

ILLINOIS COMMERCE COMMISSION

DOCKET No. 12-0293

REBUTTAL TESTIMONY

OF

CRAIG D. NELSON

Submitted on Behalf

Of

**AMEREN ILLINOIS COMPANY
d/b/a Ameren Illinois**

July 31, 2012

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7 **I. INTRODUCTION**

8 **A. Witness Identification**

9 **Q. Please state your name and business address.**

10 A. My name is Craig D. Nelson. My business address is 300 Liberty Street, Peoria, Illinois
11 61602.

12 **Q. By whom are you employed and in what capacity?**

13 A. I am employed by Ameren Illinois Company d/b/a Ameren Illinois (AIC or the
14 Company) as Senior Vice President, Regulatory Affairs and Financial Services.

15 **Q. Please describe your education and relevant work experience.**

16 A. See my Statement of Qualifications, attached as an Appendix to this testimony.

17 **Q. What are your responsibilities as Sr. Vice President of Regulatory Affairs and
18 Financial Services?**

19 A. My role is to oversee the power procurement, implementation of Senate Bill (SB)
20 1652/House Bill (HB) 3036, asset and risk management, community and public relations,
21 budgeting, financial analysis/reporting, legislative affairs, and regulatory affairs activities for
22 Ameren Illinois Company.

23 **B. Purpose, Scope and Identification of Exhibits**

24 **Q. What is the purpose of your rebuttal testimony?**

25 A. The purpose of my rebuttal testimony is to comment on and respond to the Illinois
26 Attorney General and AARP (AG/AARP) joint witnesses Mr. Michael Brosch and Mr. David J.
27 Effron, and Citizens Utility Board (CUB) witness, Mr. Ralph C. Smith on average rate base; Mr.
28 Brosch and Mr. Smith on reconciliation interest; and Illinois Commerce Commission
29 (Commission) Staff (Staff) witness, Ms. Theresa Ebrey on regulatory commission expense.

30 **Q. Are you sponsoring any exhibits with your rebuttal testimony?**

31 A. No, I'm not.

32 **II. AVERAGE RATE BASE**

33 **Q. What are the parties' position on reconciliation rate base?**

34 A. Commission Staff does not address this issue in its direct testimony. Mr. Brosch, Mr.
35 Effron and Mr. Smith all recommend that an average rate base be used to determine
36 reconciliation revenue requirements. In general, they argue that use of a year end rate base
37 would systematically overstate the reconciliation rate base and the resulting reconciliation
38 revenue requirement, and inflate AIC's return on actual investment.

39 **Q. Is the question of the appropriate reconciliation rate base relevant to this**
40 **proceeding?**

41 A. No. The reconciliation rate base to be used in the formula rate will be determined in
42 Docket 12-0001, which will establish the formula rate structure and protocols. This proceeding is
43 simply to provide updated cost inputs to the formula rates. As such, the discussion by

44 interveners recommending the use of average rate base is not applicable to this proceeding. I,
45 nevertheless, address the position of the interveners on this below.

46 **Q. Please summarize the problems with the use of an average rate base for**
47 **reconciliation.**

48 A. I believe there are three main concerns:

- 49 • Although I am not a lawyer, I am informed by counsel that the Energy
50 Infrastructure Modernization Act (EIMA) requires use of a year end rate base for
51 reconciliation;
- 52 • Use of a year end rate base for reconciliation reflects appropriate ratemaking
53 policy because it matches customers' rates with the cost of the plant providing
54 them service; and
- 55 • AIC would be adversely impacted by the use of an average calendar year
56 reconciliation rate base.

57 **Q. Why does the EIMA require use of year end rate base?**

58 A. Although I am not an attorney, I believe the General Assembly made it clear what the
59 inputs for the reconciliation were to be. Section 16-108.5(d)(1) states, "The inputs to the
60 performance-based formula rate for the applicable year shall be based on **final** historical data
61 reflected in the utility's most recently filed annual FERC Form 1..." (emphasis added). An
62 average rate base is not "final" data. And, in that same section, the General Assembly specified
63 that the required reconciliation is to "the actual revenue requirement for the prior rate year (as
64 reflected in the applicable FERC Form 1 that reports the actual costs for the prior rate year)".
65 FERC Form 1 does not report an "average" rate base, or for that matter, any aggregate "rate
66 base" figure at all. It reports year end values for components that, added together, comprise a
67 "rate base" used for ratemaking purposes.

68 Section 16-108.5(c)(6) also drives home the “actual cost” theme by specifying an annual
69 reconciliation “with what the revenue requirement would have been had the actual cost
70 information for the applicable calendar year been available at the filing date.” The cost
71 information for reconciliation available at the filing date would be the year end rate base, not an
72 average (i.e., on the May 1, 2013 filing date the final actual 2012 cost data would be available).
73 The General Assembly’s use of the words “final” and “actual” are in sharp contrast to the
74 interveners’ “average” concept theory. “Final historical data” and “actual costs” are simply not
75 averages, as interveners suggest.

76 Moreover, nowhere in Section 16-108.5 is the use of an average rate base specified.
77 Based on my review of the statutory language, it appears where the General Assembly wanted to
78 use “average” for an applicable calendar year, they expressly used the term “average”. I would
79 note that Section 16-108.5 contains the phrases “average for the applicable calendar year”. (See
80 Section 16-108.5 (c)(3)(A) of the Act concerning yields of 30-year U.S. Treasury Bonds), and
81 “average capital spend for calendar years” ((See Section 16-108.5 (b)(2) of the Act concerning
82 infrastructure investment program). These Sections of the Act contain the terms “average” and
83 “calendar year” in the same phrase, meaning the General Assembly distinguished between where
84 they intended an “average” to be used and where they did not. Sections 16-108.5 (c) (6) and 16-
85 108.5 (d) (1) do not contain the word “average” and therefore interveners should not contend that
86 the General Assembly intended the use of a reconciliation average rate base as they propose.

87 **Q. Mr. Smith states that “If the legislature intended a year end rate base, presumably**
88 **the specification would have been for a “calendar year end” and not for the “applicable**
89 **calendar year.” How do you respond?**

90 A. He is wrong – he, along with Mr. Brosch and Mr. Effron are offering interpretations of
91 the statute which I understand to be incorrect.

92 **Q. What information do you have that supports the conclusion that these experts’**
93 **interpretation of the EIMA is wrong?**

94 A. The question with respect to reconciliation rate base is what the legislature has directed.
95 What the legislature has directed is reflected in the language of the EIMA, not what parties might
96 wish that language to be. Although I am not an attorney, as discussed above, I am informed by
97 counsel that the language of the EIMA makes clear that a year end rate base, not an average rate
98 base, is to be used for the annual reconciliation. Further, I am aware that the Public Utilities
99 Committee of the Illinois House recently confirmed as much, when it adopted a resolution
100 explaining that the Commission's order in Commonwealth Edison Company's (ComEd) Docket
101 11-0721 was incorrect with respect to certain interpretations of the EIMA, including in its
102 endorsement of average rate base. House Resolution (HR) 1157 was adopted by the Public
103 Utilities Committee on July 11, 2012. HR 1157 has almost 50 sponsors, including the speaker of
104 the house. A similar resolution has been offered in the Illinois Senate (Senate Resolution (SR)
105 821). In states, in pertinent part:

106 WHEREAS, The Energy Infrastructure Modernization Act also provides that the final
107 year-end cost data filed in FERC Form 1 should generally be used to determine rates; and

108 WHEREAS, No statutory authority was given to the Illinois Commerce Commission to
109 set rate base and capital structure using average numbers that do not represent final year-
110 end values reflected in the FERC Form 1, and the Illinois Commerce Commission's use
111 of such average is contrary to the statute; and

112 WHEREAS, The Illinois Supreme and Appellate Courts have consistently held that,
113 because the administrative agencies are creatures of statute, administrative agencies
114 possess only those powers expressly delegated by law and may not act beyond 14its
115 statutorily delegated authority;

116 The co-sponsors of HR 1157 and the House Public Utilities Committee, which approved HR
117 1157 and sent it to the House floor, thus completely disagree with the average rate base position.
118 HR 1157 clearly states a year end rate base should be used, and not an average calendar year rate
119 base.

120 **Q. Why is the use of a year end rate base appropriate from a ratemaking policy**
121 **perspective?**

122 A. In Illinois, traditional ratemaking utilizes either a historical or a future test period.
123 Historical test years (including pro forma adjustments based on projected information for known
124 and measureable changes) have typically used a year end rate base. With a historical test year,
125 when new rates go into effect, the plant investment cost that the rates are set to recover has been
126 incurred and the plant is in service. Thus, this is a reasonable approach because it matches rates
127 paid by ratepayers with the costs of the utility plant actually serving them. By contrast, future test
128 years typically have used an average rate base. With a future test year, new rates will typically go
129 into effect early in the future test period – in other words before the full investment cost for the
130 test period has been incurred and before all plant projected for in the future period is in service.
131 Thus, an average rate base is reasonable because again it matches the rates paid by utility
132 ratepayers with the cost of the plant actually providing them service.

133 **Q. Is the formula rate process more like an historical or future test year?**

134 A. It is more like an historical. In the current case, the reconciliation year, at the time of
135 reconciliation, is a fully historical period. For example, when the annual update is filed on or
136 before May 1, 2013, a reconciliation will be performed for the historical year 2012 and based on
137 2012 actual costs as shown in FERC Form 1. The Commission has traditionally looked at year

138 end rate base for historical periods. The use of projected plant additions for the year in which
139 updated cost inputs are filed is also consistent with a historical – type test year because these
140 projected plant additions mirror the pro forma plant adjustments allowed under the
141 Commission’s test year rules for historical test years. Because the reconciliation period is a fully
142 historical period, use of a year end rate base is appropriate to ensure a match between the rates
143 paid by ratepayers and the cost of the plant used to provide them service at that time.

144 **Q. Please explain further why use of a year end rate base ensures a match between the**
145 **rates paid by ratepayers and the cost of the plant used to provide them service at that time.**

146 A. Using again the example of the reconciliation filed on or before May 1, 2013, the
147 reconciliation will be for the historical year 2012. Following reconciliation, new rates would go
148 into effect in January 2014. Thus, at the time the new rates go into effect reflecting the
149 reconciliation, 2012 plant will be have been fully in service for over a year. Rates should be set
150 so that customers are paying for the full cost of this plant which is fully used and useful in
151 serving them. Use of an average reconciliation rate base, as Staff and interveners recommend,
152 would create a situation in which ratepayers are not paying for the full amount of utility plant
153 providing them service.

154 **Q. Intervenors take the view that average rate base more closely matches actual plant**
155 **balances in service throughout the year and more closely matches actual costs being**
156 **incurred during the year. Mr. Effron, for example claims the rate of return times the**
157 **average rate base best reflects the dollar cost to the Company of carrying its net capital**
158 **investment for the year. Do you agree?**

159 A. No. As I explain above, the key question is whether the rates a customer is paying match
160 the costs incurred to serve that customer. Obviously, there will never be a perfect match, but rate
161 regulation should seek to avoid situations where customers are either not paying for plant that is
162 currently serving them or are paying currently for plant that will not begin to serve them for
163 some time. However, the testimony of intervenor witnesses have constructed interpretations of
164 Sections 16-108.5 (c) (6) and 16-108.5 (d) (1) of the Act to produce a mismatch, presumably to
165 lower revenue requirements for the reconciliation period. Their positions create a conflict with
166 the overall construct of the formula rate sections of the Act and would also produce an under-
167 recovery for reconciliation rate base.

168 **Q. Both Mr. Smith and Mr. Brosch claim that AIC could over-earn its rate of return**
169 **using a year end rate base. How do you respond?**

170 A. They are wrong. Use of an average calendar year rate base actually results in under-
171 recovery because, as explained above, ratepayers are not paying for the full amount of utility
172 plant providing service. When a utility is under-recovering its costs, it is not over-earning.

173 **Q. Mr. Brosch claims regulatory lag concerns are completely mitigated by the new**
174 **formula rate regime. How do you respond?**

175 A. I disagree that regulatory lag is eliminated by the EIMA. If AIC experiences an increase
176 in expenses (for example, resulting from its investment commitments under the Act) there is a
177 lag of one year before recovery. Using again the example from above, estimated costs for 2012
178 will be recovered in 2013 rates, but final 2012 costs will not be captured until 2014 when the
179 rates reflecting the reconciliation of 2012 go into effect. Likewise, if AIC's actual plant

180 investment exceeds what is projected, there would be a lag in recovery of the increased actual
181 amount.

182 **Q. Is there another policy goal that supports use of a year end rate base?**

183 A. Yes, minimizing reconciliation balances. Mr. Brosch agrees that a goal should be “to
184 minimize the size of future reconciliation revenue adjustments.” Use of an average rate base for
185 reconciliation, however, is not necessarily consistent with this goal. With a year end rate base for
186 reconciliation, the reconciliation amounts related to rate base would reflect only the variance
187 between the projected year end rate base and the actual year end rate base, which would be zero
188 if projected plant additions and actuals are the same. If the initial or inception revenue
189 requirement for a year is set using a year end rate base, and is reconciled using an average rate
190 base, however, there will always be a larger related impact on the reconciliation amount, equal to
191 the revenue requirement effect associated with the difference between a year end rate base and
192 an average rate base (e.g., the revenue requirement associated with as much as half the projected
193 annual increase in plant additions). Thus, the use of a year end rate base reconciliation can help
194 limit reconciliation balances.

195 **Q. How will AIC be adversely affected by use of an average rate base?**

196 A. Section 16-108.5 first requires estimating revenue requirements using actual costs for an
197 historical period and projected values (for the year of filing) for plant additions, plus associated
198 depreciation expense and accumulated depreciation. The projected plant values are determined
199 based on what is in service at the end of the projected period, i.e., on a year end basis. Once an
200 estimated or projected period becomes an actual period, then the formula rate construct requires
201 a true-up or reconciliation of the projected period using actual costs as they would be recorded in

202 FERC Form 1 for the now historical period. If the reconciliation year is determined using an
203 average rate base however, this average rate base is being reconciled to the previously projected
204 rate base determined using projected year end balances. Such a reconciliation will likely result
205 in AIC simply not recovering the difference between the average rate base amount and the year
206 end plant balance for the reconciliation period. The reconciliation will reconcile the projected
207 year end balance for the reconciliation year back to an average balance, resulting in an under-
208 recovery for reconciliation rate base. In the subsequent rate year, rates will reflect the year end
209 plant balance of the reconciliation year plus projected plant additions for the subsequent year.
210 But by reconciling the reconciliation year rate base back to an average rate base, the
211 reconciliation revenue requirement will be understated once again. In short, AIC will be forced
212 to forego those dollars each year, as a permanent deferral, even though ratepayers were
213 benefiting from a full year of the plant's service.

214 **III. RECONCILIATION INTEREST**

215 **Q. What are the parties' positions on the interest rate to be used for reconciliation**
216 **interest?**

217 A. Mr. Brosch recommends a short term debt interest rate. Alternatively, he asserts the
218 Commission could deem the revenue requirement variances under formula ratemaking to be
219 regulatory assets that represent a deferral of operating expenses to be recoverable (or returnable)
220 in future rate periods, and apply interest to only the net of income tax balance associated with
221 such deferrals. Mr. Smith recommends interest on over-collections be computed at the larger of
222 (1) AIC's overall cost of capital or (2) AIC's short term debt cost; on under-collections, at the
223 smaller of (1) AIC's overall cost of capital or (2) AIC's short term debt cost. He claims such

224 disparate treatment is necessary to protect ratepayers, deter AIC from manipulating projected
225 plant additions and encourage AIC to make accurate projections.

226 **Q. What is your response?**

227 A. The Company proposed that the carrying cost rate applicable to over- or under-collection
228 amounts determined in a reconciliation proceeding should be equal to the weighted average cost
229 of capital (WACC). AG/AARP proposes that the rate should be the Company's short-term debt
230 cost; and CUB proposes asymmetrical treatment, by which over-collections would carry a
231 WACC rate, and under-collections would be at the Company's cost of short-term debt.

232 Intervenor base their proposals on an assumption that reconciliation amounts do not
233 represent or require permanent financing, and that they would either displace or require only
234 short-term debt. The Company does not agree with these proposals for the simple reason that, if
235 reconciliation amounts only affect short-term debt, the effect on short-term debt will be fully
236 reflected in the Company's actual capital structure used for ratemaking purposes. It is not
237 appropriate to both assign some amount of short-term debt exclusively to reconciliation amounts
238 and also reflect it in the capital structure as though it were also supporting rate base generally.

239 For example, let's assume that next year, the Commission determines that the Company
240 is entitled to recover an additional \$5 million from customers that it undercollected in 2012.
241 Assuming for the sake of argument that the other parties are correct that the Company would
242 fund the under-collection with \$5 million of short term debt, customers would already receive
243 the benefit of the lower interest rate because the additional short term debt will be reflected in the
244 Company's actual capital structure used to develop the WACC. This lower WACC would then
245 be applied to the entire rate base, resulting in a lower revenue requirement to be collected from

246 customers. If that short term debt is also assumed to be assigned to the under-recovered amount
247 specifically, it will be in two places at once – in the capital structure supporting all investment
248 and supporting the under-recovery specifically. The only way to avoid this double-counting of
249 short term debt is to reflect short term debt in the actual capital structure and apply the WACC to
250 the reconciliation amount.

251 Mr. Smith's proposed asymmetrical treatment is unfair and unsound. There is no basis in
252 the law or regulatory policy for treating the Company differently from customers on surcharges
253 or credits coming out of reconciliation proceedings. Mr. Brosch's suggestion that interest be
254 applied to the net of tax over or under recovery does not comply with the law. The full amount of
255 the under or over recovery, with interest, is to be recovered as an additional charge or credit to
256 customers.

257 **Q. Could the hybrid interest rate and methodology adopted by ICC in Docket 11-0721**
258 **(ComEd) be appropriate for AIC?**

259 A. No. The use of a weighted cost of short-term and long-term debt would not compensate
260 AIC for its actual costs of accessing capital in the markets to fund investments required under the
261 statute. It effectively would require AIC to alter its capital structure to fund reconciliation
262 amounts with a certain mix of debt, irrespective of: (i) the consequences of using only debt on
263 AIC's financial condition and credit ratings; (ii) whether such funding is prudent and; (iii)
264 whether such funding is practicable. In effect, the parties are arguing that it is imprudent to fund
265 reconciliation amounts – which themselves represent unrecovered costs associated with the
266 incremental investment in plant that the formula rate is supposed to support – with anything
267 other than debt. The far more reasonable position is that this investment should be supported by

268 the same mix of capital as other investment. To the extent that AIC issues short-term debt, it will
269 be reflected in the capital structure and its effect thus captured in a reconciliation. There is no
270 need to assign specific debt to specific investment as the other parties do with their proposal.

271 **Q. Do you have any other comments on this issue?**

272 A. Yes. HR 1157, discussed above, also specifies that the Legislature intended the
273 reconciliation interest "be set at the utility's weighted average cost of capital, determined in
274 accordance with the statute, which represents the reasonable cost and means of financing a
275 utility's investments and operating costs."

276 **IV. REGULATORY COMMISSION EXPENSE**

277 **Q. Ms. Ebrey proposes an adjustment to remove costs (included in regulatory**
278 **commission expense) associated with Docket 11-0279 from recovery in rates set in this**
279 **proceeding. What is your response?**

280 A. These costs represent prudently incurred and reasonable rate case expense, and Ms.
281 Ebrey does not suggest otherwise. As such, they are a properly recoverable utility operating
282 expense. Moreover, they represent actual costs reflected on the 2011 FERC Form 1, and so are
283 recoverable under the terms of the EIMA.

284 **Q. She states AIC spent substantial sums of money in an attempt to obtain a rate**
285 **increase, and then abandoned the attempt, and this did not improve or enhance the electric**
286 **service AIC provides to its customers in any way whatsoever. What is your response?**

287 A. I believe Ms. Ebrey is not applying the an appropriate standard for recovery of rate case
288 expense and has also mischaracterized the requirements of the EIMA. The subject costs were

289 incurred with the anticipation the electric rate case would proceed in the ordinary course. They
290 were prudent and reasonable costs. The final passage of EIMA, which AIC could not anticipate
291 at the time the rate case was being prepared and during the course of its litigation, necessitated
292 the termination of the case in order that AIC elect to become a “participating utility”. As soon as
293 the law was passed (in its initial form), AIC filed a motion to withdraw from the Docket 11-0279
294 rate case to mitigate any further incurrence of rate case expense. However, the Commission did
295 not act on this Motion. The final version of the EIMA *required* that AIC file a notice of
296 withdrawal of its pending electric rate case. By making the election to be a participating utility,
297 AIC was able to pursue a course of action that will ultimately benefit its customers by improving
298 the delivery system infrastructure and implementing smart grid in its service territory. Moreover,
299 I am not aware of the Commission determining whether rate case expense was recoverable based
300 on whether the expenses “improve or enhance the electric service Ameren provides to its
301 customers”. Further, there is nothing in the EIMA that indicates the utility would forgo its rate
302 case expense in the event the case is terminated for the reasons indicated. Additionally, I
303 understand the Commission’s charge in reviewing the prudence of an expense should be based
304 on information available at the time the expense was incurred. Thus, given what AIC knew at the
305 time Docket 11-0279 was ongoing, the expenses incurred were reasonable and prudent. Further,
306 as Mr. Stafford discusses, the electric rate case was consolidated with the gas rate case, and the
307 gas portion of the rate case expense (which reflected the time and cost of the same attorneys and
308 consultants) was found reasonable in Docket 11-0282.

309 **Q. Ms. Ebrey states that the new law “allowed AIC to withdraw its electric rate case at**
310 **the time of its initial formula rate filing.” Do you agree?**

311 A. No. The EIMA did not "allow" AIC to withdraw its electric rate case, it *required* it to do
312 so. The EIMA states that "the participating utility *shall*, at the time it files its performance-based
313 formula rate tariff with the Commission, *also file a notice of withdrawal* with the Commission to
314 withdraw the electric delivery services tariffs previously filed pursuant to Section 9-201 of this
315 Act. Upon receipt of such notice, *the Commission shall dismiss with prejudice any docket* that
316 had been initiated to investigate the electric delivery services tariffs filed pursuant to Section 9-
317 201 of this Act." Thus, Ms. Ebrey's position is based on an incorrect assumption that the
318 withdrawal requirement was voluntary when in fact it was mandatory.

319 V. **CONCLUSION**

320 Q. **Does conclude your rebuttal testimony?**

321 A. Yes, it does.

APPENDIX

STATEMENT OF QUALIFICATIONS

CRAIG D. NELSON

I am Senior Vice President of Regulatory Affairs & Financial Services for the Ameren Illinois Company. I earned a bachelor's degree in accounting in 1977, graduating with highest honors, and earned a master's degree in business administration in 1984. Both degrees were awarded by Southern Illinois University – Edwardsville. I am a Certified Public Accountant.

I worked for Arthur Andersen & Co. from 1977 to 1979, when I joined Central Illinois Public Service Company as a Tax Accountant. In 1979, I was promoted to Income Tax Supervisor. I served in various tax and accounting positions until 1985 when I was appointed Assistant Treasurer. In 1989, I became Treasurer and Assistant Secretary, a position I held for seven years. In 1996, I was elected Vice President of Corporate Services. After Union Electric Company and CIPSCO Incorporated merged, I was named Vice President, Merger Coordination for Ameren Services Company effective December 31, 1997. In 1998, I assumed the additional responsibility of Vice President of Regulatory Planning. Effective June 1, 1999, I was appointed Vice President, Corporate Planning. Effective October 15, 2004, I was appointed Vice President – Strategic Initiatives for Ameren Services Company. Effective September 1, 2006, I was also appointed Vice President – Power Supply Acquisition for AmerenCILCO, AmerenCIPS, and AmerenIP. Effective August 16, 2007, I was appointed Vice President – Regulatory Affairs & Financial Services.

In my current position, as Senior Vice President – Regulatory Affairs & Financial Services, effective December 15, 2009, my role is to direct power procurement, implementation of SB 1652/HB 3036, asset and risk management, community and public relations, budgeting,

financial analysis/reporting, legislative affairs, and regulatory affairs for Ameren Illinois Company.