceeding despite Staff's objections include OSHA Recordable Injuries, Energy Efficiency, Gas Leak Response Objectives, and Gas Compliance. As indicated above, evaluating at what point the benefits of injury prevention began to outweigh the costs of a safety initiative is difficult to say. The incentive compensation expenses associated with the OSHA Recordable Injuries ($1,268,510), Gas Leak Response Objectives ($1,272,685), and Gas Compliance ($59,575) KPIs, however, do not appear unreasonable in light of the health and safety benefits for employees and customers. Regarding the Energy Efficiency KPI, the Commission is persuaded that the long term benefits attributable to this KPI outweigh the $628,865 expense. Collectively, these "allowed" KPIs amount to $3,229,635 for all three operating utilities.

The remaining incentive compensation expenses that AIU seeks to recover amount to $4,332,686 associated with AMS' KPIs. After reviewing the voluminous record on this issue, it is not entirely clear what the specific KPIs for AMS are. Even if that information was available, the record lacks evidence as to how the $4,332,686 is broken down among the AMS KPIs. In the absence of useful information, the Commission is compelled to accept Staff's proposed adjustment regarding the AMS KPIs. Accordingly, the Commission finds that AIU may recover the $2,995,008 in incentive compensation expenses to which no one objects and the Commission finds reasonable and the $3,229,635 which the Commission has allowed over Staff's objection. This total of $6,224,643 represents approximately 51% of the amount requested by AIU, which the Commission notes is similar to the 50% allowed in AIU's last rate case. The Commission adds that nothing in this conclusion prevents AIU from offering incentive compensation plans; AIU is simply limited in its means of recovering the expenses for such.

Also of some concern to the Commission is the record's silence on why AIU's KPIs for 2008 and 2009 are different. Nor is it clear whether and to what extent KPIs may change in the future. It would behoove AIU to settle on a set of KPIs. If alterations are necessary, an explanation should appear in AIU's testimony in future rate cases.

The Commission also questions whether AIU fully appreciates that cost management/cost control efforts benefit shareholders as well as ratepayers, as Staff suggests. KPIs which appear to benefit ratepayers by reducing costs should not necessarily be allocated entirely to ratepayers for cost recovery purposes. AIU should consider the benefits that accrue to shareholders as well under cost management/cost control measures and is expected to reflect such consideration in future rate cases.

3. Pension, OPEB, and Major Medical Expenses

a. AIU Position

AIU‘s cost of service includes pension and OPEB expenses for current and former employees. AIU claims that the financial meltdown that occurred late in 2008 caused a significant decline in plan assets used to pay benefits, resulting in an increase in pension and OPEB expense beginning in 2009. Because actual 2008 pension and OPEB expense is not representative of either actual 2009 expense or expense that will be incurred in 2010 when new rates go into effect, AIU proposes to establish test year expense based on twelve months of actual expense for the period October 2008 through September 2009. AIU asserts that the use of actual expense amounts for the year following the test year is consistent with the treatment of pension and benefits expense in AIU‘s two most recent rate proceedings.

Staff argues that pension and benefits expense for the 12-month period ending September 30, 2009 is not known and measurable, and therefore proposes to establish pension and benefits expense based on calendar year 2008 data. According to AIU, Staff takes this position notwithstanding Staff witness Ebrey‘s acknowledgement that the value of securities used to fund AIU‘s pension and OPEB plans decreased significantly in 2008, resulting in an increased level of pension and benefits expense that began to be recognized in 2009. According to AIU, Staff states that the entries for pension costs for the months during 2009 are based on the reports prepared by Towers Perrin in January 2009 and July 2009. Staff says the actual pension cost for the year ending December 31, 2009 and the Employer Contribution for the Plan Year beginning January 1, 2009 will not be determined until the year end 2009 actuarial study has been completed, after the record in these proceedings will be marked heard and taken. AIU says Staff's adjustment for pension and benefits expense would reduce AIU's aggregate revenue requirement by almost $16 million.

AIU believes Staff's proposed adjustment reflects a misunderstanding of the accounting for pension and benefits expense and should be rejected. AIU states that the calculation of pension and OPEB expense is determined by Accounting Standards Certifications 715-30 and 715-60 ("ASC 715"), formerly FAS 87 and 106, respectively. According to AIU, under ASC 715, employee census data, plan asset values, and financial market conditions as of the last day of the prior year are used to develop pension and OPEB expense for the following year. AIU claims that 2009 pension and OPEB expense is based on a valuation using data as of December 31, 2008. AIU says the year-end financial data for the prior year is used to prepare quarterly reports that AIU uses to record pension and OPEB expense for the following year. AIU states that the first quarter report is based on estimated employee census data while actual census data is used for the second quarter report. AIU says that third and fourth quarter reports are also based entirely on actual data.

AIU contends that when the valuation report is completed for the second quarter of each year, the pension expense for that year is already known and measurable. AIU asserts that expense levels will not vary from the second quarter valuation report to the final valuation report unless there is a —significant event," as determined by ASC 715, such as a material workforce reduction or acceleration of benefits. According to AIU, the last —significant event" that occurred for AIU was the 2004 acquisition of IP. AIU says no significant events have occurred since, nor are any expected.

Considering how pension and OPEB expense are accounted for under ASC 715, AIU insists that Staff's claim that these expenses will not be determined until the year end 2009 actuarial study has been completed is not correct. AIU argues that the July 1, 2009 Towers Perrin report (Ameren Ex. 38.2) provides a known and measurable level of pension and OPEB expense that has been incurred through September 2009. AIU reiterates that there were no —significant events" in the third quarter of 2009, and asserts that even if a significant event occurred in the fourth quarter, such an event would not affect pension and OPEB expense for prior quarters.

In AIU's view, the July 2009 valuation report provides reliable, probative evidence of pension and OPEB expense booked in 2009 through September. AIU states that the amounts provided in this report are the same amounts recorded on the books of AIU. AIU suggests that in determining the appropriateness of any pro forma adjustment, all the evidence should be considered, including recent actual data where available. AIU claims that Staff assumes that the amounts booked through September 30, 2009 could change when the final actuarial report is issued. AIU insists that no reason, no rationale, and no record evidence support this assumption. AIU states that the amounts booked through September 30, 2009 will not change when the final report is issued in early 2010. AIU also indicates that expenses through September 2009 have already been incurred and recorded on the books of AIU and will not change. AIU also says that pension expense for the 12-month period ending in September 2009 significantly exceeds 2008 expenses, by $16 million. If AIU's rates do not reflect this increased level of expense, AIU insists it will fail to recover its authorized ROR.

AIU claims that the amounts reflected in its books to support the pro forma adjustment are based on the July report, not the January report. More importantly, in AIU's view, the Towers Perrin July 2009 report reflects known and measurable data for pension and OPEB expense as required by the relevant accounting standard. AIU maintains that as there were no significant events in 2009, this report contains final pension and OPEB expense amounts for AIU through September 30, 2009. AIU argues that because the July 2009 report reflects known and measurable data, the pro forma adjustment based on this data is equally known and measurable. AIU says it bears repeating that the pro forma adjustment is based on amounts actually recorded in AIU's books, not budgeted amounts as initially proposed in Direct Testimony.

Staff argues that the changes to AIU's headcount as a result of workforce reductions occurring in the fourth quarter of 2009 are not reflected in the amounts recorded on AIU's books as of September 30, 2009. AIU states that this argument fails because the fourth quarter workforce reductions and other events occurring after the fourth quarter can not impact the calculation of pension and OPEB expense through September 30, 2009. AIU also asserts that such events will not cause the fourth quarter 2009 expense accruals to vary from those provided in the July 2009 valuation report by Towers Perin. According to AIU, neither the workforce reductions nor the market meltdown of 2008 constituted a significant event, as defined by the relevant accounting standard, which could impact expense accruals for the fourth quarter of 2009.

AIU disputes Staff's claim that AIU has selectively picked significant expense items and proposes to update them to the most current amounts recorded on the utility books. AIU says its proposal to establish pension and OPEB expense based on the 12 months ending September 30, 2009 is well within the period for pro forma adjustments allowed by Section 287.40 or Part 287. AIU indicates that Staff itself has proposed a number of adjustments based on 2009 actual data. AIU claims that in its last two rate proceedings, pension and OPEB expense was based on data for the year following the test year. AIU believes its proposal does not violate test year principles.

AIU argues that Staff's real reluctance to adopt AIU's proposal seems to stem from the fact that AIU does not propose to establish pension and OPEB expense based on the ―final" 2009 actuarial report that will be issued by February 1, 2010. AIU says that Staff distinguishes AIU's proposed treatment of this expense in this case from the treatment afforded AIU in its last two rate cases, where pension and OPEB expense were established based on expense levels for the year following the test year, because the timing of the rate cases allowed for consideration of the final actuarial reports in those proceedings. Regardless of whether the actuarial reports were considered, AIU claims they were not part of the record in the prior proceedings.

AIU says Staff also seems concerned with calculating pension and OPEB expense based on data that does not match a calendar year. AIU asserts that it is unaware of any rule that requires pension and OPEB expense to be determined based on calendar year data. AIU asserts that normalization calculations and pro forma adjustments for various types of expenses are often determined based on periods that do not match a calendar year. AIU claims there is no reason to treat pension and OPEB expense any differently.

AIU suggests that the Commission does not have to accept at face value its representation that there will be no material difference between the July 2009 report and the final actuarial report. In testimony and in its Initial Brief, AIU offered to submit the final actuarial report for 2009, in order to confirm the accuracy of the July 2009 report. AIU says Staff rejects this idea, claiming it is unaware of any other proceeding where the record is purposefully held open for the entry of documentation supporting a pro forma adjustment until well after the hearings in the matter are concluded. AIU cites Docket No. 07-0566, where AIU says Staff entered a stipulation with ComEd requiring ComEd to file a post-hearing reconciliation of actual versus pro forma capital additions. AIU further suggests the Commission would be within its authority, under Section 200.875 of Part 200, to also accept post-hearing evidence confirming the accuracy of AIU's pension and OPEB expense.

b. Staff Position

Staff has proposed an adjustment limiting pension and OPEB costs to the December 2008 level, which Staff says is known and measurable. Staff indicates that AIU initially proposed to set pension and OPEB expense at the budgeted 2010 level; however, in Surrebuttal Testimony, AIU revised its proposal to set the test year expense to the level for the 12 months ending September 30, 2009.

Staff proposes to remove the pension and OPEB adjustment proposed by AIU since Staff believes the amounts proposed by AIU are not known and measurable. Staff states that the current 2010 pension budget is based on the updated actuarial report provided to AIU in July 2009. Staff indicates that AIU proposed updates to its initial position, which was based on a January 2009 actuarial report, in Supplemental Direct Testimony filed in July 2009. The fact that the budgeted amounts changed in the six months from January to July confirms Staff's position that the amounts do not meet the Commission's known and measurable standard. Staff argues that the 2010 benefits budget is based on a variety of assumptions, expectations, and trend analyses, none of which meet the Commission's known and measurable criteria.

According to Staff, the actual amounts recorded in AIU's books for pension expense at September 30, 2009 are not known and measurable because those estimated amounts are based on the reports prepared by Towers Perrin in January 2009 and July 2009. It is Staff's position that the actual pension cost for the year ending December 31, 2009 and the employer contribution for the plan year beginning January 1, 2009 will not be determined until the year end 2009 actuarial study has been completed, after the record in these proceedings will be marked heard and taken. In addition, Staff contends that the changes to AIU headcount as a result of the workforce reduction occurring in the fourth quarter of 2009 are not reflected in the amounts recorded on AIU's books as of September 30, 2009. Staff insists that AIU's alternate proposal to include pension costs through September 2009 does not reflect a known and measurable change and must be rejected.

Staff disputes AIU's suggestion that Staff acknowledges that the amounts provided on the July 2009 valuation report and the amounts recorded on the books of AIU at September 2009 are the ―same amounts.” Staff asserts that the amounts recorded on the books at September 2009 are <u>based on</u> the amounts in the July 2009 report. Staff says since the July report represents a 12-month period and the amounts on the books at September 2009 are for a 9-month period, the amounts would not reasonably be the same.

Staff also disputes AIU's claim that no reason, rationale, or record evidence is cited to support the assumption that the amounts booked through September 30, 2009 could change. Staff states that during cross examination, Ms. Ebrey stated that the workforce reduction that occurred in November and December 2009 would, in her opinion, meet the definition of a significant event that would in turn impact the expense for 2009, yet would not be reflected in the September 30, 2009 balance per AIU books.

Staff says that during the evidentiary hearings, AIU attempted to gain Staff's agreement that the record in these proceedings could be held open until the final actuarial study for 2009 was prepared. Staff is unaware of any other proceeding where the record is purposely held open for the entry of documentation supporting a pro forma adjustment until well after the hearings on the matter have concluded. In Staff's view, such a tactic is clearly contrary to the known and measurable criteria which Section 287.40 requires to be ―individually identified and supported in the direct testimony of the utility” when the case is filed, not after the evidentiary hearing.

Staff states that both it and AIU reflected reductions related to the production retiree expense that is included in the pension and OPEB balances. According to Staff, the theory behind the two proposals is the same. Staff says that it and AIU agree that the costs associated with production retiree pensions and OPEBs should be removed from the revenue requirement. According to Staff, the only difference is the timeframe for the costs that are removed. Staff contends that the decision on this issue is derivative of the Commission conclusion on the proper period for measurement of pension and OPEB costs.

c. IBEW Position

IBEW agrees with AIU that the 12 months of actual expense from October 2008 through September 2009 are the proper measure of pension, OPEB, and major medical expenses. IBEW claims such expenses are known and measurable, as the expenses have already been incurred and recorded by AIU. IBEW claims actuarial studies have not been required to establish actual pension and OPEB expenses in past rate cases, and even if such a report is required, it will soon be available.

d. Commission Conclusion

The Commission understands that everything else being equal, a decline in financial markets would cause an increase in pension and OPEB expense. Nevertheless, financial markets, by their very nature, fluctuate over time. Whether the declines in asset values experienced by AIU in 2008 have been fully recouped is unknown but, there is no question that these asset values are different than they were at December 31, 2008 as well as September 30, 2009. The Commission's point is that many things fluctuate after the end of the test year. Some changes benefit the utility, while others are detrimental to the utility. Presumably, AIU selected a historical test year of calendar year 2008 because this test year is beneficial to it.

In the Commission's view, Staff has raised valid concerns about whether AIU's proposed pro forma adjustment constitutes a known and measurable change. Among other concerns, the Commission notes that AIU's proposal to use the twelve months ending September 30, 2009 for measuring pension and OPEB expense was initially proposed as an alternative in AIU's Rebuttal Testimony and became its primary proposal in AIU's Surrebuttal Testimony. The Commission understands that parties' positions typically evolve throughout a contested rate case; however, Section 287.40 of Part 287 specifically requires that any proposed pro forma adjustments shall be individually identified and supported in the Direct Testimony of the utility. In this instance, the Commission finds AIU's proposed pro forma adjustment to pension and OPEB expense is not supported by the record and it is therefore rejected.

4. NESC Expenses

a. Staff Position

Staff expressed concern that AIU proposed to recover a greater amount than appropriate for correction of National Electrical Safety Code (―NESC") violations. Staff indicates that AIU is required to repair or replace distribution facilities that are in violation of the NESC, and that the AIU's circuit inspection program appears to be an effective tool to identify locations that require NESC-related repairs. Staff reports that the Commission's Order in AIU's prior rate proceeding stated in relevant part, ". . . ratepayers will not be responsible for paying the costs associated with correcting distribution facilities that were initially constructed in a manner that does not comply with the NESC." (Docket Nos. 07-0585 et al (Cons.), Order at 142)

Staff asserts that ratepayers should not bear AIU‘s estimated test year repair costs for four specific NESC-related repair categories for which AIU proposes recovery: (1) missing guy guards, (2) down guys where no insulator exists in the guy wire, (3) overhead guys where no insulator exists in the guy wire, and (4) ungrounded metal underground risers. According to Staff, for all four of these repair categories the utility left off a required part when making the initial installation, so that the installation was in violation of the NESC. Staff claims that although the cost of installing the part would have been negligible at the time of the initial installation, AIU proposes to recover from ratepayers its estimated test year costs for installing the missing parts. Staff believes AIU‘s proposal is inconsistent with the Commission‘s Order in Docket Nos. 07-0585 et al (Cons.), and would cause the utilities to recover amounts far greater than what the utility‘s costs would have been, had the utility installed the part at the time of initial construction, as it should have done.

In support of AIU‘s proposal to recover its estimated test year costs for the four specific NESC-related repairs, AIU claims it did not re-do work previously performed by the utility when making the repair, so AIU did not categorize those repairs as ―re-work” to be excluded from cost recovery. AIU uses the example of guy guards to illustrate AIU‘s method of categorizing work as either ―re-work” or ―new work,” explaining that if a guy wire does not have the required guy guard, then ratepayers would not have paid for the guy guard in the first place, so that installing the guy guard would be ―new work,” and should be eligible for cost recovery. AIU asserts that no locations with missing guy guards should be considered NESC-related re-work, and ratepayers should bear all test year costs related to installing them. Likewise, AIU reasons that ratepayers had not previously paid for missing down guy insulators, missing overhead guy insulators, and missing grounds on metal underground risers.

Staff suggests that the very fact AIU was not aware that the required parts were missing casts doubt on its knowledge of whether or not ratepayers previously paid for the missing part. Regardless of whether or not ratepayers previously paid for the installation of the missing parts, in every case, Staff maintains that utility costs for installing the missing part at the time of initial construction would have been negligible. AIU does not know its actual test year costs to install these missing parts, stating it would be difficult, if not impossible, to determine a precise breakdown of labor costs for NESC and non-NESC repairs. Staff believes recovery of estimated test year cost for installing NESC-required missing parts would be unfair to ratepayers who may have already paid for them.

Because AIU claims not to know its actual test year costs for its NESC-related repair work, Staff understands that AIU estimated its test year costs for each NESC-related repair activity by averaging the costs of jobs with work descriptions that appeared to closely match each NESC-related repair category. In Direct Testimony, AIU estimates that the amount of its expenditures for NESC-related repairs that should be eligible for recovery is $4,500,000, and the amount of its expenditures for NESC-related repairs that should be excluded from recovery is $8,600,000.

AIU asserts that installing a missing guy guard, insulator, or ground merely completes the construction of the infrastructure in compliance with the NESC. AIU uses an example of installing smoke detectors in two homes, one with smoke detectors installed incorrectly, and one with no smoke detectors installed at all, in order to illustrate AIU's position on cost recovery for NESC-related repairs. AIU states that in one home there is time and cost required to correct the improperly installed smoke detectors, and in the other there was never an initial amount of time and cost spent installing the detectors.

Staff does not find AIU's rationalization for charging ratepayers the utility's estimated test year cost to install missing parts to be reasonable, and believes that the requirements for the missing parts have existed for several decades in Illinois, so that the utility should have known of the requirement at the time of initial construction, and initially completed the installation correctly. Staff says AIU agrees that the missing parts should have been installed at the time of initial construction. In Staff's view, AIU's smoke detector analogy does not accurately describe the situation associated with AIU's NESC-related repairs. The situation, Staff contends, is not that AIU did not install down guys, overhead guys, or metal underground risers; instead, the situation is that AIU (or the predecessor company) left required parts off of these facilities when it installed them. Staff claims this is more similar to installing a smoke detector but leaving the sensor or battery out of it.

Staff states that the repair costs associated with individual locations for each of the four NESC-related repair activities identified are not large, but the large number of locations where AIU performed each repair activity during the test year causes the aggregate costs to warrant the Commission's careful consideration. In every case, Staff says the cost for the utility to install the missing part when the facility was initially constructed and that the NESC required would have been negligible, but AIU's test year costs are not negligible. Staff indicates that AIU seeks to charge ratepayers $235.52 per repair location to install insulators in down guys at more than 5,200 locations, even though AIU's average material cost for the insulators has been approximately $16, and its incremental labor cost to install the insulator would have been negligible at the time of initial construction. Staff indicates that AIU proposes to charge ratepayers $125 per installation for installing 6,399 guy guards during the test year, even though each guy guard costs slightly more than $2, and would have added no additional labor costs to the initial installation. Staff witness Rockrohr explains why actual installation costs would have been negligible. (See Staff Ex. 24.0R at 9-10)

Staff says that in its Surrebuttal Testimony, AIU suggests that even if the Commission were to accept Staff's position regarding NESC-related repairs, the proposed disallowance for guy guards should be modified. AIU believes 90% of the 6,399 missing guy guards that AIU installed during the test year had been removed after the AIU installed them. Staff's opinion has not changed with regard to guy guards. Staff continues to believe that the percentage of guy guards removed after they are initially installed is very small, and asserts that no more than 10% of the 6,399 guy guards that AIU installed during the test year were replacements for guy guards that had been previously installed and removed.

AIU further recommends that, should the Commission choose to allow AIU to recover only material costs for the guy guards, insulators, and grounds, then test year costs should be used, rather than average material costs. According to Staff, however, AIU could not demonstrate whether or not ratepayers have already paid for the missing parts at locations with NESC violations, and does not recommend that the Commission allow cost recovery for these materials. Should the Commission choose to allow recovery of the utility‘s material costs associated with these NESC-related repairs, Staff proposes the use of the average material cost listed in Staff Ex. 24.0 (Rev.) Attachment E, which Staff believes more accurately reflects the material costs at the time that the material should have been installed.

Finally, with regard to AIU‘s obligation to correct NESC violations that it discovers, Staff wishes to make the Commission aware of AIU‘s lengthening timelines. Staff states that in its NESC Corrective Action Plan, dated October 31, 2007, AIU agreed to identify and correct all existing NESC violations on the three electric utilities‘ distribution circuits by the end of 2011. After it made its rate case filing, AIU notified Staff that it was extending the time to correct its existing NESC violations until the end of 2013. Staff reports that in its Surrebuttal Testimony, AIU indicates that it might extend its NESC violation correction timelines still further.

Staff insists that AIU should correct its NESC violations as quickly as it can by using a systematic and thorough inspection process. Staff is concerned that after already extending its previously agreed upon timelines in July of 2009, in its surrebuttal testimony, AIU threatened to delay completion of its corrections of NESC violations still further if the Commission does not grant the cost recovery it seeks. Staff finds this veiled extortion by AIU to be troubling. Staff argues that AIU is already in violation of NESC and Commission rules as a result of its own construction practices at the time of initial construction, and AIU admitted that it should have known the missing parts were required at the time of initial construction. Staff urges the Commission to order AIU to complete its corrective actions for existing NESC violations by no later than the end of 2013.

According to Staff, IBEW‘s concern appears to be that reduced recovery for NESC-related repairs could lead to AIU reducing expenditures for other maintenance projects, which could have a negative impact on service reliability, and could result in a loss of jobs. Staff is unsure whether or not IBEW‘s concern is valid. Though Staff does not believe it would be a good idea to do so, Staff says AIU could decide to reduce its maintenance expenditures for any number of reasons, independent of the Commission‘s decision regarding this NESC issue. While potential job loss might be a legitimate concern, Staff does not believe the Commission should base its decision upon this concern.

b. AIU Position

AIU seeks recovery of a portion of its NESC-related repair costs, specifically, the costs for —new work" repairs to bring facilities into compliance with NESC without rebuilding existing infrastructure or duplicating work previously performed. With respect to these NESC-related —new work" repairs, Staff contends that ratepayers should not pay now to install parts that should have been installed when the infrastructure was initially constructed. AIU claims it is not seeking to recover the costs of fixing incorrectly installed or constructed infrastructure. Rather, AIU seeks recovery of the costs of installing infrastructure components that were missing entirely. AIU contends that adding on missing parts to existing infrastructure does not charge ratepayers a second time to correct improperly constructed facilities. AIU believes it is fair and reasonable for AIU to recover NESC-related —new work" costs from ratepayers in instances where the repairs do not require AIU to reconstruct existing infrastructure or redo work previously done improperly.

AIU argues that recovery of NESC-related expenditures does not turn on whether those expenditures were necessary and prudent. AIU says no party to this proceeding has suggested that the NESC-related repairs at issue should not have been performed or were not performed at a reasonable cost. AIU claims it has pursued vigorously the enhancement of its acquired electric infrastructure to correct problems that existed prior to its ownership and to ensure safe and reliable distribution systems since its ownership. Specifically, AIU says it has implemented a system-wide circuit inspection program to, among other things, find and resolve NESC-related violations on its circuits. AIU indicates it has submitted to Staff an NESC Corrective Action Plan that sets forth a commitment and timeframe for inspecting all of its Illinois distribution circuits and correcting all existing NESC violations.

AIU understands Staff to be interpreting the Commission's conclusion in its last rate proceeding Order to mean that if ratepayers already paid the utility for the installation, AIU should not charge ratepayers a second time to properly install the infrastructure. In AIU's view, Staff's position fails because AIU is not asking ratepayers to pay twice to construct distribution infrastructure in compliance with the NESC. In the 2008 test year, AIU says it performed over 52,000 reliability and corrective repairs on its circuits. AIU indicates that out of the 25 types of repairs performed, AIU identified 11 categories of repairs that concerned NESC issues. AIU claims it spent a total of approximately $13.1 million for these 11 categories of NESC-related repairs. AIU says it does not seek recovery of all, or even a majority, of these repair costs. Cognizant of the Commission's concern that ratepayers not pay twice to properly construct infrastructure in compliance with the NESC, AIU says it is not seeking to recover —re-work" costs. For example, AIU indicates it does not ask for recovery of costs to correct improperly placed insulators on guy wires. Similarly, AIU indicates it does not seek recovery of costs to correct inadequate line clearance where lines were installed too close to the ground, another wire, or structure. AIU does not seek recovery of costs to replace low brackets on underground risers. Of the $13.1 million in NESC-related repair costs, AIU claims it excluded approximately $8.7 million spent on ―re-work” repairs from its request for cost recovery in this proceeding.

Having excluded ―re-work” repair costs, AIU indicates that the ―new work” costs for which it seeks recovery in this proceeding total approximately $4.4 million. Staff, however, contends that a large portion of AIU‘s NESC-related ―new work” costs are really ―re-work” costs that should be disallowed. Staff recommends that 90% of AIU‘s test year costs to place guy guards on existing guy wires, 100% of its costs to install insulators on existing guy wires, and 100% of its costs to ground existing underground risers be considered ―re-work.”

AIU argues that the installation of missing guy guards, insulators, and grounds does not require AIU to reconstruct improperly constructed infrastructure. AIU contends that unlike the ―re-work” repairs necessary to correct inadequate wire clearance, remove low brackets from risers or replace improperly placed insulators, the installation repair work simply requires AIU to add missing parts to existing infrastructure. The cost of installation, AIU asserts, is essentially the cost required to complete construction of the infrastructure in compliance with the NESC. Because the parts were never installed and the work was never performed, AIU claims ratepayers were never charged for the costs associated with the installation. AIU believes that approving recovery of such NESC-related ―new work” installation costs is consistent with the Commission‘s Order in AIU‘s prior rate case because ratepayers are not being charged a second time.

Staff also argues that the costs to install the parts at the time the infrastructure was initially constructed would have been negligible in comparison to the test year costs. AIU claims the added cost to install these missing parts, however, whether incurred during the test year or at the time of initial construction of infrastructure, is identifiable, quantifiable and material. In preparing its case, AIU says it calculated a reasonable average cost for each ―new work” and ―re-work” repair, relying on specific project data from actual work orders and job requests from the 2008 test year. In preparing its rebuttal case, AIU says it relied on the same cost data and actual field experience to derive a reasonable average labor cost for a specific step in the process of installing insulators in existing guy wires that could be considered ―re-work.” AIU also indicates it explained the basis and methodology for its cost calculations and also calculated the average man-hours to install these parts. AIU contends that this analysis demonstrates that the installation of these parts at the initial time of construction would have resulted in additional billed time for labor. Because the work was not performed, AIU asserts that ratepayers did not pay this additional labor cost. In addition, AIU claims the parts themselves would have remained in inventory for future use. AIU says ratepayers would not have paid for these parts until they were used.

AIU claims that Staff has not presented sufficient analysis or data to demonstrate that the labor cost to install these missing parts at the time of initial construction would have been negligible. According to AIU, Staff has not demonstrated that the ratepayers would have somehow previously paid for materials never before used. AIU says its test year costs, which again were calculated using cost data for the individual repairs are not negligible. If AIU is incurring incremental costs during the test year to install these missing parts, AIU wonders how it could not have incurred incremental costs if the parts had been installed at the time of initial construction. AIU argues that the only basis for Staff‗s opinions that these costs would have been negligible or non-existent is speculation.

Finally, AIU says it is not attempting to extort the Commission, as Staff alleges. AIU states that it is committed to inspecting and correcting all existing NESC violations as quickly as possible, but that it takes money do so. AIU claims it is asking to not be placed in the untenable position of having to perform this work without the necessary funds. AIU asserts that it recognizes that the Commission has held that much of the funding necessary for this work should be borne by shareholders. AIU believes its proposal to recover only $4.4 million in costs for NESC-related ―new work" repairs fairly and reasonably allocates to ratepayers only those costs for labor and materials previously not paid.

c. IBEW Position

IBEW says AIU should be allowed to recover its expenses for ―new work" performed to comply with the NESC. IBEW states that AIU is not seeking to recover the costs of fixing incorrectly installed or constructed infrastructure, but rather the costs of installing infrastructure components which are missing entirely. According to IBEW, the man-hours expended on components installed are the same as those required to complete the work in the first instance, but ratepayers have not yet paid for the repairs. IBEW claims there is minimal expense for crews to return to sites to conduct the ―new work," because it was scheduled to coincide with other necessary repairs at the same site.

IBEW also claims an inadequate recovery would impact both customer service and the Illinois workforce. If not allowed to recover the costs of NESC related expenses, IBEW states that AIU may need to reduce expenditures on other maintenance projects, including reductions in the staff and contractors responsible for such maintenance. IBEW suggests this could have a negative impact on service reliability due to less preventative maintenance. In addition, IBEW says a reduction in repair staff and contractors would be a loss of jobs at a time when the Illinois workforce is already challenged.

d. AG/CUB Position

In its Reply Brief, AG/CUB voices support for Staff's proposed adjustment. In AG/CUB's view, ratepayers should not be liable for work that was done improperly or not done at all in violation of the NESC, regardless of the entity owning the utility at the time.

e. Commission Conclusion

AIU proposes to include in operating expenses certain costs associated with installing NESC required facilities that it considers to be new work. Staff objects to recovery of four specific types of costs (1) replacing missing guy guards, (2) correcting down guys where no insulator exists in the guy wire, (3) correcting overhead guys where no insulator exists in the guy wire, and (4) installing grounds on ungrounded metal underground risers. Staff argues that the incremental labor costs to install these facilities would have been negligible if the work had been done correctly at the time of initial construction. AIU claims the incremental labor is the same regardless of when the facilities are installed.

In discussing alternatives to its primary position, AIU asserts that 90% of the missing guy guards installed during the test year were replacements after the original guy guard had been installed. In contrast, Staff argues that no more than 10% of the missing guy guards installed during the test year were replacements after the original guy guard had been installed. AIU also recommends, if the Commission decides to allow AIU to recover only material costs, test year costs rather than average material costs should be utilized. In contrast, while Staff does not believe material costs should be recovered from ratepayers, Staff recommends the use of average material costs rather than test year costs, should the Commission decide to allow recovery.

The Commission's review of the record suggests that AIU has overstated the cost of installing the facilities in question. For example, the Commission can not believe that the average incremental cost of installing a $2.19 guy guard, at the time the guy is installed is over $120. This calls into question all of AIU's estimates of installation cost. The Commission believes that Staff witness Rockrohr's position that the cost of installing the four facilities at issue here would have been negligible is much closer to the truth. Similarly, the Commission is convinced that Mr. Rockrohr's estimate of the percentage of guy guards that were replacements after an original guy guard had been installed is superior to AIU's estimate.

The Commission believes that it is reasonable for AIU to be allowed to recover from its customers the average cost of materials associated with the four facilities at issue here. The Commission also believes that AIU's suggestion that test year material costs should be used would overstate what ratepayers would have been charged if the projects had been completed correctly at the time of the original construction. As a result, the Commission finds Staff's material costs to be superior to AIU's. The Commission concludes that for NESC work, AmerenCILCO should be allowed to reflect in revenue requirement an amount of $13,097, AmerenCIPS should be allowed to include in revenue requirement an amount of $28,791, and AmerenIP should be allowed to include in revenue requirement an amount of $57,730. The values are shown on Staff Ex. 24.0R, Attachment E.

Finally, the Commission is greatly concerned about AIU's commitment to providing safe, reliable electric service. According to Staff, in its NESC Corrective

Action Plan, AIU agreed to identify and correct all existing NESC violations on the utilities' distribution circuits by the end of 2011. Thereafter, AIU notified Staff that it was extending the time to correct its existing NESC violations until the end of 2013. Staff reports that in its Surrebuttal Testimony, AIU indicates that it might extend its NESC violation correction timelines still further. AIU's disregard for this Commission's remonstrations regarding correction of safety violations that resulted from AIU's failure to follow NESC codes is, simply put, of significant concern to this Commission. Combined with AIU's request to recover these costs after our decision on this matter in Docket Nos. 07-0585 et al (Cons.), where we stated clearly that, "ratepayers will not be responsible for paying the costs associated with correcting distribution facilities that were initially constructed in a manner that does not comply with the NESC." (Docket Nos. 07-0585 et al (Cons.), Order at 142), raise significant concerns about AIU's management of this issue. In addition, AIU's threat that it might reduce tree trimming activities in the event its proposed expenditure recoveries are not approved, raises significant reservations that AIU may not be providing safe and reliable service. The record indicates that AIU is expending resources on activities such as economic development and the promotion of renewable electric generation. While the Commission does not necessarily want to discourage such activities, AIU needs to reevaluate its priorities. The Commission requires that AIU make the activities that are essential to the provision of safe, reliable utility service the highest priority in serving their customers.

As for Staff's recommendation that the Commission order AIU to complete its corrective actions for existing NESC violations by no later than the end of 2013, the Commission believes it is necessary to require AIU to complete all work by the end of 2013. The Commission is aware of the severity of NESC violations and requires AIU to correct these violations by the end of calendar year 2013, at the latest, in order to comply with this Order. Any further AIU requests for deviation from this schedule may only be granted by formally petitioning the Commission.

5. Amortization of IP Merger Expense

a. AIU Position

AIU indicates that in Docket No. 04-0294, the Commission approved a reorganization that resulted in the merger of IP with Ameren, creating the entity now known as AmerenIP. As part of this reorganization, AIU states that the Commission authorized AmerenIP to record up to $67 million of merger-related costs as a regulatory asset to be amortized between 2007 and 2010. AIU says AmerenIP will not fully recover the authorized $67 million by December 2010. According to AIU, test year amortization is $16.75 million, which AIU says represents the balance of the authorized $67 million regulatory asset not yet recovered.

AIU reports that Staff, AG/CUB, and IIEC object to including the full test year amortization in rates. Staff argues that any recovery after 2010 is prohibited by the Order in Docket No. 04-0294. AG/CUB and IIEC argue that because the remaining amortization will be $11.167 million when new rates go into effect in May 2010, AmerenIP will over recover the regulatory asset if new rates are in effect for more than one year. AIU indicates that Staff and IIEC propose to amortize the balance of the regulatory asset over two years, while AG/CUB proposes a three year amortization.

To reduce the number of contested issues, AIU indicates it agrees with the Staff and IIEC approach of amortizing the remaining balance of the regulatory asset, calculated as of May 2010, over two years. AIU says this adjustment is reflected in AmerenIP's statement of operating income. If the Commission adopts this proposal, AIU requests that the Commission make an express finding that AIU will be permitted to adjust its regulatory asset amortization at May 1, 2010, as recorded in the books of AmerenIP, to match the same two year period established for rates.

AIU states that AG/CUB agrees in principle with the adjustment but maintains its preference for a three-year amortization period. AIU says AG/CUB does not explain why a three-year amortization period is more appropriate than the two year amortization that everyone else agrees to. AIU believes AG/CUB's alternative amortization period should be rejected.

b. AG/CUB Position

In the present case, AmerenIP is proposing to recognize annual amortization expense of $16,750,000 per year, with $11,849,000 included in pro forma electric expenses and $4,901,000 included in pro forma gas expenses. AG/CUB asserts that as of May 2010, when the rates established in this case will go into effect, the costs remaining to be recovered will be only $11,167,000. With annual amortization of $16,750,000, AG/CUB claims these $11.1 million in costs will be fully recovered less than one year after the rates in this case go into effect. According to AG/CUB, if the rates are in effect for more than one year, as it is reasonable to assume, then the rates being charged by AmerenIP after that time will continue to recover an amortization expense that no longer exists.

To avoid over-recovery of the AmerenIP regulatory asset, AG/CUB believes the remaining balance as of May 2010 should be amortized over the expected period that the rates in this case will be in effect, and the pro forma amortization expense should be adjusted accordingly. AG/CUB states that amortization of this balance over three years results in annual amortization of $3,722,000, or $2,633,000 for AmerenIP electric operations and $1,089,000 for AmerenIP gas operations. AG/CUB indicates that these amounts are less by $9,216,000 and $3,812,000, respectively, than the amortization expenses included in pro forma expenses by AmerenIP.

c. Staff Position

Staff urges the Commission to accept its proposed adjustment to the amortization of the AmerenIP regulatory asset which limits the recovery to the amount allowed by the Commission in Docket No. 04-0294. Staff believes that the evidence supports Staff‘s adjustment which spreads the remaining 8-months amount to be recovered over the two year amortization period consistent with the proposed period for rate case expense. Staff does not take issue with AIU adjusting its regulatory asset amortization, as recorded on the books of AmerenIP, to match the amount and two-year period proposed by Staff‘s adjustment.

d. IIEC Position

IIEC recommends amortizing over two years the level of merger expense which will still need to be collected when new rates take effect in this case. For purposes of this adjustment, IIEC assumed that rates in this case will become effective May 1, 2010. IIEC says this would mean that eight months of the annual amortization expense will still need to be collected in rates. IIEC is proposing that the eight-month total of unamortized expenses of $11.2 million be amortized over the subsequent two years. IIEC asserts that this two year period is roughly consistent with the interval between AIU‘s last rate case and this one, and is consistent with AIU‘s proposed period for amortizing rate case expense in this proceeding.

If IIEC‘s adjustment to the merger expense amortization is accepted and AmerenIP does not file for another rate increase within two years, at the end of the two year period, IIEC says it will begin to over-collect only $5.6 million of fully amortized merger-related expense on an annual basis. IIEC asserts that this $5.6 million dollar recovery must be compared to the $16,750,000, which AmerenIP would otherwise over-collect on an annual basis beginning January 1, 2011 in the absence of IIEC‘s adjustment.

In the alternative, if the Commission does not want to change the current amortization expense for the AmerenIP merger costs, then IIEC urges the Commission to limit many, if not all, of the requests by AmerenIP to update its case through pro forma adjustments through May 2010. Specifically, IIEC believes the Commission should limit the increase in AmerenIP‘s cost of service through May 2010 to only recognize those costs which are in excess of the over-collections above.

e. Commission Conclusion

AIU, Staff, and IIEC all agree that AIU should be authorized to amortize the remaining balance of the regulatory asset, calculated as of May 2010, over two years. AG/CUB recommends amortizing the remaining balance over three years. The Commission believes that an amortization period of two years is appropriate with regard to the regulatory asset at issue here. This period is consistent with the period over which AIU proposes to amortize rate case expense and is consistent with the time period between AIU's last rate case and this proceeding. AG/CUB's proposed three year amortization period has not been adequately supported and it is therefore rejected. The Commission adopts a two year amortization period for the regulatory asset and AIU is hereby permitted to adjust its regulatory asset amortization at May 1, 2010, as recorded on the books of AmerenIP, to match the two year period established for rates.

6. Economic Development Expenses

a. AIU Position

AIU seeks to recover approximately $600,000 of labor and labor-related expenses incurred by the Ameren Economic Development Department ("ED Department") (and accounted for in Account 912) in AIU's approved operating expenses. AIU states that the ED Department, as part of AMS, provides economic development services to AIU to assist Illinois service area communities in attracting new business and investment, which supports the economic viability and sustainability of service area community economies in terms of population growth and maintenance, housing, new investment, and improved tax base. For AIU customers' communities, AIU says the ED Department provides technical services and programs to help enhance the local/regional economic development capacity, support community planning, and successfully prepare those communities to compete for new business investment and retention. For business development, AIU says the ED Department partners with local/regional/state governmental and non-governmental development organizations to attract new business growth and investment by engaging in business outreach activities regarding business location assistance services available via AIU. According to AIU, the ED Department is also the point-of-contact for new and expanding business inquiries and offers Illinois communities programs to support canvassing of business for retention and expansion opportunities to utilize existing infrastructure.

AIU contends that the services provided by the ED Department benefit AIU's ratepayers across all customer classifications in the communities and businesses with whom it works. AIU asserts that its business and community development services provide economies of scale to programs and activities that would otherwise not materialize. According to AIU, the ED Department's efforts to add new customers to AIU's existing delivery infrastructure system have the added benefit of spreading fixed operating costs across a broader customer base, which AIU says ultimately benefits all ratepayers. In addition, AIU indicates that the ED Department works with AIU's customers and customers' communities to avoid plant closure, job loss, and community disinvestment. AIU says the ED Department also supports existing customers to ensure continued and efficient use of existing delivery infrastructure and works to avoid any disruption to existing service when connecting new industrial or commercial customers.

As an example of the tangible results of the ED Department's efforts, AIU states that in 2008, the ED Department helped support the location/expansion of new business, which AIU says resulted in the projected creation of 546 direct new jobs throughout its Illinois service territory, an additional 855 projected new indirect jobs resulting from project multiplier effects, and approximately $222 million in new project investment in Illinois. With each location/expansion, AIU says the ED Department coordinated development activities on behalf of AIU until the electric meter was properly installed and the prospect was a customer of record for AIU. According to AIU, no party has disputed either the essential services provided by the ED Department during these projects or the tangible benefits enjoyed by AIU‘s customers as a result.

AIU believes that Staff‘s reliance on Section 9-225 of the Act is misplaced. AIU argues that even if Section 9-225 applied to this issue, AIU has established that its economic development labor and labor-related expenses benefit customers and are incurred in the best interest of those customers. According to AIU, Section 9-225 only restricts recovery, in certain circumstances, of —Advertising" expenses. AIU states that —Advertising" is explicitly defined as —the commercial use, by an electric, gas, water, or sewer utility, of any media, including newspapers, printed matter, radio and television, in order to transmit a message to a substantial number of members of the public or to such utility‘s consumers." AIU contends that, —Advertising," as defined by the statute, is not the sort of expense for which it seeks recovery. AIU claims it has taken a conservative approach by including only labor and labor-related costs for the ED Department in the adjustment to Account 912 and that no other charges have been included.

Even if the Commission were inclined to apply Section 9-225, AIU argues that its economic development labor and labor-related expenses would still be recoverable. AIU says that pursuant to Section 9-225(b), recovery of —promotional, institutional, or goodwill" advertising expenses is appropriate if —the Commission finds the advertising to be in the best interest of the Consumer." AIU states that while it believes that labor and labor-related expenses are not —advertising," even if they were so considered, the evidence establishes that the ED Department provides services that ultimately benefit AIU‘s customers. AIU claims Staff has presented no evidence to the contrary, and acknowledged that AIU‘s customers could enjoy significant benefits from the types of results obtained through the labor of the ED Department.

AIU complains that Staff focuses solely on whether AIU‘s investors also benefit from the ED Department‘s work. AIU contends that the issue of AIU‘s investor benefits is a red herring. AIU says that Section 9-225(b) contains no mention of investors‘ interest. According to AIU, the only consideration is whether the advertising expenses incurred were —in the best interest" of AIU‘s customers. AIU says the best interests of customers and shareholders are not mutually exclusive. AIU adds that allowing recovery would be consistent with prior decisions of the Commission. (AIU RB at 72, citing Docket No. 91-0147 (1992), Order at 174-77 (allowing recovery of economic expense because —it benefits ratepayers and promotes more efficient use of its system"))

AIU states that as a secondary argument, Staff asserts that AIU‘s expenses should be removed because they are —not necessary" to —providing utility service." AIU claims Staff‘s position is inconsistent with the law and the record evidence. According to AIU, various sections of the Act contradict the premise of Staff‘s argument. AIU claims that many provisions allow recovery of expenses associated with activities that are not strictly necessary to provide utility service. For example, the Act permits recovery of —Advertising" expenses under Section 9-225 when doing so is in the best interest of customers. AIU also states that utilities can provide service without making charitable donations. Section 9-227 of the Act provides that the Commission —is prohibited from disallowing by rule, as an operating expense, any portion of a reasonable donation for public welfare or charitable purposes." AIU contends that if the Commission can not *per se* preclude recovery for donations that benefit the public welfare, Staff's position that the Commission must *per se* preclude recovery for labor and labor-related expenses that benefit the public welfare can not be correct. AIU insists that its economic development labor and labor-related expenses, while not necessarily required to —keep the lights on" are not *per se* unrecoverable.

b. Staff Position

Staff proposes adjustments to remove ED Department labor and labor-related costs from AIU's revenue requirement, as presented in Staff Ex. 18.0R, Schedule 18.06. According to Staff, Section 9-225 of the Act prohibits recovery of costs of a promotional, institutional, or goodwill nature. Staff believes that these ED Department expenses are unrecoverable under the Act.

Staff relates that its recommendation disallowing ED Department labor and labor-related costs was not initially made in its Direct Testimony. Initially, Staff proposed an adjustment to remove Demonstrating and Selling Expenses, Account 912, from each gas utility's respective revenue requirement because the transactions identified in that account were not recoverable. Staff says a similar adjustment to the AIU electric utilities was not necessary, as AIU did not claim any Account 912 costs for the electric utilities. Staff states that in Rebuttal Testimony, however, AIU offered alternative adjustments which purported to include in Account 912 only what AIU termed as —economic development labor and labor-related costs" for both the AIU electric and gas utilities.

In Rebuttal Testimony, Staff proposed an adjustment to remove the newly-defined ED Department expenses as presented in the AIU Rebuttal Testimony. Review of AIU Rebuttal Testimony and data request responses led Staff to conclude that economic development labor and labor-related costs as presented by AIU are for promotional, institutional, and goodwill purposes, which, while perhaps promoting good corporate citizenship, keeping AIU in contact with other members of the business community, and recruiting new corporate customers, are not necessary in providing utility service. Staff insists that such costs should be the responsibility of the investors, not the ratepayers. In Surrebuttal Testimony, AIU expressed its disagreement with Staff, further explaining the services provided by the ED Department.

According to Staff, there is no disagreement regarding the nature of the services provided to AIU by the ED Department. Staff indicates the disagreement relates to who should shoulder the burden of the expenses related to these services. Staff maintains that AIU shareholders should bear this burden, as the costs are non-recoverable per Section 9-225 of the Act, and benefit AIU and shareholders by increasing revenues.

In effort to justify the recoverability of ED Department costs, Staff says AIU stated in its Surrebuttal Testimony that the services benefit ratepayers by providing information to prospective new businesses, by attracting new investment to areas that have existing AIU infrastructure, by spreading fixed operating costs across a broader customer base, and by ensuring continued use of existing infrastructure. Staff counters that such ED Department services benefit shareholders as well. AIU also avers that the services provided by the ED Department are an integral component in the process of providing utility service. Staff claims that AIU would provide utility service in the absence of such programs. Staff insists that ED Department costs are not necessary in providing utility service, and such costs should be the responsibility of the investors, not the ratepayers.

AIU claims that no party has disputed either the essential services provided by the ED Department during these projects or the tangible benefits enjoyed by the AIU customers as a result. Staff finds this statement misleading. While no party has disputed the services provided or the benefits AIU claims customers enjoy, Staff specifically states in its Rebuttal Testimony that the ED Department costs are not necessary in providing utility services. Staff‘s position is that ED Department services are not essential. Staff says AIU would provide utility service in the absence of such programs.

Staff disputes AIU's assertion that Staff agrees that the ED Department provides an essential function by answering questions from customers about the provision of utility service, including questions regarding expanding service or consuming service more efficiently. Instead, Staff believes that it sounds reasonable that a utility would be fulfilling an essential service by answering customers‘ questions and concerns regarding provision of service. Staff also takes issue with AIU's assertion that it agrees that AIU‘s customers benefit from efforts to actively increase its customer base because doing so spreads the fixed operating costs of AIU across a larger number of customers. Staff emphasizes that the addition of new customers between rate cases would have the effect of increasing company revenues, while costs included in rates would remain the same. Staff says that customer count and revenues would increase, but the costs and number of customers those costs are spread across would remain unchanged until the next rate case. At the time of the next rate case, Staff asserts that fixed costs to be spread across the new, increased number of customers would also increase due to the costs of new plant or increased O&M costs incurred to serve the new customers.

c. IBEW Position

IBEW believes that AIU‘s expenditures on economic development are beneficial not only to existing ratepayers, but also for the general Illinois economy and workforce as a whole, and should be recoverable. In addition to the general benefits due to increased economic development in its areas, IBEW alleges that existing ratepayers benefit when new customers are added to AIU‘s existing infrastructure.

d. Commission Conclusion

AIU proposes to pass along to customers approximately $600,000 of labor and labor related expenses associated with economic development activity. IBEW supports AIU's proposal. Staff opposes recovery of the costs from ratepayers arguing, among other things, that the economic development activity primarily benefits shareholders.

Staff asserts that the provisions of Section 9-225 of the Act prohibit AIU from passing the disputed costs along to ratepayers. AIU claims that economic development activity does not constitute advertising and that even if it did, because it provides benefits to ratepayers, such activity fits one of the exceptions in Section 9-225 and the costs can be passed on to ratepayers. In the Commission's view, the economic development activities fall under the definition of "promotional advertising" contained in Section 9-225 of the Act.

The Commission believes there is evidence that the economic development activities at issue provide, or at least potentially provide, benefits to both customers and shareholders. Contrary to AIU's suggestion, however, advertising that provides some benefit to customers is not necessarily in the customers' best interest. The economic development activities at issue here appear to provide significantly more benefits to AIU shareholders than to its customers. The fact that customers receive a tangential benefit from activities that primarily benefit shareholders does not mean the activities are in the best interest of the ratepayers or that any portion of the cost of such activities should be passed along to ratepayers. The Commission concludes that the economic development activities at issue here should not be included in the revenue requirement and Staff's proposed adjustment to remove such costs is hereby approved.

7. Workforce Reduction

a. Staff Position

Staff states that its revised proposed adjustment for the AIU workforce reduction reflected in the Appendices attached to its Initial Brief corrects payroll tax costs consistent with payroll taxes associated with other pay related adjustments. According to Staff this proposed adjustment does not reflect an offset for the one-time costs associated with severance pay to those employees taking the voluntary separation package.

Staff indicates that in Surrebuttal Testimony, AIU discussed certain disputes it has with Staff‘s proposed rebuttal adjustments. Accordingly, in its Initial Brief Staff revised its rebuttal position adjustment so that the incentive compensation costs already removed from the operating expenses are not double counted. In addition, Staff indicates it also reflected the jurisdictional allocations included in Ameren Ex. 51.9, for its electric utilities in the revised adjustment schedules.

Staff says AIU calculated the amounts for payroll taxes associated with the workforce reduction based on factors calculated by dividing payroll taxes into labor. Staff states that the resulting factors range from 4.19% - 5.25% for total payroll taxes, all of which Staff claims is less than the amounts for FICA tax alone. Staff asserts that during cross examination, AIU agreed that the tax rates for each of the three utilities would include 7.65% for FICA tax, 0.8% for Federal Unemployment Tax Act tax, 0.6% for State Unemployment Tax Act tax, and further that these tax rates would not vary between the utilities. Staff also claims AIU acknowledged that the complicated calculation it uses for the payroll taxes associated with the workforce reduction does not accurately reflect the correct adjustment and would require correction should the Commission approve AIU's proposed adjustment.

Staff asserts that its proposed adjustment for payroll taxes reflects the same calculation used for other payroll tax related adjustments, multiplying the amount of the compensation-related adjustment by 7.65%. Staff says that while AIU argues that the costs for severance pay should be recovered over a three-year period similar to rate case expenses, it also agrees with Staff that those costs are one-time costs.

AIU cites Docket No. 05-0597 as precedent for the approval of severance costs associated with the workforce reduction which took place in November and December 2009. Staff says the severance costs in that case were related to a specific Cost Savings Program called the Exelon Way program. According to Staff, the specifics of that program were provided under Section 285.3215, which provides a utility an incentive to initiate cost savings programs and outlines the specific detail required for recovery. Staff contends that no similar information was provided by AIU in the current cases. Staff states that AIU specifically excluded this information from its filing. Staff claims that only in response to discovery generated by a press release by AIU in early September 2009 did AIU provide to Staff the information about the workforce reduction. Staff says no detail of savings was provided until late October. Since the circumstances surrounding Docket No. 05-0597 are so different from AIU's cases, Staff insists that the conclusion in that case is not instructive for this case. Staff maintains that severance costs related to the AIU workforce reduction should not be allowed for recovery.

b. AIU Position

AIU agrees that an adjustment to labor and associated expenses (such as payroll taxes) is warranted to reflect decreased salary and benefits expense that will occur as a result of the buyout. AIU claims that Staff, however, has miscalculated the appropriate adjustment. AIU recommends that the Commission adopt the workforce reduction adjustment reflected in Ameren Ex. 51.9.

AIU asserts that the most serious flaw in Staff's proposed workforce reduction is Staff's failure to recognize that the long-term savings that will result from the workforce reduction come at a short-term cost. AIU says these costs total just over $2.7 million and consist mainly of employee severance payments. AIU indicates that Staff considers severance costs a one-time cost which does not reflect a normal on-going level of cost, and on that basis proposes to disallow severance costs in their entirety. AIU argues that the one-sidedness of this approach is obvious, for it provides ratepayers the full benefit of the cost-savings associated with workforce reductions while saddling AIU's shareholders with all of the costs necessary to achieve those benefits.

Rather than disallow severance costs in their entirety, as Staff proposes, AIU believes a more rational, and fairer, approach is to amortize these costs over a period of three years. AIU claims no party has argued that the severance costs incurred by AIU were unreasonable or imprudent. AIU complains that to disallow these severance costs sends a message to utilities that necessary and prudent workforce reductions will be punished financially. AIU asserts this would be a radical departure from past practice, where the Commission has recognized that utilities should not be punished for incurring short-term severance costs that produce long-term reductions in the cost of service.

According to AIU, in Docket No. 05-0597, the Commission approved amortization of severance costs incurred by ComEd in implementing its Exelon Way severance program, notwithstanding objections by the AG that these were one-time, nonrecurring costs. AIU asserts that the same is true here, where Staff's adjustment reflects the savings that will be realized from AIU's workforce reductions. AIU contends that the workforce reduction adjustment must be calculated net of severance costs, as shown in Ameren Ex. 51.9.

In addition to severance costs, AIU indicates that in its Initial Brief it identified three other corrections that should be made to Staff's workforce reduction adjustment. AIU says Staff made these three corrections. Specifically, Staff revised its rebuttal position so that incentive compensation costs are not double counted. Staff has also removed any double counting of payroll tax and used a rate of 7.65% to calculate the tax as agreed by AIU. It appears to AIU from Staff's schedules that Staff has also removed transmission-related costs from its adjustment. AIU says these matters are now uncontested.

c. Commission Conclusion

The Commission finds that in light of the fact that ratepayers will reap the long-term benefits of the workforce reduction program, it is fair for them to bear the costs associated with the program. Staff's proposal to disallow these costs is not fair and it is therefore rejected. The Commission adopts AIU's proposal to amortize the severance costs over three years.

8. Public Utilities Revenue Act Tax

The Public Utilities Revenue Act ("PURA"), 35 ILCS 620/1 et seq., levies a tax on electric utilities based on the total amount of energy delivered in a year at different rates for up to seven different kilowatt-hour ("kWh") sales blocks. Although all parties recognize that this tax is part of the cost of service and must be recovered in rates, this issue nonetheless produced several points of contention. AIU initially proposed to recover the PURA tax expense through a separate rider mechanism instead of through base rates, but has since withdrawn this proposal in the face of opposition from Staff and IIEC. AIU also proposes to allocate the PURA tax expense on a per kWh basis, rather than on the same basis as general plant, as is currently done. This issue is discussed elsewhere in this Order. The third area of contention concerns Staff and IIEC's proposed revenue requirement adjustment associated with the PURA tax and is discussed below.

a. AIU Position

AIU proposes a pro forma adjustment to restate test year expense associated with the PURA tax to be consistent with the use of weather-normalized kWh sales in the calculation of revenues at present rates. AIU states that weather normalized sales are then multiplied by current statutory tax rates to arrive at the pro forma amount for this tax. IIEC and Staff object to this adjustment because it does not account for refunds/credits routinely received by AIU for overpayment of the tax.

Based on the fact that AIU receives periodic refunds/credits and did not reflect these in its adjustment, AIU understands that Staff recommends that the pro forma adjustment should be eliminated in its entirety. AIU believes a more even-handed approach would be to simply correct the adjustment to reflect the refunds/credits, as IIEC proposes. AIU says that IIEC's approach adopts the use of weather normalized kWh sales applied to statutory tax rates. AIU claims that since these sales are used to calculate delivery service revenues, there is a matching of sales used to derive revenues with sales used to calculate expense. AIU believes that IIEC's approach has the added benefit of eliminating the impact of prior period adjustments to prior period accruals that may exist with the per-books distribution tax expense. AIU indicates that Ameren Ex. 51.13 reflects IIEC's approach and should be adopted as the basis for determining the recoverable test year electric distribution tax expense.

AIU explains that the calculation used by it and IIEC results in an increase over actual 2008 net costs because the AIU and IIEC approach eliminates the impact of any adjustments to prior period accruals that may exist with the per books PURA tax expense. AIU states that because the AIU and IIEC approach uses kWh sales to calculate delivery service revenues, there is a matching of sales used to derive revenues with sales used to calculate PURA tax expense. AIU claims that Staff's alternative proposal to take a —snapshot" of net 2008 costs ignores the impact of prior period adjustments, thereby creating a mismatch between test period revenues and expenses. AIU believes that its approach is the better one, and should be adopted in these proceedings.

b. IIEC Position

IIEC has recommended that AIU's test year revenue requirements reflect the impact of credits or refunds of the PURA tax to AIU during the 2008 test year to the extent such credits and refunds are not already reflected in the revenue requirement. AIU responds that a review of the history of the PURA tax indicates that AIU has received some level of refunds of this tax. AIU therefore agrees with IIEC's proposal to reflect the test year level of refunds as a reduction in AIU's requested revenue requirement. IIEC understands that AIU is recommending that the AmerenCILCO revenue requirement be reduced by $649,000, the AmerenCIPS revenue requirement be reduced by $638,000, and the AmerenIP revenue requirement be reduced by $2,686,000. Since these reductions are very close to the reductions recommended by IIEC witness Stephens, IIEC accepts AIU's proposed adjustment. IIEC has no position on whether an additional or further adjustment as proposed by the Staff is necessary.

c. Staff Position

Staff has proposed an adjustment to remove AIU's pro forma adjustment which weather-normalizes the PURA tax expense. Staff believes AIU has not shown that AIU‘s share of the statutory cap on the tax will increase during the period rates determined in these proceedings are in effect. Staff asserts that the amount of electric distribution tax for a given calendar year is a combination of the amount remitted quarterly by the utility based on a tiered structure of rates for delivery volumes as well as credit memoranda resulting from the statutory cap on the tax. Staff claims that AIU has received credit memos in each year for which information was provided. Staff contends that AIU's adjustment was simply based on the application of the tiered formula for computing the tax without considering the credit memos that are routinely received by AIU.

Staff acknowledges that AIU revised its adjustment to reflect the test year level of refunds (credit memoranda) as a reduction to the weather-normalized tax amount. While Staff agrees that this is an improvement over the initial proposal which did not reflect the refunds, Staff says it still results in an overall increase over the 2008 net costs, which Staff believes AIU has not demonstrated will occur. In the absence of a clear demonstration of an increase in its share of the PURA tax, Staff believes no increase in the expense is warranted.

d. Commission Conclusion

As the Commission understands it, the PURA tax is a function of kWh delivered by an electric utility, a tiered tax rate structure for different levels of kWh delivered, and credits or refunds from previous years that result from a statutory cap on the total tax collected from all electric utilities. It appears to the Commission that AIU's proposal, modified to reflect the credits or refunds, properly takes into consideration all of the relevant factors. The PURA tax is a function of kWh delivered, which will depend in part upon the weather. Why Staff objects to weather normalizing the PURA tax obligation is not clear to the Commission. Staff seems to suggest that the statutory cap on the PURA tax somehow influences its objection to AIU's proposed weather normalization adjustment. The Commission believes, however, that by incorporating the credits or refunds discussed above, this concern has been addressed. The Commission rejects

Staff's recommendation on this issue and finds that the calculation of the PURA tax that AIU and IIEC have agreed to should be used for purposes of this proceeding.

9. Transportation Fuel Expense

a. AIU Position

AIU's cost of service includes the cost of gasoline and diesel fuel used to operate fleet vehicles and construction equipment. AIU originally calculated its test year transportation fuel expense based on actual fuel costs for calendar year 2008. In light of Staff's concern that fuel prices have declined from levels reached during 2008 and to reduce the number of contested issues, AIU subsequently proposed that this expense be normalized for purposes of this proceeding by calculating AIU's average gasoline and diesel fuel costs over a three-year period from August 2006 through July 2009. AIU asserts that its normalization method captures the variation and fluctuations in prices that actually have occurred for gasoline and diesel fuel in recent years. As a result, AIU proposes a downward adjustment to its original request for fuel expense of approximately $367,000 for the gas utilities and $899,000 for the electric utilities.

Staff proposes that AIU's average fuel costs be calculated (and adjusted further downward) using prices from August 2008 through July 2009. AIU asserts that fuel expense is volatile and that any number of factors beyond the utility's control can cause fuel prices to fluctuate rapidly. AIU asserts that normalization of a volatile, fluctuating expense over a historical period accounts for volatility and smoothes out fluctuations. AIU complains that Staff's calculation of average fuel costs relies on a period of time that is too narrow and largely encompasses a decline in fuel prices in the second half of 2008 and depressed fuel prices during the first half of 2009. AIU insists that it is inappropriate to normalize a volatile and rapidly fluctuating expense item like transportation fuel costs by selectively relying on only a 12-month period of time where the prices in large part were abnormally low.

In response to Staff's claim that its method will be representative of future fuel costs, AIU argues that the Energy Information Administration's ("EIA") latest 2010 forecast issued in December 2009 shows an average price for gasoline 37¢ higher ($2.88 vs. $2.51) and for diesel fuel 18¢ higher ($2.96 vs. $2.78) than the average fuel prices in the 12-month period relied on by Staff. Using its proposed three-year period as the source for its adjustments, AIU believes that its proposal appropriately accounts for price fluctuations and volatility. AIU contends that its calculation captures not only the higher prices experienced in the first half of 2008, but also the lower prices experienced in the second half of 2008 and first half of 2009 that Staff relies on in its calculation. AIU states that even with the higher 2008 prices included in AIU's normalization, the average price of gasoline calculated by AIU ($2.83) is actually less than the average price of gasoline for 2010 based on the EIA forecast issued in December 2009 ($2.88).

AIU also contends that more often than not the historical period of time that is examined to normalize an expense is a number of years. AIU notes that Staff recommends a normalization adjustment to AmerenIP's test year expense for Account 887, Maintenance of Mains, based on a three-year average of historical expenses. In this instance, AIU does not believe that Staff's proposal even amounts to a normalization of the expense. Rather, AIU claims that Staff essentially proposes to shift AIU's 2008 test year period forward seven months, to August 2008 through July 2009, to mask the reality of higher fuel prices that occurred earlier in 2008. According to AIU, Staff's reliance on fuel prices from a different 12-month period of time is subject to the same criticisms that Staff makes concerning AIU's initial reliance on calendar year 2008 prices. AIU states that to rely on too narrow a window of time to calculate an average price of a volatile, rapidly fluctuating item can skew the average. AIU contends that in this instance Staff's reliance on prices from August 2008 to July 2009 not only masks the reality of higher prices that occurred earlier in 2008, but also gives too much weight to declining and depressed prices that occurred later in 2008 and 2009.

Despite its concerns about 2008 fuel prices, AIU observes that Staff itself relies on 2008 data in its proposed calculation of AIU's average fuel costs. AIU complains that Staff just selectively relies on fuel prices from the second half of 2008, when the United States was in the midst of an economic recession and fuel prices plummeted. AIU agrees that fuel prices rose during the first half of 2008 and then sharply declined in the second half. According to AIU, this does not mean that the low price period should be considered and the high price period ignored.

Staff further claims that the 2010 price forecast issued by EIA in October 2009 shows no trend for fuel prices in 2010 to return to levels reached in 2008. AIU asserts that even if 2010 forecasted prices prove that certain higher 2008 prices should be selectively excluded from the calculation of AIU's average fuel prices, EIA's short-term forecasts do not foreclose the possibility the fuel prices could rapidly rise in 2010. AIU claims that EIA's short-term price forecasts are issued and revised upward or downward on a monthly basis. According to AIU, these revisions can be significant. AIU says that comparing the EIA 2010 forecast issued in January 2009 to the one issued in October 2009 shows that, in the past few months, forecasted prices for 2010 already have been revised upward by an average of 21% for gasoline and 9% for diesel fuel.

AIU adds that comparing EIA's October 2007 forecast of 2008 prices to actual 2008 prices shows that EIA failed to predict a sharp increase in prices that actually occurred. AIU states that actual prices in 2008 were on average 15% higher for gasoline and 28% higher for diesel than prices EIA projected in the fall of 2007. Given the number of external variables that can cause the fuel prices to fluctuate rapidly, such as consumer demand, conflicts in oil producing regions, cuts in production by the Organization of Petroleum Exporting Countries, refinery capacity, and even hurricanes in the Gulf of Mexico, AIU argues that there can be no assurances that fuel prices will not vary significantly from the EIA October 2009 forecast relied on by Staff.

b. Staff Position

Staff recommends each AIU utility revalue its transportation fuel expenses using an average gasoline price of $2.51/gallon and an average diesel fuel price of $2.78/gallon. In response to Staff‘s concerns, AIU revised its initial position of using 2008 gasoline and diesel fuel costs to value its transportation fuel expense amounts and instead propose to use an average of fuel prices from August 2006 through July 2009. AIU's proposal is not satisfactory to Staff, who recommends using the average fuel prices from August 2008 through July 2009.

In formulating its position, Staff reviewed the EIA/Short Term Energy Outlook, U.S. Nominal Prices. Staff believes that gasoline and diesel fuel prices experienced in 2008 are not representative of gasoline and diesel prices on a going forward basis. According to Staff, the EIA 2010 price forecast for gasoline prices shows no trend of returning to the high costs AIU experienced in 2008, especially those gasoline prices in the $4/gallon range. Staff asserts there is, on average, a 61¢/gallon variance between the currently forecasted 2010 gasoline prices and those AIU experienced in 2008. Staff also contends that the EIA price forecast for diesel fuel in 2010 shows no trend of returning to the diesel prices reached in 2008, especially those diesel prices in the $4/gallon range which AIU utilized in its calculation of the average diesel fuel prices. Staff asserts that, on average, a $1.03/gallon variance exists between the currently forecasted 2010 diesel prices and those AIU experienced in 2008.

Staff says that AIU identifies three concerns regarding the gasoline and diesel fuel prices utilized in Staff‘s calculation of average fuel prices. First, AIU alleges that Staff‘s analysis arbitrarily chose fuel prices from August 2008 to July 2009. Second, AIU claims that fuel prices are volatile and fluctuating, and as a result, AIU recommends normalizing the average fuel price over the period of August 2006 to July 2009, versus Staff‘s one-year proposal. Finally, AIU asserts that the EIA short-term price forecasts are subject to frequent revisions.

Regarding AIU's first concern, Staff claims it did not choose the fuel prices arbitrarily. Staff states that it selected the most recent EIA data available at the time Staff filed its Direct Testimony. Staff believes AIU‘s claim that Staff‘s analysis arbitrarily applied fuel prices from August 2008 through July 2009 is unsubstantiated. Further, Staff asserts its recommendation yields a more accurate representation of fuel prices AIU will experience when rates established by the Commission go into effect.

In response to AIU's second concern, Staff does not dispute AIU's claim that transportation fuel prices are volatile and fluctuate. Staff, however, disagrees with AIU‘s proposal to utilize a three-year average to normalize those prices. Staff states that AIU‘s proposal relies too much on 2008 transportation fuel prices that happen to be the highest experienced by AIU. Staff believes that the inclusion of these costs would result in an overstatement of costs attributed to transportation fuels on a going forward basis.

With respect to AIU's third concern, Staff does not dispute AIU's claim that EIA updates its forecasts frequently. Staff recognizes that EIA provides monthly updates. Staff contends that any forecast of future events will have inaccuracies. In Staff's view, AIU's observation that significant differences have occurred between actual and forecasted EIA information ignores this basic fact. Staff asserts that AIU's selective comparison points out some of the highest differences between EIA's short-term forecasted prices and actual fuel prices, but does not change what the current forecast shows. Staff suggests that no one knows if major events, such as a hurricane or any other event, could influence those prices in the near future. Staff contends that the current and best information available regarding future transportation fuel costs supports Staff's recommendation.

AIU claims that the average gasoline and diesel fuel prices that it proposed are more closely in line with the latest EIA forecasts than the average gasoline and diesel fuel price proposed by Staff. Staff does not dispute that the December 2009 EIA forecasts for 2010 prices for gasoline and diesel fuel rose slightly since Staff filed its Rebuttal Testimony. Staff says it used the August 2009 EIA forecasts to show that AIU's 2008 transportation fuel prices were price outliers. In Staff's view, the December 2009 EIA forecast for transportation fuel prices in 2010 still demonstrate that AIU 2008 gasoline and diesel fuel prices are outliers, which Staff claims support its arguments.

AIU argues that since its proposed transportation fuel price more closely resembles the average gasoline and diesel fuel prices forecasted by EIA in December 2009 for calendar year 2010 than Staff's proposed prices, the Commission should adopt its proposal. Staff states that AIU selected a historical test year where only known and measureable changes are considered. According to Staff, forecasted fuel prices are not known and measureable. Staff contends that the actual 2009 prices that were included in the EIA December 2009 report are what is known and measurable. Staff states that this report showed the actual average price data for transportation fuels for January 2009 to December 2009 was $2.40/gallon for gasoline and $2.47/gallon for diesel fuel. Staff claims these values more closely correspond to Staff's proposed numbers, $2.51/gallon and $2.78/gallon, then AIU's proposed prices, $2.88/gallon and $2.96/gallon, respectively.

Staff also denies that 12 months is too short of a period to use as the basis for normalizing costs. Staff relates that it recently relied on 12 months of EIA data to value transportation fuels in the Peoples and North Shore rate cases in Docket Nos. 09-0166 and 09-0167 (Cons.). With regard to its adjustment for Account 887 based on a three-year normalization period, Staff denies there is any inconsistency with the 12-month period it proposes for fuel costs. Staff claims that its proposal regarding Account 887 is unique to the circumstances associated with that issue.

Staff reports that use of its proposal would result in a reduction in O&M expense for each utility as follows: AmerenCILCO, $27,000 (gas) and $180,000 (electric); AmerenCIPS, $51,000 (gas) and $494,000 (electric); and for AmerenIP $72,000 (gas) and $560,000 (electric).

c. Commission Conclusion

AIU proposes to normalize gasoline and diesel fuel costs over a three year period from August 2006 through July 2009. In contrast, Staff proposes to average fuel prices from August 2008 to July 2009. The Commission is concerned that AIU‘s methodology utilized in calculating transportation fuel costs could lead to fuel prices that are unreasonably high.

It is not entirely clear how AIU decided that the three-year period from August 2006 to July 2009 was the appropriate period for measuring fuel prices, whereas Staff provided a reasonable basis for its selection. Consequently, of the two proposals in the record, the Commission finds that a twelve month average is superior to AIU's proposed three year average. For purposes of this proceeding the Commission concludes that Staff's method for measuring fuel costs, and the results thereof, should be approved.

10. Account 887, Maintenance of Mains

a. AIU Position

In order to render safe, adequate, and reliable gas delivery service, AIU says it must perform both routine and special maintenance on gas distribution mains. The distribution expenses associated with these gas maintenance activities are collected in FERC Account 887, otherwise known as the ―Maintenance of Mains” account. AIU indicates it initially requested recovery of approximately $4.981 million in expenses for AmerenIP‘s Account 887 for the 2008 test year. In response to Staff‘s objection that expense in this account has trended upward in recent years and to limit the number of contested issues, AIU says it subsequently proposed, for purposes of this proceeding only, to normalize expense for this account using amounts for a three-year period ending September 2009. As a result, AIU indicates that in rebuttal it requested recovery of only approximately $3.78 million in expense for this account, which represents a downward adjustment of $1.201 million from the amount initially requested.

AIU reports that Staff rejects the proposed use of more recent 2009 data to normalize expense for AmerenIP‘s Account 887. Staff asserts that AIU is unable to explain or provide any basis for why the costs in this account have increased from 2006 through 2008. AIU says Staff claims that AIU‘s testimony and responses to data requests failed to provide any supporting data that demonstrated that the dramatic cost increases to Account 887 between 2006 and 2008 were just and reasonable. AIU contends that in responding to AIU‘s normalization approach in rebuttal, Staff fails to explain why more recent actual 2009 data should not be used in the calculation of an average expense for this account. According to AIU, Staff continues to maintain that AmerenIP‘s Account 887 expense should be averaged using older expense data from calendar years 2006-2008. As a result, Staff requests an additional downward adjustment of $665,000 for this expense compared to AIU‘s rebuttal request.

AIU indicates that it disagrees in principle with Staff‘s approach to selectively review and normalize the expense for one account based on prior period spending simply because the test year expense for that account may be higher than in previous years. AIU contends that such an approach fails to consider that costs associated with a utility‘s recurring business activities can impact any particular account differently from year to year. AIU insists that it is neither unreasonable nor unexpected for a utility‘s maintenance expense to vary annually depending on the type and number of projects required to repair damaged distribution infrastructure, replace obsolete assets, and expand systems to meet customer demands and improve reliability of service.

AIU asserts that comparing the expense for Account 887 for the 12 months ending September 2008 ($4.318 million) and September 2009 ($4.451 million) confirms that the 2008 test year expense is not an abnormally high amount. In AIU's view, the 2009 data confirms that the expense associated with this account is trending upward. Despite this upward trend, AIU says it seeks recovery of only $3.780 million. AIU claims that the 2009 data confirms that test year expense is representative of the level of expense that AIU will incur in 2010, when rates set in this proceeding will be in effect. In AIU's view, there is no doubt that costs in Account 887 increased from 2006 to 2008. The mere fact that expense for Account 887 has increased in recent years, AIU contends, does not establish that the test year expense is unreasonable.

AIU also disagrees with Staff‘s assertion that it is unable to explain or provide any basis for the increase or failure to provide any supporting data to demonstrate that the increase is ―just and reasonable.” AIU claims it identified the specific costs that contributed to the increase in expense in this account and has explained that the increase was largely due to increased costs for union and management labor and labor relating loadings. AIU argues that it is neither unreasonable nor unexpected for AmerenIP‘s maintenance expense to trend upward based on incremental increases in costs associated with labor and inflation. AIU believes Staff is mistaken to suggest that AIU has not provided any basis or explanation for the increase in expense.

In response to AIU‘s proposal to include 2009 data, AIU claims Staff repackages its complaints that AIU has not supported the reasonableness of the 2008 test year expense. According to AIU, Staff fails to explain why use of more recent data in the averaging calculation is not appropriate, especially when Staff has used 2009 data when proposing adjustments for other expenses. AIU states that Staff relied on 2009 pricing data to calculate AIU‘s average fuel costs, but failed to rely on 2009 data in making the proposed adjustment to AmerenIP‘s Account 887 expense.

In AIU's view, Staff‘s argument, when boiled down, is that 2009 data can not be used to normalize the expense because AIU has not demonstrated that the 2008 expense is just and reasonable. AIU says Staff includes 2008 in its normalization calculation. AIU believes that if it is appropriate to use 2008 expense amounts in the calculation, it is also appropriate to use 2009 data. AIU contends that Staff‘s argument misses that point and clouds the issue of the appropriate normalization period by recanting Staff‘s complaints about the level of test year expense.

AIU states that it agreed to normalize the expense in AmerenIP‘s Account 887 over a number of years to satisfy Staff‘s concern that the expense for the 2008 test year is somewhat higher than in previous years. AIU argues that Staff‘s proposal to use older, outdated data in the calculation of an average expense for this account unreasonably increases the adjustment to the 2008 test year expense proposed by AIU. AIU states that rates are set prospectively, not retroactively, so what the expense was historically for this account is not as relevant as what the expense is now and what it will be going forward. Accordingly, AIU urges the Commission to accept its proposal to normalize this expense based on data from the three-year period ending September 2009.

According to AIU, Staff does not address the accuracy of the 2009 data at all. Instead, AIU continues, Staff argues that because 2008 costs were allegedly excessive, 2009 data should be ignored. AIU believes this makes no sense. AIU contends that recognition of 2009 data actually serves to validate the reasonableness of 2008 costs. In AIU's view, this issue does not center on the reasonableness of 2008 data, since both Staff and AIU include 2008 in its calculation of normalized test year expense. Rather, the issue centers on whether more recent actual 2009 data, under AIU‘s proposal, or older 2006 data, under Staff‘s proposal, should be included in the calculation to normalize test year expense. AIU contends that Staff‘s proposal to adjust downward AIU‘s normalized test year expense should be rejected.

AIU says Staff has endorsed the use of 2009 data in making adjustments to other test-year expenses such as tree trimming, uncollectibles, and storm expenses. AIU points out that Staff witness Seagle refuses to use 2009 data when calculating the adjustment to AmerenIP‘s Account 887 expense even though he relies on 2009 data to calculate adjustments for AIU‘s transportation fuel costs and company-use and franchise gas amounts. AIU claims that Staff‘s approach of selectively excluding 2009 data in this instance from its calculation of an average expense without explanation is neither appropriate nor consistent with its treatment of normalizing other operating expenses.

b. Staff Position

Staff reports that AmerenIP‘s requested expense for its Account 887 is higher in the test year than in any other period reviewed for this account. Further, Staff alleges AmerenIP was unable to explain why Account 887 had experienced such a large increase from historical periods. As a result, Staff recommends that the Commission average AmerenIP‘s Account 887 expense amount over the three-year period spanning 2006 through 2008. In response to Staff‘s recommendation, AmerenIP proposed to use the most recent three-year period of actual experiences to value this account. Staff disputes this proposal due to AmerenIP‘s inability to demonstrate the just and reasonableness of its requested value.

Staff observes that AmerenIP's Account 887 expense amounts more than doubled between 2006 and 2007 and then increased significantly between 2007 and 2008. Staff calculates that there was a 259% increase in expenses over a three-year period. Staff states that while AmerenIP provided a list that identified each cost that contributes to the large increase from 2007 to 2008, Staff claims AmerenIP could not provide any meaningful explanation regarding the increase. Staff says that AmerenIP attributes the increase in costs associated with this account to increases in labor and labor related loading. Staff complains that AmerenIP also indicated that it is unable to track costs passed through Account 887 due to "so many activities and variables" and —operational reasons." Staff finds AmerenIP's explanation unacceptable. Staff argues that AmerenIP must demonstrate that the costs it proposes to pass on to ratepayers are just and reasonable.

Staff explains that it limited its comparison to the last three full calendar years because AmerenIP was transitioning to AIU's accounting system in 2005 and prior to 2006 used a different accounting system. Staff asserts that the Account 887 expense from the period prior to 2006 was approximately the same or less than the 2006 amount.

Staff disputes AIU's assertion that it provided a detailed explanation of why Account 887 expense has increased so dramatically from 2006 to 2008. Staff says it issued multiple data requests that attempted to establish what, if any, business activities had changed between 2006 and 2008 and how that impacted Account 887. Staff argues that AIU's testimony and responses to its data requests were insufficient for Staff to determine if AmerenIP's Account 887 expense was just and reasonable.

c. Commission Conclusion

As an initial matter, the Commission must be clear that dispute concerns only AmerenIP's gas operations. To normalize AmerenIP's Account 887 expenses, AIU proposes to use the three-year period ending September 2009. Staff proposes to use the three-year period ending December 2008. The table below shows the proposals of both AIU and Staff.

AIU's Proposal		
2,572,000		12 months ended September 2007
4,318,000		12 months ended September 2008
4,451,000		12 months ended September 2009
$ 3,780,333		Average

Staff's Proposal		
1,388,100		Calendar 2006
2,976,633		Calendar 2007
4,980,993		Calendar 2008
$ 3,115,242		Average

As noted above in the Commission's discussion of the value of gas in storage to be included in rate base, the Commission is somewhat frustrated with the various measurement periods selected by AIU and Staff in this proceeding. In this instance, both AIU and Staff make interesting statements about their own proposal and that of the other entity. It is not clear to the Commission that either is entirely correct. As a result, the Commission finds that for purposes of these proceedings, AIU's proposal and Staff's proposal should be combined to determine the level of Maintenance of Mains to include in AmerenIP's operating expenses. Averaging AIU's proposal and Staff's proposal produces a value of $3,447,788, or a reduction of approximately $332,000 from AIU's proposal. The Commission hereby finds that this value should be reflected in AmerenIP's operating expenses.

11. Injuries and Damages Expenses

a. AIU's Position

AIU indicates that its cost of service includes payments made to settle injury and damage claims. Because this expense fluctuates from year to year, AIU proposes to normalize this expense for the test year. AIU's normalization approach uses a five-year average (calendar years 2004 through 2008) of actual payments for injury and damages claims (four years in the case of AmerenIP to eliminate an outlier year), adjusted for inflation using the consumer price index (―CPI"). According to AIU, the only point of contention with respect to AIU's normalization approach is the use of an inflation factor in calculating the historical average. Elimination of an inflation factor would reduce the total electric revenue requirement by $673,000 and the gas revenue requirement by $129,000.

AIU indicates that IIEC is the only party to argue that the AIUs' normalization method should not include an inflation component. IIEC claims that the use of an inflation factor is improper because the absence of an inflation factor has not caused these fluctuations. Instead, IIEC asserts that the logical assumption is that the fluctuation in these charges would be a function of the number of claims settled during and calendar year and the size of the claims settled in the year. In AIU's view, IIEC misses the point. AIU states that no one disputes that injuries and damages expense fluctuates from year to year. AIU suggests that smoothing out these fluctuations is accomplished through the use of a four- or five-year average. AIU adds, however, that calculating a mathematical average of historical claims experience fails to account for the fact that today's dollars purchase fewer goods and services than dollars in years past. AIU states that inflation is the rise in the general level of prices over a period of time. When inflation rises, AIU says a dollar purchases fewer goods and services. Assuming a positive level of inflation between 2004 and 2008, AIU indicates a dollar would be worth less today than it was worth in 2004.

AIU contends that while its proposed normalization calculation properly recognizes the affect of inflation, IIEC‘s adjustment does not. AIU notes that the inflation adjustment has not been opposed by Staff and is consistent with the treatment of normalized storm expense, which AIU describes as another volatile expense analogous to injuries and damages that Staff and AG/CUB have endorsed in these proceedings. By ignoring inflation, AIU alleges that IIEC‘s calculation understates injuries and damages expense and should be rejected.

According to AIU, IIEC suggests that the Commission should adhere to an alleged —customary, systematic approach" to determining injuries and damages expense; i.e., without an inflation adjustment. AIU says it is unaware of any —customary, systemic" approach for calculating this expense. AIU asserts that this is the first case in which AIU has requested an inflation adjustment for injuries and damages expense. Because the Commission has not previously addressed whether an inflation component is appropriate, AIU believes it can hardly be said that the Commission has developed a —customary, systemic approach" on this issue.

AIU argues that regardless of what the Commission ordered in prior proceedings, the record in this proceeding supports the use of an inflation factor. AIU contends that IIEC attempts to ignore the fact that goods and services cost more today than they did in the past by arguing that the proper focus of the injuries and damages expense item is not the level of time and material costs of the construction or other activities that may give rise to personal injury or property damage claims. Rather, IIEC says injuries and damages expense covers the costs of resolving the claims themselves. AIU claims that lost in this argument is any recognition of the fact that the —cost of resolving the claims themselves" will be higher in 2010 than in 2004 because of inflation. In AIU's view, the claim that it presented no evidence that would establish a relationship between the actual costs of resolving claims and the inflation of construction materials and labor costs is unfounded. AIU insists that any claim that requires AIU to compensate someone for damage to person or property will necessarily be higher today than in 2004, because labor and material costs are more expensive today than in 2004 due to inflation.

b. IIEC Position

IIEC opposes AIU‘s addition of an inflation adjustment to what it describes as the consistent, systematic approach to annualizing injuries and damages expenses the Commission has employed in at least the last two AIU rate cases. IIEC claims that continued use of the Commission‘s customary, systematic approach will allow recovery of injuries and damages expenses at a level that reflects AIU‘s actual expenses. In

IIEC's view, modifying that level of expense using a CPI factor is unnecessary and inappropriate.

IIEC reports that AIU accepted Staff's proposed adjustment to remove certain hazardous materials costs from the calculation of normalized injuries and damages expense. IIEC asserts that the acceptance of Staff's modification does not eliminate AIU's inflation adjustment, and it does not change IIEC's opposition to the inflation adjustment.

IIEC believes AIU's proposed adjustment is inappropriate for at least two reasons. According to IIEC, AIU claims the purpose of the inflation factor is that the underlying materials or labor costs giving rise to historical claims payments would cost more today than they did five years ago. IIEC argues that the proper focus of the injuries and damages expense item is not the level of time and material costs of the construction or other activities that may give rise to personal injury or property damages claims. Rather, IIEC contends that the injuries and damages expense covers the costs of resolving the claims themselves. IIEC asserts that if the simplistic relationship assumed by AIU's adjustment actually existed, there would be few disputed injuries and damages claims. IIEC suggests AIU could simply pay time and material costs for affected persons and property, rather than using investigations, negotiations, and litigation to minimize those expenses.

IIEC also contends that the factual assumptions underlying AIU's adjustment are not supported by any record evidence. AIU claims the assumed, but unproven, relationship noted above is the prime example. IIEC asserts that the level of actual injuries and damages expense incurred in a year is more closely related to the number of claims filed and subsequently settled during a year. With respect to the costs of the claims, IIEC insists that inflation is not a significant driver. Furthermore, IIEC claims use of the inflation factor also has no effect or impact on the number of claims processed. Faced with IIEC's challenge to the sole stated basis of its proposal, IIEC says AIU presented no evidence that would establish a relationship between the actual costs of resolving claims and the inflation of construction materials and labor costs.

IIEC states that there are significant fluctuations in the levels of injuries and damages expenses from year to year. In IIEC's view, such fluctuations, that are distinct from the rate of inflation, add support to IIEC's view that inflation is not a driver of this category of expenses. IIEC claims that applying the proposed adjustment for a factor (inflation) that has no demonstrated relationship to the fluctuating expenses could distort (increase) the level of expenses included in ratemaking expenses.

According to IIEC, AIU presented no quantitative evidence that the effects of inflation are not adequately reflected in the amounts for which it was able to settle injuries and damages claims or in the Commission's traditional normalization through a multi-year average. IIEC complains that AIU provided no analysis or other evidence showing that AIU has actually experienced any under-collections of this expense over the period the Commission has used a multi-year average that is not adjusted for inflation.

IIEC asserts that test year ratemaking rests on an assessment of a utility's costs and revenues over a consistent time period -- the test year. In this case, IIEC says AIU proposed an historical test year, 2008. Data from post-test year periods can be considered only if they meet the requirements established by the Commission's rule on post-test year adjustments. IIEC says Section 287.40 prohibits the use of attrition or inflation factors.

According to IIEC, the evidence of record does not support the assumptions on which AIU's request depends. AIU argues that all other things being equal, if it cost $100 to settle a claim in 2004, it would cost more than $100 to settle that same claim in 2010, when rates in this proceeding go into effect. IIEC asserts that while that argument depends on —all other things being equal," AIU has presented no evidence that all other things will be held equal. IIEC suggests that through safety programs to prevent claims and through investigations, negotiations, and litigation to reduce the cost of claims that do occur, AIU is presumably working to assure that all things are not equal.

c. Staff Position

Staff recommends that the Commission accept its proposed adjustment to the AIU test year injuries and damages expense for AmerenIP to remove the effects of HMAC costs from the normalized level. Staff relates that AIU accepts its proposed adjustment. Staff notes that IIEC agrees with normalizing the level of injuries and damages expense, but takes issue with adjusting each year's costs for inflation using the CPI index, arguing that the fluctuations in the cost level from year to year was a function of the number of claims and the size of the claims processed in any given year. Staff says that AIU counters that argument by claiming that the inflation factor is not meant to level out the fluctuations in cost, but rather to reflect the increases in costs from year to year for materials and labor associated with those claims. Staff does not take issue with the use of the CPI Index in AIU's calculations.

d. Commission Conclusion

Because costs associated with injury and damage claims fluctuate from year to year, AIU proposes to normalize this expense for the test year. AIU's normalization approach uses the annual average from the years 2004 through 2008 of actual payments for injury and damages claims (four years in the case of AmerenIP), adjusted for inflation using the CPI. IIEC opposes the adjustment for inflation, arguing that AIU has not shown that inflation affects injury and damage claim costs. Staff proposes an adjustment to AmerenIP's injuries and damages expense, which AIU accepts.

This is the first case in which AIU has requested that an inflation factor be included in the normalization of injuries and damages expense. In the Commission's view, AIU's argument for including an inflation factor in the calculation is based on two premises, that inflation causes the cost of labor and materials to increase over time and that injuries and damages expenses are a direct function of labor and materials costs. It appears that IIEC essentially challenges the second premise, arguing that injuries and damages expenses are not a direct function of labor and material costs. The Commission concludes that AIU has not established that injuries and damages expenses are a direct function of labor and material costs. While it seems quite logical that such costs would, in some way, contribute to the injuries and damages expenses, there could well be other factors, which are independent of inflation, that also influence injuries and damages expenses. The Commission, therefore, adopts IIEC's recommendation that the inflation factor be excluded from the normalization calculation of injuries and damages expenses in these proceedings.

12. Overall Reasonableness of O&M Expenses

a. AIU Position

AIU states that in prior rate proceedings, parties have expressed concern to the Commission that AIU has not been effective in controlling certain of its O&M expense levels. In connection with filing these rate cases, AIU retained Concentric, a management consulting and economic advisory firm focused on the North American energy and water industries, to compare AIU's O&M expenses (electric and gas companies) to those of other utilities. AIU witness Amen, a Vice President with Concentric, used the peer-group approach to benchmark AIU's O&M expenses against those of other utilities. Specifically, Mr. Amen took the most recent data available to Concentric – FERC account level data for calendar year 2007 obtained from Federal Energy Regulatory Commission ("FERC") Form 1 and Form 2 filings – and analyzed the data through what AIU describes as a series of objective, comprehensive studies by benchmarking AIU's actual O&M expenses against other electric, gas, and combination utilities.

AIU states that the results of his 16 peer-group benchmarking studies led Mr. Amen to conclude that AIU's O&M expenses, including its A&G expenses, are on average lower than the majority of other gas, electric, and combination utilities. According to AIU, these studies demonstrate that AIU effectively controlled O&M expenses because it consistently performed better than its peers on a cost per customer basis. AIU contends that based on these results, the Commission can take comfort that AIU has been effective in controlling it O&M expenses at reasonable levels.

AIU asserts that the peer-group benchmarking approach produces studies that are objective, straight-forward, verifiable, replicable, and relevant to AIU. AIU also claims these types of studies are also often filed with regulatory commissions as an indicator of the reasonableness of a company's expenses. AIU suggests that this approach should be relied upon by the Commission in these proceedings as in the last rate case. AIU contends that the studies are objective because they include all costs for all companies that meet the parameters of the peer group being examined. AIU says no costs or companies are excluded subjectively or arbitrarily; if a company meets the parameters of the study, AIU says it is included.

AIU claims the studies are straightforward because by viewing the results of the studies, the Commission can easily understand how each of the three Ameren operating companies individually and collectively compare to other utilities. AIU says the results of each of the studies are graphically presented in an accessible exhibit. AIU states that if any of the three utility's performance did not compare well to its peers, the study and the corresponding exhibit would clearly reflect that fact. AIU contends that the studies are easily verifiable and replicable because they use information from the Form 1 and 2 annual reports filed with FERC by each of the peer group companies. AIU says it compiled this information and reported it without adjustment.

AIU states that through the use of relevant parameters, a researcher can create peer groups that consist of companies with similar operating characteristics. AIU suggests that comparisons can then be made as to the cost performance of each of the companies that meet the characteristic or parameter being studied. AIU says Mr. Amen created and compared peer groups consisting of gas, electric, and combined utilities, as AIU fits these parameters. AIU indicates that he also benchmarked Midwestern gas and electric companies as well as companies of sizes comparable to AIU and comparable breadth of services (e.g., whether the utility owns generation.) By accounting for all of these characteristics in various peer groups, AIU believes that Mr. Amen‘s studies aptly illuminate AIU‘s cost performance.

AIU contends that the peer-groups consist of a sufficient number of peers, which serve as the basis to evaluate AIU‘s cost performance. AIU contends that a peer group consisting of roughly 10 peers is adequate; the peer groups in Mr. Amen‘s studies ranged from nine to 205 peers. AIU says that while there is no single peer group containing companies with all of the same attributes against which to compare AIU‘s cost performance, Mr. Amen constructed 16 different peer groups, taking account of differences associated with size, geographic location, and the fact that AIU owns no regulated generation. Collectively, AIU asserts that Mr. Amen‘s peer-groups adequately account for the operating characteristics of AIU, and include more than a sufficient number of peers from which Mr. Amen could make robust and relevant findings about AIU‘s cost performance.

For his studies, Mr. Amen collected total A&G expense amounts and customer counts for peer companies. AIU says the costs included in the ten benchmarking analyses are unadjusted and reflect the amounts as reported in all peer companies‘ respective FERC Form 1 and 2 annual reports. AIU indicates that Mr. Amen took this information and unitized the costs on a per-customer basis to compare the AIUs‘ A&G expenses per customer to those of other utilities. AIU states that Mr. Amen prepared ten different iterations of the analyses to make the peer group of utilities more comparable to the characteristics of AIU.

According to AIU, Mr. Amen‘s ten studies show that AIU‘s A&G expenses compare favorably to the peers with similar operating characteristics. Mr. Amen included the following peer groups in his A&G expenses benchmark analysis: (1) electric utilities, (2) electric utilities in the Midwest, (3) electric utilities that own no generation, (4) electric utilities in the Midwest that own no generation, (5) similarly sized electric utilities that own no generation, (6) combination utilities, (7) combination utilities that owned no generation, (8) gas utilities, (9) gas utilities in the Midwest, and (10) similarly sized gas utilities in the Midwest. AIU asserts that for nearly all of these peer groups, the three Ameren operating utilities – both individually and collectively – operated at or below the mean and/or median costs of their peers. AIU claims that these peer-group benchmarking studies demonstrate that AIU has effectively controlled A&G expenses during calendar year 2007, and AIU‘s A&G expenses per customer compare favorably to those of other electric, gas, and combination utilities.

AIU says Mr. Amen expanded his analysis to include studies of AIU‘s total O&M expenses. AIU argues that unlike Mr. Fenrick‘s —total O&M” study, Mr. Amen‘s six O&M studies analyzed all relevant O&M costs (including transmission, distribution, customer care, and A&G expenses) with the exception of total electric power production and total gas production expenses. AIU states that like his A&G studies, Mr. Amen‘s O&M studies compared AIU‘s O&M expenses per customer to several similarly situated peer groups: (1) electric utilities, (2) gas utilities, and (3) combined utilities.

AIU asserts that the total O&M studies confirmed what Mr. Amen had found with respect to the A&G studies: the three Ameren utilities – both individually and collectively – performed at or below the mean and median expenses of their peers. AIU says Ameren Ex. 32.1 shows the results of the study of the total electric O&M per customer for each of the electric utilities that filed a Form 1 with the FERC; the AIUs individually and collectively perform at or below the mean and the median of the 145 companies under review. According to AIU, Ameren Ex. 32.1 shows the peer group mean was $403.94 per customer, while the median was $388.45; AIU‘s total O&M cost per customer was below both the mean and median at $348.64.

AIU states that for the gas utilities, Ameren Ex. 32.2 shows that AmerenCILCO, AmerenIP, and the combined Ameren utilities were all below both the mean and the median of the peer group, which consisted of 192 gas companies. According to AIU, the only variance in performance related to AmerenCIPS, which when compared to gas only companies fell below the mean, but slightly higher than the median of the peer group.

Ameren Ex. 32.3 shows the results of the benchmarking study of combined total electric and gas companies‘ O&M expenses. AIU says that in this study, AIU ranked well below both the mean and the median of the peer group, which consisted of 42 combination utilities. Finally, AIU says that to compare labor cost efficiency among combination utilities like AIU, Mr. Amen studied the number of customers per employee. This metric serves as a check of the efficiency with which each company provides service to its customers. AIU asserts that in this study, AIU compared very favorably to the peer group of other combination utilities. The three Ameren utilities, individually and collectively, ranked between 4th and 14th out of a peer group of 89 electric and diversified utilities. AIU reports that AmerenCILCO had 701 customers per employee, AmerenCIPS had 864, and AmerenIP had 888, and that collectively they had 835. AIU indicates that the mean of the peer group was 446 and the median was 382.

Rather than critique the results of any specific study of Mr. Amen‘s, AIU states that AG/CUB witness Fenrick largely focuses on his alternative study, an econometric or translog cost model that purports to statistically predict AIU‘s A&G and distribution and customer care ("D&CC") expenses. AIU states that AG/CUB suggests that the results of Mr. Fenrick‘s study can be relied upon as a basis to show why AIU is not entitled to any rate increase. AIU contends, however, that even Mr. Fenrick admits that his statistical study should not be used to establish an authorized level of AIU-related expenses.

AIU argues that Mr. Fenrick‘s complex study suffers from substantial deficiencies and errors. AIU claims his study is deficient because Mr. Fenrick discarded numerous alternative models that he researched and created. AIU alleges that these alternative models contained data and information that were an integral part of his research process that led to Mr. Fenrick‘s final model. AIU says it is not possible to understand Mr. Fenrick‘s criteria for selection of the variables in his model without production of the process followed to arrive at his opinions. As neither AIU nor the Commission have access to that process, AIU argues any conclusion regarding O&M cost efficiency should be rejected for that reason alone.

AIU also complains that Mr. Fenrick‘s study contains numerous specification errors. AIU asserts that correcting some of the errors in Mr. Fenrick‘s study leads to material changes in his results that are qualitatively similar to the results of Mr. Amen‘s peer-group benchmarking studies. AIU alleges that the flaws in Mr. Fenrick‘s study notwithstanding, the only conclusion supported by the statistical properties of his model is that AIU is, at worst, an average cost performer.

Furthermore, AIU states that the specification of an econometric model includes formulating a mathematical equation by selecting appropriate variables to be used in the equation. AIU alleges that in so doing, Mr. Fenrick has committed two common specification errors: (1) the omission of relevant variables; and (2) the inclusion of irrelevant variables. According to AIU, these specification errors bias the results of Mr. Fenrick‘s econometric cost model, rendering it an inappropriate basis for drawing any conclusions. As an example of the first error, AIU believes it is significant that Mr. Fenrick omitted total sales as an output variable in his A&G model. AIU claims that using total sales as a measure of output in Mr. Fenrick‘s model yields results that are qualitatively similar to the results of Mr. Amen‘s peer-group benchmark for A&G expenses. According to AIU, using total sales instead of net generation and making no other changes to Mr. Fenrick‘s A&G model, the model suggests that AIU‘s A&G expenses compare favorably to the other utilities in Mr. Fenrick‘s study.

AIU alleges that another specification error is Mr. Fenrick's use of a wage level variable that is severely flawed. AIU states that Mr. Fenrick's study period is 1994 to 2007. AIU claims that despite the availability of data for this period, he used a single May 2008 wage level for each of the 115 companies in his study. AIU asserts that his wage metric implies constant real wages over a 14-year time period, as well as constant relative wages across regions. In using this wage level variable, AIU alleges that Mr. Fenrick incorrectly assumes that changes in wage rates over time and relative changes between regions can not be a cost factor. AIU insists that wage levels change over time and across regions of the country, even after adjusting for inflation. AIU alleges there are other problems with the wage information used by Mr. Fenrick.

AIU asserts that AG/CUB, like Mr. Fenrick, confuses correlation with causation. AIU states that it is important in a model of cost causation to distinguish between a factor that causes costs and a factor that is correlated with costs. AIU says if one factor causes cost, then the two are certainly correlated. AIU argues that just because two metrics move together does not mean that one caused the other, even if causation seems to make sense. AIU indicates that the choice of explanatory variables for a cost model must be based on sound economic theory. AIU contends that Mr. Fenrick has failed to provide a sound basis in economic theory for the cost models underlying his benchmarks.

According to AIU, when a 95% confidence interval is constructed around his estimated results, both of Mr. Fenrick's models fail to demonstrate that AIU's actual expenses between 2005 and 2007 are statistically significantly different from his estimated expenses. AIU asserts that Mr. Fenrick's estimated expenses, at which AIU would be operating efficiently, were statistically indistinguishable from AIU's actual expenses. AIU asserts that Mr. Fenrick has no basis for concluding that AIU is inefficient. Instead, AIU says the only conclusion supported by the statistical properties of Mr. Fenrick's model is that AIU is an average cost performer. AIU also criticizes the confidence interval analysis performed by Mr. Fenrick.

AG/CUB criticizes AIU because no one peer group can account for all the key variables that drive AIU's costs. AIU contends that is precisely why Mr. Amen constructed 16 different peer groups, each one taking into account certain of AIU's characteristics, such as size, geographic location, and the fact that AIU owns no generation. AIU says that collectively, these peer groups account for nearly all the operating characteristics that Mr. Fenrick concluded were significant drivers of expenses.

AIU disputes AG/CUB's statement that Mr. Amen's study did not account for economies of scale because his inclusion criterion was wide ranging (100,000 to 1,000,000 customers) enough to significantly distort the results. AIU says Mr. Amen prepared A&G peer group studies for gas and electric utilities within a range of customer counts that equaled the number of customers served by each of the Ameren utilities in Illinois. AIU states that AmerenCILCO serves approximately 206,000 electric customers and 212,000 gas customers, AmerenCIPS serves approximately 380,000 electric and 181,000 gas customers, and AmerenIP serves approximately 611,000 electric and 416,000 gas customers. AIU contends that Mr. Amen‘s peer groups with a range of 100,000 to 1,000,000 customers explicitly corrected for scale economies inherent in A&G expenses, contrary to AG/CUB‘s charge.

AG/CUB criticizes Mr. Amen for including a wide range of 145 utilities in his electric O&M cost per customer comparison. AIU says each of the companies that AG/CUB complains about are also included in Mr. Fenrick‘s econometric study. According to AIU, these companies were included because they met the all-electric-utility criteria of one of Mr. Amen‘s O&M studies. AIU says this study was meant to compare AIU to all electric utilities on an O&M cost per customer basis. AIU claims this industry-wide O&M study was submitted as part of Mr. Amen‘s rebuttal testimony after he submitted both industry-wide and attribute-specific A&G studies in his direct testimony, the results of which showed that AIU performed at or better than the majority of utilities in managing A&G expenses.

AG/CUB contends that Mr. Amen failed to account for the presence or absence of generation facilities. In response, AIU says Mr. Amen‘s studies explicitly addressed how AIU compared to utilities that did not own generation facilities. According to AIU, Mr. Amen prepared several studies specifically designed to compare AIU‘s A&G expenses per customer against all electric companies that owned no generation, Midwest electric utilities that owned no generation, and electric companies with between 100,000 and 1,000,000 customers that owned no generation. AIU insists that Mr. Amen‘s peer-group benchmarking study did account for the presence or absence of generation facilities.

AIU also understands LGI to make the following recommendations to the Commission: (1) monitor AmerenIP‘s annual maintenance and system improvement investments, (2) direct AmerenIP to identify, prioritize, and address the need to replace aged assets on a case-by-case basis, (3) direct AmerenIP to expedite its correction of existing NESC violations, and (4) continue to monitor the status of unresolved Liberty Report recommendations. AIU asserts that the recommendations offered by LGI in this proceeding, if approved by the Commission, would increase AmerenIP‘s capital expenditures and O&M expenses in 2010 and require AmerenCIPS and AmerenCILCO to spend less on their systems.

AIU says AmerenIP already provides Staff, on an annual basis, with data concerning its capital and O&M expenditures. AIU believes that introducing yet another level of monitoring of AmerenIP‘s expenditures is an unnecessary exercise and very likely a waste of resources. Despite LGI's claims, AIU insists AmerenIP‘s investment in its systems has not declined, nor is the reliability of its service threatened. AIU also says that AmerenIP already reports the book depreciation values of its distribution assets, as allowed under Section 411.120(b)(3)(G) of 83 Ill. Admin. Code 411, "Electric Reliability." AIU argues that requiring AmerenIP to identify and report on the physical age of each distribution asset is neither required nor warranted. AIU says it already regularly inspects the condition of its electric distribution assets. AIU contends that the method of age-reporting proposed by LGI does not allow AIU (or the Commission) to predict the future reliability of an asset. AIU claims it has already agreed with Staff on a timetable for inspecting its distribution networks and resolving NESC violations. AIU claims that requiring AIU to arbitrarily expedite NESC corrective actions in any one area of its operations, or at the expense of undertaking other capital investments and maintenance projects concerning AmerenIP‘s own infrastructure, would be inappropriate. AIU represents that it and Staff are in agreement that LGI's recommendations are unnecessary or inappropriate.

LGI complains that AmerenIP‘s investments have declined significantly from 2006. AIU responds that AmerenIP‘s capital investments in maintenance and system improvements have in fact increased between 2007 and 2009. According to AIU, LGI ignores that AmerenIP‘s expenditures, both its capital investments and O&M expenses, spiked in 2006 because of severe summer and winter storms. AIU also claims that LGI ignores the fact that AmerenIP invested heavily in its distribution infrastructure in 2004 through 2006 after Ameren acquired IP. AIU asserts that LGI witness Brodsky was hired to develop and evaluate AIU‘s audit of the AmerenIP electrical distribution systems. According to AIU, Mr. Brodsky acknowledges that AIU spent millions of dollars on system improvements to correct and upgrade those systems, including projects specifically requested by Champaign and Urbana that were identified and designed by Mr. Brodsky.

LGI further complains that AmerenIP‘s investments fall significantly behind that of AmerenCILCO and AmerenCIPS. AIU asserts that the data relied on by LGI concerning AIU‘s capital investments in maintenance and system improvements shows that, in the 2008 test year, the total capital dollars spent per customer were practically identical: $108.09 for AmerenCILCO; $107.98 for AmerenCIPS; and $105.00 for AmerenIP. AIU also asserts that LGI does not consider the typical fluctuations that occur in a utility‘s amount of investment on an annual basis because of extreme weather, circuit inspection findings, completion time of projects, and system enhancement needs. AIU also asserts that LGI does not consider the unique characteristics of the individual utilities, such as customer density, the makeup of the customer classes, or whether the utility services predominantly urban or rural areas, all of which impact the per customer investment levels of the individual utilities. AIU claims that LGI fails to consider other indicators of the reliability of a utility‘s service and systems, such as the utility‘s System Average Interruption Duration Index, Customer Average Interruption Duration Index, or Customer Average Interruption Frequency Index ratings or data concerning the utility‘s worst performing circuits. Even if LGI were correct that AmerenIP‘s investments in its systems are in decline or are lagging behind the other utilities, AIU argues that LGI has failed to conduct a sufficiently reliable study to identify AmerenIP‘s appropriate level of capital investment per customer or assess the overall reliability of AmerenIP‘s distribution network. AIU insists that it would be inappropriate to conclude on this record that AmerenIP‘s investments are lacking or that its service is unreliable.

AIU believes that LGI's recommendations for the Commission regarding AmerenIP‘s reporting of aging assets and expediting of NESC violations are similarly flawed and should be rejected. AIU states that it utilizes book depreciation, rather than actual physical age, when reporting the age of existing distribution assets. According to AIU, whether an asset has exceeded its book depreciation is not necessarily determinative of the asset‘s reliability. AIU contends that well-maintained distribution facilities/equipment can last well beyond the facility‘s assigned depreciable life. AIU says it utilizes a comprehensive circuit inspection program to identify and correct potential performance issues with their distribution assets. AIU says the method of age-reporting that the utility uses is not nearly as significant as the utility‘s inspection and maintenance practices. AIU also alleges that LGI knows that AIU does not have physical installation records for a significant portion of its distribution poles, transformers and conductors/cables, making it nearly impossible for AmerenIP to report the physical age of its assets.

b. AG/CUB Position

According to AG/CUB, econometrics combines economic theory with statistics to analyze and test economic relationships. AG/CUB asserts that experimental data is usually observational – that is, it examines one variable to infer an effect on a subject – rather than derived from controlled experiments. AG/CUB claims that in contrast, the field of econometrics has developed methods for identifying and estimating the impact of simultaneous variables that reflect the state of the market at any given time. AG/CUB says these methods allow researchers to make causal inferences in the absence of controlled experiments. Econometric benchmarking, AG/CUB continues, allows the researcher to create a target (a benchmark) for a given metric, in this case the O&M expense for an electric utility. AG/CUB asserts that this type of benchmarking approach offers a statistical perspective for the Commission to use in evaluating the performance of AIU in containing O&M expenses relative to comparable utilities.

AG/CUB asserts that effectively managing costs is an essential element of a well-performing utility. In a rate case such as this, what constitutes an appropriate level of O&M expense is often a contested issue. Absent market forces to provide the impetus for efficient operation, AG/CUB avers that regulators must provide diligent oversight of expenses in determining their just and reasonable levels. AG/CUB says O&M expenses are short-run costs upon which current management can assert the most immediate control. AG/CUB states that Mr. Fenrick‘s benchmarking study reviewed O&M costs in two categories: A&G and D&CC. AG/CUB believes AIU‘s recent performance in these cost areas is of considerable importance in the context of the current rate proceeding.

AG/CUB agrees with AIU that benchmarking is an important tool for the Commission to evaluate the reasonableness of AIU‘s costs and performance. AG/CUB suggests that regulators can use benchmarking when regulating electric reliability, determining appropriate cost or salary levels, evaluating energy efficiency attainment and goals, and in the escalation provisions of multi-year rate or revenue caps. AG/CUB also says that utility managers can also use benchmarking to determine overall performance within the industry, pinpoint areas where improvements can be made, set challenging yet achievable goals, and identify best practices.

Mr. Fenrick entered into his econometric benchmarking model the expenses of a sample of 115 U.S. investor-owned electric utilities, which created the target against which he compared AIU's test year spending. AG/CUB asserts that the data shows that once AIU's electric utility operations were compared to the sample utilities, AIU's actual costs consistently exceeded those of comparable utilities. AG/CUB asserts that AIU's benchmarking analysis is inferior to Mr. Fenrick's approach, as it fails to adequately adjust for one or more variables that Mr. Fenrick's research found to be significant cost drivers. AG/CUB believes the results of Mr. Fenrick's study and analysis provides additional support for the adjustments AG/CUB adopt in this proceeding.

Mr. Fenrick states that the role of benchmarking in energy utility regulation has grown. AG/CUB states that in 2009, Florida Power & Light ("FPL") and Oklahoma Gas & Electric sponsored benchmarking studies to display superior cost performance relative to the industry. AG/CUB indicates that FPL noted that it was consistent with both cost-based regulation and the long-standing latitude of regulators to recognize low-cost efficient service in setting an appropriate return. AG/CUB asserts that the Ontario Energy Board now requires annual cost benchmarking updates of all power distributors operating in Ontario, Canada, and allowed rate escalation is partially determined by benchmarking scores. AG/CUB states that in the early 2000's, AmerenUE filed benchmarking testimony defending the cost performance of its Missouri electric operations. AG/CUB says the AmerenUE report used econometric benchmarking techniques similar to the approach used by AG/CUB in this proceeding.

AG/CUB asserts that a performance cost benchmarking study like the one Mr. Fenrick conducted evaluates those management decisions involving input quantities and prices given the external conditions and constraints faced by utility management. AG/CUB says this allowed Mr. Fenrick to incorporate multiple variables believed to impact cost. This way, AG/CUB avers he could create statistically valid comparisons between a utility's actual performance and a customized expectation of those costs. AG/CUB says that in this instance, —customized" means the model generates a custom expectation based on the comparison sample size and the number of variables accounted for in the model. AG/CUB asserts that good cost performers will have actual costs below the expected amounts, whereas poor performers will have actual costs above the expected amounts.

The goal of the econometric model, AG/CUB says, is to quantify expected costs in a fair and accurate way, accounting for the specific advantages and disadvantages inherent in the operating circumstances of each utility. AG/CUB asserts that the most accurate way to do this is to use regression analysis on each variable collected for each utility in the sample. In statistics, regression analysis is focused on identifying the relationship between a dependent variable and an independent variable. It illustrates how the typical value of the dependent variable changes when any one of the independent variables is varied, while the other independent variables are held fixed.

AG/CUB contends it can also, as it does with Mr. Fenrick's model, estimate what value the dependent variable would be given the independent variables used in the analysis - that is, the average value of the dependent variable when the independent variables are held fixed.

In Mr. Fenrick's analysis, the dependent variable was a utility's inflation-adjusted D&CC, or A&G, expense. The independent variables were the outputs (e.g., customers, volumes) and business condition variables (e.g., percent undergrounding, wage level, forestation) specific to each utility. AG/CUB says that to make sure that each independent variable included in the study did, in fact, affect the expense category, as he hypothesized when he included them, Mr. Fenrick conducted regressions and statistical testing to make sure that those variables were statistically significant cost drivers.

AG/CUB claims that the research shows that AIU's actual costs have consistently been above the model's expected costs for each Illinois utility in both of the examined O&M subcategories. For D&CC expense, AG/CUB states that AmerenCILCO, AmerenIP, and AmerenCIPS rank 76th, 80th, and 94th, respectively. AG/CUB claims that AIU's total D&CC expenses, across all three utilities, were 14.8% above what an average performing utility would be expected to spend under AIU's specific operating conditions. As compared to the top quartile of utilities, AG/CUB says AIU's D&CC expenses are approximately 35% above this standard. According to AG/CUB, the 2005-2007 A&G expenses even further exceed the model's prediction. For A&G spending, AG/CUB claims AmerenCILCO, AmerenIP, and AmerenCIPS rank 105th, 95th, and 85th, respectively. AG/CUB says the model showed expenses were 27.2% above expected spending for an average performing utility and about 48.6% above a top quartile performance standard.

AG/CUB contends that AIU's proposed test year expenses exceed normal cost increase expectations. To estimate AIU's performance in 2008 as compared to the sample utilities, Mr. Fenrick took the AIU's average annual cost performance in 2005-2007 and added the change in cost performance of AIU's proposed 2008 test year expenses. Mr. Fenrick first compared the AIU's actual 2005-2007 expenses to those proposed for the 2008 test year and calculated the percentage increase. AG/CUB says the percentage increases for the 2008 test year compared to the 2005-2007 average for AIU was about 31% for D&CC expenses and 24% for A&G expenses. According to AG/CUB, Mr. Fenrick then estimated the expected level of cost increases from 2005-2007 to 2008. To do this, he incorporated the cost impacts of inflation, productivity, and system growth. From the 2005-2007 average period to 2008, the U.S. Gross Domestic Product Price Index rose by 5.03%. AG/CUB states that during this same time, the number of customers for AIU increased by about 3%. AG/CUB asserts that these two components put upward pressure on costs of about 6 to 8%. AG/CUB contends that this cost pressure, however, would be partially offset by expected increases in productivity, a factor Mr. Fenrick's model takes into account in the parameter estimate of the trend variable.

AG/CUB says the change in cost performance is calculated as the difference between the actual percentage increase and the expected increase. AG/CUB states that these performance results are then compared with AIU's proposed statement of operating income, Ameren Exs. 2.1-2.3, and from this Mr. Fenrick determined the estimated inefficient O&M spending – that is, O&M spending AG/CUB believes is above what should be expected. Compared to the 2005-2007 spending, AG/CUB says AIU is proposing to increase D&CC spending by about 31% above the average level of AIU spending during 2005-2007. AIU's proposed A&G spending is about 24% above the average level of AIU spending during 2005-2007. AG/CUB avers that the model, however, estimates increases of only 6% in D&CC spending and 8% in A&G spending, based on an average performing utility. Taking into account expected cost increases, AG/CUB claims AIU's proposed costs are 25% more than an average performing utility for D&CC spending and 16% more for A&G spending.

AG/CUB states that to convert the cost performance into dollar terms, Mr. Fenrick estimated the percentage by which actual costs were above or below the expected amount. AG/CUB says he then used this number to approximate how much of AIU's proposed costs would need to change in order to achieve a given performance standard, whether that be an average or top quartile standard. For D&CC, AG/CUB contends that AIU's inefficiencies equate to $96.7 million for AIU's proposed 2008 test year spending levels, assuming an average performance standard. If a top quartile standard is used, AG/CUB asserts that D&CC inefficiencies amount to $132.3 million for AIU. AG/CUB claims that A&G expense inefficiencies are $61.8 million for AIU's proposed 2008 test year spending levels, assuming an average performance standard. Using a top quartile standard, AG/CUB asserts that A&G inefficiencies are estimated at $83.9 million. According to AG/CUB, in total, as measured against an average utility's performance, AIU's 2008 test year D&CC and A&G expenses are $158.5 million higher. As measured against the top quarter of utilities, AG/CUB alleges that AIU's sum of estimated D&CC and A&G inefficiencies is equal to $216.2 million.

AG/CUB states that Mr. Amen divided AIU's A&G expenses by the number of customers served and compared AIU cost per customer to a number of different peer groups. While Mr. Fenrick's model simultaneously accounts for multiple variables in determining expected costs, AG/CUB contends the AIU study depends solely on the construction of peer groups to adjust for the different operating conditions encountered by each sampled utility. Mr. Amen presents 16 separate peer groups, each one examining a variable similar to those used in Mr. Fenrick's study. Each AIU utility had its electric and gas delivery service operations compared both separately and together to a sample group for characteristics such as size, geographic location, ownership of generation, and combined gas and electric utilities as reported in 2007. AG/CUB complains that no single peer group encompassed all of these characteristics at one time.

AG/CUB says that while the peer group method is one that is frequently used in utility rate cases, it provides a less sophisticated analysis for the Commission to use. AG/CUB asserts that all of the suggested peer groups in the AIU study fail to adequately adjust for one or more variables that Mr. Fenrick's research found to be significant drivers of A&G spending. AG/CUB claims they are simple comparisons which do not address the impact of any one characteristic on any other characteristic, much less on AIU's operations as a whole. In AG/CUB's view, simplicity should not be held above accuracy. According to AG/CUB, the AIU study does not explicitly correct for scale economies inherent in A&G expenses as does Mr. Fenrick's. As size increases, it is expected that unit costs (A&G cost per customer) decrease due to economies of scale. AG/CUB alleges that if the analysis does not adequately adjust for this reality, it will be biased toward larger utilities. AG/CUB says that in most of the AIU peer groups, size is completely ignored. In two of the peer groups, AG/CUB says the impact of scale is acknowledged, but the analysts' inclusion criteria was wide ranging (100,000 to 1,000,000 customers), enough to significantly distort the results. AG/CUB contends that Mr. Amen's slides represent 16 different comparisons rather than one comprehensive comparison.

AG/CUB asserts that Mr. Amen also inappropriately includes A&G expenses without making any adjustments for the fact that AIU is not a vertically integrated utility. By including a large number of vertically integrated utilities in his sample, AG/CUB contends that Mr. Amen is biasing the results in favor of utilities that are not vertically integrated. According to AG/CUB, the A&G functions of a utility serve the production processes of a vertically integrated utility, if they exist. AG/CUB alleges that those utilities engaging in electricity production are putting forth more A&G ―effort" than their delivery-only counterparts, yet Mr. Amen's peer groups make no correction for this fact.

AIU witness Dr. Sosa claims that Mr. Fenrick's analysis should be ignored because it fails to include total sales as an output variable versus net generation in his A&G benchmarking model. AG/CUB states that Dr. Sosa ran his own analysis and concluded that with the correction of this ―flaw" his model yields results that are qualitatively similar to the results of Mr. Amen's peer group benchmark for A&G. In response to Dr. Sosa's criticism, Mr. Fenrick adjusted his model and ran his analysis again with the net generation output variable total sales. AG/CUB says the AIU results were both qualitatively and quantitatively similar to those found using the original econometric models. AG/CUB states that for estimated 2008 test year A&G expense inefficiencies were projected at over $50 million, versus the $61.8 million originally estimated, when compared to an average performance standard. AG/CUB says when compared to a top quartile performance standard, the levels are in excess of $70 million versus the $83.9 million from the original analysis.

AG/CUB contends that this shows the robustness of Mr. Fenrick's models and that the results are not dependent of model specifications, assuming these specifications account for the major drivers of cost. AG/CUB believes AIU failed to show such a model with results contrary to Mr. Fenrick. AG/CUB notes that Dr. Sosa was able to replicate Mr. Fenrick's model and results. According to AG/CUB, such replication from the opposing party offers the Commission additional confidence in the method and results undertaken by Mr. Fenrick in evaluating the reasonableness of AIU's proposed spending levels in this case.

c. LGI Position

According to LGI, Mr. Brodsky's testimony raises issues with AmerenIP's maintenance of its system. One of the areas that Mr. Brodsky examined was compliance with the NESC. Mr. Brodsky does not propose specific dollar amount adjustments for AmerenIP's efforts to resolve NESC violations, but he does express concern about the pace to remedy the violations. LGI, however, is still concerned with how the dollars are spent.

Mr. Brodsky found that since 2007 AIU has identified 34,262 NESC violations on the AmerenIP system and as of August 2009, 11% of the violations remain unresolved. LGI states that while AIU is periodically reporting the status of resolving the violations to Staff, Mr. Brodsky believes that AmerenIP should expedite the completion of the remediation since the unresolved NESC violations unnecessarily exposes the public to potential harm and could lead to failures in the electric system. LGI adds that Mr. Brodsky is an engineer and is familiar with the AmerenIP system. LGI indicates that he assisted Champaign and Urbana in conducting an audit of the AmerenIP system as part of a settlement agreement pertaining to the acquisition of IP by Ameren. LGI also claims he had a role in the development of the audit's requirements and had a role in formulating additional projects to improve reliability of AmerenIP's electric system serving Champaign and Urbana.

With regard to how maintenance dollars are spent for AmerenIP customers, LGI contends that AmerenIP's total investment per customer declined significantly between 2006 and 2009, falling form $143.82 per customer to $112.01 per customer. LGI believes that reductions in maintenance could lead to reductions in the reliability of electric service and that AmerenIP should increase its maintenance investments. LGI claims that the per customer maintenance and system improvement data is a more appropriate measurement for considering future reliability than other measurements such as CAIDI, SAIDI and CAIFI since those indices pertain to a given year. LGI suggests that when considering maintenance investments, one should also contemplate investments in the future. LGI asserts that the reliability data that AIU reports to the Commission indicates that the data was generally volatile and there was no clear pattern of improvement or degradation. When considering future reliability, LGI contends that quite often, it is likely to expect a lag period. LGI says that investments in the maintenance of a system today may cause improvement to reliability in the future, whereas looking at near term reliability indices only indicates what is happening or the consequences of investments that happened in the near past.

LGI claims it is more useful to look at maintenance investments on a per customer basis since the size of each of the three AIU electric systems is different. Between 2006 and 2009, LGI asserts that AmerenIP decreased its total annual maintenance investments from $70,646,100 to $24,910,400, an overall reduction of approximately 65%. On a per customer basis, LGI asserts AmerenIP decreased its maintenance investments from $114 per customer to $40 per customer, an overall reduction of approximately 65%. LGI states that maintenance investments for AmerenCILCO and AmerenCIPS increased in both the total dollars and per customer. Between 2006 and 2009, LGI claims AmerenCILCO's total investment per customer increased by 60% and AmerenCIPS' total investment per customer increased by 96%. LGI states that AmerenIP's total investment per customer decreased by 22% over the same period. LGI is concerned about the trend. LGI recommends that the Commission monitor AmerenIP's annual maintenance investments and system improvement investments and investigate why AmerenIP's investments are lagging that of AmerenCILCO and AmerenCIPS.

d. Commission Conclusion

AIU performed certain benchmarking studies that it claims demonstrate that its O&M expenses are reasonable. AG/CUB contends that AIU's studies are flawed. AG/CUB also presented an econometric study which it claims demonstrates that AIU's costs are higher than should be expected. AIU believes that AG/CUB's study is flawed. In addition, LGI expresses concern that AIU is not expending enough money in maintaining the AmerenIP distribution system. AIU disputes LGI's assertions and objects to the recommendations that additional monitoring and reporting is necessary with regard to the reliability of its distribution system.

There are essentially two experts that analyzed the same data, but utilized different approaches, and reached opposite conclusions. The Commission finds that the studies presented by Mr. Amen, while not perfect, are straightforward and easy to understand. In the Commission's view, the study presented by Mr. Fenrick is obviously more complex and therefore more prone to error and improper interpretation. The Commission believes it is particularly important to take care when attempting to use an econometric model to either predict outcomes or draw conclusions about causes and effects. In this instance, the Commission is not convinced that the AG/CUB's study demonstrates what it contends that it does. Even if one were to assume that it did demonstrate that AIU is inefficient and that some of its costs are higher than they should be, AG/CUB has provided no real method whereby the results could be used. In other words, AG/CUB has not shown what costs, if any, should be reduced or eliminated from AIU's operating expenses. The Commission believes there would be no way to utilize the AG/CUB study for ratemaking purposes in this proceeding, even if the Commission were fully convinced of its validity.

The Commission and its Staff have been monitoring and will continue to monitor AIU's activities to operate and maintain the distribution system of AmerenIP. However, the Commission shares LGI's concerns. As discussed elsewhere in this Order, the Commission has required AIU to correct its NESC violations by the end of 2013. The Commission concludes that the specific recommendations of LGI regarding monitory and reporting are reasonable and those recommendations are hereby accepted.

VI. COST OF CAPITAL/RATE OF RETURN

A. Overview

A company utilizes various types of investor-supplied capital to purchase assets and operate a business. Utilities typically rely upon long-term debt and common equity, and in some instances preferred stock and short-term debt, to purchase assets and fund operations. The costs of different types of investor-supplied capital vary depending upon a multitude of factors, including the risk associated with the investment. As a result, the proportion of the different types of capital, also known as the capital structure, when combined with the costs of each different type of capital affects the overall or weighted average cost of capital, which is the ROR a utility is authorized to earn on its net original cost rate base.

The Commission relies on the cost of capital standard to determine a fair ROR. This cost, which can be determined from the overall ROR or weighted average cost of capital, should produce sufficient earnings and cash flow when applied to the respective company's rate base at book value to enable a company to maintain the financial integrity of its existing invested capital, maintain its creditworthiness, attract sufficient capital on competitive terms to continue to provide a source of funds for continued investment, and enable a company to continue to meet the needs of its customers.

These standards are effectively mandated by the landmark U.S. Supreme Court decisions Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679 (1923) ("Bluefield") and Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 391 (1944) ("Hope"). Meeting these requirements is necessary in order for a company to effectively meet the utility services requirements of its customers and provide an adequate and reasonable return to its investors, debt holders and equity holders, alike.

B. Capital Structure

1. AmerenCILCO

According to AmerenCILCO, its March 31, 2009, preferred stock balance is $18,893,567. This number reflects the carrying value or net proceeds amount of AmerenCILCO's preferred stock as found in the embedded cost calculation for this component of capitalization. Staff adjusted the discount expense for AmerenCILCO's outstanding preferred stock issues, which Staff maintains had a small effect on the balance and did not affect the embedded cost of preferred. As a result, Staff's adjusted balance for AmerenCILCO's preferred stock is $18,893,282. AmerenCILCO and Staff both indicate they are of the opinion this represents an immaterial difference.

As the parties are in agreement that there is no material difference in the result whether AmerenCILCO's suggested preferred stock balance or Staff's suggested balance is used, the Commission will adopt Staff's suggested preferred stock balance of $18,893,282.

AmerenCILCO maintains that the balance of AmerenCILCO's short-term debt equals $32,017,993. Staff does not take issue with AmerenCILCO's calculation of the balance of short-term debt. The Commission finds the calculation of short-term debt to be reasonable and it will be adopted.

With respect to AmerenCILCO's long-term debt, Mr. O'Bryan testified that the balance, $271,492,364, is the total carrying value of all of AmerenCILCO's long-term debt (first mortgage bonds and pollution control bonds) using the net proceeds method, as outlined in AmerenCILCO Ex. 13.2. Staff witness Phipps testified that in her opinion, this balance should be $271,691,990. AmerenCILCO and Staff both indicate that they are of the opinion that this adjustment represents an immaterial difference. As the parties are in agreement that there is no material difference in the result whether AmerenCILCO's suggested long-term debt balance or Staff's suggested balance is used, the Commission will adopt Staff's suggested long-term debt balance of $271,691,990.

AmerenCILCO and Staff agree that AmerenCILCO's March 31, 2009, common equity balance is $249,457,171. The Commission finds the common stock balance for AmerenCILCO to be reasonable and it will be adopted.

2. AmerenCIPS

AmerenCIPS and Staff agree that AmerenCIPS' balance of preferred stock is $48,974,984, which is the carrying value or net proceeds amount of AmerenCIPS' preferred stock as found in the embedded cost calculation for this component of capitalization. The Commission finds the agreed preferred stock balance for AmerenCIPS to be reasonable and it will be adopted.

AmerenCIPS maintains, and Staff does not dispute, that AmerenCIPS' short-term debt balance equals $58,098,936. The Commission finds AmerenCIPS' proposed short-term debt balance to be reasonable and it will be adopted.

AmerenCIPS initially proposed a balance of long-term debt of $397,043,827, which AmerenCIPS states is the total carrying value of all of its long-term debt (first mortgage bonds and pollution control bonds) using the net proceeds method. Staff argues that AmerenCIPS' balance of long-term debt should be $397,751,866, which reflects an adjustment to remove any incremental cost increase due to AmerenCIPS' decision to refinance a $67 million, 5-year intercompany promissory note bearing an interest rate of 4.7% with $61.5 million in 30-year bonds bearing an interest rate of 6.7%. While AmerenCIPS argued in its previous rate case, Docket Nos. 07-0585 et al. (Cons.), that AmerenCIPS was justified in refinancing the 4.70% note; AmerenCIPS accepts Staff's position on this issue for the purposes of this case only. The

Commission finds that Staff's proposed balance of long-term debt for AmerenCIPS is reasonable, and it will be adopted.

AmerenCIPS proposes a December 31, 2008, common equity balance of $478,676,606. Staff agrees with AmerenCIPS' proposed common equity balance. The Commission finds AmerenCIPS' proposed common equity balance to be reasonable and it will be adopted.

3. AmerenIP

a. Preferred Stock Balance

AmerenIP and Staff agree that AmerenIP's balance of preferred stock is $45,786,945, which is the carrying value or net proceeds amount of AmerenIP's preferred stock as found in the embedded cost calculation for this component of capitalization. The Commission finds the proposed preferred stock balance for AmerenIP to be reasonable and it will be adopted.

b. Short-Term Debt Balance

(1) AmerenIP Position

AmerenIP maintains that its balance of short-term debt is $10,404,002, while noting that Staff argues that AmerenIP's short-term balance should be adjusted to $10,791,502 to reflect an adjustment wherein the short-term debt calculation does not subtract cash from short-term debt. According to AmerenIP, Staff argues that for the one month during the short-term debt measurement period that AmerenIP had short-term debt outstanding, AmerenIP subtracted ―excess cash" from short-term debt. AmerenIP argues that Staff admits that AmerenIP's calculation does not affect AmerenIP's overall cost of capital, arguing, however, that the calculation was improper because it is not a part of short-term indebtedness.

AmerenIP submits that its short-term debt balance was calculated pursuant to the formula set forth in the "Illinois Commerce Commission Rate of Return Instructions, Section 285.4020 Schedule D-2: Cost of Short-term Debt (b-4)" (as outlined in AmerenIP Ex. 13.3). AmerenIP argues that it followed the Commission's approach from recent rate proceedings, which calculates the amount of short-term debt in the capital structure by taking an average of month-end short-term debt balances six months prior to and following the capital structure measurement date. This approach aligns the measurement period with a midpoint that coincides with the measurement date of the long-term capital structure components.

(2) Staff Position

Staff takes the position that AmerenIP's calculation improperly subtracts —excess cash" from the short-term debt balance. Staff explains that the short-term debt calculation adopted by the Commission in AmerenIP's 2007 rate case, which subtracted —excess cash" from short-term debt, was based on very specific, unique circumstances that do not apply in the instant case. Staff, therefore, does not subtract cash from short-term debt in its calculations. Staff notes, however, that notwithstanding Staff's opposition to AmerenIP's improper short-term debt balance calculation, AmerenIP's improper calculation does not materially affect AmerenIP's overall cost of capital.

(3) Commission Conclusion

The Commission notes that AmerenIP indicates it is attempting to follow the Commission decision from AIU's last rate case, Docket Nos. 07-0585 et al. (Cons.) by subtracting "excess" cash from short-term debt balances, while Staff argues that decision was based on the unique circumstances presented which are not present in this proceeding. The Commission agrees with Staff that the circumstances present in the prior rate proceeding which caused AIU to retain "excess" cash are not present in this proceeding, and the Commission will therefore adopt Staff's proposed short-term debt balance for AmerenIP. The Commission also recognizes that the parties agree that opting for Staff's suggestion over that of AmerenIP will not have a material impact on AmerenIP's overall cost of capital.

c. Long-Term Debt Balance

(1) AmerenIP Position

AmerenIP maintains that its balance of long-term debt is $1,357,044,075, which is the total carrying value of all of the Company's long-term debt (first mortgage bonds and pollution control bonds) using the net proceeds methods, while Staff argues that AmerenIP's long-term debt balance should equal $1,307,983,675, to reflect a reduction in the principal amount of AmerenIP's October 2008 debt issuance from $400 million to $350 million.

AmerenIP opines that Staff's adjustment to exclude a portion of the principal amount of AmerenIP's long-term debt issuance is unwarranted. AmerenIP notes that its long-term debt issuance was not impacted by its temporary short-term debt with an objective of maintaining an appropriate level of available liquidity. AmerenIP avers it sized the debt issuance to retire its own short-term debt with an objective of maintaining an appropriate level of available liquidity. AmerenIP notes that prior to its recent ratings upgrade, it had sub-investment grade, or —junk" issuer credit ratings which made it subject to material cash collateral calls from its counterparty suppliers. AmerenIP argues that these collateral demands can create sizable, volatile, unpredictable and immediate needs for cash, thus requiring meaningful liquidity resources. AmerenIP further argues that these obligations must be met regardless of the timing and amount of the company's incoming cash flows. AmerenIP avers that at the time of the issuance, the money pool loan to AmerenCIPS was simply a temporary use of funds which would have otherwise been maintained as highly liquid short-term investment as a liquidity reserve.

AmerenIP notes at the time of this debt financing, AmerenIP was fully utilizing its capacity under its two bank facilities and had to further meet its short-term borrowing requirements through borrowings from Ameren. AmerenIP argues that another key factor impacting the need for this financing and the requirement to improve AmerenIP's liquidity position was the condition of the capital markets and bank markets, noting that during this time, the capital markets were in a high state of distress and the bank markets were effectively closed. AmerenIP states that after filing bankruptcy, Lehman Brothers was no longer funding loan requests under these facilities, and at the time of its filing, Lehman Brothers represented $71 million of the $1 billion in credit facilities AmerenIP could directly access, while three other troubled institutions represented a combined total of approximately $265 million under these facilities. AmerenIP notes that Staff witness Phipps acknowledged these circumstances existed in the financial market at the time.

AmerenIP claims that the evidence showed the debt capital markets were also severely distressed, as many issuers could not access debt capital, and those that could were faced with very high investor return requirements as evidenced by higher credit spreads. AmerenIP avers that as AIU's bank facilities were scheduled to expire in January 2010, and with no assurance that the bank markets would improve and permit the extension or renewal of these facilities, AmerenIP took the prudent step of completing a refinancing in order to improve its liquidity position and ensure that it would have sufficient liquidity to fund its utility operations going forward.

AmerenIP notes that Staff alleges that AmerenIP could have recalled its money pool loan to AmerenCIPS, in which case AmerenCIPS could have borrowed its funds from Ameren. AmerenIP disputes Staff's argument that if AmerenIP had recalled its money pool loan, it would not have needed to borrow $60 million from Ameren on October 21, 2008, and that if AmerenIP had not borrowed from Ameren on October 21, 2008, it could have reduced the size of its October 2008 long-term debt issue from $400 million to $350 million because it would have had less short-term debt to retire.

While Staff avers that Ameren and its subsidiaries, including AIU, did not believe the potential reductions in available capacity under the credit facilities would materially affect their liquidity if Lehman Brothers did not fund its commitments and that AmerenIP did not require the additional $50 million long-term debt balance to repay existing short-term indebtedness; AmerenIP opines that Staff's arguments utilize the benefit of hindsight and can only be made now given conditions in the capital and bank markets have improved. AmerenIP notes that it would have had to continue to fund itself regardless of whether it had been able to access the capital markets in June 2009 to fund its long-term debt maturity, without having received an upgrade in its credit ratings, and regardless of the direction of commodity prices and resultant demands for collateral pricing. AmerenIP argues it was concerned about renewal one year in advance because by the time Ameren IP completed its $400 million long-term debt financing in October 2008, Moody's Investors Service ("Moody's") had already been publicly signaling its focus on the renewal of AmerenIP's, as well as AmerenCILCO's and AmerenCIPS', bank facilities, noting this in August, and September, 2008 credit reports.

(2) Staff Position

Staff recommends that the Commission determine that AmerenIP's March 31, 2009, long-term debt balance was $1,307,983,675, while AmerenIP recommends a balance of $1,357,044,075. Staff states it adjusted the principal amount of AmerenIP's 9.75% senior secured notes by calculating the amount of net proceeds that would be required to repay AmerenIP's $343.7 million borrowings under the 2006 and 2007 credit facilities, taking into consideration AmerenIP's $1.2 million debt expense, 1.58% original issue discount, and 70 basis points underwriting fee. Staff calculated that AmerenIP would have needed to issue $350 million in debt to raise sufficient cash to retire $343.7 million in short-term borrowings and, therefore, proposes to reduce the principal amount of AmerenIP's October 2008 debt issuance to $350 million from $400 million.

Staff notes that on October 23, 2008, AmerenIP issued $400 million, 9.75% senior secured notes, and used the proceeds to repay borrowings under the bank facilities and the money pool. AmerenIP asserts that it issued indebtedness totaling $400 million instead of a lower amount because this was the amount of AmerenIP's outstanding short-term debt at the time of the issuance. Staff notes that on October 22, 2008, AmerenIP was simultaneously contributing surplus funds to and borrowing from the money pool. Staff argues that such transactions are unnecessary given the Commission's rules governing money pools require that money pool borrowers repay the principal amount of money pool loans on demand of the lending utility. Staff opines that AmerenIP should have recalled its money pool loan and issued long-term debt in an amount sufficient to repay its credit facility borrowing rather than issue $400 million in bonds, given the high cost of long-term debt at that time. Staff argues that without its proposed adjustment, AmerenIP customers would pay a 9.75% interest rate on $50 million in bonds, the proceeds from which AmerenIP did not require for its electric and gas delivery services operations.

Staff states that AmerenIP argues that it did not recall its money pool loans in order to reduce the amount of the $400 million bond issuance, as AmerenIP was holding cash and could temporarily provide AmerenCIPS with the cash it needed. Staff opines that AmerenIP's argument supports Staff's position that AmerenIP had liquidity available with which it could reduce its outstanding short-term debt before AmerenIP went to market securities in a high cost debt market.

Staff avers that while AmerenIP argues it did not need the funds it loaned to AmerenCIPS during October 2008, AmerenIP further states that it was fully utilizing its capacity under its two bank facilities and had to further meet its short-term borrowing requirements through borrowings from Ameren. Staff argues that these two statements are contradictory, as a utility that has cash available to lend should not simultaneously need to borrow additional short-term funds from either banks or affiliates. Staff opines that AmerenIP could have recalled its money pool loan to AmerenCIPS, in which case AmerenCIPS could have borrowed funds from Ameren or from the credit facility. Instead, Staff argues, AmerenIP borrowed $60 million from Ameren on October 21, 2008, which AmerenIP repaid two days later. Staff avers that if AmerenIP had not borrowed from Ameren on October 21, 2008, it could have reduced the size of its October 2008 long-term debt issue from $400 million to $350 million. Furthermore, Staff notes that AmerenIP‘s cash balance grew significantly from October 20, 2008 to October 22, 2008, indicating that AmerenIP did not use the proceeds from the Ameren loan.

Staff avers that on October 20, 2008, AmerenCIPS' short-term debt balance was less than AmerenIP's, as AmerenCIPS had borrowed $64 million from the money pool, had no outstanding bank loans, surplus funds or cash, leaving AmerenCIPS with $135 million in total available liquidity. Nevertheless, Staff argues that AmerenIP issued $50 million more long-term debt than required for AmerenIP‘s utility operations while AmerenCIPS relied upon low cost money pool funds rather than issue any long-term debt during 2008.

Staff disagrees with AmerenIP's position that it needed substantial cash balances, as it does not have ongoing cost-effective daily access to same-day funds for uncertain working capital needs due to the three-day lag between when it requests a London Inter-Bank Offer Rate ("LIBOR") loan and when the banks fund the LIBOR loan, and that AmerenIP also commonly holds cash to fund payment requirements on a daily basis and to be ready to fund cash collateral requirements, which can change on a daily basis.

Staff notes that the three-day lag on LIBOR loans has been a requirement since AIU entered the 2006 credit facility. Furthermore, Staff avers that the pricing schedule for the AIU credit facility mirrors the pricing schedule for Ameren‘s non-utility credit facility, including an —ABR spread” that applies to same-day loans. Staff notes the ABR rate would have to be 673 basis points higher than current cost of short-term bank loans for AIU (3.02%) before it would be as costly as AmerenIP‘s 9.75% bonds. Staff submits that over the long-term, the ABR rate would be less costly than AmerenIP‘s 10-year bonds because borrowers may prepay ABR loans without premium or penalty, while AmerenIP locked in the 9.75% rate for 10 years.

Staff argues that AmerenIP never explains why its working capital and cash collateral requirements are not predictable, presenting no evidence that it is unaware of upcoming due dates for the services and goods it purchases such that substantial calls for cash payments can occur on fewer than three days‘ notice. Staff submits that the record contains evidence that there are no significant surprise calls for cash, as none of the contractual obligations for which AmerenIP received three days or less notice during October 2008 was larger than $5 million. Further, Staff opines that there was little risk of significant surprise calls for cash, as AIU allowed AmerenCIPS to carry less than $1 million cash balances (including contributions to the money pool) from October 17, 2008 through March 31, 2009.

Although AmerenIP claims it needed to issue excess high cost long-term debt due to the financial crisis, claiming that net available liquidity to AIU was as low as $99 million in September, causing AmerenIP to conservatively and proactively manage its own liquidity, Staff finds these arguments to be flawed.

Staff opines that the reference to the $99 million liquidity available to AIU under the credit facilities on September 25, 2008, ignores AIU's adequate aggregate cash balance. Staff further submits that this argument ignores the fact that of the three utilities, only one issued excess debt at high cost. Staff notes that on September 18, 2008, AIU had available liquidity (including cash balances) of approximately $1.197 billion, excluding the $121 million of Lehman Brothers' credit facilities commitments.

While AmerenIP argues that AIU's bank facilities were scheduled to expire in January 2010 with no assurance that the bank markets would improve and permit the extension or renewal of these facilities, Staff submits that AmerenIP issued the long-term indebtedness more than one year before AIU's bank facilities would expire.

Staff avers that none of AmerenIP's reasons for maintaining substantial cash balances warrants AmerenIP customers paying 9.75% interest on $50 million in bonds for ten years, the proceeds from which earned a return below 0.25% through either a loan to an affiliate or an investment in money market funds.

(3) Commission Conclusion

The Commission notes that Staff recommends a long-term debt balance for AmerenIP of $1,307,983,675; approximately $50 million less than that recommended by AmerenIP, to reflect what Staff believes was excessive borrowing by AmerenIP to repay borrowing under bank facilities and the money pool. AmerenIP argues it was necessary to borrow $400 million because this was the amount of short-term debt outstanding at the time of the long-term borrowing.

It appears to the Commission that AmerenIP issued more long-term debt than required for AmerenIP's utility operations, especially at a time when AmerenCIPS was relying on low cost money pool funds, contributed in part by AmerenIP, rather than resorting to the issuance of costly long-term debt. The Commission agrees with Staff that AmerenIP's proposal would unnecessarily burden ratepayers with $50 million in excess debt at a relatively high interest rate of 9.75%. The Commission will, therefore, adopt Staff's proposed long-term debt balance for AmerenIP for the purposes of this proceeding.

d. Common Equity Balance

(1) AmerenIP Position

AmerenIP proposes a March 31, 2009, balance of common equity of $1,110,636,039, adjusted for purchase accounting, ratemaking, and other non-cash items, while Staff maintains that AmerenIP's balance of common equity should be $1,052,637,039 to reflect an adjustment removing the $58 million common equity infusion by Ameren during March 2009.

AmerenIP disputes Staff's exclusion of the equity infusion from AmerenIP's capital structure, arguing that ignoring the credit and liquidity enhancing step of making a common equity infusion into AmerenIP implies neither of these objectives is worthwhile. AmerenIP argues that Ameren infused $58 million of common equity into AmerenIP in an effort to bolster AmerenIP's credit quality by enhancing its credit metrics and de-levering its capital structure, which action was intended to send a positive signal to the rating agencies and fixed income investors regarding the importance of AmerenIP's credit quality. AmerenIP submits that this was another of the multiple credit enhancing steps taken by Ameren and AmerenIP which ultimately led to improvement in AmerenIP's ratings including the restoration of its issuer rating to investment grade. AmerenIP opines that this equity infusion, as well as an additional equity infusion made in September 2009, further enhances AmerenIP's ability to achieve its stated equity ratio target in the range of 50% to 55%.

AmerenIP notes that although the March equity infusion resulted in a temporary increase in cash, this enhanced AmerenIP's liquidity position and reduced the extent to which it would need to rely on its bank facilities. AmerenIP argues that at the time, AmerenIP's bank facilities had not yet been renewed and its ability to do so was uncertain. AmerenIP notes that while the capital markets also were tentative and AmerenIP was facing a near-term $250 million long-term debt maturity, once it became apparent that AmerenIP would be able to successfully complete the renewal of its bank facilities, it elected to fund this long-term debt with cash.

While Staff acknowledges that AmerenIP's objectives were worthwhile, Staff maintains that Moody's August 13, 2009, announcement of AIU's upgrade does not support AmerenIP's contention that the common equity infusion ultimately led to Moody's decision to restore AmerenIP's credit rating to investment grade. Staff also argues that AmerenIP did not require an equity infusion from Ameren due to a lack of available liquidity because AmerenIP had available liquidity of at least $461 million to $590 million during March 2009.

AmerenIP acknowledges that Moody's did not specifically cite the $58 million common equity infusion in its August 13, 2009, announcement of the ratings upgrade for AmerenIP. However, AmerenIP argues that Moody's was clearly aware of this equity infusion and plans for further equity infusions and would have incorporated that into its analysis leading to the upgrade, noting an AmerenIP-specific credit opinion published by Moody's the day following the announcement of the upgrade wherein Moody's cited concerns around additional pressure on AmerenIP's financial metrics as a potential driver or factor which could drive the rating down. AmerenIP avers that common equity infusions are helpful for financial metrics and would thus act as an offset to any factor placing negative pressure on these metrics.

(2) Staff Position

For ratemaking purposes, Staff recommends AmerenIP's March 31, 2009, common equity balance equals $1,052,636,039. Staff recommends removing from AmerenIP's common equity balance a $58 million common equity infusion by Ameren that occurred during March 2009 in order to bolster AmerenIP's equity ratio. Staff argues that this equity infusion bolstered AmerenIP's equity ratio after AmerenIP issued $50 million more bonds than necessary to repay its outstanding short-term bank loans. Staff therefore recommends removing both the $50 million in long-term debt that AmerenIP did not require and the subsequent $58 million equity infusion.

Staff contends that if AmerenIP had issued $350 million 9.75% bonds during October 2008 instead of $400 million, then bolstering AmerenIP's common equity ratio would not have been necessary. While AmerenIP alleges the common equity infusion was a credit enhancing action taken by Ameren and AmerenIP that ultimately led to Moody's decision to restore AmerenIP's credit rating to investment grade, Staff opines that Moody's August 13, 2009, ratings upgrade announcement does not support AmerenIP's claim, instead stating that the upgrade of AIU was prompted by the recent execution of new bank facilities and the improved political and regulatory environment for utilities in Illinois.

Despite AmerenIP's claim that the equity infusion enhanced AmerenIP's liquidity position and reduced the extent to which it would need to rely on its bank facilities, Staff counters that AmerenIP did not need the cash from the $58 million infusion of common equity, noting that AmerenIP's March 2009 surplus funds balances were significant. Staff further avers that since the October 2008 bond issuance, AmerenIP has not borrowed under any of its $350 million bank credit facilities or the money pool. Staff opines that this shows that during March 2009, AmerenIP had sufficient available liquidity. Therefore, Staff urges the Commission to reject AmerenIP's proposed common equity balance and instead adopt Staff's proposed common equity balance.

(3) Commission Conclusion

The Commission agrees with Staff that the $58 million equity infusion from Ameren should be removed from AmerenIP's common equity balance. The record does not appear to contain any real justification for the equity infusion, other than the fact that AmerenIP borrowed $50 million more than required in its March 2009 bond issue, which the Commission has already determined should be removed from AmerenIP's long-term debt balance. As the Commission has made that determination regarding AmerenIP's long-term debt balance, it is clear the equity infusion should likewise be removed from the common equity balance. This adjustment will ensure that ratepayers will not be burdened with a capital structure that includes an excessive amount of common equity.

e. Staff's Alternative AmerenIP Capital Structure

AmerenIP notes that in the event the Commission accepts Staff's adjustment to AmerenIP's long-term debt balance, but does not adopt Staff's recommended adjustment to AmerenIP's common equity balance, then Staff recommends that the Commission also not remove the $50 million in debt AmerenIP issued in October 2008 from AmerenIP's long-term debt balance. As an alternative, Staff recommends the Commission adjust the interest rate on that $50 million in debt to the embedded cost of long-term debt had the $50 million in debt not been issued, or 7.83%. Staff maintains that, absent such an adjustment, AmerenIP's before-tax ROR on rate base would be higher if the Commission only reduced the balance of the October 2008 debt issue, than if the Commission adjusted neither the amount of the October 2008 debt issue nor the March 2009 common equity infusion.

Staff recommends the Commission consider the related adjustments to AmerenIP's long-term debt and common equity balances together. In terms of capitalization, the March 2009 $58 million common equity infusion essentially offsets the $50 million in excess debt IP issued in October 2008. Staff argues that if AmerenIP had issued $50 million less in debt in October 2008, it would not have needed $58 million of common equity in March 2009 to keep its common equity ratio from sinking further. Nevertheless, if the Commission agrees with Staff's adjustment to AmerenIP's long-term debt balance, but not the adjustment to AmerenIP's common equity balance, then Staff recommends the Commission also not remove from AmerenIP's long-term debt balance the $50 million in excess debt IP issued in October 2008.

Staff's alternative recommendation is to adjust the interest rate on the $50 million in excess debt to 7.83%, which Staff submits is AmerenIP's embedded cost of long-term debt had the $50 million in excess debt never been issued. Staff submits this approach would prevent the $50 million of excess debt from increasing AmerenIP's embedded cost of long-term debt while still recognizing the equity infusion. Staff notes the before tax cost of common equity is more expensive than even 9.75% debt. Staff submits that absent Staff's alternative proposal, AmerenIP's before-tax ROR on rate base would be higher if the Commission only reduced the balance of the October 2008 debt issue than if the Commission adjusted neither the amount of the October 2008 debt issue nor the March 2009 common equity infusion.

The Commission notes that since this order accepts both Staff's recommendation to reduce AmerenIP's long-term debt balance, as well as to reduce AmerenIP's common equity balance, there is no need to address this issue.

C. Cost of Preferred Stock

Staff and AIU agree that AmerenCILCO's March 31, 2009, embedded cost of preferred stock equals 4.61%; AmerenCIPS' December 31, 2008, embedded cost of preferred stock equals 5.13%; and AmerenIP's March 31, 2009, embedded cost of preferred stock equals 5.01%. The Commission finds these costs of preferred stock to be reasonable for each company, and they will be adopted for the purposes of this proceeding.

D. Cost of Long-Term Debt

1. AmerenCILCO

a. AmerenCILCO Position

AmerenCILCO proposes an embedded cost of long-term debt of 8.161% as of March 31, 2009, noting however that Staff seeks to adjust the coupon rate for AmerenCILCO's 8.875% bonds to reflect AmerenCILCO's alleged higher business risk profile due to its non-utility affiliates. Staff maintains that, during December 2008, AmerenCILCO's issuer rating from Moody's was Ba1 and its senior secured debt rating was Baa2. Staff acknowledges that Moody's classifies AmerenCILCO as having a —Medium" business risk, however, Staff maintains Moody's views U.S. transmission and distribution utilities' business risk as —Low." AmerenCILCO avers Ms. Phipps evaluated Moody's rating factors for AmerenCILCO using the benchmarks for low business risk electric utilities, and concluded that AmerenCILCO's implied issuer rating would be Baa1 for its regulated utility operations. Ms. Phipps argues that, since AmerenCILCO's secured debt rating is two notches above its unsecured ratings, Moody's would assign AmerenCILCO a secured debt rating of A2 if non-utility affiliates had not increased its business risk. Ms. Phipps makes a similar argument with respect to the Standard & Poor's ("S&P") rating, arguing that since AmerenCILCO's current S&P secured debt rating is two notches above its issuer rating, S&P would assign AmerenCILCO a secured debt rating of A if its business risk profile was not affected by its riskier non-utility affiliates.

AmerenCILCO states Ms. Phipps also changed various dates to conform to AmerenCILCO's 2008 Form 21 annual report and set the annual amortization of expense, premium, or discount, and loss or gain for each debt issue using a rate that she purports recovers those debt costs in equal monthly amounts between the embedded cost of debt measurement date and the end of the applicable amortization period. AmerenCILCO notes Ms. Phipps also argues for removal of three months of amortization from the year-end 2008 unamortized balances of expense, premium or discount, and loss or gain for each debt issue to determine the unamortized balances on the March 31, 2009, measurement date.

AmerenCILCO opines the rating agencies use a combination of qualitative factors along with quantitative analysis in determining an issuer's credit ratings, and are ultimately the final arbiters of credit ratings, and any adjustment based on an assumption that AmerenCILCO would be entitled to a higher rating is unfounded. AIU submits Ms. Phipps does not offer any compelling evidence that AmerenCILCO‘s rating, or the coupon/interest rate on AmerenCILCO‘s 2008 long-term debt issuance would have been any different than what either was at the time this debt was issued. AmerenCILCO states it needed to complete this refinancing in order to reduce borrowings under its bank facilities (its borrowing sublimits thereunder were fully utilized at the time) and improve its liquidity position. AmerenCILCO avers that to deprive it of its ability to adequately recover the cost of this capital in effect is penalizing AmerenCILCO for taking a prudent action to protect its ability to maintain appropriate levels of liquidity and ensure a reliable, continuing ability to make payments, including the posting of collateral, to its suppliers, employees, etc. on a contractual and timely basis going forward.

While Staff indicates it does not address whether AmerenCILCO should have issued the long-term debt, Staff continues to argue that AmerenCILCO is affected by its non-utility affiliates. AmerenCILCO suggests that it is inappropriate for Staff to step into the shoes of the ratings agencies and opine that the credit ratings for AmerenCILCO would be any different than they are today if it no longer had an unregulated generation subsidiary and/or was no longer owned by an intermediate parent company.

b. Staff Position

Staff proposes an embedded cost of long-term debt for AmerenCILCO of 6.69%, as opposed to AmerenCILCO's proposed rate of 8.16%. Staff proposes to adjust the coupon rate for AmerenCILCO‘s 8.875% bonds to reflect the low business risk profile of AmerenCILCO‘s electric and gas delivery service operations. Staff notes that Moody‘s, S&P and Fitch Ratings ("Fitch") each recognize that non-utility affiliates affect CILCO‘s credit rating.

Staff argues that despite the rating agencies‘ comments that AmerenCILCO‘s affiliation with CILCORP and Ameren Energy Resources Generating Co. ("AERG") increase AmerenCILCO‘s business risk, AmerenCILCO has not performed any analyses regarding the effect of AmerenCILCO‘s affiliation with CILCORP and AERG on the 8.875% coupon rate for AmerenCILCO‘s December 2008 bond issuance. Staff, therefore, proposes to remove the incremental risk in AmerenCILCO‘s credit ratings resulting from its non-utility affiliates.

Regarding Moody‘s ratings, Ms. Phipps considered that during December 2008, AmerenCILCO‘s issuer rating from Moody‘s was Ba1 and its senior secured debt rating was Baa2, with Moody‘s classifying AmerenCILCO as having ―Medium” business risk, which is typical for integrated utilities. Ms. Phipps states that Moody‘s viewed U.S. transmission and distribution utilities‘ business risk as ―Low.” Ms. Phipps then evaluated Moody‘s rating factors for AmerenCILCO using the benchmarks for low business risk electric utilities, concluding that AmerenCILCO‘s implied issuer rating would be Baa1 for its regulated utility operations. Since AmerenCILCO‘s secured debt rating is two notches above its unsecured ratings, Ms. Phipps concluded that Moody‘s would assign AmerenCILCO a secured debt rating of A2 if non-utility affiliates had not increased its business risk.

Regarding S&P ratings, Ms. Phipps evaluated AmerenCILCO‘s implied stand-alone S&P credit rating using financial ratios published by S&P, combined with a —Strong” business risk profile rather than AmerenCILCO‘s actual business risk profile of —Satisfactory.” Ms. Phipps stated that the S&P Business Risk/Financial Risk Matrix (—S&P rating matrix”) indicates AmerenCILCO‘s current BBB issuer rating is consistent with a —Satisfactory” business risk profile and AmerenCILCO‘s stand-alone financial ratios, as calculated by S&P. Using the S&P rating matrix, Ms. Phipps concluded that changing AmerenCILCO‘s business risk profile to —Strong,” would likely raise its issuer rating to BBB+. Since AmerenCILCO‘s current S&P secured debt rating is two notches above its issuer rating, Ms. Phipps estimates S&P would assign AmerenCILCO a secured debt rating of A if its business risk profile was not affected by its riskier non-utility affiliates.

Using AmerenCILCO‘s implied, low business risk, senior secured ratings of A2/A, Ms. Phipps estimated a coupon rate for AmerenCILCO‘s December 2008 bonds. Ms. Phipps states she reviewed A-rated, secured, electric utility debt financings with five-year terms to maturity that occurred between September 25 and December 31, 2008, and at that time, five-year, A-rated secured electric utility bonds were yielding 6.24%.

Ms. Phipps avers that despite AmerenCILCO's claim that it needed to complete this refinancing in order to reduce borrowings and improve its liquidity position; she did not argue that AmerenCILCO should not have issued $150 million long-term indebtedness. Ms. Phipps argues that her adjustment is limited to removing any incremental cost of AmerenCILCO‘s capital due to its non-utility affiliates, as required by Section 9-230 of the Act.

While AmerenCILCO claims that Staff does not present any compelling evidence regarding whether AmerenCILCO‘s rating, or the rate on its debt offering, would have been any different than what either was at the time this debt was issued, Staff argues that AmerenCILCO's decision to purchase the credit rating services of S&P, Moody‘s, and Fitch belies its contention that the opinions of those credit ratings agencies do not constitute compelling evidence. Staff notes that each of the rating agencies notes that AmerenCILCO‘s non-utility affiliates affect its credit rating. Staff notes that S&P ratings indicate that AmerenIP‘s strong business profile reflects its lower operating risk, being a distributor with no owned generation, therefore AmerenIP has less operating risk than a fully integrated utility. Staff contrasts this with AmerenCILCO, wherein S&P states that AmerenCILCO‘s satisfactory business profile reflects its non-regulated businesses, partially offset by its lower risk regulated transmission and distribution business.

While AIU argues actual ratings could span one notch above or below the midpoint indicated on the S&P rating matrix, meaning AmerenCILCO‘s rating using a —Strong” business risk profile could still be BBB (actual rating), rather than BBB+

(adjusted rating), Staff notes the first step in making Ms. Phipps' adjustment to AmerenCILCO's S&P rating was plotting the actual S&P issuer rating on the matrix using the —Significant" financial risk profile and the —Satisfactory" business risk profile that S&P actually assigns AmerenCILCO. Staff states that without changing where AmerenCILCO's rating falls on the financial risk spectrum, Ms. Phipps moved AmerenCILCO's business risk profile up one category to —Strong," thereby changing only the business risk profile; everything else remaining the same.

Staff states that Moody's, S&P, and Fitch have never stated their review of AmerenCILCO's financial performance is indicative of the stand-alone, regulated utility, without the presence of any unregulated subsidiaries. Staff notes that the August 14, 2009, Moody's report notes that CILCORP's debt and AERG's non-utility operations affect AmerenCILCO's credit rating. Staff asserts it is not clear why the rating agencies would view AmerenCILCO as a stand-alone regulated utility since AIU is not certain when AmerenCILCO would spin-off AERG. For all the foregoing reasons, Staff believes its recommended costs of AmerenCILCO's long-term debt for ratemaking purposes should be adopted.

c. Commission Conclusion

It appears to the Commission that Staff is of the opinion that the presence of the unregulated affiliates of AmerenCILCO is raising the cost of AmerenCILCO's long-term debt, which Staff argues is contrary to Section 9-230 of the Act, which states as follows:

> In determining a reasonable rate of return upon investment for any public utility in any proceeding to establish rates or charges, the Commission shall not include any (i) incremental risk, (ii) increased cost of capital, or (iii) after May 31, 2003, revenue or expense attributed to telephone directory operations, which is the direct or indirect result of the public utility's affiliation with unregulated or nonutility companies.

The Commission notes that this issue of increased risk from an unregulated affiliate has been addressed previously by the courts, including Illinois Bell Telephone Co. vs. Illinois Commerce Comm'n., 218 Ill. Dec. 598, 283 Ill. App. 3d 188, 669 N.E. 2d 919 (2nd Dist., 1996) ("Illinois Bell"), wherein the appellate court found that:

> Where utility's exposure to risk is one iota greater, or it pays one dollar more for capital because of its affiliation with unregulated or nonutility company, (the) Commission must take steps to ensure that such increases do not enter into it rate of return calculations.

Based on the evidence presented, the Commission can only conclude that there has been an increased cost to AmerenCILCO for long-term debt due to the presence of its unregulated affiliates, CILCORP and AERG. Staff has made a persuasive showing that but for these unregulated affiliates, AmerenCILCO would have been assigned a more favorable debt rating and would have been able to accomplish the December

2008 bond issue at a lower interest rate, as suggested by Staff. Therefore, the Commission will adopt Staff's proposed cost of long-term debt rate of 6.69% for AmerenCILCO, as to do otherwise would penalize ratepayers for the presence of AmerenCILCO's unregulated affiliates, contrary to the provisions of Section 9-230 of the Act.

2. AmerenCIPS

Staff and AmerenCIPS agree that for the purpose of this case, AmerenCIPS' December 31, 2008, embedded cost of long-term debt equals 6.49%. AmerenCIPS' embedded cost of long-term debt reflects Staff's adjustment to remove any incremental cost increase due to AmerenCIPS' decision to refinance the 4.7% intercompany note with 6.7% bonds during June 2006. Both parties note that the Commission adopted this adjustment to AmerenCIPS' embedded cost of long-term debt in AIU's most recent rate cases, Docket Nos. 07-0585 et al. (Cons.). For the purposes of the instant case, AmerenCIPS accepted Staff's adjustment. The Commission finds the agreed embedded long-term cost of debt for AmerenCIPS of 6.49% to be reasonable and it will be adopted for this proceeding.

3. AmerenIP

a. AmerenIP Position

AmerenIP proposes an embedded cost of long-term debt of 7.94% as of March 31, 2009. AmerenIP notes that it issued $400 million of long-term debt in October 2008, which Staff proposes to adjust to $350 million. Based on this reduction, Staff proposes to reduce the total debt expense and debt discount based on the lower principal amount. As AmerenIP argues that Staff's exclusion of a portion of the principal amount of AmerenIP's long-term debt issuance is improper, AmerenIP believes Staff's adjustments to the long-term cost of debt are equally misplaced and should be rejected.

b. Staff Position

Staff's calculation of AmerenIP's March 31, 2009, embedded cost of long-term debt equals 7.83%. Under Staff's alternative proposal for AmerenIP's capital structure, as described previously, AmerenIP's embedded cost of long-term debt also equals 7.83%, while AmerenIP proposes a 7.94% embedded cost of long-term debt. The only contested issue between Staff and AmerenIP relating to long-term debt is the previously described adjustment that Staff proposed to the amount of IP's 9.75% bond issuance, which also affects AmerenIP's embedded cost of long-term debt.

c. Commission Conclusion

As the Commission has previously accepted Staff's recommendation to reduce AmerenIP's long-term debt balance by $50 million, the Commission finds it appropriate to adopt Staff's suggested embedded cost of long-term debt of 7.83%. The

Commission finds this cost rate to be reasonable and it will be adopted for the purposes of this proceeding.

E. Bank Commitment Fees

1. AIU Position

While AIU accepts Staff's proposal that bank facility costs should be recovered by a direct adder to each of the AIUs' cost of capital, AIU argues that Staff witness Phipps makes errors in her allocation of the fees, and thus understates the overall cost of capital. AIU avers that Ms. Phipps erroneously assigns a lower amount of total upfront fees than the amount actually realized by AIU in connection with putting the Illinois Facility in place. AIU indicates that Ms. Phipps' calculations utilize a 1.50% - 1.75% upfront fee rate range rather than the 1.50% - 2.00% upfront fee range incurred. AIU opines that this is due to assuming that the various facility commitment levels, or tiers, and their corresponding upfront fee rates are based on a certain total size of all commitments, and Ms. Phipps therefore reduces those tiers based on the smaller size of the Illinois Facility, $800 million ("the Illinois Facility") relative to the total size of the Ameren facilities being arranged at the time, $2.15 billion ("the Missouri Facility"). AIU suggests it is wrong to suggest that banks would be willing to lend into a smaller facility at a 1.50% rate. AIU submits if it had only been arranging the $800 million Illinois Facility and not a total of $2.1 billion of multiple credit facilities it would have still paid upfront fee rates in the 1.50% - 2.00% range; it would have simply required participation from fewer lenders and/or smaller commitments from these lenders with a corresponding reduction in various commitment level tiers in dollar terms.

AIU argues that Ms. Phipps also allocates the bank fees incorrectly to the various parties of the Illinois Facility as she subtracts Ameren's entire sublimit, along with an equal proportion of the costs, under the facility from the total facility size rather than the total sublimits of the participants. While Staff argues that AIU's methodology of allocating the facility fees does not recognize that Ameren's sublimit could reduce AIU's borrowing capacity to $500 million from $635 million, AIU opines that Staff's approach would assign too much cost to Ameren, and too little to AIU.

AIU notes that the parties to this facility and their individual borrowing sublimits consist of AmerenCIPS, $135 million; AmerenCILCO, $150 million; AmerenIP, $350 million; and Ameren, $300 million. AIU notes that the sublimits total of $935 million obviously exceeds the size of the credit facility ($800 million), which AIU states is not unusual, as it is predicated on the assumption that borrowers' needs fluctuate and coincident borrowing at the maximum amount of each sublimit is rare. While it is true that Ameren could at any time borrow up to its sublimit of $300 million and reduce the amount available to the AIUs under the facility to $500 million from $635 million, AIU avers that Ms. Phipps' methodology wrongly assumes that Ameren will consistently do so over the life of the facility and ignores the fact that Ameren may borrow under the facility in order to provide funds to the AIUs. AIU opines that the sublimits in the case of the AIUs also reflect their mortgage bond capacities since the security of the mortgage bonds was a necessity to the participating lenders.

AIU argues that Ms. Phipps also ignores the fact that Ameren can and does from time to time provide supplemental liquidity to the AIUs and can act as their ―lender of last resort" when their individual borrowing sublimits are at their maximum and there is no additional liquidity available in the utility money pool. AIU notes that this was the case between October 27, 2008, and October 29, 2008, when Ameren lent between $4.1 million and $13.6 million into the utility money pool at a time when AmerenCILCO's credit facilities sublimit total of $150 million was at capacity and the other AIUs did not have any additional funds to lend.

AIU further notes that third quarter borrowing, representing the initial quarter that the Illinois Facility was in place, shows that Ameren's average daily amount outstanding was $133.3 million, far less than the $300 million assumed by Ms. Phipps in her analysis.

AIU submits that the objective of allocating the costs of the facility is to do so fairly so as to not overcharge or undercharge AIU's fair share of the fees. AIU argues this can be accomplished by allocating the total bank facility fees by each borrower's proportion of the total borrower sublimits under the facility, which would set AIU's collective allocation of the total Illinois Facility fees at 67.9%, rather than at 62.5%, as Staff suggests. AIU avers that this method of allocation is fair in that it does not show bias toward any borrower beyond what its individual sublimit implies. AIU submits that under Staff's approach, it could borrow over 79% of the available facility (not counting any borrowings by Ameren on its behalf), but bear just 62.5% of the cost, whereas weighting cost responsibly in proportion to sublimits is far more reasonable.

While Staff claims that the examples supporting AIU's position that smaller facilities and bank commitments can have higher commitment fee rates have no value, AIU submits that they are completely on point. AIU points to a recent Integrys Energy Group, Inc. ("Integrys") facility, where the amount of the financing was a fairly minor portion of Integrys' aggregate bank facilities, yet it attracted a higher upfront fee. (Ameren Ex. 37.0 Revised at 4)

AIU argues that each bank financing is different with its own unique circumstances. AIU submits that these unique circumstances include, but are not limited to, absolute size of the facility, size of the facility relative to the borrower's total facilities, borrower's credit ratings, date the facility is put in place, opportunity for ancillary business and terms of the facility (tenor, existence of an extension option, security, etc.). While Staff suggests a lowering of the upfront fee rate to the lowest rate tranche for the aggregate Ameren facilities is proper, AIU avers that as each deal presents a unique set of circumstances and involves a negotiation process with a unique group of financial institutions, the correct adjustment is to maintain the same upfront fee rate that the banks agreed to pursue to the actual negotiations.

AIU opines that Staff's position assumes Ameren‘s borrowing in this facility will crowd out AIU, thus not allowing AIU full sublimit access; however, AIU submits that history shows such a case is very unlikely. AIU notes that over the past two years (371 total days) there have been only two days that more than one of the AIUs has borrowed at their sublimit on the same day, while over the same time period aggregate AIU borrowing has exceeded $500 million on just 53 days. AIU avers that borrowers' needs fluctuate and coincident borrowing at the maximum amount of each sublimit is rare, while Ameren also has access to $1.3 billion of credit facilities outside of the Illinois Facility at a lower rate. AIU argues that this gives Ameren a financial incentive to borrow from the other facilities, which it appears Ameren has adopted, as its average daily borrowing from the Illinois Facility is $81 million while over the same period it was borrowing at an average rate of $302 million per day from the other facilities. AIU therefore submits that the Commission should adopt its position on allocating the credit facility fees.

2. Staff Position

Staff notes that Ameren established two credit facilities in June 2009, the $800 million Illinois Facility, and the $1,150 million amended and restated Missouri Facility that covers AmerenUE, AERG, and Ameren. Staff recommends allocating annual bank commitment fees of $1,467,431 to AmerenCILCO; $1,453,649 to AmerenCIPS; and $3,768,782 for AmerenIP. Staff calculates these amounts by reducing the amount of upfront fees from $15,505,000 to $12,205,000, and allocated 62.5% of all fees to AIU. Staff further reduces the facility fees for AmerenCILCO to reflect its stand-alone S&P credit rating, and for AmerenIP to reflect its Moody‘s credit rating upgrade during August 2009. Staff notes that AIU allocates 67.9% of the fees to AIU, including $15,505,000 in upfront fees. Staff avers that it calculates the cost of bank commitment fees that should be added to each company‘s cost of capital by dividing each company‘s total bank commitment fees by total capitalization. Hence, Staff recommends adding 28 basis points to AmerenCILCO‘s overall cost of capital; 15 basis points to AmerenCIPS‘ overall cost of capital; and 16 basis points to AmerenIP‘s overall cost of capital.

Staff opines that Section 9-230 of the Act, states, in part as follows:

> In determining a reasonable rate of return upon investment for any public utility in any proceeding to establish rates or charges, the Commission shall not include any . . . increased cost of capital . . . which is the direct or indirect result of the public utility_saffiliation with unregulated or nonutility companies.

Staff notes that the legislature used the word "any" to modify its prohibition of considering increased cost of capital in determining a reasonable ROR. Staff opines that this language prohibits the Commission from considering what portion of a utility's increased cost of capital caused by an affiliation is reasonable and, therefore, should be borne by ratepayers. Staff notes that in the Illinois Bell case, 283 Ill. App. 3d at 207, the court held that if a utility's exposure to risk is one iota greater, or if it pays one dollar more for capital because of its affiliation with an unregulated or non-utility company, the Commission must take steps to ensure that such increases do not enter in its ROR calculation. Staff argues that it would therefore be improper to reflect any resulting incremental cost increase in AIU's cost of capital, regardless of any potential benefits of either jointly negotiating the Illinois and Missouri credit facilities or including Ameren as a borrower under the Illinois credit facility.

While AIU objects to Staff's calculation of the amount of upfront fees, which removed any incremental cost resulting from higher upfront fees based on aggregate commitment under the Illinois and Missouri Facilities combined than would result from the Illinois Facility commitments only, and further object to Staff's allocation of bank commitment fees between Ameren and AIU because Staff reduced the combined AIU sublimits, Staff submits that this is the only proper result under ratemaking principles.

Staff also calculated one-time upfront fees for AIU to maintain its bank lines of credit, which vary from 1.5% to 2.0% of the aggregate amount of each lender's commitments under both the Illinois and Missouri Facilities and increase as the commitment amount increases. Staff avers that this calculated upfront fee is $12,205,000, based on each lender's commitments under the Illinois Facility.

Staff argues that the smaller credit facilities cited by AIU, Integrys and NiSource, Inc. ("NiSource"), for the proposition that a smaller credit facility would not necessarily have lower upfront fees, are not relevant to this position. AIU notes that each cited financing had 2% upfront fees, as opposed to Staff's suggested 1.5% fee for AIU. Staff avers that the Integrys $500 million financing actually replaced a small portion of Integrys' $2.2 billion credit facilities, while the NiSource financing is distinguishable from the Illinois Facility because NiSource entered a term bank loan to supplement $1.5 billion revolving credit facilities. Staff argues that a term bank loan is not a credit facility. Staff avers that these financings were entered into prior to the date AIU closed on the Illinois Facility and the amount of each of the credit facilities lenders' commitments to the borrowers is unknown.

While AIU argues that there is no reason the Illinois Facility should have a lower upfront fee than the larger aggregate Ameren facilities, implying there are economies of scale associated with a larger credit facility, Staff opines that under the terms of the Illinois Facility, upfront fees increase as commitment amounts increase.

Staff states it divided one-time costs between AIU and Ameren according to borrower sublimits under the Illinois Facility, as the borrower sublimits total $935 million; however, combined Illinois Facility borrowings can not exceed $800 million. Staff argues that as Ameren can borrow up to $300 million, the Illinois credit facility could at times effectively reduce AIU sublimits to $500 million, or 62.5% of the $800 million Illinois Facility, therefore Staff allocated $1,000,000 in arrangement fees, $7,628,125 in upfront fees, and $23,438 in annual administrative agency fees to the combined AIU.

While AIU alleges that this calculation assumes that Ameren will consistently borrow up to its sublimit over the life of the Illinois Facility, Staff opines that without this adjustment, AIU, and ultimately AIU customers, would pay costs associated with more credit facility capacity than it would have available if Ameren borrows more than $165 million under the Illinois Facility, which Staff notes occurred during July and August 2009.

While AIU asserts that Staff's methodology does not recognize that Ameren may borrow under the facility to provide AIU supplemental liquidity by acting as its —lender of last resort," Staff avers that this argument does not support AIU's claim that AIU should pay costs associated with the $135 million borrowing capacity that either AIU or Ameren could borrow. Staff opines that the AIU argument applies only to borrowing capacity over the aggregate AIU sub-limit of $635 million because, under the Illinois Facility, Ameren pays a higher short-term bank loan rate than any of the AIUs due to its Baa3/BBB- unsecured debt ratings from Moody's and S&P. Staff states it is clear the Commission's rules for utility money pool agreements prohibits utilities borrowing from affiliates whenever utilities may borrow at lower cost directly from banks or other financial institutions.

Although AIU argues that Ameren has access to $1.3 billion of credit facilities outside the Illinois Facility at a rate that is slightly lower than the rate it can borrow from the Illinois Facility, giving it a financial incentive to borrow from the other facilities, Staff opines that this wrongly implies that Ameren can borrow $1,150,000,000 – its entire sub-limit under the Missouri Facility – for the entire two-year term of the Missouri Facility at lower cost than Ameren can borrow from the Illinois Facility. Staff states that AIU fails to note that these lower borrowing costs are available only from —Declining Lenders" through July 14, 2010. Staff states that —Declining Lenders" are those lenders under the original Missouri Facility that declined the option to extend their original commitments beyond July 14, 2010.

Staff avers that amending and restating the 2006 and 2007 Illinois credit facilities would have benefited AIU by making lower borrowing rates available from Declining Lenders, citing the fact that under the prior facility's pricing schedule, the spread over LIBOR for a Level III borrower equals 0.60%, while the current spread over LIBOR for a Level III borrower equals 2.75%. Despite that, Staff notes that Ameren terminated the 2006 and 2007 Illinois credit facilities seven months before they expired.

Staff avers that Ameren is not obliged under any agreement to provide AIU supplemental liquidity, and in fact, Ameren has taken steps to insulate itself from AIU when the Illinois legislature was considering rate freeze legislation by removing AIU as borrowers under Ameren's credit facility and removing provisions from the credit agreement that would treat AIU as subsidiaries for purposes of cross-default provisions.

Staff opines that AIU ignores the rationale for a commitment fee, which as its name implies, compensates banks for making a firm commitment to provide up to a specified amount of credit on demand. Staff argues that the full commitment fee applies regardless of the amount of money borrowed or letters of credit issued by each borrower. Staff argues that because of the overlapping sublimits in the Illinois Facility, the commitment available to AIU is a function of the amount of credit already committed to Ameren, which means AIU can only count on $500 million of the Illinois credit facility, not the $635 million of its combined sublimits would otherwise suggest.

While AIU argues that adjusting the facility fee rates for AmerenCIPS and AmerenIP in response to Moody's ratings upgrades for AIU on August 13, 2009, is improper, Staff notes that prior to the August 2009 rating upgrade by Moody's, AmerenCIPS was a Level III borrower, and AmerenIP was a Level IV borrower. Staff argues that the Moody's upgrade did not change AmerenCIPS' Level III borrower status, but instead raised AmerenIP's borrower status to Level III from Level IV.

Staff disputes AIU's argument that using AmerenIP's current senior secured credit rating is a selective adjustment to the cost of capital. Staff explains that the adjustment is not the consequence of an out-of-measurement period change in capitalization, such as the issuance of new debt or common equity, the retirement of debt, or the payment of common dividends. Staff notes that selective capital structure adjustments such as those would be improper because they wrongly imply those events occur in isolation. Staff avers that while facility fees will change during the term of the credit agreement as each borrower's credit rating changes, the change in the fee rate does not significantly affect the amount of capital the utility needs to maintain. Staff argues that adjustable facility fee rates are similar to variable interest rates, which the Commission has estimated using current rates rather than those that were in effect during a historical measurement period. Staff further notes that if AIU's argument had any merit, then AIU cost of capital could not reflect any costs associated with the 2009 Illinois Facility because AIU was a borrower under the 2006 and 2007 credit facilities on the capital structure measurement dates.

3. Commission Conclusion

The Commission notes that the principal difference between the parties on this issue is that AIU weights each individual company's allocation in proportion to total borrowing sublimits, while Staff does not. AIU argues that the effect of this is that under Staff's approach, the three utilities could borrow 79.4% of the available facility, while bearing responsibility for only 62.5% of the associated bank commitment fees. AIU states that Staff assumes that utility borrowing would be limited to 62.5%, when there is no such strict limitation on AIU. AIU argues that the more reasonable approach is that of AIU: weight the allocation based on sublimits. Under AIU's approach, the utilities bear 67.9% of the commitment fees, while being able to borrow between 62% and 79.4% of the facility. Staff takes the position that to allocate 67.9% of the commitment fees to AIU has the potential of subsidizing Ameren, should Ameren choose to borrow its maximum of $300 million of the credit facility. As this would leave only $500 million available to borrow by AIU, such a borrowing by Ameren would cause AIU to pay a greater portion of the commitment fees than allowed by Section 9-230 of the Act. The Commission is rightfully concerned that the ratepayers of AIU not subsidize the cost of

Ameren's borrowing, and therefore the Commission will adopt Staff's proposal on this issue.

The Commission will also adopt Staff's adjustment to reduce the amount of fees associated with the Illinois Facility. Staff postulates that there were no benefits to jointly negotiating that Facility with the Missouri Facility and that the allocation of overall costs to the Illinois Facility was too high. The Commission finds Staff's arguments on this issue convincing, and will adopt Staff's proposed facility fee adjustments for the purposes of this proceeding.

F. Cost of Short-Term Debt

1. AmerenCILCO

AmerenCILCO maintains that its cost of short-term debt is 2.15%. As AmerenCILCO does not have any short-term debt currently outstanding, the cost of short-term debt was calculated in accordance with the terms of the source of AmerenCILCO‘s last short-term borrowing—its credit facilities. AmerenCILCO states the cost is the sum of the April 30, 2009 one-month LIBOR and the applicable margin, which is based on both AmerenCILCO‘s current senior secured credit ratings (Baa2/BBB+) and the current utilization of the facility at the time of the loan. Staff proposed in its Initial Brief a cost of short-term debt for AmerenCILCO of 2.5%, however in its Reply Brief, Staff recommended a cost of short-term debt of 2.15%, in accordance with the recommendation of AmerenCILCO. As the parties appear to be in agreement on this issue, the Commission will adopt a cost of short-term debt for AmerenCILCO of 2.15% for purposes of this proceeding.

2. AmerenCIPS

Staff and AIU agree that AmerenCIPS‘ cost of short-term debt equals 1.50%. Staff calculated AmerenCIPS‘ weighted cost of short-term debt based on the proportion of AmerenCIPS‘ borrowings at a bank loan rate of 3.02% and an internal money pool rate of 0.19%. In her Direct Testimony, Ms. Phipps stated that during the short-term debt period, 46% of the Company‘s short-term borrowings were at the bank loan rate and 54% were at the internal money pool rate. Thus, Ms. Phipps maintains the weighted average interest rate for AmerenCIPS' short-term debt equals 1.50%. While AmerenCIPS disagreed with Ms. Phipps' reasoning for not including upfront facility fees in A&G expenses, Mr. O‘Bryan accepted her general methodology for the calculation of the costs and the addition of these costs as a direct adder to AmerenCIPS‘ of capital. AmerenCIPS does not contest Staff‘s adjustments, as the updated weighted average cost of capital schedule in Ameren Ex. 37.1 reflects a 1.50% weighted cost of short-debt for AmerenCIPS. The Commission finds that the parties agree that an appropriate cost of short-term debt for AmerenCIPS is 1.50%. The Commission finds this amount to be reasonable and it will be adopted for the purposes of this proceeding.

3. AmerenIP

Staff and AIU agree that AmerenIP's cost of short-term debt equals 3.02%. AmerenIP does not contest Staff's adjustments, as the updated weighted average cost of capital schedule in Ameren Ex. 37.1 reflects a 3.02% weighted cost of short-debt for AmerenIP. The Commission finds that the parties are in agreement that the cost of short-term debt for AmerenIP is 3.02%. The Commission finds this amount to be reasonable and it will be adopted for the purposes of this proceeding.

G. Cost of Common Equity

1. AIU Position

a. Return on Equity Estimates

AIU witness McShane recommends for the gas operations of AmerenCILCO, AmerenCIPS, and AmerenIP, the cost of common equity is 11.2%, 10.8%, and 11.2%, respectively. For the electric operations, the recommended cost of common equity is 11.7%, 11.3%, and 11.7%, respectively.

AIU notes that Staff, IIEC, and CUB have also recommended costs of common equity. Staff calculates costs of equity for the gas operations as 9.64% for AmerenCILCO, 9.38% for AmerenCIPS, and 9.64% for AmerenIP. For electric delivery service operations, Staff recommends costs of common equity of 10.38% for AmerenCILCO, 10.14% for AmerenCIPS, and 10.44% for AmerenIP. IIEC proposes a combined ROE of 10.0% for AIU that reflects AIU's actual combination gas and electric investment fundamentals, while AG/CUB calculates that the cost of common equity for AIU's electric operations is 8.76% and the cost of common equity for AIU's gas operations is 7.97%.

AIU notes that each party bases its analysis on a sample group for the respective service because AIU's operations should reflect the risk profile and cost of equity of comparable utilities. For AIU's gas operations, Ms. McShane selected a sample of nine comparable gas local distribution companies (―LDCs") according to certain criteria specified in her Testimony. For AIU's electric operations, Ms. McShane selected a sample of 29 electric utilities according to similar criteria specified in her Testimony. Staff witness Freetly uses the same gas sample as Ms. McShane and a subset of her electric sample. IIEC witness Gorman and CUB witness Thomas both rely on the same electric and gas proxy groups as Ms. McShane.

In its Reply Brief, AIU argues the Commission's January 21, 2010 decision in the Peoples/North Shore rate case, Docket Nos. 09-0166/09-0167 (Cons.) supports AIU's suggested use of a constant growth discounted cash flow ("DCF") model and argues that the Commission should follow its reasoning as expressed in that Order.

b. DCF and CAPM Model Issues

AIU notes that Ms. Freetly and Mr. Gorman criticize the use of the comparable earnings test for determining the cost of equity, while Mr. Thomas asserts that the Commission has rejected the comparable earnings method in the past. AIU asserts that this criticism misinterprets Ms. McShane's use of the comparable earnings test in her cost of equity analysis. AIU argues that Ms. McShane agrees that the comparable earnings test does not measure the investor's opportunity cost of attracting equity capital as measured relative to market values; therefore she does not use the comparable earnings test to actually determine the cost of equity. Rather, AIU asserts that the comparable earnings test provides a measure of the fair return based on the concept of opportunity cost, and the returns earned by relatively low risk unregulated companies provide a relevant perspective on the reasonableness of the recommended ROE. AIU argues that the results of its comparable earnings test here indicate that AIU's proposed returns on equity, as calculated by the DCF and equity risk premium tests, are conservative when compared to the earnings level of relatively low risk unregulated companies.

AIU avers that Ms. Freetly's use of a multi-stage non-constant-growth quarterly DCF model is a departure from Staff's typical model – a constant-growth, single-stage, DCF model. AIU argues that this departure is not warranted in this case because analysts' forecasts are indeed the most objective measure of investor expectation embedded in the stock prices and dividend yields used to estimate the DCF cost of equity. AIU opines that Ms. Freetly admits she has previously relied on a constant-growth DCF model when analysts' consensus forecasts were higher than the forecast long-term growth in the economy. AIU states Ms. Freetly's use of the average of the constant growth and the three-stage DCF models, rather than the results of the three-stage model alone, recognizes the imprecision of the period during which investors might expect analysts' forecast growth rates to persist.

c. Growth Rates

AIU notes that Ms. McShane relies on three DCF estimates: (1) a constant growth model that relies on analysts' earnings forecasts; (2) a sustainable growth model; and (3) a multi-stage model that includes both analysts' forecasts and nominal GDP growth as proxies for longer-term growth. AIU argues that because she weighs all three estimates, she incorporates a potential range of utility investor expected returns.

AIU observes that Ms. Freetly applies a multi-stage non-constant-growth quarterly DCF model to both her gas and electric samples, with her DCF analysis using three stages of dividend growth. AIU avers that Ms. Freetly's use of a multi-stage non-constant-growth quarterly DCF model is a departure from Staff's typical model, the constant growth (single stage) DCF model. AIU argues that Staff has not typically used a non-constant growth DCF model because it is more elaborate and has additional unobservable growth rate variables. AIU notes that Ms. Freetly argues that the levels of growth indicated by the average three- to five-year growth rates for her samples here are not sustainable over the long-term, largely because the analysts‘ growth forecasts for the samples are higher than the current growth expectations for the economy.

AIU opines that this departure is not warranted in this case, and argues that analysts‘ forecasts are the most objective measure of investor expectations that are embedded in the stock prices and dividend yields used to estimate the DCF cost of equity. AIU further notes that Mr. Freetly testified she has previously relied on a constant growth DCF model when analysts‘ consensus forecasts were higher than the forecast long-term growth in the economy. Ms. Freetly also uses a constant growth DCF test to develop her equity risk premium model; therefore AIU submits that if a constant growth DCF model is appropriate for the equity risk premium model, it is also appropriate for developing an expected return.

AIU avers that use of the average of the constant growth and the three-stage DCF models, rather than the results of the three-stage model alone, recognizes the imprecision of the period during which investors might expect analysts‘ forecast growth rates to persist and avoid potentially internally inconsistent results. As the multi-stage model can also create inconsistencies in the DCF cost estimates for the individual companies, AIU opines that it is more reasonable to give equal weight to the results of both the constant growth and multi-stage models.

AIU notes that in the final stage of her multi-stage DCF analysis, Ms. Freetly uses forward yields on the 20-year U.S. Treasury bonds as a proxy for long-term GDP growth, stating that the changes in the U.S. Treasury bond yield indicate that investors‘ current long-term expectations vary over time. Ms. Freetly argues the yield on U.S. Treasury bonds is a timely gauge of expected long-term economic growth because it reflects changing investor expectations due to current economic conditions, and posits that long-term forecasts, from which Ms. McShane implies that investor expectations of long-term growth are essentially static, might not be often updated.

While AIU admits Ms. Freetly is correct that the Blue Chip long-term consensus forecast of GDP growth extends only ten years, and that some long-term GDP forecasts are updated only annually or infrequently, AIU submits her arguments do not support the use of forward interest rates as a proxy for long-term GDP growth. AIU argues there is no basis to conclude that investors will not rely on forecasts of GDP over the next ten years as the best available estimate for very long-term growth and the stability of the Blue Chip ten-year consensus forecasts of GDP growth likely represents the expected reversion of growth to trend levels. AIU avers that compared to forward yields, it is more appropriate to use a direct estimate of long-term economic growth as provided by the consensus of economists‘ forecasts.

AIU opines that there are too many influences to conclude that the forward 20-year U.S. Treasury yield is a good proxy for investor expectations of long-term growth of the economy, with such factors as global influences on interest rate, high demand for U.S. securities, and the global savings glut putting downward pressure on U.S. Treasury bond yields. AIU notes that although the difference between the specific implied forward yield on the 20-year U.S. Treasury and the most recent consensus forecast of long-term economic growth is relatively small, the capital market experience over the past two years shows the differential can be substantial.

AIU avers that Ms. McShane applies an average daily stock price over a relatively short period of time when applying the DCF test, which Ms. Freetly criticizes and instead advocates a —spot" stock price. AIU opines that the price of a stock can rise or fall temporarily on any given day. AIU argues that —spot" stock prices are typically combined with a corresponding growth rate forecast, which may have been prepared and disseminated earlier, which may lead to a mismatch between the price and investor growth expectations – and thus, an erroneous DCF cost. AIU submits that the preferable price for the DCF test is an average daily price over a relatively short period of time.

AIU notes that Mr. Gorman employs three DCF models, a multi-stage model, a sustainable growth model, and a constant growth model, in which he gives his DCF and CAPM tests equal weight. AIU states that because he argues that AIU is a combination utility – a combined risk reflected in its bond rating, its operating risk, and the operating risk considered by its bond holders and equity holders – he recommends a single ROE to reflect this combined risk.

AIU disputes that because AIU is a combination of gas and electric utilities, the same cost of equity should apply to each of its operations. AIU opines that the return allowed for the electric utility operations should reflect the cost of equity for electric utility operations, and the same for the gas operations. AIU submits this combination results in cross-subsidies, erroneous investment decisions, and a misallocation of capital resources. AIU states that Staff agrees with AIU that the gas and electric operations should be considered separately to assign the proper ROR for each entity based on the level of operating and financial risk specific to the operations of each company.

While Mr. Gorman's initial sustainable growth DCF study ignored the external growth component, AIU notes that Mr. Gorman updated his sustainable growth model to add the component, but argue he failed to estimate it correctly, incorrectly assuming book values per share will increase while stock prices stay the same. AIU submits that Mr. Gorman's incorrect assumption about stagnant stock prices leads him to incorrectly conclude that the external growth component of the sustainable growth model is negative for the electric sample and minimal for the gas sample.

While Mr. Gorman criticizes the dividend yield in Ms. McShane's constant growth DCF studies based on his view that her dividend yields are abnormally high, AIU notes that during much of the five-year period of dividend yields he compares to recent years, the cost of capital was abnormally low, characterized by easy credit, low economic volatility, and a relatively high investor tolerance for risk. AIU submits that the landscape has since been altered by the financial crisis of 2008-2009, and the current dividend yields, therefore, are more representative of its historic average levels.

AIU notes that Mr. Gorman also challenges Ms. McShane‘s constant growth DCF because he believes it includes irrationally high growth, and thus, unreasonably inflates AIU‘s ROE. Although Mr. Gorman argues that short-term analysts‘ growth rates in the market today are too high to be reasonable estimates of sustainable long-term growth, AIU avers that he is incorrect as analysts do not make forecasts beyond five years, and therefore, it is not possible to determine whether investors implicitly expect the forecast growth rates to continue indefinitely and when any decline, if any, may occur. Accordingly, AIU submits the constant growth DCF model is the only model that fully retains the only objective evidence of investors‘ growth expectations.

AIU states that Mr. Thomas uses a three-stage DCF test, with the three stages being for the short-term that the sample companies will grow at their average internal growth rate over the last five years, for the long-term that growth for the sample companies will trend toward the historical average growth rate in real GDP, and in the final stage he uses a forecast of real economic growth, rather than nominal growth. AIU opines that Mr. Thomas‘ choice of historical period for the first stage is purely subjective and not related to investor expectations embedded in current stock prices, while with respect to the long-term growth rate; his use of a real rate of growth fails to consider that investors require both a real return and compensation for inflation. AIU argues that the studies do not suggest that the actual nominal rate of long-term growth has been equal to the real rate of growth in the economy or that the expected nominal rates of long-term growth should be equal to the real rate of growth in the economy, and do not support using a real rate of GDP growth as a proxy for investors‘ expected long-term growth.

AIU states that Mr. Thomas recommends that the Commission place less reliance on analysts‘ forecasts of growth in the DCF calculation. AIU avers that Mr. Thomas argues that, due to discontinuity in the equity markets and uncertainty in information, the Commission should base its analysis of the DCF growth component on three criteria: (1) earnings growth rate inputs that are reasonable in light of anticipated growth in GDP; (2) the long-term growth rate must not implicitly require continued earnings above the regulated firm‘s cost of equity, as derived in the analysis; and (3) the long-term growth rates must not require dividend payout ratios that are not consistent with the capital expenditure growth rate and the ROE. AIU opines that Mr. Thomas argues incorrectly that current analysts‘ three- to five-year growth projections do not meet these criteria, but rather, he asserts that research demonstrates analysts tend to be optimistic about future growth and produce upwardly-biased forecasts, which translate into DCF costs of capital above the true required cost of capital. While Mr. Thomas states that Ms. McShane‘s proposed growth rates would require that the sample companies exceed their own historic growth, AIU notes that the Commission has not previously accepted this argument. AIU argues that the studies that Mr. Thomas cites to support his opinion that analysts are optimistic about future growth rates are less applicable to utilities, and utilities can not expect similar results. AIU avers that Ms. Freetly agrees these studies tend to report generalized findings and do not specifically suggest that growth rates for utilities are overstated relative to achieved growth, further noting that other studies indicate that analyst growth rate estimates for utilities are not overstated.

AIU submits that Mr. Thomas' proposed ROE is not comparable to any cost of equity or return granted by other regulators, which is significant because the national average allowed ROE can be interpreted as a consensus assessment of the expert testimony that has been proffered by a wide range of stakeholders. AIU avers that the national average allowed ROE is a relevant indicator of the capital markets in which AIU will have to compete for capital. AIU opines that returns at the levels proposed by Mr. Thomas are significantly below any reasonable indicator of the returns investors expect to receive on investments of comparable risk, and would not allow the utilities to attract capital as required on reasonable terms or meet the comparable returns standard.

d. Beta

AIU notes that both Ms. McShane and Mr. Gorman apply Value Line (adjusted, weekly) betas to their CAPM analyses, while Ms. Freetly recommends equally weighing weekly and monthly betas, contending that neither weekly nor monthly betas are superior to the other. AIU avers that Ms. Freetly explains that the better type of beta estimate is unclear because both Value Line and regression betas are estimates of the unobservable true beta that measures investors' expectations of the quantity of non-diversifiable risk inherent in a security. AIU opines that Ms. Freetly states that her method has been regularly used by both Staff and the Commission and employs the same monthly frequency of stock price data as the widely accepted Merrill Lynch methodology, while the Commission has rejected Ms. McShane's position in a prior proceeding.

AIU states that Ms. Freetly recognizes the strengths of weekly betas, but notes she asserts that weekly and monthly betas have strengths and weaknesses relative to each other, while recognizing that the standard deviation of weekly beta estimates is typically lower than for monthly beta estimates, making weekly betas usually more reliable. AIU avers Ms. Freetly incorrectly argues that non-synchronous trading is a problem with Ms. McShane's weekly data, but not for monthly data.

AIU asserts Ms. Freetly is incorrect when she asserts that non-synchronous trading is a problem with weekly betas. AIU states the non-synchronous trading effect arises when stock prices respond to economic events with a lag, which is a particular problem when analyzing daily data collected on thinly-traded stocks. AIU argues it is not a problem here because the companies are not thinly traded. Moreover, AIU avers that Ms. Freetly's analysis that portends to show a statistically-significant negative relationship between the lagged returns on the gas utilities and the returns on the equity market composite may actually relate more to the market conditions during the financial crisis than to non-synchronous trading issues. AIU opines that Ms. Freetly's calculation of the coefficient of variation for the monthly and weekly series of returns does not indicate that there is increased random error in the weekly series relative to the monthly series, but rather, higher coefficients of variation associated with weekly betas are consistent with higher weekly betas.

Staff argues that changes in risk can bias the beta estimate, asserting a decrease in a company's systematic risk can increase its estimated beta. Therefore, Staff avers that given the long time period examined in this case, one can not conclude that the Value Line betas underestimate actual returns or that using monthly returns would have further underestimated the actual returns for gas and electric utilities from those implied betas because the relatively high returns could be a consequence of declining systematic risk. AIU submits that greater confidence can be placed in weekly betas because weekly betas are less likely to be impacted by the presence of outlying observations, noting that weekly betas have five times as many observations, diluting the impact of observations that are outliers. AIU argues that regression betas calculated by Staff using monthly data have consistently been lower than the Value Line weekly betas, arguing that its analyses conclude that much greater confidence can be placed in weekly betas.

AIU notes that as Ms. McShane agrees that the calculated beta may decrease when ―true" systematic risk is rising and may increase when ―true" systematic risk is falling, she therefore compares a series of calculated betas for both the gas distributors and electric utilities to the average returns to assess whether, over time, the actual returns were in line with what the betas would have predicted. AIU avers that she concluded that the adjusted weekly Value Line betas underestimated the actual returns for both the gas distributors and electric utilities. While Staff faults Ms. McShane's analysis comparing weekly and monthly betas, AIU opines that Staff is incorrect in emphasizing Ms. McShane's report of the coefficient of determination ("R^2") and the statistical significance test and downplaying Ms. McShane's comments regarding the standard error, as AIU submits that standard errors are consistently lower and confidence intervals are consistently narrower for weekly betas, than monthly.

AIU states that Mr. Thomas recommends unadjusted, not Value Line, betas, asserting there is no evidence to support the rationale for the argument that utility betas trend toward the market mean of 1.0, citing financial literature purporting to demonstrate that the mean reversion adjustment is inappropriate and overstates the beta parameter. AIU notes that Mr. Thomas calculates corrected betas by removing the adjustment for each of the companies in his sample group, which AIU submits is incorrect. AIU avers there is significant empirical evidence indicating that ―raw" or unadjusted betas underestimate the returns of low beta stocks and overestimate returns of high beta stocks, stating the adjustment corrects for the empirically observed relationships between betas and returns. AIU notes that Mr. Thomas admits that the Commission has accepted a static beta adjustment in the past, although Mr. Thomas argues there is absolutely no evidence that a one-size fits all adjustment is reasonable. AIU notes that Staff agrees betas should be adjusted, stating that the texts cited by Mr. Thomas concedes that adjustments result in appreciably better forecasts, and further noting that Mr. Thomas' proposal has been explicitly rejected in prior rate cases.

e. Market Risk Premium

AIU states that the CAPM requires determining the equity risk premium required for the market as a whole, and then adjusting it to account for the risk of the particular security or portfolio of securities using the beta. AIU notes the result (market risk premium multiplied by beta) is an estimate of the equity risk premium specific to the particular security or portfolio of securities, and the required market risk premium varies with the outlook for inflation and other economic and capital market conditions, interest rates, investors' willingness to bear risk, and profits.

AIU opines that required expected market risk premium ("EMRP") can be developed from estimates of prospective market risk premiums and from an analysis of experienced market risk premiums. AIU avers the DCF model can be used to estimate the cost of equity where the expected return is comprised of the dividend yield plus investor expectations of longer-term growth based on prevailing capital market conditions. AIU states that for the DCF-based market risk premium, an estimate of a forward-looking market risk premium is valuable because the required market risk premium is not static, and thus, a direct measure of the prospective market risk premium may provide a more accurate measure of the current level of the expected differential between stock and bond returns than experienced risk premiums. AIU submits that an estimate of a forward-looking market risk premium provides value because the equivalence of past return to what were investors' ex ante expectations may be pure coincidence, and the determination of a fair ROE reflective of the expected interest rate environment requires a direct assessment of current stock market expectations.

AIU states the forward-looking market premium may be determined by an application of the DCF model to the S&P 500 with the inputs of an expected dividend yield and an expected growth rate. AIU avers that the expected dividend yield is equal to the average of the month-end February and March 2009 market-value weighted expected dividend yields for the S&P 500 companies of 3.7%, while for the expected growth rate, the market-value weighted consensus forecasts of earnings growth for the companies in the S&P 500 were used as a proxy for investor expectations of long-term growth. For the risk-free rate, AIU notes Ms. McShane uses the forecast 30-year U.S. Treasury yield expected to prevail over the same 5-year time frame for which the forecast growth rates for the market are made.

Because the equity markets are currently experiencing significant turmoil and uncertainty, AIU avers that Ms. McShane recommends giving greater weight to the DCF-based market risk premium than she has in the past. Given the extent of equity market risk at present, with the current level of the market risk premium higher by a significant margin than its long-term average, AIU notes Ms. McShane made two CAPM estimates of the cost of equity – one based on ex post market risk premiums and one based on an ex ante estimate of the market risk premium.

Based on the DCF-based market risk premium, AIU states the forward-looking estimate of the CAPM market risk premium amounts to 6.8%, which, with a dividend yield for S&P 500 of 2.1% and a consensus IBES forecast of 5-year growth of 9.63%, results in an expected market return produced by the ex ante DCF-based market risk premium approach of 12.0%. AIU avers that CAPM ROE produced by the ex post market risk premium approach is 9.7% for the gas sample and 10.3% for the electric sample. Because the DCF-based market risk premium approach explicitly captures current financial market conditions, AIU recommends that the CAPM ROE produced by the ex ante DCF-based market risk premium approach be given greater weight than the CAPM ROE produced by the ex post (or historic) market risk premium approach.

As the estimation of the EMRP from achieved (ex post) market risk premiums is premised on the notion that investors' expectations are linked to their past experience, AIU opines that basing calculations of achieved risk premiums on the longest periods available reflects the notion that it is necessary to include as broad a range of event types as possible to avoid overweighing periods that represent unusual circumstances. Since the objective of the analysis is to assess investor expectations in the current economic and capital market environment, AIU avers that weight should be given to periods whose equity characteristics are more closely aligned with what today's investors are likely to anticipate over the longer term. When an estimated market risk premium is developed from historic average returns, AIU argues that arithmetic averages need to be used, and the income return – not the total return on long-term government bonds – should be the measure of the historic risk-free rate used when calculating historic risk premiums.

AIU states that Ms. McShane also performs an equity risk premium test based on utility achieved risk premiums. Ms. McShane estimated the historic equity risk premiums for utilities relative to long-term A-rated public utility bonds and BAA-rated public utility bonds, and AIU avers she estimated the historic equity risk premium for utilities relative to long-term A-rated public utility bonds and Baa-rated public utility bonds at 4.5% and 4.25%, respectively. AIU opines that adding the historic spreads between the utility and bond yields to the long-term U.S. Treasury yield of 5.5% results in a forecast A-rated utility bond yield of 6.8% and a Baa-rated utility bond yield of 7.2%, and the resulting required equity returns are 11.3% and 11.5% for the gas and electric samples respectively.

AIU states that in Ms. Freetly's CAPM test, for the risk-free ROR; she examines the suitability of the yields on 4-week U.S. Treasury bills and 30-year U.S. Treasury bonds, using a 4.4% —spot" 30-year U.S. Treasury yield in deriving her CAPM estimate. AIU notes Ms. Freetly then estimates the expected ROR on the market by conducting a DCF analysis on the firms composing the S&P 500 as of June 30, 2009, with the resulting rates of return on common equity of 9.46% for the gas sample and 10.21% for the electric sample.

AIU opines that Ms. McShane also advocates using a longer-term U.S. Treasury, to more closely match the duration of the risk-free rate and common equities, whose values reflect expected cash flows that are perpetual in nature. AIU states that most analysts rely on a long-term government yield, which is risk-free in that there is no default risk associated with U.S. Treasury securities; therefore Ms. McShane utilizes forecast yields on the 30-year U.S. Treasury bond. AIU states the 30-year U.S. Treasury bond is once again considered a benchmark bond for the purpose of pricing securities.

While Ms. Freetly criticizes Ms. McShane's use of historical data in developing her market and utility equity risk premiums, AIU asserts it is unreasonable to expect investors to ignore returns they have achieved historically when forming their equity market return expectations going forward. AIU avers that without a discernable trend in achieved returns over time, as is the case here, historic returns provide a relevant perspective on the returns investors may reasonably expect over the longer term.

AIU argues that Mr. Gorman's CAPM analysis is inappropriately based on his market risk premium. AIU notes Mr. Gorman makes two estimates of the market risk premium: a forward-looking estimate and an estimate based on a long-term historical average. Although Mr. Gorman re-did his CAPM estimates to reflect Ms. McShane's proposed modifications to his market risk premium estimate, AIU states Mr. Gorman's risk premium method also incorrectly estimates the market return by adding an estimate of the long-term rate of inflation to the historic average real return. AIU argues the real return should be correlated with historical stock returns, which Mr. Gorman does not do. AIU avers that combining the average real return achieved on the market with expected inflation would be appropriate only if there were evidence that the expected return on the market moves in tandem with the rate of inflation, which has not been shown here.

AIU states Mr. Gorman's evidence on the market risk premium also does not address the fact that the historic measured risk premiums through 2008 were negatively impacted by the significant sell-off in the equity market in 2008. As the 2009 upswing in the equity market, through the end of October, indicates a higher measured equity market risk premium than did the values calculated through the end of 2008, AIU asserts Mr. Gorman's estimate of the market risk premium and resulting CAPM costs of equity are too low.

Although Mr. Gorman also performs a multi-stage DCF model to support his risk premium estimate, AIU avers his model assumes investors expect that analysts' forecasts of growth will persist for ten years and that growth will then drop precipitously to the expected nominal rate of growth in the economy. AIU argues the result of Mr. Gorman's model is well below his multi-stage DCF estimates for both the electric and gas samples, which does not help assess the reasonableness of Mr. Gorman's equity market risk premium estimate.

AIU notes that Mr. Gorman criticizes Ms. McShane's risk premium studies for their use of long-term forecasts of interest rate in conjunction with her historic risk premiums, as well as her use of forecast of utility bond yields, particularly in her application of the equity risk premium tests. However, AIU asserts that when conducting her equity risk premium tests by reference to historic average returns and risk premiums for both the market as a whole and for utilities, Ms. McShane combines a long-term average risk premium with long-term average expected bond yields. AIU argues the combination of a historic risk premium with a spot interest rate will result in an under- or over-estimation of the cost of equity at any given point in time, which produces an estimate of the cost of equity that matches the constancy of the equity risk premium implied by the use of historic averages with a similarly estimated interest rate.

AIU opines that Mr. Gorman himself uses forecasts of long-term U.S. Treasury interest rates in his CAPM, which is comparable to Ms. McShane's use of forecasts of utility bond yields. AIU avers that as the economy recovers, if long-term U.S. Treasury bond yields are expected to rise, so will utility bond yields, therefore Ms. McShane's analysis correctly incorporates the impact of the expected increase in long-term U.S. Treasury bond yields on the corresponding utility bond yields.

While Ms. Freetly and Mr. Gorman recommend the Commission use current or "spot" interest rates rather than forecast interest rates in Ms. McShane's risk premium studies, AIU notes that to estimate the risk-free rate, Ms. Freetly states she used current U.S. Treasury yields that reflect all relevant, currently available information, including investor expectations regarding future interest rates. Ms. Freetly asserts that investor appraisals of the value of forecasts are reflected in current interest rates, and therefore, if investors believe that the forecasts are valuable, that belief would be reflected in current market interest rates.

AIU states that —spot" U.S. Treasury yields remain at relatively low levels as a result of several factors, including the global demand for U.S. Treasury debt and relatively weak economic conditions. With the U.S. federal budget deficit for 2009 topping $1.4 trillion, AIU argues that the most likely trajectory for U.S. Treasury bond yields, as the U.S. global economies strengthen, is an upward trajectory. AIU opines that since such an upward trajectory is reflected in the consensus of economists' forecasts, which recognize that interest rates will rise as the economy improves, therefore the application of the CAPM should recognize the high probability that U.S Treasury yields will increase, making current interest rates inappropriate.

IIEC argues that Ms. McShane's market risk premium estimated from historic data is overstated because it relies on income returns rather than on total returns on U.S. Treasury bonds, and because of Ms. McShane's use of Morningstar data, which overstate the market risk premium that would be measured from total U.S. Treasury bond returns because Morningstar risk premiums are measured using the U.S. Treasury bond income returns. While AIU agrees that the estimated risk premium using income returns on U.S. Treasury bonds is higher than it would be if it were measured using total returns AIU asserts that IIEC ignores the fact that proper application of CAPM requires a risk-free rate, therefore the income return is the best representation of the true long-term historical risk free rate.

While Mr. Thomas argues that an EMRP of 5% may be too high, indicating that current academic research estimates range from 3.4% to 5.1%, AIU opines that there is no reason to conclude that equity market returns will be lower in the future than they were in the past and that historic evidence supports an equity risk premium equal to or slightly higher than 6.5%. As Ms. Freetly asserts, because the relationship between 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. AIU concurs with Ms. Freetly when she disagrees that the proper expected common equity market risk premium for determining the investor-required ROR is between 3% and 5%.

f. Proposed Adjustments

(1) Financial Risk

AIU states that to determine a fair ROE for a utility, it is vital to recognize that the cost of capital is determined in the capital markets and reflects the market value of firms' debt and equity capital, which may differ from book value capital structures. AIU recognizes that both it and Staff agree that a market-based cost of equity is appropriate and that it is necessary to use a book value rate base for regulatory rate setting. Further, AIU notes that both agree that differences in financial risk must be accounted for in the cost of equity and that higher or lower financial risk than the proxy companies, given similar business risk, requires an adjustment to the proxy companies' costs of equity, however the issue is how to measure those differences.

AIU avers that Ms. McShane uses two approaches to quantify the impact of a change in financial risk on the cost of equity. AIU states her first approach is based on the widely accepted view that the overall cost of capital does not change materially over a relatively broad range of capital structures, while her second approach is based on the theoretical model that assumes that the overall cost of capital declines as the debt ratio rises due to the income tax shield on interest expense. AIU submits the latter approach will overestimate the impact of leverage on the overall cost of capital and understate the impact of increasing financial leverage on the cost of equity because that approach does not account for any of the factors that offset the corporate income tax advantage of debt.

AIU avers that to apply these approaches, Ms. McShane first determines the market value capital structures of the sample companies over the period corresponding to the relevant period of analysis for the specific cost of equity. AIU states she then estimates the utility samples' weighted average cost of capital using market value capital structures and the appropriate market value common equity ratio and cost of equity. Finally, she estimates the change in common equity return requirement for each of her tests (DCF, CAPM, and DCF-based risk premium tests) to account for the difference between the sample average market value common equity ratio and the company's book value common equity ratio. AIU opines that if the difference between the company's ratemaking common equity ratio and the relevant market value common equity ratios results in an adjustment, Ms. McShane recommends that the allowed ROE be adjusted accordingly. AIU argues that Ms. McShane's method has been accepted by other regulators in the past.

While AIU recognizes that in the past the Commission has rejected Ms. McShane's approach because the AIUs do not have market traded stock, AIU avers that applying a market-derived cost of equity to the book value (ratemaking) capital structure without recognizing the financial risk differences between the market value capital structures that underpin the estimates of the cost of equity and the book value capital structures of the AIU utilities will understate AIU's cost of equity. AIU opines this lack of observable market value capital structures for AIU does not alter this conclusion because the relevant comparison is between the financial risk inherent in the market value capital structures of proxy utilities and the financial risk inherent in the book value (ratemaking) capital structures of AIU.

AIU states that for each AIU gas utility relative to the gas sample, Ms. Freetly concludes that her revenue requirement recommendations, including her cost of common equity recommendations, indicate levels of financial strength commensurate with a Baa3 credit rating for AmerenCILCO Gas, an A3 credit rating for AmerenCIPS Gas, and a Baa3 credit rating for AmerenIP Gas. AIU notes that Ms. Freetly believes the gas sample's level of financial strength indicates it has more financial risk than AmerenCIPS and less financial risk than AmerenCILCO and AmerenIP. Given the difference between the credit ratings commensurate with the forward-looking financial strength of AIU gas operations and the credit rating commensurate with the gas sample, Ms. Freetly recommends that the sample's average cost of common equity be adjusted to determine the estimate of each company's cost of common equity, using the spreads for 30-year utility debt yields as of August 31, 2009. Ms. Freetly recommends a 10.5 basis point adjustment for AmerenCILCO and AmerenIP and a decrease of 15 basis points for AmerenCIPS.

AIU submits that for each AIU electric utility relative to the electric sample, Ms. Freetly concludes that her revenue requirement recommendations, including cost of common equity recommendations, indicate levels of financial strength commensurate with a Baa1 credit rating for AmerenCILCO, an Aa3 credit rating for AmerenCIPS, and a Baa2 credit rating for AmerenIP. According to Ms. Freetly, the electric sample has a lower average implied credit rating, which indicates that its financial risk is higher than that of either AmerenCILCO's or AmerenCIPS' electric delivery service operations. Given the difference between the implied forward-looking credit ratings for the Companies and the average credit rating of the electric sample, Ms. Freetly recommends that the sample's average cost of common equity be adjusted to determine the estimate of each company's cost of common equity. To make the adjustments to the cost of common equity of the electric sample, Ms. Freetly used Reuters Corporate Spreads for Utilities from August 31, 2009. Her analysis recommends a cost of equity adjustment for the electric operations of 6 basis points for AmerenCILCO and 30 basis points for AmerenCIPS. This equates to a 0.06% downward adjustment for AmerenCILCO and a 0.30% downward adjustment for AmerenCIPS. Ms. Freetly does not recommend adjusting for AmerenIP because the financial ratios for AmerenIP are commensurate with the same level of financial risk as the electric sample.

AIU argues that Ms. Freetly's adjustments are incorrect, in part because they are based on the assumption that AIU will achieve the credit metrics implicit in Staff's recommendations. While Ms. Freetly claims that Staff's revenue requirement recommendations, including her cost of common equity recommendations, indicate credit metrics commensurate with higher or lower debt ratings than the implied debt ratings suggested by the credit metrics of her utility samples, AIU avers that her comparisons are flawed because she compares credit metrics that her utility samples have actually achieved from 2006-2008 with credit metrics that could be achieved if AIU were able to earn the returns on equity that they are allowed. AIU submits that recent history, however, demonstrates AIU has significantly under-earned its allowed returns on equity and thus has not achieved the levels of financial strength assumed by Ms. Freetly's financial risk adjustments. By comparing the potential financial performance and credit metrics of AIU to the actual financial performance and credit metrics of the proxy utilities, Ms. Freetly understates AIU's financial risk relative to the proxy utilities.

Further, while Ms. Freetly's adjustments assume an equity investor quantifies financial risk differences identically to a bond investor, AIU avers that proper financial risk adjustments to the cost of equity for the electric and gas samples consider the higher or lower return that equity investors require for bearing the higher or lower financial risk inherent in AIU's proposed ratemaking capital structures. AIU submits that Ms. Freetly is also incorrect when she contends that Ms. McShane's adjustments would perpetuate further increases in earnings and the market value of the stock. Earnings, dividends, book, and market values increase at the same rate, arguing changes in the market/book ratio should occur only if the cost of capital or the expected return on book equity changes.

AIU notes that Mr. Gorman also disagrees with Ms. McShane's financial risk adjustment, asserting it inflates a fair and reasonable return. While Mr. Thomas disagrees with adjusting the market-based DCF model results before applying them to the book value of assets in rate base, arguing that the adjustment inflates the market-based DCF cost of equity and that no such adjustment is required, AIU opines that Mr. Thomas' recommended returns are too low and would deprive AIU of a chance to earn a return commensurate with those of comparable risk firms.

(2) Fixed Customer Charge

AIU notes Ms. Freetly recommends an additional downward adjustment to the gas distribution operations' Rate of return on common equity based on the Commission's recognition, in AIU's last rate cases, that the AIU gas utilities' move toward more fixed cost recovery – through the fixed monthly charge – gives AIU more assurance of recovering its fixed costs of service for gas operations. As Ms. Freetly contends this cost recovery reduces risk and provides greater assurance that the authorized ROR will be earned, she therefore recommends a downward adjustment of

10 basis points to the AIU gas utilities' Rate of return on common equity – the same adjustment the Commission found proper in the last rate cases.

AIU claims that Ms. Freetly disregards the fact that eight of the nine gas distributors in the gas sample have similar mechanisms in place; therefore the cost of common equity estimate for the sample already reflects the risk reduction. While Ms. Freetly argues that some of the mechanisms apply only to portions of a company's service territories, AIU opines if equity investors impute lower risk due to the adoption of such mechanisms, lower risk would already be reflected in the cost of equity estimates for the sample companies. AIU argues that Ms. Freetly's recommended reduction would double count the risk reduction that might be imputed by investors and should thus be rejected.

(3) Uncollectibles Riders

While Ms. Freetly asserts the uncollectible riders would reduce AIU's risk because they would reduce uncertainty of cash flows, AIU notes she admits she is unaware of an established approach for gauging the effect that adoption of the riders would have on investor perceptions of AIU's risk levels and the resulting costs of equity. AIU states she instead proposes adjustments for the riders, based on two distinct approaches: (1) estimate the effect of the adoption of the riders on AIU's Moody credit ratings, and then, adjust based on the resulting change in implied yield spreads; and (2) adjust cost of common equity downward to offset the increased operating income resulting from the adoption of the riders. AIU opines that like Ms. Freetly, Mr. Thomas states that the riders will reduce both uncertainty of cash flows and AIU's risk, but as he is not aware of an approach to gauge the effect of the riders, he therefore supports Ms. Freetly's methodology as reasonable, although conservative.

AIU notes that for her first approach, Ms. Freetly assumes the credit rating assigned to the —ability to recover costs and earn returns" factor would improve by one credit rating with the implementation of the uncollectibles rider, while for her second approach, Ms. Freetly adjusts her cost of common equity downward to offset the increased operating income resulting from the adoption of Rider GUA-Gas Uncollectible Adjustment ("Rider GUA"). AIU states she adjusts her cost of common equity downward until the pro forma operating incomes under Rider GUA equal the original pro forma operating incomes she calculated for AIU without Rider GUA. For the electric operations, AIU says Ms. Freetly estimates the incremental recovery of uncollectibles expense had Rider EUA-Electric Uncollectible Adjustment ("Rider EUA") been in effect for the past ten years, then adjusting her cost of common equity downward until the pro forma operating incomes under Rider EUA equal the original pro forma operating incomes she calculated for AIU without Rider EUA.

AIU states Ms. Freetly averages the results of her two approaches to determine her recommended adjustments for the electric operations of AmerenCILCO, AmerenCIPS, and AmerenIP of 63, 64.5, and 34 basis points, respectively, to reflect the reduced risk due to Rider EUA; while she recommends adjustments to the costs of common equity for the gas operations of AmerenCILCO, AmerenCIPS, and AmerenIP of 87.5, 79.5, and 60.5 basis points, respectively, to reflect the reduced risk due to Rider GUA.

AIU argues Ms. Freetly's approaches are both flawed. AIU opines Ms. Freetly is incorrect to assume that the credit rating of Moody's ―ability to recover costs and earn returns" will increase by one full credit rating as there is no empirical evidence to support that assertion. AIU avers that Ms. Freetly's assumption that Moody's would change both the ―regulatory framework" and ―sustainable profitability" factors by a full credit rating for the adoption of the riders is without merit. AIU claims Moody's already acknowledged the legislation and factored it into its decision to upgrade AIU to investment grade, so the actual adoption of the riders is unlikely to result in a full credit rating improvement in both regulatory framework and sustainable profitability. AIU states that even if this were the case, AIU would still have equivalent credit ratings to Ms. Freetly's electric utility operation proxies and lower credit ratings than her gas utility operation proxies. AIU asserts there would be no reason to conclude that, even with the riders, the equity market would view them as less risky than the proxies.

AIU argues Ms. Freetly's second approach presumes there is an expectation built into the proxy utilities' costs of equity, for when they systematically under-recover bad debt expense. AIU states there is no such expectation, and thus, there is no rationale for removing a premium that does not exist. AIU asserts Ms. Freetly did not look at the specific under- or over-recovery experience of the proxy utilities for the same ten-year period that she reviewed for AIU, therefore she can not know whether AIU faces greater risk; she only knows one side of the equation. AIU notes this second approach would also reduce the return for a risk for which AIU has never been compensated because, as historic evidence shows, risk is not symmetric and AIU has not historically earned more or less than the allowed return.

AIU opines that Ms. Freetly's downward adjustments for the uncollectible riders are effectively premised on the assumption that AIU has similar business risk to the proxy utilities before the adoption of the riders. AIU argues several factors – including regulatory lag and rising operating costs and capital expenditures – indicate AIU has higher business risk than the proxy companies. AIU avers that a relatively broad sample of gas and electric utilities has higher implied credit ratings on Moody's ―regulatory framework" and ―ability to recover costs and earn returns" factors than AIU, which suggests that Ms. Freetly's implicit point of departure for making her downward adjustments, similar business risk, is incorrect.

AIU states Ms. Freetly's approach is further flawed because her analyses of each of the AIUs' risk relative to each other, which are then applied to the sample group, arrive at disparate conclusions. AIU argues that the adjustment calculated by Ms. Freetly indicates that the reduction in risk would be higher for AmerenCILCO than for AmerenIP, indicating more uncollectible risk for AmerenCILCO. AIU points out however, that Ms. Freetly, based on her metrics applied relative to the sample group, indicated the two companies have the same indicated level of risk, which led her to recommend the same ROE for each. AIU argues the proposed adjustments are arbitrary and lack the precision needed to impact the Commission authorized rate or return on common equity. While Ms. Freetly denies that Moody's reflection of the bad debt rider legislation eliminates the need to adjust the costs of common equity of the gas and electric samples, AIU notes she provides no empirical evidence to support this assertion.

AIU argues that Staff's method of taking two estimates of the reduction in perceived investor risk is hopelessly flawed and offers false precision. By doing any calculation, Staff is suggesting that it can isolate the uncollectibles risk embedded in the ROEs produced by its analysis. To do this, Staff just takes two bad estimates and averages them, which AIU opines produces nonsensical results. Moreover, AIU avers that the two approaches she averages produce results so far apart that averaging offers no confidence that the resulting adjustment is reasonable. While Ms. Freetly acknowledged that she saw one method as being as likely as the other to be accurate, AIU submits that where one approach produces a result 16 times greater than the other approach, it is hard to say either is likely to be right. If the Commission concludes a downward adjustment is required, AIU suggests the Commission should simply adopt the 10 basis point adjustment it approved in the Peoples/North Shore dockets for each of the AIU companies.

2. Staff Position

a. Return on Equity Estimates

Ms. Freetly measured the investor-required Rate of return on common equity with the non-constant DCF and Capital Asset Pricing Model (―CAPM”) analyses. For AIU gas utilities, Ms. Freetly applied those models to the same sample of 9 local gas distribution companies utilized by AIU witness McShane. For the AIU electric utilities, Ms. Freetly began with Ms. McShane‘s sample of electric utilities but eliminated the electric companies the Edison Electric Institute categorized as ―Mostly Regulated” since her return on common equity recommendation is for the regulated electric operations of AIU. Ms. Freetly then eliminated the companies that were not assigned an industry classification code of 4911 or 4931 within S&P Utility Compustat. Then, Ms. Freetly removed companies that are, or recently have been, involved in mergers, acquisitions, or divestures. Finally, Ms. Freetly removed companies that lacked growth rate estimates from Zacks Investment Research (―Zacks”) or the data necessary to calculate beta. The remaining 16 regulated electric utilities compose Ms. Freetly‘s electric sample.

Staff states that a 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. Staff notes that since a DCF model incorporates time-sensitive valuation factors, it must correctly reflect the timing of the dividend payments that a stock price embodies, further noting that the companies in Ms. Freetly‘s gas and electric samples pay dividends quarterly. Therefore, Ms. Freetly employed a multi-stage non-constant-growth DCF model that reflects a quarterly frequency in dividend payments.

Ms. Freetly modeled three stages of dividend growth. The first, near-term growth stage is assumed to last five years. The second stage is a transitional growth period lasting from the end of the fifth year to the end of the tenth year. The third or —steady-state" growth rate is assumed to begin after the tenth year and continue into perpetuity.

For the first stage, Ms. Freetly used market-consensus expected growth rates published by Zacks as of August 18, 2009. To estimate the long-term growth expectations for the third, steady-state stage, she utilized the implied 20-year forward U.S. Treasury rate in 10 years, 4.83%. The growth rate employed in the intervening, 5-year transitional stage equals the average of the Zacks growth rate and the steady-state growth rate. The growth rate estimates were combined with the closing stock prices and dividend data as of August 18, 2009. Based on these growth assumptions, stock price, and dividend data, Ms. Freetly‘s DCF estimate of the cost of common equity was 9.79% for the gas sample, and 10.67% for the electric sample.

Staff states that according to financial theory, the required ROR for a given security equals the risk-free ROR plus a risk premium associated with that security. Staff notes that 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. Ms. Freetly used a one-factor risk premium model, the CAPM, to estimate the cost of common equity. In the CAPM, the risk factor is market risk, which can not be eliminated through portfolio diversification.

Staff avers that the CAPM requires the estimation of three parameters: beta, the risk-free rate, and the required ROR on the market. For the beta parameter, Ms. Freetly combined adjusted betas from Value Line, Zacks, and a regression analysis to estimate the beta of the gas and electric sample. For the gas sample, the average Value Line, Zacks, and regression beta estimates were 0.68, 0.56, and 0.51, respectively. For the electric sample, the average Value Line, Zacks, and regression beta estimates were 0.71, 0.72, and 0.66, respectively. The Value Line regression employs 260 weekly observations of stock return data regressed against the New York Stock Exchange (—NYSE") Composite Index. Both the regression beta and Zacks betas employ 60 monthly observations; however, while Zacks betas regress stock returns against the S&P 500 Index, the regression beta regresses stock returns against the NYSE Index. Since the Zacks beta estimate and the regression beta estimate are calculated using monthly data rather than weekly data (as Value Line uses), Ms. Freetly averaged those results to avoid over-weighting betas estimated from monthly data in comparison to the weekly data-derived Value Line betas. She then averaged the resulting monthly beta with the Value Line weekly beta, which produced a beta of 0.61 for the gas sample and 0.70 for the electric sample.

Staff avers that for the risk-free rate parameter, Ms. Freetly considered the 0.14% yield on 4-week U.S. Treasury bills and the 4.40% yield on 30-year U.S.

Treasury bonds, with both estimates measured as of August 18, 2009. Forecasts of long-term inflation and the real risk-free rate imply that the long-term risk-free rate is between 4.3% and 5.2%. Thus, Ms. Freetly concluded that the U.S. Treasury bond yield is currently the superior proxy for the long-term risk-free rate.

Staff opines that for the expected ROR 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 ROR on the market was 12.70% for the second quarter of 2009. Inputting those three parameters into the CAPM, Ms. Freetly calculated a cost of common equity estimate of 9.46% for the gas sample and 10.21% for the electric sample.

Ms. Freetly estimated the investor-required rate of return on common equity for the gas sample of 9.63% by taking the simple average of the DCF-derived results (9.79%) and the risk-premium derived results (9.46%) for the gas sample. She then adjusted the gas sample‘s investor-required ROR downward by 15 basis points for AmerenCIPS to reflect the lower financial risk of AmerenCIPS relative to the gas sample. She also adjusted the gas sample‘s investor-required ROR upward by 10.5 basis points for AmerenCILCO and AmerenIP to reflect higher financial risk of AmerenCILCO and AmerenIP relative to the gas sample. Next, Ms. Freetly adjusted the companies‘ cost of equity downward by 10 basis points to reflect the reduction in risk associated with the recovery of a greater portion of fixed delivery services costs through the monthly customer charge, which was authorized in AIU's last rate cases, Docket Nos. 07-0585 et al. (Cons.). Staff therefore recommends that for the natural gas distribution operations of AIU, the investor-required rate of return on common equity is 9.64% for AmerenCILCO, 9.38% for AmerenCIPS, and 9.64% for AmerenIP.

To estimate the investor-required rate of return on common equity for the electric delivery service operations of AIU, Ms. Freetly first took the simple average of the DCF-derived results (10.67%) and the CAPM derived results (10.21%) for the electric sample, or 10.44%. Ms. Freetly then adjusted the electric sample‘s investor required ROR downward by 6 basis points for AmerenCILCO and 30 basis points for AmerenCIPS to reflect the lower financial risk of AmerenCILCO and AmerenCIPS relative to the electric sample. Thus, for the electric delivery service operations of the companies, the investor required rate of return on common equity is 10.38% for AmerenCILCO, 10.14% for AmerenCIPS, and 10.44% for AmerenIP.

Staff notes that AIU witness McShane estimated the cost of common equity using both the constant growth and non-constant growth DCF models and three equity risk premium analyses. Ms. McShane also applied the comparable earnings test for purposes of assessing the reasonableness of her results. Based on the updated analysis in Rebuttal Testimony, for the natural gas distribution operations, she recommended an 11.2% cost of common equity for AmerenCILCO and AmerenIP and a 10.8% cost of common equity for AmerenCIPS. For the electric delivery service operations, Ms. McShane recommended an 11.7% cost of common equity for AmerenCILCO and AmerenIP and an 11.3% cost of common equity for AmerenCIPS.

Staff asserts that Ms. McShane‘s analysis contains several errors that lead her to over-estimate AIU‘s cost of common equity. Staff argues the most significant flaws in Ms. McShane‘s analysis of the companies‘ cost of common equity are the use of historical data in her DCF and risk premium models; the inclusion of unwarranted adjustments to the DCF and risk premium results for alleged difference between market value and book value; and the inappropriate use of comparable earnings model as a check on her recommended cost of equity. Staff, therefore, recommends that the Commission reject AIU's recommended costs of common equity, and adopt Staff's recommendation, as stated above.

b. DCF and CAPM Model Issues

Staff argues that the use of historical data is problematic, as historical data favors outdated information that the market no longer considers relevant over the most-recently available information. Staff further opines that historical data reflects conditions that may not continue in the future. Staff avers that the use of average historical data implies that securities data will revert to a mean, and while state there is no evidence securities data is mean reverting, there is also no method for determining the true value of that mean let alone the length of time over which mean reversion will occur.

Staff states Ms. McShane uses historical data in determining the dividend yield in her DCF model, however, since stock prices reflect all current information; only the most recent stock price can reflect the most recently available information. Staff asserts that historical stock prices must include observations that can not reflect the most current information available to the market.

While Ms. McShane implies that her use of historical data to estimate the dividend yield is an attempt to reduce measurement error, Staff asserts that introducing old stock prices into an analysis simply substitutes one alleged source of measurement error, volatile stock prices, for another, irrelevant stock prices. Staff notes that stock prices can be influenced by temporary imbalances in supply and demand; however, any distortions such imbalances might have on the measured cost of common equity can be reduced through the use of samples, a technique which Ms. McShane already applies.

Staff notes that Ms. McShane performed an equity risk premium analysis, which calls for an estimate of the investor-required ROR on the market portfolio. Staff opines that to compute the achieved equity risk premium for her sample, she first calculated the achieved equity risk premium for the S&P 500 Common Stock Index for two historic periods (1926-2008 and 1947-2008) relative to the 20-year U.S. Treasury bond income return, then calculated the achieved equity risk premium for the S&P/Moody‘s Electric Utility Index and the S&P/Moody‘s Gas Distribution Utility Index relative to the 20-year U.S. Treasury bond income return. Staff notes she also estimated the historic equity risk premium relative to the total return on Moody‘s long-term A-rated public utility bonds.

Consequently, Staff argues Ms. McShane estimates the required ROR on the market using, in part, historical earned rates of return. Staff avers that as proxies for current required rates of return, historical earned returns possess several shortcomings, in that the returns an investment generates are unlikely to have equaled investor return requirements due to unpredictable economic, industry-related, or company-specific events. Staff further argues that 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. Further, Staff avers that the magnitude of the historical risk premium depends upon the measurement period used, therefore historical earned rates of return are questionable estimates of the required ROR that are susceptible to manipulation and whose use could distort the estimate of a company's cost of common equity. Staff notes the Commission has consistently rejected the use of historical dividend yields in calculating an appropriate ROE.

Ms. McShane argues that if the market value differs from book value, a cost of equity estimate derived from market values needs to be adjusted when applied to book values of common equity to determine utility rates. Staff argues that market to book adjustments such as Ms. McShane's are based on the flawed argument that a market-derived required ROR does not produce a ―fair" return when applied to a book value rate base if the market to book ratio differs from one. Staff avers that the crucial flaw in that argument is that it 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). Staff notes 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. Staff argues that under original cost ratemaking, ratepayers provide a return only on the amount of capital that is invested in assets that serve ratepayers, and that inflating that return to compensate investors for capital not invested in plant and equipment is neither fair nor appropriate. While book value represents the funds a company receives from investors though security issuances on the primary market, Staff states that book value does not adjust to reflect changing investor assessments; it only reveals how much money the company has to invest in assets to serve its customers.

Staff notes that the market price is the price investors are willing to pay each other for a security on the secondary market. Staff avers that cost of common equity analysis uses market price data because market data continuously adjusts to reflect investor return requirements as they are continuously re-evaluated. Staff states the market value of a stock would grow to exceed its book value only if investors expect to earn a return above their required return, and that the market price always reflects the investor-required return, regardless of the book value. Staff argues there is no merit to Ms. McShane's claim that her adjustment is required to recognize the higher return that equity investors require for bearing the higher financial risk inherent in AIU's proposed ratemaking capital structure in comparison to the market value capital structures of the gas and electric samples.

Staff submits that if a utility's services were entirely subject to original cost-based, ROR regulation and its rates perfectly and instantaneously reflected changes in its costs, then the market value of the firm would equal the book value whenever the expected ROR matches the investor required ROR. However, if the expected ROR exceeds the investor required ROR, Staff opines demand for the company's stock will increase as investors seek a share in those abnormally high returns, which will cause the stock's market value to rise until the expected ROR on market value equals the required ROR. Staff avers that 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.

Staff further argues that allowing upward adjustments to the allowed ROR based on a market-to-book value ratio greater than one, would require the Commission to continually make upward adjustments to the allowed ROR, 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 ROR.

While Ms. McShane argues that the lower book value common equity ratios of the companies relative to the gas and electric sample's market value common equity ratios indicate that the companies possess higher financial risk than the gas and electric samples, Staff opines that the intrinsic financial risk of a given company does not change simply because the manner in which it is measured has changed. Staff notes that capital structure ratios are merely indicators of financial risk; they are not sources of financial risk. Staff avers that Ms. McShane has previously proposed the same adjustment to her market-derived cost of equity estimates. In Docket Nos. 02-0798 et al. (Cons.), the Commission rejected her proposed market-to-book adjustment, noting that 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. The Commission found that there was no evidence that this practice had served as an impediment to a utility's ability to raise capital or maintain its financial integrity. Ms. McShane's argument was similarly rejected in Docket Nos. 06-0070 et al. (Cons.).

Staff notes that Ms. McShane's comparable earnings model uses the average historical earned return on book value of common equity for a proxy group of 81 U.S. industrial companies over the period 1991-2007, claiming that her comparable earnings test indicates that competitive firms of similar risk to her sample of gas utilities may be expected to earn average returns of approximately 15.0% to 16.0%.

Staff opines that the comparable earnings methodology is based on the erroneous assumption that earned or expected returns on book equity are acceptable substitutes for investor-required returns. Staff avers that investor return requirements are a function of risk and manifested in the market prices of securities, while Ms. McShane's comparable earnings analysis is based on accounting returns, which are largely unresponsive to market forces. Staff argues that Ms. McShane herself acknowledges that the comparable earnings test does not measure the investor-required rate of ROE. Staff notes that the Commission has likewise repeatedly rejected the comparable earning methodology, finding that it is faulty as it incorrectly assumes that earned returns on book common equity are representative of investor required returns on common equity, referencing Docket Nos. 02-0798 et al. (Cons.) and Docket Nos. 06-0070 et al. (Cons).

Staff submits that both of the comparable earnings analysis in the prior cases cited above are based on earned returns on book equity as substitutes for investor required returns, while in this proceeding, Ms. McShane claims that the results of the comparable earnings test should be relied on as an indicator of whether her market-based test results (the DCF and equity risk premium), as adjusted for the market/book ratio are reasonable. Staff urges the Commission to once again disregard Ms. McShane‘s comparable earnings analysis.

c. Growth Rates

Staff notes that AIU insists that it is appropriate to include the results of the constant growth DCF analysis in the estimation of the investor required ROR for AIU, while in Staff‘s opinion, the three- to five-year growth rates for the companies in the Gas and Electric samples can not be sustained over the long-term.

While AIU notes that Staff did utilize a constant growth DCF to develop the expected return in the market in the risk premium model, Staff suggests its use of the constant growth DCF to estimate the return on the market does not support performing a constant growth DCF analysis on the gas and electric samples. Staff argues it did not use a non-constant growth DCF to estimate the return on the market because of the extreme difficulty of attempting to apply the more elaborate non-constant growth DCF on 500 companies. Staff avers that as with the three- to five-year growth rates for some of the companies in the gas and electric samples, some of the growth rates used in Staff‘s DCF analysis of the S&P 500 are unsustainably high, which produces an upward bias in Staff‘s market return estimate and, thus, in Staff‘s CAPM cost of equity estimate.

While Staff used the implied forward yield on 20-year U.S. Treasury bonds to estimate long-term overall economic growth during the steady state growth stage of the non-constant DCF analysis, AIU advocates using the Blue Chip forecast to estimate long-term economic growth. Staff states the Blue Chip forecast used by AIU to estimate long-term economic growth only projects forward 10 years, while the period for which the long-term growth rate is applied begins after 10 years. Staff argues the forecasts do not even overlap, much less coincide with, the period of time the steady-state growth stage covers.

While AIU points to the recent swings in the implied 20-year forward U.S. Treasury yield in comparison to the virtually unchanged consensus forecasts of long-term economic growth, Staff states the changes in the U.S. Treasury yield indicate that investor‘s current long-term expectations vary over time, while AIU's argument implies that investors' expectations of the long-term economic growth are essentially static. Since the yield on U.S. Treasury bonds reflects changing investor expectations due to current economic conditions, Staff submits it is a timely gauge of the expected long-term economic growth. In contrast, Staff argues as the long-term forecasts AIU relies on are not updated regularly, the alleged stability in the Blue Chip forecasts of long-term economic growth might come from a low update frequency.

While AIU notes that Staff's use of the non-constant DCF is a departure from Staff's typical use of the constant growth DCF, pointing out that Staff relied on the constant growth DCF model in previous testimony when analysts' consensus forecasts were higher than the forecast long-term growth in the economy, Staff states AIU's argument implies that Staff can not modify its methodology even when a revised methodology more accurately reflects existing circumstances, and is likely to yield more reliable results.

Staff notes that Ms. Freetly testified that a single-stage constant growth DCF model employs a single growth rate estimate, which is assumed to be sustainable infinitely. Staff argues a cost of common equity calculation derived from a constant growth estimate is correct only if the near-term growth rate forecast for each company in the sample is expected to equal its average long-term dividend growth, as no company could sustain into infinity a growth rate any greater than that of the overall economy. Staff states that given the difference between the growth rates for the gas and electric samples and the overall growth of the economy, the continuous sustainability of the analyst growth rates for the gas and electric samples is highly unlikely.

Staff agues that inclusion of the constant growth DCF analysis can not be reconciled with the compelling rationale for employing the non-constant DCF analysis, namely that the three- to five-year analyst growth rates are unsustainable, noting the decision as to which model to employ must be consistent with the judgment regarding the sustainability of the growth rate to be used in the model.

While AIU states that Staff's long-term growth rate used in the final stage of the non-constant DCF analysis based on the implied 20-year forward U.S. Treasury rate is inferior to the estimate of long-term economic growth provided by the consensus of economists' forecasts published by Blue Chip, Staff avers that AIU ignores Ms. Freetly's Testimony that she compared her 4.83% U.S. Treasury bond-derived estimate of long-term growth against the 4.5% forecast of Global Insight. While Staff agrees that with the use of a consensus forecast of long-term economic growth for a period that begins 10 years from now, the record contains nothing to suggest that any exists, noting the Blue Chip forecast that AIU espouses covers a period that ends 10 years into the future.

Staff submits that AIU's argument concerning the alleged stable nature of long-term growth forecasts aims at one target, Staff's long-term growth estimate, but hits another, the constant growth DCF. Staff notes that the constant growth DCF assumes that short-term growth equals long-term growth, and therefore the growth rates used in the constant growth DCF should be stable. Staff submits the evidence proves that the growth rates Ms. McShane uses in her constant growth DCF analysis are anything but. In the last rate case proceedings for AIU, Docket Nos. 07-0585 et al. (Cons.), Staff avers that Ms. McShane's constant growth DCF analysis used Institutional Brokers' Estimate System ("IBES") growth rate forecasts, with the IBES growth rate for the gas companies common to the 2007 and current cases averaged 4.6%. Staff notes that in the current proceeding, the IBES growth rate for the gas utilities in common to the 2007 and current cases averaged 5.7%. Staff submits that many of the electric companies common to the 2007 and current cases also exhibit some large differences in the IBES growth rate forecasts, with 13 of the 24 electric companies that were part of the electric sample in both 2007 and 2009 changing by more than two percentage points. Staff argues that those large differences indicate the IBES growth rates are not stable, which, according to AIU, disqualifies the IBES growth rates from being considered as long-term growth rates. Staff states that since the IBES growth rates can not be used as long-term growth rates, they can not be used in a constant-growth DCF model, and, therefore, the results of the constant growth DCF should not be considered in determining the investor required rate of return on common equity for setting rates in this proceeding.

Staff avers there is no valid justification for disregarding the investor expectations imbedded in objective, observable current market data in favor of a proxy for those expectations imbedded in speculative projections. Staff states it is important to note that U.S. Treasury bond yields directly reflect the expectations of investors, while Blue Chip forecasts do not. Staff argues the forecasts Ms. McShane advocates are merely proxies for investor expectations, and that proxies should be used only when the market factor in question is not observable. Staff states that since market expectations for U.S. Treasury bond yields are observable, proxies for those expectations, such as a Blue Chip forecast, should not be used.

Staff further notes that the Blue Chip Financial Forecasts relied on by Ms. McShane to estimate the long-term economic growth reveals that the forecast did not include the recessionary period in 2009 and 2010, and submits that when using a forecasted growth rate for the economy, the whole business cycle must be included in order to get a measure of the normal steady state rate of growth that can reasonably be expected over the long term.

d. Beta

Staff proposes to use regression betas in this proceeding, while AIU proposes to use Value Line betas. While AIU complains that regression betas have been consistently lower than Value Line betas, Staff notes this argument does not provide insight into which beta estimation procedure is superior. Staff opines that Value Line, Zacks, and regression betas are estimates of the unobservable true beta, which measures investors' expectations of the quantity of non-diversifiable risk inherent in a security. Staff avers that different beta estimation methodologies can produce different betas when those methodologies employ different samples of stock return data. Staff submits that its methodology used to calculate the regression betas for the gas sample, which Staff has regularly used and the Commission has consistently approved, employs the same monthly frequency of stock price data as the widely accepted Merrill Lynch methodology. Staff states further that Ms. McShane‘s argument to exclude Staff calculated betas and rely upon only Value Line betas was rejected by the Commission in Docket No. 00-0340.

Staff avers that while Ms. McShane presented an analysis comparing weekly and monthly betas to support her conclusion that weekly betas are to be preferred, the statistics that she presents do not compare the —superiority" of the parameter estimates, but rather they test the predictive ability of the model. Staff argues that to test the predictive accuracy of different betas, the beta estimate has to be the independent variable, while in Ms. McShane‘s analysis, beta is the parameter estimate. Staff opines her test simply indicates how much the variation in the market return explains the variation in the return of the stock, but does not support the conclusion that monthly betas are statistically inferior to weekly betas. Staff notes that Ms. McShane did not provide any academic support for her conclusion that weekly betas are superior to monthly betas. Staff avers that in response to Staff DR JF 6.04, AIU stated that Ms. McShane was not aware of any studies that have addressed whether weekly betas are more accurate predictors of future utility stock performance than monthly betas.

In contrast, Staff cites two studies that compared weekly and monthly beta estimates but neither concluded that either beta was superior. Staff opines that those studies found a relatively weak relationship between Value Line and Merrill Lynch betas and showed that the major cause of the significant differences in beta was the use of monthly versus weekly return intervals. Staff argues that the difference in beta estimates may be the effect of non-synchronous trading, which occurs when the market return reflects information that is not yet reflected in the stock‘s return.

Staff notes it investigated whether non-synchronous trading was a problem for weekly or monthly betas. Staff avers that to account for the lag in stock price reaction to economic events that affect the market, security returns can be regressed against the returns of the market in the current period as well as the returns of the market in prior periods, with the coefficients for the current and lagged regressions summed together to derive a beta estimate. Staff argues it calculated Ms. McShane‘s weekly regression betas with three lags, with the security returns of the gas sample lagging behind the market data by one, two and three weeks. Staff notes the one and two week lags, which are -0.07 and -0.11, respectively, are statistically different from zero, which indicates that non-synchronous trading is a problem with Ms. McShane‘s weekly data. Staff also calculated the lag beta for the monthly regression beta for the gas sample that Staff proposed. Staff avers the lag beta was not significantly different from zero, which indicates that non-synchronous trading was not a problem when using monthly data.

While Ms. McShane speculated that the results might relate to the market conditions during the financial crisis since the same analysis conducted for the periods ending 2005 and 2006 produces different results, Staff states that its lag beta analysis used the same five-year time period as Ms. Freetly‘s CAPM analysis to estimate the investor-required ROR. Staff opines it is the relevant time period to examine to determine whether non-synchronous trading affected the data Ms. Freetly used to calculate beta.

Further, Staff compared the coefficient of variation using Ms. McShane‘s weekly and monthly data, noting the coefficient of variation was higher for weekly data. Staff states although the higher number of observations of the weekly data increases the degrees of freedom, and hence narrows confidence intervals, it also increases the magnitude of the variation relative to the mean of the sample stock returns, which leads to an increase in random error.

Staff opines that weekly and monthly betas have strengths and weaknesses relative to each other. Staff states that Ms. McShane‘s analysis shows the standard error of weekly beta estimates is generally lower than those for monthly beta estimates, indicating that weekly betas are usually more reliable, or have lower variation in the beta estimate than monthly betas. Conversely, Staff avers that monthly betas are less susceptible to non-synchronous trading than weekly betas. Staff argues monthly betas are calculated from returns that have lower coefficients of variation than weekly betas, which indicates that the monthly betas are more accurate than weekly betas. Since neither type of beta is clearly superior to the other, Staff recommends the Commission equally weight weekly and monthly betas in determining a cost of common equity with the CAPM.

e. Market Risk Premium

While Ms. McShane states that a ―spot‖ yield should not be relied upon as representative of expected yields and used as the risk-free rate in the CAPM, Staff avers that the current U.S. Treasury yields that Staff used to estimate the risk-free rate reflect all relevant, currently available information, including investor expectations regarding future interest rates. Staff argues that investor appraisals of the value of forecasts are reflected in current interest rates, therefore, if investors believe that the forecasts are valuable, that belief would be reflected in current market interest rates. As interest rates are constantly adjusting and accurately forecasting the movements of interest rates is problematic, Staff urges the Commission to continue to rely on current, observable interest rates rather than the forecasted rates supported by Ms. McShane.

Although AIU maintains that the ―spot‖ interest rates are not appropriate for application of the CAPM since a forward looking estimate of the cost of equity should recognize the high probability that U.S. Treasury yields will increase, Staff argues the current U.S. Treasury yields that Staff used as the risk-free rate reflect all relevant, currently available information, including investor expectations regarding future interest rates. Staff avers that as of August 18, 2009, investors were willing to accept a 4.40% return on U.S. Treasury bonds. Staff states there is no valid justification for disregarding the investor expectations directly reflected in objective, observable current market data in favor of a proxy for those expectations imbedded in speculative projections.

Staff notes that AIU chose to initiate this proceeding during a severe economic recession when it appears a large segment of its customer base is suffering financially, and during economic downturn, interest rates have fallen. Staff‘s recommended cost of common equity reflects that economic reality, while AIU would have the Commission reward AIU‘s decision to file a rate case during a severe economic recession with a rate increase that assumes that AIU filed its requested rate increase during a far more favorable economic environment.

IIEC argues that Staff‘s market risk premium in its CAPM analysis is overstated, Staff recognizes that some of the growth rates used in Staff‘s DCF analysis of the S&P 500 are unsustainably high, which produces an upward bias in Staff‘s market return estimate, and, thus in Staff‘s CAPM cost of equity estimate. Staff avers that while there is upward bias in Staff‘s estimate of the market return, there is no way to know the extent of the bias. Staff notes it did not use a non-constant growth DCF to estimate the return on the market because of the extreme difficulty of applying the more elaborate model to 500 companies. Staff states Mr. Gorman‘s non-constant DCF analysis of the S&P 500 illustrates the difficulty of applying that model to the diverse group of companies that compose that index, as his estimate of the required return of the market is 8.71%, 129 basis points below his 10.00% rate of return on common equity recommendation for AIU. Staff asserts his results imply that the S&P 500 is less risky than AIU, which is not plausible.

f. Proposed Adjustments

(1) Financial Risk

Staff states that based on a simple average of her DCF and risk premium analyses, Ms. Freetly estimated that the investor-required rate of return on common equity is 9.63% for the gas sample and 10.44% for the electric sample, which are proxies for the gas and electric operations of AIU. Staff avers if the proxy does not accurately reflect the risk level of the target company, an adjustment should be made.

To estimate the financial risk of AIU going forward, Ms. Freetly compared the financial strength implicit in Staff‘s proposed revenue requirement for each company‘s gas and electric operations to Moody‘s guidelines for the regulated gas and electric utilities, focusing on four ratios: (1) Funds From Operations ("FFO") to interest coverage; (2) FFO to total debt; (3) retained cash flow to total debt coverage; and (4) debt to capitalization.

Staff states that Ms. Freetly concluded that Staff‘s revenue requirement recommendations, including Staff‘s cost of common equity recommendations, indicate levels of financial strength that are commensurate with a Baa3 credit rating for AmerenCILCO gas, an A3 credit rating for AmerenCIPS gas and a Baa3 credit rating for AmerenIP gas.

In contrast, Ms. Freetly notes the gas sample‘s average financial ratios for 2006-2008 are indicative of a level of financial strength that is commensurate with a credit rating of Baa1, which is consistent with the current average credit ratings Moody‘s has assigned the gas sample, indicating the gas sample‘s level of financial strength indicates that it has more financial risk than the gas operations of AmerenCIPS and less financial risk than the natural gas distribution operations of AmerenCILCO and AmerenIP. Given the difference between the credit rating commensurate with the forward-looking financial strength of AIU's gas distribution operations and the credit rating commensurate with the financial strength of the gas sample, Staff asserts the sample‘s average cost of common equity needs to be adjusted to determine the final estimate of AIU's cost of common equity.

Staff states that using 30-year utility debt yield spreads published by Reuters; Ms. Freetly calculated the yield spreads between the credit ratings implied by the financial ratios for AIU and those of the gas sample. Staff opines the spread between the implied ratings of A3 for AmerenCIPS and Baa1 for the gas sample is 50 basis points, while the spread between the implied ratings of Baa3 for AmerenCILCO and AmerenIP and Baa1 for the gas sample is 35 basis points. Staff notes to determine the cost of equity adjustment, Ms. Freetly then multiplied those yield spreads by 30%, which is the percent of the overall credit rating that Moody‘s assigns to the financial ratios under the new rating methodology for regulated gas and electric utilities. Staff therefore recommends a financial risk adjustment to the cost of equity for the gas operations of an increase of 10.5 basis points for AmerenCILCO and AmerenIP and a decrease of 15 basis points for AmerenCIPS.

Using the updated Moody‘s financial guideline ratios for electric utilities, along with AIU electric utilities‘ scores on those financial ratios, Staff submits Ms. Freetly concludes that Staff‘s revenue requirement recommendations, including Staff‘s cost of equity recommendations, indicate a level of financial strength that is commensurate with a Baa1 credit rating for AmerenCILCO, an Aa3 credit rating for AmerenCIPS, and a Baa2 credit rating for AmerenIP. In contrast, the electric sample‘s average financial ratios for 2006-2008 are indicative of a level of financial strength that is commensurate with a credit rating of Baa2, which Staff states is consistent with the current average credit ratings Moody‘s has assigned the electric sample. Staff argues the electric sample‘s level of financial strength indicates that it has more financial risk than the electric delivery service operations of AmerenCILCO and AmerenCIPS, therefore the sample‘s average cost of common equity needs to be adjusted to determine the final estimate of the cost of common equity.

Staff states that using 30-year utility debt yield spreads published by Reuters; Ms. Freetly calculated the yield spreads between the credit ratings implied by the financial ratios for AIU and those of the electric sample. Staff submits the spread between the implied ratings of Baa1 for AmerenCILCO and Baa2 for the electric sample is 20 basis points, while the spread between the implied ratings of Aa3 for AmerenCIPS and Baa2 for the electric sample is 100 basis points. To determine the cost of equity adjustment, Staff notes Ms. Freetly then multiplied those yield spreads by 30%, which is the percent of the overall credit rating that Moody's assigns to the financial ratios under the new rating methodology for regulated gas and electric utilities, therefore Staff's financial risk adjustment to the cost of equity for the electric operations is a decrease of 6 basis points for AmerenCILCO and 30 basis points for AmerenCIPS.

Staff and AIU agree that when a utility has more or less financial risk than the sample companies used to estimate the cost of equity, an adjustment to the cost of equity is necessary. Ms. McShane asserts that when the market value common equity ratio is higher than the book value common equity ratio, the market is attributing less financial risk to the companies than the book value capital structure suggests. Staff states she claims that since the investor required ROR is estimated based on the market value of the companies in the gas and electric samples, adjustments to recognize the higher financial risk implied by the book value capital structure of AIU is required.

Staff maintains that there is no merit to Ms. McShane's claim, arguing the fundamental problem with Ms. McShane's claim is that it assumes, without foundation, that the book value capital structure of AIU directly reflects investors' perceptions of the financial risk of AIU. Staff opines that while investors are unlikely to ignore the book value capital structure of companies generally and utilities specifically, investors' perceptions of AIU's financial risk inherent in its book value capital structure are not observable because its common stock is not market traded.

Staff states its recommendations reflect the revenue requirements necessary to set just and reasonable rates, which will remain in effect until a future rate proceeding. While Ms. Freetly used Staff's recommendations to estimate the credit metrics that may be achieved with the rates set in this proceeding, Staff's analysis of the implied level of financial strength of the gas and electric utility operations of each of the AIU is not an attempt to predict the rating outcome of Staff's position in these rate proceedings. Staff claims it did not attempt to determine its own credit ratings for AIU nor is Staff suggesting that simply because AIU's metrics fall within the guideline ranges that the implied ratings will result. Staff asserts it performed the ratio analysis in order to compare the financial strength of AIU, based on the FFO to interest coverage, FFO to total debt, DCF to total debt coverage and debt to capitalization, to those of the gas and electric samples. Staff opines the resulting ratios were translated into implied credit ratings only to have a metric on which to base an adjustment to the cost of equity.

Staff avers it did not use the current credit ratings of AmerenCILCO, AmerenCIPS and AmerenIP for comparison to the gas and electric samples for several reasons. Staff claims credit ratings reflect the risk of a company's entire operations, not just those operations subject to the Commission's rate jurisdiction. Further, Staff states credit ratings also reflect a company's affiliation with other companies, while Section 9-230 of the Act prohibits including in a utility's allowed ROR any incremental risk or increased cost of capital which is the direct or indirect result of a public utility's affiliation with unregulated or nonutility companies. Third, Staff asserts credit ratings reflect the credit ratings agency's forecast, and since those forecasts are not published, they can not be compared to Staff's revenue requirement recommendations. Staff states that based on this, AIU's credit ratings should not be relied upon absent an investigation of the underlying stand-alone, going forward strength of AIU.

Staff notes AIU claims that Staff's financial risk adjustment incorrectly assumes that equity investors quantify financial risk differences in the same manner as bond investors. Although Staff agrees that bond and common equity investors would not likely apply the same price to a given difference in financial risk, since Staff notes the price the latter would attach to financial risk can not be observed, a proxy is necessary. Staff claims the bond yield spreads that Staff's adjustment is based on are the best estimate of the different return requirements that investors would demand for varying levels of financial risk. Staff asserts it is an objective measure of the return equity investors would require to invest in AIU given the different levels of financial risk indicated by Staff's ratio analysis.

(2) Fixed Customer Charge

Staff notes the Commission authorized the AIU gas utilities to recover 80% of the fixed delivery service costs through the monthly customer charge in the last rate cases, which cost recovery method will remain in effect when the rates set in this proceeding go into effect. Staff asserts in AIU's last rate cases, the Commission recognized that this move toward more fixed cost recovery through the fixed monthly charge provides the AIU gas utilities more assurance of recovering its fixed costs of service for gas operations, reducing risk and providing the utilities greater assurance that the authorized ROR will be earned. Ms. Freetly's cost of common equity recommendation therefore includes the same 10 basis point adjustment to the cost of common equity for the AIU gas companies that the Commission found appropriate in the last rate cases to reflect the reduction in risk provided by this method of cost recovery.

While Ms. McShane claims that eight of the nine gas distributors in the Gas sample have similar mechanisms in place and therefore, the cost of common equity estimate for the gas sample already reflects the risk reduction, Staff states most of the companies in the gas sample have in place some sort of de-coupling mechanism, some of those mechanisms are only applicable to a portion of the company's service territories, and one of the companies has no de-coupling mechanism at all. Staff opines that a small cost of equity adjustment for the reduction in risk provided by this method of cost recovery is warranted, and the 10 basis point downward adjustment adopted in AIU's last rate case is appropriate in this proceeding.

(3) Uncollectibles Riders

Staff asserts its cost of equity recommendations do not take into account any change in risk associated with the new uncollectibles riders AIU approved in Docket No. 09-0399, therefore, Staff recommends further adjustment to the cost of common equity for the uncollectibles riders authorized by the Commission.

Staff argues the uncollectibles riders approved in Docket No. 09-0399 ensure more timely and certain collection of bad debt expense, which provides greater assurance that the Companies will earn their authorized rates of return. Staff states that since the uncollectible riders would reduce uncertainty of cash flows, it would reduce risk, and therefore, downward adjustments to AIU's rates of return on common equity would be appropriate to recognize the reduction in risk associated with the use of the uncollectibles riders.

Staff notes that Moody‘s recently upgraded the ratings of the AIUs to investment grade reflecting reflects positive developments in Illinois, including the recently passed legislation providing Illinois utilities with a bad debt rider. Staff avers that Moody‘s acknowledges that such riders would reduce the risk of the utilities by providing greater assurance of bad debt cost recovery and factored that into the decision to upgrade the AIUs to investment grade.

Staff states it is unaware of any established approach for precisely gauging the effect the adoption of the uncollectibles riders would have on investors‘ perceptions of AIU's risk levels and the resulting costs of equity, therefore any adjustment will inevitably be inexact. Therefore, Staff‘s proposed adjustments for Riders GUA and EUA reflect a range of alternatives using two distinct approaches.

In the first approach, Staff estimated the effect the adoption of Riders GUA and EUA would have on AIU's Moody's credit ratings and based the adjustment of the resulting change in the implied yield spreads. Staff states Moody‘s updated rating methodology for regulated electric and gas utilities focuses on four core rating factors: regulatory framework, ability to recover costs and earn returns, diversification, and financial strength and liquidity.

Staff avers that of the four updated rating factors, the adoption of an uncollectibles rider would affect the utilities‘ ability to recover costs and earn returns, which factor assesses the ability of the utility to recover prudently incurred costs in a timely manner. For local gas distribution companies in the United States, Staff opines this factor addresses the sustainable profitability and regulatory support assessments in the previous methodology. Staff argues a utility‘s score on this factor would improve with implementation of an uncollectibles rider that allows timely adjustment of rates to cover uncollectible costs since its ability to earn its authorized ROR would be enhanced, and notes Moody‘s assigns a 25% weighting to this factor.

Staff assumed that the credit rating assigned to this factor would improve by one credit rating (3 points on the numeric scale) with the implementation of the uncollectibles rider, which would raise the score for this factor by 3 rating points, and result in an improvement to the Companies‘ overall credit ratings of approximately one credit rating notch.

Staff asserts that for the natural gas distribution operations, this analysis indicates that the going forward level of financial strength is consistent with credit ratings which would change from Baa3 to Baa2 for AmerenCILCO and AmerenIP and from A3 to A2 for AmerenCIPS. Staff opines the returns on common equity would be reduced by the 15 basis point spread between credit ratings of Baa3 and Baa2 for AmerenCILCO and AmerenIP, and by the 10 basis point spread between credit ratings of A3 and A2 for AmerenCIPS.

For the electric delivery service operations, Staff argues its analysis indicates that the going forward level of financial strength is consistent with credit ratings which would go from Baa1 to A3 for AmerenCILCO, Aa3 to Aa2 for AmerenCIPS, and from Baa2 to Baa1for AmerenIP. Staff argues the returns on common equity should therefore be reduced by the 50 basis point spread between credit ratings of Baa1 and A3 for AmerenCILCO, the 10 basis point spread between credit ratings of Aa3 and Aa2 for AmerenCIPS, and by the 20 basis point spread between credit ratings of Baa2 and Baa1 for AmerenIP.

Staff states the second approach is an iterative process of adjusting Staff's cost of common equity estimate downward to offset the increased operating income resulting from the adoption of Rider GUA in Docket No. 09-0399 (hereafter, —Operating Income Analysis"). Based on Staff's pre-adjustment ROR recommendations of 9.64% for AmerenCILCO gas and AmerenIP gas and 9.38% for AmerenCIPS gas and Staff's rate base recommendations of $190,360,000 for AmerenCILCO gas, $193,701,000 for AmerenCIPS gas, and $511,117,000 for AmerenIP gas, Ms. Freetly calculated pro forma operating incomes without Rider GUA (Staff's rate base x ROR recommendations) of $15,135,546 for CILCO gas, $14,884,141 for CIPS gas and $44,473,038 for IP gas. To estimate the effect Rider GUA would have on the pro forma operating income of each of the AIU gas utilities, Staff avers that Ms. Freetly subtracted the companies' estimates of uncollectibles recovery via base rates from the Account 904 balances for the years 1999-2008, dividing the average difference between the companies' estimates of uncollectibles recovery via base rates and Account 904 balances over the last 10 years by the pro forma operating income without Rider GUA. If Rider GUA had been in effect during the last 10 years, Staff's analysis indicates if Rider GUA had been in effect during the last 10 years, the pro forma operating incomes for the gas operations of AmerenCILCO, AmerenCIPS, and AmerenIP would have been approximately 9.61%, 10.35%, and 5.60% higher, on average. Ms. Freetly then multiplied the pro forma operating incomes for the gas operations of AmerenCILCO, AmerenCIPS, and AmerenIP by those respective amounts to estimate the effective pro forma operating incomes if Rider GUA were adopted but no adjustments were made. Staff states Ms. Freetly then adjusted her cost of common equity downward until the pro forma operating incomes under Rider GUA equaled the original pro forma operating incomes Staff calculated for the companies without Rider GUA. Staff opines this process produced downward adjustments to the costs of equity for the gas operations of AmerenCILCO, AmerenCIPS, and AmerenIP of approximately 160, 149, and 106 basis points, respectively, to reflect the risk reduction associated with Rider GUA.

Staff states it performed the same calculation regarding AIU's electric operations, additionally performing various calculations involving Staff's pre-adjustment ROR recommendations for AIU, along with the ratio of average Account 904 balances to pro forma operating income for each AIU. Staff in its Initial Brief ("IB") discusses the exact formula it used to estimate the operating income for each company if the respective uncollectible rider had been in effect. (Staff IB at 137-140) Staff asserts that this process produced downward adjustments to the costs of common equity for the electric operations of AmerenCILCO, AmerenCIPS, and AmerenIP of approximately 76, 119, and 48 basis points, respectively, to reflect the risk reduction associated with Rider EUA.

While AIU Nelson criticizes Staff's recommendation to adjust the ROR downward to reflect the reduced risk from adoption of the uncollectibles rider, claiming there should be zero impact on the ROE; Staff claims this is contrary to financial theory on the trade off between risk and return. Staff claims the increased certainty of uncollectibles cost recovery by adoption of the riders results in a reduction in risk and, thereby, warrants a reduction to the cost of common equity, as the adopted riders remove uncertainty associated with the recovery of uncollectible expense.

Although Mr. Nelson claims that the riders provide reciprocal benefits to shareholders and ratepayers, Staff avers the uncollectibles riders shift the risk of under recovery of uncollectibles expense from investors to the customers who pay their bills, in essence requiring ratepayers who pay their bills to provide a guarantee to AIU that all of its uncollectibles expense will be recovered. Staff notes that if ratepayers are compensated for the guarantee that they will provide, Mr. Nelson would be correct that ratepayers would get a benefit from providing this guarantee to AIU and its investors; however AIU seeks to deny ratepayers that compensation.

AIU's claim that Staff's proposed adjustment to the ROE is an indirect approach to ensure that AIU continues to under recover uncollectibles and is punitive in nature ignores, Staff opines, that the uncollectible riders guarantee AIU recovery of uncollectible expenses, thereby reducing the uncertainty of cost recovery. Staff notes that guarantees have costs in the financial markets, and as AIU is asking its customers to guarantee the recovery of uncollectible expenses through the rider mechanism, AIU ratepayers should be compensated for providing that guarantee.

Staff opines that basing the magnitude of the ROR adjustment on the amount of uncollectibles is appropriate not only because the amount of risk that is shifted from investors to ratepayers is related to the amount of uncollectibles, but it also provides AIU with a financial incentive to reduce uncollectibles. Staff states the lower the amount of uncollectibles, the lower the downward adjustment to the ROR related to Riders GUA and EUA.

While AIU states that Moody's was aware of the passage of this rider prior to its recent upgrade of AIU's credit ratings and no further upgrade could be expected, Staff claims Moody's upgrade to AIU's credit ratings directly affects the cost of AIU's credit facilities and will affect the cost of future debt issues. Staff avers that upgrade does not affect the starting point for analysis of AIU's costs of common equity: the costs of common equity of the gas and electric samples. Staff notes it used the effect of the riders on credit ratings as one proxy of the effect of the riders on cost of common equity.

Staff states that AIU's comparison of Staff's financial risk adjustment and Staff's adjustment for the uncollectibles riders is not valid. Staff avers that the uncollectibles rider adjustment affects operating risk, not financial risk. Staff notes the operating income analysis recognizes the effect of the adoption of the uncollectibles riders and is based on the under-recovery experienced by each of the Companies over the last 10 years. The uncollectibles data shows that the affect of Rider GUA on AmerenCILCO gas would be greater than AmerenIP gas given the fact that uncollectibles is a much higher percentage of AmerenCILCO gas' operating income.

Staff notes that the results of its two analyses of the effects of the uncollectible riders range from 15 to 160 basis points for AmerenCILCO gas operations, 10 to 149 basis points for AmerenCIPS gas and 15 to 106 basis points for AmerenIP gas. Based on the midpoints of those ranges, Staff recommends adjustments to the costs of common equity for the gas operations of AmerenCILCO, AmerenCIPS, and AmerenIP of 87.5, 79.5, and 60.5 basis points, respectively, to reflect the reduced risk that will result from the adoption of Rider GUA. Staff states the results of this calculations range from 50 to 76 basis points for AmerenCILCO electric, 10 to 119 basis points for AmerenCIPS electric, and 20 to 48 basis points for AmerenIP electric. Staff recommends using the midpoints of those ranges, with adjustments to the costs of common equity for the electric operations of AmerenCILCO, AmerenCIPS, and AmerenIP of 63, 64.5, and 34 basis points, respectively, to reflect the reduced risk that will result from the adoption of Rider EUA.

3. AG/CUB Position

a. Return on Equity Estimates

AG/CUB states that the Commission's task is to ensure that the cost of equity capital used to develop rates compensates investors for their investment risk, while assuring that customers do not pay an excessive or unreasonable return in those rates. AG/CUB avers that this is a decision made by weighing the relative riskiness of the regulated company against the relative riskiness of other investments, a task complicated by the fact that a "fair" return changes over time as the debt and equity markets change. AG/CUB notes that in the past two years, the relevant market changes include a fall in stock prices (as measured by the S&P 500) of more than 50% from the fall of 2007 through March 2009.

AG/CUB suggests that the problem with using the DCF and CAPM with the inputs AIU proposes is that the limited credit availability that has been endemic of the crisis has been caused by uncertainty in market fundamentals. AG/CUB submits that as the financial crisis has made clear, financial information from typical financial industry sources, such as rating agencies, can be dramatically wrong and strongly biased.

AG/CUB argues that the financial climate requires the Commission to return to basics instead of simply repeating past approaches that ignore very different market circumstances. AG/CUB notes that while CUB witness Thomas uses the same DCF and CAPM models, he adjusts the models, as well as the data inputs used in the models, to reflect the credit crisis and resulting discontinuity in the financial markets.

AG/CUB argues that AIU's analysis of the appropriate ROE is flawed because it incorporates overstated estimates of company growth and overstates the degree to which utility stock prices correlate to market prices, both of which increase AIU's proposed cost of equity estimate. While Ms. McShane proposes to increase these estimates further, producing different returns for each operating subsidiary based on the mistaken notion that the Commission should adjust returns to reflect the divergence of market and book values, AG/CUB opines that this results in inflated and unsupportable results. AG/CUB also notes that Ms. McShane advocates a comparable earnings test which has been rejected by the Commission in recent cases.

While AIU argues the Commission should reject Mr. Thomas‘ cost of common equity because it is not comparable to any cost of equity or return granted by other regulators, AG/CUB notes that the Commission has rejected such arguments in the past, noting each company must show that its proposed ROE is just and reasonable. AG/CUB argues that instead of rejecting Mr. Thomas' results because AIU finds them to be lower than any reasonable indicator of the returns investors expect, the Commission should base its order on the entirety of the record evidence, including the reasonableness of the analysts' various models and the inputs and assumptions. AG/CUB notes that the Commission has historically used the DCF and CAPM models, however Mr. Thomas testified that real world investors use very different techniques to determine the true cost of equity capital.

AG/CUB states that all parties have observed that the economic recession that began in 2008 has produced a very different economic climate than that of times past. AG/CUB argues that financial information from typical financial industry sources, such as rating agencies, can be dramatically wrong and strongly biased, and opines that the use of DCF and CAPM, both of which has been relied upon by the financial markets for a number of years, have proven to be unreliable in estimating an appropriate ROE.

AG/CUB further urges the Commission to reject AIU's proposed financial risk adjustment, noting that the Commission applies a market-determined ROR to the book value of the capital structure, and AIU presents no evidence that a change from this practice is required. AG/CUB opines that adjusting market-based DCF results before applying them to the book value of assets in rate base inflates the market-based cost of equity.

AG/CUB further supports the proposal by Ms. Freetly to adjust the AIU gas utilities‘ rate of return on common equity downward by 10 basis points, and continues to support her proposed adjustment to account for the presence of the AIU uncollectibles riders. AG/CUB avers that such an approach is reasonable in the event the riders are implemented. AG/CUB therefore recommends a return on common equity for AmerenCILCO's gas and electric operation of 6.92% and 8.35%; AmerenCIPS' gas and electric operation of 7.13% and 8.09%; and AmerenIP's gas and electric operation of 7.12% and 8.47%, respectively.

b. DCF and CAPM Model Issues

AG/CUB notes that the DCF model estimates the cost of equity capital by assuming that investors who purchase stock are paying a price that reflects the present value of the cash flows they expect to receive from the stock in the future. AG/CUB avers that using information about the current stock price and expected future cash flows from dividend payments and earnings growth, the model, which is based on the relationships among various factors, estimates the return that investors expect to receive on their investment.

AG/CUB submits that the actual return required to induce investors to make a particular investment is not a directly observable number because investors' requirements for future dividends and rates of growth can not be found in the pages of the Wall Street Journal and plugged into the model. AG/CUB states that in this case, the analysis is further complicated by the current market upheaval and by the fact that AIU does not have publicly traded stock, which would provide current, objective dividend and price information. AG/CUB opines that instead, proxy groups of companies are used to estimate the investor-perceived level of risk associated with a company such as the AIU and make projections of AIU's future growth. AG/CUB states the fundamental difference between AG/CUB and AIU's analysis lies in what is used to project AIU's future growth.

AG/CUB opines that the CAPM is an alternative analytical tool commonly used in regulatory proceedings to estimate investors' required ROR, or the cost of equity capital for the firm. AG/CUB states that for a utility, the investors' required ROR is the risk-free rate plus the value of the non-diversifiable risk that investors take on by investing in the utility. AG/CUB avers that the amount of that non-diversifiable risk that investors are exposed to through their investment in a particular firm's shares is measured by a beta coefficient.

AG/CUB notes that the key assumptions of the CAPM are that (1) in the market, investors are compensated only for non-diversifiable risk, quantifiable as a uniform EMRP, and (2) beta is an accurate measure of the relative risk of an individual security when compared with the overall market. AG/CUB states that CAPM is generally best employed as a check of the DCF model, arguing there are several well-known problems with both the theory and practical application of the CAPM. AG/CUB opines that even in that limited role, the Commission must recognize the deficiencies of the CAPM, require appropriate inputs, and use the results judiciously. AG/CUB asserts that the CAPM analysis presented by Ms. McShane has both an inappropriate adjustment of the beta parameter, and a grossly overstated EMRP.