Regulatory Research Associates
REGULATORY FOCUS

FINAL REPORT January 23, 2012

STATE: ILLINOIS
COMPANY: Ameren Illinois[1]
ACTION: $32.2 million gas base rate increase authorized

CASE HISTORY

		Millions
2/18/11	Gas base rate increase requested (Company supported a $49.5 million increase at end of case)	$50.7[2]
6/29/11	Rate increase recommended by ICC Staff	16.2
11/15/11	Rate increase recommended by Administrative Law Judges	30.4
1/10/12	Final order issued, rate increase authorized	32.2
1/20/12	New rates effective	32.2

	PRESENT CASE		
	Supported by Company	Authorized by Commission	Previous Decision 4/29/10[3]
Annual Revenues (millions)	$49.5	$32.2	$0.3
% of Revenues	16.5%	10.7%	0.3%
Test Year End	12/31/12	12/31/12	12/31/08
Rate Base Value (millions)	$956.3	$952.3	$187.0
Rate Base (Year-End or Average)	Average	Average	Year-End
Return on Common Equity	10.75%	9.06%	9.19%
Common Equity % of Capital	52.87%	53.27%	48.67%
Return on Rate Base	9.31%	8.33%	7.59%

1 In October 2010, Central Illinois Light (CILCO), Central Illinois Public Service (CIPS), and Illinois Power (IP) merged to form Ameren Illinois.
2 Ameren Illinois had simultaneously filed an electric rate case that was terminated by operation of law on Jan. 5, 2012, following the company's filing of a formula rate plan.
3 Decision shown was for CIPS. The ICC simultaneously ordered CILCO to reduce gas rates by $5.7 million premised upon a 9.4% return on equity (43.61% of capital) and a 7.83% return on a $181.3 million rate base, and required IP to reduce gas rates by $7.4 million premised upon a 9.4% return on equity (43.55% of capital) and an 8.59% return on a $486.2 million rate base.

RRA EVALUATION

This Illinois Commerce Commission (ICC) decision for Ameren subsidiary Ameren Illinois (AI) is negative from an investor perspective. The 9.06% authorized return on equity (ROE) is significantly below the average of returns authorized for gas utilities nationwide during 2011, is one of the lowest equity returns accorded a gas utility nationwide since RRA began tracking equity returns in the early-1980's, and is below the ROE authorized in a 2010 rate decision for the company. The ICC's adjustments to rate of return accounted for the vast majority of the revenue requirement shortfall in the case. On a somewhat favorable note, the ICC's rate base and net operating income (NOI)-related disallowances were rather modest and therefore, it appears that AI will have a reasonable opportunity to earn the authorized ROE in the first year of new rates. We accord Illinois regulation a Below Average/2 rating.

Rate Case Summary

This proceeding was initiated on Feb. 18, 2011, when AI filed for a $50.7 million gas delivery rate increase premised upon an 11% return on equity (52.95% of capital) and a 9.44% return on a $977.6 million rate base. At the end of the case, the company supported a $49.5 million increase premised upon a 10.75% ROE. AI initially proposed to implement a rider to facilitate recovery of incremental changes in pension costs; however, the company subsequently withdrew the proposed rider. AI cited increased operations and maintenance costs, increased cost of capital, and recent system investments as necessitating the requested increase. We note that AI had simultaneously filed an electric rate case (Docket No. 11-0279) that was ultimately terminated by operation of law on Jan. 5, 2012, following the company's filing of a formula rate plan.

On June 29, 2011, the ICC Staff filed testimony recommending a $16.2 million gas rate increase premised upon an 8.9% return on equity (51.81% of capital) and an 8.2% return on a $942.2 million rate base. On Nov. 15, 2011, the ICC Administrative Law Judges (ALJs) issued a proposed order recommending a $30.4 million rate increase premised upon a 9.01% return on equity (53.27% of capital) and an 8.306% return on a $952.3 million rate base.

On Jan. 10, 2012, the ICC issued an order authorizing AI a $32.2 million rate increase premised upon a 9.06% ROE. The following table summarizes the adjustments accounting for the $17 million revenue requirement difference between the $49.5 million increase supported by AI at the end of the case and the $32.2 million increase authorized by the ICC.

RATE CASE DISALLOWANCES (Approximate)

Disallowances Related To:	(Millions)
Rate of Return	$15
Rate Base	1
Net Operating Income	1
Total Disallowed	$17

Rate of Return

We calculate that the adoption of a lower rate of return than that supported by AI accounted for roughly $15 million of the total revenue requirement shortfall in the case. At the end of the case, AI supported a 10.75% equity return based upon discounted cash flow (DCF), capital asset pricing model (CAPM), and risk premium approaches for a proxy group of companies. The Staff recommended an 8.9% ROE, calculated using DCF and CAPM approaches. The Staff's recommended equity return included a 16.25-basis-point downward adjustment to reflect the perceived risk reduction associated with AI's existing bad-debt-expense cost recovery rider. (AI recommended that this proposed adjustment be rejected.) The Government and Consumer Intervenors (including the Attorney General/Citizens Utility Board) and the Illinois Industrial Energy Consumers recommended ROEs of 8.22% and 9.25%, respectively, calculated using DCF and CAPM approaches. The ALJs recommended a 9.01% ROE.

The ICC adopted a base ROE of 9.22%, representing the average of: (1) the parties' DCF results (a 9.12% mean); and, (2) the Staff's CAPM result (9.31%). The ICC adopted the Staff-proposed 16.25-basis-point downward adjustment to account for the presence of the bad-debt rider; according to the Commission, AI presented "no real alternative" to the Staff's recommendation on this issue. Accordingly, the ROE adopted by the ICC is 9.06%.

AI supported a 7.59% long-term-debt cost rate. The Staff recommended that a 7.44% cost rate be adopted, reflecting certain adjustments. Specifically, the Staff made a downward adjustment to account for the higher coupon rate of a 2008 AI debt issuance; this adjustment was designed to remove the impact of the incremental business risk attributed by the rating agencies to AI's affiliation with certain non-regulated Ameren businesses. (The Staff also recommended a reduction to the cost rate associated with another 2008 AI debt issuance.) In addition, the Staff proposed a downward adjustment to the estimated coupon rate associated with a debt issuance planned for October 2012; AI utilized forecasted Treasury yields in its estimate, while the Staff relied on prevailing Treasury yields. The ICC adopted the Staff-recommended adjustments on all three of these issues and approved a 7.44% cost rate for long-term debt.

There was also disagreement between AI and the Staff regarding the calculation of the company's short-term debt cost rate. AI supported a 3.85% rate that was based on a forecasted three-month LIBOR rate; the Staff recommended that a 2.24% rate be utilized, calculated using the prevailing one-month LIBOR rate. The ICC adopted the Staff-proposed cost rate, finding it to be "better" than the company-supported rate. The Commission stated that, "It is impossible to know what the [one-month] LIBOR rate will be" when rates established in this proceeding will be in effect.

AI and the Staff both supported an adder to the overall return to reflect the bank commitment fees associated with the company's credit facilities. AI supported a ten-basis-point adder, while the Staff quantified the adder at eight basis points. The ICC adopted the rate-of-return adjustment recommended by the Staff, finding this adjustment to be "reasonable."

Regarding capital structure, the parties largely agreed as to the appropriate balances of long-term debt, preferred stock, and common equity. The capital structure and associated cost rates adopted by the ICC are included in the table below.

Type of Capital	Percent of Capitalization	Cost Rate
Long-Term Debt	44.88%	7.44%
Short-Term Debt	0.18	2.24
Preferred Stock	1.67	4.98
Common Equity	53.27	9.06
	100.00%	8.33%*

* Includes an eight-basis-point adder to account for the commitment fees associated with the company's credit facility.

Rate Base

The ICC's adjustments to rate base ($4 million net), in aggregate, reduced AI's supported revenue requirement by approximately $1 million. The Staff recommended an approximate $5 million reduction to rate base to reflect the company's accrued liability for other-post-employment-benefits (OPEBs), stating that this liability (the excess of OPEB expense above amounts actually contributed to the OPEB trust) represents ratepayer-supplied funds. The ICC adopted the Staff-proposed adjustment, thereby reducing the revenue requirement by about $1 million. The ICC adopted certain other rate base adjustments that, in aggregate, had a negligible impact on the revenue requirement.

Net Operating Income

The ICC adopted certain NOI adjustments that on a net basis reduced the revenue requirement by roughly $1 million. The Staff recommended that all costs related to AI's "performance share unit" incentive compensation plan be disallowed, since the benchmarks in the plan are "designed primarily to benefit shareholders." The ICC adopted the Staff-proposed adjustment, thereby reducing the revenue requirement by about $0.5 million. The ICC adopted certain other NOI-related adjustments that, in aggregate, reduced the revenue requirement by about $0.5 million.

Retail Competition Issues

The Retail Gas Suppliers (RGS) requested that the ICC order the Staff to commence a workshop to consider the merits of permitting AIs residential and small commercial customers to select their gas suppliers. Although AI stated that it does not oppose allowing these customers to choose their gas supplier, the company noted that certain issues would need to be addressed, including: whether there would be identifiable customer benefits; whether the cost of implementing such a program would be reasonable; and, how AI would recover the related costs in a timely manner. The Staff recommended that RGS' request be rejected, as a report is expected to be presented to the Legislature in 2013 that will address the state of retail gas competition in Illinois; the Staff opined that the parties should ultimately consider the results of the report in a workshop to be held at a later date.

The ICC approved the RGS' request and required the parties to commence a workshop, within 60 days of the final order in this case, on a potential gas supplier choice program for AI's small-volume customers. The ICC stated that it is "troubled" by certain parties' suggestions that this issue not be addressed until the aforementioned report is issued to the Legislature. The ICC concluded: "While the Commission strongly embraces retail competition in the energy markets, the Commission believes it is appropriate to examine and address market barriers and other related issues as [a gas choice program for AI] is being developed, rather than address them when a program might already be in place."

Docket No. 11-0282
Russell Ernst